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MASTER THESIS

Relationship between oil and GDP: The case of
Kazakhstan. Assessment of economic situation and
economic development of Kazakhstan based on the
economy of oil.



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Prague

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DIPLOMOVÁ PRÁCE

Vztah mezi ropou a HDP: Případová studie Kazachstánu.
Hodnocení ekonomické situace a hospodářského rozvoje
Kazachstánu na základě ropného hospodářství.



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Praha

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Declaration of Authorship

The author hereby declares that he compiled this thesis independently, using only the listed resources and literature.

Prague, May 17, 2013

Signature

Abstract

This Master thesis is devoted to research of the economic development of Kazakhstan based on the economy of oil.

This study is an attempt to analyze the relationship between oil price, GDP, inflation and oil exports in Kazakhstan on the basis of quarterly data from 2000Q1 to 2010Q4. We explored the role of oil price for the economy of Kazakhstan by using time-series Vector Error Correction Model (VECM) approach. Moreover, we applied the Johansen cointegration test to examine the sensitivity of economic growth to changes of oil prices in the long term. The key result shows that oil price shock has no significant impact on real economic growth in Kazakhstan. However, the price of oil has significantly positive effect on GDP in the short-term.

In addition, we investigated a relationship between FDI and economic growth of Kazakhstan. Foreign direct investment plays a significant role in the development of republic. For the analysis we used the annual data for the period 1993 to 2011 (almost from the period of independence of Kazakhstan). Regression analysis of Ordinary Least Square (OLS) was used in analyzing the data. Based on the empirical results, the analysis shows that there is a positive relationship between the FDI and economic growth. Our findings confirmed that Kazakhstan as a new developing economy attracts FDI to country. However care should be taken when attracting FDI, because the investment potential of the republic largely based on natural resources.

JEL Classification: C32, E22, F21, F43, L71, N55, N65, Q43

Keywords: GDP, Oil price, Kazakhstan, Foreign Direct Investment, Vector Autoregression, Vector Error Correction Model.

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Abstrakt

Tato diplomová práce se zabývá výzkumem ekonomického vývoje v Kazachstánu na základě vývoje ropného sektoru.

Tato studie je pokusem analyzovat vztah mezi cenami ropy, HDP, inflací a objemem exportu ropy v Kazachstánu, na základě čtvrtletních dat z období od prvního čtvrtletí roku 2000 do čtvrtého čtvrtletí roku 2010. Zkoumali jsme roli cen ropy v rámci kazašské ekonomiky s pomocí časových řad modelu VECM (Vector Error Correction Model). Dále jsme aplikovali Johansenův test kointegrace k přezkumu citlivosti ekonomického růstu na změny v cenách ropy z dlouhodobé perspektivy. Hlavní výsledek neprokázal významný vliv šoku cen ropy na růst reálné ekonomiky Kazachstánu. Avšak cena ropy má podstatný pozitivní vliv na HDP v krátkodobém horizontu.

Nadto jsme zkoumali vztah mezi přímými zahraničními investicemi a ekonomickým růstem Kazachstánu. Přímé zahraniční investice hrají důležitou roli ve vývoji země. Pro tutu analýzu jsme využili roční data z období mezi lety 1993 a 2011 (tj. téměř z celého období nezávislosti Kazachstánu). Ke studiu těchto dat byla použita regresivní metoda OLS (Ordinary Least Square). Analýza, která je založena na empirických výsledcích, dokazuje pozitivní vztah mezi přímými zahraničními investicemi a ekonomickým růstem. Naše výsledky potvrdily předpoklad, že Kazachstán, jakožto nově rychle rostoucí ekonomika, je atraktivní zemí pro přímé zahraniční investice. Při upoutávání pozornosti zahraničních investorů by však měl být zohledněn fakt, že investiční potenciál země se do velké míry zakládá na přírodních surovinách.

Klasifikace JEL: C32, E22, F21, F43, L71, N55, N65, Q43

Klíčová slova: HDP, Cena ropy, Kazachstán, Přímé zahraniční investice, Vector Error Correction Model

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Acronyms

Bcf	Billion cubic feet
CPC	Caspian Pipeline Consortium
CNPC	China National Petroleum Corporation
CIS	Commonwealth of Independent States
ECT	Error-Correction Term
FDI	Foreign Direct Investment
IOCs	International Oil Companies
IPF	Investment Privatization Funds
KMG	KazMunayGas
KMG EP	KazMunayGas Exploration Production
KPO	Karachaganak Petroleum Operating
NC KMG	National Company KazMunayGas
NFRK	National Fund of the Republic of Kazakhstan
OECD	Organization for Economic Cooperation and Development
OSCE	Organization for Security and Co-operation in Europe
OKIOC	Offshore Kazakhstan International Operating Company
PSA	Production Sharing Agreement
RK	Republic of Kazakhstan
SOE	State owned enterprises
TCO	Tengizchevroil
Tcf	Trillion cubic feet
VAR	Vector Autoregression Model
VECM	Vector Error Correction Model
WTO	World Trade Organization

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Master Thesis Proposal

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Proposed Topic:

Relationship between oil and GDP: The case of Kazakhstan. Assessment of economic situation and economic development of Kazakhstan based on the economy of oil.

Topic characteristics:

In our opinion today the issue of oil is very crucial. Great interest of the world powers now hitting the country's of Caspian region. Also at today Kazakhstan is a leader economic indicator in the CIS and the post-Soviet countries, therefore the republic arouse a double interest in the global community. The aim of this work is to present the latest picture of oil situation in the Kazakhstan. We want to show in the thesis that the development of the republic's economy is inextricably linked with the development of energy resources. Also in the study, we want to show the relationship between GDP and oil prices as well as FDI.

Hypotheses:

1. Hypothesis: Development of Kazakhstan's economy is directly dependent on development of oil and gas complex of the republic.
2. Hypothesis: Oil price increases have a clear and positive effect on the oil exporter's GDP growth.
3. Hypothesis: Attracting foreign investment into the oil sector is a positive factor for GDP growth.

Methodology:

In thesis we will use linear regression analysis with the time series data from 1993 to 2010, for examine the correlation between GDP growth and performance of oil and gas sector. And also for determining positive or negative impact FDI on GDP. Summarizing different resources of literature on FDI determinants, we assume that FDI inflows into Kazakhstani economy can be captioned by variables that can be important for the analysis. Such as GDP and Net export.

Also we want to analyze relationship between oil price, GDP (economic growth), exchange rate, export and inflation. We will plan to use VAR or VEC approach to this issue (in order to investigate the macroeconomic consequences of oil price shocks).

Outline:

1. Kazakhstan in the context of transition periods, 1992-2010
 - 1.1 Short overview of Kazakhstan development (Dynamics of development of the republic).
 - 1.2 Kazakhstan as a state with enormous potential of natural wealth.
 - 1.3 The main stages of development of the oil and gas complex of Kazakhstan.
2. Influence of oil sector on the economy of the country.
 - 2.1 VAR/VECM analysis
 - 2.2 Regression analysis of FDI.
 - 2.3 Empirical result.
3. Analysis of the activities of oil and gas companies in Kazakhstan.
 - 3.1 Resource of nationalism in Kazakhstan petroleum sector.
 - 3.2 Local Corporation and Foreign Investors.
4. Forecast of the future of the Kazakhstan petroleum sector.
5. Conclusions

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Author

Supervisor

Introduction

Last two decades Kazakhstan demonstrated good economic indicators literally in all directions of economy. In such a way Kazakhstan is a very interesting object for researches in various areas of the economy. However, to date, not so much studies that consider Kazakhstan as an example have been completed. But every year their numbers are increasing together with growing interest in Kazakhstan.

The traditional advantages of Kazakhstan in global economy are the natural and mineral resources. Kazakhstan has great potential natural resources; whole periodic table is represented in the republic. Kazakhstan is one of the largest exporters of energy products. This Master thesis will be devoted to the oil and gas sector of Kazakhstan, as to one of the main sectors in the country. A significant part in the structure of the fuel and energy complex of Kazakhstan occupies the oil and gas sector, which share in GDP is about 15% and in the total export is more than 63%.

The oil is one of the most important raw materials in the modern economy. Petroleum products are widely used in various industries. Due to high global dependence on oil products, the relationship between oil prices and different economic indicators has received much attention from economists over many years. Nowadays, there is accumulated a lot of literature dealing with this issue, but still not fully examined the effect of oil prices.

Hamilton's study of 1983 has particular importance for analysis of oil prices. He stressed that there is a strong relationship between sharp rise in the oil prices and it follows economic downturns of US economy. His research caused enormous interest from the economists.

Subsequently, a large number of literature and papers had considered the relationship between oil price and economic growth for a number of countries based on different theoretical linkages.

The effects of oil price fluctuations could be different in oil-importing and oil-exporting countries. The increase in oil prices usually leads to positive consequences for the oil-exporting countries. And vice versa, rising oil prices conducts to adverse effects for the oil-importing countries. When oil price falls there can be expected inverse reaction.

In this Master thesis we are first of all interested in studying the effect of oil price on economic growth of Kazakhstan. In order to provide insight into this relationship, we apply a Vector Error Correction approach to this issue. Our analysis is conducted using quarterly data from the first quarter of 2000 to the fourth quarter of 2010. This period includes years of more stable monetary policy regime as well as stable growth and development of the Kazakhstan.

The main findings based on the VECM analysis are that the oil price is not significant for economy of the Republic of Kazakhstan in the long-term, but in the short-term the price of oil is positive for the country.

It is reasonable that the fuel and energy complex of Kazakhstan plays important role in attracting investment. Secondly we are interested in studying the effect of Foreign Direct Investment on the Kazakhstan's economy.

Attraction and effective use of foreign investment in the economy is essential, especially for the developing countries. FDI affects economy by creating employment, technological development, stimulating domestic investment and etc.

Today there is a burgeoning body of empirical literature that investigates effect of FDI on economic growth. A large percentage of the existing literature argues that impact of FDI on economic growth of the host country is positive. Many authors such as Blomstrom et al (1994), Borensztein et al (1998), Hansen and Rand (2004), Lall (2002), De Gregorio (2003) and etc. have concluded that FDI has positive impact on growth, using different data and methods. They also claim that positive impact of FDI depends on economic conditions of host country.

Also there are some studies that have come to other conclusions. For instance, Carkovic and Levine (2002) argue that FDI does not exert a robust influence on economic growth. Lee, Baimukhamedova and Akhmetova (2009) pointed out that FDI has a minimum or statistically insignificant impact on GDP growth in Kazakhstan.

The primary objective of this part of the Master thesis is to examine the relationship between FDI and Economic Growth in Kazakhstan. We use annual data from 1993 to 2011. We use the Ordinary Least Squares regression analysis to estimate our data.

Based on the empirical results, our analysis shows that there is a positive relationship between the FDI and GDP. This result is in line with our expectations. Moreover we note

that Kazakhstan should conduct more balanced policy and use caution when attracting foreign investors, because the investment potential is largely based on natural resources.

Our study is motivated by a number of factors. First, there is a lack of sufficient literature and papers which examine the interaction between GDP and Oil price, and also relationship between FDI and other economic variables for Kazakhstan. Second, our study covers a period which includes some of the most important economic, political and social events leading to a more developed, open and integrated Kazakhstan's economy.

The Master thesis is organized in the following way. The second chapter describes the economy of Kazakhstan, and considers the main stages of development of the oil and gas sector of the republic.

The third chapter analyzes activities of main oil and gas companies in Kazakhstan and the role of the state in the oil sector.

The fourth chapter presents our empirical approaches. In this part we analyze influence of oil sector on the economy of Kazakhstan. This chapter provides overview of methodologies and our data, and presents our results.

The fifth chapter deals with the state Strategies that are directly related to the development of the country as well as to the development of the oil and gas sector.

In the conclusion, we will summarize major facts of our study and will draw conclusions.

Kazakhstan in the context of transition periods, 1991-2010

2.1 A short overview of the development of Kazakhstan.

Kazakhstan is the largest country in Central Asia in terms of land area. Neighbors of Kazakhstan are Russia, China, Kyrgyzstan, Uzbekistan, Turkmenistan and Mongolia (see Figure 2.1). This land-locked country is the ninth largest in the world equaling Western Europe. It has 2 699 700 km² of land area (seven times bigger than Japan) with the population of 16, 04 million; ethnic Kazakhs represent 63.1%. Other ethnic groups include Russians 23.7%, Uzbeks 2.9%, Ukrainians 2.1%, Uyghurs 1.4%, Tatars 1.3%, Germans 1.1% and others 4.5% (The Agency of statistics of the Republic of Kazakhstan).

Figure 2.1: Map of Kazakhstan



Source: U.S. Energy Information Administration
http://www.eia.gov/countries/analysisbriefs/Kazakhstan/images/kazakhstan_map.png

Small historical background is given below. In the 16th century, the formation of a single Kazakh nation was completed. Kazakhstan became a part of the Russian Empire in 1848. In 1936 Kazakhstan was raised from autonomous status within the Russian republic and

became a full republic of the Soviet Union (Batalden & Batalden 1997, p.142). Kazakhstan was not only the most important grain supplier among the other USSR republics, but also the most significant site of military industrial activity in Central Asia. In Kazakhstan, during World War II marked an increase in industrialization and increased mineral extraction in support of the war effort. During the Soviet period Kazakhstan was an agricultural region and supplier of raw materials for the USSR economy. Moreover, thanks to abundant mineral resources and large territory, Kazakhstan played a role of a “trial lab” where the Soviet authorities implemented its initiatives, such as the “Virgin Lands” campaign and the Baikonur space station or decision to test a nuclear bomb on the territory of Kazakh SSR in Semey in 1949. Of course all this has led to different social, economic, ecological and biological implications for the country.

On the 16th of December, 1986, long-time first secretary of the Kazakh Communist Party, Dinmukhamed Konayev, was replaced by an ethnic Russian more closely fitting the mold of Mikhail Gorbachev’s policy of perestroika (Batalden & Batalden 1997, p.145). The reaction to Kolbin’s appointment was swift, mass demonstrations by young ethnic Kazakhs, later called “Jeltoqsan¹” riot, that took place in Almaty to protest the replacement of the First Secretary of the Communist Party of the Kazakh SSR.

By mid-1989, two and half years into his leadership of Kazakhstan, Party of Secretary Gennady Kolbin had been transferred to a post in Moscow. The resulting vacancy at the head of the Kazakh Soviet Republic was filled by the Party election of Nursultan Nazarbayev as first secretary of the Kazakh Communist Party (Batalden & Batalden 1997, p.147).

In the August 1991 was the abortive coup attempt in Moscow, after that there was a parade of sovereignties Soviet republics and the subsequent collapse of the Soviet Union. After several attempts by Nazarbayev to “save” the Soviet Union, the Slav republic gathered in Minsk on 8 December 1991 to declare the Union defunct, creating a Commonwealth of Independent States in its place. Just over a week later, as the last republic to do so, Kazakhstan declared its independence 16 December (Cummings 2005, p.16).

¹ The Jeltoqsan in Kazakh language mean December, which corresponds to the time of the demonstration.

After gaining independence, Kazakhstan became a unitary state with the presidential form of government. In accordance with the Constitution, the Republic of Kazakhstan proclaims itself a democratic, secular, legal and social state whose highest values are an individual, his life, rights and freedoms (The Constitution of the Republic of Kazakhstan 1995).

Since gaining independence, Kazakhstan has undergone through a serious economic reform process which led to the establishing one of the most rapidly developing economies.

The main economic challenge of independence has become transition from the Soviet-styled central planning to the market economy. During these years, Kazakhstan reached significant progress in implementing complex economic, political and social reforms to establish a democratic state with a market economy.

Kazakhstan was the last Soviet republic to formally declare its independence in 1991 and its leader was the most assiduous in trying to construct a viable successor organization to the USSR. Kazakhstan followed Russia's radical reforms, notably the price liberalization of January 1992 and early privatization measures (Pomfret 1995). This implied a relatively radical reform program, which dominated the agenda in the wake of the collapse of the USSR. The goal was to create a well-functioning market economy through a series of measures aiming at liberalizing, stabilizing and privatizing the economy.

It can be stated that the macroeconomic dynamics of recent decades involves several basic steps.

The first stage (1992-1995) is characterized by realization set of measures for the transition from a planned to the market economy: formation of the institutional and legal framework of market economy; liberalization of the economy; filling the market with consumer goods. In this period, the economy was at the stage of deep production and financial crisis which has negative impact on the development.

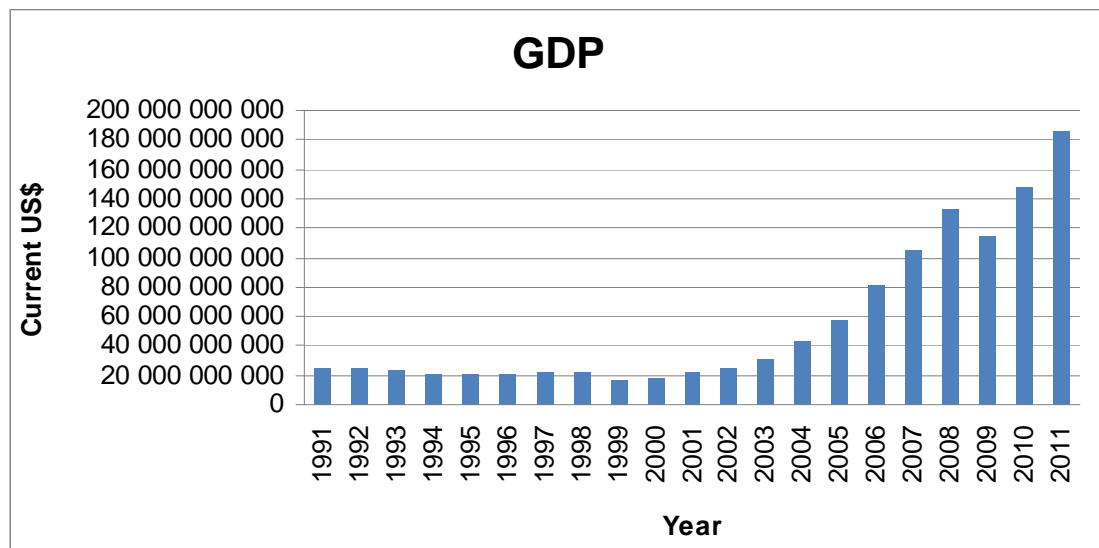
The government moved quickly towards price liberalization in January 1992, but it failed to follow up with the institutions required for a well-functioning market economy. Thus the functioning, albeit inefficiently, coordinating mechanisms of central planning were replaced by a coordinating void. Slowness in bringing the hyperinflation of 1992-93 down to moderate inflation levels also contributed to the poor functioning of the market

economy, although inflation was more or less under control by 1997 (see Figure 2.7) (Pomfret 2005, p.861).

Kazakhstan withstood a severe recession in the early 1990s. In 1999, the worst year in Kazakhstan's economy, total GDP was equivalent to 69% of its 1990 value (see Figure 2.2). The severe economic crisis after the collapse of the centralized Soviet economic system impelled the Kazakh leadership to pursue a hydrocarbon-based path to economic development by attracting foreign direct investment in the oil and gas sectors (Ipek 2007).

After 2000, there has been steady growth of GDP. Also Kazakhstan experienced high emigration during the 1990s, as its population fell from over 17 million at the time of independence to less than 15 million ten years later (see Figure 2.3). The economic downturn in 1990-1995 was largely associated with the collapse of economic relations with former Soviet countries, the general economic downturn in Russia and other CIS countries and a sharp drop in oil prices.

Figure 2.2: Total GDP of Kazakhstan



Source: Agency of statistics of the Republic of Kazakhstan

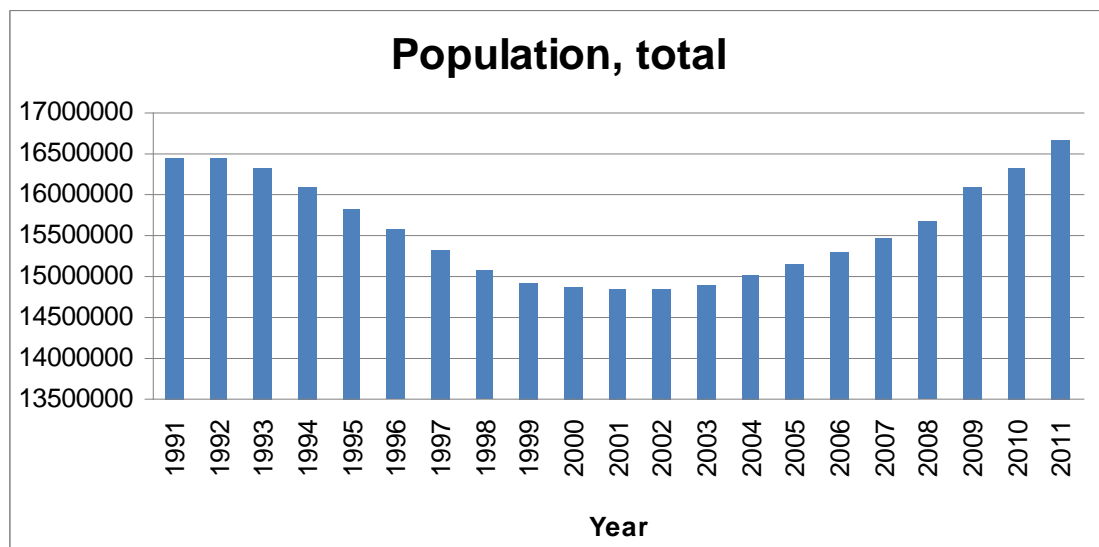
Between September 1995 and the end of 1996 many of the most valuable state enterprises were sold. During this period the government's attention also began to focus more

narrowly on oil sector development, and became associated with wealth accumulation by the elite (Pomfret 2005, p.859).

