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## **KAZAKHSTANI ECONOMY SINCE ITS INDEPENDENCE: MAIN CHALLENGES AND POTENTIAL FOR DEVELOPMENT**

This article describes the economic development of Kazakhstan since it gained its independence in 1991. Specifically, article draws upon the difficulties Kazakhstan faced in 1990s after the collapse of the Soviet Union. Moreover, the initial reforms of the government, such as introducing own currency, privatisation, creation of National Fund is discussed. Gradually article defines the stages of development of the country during the boom period of the economy starting from 2000s, mainly caused by the high oil prices. On the other hand, author describes about overreliance of the economy on prices of raw materials, leading to signs of Dutch disease. The world economic crisis in 2008 and its influence on Kazakhstani economy, mainly to its currency and banking system is mentioned by analysing country`s macroeconomic indicators. Main goal of this article is to analyse the condition of the economy during this period and measures fulfilled by the government to tackle the challenges that Kazakhstani economy faced in recent years.

**Key words:** Kazakhstan, Central Asia, oil, Dutch disease, Customs Union, Eurasian economic union, crisis, Nurlyzhol program.

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### **Тәуелсіздік жылдарындағы Қазақстан экономикасы: өзекті мәселелер және болашақтағы даму әлеуеті**

Аталмыш мақала Қазақстан Республикасының 1991 жылы тәуелсіздік алған уақыттан бастап, қазіргі таңға дейінгі экономикалық даму кезеңдерін баяндайды. Атап айтар болсақ, КСРО ыдырағаннан соңғы Қазақстан Республикасы экономикасының 1990 жылдарында басынан өткерген қиыншылықтары суреттеле отырып, ел үкіметінің ұлттық валютаны енгізу, жекешелендіру, Ұлттық қорды құру секілді алғашқы реформалары баяндалады. Мұнай бағасының шарықтауы түрткі болған, 2000 жылдардан бастау алған еліміздің қарқынды даму кезеңі де бөлек талданады. Экономиканың қарқынды дамуымен қатар, автор шикізат бағасына тәуелділігінен туындаған ел экономикасындағы Голландиялық ауру теориясының белгілерін сипаттайды. Сонымен қатар 2008 жылындағы әлемдік дағдарыстың Қазақстан экономикасына әсері, атап айтар болсақ, дағдарыстың ұлттық валюта мен банк жүйесіне тигізген жағымсыз әсері кеңінен суреттеледі. Бұл мақаланың басты мақсаты ел экономикасының жалпы жағдайын және соңғы жылдардағы үкіметтің экономикалық қиыншылықтарды жеңуге бағытталған бағдарламаларын оқырман назарына ұсыну болып табылады.

**Түйін сөздер:** Қазақстан, Орталық Азия, мұнай, Голландиялық ауру, кеден одағы, Еуразиялық Экономикалық Одақ, дағдарыс, Нұрлы жол бағдарламасы.

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**Экономика Казахстана за годы независимости:  
основные вызовы и потенциал для дальнейшего развития**

Данная статья посвящена развитию экономики Республики Казахстан с момента обретения независимости в 1991 году до нынешнего времени. Особенный акцент в статье делается на описании экономических трудностей, с которыми Республика Казахстан столкнулась в начальном этапе своего развития, после развала СССР. В начале статьи автор также уделяет внимание изначальным реформам Правительства страны, как выпуск собственной валюты, приватизация, создание Национального фонда РК. В статье также описывается поэтапное развитие экономики страны во время своего бурного развития, начиная с 2000 годов, вызванного высокими ценами на нефть. Параллельно с этим автор описывает проблемы экономики, связанные с зависимостью экономики страны от цен на углеводороды, что привело к признакам Голландской болезни. Отдельной главой анализируется влияние Всемирного кризиса в 2008 году на казахстанскую экономику, в частности на национальную валюту страны и банковский сектор. Основной целью данной статьи является анализ экономики страны за данный период и описание основных государственных реформ, направленных на решение негативных вызовов для экономики, возникших в последние годы.

**Ключевые слова:** Казахстан, Центральная Азия, нефть, голландская болезнь, Таможенный союз, Евразийский экономический союз, кризис, программа Нурлы жол.

