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## Article

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# The Dependence of the Kazakhstan Economy on the Oil Sector and the Importance of Export Diversification

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## ABSTRACT

The recent decline in oil prices caused Kazakhstan, like many oil-dependent countries, to lose its financial resources and weaken economically. In Kazakhstan, which supplies about 50% of budget revenues from oil and petroleum products, the currency (KZT) has depreciated by 20% in the first and 60% in the second stage due to oil prices falling sharply in 2014. Also in March 2020, the Kazakh tenge, which was affected by the drop in oil prices, depreciated by 18%. The fact that oil revenues are not used correctly and strategically in time and the necessary attention to non-oil sectors has an effect on this. In order to get out of this situation, it is important for Kazakhstan to give importance to the development of non-oil sectors and to ensure the development of exports in these sectors. In this study, the importance of the oil sector in Kazakhstan economy and the current situation of non-oil sectors are examined. In addition, suggestions and recommendations were given for the development of the non-oil sector and exports.

**Keywords:** Kazakhstan, Oil Sector, Non-oil Sector, Diversification of Exports

**JEL Classifications:** F43, F13, Q00

## 1. INTRODUCTION

Kazakhstan's oil and gas industry played an important role in the development of the state during the early years of independence and currently remains the locomotive of the country's economy. The development of the oil and gas industry has helped Kazakhstan strengthen its relations with its neighbors and made the country an important participant in the international arena (Syzdykova et al., 2020). Kazakhstan has generated large volumes of revenue as a result of oil exports since independence. As a result, the social welfare of the population of Kazakhstan has increased, and the country has managed to enter the list of high-middle income countries. But the country's natural resources are not permanent, and experts have officially declared their warning. If Kazakhstan's approved oil reserves continue at the same level as the current production level, they will run out after 42.7 years (BP, 2019. p. 14).

Increases in oil prices are considered a good gain for exporting countries (Syzdykova, 2018). But the processes of low oil prices and economic stagnation starting in 2014 have made it clear that Kazakhstan's economy is dependent on oil. Some of the following figures, which are key indicators of the economy, show how serious these problems are. As such, Kazakhstan has reached a foreign trade volume of 96.1 billion USD in 2019 and exports accounted for 60% (57.7 billion USD) of that. 72.8% of total exports are crude oil exports. The country's GDP volume in 2019 is 170.3 billion USD, of which 23% is made up of oil revenues ([www.stat.gov.kz](http://www.stat.gov.kz), [www.nationalbank.kz](http://www.nationalbank.kz)).

The weight of natural resources in foreign trade is very high. Petroleum and natural gas, metals, chemistry (including gasoline, diesel, uranium classified in this context), mines (copper, iron, zinc, chrome, manganese) constitute almost 90% of the export since the years. Despite numerous plans and programs in which diversification

of the economy is emphasized (Konkakov and Kubayeva, 2016), there has been no structural change in the production and export of Kazakhstan. On the contrary, the share of industries such as natural resources, metals, petrochemical continues to increase.

Because natural resources are depleted, the high incomes they bring in are also not permanent. Therefore, planning the use of resources and their income accurately in terms of time determines the current and future social-economic development of the country. Thus, the weakening of the growth pace of the national economy in general, the limited resources that enable the volume of exports to increase, necessitates the development of export potential in non-oil sectors in Kazakhstan. In order to increase the export potential in the non-oil sectors, the processes of diversification and modernisation of the national economy must first be accelerated. Furthermore, the non-oil sectors should be examined deeply, taking into account the country's natural resources and economic factors, and its potential should be evaluated objectively.

## 2. IMPORTANCE OF OIL SECTOR IN KAZAKHSTAN ECONOMY

Since independence, the oil and gas sector continues to form the basis of Kazakhstan's economic and industrial development. Therefore, changes in the oil market, especially fluctuations in oil prices, greatly affect the country's economic development (Figure 1). Kazakhstan has been heavily affected by the drop in oil prices since 2014.

As can be clearly seen from the graph, the Kazakhstan economy is highly dependent on the oil sector. On the other hand, the share of oil production in GDP has been steadily decreasing since 2011. The main reasons for the decline are the postponement of the use of new fields, especially Kashagan, and a significant drop in world oil prices in 2014-2015. Another factor limiting the growth of production is the limited capacity of the export transport infrastructure. At the end of 2018, the share of oil in the country's GDP increased by 15% compared to the previous year, reaching 19.51% (Figure 2).