At the second phase (1996-1998) the main focus of reforms was ensuring macroeconomic stability; improving the legislative framework, financial system, social services and manufacturing sector; implementation of demonopolization and privatization; development of small and medium enterprises; creation of the competitive environment. Privatization - one of the important areas of economic reform. The basis of market economic relations is the separation of ownership from the state, privatization of property. A market economy promotes the strengthening of ties between producers and consumers.

Denationalization began in the republic since the early days of independence. In 1992 it was privatized by 6200, in 1993 - 2700 enterprises. The privatization program was continued in 1994-1996. In 1996, revenues in the budget amounted to 19 359 898 tenge.

Figure 2.3: Total population of Kazakhstan

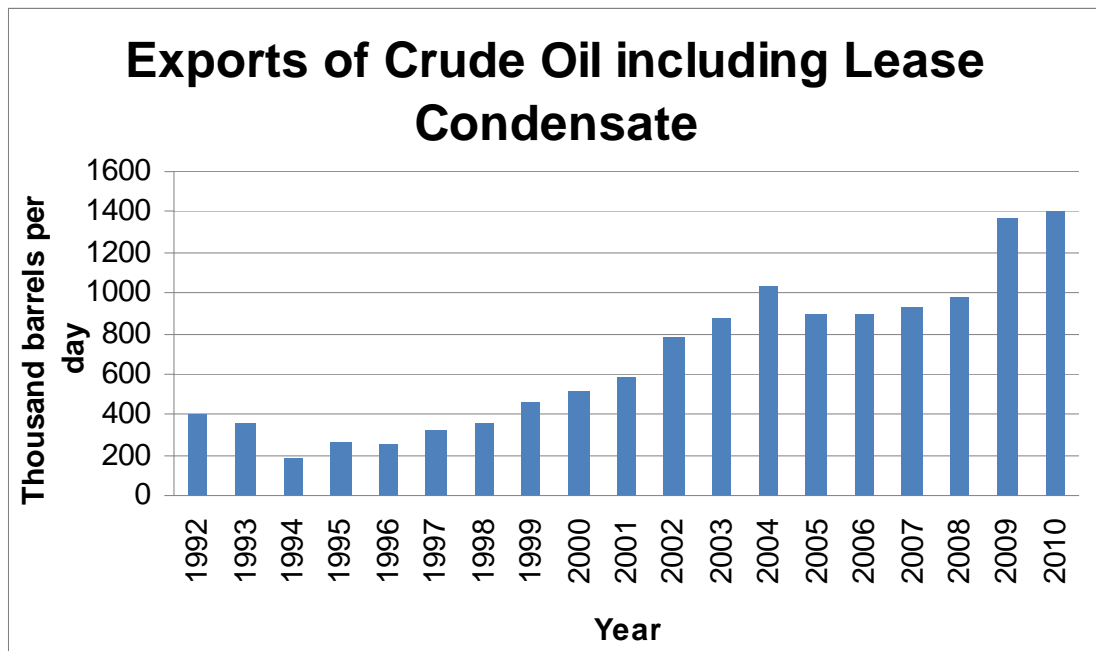


Source: Agency of statistics of the Republic of Kazakhstan

The first Privatization and Denationalization Act was passed in June 1991, but Kazakhstan only started to work seriously on privatization in 1992. In the first phase housing was privatized through a coupon scheme (Pomfret 2005, p.863). The second

stage of privatization began in 1993 with the issue of vouchers with which citizens could buy shares in Investment Privatization Funds which would buy shares in medium and large state enterprises. The scheme was a mix of Czech and Russian voucher schemes, intended to ensure a fair denationalization of state assets, and Poland's IPF scheme, intended to forestall excessive fragmentation of ownership (Olcott 2002, p.138). Despite the chaotic circumstances that characterized the privatization process, this should be considered a success. The non-tradable sector had increased rapidly with small restaurants, cafe etc. In the third stage of privatization companies were sold in part or whole, or contracted to the management of individual investors for a specified period, under an individually negotiated agreement – ‘making this the most corrupt stage’ (Olcott 2002, p.139). The third stage coincided with a period of increased interest in oil exploitation, and sale of rights and the privatization process slowed down after 1997. This was expected since a majority of the economy already had been privatized. Although there were also other reasons, as the revenues from oil and gas export grew (see Figures 2.4 and 2.5), the state faced less budgetary pressure to denationalize the SOEs.

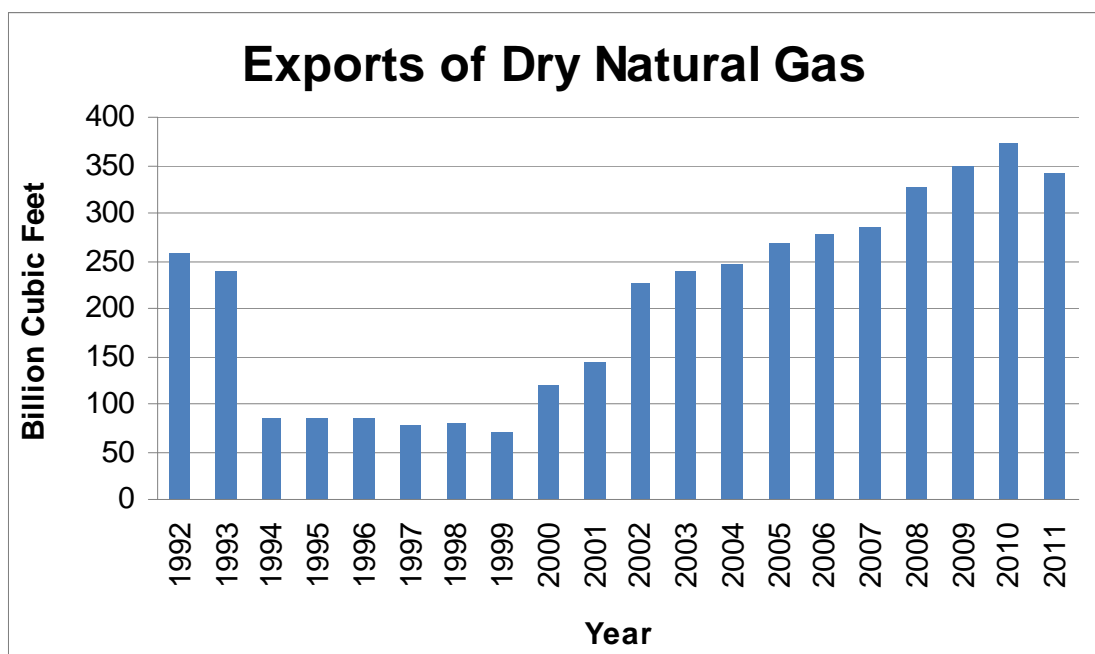
Figure 2.4: Kazakhstan Crude Oil Exports



Source: U.S. Energy Information Administration

The most important event of the second stage was the adoption of the development strategy “Kazakhstan-2030” and identification of the main long-term priorities on the way of building a new model of economic development. Adopted Strategy aims to ensure the economic security of Kazakhstan through the effective use of existing fuel and energy base; creating a modern transport and telecommunications infrastructure; modernization and creation of new enterprises in the manufacturing sector; formation of favorable investment environment, and the development of foreign trade policy. In the fifth part of this study we elaborate on the “Strategy 2030”.

Figure 2.5: Kazakhstan Natural Gas Exports



Source: U.S. Energy Information Administration

At the third stage (1998-2000) the global financial crisis of 1997-1998 affected the economic development of the republic. The positive dynamics of the economy that observed in previous stage has been significantly slowed. In April 1999, in reaction to the Russian and South-East Asian financial crises the tenge underwent devaluation. Introduction of a free-floating exchange rate regime allowed stabilizing the financial

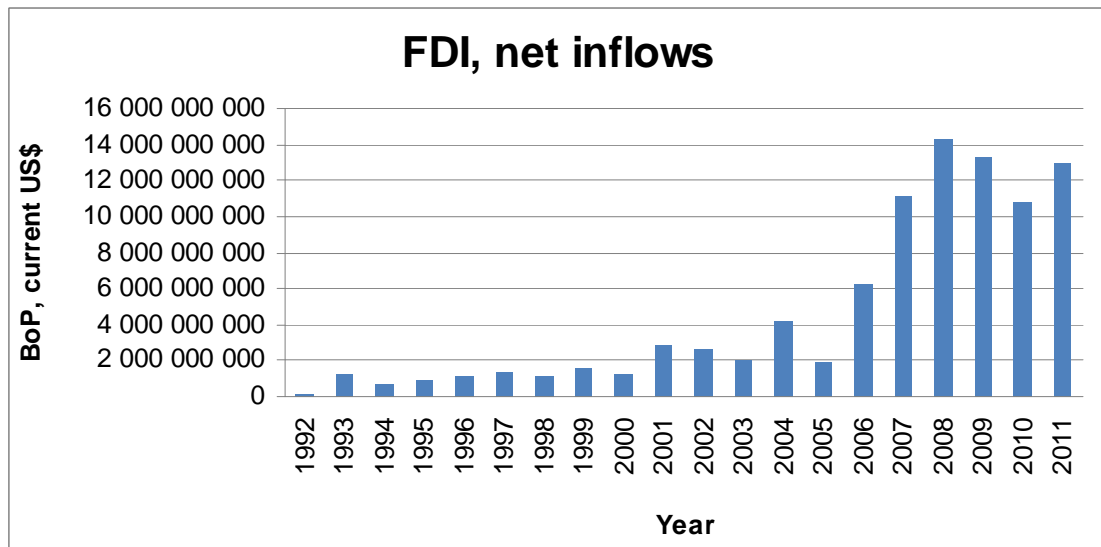
market. Due to the right and timely anti-crisis measures of the government, the depth of the economic recession was small.

Following large currency devaluation and an upturn in proven oil reserves and in oil prices, Kazakhstan entered a boom period in the early twenty-first century. Oil boom following the Russian crisis positively affected the Kazakhstan's economy, as far as oil prices increased, more favorable conditions for transporting the country's oil to export markets, and large new discoveries; the economy stabilized, the growth became rather strong in the late nineties. Major reforms of the mid-1990, including freely convertible currency and launching of a stock exchange and development of modern banking sector, began to give positive results. From 2000 onwards the growth was impressively strong. This made Kazakhstan one of the fastest growing countries in the world.

Despite the problems, Kazakhstan has been relatively successful among CIS countries in attracting foreign direct investment (Pomfret 2005). In 1990, Chevron started negotiating for the Tengiz oilfield; it was the biggest FDI deal in the Soviet history. From 1996 to 2000 FDI exceeded a billion dollars a year and since 2001 it has exceeded two billion dollars (see Figure 2.6), with over 85% going to natural resource activities. In manufacturing some of the earliest investors have made further investments, e.g. Philip Morris built a \$340 million tobacco factory in 2000 and now controls 80% of Kazakhstan's tobacco market (Olcott 2002, p.145). The FDI plays a significant role in Kazakhstan's GDP. The FDI is mostly directed to the oil and gas industry which attracted sixty seven percent of FDI over the 1993-2000.

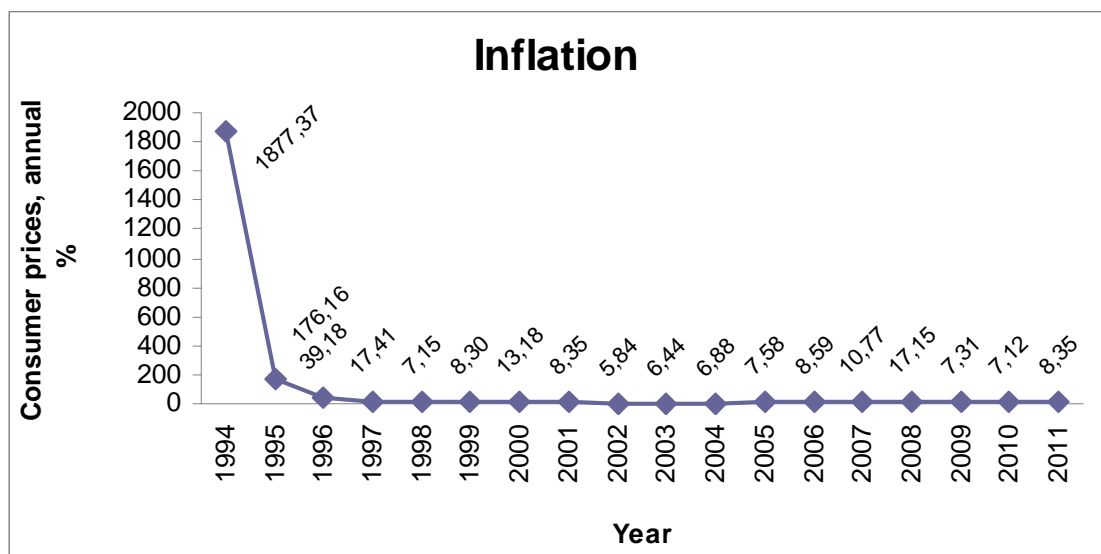
At the beginning of the fourth stage (2000-2007) due the oil and gas sector began a rapid recovery of the economy of Kazakhstan. In the early the XXI century up to 2007 was observed dynamic and sustainable economic growth in republic. Over the years 1995-2008, GDP of Kazakhstan increased by 2.4 times. Rate of economic growth has been among the highest in the CIS. The inflation rate in 2002 was the lowest over independence years, which was 5, 84% (see Figure 2.7).

Figure 2.6: Foreign Direct Investment



Source: Agency of statistics of the Republic of Kazakhstan

Figure 2.7: Inflation of Kazakhstan



Source: Agency of statistics of the Republic of Kazakhstan

Economic reforms based on free market principles have to a large extent been successful in Kazakhstan. It started in 1992 when Kazakhstan took the initiative in economic reform, with some help of International Financial Institutions. Eventually, Kazakhstan

has been recognized by the USA and EU as a country with market economy in 2001 and 2002. Republic of Kazakhstan has become the first country in the CIS, which reached investment grade status.

The economy became focused on the export of oil and gas, which had strongly positive effects on growth. The huge inflow of FDI has certainly played a crucial role as a catalyst in the economic growth and transition process.

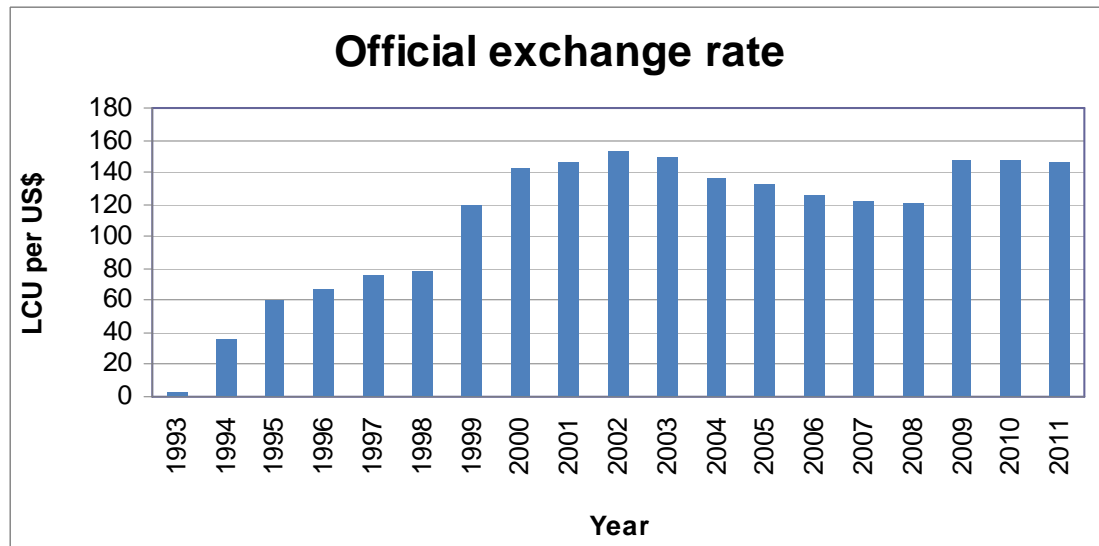
In 2007, the economy has suffered from the negative effects of the global economic crisis. The sharp decline in borrowing and liquidity deficit has limited the amount of bank lending, which primarily affected the construction market and trade.

The fifth stage (2008 - present time) is characterized as a stage of overcoming the global financial crisis. The given crisis situation caused an increase of the regulatory functions of the state administration in financial and economic sphere. It should be noted that high oil prices in the first part of the 2008 year partly cushioned the GDP decline.

The national economy has developed largely by external sources such as high commodity prices, “cheap” loans from foreign banks. It became apparent that to overcome the crisis and ensure long-term sustainable economic development necessary to find internal sources of growth.

In November 2008, the President outlined anti-crisis plan that included lowering tax rates and drawing 10 billion U.S. dollars from a National Oil Fund to recapitalize banks that had large foreign debt payments; to support Kazakhstan’s currency. In early 2009, reduction oil revenues and foreign debt repayments led to devaluation of the local currency by 20 percent against the U.S. dollar (see Figure 2.8).

Figure 2.8: Exchange rate



Source: Agency of statistics of the Republic of Kazakhstan

For the more active participation of the state in the modernization of the economy of Kazakhstan by decree of the President there was created new big holding National Welfare Fund “Samruk-Kazyna”. Assets under management of the fund are about 70 billion dollars, and it is almost 65% of GDP. Holding played an important role in overcoming the effects of the crisis.

Stabilization plan implemented in the following five areas:

1. stabilization of the financial sector;
2. solving problems in the real estate market;
3. development of small and medium businesses;
4. development of agriculture;
5. realization of innovation, industrial and infrastructure projects.

Plan was timely. The government took the right position, deciding during the recession to concentrate on domestic reserves; invest in the real sector, infrastructure, and human capital development.

Since January 1, 2009 introduced a New Tax Code within this solved the following problem: reducing the overall tax burden for businesses; improving the tax climate for

businesses non-oil sector while increasing taxation of enterprises of oil sector; and improving tax administration.

According to the IMF, in 2009 GDP increased by 1.2% and in 2010 by about 6.0%, due to higher oil prices, a recovery in domestic spending, as well as financial assistance from the state.

In recent years were achieved successes in the field of foreign relations. Desire to further the development of mutually beneficial economic relations and the close customs integration prompted the three heads of states (Russia, Kazakhstan and Belarus) to create the Customs Union within the Eurasian Economic Community (EurAsEC).

The 15th Ministerial Meeting of the OSCE in Madrid in late November 2007 decided that Kazakhstan would hold the OSCE chairmanship in 2010, it the first post-Soviet, Eurasian, Muslim-majority country to host OSCE summit. Moreover there was conducted extensive work on accession of Kazakhstan to the WTO.

2.2 Kazakhstan as a state with enormous potential of natural wealth.

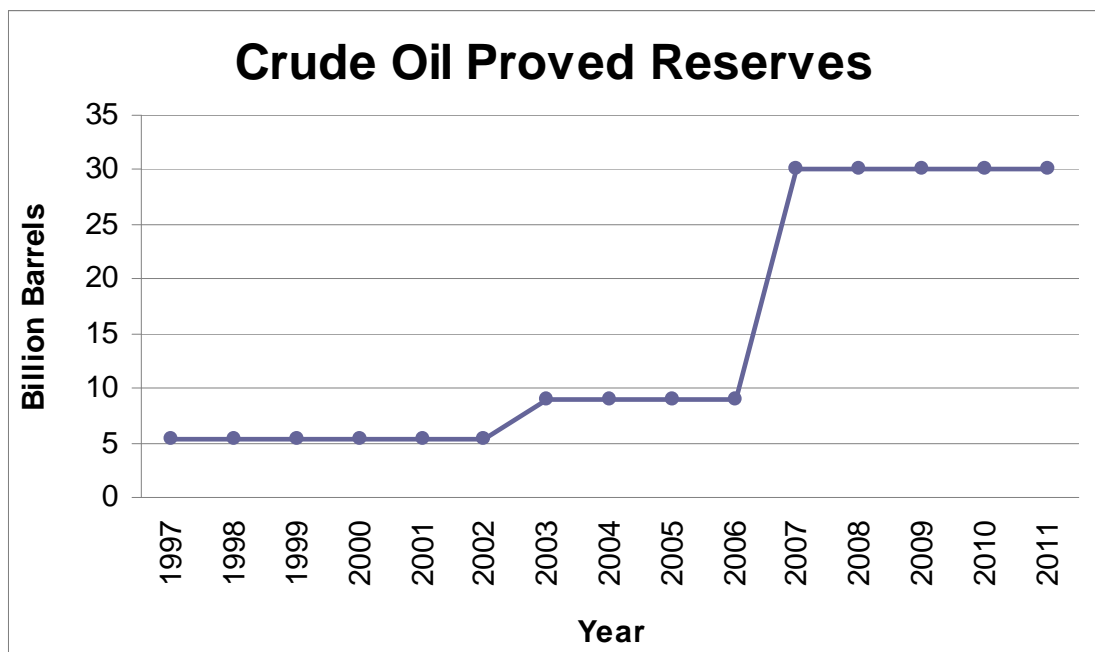
The traditional advantages of Kazakhstan in the international division of labor are the natural and mineral resources. Kazakhstan is a state with enormous potential natural wealth; whole periodic table is represented in the republic. In fact, one Soviet geologist boasted that Kazakhstan was capable of exporting the entire periodic table of elements. Kazakhstan has vast untapped fossil-fuel reserves, substantial gold deposits, copper, chrome, uranium and aluminum. Republic occupying the eleventh largest of oil reserves, the eleventh - the largest gas reserves and the second - largest uranium reserves, Kazakhstan is one of the largest exporters of energy products. In terms of oil production Kazakhstan is currently ranked second place in the CIS and 18's - in the world after the Middle East, Russia, Venezuela, China, Norway, Canada, UK, Indonesia, Brazil and some African states.

