

A formal portrait of Nursultan Nazarbayev, the former President of Kazakhstan. He is shown from the chest up, wearing a grey suit jacket, a light blue shirt, and a red tie with a blue and white pattern. A matching red pocket square is visible in his jacket. He has grey hair and is looking directly at the camera with a serious expression. The background is a blurred bookshelf filled with books. In the bottom left corner, there is a small, partially visible logo of the Kazakh coat of arms.

Nursultan
NAZARBAYEV

**RIDING OUT THE
STORMS OF TIME:**

from communism to capitalism



Nursultan
NAZARBAYEV

«ҚАЗАҚСТАН РЕСПУБЛИКАСЫНЫҢ
ТҰҢҒЫШ ПРЕЗИДЕНТІ - ЕЛБАСЫНЫҢ КІТАПХАНАСЫ»
МЕМЛЕКЕТТІК МЕКЕМЕСІ

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ГОСУДАРСТВЕННОЕ УЧРЕЖДЕНИЕ
«БИБЛИОТЕКА ПЕРВОГО ПРЕЗИДЕНТА
РЕСПУБЛИКИ КАЗАХСТАН - ЛИДЕРА НАЦИИ»



In the near future,
we must not only overcome
the crisis period,
but to emerge from it ready for
further breakthrough.
The world is not static.
The only way to retain our
achievements and successes is
to quickly move forward.
All crises tend to pass.
After the crisis,
the world will change.
We must take our rightful place
in this new world order.

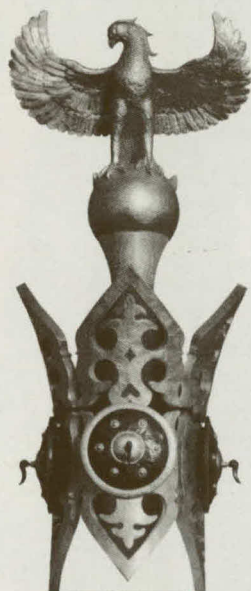
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RIDING OUT THE STORMS OF TIME:

From Communism to Capitalism

The First Lessons of Economics Learned in the New Century



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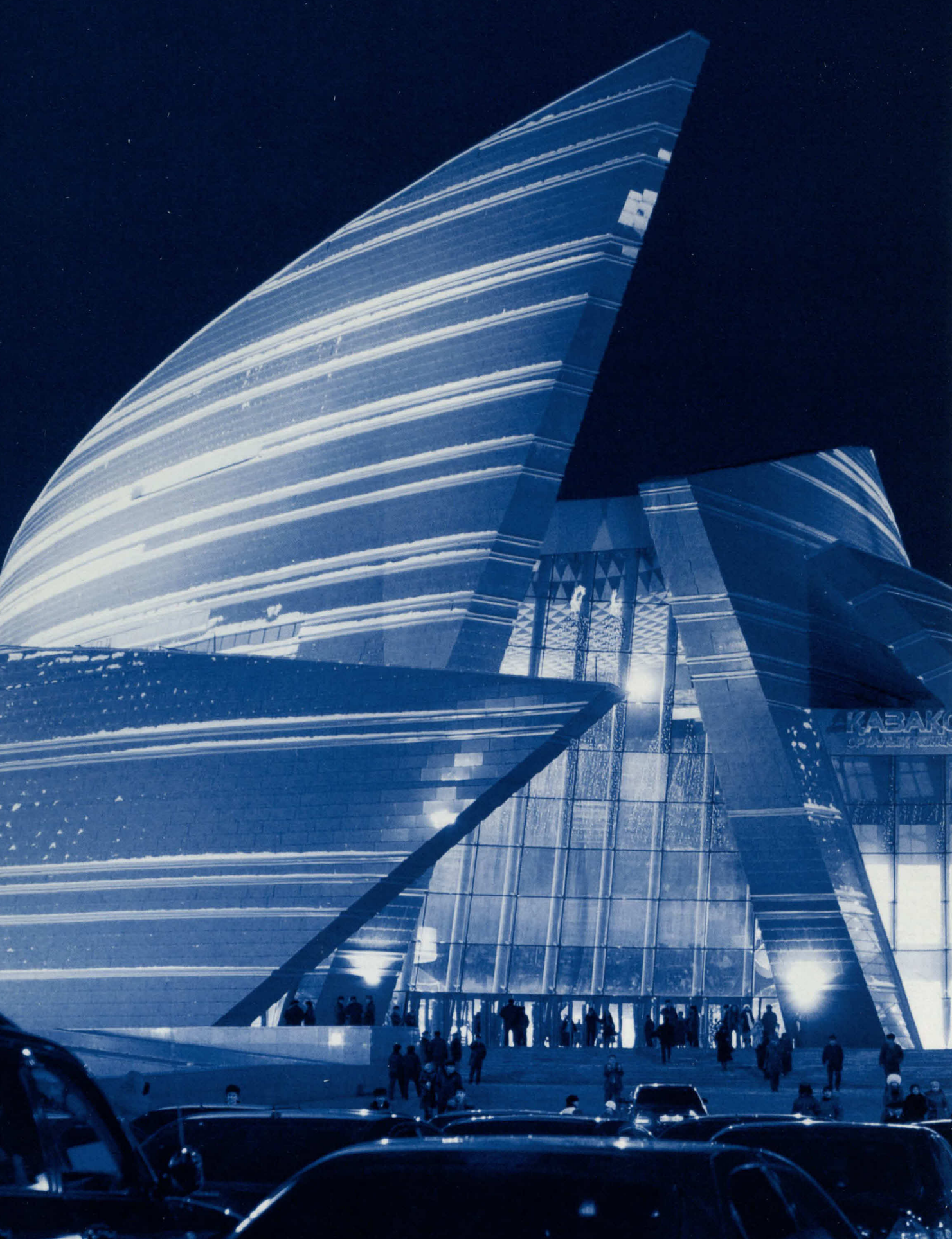
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КАБАКОВ
СПАСИБО



THE GLOBAL ECONOMIC CRISIS AND ITS CHALLENGES

A once in a century event – this is how economists characterize the current global financial and economic crisis. Indeed, direct losses in wealth suffered by the world economy are measured in trillions of dollars. The severity of this event is hard to overstate – the world reached the brink of a full depression. This crisis has seen problems in credit and financial markets spillover into real economies around the world, placing tremendous pressure on the global economic system as we know it. As a result, governments and business leaders as well as the expert community have been forced to reconsider the established wisdom on the nature of crises, their causes and consequences.

In these circumstances it is unproductive to look for scapegoats or culprits. The triggers for the crisis are easily observable and they are not

found in the emerging markets, including Central Asia. But the dynamics of the modern global economy are clear: if you are integrated into the global economic system, then you will be affected by the crisis. There are no safe havens in this most global of crises.

I have always taken the sober and realistic view that a comprehensive modernization strategy, aimed at building an open and competitive economy integrated into the world economic system would not only result in clear benefits and advantages for Kazakhstan, but would also be subject to risks. That is exactly why safety mechanisms were created to protect Kazakhstan's economy – deep structural reforms were carried out, the country's export potential was supported, and a process of economic diversification was launched. I have closely monitored the situation on the domestic and international markets, taking prompt and decisive measures. In the years preceding the crisis, many steps were taken to reduce the vulnerability of our economy.

As a result, Kazakhstan was one of the first countries in the world which responded to the growing turbulence in the global economy and which implemented crisis mitigation measures. The global financial and economic crisis has undoubtedly affected our rate of economic growth, but it has not stopped our development. The accumulated economic potential has provided for Kazakhstan's stability during the most difficult moments over the past three years, and has enabled the Government to adopt an effective anti-crisis policy.

The country's financial system is stable and the systemic banks have been rescued. The most disadvantaged members of our population as well as small and medium businesses have been insulated. Unparalleled growth has been achieved in local, Kazakh content of the goods and services purchase by domestic and multinational companies. Unprecedented assistance has been provided to the agriculture industry. The Government has implemented strong measures to address the mortgage crisis, including taking over all the costs to complete unfinished residential construction projects. More than 400 thousand local jobs were created as a result of the Government's employment strategy. Kazakhstan has also made its own contribution to regional anti-crisis measures.

As a result, we did not stumble. The skeptics predicted that Kazakhstan's economy would fall significantly compared with other high growth economies. Yet, Kazakhstan appeared alongside other resilient countries with positive growth rates during the crisis. In 2009, the country achieved economic growth of 1.2% and 1.8% in the industrial sector. Unemployment was estimated at 6.6% at the end of 2009, which is lower than during the pre-crisis period. Today, Kazakhstan's gross international reserves and National Fund assets exceed US\$50 billion – a level 25 times higher than a decade ago.

I certainly do not set out to provide a formula in this book for successful economic development and crisis management. The economies commonly referred to as emerging markets are as diverse as the people that live within

them. They each have different prospects for economic recovery, which are based on different economic and socio-political features and different sources of competitive advantage. I am sure, however, that Kazakhstan's approach would be of interest to those who are looking for their own path to sustainable development in today's challenging environment. What I want to demonstrate in this book above all is that self-confidence combined with political will, public support and prudent development choices can overcome even the most difficult obstacles.

N.Nazarbayev







CHAPTER I



**KAZAKHSTAN'S MODEL FOR SOCIO-ECONOMIC
MODERNIZATION:
THE SAFETY MARGIN AND DEVELOPMENT POTENTIAL**





Kazakhstan's development paradigm has irrevocably shifted - from a survival model to an accelerated development model



KAZAKHSTAN'S MODEL FOR SOCIO-ECONOMIC MODERNIZATION: THE SAFETY MARGIN AND DEVELOPMENT POTENTIAL

It should be noted that the current financial crisis is not the first period of acute economic distress experienced in Kazakhstan. In fact, we have encountered more than our fair share of challenges since independence: first, the transition to a market economy in the early 1990s, then the Asian financial crisis of 1997 followed by Russia's financial crisis in 1998. The economic situation immediately following independence was much more challenging because at that time we had no foreign exchange reserves, no international specialists, no market experience, nor a modern institutional framework. There were insufficient resources to satisfy even minimum needs. Yet the hardships of the transition period were successfully managed, and the country emerged from each subsequent crisis stronger and more resilient. Although the current global crisis is the most severe since the Second World War, today we are better prepared and have a greater range of tools to deal with its consequences.

The current crisis is unprecedented in many ways. Coverage of events has been particularly dramatic with political rhetoric and news reports from around the world resembling wartime combat reports.

My role as leader and my status as President did not permit me to vacillate or act indecisively. Since the first signs of trouble emerged



from our banking sector, I responded firmly by taking three critical steps:

1. I assumed ultimate responsibility for the measures to combat the crisis;
2. I transformed the Government into a crisis-management administration;
3. I personally monitored and directed day-to-day developments in order to provide the necessary authority to ensure timely and bold decisions.

I must confess, however, that despite all the difficulties, I am grateful in a way for the crisis. It has helped me develop a new, more nuanced perspective on a range of issues. Further, I mastered a new craft during the crisis – how to exploit difficult situations for the sake of one's country.

I have worked tirelessly, and demanded the same of the Government. Literally, each day brought new urgent tasks, which required resolute actions.

Early on in the crisis, it became clear that everyday routine activities needed to be handled in a systematic fashion. Specifically, up to date information on the state of Kazakhstan's economy and finances needed to be reviewed critically and fed into the preparation of targeted action plans.

As a result, I carefully reviewed statistical and financial information on a daily basis and ensured that I received a continuous flow of up-to-the-minute information.

My preliminary conclusions indicated that the country was in a strong position overall to deal with the crisis and its effects. However, at the same time, there were a number of clear weaknesses which required attention.

First, I noted with satisfaction that the public sector was balanced in terms of funding sources and overall it was in a solid financial position. The state had no urgent funding needs. In fact, the state had a substantial financial cushion at its disposal to mitigate the effects of the crisis.

Second, in contrast, the private sector was full of surprises. Some banks had created unsustainable capital structures and financed ill-conceived projects. Other companies, which appeared on the surface to be legitimate



enterprises or banks, actually operated as criminal groups. Also, we had our own local versions of Bernie Madoff. Some of these criminals were brought to justice, but others remain on the international wanted list.

The global economic crisis became an endurance test for the Kazakh modernization model. We can say today that the strategy I have developed for the country's socio-economic development made it possible not only to withstand hard economic times, but also to proceed with Kazakhstan's accelerated modernization. I am proud that Kazakhstan was the first post-Soviet country to adopt strategic Government planning – an internationally recognized public administration tool – along with creating market economy institutions. The clarity of our long-term strategy and vision for the country's future helped guide us during the crisis by providing a framework for making practical decisions.

Our previous experience had to be reconsidered as it did not provide us with the necessary tools to address the present circumstances. The challenges of post-Soviet transition did not prepare us for the most destructive global economic crisis since the Great Depression of the 1930s.

Kazakhstan was a member of the Soviet Union for more than 70 years and a participant in the global socio-economic experiment called The Building of Communism. For Kazakhs, the experiment nearly ended with national disaster. Without exaggerating, our people experienced unprecedented destitution and hardship in the 20th century - forced emigration, hunger, repression, and wars.

In 1960, Kazakhs became an ethnic minority on their own soil, representing as little as one third of the republic's population. Having lost their traditional way of life at the beginning of the 20th century, by the end of the century the Kazakh people almost lost their main heritage – their language and culture.

That is why we regard independence as the most fundamental principle for a nation. Sovereignty has given us an historic chance to revive our statehood and make our own way in the world.

Independence has enabled us to solve pressing issues: to close the Semipalatinsk nuclear testing facility, to carry out far-reaching economic



reforms, to eliminate sharp structural imbalances in the economy, to make the country's natural resources work for the benefit of our people. Independence helped us halt the dismantling of Kazakhstan's traditional cultural values and it gave us the means to revive the Kazakh language.

It was clear from the outset that Kazakhstan could not develop successfully without a long-term social development agenda. In our view, it was naive to assume that socialism could be easily substituted by capitalism. We needed to understand the depth of the transition process, and to define the many trajectories and practical steps towards building a new society.

The fact that one way of life was suddenly replaced with another was at once a tragedy and an excellent window of opportunity. Our greatest source of strength during this period is that we knew where we came from.

In principle, it was clear that our future should rest on three pillars — the rule of law, a market economy, and democracy. The people of Kazakhstan made that historic choice and enshrined these pillars in the Constitution. Our aspiration is for Kazakhstan to flourish as a democratic, secular, and social state, in which individual rights and freedoms respected and are protected by the rule of law.

According to Samuel Huntington, a reformist must possess the art of politics one order greater than a revolutionary. Before sowing the first seeds of independence, Kazakhstan had to restore its national self-esteem.

At the time, many experts predicted that Kazakhstan would fail in its quest to build a new state and achieve its ambitious economic and social restructuring goals.

Now, of course, it is clear that the experts were wrong to doubt us. Kazakhstan has succeeded as a sovereign, independent state. We have joined the world community with dignity, establishing political, economic, and cultural cooperation with the leading countries of the world.

We have avoided the type of social instability that is so common among post-communist countries. We have launched sweeping socio-political and economic reforms, which to date, have produced positive results.



We also stabilized the national economy. Our primary tasks immediately following independence were: to remove the economic shackles placed on us by the Soviet Union; to restore the fortunes of the country's largest industrial enterprises; to curb hyperinflation; and to create our own currency and financial system.

At the same time, it was critical to liberalize the economy, to introduce market-oriented legislation, to integrate our economy with the rest of the world, and to attract foreign investment. These were the main influences of the economic reforms that we pursued during the mid-1990s (1993–1997). We have thoroughly carried out these reforms. Privatization was achieved quickly and a banking system was built from scratch, based on international experience.

Next, we developed a long term economic growth strategy. By the end of the 1990s, the economic system was stable enough to focus more on enterprise and industry level economic processes: to liberalize the tax system; to carry out communal reform to reform the pension system; and to launch an import substitution development policy.

These reforms helped us to endure the Asian and Russian financial crises. In fact, foreign investments grew during 1998, despite the crisis in Russia, which reflects the confidence of investors in our progress.

Following more than 70 years of Soviet history and two decades of independence, our view of the world in Kazakhstan – our *Weltanschauung* – has come under significant pressure. But, nevertheless, the weight of history has not stifled our national character or our ethnic pride.

The democratic principles that underpin Western societies do not contradict the traditional values of the Kazakh people. I cannot help agreeing with Woodrow Wilson who stated, “I believe in democracy because it releases the energy of every human being.” However, democratic principles are not innate to Kazakh people. This means that it will take time for democratic principles to take root in Kazakh society. Democracy is not just a system or a set of processes; it is also a form of culture.

This latter point is very important. We will be able to say that democracy prevails in Kazakhstan only when it merges with the local culture.



However noble and benevolent the intentions of advocates of “paramount democracy” are, one must acknowledge that the simple cloning of political models has substantial flaws. A broader, more nuanced view should be taken of the processes occurring in the former Soviet republics. If, for example, the fall of the Soviet Union resulted in a vacuum of authority, totalitarianism would have been replaced with anarchy.

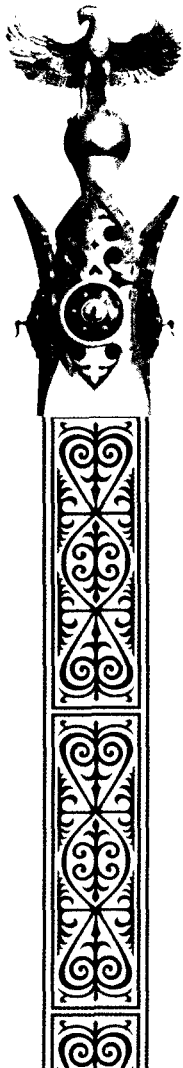
Political and legal tools are critical for facilitating modernization in post-Soviet societies, but for these tools to work effectively they must be supported by social psychology. For example, much of the resistance and antagonism in Russia directed towards reforms is directly linked to the psychological consequences of the dismemberment of the Soviet Union and the collapse of the socialist ideals of collectivism.

As far as Kazakhstan is concerned, our goal is not to become a mirror image of Western democratic states. One size of democracy does not fit all. Democratic standards are universal, but they acquire different features in different countries.

We respect the experience of our Western partners. But this does not mean, of course, that Western practices can be transplanted directly into Kazakhstan. One must not forget that Western societies have enjoyed statehood for a thousand years, in some cases, whereas it was only twenty years ago when we made our first steps in this direction.

We are progressively introducing democratic principles into Government practices and social life. To merely reproduce another country’s model without adjustment for local conditions would be irresponsible. Democracy cannot be declared; it can only be achieved through experience. Democracy is our ultimate development goal; it is not the starting point.

Perhaps, we have not created the most democratic society yet. But we can be proud of what we have achieved to date. Our progress towards a truly democratic system is irreversible. We have created the fundamentals of democracy, which are embodied in our democratic electoral system, our bicameral parliament, our independent judicial system, our freely operating media and dynamically developing political parties.



Today we have developed a vision for further reforms and initiated a broad public dialog on the most pressing issues, including: strengthening the role of political parties, improving the electoral legislation, developing local governance, increasing the role of non-government organizations and civil society institutions, and strengthening the freedom of the press.

Building Kazakhstan as a truly peaceful state, we have voluntarily eliminated our nuclear missile arsenal. This decision was supported by both the Nuclear Club member countries, which provided Kazakhstan with security and territorial integrity guarantees, and our Central Asian neighbors, whose leaders declared Central Asia as a nuclear weapons free zone.

Kazakhstan's commitment to disarmament was lauded by the global community. As a result, Kazakhstan has become widely recognized as a reliable partner for cooperation in the fields of regional and global security.

Kazakhstan welcomes intergovernmental associations as peer communities, where relationships are built based on mutual respect and accommodation of interests. Pursuing a balanced foreign policy, Kazakhstan has established positive and dynamic relationships with all neighboring states, creating a "security belt" along our borders. Considering our strategic location between Russia and China, and adjacent to the Middle East region, this is an important result.

Kazakhstan is a multi-ethnic and multi-religious country where peace and harmony are fundamental to our society. This is a reflection of our values, and in my opinion, a prerequisite for the prosperity of our country. We therefore support the anti-terrorist coalition and are supporting peace building efforts in Afghanistan. We condemn extremism and radicalism of any kind.

Kazakhstan is known to possess huge reserves of oil and gas. I am confident we will be able to find a reasonable balance of interests in the competition for the natural resources of the Caspian Sea basin. This region is likely to become one of the major suppliers of hydrocarbons during this century. It is crucial that all countries in the region and the key international players in this competition find common ground and interests.



Following independence I made a resolute decision to devote my life to pursuing integration between our neighboring countries. I saw that greater regional integration would bring not only economic benefits, but also increased political stability, improved security and greater cultural exchange. For many years, I offered various integration proposals to our neighbors, but to no avail. Frankly speaking, a number of the regional leaders at the time did not share my vision.

In fact, it is only the past year that has witnessed the first real steps towards integration – that is, the formation of a Customs Union between Kazakhstan, Russia and Belarus.

The next steps, I hope, will be to expand the number of members of the Customs Union and creating a common economic space between us.

1.1. CONSISTENT ECONOMIC GROWTH IN A PERIOD OF TRANSITION TO A MARKET ECONOMY

Our integration into the global economy following independence occurred during an adverse economic climate. The transition from a centrally planned to a market economy took a heavy toll. Production patterns were disrupted, the financial system was destabilized, and inflation reached four-digit figures. The sharp decline in employment and personal incomes led to rising poverty. In 1993, the proportion of the country's population living below the subsistence level was more than 40%.

Solving economic problems demanded a systemic approach, and in 1992, the Government developed a Strategy for the Formation and Development of Kazakhstan as a Sovereign State. This strategy was our first attempt at medium term planning as an independent nation. Not only did the strategy cover economic and political issues, but it also explored issues of ideology. As a newly independent country, it was necessary for Kazakhstan



to substantiate formal, legal independence with genuine sovereignty. We needed to strengthen our statehood, carry out systematic and broad based economic reforms, and establish pragmatic political and economic relationships with the outside world. However, these economic and political transformations also needed to be implemented at the lowest cost to the population. Even beneficial economic reforms would fail if they were rejected by the population.

The main measures aimed at reforming the economy included encouraging entrepreneurship, elimination of price controls, privatization of state assets, and attraction of foreign investments.

The National Bank of Republic of Kazakhstan ("National Bank") was established in 1993, and in November of that year, the national currency Tenge was introduced. This gave us responsibility for the domestic money supply and monetary policy. This established a firm foundation for macroeconomic management. As a result, the consumer price index fell from more than 1,100% to 60.3% in 1995. In 1997, the inflation rate had fallen to 11.2%.

We also invested considerable effort in developing our commercial banking sector. Strict regulatory and supervisory measures were introduced. As a result, the industry became more stable. To encourage competitiveness and improve transparency, we introduced International Financial Reporting Standards.

A key economic priority following independence was putting the country's industrial sector back on its feet. Many industrial enterprises across the former Soviet Union were faced with bankruptcy as the Soviet Union collapsed due to sharp declines in demand. In addition, machinery and equipment were often in a state of disrepair or technologically obsolete. As a result, enterprises cut staff drastically and unemployment rose in the second half of the 1990s. Even the oil and gas sector was stagnating, as it required massive capital investments and technical expertise.

A prudent foreign economic policy towards major countries such as the United States, Russia, and China has helped Kazakhstan preserve its economic independence and develop our natural resources in a manner



consistent with our national interests. We have developed successful trade relationships with these countries, they have transferred their technologies to us and we have received their investments.

Regarding structural reforms, Kazakhstan has emulated East Asian countries, such as Malaysia, Singapore, South Korea, and Thailand. We modeled many of our economic reforms based on the experience of these countries. These reforms helped to stabilize our economy and supported growth. In 1996 GDP growth was positive for the first time since independence.

The Russian financial crisis in 1998 resulted in a devaluation of the Ruble. Because Russia was Kazakhstan's main trading partner this hurt the competitiveness of domestic manufacturers in Kazakhstan. In order to protect local industry, the Government had to devalue the Tenge. Further, the crisis was exacerbated by a decrease in world prices for oil, which had a large knock-on effect on Kazakhstan's export earnings and budget revenues. Thus, the Government acted to cut public spending. In the end, the crisis hurt Kazakhstan's economy, which shrank by 1.9% in 1998.

In general, Kazakhstan's development experience during the first years of independence showed us that it was possible to complete large, complicated reforms based on medium term scenario planning. However, additional growth required a longer-term vision for Kazakhstan's development. In 1997, I adopted a long-term Strategy for the Development of Kazakhstan up to 2030, called "Strategy 2030" for short. The first priority of this strategy is that economic growth must be based on an open market economy with high-levels of foreign investment and domestic savings. Ten years after Strategy 2030 was adopted, Kazakhstan has become one of the leading economies of the Commonwealth of Independent States ("CIS"). Favorable conditions were created in the country for both foreign investors and domestic entrepreneurs. Inflows of foreign direct investment ("FDI") have played an important role in the development of Kazakhstan's economy. Between 1998 and 2008, the net inflow of FDI into Kazakhstan amounted to US\$56.6 billion, according to the National Bank

Moreover, Kazakh companies have accessed the international capital markets via bond offerings and listings on the London Stock Exchange. Now



Kazakh companies are looking eastwards, to stock exchanges in Shanghai and Hong Kong.

However, large oil revenues had an undesirable side-effect: a strengthening real exchange rate which hurt the competitiveness of Kazakh manufacturers. The experience we gained during the Asian and Russian financial crises also showed us that Government should have access to savings to mitigate potential external shocks. To address these issues, the National Fund was established in 2001. The main goals of the Fund are to ensure macroeconomic stability by sterilizing oil revenues and providing successive generations with a pool of long term savings. As of the end of 2009, the National Fund's total foreign currency assets amounted to US\$24.4 billion.

The National Fund has played an extremely important role during the current crisis. It has, for instance, funded a proportion of the Government's anti-crisis plan. Its scale has also given investors confidence about the Government's ability to meet its obligations. Recent economic indicators show that Kazakhstan's economy improved in January 2010. The short-term economic index - an indicator characterizing the existing trends in economic development, calculated by the Statistics Agency of the Republic of Kazakhstan (SARK) on the basis of output indices for key sectors (agriculture, industry, construction, trade, transportation, and communications) - showed an 8.5% increase in January 2010 compared with January 2009. Growth in the mining industry amounted to 5%, and the manufacturing industry experienced a record 24.5% surge in activity. Virtually all other sectors showed positive growth: communication services grew by 6.8%, freight transportation increased by 1.3%, and agricultural output increased by 2.1%.

Contrary to a number of catastrophic projections made by some international agencies, Kazakhstan's economy has remained on the path towards development, despite, or perhaps in spite of, the global crisis.

Overall, Kazakhstan's experience during the global crisis has shown the resilience of the country's development strategy and economic policy.



1.2. MANAGING THE FUTURE: THE KAZAKHSTAN-2030 STRATEGY

Since Kazakhstan's early days as an independent state, I have always understood there was a need for strategic planning. The dream of an independent and prosperous Kazakhstan needed to be supported by clearly defined goals and action plans, taking into account our resources and capabilities. It was necessary to set the pace and the broad direction of our progress, and also to clearly see the objectives for each stage. As the ancient sage Lucius Annaeus Seneca put it, "If one does not know to which port one is sailing, no wind is favorable." Following independence we certainly required a favorable wind.

In my book "The Kazakhstan Way", I wrote about the "Strategy for the Formation and Development of Kazakhstan as a Sovereign State", developed in early 1992, which was our first experience of medium-term planning. It was an attempt to determine the optimal path for development during those early, difficult years. It was also designed to identify solutions to a large number of high priority issues, encompassing economic, political, social and ideological issues. It was, to put it bluntly, a survival strategy.

The strategy outlined an ideology for modernizing Kazakhstan's society, which was referred to as "well-being for all". I intended to encourage development of a society committed to the principles of interethnic harmony, a society ruled by law, the will of the people, and common sense. In our state-building efforts, we tried to draw on the experience of advanced democratic countries, remodeling it in the context of our national culture and traditional values.

It is clear today that our early experiences of strategic planning have taught us to strike the right balance between courage and caution, between aspirations and resources, between the firmness of principles and tactical flexibility. These observations have strengthened our subsequent strategic decisions, which include our current crisis response.

In 1997, a vision for the future of Kazakhstan's society and for the objectives for our state was outlined in the Strategy 2030. This document has irrevocably shifted the paradigm of our development - from a survival



model to an accelerated development model. The strategy included eight main components:

First, only a modern, competitive, diversified and open market economy can provide the foundation for a prosperous and dynamic society.

Second, we are building a society based on equal opportunity, in which vulnerable groups are treated with care and respect and high living standards are available to all citizens.

Third, we are building a free, open, and democratic society, which respects and protects human rights and freedoms.

Fourth, we are progressively strengthening the rule of law to ensure the Government is fully accountable and answerable to society at all levels, with a strong system of political checks and balances.

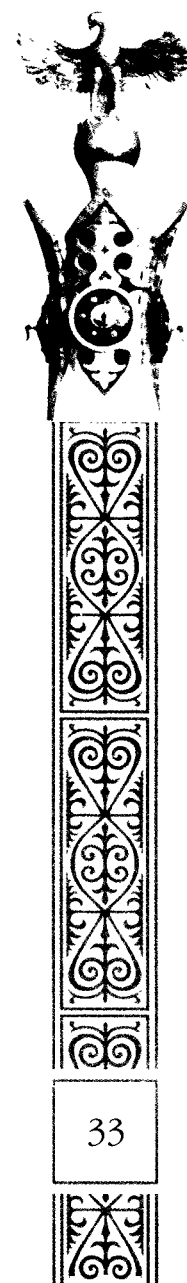
Fifth, we believe that every member of society has the right to free access for modern education and knowledge.

Sixth, we respect and protect freedom of religion. We observe and respect the traditions of Islam and other world and traditional religions, but we are building a modern secular state.

Seventh, we maintain the centuries-old traditions of the Kazakh people, ensuring and maintaining inter-ethnic and intercultural harmony, as well as progress of the united people of Kazakhstan.

The final element of Strategy 2030 is that we see Kazakhstan as a fully-fledged and responsible member of the international community, performing important functions to ensure geopolitical stability and international security in the region.

The vision of Kazakhstan's future described in Strategy 2030 reflects the fundamental aspirations of our people. The strategy's goals have been a large source of creative energy, which in turn, has supported strategy execution.



Tackling day-to-day issues, I always kept one eye on our long term strategic objectives. Of course, Strategy 2030 is not set in stone. It is a working, living document. Kazakhstan itself is evolving, and new priorities are emerging as a result. We live in a dynamic world and thus we must be sensitive to major new trends and shifting circumstances. To ensure Strategy 2030 remains current, up-to-date program documents such as "strategy roadmaps" are adopted with a shorter time-horizon. The documents define the short and medium actions necessary to meet the long term objectives of Strategy 2030. Several of such documents were adopted recently - on social development, entrepreneurship development, amongst other issues.

Our long-term strategy has several stages which are measured in decades. Each stage focuses on a specific set of high priority objectives. Kazakhstan has achieved all the objectives set during the previous stage. During this period, we doubled our GDP, despite the global crisis. The next stage will begin in 2010 and will consist of two five-year periods of accelerated industrialization. Developing the programs for this stage, the Government has made adjustments based on the effects of the global crisis. The main aims of the second stage of Strategy 2030 are economic renewal and stability. A new impetus will be given to the diversification of the economy, development of new industries, adoption of new technologies, commercialization of innovations and labor productivity growth, as well as development of competitive human capital.

One of the main conclusions that I drew from the crisis is that Kazakhstan's systems of governance are capable of responding effectively to external threats and challenges. The system is flexible enough to respond to rapidly changing circumstances.

I must confess that I too have changed over the past few years. My attitude towards certain issues, which was once unshakable, has become more flexible.

1.3. DEVELOPMENT OF BASIC INDUSTRIES

To date, Kazakhstan's large natural resource base has served as the engine of growth, and thus the backbone of development. The country possesses all known useful minerals including large reserves of oil, coal, iron ore,

uranium, chrome and zinc. In fact, on a per capita basis, Kazakhstan is one of the wealthiest countries in the world in terms of natural resources. I considered these extractive industries as the "locomotive" for the development of the economy and a source of funding for diversification projects. Therefore, improving the efficiency of the extractive industries is an extremely important task. Within the framework of the overall socio-economic modernization strategy, the Government has developed and approved a Program for the Development of the Resource Base of Kazakhstan's Mineral & Raw Materials Complex for 2003-2010.

Accelerated development of these industries and the creation of an adequate export infrastructure have required foreign capital, technologies, and experience and development of an international cooperation infrastructure. I initiated and vigorously pursued an open policy on the use of natural resources to ensure transparent and stable conditions for cooperation with multinational companies and our major regional neighbors.

In 1998, a Foreign Investors Council was established to facilitate greater interaction and dialogue between Kazakhstan and the international investment community. In order to attract foreign companies to in Kazakhstan, I signed a law on Investment. This law provided a unified investment regime for both local and foreign investors. Subsequently we have worked hard to improve the business environment and to increase the transparency and predictability of Government policy on subsoil use. For example, the Law on Oil, passed in 1995, has provided a clear legal framework for international cooperation in the development of the local oil industry.

The work of the Foreign Investors Council provided me with an opportunity to view Kazakhstan through the eyes of foreign investors from a multitude of countries. Council meetings are held twice a year and provide investors with an opportunity to share their plans, ideas, or problems personally with the Government members and me. I must admit that the Government's investment policies were significantly influenced by the interactions at the Foreign Investors Council.

However, our work on attracting investment is entering a new phase. To date, Kazakhstan has benefitted from large investments into the oil and



gas and mining and metallurgy industries. We are now creating the conditions to attract investment for economic diversification projects, including agriculture, infrastructure and domestic research and development.

Our approach to the natural resources sector has become a critical element of overall Government policy. The key elements are as follows: developing long-term partnerships with major international companies to attract investment, expertise and modern technologies; selecting partners who are willing to engage in long-term cooperation and whose objectives are consistent with Kazakhstan's economic, social, and environmental priorities; ensuring transparency; and encouraging business practices that are consistent with international best practice. One example of our commitment to transparency and best practice is the decision made in 2005 to join the Extractive Industries Transparency Initiative.

Other aspects of our strategy for the natural resources sector are diversification of export routes for oil and gas, major infrastructure upgrades, strict monitoring and control over strategic resources, and judicious use of revenues generated from the sector to provide for future generations whilst providing for the country's development needs.

During 2007, investments into the oil and gas industry grew to US\$12 billion. Investors from more than 40 countries were represented, including major companies from the United States, the Netherlands, Indonesia, the United Kingdom, Canada, China, France, Korea, Japan, and Russia.

1.4. OPEN INFRASTRUCTURE

There is no doubt that strong infrastructure networks facilitate economic development. The aging and unbalanced infrastructure that we inherited from the Soviet Union did not permit us to exploit our geostrategic potential. As a land-locked country, we face higher relative transportation costs in the movement of goods. However, our strategic location means that the opportunity exists, provided the right infrastructure is in place, for Kazakhstan to play a leading role as a transit country. If this opportunity is captured, it will have a major positive effect on the economy.

Creation of modern transportation infrastructure and the development of transit routes for trade flows will support our economic modernization objectives and create new production capacities. Of course, modernizing existing transportation networks will require massive investments. Thus, there is a major role for both domestic and foreign investors to play. The Government has already begun to implement its Transportation Strategy up to 2015, which is showing promising early results. We have begun work on a road mega-project connecting Western Europe with Western China through Kazakhstan. Funding has been arranged with a number of major international financial institutions, including the International Bank for Reconstruction and Development, the European Bank for Reconstruction and Development, and the Asian Development Bank.

The main objective of creating new transportation networks is greater regional integration. This would allow Kazakhstan and its neighboring countries to establish transportation routes to the Persian Gulf through Iran; to the Indian Ocean through Afghanistan and Pakistan; and to South-East Asia and the Pacific region through China. This will improve existing trade flows and open up new markets for local producers, bringing development to Kazakhstan's regions. It will also significantly reduce transportation costs, which will alleviate constraints to future growth.