There is also the fact that budget revenues are highly dependent on oil revenues (Table 1).

On the other hand, most of the financing sources of the non-oil sectors in the country depend on the oil sector. The inflow of investments related to the oil industry and income from oil exports are also used in other sectors of the economy related to the activities of the oil sector. Therefore, investments and revenues in the oil sector contribute to the formation and development of the country's non-oil sectors. Therefore, the decline in oil prices negatively affects the country's budget and GDP dynamics, as well as indicators of non-oil sectors.

## 3. THE LIMITED DIVERSIFICATION OF KAZAKHSTAN'S EXPORT STRUCTURE

After Kazakhstan gained its independence, the reforms it had made in foreign trade and the foreign trade policy mentioned, on the

Figure 1: Brent oil price and GDP change of Kazakhstan

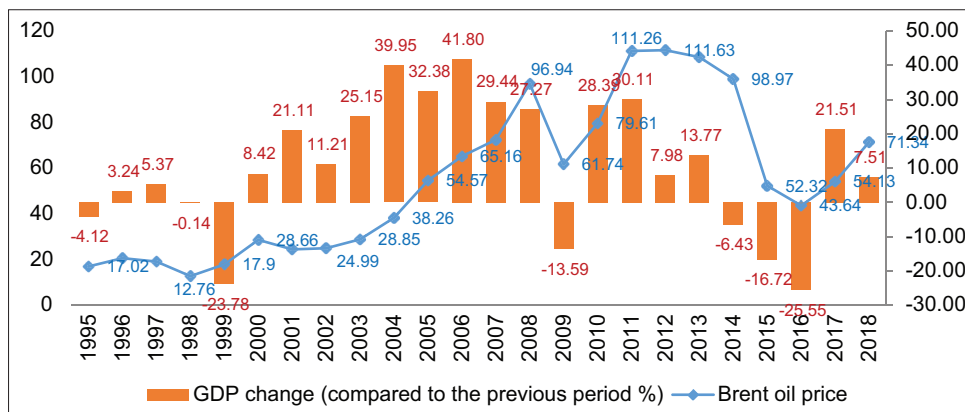
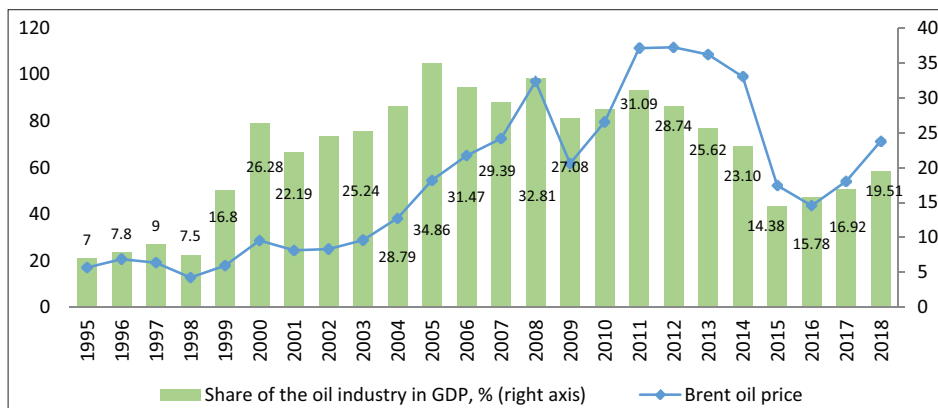


Figure 2: Brent oil price and share of the oil industry in GDP



other hand, Kazakhstan's high import-export potential, significant developments in the field of foreign trade of the national economy emerged (Syzdykova et al., 2019).

Kazakhstan's foreign trade volume amounted to 96,1 billion dollars in 2019, of which 57.7 billion dollars was for export and 38.3 billion dollars for import. According to Trade Map data, Kazakhstan is ranked 50<sup>th</sup> in the world in terms of total exports and it is in the 62<sup>th</sup> place in terms of imports (Trade Map, 2020). Export figures and export structure of Kazakhstan are given in Table 2.

