КОНСОРЦИУМ ЭКОНОМИЧЕСКИХ ИССЛЕДОВАНИЙ И ОБРАЗОВАНИЯ
ECONOMICS EDUCATION AND RESEARCH CONSORTIUM
Working Paper Series

ISSN 1561-2422

OIL AND GROWTH CHALLENGE IN KAZAKHSTAN

Mira Nurmakhanova

Policy Brief No E16/06

This project (No 14-510) was supported
by the Economics Education and Research Consortium
and funded by GDN

Oil and Growth Challenge in Kazakhstan

Mira Nurmakhanova

Policy Brief

A. Exposition of the policy problem under investigation

Kazakhstan possesses extensive natural resources and relies heavily on revenues from the export of primary commodities, in particular petroleum and natural gas. Starting 1999 the Kazakhstani economy was growing rapidly with average growth rate of nine percent annually with most of this growth attributed to the export of petroleum and natural gas. However, Kazakhstan's dependence on revenues from the oil sector raises the possibility that the economy is vulnerable to external commodity price fluctuations:

- High dependence on commodities leaves economy vulnerable to oil price shocks. Moreover, shifts in the tax composition have further heightened the exposure of public finances to commodity price swings and raised the importance of the stabilization function provided by national oil fund.
- Upward pressures on the exchange rate, resulting from vast oil earnings and FDI flows into the oil sector, might complicate monetary policy management.
- The appreciation in the real exchange rate makes the development of the non-oil sector more difficult.

B. Critical review of existing policies and/or legislation

The National Fund of the Republic of Kazakhstan (NFRK) was established in 2001. This oil fund accumulates financial resources when oil prices exceed target level and dispense funds when prices fall below that level. The NFRK receives 10% of planned budget receipts from taxes on the major oil companies each year irrespective of the actual oil price. In addition, extra payments are made from excess receipts from the oil industry when the oil price exceeds trigger price. Finally, it also receives one-off flows from bonuses and privatizations in the mineral sector. Part of this fund is set aside for stabilization purposes. If the oil price falls below the trigger price, transfers are made from the stabilization component to the government budget. Thus, it limits the opportunity to boost current spending when prices are high and make additional income available when oil prices are depressed, thereby limiting the need to cut government spending sharply. As it is invested in overseas assets, the oil fund also helps to limit upward pressure on the exchange rate.

C. Overview of alternative policy changes

The aim of the project is to study the impact of oil price fluctuations on oil exporting developing economies concentrating on Kazakhstan. National Bank of Kazakhstan could implement the policy of responding to the changes in oil prices.

D. Policy recommendations arising from the research

Results are based on the inspection of the dynamics of key energy and macroeconomic variables as well as the insights from a Bayesian VAR model. We find evidence of significant effect of oil prices on Kazakhstani economy. It is found that one of the key channels playing a role in the effect of oil prices on real activity is related to the real effective exchange rate. Our finding that an increase in oil prices leads to appreciation of real exchange rate is consistent with the literature on oil exporting countries. The results of this study indicate that the impact of the oil price changes on output could be balanced by respective changes in the real exchange rate.

There are different channels for oil price shocks to result in appreciation of real exchange rate. Positive oil price shocks could result in appreciation of the real exchange rate through domestic pricing, or work through pro-cyclical fiscal policy. Results of this research indicate that one possible channel for oil price shocks to affect the real exchange rate is through the upward pressure on domestic price level.

From the economic policy perspective, Kazakhstan should continue to decrease its dependency on energy prices in the longer run through reform policies. In particular, given the important role of real exchange rate, the findings of this study give support to anti-inflation policies. These anti-inflationary policies could restrain the real appreciation of tenge and, hence, support output growth.