Currently, work is ongoing to increase capacity at the East Gate (the Khorgos customs checkpoint) and the Ozinki customs checkpoint. To develop multimodal transportation networks, the Aktau seaport, also known as the Western Gate to Kazakhstan, is being rehabilitated and a new port at Bautino is being built. These projects will revive the Great Silk Road.

- The Great Silk Road operated from as early as in the 2nd century BC. In those days, it was a caravan route carrying goods and people from China to Central and West Asian countries. It ran from Xian through Lanzhou to Dunhuang, where it split into two: the North Road passed through Turpan, then crossed the Pamir Mountains and traveled to Fergana and the Kazakh steppes. The South Road traveled along the southern edge of the Taklimakan desert, past Lake Lobnor, through Yarkand and the southern Pamir mountains to Bactria and then to Parthia, India, and the Middle East.



- During the Soviet period, virtually all of these historic transportation corridors were abandoned and transport infrastructure revolved around Soviet interests. However, in the post-Soviet period, balance is being restored. Russian interests are represented by the Trans-Siberian Railroad and the new South-North corridor. Meanwhile, European interests are represented by the Transport Corridor Europe-Caucasus-Asia (TRACECA). Kazakhstan will participate in both the South-North and TRACECA projects.

Competition exists between these two transportation corridors. The main features can be described as follows:

1. TRACECA

- European Union countries are interested in obtaining improved access to huge consumer markets in India and China;
- The United States is interested in strengthening its interests in the Central Asian and Caucasian countries.

2. The North - South project

- Russia and India are interested, among other things, in improving security among the Islamic belt of Eurasian states.

One may get the impression that, despite the obvious economic benefits of the two projects, political interests currently dominate their execution. As a result, in my opinion, both projects are progressing too slowly.

In these circumstances, Kazakhstan must act prudently and avoid fanning political flames. Our objective is to accelerate development of transport infrastructure in Kazakhstan. Therefore, we are focused on the commercial aspects of both projects.

To link regional transport networks and facilitate cross-border trade, I propose creating joint border trade areas (JBTA) with our neighbors at traditional border crossing points. JBTA's would help promote trade between South-East Asian and CIS countries and with European countries in the future. This would stimulate competition and greater consumer choice. Market participants would be able to choose from a larger selection of suppliers. They would also have a greater range of transportation services. Manufacturers would also have more direct contact with buyers.



JBTAs would operate in a similar fashion to permanent selling exhibitions - sales alongside a whole range of related services. Citizens of participating countries would benefit from visa-free access (registration only) to JBTAs, which would be located at convenient border crossings. The project would not require any amendments to the customs, tax, or other related legislation.

Given the main directions of freight traffic currently passing through Kazakhstan (East-West), key points-of-sale would be established at the border checkpoints of Bakhty, Druzhba, and Khorgos. Creating favorable political and economic conditions for investment in these locations would make it possible to quickly develop checkpoint infrastructure.

In my opinion, JBTAs would be attractive to foreign investors, particularly to Chinese investors, which are supplying greater quantities of goods to Central Asian countries. Kazakh investors, banks, and transportation companies would also find opportunities in increasing trade flows.

Ultimately, JBTAs will not only increase consumer choice, but also they will improve efficiency. Buyers from Kazakhstan, other CIS countries, and Europe would not need to search for manufacturers from South-East Asia, as their representative offices and samples of their goods will be available in our JBTAs.

This concept is currently being implemented at the Khorgos - East Gate Free Economic Zone, a joint project we have with China.

At the same time, we are working hard to diversify and expand the existing routes for Kazakhstan's energy exports. To support domestic manufacturers in the non-extractive sector and encourage greater international competitiveness, domestic manufacturers will be provided with the necessary electric energy resources. Here we are looking seriously at the development of a nuclear power industry in Kazakhstan.

However, building modern infrastructure is not something we can achieve single-handedly. That is why I have called upon our long term partners to work with us in this area. Via public private partnerships, we intend to attract foreign investors into the transportation sector, which would enable us to decrease the burden on the budget and allow us to draw upon



the best experience and technologies. Towards this end, we continue to improve the public-private partnership mechanisms in Kazakhstan.

I have great ambition for building a regional transportation network. Ideally, I envisage a mega transport corridor which would link Shanghai with Rotterdam, passing through Astana, Moscow and Berlin. This mega-project could be called the New Silk Road. Such a massive project would combine the efforts of multiple countries - China, Russia, the European Union, and the United States.

Initially, I envisage a high-speed passenger rail link with a freight link to follow. It would also be possible to lay fiber optic communication lines along these tracks. This project would create a trans-continental railway of unprecedented scale. Not only would it open up new markets and dramatically change the patterns of world trade flows, but it would also vastly improve human and labor mobility, strengthening integration between participating countries. This would truly represent a lasting legacy.

Such a project would create a huge range of commercial opportunities: from the construction of railway lines and supporting roads, to telecommunication channels and information systems, through to power generation and transmission networks.

Kazakhstan has already started to implement individual elements of the New Silk Road mega-project:

- ✓ The international road corridor Western Europe to Western China;
- ✓ The transit corridor South - North;
- ✓ The transit communication channel TAE; and
- ✓ Transit oil & gas pipelines to Europe, China, etc.

1.5. COMPETITIVENESS AND SUSTAINABILITY: ECONOMIC CLUSTERS

Our approach to modernization attempts to strike the right balance between the rates and quality of growth and between regional and territorial development. Economic clusters, which have been used successfully in many countries around the world, have also influenced our approach.

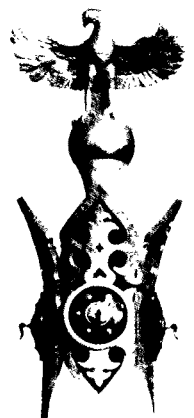


Professor Michael Porter, the renowned economist who popularized the concept of industry clusters, advised the Government on developing a cluster strategy in Kazakhstan. Clusters are defined as a geographically proximate group of interconnected companies and associated institutions in a given field, linked by common activities and complementarities. In other words, within a specific location, groups of interrelated companies are established around basic industries. These companies include suppliers of equipment, parts and components, specialized industrial services, infrastructure providers as well as research centers, universities, and other organizations. Their interaction multiplies the overall economic effect, resulting in greater economic competitiveness.

Today it is clear that the advantages of the cluster approach are not limited to the geographical convergence and synergies created between manufacturers and service providers. The exchange of knowledge and technologies is also an important outcome. Convergence between science and industry within clusters facilitates introduction of innovative processes and new technologies. Clusters create a nexus of industry and research and development, which stimulate innovation and facilitate commercialization of new products and processes.

Three basic industries currently provide the backbone of Kazakhstan's economy - oil and gas extraction, mining, and metallurgy. Large manufacturing enterprises in these sectors can become powerful cluster development centers. A network of companies engaged in ancillary businesses must grow around these centers, which would encourage manufacturing of higher value-added downstream products. Such a network would include small and medium sized businesses that more efficiently produce specialized goods or services which are non-core to the basic enterprise. Thus, the creation of clusters would encourage greater productivity and, at the same time, contribute to Kazakhstan's economic diversification.

Of course, the cluster approach is not only relevant to the extractive industries. In 2004, the Government initiated a project titled "Diversification of Kazakhstan's Economy through Development of Clusters in Non-Extractive Industries", which identified a number of industries most suited to the cluster



approach. These include: mechanical engineering, production of building materials, food processing, textiles, tourism, and transportation and logistics services.

Special economic zones and technological parks with preferential customs and tax treatment were set up to facilitate cluster development. Four Special Economic Zones were established: Seaport of Aktau, Astana - New City, The Information & Technological Park, and Ontustik. Two other special economic zones - Burabai and The National Industrial Petrochemical Technological Park - are currently being established. These zones have become platforms for innovative development and for creating new highly skilled jobs. In addition to these zones, the Government opened five technology parks: the Nuclear Technology Park "TOKMAK"; parks for space monitoring in Astana, Almaty, and Priozyorsk; the Almaty Technology Park; the Technology Park "Algorithm" in Uralsk; and the Technology Park "Business City" in Karaganda. These parks provide similar preferential treatment compared with special economic zones, but they focus on the development of a specific sector. The parks also provide for the operation of business incubators.

The importance of these projects over the long run cannot be overestimated. They are designed to play a significant role in the industrial and innovative development of Kazakhstan and to facilitate economic diversification. The extractive industries, of course, will continue to be strategically important for the country's economy, but I understand that our future - our international competitiveness, the quality of our jobs, and opportunities for attracting investments - is linked to new industries.

From the outset, I was struck by the potential of the cluster approach. However, this concept does not operate in a vacuum. To ensure successful outcomes, it is not enough simply to finance cluster projects. It is also necessary to create an enabling environment - supporting infrastructure, for example, and a favorable legislative framework.

1.6. STRONG LEGISLATIVE FRAMEWORK AND ENABLING ENVIRONMENT FOR BUSINESS ACTIVITY

In 2009, the World Bank's "Ease of Doing Business 2009" report ranked Kazakhstan first among CIS countries. The Government is working hard to improve upon this ranking by adjusting the legislative framework and eliminating administrative and bureaucratic barriers.

Improving the business climate is a critical task for the country's leadership. We pay close attention to adopting new administrative methods, streamlining the bureaucracy and improving regulation and policy. In recent years, the Government has carried out reforms to: support new business creation; provide faster approvals for building permits and cross-border trade licenses; provide better protect investor rights; improve access to finance. Bankruptcy legislation has also been improved. Registration procedures for starting businesses people at newly created Public Service Centers (PSC) have been eased and simplified. Under a joint project with the USAID, amendments were made in July 2009 to certain Kazakhstan laws on private entrepreneurship, aimed at streamlining the inspections of small and medium businesses. The entire concept of business inspection has been redefined, with the focus shifted from performing oversight to taking preventive measures.

Thanks to the active assistance of the World Bank, a computerized tax administration system has been introduced. Today, most corporate taxpayers fill out and submit their tax returns in electronic form via a data processing system. This has substantially reduced the tax administration burden. However, we must continue in this direction: the existing administration system is overloaded and requires additional capacity. I must also say, unfortunately, that the positive changes in the business environment are sometimes hindered by bureaucracy, and new regulations are often not fully implemented at the local level. But these problems, too, will be addressed.

The creation of a favorable legislative framework for special economic zones, clusters, technological parks, and industrial zones has also played an important role. I must say that there is a risk of becoming too enthusiastic about the prospects for some industries and projects, thus losing sight of the practical realities. That is why I always emphasize our task in the public



sector is not to pick industrial winners or focus on individual projects. We must facilitate a more competitive economic environment, creating the conditions in which private enterprise can thrive. This means putting an end to large-scale subsidies and state protection for certain industries, to favoritism in public procurement, and to interference in corporate matters. It is important that national champions develop in an atmosphere of competition. Otherwise, we put the competitiveness of our economy at risk.

Creating a favorable business environment requires a transparent and professional bureaucracy, especially among those institutions which are directly responsible for the administering of public funds. This includes public procurement, public fund management, financial planning, and program implementation at the local executive level. Other vital institutions include those whose activities directly affect the cost of doing business. These include the customs and tax services as well as the judiciary. The relevant departments and agencies must be staffed by qualified personnel and follow predictable processes to ensure high quality public services.

A favorable business climate amounts to more than the ease of opening a business, the speed and simplicity in obtaining approvals, and the lack of Government interference in commercial activities. Entrepreneurs must also believe that they are protected by the rule of law.

Firstly, the rule of law applies to private property protection and contract enforcement. The Government has made considerable efforts in this area to improve the legislative framework and tighten the systems for contract enforcement, based on international best practices and collaboration with international organizations.

The world community highly appreciated these efforts. It is illustrated by the World Bank's "Ease of Doing Business-2010" ranking, in which our country was ranked 63th out of 183 countries, herewith the fact that Kazakhstan's position constantly improves. It is noteworthy that the time spent from filing a contract claim to receiving due payment is 390 days in Kazakhstan, on average. This compares with 462.4 days, on average, for OECD countries.

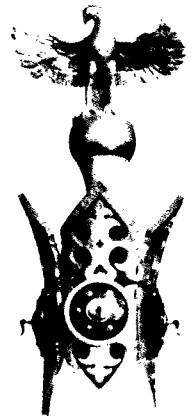


To protect the interests of commercial enterprises, the rule of law and an effective judiciary are critical. Today, we have commercial and administrative courts in Kazakhstan, and the Government is considering the creation of tax courts. A specialized financial court has been operating in Almaty since 2006. The system of specialized inter-district commercial courts, which are located in every oblast capital city around the country, is working. The annual increase in cases filed with commercial courts (an average of 6% per year) demonstrates growing popular confidence in the court system. I think we can say today that the specialized courts have contributed to better protection of citizens' rights, stronger institutions, and improved investment attractiveness.

A Concept of Legal Policy for the Republic of Kazakhstan for the period from 2010 to 2020 was approved by the Government recently. The concept defines main areas for modernizing the country's judicial system within the broader legal reform process. The document aims to improve judicial proceedings and ensure greater openness and transparency of the judiciary in our country. The process of building a better judicial system should go hand-in-hand with the reform of existing laws. We need laws that protect our market economy and private enterprise.

The introduction of new technologies would aid the judiciary. Automated electronic document workflow, internet portals of the Supreme and oblast courts and the use of videoconferences in trials would help increase the efficiency and transparency of the judiciary.

At the same time, business has a responsibility to society and must live up to its end of the bargain. Kazakh companies must be honest, transparent, and encourage fair competition. They should also aspire to meeting the highest international standards of doing business. As a result corporate governance is a critical issue. Kazakh companies realize that to successfully attract investment, corporate governance standards must comply with international best practice. I am pleased to say that good progress has been achieved in this area. Kazakhstan's corporate governance legislation has been judged to comply with the Principles of Corporate Governance of the Organization for Economic Cooperation and Development. Also, many of our domestic companies have successfully listed their securities on leading international stock exchanges.



To improve overall levels of transparency and attract investment, it is also important that Kazakh companies adopt international accounting standards. Kazakhstan was one of the first CIS countries to announce the introduction of a system of national accounting standards based on international accounting standards (IFRS). Kazakhstan was also the first CIS country which passed a Law on Auditing. As a result, accounting and auditing practices in Kazakhstan are widely acknowledged to be the most advanced in the CIS. At the same time, we are also trying to minimize the costs of compliance for small businesses. According to amendments made to the Law on Accounting in 2007, the Government introduced a three-level reporting system: micro-companies are permitted to use existing simplified rules; small and medium-sized companies must adopt national accounting standards (Kazakhstan Accounting Standards); and Government-owned and large companies must adopt IFRS.

Kazakhstan is progressively incorporating international standards in different areas of the economy. This is important not only for improving cooperation with foreign partners, but also for establishing credibility and encouraging competitiveness of local industries. Introduction of advanced technological standards, for example, helps us to adopt innovations. By 2007, more than 750 companies in Kazakhstan have implemented the ISO 9000 quality management system. Furthermore, domestic businesses continue to roll-out other ISO standards - in environmental protection, health and occupational safety, food safety, and information security.

1.7. A POSITIVE BALANCE: INTEGRATION PROCESSES AND SUPPORT OF DOMESTIC MANUFACTURERS

Kazakhstan is a land-locked country, which places additional costs on the economy. According to World Bank and Columbia University research, land-locked countries suffer higher transportation costs (50% on average) and lower external trade volumes (70% on average) compared with countries on the open sea. We are attempting to mitigate these geographic constraints by investing in infrastructure and pursuing an active external trade policy.

Kazakhstan's foreign trade relations are governed by bilateral and regional trade agreements. For example, trade relations between the



European Union and Kazakhstan are carried out pursuant to an agreement on partnership and cooperation, which grants mutual most-favored status, and prohibits establishing tariffs and quotas. Other regional trade agreements are summarized as follows:

Kazakhstan's Regional Trade Agreements

Name	Effective date	Counterparties	Objective
CIS	1991	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, the Russian Federation, Tajikistan, Ukraine, Uzbekistan, and Turkmenistan as a participant	CU (established in 1995)
EurAsEC	2000	Belarus, Kazakhstan, the Russian Federation, and Ukraine	CU, totally belonging to the CIS
CES	2004	Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan and Uzbekistan	CU and a monetary union
Organization for Economic Cooperation	1985	Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan, Turkey, Turkmenistan, and Uzbekistan	An agreement within the framework of the CES since 2003
Central Asian Cooperation Organization	1994, part of EurAsEC since 2002	Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan, Uzbekistan, Georgia, Turkey, and Ukraine	Signing of a free trade and common market agreement
Shanghai Cooperation Organization	1996, formerly, the Shanghai Five	Kazakhstan, the Kyrgyz Republic, the Russian Federation, China, Uzbekistan and Tajikistan	FTA in 2003

CU – Customs union; FTA – Free trade agreement



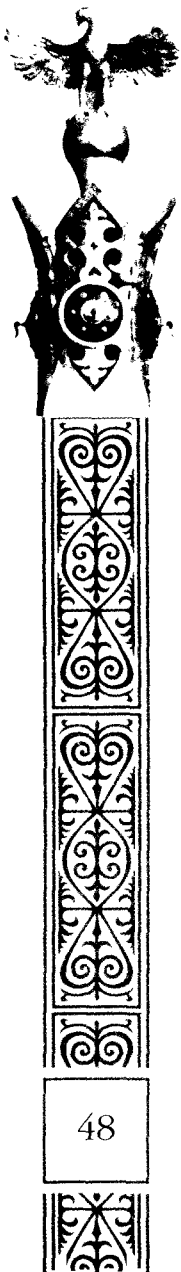
On January 26, 1996, Kazakhstan submitted its application for membership to the Secretariat of the World Trade Organization (WTO). The following month, Kazakhstan was granted observer status, and a working group on accession was established. The creation the Customs Union with Russia and Belarus earlier this year has altered the trajectory of our WTO accession process. However, we remain committed to becoming a full member of the WTO.

In fact, I regard Kazakhstan's accession to the WTO as a strategically important step. Membership will open up new markets for Kazakh products. It will also encourage greater competitiveness via competition, which will benefit Kazakhstan's consumers. In addition, membership will provide an established mechanism for resolving trade disputes.

More than 130 of Kazakhstan's trading partners are WTO member-states, and we need a fair mechanism to settling any disputes in our trading relationships. We have faced a number of dumping claims in the past related to our exports of steel, ferrous metal products, ferrochrome, titanium sponge, highly enriched uranium, and other products.

Accession to the WTO would provide a number of benefits to Kazakhstan, including lower tariff and non-tariff barriers in industrial and agricultural goods, the creation of conditions for free and fair competition on world markets, and an effective protection mechanism for intellectual property rights, taking into account the existing differences in national legal systems. Kazakhstan would be granted most favored nation status in trade relationships with all WTO member countries, which would open up new markets for Kazakh producers. Also, the commercial risks for exporters would fall via access to a more stable trade regime and lower transportation costs resulting from the freedom of goods transit through the territory of WTO member countries. Membership would also facilitate foreign investment into Kazakhstan. Overall, WTO membership will help to reduce the costs and increase the competitiveness of Kazakh products.

However, trade policy must be balanced and we should not be blind to the risks associated with integration into international institutions. On the one hand, free trade and an open economy deliver obvious benefits in many areas. However, at the same time, free trade can hurt local producers who



are unable to respond to new market conditions. Free movement of capital can increase the economy's vulnerability to external shocks and greater labor mobility can lead to skills shortages. Yet, I strongly believe that these risks can be successfully mitigated if we focus on supporting the competitiveness of our domestic industries and on creating an attractive labor market for our highly qualified professionals.

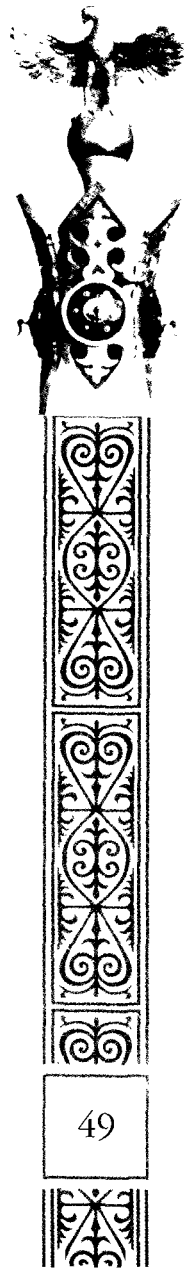
Currently, as a result of the global crisis, there are increasing trends towards trade protectionism. Countries around the world are looking for ways to boost their own exports. Russia, for example, supported the establishment of the Customs Union on the one hand, but simultaneously cracked down on poor quality imports. This has affected Chinese exporters.

1.8. LOAD BEARING STRUCTURES FOR A BALANCED ECONOMY: PUBLIC DEVELOPMENT INSTITUTIONS

Kazakhstan's Strategy 2030 is aimed at liberalizing international trade, reducing trade barriers, and creating a favorable environment for Kazakh exporters to access external markets. Therefore, high levels of attention are focused on economic growth driven by greater competitiveness and a larger proportion of value added exports.

This objective is twofold - modernizing and improving efficiency of the extractive industries and accelerated development of the non-extractive sector. Currently, the non-extractive industries lag behind the extractive industries in terms of productivity and rates of return. Development of these industries has been hampered by limited infrastructure, low efficiency of export administration, and the lack of qualified personnel. Red tape continues to be a problem as well. These barriers cannot be eliminated overnight. However, work is currently being carried out to address these issues.

The latest strategic initiatives developed by the Government are aimed at reducing the economy's dependence on raw materials and developing manufacturing and processing industries. Samruk-Kazyna plays a key role in executing these strategic initiatives, particularly in the state's interaction with the private sector. Samruk-Kazyna's primary goal is to improve efficiency of state sponsored projects and attract private investment. This will encourage



development of modern industries and economic diversification and thus lay the foundation for long term prosperity.

Several development institutions, which are overseen by Samruk-Kazyna, are aimed directly at promoting economic diversification. These include the Development Bank of Kazakhstan, which specializes in financing major investment projects (greater than US\$5 million) via debt funding; the Investment Fund of Kazakhstan, which was established to support private enterprises via equity investments; the National Innovation Fund, which specializes in venture-type financing for emerging industries; and the State Export Credit Insurance Corporation, which insures the risks of exporters and overseas investments. These development institutions also include: the Kaznex Export Development and Promotion Corporation, which provides services to local companies aimed at attracting investment and technologies as well as institutional capacity building and export promotion; and the Damu Fund, which provides concessional lending to small and medium sized businesses.

2.1. INCREASING LIVING STANDARDS

Increasing living standards and ensuring a reasonable distribution of income is an issue for all countries, particularly those rich in natural resources. Kazakhstan is a successful example of a country where oil revenues are not concentrated in the hands of a few private individuals, but, instead, are reinvested in the economy, increasing business activity and personal incomes around the country. Raising the living standards of the citizens of Kazakhstan and maintaining a high level of social stability and interethnic harmony is a fundamental public policy objective.

Since 2001, personal incomes have grown by more than 10% per year, on average. From January 2007 to November 2009 alone, real personal

incomes increased by 25%, and since 1997, by more than two and a half times. The percentage of the population with incomes below the subsistence level has decreased by three times - from 38.3% in 1997 to 12.1% in 2008. According to common practice, standards of living are calculated based on various indicators, including the availability and affordability of housing. Provision of housing loans to public servants and employees of budget-financed organizations at lower interest rates through the system of housing construction savings has helped many families build or buy their own homes, and since the beginning of this century, the number of homeowners exceeded 350 thousand families, which translates into more than 1.2 million Kazakh citizens.

According to a number of estimates, the share of the middle class constitutes approximately 25% of Kazakhstan's population. However, the problem of disparity in living standards between urban and rural areas remains a pressing issue. The Government has developed a State Program for the Development of Rural Areas in the Republic of Kazakhstan for 2004 - 2010, which, if successfully implemented, will provide higher living standards for people living in rural areas and lay a foundation for sustainable development of rural areas. This program is already yielding results. For example, the proportion of citizens living in rural areas and with incomes below the subsistence level has decreased by approximately three times since 2004, which suggests that our policies are having the desired effect.

In recent years, the opportunities for our citizens to engage in economic activity have expanded greatly. The unemployment rate remains low at present, even taking into account the consequences of global financial and economic crisis (6.3% in 2009). It has fallen by more than half over the past decade. Importantly, the long-term unemployment rate has decreased to 2.3%, and the unemployment rate among young people has fallen to 5.9%. The number of individual entrepreneurs is also growing. Whilst there were 122 thousand individual entrepreneurs in 2008, this number grew to 161 thousand in 2009 thanks to the development of small and medium businesses in the country. As a reflection of the strength of our labor market, Kazakhstan ranks 18th out of 133 countries in terms of the Labor Market Efficiency in the World Economic Forum's Global Competitiveness Index.

Equal access to education is one of the most important indicators of effective social support and of the level of individual well-being. Kazakhstan



ranks highly according to this criterion compared with its peer countries and, in fact, it is ranked higher than many developed countries. According to a 2009 UNESCO world report on monitoring of education, titled "Overcoming Inequality: Why Governance Matters", Kazakhstan was ranked fifth among 129 countries around the world in terms of Primary Education Coverage and first in terms of Grade 5 survival rates.

Social spending represents almost half the total national budget expenditures. Public expenditures for the education and healthcare sectors have increased more than 8 times over the past 10 years - from KZT 85 billion to KZT 710 billion for education and from KZT 54 billion to KZT 468 billion for health care. During that period, 641 schools and 124 hospitals and clinics were built.

Overall, the measures undertaken by the Government in the healthcare sector made it possible to reverse many negative trends in the state of health of the population. Birth rates, for example, increased 1.5 times and infant and maternity mortality rates decreased twofold. In addition, average life expectancy also increased, which has contributed to a rise in natural population growth.

Mortality from cardiovascular diseases fell from 490 per 100 thousand people in 2008 to 421 per 100 thousand people in 2009. Mortality from cancer dropped from 116 per 100 thousand people in 2008 to 106 per 100 thousand people in 2009. The incidence of tuberculosis fell from 126 per 100 thousand people in 2008 to 106 per 100 thousand people in 2009. As a result of targeted anti-epidemic measures, the spread of HIV has stabilized. In fact, there were 10% fewer new registered cases of HIV in 2009 (2,081 in total) and the incidence of HIV is currently 13.1 cases per 100 thousand people. The incidence of viral hepatitis is also falling. I am confident that the broad measures that the Government is currently undertaking will lead to further significant improvements in the health of the nation.

A further reflection of our progress in raising living standards was provided by a United Nations development in 2009 which included Kazakhstan in a list of countries with high development potential. We performed better on this measure than many of our peers in Central Asia and CIS. Further, in September 2009, speaking at the opening of the III Session of the 4th

Parliament of the Republic Kazakhstan, I noted that we had reversed previous negative trends in migration. This indicates that significant progress has been achieved in improving day-to-day life in Kazakhstan.

Administrative reforms played an important role in improving the well-being of society and our citizens. These reforms were aimed at increasing the efficiency of administrative staff and transforming an inflexible public administration system into a modern, responsive system which serves the needs of our citizens.

At the end of 2007, a new performance-based national planning system focused on reaching strategic goals and objectives of the country was adopted. Since 2008, all federal Government agencies have developed strategic three-year plans for their activities. This means that their activities will be results-oriented with specific and measurable targets. In 2007, the Government approved model standards and procedures for the provision of Government services, and a registry of Government services provided to individuals and legal entities. All this is being done to enable our citizens and businesses to interact more effectively with Government agencies, to be aware of their goals, and to use the opportunities offered to them.

To ensure Government decisions and processes are as transparent and accessible as possible, a national e-Government program for 2005 - 2007 was developed based on my instructions in 2004. Now, this Internet portal is an efficient system of interaction between Government agencies, the general public, and businesses, based on modern information technologies. Continuing the development of the system, in 2007 we adopted a national e-Government program for 2008 - 2010, which aims to expand and develop the system's basic infrastructure and accessibility, as well as to increase the level of automation and integration in the provision of Government services. Today, every citizen can log on to the Government's website and access e-services without delay. This is, of course, a common service in many countries. However, I highlight it because it represents a step change in the civil services here in Kazakhstan.

To facilitate interaction between the general public, businesses and the Government, PSCs have been operating in Kazakhstan since 2005. The PSCs use the "one stop shop" principle and already provide more than fifty different



services. Currently, there are more than three hundred such centers operating around the country. Beginning in 2010, these centers will be transferred to the regional Akimat authorities, which will reduce bureaucracy and improve the quality of Government services. All this work is ultimately aimed at increasing the well-being of people and to ensure equal opportunities for increasing standards of living.

But, just as important, we must work to help support the overall level of optimism in Kazakh society. According to the Kazakhstan Statistics Agency, despite the serious consequences of the global financial and economic crisis, in 2009 most families (63%) in Kazakhstan were confident that their children would live better than their parents. I will continue to make every effort to ensure that these expectations are met.

Effective protection of vulnerable segments of the population is the most important outcome of Kazakhstan's successful economic policy. How these groups are treated is the true measure of a society. By vulnerable, I mean retirees, i.e. people whom society should repay for their service, those who have not yet started working for the benefit of society and those that face physical and economic hardships. I have made it clear to the Government that it should continue working on increasing the well-being of all our citizens. I will do my very best to see that the percentage of the population living below the subsistence level does not exceed 8% by 2020. The main instruments here will be measures to support employment; provision of social services will be geared towards those who need them most and the quality of social services will be improved to meet the highest standards.

We are continuing to implement our social program. During the crisis, we made a decision to protect social programs and public spending. Moreover, in the heat of the crisis in 2009, the size of pensions, stipends, and salaries for budget-financed sector employees was increased by 25%. A further 25% increase is planned for 2010. Social benefits have also been increased by 9%, on average.

Since 2000, the minimum monthly wage has increased by more than 5 times and the average pension has grown by 4 times. In order to improve the demographic situation and increase social support for families with children, a lump sum allowance for the birth of a child has been paid



since 2003, and a childcare allowance until the child is one year old has been paid since July 2006. In 2009 alone, child allowances were paid to 297 thousand people, and 145 thousand people received childcare allowances.

The quality of the natural environment remains a major, high priority issue. Unfortunately, water and air pollution continues to be a severe problem, along with the accumulation of industrial and consumer wastes. Solving this problem requires further cooperation between businesses, the population, and the Government. The Government is currently overhauling existing legislation on environmental protection. For example, Kazakhstan recently ratified the Kyoto Protocol to the United Nations Framework Convention on Climate Change. Currently, we are in the process of acceding to Annex B to the Kyoto Protocol, which will involve specific targets for greenhouse gas emissions. Further, in terms of environmental legislation, our country's international ratings have improved.

Our citizens' well-being and standards of living largely depend on how effectively and efficiently the Government provides services to its citizens and whether the Government is accessible and responsive to their needs.

2.2. ASTANA - A POWERHOUSE FOR KAZAKHSTAN'S INFRASTRUCTURAL, TECHNOLOGICAL, AND SOCIAL TRANSFORMATION

I attach special importance to the development of Astana - the capital city of the renewed Kazakhstan and the leading center of the country's socio-economic development.

The construction of the new capital Astana began during a very difficult period. Most people at the time did not believe that we would succeed. To select Astana, we relied on a nation-wide survey, which incorporated 32 factors, including socio-economic indices, climate, landscape, seismic conditions, the natural environment, transportation infrastructure, construction materials and supplies, and the workforce. The crucial advantages in favor of Astana were its large area, its central location, the proximity to the country's major economic centers and arteries, as well as



its demographic potential, transportation infrastructure, and natural environment.

In total, 71 cities, 432 construction companies, and 135 factories were involved in building our new capital. Along with local firms, Astana was also built by Turkish, Italian, French, and Swiss companies. Each year, between 60 and 100 medium and large sites were completed and successfully brought into operation. The accelerated construction and nationwide public support made it possible to build a modern city with its own unique design and character in the steppes of Kazakhstan in just 10 years. The author of Astana's master plan was the famous Japanese architect Kisho Kurokawa. In a few years, important sites appeared on the map such as the Akorda, the presidential residence, the House of Ministries, the Parliament buildings, the Supreme Court, the Ministry of Transportation and Communications, the Ministry of Foreign Affairs, the Cardiac Center, the National Academic Library, and many others.

Transferring Kazakhstan's capital city to Astana has marked a new era in the development of both the city and the Republic. Moving the leadership and the administration of the country to Astana led to a wave of professional migration, including of management executives, politicians, economists, and artists. Most of the migration to Astana is represented by highly qualified specialists aged 23 to 45. The population of Astana is growing also because the city, with modern infrastructure and service industries, is becoming an increasingly comfortable place to live and work. Currently, the population of our new capital city is approximately 700 thousand people.

Transferring the country's capital from Almaty to Astana has stimulated significant local economic development. Astana's gross output increased by more than 28 times from 1998 to 2008 (from KZT 46 billion to more than KZT 1 trillion) and the city's contribution to national GDP increased from 3% to 8% during the same period. Between 2002 and 2008, investment in the fixed capital of Astana's enterprises increased by more than 3 times in real terms, reaching KZT 454.5 billion in 2008 (more than 35% of the total gross output). Astana has become an engine of economic growth, having been transformed from a small provincial town to a modern city with great potential in just a decade.

In July 1999, the city was awarded a UNESCO City of Peace prize. In 2002, I approved a new special economic zone within city limits called "Astana - New City". This zone has increased the attractiveness of the city for investment. In 2003, Astana received an investment grade rating from Moody's Investors Service.

Today, the necessary infrastructure has been created in Astana; the city accommodates all Government and legislative bodies. It must be noted at the same time that, despite the importance of this process the development of Astana has not been an end in itself. The city has had a strategic effect on the entire country. This effect extends not only to economic development, but also to the momentum for political, social, and cultural development. When the whole country was building the new capital city, the new capital city was developing the entire country.

The ten years it took to build Astana have become the pivot point for Kazakhstan's independence; a critical reflection of national success. Ten years is a short period in the history of a nation, but in the case of Astana, these ten years represent profound change for Kazakhstan and its people. The creation of a new capital city has crowned Kazakhstan's modern statehood. Kazakhstan now has a new center of power, a fitting venue for reaching important national decisions.

Moreover, our capital city has become an ideological symbol, which elevates our national pride. Its contribution to the growth of patriotic spirit among our citizens is priceless.

The geographical location of Astana has had another important implication for our country - shifting the country's center of gravity has encouraged a renewal of Kazakhstan's Government elite and the formation of a new class of public servants. The transfer of the capital city has stimulated social mobility and positively influenced the development of human resources. Young, educated, and ambitious Kazakhs, who now form the basis of the new generation of public administrators, came to Astana from all over the country.

I would like to say, without false modesty, that Astana was built from scratch in just 10 years; I, along with my fellow Kazakhs, draw great personal



pride from this achievement. I have invested enormous effort into the city. Each building, each object of architecture and infrastructure, has come from my heart. Creating a new capital city in such a short timeframe is, I believe, unprecedented. Many times have I heard from visitors to Astana that they felt as if they found themselves on a movie set. And how many skeptics, critics, and doubters there were! Astana has become a symbol of the great capabilities of the Kazakh people - it is a feat befitting the birth of independent Kazakhstan.

In my annual address to the people of Kazakhstan in 2006, I stressed that work must continue to ensure Astana takes its rightful place among the many leading modern cities of the world. Towards this end, I have overseen several large-scale projects. A modern, innovative, and dynamic medical services cluster was created in Astana. It consists of seven healthcare centers covering: primary healthcare, maternity care, neuroscience, disabled child care and blood transfusions. In terms of equipment, these centers are the most advanced among the post-Soviet countries. These centers embrace the major trends in modern medicine. In addition, to establish a leading edge academic environment in our capital city, a prestigious new world class university was established in Astana. To groom talented young people for admission to the university, twenty intellectual education schools are being created across the country. Research centers encompassing medical, engineering, and high-tech laboratories are being established under the auspices of the university.

To facilitate industrial development of the city, an industrial area focused on specific industries needed to be established including the manufacturing of building materials and furniture, food processing amongst other industries. Some of these tasks have been fulfilled; others are being implemented now.