## Introduction

After the collapse of the Soviet Union in 1991, Kazakhstan had faced severe difficulties in its economy. Economy has entered into deep recession, mainly starting from its declaration of independence in December 1991. During the period between 1991 to 1995, Kazakhstan's GDP fell by two fifth. Inflation rate reached its peak of 1 892% in 1994. (Pomfret, 2005) According to Agrawal (2007) one of the main factors was the fact that inter-connection of Kazakhstani economy with other Soviet countries was at extremely high level. Under the Soviet planned economy, Kazakhstan produced few finished goods. Instead, Kazakhstan was the supplier of raw materials and specific components of industrial products. Raw material from Kazakhstan was used as part of final good somewhere in Russia or Ukraine. Kazakhstani oil used to be transported to Russia, whereas oil refineries in Pavlodar and Shymkent were linked to Siberian oil fields. Thus, collapse of Soviet Union affected heavily the industries of Kazakhstan, as the economy became isolated. Most factories in Kazakhstan stopped their production or went bankrupt. Unemployment level has risen sharply, portion of population living below living wage has equalled to almost 40% in 1998. As a result, mass migration of mainly non-Kazakh population took place, reducing the population of country from 16.4 million in 1991 to 14.9 million in 1999. (Ministry of National Economy)

## Early reforms of government

Government of Kazakhstan faced high pressure during this period. State officials started working seriously on privatisation in 1992. Kazakhstan has introduced its own currency – tenge in November 1993. Starting from 1993, government started an initial campaign of offering shares in large enterprises to foreign purchasers. In 1993, Kazakhstan concluded an agreement with oil giant Chevron to develop Tengiz oil field. In 1995, privatisation process accelerated. Government has offered its main enterprises to foreign investors. Only between the period from September 1995 to October 1996, government has raised almost 7 billion US Dollars on privatisation. As a result of massive privatisation campaign, the private sector's share in GDP rose from 25% in 1995 to 60% in 1999 and to 65% in 2002. (Pomfret 2005) These steps allowed country to stabilise the economy. Starting from mid-1996 to early 1998 output was growing and inflation has fallen to less than 10% by 1998. (Kuralbayeva et al, 2001) However, the economy was hit by the Asian financial crisis in 1998 and further Russian crisis. GDP growth in 1998 equalled to -2,5%. Government of Kazakhstan had spent approximately 600 million US Dollars on currency interventions to stabilise the nominal exchange rate. Eventually, Government decided to devalue the currency, by introducing freely floating currency policy on April 4, 1999. Nominal exchange rate of tenge has fallen from 88 KZT/USD in March

1998 to 145 KZT/USD at the end of 1999. (Kuralbayeva et al, 2001) Devaluation in turn, boosted the economy growth starting from 2000s.

**Economic recovery**

Kazakhstani economy flourished in 2000s. Increase in oil production, mainly caused by investments from West, accompanied by high oil prices. Oil prices peaked to a record 147\$ per barrel in 2008. Percentage of population living below the

subsistence minimum has declined from 46,7% in 2001 to 8,2% in 2009. Nominal wages of the population has increased from 118 USD in 2001 to 505 USD in 2008. GDP of the country has increased from 18.2 billion USD in 2000 to 133 billion USD in 2008, with an average growth of 10% annually. Nominal GDP has grown from 1 229 USD in 2000 to 8 513 USD in 2008, meaning that economy has grown seven times compared to 2000 level. In turn, almost 70% of Kazakhstani exports came from oil. (Stratfor)