Considering the export structure of Kazakhstan, raw material goods: crude oil, refined copper and copper alloys, radioactive chemical elements, petroleum gases and ferro alloys, etc., gain weight in the commodity structure of Kazakhstan's exports. Over the years, crude oil accounts for more than half of the country's exports. Even after 2015, when oil prices in the world decreased by half, more than 60% of total exports were oil. As a matter of fact, 67.1% of the total exports of 2019 consists of crude oil. On the other hand, Kazakhstan is the country that exports crude oil but imports petroleum products (Syzdykova et al., 2019). It is understood from the analysis of the country's export structure that the machinery, light, food and chemical industries have very little share in exports. As a matter of fact, the export diversity index of Kazakhstan supports the above information (Figure 3).

Greater values of the index indicate less export diversification. Figure 3 clearly demonstrates that from 1998 to 2014, the export structure of Kazakhstan became more concentrated. Felipe and Hidalgo (2015) in their work use the Product Space methodology to document, with the help of a highly disaggregated data set, Kazakhstan's low export diversification. They argue that Kazakhstan should diversify by developing products.

Although Kazakh products are exported to 122 countries, 63% of exports belong to only 6 countries (Italy, China, the Netherlands, Russia, France, Switzerland). In the commodity structure, 75-80% of exports are raw materials and minerals, ie the level of concentration prevails in both the commodity structure and the geographical structure. Figure 4 shows that during 2000-2018, 66% of total export growth of Kazakhstan was explained by ability to sustain market presence (selling the same commodities to the same destinations), and 34% was explained by product expansion in the existing markets (sales of new products to old markets). More significantly, <1% of growth resulted from selling (either old or new products) to new markets. Pendergast et al. scientists believe that in countries rich in fossil resources, a highly concentrated export structure is being formed and may lead to instability in economic growth.

Kazakhstan demonstrates that there has been little progress in terms of diversifying the production base and export portfolio despite considerable government efforts. Misaligned economic policies, insufficient regulation of the financial sector, inadequate diversification strategy and weak institutions were major factors that held back private investment in the manufacturing industries and derailed the diversification strategy. In short, strong market reforms have not been followed by similar market-oriented institutional changes, which created tensions among advanced market reforms, long-term development policies and weak institutions (Esanov, 2012).

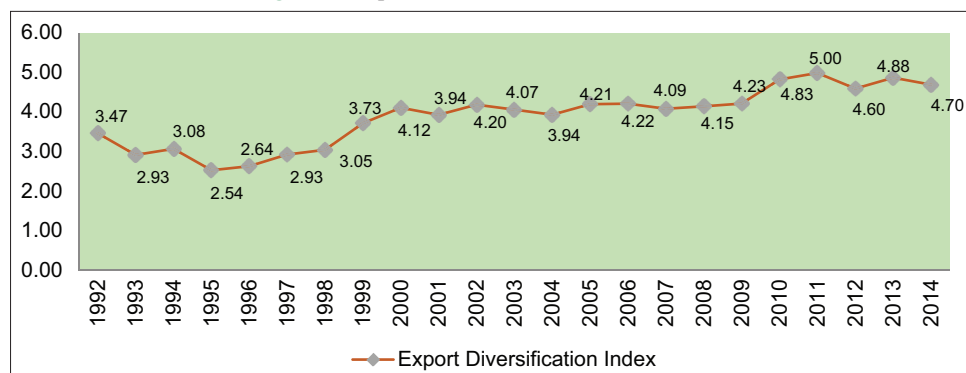
#### 4. EVALUATION OF NON-OIL SECTORS IN KAZAKHSTAN

Although Kazakhstan has made significant advances in terms of real GDP growth over the past decades, the economy's structure has not changed much, and the hydrocarbon sector continued

**Table 1: Importance of crude oil exports in Kazakhstan's economy**

Variables	1995	2000	2010	2015	2016	2017	2018	2019
GDP, mln USD	20374.3	18292.0	148047.3	184388.4	137278.3	166805.8	179340.0	170326.1
Total exports, mln USD	7940.7	10353.7	65502.3	52581.5	43714.8	55964.4	67300.8	57722.9
Share of total exports in GDP	38.97	56.60	44.24	28.52	31.84	33.55	37.53	33.88
Crude oil exports, mln USD	793,1	4249,1	41033	31120	22335	30679	42738	38717
Share of crude oil exports in GDP (%)	3.89	23.23	27.72	16.88	16.27	18.39	23.83	22.73
Share of crude oil exports in total exports (%)	9.99	41.04	62.64	59.18	51.09	54.82	63.50	67.1