As I mentioned earlier, particular importance will be attached to developing Astana as a leading socio-economic center in Kazakhstan. Our plans for the capital city will be carried out in accordance with the approved Strategic Plan for the Sustainable Development of the City of Astana up to 2030. The main goal of this plan is to ensure a competitive economy for the capital and an attractive city to live in. By 2030, we have set an objective for Astana to rank among the top thirty most competitive cities of the world, with a population topping 1.2 million people.



Sustainable development is a major challenge for today's urban planners. Successful urban development in modern cities requires advanced tools, including:

- Collaborative goal oriented strategic planning;
- Technological transformation of urban infrastructure based on intellectual networks;
- Scenario-based forecasting;
- Simulation development models;
- Geo-spatial planning;
- Geo-information systems;

Technology creates many opportunities for improving urban planning. Automated navigation systems, for example, can make vehicle flows more efficient. Advances in building system technology have led to the development of intelligent buildings. These technological advances, if intelligently applied, can improve efficiency and deliver greater flexibility to city design and management.

In summary, I strongly believe that the combination of individual creativity, private enterprise, Government support and technology will establish Astana as a city of the future. This will bring together economic potential, efficiency, human capital, information technology, transport infrastructure, quality of life and investment promotion.

2.3. REGIONAL GROWTH POINTS

In 2006, a Territorial Development Strategy up to 2015 was adopted. This document laid the basis for accelerated development of specific regional areas, which were to become the "growth points", or drivers of development.

Kazakhstan is a country that combines a vast territory with a small population and a relatively small economy. These features have resulted in unbalanced economic development across the country. The economic disparity in Kazakhstan presents a significant development challenge. In 2008, for example, about 50% of Kazakhstan's population lived in regions where the level of per capita gross output was below 75% of the overall average.



Studying the experience of developed and developing countries, I came to the conclusion that we needed a new approach towards the development of our regional areas. Looking at China as an example, the region driven approach to development has been successful. Canada and Australia, which have similar geographic attributes, can also serve as examples. In Canada, for instance, the population is concentrated in the south of the country near its border with the United States, and Australia's economic centers have developed primarily along the country's east coast.

The Territorial Development Strategy, based on specific growth points, makes it possible to define clear-cut priorities for our regional policy. For the sake of the prosperity of the entire nation, we should concentrate resources, create a powerful incentive system, and work out effective support mechanisms for the development of key regions, whose economic potential would enable domestic businesses to occupy specific market niches in international markets and give a strong impetus to the development of the entire country.

Kazakhstan's growth points are cities that are characterized by high concentration of economic activity, access to export-oriented transportation corridors, and proximity to major export markets. The greatest potential in this regard include Almaty (the largest city in the country, both in terms of population and economic output and which is located close to China) Astana (the most dynamic non-extractive regional economy, which accounts for 9 percent of the country's GDP and is located near the Russian border), Shymkent (the center of the most populous region, located in the south of Kazakhstan close to Central Asian and Chinese markets), and Aktobe (a city located on the West Europe - Western China transportation corridor, near the Russian border).

For these cities to play the role of "growth points" it is necessary to not only support their internal development, but also to encourage greater integration between them, in terms of both transportation and communications, and to develop regional-level linkages with neighboring areas of the country.

To date, much work has been done to develop the legal, regulatory, and methodological frameworks for developing an effective and efficient



distribution of the country's economic potential. We must continue this work to achieve the desired outcomes. The Government will implement highly targeted support measures where it will yield the greatest results.

Astana and Almaty will play a special role. These cities will accommodate what I call "regional innovation systems" - these systems combine education, business technology, and support subsystems. These cities should become meeting points for foreign companies and domestic businesses. As a result, they will need to train highly qualified specialists and build advanced infrastructure networks.

In addition, our new performance based budgeting system will play a supporting role. Regional budgets and development-oriented transfers from the central Government will be based on the goals and targets set for each individual region to provide for the industrial development of the country.

2.4. REFORM OF THE EDUCATION AND PROFESSIONAL TRAINING SYSTEM

Education plays a vital role in economic development because it stimulates competitiveness. Each year more importance is attached to the development of the education system in Kazakhstan. The development and reform of education is integral to Kazakhstan's development model. We aim to bring the existing system into line with world standards.

Since independence, Kazakhstan's education system has been totally overhauled. The first Law on Education was passed in 1999. It provided guarantees for equal access to education at all levels for the people of Kazakhstan. This applied to pre-school education, secondary schooling, professional education, and higher (tertiary) education. All education services were provided on a competitive basis. Eight years later, in July 2007, a new, law On Education was implemented. The new law envisioned the introduction of a 12-year school education, which is consistent with world best practice, and a restructuring of the technical (vocational) and professional education system. The law also introduced a three-tier model for higher and graduate education: the Bachelors degree program, the Masters Degree program and the Ph.D. degree program, as well a national



system of education quality assessment. In the long run, the new law is aimed at improving the status of teachers and professors, raising the prestige of this important profession.

Today, we can confidently state that Kazakhstan has built a strong education system. Currently, Kazakhstan ranks first among CIS countries in terms of the proportion of students in the total population. In addition, Kazakhstan's literacy level of 99.5% is one of the highest in the world.

The issue of establishing better links between the needs of the labor market and the education system is an important issue facing policymakers. The present-day situation, where university graduates with degrees in law or economics are, to a large extent, not valued by the labor market is currently the subject of great debate. At the same time, there is a clear shortage of graduates with technical educations, who could replace the older generation of engineers, telecommunications specialists, and professional builders.

Therefore, an important area for reforming the education system in Kazakhstan is the development of technical and professional education. This issue has not received adequate attention for a long time. Since independence, the main obstacle to the development of technical and professional education was insufficient funding, which has resulted in obsolete curricula, learning materials, and infrastructure. At the same time, poor integration into the core curriculum at secondary and tertiary levels have contributed to the decline of technical and professional education standards. Also, the transition to a market economy has resulted in the disappearance of "basic enterprises", which traditionally provided on-the-job technical training and funded vocational programs.

To resolve this problem and to adjust the national education system to the needs of the labor market, in 2007, the Government in cooperation with the World Bank, prepared a Government Program for the Development of Technical and Professional Education in the Republic of Kazakhstan for 2008 - 2012. This program includes three main components: improving the quality of the technical and professional education system; modernization of management systems, laboratories, and equipment.



The Bolashak program, which is well known in Kazakhstan and elsewhere in the world, continues to be an important tool for improving access to high quality education for Kazakhstan's citizens. The Bolashak program provides free education and training at leading universities around the world for talented young people. Upon graduation, the graduates are obliged to return home and work in Kazakhstan, thus making their own contribution to building a competitive national economy. Approximately 3 thousand young people are sent annually to study at the world's best universities under Bolashak. This program was launched in 1993 despite the funding challenges we faced at the time. Today, there are around 20 thousand Kazakhs studying at universities all over the world.

Bolashak aims to educate and train future business leaders and experts in international relations, law, science, engineering, and other key areas. The program continues to evolve and expand, providing leading edge training and education to a greater number of young people. Most recently, the program was amended in 2009 to include new selection criteria, which include quotas for young people from rural areas, public servants, scientific researchers, and faculty members of state colleges and universities.

2.5. RELIGIOUS TOLERANCE AND INTERFAITH UNDERSTANDING

Kazakhstan's development model reflects the country's ethnic and religious diversity.

Representatives of more than 130 ethnicities belonging to more than 40 religious denominations currently live in Kazakhstan. Ensuring the internal stability and peace between representatives of different ethnicities and religious faiths has always been one of the primary national policy priorities. During the early years of independence, we took great care to establish the fundamental principles for a democratic social structure and the development of civil society. These include internal stability, inter-ethnic and inter-faith peace and harmony.

I am proud that Kazakhstan has succeeded in establishing and preserving national harmony among people of different creeds and races. In fact, ethnic



and religious diversity is integral to our statehood. Our society is more vibrant and dynamic as a result.

Our commitment to diversity is reflected in the Assembly of the Peoples of Kazakhstan, which was created to strengthen inter-ethnic and interfaith harmony. The Assembly, which I initiated at the first Ethnic Forum in Kazakhstan, celebrated its fifteenth anniversary in 2010.

Today, the Assembly has become an important element of Kazakhstan's political system, which reflects the interests of all ethnic groups and religions and respects the rights and freedoms of all citizens. The Assembly abides by responsible goals and objectives, which include: strengthening the country's statehood, protecting human rights and freedoms, encouraging transition to a new qualitative level of development to meet the requirements of the civilized world community.

This organization has progressively elevated its profile over the years. Kofi Annan, the then UN Secretary General, called Kazakhstan "a model of interethnic accord and a stable and sustainable development for other states", and said, "thanks to the work of the Assembly of the Peoples of Kazakhstan, diverse ethnic, cultural and religious groups constituting this great nation can participate in the process of making important decisions that influence their life."

In May 2007, a number of constitutional amendments were passed, which introduced significant changes to the role of the legislative branch. One of the most important changes was to increase the number of Majilis members to 107 people, nine of whom are elected by the Assembly of the Peoples of Kazakhstan. This will ensure greater diversity in the Majilis and strengthen the role of the Assembly of the Peoples of Kazakhstan.

It is also noteworthy that since independence the number of religious associations in Kazakhstan has increased by six times. In the early 1990's there were 671 registered religious associations. By March 1, 2009 this had increased to 3,993 religious associations, representing more than 40 faiths and denominations. This was facilitated by the introduction of simplified registration procedures for religious associations, and also by the Government's tax policy which exempts religious associations from taxes on profit and offertory.

Astana hosted three Congresses of the Leaders of World and Traditional Religions in 2003, 2006 and 2009. I assign great importance to these events. The forums reflect the effectiveness of Kazakhstan's unique interfaith cooperation model.

To provide for internal stability and interfaith peace, a Program for Ensuring Religious Freedom and Improvement of Relations between the Government and Religions in the Republic of Kazakhstan for 2007-2009 was adopted in 2007. In addition, the National Human Rights Action Plan for the Republic of Kazakhstan for 2009 - 2012, included an assessment of religious freedoms in Kazakhstan and the necessary measures to provide better protection of the right to religious freedom.

The Government publicly expresses its support for religious tolerance and religious diversity and actively works in this area, promoting religious tolerance among its staff. This can be illustrated by a recent example: in February 2009, the Constitutional Council of the Republic of Kazakhstan overruled a law on the grounds of unconstitutionality, which had been passed by the Parliament and caused numerous objections from civil society and religious groups as limiting religious freedom.

The Commission on Human Rights (an advisory body of the Office of the President) proposed to amend the country's religious legislation to ensure consistency with international standards. This indicates that Kazakhstan's efforts to promote religious tolerance and interfaith understanding are durable and forward looking.

In this connection, I recall a meeting with the OSCE Secretary General, Marc Perrin de Brichambaut, in November 2009. The Secretary General said at the time that Kazakhstan could serve as an example of successful interethnic and interfaith relations for other countries. We are, of course, proud that our commitment to tolerance is acknowledged by the international community.

Friendship between peoples, integration between countries, and integration between cultures - these are not just empty words. Instead, in my opinion, this may very well be the only basis for the survival and prosperity of the peoples of the world. That is why I ardently support all sensible forms of integration.



3.1. CREATING A NEW POLITICAL SYSTEM FOR KAZAKHSTAN: POLITICAL STABILITY AND MODERNIZATION

The building of a new state following the collapse of the Soviet Union began in very difficult circumstances. During the first few years of independence, Kazakhstan was faced with a serious economic crisis, hyperinflation, a dramatic fall in economic output, and unprecedented growth of unemployment.

In a country where a totalitarian political system and, therefore, a total absence of pluralism of opinions had existed for seventy years, there was no historical experience of creating civic institutions or a democratic culture as such.

For this reason, shifting from a command economy and totalitarian system to a modern open market economy and liberal political system required a comprehensive strategy for accelerated economic modernization and step-by-step socio-political development in Kazakhstan.

This strategy rested on the main principle - economy is foremost, politics is second most. It was clear to me that carrying out political reforms during times of economic weakness and uncertainty, coupled with a nascent civil society, could lead to social instability and a rejection of liberal values.

I firmly believed that liberalization of the socio-political system would be successful only once a strong economic foundation had been created. Therefore, unpopular yet strategically important economic structural reforms were carried out within a short time. The basic principles of a market economy, which is a major economic prerequisite for democracy, were developed.

Having chosen the path of continuous liberalization, whereby sustainable economic development is based on the reliable and progressive political democratization process, we have carried out a step-by-step modernization of the political system.



In the early years of independence, we focused on shaping the foundation for Kazakhstan's statehood. We dismantled the basis of the previous totalitarian political system, established brand new modern democratic institutions, and created incentives for civic initiatives.

During this period, the basic structure of the public administration system was established. The position of President was established for the first time in the country's history, and a uniform system of executive bodies of power - from the Head of State to heads of local administrations - was laid down in the legislation. Initially, as decisive anti-crisis steps were needed, an objective choice was made to centralize power within this executive branch. However, as the market economy developed further over time, the public administration system began to evolve into a more decentralized system, and a path towards decentralization was chosen.

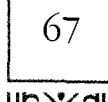
The first 1993 Constitution of Kazakhstan established the separation of state power into three branches - legislative, executive, and judicial, one of the basic principles of modern democracy. For the first time in history, multi-candidate parliamentary elections were held as well as elections for the new bodies of local representative power - maslikhats.

With the adoption of the 1995 Constitution, democratic institutions continued to strengthen and a Kazakh political culture was being formed. The establishment of a presidential system of government and a modern, two-chamber parliament provided for a stable political development of the state.

The 2007 constitutional reform has given new impetus to socio-political change, one of which was the switch to the use of proportional representation when electing deputies to the lower house of Parliament.

With the aim of representing a broad range of ethnic interests in the supreme legislative body of multinational Kazakhstan, a certain number of deputies were nominated to the Parliament by the Assembly of the Peoples of Kazakhstan.

In turn, the transition to a proportional electoral system has created conditions for forming the Government on the basis of the parliamentary majority party.



To enhance the status of Legislative Power, the Government was made responsible not only to the Head of State, but also to the entire Parliament to ensure the accountability and transparency of the Government with regard to its activities. Now a simple majority vote in Majilis would be enough for a no-confidence vote on the Government to pass the Parliament. The procedure for expressing "no confidence" in an individual minister has been substantially simplified.

In accordance with the latest constitutional amendments, maslikhats will become the institutional basis for the development of the local self-governance system.

The work of the Executive Branch is being consistently improved. The Kazakhstan public administration model is being gradually developed under the principles of efficiency, transparency, and accountability to society.

In accordance with the new state planning system, all bodies of executive power must develop five-year strategic plans with clear targets set for their activities and linked to the budgetary resources. The strategic plans and reports on their implementation are published in the media, which increases the transparency and accountability of public administration. Annual reporting of local executive bodies of all levels to the population has become a standing operating procedure.

The critical institutional changes that were performed have strengthened the basics of our democratic society and our liberal political system. Today, the Kazakhstan socio-political development model is recognized as unique; with its inherent stability and reform consistency, it has become a recipe for dynamic economic growth and investment attractiveness of a country.

3.2. THE RULE OF LAW AND PROTECTION OF CITIZENS' RIGHTS

Ensuring the rule of law and protecting citizens' rights has been high on Kazakhstan's agenda since independence. One of the main ways of achieving these objectives is to develop the legal system. I noted time and again that the guarantees of citizens' rights in the country should be strengthened within the framework of judicial proceedings and in the course of the

execution of court decisions, thus gradually moving towards modern and open proceedings.

Kazakhstan has made a few important steps, increasingly moving away from its Soviet past. In particular, many types of wrongdoings have been decriminalized, with suspended sentences/ probation and public works having been introduced as alternative punitive measures. In addition, capital punishment has been abolished in Kazakhstan and jury trials have been introduced. Unlike its neighbors, Kazakhstan allocates significant funding to improve working conditions for judges.

The development of an independent judicial system and the introduction of jury trials are two of the basic ways to ensure the rule of law in the country. It is noted in the Strategic Plan of the Supreme Court of the Republic of Kazakhstan for 2009 -2011 that at present there are commercial, administrative, military, and juvenile courts operating in the country. Since November 13, 2006, a financial court became operational in the City of Almaty. The effectiveness of the existing system of specialized inter-district commercial courts, located in every regional center of the country, as well as in the cities of Astana and Almaty, has been already proven, with the number of claims filed with commercial courts growing at an average rate of 6 percent per annum.

Overall, we can say that the activities of specialized courts have produced a positive impact on strengthening citizens' rights protection mechanisms, developing market institutions, and enhancing the investment attractiveness of the Republic. In the medium term, it is planned to establish specialized inter-district criminal courts and to increase the number of juvenile courts and administrative courts, which will deal with resolving disputes between citizens and Government authorities, therefore, providing for a higher level of protection of the rights and legitimate interests of citizens, shielding them from malfeasance and misconduct on the part of Government and other officials.

As indicated by international organizations, the introduction of jury trials has been an important step forward for Kazakhstan. If this model is implemented in the right way, jury trials, even in their limited capacity, can play a significant role in combating bribery and corruption, reducing pre-



trial waiting periods, and developing the independence of justice as well as transparency and accountability in the system, especially in a situation where citizens tend to mistrust courts.

Nevertheless, there are several significant problems that still remain to be solved under the rule of law reinforcement efforts undertaken in Kazakhstan. Obviously, the legal reform should encompass not only the judicial system, but the prosecution authorities and the attorney bars as well. There are a very small percentage of acquittals in Kazakhstan - less than 1% of the total number of criminal cases. This indicates not only that prosecutors' offices exert influence [on judicial proceedings] and that the judges are overcautious and afraid of responsibility, but also that the defenders are helpless or perform poorly. Another concern is the lack of openness and transparency in the system. According to the American Lawyers Association, problem areas that require further steps towards reforming the judicial system and establishing the rule of law in Kazakhstan include judicial review of legislation, judicial powers with regard to citizens' freedoms, appeal proceedings, dismissal of, and disciplinary sanctions against judges and other officials. Some of these estimates can be disputed, but it is obvious that we should not rest on our laurels - there is still a lot of work ahead.

3.3. DECENTRALIZATION OF GOVERNANCE

After the collapse of the Soviet Union, the newly independent states each launched an accelerated development of their national public administration systems. Kazakhstan was no exception. The country's long-term "Kazakhstan - 2030 Development Strategy" highlighted the creation of an effective and modern public service system, optimal for a market economy, as one of the top priorities. One of the key areas for modernizing the public administration system in Kazakhstan was its decentralization. The process of gradual transfer of functions from the center to the regions and from the Government to the private sector has been going on all these years.

The transition to a market economy demanded that the Government no longer directly regulate certain sectors of the economy and certain areas of life in society. Limitations imposed on Government intervention in the market and the improved effectiveness and efficiency of public administration



called for the need to streamline and optimize Government functions, to transfer some non-relevant, non-core Government functions to the competitive sector, to reasonably redistribute powers between the different levels the public administration system, and to form a sound system of inter-budgetary relations.

I have repeatedly emphasized in my annual addresses to the nation the need for an accelerated modernization of our public administration system, including through effective redistribution of Government functions and a clear-cut delimitation of competence and powers for each level of public administration, i.e. national, oblast, and local authorities, to avoid overlapping and duplication of functions and confusion, to enhance personal responsibility of Government members, akims, and other officials, and to improve the quality of Government services.

Decentralization of public administration in Kazakhstan was carried out on a step-by-step basis. During Phase 1 (1997 - 1998), a solid foundation for the future delimitation of powers between the public administration levels was created. In 1998, a functional overview of the activities of Government agencies, the first in the history of independent Kazakhstan, was conducted. The review was a kind of response to the then difficult situation, brought about by the huge amount of non-relevant, non-core Government functions in the conditions of a market economy and the insufficient level of budget revenues.

Under the 1998 functional review, an analysis of all budget-financed entities was conducted, with the functions performed by those entities divided between Government functions and commercial service functions. This made it possible to optimize a part of Government functions and to significantly reduce the number of budget-financed organizations and administrative costs, for that matter. However, those measures were not enough.

During Phase 2 (2003-2007), a systemic approach towards decentralization of public administration functions was developed and launched. A Concept for Delimitation of Powers between Public Administration Levels and for Improvement of Inter-Budgetary Relations was adopted and an ad-hoc committee for development of proposals on



redistribution of Government functions was set up under the Government of the Republic of Kazakhstan. In order to formalize the proposals of the said committee in relevant legislation, the first law on delimitation of powers between the levels of public administration came into force in 2005. In accordance with that law, the competence of local authorities encompassed a large number of functions in the areas of education, health care, culture, the social sphere, trade, and entrepreneurship.

Based on the analysis of the implementation of the powers transferred to lower levels and with the goal of providing further decentralization, the second law on the delimitation of powers between the levels of public administration was passed in 2006. The second law specified the distribution of powers in such areas as environmental protection, agriculture, land management, architecture, town planning, and construction, i.e. in the areas not covered by the previous law.

To optimize public administration at the local level, in 2004 the Government approved a model local Government structure, which provided a streamlined system of existing regional-level public administration bodies and created conditions for the qualitative implementation of the transferred powers.

The first budget code, which came into effect in 2005, governed the distribution of budgetary revenues and expenditures between the budgets of the different levels of public administration, which made it possible to clearly define inter-budgetary relations.

Finally, the distribution of functions between the central and local public administration bodies has been drastically changed in favor of the latter, and duplication in the activities of public administration authorities was largely removed. Implementation of a number of Government functions at lower public administration levels turned out more efficient than at the central level, and the objective of bringing Government services directly to the end-users as much as possible was fulfilled. These components of Kazakhstan's new public administration model have largely determined the economic success of the country.

An important step towards decentralizing public administration and, consequently, enhancing its effectiveness and efficiency was the development



of local self-governance within the oblast (region), administrative district, city/town, city/town district, the rural district, settlement, and village. Along with public administration functions, local representative bodies (maslikhats) and akims were also authorized to perform local self-governance functions.

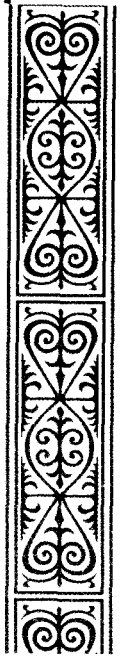
Modernizing public administration, increasing its effectiveness, and providing for the transparency of public administration continues to remain important priorities for us. In the long term, we will have to better understand issues of centralization or decentralization of governance in certain areas of public administration, and to expedite the transfer of non-relevant, non-core Government functions to the competitive sector, taking into account the development of self-regulatory organizations.

3.4. DEVELOPMENT OF THE ELECTORAL PROCESS

A stable political environment is fundamental for dynamic economic development. Therefore, it is important to create an effective electoral field within the framework of Kazakhstan's modern political system, and to ensure its maximum possible conformity to world standards, as well as the further development of the electoral legislation and quality improvements in electoral mechanisms to bring them fully into line with international standards and the level of development of Kazakh society.

The development of Kazakh electoral legislation has been gradual and steady. Constitutional amendments approved in 1998 introduced elections based on party lists, which encouraged the development of political parties. This represented an important step towards creating a new political culture to replace the previous system of direct election of deputies within electoral districts by a simple majority vote.

The next step towards democratization was the full introduction of the proportional electoral system for the election of Majilis (the lower chamber of Parliament) deputies in 2007. Other notable positive changes to the legislative framework were the increase in the number of deputies from 77 to 107 and a lifting of the ban on mass meetings between the end of the electoral campaign and the release of final election results. Given these changes, in the course of election for the Majilis in 2007, the Nur Otan party



won all the seats in the legislative body of the country. It has mainly determined the speed and effectiveness of the anti-crisis legislation being approved.

At the same time, the latest legislative changes to the electoral process provided for a legal mechanism for forming a Parliament with no less than two political parties. Thus, if the election results show that only one political party has overcome the 7 per cent entry threshold, the runner-up political party is allowed to take some deputy mandates.

Political parties will play the main role in the modernization of the political system. For this reason the quantitative "threshold" for the registration of political parties has been lowered. The procedures and requirements for the registration and financing of the political parties represented in Parliament have been simplified.

During the electoral campaign, the mass media are required to give fair coverage and equitable access to all candidates and party lists' nominations, and to provide equal newspaper coverage and airtime in broadcast media. A ban on persons without relevant experience acting as election monitors was lifted in order to allow for an increase in election monitors representing all parties and candidates.

All these reforms have formed a stable political environment in Kazakhstan, which constitutes one of the key factors for a favorable business climate and social progress.

3.5. INDEPENDENCE OF THE JUDICIAL SYSTEM

During the years of Kazakhstan's existence as a sovereign country, its own judicial branch of power was built in accordance with the Constitution as an instrument to provide for the protection of the rights, freedoms and lawful interests of citizens and organizations. One of sovereign Kazakhstan's principal achievements appears to be not only the formal independence of the judiciary, but also the actual independence of courts and judges. This independence has been there from the very moment of the formation of judicial power. The democratic



system of transparent and competitive selection and appointment of judges constitutes the foundation of independent justice. The broad legal public is to decide what the judiciary should be like. In Kazakhstan, the judges are appointed by me on a permanent basis. This allows them to work without looking at executive officials of all levels, deputies, or their own judicial authorities.

Now a unified court system exists in Kazakhstan, headed by the Supreme Court. Specialized courts have also been developed in the country: administrative, commercial, military, and juvenile courts, which improve the efficiency of court proceedings. Since 2006, a specialist financial court has been operating in Almaty.

From January 1, 2007, jury trials are being held in the country for criminal cases, thereby greatly broadening public control and citizens' participation in court procedures.

To strengthen the judiciary and to help guarantee its real independence from the executive branch, the function of providing for the activities of courts has been transferred from the Ministry of Justice to the Court Administration Committee of the Supreme Court. By virtue of the constitutional reforms that took place in 2007, Kazakhstan's judiciary has acquired powerful new tools for protecting citizens' rights, including the sole right to arrest warrants for citizens. The approval of the new Law on the Supreme Judicial Council of the Republic of Kazakhstan has broadened this body's authority to ensure the independence and immunity of judges and the selection of high-quality personnel, in collaboration with the Supreme Court.

The reforms of Kazakhstan's judiciary, which had inherited many of the negative anachronisms of the Soviet past, are the most successful ones among Central Asia countries by their scale and substance. These measures are characterized by their consistency and high speed of implementation. At the same time, Kazakhstan is still looking for the answer to the question of how to better develop the judicial system to meet the needs of civil society and of the growing number of foreign investors.

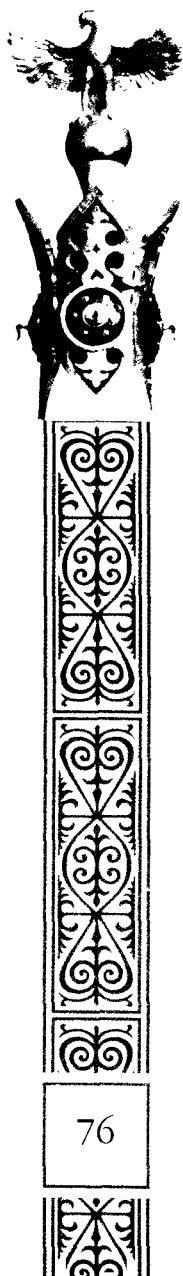


In ancient times, Kazakhstan provided a historic bridge between East and West, North and South. It was a crossroads of cultures and civilizations. Kazakhstan's foreign policy has always been multi-vector, aimed at cooperating in various fields and at various levels and at forming Kazakhstan's image in the eyes of the world community as an attractive and reliable partner. This approach was reflected in Kazakhstan's chosen model which is based on openness to the external world. It can be said that international cooperation is one of the "pillars" laid in the foundation of our country's chosen development model.

4.1. ECONOMIC INTEGRATION

I have always considered this country's economic integration into the world and regional economy as an objective necessity related to the development of globalization processes. Ignoring these processes could obviously lead to the hopeless lagging behind. It is abundantly clear that handling modern global problems alone is extremely difficult, maybe even impossible. That is why I am committed to integration, both regional and global.

Kazakhstan's cooperation with the "outside" world is determined by separate bilateral agreements and regional trade agreements within the framework of certain integration associations, such as the Commonwealth of Independent States, the Shanghai Cooperation Organization, the Eurasian Economic Community, and the Customs Union. Kazakhstan demonstrates an active member position in regional associations, often initiating their inception. Here, the vector of regional associations is directed not only towards other Central Asian countries, but towards nearest neighboring countries, i.e. Russia and China, which are the biggest economic players in the region as well. Kazakhstan is known as frequently performing the role of "locomotive" in regional development and the founder of regional associations. It is hard to overestimate the importance of such associations: they serve as the basis for developing large capacity markets and are the necessary conditions for attracting investments that play the most important



role in Kazakhstan's economic growth. Kazakhstan and its regional and continental integration partners (the CIS, the EurAsEC, CAC and the SCO) have long been in the mainstream of the global trends of the first quarter of the XXI century, which was the formation of regional integration associations.

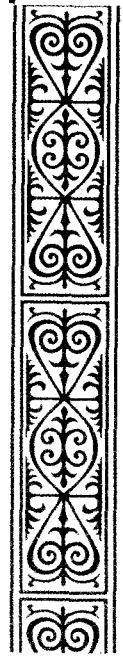
Currently, Kazakhstan is a member of the following regional associations:

The Commonwealth of Independent States (CIS) - membership since 1991. The CIS unites Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, the Russian Federation, Tajikistan, Uzbekistan and Ukraine. In September 1993, the Commonwealth Heads of States signed a treaty on the creation of an economic union to form a common economic space, based on the free movement of goods, services, labor, and capitals; to develop a coordinated monetary, credit, tax, pricing, customs, and foreign economic policies; to harmonize economic regulation practices; and to create favorable conditions for promoting direct production linkages.

The Shanghai Cooperation Organization ("SCO") unites the Central Asia region and China. While originally focused on ensuring regional security, the goals of the organization have now been broadened to include economic cooperation. One of the long-term goals of the SCO, for example, is to create free trade zone between its members. In 2005, an Interbank Council was established within the SCO in order to finance joint energy projects. In 2009, China announced its intention to provide a US\$10 billion loan to the members of the organization for the purposes of overcoming consequences of the global economic crisis.

SCO member countries devote significant attention to ensuring stability and security in area covered by the organization, which is especially important, given the situation in North Korea and Afghanistan, and to promoting trade and economic cooperation. I believe that the Shanghai Cooperation Organization could introduce a single supranational settlement unit, tied to the basket of main regional currencies. This unit could be used in trade and economic settlements between the SCO member-countries.

Eurasian Economic Community ("EurAsEC") is a regional organization, created with the purpose to assist in the establishment of a Customs Union



and a common economic space for its member countries. EurAsEC was created in May 2001. Armenia, Moldova, and Ukraine all have an observer status, and in 2002, after the Organization of Central Asian Cooperation joined the EurAsEC, Georgia and Turkey also received an observer status. Uzbekistan joined EurAsEC in 2006. This association currently is one of the most dynamically developing organizations. Thus, in June 2009, EurAsEC member-countries agreed to establish a US\$10 billion anti-crisis fund. Its goal is to help the member-countries maintain their balances of payment during the crisis. As the largest founders, Russia and Kazakhstan will contribute US\$7.5 billion and US\$1 billion, respectively, to the fund.

During the latest EurAsEC summit in November 2009, a regulation on the main principles, directions, and forms of cooperation of the EurAsEC member states to maintain their external border regime and a memorandum on the establishment of a common insurance market for EurAsEC member-states were approved. The budget address "On the Budget Policy for 2010", which outlined the overall strategy of economic cooperation of EurAsEC member states was also approved along with other major decisions. It should be noted that a Customs Union between Kazakhstan, Russia and Belarus has been created within the EurAsEC framework.

International trade and foreign direct investments have played a central role in Kazakhstan's development. A thoroughly calculated integration strategy provided external resources for Kazakhstan's industries and businesses through obtaining access to more sizeable markets for Kazakhstan-produced goods, as well as through attracting financial resources.

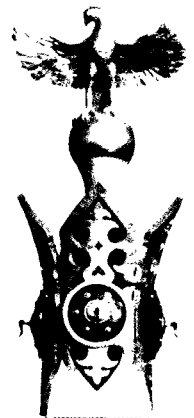
Since gaining independence, Kazakhstan has developed its own traditional export structure, reflecting the country's richness in natural resources. Thus, according to the 2008 BP Statistical Review of World Energy 2008, , Kazakhstan possesses nearly 3.2% of world proven oil reserves (39.8 billion barrels), 3.8% of natural charcoal reserves (31.3 billion tons), 1.6% of world natural gas reserves (rank 11), 1.5% of natural coal reserves (rank 10). Kazakhstan also has deposits of chromium, lead, aluminum, zinc, iron ore, and gold. Kazakhstan is one of the largest grain exporters, ranking in the top ten globally. Selling [natural] resources in international markets has been the engine of foreign trade growth and the source of hard currency, and, ultimately, the source of the growing wealth of Kazakhstan for a long time.

Kazakhstan's largest trade partners are China and Russia, which are also our largest neighbors, and the European Union. They have always had a demand for raw materials, and Russia has been using Kazakhstan's resources for its industry since the time of the Soviet Union. China's demand for Kazakhstan's raw materials has eventually been growing, given its geographic proximity and stable economic growth. However, the European Union remains the undisputed leader so far, consistently taking around 40% of Kazakh's exported goods.

Kazakhstan is the European Union's strategic partner in the Central Asia region. To intensify trade cooperation, Kazakhstan has approved a state program called "The Path to Europe". However, it should be taken into account that, while the European Union is Kazakhstan's largest trade partner, for the European Union itself Kazakhstan is but one out of many suppliers of raw materials. For example, in 2007, Kazakhstan ranked 29th among European Union trade partners, supplying only 0.5% of European imports (rank 22) and absorbing 1% of exports (rank 36).

China's importance for Kazakh exports has been growing over the last few years. This is a result of growing Chinese demand for raw materials and its relative stability during the global financial and economic crisis. It is also a result of improved trade logistics between Kazakhstan and China, particularly the recently completed construction of a gas pipeline and the second phase of an oil pipeline from Kazakhstan to China. It is now important for both countries to refocus on cooperation in non-extractive sectors. In this regard, during my official visit to China, both sides stressed the importance of implementing an action plan for improving cooperation in non-extractive sectors between the Kazakhstan and China, effective as of April 9, 2008. This plan is directed at broadening the trade turnover between the two countries, at raising the relative share of high value-added and high-tech products in bilateral trade, and at taking mutual steps to diversify the structure of trade.

Russia continues to be a significant economic partner to our country. The somewhat weakening position of the Russian Federation as one of Kazakhstan's main trading partners is explained, primarily, by the consequences of the global crisis. The decline in Russia's GDP, the fall in industrial output and weakening purchasing power have led to a decrease



of aggregate demand in Russia. However, trade between the two countries will undoubtedly revive and strengthen as economic growth returns. More so, the creation of a Customs Union, which also includes Belarus, will support this trend. The markets in Russia and Belarus will be more open for Kazakhstan's export goods, and these goods will be cheaper and, therefore, more attractive than similar goods from third-party countries.

Kazakhstan's role in the Eurasian and Central Asian development will always be significant, given its strong growth compared with that of other Central Asian countries and its strategic geographic position, as Kazakhstan is located at the crossroads of major investment and trade flows in Eurasia. However, we need to capitalize on our position as the "transportation corridor" between Europe and Asia for the more effective development of international economic cooperation. There are some problems here that need to be addressed. Kazakhstan does not have access to the sea. As I have mentioned earlier, this raises transportation costs by 50% on average, according to the World Bank and Columbia University estimates. As a result, volumes of trade of "land-locked" countries constitute about 30% of the corresponding volumes of countries that have direct access to sea transport. There is another geographic factor which seriously complicates our efforts to become a "corridor" between Europe and Asia. Kazakhstan used to be located in the middle of the Great Silk Road, but now it is surrounded by developing countries with weak transportation infrastructure and low-level economies. The creation of a modern transportation corridor through Central Asia is also complicated by the unwillingness of the neighboring countries to make joint efforts to increase cross-border traffic. It affects Kazakhstan's plans to position itself as a transit zone between Europe and Asia, and as a result the Government is making significant efforts to develop highway and railroad connections with Russia and China.