Oil production in Kazakhstan is geographically concentrated in two regions, Mangistau and Atyrau, on the shores of the Caspian Sea. Atyrau became the country's main oil center.

Kazakhstan is the second largest oil exporter in the CIS after Russia. According to the EIA, the proven oil reserves of Kazakhstan are estimated to lie in the range between 9 and 30 billion barrels (see Figure 2.9).

In 2000 was discovered Kashagan field, which is the most significant since the moment of discovery deposit Prudhoe Bay in Alaska in 1969. By today Kashagan reserves contain 38 billion barrels of oil, of which 8-13 billion are recoverable with existing technologies. Following the discovery of Kashagan, another achievement of oil industry was the discovery of oil on Zhemchuzhina project in 2007.

Figure 2.9: Proved Reserves of oil in Kazakhstan



Source: U.S. Energy Information Administration

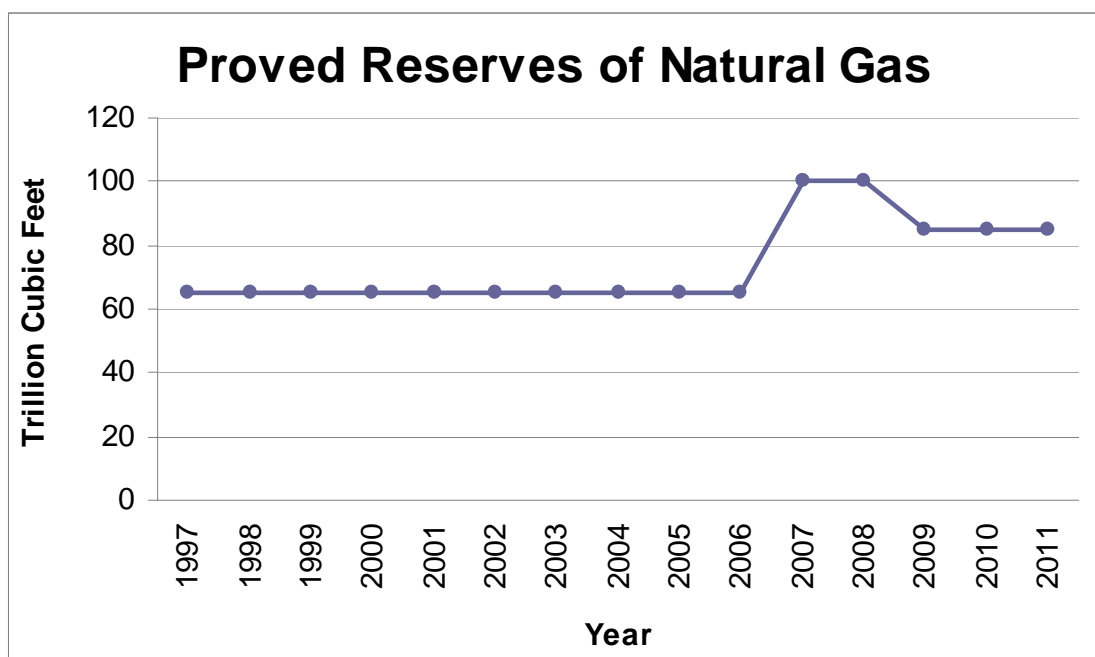
In 2007, JSC KazMunayGas reported an increase in proved oil and gas reserves. The main factors that contributed to the growth of proved reserves during 2006-2007 were: discovering of the super-giant Kashagan oilfield, as well as additional reserves from other massive oil and gas fields; updating information about existing oil and gas fields.

Most of the oil produced in Kazakhstan is intended for export. Crude oil is exported in three main directions: northward (using Russian pipeline and rail networks), southward

(through swaps with Iran) and westward (via the Caspian Pipeline Consortium Project and barge to Azerbaijan) (EIA, Country Analysis Brief 2010).

The country's proven reserves of natural gas come to 65 – 85 trillion cubic feet (see Figure 2.10) this gives Kazakhstan 11th place in the world and 4th in the CIS. Due to the lack of infrastructure, before 1999 most of the extracted gas had to be flared. But in August 1999 the government introduced changes to the 1995 law on oil.

Figure 2.10: Proved Reserves of natural gas in Kazakhstan



Source: U.S. Energy Information Administration

In January 2010, the Oil and Gas Journal estimated Kazakhstan's proven natural gas reserves at 85 trillion cubic feet. Natural gas production in Kazakhstan is almost entirely associated gas. Kazakhstan shifted from being a net natural gas importer to becoming a net exporter of 134 billion cubic feet in 2009 (EIA, Country Analysis Brief 2010).

Natural gas is imported from Uzbekistan, Russia and Turkmenistan in decreasing volumes. The largest gas and gas condensate field is Karachaganak in the northwest. In July 2002 Kazakhstan's KazMunaiGas and Russian's Gazprom created a joint venture,

KazRosGas that will increase Kazakhstan's export capacity in the north and led to more attractive prices for Kazakhstan's gas exports and access to Western European markets.

The Karachaganak oil and gas field reportedly produced around 558 Bcf gross gases in 2008, close to half of Kazakhstan's total gross gas production. The Tengiz oil and gas field reportedly produced 494 Bcf gross gases during 2008, and the consortium developing the field says it could boost production to 780 Bcf by 2015. The remainder of gas produced came from other smaller fields. Kazakhstan reportedly plans to boost its total gross gas production to 2.5 Tcf by 2015, with gas exports of 1.4 to 1.6 Tcf planned, as new pipeline infrastructure allows the country to export its rising gas output. Development of the Amangeldy field is important for Kazakhstan's energy security, as gas output from the field is geared to make the country self-sufficient in gas (EIA, Country Analysis Brief 2010).

Kazakhstan is a net exporter of coal, with proven reserves amounting to 34-37 billion tones. The estimated total reserves of coal come to 283 billion of tones. The energy sector, including power generation, is the main end-user of coal, accounting for 65% of total coal production, followed by industry (16%), households (2%), transport (1%) and agriculture (1%) (OTAC working paper, "Kazakhstan's Energy Sector Overview" 2004). At present, approximately 25-30 percent of the coal produced in Kazakhstan is intended for export. Russia is the main importer of Kazakhstan's coal, followed by Ukraine and Kyrgyzstan.

2.3 The main stages of development of the oil and gas complex of Kazakhstan.

The first information about the presence of oil on the territory of Atyrau region were found in the notes Bekovich-Cherkassky, who organized military typological expedition under the decree of Peter I in 1717 (Yessenov et al. 1968). In the reports of a scientific expedition organized in 1768, there are some facts about the geology and mineral resources in Western Kazakhstan - coal, oil and mineral substances. Special attention of researchers of Western Kazakhstan was directed to Mangistau peninsula. Surveying started in 1846 when expedition on Mangistau peninsula of M.I. Ivanov discovered first evidences of oil show (Mirzoev 1994).

Great importance for targeted geological exploration and disclosure of oil wealth of the region had special research expedition in 1892 in Western Kazakhstan. The goal of this expedition was to find the emerging route of the railway to Turkestan and exploring the natural riches of the region. The expedition has drilled several wells in the areas Dossor, Iskine, Karashungul. Discovered in the excavation of salt Lake Karashungul oil in its chemical composition was easier and more qualitative than Baku oil, with specific gravity of 0.82 versus 0.87 g/cm³, which attracted the attention of Russian entrepreneurs. Soon were formed many societies, associations and companies for exploration of oil in the Ural-Emba and other regions of western Kazakhstan. Among them most prominent were: “Ural Caspian Oil Company” (UKOC), “Emba-Caspian”, “The Nobel Brothers Partnership”, “Emba”, “Ural oil” and etc.

In 1899, the oil-bearing areas have been sold Lehman, Doppelmaer and Grumm-Grzhimaylo, they founded “Emba-Caspian Company”. In November 1899, on the field Karashungul in the borehole № 7 (a depth of 40 meters) was obtained by a fountain of oil. This event is rightly viewed as the beginning of the discovery of oil on the land of the Kazakhs.

In April 1911, such high quality of oil field was discovered in Dossor area, that buzz about it spread across the entire world. Even the London Royal Exchange issues stocks at an overall cost of 5 million pounds sterling for exploring and developing oil reserves in the region. The Makat field was opened in the Guryevsky District in 1913. By 1914 more than 200 thousand tons of oil is produced in Makat and Dossor. It is not fortuitous that many historians believe that one of the reasons that World War I broke out was the fight for control over oil reserves in the Caspian Region (Oil of Kazakhstan the photographic history 2011).

Since the mid 1920s was started large-scale geological survey of the Kazakh side of the Caspian Sea. During the Soviet period the oil industry was nationalized, were eliminated all small domestic and foreign associations, enterprises and firms. In their place were organized by various trusts, endowed with the right to conduct explore and produce. In 1926 was discovered oilfield Kosshagyl where oil reserves exceed the reserves of Dossor more than 3 times.

With the growth of oil production the problem of its transport became more and more important. It was performed by railway and water transport. Constructed in 30's oil pipelines Dossor-Guryev, especially the oil trunk line Caspian-Orsk, through the fields of Aktyubinsk region, was of great national importance (National Company KazMunayGas, Industry History 2010).

Development of exploration and discovery of oil and gas fields in 30-years was dictated by the need to create a strong resource base of oil and gas industry in the east of the country in case of hostilities. Severe test for the whole country became the World War II (1941-1945). In order to compensate production activity of the oil regions of Maikop and Grozny, which temporarily ceased its operation, was decided to develop oil production in Kazakhstan. For meeting the basic needs of the country's economy and combat capability of the Soviet Army.

In the postwar period, the Soviet Government adopted a series of special solutions to increase of drilling and construction works in oil industry of the country.

In 1945 was organized the production association "Kazakhstanneft", which included all enterprises and institutions of prospecting, production and refining of oil in Kazakhstan. In 1956 The Ministry of Geology of the Kazakh SSR was organized, what marked the centralized planning and purposeful conduction of the whole complex of geological prospecting works, aimed to the further increase of mineral and raw mineral resources of the republic (National Company KazMunayGas, Industry History 2010).

In 1961, at Uzen the first time in south Mangistau during drilling hole was obtained by a fountain of gas. In 1959 was started exploratory drilling on Zhetybai. In 1961, out of an exploration well Zhetybai has been received fountain of oil. Thus, in 1961, on the south Mangistau almost simultaneously, were discovered two oil and gas fields - Uzen and Zhetybai.

Attaching a great importance to oil-gas deposits development on Mangistau, the Council of Ministers of Kazakh SSR on 19 January 1962 adopted the resolution № 41 "On the intensification of geological prospering works of oil and gas on Mangyshlak peninsula at the territory of south-eastern part of Caspian depression and the preparation of oil deposits discovered in this region for exploitation". For the commercial development of South Mangistau resources on January 1964, the production association

“Mangyshlakneft” was established (Shaukenbaev 1974). In 1969 commissioned the first stage of the pipeline Uzen – Guryev - Kuybyshev (now Samara).

The discovery and rapid development of Mangistau oil played crucial role in the large increase in explored reserves and facilitated the entry of Kazakhstan in the number of major oil-producing Soviet republics. By 1969, Kazakh oil production is more than 10 million tons a year.

The period of 1970-1979 in the history of Kazakhstan’s oil industry can be easily called a period of great oil discoveries that marked a new era in oil sector development. The Pavlodar Oil Refinery is brought on line with an annual production capacity of 8 million tons of oil (Oil of Kazakhstan the photographic history 2011).

On the eve of the new 1980 drilling operations led to the discovery of the giant Tengiz oil field, which are among the 5 largest deposits of oil of the world at that time. In 1979 was discovered largest oil and gas field Karachaganak. Identification of the Karachaganak field was a big achievement. In the south Turgai region in 1984 was discovered the largest oil and gas field Kumkol.

After collapse USSR Kazakh authorities recognized that development of the oil reserves offers a powerful inducement for foreign investment in the economy of Kazakhstan. In turn, Russia has demonstrated its interest in maintaining a foot-hold in the Kazakh oil industry. At the center of the oil question are the Tengiz oil fields. These oil fields, located on the northeast coast of the Caspian Sea, contain a proven reserve of six billion barrels of crude oil. To develop such potential, Kazakhstan must be able to market these petroleum resources. The Nazarbayev government has actively sought to reach international agreement on the construction of a major oil pipeline (Batalden & Batalden 1997, p.149).

During the 1990s the oil sector of Kazakhstan suffered from some obstacles. Kazakhstan’s industrial enterprises were tightly integrated into the Soviet economic system. Kazakhstan’s oil and gas enterprises were particularly vulnerable in this respect. The oil and gas extracted in Kazakhstan usually has been sent for processing to Russia, while Kazakhstan’s own oil refineries (Pavlodar, Shymkent and Atyrau) mainly processed Siberian crude. Kazakhstan’s dependence on Russia was magnified by the lack of adequate pipeline infrastructure to generate sufficient oil revenues to boost its

economic recovery. Therefore, Kazakhstan had to export its oil through Russian territory via Russian-controlled pipelines (Ipek 2007).

On December 1992 Kazakhstan announced to the world about the intention to conduct search works on Caspian Sea. At the second half of this year a group of Kazakhstan's specialists developed "The State program on development of Kazakhstan's sector of the Caspian Sea" (National Company KazMunayGas, Industry History 2010). By the government resolution of Republic of Kazakhstan from 13 February 1993 established the state-owned company "KazakhstanCaspishelf" for the implementing the program on geological and geophysical research and development of oil fields in the Caspian Sea.

The Kazakhstan International Oil and Natural Gas Exhibition (KIOGE) are held in Almaty in 1993 for the first time ever.

On 3 December 1993 the Government of the Republic of Kazakhstan signed the international agreement with foreign companies SHELL (Holland), STATOIL (Norway), MOBIL (USA), BP (England), TOTAL (France), AGIP (Italy) on the creation of the international consortium (National Company KazMunayGas, Industry History 2010).

Under a 1993 accord, the Chevron Corporation secured a 10 billion dollars contract to develop the Tengiz oil fields, but progress on the development of these reserves has awaited the more protracted negotiations over construction of the oil pipeline. In April 1996, eight Western, Russian, and Kazakhstan oil companies agreed to form a consortium for construction of the pipeline, a project that is expected to cost 1.2 billion dollar. Under terms of the agreement, Russia, Kazakhstan, and Oman will own approximately 50 percent of the consortium's interests. Notable for the size of its share in the venture was the Russian government's portion (24 percent), along with the participation of the largest Russian oil company Lukoil (12.5 percent) and Russian's Rosneft (7.5 percent). Among the Western firms participating in the consortium will be Chevron (15 percent ownership), Mobil Oil (7.5 percent), British Gas (2 percent), and the Dallas-based Oryx Company (1.75 percent) (Gordon 1996).

Mastering of the Tengiz field has led to the creation of a new industrial area, infrastructure development, social and cultural spheres, raising the economic potential of both the Atyrau region and the country as a whole. With the commissioning of Tengiz, Kazakhstan surely became one of the major oil producing countries in the world.

The country founds the Ministry of Oil and Gas Industry of the Republic of Kazakhstan. A law “on oil” is passed based on a decree by president of Kazakhstan # 2350 dated June 28, 1995. An agreement is signed on the principles for dividing up natural gas produced at Karachaganak field between Agip, British Gas, Gazprom, Kazakhgas and the Republic of Kazakhstan (Oil of Kazakhstan the photographic history 2011).

In 1997 the government of Kazakhstan has signed with international consortium OKIOC an agreement on production sharing, and in 1999 started exploratory drilling. On July 2000 the Consortium announced about the oil discovery at East Kashagan in the well № 1. After East Kashagan the deposits West Kashagan, Kalamkas-sea, Kairan, Aktoty and South-West Kashagan were discovered, and in Russian sector - Shirotnoe and Khvalynskoe. The discovery of Kashagan deposit allowed increasing of oil reserves on 35%. At the present time at Kashagan and a number of other deposits of Caspian Sea preliminary and prospecting works are performed (National Company KazMunayGas, Industry History 2010).

In 1998, the Presidents of Kazakhstan and Russia signed a historical agreement on the borderline between the two countries in the northern part of the Caspian Sea (Oil of Kazakhstan the photographic history 2011).

Increase of oil and gas production requires acceleration solutions of problems of transportation within and outside the country. Therefore, one of the most important projects is the Caspian Pipeline Consortium, extending through the territory of the Russian Federation to port of Novorossiysk. The main objective of the project was the creation of an independent pipeline system for output of Kazakhstan’s oil from Tengiz on the Mediterranean market. May 12, 1999 in Novorossiysk held laying the first stone to the future site of an oil terminal. Start of implementation of the CPC was an important event in the oil industry in Kazakhstan.

The first line of the CPC pipeline system was put into regular operation in 2003 and by the end of 2009 capacity reached 34.574 million tons, of which the volume of Kazakh oil amounted 27.5 million tons. Since the CPC project is not yet complete, it is planned to increase throughput capacity to 67 million tons of oil a year. Total value of pipeline is 4 billion dollars. In June 2010, was put into operation a new section of the CPC pipeline

from the station Tengiz in Atyrau region length of 180 km. Completion of a project to its full capacity of the pipeline, provided timely funding is planned in 2014.

Uzen - Atyrau - Samara is the second largest export oil transportation pipeline through which Kazakh oil is supplied to the terminals of the Black Sea region (to the port of Odessa, Novorossiysk), Baltic Sea (Primorsk and Gdansk) and the markets Eastern Europe (Czech Republic, Poland, Germany, Hungary, Slovakia, etc.). The total length of the pipeline is 1500 km and its capacity is 15.75 million tones. It should be noted that before the CPC pipeline, the export of Kazakh oil was carried out through this pipeline.

The East is the third direction of Kazakhstan oil exports. Construction and operation of the Kazakhstan-China pipeline allows diversifying the supply of oil and reaching the growing China's energy market. This direction is of strategic importance because, in addition to export diversification, pipeline connected Western Kazakhstan Region with refineries of Pavlodar and Shymkent. The project is implemented in two phases. Pipeline "Atasu - Alashankou" length 962.2 km was put into operation in 2006. The pipeline was constructed by the China National Petroleum Corporation and KazMunayGas. Pipeline cost 700 million dollars.

President of the Republic has been very consistent in highlighting the priorities of Kazakhstan's foreign policy to be the maintenance of good relations with Russia, China, and the United States (Ipek 2007).

In addition to listed pipelines, there are several alternative projects to transport oil to international markets: Turkish, running from Baku (Azerbaijan) to the Mediterranean through Georgia and Turkey; Iranian, through Iran with access to the Persian Gulf; through Afghanistan to Indian Ocean; Pacific, connecting the Caspian Sea with the Pacific Ocean through China etc.

A more detailed picture of the pipeline systems of Kazakhstan and the alternative projects to transport oil are presented in Appendix A.

In 2002 oil exploration and production began in Kurmangazy oil field, where reserves were 7 billion barrels.

In May 2003 the government announced as priority areas sectors with linkages to the oil extraction sector, high value-added sectors (such as space, nuclear and information technology) and agriculture (Pomfret 2005).

Adopted in May 2004, the State Program for Development of the Kazakhstan sector of the Caspian Sea until 2015, means achieving two main objectives in the oil industry. First - exploration of oil production and the creation of an optimal network of pipeline. Second - the creation of the domestic oil and petrochemical industry.

Kazakhstan has been an active participant in the U.S.-led Global Nuclear Energy Partnership.

Analysis of the activities of Oil and Gas Companies in Kazakhstan.

3.1 Oil and Gas Companies.

The basis of Kazakhstan's oil and gas industry constitute approximately 80 extracting companies, 3 refineries, 6 gas processing plants and about 250 tank farms. Nowadays in Kazakhstan there are a huge number of oil companies, involved in field development and oil extraction.

Enormous oil reserves attract foreign entrepreneurs, businessmen and investors. Many international oil companies have offices in different cities of Kazakhstan and cooperate with local companies.

KazMunayGas² is the largest national oil company. Besides that the activity is carried out less major Kazakh oil companies, such as: Aday Petroleum, TolkynNefteGas, Aktau TRANSIT, ANAKO (the first private oil company, established in 1994), Caspian Tristar, Zhalgiztobemunai, Kazpolmunai, EmirOil, HazarMunai, AiDanmunai, NC Kolzhan and others.

Among the Russian companies operating in Kazakhstan are Lukoil and Rosneft. Lukoil produces oil in the Tengiz (2.5%), Karachaganak (15%), Karakuduk (62.5%), Arman and other fields. Rosneft has a 50% oilfield Kurmangazy.

The starting point of cooperation between Kazakhstan and American oil companies may be considered April 6, 1993, when the Kazakh government has entered into an agreement with Chevron period of 40 years. Chevron produces oil from Tengiz, Kashagan, and Karachaganak. Other American companies such as ExxonMobil and ConocoPhillips are working quite successfully in the oil market in Kazakhstan.