**Figure 3: Export diversification index, 1992-2014**

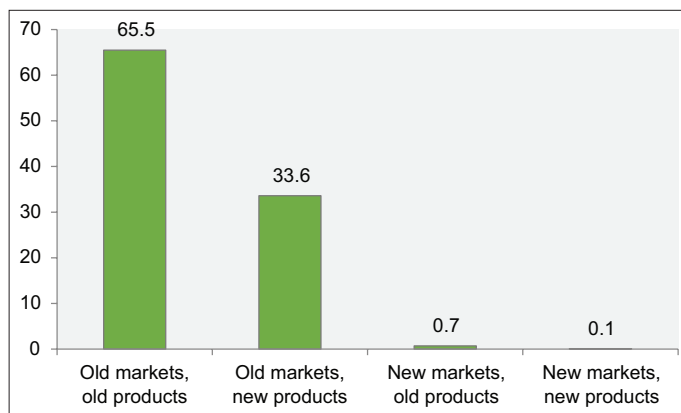


to dominate. Looking at the figure showing the sectoral shares in Kazakhstan's GDP; The service sector (55.45% in 2018) constitutes the majority of GDP. The share of the industry sector in GDP is 33.50% and the agriculture sector is 4.40% (Figure 5).

The employment and foreign trade structure of an economy is basically shaped depending on the production structure. Therefore, how the production structure changes is of great importance. Information on the production structure of the Kazakhstan economy is given in Table 3.

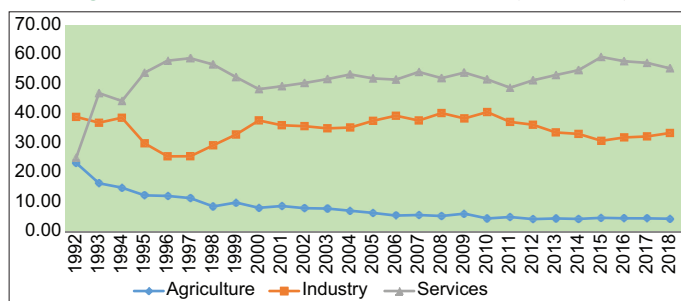
While the share of the agricultural sector in GDP was 12.33% in 1995, it decreased to 4.40% in 2018. Although agriculture is significantly subsidized in Kazakhstan, it imports more agricultural products than exports in 2018. When an investigation is made on the agricultural sector, Kazakhstan has very favorable natural conditions. The surface area of Kazakhstan – 2,724,902 km<sup>2</sup> and approximately 272 million hectares, or 74% of Kazakhstan's land, is devoted to agriculture. The figure includes 167.7 million hectares of pastures, 30 million of tilled and lea land and more than four million of hay. Despite being surrounded by huge areas of idle land, farmers in many regions still cannot obtain a plot for their business. During the past 3 years, the ministry found nine million hectares not in use. In 2018 alone, 2.57 million hectares were not used or used with land code violations (The Astana Times, 2019). Due to the inability to use modern agricultural techniques in Kazakhstan, it is not sufficiently benefiting from its existing potential. However, structural and insufficient investment in this sector are other problems. Space monitoring and digital agricultural maps could help make land use more efficient.

**Figure 4:** Export growth decomposition, 2000-2018 (percent)



Sources: World bank, 2019: 25

**Figure 5:** The structure of Kazakhstan's GDP (1992-2018)



The industrial production of Kazakhstan consists of the mining, manufacturing industry and electricity, water, gas, steam production and distribution sectors. The reason for the high share of the industry sector in GDP is that the mining sub-sector associated with oil production in Kazakhstan has a high rate. Considering the structure of the industry sector, the share of the manufacturing industry in GDP decreased from 51.38% in 1995 to 38.22% in 2018. There are two important sub-sectors within the manufacturing industry. These are the metallurgical industry (heavy industry) and the food industry. There is little change in the 23 years from 1995 to 2018. In this process, the light industry and food industry became the most decreasing industry group. In 2018, food imports are higher than exports, so the most obvious products are meats (mainly poultry meat), dairy products, vegetables (especially tomatoes), fruits (mainly apples, grapes, cherries, peaches, fresh dates, dried fruits, etc.), sugar, vegetable oils, bakery products (interesting situation considering high flour production, pasta is also imported), food products made of fruits and vegetables, other food products, alcoholic beverages, tobacco and tobacco products. It is clear that many of these products are actually products that can be produced in Kazakhstan.