It is also necessary to work on improving the terms and conditions of cross-border trade. According to World Bank experts' estimates, foreign trade costs in Kazakhstan are 6.5 times more expensive than those of the world leader - Singapore; the number of required documents is 3 times greater, and the time necessary for such trade is 18 times greater. To address this problem, the Government is implementing a number of reforms aimed at improving and facilitating trade relations. These include a reduction of administrative barriers (legal changes, facilitation of cooperation between

Government agencies, and technical and information technology improvements at customs checkpoints) and customs control improvements (including the introduction of important changes to simplify customs control procedures and a reduction in the number of documents necessary for carrying out foreign trade activities, and simplified procedures for obtaining the Certificate of Origin).

4.2. KAZAKHSTAN'S FOREIGN POLICY INITIATIVES

Kazakhstan's integration into the world community is taking place not only in the economic, but also in the political, social, and cultural spheres. This cooperation takes place at various levels and goes manifests itself in many different ways, including, but not limited to, strengthening regional security, hosting congresses of representatives of all world religions, humanitarian aid to countries in need, launching intergovernmental dialogs on key development issues of various countries, and, in the global perspective, introducing Kazakhstan to foreign audience, studying and introducing foreign experience in the fields of education, healthcare, and many others. The principles of a balanced, multi-vector foreign policy have proven their consistency and constitute an uncontested foundation for our interaction with the international community.

The non-confrontational presence of world leading political and economic powers in Kazakhstan and the region is being ensured by political means. Today Kazakhstan has strategic partnership relations with Russia and China, with USA and the European Union. The creation of stable, predictable, and constructive cooperation with these world powers, given the permanent confrontation of their different and mutually exclusive interests in the region, was made possible by virtue of carefully planned foreign policy strategies. Here, our diplomacy strictly complies with the economic potential and political capabilities of Kazakhstan.

The Russian Federation has been and will continue to be our key partner and ally. Our bilateral relations are characterized by scale, dynamics, and a high level of mutual understanding. We have developed a unique practice of solving issues on a parity premise between us, in the interests of both states. Furthermore, Kazakh-Russian relations have become not only a driving



force of economic development and integration, but a guaranty of stability within the whole of the CIS area.

There is absolutely no doubt that our great neighbor China is becoming one of the world's superpowers. This is why I keep saying there is no alternative to the development of friendly relations with this giant state. Moreover, in the foreseeable future, China, given its dynamic growth, will be playing an increasingly important role in Kazakhstan's economic program.

The development of strategic cooperation with the USA has special importance for Kazakhstan. The economic and political leader of the world community holds Kazakhstan's role in ensuring global and regional stability and security, our country's contribution into addressing the problems of nuclear non-proliferation, our anti-terrorism and anti-extremism efforts, and our efforts in maintaining energy security in high regard. Active political contacts at the highest level have confirmed the growing understanding in Washington of our country's role in the region and of the essence of democratic changes in Kazakhstan. The United States perceive us as a key state in the region which is crucial for promoting stability and economic and political development in the Central Asia region.

The tremendous economic interests and growing geopolitical interests of European countries constitute the foundation of our cooperation with the EU, and we have jointly initiated the intensification of the close political dialogue between us.

The relations of trust and cooperation are being shaped with the European Union countries. The European Union is Kazakhstan's largest trade partner. We will continue to develop these relationships. Strategic partnership agreements have been signed with France and Italy; additional proof of this fact is the developing cooperation with Germany.

The Arab world has also made its contribution to the formation and development of Kazakhstan. We will certainly continue to cultivate constructive relations with Arab countries for the benefit of both sides.

We consider it our duty to promote stability in the world and in our region. We made our contribution to the global stability when we rejected



nuclear weapons, and we have continued to follow this principle. The echoes of instability in Central Asia are still reaching our southern borders, which certainly concerns us. No country can be prosperous whilst it has poor and unstable neighbors. Whilst discussing regional stability, we cannot help but mention the problem of Afghanistan. Afghanistan's recovery is crucially important for ensuring security in the region: by creating an economic prosperity "belt" we will be able to establish a reliable barrier to international terrorism, religious extremism, drug trafficking, and illegal migration. Taking this into account, Kazakhstan is making substantial efforts to stabilize the situation in Afghanistan.

In November 2006, the Government approved a special assistance program for Afghanistan. Our participation in Afghan recovery consists of humanitarian aid and cooperation in the field of education. We intend to sign a number of intergovernmental agreements with Afghanistan in the near future, relating to investment protection, combating drug trafficking, and highway and air connections. Furthermore, a new plan of measures to help Afghanistan is being prepared for the forthcoming period, which will contain priority projects for that country's economic recovery.

Our US\$50 million support plan for Afghanistan has been approved, with the focus being on personnel training for the needs of the Afghan economy.

I am becoming increasingly convinced that solving Afghanistan's problems is a global challenge, and it requires pivotal decisions. For a hundred years already, Afghan children have been first taking weapons in their hands, not toys. The war and drugs have become easy ways for surviving. The task is daunting: how to turn the warrior nation into a working nation.

Maybe, one of the real ways is to create transit corridors out of Turkmenistan and Uzbekistan into Pakistan, India, and down to the Indian Ocean. Transit may include gas and oil pipelines, automobile highways and railroads.

I am fully aware of the fact that it will require a lot of effort from many countries, but I believe it is worth doing. I am sure that former Taliban members themselves would value and guard this "road of life". In any case,



war in Afghanistan, the costs of the protective measures against drug trafficking and terrorism, ineffectively consume much more in terms of resources than would have been spent for the organization of such transit or other creative measures.

The participation in the work of multilateral structures at the global and regional levels plays an even more important role in our foreign policy activity. Here, Kazakhstan participates only in those organizations, whose activities correspond with its national interests. The three pillars of the Eurasian Idea, realized at the initiative of Kazakhstan, are EurAsEC, the CICA and the SCO. And these are three different practical expressions of one inexpressible whole, which is the United Eurasian Idea.

Today, the attention of the world community has turned to the Shanghai Cooperation Organization. The SCO, in which Kazakhstan participates very actively, is being transformed into a full-fledged factor of international politics, exerting positive influence on the geopolitical situation. The mutual trust in the military-political sphere is being strengthened in the vast SCO space, and the multi-profile regional cooperation is being successfully realized on this solid basement. Kazakhstan sticks to a weighted position and watches carefully to rule out any speculations that SCO activities are becoming clearly anti-western.

The CICA summits held in Kazakhstan are a sizable contribution of our state to the world community's efforts to provide for global stability, peace and security. These steps by Astana are, without doubt, highly praised by the world community. In particular, the CICA serve as a fundamental element for working out a Pan-Asian security system.

As for the measures being taken to fight security threats, we wish to note specifically the establishment of the Central-Asian regional information coordination center, which is to consolidate the efforts of the region's countries in their fight against drugs and crime.

During the past years, the world community's attention to the Central Asia and Caspian Sea region has increased and become a priority for many global and regional players. Attention to Kazakhstan as the leading regional power requires strict and coordinated actions on our



part and makes foreign policy activities one of the most important areas in the work of country's leadership. It is necessary to note in this regard that our foreign initiatives are aimed to solve urgent problems of modern world, and I devote all my efforts to this. This is strengthening our positions on the world arena and is being supported by the world community.

4.3. COOPERATION IN THE SOCIAL AND CULTURAL SPHERE

Cooperation in the social and cultural sphere comprises various directions. These are congresses of representatives of all world religions and activities within the framework of international organizations, introducing Kazakhstan to foreign audiences, studying and drawing on foreign experience in the fields of education, healthcare, and in other spheres.

Kazakhstan is a unique multinational state located in the center of the Eurasian continent. Being a kind of bridge between East and West, the Christian and the Muslim worlds, the Slavic and Turkish peoples, Kazakhstan has absorbed spiritual values, humanitarian ideas, and best traditions of world cultures and religions. Kazakhstan became a real home for many nations who appeared in our land by the twist of fate. More than 130 ethnicities and representatives of various religions are united on the territory of Kazakhstan. Based on such universal values as tolerance, peacefulness, and mutual respect, we were able to turn historic diversity into our advantage and national strength.

I am deeply convinced that our positive experience in the peaceful coexistence of different cultures and religions is of interest to many countries. The congresses of the leaders of the world and traditional religions, held in Astana in 2003, 2006 and 2009, brought together the most prominent religious figures of the world, and became an example of a global cultural and religious dialogue. Our country has become known to the world community as a state with a stable political system, a state where social accord and stability prevail, a state where all the necessary conditions have been created for a free and peaceful coexistence of various denominations.



We are always ready to support initiatives directed at achieving harmonious development of human society and at the convergence of the Eastern and Western cultures. I made this choice at the 62nd session of the UN General Assembly in 2007, where the resolution proclaiming the year 2010 the "International Year for the Rapprochement of Cultures" was approved, mainly owing to our efforts. A conference of foreign ministers entitled "The Common World: Progress through Diversity", which took place in Astana on October 17, 2008, was also aimed at furthering the basic idea of harmonization of the East-West relations in the political and ideological contexts.

It should be noted that Kazakhstan's candidacy was approved for chairmanship in such highly regarded and reputable organizations as the Organization for Security and Co-operation in Europe (OSCE) in 2010 and the Organization of the Islamic Conference in 2011, mainly due to the policies of peacefulness and tolerance promoted by our state.

Our country has become known to the world community as a state with a stable political system, a state where social accord and stability prevail, a state where all the necessary conditions have been created for a free and peaceful coexistence of various denominations. Kazakhstan's experience in ensuring inter-religious accord is being studied in many western and eastern countries. Our domestic and international achievements are the result of our consistent and weighted policy, aimed at creating a democratic state with a market economy, where peace and the unity of the Kazakhstan people is the main value.

Our interaction with the Islamic world constitutes to be a top priority of the state's foreign policy. On its part, the Islamic world considers Kazakhstan as an unalienable part of the Muslim community. Therefore, in 1995 Kazakhstan joined the Organization of the Islamic Conference. From the moment of joining, Kazakhstan has been steadily developing its interaction with the General Secretariat, and the subsidiary bodies and institutions of the Organization which we will chair in 2011.

Being a poly-ethnic and multi-confessional state, Kazakhstan fully supports the global process aimed at facilitating the dialogue between civilizations and religions. Our country's active participation in the



Organization of the Islamic Conference, as well as in other major regional and global organizations, is becoming ever more important today. Apart from economic cooperation, it is important to increase cooperation with the Organization in the fields of education, culture, science and technology. Facilitating close interaction with the Islamic Educational, Scientific and Cultural Organization (ISESCO) gives Kazakhstan the opportunity to be more successful in the realization of such national projects, as the protection and restoration of cultural heritage artifacts, the exchange of experience in studying and teaching foreign languages, history and culture of the Islamic world countries.

In 1992, Kazakhstan together with Azerbaijan, Kyrgyzstan, Turkmenistan, Turkey, and Uzbekistan signed a treaty on the establishment of an international organization for cooperation in culture and arts named TURKSOY (Organization for Joint Development of Turkic Culture and Arts).

The creation of TURKSOY is aimed, first and foremost, at the revival of spiritual exchange traditions between related nations and countries of the Turkic language area. At the same time, the Organization's multi-profile work facilitates not only cultural interchange and cooperation among TURKSOY member-countries, but also the establishment of a stable peace, dialogue and solidarity between all people of good will on the planet.

This Organization builds its work based on the principles of respect of sovereignty and independence of its member-countries and third countries and complete non-interference in their political orientation. While setting the goal of becoming a kind of pillar for the spiritual convergence of Turkic peoples, TURKSOY has become our common hearth and home. Today, 14 nations of the Turkic area are united under the banner of TURKSOY. This is a very important achievement.

Cultural cooperation between the Republic of Kazakhstan and foreign countries is also dynamic. Efforts in this sphere are directed at familiarizing the foreign audience with the culture and rich traditions of not only Kazakhs, but of all the peoples of Kazakhstan, representatives of various nationalities and confessions living in our country.

To provide for a sustainable nature and dynamic development of interaction in the cultural sphere Kazakhstan has signed a number of cultural

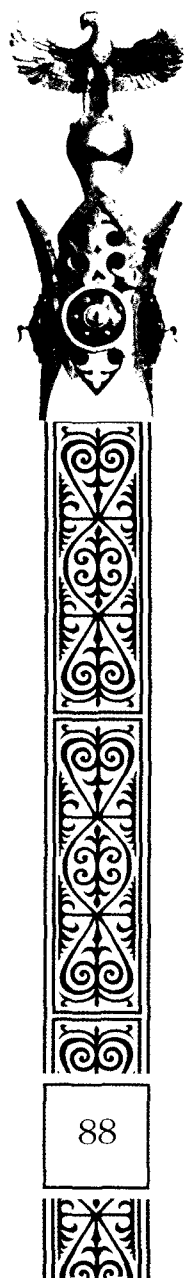


cooperation agreements with various countries. Among them are Italy, Israel, Jordan, China, South Korea, Azerbaijan, Russia, Armenia and many others. Under the framework of these agreements, Kazakhstan's and foreign artists and performers take part in festivals and competitions organized in the participating countries, and exchange tours, exhibitions, internships are also being arranged for. The sphere of interaction includes cinematography, opera, theater, studies of cultural and historical heritage, and many other areas.

Days of Kazakhstan's Culture in foreign countries and those countries' Culture Days in Kazakhstan are being held on the regular basis. This also facilitates mutual acquaintance and promotes friendly relations of Kazakhstan with the outside world. For example, in 2009 Kazakhstan's culture days were held in the United Arab Emirates, the Republic of Belarus, Turkmenistan, the Kingdom of Saudi Arabia, and the Hashemite Kingdom of Jordan. In total, Kazakhstan's cultural events abroad were visited by more than 50 thousand spectators.

International cooperation is highly important for the development of Kazakhstan's education system. Free contributions of foreign partners into our education system amount to more than US\$25 million annually; they are being provided in the form of stipends, grants, contributions to joint projects, etc. Some 20 thousand Kazakhs are studying annually in 34 foreign countries, apart from members of Bolashak Program. Receiving education in Russia is in the highest demand - 12.5 thousand people. China ranks second - 3.5 thousand people. The United Kingdom, the USA and Turkey come next, with approximately 1,000 Kazakh citizens studying in each of these countries annually.

There are joint international universities operating in Kazakhstan: the Kazakhstan-British Technical University, the Kazakhstan-Turkish Yasavi University, the Kazakhstan-German University, the Kazakh-American Free University, and the Kazakhstan-Russian University. The Kazakhstan branch of the Lomonosov Moscow State University also makes a big contribution to the education of qualified specialists. Currently a dual diploma education program is being realized in the nine universities of Kazakhstan in partnership with foreign universities.



The USA is our largest partner in the field of education. Programs for students, graduates, and specialists are being organized annually with the support of the Department of State, mainly including: projects administered by the American Council for International Education, Future Leaders Exchange Program (FLEX), Junior Faculty Development Program (JFDP), Eurasian Undergraduate Exchange Program (UGRAD), and many others. Kazakhstan also cooperates with the European Union, Russia, Turkey, Egypt, China, Poland, the Czech Republic, Israel and Japan.

International cooperation in the sphere of healthcare is being implemented on the basis of international treaties, agreements and conventions. Currently, there are 50 active cooperation agreements with neighboring and non-neighboring foreign countries and international organizations (WHO, USAID, UNICEF, the World Bank and others). Kazakhstan has been an official member of the WHO since August 1992. Kazakhstan's healthcare system has received substantial assistance from the WHO during its membership. A Two-Year Cooperation Agreement between the Kazakh Ministry of Health and the Regional Bureau of the WHO for 2008 - 2009 was signed to develop cooperation further.

Kazakhstan has been the member of the World Bank since 1992, and the Bank, in turn, has provided more than US\$2 billion in the form of low-interest rate loans and grants for 28 projects in various spheres, including the healthcare sector. The United Nations Children's Fund (UNICEF) provides assistance with projects on introduction of birthrate increase criteria, combating HIV/AIDS, etc. The USAID committed itself to support the State Program of the Republic of Kazakhstan on Health Care Reform and Development until 2010 in the area of improving reproductive health and diminishing the number of abortions, supporting family practice, evidence-based medicine and quality primary health care. Taking part in the implementation of the projects, the USAID renders assistance to the Government of Kazakhstan in conducting financial reforms in the healthcare sector.

Kazakhstan is an active participant of the world migration processes, and it is becoming more and more attractive for ethnic Kazakhs living abroad. A proof to this fact is the return of more than 706 thousand ethnic Kazakhs



to our country since 1991. At the same time, the migration flows were often spontaneous and irregular.

Therefore, to address the problems of rational settlement of former Kazakhstan citizens who returned home to look for a job, as well as for ethnic in-migrants, in 2008 the Government adopted its "Nurly Kosh" program.

I could not permit a situation in which ethnic Kazakhs who have returned to their historic Motherland were unable to find jobs or decent housing. The Government has been providing, and will continue to provide, all necessary social assistance and support to such migrants. There are already 14 resettlement centers for so-called "oralmans" in Kazakhstan, special adaptation and official language teaching programs, as well as professional education and training programs, and special Councils to address oralman's issues that are operational and provide assistance to such immigrants. The Government carries out housing projects for ethnic immigrants.

At the same time, Kazakhstan also requires a qualified or highly skilled foreign workforce to meet the demands of national economy, but nevertheless sets quotas for foreign workers as a certain percentage of the economically active domestic population so as to protect the internal labor market.

In general, Nurly Kosh Program allows for a streamlining of the processes of ethnic and labor migration based on the socio-economic interests the country's regions, to prevent risks that may appear in connection to unemployment and spontaneous migration, and, most importantly, to raise the quality of life of a significant portion of ethnic and labor migrants.

In summary, I can say that international cooperation, being crucially important for the achievement of our strategic goals and implementation of our initiatives, is developing successfully and dynamically, mainly due to the fact that Kazakhstan was able to win the reputation of an honest, open, and reliable partner.

A lot has already been written about Kazakhstan's modernization model. It has become an object of learning without moving away to history annals.



And I have already written and spoken much about it before very diverse audiences. But, trying to think over the lessons of the global economic crisis and the new challenges and opportunities for our country's development connected with it, I could not stand the motion to return to this topic. I felt this was extremely important to point out to those "carrying structures" of this model, which were hard enough to withstand the strongest blows. In this chapter I wanted to remind the reader about the path on which we have come, about the step-by-step modernization of our society and its social and political institutions which has been built on the foundations a strong and stable economy, about the growth in the prosperity of our people, and about Kazakhstan's growing international respect which has allowed us to set ourselves the goal of entering the 50 most developed countries of the world. In addition, I wanted to remind the reader about the fact that the driving force of our development was the energy of the dream of the wonderful people of Kazakhstan, clothed into dry strategic calculations and verified "road maps". The consolidation of society based on the construction of a new, modern, and prosperous Kazakhstan has become the main factor of the country's sustainability in today's difficult environment and a guarantee for the successful continuation of the path we have chosen.

It is impossible to describe precisely the hardships which our people had lived through when they lost their guidelines after the collapse of the Soviet Union and were left to deal with a collapsing economy and massive unemployment. We did not have any experience either in building capitalism via socialism (there were no precedents anywhere in the world) or building a state. We did not have any liberal traditions in politics and economy. We did not have our own security system and foreign policy. Ethnic conflict, collapse, and a return into the Russian Federation were predicted for us.

But the people who got independence and freedom for the first time in their centuries-old history did not want to lose these accomplishments, and they have prevailed. The independence of Kazakhstan, our Motherland, is foremost! I am sure that this call, this idea, will always be with my people.



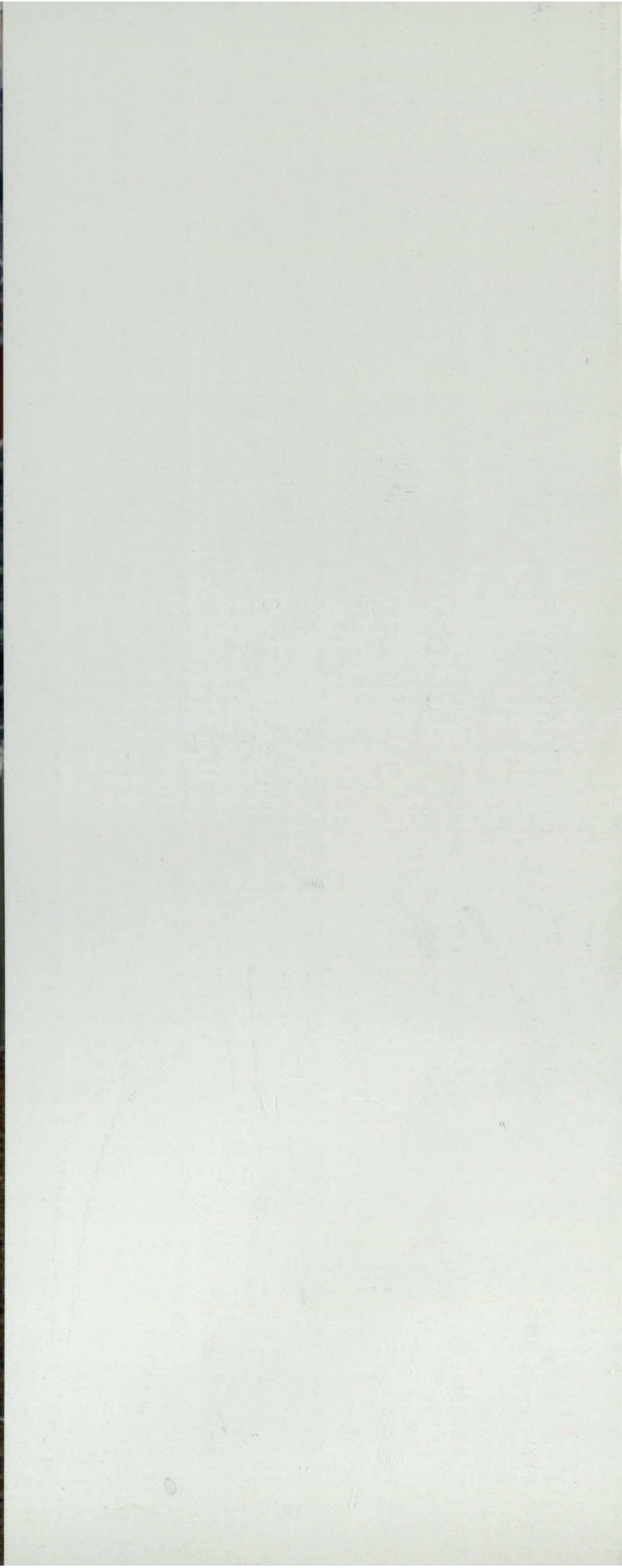


**MAINTAINING STABILITY AND
THE WILL FOR DEVELOPMENT IN
THE FACE OF THE GLOBAL
ECONOMIC CRISIS**



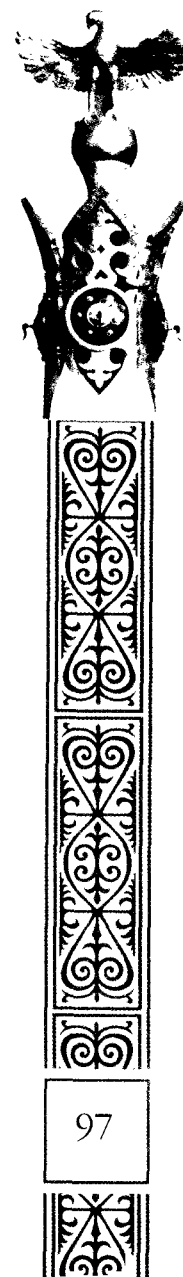


Kazakhstan's anti-crisis measures have been designed in such a way as to provide immediate support to the economy in times of external shock and to build an infrastructural and industrial framework for further economic development at the same time



CHAPTER II. MAINTAINING STABILITY AND THE WILL FOR DEVELOPMENT IN THE FACE OF THE GLOBAL ECONOMIC CRISIS

In the global economy the line between external and internal economic problems has become increasingly difficult to draw. Today, not a single state can pursue successful development outside the system of global economic relations. However, at the same time, this also implies that no country is safe from the negative impacts of crises, which can start at different corners of the globe. This leads to a situation where a balance between milestones of accelerated development and durability against external shocks becomes an especially important component of national strategies of developing countries. The record of measures adopted by Kazakhstan to address the world economic crisis demonstrates that we managed to find such a balance, mitigating the negative consequences of the crisis on the country's socio-economic conditions and providing a basis for future qualitative and sustainable economic growth.



The crisis that hit the world economy in 2007-2009 is often described as the most serious economic recession since the Great Depression of the 1930's. The scale, synchronized nature (it impacted the economies of all

countries worldwide), scope and rapid advance of the crisis became the distinguishing features. Total losses during the crisis from asset write-offs around the world are estimated at approximately US\$4 trillion. The current financial and economic crisis, having started in an individual country, spilled over into a global phenomenon. Its echoes will continue reverberating for some time, affecting global, regional and national economies, particularly as far as national economic systems of mid- and less-developed countries are concerned.

The causes of the crisis involved financial market bubbles that emerged as a result of unbalanced development of real and financial sectors of the global economy, the 2007 mortgage crisis in the US, and a sudden increase in world commodity and food prices. Several years preceding the crisis, low interest rates and inflows of foreign capital created conditions for "cheap credit" in many countries, feeding house price booms and consumption financed on credit. A securitization model which reduced the transparency of risk and deterioration of lending standards ultimately led to the collapse of financial institutions which had been previously considered to be more reliable.

The immediate start of the crisis stemmed from the collapse of an overheated US mortgage loan market. This overheating was characterized by significant growth in so-called sub-prime mortgages which were issued to borrowers with weak credit ratings (for example, as a result of poor credit histories or low incomes) or with limited equity. A variation of this was to issue mortgages with low interest rates for the first few years, with the interest rate increasing significantly thereafter. One of the main assumptions underpinning such lending practices was that if sub-prime borrowers ran into trouble with their repayments rising house prices would allow them to remortgage their properties. The practice of lending to sub-prime borrowers was fueled by the ability of banks to securitize these mortgages, repackaging the risks and on-selling them in the form of mortgage backed bonds to other banks and investors such as mutual funds and hedge funds, thus in many cases separating the bank which made the original loan from the credit risk itself, leading to further erosion in lending standards. As house price appreciation began to slow the US mortgage market bubble eventually burst, affecting not only the originating banks but the wider financial system too. At the same time, US consumers had been financing much of their



consumption through credit (including home loans or mortgages). The US mortgage market collapse coupled with banks' increasing wariness to extend other forms of credit to consumers had significant negative consequences for the US economy as well as other economies dependent on US imports. In addition, the losses experienced by banks and other investors lead to a contraction of credit to other sectors further impacting not only the US economy but the wider global economy.

Central banks throughout the world instituted emergency measures in order to support their financial systems and bringing stability in these circumstances. The European Central Bank ("ECB") provided loans to commercial banks in Europe totaling US\$130.2 billion to address acute liquidity shortages. The US Federal Reserve injected US\$24 billion into the financial system, mainly in the form of repo operations. Other leading central banks around the world, including the Reserve Bank of Australia, the Bank of Japan, the Swiss National Bank and the Bank of Canada followed suit. However, the unwinding of credit markets continued, and a second wave of the global crisis began after the failure of Lehman Brothers, one of the largest US investment banks and brokerages, in September 2008. The global financial system was subjected to severe stress, and governments and financial authorities implemented unprecedented measures by injecting financial markets with liquidity and nationalizing some of the largest financial institutions.

Such was the course of events. However, we should take into account the fact that the global financial and economic crisis had further systemic causes in addition to the structure of the US and other mortgage markets. The 2007 mortgage crisis helped uncover the fragility and instability of the wider global financial sector. Over a number of years the financial sector had seen significant growth in the securitization of not only residential mortgages but many other forms banking loans too. Similarly to pools of residential mortgages, banks had been originating commercial real estate loans, credit cards loans, student loans, consumer loans and leveraged loans (loans to risk companies) and had been repackaging the exposure to other investors via the capital markets. This contributed to the increase in overall levels of debt in the global financial system together with a further separation between the originators and ultimate owners of credit risk. As the financial markets collapsed and the prices of financial assets plunged, many investors



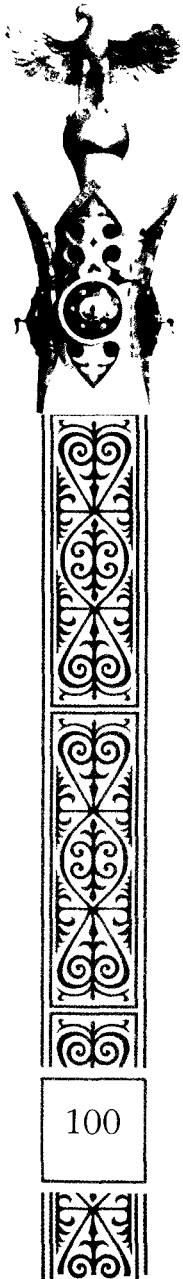
who themselves were heavily leveraged were required to liquidate investments in order to meet demands from their lending banks for additional collateral which placed further downward pressure on prices. To protect themselves against the turmoil in financial markets, banks began to hoard cash, tighten lending standards and reduce lending.

The financial crisis, which started in 2007, demonstrates that the monetary and financial system encouraged a virtualization of capital and its separation from the real economy, as well as emergence of multiple asset bubbles, the bursting of which has affected the well-being of millions of people.

We need to recognize that poor government regulation, including in developed countries, played a role in creating the global financial crisis. Investment banks and hedge funds, which were often referred to as "the shadow banking system", and financial derivatives were subject to insufficient regulation. Many experts believe that poor government regulation of the banking system became the major cause of the crisis. Indeed, it should be recognized that politicians and government officials were very late in identifying the scale of financial misbalance and related risks. The crisis also revealed the use of so-called "off-balance sheet assets" utilized by banks to bypass banking regulation requirements. Taken together, such assets constituted billions of US dollars.

Some of the systemic problems of the world economic structure also include serious imbalances, such as the ratio of investment and savings in various countries, their nature and trends. Investors from more developed economies over a period of many years saw it more profitable to invest funds in financial speculation as opposed to productive capital where a range of real sector investment opportunities was limited. A surplus of capital in the financial sector created asset bubbles, the collapse of which led to the start of the crisis.

The domination of the US dollar as a world reserve currency played its own role in the emergence and scope of the crisis. Many emerging economies accumulated considerable gold and foreign currency reserves in the aftermath of the Asian crisis. In the main, these reserves were US dollar-denominated, which reflected the role of this currency in international



transactions, as well as the size of the US bond and stock markets. Not only did this increase the dependency of the world economy on the currency and economy of the United States, it provided an opportunity for the United States to carry out an essentially unlimited issuance of currency, unsecured by real output.

It is obvious that a lot will be written on the subject of the causes and development of this global economic crisis. It is my belief that after a number of years many issues will appear in a clearer light. However, for us in 2007, the major issues were not so much the causes of the global crisis, but its consequences for Kazakhstan. Despite the fact that the crisis began in developed economies, I was under no illusion as to the threat that it posed to our own economy. The modern Kazakh economy is closely integrated into the global economic system. Global market conditions could not but affect our economy. The volume of export revenues and flows of private capital decreased significantly, while global credit markets were virtually shut. This dealt a blow to the banking system and industrial sector, putting at risk our social and economic development plans. With hindsight, it is evident that Kazakhstan has managed to pass the extremely difficult test posed by the crisis. However, it is also clear that this outcome would not have been possible without the steps taken at the time to shield our economy.

2.1. THE REGIONAL COUNTRIES IN CRISIS

As a result of the sophistication and openness of its banking system, Kazakhstan was the first country in the region to be affected by financial instability, adopting a number of anti-crisis measures as early as 2007. The anti-crises responses of other Central Asian republics followed at slightly later stages. Specifically, Kyrgyzstan and Uzbekistan implemented anti-crisis



programs in December 2008, while Turkmenistan adopted its own anti-crisis measures in May 2009.

Our country started experiencing truly challenging times in the summer of 2008 when prices for commodities experienced massive volatility. Oil and metal prices rose by sharply and then collapsed just as quickly. As a result, export earnings fell, just as investment inflows were decreasing. But we were able to provide ourselves with an opportunity to carry out countercyclical fiscal policy. Before the start of the economic crisis, budget surpluses, growing oil revenues, low levels of public debt, and inflows of foreign investment provided the Government with the means to build up the resources necessary to combat the effects of the international economic crisis. By the end of 2008 international reserves and assets of the National Fund amounted to US\$19.9 and US\$27.5 billion respectively, which taken together amounted approximately equal to 35.5% of GDP.

However, commodity prices in the first half of 2008 reduced the earning power of producers and contributed to a worldwide economic recession. The sharp hike commodity prices, particularly oil, caused rising costs of production and increased transportation costs, which triggered falls in manufacturing output and significantly exacerbated the unfolding financial crisis.

High oil prices mitigated the first wave of the liquidity crisis in Kazakhstan. But a sudden drop in oil prices (in October 2008 the price of Brent crude oil fell below US\$70 per barrel for the first time in 14 months) resulted first in a slackening in the rate of economic growth and eventually economic contraction. A need emerged for an integrated approach to bringing about economic recovery in order to counteract the second wave of the crisis. As part of its anti-crisis plan, the Government rendered support to five major areas: financial sector, construction, small and medium-sized businesses, agricultural industry, innovative industrial projects and infrastructure projects.

Decreases in prices for Kazakhstan's principal exports, including oil and metals, forced the Government to revise the triennial budget with the forecast price of oil at US\$40 per barrel. Moreover, non-oil related budget revenues declined as a result of the contraction in the real sector of the economy. At



the same time, the Government's expenditures increased due to the efforts aimed at overcoming the consequences of the crisis. These expenditures were primarily focused on ensuring the continued functioning of the banking system during the global "credit crunch" which had virtually closed access to the international capital markets for Kazakh banks. The collapse of asset bubbles in specific markets, such as real estate, raw materials, etc., resonated in individual sectors, while the destabilization of the financial system would have had a severe negative impact on the country's entire economy.

Low oil and metal prices led to current account deficits. In the first quarter of 2009 the current account deficit reached 4.7% of GDP, which marked a significant departure from a budget surplus of over 14% of GDP in the first quarter of 2008. However, the ongoing inflows of foreign direct investment buttressed Kazakhstan's balance of payments. For 2008, as planned, the Government deficit hit 2.1% of the GDP. However, GDP rose by 3.2% and the trade balance surplus was US\$33.5 billion.

At the same, a full-scale economic crisis was also developing in Russia. Russia's economy started facing serious challenges in the second half of 2008 following the collapse of commodity prices. In September 2008, Russian authorities undertook a number of measures aimed at supporting the country's financial system. The terms and limits of deposits of government budget funds in strategic banks were increased to bolster their deposit bases. Government guarantees on bank deposit insurance for individuals were increased to RUR 700 thousand, or a little more than US\$23 thousand. The anti-crisis measures of the Russian government included loans and leasing of equipment to the country's agricultural industry, interest rates subsidies on loans to machine-building companies. The government's anti-crisis program paid significant attention to the social protection of the population and the preservation of existing jobs when creating new ones. Modernization of the economy and introduction of energy conservation technologies became a major aspect of the government's policy during the crisis. The Russian government spent RUR 1.09 trillion (US\$36.2 billion) and RUR1.23 trillion (US\$40.9 billion) on its anti-crisis measures in 2008 and 2009, respectively.

Another large economy in the region - China - spent CNY 4 trillion, or about US\$586 billion, to tackle the crisis. To offset the losses resulting from



the reduced world demand for Chinese exports, the government adopted an anti-crisis program focused on stimulating domestic demand. According to this plan, China earmarked CNY 600 billion (US\$87.6 billion) for scientific and technological innovations, and technical retooling and modernization; and CNY 850 billion (US\$124.1 billion) was earmarked to improve the country's healthcare system. China's continuing rapid economic growth also required increasingly heavy spending to secure energy resources, and prompted China to start strengthening energy cooperation with its neighbors.

Deceleration of economic growth in Russia and Kazakhstan affected their neighbors, as well. The populations of Kyrgyzstan and Tajikistan suffered as a result of significant declines in remittances from Kyrgyz and Tajik citizens working in Kazakhstan and Russia. In addition, Kyrgyzstan and Tajikistan both are dependent on energy imports, while countries in the region which are commodity exporters were less affected.