European oil companies also make up a segment of oil sector in Kazakhstan. In 1992 the Republic of Kazakhstan and companies "Agip" (Italy) and "British Gas" (United Kingdom) signed an agreement to develop Karachaganak field of oil and gas. This can be considered as the beginning of international cooperation between Kazakhstan and European countries in the oil sector. Today in Kazakhstan are at various oil fields

² "Munay" is translated as "oil" from Kazakh language. In some sources it is written as Munai.

following European companies: Italian “Eni”, French “Total”, German “Royal Dutch Shell”, British “British Gas”, Spanish “Repsol YPF”, Romanian “Petrom”, Danish “Maersk Oil” and others.

In September 1997, for the first time the Chinese government has received full access to the strategic areas of the Kazakhstan’s economy, oil and gas industry. The company CNPC has acquired 60.33% shares of AktobeMunaiGas, one of the largest oil companies in Kazakhstan. In 2001, the same company acquired 50% of Buzachi Operating Ltd, and in 2006 - PetroKazakhstan. Taken together, the share of these companies (include KazakhOilAktobe which is also owned by Chinese investors) accounted for 97% of crude oil in Aktobe region. In 2009 CNPC bought 50% of MangistauMunaiGaz. Another Chinese company CITIC (China International Trust and Investment Corporation) bought 50% Karazhanbasmunai.

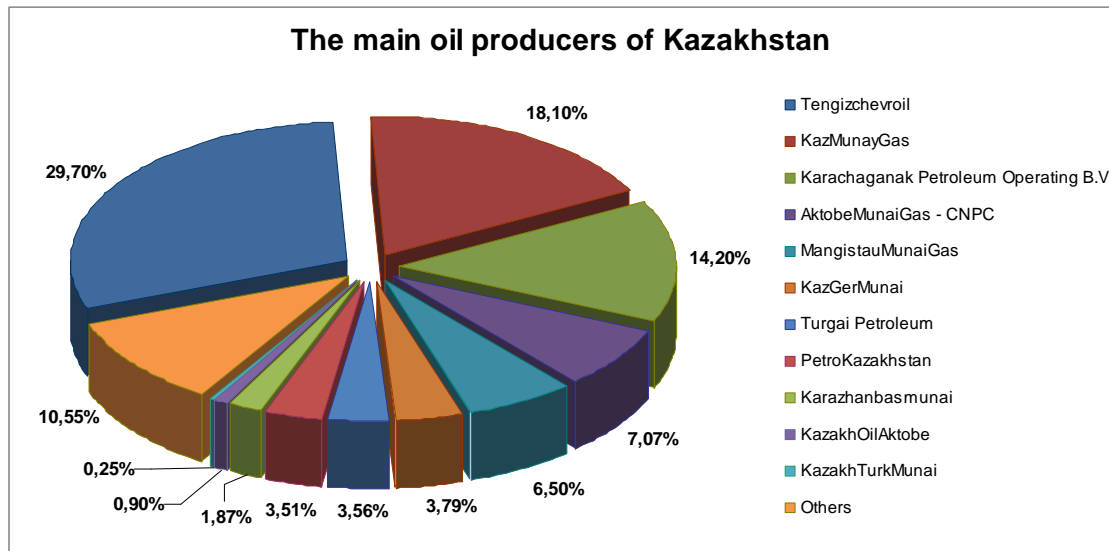
Japanese Inpex Corporation from 2002 has tried to establish relations with the Kazakh oil sector. Japan is very interested in Kazakh oil. Today the company is engaged in the Kashagan oil field with share of 7.56%.

Also contribute to the development of Kazakhstan’s oil industry are making, and other Asian oil companies: Indian “Mittal Investments” and “ONGC Videsh Ltd”, Turkmen “KazakhTurkMunai”. The main oil producers in the Republic of Kazakhstan are shown in Figure 3.1.

In 2010 the share of KazMunayGas from the whole extraction was on average 28%, American investors ensured 24%, Chinese oil companies - 22%, European - 17%, Russian - 9% (JSC Sovereign Wealth Fund “Samruk-Kazyna”).

Unexplored oil reserves in Kazakhstan, which experts predict as being very large, attract the attention of world’s largest companies, so maybe that soon the list will expand with new names.

Figure 3.1: The main oil producers in the Kazakhstan as of the 1st quarter of 2010



Source: Ministry of oil and gas of the Republic of Kazakhstan

The three largest companies ensure 64% of total oil production in Kazakhstan. More than 29% of the market of hydrocarbons occupies Tengizchevroil, followed KazMunayGas occupies about 18%. On the third place in terms of production is a company Karachaganak Petroleum Operating B.V. with a market share equal to 14.2% (see Figure 3.1). Further in detail we will consider activities of these three major oil companies leading their activities in Kazakhstan.

3.1.1 KazMunayGas

The largest national Oil and Gas Company engaged in exploration, production, refining and transportation of oil, is the KazMunayGas. This is a joint stock company with 100% share of the state from 2002. NC KMG and its subsidiaries act on behalf of Kazakh government in all aspects concerned oil and gas field. In actives of the company are: KazakhOil-Aktobe (67%), Mangistaumunaigaz (50%), PetroKazakhstan (33%), Tengizchevroil (20%), KazMunayTeniz (20%) and so on. Among the main Company's subsidiaries there are: JSC KazMunayGas Exploration Production (KMG EP); JSC KazTransOil (transportation of oil); JSC KazTransGas (transportation of gas); Trading House JSC KazMunayGas (sales of oil, oil and gas derived products and other

services), National Maritime Shipping Company KazMorTransFlot JSC (tanker transportation) and “Kazakh Institute of Oil and Gas” JSC.

In 1991 State Corporation “Kazakhstanneftegas” was formed from the oil assets “inherited” from the Soviet Union. In 1997 the government transferred all of its shares in EmbaMunaiGas and UzenMunaiGas to KazakhOil CJSC (Closed Joint-Stock Company), the Kazakh national oil company. National company KazMunayGas JSC with 100% share of the state was founded by the Decree of the President of the Republic of Kazakhstan as of 20 February 2002 with the purpose to increase efficient and transparent development of oil and gas complex and to protect interests of Kazakhstan in the oil and gas sector. NC KMG is a successor of National Oil and Gas Company Kazakhoil CJSC and NC Transport Nefti I Gaza CJSC (NC KMG). Creation of JSC KazMunaiGas Exploration Production: merger of JSC UzenMunaiGas and JSC EmbaMunaiGas in 2004. In September 2006, KMG EP carried out its Initial Public Offering on the Kazakhstan Stock Exchange, along with a placing of global depository receipts (GDRs) on the London Stock Exchange (KMG EP www.kmgep.kz/eng/the_company/history/).

Main missions of KMG are:

- Maximizing the profits of the Republic of Kazakhstan from participation in the development of the national petroleum industry;
- Maximizing the company’s value, raising the profitability, ensuring industrial safety;
- Becoming an internationally competitive integrated oil and gas company;
- Support for domestic suppliers of goods, works and services, development of the local workforce (KMG Annual report 2010).

The core operations of National Company “KazMunayGas” are as follows:

- Participation in the implementation of the common state policy in the petroleum industry;
- Ensuring efficient and rational utilization of the republic’s petroleum resources;
- participation in the development of the strategy to use, restore and further increase the oil and gas resources;
- Representation of the state interests in contracts with contractors conducting petroleum operations, through obligatory participatory interest in contracts;

- Participation in arrangement of competitive tenders for petroleum operations on the territory of the Republic of Kazakhstan;
- Corporate governance and monitoring of exploration, development, production, refining, sales, transportation of hydrocarbons, engineering, construction, operation of oil and gas pipelines and petroleum field infrastructure;
- Participation, in accordance with the procedure established by law, in domestic and international projects of the Republic of Kazakhstan for conduct of petroleum operations (KMG Annual report 2010).

Table 3.1: Oil and Gas Condensate Production in Companies with Participation of JSC NC KazMunayGas (thousand tons)

Name	2010	2009	2008	2007	2006
KazMunaiGas Exploration Production	8,780	8,978	9,486	9,548	9,551
KazTransGas (Amangeldy Gas)	24	26	26	26	-
Kazakhoil-Aktobe (50%)	488	468	380	435	509
Kazakhturkmunai (51%)	116	113	111	129	163
PetroKazakhstan (33%)	1,999	2,077	2,109	2,238	-
Kazgermunay (50%)	1,551	1,601	1,570	1,527	-
Karazhanbasmunay (50%)	970	933	914	-	-
Tengizchevroil (20%)	5,183	4,505	3,455	2,786	2,664
MangistauMunaiGaz (50%)	2,860				
TOTAL	21,971	18,701	18,051	16,689	12,887

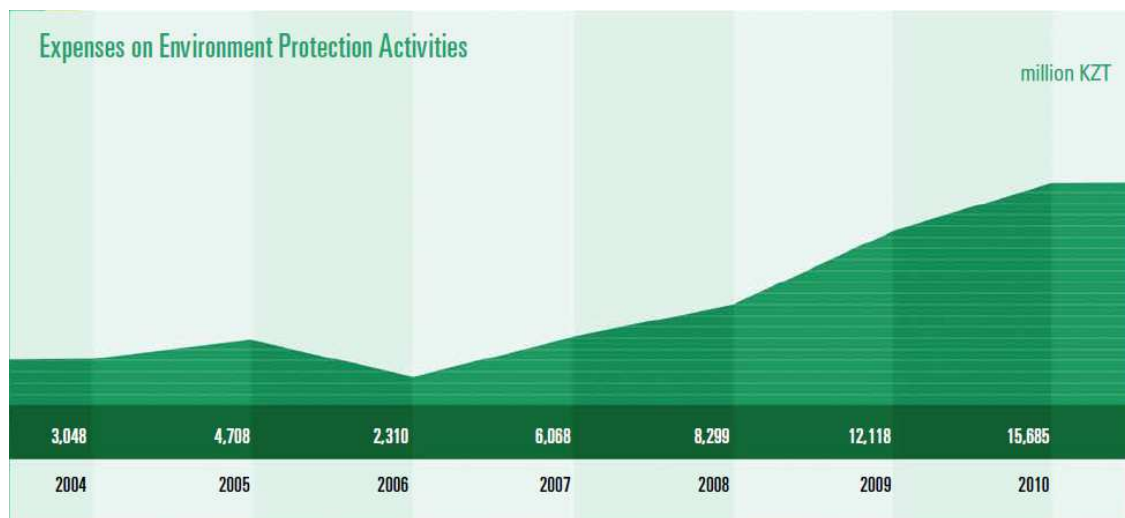
Source: KMG, Annual report 2010

The main advantage of the Company is guaranteed by the economic and political support of the state on behalf of the government. Under these circumstances, the state legislation allows KMG EP to have more rights in the acquisition of territory alienated oil and gas regions. In the period 2010-2014 KMG plans to invest about 20 billion U.S. dollars. The Company entered into a number agreements, that guarantee access of KMG EP to pipeline Uzen-Atyrau-Samara, through which carried the most of exports in the near and far abroad.

KMG's Policy is aimed at the reduction of negative impact on the environment and improvement of the ecological situation in the territories of the corporate responsibility.

In spite of the increasing production over recent years, there is a stable decrease in the specific emissions during oil production and refining and transportation of oil and gas. The work on elimination of the oil-polluted areas and contaminated soil remediation is underway. 1,040 million tenges were assigned during 2010 for these purposes (KMG Annual report 2010). Figure 3.2 shows the costs of KMG on environmental protection, which in the last seven years, have been constantly growing.

Figure 3.2: Expenses of NC KMG on environment protection activities



Source: KMG, Annual report 2010

Moreover, NC KMG JSC is a socially conscious company, which contributes considerably to the development of the society. NC KMG JSC developed and realized a number of social programs aimed at material incentives of work, encouragement and professional growth of young specialists, care for veterans and invalids, and support of other segments of social sphere of regions which are not directly connected with the production activity (NC KMG, Review of corporate social programs for 2009).

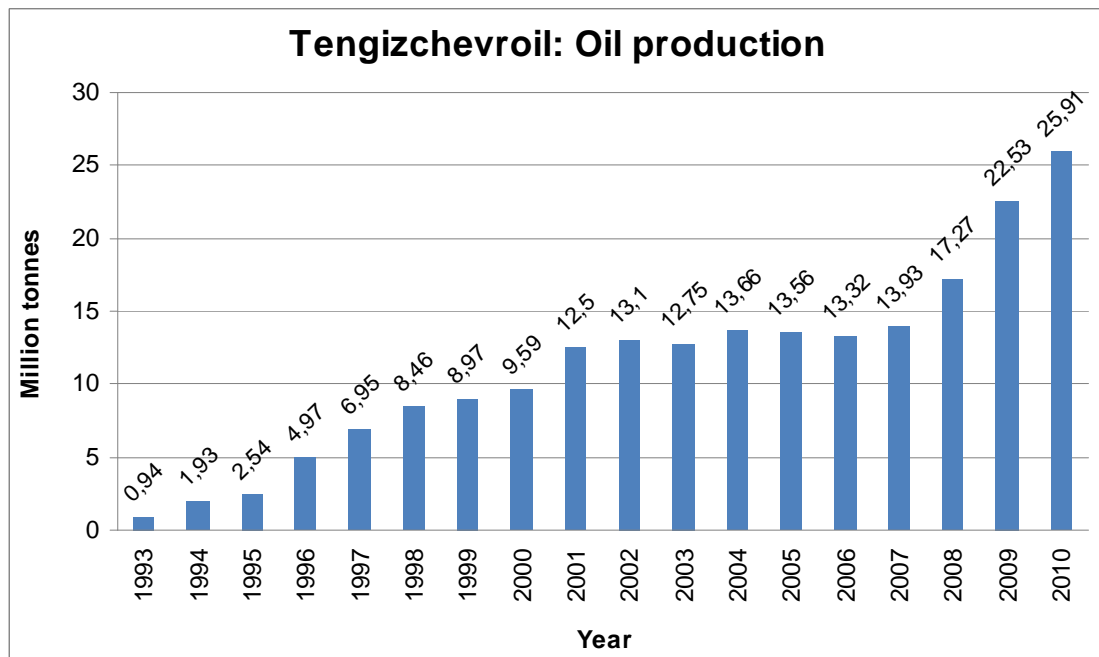
3.1.2 Tengizchevroil

The company Tengizchevroil is the largest oil producer in Kazakhstan. The company was founded April 6, 1993 based on agreement between the President of the Republic of Kazakhstan Nursultan Nazarbayev and the U.S. Company “Chevron”. Term of agreement

on the joint corporation is 40 years. Currently, the owners of TCO are: “Chevron” - 50% of JSC “NC KMG” - 20%, “ExxonMobil Kazakhstan” - 25% and “LukArco” - 5%.

Technological equipment is one of the key benefits of TCO. The main point in the issue of business development TCO associated with the expansion of production capacities and introduction of advanced technology of oil production.

Figure 3.3: Tengizchevroil - Oil production



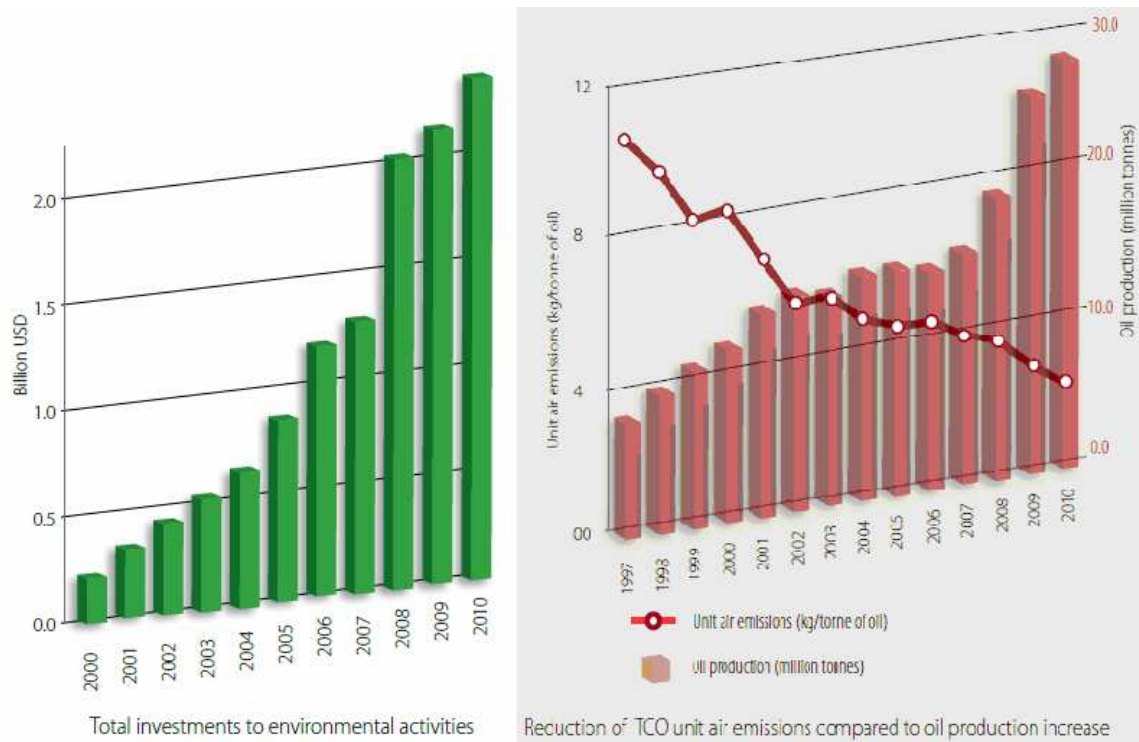
Source: Tengizchevroil LLP. 2009-2010 Corporate Responsibility Report

As seen from the figure, TCO set a record in producing and selling for all of its products in both 2009 and 2010 (see Figure 3.3). Crude sales exceeded the 2009 crude oil production record of 22.5 million tones by 15 percent in 2010, producing nearly 26 million tones.

Since 2000, TCO has invested \$2.2 billion on projects to minimize environmental impact related to Tengiz operations. This investment resulted in significant improvement to TCO’s environmental protection performance. TCO achieved its lowest specific emissions rate ever in 2010, with an average of 2.16 kilograms per tone of oil produced, an improvement from previous 2009 record of 2.68 kilograms per tone (see Figure 3.4).

These historic lows in overall emissions represent a 74 percent reduction in air emissions per tone of oil produced since the year 2000 (Tengizchevroil: 2010 in Review, 2010).

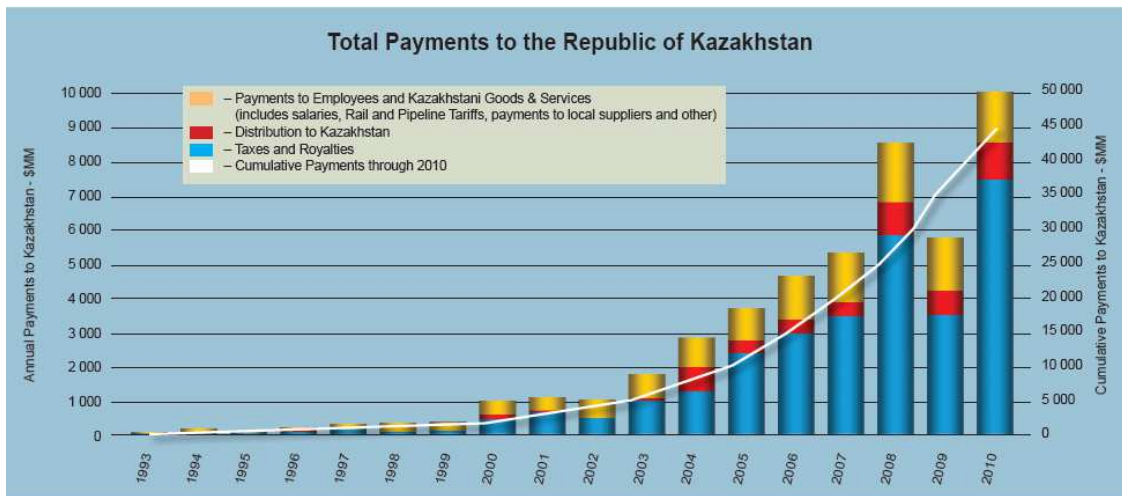
Figure 3.4: Tengizchevroil: “Total investments to environmental activities” and “Reduction of TCO unit air emissions compared to oil production increase”



Source: Tengizchevroil: Corporate Responsibility Report 2009-2010

Since 1993, TCO has made cumulative payments of 45.4 billion dollars (see Figure 3.5) to the Republic of Kazakhstan including purchases of Kazakh goods and services, tariffs and fees paid to state-owned companies, Kazakhstani employees’ salaries, profit distributions to KazMunayGas, taxes and royalties paid to the government. Payments in 2010 were 9.6 billion dollars due to the increase of oil and gas production and higher oil prices (Tengizchevroil: 2010 in Review, 2010).

Figure 3.5: Tengizchevroil – Total Payments to the Kazakhstan



Source: Tengizchevroil website

TCO has funded various social infrastructure projects for Atyrau Oblast including schools, hospitals and clinics, as well as the construction of water, electricity and water systems. In 2010, TCO spent 20 million dollars in social infrastructure projects in Atyrau Oblast as part of TCO’s voluntary program, the bulk of which was invested in the construction of a new water system in Kulsary city. TCO also voluntarily funds about 1 million dollars per year in community investment programs by partnering with civil society and non-governmental organizations which focus on improving education, training and health in Atyrau Oblast (Tengizchevroil <http://www.tengizchevroil.com/en/responsibility/egilik.asp>).

3.1.3 Karachaganak Petroleum Operating B.V.

Company Karachaganak Petroleum Operating B.V. was founded in 1997 with the participation of foreign companies: BG Group – 32.5%, Eni – 32.5%, Chevron - 20% and Lukoil - 15%. The total amount of investments made by KPO in the development of the project on mastering of the Karachaganak field, by now amounted to 14 billion U.S. dollars. KPO is the operator of one of the largest oil and gas fields in the world.