#### 4.1. Why Does Export Diversification Matter?

If a country's exports cover a small number of sectors or countries, there is a dependency on that country's exports. In most countries with a dependency on basic goods or limited export basket, there is usually a decrease in export earnings and instability as a result of the fluctuation in prices of goods and the contraction in foreign demand. It is possible to have a more stable structure by minimizing the fluctuations and negativity experienced in an export structure where there is diversity in terms of country and sector. In addition, in order to achieve sustainable growth in the countries according to the increasing competitive structure with the globalization and the structural model of economic development, the basic goods produced for export should be diversified (Hesse, 2009). Theoretically, there are many way through which export diversification promotes economic growth. According to Herzer and Nowak-Lehmann (2006), export diversification could positively affect economic growth by reducing the dependency on limited number of commodities. This argument is particularly true in the case of commodity-dependent developing countries, where overdependence on agricultural sector could—according to the Prebisch-Singer thesis—reduce the terms of trade.

There are other reasons why economic diversity is important, which go beyond the path- dependence intrinsic to development. For example, export diversification matters because it can lower volatility and instability in export earnings. Such portfolio effects can help hedge against the risk inherent in markets with uncertain returns (Bertinelli et al., 2009). In fact, economic downturns turn out to be shorter- lived in countries that are better located in the Product Space (Hausmann et al., 2006). Another reason for the diversification in export is its benefit against export instability (Hesse, 2009).

Another way of illustrating the dynamic effect of export diversification on growth is by linking the connection between these two variables based on modern theory vis-à-vis the classical



trade theory. Based on the modern trade theory, there are three main features of modern market behaviour. First, the increasing dynamic features of production factors and national policies to influence the production capacity to grow with increasing return. Second, the expansions of trade model from perfect competition to the imperfect competition especially the monopolistic competition (Arip et al., 2010).

Issues of export diversification should be addressed constantly by politicians in countries. Therefore, at the end of 2017, Kazakhstan also set a task to diversify exports in order to ensure sustainable economic growth and approved the program “National Export Strategy for 2018-2022.”<sup>1</sup> The main task of the program is to provide financial and non-financial support to domestic exporters in Kazakhstan, to increase non-oil exports. It is also necessary to create conditions for a 1.5-fold increase in non-primary exports by 2022, diversification of export markets for goods and services. It is also planned to introduce the production of new products and increase the share of innovative products, which will attract investment and attract new foreign and domestic technologies. In 2019, the state program of industrial innovation development for 2020-2025 “Export for development” was approved. The main objectives of this program are to increase labor productivity in the manufacturing industry by 1.7 times compared to 2016, increase the volume of exports in the manufacturing industry by 2.3 times compared to 2016, increase investment in fixed assets in manufacturing by 2 times compared to 2016 and this. It is planned to increase the number of enterprises in the industry by 1.6 times. In order to diversify exports, export diversification included trade transparency in organizations such as the World Trade Organization (WTO) and the Eurasian Economic Union. After all, the elimination of barriers to bilateral trade and the reduction of transport costs will increase bilateral diversification.

## 4.2. Determination of Development Strategies in Non-oil Sectors of Kazakhstan

Although many steps have been taken to increase the total exports of non-oil sectors in Kazakhstan, the main reason for the severe economic crisis that the economy experienced in 2015 is the lack of enough jobs and the country, which is experiencing a transition economy is still unable to carry out serious economic reforms. A mix of factors explains why, despite efforts to diversify the economy in 2018, Kazakhstan exported with revealed comparative advantage fewer products than in 2000. These are: (1) In general, economies well endowed with natural resources have problems diversifying their economies; (2) weak incentives to diversify in a context of high oil prices; (3) the government selected sectors and specific companies for public support instead of fostering innovation, technological upgrading and the development of new products; and (4) the country's framework for competition was very shaky (Feliipe and Hidalgo, 2015).

The dependence of the economy on oil prices has shown more clearly and heavily in the crisis experienced as a result of the sharp decline in oil prices in 2014. In February 2014 the national currency Kazakhstan tenge (KZT) devaluated by almost 20%

against the USD. Since then the National Bank of Kazakhstan has held the exchange rate fairly stable in a band of KZT 182-188 per USD, which was widened to a band of KZT 170-188 in September 2014. Decreasing overall business activity, decreasing consumer demand and disparity between the exchange rate of the tenge and the Russian ruble were conducive to the slowdown in inflation in Kazakhstan to the end of 2015. After moving to a floating exchange rate in band the depreciation of Kazakhstan tenge against USD gradually decreased to the end of 2015. The devaluation reached almost 60% at the end of 2015 (Aleksandrova, 2016). Of course, all this has caused prices to increase in general and many companies to go downsizing in the country.