2.2. KAZAKHSTAN'S TRADE RELATIONS WITH RUSSIA, CHINA, AND CENTRAL ASIA DURING THE CRISIS

The global financial and economic crisis led to declines in trade volumes and, consequently, reductions of Kazakhstan's regional and global exports.

All Central Asian countries experienced negative effects stemming from reduced global demand. The exporters of hydrocarbons and raw commodities, as well as the countries primarily dependent on exports of their goods to Russia, suffered on a larger scale.

For the CIS countries, the crisis played a unifying role. At the CIS summit in Bishkek in October 2008, member countries agreed to coordinate economic policies with a view to counteracting the consequences of the crisis. Already in March 2009, the Economic Council of the CIS discussed joint anti-crisis measures by CIS member countries. According to the CIS strategy of economic development for 2020, the first stage is set for 2009-2011. It will comprise 18 areas that can be divided into two spheres - cooperation in strategic sectors and economic cooperation. An important aspect of this plan is cooperation in the field of transportation and

infrastructure development, which will facilitate development of trade relations among the member-states.

If we consider the recent geographic distribution of Kazakhstan's exports, it becomes apparent that China has become more important. In 2007, China replaced Russia as the third-largest importer of Kazakh goods. In 2009, China, overtaking Switzerland, became the second most important destination for Kazakhstan's exports. This occurred as a result of growing demand in China for raw materials and the relative stability of the Chinese economy during the crisis. Moreover, improvements in trade infrastructure and logistics between the two countries following the construction of gas and oil pipelines played a big role.

The table below provides export shares for Kazakhstan's trading partners among Kazakhstan's total volume of exports:

Major trading partners - share in total exports					
	2005	2006	2007	2008	H1 2009
EU	39.5	43.2	40.7	42.9	n.a
Switzerland	19.8	17.6	15.7	15.9	11.6
China	8.7	9.4	11.8	10.8	13.4
Russia	10.5	9.8	9.8	8.7	8.7

Source: Statistics Agency of the RK, WTO

Bearing this in mind, the volume of regional trade in Central Asia is significantly lower than the volume of turnover of the regional states with third-party countries and considerably lower than the existing potential. The intra-regional exports of the four Central Asian countries represented 11.67% of the total trade volume in 2005. The intra-regional imports for the same period were only 19.7% of the total volume of imports of the regional countries.

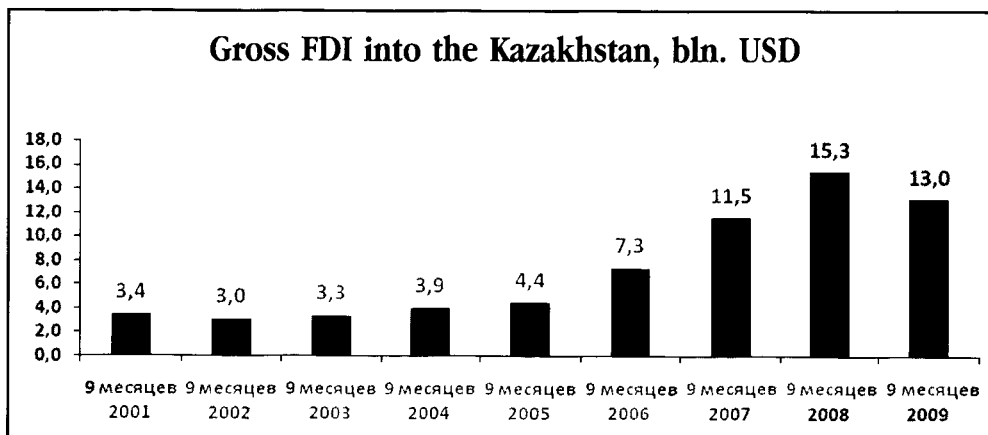
2.3. SLOW-DOWN OF FOREIGN DIRECT INVESTMENT

During the period from 2004 to 2008 Kazakhstan emerged as the leader among CIS member countries in terms of FDI per capita owing to the availability of natural resources, political and social stability. The largest oil



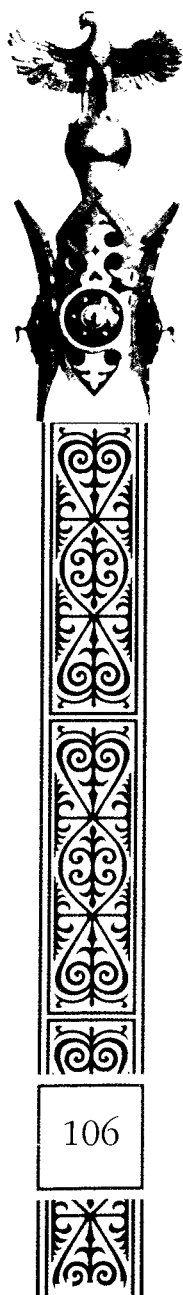
deposits in the Caspian Sea are concentrated in Kazakhstan's part of the Caspian Sea shelf and comprise about 3.2% of world reserves. Kazakhstan also ranks 9th in the world for its discovered reserves. Kazakhstan is home to such fields of global significance as Tengiz (6-9 billion barrels) - the largest operating oilfield in the country, Karachaganak (8-9 billion barrels of oil and gas condensate), and Kashagan (13 billion barrels of retrievable reserves) - the largest field located outside the Middle East that ranks 5th in the world in terms of its size.

Despite the global financial and economic crisis, flows of FDI into Kazakhstan remained high in 2008, continuing also in 2009. This was, for the most part, due to the development of large oil and gas fields. FDI inflows in 2008 were at an all-time high for Kazakhstan, reaching almost US\$20 billion, or about 16% of GDP. FDI levels in 2009 were of similar proportions, at around US\$18 billion. It is worth pointing out in this context that FDI into Russia and Ukraine dropped by more than 40% and 60%, respectively.



Source: National Bank of the RK

I estimate that in 2010, FDI flows into Kazakhstan will resume their growth owing to the Government's active policy of investment facilitation. It has become clear in the course of my meetings with various international investors in 2008 that foreign investors have immense interest in Kazakhstan and our projects. Subsequent to the results of my trip to Sharm-el Sheikh alone, two investment funds are being created with Bahrain and Abu-Dhabi totaling more than US\$1.5 billion. Following a trip to China, a fund with capitalization of up to US\$1 billion has been created jointly with CITIC

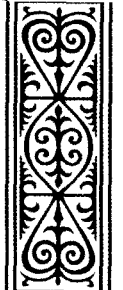
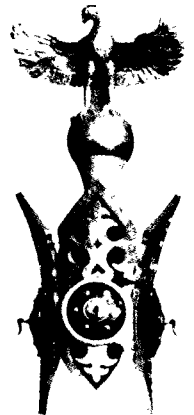


Corporation. Following visits to France and Japan, agreements were also reached between Kazakh state-owned companies and foreign partners on the implementation of projects totaling more than US\$3 billion; similarly, agreements with a total value of US\$4 billion have been reached with South-Korean companies. Whilst actively seeking to attract investment, I kept in mind that the competent and consistent implementation of these projects by Kazakh companies was of equal importance. Moreover, the Government should look to swiftly resolve all issues within its own remit related to such projects.

Thanks to contacts at the highest levels with such countries as South Korea, China, Italy, France, Turkey, and Belarus agreements on joint projects were reached in 2009 totaling more than US\$25 billion.

In accordance with these arrangements, and in partnership with leading companies in Europe and China, large projects are being implemented, such as the construction of the Balkhash thermal electric power station, the Beineu-Bozoi gas pipeline, fuel assemblies for atomic power stations, the modernization of Atyrau oil refinery and the construction of a petrochemicals plant. Other noteworthy projects include a shipyard, a gas-turbine power plant, and a road asphalt production plant. I believe this is the best testimony of investor confidence in the long-term durability and stability of Kazakhstan and its economy.

In the period following the Asian financial crisis in the late 1990's Kazakhstan had been actively promoting its economic openness and integration into global financial markets. Kazakhstan's private sector, particularly the banks, was behind such developments. Kazakh banks began to actively access international credit markets in the beginning of the decade. However, the period from 2006 - H1 2007 saw a significant increase in their international borrowing activity. On the eve of the crisis, foreign borrowings by Kazakh banks constituted more than half of all external borrowings by Kazakh borrowers. Whilst the level of the Government's external debt during



this decade had reduced significantly compared to the 1990's and remained stable, the foreign borrowings of the private sector had been growing sharply. This was due to the fact that the domestic deposit base and domestic capital markets were insufficient to support rapid economic growth, while external loans were relatively cheap and accessible. Despite that, favorable conditions in commodity markets and high growth rates improved the image and sovereign credit ratings, further facilitating access to external credit.

In 2007, Kazakhstan ranked 3rd in the world in terms of banking assets to GDP. Annual lending growth in Kazakhstan was, on average, 51.5% from 2004 to 2007. By the end of 2007, the amount of loans made by Kazakh commercial banks in the economy reached 56.5% of GDP. However, foreign borrowings by the private sector were, in large part, used to finance consumption and real estate speculation rather than to finance production. This hindered the diversification of the country's economy. From August 2007 onwards, sharply tighter conditions in international credit markets resulting from the problems emerging in the US mortgage market meant that Kazakh banks were no longer able to raise external financing. As a result, producers of construction materials and construction companies, which were financed by means of bank loans, suffered. However, steadily high prices paid for Kazakhstan's exports prevented the economic crisis from overwhelming us.

By 2007, one could observe the signs of overheating in the Kazakh economy. The volume of consumption loans increased by 1.5 times in 2007 compared to 2006, while the aggregate volume of bank loans rose by 54.7%. Inflation moved up from the 5-7% range to around 8-9%. Increases in average wages considerably outstripped gains in productivity (17.8% compared with 7.5%), reducing the competitiveness of production. One should also note the insufficient level of infrastructure development and low quality of services as some of the major weaknesses of Kazakhstan's economy.

Kazakhstan was first to feel the consequences of the US mortgage crisis in September 2007 due to the openness of its economy, its dependence on foreign credit markets and insufficient economic diversification. Historically, the impact of a crisis is most felt in those countries that have economic imbalances in their development, for instance dependence on short-term capital inflows and concentration of exports. Similar imbalances revealed



themselves in Kazakhstan's economy with the advent of the global financial crisis. The increasing volatility and nervousness in international markets and economies placed the issue of protecting the Kazakh economy from the resulting potential challenges and threats high on the Government's agenda.

The first signs of the financial crisis in Kazakhstan emerged in the second half of 2007. Credit spreads on Kazakh bank bonds increased markedly threatening the ability of Kazakh banks to finance and indeed refinance themselves in the international credit markets. In November 2007, Moody's, one of the leading international credit rating agencies, highlighted the high reliance on foreign funding of Kazakh banks, and cited a significant level of refinancing risk. The external debt of Kazakh banks at this point constituted US\$45.9 billion - approximately half of all existing external debt.

I saw a way of reducing the vulnerability of the country's economy in unstable global economic conditions through diversification of the economy, promotion of structural reforms, and enhancement of competitiveness of the economy on the basis of sustainable development. In the period preceding the advent of the global financial crisis, the Government worked actively along these lines. Efforts were undertaken to implement the Strategy for Industrial and Innovative Development, which was adopted in 2003. Negotiations were held with investors aimed at identifying investment projects to be implemented jointly with the Government. Recommendations were also developed on the creation of territorial manufacturing clusters on the basis of public-private partnerships. Development institutions, particularly Samruk-Kazyna, became major tools behind the implementation of the Government's diversification policy in 2007, especially as related to the support of the small and mid-sized businesses, the development of production and processing of agricultural products, and the implementation of infrastructure projects. However, the Government was consistent in focusing on the creation of essential conditions for a diversified and competitive economy by developing infrastructure, human capital and technological modernization.

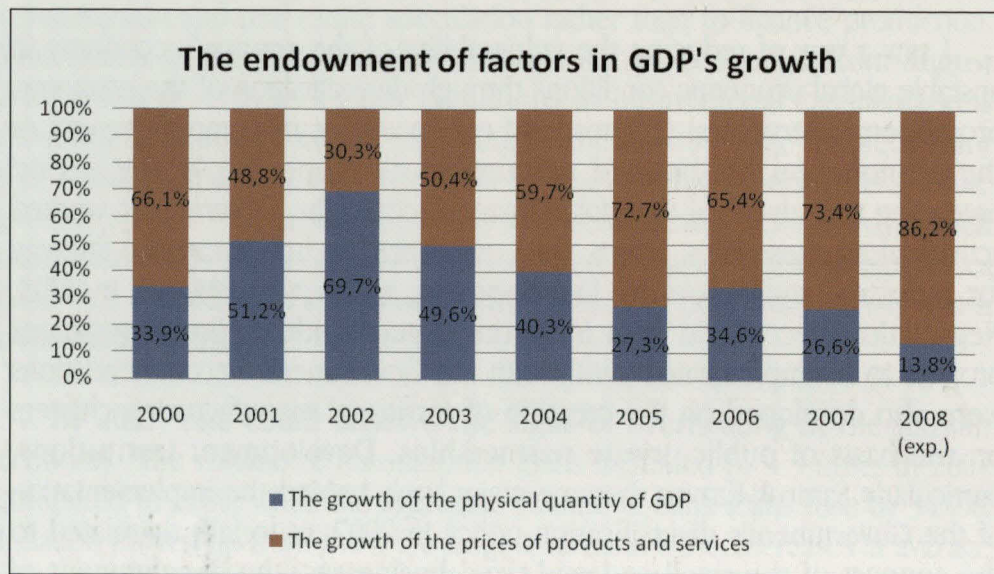
With respect to the immediate economic stabilization measures in 2007, Kazakhstan proceeded by adjusting the activity of its banking sector with a view to reducing risks through the introduction of better financial regulation along the lines recommended by international advisors and financial



institutions, such as the IMF. At the same time it was vital to ensure effective coordination of fiscal and monetary policies. The Government put these goals on its agenda for 2007-2009. At the same time, the National Bank and the FMSA submitted proposals aimed at tightening the regulations for external borrowing by banks.

Nevertheless, abrupt changes in the world economy in mid-2007 severely affected Kazakhstan's economy.

Starting from 2003, prices on the external, export and internal markets determined the bulk of GDP. However, such price increases did not contribute to the substantial stimulation of production growth to meet internal or external demand.



Combined with the decline in production, a drop in prices for export items and difficulties of the financial sector led to a severe crisis in the third quarter of 2008. Production began to fall in the fourth quarter. The beginning of the crisis in Kazakhstan, to a large extent, was triggered by global causes. At the same time, however, the features of the crisis were determined by the structure and weaknesses of Kazakhstan's economy.

Sources of capital investment financing

Percentage terms

	Total investment	Own funds	State budget	Foreign investment	Other borrowings
2007					
Total	100,0	48,8	15,8	18,4	17,0
State property	100,0	2,7	94,9	2,0	0,3
Private property	100,0	76,3	0,5	1,8	21,4
Foreign-owned property	100,0	18,4	0,0	63,8	17,8
2006					
Total	100,0	56,7	13,1	20,2	10,1
2005					
Total	100,0	56,1	11,7	23,9	8,3
2004					
Total	100,0	64,3	11,4	17,7	6,7
2003					
Total	100,0	59,8	12,4	21,7	6,2
State property	100,0	10,9	77,1	11,9	0,2
Private property	100,0	84,0	1,4	5,7	9,0
Foreign-owned property	100,0	24,8	0,0	72,9	2,3

In recent years there has been a decline in the share of investments into the Kazakh private sector's property and an increase in the share of investments into the foreign-owned and state properties. The sectors that were involved in the production of goods for the domestic market were most disadvantaged as they did not benefit from access to cheap and long-term sources of financing. That said, one can note the strengthening of sources of investments across types of ownerships. Thus, state property "self-invested" through the state budget and had extremely low level of investments from own funds.

In contrast, the private sector had been relying on its own internal funds for investments, however, over the last years the volume of bank lending started to grow, which in turned raised investment risks. Foreign investors, who did not have access to sufficient foreign equity funding, also started to

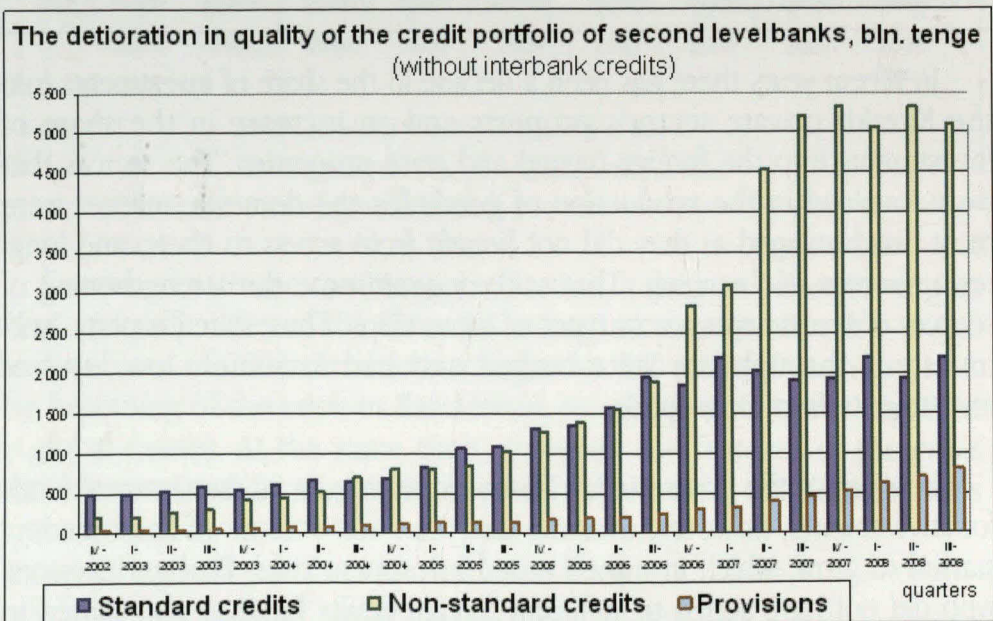


use bank loans to a larger extent. The table above demonstrates the deterioration of the structure of sources of financing.

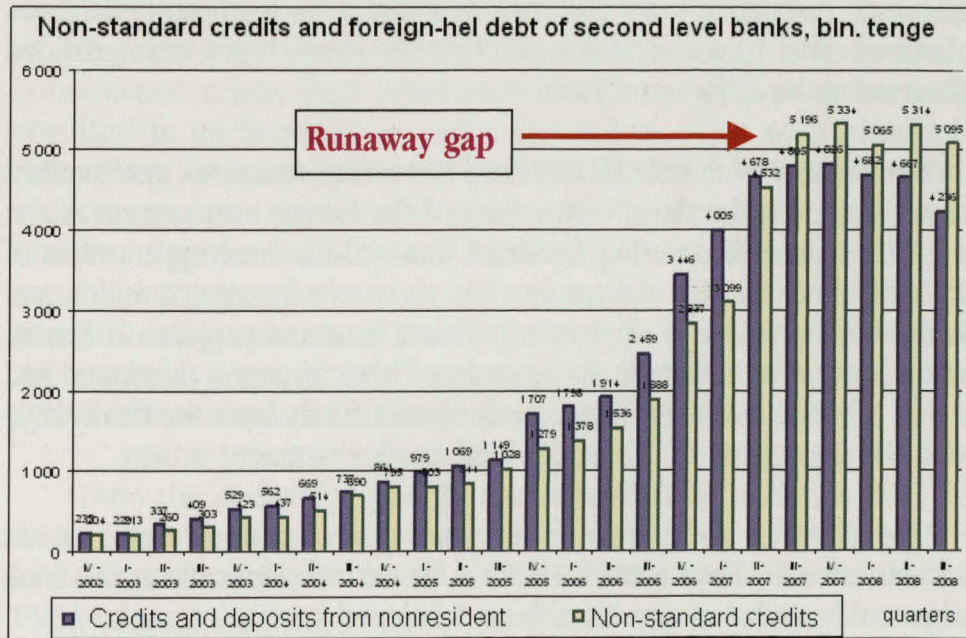
By 2007 the share of internal funds rapidly declined and was replaced by borrowed funds. The economy was clearly "overheated" and undertook the investments that were beyond its existing capacity. Unexpected as it may be, only the public sector was fairly balanced in terms of the sources of financing.

Private investments were too expensive for the investment activity to remain effective and proceed further under similar economic conditions. The interest of the private sector in co-financing arrangements to be jointly implemented with the government's development institutions may be explained by the costs and terms of the provided loans.

At the same time, a limit of prudent private sector investment into Kazakh economy had been exceeded. During the past two years expensive financing, especially, of the doubtful business concepts, had made the bulk of foreign loans into net profits of developers and uncompleted projects, which would be impossible to implement in the medium term. At the end of 2008 uncompleted construction comprised more than 30% of the value of fixed capital.



In addition, considerable credit was directed into investments in undeveloped land and other forms of speculation, including equity trading. After the collapse of speculative bubbles in the areas of land plots and housing, the macro-economic consequences of the 2004-2007 boom began to become apparent.



By the start of 2009 funds were used in long-term credit operations of private industry, which, dubious from the standpoint of their recoverability, exceeded the volume of foreign borrowings of commercial banks. Moreover, as external debt of the commercial banks decreased (as repayment of foreign loans, deposits and redemption of bonds occurred), a gap was increasingly expanding between nonprime loans and external debt. In other words, some banks increasingly compromised the funds entrusted to them by residents.

Specifically, inspections of BTA Bank's activities showed that over a period of years its executive officers, acting in secret and disregarding the interests of creditors and thousands of bank depositors, had moved substantial amounts of funds out of the bank by illegally disbursing loans to numerous, purposefully-created Kazakh and offshore companies, embezzling significant amounts of money in the process.



Criminal proceedings were instituted based on the results of the investigation. Some criminals have already been convicted, while a number of criminal cases remain in a pre-trial investigation stage.

During the course of investigations it was established that the management flagrantly violated the law and bank procedures when filing paperwork, disbursing loans and bank guarantees on partnership liabilities in favor of other banks, as well as servicing the loans. Loans were provided against no or insufficient collateral.

The majority of the bank's off-shore borrowing structures were created and registered on the direct instructions of the former management of the bank with a view to covering up illegal transactions involving transfers of significant funds outside the country and their subsequent acquisition and use for the purposes of their own personal business projects in Russia, Ukraine, and other countries in the region. These managers developed and applied schemes involving withdrawals of cash funds from the bank while giving the impression of the bank's legal credit-investment activity.

As it turns out, some of those same managers committed similar crimes in Russia, as well. Their activities dealt a severe blow not only to the bank and its creditors but also to Kazakhstan's financial system.

In the mid-2007 the collapse of the US housing bubble and mortgage market and the subsequent panic in the global financial markets reversed the economic trends in Kazakhstan, requiring active state intervention. Kazakh banks started experiencing difficulties in refinancing external borrowings. In response, many banks began to curtail loan origination, reduce their local loan books and build-up cash cushions. Construction, trade and small businesses were the first to suffer. Economic growth slowed down with GDP growth of 8.9% in 2007, down from 10.7% in 2006.



Continuing escalating inflation, particularly for foodstuffs, only further complicated the economic conditions.

As banks stopped providing affordable financing, demand for property collapsed and real estate prices fell. At the same time many people who had invested in so-called "share-holding participation" agreements in housing projects that should have been built in a period of 1-2 years after the investment was made found that, due to the construction crisis, their apartments were not being completed. This resulted in an increase in social discontent. The unavailability of refinancing for many borrowers (due to the system-wide contraction of credit) caused significant asset quality deterioration, further undermining the liquidity and, through increased provisioning, the capital positions of the banks. Press reports that almost half of the external debt payments of the banks were due in 2007-2009 and that the country's external debt as at the end of 2007 constituted around US\$97 billion were also adding fuel to the flames.

Given the deepening global crisis, Government policy in 2007-2008 focused on mitigating the negative effects of the crisis and maintaining social and economic stability. In the fall 2007, the Government, National Bank and FMSA adopted the first package of measures aimed at reducing the negative effects of the global financial crisis on the country's economy, while the National Bank took steps to maintain liquidity in the banking sector. In formulating this first package of measures, it was decided that, in order to ensure social and economic development, individuals who had invested in so-called "share-holding participation" agreements in housing construction projects, small and medium-sized businesses and enterprises operating under the framework of the Industrial-innovative Development Strategy should not suffer.

The Government earmarked more than KZT 540 billion to support the economy in 2007-2008. More than KZT 175 billion went to stabilization of the housing construction market, with the investors in residential housing construction projects receiving priority. About KZT 131 billion was also used to support agricultural development in 2008 with a view to ensuring the country's food security. And over KZT 165 billion was used to support small and medium-sized businesses in 2008.



The funds were disbursed through commercial banks so as to provide additional support to these banking institutions. The banks receiving these funds had signed agreements on the targeted use of funds with the Ministry of Finance and the Kazyna Fund (subsequently, Samruk-Kazyna). All of the funds were provided to the banks on condition of repayment and the banks are responsible for repayment of these the budget funds.

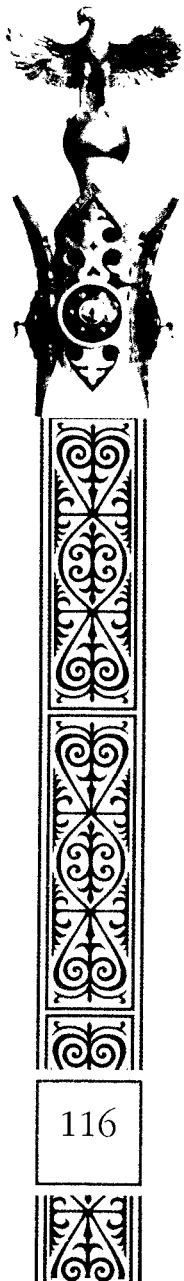
All state development institutions were engaged in implementing the anti-crisis measures. The Kazakhstan Mortgage Company ("KMC") purchased mortgage loans from commercial banks, while the Damu Fund worked with banks to ensure financing for small and medium-sized businesses. The Development Bank of Kazakhstan, in turn, co-financed investment projects that were suffering from the lack of liquidity in the banking sector.

In addition, the Government implemented a series of measures to control inflation. It also reduced import tariffs for major food products, introduced licensing for grain exports and a ban on vegetable oil exports, signed memorandums restricting price increases in basic food products and placed a temporary freeze on utility and transport rates.

The implementation of the first package of anti-crisis measures was, by and large, successful. It is fair to say that the Government, National Bank and the FMSA had by October 2008 prevented a precipitous fall in economic growth rates and a collapse of the banking system. International analysts also concurred with this assessment of the Government's measures to support the economy. Thus, due to the joint actions of the Government, the National Bank and the FMSA during the first wave of the crisis, the stability of the country's financial system was preserved.

In the fall of 2008, however, conditions in global financial markets deteriorated rapidly. A second wave of the global crisis engulfed the world economy. External capital markets were essentially frozen, with many, if not all, of the largest economies entering into recession. The global economic downturn caused a sharp decline in the price of oil and metals - both major exports of Kazakhstan.

These global economic trends required that the Government implement a second anti-crisis program. In November 2008, the Government, National



Bank and the FMSA adopted a joint action plan to stabilize the economy and financial system over 2009-2010. At this stage, the Government's key areas of activity included the provision of macroeconomic stability and social welfare, and the modernization of the economy.

The goal of the plan was not only to mitigate the negative consequences of the global crisis to improve socio-economic conditions in Kazakhstan, but also to establish a framework for future qualitative economic growth.

The National Fund earmarked US\$10 billion to implement the plan (KZT 1,200 billion, or 7.5% of GDP). Of the total amount, US\$4 billion (KZT 480 billion, or 3% of GDP) went to stabilize the financial sector, US\$3 billion (KZT 360 billion, or 2.25% of GDP) - to the development of the housing sector, US\$1 billion (KZT 120 billion, or 0.75% of GDP) - to support small and medium-sized businesses, US\$1 billion (KZT 120 billion, or 0.75% of GDP) - to develop the agricultural industry, US\$1 billion (KZT 120 billion, or 0.75% of GDP) - to implementing innovative, industrial, and infrastructure projects.

The total fiscal stimulus, including funds from the National Fund, the state budget, and the National Bank as well as tax relief measures totaled KZT 2.2 trillion, or US\$18.3 billion (about 15% of Kazakhstan's GDP).

To strengthen control over banking activities and to enhance their accountability for Government anti-crisis funding, the Law of the Republic of Kazakhstan "On amendments and additions to some legislative acts of the Republic of Kazakhstan on durability of the financial system" was adopted in the first half of 2008. The law provided for a strengthening of measures pertaining to administrative and criminal responsibility for purposefully bringing a financial organization into insolvency. Minimum reserve requirements for internal and other liabilities were also lowered. This allowed the banks to expand their capital base by almost US\$2.3 billion.

At the end of 2008 and beginning of 2009 the economic crisis deepened further. The collapse of world prices for Kazakh exports impacted the solvency of Kazakh companies. Production volumes decreased not only in the construction sector but also in the trade and processing industry, as well as in the production of electric power, gas and water.



In response to the deteriorating conditions the Government developed and implemented a series of anti-crisis measures that included a reduction of the minimum reserve requirements for internal liabilities of commercial banks from 5% to 2%, increases in expenditures for the development of the agricultural industry and provision of food security, an expansion of support to small and medium-sized businesses. A total of KZT 214.8 billion was disbursed. It also introduced a one-year moratorium on administrative and tax inspections for small and medium-sized businesses. The actions taken to remove administrative barriers and improve business conditions for small and medium businesses had a positive impact on the business climate in the country, and were reflected in the 63rd place achieved by Kazakhstan in the World Bank's "Doing Business - 2010" rankings.

The creation of the national welfare fund Samruk-Kazyna and the decision of the Government to purchase equity interests in each of the four systemically important banks also played a key role in stabilizing the financial system and economy. Amendments were also made to the Law "On Public Procurement" in order to stimulate internal demand: public purchases were now primarily focused on Kazakh suppliers. A transition was also made to a new system of state planning focused on the achievement of strategic goals and implementation of priority tasks of the country's socio-economic development. Fiscal and tax reforms were implemented. Budget and Tax codes were adopted. The system of state administration saw a transition to the triennial system of planning.

Socially-oriented measures constituted an important part of the anti-crisis programs and included the expansion of state guarantees covering 99% of the bank deposits to KZT5 million, increases in Government expenditures on targeted social aid, and increases in pensions. In 2008, Government expenditures on welfare and public assistance grew by 23.8% compared to 2007.

In February 2009, the National Bank devalued the Tenge against the US dollar by 20%. The devaluation allowed Kazakhstan to restore the competitiveness of the domestic industries and, in particular, the export industries.



5.1. FOOD SECURITY AND PROVISION OF BASIC COMMODITIES

Kazakhstan is a large exporter of grain and flour, but it is dependent on imports of other food products. Sharp increases in world food prices in 2007-2008 led to escalating inflation in the country. Due to increasing food prices the consumer price index soared to 20% in June 2008.

In response, the Government took a number of steps aimed at ensuring the availability of food supplies, stabilizing prices, and stimulating domestic production. In, 2008 the Government earmarked KZT 57.1 billion to replenish strategic food reserves in Kazakhstan's regions. The funds allocated for development of the agricultural sector allowed us to decrease imports of various types of food in 2009. Thus, drip irrigation was actively introduced along with high-capacity dairy farms, feedlots, poultry farms, and greenhouses. For instance, massive livestock feed yards with developed infrastructure were created in Almaty, Akmola, East-Kazakhstan, Pavlodar, Karaganda, and North-Kazakhstan provinces. Almaty, South-Kazakhstan, Zhambyl, and Akmola provinces, in turn, saw the construction of modern greenhouses.

One of the major lessons of the global crisis is that the issues of food security and massive industrialization of rural areas are not easily achieved by market participants alone. From this moment on, we will have to solve problems of our agricultural sector by applying direct measures. The legal basis and the best practices of other countries exist to support this proposition. The practices include:

- The Government serves as the administrator of key natural resources (land and water) for the agricultural sector, and as a proprietor of basic and applied research organizations for the sector. It expends significant funding to ensure the maintenance of the agricultural industry;
- The Government is an active player in food and raw commodity markets, carrying out significant purchases to meet the state needs;
- The Government controls the quality and prices of food, agrarian technologies, and compliance with nature management requirements;



- There is also a household sector, along with the market sector, that produces food, mainly to meet household needs, and relies on Government support;
- Experience of various foreign countries demonstrates the need for diversification of, and comprehensive government support for, the production and export of food and agricultural stock.

In October 2008, the Government developed and submitted to Majilis a draft law "On amendments to some legislative acts of the RK on issues of grain market regulation and state support to individual agricultural sectors." In 2009, the draft was revised and named "On amendments and additions to some legislative acts of the Republic of Kazakhstan on food security issues."

According to the draft law, the Ministry of Agriculture is vested with sweeping powers to control food supplies. The Ministry monitors grain stocks and can employ measures against speculators and those who attempt to manipulate the grain market. Moreover, the Law provides for priority rankings of local producers when engaging in public procurement.

It is important that the Law include a social component and that it obligates the Government to provide staple food to the most vulnerable segments of the population during times when national food security is threatened.

The Government executive order stipulated that governors of provinces and the Ministry of Agriculture were responsible for maintaining stability of food prices. Local executive bodies were also supposed to sign memorandums of cooperation with bread producers, trade fairs and supermarkets to maintain stable prices. The local businesses, in turn, could purchase grain from the Government at subsidized prices. To increase cultivated areas and grain crop yield, Akimats were given KZT 21.7 billion to develop agricultural projects and to increase farm subsidies. Grain crop acreage reached 16.2 million hectares in 2008, up by 774 thousand hectares compared to 2007.

The Government rendered unprecedented support to the agriculture industry in 2009 and will continue assisting the industry in 2010. In 2009, the state budget earmarked KZT 97 billion for the development of rural



areas. In addition, the National Fund provided KZ T120 billion to finance investment projects across key areas of the agricultural industry. Temporary surplus funds of the National Fund, in turn, were used to provide loans for spring field and harvest works (KZT 68.8 billion) and for the subsequent financing of agricultural producers through purchases of their produce (KZT 13.8 billion).

These measures achieved their intended results. Preliminary figures indicate that in 2009 the index of physical volume of agricultural production stood at 113.8%, which is the highest rate for the past 8 years.

During the course of 2008, the emphasis of the Government's policy on the long-term development of the agriculture industry became more pronounced. Given its land resources, climate conditions, labor and technological experience, Kazakhstan is capable of providing food several times exceeding the needs of its current 16 million people. These capacities have been developed over the past half a century and are proven by practice.

25 years ago Kazakhstan was already a large exporter of some of the most valuable agricultural products - hard wheat and meat - and commanded a powerful agricultural complex. Since then, its resource potential has reduced by approximately twofold, its farm machinery industry has virtually been lost, demand for mineral fertilizers remains weak, while processing capacity is not fully utilized. Rural infrastructure has been on the downward path, from electric power supplies and mechanical material maintenance to agronomy and veterinary science.

The food shortages arising from flaws of industrial structures involved in the production of food products in Kazakhstan in recent years have been offset by imports. In recent years, international trade in food has become highly politicized and can threaten the cohesiveness of states and the survival of peoples. Food security is becoming a "national idea" for most countries, while the export of food has become an indicator of economic power. At present, engineering production is increasingly shifting to developing countries, while the production of food is growing in developed countries.

Concurrent growth in demand for both grain (on the part of the poorest consumer-countries) and dairy and meat products (first and foremost in



BRIC countries) has come to represent a distinguishing feature of today's global food market. Symptomatically, imports of food are in direct relationship to political stability of states (for example, in the last years Iraq has become one of the largest importers). Increasing global instability reduces the output of food and food stocks. Given bio-fuel consumption and mistrust toward genetically-modified products, there is a continuously growing demand for traditional food product resources and agrarian raw materials. Therefore, prices of high quality natural food products will rise in the long term, while quality animal products, which exhibit a longer production cycle, will become increasingly costly.