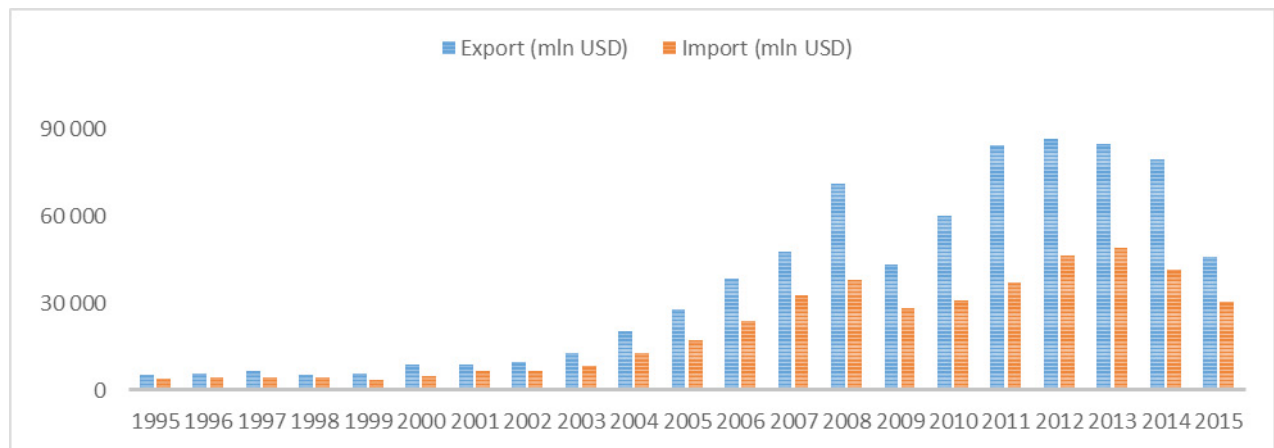
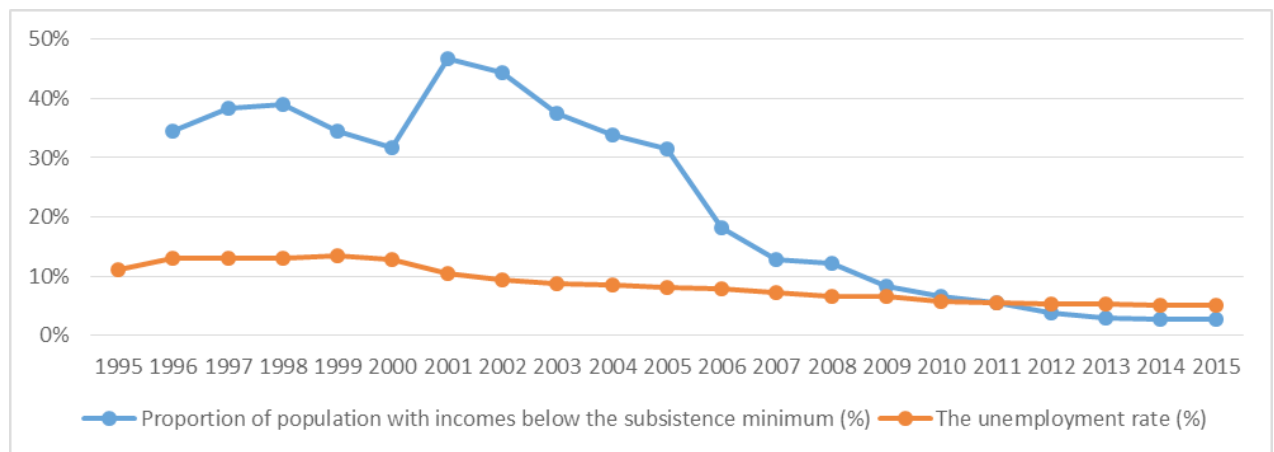


Figure 1 – (Exports and Imports 1995-2015) 1995-2015)



Source: Committee of Statistics of Ministry of National Economy of RK (www.stat.gov.kz)

Figure 2 – Poverty level and unemployment rate

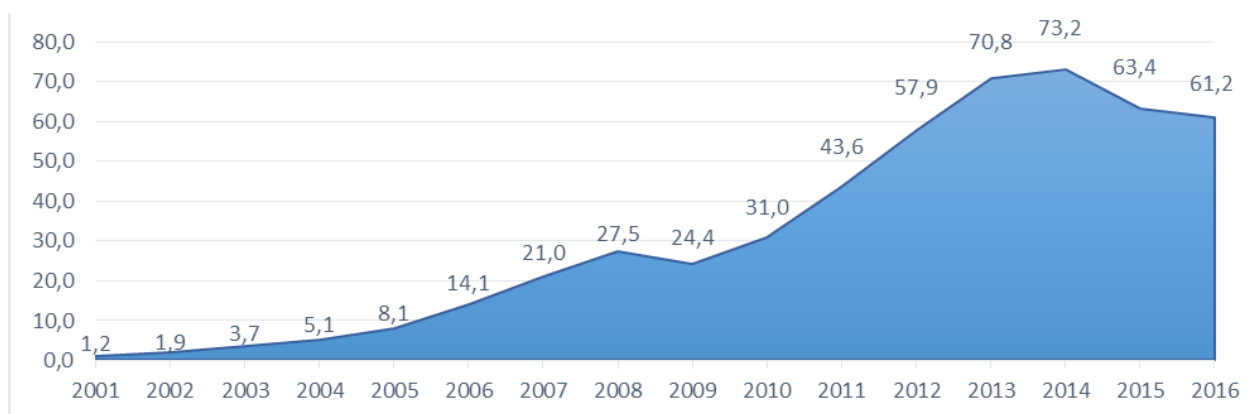
Between 1993 and 2012 Kazakhstan has attracted almost 180 billion USD foreign direct investments. (Sadvakassov et al, 2015) Experts highlight three most important factors of attracting FDI: advantages of localisation, favourable investment

climate and political stability in the country. According to the data from December 31, 2012, main portion of FDI amounting to 66.4 billion USD or 38,8% were attracted into scientific and technical sector (geological exploration and research), mining