Today, Karachaganak is producing at record levels and is the largest gas producing field in Kazakhstan, accounting for some 45 per cent of the country’s total gas production and

around 16 per cent of total liquids production. In 2010 (see Table 3.2), the venture produced some 133.7 million barrels of oil equivalent (Karachaganak Field Discovery, <http://www.kpo.kz/about-kpo.html?&L=0>).

Table 3.2: KPO Production

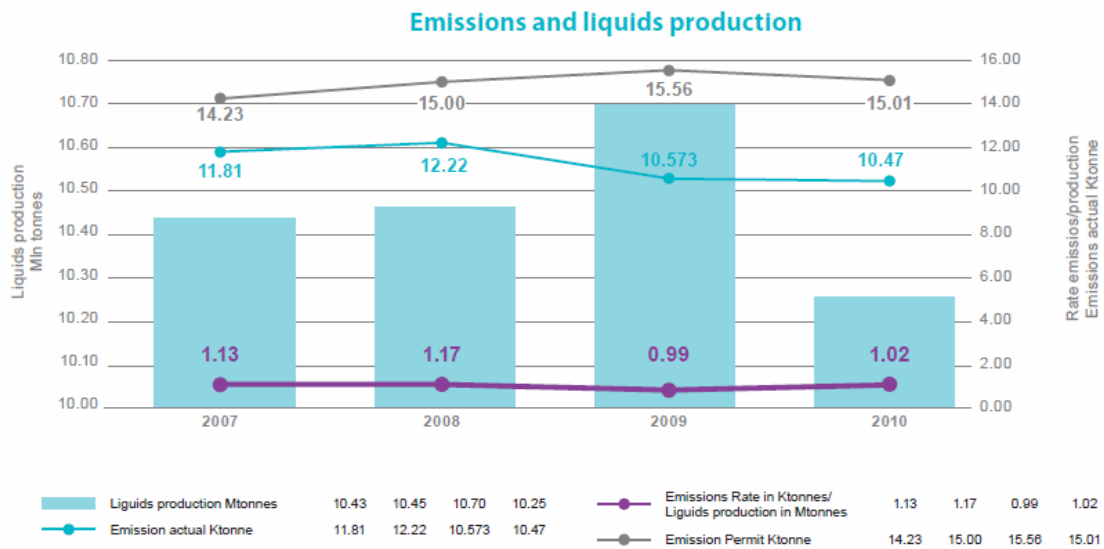
<i>Production</i>		<i>2009</i>	<i>2010</i>
Global Production	Mboe	139,4	133,7
Unstable Liquids <i>Condensate to Orenburg Gas Plant and Mini Refinery</i>	Kt	2,295	2,346
Stable Liquids <i>Oil and stabilized condensate to CPC and Atyrau-Samara</i>	Kt	8,607	8,064
Raw gas <i>To Orenburg Gas Plant</i>	Mscm	8,266	7,901
Sweet gas production <i>Providing energy for the plant and the community</i>	Mscm	686	650
Gas injection <i>Not included in global production, as this is not sold</i>	Mscm	6,587	6,437

Source: Karachaganak Sustainability Report 2009-2010

In the course of recent years, KPO has developed and adopted a variety of innovative techniques and technologies aimed at reducing emissions to air associated with hydrocarbon production processes (see Figure 3.6). Over the last three years, the total indicator of air emissions per unit of oil production decreased from 1.17 to 1.02 (Karachaganak Sustainability Report 2010).

KPO invest massively in the development of national workforce using the international expertise of their partners in the venture, appropriate classroom training and renowned educational institutions. The implementation of the company's nationalization plan contributed to the reduction in the number of expatriate staff. At the end of 2010, the decision was taken to relocate the Project Development Directorate from London to Kazakhstan, in order to further enhance the effectiveness of the KPO organization in its liaison with the technical authorities (Karachaganak Sustainability Report 2010, p.23). As of end 2010, 4 123 employees worked at KPO, of which Kazakhstan citizens constituted 3 706 people, and expatriates – 436.

Figure 3.6: KPO: Emissions and liquids production



Source: Karachaganak Sustainability Report 2010

KPO provides USD 10 million per annum to the development of social infrastructure projects identified by the West Kazakhstan Oblast Akimat in accordance with social development priorities. These projects mostly take place in the regional capital, Uralsk, and include building schools, nurseries, hospitals and cultural and sporting facilities (Karachaganak Sustainability Report 2010).

3.2 Resource nationalism in Kazakhstan’s petroleum sector.

A resource nationalism policy is a concept of the 20th century that emerged in era of oil and decolonization. In the 1930s in Latin American countries emerged the first wave of resource nationalism. After the World War II, more and more countries used resource nationalism as their main policy tool.

In economic terms, the concentration of energy resources in state hands can strengthen the competitive advantages of national companies and make it appear as if the companies are developing positively. In most cases, however, state ownership of energy resources has been shown to end up in weakening the development of non-oil sectors of the economy (Razumnova 2007).

In political terms, resource nationalism has already become a significant propaganda tool, both internally and externally, in many countries that have now become influential players in ensuring global energy security (Overland et al. 2010, p.21).

Today world is going through a new wave of resource nationalism. During the first decade of the new millennium, many hydrocarbon-exporting countries, sought to take advantages of the upward trend in energy prices to strengthen their national oil companies, boost government revenues and act to promote what they saw as their national interest (Overland et al. 2010, 20). This is clear from the latest action, rich in natural resources countries such as Russia, Venezuela and Bolivia. Kazakhstan is not an exception because it is becoming one of the major oil producers in the world (Sarsenbayev 2011).

In the 1990s, when Kazakhstan, as a young independent country, was desperate for cash and was suffering from the collapse of the Soviet economy, many subsoil use contracts were signed with International Oil Companies. Contracts for giant oil fields such as Tengiz, Kashagan and Karachaganak were concluded as Production Sharing Agreements. Later, when oil prices started to rise (from 2000), it was discovered that terms and conditions in many of these contracts made it impossible to apportion growing revenues equally between IOCs and the State (Sarsenbayev 2011). Today many of the contracts signed with IOCs in 1990s are perceived as unjust and damaging to national interests.

In 2009 Kazakhstan introduced the new Tax Code and in the 2010 the new Law on Subsurface Operations. These new regulations have significantly influenced on subsoil users' activities in Kazakhstan. The new tax code was designed to substantially ease the tax burden on small and medium enterprises and the non-extractive sector, while increasing revenues from extractive industries (Nurmakov 2009). Moreover, Kazakhstan used an additional levy called an 'oil export duty', which is aimed at boosting tax revenues from exports of crude oil. This duty was introduced in 2008 and amounted to USD 110 per tone, but was later in 2009 reduced to zero because oil prices dropped dramatically. However, it was reintroduced by the middle of 2010 and has increased to USD 40 per tone as of 1 January 2011 (News Report: Kazakhstan Doubles Oil Export Duty, 8 January 2011). It was estimated that the tax burden on subsoil users increased from 49-59% to 72-74% after adoption of the new Tax Code.

From a regulatory perspective, the government of Kazakhstan has introduced several important changes to the regulatory framework for IOCs. In October 2005, modifications were introduced to the Law on Subsurface Operations, which increased the government's ability to regulate the sale and development of subsoil resources. One of the main provisions gave the state a priority option to purchase any stakes in companies involved in developing subsoil resources at the price offered to other bidders (Kennedy & Nurmakov 2010).

The main novelties and key provisions stipulated by the new Subsoil Use Law could be summarized as follows:

- Elimination of a PSA regime in 2008 was confirmed by the new law, there is only one way of entitlement of subsoil use rights in Kazakhstan - to conclude a concession type agreement for exploration or production, or combined exploration and production (The Law of the Republic of Kazakhstan "On Subsoil and Subsoil Use" 24.06.2010).
- Due to its preferential right Kazakhstan has increased its share in the energy sector since 2005. For instance, during 2005-2007 KMG acquired 33.3% of the stock in PetroKazakhstan, 50% of the shares in Shymkent Refinery Plant, the largest refinery in south part of Kazakhstan, and 50% of the shares in Karazhanbasmunai. Moreover, the transaction on acquisition of the 50% block of shares of MangistauMunaiGaz closed in November, 2009 (KMG, Chronology).
- Associated gas is currently considered state property and therefore exploitation of oil fields without utilization gas or its processing is prohibited.
- Government of Kazakhstan has the right to terminate the contract unilaterally, if there are any threats to national security or economic interests of the country caused by the activities of subsoil users.

Thus, the new Subsoil Use Law set a considerable state control over the activities of oil companies in Kazakhstan.

Alex Gorbansky (2007) divides the policies of resource nationalism into four types, each with different key drivers and risks. These four types are:

- 1) State domination, in which populist and geopolitical agendas threaten investors with expropriation in favor of national or oligarchic companies;

- 2) Balanced state participation, where politically articulated desires to capture greater benefits from resources may jeopardize contracts, with increasing state ownership in projects;
- 3) Geopolitical expediency, in which the authorities use resources to foreign policy objectives, making contracts highly vulnerable to license revocation;
- 4) Greater economic participation, where domestic policy agendas may lead to increased tax rates and pressure on operating profits.

In contrast to Russia, where resource nationalism is driven primarily by a populist political and economic agenda and the presence of strong state-owned champions, resource nationalism in Kazakhstan is combined with balanced state participation: the government exerts control over the petroleum sector, but allows foreign participation. This type of resource nationalism is driven by the desire to use resources to build foreign alliances and to capture greater economic benefits for the nation from its resources (Overland et al. 2010, p.22).

The world press is now full of publications on the topic that Kazakhstan has become on the path of resource nationalism. Most of all being discussed danger is that this way the country could damage relations with foreign investors and could lose their unmatched in the post-investment attractiveness.

But it is important to note that there are some basic distinctions between the type of resource nationalism that has taken root in Kazakhstan, as opposed to the activities in Russia, Venezuela, Bolivia and elsewhere. Kazakhstan has avoided full-scale nationalization or unilateral contract revision (Kennedy & Nurmakov 2010). Kazakh resource nationalism between 2004 and 2008 is best understood as essentially economic in character. The aim has been to improve economic terms and long-term economic benefit for the country. Kazakhstan has done this in three ways: first, by increasing the state share of ownership in major projects; second, by placing more of the burden of cost overruns and delays on the international oil companies; and third, by increasing the state's control of the project through KMG (Domjan & Stone 2010).

3.3 The National Fund of the Republic of Kazakhstan.

Sovereign wealth funds or state funds represent a specialized investment agency, dealing with investment official government reserves for profit. The first such funds appeared in the 1970s, when oil-exporting countries were necessary in the effective placement of “petrodollars”. Spurred by trade surpluses, official reserves of some governments have already reached astronomical figures.

To these funds also relates the National Fund of the Republic of Kazakhstan. As a basis for establishing the Fund in Kazakhstan was adopted the Norwegian State Petroleum Fund, as an example of transparency of work similar Oil Funds. By size of the National Fund of Kazakhstan occupies 13th place among the other funds. The size of the fund concedes only a few countries such as Brunei, USA, Qatar, Russia, Norway, Singapore, UAE and some others.

The Kazakh Oil Fund or The National Fund of the Republic of Kazakhstan was established August 23, 2000 by Presidential Decree № 402. The main objective of the National Fund was formulated as “to ensure a stable socio-economic development of the country, the accumulation of financial resources for future generations, reducing the dependence of the economy from adverse external factors”.

The NFRK is run by a special Management Council, formed by President Nazarbayev. The governing body includes the president of the country, the prime minister, the heads of the two chambers of parliament, the National Bank chairman and the finance minister. The fund is managed by the National Bank and overseen by a governing board chaired by the President of Kazakhstan (Kalyuzhnova 2006).

In accordance with the Presidential Decree “On Certain Issues of the National Fund of Kazakhstan” dated January 29, 2001, the Fund is a combination of financial assets accumulated in the account of the Government of the RK in National Bank of republic. Goal of the Fund was the implementation of two main functions:

- 1) Savings, which is the formation savings of the state, 75% of NFRK assets are dedicated to savings portfolio;
- 2) Stabilization, which reflected in the reduction depending of the republican and local budgets from world prices, 25% of assets make up stabilization portfolio.

Stabilization by the NFRK is achieved by means of “reference prices” for gas, oil, and chrome, zinc, lead and copper.

Also by the Decree were approved the attached rules of formation and application of the NFRK. Rules that were approved by the President secured three main lines of expenditure of the Fund:

- 1) In the form of incomings from the Fund to the republican and local budgets to compensate the losses, determined as the difference between approved and actual amounts of inflow taxes and other obligatory payments to budgets from extraction sector;
- 2) In the form of targeted transfers, transferred from the Fund to the republican and local budgets for the purposes defined by the President of the RK;
- 3) To cover the costs associated with Fund management and conducting annual external audit.

On June 1, 2006 entered into force “Concept formation and application funds of NFRK in the medium term” which changed the procedure of formation and application of the fund. With enactment of the “Concept”, the main sources of formation of funds of the NFRK have been identified:

- 1) Direct taxes from the oil sector (except for taxes to local budgets), which include corporate income tax, excess profit tax, royalties, bonuses, share in production sharing, rent tax on exported crude oil and gas condensate. Other types of taxes paid by the oil sector, in accordance with the tax legislation of the RK. At the same time, to enterprises of the oil sector relates all legal entities engaged in production and sale of crude oil and gas condensate;
- 2) Proceeds from privatization of state property being in the republican ownership and belonging to mining and manufacturing industries;
- 3) Proceeds from the sale of agricultural land;
- 4) Other receipts and income not forbidden by the legislation of the RK.

Also the adoption the “Concept” has changed the procedure for expenditure funds. Now money of the NFRK can be sent only to ensure guaranteed transfer to the national budget and financing costs associated with managing and auditing.

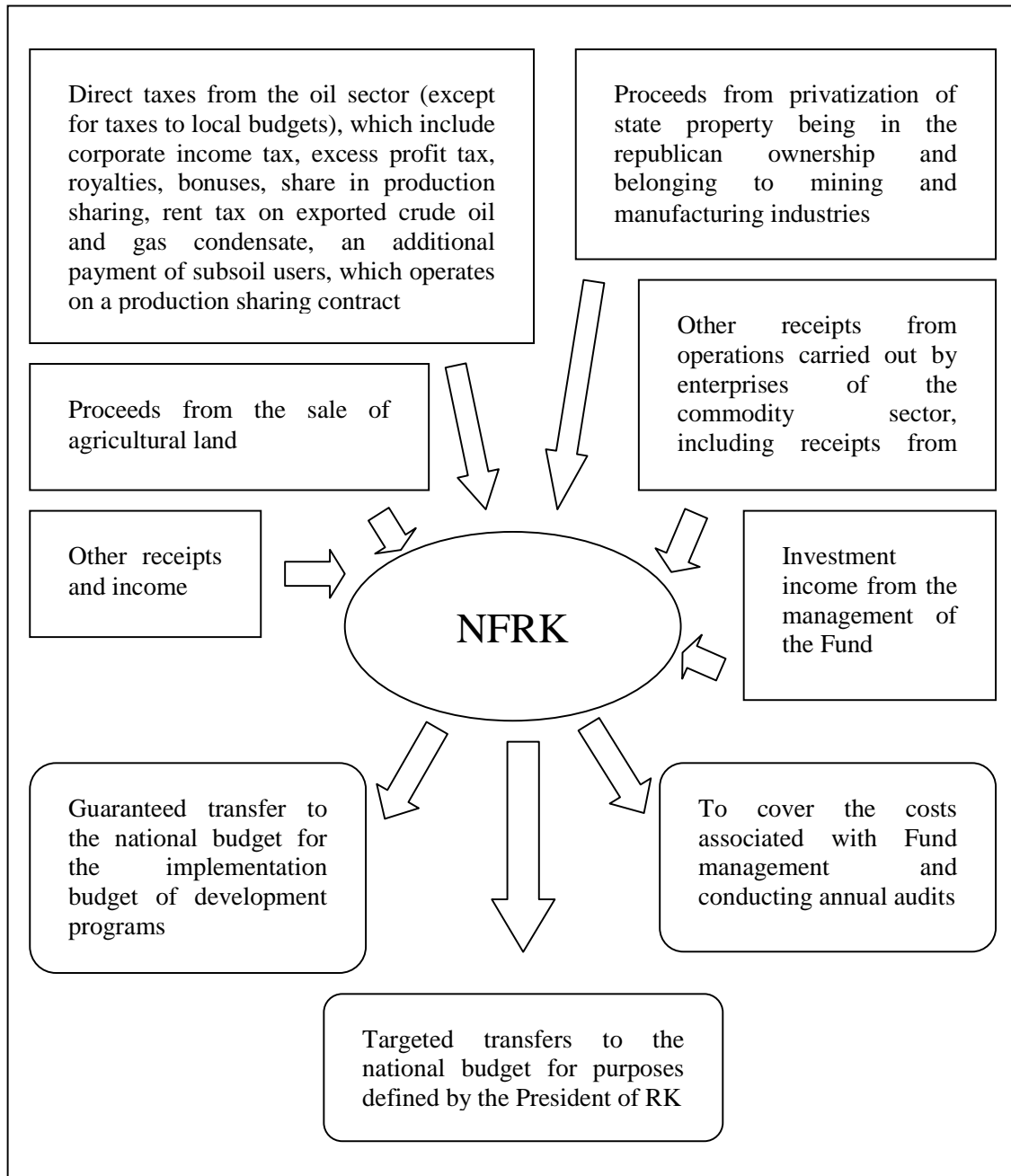
An important difference after adoption of the “Concept” was the expansion of the list payers of the NFRK; earlier were 6 businesses, but now in the list included 55 companies. It was also a lot of discussion about for how long makes sense to accumulate money in the fund. So the maximum size of the NFRK can not be restricted.

In the rules that regulating the use of the NFRK, stipulated that purposes for which are transmitted funds to the Fund, in form of targeted transfers to the national and local budgets, shall be determined solely by the President of the Republic of Kazakhstan.

Among the latter transfers to the state budget was 10 billion dollars, transferred in 2008 and 2009 for government expenditures to fight the financial crisis and recession. These extra expenditures explain that NFRK assets decreased only from 2008 to 2009 although revenues were substantial (Lücke 2010).

The following figure shows the formation and application of NFRK with the latest changes.

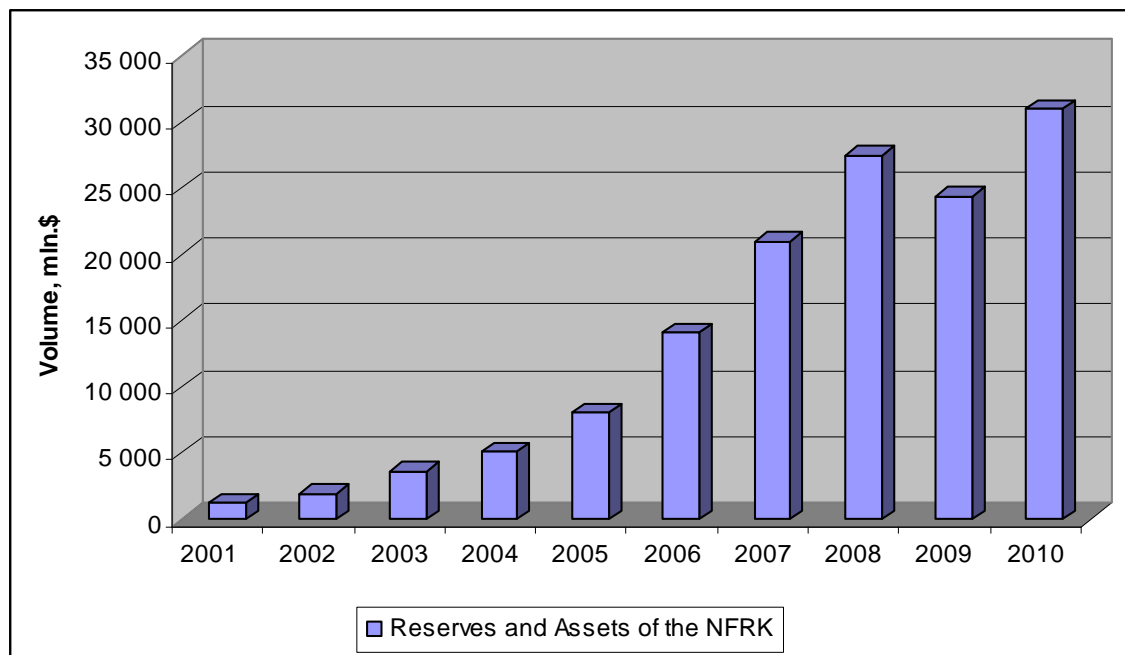
Figure 3.7: The procedure of formation and application NFRK (with latest changes)



Source: Author's computations

During the first 5 years of its existence the NFRK has accumulated extra payments made to the nation's budget from major companies operating in the raw materials sector. In 2003, the fund began accumulating proceeds from the sale of state property. The fund's reserves currently exceed 30 billion U.S. dollars (see Figure 3.8).

Figure 3.8: Reserves and Assets of the NFRK (million of dollar/ end of period)



Source: National Bank of the Republic of Kazakhstan

One disadvantage of fund is that NFRK provide little information on its operations to the public. There is no published annual report or other documentation of investment strategy. While Kazakhstan is a candidate for membership in the Extractive Industries Transparency Initiative, full disclosure of government revenue was not achieved because not all oil companies participated. So far, Kazakhstan has also not actively participated in the International Forum of Sovereign Wealth Funds (Lücke 2010).