Key areas of food security in Kazakhstan include an accelerated development of production of economical and balanced composition of feed - the major products, tonnage-wise, of the agricultural sector. Only in this way is the build-up of market meat, poultry, and fish production possible. Feed does not so much represent the grains, but more so vegetable production, potato growing, beans, oil crops, cultivated forage herbs and biological supplements. Therefore, the central component of the long-term rural strategy should focus on the build-up of feed production and agricultural microbiology.

It became apparent that a radical modification of cropping patterns and the build-up of production of high-quality feed are needed. In Kazakhstan's conditions it is necessary to return to a Government policy aimed at creation and maintenance of 1.5-2 year feed reserves (subject to regional circumstances) in order to maintain stable and productive flocks (as well as to reduce production costs for agricultural products in general while increasing profitability).

5.2. GOVERNMENT SUBSIDIES TO COMPANIES OPERATING IN "RISK ZONES"

The global financial and economic crisis significantly diminished the welfare of people in most countries. In Kazakhstan the first alarming symptoms emerged with outflows of deposits of private individuals from the banking system that first occurred in September and October 2007. The Government responded immediately by undertaking measures aimed at



restoring the confidence of the population in the banking system and measures at stimulating savings. A decision was taken to increase the limit on bank deposit insurance payouts for individuals sevenfold to KZT 5 million. This measure ensured a guarantee covering approximately 99% of all retail bank accounts.

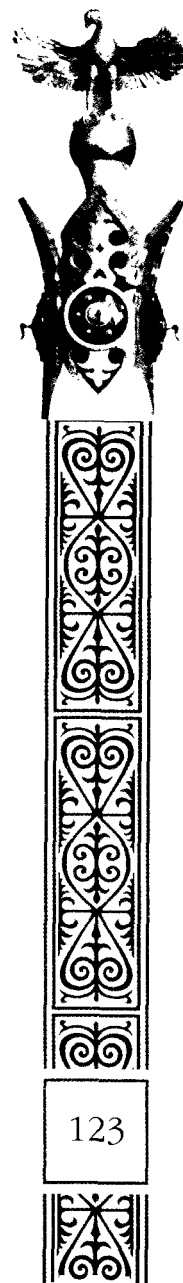
Furthermore, the capitalization of the Kazakh Fund for Guaranteeing Deposits was increased fourfold to KZT 100 billion, in accordance with the IMF's recommendations as part of its financial sector evaluation program. Currently, the funds' reserves are sufficient to service unforeseen expenses in the short term.

The anti-crisis plan of the Kazakh government is focused on addressing economic and social problems pertaining to the real estate market. The plan includes a special program on the completion of construction projects, with total budget of KZT 240 billion. As a result, numerous companies were able to complete started construction projects at lower cost. A mortgage refinancing program is aimed at reducing the cost of mortgages to individuals. The Government earmarked and deposited KZT 120 billion to commercial banks through Samruk-Kazyna. The bulk of this money has been already disbursed. The program provided for subsidies of interests rates paid by borrowers who own a house or an apartment with a floor space of not more than 120 square meters.

Moreover, a "Public Housing Construction Program for 2008-2010" was adopted. Regional Akimats are responsible for the implementation of the program, which is primarily aimed at the construction of housing for socially vulnerable segments of the population. The budget of the program is KZT 300 billion.

5.3. CREATION OF JOBS AND RESTRUCTURING OF THE LABOR MARKET

The Kazakh labor market, too, suffered as a result of the impact of the crisis on the Kazakh economy, as evidenced by an increased unemployment rate, starting in August 2008. The branches of economy that suffered the most as a result of the crisis, such as construction, metallurgy and extractive



industries, tend to also be fairly labor-intensive. About 25% of Kazakhstan's work force is employed in these sectors. Therefore, we had to take short-term and long-term measures to keep up employment, preserve and create new jobs. This became one of the key areas of the Government's activities.

After the first wave of the crisis, which had not yet affected the labor market, we, anticipating possible consequences, adopted the "Employment Rehabilitation Plan for 2008-2010" in September 2007. The plan aimed to create of socially significant jobs (including jobs in social institutions, such as hospitals, nursing homes, and boarding schools), to create internships for young people with a view to make them adaptable to the needs of the labor market, to establish career fairs throughout the country, to create jobs via infrastructure projects and community services, and to improve professional training programs for the unemployed.

The state budget earmarked more than KZT 15 billion to implement this triennial plan. By the end of the first half of 2009, more than 29 thousand people received vocational training, while 13 thousand people from among the most socially disadvantaged segments of the population were engaged in welfare works and more than 68 thousand people were hired to implement infrastructure and community projects.

With the advent of the second wave of the crisis, which had already begun affecting the labor market, the Government responded promptly and, jointly with the Federation of Trade Unions and the national business association Atameken, initiated the negotiation and agreement of memorandums with large companies to preserve jobs and prevent large-scale lay-offs. By October 2009, more than 8 thousand memorandums were signed, covering about a million workers.

Additionally, in my address, titled "Through Crisis to Renovation and Development," I tasked the Government to prepare a program to support employment and job retraining in the regions. The Government developed the program in due course. Named "The Road Map," it was aimed at creation of conditions for stable post-crisis development.

Key areas of the Road Map include:

- reconstruction and modernization of utility networks;



- construction, maintenance and rehabilitation of highways of local significance, as well as renovation of social infrastructure, first and foremost, schools and hospitals;
- maintenance and upgrading of objects of local significance in each specific population center;
- expansion of social jobs and organization of internship programs for young people;
- retraining and continuing education for workers;
- increasing the maximum period for provision of unemployment benefits from 4 to 6 months

I personally supervised the implementation of these measures. The Government provided progress reports on a monthly basis, at times even more frequently. The population of the country was aware of this. This instilled confidence in anti-crisis measures.

The actions that were undertaken were sufficiently successful. The unemployment rate fell to 6.6% in 2009, according to preliminary figures, compared with 7.3% in 2007.

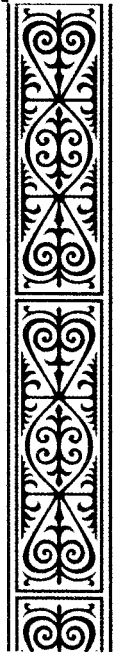
5.4. CRISIS MITIGATION IN THE AREA OF EDUCATION, HEALTHCARE, AND PENSION PROVISIONS

Healthcare and education are key sectors determining the growth of human capital, which in turn determines the country's economic competitiveness. We were able to achieve significant progress in these areas. In 2007, the Organization for Economic Cooperation and Development noted the achievements of the Government in the area of educational reforms.

However, the crisis did have an impact on these areas, forcing us to take urgent measures to ensure that our citizens are not exposed to related impacts.

EDUCATION

As a whole, public financing of the education sector was strengthened during the crisis. In 2009, the education budget in Kazakhstan grew by more



than 10% compared to 2008, reaching KZT 710 billion. 144 kindergartens and 87 schools were put into operation, while the coverage of pre-school education increased from 35.6 % to 37%.

Special safeguards were also established to support vulnerable segments of the population. Numerous students faced tuition payment problems as a result of the crisis. Social support to the student body in conditions of the global economic crisis is an integral part of the Government's education program. Therefore, I authorized an additional 10 thousand grants for junior students studying in universities on a paying basis.

The grants are provided to five-pointers of the higher educational institutions, starting with juniors, who study for a fee and on an intramural basis. There are about 12 thousand such students. I would also like to note that students who receive the grants will get a 15% increase in state stipends and compensation for using inter-city rail and highways during winter and summer holidays.

In addition, those who strongly need material support also receive long-term loans on favorable terms, despite the economic difficulties. These loans are intended for students who are orphans, disabled, come from families with many children, whose parents are disabled or retired, students who have only one parent or those left without custody care by parents. The terms of the loans specify that students pursuing technical and medical professions and receiving good and excellent grades can obtain these loans. The repayment period starts following the receipt of a higher education diploma.

The implemented measures will allow us to achieve our major goal. The crisis will disappear, but Kazakhstan will not have lost a single young person who was compelled to quit their studies to the detriment of their future opportunities. Before, during and after the crisis Kazakhstan will proceed with reforms in the education sector that will meet the challenges and imperatives of the times.

HEALTHCARE

I believe there is no need to argue today that care of people's health is necessary, both on moral and economic grounds. This is a manifest truth.



However, the development of healthcare system requires considerable efforts and funds. Nevertheless, even in the difficult economic circumstances, this task remains a priority for us.

The share of healthcare expenditures in the state budget is consistently rising. From 2008 to 2009 alone it increased from 10.7% to 12% despite the crisis times.

In the first half of 2009, healthcare expenditures in Kazakhstan amounted to 2.3% of GDP. According to the healthcare reform program adopted by the Government for 2005-2010, the healthcare expenditures will increase to 4% of GDP in 2010. This program is aimed at the transformation and development of hospitals, the development of the public administration system, the improvement of vocational training programs for medical personnel, and service quality improvements for mothers and children. Special attention is also given to preventive measures, such as diagnostics and patient aftercare. To this end, the budget earmarked about US\$1.2 billion in 2008, which is almost 40% higher compared to 2007.

In January 2008, the World Bank approved a US\$117.7 million loan for technology transfers in the field of healthcare and implementation of institutional reform projects in Kazakhstan. The state budget, in turn, earmarked US\$178.4 million for this purpose. Thus, the total value of the project will comprise US\$296.1 million. The project provides for the development of an information management healthcare system, quality improvements in medical services, the development of a health funding and administration system, medical science and education reforms, pharmaceutical policy reforms and solutions to other problems.

On 18 September 2009, the Law "On people's health and healthcare system" was adopted. The law will allow Kazakhstan to enhance the public status of medicine, systematize a large body of legislative acts in the field of healthcare, harmonize them with international legislation, improve the level of medical care and change the attitude of the population to health issues.

The Concept of an Integrated National Healthcare Framework was also developed. Put into effect in 2010, the concept will allow the costs of

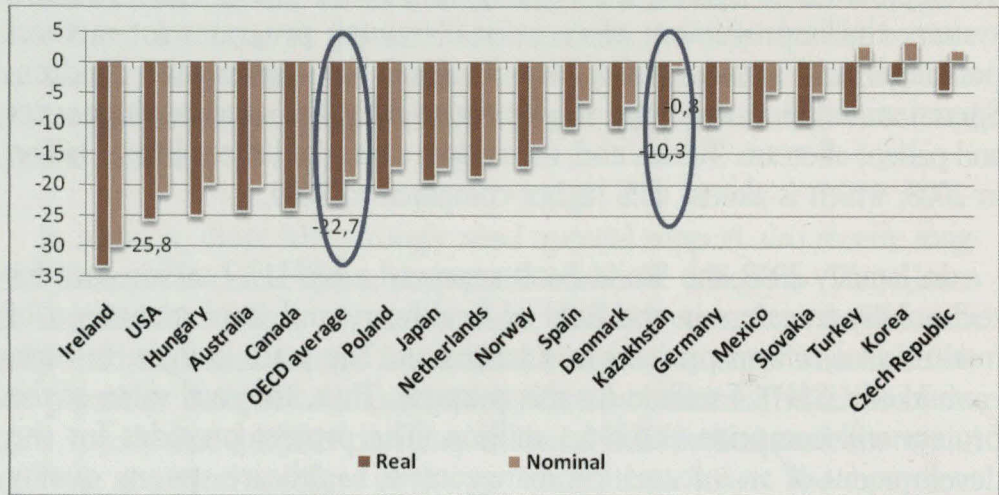


each medical treatment to be reimbursed to medical organizations providing hospitalization and in-patient-substitution assistance.

The system of single distribution of medications as part of guaranteed volume of free medical care was also introduced, as well as state control on prices for medications procured at the Government's expense.

PENSION SYSTEM

Due to turbulence in stock and bond markets in 2007, the profitability of pension funds declined around the world. Kazakhstan was no exception.



Source: OECD, AFN, *data on Kazakhstan: AFN, January-December 2008.

In 2008, following pension fund losses, the Government took proactive steps to guarantee the security of pension contributions. Specifically, on 15 May 2009, the Government enacted resolution # 726 "On adoption of regulations relating to execution of state guarantees on security of compulsory pension contributions to pension savings funds". Since the second half of 2008, the amount of base pension has been increased by 14%. The amount of minimum pension payments was increased by 24%. In 2009 and 2010 the size of pension payments rose by 25%. Increases of 30% in pension wages, and stipend payments are also planned for 2011.

Currently, there are no grounds for concern regarding decreases in pension savings. The Government provides the necessary guarantees, while pension funds offset losses in the context of improvements in the Kazakh economy and stabilization of conditions in global financial markets.

The situation in the defined contribution pension system is gradually leveling off. The figures of the FMSA confirm this trend. According to the FMSA, the grand total of net profits of pension savings funds for 1 January 2010 amounted to KZT 17 billion as a result of gradual stabilization of financial market conditions.

Data	1.01.08	1.01.09	1.12.09	Growth in comparison with 1.01.09	Growth in comparison with 1.01.09 (in %)
Pension accumulations	1 208.10	1 420.5	1 824,20	403.70	28.40
Pension contributions	912.1	1 184.7	1 455,30	270.6	22.8
Net investment income	339.3	307	477.4	170.4	55.5
Share of net investment income in total pension accumulations	28.1	21.6	26.2	-	4.6

Source: AFN

5.5. BALANCING FISCAL POLICY GOALS - STIMULATING ECONOMIC GROWTH AND MITIGATING THE IMPACT OF THE CRISIS

The mobilization of domestic business and economic resources during the crisis was carried out by reducing the tax burden so that simplified taxation could facilitate accelerated economic growth as a result of reduced general tax rates and increased revenues from key extractive industries. Also, a new Tax Code of the Republic of Kazakhstan came into force on 1 January 2009, which significantly decreased major tax rates and, in so doing, substantially reduced the tax burden, first and foremost for the non-extractive industries of the economy. The aforementioned measures provided an overriding impetus to the development of economic sectors other than oil and gas



and mining. Overall, the reduction of tax burden leaves around US\$3.0-3.5 billion, or KZT 361.3 billion, at the disposal of entrepreneurs, which constitutes 12% of Government revenues, or 2.3% of GDP. In addition, the simplification of the country's tax system was one of the critical goals of the tax reforms.

The new Tax Code provides for noticeable changes in Kazakhstan's taxation system. Besides the reductions in some standard tax rates, small and medium-sized businesses are now exempted from provisional corporate income tax payments. Social tax was also changed from a progressive scale to a flat rate of 11%. The idea behind this move is that a flat rate helps avoid tax evasion and, in so doing, strengthens tax discipline. The Tax Code also makes preferential provisions for all enterprises carrying out investments. In addition, the Tax Code abolishes agreements with primary producers on joint subsurface use (existing arrangements remain in force) and introduces a mining operation tax.

It should be recalled that the taxes paid by companies producing oil and gas go to the National Fund, while taxes paid by other natural resource users go to state budget.

On 16 November 2009, I signed the Law "On amendments and additions to some legislative acts on taxation issues." This law brings changes into the Tax Code that freeze corporate income and extraction tax rates for 2010-2012 at the level observed in 2009, which will increase the state budget revenues. The law also introduces a series of measures to improve tax administration.

On the whole, foreign observers gave a positive assessment of the 2009 Tax Code because the policy of easing the tax burden for non-extractive sector facilitates improvements in Kazakhstan's business climate and creates favorable conditions for diversification of the economy.

During the crisis Kazakhstan also encountered a need to reconsider the budget requirements and sources of its revenues. At the end of 2008, the Government modified revenue projections for the three-year budget based on the annual average price of oil of US\$40 per barrel in 2009 and



US\$50 per barrel in 2010 and 2011 (the original draft assumed a price of US\$60 per barrel). According to the updated draft, the forecast Government revenues for three years were reduced by a third. As a result, Kazakhstan's fiscal policy is based on prudent estimates. In reality, conditions were more favorable in 2009 given an average oil price of US\$61.9 per barrel.

Against the backdrop of the financial crisis, the task of cutting public expenditures to help in overcoming the crisis became an especially pressing issue. To solve this problem the Government sought to increase efficiency and optimize expenditures in public agencies and affiliated national companies, as well as in commercial banks partially owned by the Government. As part of the process, social expenditures were excluded from the cuts.

Moreover, the Government continues to enhance the effectiveness of state budget expenditures during the crisis. But serious work still lies ahead of us, including in the area of quality improvements in the development and preliminary analysis of budget requests (this is especially important for investment projects receiving budget funding), upgrades in the level of qualitative assessment of investment projects, enhancement of budget and fiscal discipline, and rigid linking of increases in administrative expenditures with gains in performance.

We have a significant cushion to increase the effectiveness of budget expenditures. The related work was begun long before the advent of the economic crisis. The concept of assessment of effectiveness of expenditures was already introduced in 2005 as part of the 2005 Budget Code. The new Budget Code was put into effect in Kazakhstan on 1 January 2009 to implement a results-oriented budgeting system. This system would allow the budget process to be organized in such a way as to ensure the necessary results are achieved through the most effective use of Government expenditures.

In addition, the following measures were undertaken as part of Kazakhstan's budget system reforms: a transition to triennial budget planning, the implementation of operational planning, the provision of certain autonomy to heads of state agencies in budget funds administration and



enhancement of their responsibility for achieving results, as well as implementation of integrated system of monitoring and results assessment.

Overall, the Government's budget deficit for 2009-2011 remains modest as a result of restrained fiscal policy and increased budget expenditure effectiveness.

5.6. BANK DEBT RESTRUCTURING

Starting in August 2007, sharply tighter conditions in the international financial markets began to disrupt the flow of credit to Kazakhstan. A high level of external debt exacerbated the position of many Kazakh banks. In 2009, two of Kazakhstan's four largest banks (two of the country's systemically important banks) - BTA Bank and Alliance Bank - were forced to enter into debt-restructuring negotiations with their creditors. The total amount of external debt held by BTA Bank and Alliance Bank was estimated at around US\$17 billion.

Insofar as these were privately owned banks, I was offered to subject them to insolvency and, in so doing, wiping out their debt.

In this situation the Government cannot and should not be liable for the mistakes of private commercial banks. This would only serve to create moral hazard. Moreover, the citizens of the country who are also its taxpayers, cannot bear liability for mistakes made by the management and shareholders of these banks.

Nevertheless, the Government has played a key role in restructuring the debt of the banking system. One of the most important measures in this respect is the creation of a regulatory framework for the restructuring process. Before the 2009 amendments to legislation on financial stability there was no regulatory framework in place that would allow banks to undertake a complete financial restructuring without the sanction of all of their creditors.

Reforms in the regulatory framework as part of an expanded legislative package made it possible to avoid bankruptcy procedures and



initiate debt-restructuring with the approval of the majority of creditors¹. Thus, a legal infrastructure was created that allowed banks to restructure their liabilities.

The process of restructuring BTA Bank is continuing. On 3 September 2009, BTA Bank signed, along with the steering committee appointed by BTA's creditors, a document called "The framework of principles for restructuring of financial indebtedness of BTA Bank and its branch organizations." BTA's steering committee of creditors proposed an alternative debt-restructuring plan. However, the FMSA approved the draft proposed by the bank.

Early in December 2009, BTA Bank and its creditor steering committee signed principled commercial terms for financial restructuring. It is expected that following the completion of the debt-restructuring, the debt of BTA Bank will be reduced from US\$11.6 billion to US\$4.6 billion, accounting for the accrued interest. Samruk-Kazyna will own approximately 85% of the bank's shares, while creditors will own the remaining share of around 15%.

As the restructuring progressed, it was established that the management of BTA Bank had perpetrated fraud and asset-stripping, moving the bank's assets to other countries. Simply put, they were stealing funds deposited into the bank by individuals and companies. But that is a separate matter. A number of bank executives have now been arrested, while others are sought by Interpol. In addition to defrauding local depositors their actions also served to deceive and defraud external creditors.

The actions of some the bank's former management severely threatened the stability of the bank. And had it not been for the timely measures undertaken by the Government, their criminal activity could have led to the total collapse of the country's largest bank.

¹The Law of the Republic of Kazakhstan as of 11 July 2009 # 185-IV "On amendments and additions to some legislative acts of the Republic of Kazakhstan on issues regarding the development of legislation of the Republic of Kazakhstan on payments and money transfers, accounting and financial reporting by financial organizations, banking activity and operations of the National Bank of the Republic of Kazakhstan."



The actions of the BTA Bank executives in question in December 2008 and January 2009 testify to the fact that they were aware that their fraudulent actions were about to be discovered. At this time, ahead of key members of the management team fleeing abroad, a number of problematic loans linked with embezzlement had their repayment dates extended illegally to 2010 - 2012. Currently, the roles of each executive in carrying out the criminal instructions of BTA Bank's former management are being investigated. Appropriate legal proceedings against such persons will be made in due course.

Prior to these events, BTA Bank had been well regarded by many: the bank had conducted annual international audits, enjoyed high credit ratings from credit rating agencies, and received various international prizes from well-known and reputable audit firms.

Apparently, I was not the only one who was disappointed by the activities of some bankers. Notably, Alan Greenspan, a former US Federal Reserve Chairman, appearing before a US Congressional Hearing on 23 October 2008 against the background of escalating financial-economic crisis, stated that he was deeply shocked by the realization that what he had believed in for 40 years turned out to be mistaken: "I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms."

As far as Alliance Bank is concerned, its creditors approved the debt-restructuring plan on 15 December 2009. Alliance Bank proposed 5 debt-restructuring options to its creditors with the process being finally concluded the end of March 2010. As a result of the restructurings, the total debt of the banks will decrease from US\$16.1 billion to US\$5.6 billion. This is profoundly an important achievement.

The process of stabilization of the banking system, I believe, has been a success. In general, the banking system maintained its stability and capacity in the most difficult conditions. Household deposits have also been protected by deposit insurance guarantees. And not a single bank was allowed to fail.

The process of debt restructuring in Kazakhstan was accompanied by a series of measures designed to improve banking regulations. Measures to



strengthen banking system regulations are required to prevent similar situations in the future that require emergency measures to restructure debts of the banking system.

In future, the banking regulations will focus on risk management with greater attention being paid to the use of risk management and internal audits by banks, capacity building for the application of effective oversight, formation of stress-coping systems, upgrades in the treatment of asset classification and assessment, and development of liquidity risk monitoring mechanisms. The FMSA has already significantly increased its monitoring and oversight by conducting overviews of the banks' financial position and stress-tests, paying special attention to systemically important banks in the process.

5.7. THE ACTIVE ROLE OF THE GOVERNMENT: SUPPORTING DISTRESSED SECTORS AND STABILIZING ECONOMIC GROWTH

Currently, investment flows in Kazakhstan are characterized by a sharp fall in investments financed by borrowed funds. Such a decline reflects more difficult conditions in global financial markets for Kazakh borrowers starting from August 2007, as well as a deficit of internal credit sources in conjunction with the problems of the Kazakhstan's banking system. Due to the decreased number of investment initiatives of the private sector, the Government has been forced to play a key role in fixed capital renovation and infrastructure modernization.

Kazakhstan's strong fiscal position enabled the Government to support the economy in the period of economic slowdown. Experience garnered during a crisis lasting for over two years demonstrates the need for large-scale Government measures to support the Kazakh economy. Such measures conform to what has and is being done internationally in many other countries to confront the challenges of the crisis. Countries around the world that had prudently built up reserves prior to the crisis have pursued fiscal stimulus measures in order to stabilize their economies. However, the effectiveness of such expenditures remains an overriding issue for us. Kazakhstan's anti-crisis measures have been designed in such a way as to provide immediate support to the economy in times of external shock and

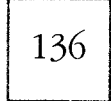


to build an infrastructural and industrial framework for further economic development at the same time.

Another crucial point is the process of withdrawing the anti-crisis measures introduced to support the economy. The anti-crisis support should be temporary and come to a close during the economic recovery. If continued for longer than necessary, the anti-crisis measures can diminish the competitive environment and, in so doing, hinder economic development or indeed bring it to a halt.

A more active Government role required concentrated efforts and review of mechanisms guiding state investment in the country's economy. On 13 October 2008, I signed a decree on the merger of the "Kazyna" Development Fund and "Samruk" State Assets Management Holding that led to the creation of national welfare fund of Samruk-Kazyna with a board of directors chaired by the Prime Minister. This fund was being created with a view to become the core of the Kazakh Government's anti-crisis program. Major goals of Samruk-Kazyna include: supporting stable economic growth, modernizing and diversifying the economy, improving efficiency of company operations. The Law of the Republic of Kazakhstan as of 13 February 2009 # 134-4 "On the National Welfare Fund" codified the powers of Samruk-Kazyna as the major agent of the Government in the efforts against the consequences of the global economic crisis. Under the law, Samruk-Kazyna can exercise special powers, including a priority right to acquire, at the discretion of the Government, strategic entities divested by owners, bankruptcy assets of failed banks whose blocks of shares (partnership shares) are classified as belonging to strategic entities in accordance with legislation of Kazakhstan, or organizations that have important strategic significance for the country's economy, as well as a right to acquire bank shares in a manner determined by the legislation of Kazakhstan.

The crisis forced the Government to pay special attention to targeted assistance to vulnerable sectors of economy, such as the financial sector, residential construction, small and medium-sized businesses, the agricultural sector, industrial and infrastructure projects. Targeted support to these sectors of the economy was provided in both the first (2007) and second package (2008) of anti-crisis measures.



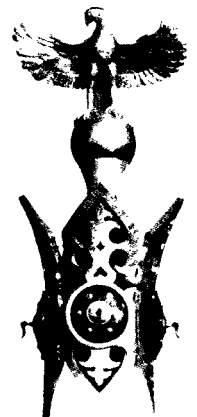
International practice of confronting the crisis shows that successful packages of state anti-crisis measures should take into account both the problems of the financial sector and falls in aggregate demand. The anti-crisis measures in Kazakhstan correspond to these criteria and contain components aimed at both rehabilitation of the financial system and at increasing of aggregate demand.

In November 2008, a plan of joint actions of the Government, the National Bank and FMSA was adopted, which sought to ensure stabilization of the economy and financial system for the period of 2009-2010. The plan's goal was to mitigate the negative consequences of the global crisis on the socio-economic conditions in Kazakhstan and provide the necessary framework for future qualitative economic growth. In other words, this plan is aimed at solving the objective of ensuring macroeconomic stability, the social welfare for Kazakh citizens, and the modernization of the economy.

International observers have positively assessed Kazakhstan's state assistance to problematic sectors of the economy, characterizing it as timely and ambitious.

It seems that one of the important lessons we can draw from our experience of implementing the strategy of industrial and innovative development is that the methods of acquiring technological value chains through the increased localization of pure assembly facilities are questionable. For example, all projects involving localization of assemblies of foreign car models and equipment in Kazakhstan have the following distinguishing features:

- Assembly projects are developed by foreign owners of technology and, consequently, bear cost burdens, including as related to copyrights commissions;
- Start-up costs of the Kazakh side require long-term credit support, which in and of itself already and more so represents high liquidity risks, given domestic interest rates rather, than effective financial support;
- After their delivery to Kazakhstan, foreign component parts become decidedly more expensive in Kazakhstan as opposed to producer countries;
- Finished parts incur production costs equal to or higher than the market prices for comparable imported products (because factors of



production in Kazakhstan exhibit lower levels of productivity), even if certification of technology and products is provided and other formal barriers for their sale are removed;

- Localized production of component parts cannot be cost-effective, just as in the case of the end products, albeit for the same reason (another scale and practice of production). This means that component parts, given the same level of quality, will not be cheaper than the imported ones, making the end products more expensive following the localization;

- Shifts of manufacturing of obsolete products to Kazakhstan see competing products with better quality-price ratios that ultimately kill assembly projects by the time of the end-product production assimilation and beginning of localization efforts to establish component parts manufacturing.

In other words, assimilation of "value chains" by means of their "extraction" from Kazakhstan's market through cooperation with foreign partners (while replicating pre-owned copyrights and well-known equipments) represents a long run of most commonly unjustified expenses and frustrations with still ongoing technological inferiority.

Participation of development institutions in these types of projects relieves hardships stemming from risks taken by private sector initiators, but cannot ensure cost-effectiveness because an ownership structure virtually does not affect technological expenditures.

In cases where an initiator recognizes a lack of prospects for a particular project and stops treating the project implementation seriously, the development institutions inevitably apply loss-reduction measures in respect to state funds invested in the project. However, the replacement of project participants cannot overcome the fundamental causes of unprofitability. Eventually, the development institutions and commercial banks end up having significant portfolios of unviable projects for which procurement by Government of large orders of non-competitive products at inflated prices is the only solution. The above-mentioned scenario is particularly prevalent in the transport machine building sector.

Creating competitive industries requires the use of secondary resources that have a low price and exhibit lower production costs compared to



imported products. For instance, supplies of scrap metal are required for the domestic production of car wheels. This facilitates production of wheel components utilizing western technologies. But for this to happen, the exports of scrap metal will need to be diverted to domestic production.

The most effective way is, of course, to organize or participate in territorial or global mega-projects to solve specific problems. Russia, China, and Kazakhstan need modern high-capacity agrarian equipment - large tractors, multi-functional combines, etc. Jointly creating these new industries could give a push to innovation, development and adoption of new technologies.

5.8. THE ANTI-CRISIS ROLE OF THE DISTRESSED ASSETS FUND AND SAMRUK-KAZYNA

After external borrowings reached a peak of 44% of GDP in 2007, the global credit crunch cut off Kazakhstan's banks from sources of external financing. As a result, the banks reduced the volume of loans provided to the economy. At the same time, falling real estate prices, a collapse in demand for property and the unavailability of refinancing for many borrowers (due to a system-wide contraction of credit) caused significant asset quality deterioration, further undermining the liquidity and, through increased provisioning, the capital positions of the banks (and so further eroding the ability and desire to lend).

Credit rating agencies provided negative credit opinions on Kazakhstan and its banks, fearing further pressure on bank capitalizations and increasing non-performing assets. For example, as early as February 2008, Standard & Poor's stated its belief that problematic assets could escalate in a Kazakh recession and estimated potential gross problematic assets at 35% - 50% of assets under such a scenario. An additional impact of the increase in non-performing loans on banks' balance sheets is that real estate was taken onto bank balance sheets as a result of foreclosures. Furthermore, this real estate was being added to bank balance sheets at valuation levels that increasingly differed from market prices, if the latter could be established at all.

Conditions in the banking sector required proactive measures on the part of the Government. The international practice of fighting severe financial



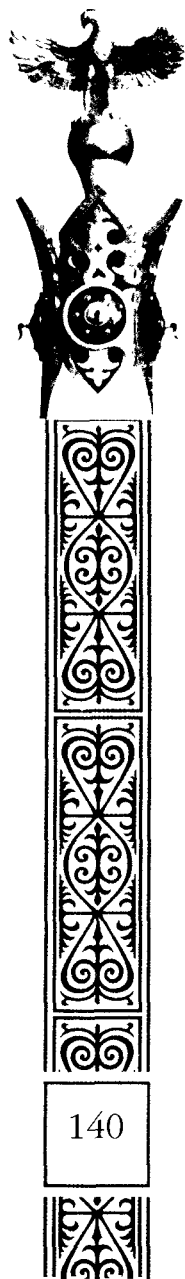
crises shows that timely solution of problems faced by the financial sector is of critical importance as it allows the creation of a framework for recovery of stable economic growth. An early, powerful and carefully designed response to shocks in banking systems is required. The timing and nature of fiscal measures are also essential.

Just as for the majority of other countries, support to the financial sector became one of the most important priorities for Kazakhstan. It was necessary to provide financial institutions with access to liquidity, identify and reduce the share of distressed assets, and ensure recapitalization of weakened but viable financial institutions.

Making efforts to support Kazakhstan's banks and provide resources for the economy, the Government took a series of direct and indirect measures to provide financial support to the banking system. Starting in the second half of 2007, several financing and fund investment schemes were put into effect that were aimed at supporting separate sectors of the economy by using banks' balance sheets. In total, the Government provided KZT 350 billion to the banking system. After that, with the advent of the second stage of the crisis in 2008, the Government provided banks with large volumes of direct financing in the form of capital investments, trust funds, and direct deposits. Major state and state-controlled companies of Kazakhstan deposited significant funds with the local banks. As a result, corporate deposits assumed a growing importance as components within the overall funding structure of Kazakhstan's banks.

Such support to banks represented a conscious move in times when the banks were forced to replace external financing with internal sources of funding and the public sector appeared to be the only source of internal investments.

Initially, the financial sector stabilization program intended to earmark US\$5 billion for recapitalization of the banking system through acquisition of ordinary and preferential shares by Samruk-Kazyna on behalf of the Government. Four large systemically important banks were selected: Halyk Bank, Kazkommertsbank, BTA Bank and Alliance Bank. The Government also suggested injecting capital into ATF Bank and Bank CenterCredit, but the owners of these banks decided to look for market solutions. As a result,



US\$4 billion was used to recapitalize the four largest banks and provide support to the banking sector in general. Samruk-Kazyna acquired shares of BTA Bank (75%), Halyk Bank (21%), Kazkommertsbank (20%) and Alliance Bank (76%) which represented total investments of US\$2.2 billion. The remaining portion of the US\$4 billion, earmarked for the support to the financial sector, was mainly provided in the form of deposits.

In February 2009, the National Bank and FMSA recommended that the Government increase the capitalization of BTA Bank. The Government agreed and increased the bank's capitalization via a mandatory issue of new shares which was dictated by the need to comply with minimum capital and liquidity requirements.

Meanwhile, the shareholders of Alliance Bank suggested the Government take over the bank for the token amount of KZT 100. However, this would have triggered change of control provisions in some of the bank's international borrowing agreements. As a result, Samruk-Kazyna set out that a waiver from relevant lenders on claims for early repayment would be a necessary prerequisite for it to acquire a controlling stake in the bank. Despite this, although the bank was not controlled by the Government, for much of last year key management decisions were taken with the participation of Samruk-Kazyna.

Nevertheless, in January 2010, pursuant to Resolution No. 268 adopted on 30 December 2009 by the FMSA, the entire issued share capital of Alliance Bank was compulsorily acquired by the FMSA and transferred to Samruk-Kazyna. This action was taken primarily as a result of the bank's negative equity capital position and its failure to comply with prudential requirements, which were not cured within the time period allowed under Kazakh legislation.

Capital injections for Halyk Bank and Kazkommertsbank took place following the conclusion of mutual agreements between all interested parties. The Government acquired common and preferred shares in the banks, promised not to interfere with their operations and not to increase its share beyond 25%. Existing owners also received options to repurchase the shares sold to Samruk-Kazyna. In total, the Government provided Halyk Bank and Kazkommertsbank with KZT 120 billion (more than half of the funds went to



the purchase of shares; the rest was used to finance the real sector of the economy). To date, all of these funds have been fully disbursed. These measures helped save 43,071 existing jobs. A further KZT 24 billion has been put on deposit with Alliance Bank. After the decision was made allowing the Government to acquire a stake in the capital of these banks, the Government has used its ownership interests as an active tool to support the country's economy. Thanks to these measures we were able to maintain the provision of credit to the economy and to prevent the failure of these financial institutions and, as a consequence, prevent the collapse of the wider financial system.

The question of when the Government intends to dispose of its stakes the banks remains outstanding. One of the options for the Government's stake in BTA Bank would be a sale to Russia's Sberbank. Negotiations are ongoing in this regard. The majority of experts and analysts agree that the Government's infusion of US\$4 billion into the systemic banks in the form of capital and long-term deposits was instrumental in alleviating the pressure on the sector. Additional Government support was provided in the form of National Bank funding, mortgage refinancing, assistance programs for small and medium-sized businesses and distressed residential construction, as well as bank deposits of state companies. Currently, state companies (first and foremost, the state owned oil company, Kazmunaigaz) are the largest depositors of the banking system. The Government-sourced funds, overall, constitute about 40% of all internal liabilities of the banking system.

DISTRESSED ASSETS FUND

In the second half of 2008, the Kazakh authorities set about creating a state Distressed Assets Fund to address the problem of deteriorating bank asset quality. A state-owned fund would purchase non-performing assets from the Kazakh banks, thereby reducing mark-to-market volatility of bank assets and drawing a line under the banks' losses, boosting confidence of depositors and creditors in the system, providing banks with much-needed liquidity and, ultimately, contributing to the resumption of lending. In other words, by helping banks stabilize capital ratios, such a fund should theoretically allow them to increase lending instead of hoarding cash to cushion against future unforeseen losses from distressed assets.