51.7 billion USD or 30,2% and manufacturing 17,4 billion USD or 10,2%.

In January 29 2001, president of Kazakhstan Nazarbayev signed a decree, which announced the creation of National Oil Fund to accumulate profit from oil. The main aim of the oil fund was to immunise budget from external oil fluctuations (stabilization function) and save the benefit from oil sales to future generations (saving function). (Ministry of Finance of RK) An annual transfer of 8 billion USD from the fund to the state is allocated to the budget, with the requirement that the fund must not fall below 20%

of GDP. (World Bank, 2016) Annual fixed amount guaranteed transfers of money from National Oil Fund, guarantees the non-affectability of budget from oil price shocks. Money in the fund is invested to liquid and safe assets, mainly to government bonds. In the future, government plans to equalize the amount of annual transfer to the budget only to the profit from investment activities. (Ministry of Finance of RK) In October 2016, National Oil fund reserves accounted \$63,7 billion (Ministry of Finance of RK) Figure 2 below shows the amount of assets accumulated in the National Oil Fund starting from 2001.



Source: National Bank of Kazakhstan (<http://www.nationalbank.kz>)

Figure 3 – Assets of the National Oil Fund of Kazakhstan 2001-2016

### Banking sector

During the boom period Kazakhstani banks borrowed heavily from abroad, rising external debt to the level of 47 billion by 2007 (44 percent of GDP), in order to provide credits to non-tradable sector. Kazakhstan's banks total assets amounted to 5% of GDP in 1998. Eventually, in 2008 banks total assets grew to 75% of GDP, outrunning the Russia with total bank assets comprising of 55% of GDP. Such a rise was alarming, since bank lending was based on foreign borrowing, not domestic deposits. Main reason was that domestic credit was unavailable in Kazakhstan, since Government saved main portion of oil revenues in National Fund. Moreover, keeping deposits in local banks was distrustful for people. Banks in turn, searched for foreign borrowing to provide credits as income of households increased during boom. Availability of cheap and abundant credit from abroad led to mass borrowing of banks. (www.stratfor.com)

Banks in turn, provided credits to local citizen with high interest, since economic boom was in favour of doing so. As a result, Kazakhstani banks' loan to deposit ratio reached the extreme level. Since loan to deposit ratio of 100% means that for every dollar deposited in bank, a dollar is lent out. Whereas, loan to deposit ratio above 100% means that banks lend more than it receives in deposits. For example, German banking system faced troubles as loan to deposit ratio equalled to a reasonable level of 96%. In comparison, loan to deposit ratio in Kazakhstan equalled to 214%, while largest Kazakhstani Bank BTA went even further with a level of 361%. Kazakhstani foreign debt rose to 104 billion USD. (www.stratfor.com) In October 2007 Standard & Poor's downgraded ratings of Kazakhstani banks and the sovereign to BBB-. Furthermore, some banks were downgraded again in December 2007. This led to the decline in the household deposits. Also, non-residents sold \$4 billion tenge assets. These factors put pressure on exchange rates. (IMF, 2008)

### **Influence of World Crisis in 2008**

In 2008, Kazakhstani economy was hugely affected by the world crisis. Plummeting oil prices led to the decline in exports, falling from \$76.4 billion in 2008 to \$48.2 billion in 2009. (IMF, 2010) GDP growth has fallen to 3,2% in 2008 and went even further in 2009, equaling to only 1,2%. (Ministry of National Economy of RK) Banks in turn, faced huge risks due to over borrowing from abroad and credit crisis. Governments actions tightening the external funding, led to declines in credit and property prices. Moreover, devaluation in 2009 increased the risks in a highly dollarized economy. (IMF, 2010)