The current state of the country's economy is, of course, the result of Dutch disease and the non-oil sectors being underdeveloped, as economists warned a few years ago. It will be possible to submit more useful offers after SWOT analysis to deal with the problems regarding the current economic situation of Kazakhstan. SWOT analysis of the economy can be done as in Table 4:

Trade offers opportunities for Kazakhstan's economic growth and for diversifying away from oil. But, to benefit from these opportunities, Kazakhstan needs further cross-cutting reforms such as improvement in transport logistics, trade facilitation, and the functioning of factor markets (finance, land, and labor). Therefore, understanding current developments and challenges in exports is important to inform policy to improve export competitiveness of non-resource products (World Bank, 2019). After doing the above SWOT analysis, we can list the development methods of exports in the non-oil sectors of the Republic of Kazakhstan as follows:

- Making the main factors of regulating export potential in non-oil sectors compatible with modern global economic development processes
- Taking steps to improve the investment climate and attract foreign investors to non-oil sectors
- Establishing mechanisms and modern chain of companies based on modern technologies in order to accelerate the development of export-oriented non-oil industry sectors and to provide more efficient state support
- Creating industrial areas that can increase export potential by considering the country's physical and economic resources
- To further accelerate the development of the scientific technologies sector, which is the main basis of economic development in the modern world, to develop the country's economy in an innovative way and to expand the production and diversity of important scientific products with great export value
- Improving the activity of the developing metallurgical industry companies recently and encouraging the production of competitive metallurgical industry products in this sector that can be exported
- Realizing big projects to investigate the current energy potential of the country more deeply and to increase exports in this field
- Increasing the export of ready-made petroleum products by processing crude oil in the country
- Creating well-functioning government institutions to aid the diversification process

1 Available at: <http://adilet.zan.kz/kaz/docs/P1700000511>

**Table 2: Export structure of Kazakhstan, mln USD**

Product name	2001	2005	2010	2015	2016	2017	2018	2019	(%)
All products	8486	27846	57244	45956	36776	48342	60956	57723	100
Mineral fuels, mineral oils and products	4758	19525	41033	31120	22335	30679	42738	38717	67.1
Iron and steel	1008	2244	3684	2501	2751	4186	4160	3473	6.0
Ores, slag and ash	222	926	2185	1084	1194	2103	2087	2727	4.7
Copper and articles thereof	704	1508	2154	2009	1919	2527	2549	2620	4.5
Inorganic chemicals	272	846	2609	3106	2413	2169	2135	2214	3.8
Cereals	344	241	988	833	817	829	1296	1351	2.3
Salt; sulphur; earths and stone; plastering materials, lime and cement	49	102	299	549	360	364	650	593	1.0
Aluminium and articles thereof	48	26	373	420	382	533	635	565	1.0
Zinc and articles thereof	158	313	555	577	554	838	281	505	0.9
Oil seeds and oleaginous fruits; miscellaneous grains	2	6	32	231	203	279	335	426	0.7
Products of the milling industry;	29	148	557	500	518	487	466	389	0.7
Natural or cultured pearls, precious or semi-precious stones	237	399	1213	749	650	595	523	381	0.7
Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	94	188	145	199	247	241	273	331	0.6
Aircraft, spacecraft, and parts thereof	3	22	101	126	13	23	68	326	0.6
Articles of iron or steel	20	81	98	135	171	207	270	255	0.4
Other	539	1272	1219	1818	2249	2281	2490	2849	4.9

Sources: Trade Map, 2020 <https://www.trademap.org/Index.aspx> Available: 03.05.2020**Table 3: Change of production structure in Kazakhstan**