The fund was established in November 2008, with an initial capitalization of US\$583.7 million that was supposed to increase to US\$1 billion in 2009. This sum was stipulated in the anti-crisis plan for 2009-2011. Samruk-Kazyna was entrusted with the administration of the fund on behalf of the Ministry of Finance.

Since then, the Government has developed a revised model of the operations for the fund.

5.9. SUBSIDIES TO THE RESIDENTIAL CONSTRUCTION SECTOR AND MEASURES TO REVIVE THE HOUSING MARKET

In 2001-2007 Kazakhstan experienced a real-estate boom supported by strong economic growth, high income growth and lack of alternative investments in the domestic market. Given the lack of alternatives, Kazakhstan's banking sector directed the bulk of the loans, which were easily available in external markets, into the country's construction and real-estate sectors. As a result, housing prices increased sharply during this period. Many citizens viewed real-estate as the single area of investment bringing higher profits not strongly impacted by inflation. The volume of mortgage loans provided by banks reached KZT 683.5 billion at the end of 2007. This volume increased by three times approximately each year from 2002 to 2004. After that the growth moderated somewhat, reaching 121.9% in 2005, 80% in 2006 and 79.6% in 2007. Starting August 2007, external loans were no longer available for Kazakh banks and, consequently, the volume of mortgage loans decreased by 4.7% by the end of 2008.

In the fourth quarter of 2007, as the global financial crisis began to bite, 450 residential complexes were being built in Kazakhstan. Following the reduction in credit financing available, the construction of many projects was halted. By March 2008, more than 140 housing projects in Almaty alone had been put on hold.

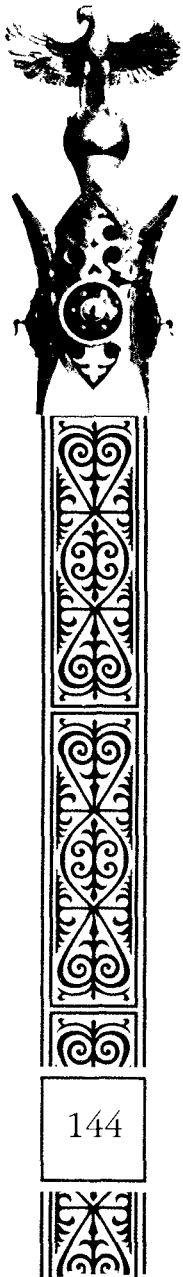
A key feature of Kazakhstan's construction and real estate market is a concept of shared construction that represents individual investments based on equity participation in construction projects that are supposed to be completed in the course of one or two years following the investments.



After the financial crisis hit Kazakhstan, many shared construction projects were abandoned as construction companies became insolvent. About 29 thousand people had invested in unfinished residential construction projects by September 2007.

The Government took a series of measures to assist the construction and real estate market. As part of the first anti-crisis plan in 2007-2008 the Government provided real estate developers with refinancing through commercial banks, as well as acquiring many of the incomplete projects. As a result, by the end of June 2009, the construction of 22,140 apartments in Astana and Almaty was completed. Samruk-Kazyna provided 85% of the funds necessary to complete the construction, while the banks and real estate developers were required to provide 15%. The Samruk-Kazyna funds were provided to banks in the form of deposits, and the banks assumed the corresponding risks of on lending them. The funds, earmarked as part of the first anti-crisis plan for the support of the distressed residential construction, reached KZT 95 billion. By September 2009, the total amount deposited in the banks in the framework of this program had reached KZT 66.3 billion.

A public housing program for 2008-2010 was developed to solve housing problems, as well. The program, totaling KZT 300 billion, plans the construction of 28 million square meters of residential space. The KMC provides banks with mortgage refinancing. The goal of the KMC is to expand the provision of mortgage loans, as well as to create favorable conditions for home loans by lowering their interest rates. Another critical component of the housing programs is a housing construction savings scheme. This scheme was put into effect in 2000, and a dedicated Housing Construction Savings Bank was created in 2003. In July 2007, the Government launched a legislative initiative to expand participation in the housing construction savings scheme. These changes focused on simplification of some procedures guiding the activities of the Housing Construction Savings Bank. In addition, Samruk-Kazyna's Real Estate Fund was created in March 2009 as part of the execution of the anti-crisis measures for 2009-2011. This fund deals with the repurchase of incomplete housing construction projects with a view to ensuring their subsequent completion and eventual sale or lease. Given the prevailing conditions of mortgage lending and commercial leasing, the housing rents are 40% more affordable for leaseholders if provided on the terms of the Real Estate Fund.



Thus, measures in various areas were utilized to mitigate the deficit of liquidity in the residential construction and real estate sector. Most of the related initiatives do not presuppose direct transfers to beneficiaries but, rather, provide companies with refinancing assistance through banks (early redemption of loans and restructuring of loan conditions). Consequently, credit risks on existing loans decrease, providing support to both banks and borrowers. As a result, many housing construction projects have been completed on more lucrative financial terms. These measures also helped prevent job losses that could have occurred in the case of frozen construction. Starting with the end of 2007, and during 2008, 195 projects have been completed, solving the problems of 21,668 shared construction participants. Over the course of 11 months in 2009, 72 projects were completed that involved 11,355 interest-holders. Partial return of funds and redistribution within other projects was carried out across 14 projects (2,037 shared construction participants), as well.

In the longer term, an important task of the Government is the development of regulatory mechanisms that should assist in the removal of system-based problems in the real estate market, such as dependency on foreign sources of financing, excessive risk taking, weak loan guarantees, in order to prevent formation of bubbles in the future. We need to realize that the construction of real estate is, unequivocally, a service industry that should follow the needs of the market as far as quality, volume and acceptable prices are concerned, and not be exposed to overheating through unsustainable profiteering. The price-quality ratio is achieved through a professional approach, not via the unrestrained pursuit of speculative profit.

5.10. DIRECT GOVERNMENT SUPPORT TO THE REAL ECONOMY

A reduction in the number of financing opportunities, along with deceleration of economic growth, had a negative impact on lending to small and medium-sized enterprises.

It is obvious that a use of a wide range of mechanisms to assist small and medium sized enterprises is needed. It is necessary to expand financing support to small and medium-sized businesses, as well as tie such assistance with state procurement. Now, many enterprises suffer from a lack of access



to working capital. Support for small and medium sized enterprises through state procurement helps them participate in the provision of goods and services to the Government and national companies, as well as buttress their businesses and preserve jobs.

In December 2007, the Government proceeded with the implementation of a small and medium sized enterprise assistance program providing the sector with access to Government financing through commercial banks. As part of this program, the Government provides financing to the Damu Fund, which, in turn, places deposits in commercial banks. The small and medium sized enterprises are thus able to receive loans on favorable terms, depending on each individual program. The bank that takes a decision about credit financing takes the credit risk upon itself. Thus, this program combines the features of market and state mechanisms.

The first tranche of the program distributed KZT 48.4 billion of funding. Then, tranches of KZT 54.7 and KZT 127 billion followed in June 2008 and February 2009, respectively. A regional program, totaling KZT 35 billion, was also launched in June 2008. During the disbursement of the first tranche, the banks could determine interest rates for borrowers, with an average interest rate reaching 17.8%. Under the second and third tranches the interest rates for borrowers were limited to a ceiling of 12.5%. The average interest rate under the regional program amounted to 12.7%. These rates were significantly lower than those of the pre-crisis level, which equaled, on average, about 22%. In total, the program earmarked KZT 265 billion. These funds also provided indirect support to participating commercial banks.

About 6 thousand small and medium sized enterprises have made use of the resources available under the anti-crisis package for 2007-2008. The plan of joint actions by the Government, National Bank and FMSA for 2009 - 2010 provided additional financial support to the sector, with 70% going to the refinancing of existing projects and the remaining portion being used for the implementation of new projects. By July 2009, the banks had concluded contracts for 2,551 projects totaling KZT 133.6 billion. Disbursement of funds has already been completed for 2,376 projects. As a result of this assistance to small and medium sized enterprises more than 6

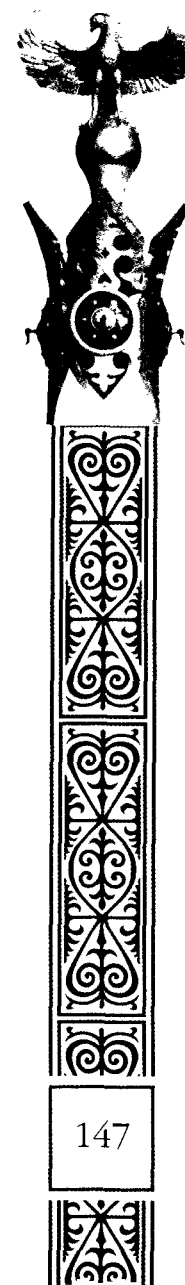


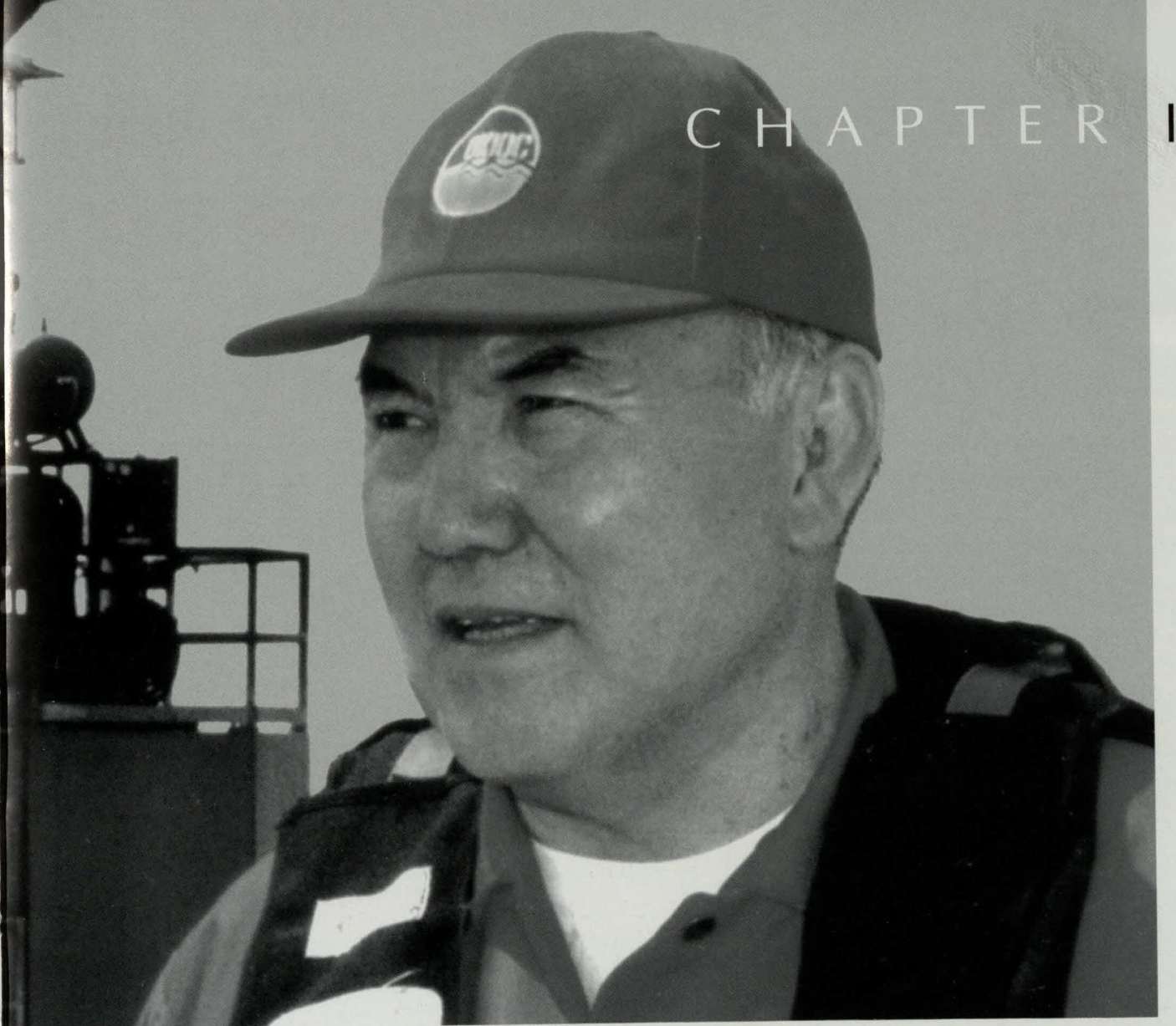
thousand projects have been funded and 12 thousand jobs have been preserved. The number of small and medium sized enterprises increased in the first 5 months of 2009 by 19.7%

Providing assistance to small and medium sized enterprises is a strategic objective, both for ensuring diversification of Kazakhstan's economy and to support almost a quarter of the population which is employed in this sector. Apart from financial support, the Government took measures to remove administrative barriers and improve the business climate.

SUPPORT TO THE AGRICULTURAL INDUSTRY

While agricultural investments fall as a result of the global crisis, Kazakhstan is increasing its share of investments into the country's agriculture. As part of the Government anti-crisis measures, KZT 131 billion was earmarked for the support of the agricultural industry. This assistance is intended to provide lending to agricultural companies, to finance agricultural projects through the National Holding KazAgro and for grain purchases in order to ensure food security. The funds are divided between micro-credit and large-scale projects. Moreover, as part of its anti-crisis measures, the Government allocated 30% of the total assistance to small and medium sized enterprises for implementation of agricultural and food industry projects.



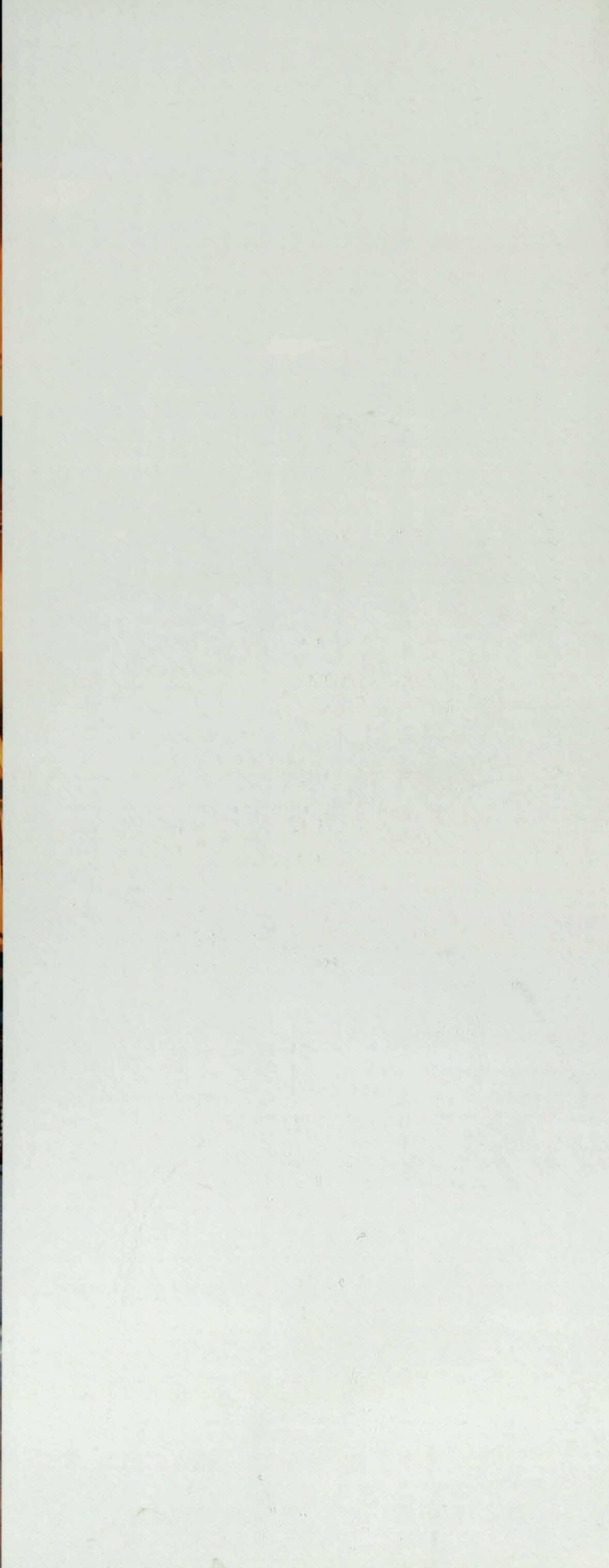
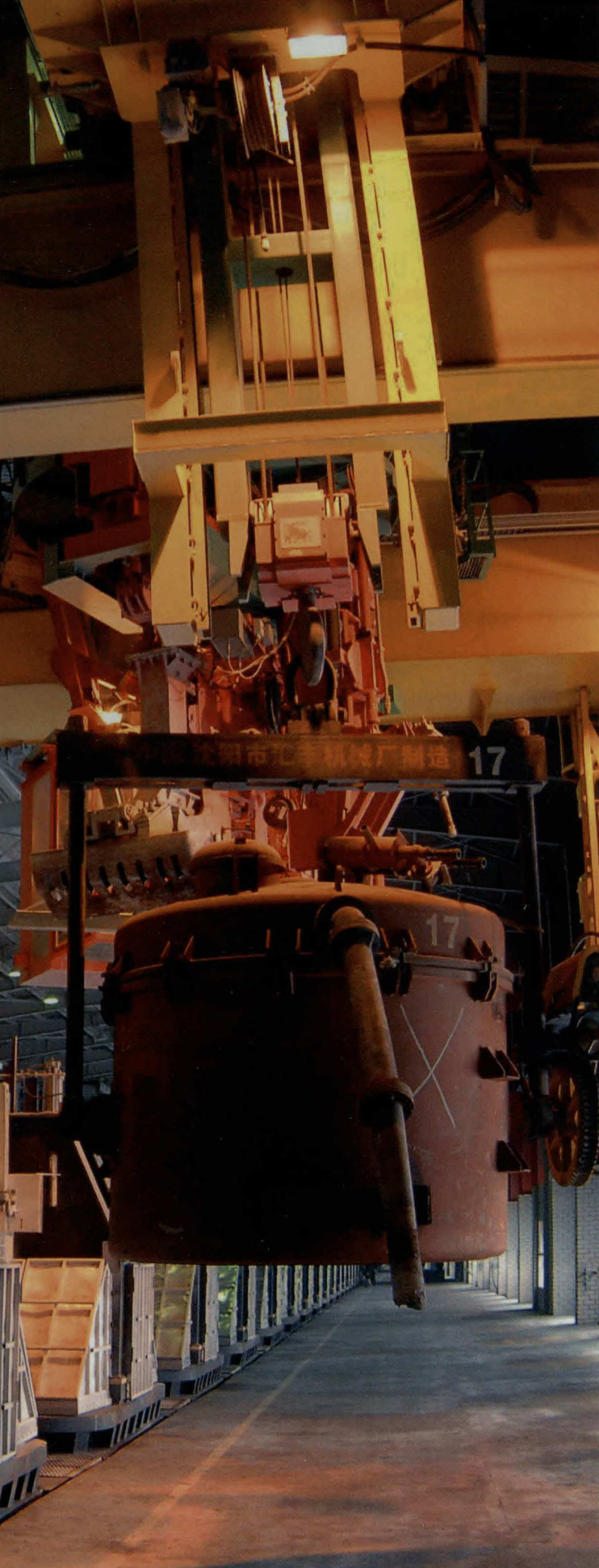


**MANAGING CRISIS RECOVERY AND POST-CRISIS
GROWTH THROUGH THE DEVELOPMENT
BENEFITS OF KAZAKHSTAN'S
MODERNIZATION MODEL**





Kazakhstan's long-term prosperity depends, in great part, on the country's large scale and broad-based industrialization. That is why the primary focus for the Government in addressing the consequences of the global financial-economic crisis in Kazakhstan is investment in industrial and innovation-based development.



MANAGING CRISIS RECOVERY AND POST-CRISIS GROWTH THROUGH THE DEVELOPMENT BENEFITS OF KAZAKHSTAN'S MODERNIZATION MODEL

Kazakhstan was one of the first nations in the world to quickly respond to the rising turbulence in the world economy and enact crisis mitigation measures. The Government helped lower risks in the banking sector that were associated with foreign loans and capital adequacy. In order to maintain the stability of the financial system and support real economic activity, banks were provided with additional liquidity. Efforts were also stepped up to improve conditions for investment: administrative barriers were removed; a new, simplified Tax Code was introduced which significantly lowers the tax burden. Furthermore, the Government took a series of measures in order to alleviate the negative consequences of the crisis on the Kazakh people, including through deposit guarantees, supporting residential construction, providing financial assistance to small and medium-sized businesses and agricultural companies. I will never forget that the most important long-term priorities of the Republic of Kazakhstan were and remain to be the development of human capital and the improvement of the quality of life for its citizens. Following the crisis, primary attention was given to increasing employment and vocational retraining. Despite all the obstacles placed in its path, the Government still delivered on its social obligations, which includes providing support to vulnerable groups, including pensioners and students.



We were able to accomplish all this because during better times, we managed to lay the foundations for a stable and flexible economy. We went into this crisis as a strong and unified society. Nevertheless, the crisis not only affirmed our commitment to the priorities that we set as part of our strategy for social-economic modernization back in 1997, but it also clearly showed us that in order to preserve our competitive position in the post-crisis environment, further decisive action is required. The crisis starkly underlined that Kazakhstan's long-term prosperity depends upon successful economic diversification. That is why, fast on the heels of the crisis, we are accelerating our industrialization program. All the building blocks are currently being assembled: a streamlined legislative framework; improved institutional capacity; targeted economic incentives; Government investment in human capital, infrastructure and technology; maintaining an appropriate balance between Government intervention and market mechanisms for improving Kazakhstan's economic competitiveness; and developing opportunities for greater international cooperation and foreign direct investment.



1.1. RESOURCE ALLOCATION AMID THE GLOBAL LIQUIDITY DEFICIT: SUPPORT FOR DOMESTIC RESOURCES

Since the beginning of the financial crisis in 2007, credit around the world has dried up. Banks around the world have tightened lending standards, whilst the risk premium has risen. As a result, the volume of private sector credit has stagnated in the United States and Europe and investments around the world have declined.

According to consensus forecasts, negative conditions in the international credit markets are expected to persist until the first half of 2010. As a result, the public sector in most countries around the world has taken an active role in supporting the economy. The scale of the crisis and

the reduced availability of capital have led to Government support becoming the main tool for economic recovery, at least in the short-term.

In Kazakhstan, this task was facilitated by the Government's strong fiscal position and reserves, which were available for implementing anti-crisis measures. In 2008, one year after the Government launched its crisis mitigation measures the size of the Government debt did not exceed 1.5% of GDP, while the budget deficit was also moderate, at around 2% of GDP.

By establishing the National Fund, we have put in place a stable system for long-term savings. Events have vindicated our decision to establish this Fund during better times. I am convinced that this is precisely how governments that are thinking about their futures should act. We have been able to provide a buffer for our economy, protecting it against external shocks. Of course, there were those that opposed the creation of the National Fund. It was suggested that we distribute the money to citizens, as several Arab countries have previously done. However, it is not difficult to imagine what the outcomes would have been had we pursued such a policy.

International financial organizations also played a role in providing anti-recessionary support, though they provided a relatively small share of the funds that were made available by the Government for economic stabilization. For example, in September 2009, the Asian Development Bank ("ADB") allocated a US\$500 million short-term loan to Kazakhstan as part of an anti-crisis program to support the Bank's member countries.

Throughout the crisis, Kazakhstan has built a strategic policy of collaborating with foreign partners. As a result, the country has attracted financing from international financial institutions, governments, and state corporations for key industrial projects. One notable example is the US\$3 billion of financing that the Government received for the renovation and construction of a 2,840 kilometer road transit corridor which links Europe and Russia to China through Kazakhstan. The lenders for this project comprised: the European Bank for Reconstruction and Development ("EBRD"), the ADB, the World Bank, the Islamic Development Bank and the Japan International Cooperation Agency.



In April 2009, the Government signed an agreement for a US\$10 billion dollar financing package with Chinese state-owned companies. The package involves a US\$5 billion loan made by CNPC, China's state-owned oil company, to KazMunaiGaz, Kazakhstan's state-owned oil company, for the joint acquisition of Mangistaumunaigaz from Indonesia's Central Asia Petroleum Ltd. The package also involves a US\$5 billion credit line from the Export-Import Bank of China to the Development Bank of Kazakhstan, which will support the country's industrialization program.

1.2. ADJUSTING THE MODERNIZATION PLAN: MAINTAINING STRATEGIC GUIDELINES AND "FINE-TUNING" SPECIFIC INSTRUMENTS

Despite the global financial and economic crisis, the overall goals of modernizing Kazakhstan (diversification, economic and innovative industrial development) remain unchanged. The Government has pressed ahead with infrastructure projects in order to support economic activity and provide employment for its citizens. The most significant changes concern economic modernization mechanisms. In the process of stabilizing and rebuilding the economy, the Government's direct responsibility for economic development has increased sharply.

In my annual Address in March 2009, I presented a new plan for further economic modernization and creating employment. Economic modernization requires resources, which is why it is necessary that the profits from our commodities sector, which are traditionally designated for our National Fund, are instead put toward fulfilling our new plan in 2009-2010. This will amount to KZT 600 million, which is in addition to the funds already earmarked for transfer from the National Fund. At the same time we will preserve resources by adhering to strict fiscal discipline and eliminating unnecessary budgetary expenditures.

Financing for existing investment projects will continue unabated, regardless of the crisis. The priority here will be given to modernizing Kazakhstan's three oil refineries, which will allow the country to reduce its dependence on oil and jet fuel imports. Work will also continue on the construction of the petrochemical facility in Atyrau, the construction of the

Moinak hydroelectric power station, the expansion and reconstruction of the Ekibastuz GRES-1 power station, the construction of a third power-generating unit at the Ekibastuz GRES-2 power station, and construction of the Balkhash thermal power station.

In 2009 alone, construction began on 170 new industrial and infrastructure projects, at a cost of more than US\$3 billion. These projects have created nine thousand permanent jobs. At the same time, a locomotive assembly facility has been put into operation in Astana in partnership with General Electric, whilst a gas plant in Kumkol and a world-class freeway between Astana and Shuchinsk have also been opened.

In addition, during the course of the year, the Government secured foreign investment for many high-priority projects. Agreements were reached with companies from South Korea, China, Italy, France, Turkey and Belarus for projects worth more than US\$25 billion. The projects include, amongst others: construction of the Balkhash thermal power station, construction of the Beineu-Bozoi gas pipeline; the manufacturing of fuel assembly units for nuclear power plants; construction of a benzene hydrocarbon complex; and construction of an asphalt plant.

The development of vibrant small and medium-sized businesses is of great importance for broad-based economic development. This sector received significant state support. In April 2009, Samruk-Kazyna and the Damu Fund signed a loan agreement with 12 commercial banks, for a total of KZT 117 billion. These funds, in turn, were provided to small and medium sized businesses in the form of loans for modernizing fixed assets, replenishing working capital, and for re-financing existing loans.

I have repeatedly emphasized that support for rural communities is a priority objective for the Government. Thanks to ongoing development of the agriculture industry, we are simultaneously solving two of the country's most important challenges - food supply security and export diversification. In this sector, first and foremost, financing for investment projects for export-oriented production will continue, as will the organization and development of dairy farms, poultry farms, feed yards, horticulture production, the installation of farm machinery, the development of meat production, processing of fine wool, and infrastructure for the export of Kazakh grain.



The priorities are to create a world-class food supply base and diversify crop production based on large-scale cooperation between small and medium-sized farms.

The Government has consistently worked with large companies to guarantee job security in the event that production levels drop at these enterprises. Local authorities have turned to large employers - particularly in the mining, metallurgy, and the building sectors - with requests to avoid layoffs should demand fall (in some cases in return for tax breaks). In 2009, major industrial enterprises, including representatives from the Council of Foreign Investors, struck agreements concerning lay-offs at major enterprises. The terms of these agreements were strictly observed, and on behalf of the Government, I offer them my sincere gratitude. To create jobs in the public sector, including in the regions, the Government has funded public works programs and large-scale municipal and critical infrastructure projects such as the 100 Schools, 100 Hospitals project.

The importance of creating jobs through Government infrastructure spending was emphasized in my annual Address to the people of Kazakhstan in 2010. The Government is responsible for implementing the "Road Map" program which allocates public funds for infrastructure projects that have an immediate effect on job creation.

1.3. THE ROAD MAP - DEVELOPING SOCIAL INFRASTRUCTURE FOR FUTURE ECONOMIC GROWTH

On March 6, 2009, the Government approved the Road Map, which is a strategy for generating employment and providing skills-based education. It was designed to stem unemployment and create stable labor conditions, which together, are necessary for the country's post-crisis growth. I was given the task of creating jobs and preventing a substantial increase in unemployment rates.

To achieve these goals, in addition to the stabilization measures taken earlier, it has been necessary to focus attention on the problems of regional job creation and retraining. Priorities include the reconstruction and development of housing and utilities infrastructure, the renovation of



schools, hospitals and other community facilities, and the renovation, reconstruction and construction of critical roads. Additional resources were also allotted for the expansion of social programs and youth employment programs and financing for priority community projects in cities, townships and villages. The program also encompassed such measures as increasing the maximum period for receiving unemployment benefits from 4 to 6 months.

The mechanism for the implementation of the strategy also provided for co-financing from the national and local budgets. The total volume of the strategy's financing totaled KZT 187 billion, including KZT 135 billion from the national budget and KZT 52 billion from local budgets.

By the end of 2009, within the framework of the Road Map, repair work was completed on 5,255 projects, 259 thousand jobs were created, 68 thousand people completed job training or retraining, 73 thousand social works jobs were created, and 51 thousand internships were funded for young people.

As a result of the Road Map program, the unemployment rate fell to 6.6% in 2009. This is an impressive result considering that unemployment has increased in countries around the world. Large-scale work to modernize community housing facilities and utilities infrastructure was carried out. Almost 1,500 facilities for public health services, education and other community infrastructure were renovated. Thousands of kilometers of roads were repaired. Resources made their way to each village and township, which honestly speaking, was not always possible previously. If truth be told, it must be said that we inherited these social problems from the Soviet era. Such social problems seemed secondary, but such is not the case. I received thousands of words and letters of gratitude from ordinary people.

The Road Map was made possible by a sound legal framework. In May 2009, amendments were made to legislation concerning employment and Government procurement in order to provide a legal framework for executing the Road Map. These amendments include requiring employers to submit information to authorized agencies concerning pending layoffs and changes to work conditions, the availability of job openings, and on hiring decisions. In addition, amendments to the law on Federal



Procurement were made to simplify Government procurement procedures for projects under the Road Map.

In August 2009, I instructed the Government to set aside resources for extending the Road Map into 2010. Within the framework of the Road Map in 2010, KZT 140 billion will be allocated - KZT 100 billion from the national budget and KZT 40 billion from local budgets. Work will continue on the renovation and reconstruction of facilities for housing and public utilities, schools, hospitals, and other rural facilities. In total, it is expected that more than 130 thousand jobs will be created.

1.4. CREATING A FOUNDATION FOR ACCELERATED INDUSTRIALIZATION AND STABLE DEVELOPMENT OF INNOVATIVE MANUFACTURING METHODS AND TECHNOLOGY

Kazakhstan's long-term prosperity depends, in great part, on the country's large scale and broad-based industrialization. That is why the primary focus for the Government in addressing the consequences of the global financial-economic crisis in Kazakhstan is investment in industrial and innovation-based development.

According to the Joint Action Plan for stabilizing the economy and financial system (2009-2010) which was prepared by the Government, the National Bank and the FMSA, US\$1 billion was allocated for the development of infrastructure and innovation-based industry. These funds were supplemented by foreign direct investment (US\$3 billion in 2009) as well as pension fund investments.

These funds are intended for financing major infrastructure and innovation-based projects. Currently, Samruk-Kazyna is attempting to identify the highest-priority projects in various industries, including electricity generation, transportation, chemicals, metallurgy, as well as tourism.

The list of priority industrial and infrastructure projects was approved by Executive Order on September 1, 2009. In addition, the Government developed an intermediate plan for co-financing 45 infrastructure projects. In 2008, US\$532 million was budgeted for these projects. In 2009-2011, US\$2.9 billion will be allocated for these projects from the budgets at different



levels of Government. I regard these projects to be breakthrough and vital for accelerated economic development.

In addition to providing access to finance, the Government is attempting to improve the attractiveness of these projects for private investment. For example, in the electric power industry, the aforementioned Joint Action Plan for 2009-2011 establishes cap rates for energy-producers over a minimum period of seven years. These rates will help investors make investment decisions with certainty. In addition, the Plan abolishes grid connection fees.

Currently, the Government is drafting a 5-year program for accelerating the country's industrial and innovative development. It is expected that this program will be approved by the end of the first quarter of 2010, along with supporting documents which set out the mechanisms and instruments for program execution. The supporting documents include a plan for the rational distribution of production capacity, a map of industrial development, and sector-based programs. All sector-based programs and pre-existing programs relating to industrialization, including the program 30 Corporate Leaders (52 programs in total) will be consolidated into a single program for accelerated industrial-innovative development.

The complex economic situation has not become an obstacle for the Government in its work on industrial development. On the contrary, this work is now taking on ever greater importance. In 2010, work is planned to begin on 44 new industrial projects, which are expected to create more than 121 thousand jobs. In 2010, 70 projects will be brought in operation.

The Government's program for industrial development also takes into consideration development institutions, which in the long-term run are expected to act as growth catalysts. To date, however, development institutions have not achieved their original mandate. The failure rate for investment projects supported by these institutions is high.

One of the primary reasons behind the many project failures is a shortage of management skill and expertise in the development institutions. Most staff was trained in legal and financial disciplines and there was a shortage of industry expertise. Staff did not have the specific skills to properly



assess and implement investment projects. This experience clearly demonstrates the necessary value of industry experience.

A similar picture emerges in the sector-based ministries (which are increasingly filled by generic office managers), which employ an insufficient number of qualified specialists with industry-specific expertise. The main reason for this is that the most qualified specialists were long ago lured out of Government service to work instead for private companies, which offered higher salaries and more cutting-edge, creative work.

National companies, which offer salaries comparable with the private sector, have the most favorable conditions for securing and employing specialists. At the same time, the political nature of investment projects carried out by national companies does not always lead to efficient outcomes (for example, the engineering industry has seen few successes). This is compounded by Government procurement practices which often result in higher costs, affecting the financial performance of projects.

As a result, due to the increasing role the Government is playing in financing investment projects, it is necessary in the long-term to raise the level of professionalism involved in the selection and execution of investment projects. This can be done by strengthening industry management agencies, developmental institutions and national companies through the employment of engineers and technology specialists with advanced training and experience in operations. Another tool is to set-up a program for internships at technologically advanced corporations and engineering companies abroad.

Where there is a "critical mass" of specialists that are capable of assessing, selecting and competently executing investment projects, it will be possible for the Government to more confidently engage in project financing. In turn, the more diverse experience and expertise that staff obtains, the more sophisticated projects may become and the more opportunities there will be for fostering cross-industry cooperation.

It is possible to argue that one of the main problems with the current stage of Kazakhstan's development is the unjustifiably low level of engineering work and the administration of investment projects. Proper



documentation of the investment process has so far been the most pressing issue to resolve among the banks, state structures and development institutions. The connection between the transaction documents and actual financing conditions is still an unresolved issue in the process of implementing a state's development budget. Banks and development institutions do not strive to make sure of the feasibility of their projects and efficiency of investment and instead rely on accreditation and other legal terms of financing.

It is not possible to claim that there is no understanding of the nature of technical problems when executing an investment strategy in Kazakhstan. However, while investment must be carried out expeditiously, the training of engineering personnel, especially high-level engineers that have in-depth knowledge, practical experience and are skilled in advanced methods of project-design and management, takes a long time.

As such, it is no coincidence that Government organizations seem to be trying to escape requirements for project engineering. The current interest in public-private partnerships (PPPs) shifts the burden of engineering problems to the private sector.