Government in turn, has created Samruk-Kazyna Fund in 2008, which included main state enterprises. (Government of the RK, 2008) Moreover, Government adopted a rescue plan of economy, with a projected 19 billion USD (almost 19% of 2009 GDP). Samruk-Kazyna took equity stakes in four large banks, public entities put deposits in these banks and key sectors of economy, which has NPLs, are funded with priority. Moreover, Distressed Assets Fund (DAF) received capital from government in late 2008, in order to eliminate overdue obligations of banks. Eventually, DAF helped not only to decrease obligations, but also assisted key economic sectors and banks. In February 2009, Kazakhstani government devaluated tenge by 20%. The day before Kazakhstan nationalised two largest privately held banks, BTA (country's largest bank) and Alliance Bank (country's fourth largest bank). (Stratfor) As a result, domestic deposits were kept from fluctuation and international reserves gained strength.

Banks external debt has declined to 20% in 2010, compared to 44% in 2007. Loan to deposit ratio in Kazakhstan decreased to 95% in 2016, meaning that Kazakh banks issue loans of 95 tenge for every 100 tenge on its deposits. The remaining 5 tenge are used as a backup source of liquidity. The total volume of deposits in Kazakh banks increased by 48.5 percent in May 2016, while loans volume grew by only 8.4 percent. (www.inform.kz)

### **Dutch Disease**

Overreliance of national economy to oil revenues is the main challenge for Government of Kazakhstan in recent years. President of Kazakhstan has set main goal to industrialize economy. The President of Kazakhstan approved initial industrialisation programme in May 17, 2003, for the period of 2003-2015. The core idea of the program was to eliminate dependence of the economy on oil

extraction and convert the economy from extraction to processing. Main aim of this program was to obtain an annual growth of 8-8.4% in manufacturing sector, by increasing productivity of labour by three times in 2015 compared to the level in 2000. Government officials has expected that by 2015 the share of finished products will rise from 46.5% to 50-52% of the total GDP. (Program of Industrial and Innovational Development, 2003)

Furthermore, the government accepted several other industrialization programs. In 2010, government accepted modified version of the industrialisation program called «National Programme of forced Industrial and Innovational Development during 2010-2014». The president called this program the most strategically significant for the country. The idea is similar to the previous program. Specifically, it states that by 2014 the portion of the manufacturing sector must be at least 12.5% of the total GDP. In addition, the portion of non-extraction sector of the economy in total exports must not fall below 40% of total exports. Other aim was to increase productivity in industry by 1.5 times. (National Programme of forced Industrial and Innovational Development, 2010) Another program called «30 corporate leaders» was aimed to create 30 new factories, consisting mainly of manufacturing. (Program of 30 corporate leaders)

### **Customs Union**

Kazakhstan, Russia and Belarus cooperated, to create Customs Union in 2010. Kazakhstan expected to gain from an increase in trade volume, free movement of labor, capital, and goods, and access to outside markets. (IMF, 2010) Furthermore, this integration resulted in creation Eurasian Economic Union starting from 1 January 2015, including Armenia and Kyrgyzstan as well. History of customs integration comes back from 1990's, just after the collapse of the Soviet Union. In January 6, 1995, Russia and Belarus signed the bilateral Customs Union agreement, Kazakhstan joining the same month and Kyrgyzstan a year later. In February 1999, these countries and Tajikistan signed other agreements called: Treaty on Customs Union and Single Economic Space. One of the reasons of creating Customs Union was the fact that former Soviet states faced exports discrimination by European states, who in turn has set tariff and non-tariff barriers.

On the other hand, there is a risk that Russia can have certain political reasons, being a superpower in this Union. Standpoint of Russia on Customs Union

is uncertain. According to Balassa 1961, integration processes are believed to improve internal trade, in expense of external trade. Therefore, largest economy would lose the most on international trade, due its inability to negotiate their preferences individually. Russia being the superpower in 20<sup>th</sup> century had lost its power to some extent after the collapse of the Soviet Union. Recovering its previous influence in Asia and Europe, may be the one reason for Russia, which actively push integration processes in CIS countries. (Yarashevic, 2014)

Moreover, Kazakhstan's benefit on this integration process can be doubted to some level. Kazakhstan has weak agriculture and manufacturing sector, thus cannot compete with Russia and Belarus in these terms, as they inherited from Soviet Union relatively strong factories on finished goods. As IMF experts note (IMF, 2011), Customs union can threaten Kazakhstani industrialization programs, due to competition inability of local companies, with more powerful Russian companies.