Looking back over the past decade, it is safe to conclude about the timeliness and feasibility of establishing of the NFRK. Furthermore, without going into some minor issues, can be generally favorably respond about fund investment strategies.

With increasing economic prosperity of the republic needed to raise the level of established objectives, now they include and the industrial-innovative development of the country. In addition, Kazakhstan will need to enter in the International Working Group of Sovereign Wealth Funds and formally adopt Santiago principles, according to which the Ministry of Finance and National Bank should ensure greater transparency in the management and application of the National Fund.

Given the experience of Alaska's oil fund, as well as frequent cases of environmental disasters in the world, associated with extraction of oil, according to the author, in the direction of the National Fund must necessarily include the allocation of funds for: 1) regional development, which ensure the production and export of non-renewable resources; 2) as well as reducing the negative impacts of resource extraction on the environment and public health regions.

Influence of oil sector on the economy of the country.

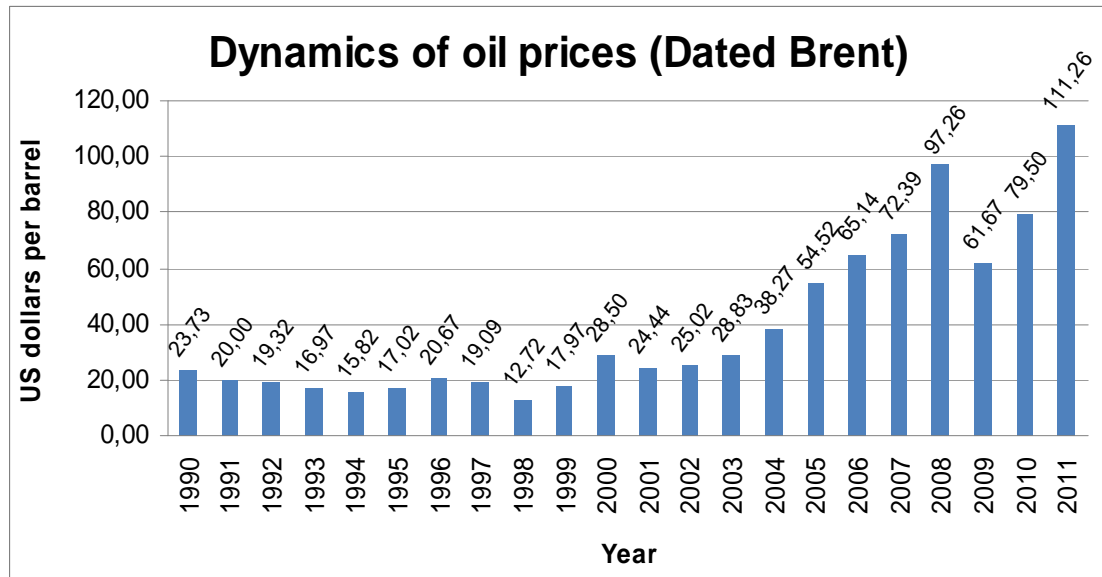
4.1 The impact of oil prices on the economy of Kazakhstan.

The oil is one of the most important raw materials in the modern economy. Petroleum products are widely used in manufacturing of chemical products, transportation and power generation etc. Ever since as the oil became an important commodity in world's life and economy, the relationship between oil and the macroeconomics has been basically investigated through the oil price. Thus the oil price is one of the main prices in the international economy.

Economists have long been interested in empirical evidence that will show that the oil price shocks may be closely linked to macroeconomic indicators. This interest dates from the 1970s, when was the first oil crisis in 1973. For example, Hamilton (1983) claimed that almost all recessions in the USA preceded by a significant increase oil price. In the analysis he applied a Vector Autoregressive model. From then this method was the most commonly used one in the empirical research of the relationship of oil and macroeconomics.

This relationship is expected to be different in oil importing and in oil exporting countries. Such authors as Abeysinghe (2001), Hamilton (2003), Hamilton and Herrera (2004), Jimenez-Rodriguez and Sanchez (2004) provided evidence that in oil-importing countries there is a negative correlation between increases in oil prices and subsequent recession. In turn, Gurvich et al. (2009), Ito (2008), Rautava (2002), Bjornland (2009), Korhonen and Mehrotra (2009) found evidence that in oil exporting countries there is a positive relationship between rise in oil prices and followed by higher economic activity. The oil market in the past 20 years shows a highly volatile trend (see Figure 4.1). In 1998 we observe significant decline in oil prices to the level of 12.72 U.S. dollars per barrel. As the graph shows the peak price accounted for 2008 (97.26 U.S. dollars per barrel). After this highest point of oil price we observe sharp drop in the prices, and for 2009 the average annual price of oil was 61.67 U.S. dollars per barrel. In 2010 average price is 79.50 U.S. dollars per barrel. Oil prices have gradually recovered.

Figure 4.1: Dynamics of oil prices



Source: BP Statistical Review of World Energy

There are many reasons of the rapid price increases that we can observe from the second half of 2007. Typically they are based on the different events. Among the causes can be, for example, the invasion of Iraq and the subsequent mutiny, or turmoil in Nigeria 2006–2008, or the Venezuelan government’s dispute with Exxon Mobil. Within this group it should be included the rapid growth of the economies of developing countries (particularly China and India) and their ever-growing oil consumption. Concerns about the actual oil reserves expressed by International Energy Agency had the effect of short-term disruption in oil supplies.

Moreover there are several factors affecting the dynamics of oil price, which can be divided into macro and micro economic parameters.

One of the fundamental macroeconomic factors affecting the change in oil prices on a global scale is the U.S. dollar. This is largely due to the formation of the national budget of oil exporting countries. The fall in the exchange rate of dollar will lead to an income reduction of countries. In addition, the situation in the financial markets has affected the volatility of oil prices. The recent financial crisis initially led to an increase in oil prices to above 100 US dollar per barrel because the stock markets fell.

In addition to the macroeconomic there are microeconomic factors that affect the price dynamics on a worldwide scale. An example of this is the lack of investment required in the oil industry. In most cases the oil complex working at maximum production capacity. Construction of additional oil production capacity, updated oil production technologies, development of new deposits requires large financial investments.

Kazakhstan is a large oil exporter. Kazakhstan's dependence on oil revenue increases the likelihood that the economy is vulnerable to external changes of commodity prices.

4.1.1 Literature review

This part of the thesis summarizes existing research and papers about oil price effect and its relationship to macroeconomic activity.

Today there is large number of studies about central Asian economic development. However, surprisingly few studies have so far focused on the relationship between oil prices and economic growth of Kazakhstan. The majority of researchers agree in opinion that after World War II, the oil price shocks are important economic events.

In 1983, Hamilton published study that can be considered as a seminal paper on oil shocks. His research still has particular importance for macroeconomic analysis of shocks to oil prices. He pointed a strong relationship between sharp rise in the oil prices and subsequent economic downturns of US economy. His study has caused great attention from the other economists. Mork (1989) confirmed Hamilton's results about the strong negative correlation between oil price increases and economic growth. He focused on the asymmetric effects and found evidence that the effects of oil price increases were different from those of decreases, and that oil price decreases were not statistically significant in U.S. Mork's contribution proved to be very influential, after his paper many authors such as Hamilton (2003), Jimenez-Rodriguez and Sanchez (2004), Cologni and Manera (2009) found asymmetry between the responses to oil price increases and decreases by the GDP growth, and concluded that the decreases are statistically insignificant.

Jimenez-Rodriguez and Sanchez (2004) examined the effects of oil price shocks on the real economic activity of the main industrialized OECD countries. They used Multivariate VAR analysis. Jimenez-Rodriguez and Sanchez found evidence of a non-

linear impact of oil prices on real GDP. They claimed that oil price increases are found to have an impact on GDP growth of a larger magnitude than that of oil price declines, with the latter being statistically insignificant in most cases.

Rautava (2002) claimed that in the long run a 10% permanent increase (decrease) in international oil prices associated with a 2.2% growth (fall) in the level of Russian GDP. His analysis based on VAR methodology and cointegration techniques, covered period 1995Q1 - 2001Q3. Also the results of estimation confirmed strong dependence of fiscal revenues on output and oil price fluctuations.

Cavallo and Wu (2006) analyzed the effects of oil-price shocks on output and prices for the U.S. economy. They provided evidence that in response to oil-price shock output declined and that the price level increased.

Blanchard and Gali (2007) considered the macroeconomic performance of a set of industrialized economies in the aftermath of the oil price shocks of the 1970s. They stated that there are four reasons for the mild effects on inflation and economic activity of the recent increase in the price of oil: (1) good luck (i.e. lack of concurrent adverse shocks), (2) smaller share of oil in production, (3) more flexible labor markets, and (4) improvements in monetary policy.

Ito (2008) stated that real GDP and inflation in Russia exhibit a positive response to an oil price increase, but not in the case of interest rates. In the paper he used co-integrated VAR model to investigate the effects of oil price and monetary shocks on the Russian economy covering the period 1995Q3-2007Q4.

According to Tazhibayeva et al. (2008) in countries where the oil sector is large in relation to the economy, oil price changes affect the economic cycle only through their impact on fiscal policy. Once fiscal policy changes are removed, oil price shocks do not have a significant independent effect on the economic cycle. Their research analyzed the impact of oil price shocks on the underlying non-oil economic cycle in oil-exporting countries, using panel VAR.

Korhonen and Ledyayeva (2009) examined the impact of oil price shocks on oil-producer and oil consuming economies. They used VAR models for different countries. Their results are: oil producers (Russia and Canada) benefit from oil price shocks; the direct

effects of positive oil price shocks are negative for Japan, USA, China, Finland, Germany, Switzerland and UK.

Now consider some study which analyses effect of oil price on the economy of Kazakhstan. Korhonen and Mehrotra (2009) investigated the effects of oil price shocks on real exchange rate and output in four large energy-producing countries: Iran, Kazakhstan, Venezuela, and Russia. Authors found that oil price shocks have a positive and statistically significant effect on GDP, with the exception of Iran. Also they argued that a positive shock to real oil prices leads to an appreciation of the real exchange rate only in Iran and Venezuela, but in Kazakhstan and Russia their role is negligible. In their study Korhonen and Mehrotra used structural vector autoregressive models. However Gurvich et al. (2009) argued that the price of oil has a significant effect on the economy of four (Russia, Iran, Norway, Venezuela) out of the five countries (except Kazakhstan). They showed that the fluctuations of oil prices do not have a significant impact on Kazakhstan's budget parameters (oil price explains only 4 percent of the change in GDP). After analysis of various international literature, which examined the effect of oil price shocks on the macroeconomic activity we consider some research that captured impact of oil price on the economy of Kazakhstan.

Gronwald, Mayr and Orazbayev (2009) examined the role of oil for the Kazakh economy. They used VAR models with such variables as real GDP, inflation and real exchange rates. The key results which emerged from their study are: firstly, that the price of oil is influenced by a large number of factors, which results in a considerable degree of volatility; secondly, all variables considered in the VAR model exhibit a strong negative significant reaction on oil price declines; and thirdly, a standard linear VAR model is appropriate for capturing the Kazakh oil macro relationship.

Nurmakhanova and Kretschmar (2010) studied the relationship between real Kazakh GDP, real exchange rates and oil prices. They used Multivariate VAR analysis and Granger causality tests to capture oil price change effects. Their analysis covered the period from 2000Q1 to 2010Q1 (time series data). Nurmakhanova and Kretschmar provided evidence of both linear and non-linear impact of oil price shocks on real GDP and real exchange rate. Also they pointed out that one of the key effects of oil prices on real economic activity relates to the real effective exchange rate.

In terms of statistical regularities, changes in the real price of oil have historically tended to be (1) permanent, (2) difficult to predict, and (3) governed by very different regimes at different points in time (Hamilton 2008).

In contrast of most existing literature, which focused on the oil-importing countries, our study extends the empirical literature which considers oil-exporting countries. In our case oil-exporting country is Kazakhstan. And based on this literature review one would expect that positive oil price shock has positive influence on GDP of Kazakhstan.

4.1.2 Data

We apply Vector Error Correction approach for analysis effect of the oil price on the Kazakh economy. The analysis is conducted using quarterly data from the first quarter of 2000 to the fourth quarter of 2010. We selected this period because it is generally assumed to be more stable monetary policy regime in the Republic of Kazakhstan. Also the selected period is a period of stable growth and development of the republic.

The first step in the use of the selected method is choice of which variables should be included in the VAR or VECM and how many of them will be. We selected four variables and added mnemonics for convenience. The variables that we used are as follows: oil price (OP), GDP, exchange rate (EXR) and inflation (INF). Data on GDP was obtained from the Kazakhstan Statistic Agency. Oil price data was taken from BP Statistical Review of World Energy 2011 and statistical bulletin of the National Bank of Kazakhstan for the different years. Also the National Bank of Kazakhstan provided information about the exchange rate and inflation.

There are a large number of macroeconomic variables which impact on economic growth. We can consider equally besides our chosen variables also investment, government spending, trade and etc. Of course if we include such variables into a model it increases the fit of the model, but also decreases the degrees of freedom. Exactly for this reason our model is restricted only by selected variables.

The price of oil is defined as Brent oil price in U.S. dollars per barrel. The inflation as measured by the percentage changes of consumer price index. The Gross Domestic Product defined in million U.S. dollars. The value of oil export is equal to the price per

unit of quantity multiplied by the number of quantity units and measured in million U.S. dollars.

The main aim of this study is determine the impact of oil price on gross domestic product. Also try to trace how will behave other variables such as inflation and exchange rate.

In the analysis, we will use STATA software.

4.1.3 Methodology

The model specification for our study is denoted as:

$$GDP_t = f(OP_t, INF_t, EXR_t)$$

If the variables are stationary in levels, a VAR model is employed. In accordance with most recent VAR studies, we consider the following VAR model proposed by Sims³ (1980) of order p :

$$y_t = c + \sum_{i=1}^p \Phi_i y_{t-i} + \varepsilon_t,$$

where y is a $(n \times 1)$ vector of variables, $c = (c_1, \dots, c_4)$ is the (4×1) intercept vector of VAR, Φ_i is the i -th (4×4) matrix of autoregressive coefficients, p is the number of lags, $\varepsilon_t = (\varepsilon_{1t}, \varepsilon_{2t}, \varepsilon_{3t}, \varepsilon_{4t})$ is the (4×1) generalization of a white noise process.

On the other hand, if the variables are non-stationary, we should use cointegration tests. If there is no cointegration, the VAR model in differences is conducted. The cointegrated VAR model developed by Johansen (1988) can be described by the formula:

$$\Delta y_t = c + \sum_{i=1}^{p-1} \Gamma_i \Delta y_{t-i} + \Pi y_{t-1} + \varepsilon_t,$$

where Δ is the difference operator, Γ_i denotes an (4×4) matrix of coefficients which contains information regarding the short-run relationships among the variables. Π is an (4×4) coefficient matrix decomposed as $\Pi = \alpha\beta'$, where α and β are $(4 \times r)$ adjustment parameters and cointegration matrices.

³ Sims was the first who represented the reduced form of a standard macroeconomic model as a multivariate dynamic system.

But if there is cointegration it is not possible to use the VAR model, we will use Error Correction model to get correct results. The VEC model:

$$\Delta y_t = \Pi y_{t-1} + D_1 \Delta y_{t-1} + \dots + D_{p-1} \Delta y_{t-p+1} + \varepsilon_t$$

where Δ is the difference operator, Π - long run (error correction) parameters, D_1, \dots, D_{p-1} are short run parameters Rank Π denotes presence of cointegrating relationship:

- Rank (Π) = 0; no cointegration (VAR in first differences)
- Rank (Π) = r ; $0 < r < k$, r cointegrating relationships
- Rank (Π) = k ; $I(0)$ process which should be modeled as VAR in levels.

Before examining the effect of oil price shocks on economic activity we test the variables for stationary process. We will test stationarity of the series by applying Augmented Dickey-Fuller (ADF) unit root tests. We will conduct tests to find more suitable from the two models, VAR and VECM. If data will be stationary we will use VAR model, for non-stationary and cointegrated data we will apply VECM model.

The Augmented Dickey Fuller (ADF) test takes the following form:

$$\Delta y_t = \alpha_0 + \alpha_1 trend + \delta_1 y_{t-1} + \alpha_i \sum_{i=1}^m \Delta y_{t-1} + \varepsilon_t,$$

where Δy_t indicates the first difference of y_t and m is the number of lags and ε_t is the error term. Equation above enables us to test whether the variable y_t is a stationary series.

The null hypothesis for ADF is:

$$H_0: \delta = 0, \text{ variable has a unit root}$$

$$H_A: \delta < 0$$

Based on the critical value of respective statistics, if the null hypothesis can be reject we test for cointegration and then use VAR model, and after that we test Granger causality. On the other hand, if the null hypothesis cannot be rejected (there is unit root) we prefer the VECM model in case that our variables are cointegrated.

Cointegration analysis is important because it helps to identify long-run economic relationships between two or several variables and to avoid the risk of spurious regression. In our study we will use Johansen (1988) cointegration test. Johansen (1988) and Johansen and Juselius (1990) develop two test statistics to determine the number of

cointegrating vectors: Trace and Maximal Eigenvalue statistics. The first is known as the trace statistic:

$$\lambda_{Trace}(r) = -T \sum_{i=r+1}^k \ln(1 - \hat{\lambda}_i)$$

And the second is called Maximal Eigenvalue:

$$\lambda_{Max}(r, r+1) = -T \ln(1 - \hat{\lambda}_{r+1})$$

where T is the number of observations, r is the number of cointegrating vectors and λ is estimated eigenvalue.

In some cases of Trace and Maximum Eigenvalue statistics may give different results, therefore Alexander (2001) indicates that in such case the results of Trace test should be preferred.

If cointegration exists we apply the VECM in order to estimate the short run properties of the cointegrated series. In the absence of cointegration VECM no longer needed and we move to Granger causality tests to establish causal links between variables. In VECM the cointegration rank shows the number of cointegrating vectors.

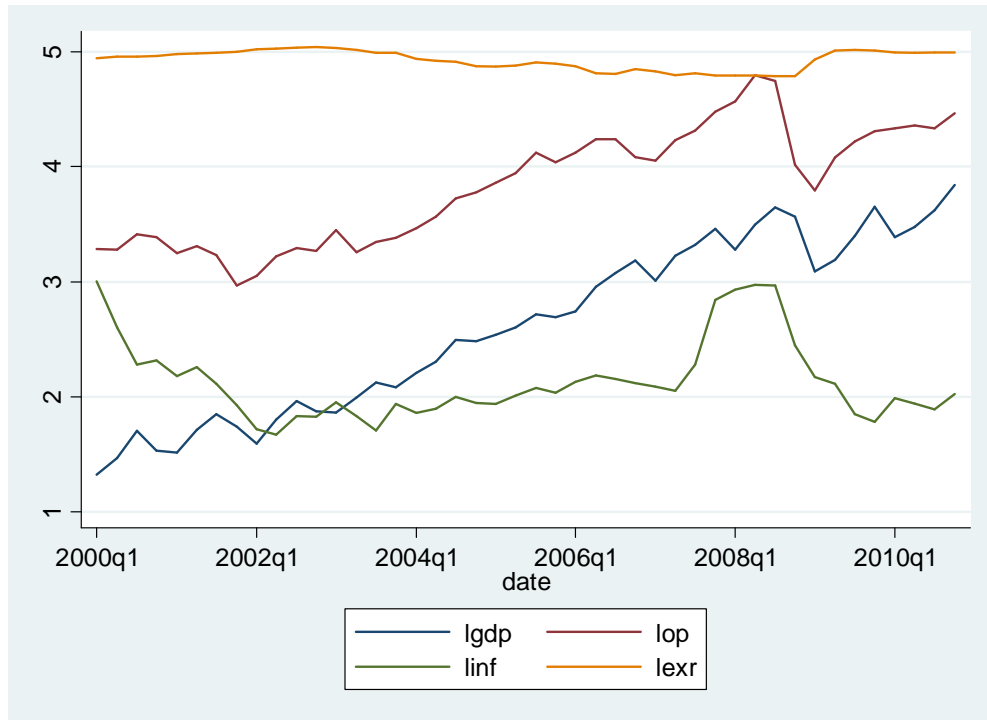
To determine the number of lags there are information criterion tests which help us to choose proper number. The commonly used three criteria: Schwarz's Bayesian information criterion (SBIC), Akaike's information criterion (AIC) and Hannan & Quinn information criterion. When all three agree, the selection is clear. But if criteria got conflicting results, then according to Ivanov and Killian (2001) the AIC used to more accurate with monthly data, the HQIC works better with quarterly data on samples over 120 and SBIC works fine with any sample size for quarterly data on VECM models. In our case all criteria suggests 4 lags. Therefore we chose 4 lags as optimum number of lags for our estimation.

4.1.4 Unit Root Test

The first step in time series analysis is to determine whether the variables are stationary. Since many economic time series have non-stationary characteristics, the variables should be checked for stationary process.

First of all we plot the series in order to identify whether constants or trend should be included in the test of stationarity. The figure below shows the plot of our variables.

Figure 4.2: Non-stationary time series



Source: Author's computations in STATA

From the Figure 4.2 we can see that our series look non-stationary in its levels. But in order to verify this and to avoid the spurious regression we use the Augmented Dickey-Fuller test. Null hypothesis is that there is a unit root, and alternative is that the variables are generated by a stationary process. The following table displays the estimation of the ADF test in levels of the data with an intercept, with an intercept and trend and with no intercept or trend.