Sectors	1995	2000	2005	2010	2015	2016	2017	2018
GDP	100	100	100	100	100	100	100	100
Agriculture	12.33	8.11	6.37	4.51	4.71	4.56	4.52	4.40
Industry	30.00	37.78	37.63	40.60	30.85	31.98	32.33	33.50
Services	53.96	48.38	52.02	51.68	59.30	57.86	57.30	55.45
Industry sector	100	100	100	100	100	100	100	100
Mining (oil industry)	24.69	44.45	59.10	61.29	50.47	49.39	50.76	54.66
Manufacturing industry	51.38	45.76	35.18	31.76	39.92	42.29	41.25	38.22
Metallurgical industry	17.83	20.35	13.13	13.18	14.36	17.77	17.88	16.96
Light industry	2.03	1.22	0.70	0.28	0.48	0.43	0.43	0.37
Food industry	11.74	14.14	9.22	7.54	9.43	9.51	8.53	7.33
Chemistry	3	1	1	1	2	1	1	1
Non-metal minerals	3	1	2	2	3	2	2	2
Ready metal products	1	1	1	1	1	1	1	1
Electricity, gas, steam and air conditioning	21.70	8.35	4.97	5.90	8.43	7.27	6.94	6.22

Sources: Agency of the Republic of Kazakhstan on statistics data and author's calculations

**Table 4: SWOT analysis of Kazakhstan economy**

Strengths	Weaknesses
Open economy	Lack of macroeconomic resilience
Strategically located between China and Europe member of the Eurasian economic union	Implementation difficulty of foreign trade strategies
Political stability	Institutional shortcomings: corruption, administrative delays, deficiencies in collective proceedings and trade barriers
Having rich natural resources	There is no cross-sectoral integration at a level that will ensure the efficient use of rich natural resources.
Oil and mining potential	Commitment to one market and few sectors
Making quality transportation roads	The lack of going out to sea is a "land country"
Increase in the labour force (67% of the population) thanks to fast population growth	Lack of necessary quality education
High levels of foreign direct investment	Inefficient use of investments
State enjoys a net creditor position, important sovereign fund	Fragile banking system
	Inability to produce technology
Opportunities	Threats
Globalization (right policies)	Globalization (wrong policies)
Free trade agreements	Increased international competition
Proximity to the Turkish States	Regional integration
Eurasia energy corridor	Regional political crises
Tourists coming to Kazakhstan	Crises in the world economy

Sources: Created by authors

- Diversifying the export of construction raw materials in the regions of Kazakhstan and determining realistic export targets
- Taking many precautions to bring export products to the world market in the agricultural sector of the country and preparing the state program although necessary
- Enabling the exporters of non-oil sectors to play an active role in increasing the export potential by strengthening their position in foreign markets and defending their interests
- Building adequate physical and social infrastructures to support diversification efforts.

## 5. CONCLUSION

Kazakhstan is a middle-income country with three important characteristics that shape its development path: it is a transition economy, a landlocked country and heavily dependent on natural resources, particularly oil. Although it is possible for a country endowed with natural resources to achieve high income per capita, it will be very difficult for Kazakhstan to become a modern industrial and service-oriented economy when its structures of production and exports are heavily biased toward oil. Furthermore, there are serious risks behind a nondiversified economic structure (for example, the instability of export earnings, the possibility of 'Dutch disease' or the risk of political capture). Despite all this, it is possible to overcome these problems by diversifying in exports and the economy.

Nevertheless the results of Kazakhstan's diversification policies have been disappointing and made it clear that the government needs a better strategy if it wants to sustain strong economic performance based on broad-based economic growth. In particular, the government should focus on improving its infrastructure and institutions. Creating various government agencies to support the export-oriented industrialization strategy without addressing basic infrastructure needs and improving governance is not sufficient to shift the economy away from the resource sector. Furthermore, the diversification strategy should be closely linked to the short-term management of natural resource revenues (Esanov, 2012). Strengthening the export potential of non-oil sectors is not limited to the establishment and implementation of the state's economic policy and adjustment mechanisms. Here, first of all, the evaluation of the potential of individual areas of non-oil sectors, the creation of an efficient production network of natural resources and other factors should also be taken into account. In order to increase the non-oil export potential of Kazakhstan, the listed bids and strategies must be fulfilled one by one, but eventually as a whole. Because the solutions are linked to each other in a chain, they always affect the other. On the other hand, proposals to be made for the development of exports or measures to be taken in Kazakhstan can be handled separately as countries and companies. Decisions to be taken and steps to be taken on the basis of both country and company will bring the necessary success in export. Most importantly, Kazakhstan needs to further develop high-tech production and diversify exports through technological modernization. Thus, the potential for sustainable economic growth will be high. After all, export diversification is a strategic tool for economic development, not a temporary campaign to overcome the crisis.

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