In recent years, economic influence of China is growing in Kazakhstani economy, as well as the presence of US and European countries' investments. Kazakhstani government in turn, tries to keep multi-vectoral politics with Russia, China and the West. Moreover, government officials tend to believe that

Customs Union will reduce its dependence in oil sector. According to IMF, Kazakhstan is expected to gain from access to large Russian market and free movement of labor and capital. Main objective is that Kazakhstani agriculture and commodity export will benefit from accessing the larger market. Moreover, Kazakhstan joined World Trade Organization in 30 November 2015. (www.wto.org) All of these steps are expected to stimulate non-oil sector development.

### Recent performance of Kazakhstan's economy

In recent years, Kazakhstani economy in general has recovered from 2008-2009 crisis. Economic growth driven mainly by high oil prices allowed economy to grow at a relatively stable manner. During 2010-2014 Kazakhstan's GDP had a growth of 4-7% annually. GDP per capita during this years has grown from 9 thousand USD in 2010 to 13,9 thousand USD in by the end of 2013. Reforms in the oil taxation and high oil prices led to the increase in National fund reserves from 31 billion USD in 2010 to 73.2 billion USD in 2014. (Ministry of National Economy of RK) Overall, Kazakhstan gained middle-income country status. (IMF, 2014)

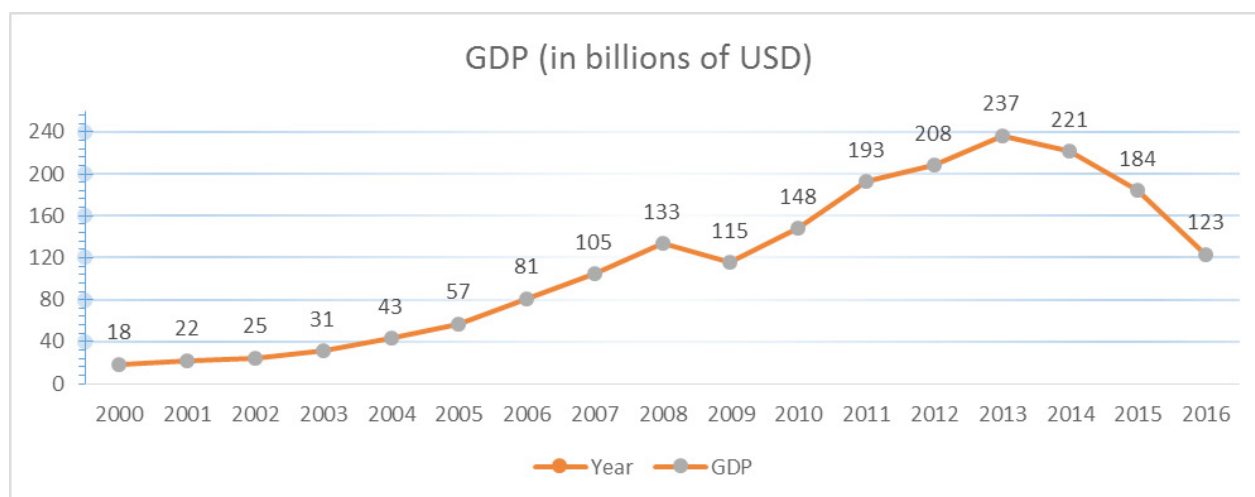


Figure 4 – (Amount of GDP 2000-2016)

Source: Committee of Statistics of the Ministry of National Economy of RK (www.stat.gov.kz)

However, country's overreliance on oil revenues remained. Industrialization programs aimed to diversify the economy did not give positive effect. Share of manufacturing sector remains at a low

level. Foreign Direct investments declined sharply in 2013, due to the end of large investment projects like Kashagan. In 2014, Kazakhstani economy faced other difficulties. Economic growth has fall-

en sharply as a result of external shocks like lower oil prices, Russia and China economy slowdown, appreciation of dollar. These shocks in turn, affected the financial sector, where portion of NPLs still remains high, despite the fact that it has been declining in recent years. (IMF, 2014) Experts in turn, believe that this crisis will last longer than ever. GDP growth has declined to from initial 6% in 2013, to 4.2% in 2014, falling even more in 2015 to the degree of 1,2%. During this period, tenge was significantly devaluated, by 18% in 2014 with a trading band of T185/USD +/- 3tenge/USD. In September 2014, the band was widened further to T170-188/USD. Eventually, by the end of 2015 it finalized at the T330-340/USD. (National Bank of Kazakhstan, 2015)

As a positive side of the economy of Kazakhstan, experts note that low public debt and large reserves in National Fund. Kazakhstani gold reserves and National fund was rising stably and is able to serve as a cushion from external shocks. However, during the last crisis National fund reserves has fallen notably.