Table 4.1 shows that results of unit root tests for four variables. The results indicate that all the series are non-stationary at level. The Null hypothesis which says that there is a unit root cannot be rejected.

Table 4.1: Augmented Dickey-Fuller Unit Root Test Results

<i>Variables</i>	<i>Test with no Constant and Trend</i>	<i>Test with Constant and no Trend</i>	<i>Test with Constant and Trend</i>
<i>GDP</i>	2.124	-0.775	-3.323
<i>OP</i>	0.928	-0.998	-2.390
<i>INF</i>	-1.230	-2.787	-2.928
<i>EXR</i>	0.229	-1.100	-0.899

Source: Author's computations in STATA

Now we take the variables in their first difference. The results presented below in the Table 4.2.

Table 4.2: Augmented Dickey-Fuller Unit Root Test Results after differencing

<i>Variables</i>	<i>Test with no Constant and Trend</i>	<i>Test with Constant and no Trend</i>	<i>Test with Constant and Trend</i>
<i>ΔGDP</i>	-6.041***	-6.779***	-6.680***
<i>ΔOP</i>	-5.165***	-5.228***	-5.162***
<i>ΔINF</i>	-4.871***	-4.792***	-4.738***
<i>ΔEXR</i>	-4.343***	-4.290***	-4.295***

Notes: 1) Δ means 1-st difference; 2) *, **, *** denote significance at 10%, 5% and 1% respectively.

Source: Author's computations in STATA

Our results show that by first-differencing series, in all cases, the null hypothesis of non-stationary process is rejected at the 1% level of significance. These are stationary variables at first differences. Thus the robust results indicate that all variables are integrated of order one for the case of Kazakhstan.

The overall findings lead us to conclude that all series in levels are non-stationary, but are stationary in the first differences at the 1 percent levels.

Unit root test show that all variables in our data sets are non-stationary at levels. Next step is to examine their cointegration vectors.

4.1.5 Cointegration Test

There are different approaches and techniques for cointegration tests. In our study we check the cointegration using Johansen test. This test is superior test for check of cointegration. This test is based on maximum likelihood estimation and two statistics: maximum eigenvalues and a trace statistics. The Null hypothesis is that there is no cointegration.

Table 4.3: Johansen Cointegration Test Results

<i>Null hypothesis</i>	<i>Trace Statistic</i>	<i>5% Critical Value</i>	<i>Maximum Eigenvalue Statistic</i>	<i>5% Critical Value</i>
$r = 0$	51.9095	47.21	32.7163	27.07
$r \leq 1$	19.1932	29.68	12.0082	20.97
$r \leq 2$	7.1851	15.41	7.1586	14.07
$r \leq 3$	0.0265	3.76	0.0265	3.76

Notes: 1) r is the number of cointegrating vectors under the null hypothesis; 2) Effective number of observations is 40.

Source: Author's computations in STATA

The table above provides the results from the Johansen test on our data. Null hypothesis states that there is no cointegration. In our case, trace statistics indicate the presence of one cointegration relation, $H: r=0$ is rejected at the 5 % level ($47.21 < 51.91$). Moreover the maximum eigenvalue is also rejected the null hypothesis at the 5% significance level. In other words, these both the maximum eigenvalue and the trace tests reject the null hypothesis that these four variables are not cointegrated ($27.07 < 32.72$). The presence of cointegration means that the variables related to each other in the long term. Therefore, the empirical findings lead to the conclusion that there is long run relationship between GDP, Oil price, Inflation and Exchange rate in Kazakhstan.

Based on our empirical results we can say that we have non-stationary and cointegrated time series, in such case it is not possible to use a standard VAR-approach. Further in the thesis we will estimate the VEC model. The Vector Error correction model is just a special case of the VAR for variables that are stationary in their differences.

4.1.6 VECM estimation

Now we apply the Johansen procedure to obtain the long-term coefficients of the model. The presence of cointegration between variables indicates a long-term relationship among the variables. We applied VEC model. The long run relationship between GDP, Oil Prices, Inflation and Exchange rate for the Kazakhstan in the period 2000Q1-2001Q4 is displayed below in the Table 4.4.

Table 4.4: VECM-Normalized Cointegrating Eigenvector

	Coef.	Std.Err.	z	P > z	[95% Coef.	Interval]
<i>lgdp</i>	1	-	-	-	-	-
<i>lop</i>	0.0793831	0.0817779	0.97	0.332	-0.0808987	0.2396649
<i>linf</i>	0.0929637	0.0588567	1.58	0.114	-0.0223932	0.2083207
<i>lexr</i>	2.03217	0.2332276	8.71	0.000***	1.575052	2.489288
<i>cons</i>	-0.0549934	-	-	-	-	-

Source: Author's computations in STATA

All the coefficients are positive. Two variables such as OP and INF are insignificant. The EXR is significant at 1% level of significance. We can say that there is positive long-term relationship between GDP and oil price.

Based on the findings we can derive the cointegrating equation as follows:

$$lg dp_t = 0.079 * lop_t + 0.093 * linf_t + 2.03 * lexr_t - 0.054$$

(0.081)
(0.059)
(0.233)

Our equation is saying that a 10 percent increase in oil price will lead to increase of GDP by 0.9 percent. The positive relationship between oil price and GDP is consistent with our hypothesis which states that increase in oil price implies an increase in GDP. But in our case oil price is insignificant. Kazakhstan as oil-exporting country confirms what has been said above that the increase in oil price usually lead to positive implications for the oil-exporting countries. Hence we expected positive sign of the OP.

Looking at the obtained values we can say that a percentage increase in exchange rate will raise GDP by 2.03 per cent at 1% level. This result is consistent with our expectation. As mentioned above that the exchange rate is one of the main

macroeconomic factors affecting the oil price changes. The point is that the fall in the exchange rate of U.S. dollar reduced income of oil-export countries whereas a significant part of imports payable in U.S. dollars or any other currency. The inflation increase is related to increasing GDP, so that 10 percent increase of the inflation leads to raise economic growth by 0.9 %.

Our results show that GDP of Kazakhstan increases more by the exchange rate increase than by the oil price. The normalized cointegrating equation shows that in the long-term, OP affects economic growth positively but insignificantly in Kazakhstan.

Short Run Vector Correlation Model

The analysis of this section aims to explore the short run effects of oil price on the GDP of Kazakhstan. The aim of our analysis is to find out whether the short-term dynamics are influenced by the estimated long-term equilibrium conditions.

A most important parameter in the estimation of the short-run dynamic model is the coefficient of the Error-Correction Term. The coefficient of the ECT provides information about whether the past values affect the current values of the variable in the study. A significant value means that previous errors play a role in determining the current outcomes.

The results presented in Appendix B. Our findings show that the value of Error-Correction Term in the model has correct sign and statistically significant at 10% level, which confirms that there isn't any problem in the long-term equilibrium relation between the independent and dependent variables. In addition, negative ECT indicates that when there is deviation from the long run equilibrium, the ECT has an opposite effect and reduces the deviation degree.

R-squared is about 0.92 which means that we can say that our model fits with the data good. Exchange rate and inflation are weakly exogenous variables in the adjustment process. Both of these variables are insignificant. In contrast of them oil price is a totally endogenous variable. Only oil price does affect the GDP but the exchange rate and inflation do not affect the GDP in Kazakhstan in the short run.

4.1.7 Summary and Conclusion

The main aim of this part of thesis is to investigate the relationship between OP and GDP in Kazakhstan using quarterly data over the period from 2000Q1 to 2010Q4. The first step in our analysis involves testing the time series characteristics of the data series using ADF test, after that conducting cointegration test. Based on the result from this test we apply VEC model. The VECM was also estimated in order to examine the short-term dynamics. Our major results include the following conclusions.

The unit root of the data was examined using the Augmented Dickey-Fuller test. We found evidence that all variables were characterized by a unit root at level. However, the hypothesis of non-stationarity was rejected at 1% level by first-differencing.

This was followed by application of the Johansen cointegration test. The cointegration analysis is important because it helps to determine long-term economic relationships between variables. The cointegration results documented the presence of one cointegrating equation using the trace statistic as well as the maximum eigenvalue. In such case we applied the VECM for further estimation.

On the next stage we used the Johansen procedure for estimation of the long-term cointegrating vectors. Using the long-term vector coefficients, we studied the sensitivity of GDP in Kazakhstan to the international oil price shock. The results for the long-term equations indicated oil price shocks having a positive but statistically insignificant effect on GDP. The similar result was obtained by research of Gurvich et al (2009). They argued that the fluctuations of oil prices do not have any significant impact on Kazakhstan's economy.

Finally, the results from the short run vector of Error-Correction term in the model showed that the value is statistically significant at 10% level and has a negative sign. This means that long-term equilibrium condition has an impact on the short-term dynamics. Also important that oil price is significant and has positive coefficient. For instance, the results showed that 10 % of increase in oil price would increase GDP by 4.5 %. The positive relationship between oil price and GDP was expected, because Kazakhstan is oil exporting country.

The key results which emerged from our analysis are: first, the price of oil is insignificant for the economy of republic in the long run; second, the oil price has positive effect on

GDP of Kazakhstan in the short-term, and in addition is significant at 1% level of significance. Based on the obtained results we can say that economy of Kazakhstan is vulnerable to oil price shocks in the short run.

Given the importance of oil and gas complex for the economy of Kazakhstan, therefore, the main recommendation for the government is to continue to direct all efforts to reduce the dependence of the republic on oil and gas sector.

4.2 The effect of FDI on Economic growth.

In recent years economists have concluded that in developing countries direct investments are needed to stimulate economic growth. The FDI can create new workplaces, increase the technological development and improve the economic condition of the country in general. But also importance of FDI is related to the fact that efforts to attract them are associated with the enhancement of structural reforms that can improve the general business climate and therefore, increment the competitiveness of the host economy.

There are enough successful examples of the influence of FDI on the transformation process from socialist, centrally planned or administrative command economy to a market economy based on healthy competitive environment, such as Czech Republic, Poland and other economies.

At the present stage of development of Kazakhstan as a new independent state, orienting on the market relations, the main focus of economic reform become elaboration and implementation of investment policy of the state aimed at ensuring high rates of economic growth and improving the economy.

Attraction and effective use of foreign investment in the economy is essential, one of the areas of mutually beneficial economic cooperation between Kazakhstan and foreign countries.

Since 1999-2000, economy of Kazakhstan has been growing rapidly an average of 10 percent annually. A great significance for economic growth of the state was contributed by its natural resources such as: oil and gas, and mining. But also attracting FDI has become an essential element of national development strategies of Kazakhstan and defines its goals and objectives.

In terms of the investment location, each country and region offers certain advantages that make them more attractive to specific types of investment projects. Over the past two decades Kazakhstan demonstrates strong economic performance in a number of sectors, but potential of the country is not yet fully disclosed.

4.2.1 Literature review

For today there are many studies that investigate the impact of FDI on economic growth of the host country, but unfortunately such research that considers Kazakhstan as an example not so much.

Many studies on FDI have found its positive influence on economic growth of the country, at the same time using different data and methodologies. For instance, Laura Alfaro (2003) claims that the inflows of FDI to growth depend on the sector of the economy. She found that FDI in manufacturing leads to positive impacts on growth while the FDI to the primary sector tends to have a negative effect on economic growth.

Alfaro et al (2003) provided evidence that the impact of FDI on growth depends on the local condition of the host economies. Better local conditions not only can attract foreign companies but also allow host country to maximize the benefits of foreign investments.

Borensztein et al (1998) argue that FDI has a positive overall impact on economic growth, although the magnitude of this effect depends on the level of human capital available in the host economy. Notwithstanding, the nature of the interaction of FDI with human capital is such that for countries with very low levels of human capital the direct influence of FDI is negative. Although Blomstrom et al (1994) find no evidence that education is critical, they postulate that FDI has positive effect only when the country is sufficiently rich.

Despite the fact that FDI contributes to economic growth, growth also affects the level of FDI into the country. Chowdhury and Mavrotas (2003) investigated the causal relationship between economic growth and FDI. In the study examined three developing countries Chile, Malaysia and Thailand over the period 1969-2000. They established that in the case of Malaysia and Thailand there is bi-directional causality. Also they found evidence that contribution of FDI to growth depends on such factors as degree of economic openness and human capital in the host country.

Hansen and Rand (2004) investigated the Granger-causal relationships between FDI and GDP of 31 developing countries covering the period 1970-2000. Their results suggested that a higher ratio of FDI in gross capital formation has positive impact on the level of GDP and hence on growth. In general they discovered that FDI and growth have a positive relationship, but the direction of causality is unclear.

It should be noted that some research argued that the contribution of FDI to growth of the host country is not positive. For example, Carkovic and Levine (2002) find that FDI inflows do not exert an independent influence on economic growth. They postulate that the lack of positive effect of FDI on growth do not depend on human capital, level of economic development or openness of the economy.

Zhang (2001) studied causality between economic growth and FDI of 11 countries of Asia and South America. According to his results the economic growth leads to FDI growth.

According to De Gregorio (2003) FDI is beneficial for economic growth. He said that the technologies and knowledge that are not available to the host country can be held together with FDI and thus lead to an increase in productivity of the whole economy. Some other authors also have some interesting findings. For example, Rappaport (2000) pointed out that FDI could not only improve the productivity of the firm that receives investment, but also the rest firms of the host country as a result of technological spillovers. Lall (2002) stated that FDI inflow affects many factors in the economy and these factors in turn affect economic growth.

Now consider some research that studied the impact of FDI on economic growth in Kazakhstan. Lee, Baimukhamedova and Akhmetova (2009) studied relationship between FDI, exchange rate and economic growth of the Kazakhstan during the ten years (1997-2006). Their results indicate that FDI has a minimum or not a statistically significant impact on GDP growth. They argued that FDI in Kazakhstan have a minimal effect on achieving economic growth and national competitiveness of the country.

Katircioglu and Naraliyeva (2006) analyzed long run relationship and direction of causality between economic growth, domestic savings and FDI. They found evidence that there is a long-run equilibrium relationship between GDP and savings and between GDP and FDI with one cointegrated vector, except between savings and FDI. Also they have identified another unidirectional causation running from real FDI to real GDP in Kazakhstan. For their research were used Johansen multivariate cointegration techniques, VAR and VECM models.

Khoich and Madiyarova (2011) investigated the impact of FDI on economic growth of Kazakhstan from 1991 to 2009. In their paper was reported that 70 percent of all FDI

inflows involved in primary sector and geological exploration. In the same time less than 10 percent of FDI falls on manufacturing sector. They noted that Kazakhstan is FDI attractive, but has highly dependence on energy sector, and such dependence can lead to negative effect for economy.

This literature review indicates that debates about the impact of FDI on economic growth have not been completed and this issue will be interesting for many researchers. As we can see that most of research works agree that impact of FDI on growth is positive but depends on economic, institutional and technological conditions in the host country.

4.2.2 Methodology and Data

One of the main objectives of this thesis is to investigate a relationship between FDI and economic growth of Kazakhstan. By analyzing various research and literature that examined the relationship between FDI inflows and GDP, we suggest following econometric method and data.

Initially we wanted to use in the model data from the period of independence of Kazakhstan, but unfortunately due to the lack of data for the first two years from country's independence we will use data covering following period. For the analysis we use the annual data for the period from 1993 to 2011 which includes the 19 annual observations.

After a comprehensive review of the various study and data, we selected three variables: GDP, FDI, and Net Export (NX). Almost all necessary data such as: GDP, FDI and Net Export for the sample period are obtained from the Kazakhstan Statistic Agency.

Using the time period, from 1993 to 2010 for Kazakhstan, this study aims to examine the relationships between the level of FDI inflow into country and economic growth. The study is based on the following hypothesis that there exists a positive relationship between GDP and FDI in Kazakhstan.

The choice of the model is based on the fact that it allows estimation of all the parameters without resulting into unnecessary data mining. The regression equation for the study takes the form:

$$GDP_t = \alpha + \beta FDI_t + \delta NX_t + \varepsilon_t$$

Where:

α – constant variable;

GDP – Gross Domestic Product;

FDI – Foreign Direct Investment;

NX – Net Export;

t – time period (1993, 1994, ..., 2011);

β, δ – coefficients that must be estimated in the model;

ε_t – error term assumed to be normally and independently distributed

The coefficient of regression indicates how a unit change in the explanatory variable affects the explained variable. The error term is included in the equation to meet for other factors that may influence GDP.

The methodology that we will employ for the empirical evidence of this thesis suggests regression analysis. Economic growth is dependent variable. The GDP is used as the proxy for economic growth in Kazakhstan and we represent the economic growth rate by using the constant value of GDP measured in millions of U.S. dollars.

The larger economy of the host country, meaning the larger the market, the more FDI is expected. FDI inflow is the independent variable. The effect of FDI on growth is more important for the developing countries, where inward investment is viewed as a mean of stimulating economic development.

There are many other variables that determine the economic growth. For the study, the other variable that is included as the explanatory variable is the net export. As said above that great contribution to the economic growth of the republic makes its natural resources. In troth, today the oil and gas sector occupies the largest share of exports in Kazakhstan, thus this is a key element of economic growth of the nation. Net export is the difference between the total export and total import, it is also known as a balance of trade. The imports variable represents the total annual value of import that is obtained by the host country from other countries. The level of imports into the economy is an indicator of openness of the country. The NX variable measures the impact of foreign trade on the economy.

In the analysis, we will use STATA software.

4.2.3 Regression, analysis and results.

The main hypothesis for the empirical work is that the FDI have a positive impact on economic growth in Kazakhstan. This hypothesis can be confirmed or rejected based on the estimated value of β . The null hypothesis $H_0: \beta_i = 0$, FDI do not promote the economic growth; against its alternative hypothesis H_1 where $\beta_i \neq 0$.

Before estimation we should check assumptions of the linear regression model. Without testing data which should satisfy the assumptions underlying the OLS regression, our results could be incorrect. We will consider and test the following assumptions:

- Linearity
- Multicollinearity
- Normality
- Homoscedasticity
- Autocorrelation

Linearity - the relationship between the response and the predictor variables should be linear. Since we have multiple regression, the test for linearity assumption is not so simple. We will illustrate technique that we will use. As we can see from the figure 4.3, relationship between the dependent variable and independent variables is clearly linear.

Figure 4.3: Linearity



Source: Author's computations in STATA

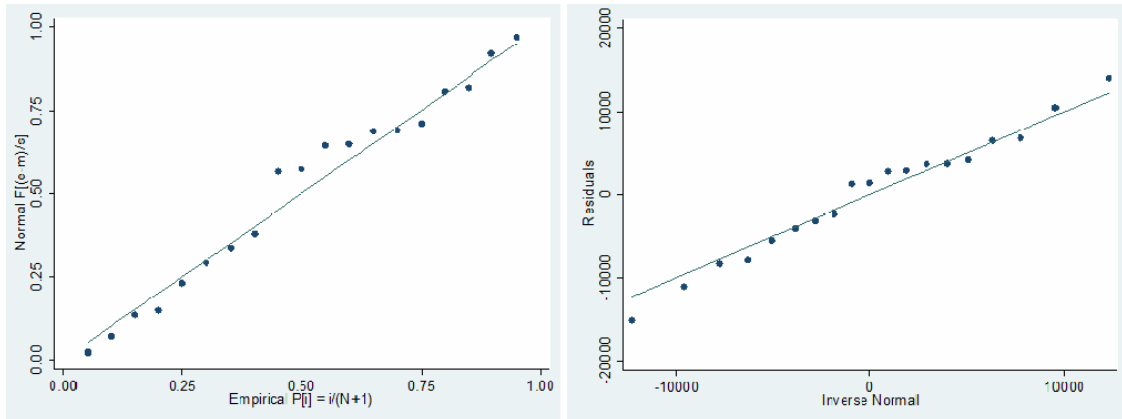
Now we deal with the checking multicollinearity. An important assumption for the multiple regression model is that independent variables are not perfectly multicollinear. Multicollinearity occurs when two or more explanatory variables are near perfect linear combinations with each other. For detecting multicollinearity we use Variance Inflation Factor (VIF). As a rule of thumb, $VIF > 10$ indicates high collinearity. In our case the VIF equals 4.13; it means that there are no perfect linear relationships between independent variables. We do not have multicollinearity of the data.

Normality, this is when the residuals are normally distributed. Normality of residuals is necessary only for valid hypothesis testing. Assumption about normal distribution of residuals is a mandatory requirement of the linear regression model.

As we can see below on the graph (see Figure 4.4), that there is slight deviation from the normal. However this deviation is minor, thus we claim that the residuals are close to normal distribution. To confirm this we also use Shapiro-Wilk test for normality. It tests the hypothesis that the distribution is normal. The p-value for our data is 0.96. The p-

value is bigger than a critical value (0.05) we cannot reject the hypothesis that the data is normal. This is further evidence that our data is normally distributed.