#### **Future plans of sustainable growth of the economy**

Government approved stimulus program called «NurlyZhol» which is aimed to offset the shocks. Program is aimed to create a single economic market by integrating macro-regions of the country, through construction of effective infrastructure by hub principle. This program is believed to ensure long-term economic growth of Kazakhstan, by creating new jobs and improving infrastructure. During the period of 2015-2019, program is aimed to create overall 395 thousand new jobs and raise Kazakhstan to 57<sup>th</sup> place in WEF base infrastructure quality ranking. Overall, government wants to finance over 9 billion USD, mainly from National Fund. (Nurlyzhol, 2016) As a result, Astana, Almaty, Aktobe, Shymkent and Ust-Kamenogorsk cities are expected to become main hubs of macro-regional development of the country. New roads, railways, houses, social buildings will be built. Eventually program must provide a 15,7% GDP growth in 2019, compared to 2014. NurlyZhol targets seven areas of infrastructure development:

- transportation and logistics infrastructure
- industrial infrastructure
- energy infrastructure

- public utilities infrastructure
- housing infrastructure
- social infrastructure
- small and medium-sized enterprises

Eventually, 1.4 million square meters of rental housing is expected to be constructed in 2015-2019.

Moreover, Agrobusiness-2020 program was adopted in 2012, which aims to stimulate agricultural sector, by injecting almost 2 986.9 billion tenge. This program is mainly aimed to improve labor productivity from low levels by providing credits to farmers. As a result, Kazakhstan must be able to cover own needs. (Government of Kazakhstan)

Kashagan oil field was discovered in 2000's and believed to be the largest oil field discovered in last 30 years. Project was embarked as the most expensive with initial cost of 10 billion USD to 50 billion USD. Oil field has reserves of 13 billion barrels of crude oil and huge reserves of natural gas. However, systematic delays have increased the cost of the project and risks. After several delays, production believed to start in late 2013, compared to initial period of 2005. However, after several days of the start of production, due to the leaks from pipeline the project was terminated. Oil production resumed in October 2016, with daily production of 100 thousand barrels. In 2017 Kashagan is expected to produce 4-7 million tonnes of oil. In the future, when Kashagan reaches its peak of production, Kazakhstan will become a key player in oil market, by entering top 10 oil producers in the world. (Financial times)

#### **Conclusion**

Overall, since its independence Kazakhstan has developed tremendously, mainly due to its oil reserves. It is important to note significant reforms in the economy, which allowed the economy to flourish. On the other hand, Kazakhstani government still struggles to industrialize the economy, in order to eliminate its dependence on oil production. In the nearest future Kazakhstan is expected to become, top 10 oil producer. Main reason for this rise is the Kashagan oil field, which is expected to double oil production. Such a vast increase in production will face Kazakhstan with even higher risks of Dutch Disease. Therefore, government needs to industrialize the economy further.

## Appendix

**Table 1** – (Country reserves 2000-2016)

Period	Assets in CFC	Gold reserves	Net International Reserves	Assets of the National Oil Fund
	volume, mln.\$	volume, mln.\$	volume, mln.\$	volume, mln.\$
2000	1 595	502	2 094	-
2001	1 998	511	2 506	1 240
2002	2 555	586	3 138	1 915
2003	4 236	726	4 959	3 663
2004	8 473	804	9 273	5 131
2005	6 084	986	7 065	8 074
2006	17 751	1 376	19 123	14 092
2007	15 777	1 853	17 626	21 006
2008	17 871	2 001	19 844	27 486
2009	20 591	2 501	22 531	24 368
2010	25 223	3 052	27 711	30 980
2011	25 177	4 151	28 769	43 625
2012	22 121	6 148	27 736	57 927
2013	19 164	5 551	24 170	70 792
2014	21 814	7 395	28 261	73 243
2015	20 295	7 576	26 975	63 392
2016	19 913	9 617	28 998	61 218

Source: National Bank of Kazakhstan ([www.nationalbank.kz](http://www.nationalbank.kz))

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