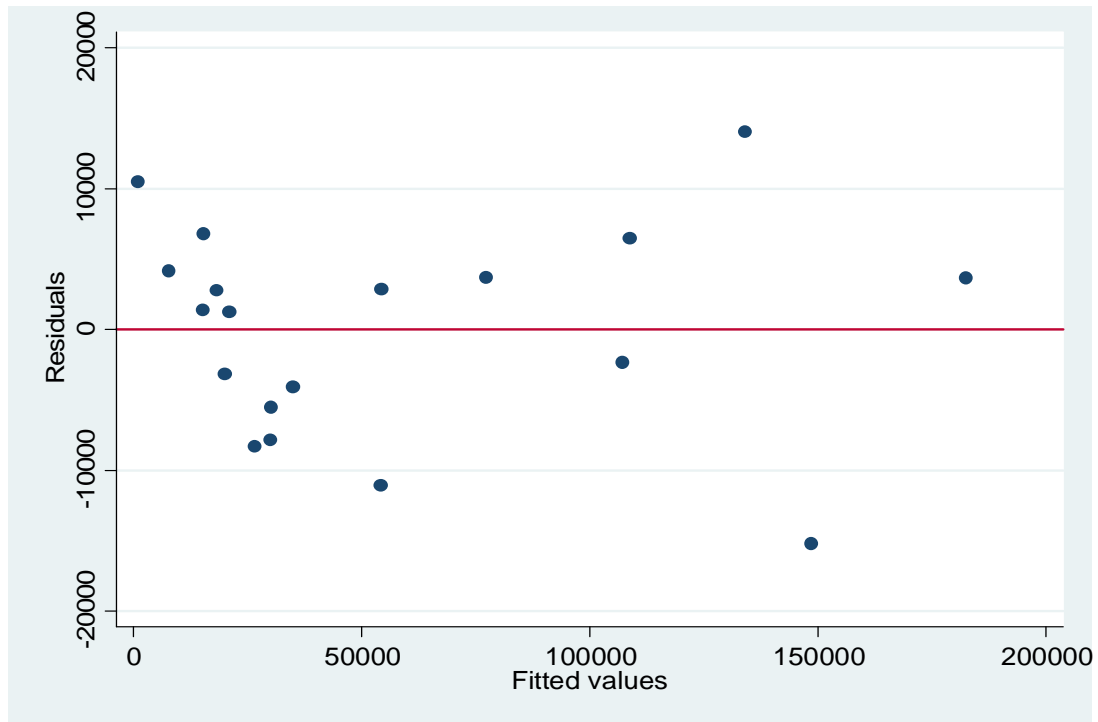
Figure 4.4: Normality



Source: Author's computations in STATA

One of the main assumptions for the OLS regression is that the variance in the residuals has to be homoscedastic. For the detection of heteroscedasticity, first we use graphical method to see if the variance of the error terms change in any systematic ways with the fitted value. We can see that the residuals seem to slightly expand when the fitted value becomes bigger (see Figure 4.5).

Figure 4.5: Graphical test for heteroscedasticity



Source: Author's computations in STATA

Second, a non-graphical test to detect heteroscedasticity is the Breusch-Pagan test. The null hypothesis is that residuals are homoscedastic. Therefore, if the p-value is 0.05 or smaller, then the null hypothesis is rejected and there is significant evidence that there is heteroscedasticity. So in our case p-value is 0.1352, then we do not reject the null hypothesis.

Like heteroscedasticity, autocorrelation has to deal with the structure of the residuals. For checking autocorrelation we use Durbin-Watson test. The null hypothesis is: No autocorrelation. In our case d-statistic equals 1.3. We know that if d is closer to 0, it means positive autocorrelation, but if d is closer to 4, it means negative autocorrelation. First of all we need to determine the upper and lower critical values for d, which depend on the number of observations ($N=19$) and number of independent variables ($k=2$). Based on the Durbin-Watson table we accept null hypothesis.

After checking of all assumptions of OLS regression, we can consider the results of estimation. In the Table 4.5 present the results of regression models explaining the effect of FDI on GDP of Kazakhstan.

Table 4.5: Regression result of FDI for Kazakhstan

Variable	Coefficient	Std. Error	t-statistic	P > [t]
FDI	3.708112	.5110196	7.26	0.000***
NX	2.001004	.2716605	7.37	0.000***
Constant	8733.658	2759.302	3.17	0.006***
R-squared	0.9810			
Adj R-squared	0.9786			

*, **, *** Significant at 10%, 5% and 1% level respectively

Source: Author's computations in STATA

Considering regression results, we see that the R-squared is equal to 98% and Adjusted R-squared is about 98%, so both are so good which means that we can say that our model fits good with the data. The independent variables explained approximately 98 percent variations in gross domestic product in Kazakhstan.

The main regression results indicate that FDI has a positive overall effect on GDP. The null hypothesis which says that FDI does not promote the economic growth was rejected. FDI in our model was indicated as valuable variable on 1% level of significance. The high t-ratio of the FDI (7.26) confirms that variable is indeed significant. This means that FDI has a direct positive effect on the economic growth of Kazakhstan. More specifically, an increase of one percentage point of FDI leads to increase of GDP by 3.708112 for country.

Another result from the estimation is that Net Export is positively related to GDP. A coefficient 2.001004 was obtained for NX, this variable is significant at the 0.00 significance level. When NX increases by one unit, the GDP is estimated to increase by 2.0 percentage points.

Therefore, the results obtained are consistent with our expected results that FDI inflows will contribute to the economic growth of Kazakhstan.

4.2.4 Conclusion and suggestions.

In conclusion, it can be said that foreign direct investment has continued to play a significant role in the Kazakhstan's economy. Based on the empirical findings of the thesis, the analysis shows that there is a positive relationship between the FDI and economic growth. The Ordinary Least Squares regression technique was employed to estimate the relationship between GDP and FDI.

Our results again confirm that Kazakhstan as a new emerging economy attracts FDI to country. This in turn led to economic growth and development of republic. Economy development of country can be achieved by encouragement of foreign direct investment, which can help to create more employment, new technology and enhance productivity in the country. But care should be taken when attracting FDI, because the nation's investment potential is largely based on natural resources.

In Kazakhstan there are many multinational companies in oil sector, where exist "quick profits". Therefore government should adopt and implement only those policies that can contribute to the rapid achievement of international competitiveness. Also government should encourage investments to such sectors of the economy as manufacturing, agriculture, tourism and infrastructure, etc.

For today there are government programs that contain a number of measures to bring the multinational companies to the non-extractive sectors. For example such program as "Strategy of Industrial Development and Innovation", this strategy has been focused on promotion of investments into less attractive sectors of the economy. We will consider state programs more detailed in the next part of the diploma.

Therefore the main task of the government of Kazakhstan has to be the extension of structural and institutional reforms, directed to: ensuring macroeconomic environment stability; developing competition; strengthening of transparency and liberalization of the economy; maintenance of favorable conditions for FDI.

Finally, our results will be interesting for further research of FDI in Kazakhstan. Because the study of the effect of foreign investment will be very useful for the decision making related to the internal and external policy of Kazakhstan in the future.

Forecast of the future development of the Kazakhstan.

5.1 National Strategy until 2030

The problem of economic growth is the most relevant for any country in the world. There are various approaches to its definition, measurement and analysis. Creation of the country's strategy, focused on economic growth and address the social and economic problems are even more challenging task.

Since independence the Republic of Kazakhstan was able independently choose its own future directions of country development. On leadership of the country was entrusted a huge responsibility not only for the results of economic development, but also for the welfare of whole population.

Despite the rich historical experience of many developed countries and the dominance of a few models of development of the economy, Kazakhstan adopted a course on the formation of own economic model and the choice of a unified long-term strategy, which was expressed in President's Message to the Nation in 1997, "Kazakhstan 2030: Prosperity, Security and Ever Growing Welfare of All the Kazakhstanis". The 2030 Strategy and all subsequent related documents emphasize the necessity to focus primarily on solving the problems of the country's economic development and then starting a process of comprehensive political change (Utegenova 2010).

Many of the world's political leaders were amazed goals and objectives that were set by the President of the country before the young and still the flanked by an immature state. Farsighted of plans of Kazakhstan also impresses, almost no country in the world has a similar strategy with the long-term vision of the future.

Experts of the Supreme Economic Council of the Republic Kazakhstan since late 1995 began developing 2030 Strategy. Also in strategy of the development were involved international organizations. In order to provide fresh ideas and new perspectives in the development of 2030 Strategy were employed a large number of younger experts.

Why does the Strategy set the deadline of 2030? Arguably, there were two reasons. The first is that thirty years represents the active life of one generation. The second is that the thirty-year period up to 2030 is expected to see the exhaustion of Kazakhstan's oil

deposits and is thus the period within which alternative energy sources will have to be found. These are two basic factors that were considered in determining the 2030 deadline (Utegenova 2010).

The major ideas on which the Strategy is based are the national unity of Kazakhstan, social justice, and the economic welfare of the population.

In the 2030 Strategy outlines seven long-term priorities: 1) national security; 2) domestic stability and consolidation of the society; 3) economic growth based on an open market economy; 4) health, education, and welfare; 5) effectively utilizing energy resources; 6) transport and communication infrastructure; 7) and the professionalism of public administration. These form the basis for the design of a number of action plans for the further development of the country (Utegenova 2010).

1. National security.

The first priority for the further development of Kazakhstan is to maintain national security. The Strategy stresses that to ensure the independence and territorial integrity Kazakhstan has to be a strong state while maintaining friendly relations with its neighbors. The Strategy also contains following foreign policy priorities: development and strengthening of trusting and equal relations with its closest and historically friendly neighbors Russia and China; strengthen ties with the Central Asian states; and fostering relations with the countries of the Middle East, strengthening cooperation with major democratic, industrialized nations, including the United States.

A good example of realization of plans is creation of the customs union of Belarus, Kazakhstan, and Russia, which has been effective since 1 January 2010. Also Kazakhstan is widening its cooperation with the USA, the EU, and NATO.

2. Internal stability

As the second priority were defined domestic stability and consolidation of the society. Preservation and strengthening of internal political stability and national unity, which will allow implement the national strategy of Kazakhstan for the current and coming decades. This priority says that the state shall provide equal rights to all ethnic groups living in country and eliminate conditions that could cause ethnic tensions.

3. Economic growth based on an open market economy with high level of foreign investments and internal savings

This section of Strategy emphasizes that the state's role in economic life should be essential but limited. State should create the legal basis for an economy in which private company is the main actor.

In order to attract investment in the basic industries of Kazakhstan, to the government was tasked to make the country more attractive to foreign investors. Development of such industries as agriculture, forestry and wood-using industries, light industry and food processing, tourism, building construction, and infrastructure not only contributes positive changes in the country's economy, but also will create new jobs and reduce poverty.

To achieve good economic result, country took example of the best international experience in the field of macroeconomic indices, where low budget deficit, low inflation, steady national currency, high saving rate. Such formula proved effective for Korea, Japan, Indonesia, Taiwan and Singapore; half from these countries known as the "Asian tigers".

Today we see that state increased involvement in economic affairs, but it is caused by consequences of the economic crisis. This was manifested in the establishment of control over the financial system and the most important industries through the nationalized companies.

4. Health, education and welfare of the citizens

World experience shows that the most important factor influencing the health of the population - is the willingness of the state to pursue a more active policy to prevent the disease, on the one hand, and the promotion of healthy lifestyles, on the other.

Demography is also important task which considered in this section. The development of Kazakhstan's human resources is currently considered to be crucial for the country's long-term progress. Future economic benefits very much depend on investment in education and healthcare, which can significantly increase the quality and productivity of the labor force. Accordingly, improving the quality of education and healthcare will be in the focus of Kazakh government efforts throughout the coming decades (Utegenova 2010).

5. Power resources

The fifth priority for the further development of country is effective use energy resources of Kazakhstan through rapid increase in extracting and exporting oil and gas in order to generate revenues which will contribute to sustainable economic growth and improvement of living standards.

The strategy of using energy resources includes the following elements:

- Long-term contracts with major international oil companies to attract the best international technology, know-how and large capital for efficiently use resources;
- Creation of a system of pipelines for exporting oil and gas. Only a large quantity of independent export routes can prevent dependence on a single neighbor and also monopolistic pricing dependency on one customer;
- Attracting investments from the USA, Russia, China, Japan, and Western Europe in oil and gas sector of republic;
- Creation and development of the domestic energy infrastructure as well as maintaining of self-sufficiency and competitive independence through foreign investments;
- Reduce costs, efficient and expedient use of future revenues from resources.

Although, back in the 1990s, the government's efforts were focused mainly on increasing oil exports, in the 2000s, emphasis was placed on developing an oil and gas processing industry and creating an integrated oil-gas-chemical industrial complex.

6. Infrastructure

The main task of Kazakhstan is to ensure the competitiveness of domestic transport and communication complex in the world market and increasing trade flows via its territory. Kazakhstan plans to improve and integrate four main domestic transport infrastructures: rail, road, air, and water transport. The country's transit potential will be improved by direct investment in transport infrastructure as well as reform of customs and border control institutions.

Special attention is given to the development of telecommunications. Kazakhstan intends to create its own effective and independent telecommunications system. Also this strategy will promote further development of automobile construction, tourism, system of rendering services.

7. Effective public administration

The seventh priority says about building of effective and modern public administration that will provide good governance in market economy.

Kazakhstan adopted its Law on Public Administration on 1 January 2000. It stipulates the division of all public officials into “political” and “administrative”. It also states that those willing to serve the public administration of Kazakhstan should be selected through mandatory competitive procedure (Utegenova 2010).

The adopted strategy identified the main priorities of the social, economic and cultural development of the state.

In the future, strategy is complemented the various strategic plans and the Strategy of Industrial and Innovation Development. The State Program for Accelerated Industrial and Innovative Development for 2010-2014 is one of the most recent and significant. All of these documents are made within the existing “Strategy 2030” and are aimed at addressing the existing social-economic problems.

5.2 The Strategy of Industrial Development and Innovation

One of the steps towards the implementation of the “Strategy 2030” was the adoption of state program of Industrial-Innovative development. The Strategy of Industrial-Innovation Development of the Republic of Kazakhstan for 2003-2015 was adopted in order to achieve sustainable development of the state through modernization and diversification of the economy, and shifting from extraction industries.

Major objectives of the Strategy of Industrial-Innovation Development of the Republic of Kazakhstan are as follows:

- maintenance of average annual growth rate of processing industries within the range of 8-8.4%; at least 3 times gains in labor productivity by 2015 against 2000; and 2-fold reduction of power-intensity of GDP;
- increased productivity of fixed assets of processing enterprises;
- cultivation of business-friendly environment; establishment of institutional settings to stimulate private sector, encourage competitive edge and strive for greater value added;

- introduction of incentives to establish science-intensive high-tech export-oriented enterprises;
- diversification of export potential of the country in favor of products and services with high value added;
- transition to world standards of quality;
- enhancement of integration into the regional and global economy, with participation in global innovation processes (Government of the Republic of Kazakhstan, Strategy of Industrial and Innovation Development for 2003-2015).

Against the background of globalization, economy of Kazakhstan has encountered a series of objective problems, among which there is extraction industries predominance, insignificant integration into the world economy, weak inter-branch and inter-regional economic integration within the country, general technical and technological backwardness of enterprises, absence of effective relations between science and production, low spending on R&D and others (Government of the Republic of Kazakhstan, Strategy of Industrial and Innovation Development for 2003-2015).

Therefore, to solve these problems and achieve goals of industrial and innovation policy it was decided to intensify functioning of the institutional structures such as: National Fund of the Republic of Kazakhstan, JSC “Development Bank of Kazakhstan”, JSC “Investment Fund of Kazakhstan”, JSC “National Innovation Fund”. These institutions are pursuing policy of investing in the development of new and already existing enterprises with high value-added, provide support scientific and technological research on the basis of complex analysis of the promising sectors, identify the most important elements thereof.

Despite the fact that Kazakhstan is a leader among the CIS countries on the volume and quality of ongoing reforms, many of the initiatives not achieved the expected results due to a number of unresolved problems related to the various aspects of state administration; in particular, the administrative barriers, corruption, inefficiency of customs and other trade procedures, etc. For example, the Strategy of Industrial-Innovation Development for 2003-2015 has almost no target values of execution efficiency. Moreover budget for implementation of the considered Strategy are not always expended efficiently. However,

in the current circumstances, none of these problems is not a fatal to the chosen strategic goals.

Within the framework of realization of the Program was undertaken huge work related to the introduction of changes and additions to the existing legislation of the republic, the creation of new laws and institutions to ensure participation of the state in the implementation of innovative projects, etc. Furthermore foundation was laid for creation of innovative structure of scientific and technological development.

State Program of accelerated industrial and innovative development of the Republic of Kazakhstan 2010-2014 is a logical continuation of conducted policy on diversification of economy and it contains the main provisions of the Industrial-Innovation Development Strategy for 2003-2015, and other program documents in the sphere of industrialization. The purpose of the Program is to guarantee stable and well-balanced economic growth by means of diversification and improvement of its competitive ability (Decree of the President of the Republic of Kazakhstan # 958, 2010).

The main condition for the successful implementation of the policy of industrialization should be an increase of factor productivity and competitiveness of the national economy. Effectiveness of industrialization policy depends on join forces of business and the government on the development of priority areas of the economy, as well as organization of effective institutions and mechanisms of their interaction.

Conclusion

This Master thesis aimed to assessment of economic situation and development of Kazakhstan based on the economy of oil. Kazakhstan was chosen not casually, this country has shown excellent economic performance for the last decade. Kazakhstan is also a leader of economic development in the CIS.

Every year increases the world's attention to the Republic of Kazakhstan. It is associated with the rapid development of the country in different areas of economic activity. However, few people know the difficulties and barriers Kazakhstan had to go through on the way to prosperity.

In this study, we tried to analyze the economy of Kazakhstan since its independence to the present day. Since the oil industry plays a key role in the economy of republic, our study was based primarily on economy of oil.

At the beginning of the thesis have been described main stages of development of the country as well as oil and gas complex. Kazakhstan has faced a number of serious transformations since independence, for example devaluation, privatization, different reforms and financial crises. Of course this was reflected in the country's economy.

The main advantages of Kazakhstan in global economy are the natural resources. One of the tasks of our study was examine the role of oil price in the economic growth of republic.

There is a large number of literature that estimated the relationship between oil price and GDP. In contrast to the most existing studies, which usually focused on the oil-importing countries, our investigation expanded the empirical researches which analyze oil-exporting countries. Kazakhstan is one of the largest exporters of oil products. Before the estimation we assumed that positive oil price shock has positive effect on GDP of Kazakhstan.

We applied Vector Error Correction model for our data. We had quarterly data that covered period from the first quarter of 2000 to last quarter of 2010. Before examining the effect of oil price shocks on macroeconomic variables, we tested our variables for stationarity and cointegration. As a result, we found that all series in levels are non-stationary, but are stationary in the first differences. Also based on Johansen cointegration test we discovered the presence of one cointegrating equation.

The results from the long-term vector of Error-Correction term showed that oil price has a positive but statistically insignificant effect on economic growth. In turn, the results from the short-term vector of Error-Correction term indicated that 10 % of increase in oil price would increase GDP by 4.5 %. This means that the oil price has positive effect on economic growth of Kazakhstan.

Based on the obtained results we concluded that economy of Kazakhstan is vulnerable to oil price shocks in the short run. Given the importance of oil to the Kazakhstan's economy, we recommended greater diversification of the economy through maintenance of the less attractive and less developed sectors. For today, the government of Kazakhstan already supports non-oil sectors. Of course, government efforts should be directed to reduce dependence on oil.

Since 2000, economy of Kazakhstan has been growing rapidly – at average annual rates of 10 %. A great contribution to the economic growth of Kazakhstan was contributed by the oil and gas sector. However, attracting FDI has become an important element of the development of the republic.

This Master thesis also engaged in research of the impact of Foreign Direct Investment on the Kazakhstan's economy. The debates about the effects of FDI on economic growth have not been completed. Most of the papers agree that impact of FDI on growth is positive but depends on economic, institutional and technological conditions in the host country.

We used the Ordinary Least Squares regression analysis to estimate our data. We took annual data from 1993 to 2011. The main regression results indicated that FDI has a positive effect on GDP. FDI in our model was indicated as significant variable on 1% level of significance. The results showed that 10 % of increase in FDI would increase GDP by 37.1 %. This means that FDI has a direct positive effect on the economic growth of Kazakhstan. Also we observed that Net Export has positive impact on GDP at 1% level of significance. Obtained results were consistent with our expectations.

Our results confirmed that Kazakhstan as a new rapidly growing economy draws FDI to the country. However, we noted that Kazakhstan should conduct more balanced policy and use caution when attracting FDI, because the investment potential is largely based on natural resources.

Analysis of the National Fund and the activities of oil and gas companies in the Republic of Kazakhstan had given us a more detailed picture of the Kazakhstan oil sector. We considered three major companies such as KazMunayGas, Tengizchevroil and Karachaganak Petroleum Operating B.V.

A resource nationalism policy is a modern concept that emerged in era of oil and decolonization. In economic terms, the concentration of energy resources in state hands could strengthen the competitive advantages of national companies. Today world is going through a new wave of resource nationalism. The world's press is full of publications on the topic that Kazakhstan has become on the way of resource nationalism. But Kazakh resource nationalism implemented between 2004 and 2008 is best understood as essentially economic in character. The aim has been to improve economic terms and long-term economic benefits for the country. Kazakhstan has done this in three ways: first, by increasing the state share of ownership in major projects; second, by placing more of the burden of cost overruns and delays on the international oil companies; and third, by increasing the state's control of the project through KMG (Domjan & Stone 2010).

Since its independence, the Kazakhstan was able to independently choose its own future way of country development. The problem of economic growth is the most relevant for any country in the world. There are different approaches to its definition, measurement and analysis. Creation of the country's strategy, focused on economic growth and to address the social and economic problems are even more challenging task.

Despite the rich historical experience of many developed countries and the dominance of a few models of development of the economy, Kazakhstan adopted a course of on the creation of its own economic model and the choice of a unified long-term strategy "Kazakhstan 2030: Prosperity, Security and Ever Growing Welfare of All the Kazakhstanis". The main idea on which the Strategy is based is the national unity of Kazakhstan.

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