Given the current economic conditions in Kazakhstan, projects that are significant for the Government do not always make efficient investments for private partners given market prices and tariffs, so the Government is compelled to significantly raise the tariffs for private partners. But even these measures, as history has shown, are not enough to ensure private partners adhere to the terms of their concession agreements. Also, PPPs are not always structured with proper economic incentives to ensure private partners deliver on project quality and performance. As is common practice among building contractors, corners are cut on expenditures for construction and installation work, and as a result, the overall quality suffers. Therefore, instead of overcoming the "investment barrier", these practices only raise it up a higher notch.

One of the reasons why it is difficult to achieve successful PPPs is that the Government establishes project criteria (technical and economic) during the tender process and often selects private partners based on cost alone. As such, tender conditions can and should be better developed.



The measures necessary for resolving these problems concern at least three areas. First, it is necessary to take advantage of the new 3-year national budgeting system and change the procedures for assessing and executing investment projects. In particular, each project and its design should have detailed supporting documents so that it is possible to trace its history and conduct full document control.

Secondly, it is necessary to improve legislation on Government procurement in order to extend the period of building and assembly work (so that it coincides with the "construction season"). It may also be necessary to introduce additional requirements covering specialized subcontractors and quality control assurance for contractors and subcontractors (spanning 3-5 years after construction is completed).

Thirdly, it is necessary to re-define the monitoring function for investment projects. If until now monitoring has consisted of supervising contractors' adherence to construction work schedules, then going forward it should be expanded in scope based on a proper risk management framework.

The monitoring process must cover an investment project throughout its life-cycle - from the project concept and initial design to the financing decision, through the construction period to commercial operations and beyond. As a result, monitoring must become an integral function of overall project management.

At the same time, the subjects of monitoring should not begin and end with project contractors. Monitoring must span all organizations that are directly or indirectly involved in investment projects. These include: administrators of government programs; contractors for engineering, design and construction; financing organizations; agencies that grant construction permits and conduct the final inspection of completed facilities; and others. Monitoring must seek to provide a holistic picture of project performance. Such a picture must, of course, be supported by the relevant documentation flow between project participants, with no exceptions.

The selection of investment projects must be a coordinated effort among the relevant ministries, national companies (including development institutions), regional Akimat authorities and other stakeholders.



Building a portfolio of investment projects for monitoring requires taking into account the importance, size, timing, and other specifics of the projects. It is also recommended to take into account the design capacity and timetable for project completion in order to determine the annual production volume (by quarter).

On a separate note, it is necessary to explore issues of inter-industry cooperation and the issues relating to selection of locations for new facilities. Such analysis will allow proper sequencing for bringing new facilities into operation, as well as produce regional groupings of investment project portfolios. The formation of regional portfolios, in turn, helps mobilize local investment resources.

The economic crisis presents an opportunity for reorganizing the Government's systems for investments. To achieve high returns on our investments, it is necessary to move toward full-scale portfolio management of nationally significant investment projects (budgets, concessions, major private sector projects). Portfolio management includes maintaining a database, conducting structural and financial audits of project documentation, and monitoring the projects' progression (from the conception phase until the conclusion of the pay-off period).

Implementing these measures will help us to avoid investing in unprofitable projects. Those projects that have passed a rigorous selection process will be under control before full calculations are made on the projects' design capacity and volume of invested funds.

2.1. THE FRUITS OF PREVIOUS ECONOMIC GROWTH AND A RATIONAL APPROACH TO UTILIZING RESERVES

Kazakhstan was the first country in the former Soviet Union to feel the effects of the crisis which began in the second half of 2007. However, the country's strong economic growth prior to the crisis - 10% on average since



2000 - allowed Kazakhstan to mitigate the impact of the downturn and preserve standards of living for its citizens.

In the pre-crisis period, many international institutions and experts noted Kazakhstan's high rate of GDP growth compared with its peers in the CIS and among energy exporters. The liberalization of national economies allowed for the growth in foreign direct investment (FDI) mainly in the oil and gas sector. In Kazakhstan, FDI inflows per capita were higher than in other CIS countries, while growth in global demand for energy stimulated export growth. This, in turn, positively affected the development of the oil and gas industry and also stimulated the development of related industries, such as construction, transportation and the financial sector. The growth of FDI was also observed in wholesale and retail trade and utilities.

Between 2000 and 2004, the volume of FDI in Kazakhstan averaged 10% of GDP and reached 13.5% in 2004. This level far exceeded that observed in Bulgaria (7.2%), Romania (3.2%), Russia (1.8%) and the average for the countries of the former Soviet Union (3.6%). The bulk of FDI in Kazakhstan (approximately 60%) was directed toward the extractive industries.

At the same time, despite Kazakhstan's economic achievements, as an export-oriented economy, it is vulnerable to external factors, such as the volatility of energy prices. As early as 2001, the IMF noted increasing risks for Kazakhstan's economy. I agreed with this assessment and approached the problem seriously. I viewed it as a twofold task: on the one hand, we had to ensure the efficient management of large revenues from the oil and gas sector without disrupting our balance of payments, and on the other hand, we had to continue structural reforms in order to lay the groundwork for sustainable economic growth and job creation.

At the same time, faced with a surge in foreign exchange earnings from the oil and gas industry, the decision was made to create a National Fund. This helped reduce the impact of commodity price volatility on the national economy whilst also preserving the benefits of oil revenues for future generations. The Office of National Fund was transferred to the National Bank, which invests the funds in foreign assets. Today, the assets of the National Fund exceed US\$25 billion and they have grown by an average of 45% per year since inception.



In 2003, efforts to diversify the national economy were intensified. To stimulate the development of the manufacturing sector and direct greater resources to economic diversification, the Government adopted the Strategy of Industrial and Innovative Development for the period until 2015, which provides for the creation of specialized development institutions and strengthens the status of existing ones. Institutions such as the Investment Fund of Kazakhstan were created to support private sector initiatives in non-primary sectors of the economy. The National Innovation Fund was also established to provide venture type financing for private businesses in emerging industries. In addition the State Insurance Corporation for Export Credits and Investment was created to support the export-oriented enterprises. At the same time, the mandate of the Development Bank of Kazakhstan was expanded, which encompassed the creation of subsidiary companies working in the sphere of leasing operations.

According to the forecasts prepared by the Ministry of Economy and Budget Planning, the Government's Strategy is expected to increase the share of manufacturing in national GDP to 12.6% by 2015.

In 2006, the Government realized that it needed to take additional measures to enhance its competitiveness in the global economy. In order to successfully implement a strategy for economic diversification and join the ranks of the 50 most competitive countries in the world, the country had to develop a stronger culture of corporate governance, transparency and accountability as well as adopt international technical, financial and business standards more widely. Thus the Samruk State Holding for Asset Management and the Kazyna Sustainable Development Fund were created. Subsequently, in late 2008, these institutions were merged into the National Welfare Fund of Samruk-Kazyna ("Samruk- Kazyna").

The creation of these two strategically important institutions and their subsequent amalgamation was motivated by the need to separate the functions of Government and commercial activity and create a more efficient Government apparatus. However, I heeded the advice of experts from the EBRD. They commended us for creating Samruk-Kazyna, but also warned of the risks posed by the market position of this large institution. This is why I am also paying very close attention to the following: greater competition in local markets; the removal of bureaucratic barriers; the elimination of



corruption; increasing openness to trade and investment; improving corporate governance practices; and attracting private investment into infrastructure projects.

2.2. MITIGATING THE SOCIAL IMPACT OF ECONOMIC SHOCKS

In Kazakhstan, the most affected sectors of the economy are mainly labor-intensive industries such as construction, metallurgy and mining. Support for these industries is driven by their significant economic and social importance: according to the ADB, these industries employ up to 25% of the working population (of which 65% are men and 35% are women).

I have always emphasized that the anti-crisis policy of the Government must address the social dimensions of the crisis. As a result, a key aspect of the Government's anti-crisis policy has been to maintain employment and increase the state's social obligations.

In 2007, the Government adopted a program to boost employment for the period of 2008-2010. This program was designed to curb unemployment in the post-crisis period by creating public works jobs, providing occupational training for recent graduates, organizing job fairs, and creating jobs through infrastructure upgrades. The Government, together with the Federation of Trade Unions and the Atameken association, signed a memorandum with large companies, especially those in the metals, construction and mining industries, to preserve jobs and prevent mass lay-offs. In total, 8,053 signatures were gathered from large and medium-sized enterprises, which employ a total of more than 979 thousand people. In turn, Samruk-Kazyna helped ensure the completion of major construction projects, which also contributed to job creation. More than KZT 15 billion was allocated from public funds to implement this program. By the end of the first half of 2009, 29 thousand people received advanced training or retraining, 13 thousand people were provided with public works jobs and over 68 thousand were involved in upgrading public infrastructure.

The Road Map program, which was launched in 2009, builds on the Government's employment program. Further, a strategy of regional employment and retraining has created new jobs in infrastructure projects as well as providing retraining and subsequent job placement.

Taken together, the Government's actions have prevented a sharp rise in unemployment. In fact, the level of unemployment fell in 2009, according to data from the Statistics Agency. At the end of 2009, the unemployment rate was 6.3% compared with 6.6% one year earlier. However, I am following the situation very closely: without doubt, the economic crisis could yet have a significant effect on the level of unemployment.

At the same time, the Government has developed other important areas of social support. Several measures were taken to prevent the growth of food prices, fuel and lubricants, for example.

Kazakhstan imports a number of basic consumer goods. In 2007 for example, according to customs data, imports represented 29% of sugar consumption, more than 90% of demand for canned fruit and vegetables and 84% of powdered milk consumption. Therefore, the sharp jump in world food prices from 2007-2008 led to increase in inflation in Kazakhstan, and in June 2008, the annual inflation rate reached 20%.

In response, the Government has taken a series of measures to ensure the security of food supplies, to stabilize prices and stimulate local food production. KZT 131 billion has been allocated to support the agricultural sector in the form of loans to agriculture companies, financing for agricultural projects through the National Holding KazAgro and purchases of grain for the national reserve. In addition, it is estimated by ADB and the investment bank Troika Dialog that about 30% of the anti-crisis funds allocated for supporting small and medium-sized businesses were connected in some way to the production of food or agricultural support.

In December 2009, the Law "On amendments to some legislative acts of the Republic of Kazakhstan on issues of food security" was adopted. The legislation is aimed at strengthening Kazakhstan's food security, promoting agricultural production, stimulating growth in employment and income for rural producers, and reducing price fluctuations in country's food markets. Amendments to the law give the Ministry of Agriculture supervisory and regulatory powers to ensure food security.

Overcoming the social consequences of the global crisis in Kazakhstan is a key item on the agenda for the Government in 2009-2010. During difficult



and uncertain economic times, Kazakhstan's citizens should feel secure that the Government is working to defend their social well-being and preserve their standards of living.

2.3. DEVELOPMENT OF INFRASTRUCTURE AND KEY INDUSTRIES

TRANSPORTATION

Kazakhstan's geography - a vast, landlocked territory with a sparsely distributed population - makes it one of the most transportation-dependent economies in the world. Currently the primary modes of transportation are railway and road transport. Located at the crossroads of Europe and Asia, Kazakhstan has substantial potential as a transit country due to the absence of alternative land-based routes connecting Asia with Russia and Europe. The economics of developing national transportation networks are supportive thanks to large neighboring markets: according to expert estimates, the European market comprises about 27% of global GDP and the countries of the Asian-Pacific Region and South-East Asia make up approximately 21% of GDP.

The transportation sector in Kazakhstan faces the challenge of balancing investments for replacing existing assets and modernizing and expanding the system. Together these investments will make the system more efficient and lay the foundations for future economic growth.

I am fully aware that despite the global crisis, we cannot afford to focus only on our present challenges. Our future depends on continued economic modernization and development of basic infrastructure. Addressing the issue of improving access to the regions and rural areas remains an important part of the strategic development of transit corridors from north to south and east to west. These corridors include the TRASEKA, North-South, Central Asian corridor, and the Trans-Asian main-line railway.

The Government's Transportation Strategy Until 2015 will enable Kazakhstan to realize 80 infrastructure projects worth US\$30 billion, of which more than 70% will be implemented through PPPs. The Western Europe to



Western China road corridor project has already begun, and by 2013, reconstruction will be completed on 6 road corridors. In addition, by 2015, more than 1.5 thousand kilometers of new railways will be built and 3 thousand kilometers of existing railways will be electrified.

The modernization of the existing transportation system will better integrate Kazakhstan into the global economy. Experts predict that trade between Asia and Europe will rise to US\$1 trillion per annum by 2015 and better transport networks will allow Kazakhstan to capture a greater share of these trade flows. The main advantage of passing through Kazakhstan will be the substantial reduction of distances: for example, cargo going from China to Europe will travel a distance two times less than the sea route and a thousand kilometers less than if the same cargo passed through Russia's territory. In addition, the development of transport infrastructure can solve access problems for Kazakhstan's remote regions, which will have a positive effect on the mobility of human resources, and open up new markets to local producers.

AGRICULTURE SECTOR

Set against the backdrop of global food shortages, Kazakhstan's agriculture industry has great potential to contribute to the diversification of the national economy. Today Kazakhstan is one of the world's largest exporters of grain and flour. Domestically, the sector is of strategic importance as it employs almost one-third of the population. Additionally, the sector supports low-income earners as it generates employment in rural areas where poverty is concentrated. Unsurprisingly, then the Government identified the sector as one of the priority targets for anti-crisis support.

However, we face several challenges in this sector. First, the agriculture industry is characterized by low productivity: although it employs 30% of the population, it accounts for only 6.3% of GDP (in the first half of 2009).

The Government's Strategy 2030 identifies steps necessary for the sustainable development of the agricultural sector. Priority is given to facilitating access to markets, modernizing infrastructure, supporting research and the development and financing purchases of modern equipment and new technologies.



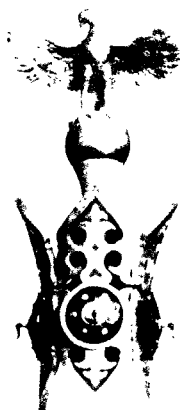
From 2008-2009, the agriculture industry received unprecedented levels of support from the state, totaling KZT 217 billion. This includes KZT 97 billion from the federal budget and KZT 120 billion from the National Fund. In 2002 this figure totaled KZT 27.6 billion. The forms of support include: direct subsidies, subsidized loans, price support schemes and infrastructure funding. As a result, the volume of gross agricultural output in 2009 grew by 13.8%, which is the highest rate for the last 8 years.

Data from the World Bank indicates that in future it will be advisable to shift from direct subsidies to more flexible forms of support. The experience of such countries as New Zealand, Australia and Chile shows how to properly structure incentives and promote competitiveness. Public support in these countries is limited to providing infrastructure, research and development support, as well as insurance for certain risks and assistance to producers for forming associations. Given that the growth of food prices on world markets has moderated and considering the relative weakness of our current infrastructure, such an approach can be useful in maintaining international investors' interest in Kazakhstan's agricultural sector.

In recent years, Kazakhstan's agriculture industry has grown mainly as a result of: expanding land use, better access to funding, increased grain and flour exports, and growth in downstream industries, particularly in processing. Only some parts of field operations were intensified through the use of expensive farming, mostly harvesting.

The activity of the food corporation KazAgro was streamlined, while the management of agricultural science was reorganized and Social Entrepreneurship Corporations were linked to the support of the agro-industrial sector. The state also invests significant sums on promoting education, stabilizing food prices, providing logistics support to villages, maintaining rural infrastructure and providing social services to rural areas. Responsibility for each sowing and harvesting campaign rests with the federal and city-level authorities. Continuing to follow outdated agricultural policies will increase the financial and organizational burden on the Kazakh state without providing a corresponding increase in benefits.

The global financial crisis has reduced the purchasing power in many countries, reducing demand and tightening financing conditions, including



for agricultural projects. Given the current level of monopolization within the international food trade and the distances of Kazakhstan's farms from ports, one should not count on a rapid improvement of grain exports in Kazakhstan in the medium term. However, the establishment of export associations for Kazakhstan's agricultural products will facilitate better organization of exports and strengthen export prices.

A number of countries have invested in agricultural modernization and now threaten Kazakhstan's position in international grain markets. Considering the advantages of neighboring countries in production costs, and Kazakhstan's planned accession to the World Trade Organization, there is a risk that domestic producers will be unable to compete against imports. If we do not take decisive action over the next 1-2 years, then agricultural production in some regions of Kazakhstan may be placed in jeopardy in the near future.

In the medium term, there will be a need to overcome a one-sided grain export profile and establish a more integrated base of agricultural production, encompassing feed production and livestock farming. To achieve this objective, we need to change the structure of land use and acreage in favor of feed and industrial crops and begin to rebuild tracts of irrigated land, which is the most valuable resource for building an industrialized agriculture sector. The Government's main areas of responsibility in overcoming the existing negative trends in the agriculture industry and increasing local food production to ensure security of food supplies are as follows:

- a) Increasing availability of basic foods throughout the territory and to all segments of the population (via support to domestic producers, promotion of efficient and transparent market trade),
- b) Raising standards for food quality (maintaining strict requirements for domestic and foreign suppliers, protecting the market from unfair competition),
- c) Supporting affordability of food prices (facilitating the reduction of production and distribution costs, increasing the competitiveness of Kazakhstan's food supplies).

Modern food and commodity markets are already largely dominated by monopolies and the process of monopolization continues unabated. In the



post-crisis environment, only large, diversified corporations that are supported by the state (even if not openly) can compete successfully. As a result, in order to maintain a strong agricultural sector, Kazakhstan should proceed to a new stage of agricultural development - specifically, the accelerated establishment of major domestic producers that can successfully compete internationally should be encouraged over the next 3-5 years.

In theory, a large, diversified corporation in Kazakhstan's agricultural sector should link upstream with downstream operations: from the harvesting and storage of raw materials through to food processing and storage to wholesale food trade. I believe it is possible in the medium term to create 5-6 of such corporations.

In line with this objective, the Government, together with regional authorities, is preparing to launch a five-year program in 2010 to rehabilitate Kazakhstan's irrigated lands. Currently, it is in the process of obtaining financing and preparing the necessary legal framework for the program.

Meeting the challenges of Kazakhstan's agriculture industry will greatly depend on institutional efforts. The regions present a particularly difficult challenge. Improving the effectiveness of organizational efforts requires strengthening the role of the Nur-Otan Party in rural areas, supporting other political parties and involving all stakeholders, including public organizations and unions.

2.4. ECONOMIC DIVERSIFICATION AND THE ACCELERATED IMPLEMENTATION OF INNOVATIVE AND CUTTING-EDGE PROJECTS

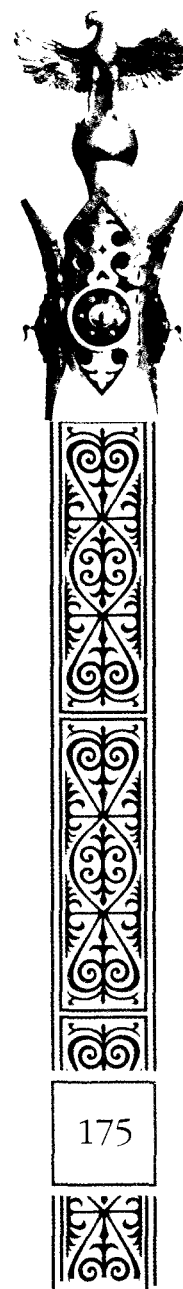
In the current environment, as the world economic system is changing, the cost of errors dramatically increases, while competition increases on all fronts. In Kazakhstan, the crisis has demonstrated to us in the starkest possible terms that the country's sustainable development hinges upon successful economic diversification. Our response to the present challenges is articulated in the Government's Plan for Post-crisis Breakthrough of Kazakhstan's Economy. This Plan builds on the Strategy 2030.



I must note that we have traveled this road before. In 2003, Kazakhstan adopted a Strategy of Industrial-Innovation Development (SIID) for the period from 2003 to 2015, which was aimed at achieving sustainable growth in the country through economic diversification and encouraging a transition from an extractive based to a manufacturing based economy. It was supposed to ensure the development of the country through diversification and modernization of the economy and creation of appropriate conditions for competitive industrial production and export growth. However, it should be acknowledged that SIID did not achieve its objectives, in part, because the selected priorities for industrial development lagged too far behind the current realities. The new strategy of industrialization is more realistic. Indeed, EBRD experts note that the new strategy focuses on industries that have sources of comparative advantage, based on existing resources and capabilities. Particular attention is also rightly paid to the efficient allocation of productive capacity.

The Government's program for accelerated industrial development of Kazakhstan's economy is, as before, aimed at diversifying and improving the competitiveness of the national economy. The program remains committed to the policy of industrialization. It integrates the best of previous policies and makes adjustments for previous policy shortcomings. The program's key objectives are to support a stable macroeconomic environment, focus state resources on priority economic sectors, create the conditions for private enterprise and investment to thrive, and build strong institutional capacity, including effective mechanisms of cooperation between the public and private sector.

Kazakhstan's policy of diversifying and modernizing its economy through industrial innovation has generated considerable interest around the world. In the course of country level dialogue, the heads of foreign states and foreign ministers expressed their willingness to lend their support. However, we want to create the conditions where private foreign investors choose to come to Kazakhstan based on commercial decisions alone, not based on the support of their governments. A recent successful example is the agreement signed between Samruk-Energo and a Korean consortium comprising Samsung and KEPCO for the construction of the Balkhash thermal power plant, which is estimated to cost US\$4.5 billion.



Priority sectors for the Government's new industrial policy include agriculture, construction and building materials, oil, gas and petrochemicals, mining and metals, chemicals, pharmaceuticals, energy, transportation and telecommunications. Objectives are defined for each sector. For example, in agriculture and food processing, the Government's objective is to encourage greater productivity in the sector via the introduction of modern technology and equipment. For the construction sector, the objective is to reduce the dependence on imported building materials, which currently stands at approximately 50%. Similarly, in oil and gas, the objective is to become self-sufficient in oil products, including high quality gasoline and jet fuel. In mining and metals, the objective is to double the current level of metal exports and domestic value-added production by 2015. For pharmaceuticals, the objective is to increase domestic production to meet a minimum of 50% of local demand by 2014. In the energy sector, the Government aims to reduce the energy intensity of the economy by 10% by 2015. It also aims to encourage development of low-carbon and renewable energy sources, such as wind and solar power.

In the first 5 years of the Government's industrial policy, GDP is expected to increase by 50%.

Considering the problems of physical and of the components of Kazakhstan's national wealth, in the long-term basic and applied sciences should be joined by a single state policy to overcome the "investment barrier" (renovation of obsolete fixed capital) on a modern scientific and technological level.

When elaborating the goals and methods of scientific and technological policy, it is necessary, first and foremost, to tackle theoretical questions and applied research questions that have social significance. In particular, scientific breakthroughs are needed in the field of integrated and sustainable management of urban and community facilities, water management and energy conservation, amongst other fields. It is necessary to expand the understanding of "commercialization" and draw upon scientific and technological achievements in the public sector and in non-production spheres.

I believe that in order to upgrade our production base, we need to invite scientific experts to conduct selective technology audits of commercial organizations (especially the natural monopolies). At the same time, practical



training internships should be offered at research institutions. Joint work plans should be developed between scientists and manufacturers on innovative topics, which should be partly funded by the organizations themselves and partly from state sources. These costs can be recouped through savings achieved through the introduction of new production technologies. For example, the joint-stock company NNTKh Parasat plans to impose control over scientific and practical activities and introduce best practices.

Investments into innovations ought to be supported by the following economic mechanisms:

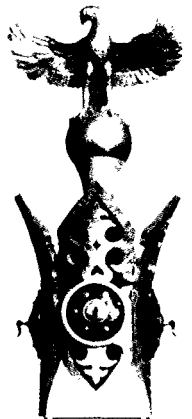
- Kazakh innovation must be given a "green light" in the tax system. Foreign engineering companies will thus have a greater interest in entering Kazakhstan and cooperating with domestic research organizations.

- Pricing should facilitate spending on research and development. This is particularly important for the pricing of natural monopolies' tariffs. We should, of course, prevent the adoption of new technologies and innovations which impose unnecessary costs on Kazakhstan's economy (except for the unavoidable costs of preserving the environment),

From the contrasting public and private positions within Kazakhstan's scientific base should emerge a system of collaboration. State science must move forward on a par with global trends in all key areas. It must be capable of supporting education, basic research and serve the needs of the public sector (utilities, industrial infrastructure and natural resources). Advancements in state science should be comparable with venture capital investment in the private sector. Funding for scientists and scientific activity should come from the profits that the state generates by commercializing scientific discoveries.

Strengthening domestic scientific capacities will also depend on improved terms for the funding scientific research and development. In particular, the following measures should be implemented:

- Financing for research and development should be available over a medium term horizon (3-5-years);
- For short term, one-off research projects, services should be available from single sources (such as a specialized research institute);



- Where tenders are required, public tenders should take place, with results attained in the first quarter of the year, and financing beginning no later than April.

Closing the gap in the education system cannot be achieved just by borrowing out of date Western teaching methods. Kazakhstan needs to organize a system that continually develops new methods for the instruction of advanced scientific, technical and methodological concepts. In particular, it is necessary to radically change the activities of the authorized Government body - the Ministry of Education and Science. The Ministry (including the relevant committees) should monitor how cutting-edge scientific ideas and technological developments are moving through Kazakhstan's universities and conduct research in the fundamental sciences.

For example, in the field of biotechnology, little has been done to develop the local public health system, improve life expectancy, and promote physical and creative activity in individuals older than 50. Another example is the poorly understood environmental and health impacts of genetically modified products in Kazakhstan. Due to the lack of an effective scientific base supporting the agriculture industry, the risks are high for using genetically modified products. The importance of this cannot be overstated - Kazakhstan may risk permanently damaging its natural ecosystem.

3.1. COMBINING STATE INTERVENTION AND MARKET MECHANISMS FOR IMPROVING THE COMPETITIVENESS OF KAZAKHSTAN'S ECONOMY

History shows us that the state has an important role to play in facilitating economic modernization. Recent events have only underlined this fact. Kazakhstan's economy will continue to be built upon market economy principles, the sanctity of private property rights and free enterprise.



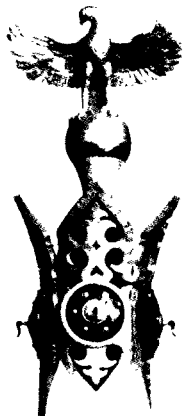
However, in the post-crisis climate, the role of the Government will inevitably grow in some areas, including the industrial and social spheres.

Due to weaknesses in our banking sector, Kazakhstan was the first state in the Asian-Pacific region to be affected by the global economic crisis. However, the Government reacted quickly and decisively, implementing measures to mitigate the effects of the crisis. In 2007, Kazakhstan implemented an anti-crisis plan aimed at stabilizing the banking sector, generating employment and supporting real economic activity, particularly among small and medium-sized businesses and the construction and agriculture sectors. This plan was further expanded in late 2008.

The Government's response to the crisis was aimed not only at fighting the effects of the crisis, but also at increasing Kazakhstan's competitiveness in the post-crisis environment. The plan included five components: stabilizing the financial sector, reviving the real estate market, supporting small and medium-sized businesses, reviving and reinforcing agriculture, and implementing medium term industrial and infrastructure projects.

The Government funded completion of residential construction projects in Astana and Almaty via deposits with commercial banks. As a result, 27 residential housing facilities were completed, 19 in Astana and 8 in Almaty. Similarly, the Damu Fund received financing from the National Fund to provide support for small and medium-sized enterprises. This financing was distributed by commercial banks in the form of new loans and refinancing. As a result, more than 6 thousand projects received funding. At the same time, the Government injected KZT 476 billion into the banking sector via equity investments and bank deposits. Without doubt, these injections prevented a collapse in confidence in the banking sector, stabilizing the financial system overall.

The responsibility of implementing the anti-crisis plan was vested in Samruk-Kazyna. The fund brought together the majority of Kazakhstan's national companies in order to strengthen their positions and increase their involvement in fighting the crisis. Samruk-Kazyna's primary strategic goal was to efficiently manage property in the national development institutions, national companies and other organizations. The Fund has played a key role in supporting the economy during the crisis.



3.2. IMPROVING THE BUSINESS ENVIRONMENT

Over the last decade, the Government has done everything in its power to create a favorable business climate. As a result, Kazakhstan has become one of the top 25 most investment-friendly countries.

The Government developed a new Tax Code which creates a more favorable tax environment for domestic businesses. The tax burden on the non-commodity sectors of the economy was significantly reduced. Today Kazakhstan has some of the lowest tax rates in the world, including corporate and individual income as well as value added taxes.

A newly created independent anti-trust agency stepped up its efforts to combat unfair competition in the markets. To regulate natural monopolies and telecommunications, as well as the financial market, authorized agencies were transformed into industry sector regulators with joint management bodies. Such initiatives will allow for greater transparency in public administration.

Furthermore, certain administrative procedures have been simplified for businesses. In order to make the regulatory system more straightforward, the Government collaborated with the World Bank and other institutions within specially created workgroups, to tackle such issues as barriers to cross-border trade, reform of corporate bankruptcy procedures, permitting in the construction sectors, business and private property registration, and protection of the rights of investors and creditors. The World Bank proposed several amendments to the Law on Joint Stock Companies, the Civil Code and the Law on Bankruptcy.

In 2009 changes to the Law on Private Entrepreneurship were introduced to create a new single procedure for the inspection of most state agencies. Also, a risk management system will be gradually introduced to make Government inspections of businesses more efficient. If a business shows high risk factors, then inspections will be conducted more frequently (once a year) than a business that shows medium risk factors (once every 3 years) and low risk factors (once every 5 years). Sanitary and health inspections will follow a different framework. Looking forward, Kazakhstan will need to conduct additional reforms, especially in the spheres of trade,



bankruptcy and construction permits. Reforms related to the registration of companies and assets must also be completed.

The crisis will not last forever and we must prepare for the recovery of the global economy today. Therefore we must create the best business climate in the region and significantly improve Kazakhstan's investment image. This will allow us to attract substantial investments and also accelerate diversification of the economy.

3.3. BUILDING A MORE DIVERSIFIED ECONOMIC BASE - DEVELOPING THE DOMESTIC MARKET WITH SUPPORT FOR THE EXPORT INDUSTRIES

The crisis clearly demonstrates the urgent need for Kazakhstan to move towards a more diversified economic model. Our future prosperity depends on the modernization of the economy and development of basic infrastructure. This was clearly revealed by the heavy toll that the crisis exerted on countries that depended heavily on external financing as well as those countries that had a largely uniform economic and export structure, particularly those dependent on natural resource exports. The issue of long-term diversification presents a significant challenge, and now, with the onset of the crisis, the time has come for tackling this issue head-on.

Tax incentives for non-primary sectors of the economy are helping to stimulate diversification during the crisis. The main objective of this tax reform is to shift the tax burden towards the extractive industries. At the same time the system of taxation has been simplified. As result, the new Tax Code is contributing to a better business climate.

These changes are likely to stimulate business activity in the non-extractive industries, because, according to independent assessments, Kazakh companies in this segment consistently cite high tax rates as a major obstacle to their development. The Government has not implemented its planned reforms as quickly as originally envisaged because some support was offered to producers of raw materials, which were also in a difficult situation because of the crisis. Despite this, some fundamental changes were



made to the tax system, primarily in providing tax incentives for the development of the non-extractive industries.

However, I can also see some potentially negative side effects arising from the new Tax Code. The Tax Code aims to increase the tax burden on natural resource companies in order to cut taxes for companies operating in other economic sectors, and thus may potentially lead to slower investments in the natural resources sector. Should negative conditions persist in international capital markets, Kazakhstan risks attracting fewer investments, especially in the natural resources sector, which has traditionally acted as the engine of economic growth. Thus we must act decisively and definitively and, without wasting time, move towards the diversification of our economy.

In order to stimulate the non-commodity sectors of Kazakhstan's economy, the Government provided significant support for small and medium-sized enterprises and the agriculture industry, as they are likely to play a major role in the economic diversification. As part of the Government's anti-crisis plan, small and medium-sized businesses received US\$1 billion of direct state support. The funding was provided through the banking system and was aimed at refinancing existing loans and providing new loans. The small and medium-sized business sector is crucial for Kazakhstan as it employs more than 2 million people, or almost 25% of the economically active population. In addition, the agricultural sector received US\$1 billion through the National Holding KazAgro. The actions of the Government clearly had economic, but also a social and political nature.

Currently the Government is developing a program of Kazakhstan's accelerated industrial-innovative development for 2010-2014 as part of its diversification and industrialization efforts. The program aims to ensure the diversification and competitiveness of Kazakhstan's economy in the long run. The program includes measures such as consolidating the efforts of business and Government, mobilizing resources for developing high priority sectors of the economy, sustaining a favorable macroeconomic environment and investment climate, as well as developing highly effective institutions.

The program incorporates a Map of Industrialization, for which a preliminary portfolio of 83 investment projects worth a total of KZT 6.4 trillion



has been identified. Going forward, this list of investment projects will become the foundation of Kazakhstan's industrializations plan for 2010-2014.

We expect that the program will result in sustained economic growth with improved economic competitiveness, growth in productivity and a shift in the structure of GDP with an increase in the share of the manufacturing industry of up to 14.5%.

In addressing economic diversification, the Government has also paid considerable attention to providing operational support for the country's export industries, including traditional exports such as oil, petroleum products and metals. The competitiveness of exports in late 2008 was threatened due to a rising real exchange rate, particularly in light of the gradual devaluation of the Russian Ruble. In early February 2009, the National Bank of Kazakhstan depreciated the Tenge by 20% against the US Dollar. Kazakhstan had to devalue the Tenge in order to protect our manufacturers. Otherwise, Kazakh products would have lost their competitiveness. Domestic producers benefited from the devaluation the most. Previously they had struggled to sell their products in Kazakhstan because of the competition from cheaper imports, especially after the devaluation of the Ruble and other regional currencies.

However, the rate of progress that we have achieved to date in economic diversification is far from satisfactory. Kazakhstan continues to face the same problems as other oil exporters: dependence on natural resources for economic growth has not evolved into tangible results for exports of manufactured goods. The plan to diversify exports has not yet been fulfilled and Kazakhstan remains an exporter of raw materials. Exports of high-tech products represent just 2% of total exports whilst exports of raw materials exceed 80%. Clearly this situation requires further efforts.

3.4. INTEGRATING KAZAKHSTAN INTO THE GLOBAL ECONOMY AND MITIGATING THE NEGATIVE EFFECTS OF THE CRISIS

Integration into the global economy comes with increased exposure to external factors; therefore, as this process of integration continues, measures must be taken to reduce the negative impact of external factors on



Kazakhstan's economy. In the pre-crisis years, we moved aggressively to integrate ourselves into the international capital markets. Commercial banks actively attracted loans for the domestic economy as well as various projects in the CIS. The foreign loans of domestic commercial banks reached their peak value in 2007. External debt of the banks gradually declined once the subprime mortgage crisis emerged in the United States. This crisis reduced investors' demand for financial assets in developing countries. Also in 2007, as Kazakhstan's external debt began to fall, the share of corporate deposits in the funding structure of Kazakhstan's banking sector started to grow.

This experience illustrates that the same external factors that have a positive impact on economic growth can suddenly switch to become negative influences. For example, foreign loans fueled rapid growth in various sectors of Kazakhstan's economy, especially in the real estate and service sector. However, the sharp fall in the availability of external funding led to a sudden deceleration of economic activity and a decline in personal incomes, and later to a significant decline in the prices for domestic real estate.

Kazakhstan has had unique experience during the current crisis because the economy has suffered from a series of consecutive negative external shocks: turbulence in the financial markets and resulting withdrawal of short-term speculative capital by foreign investors; sharp declines in prices of exported commodities, including oil; and deterioration in the value of trade partners' currencies. These external shocks fed into the domestic economy, resulting in a rapid deceleration of credit growth and falls in real estate prices. These forces exerted pressure on the country's balance of payments and exchange rate. To put this into perspective, the price of housing in Almaty fell from \$2,286 per square meter in late 2008 to \$1,752 in mid-2009. These forces fed each other in a negative feedback loop - lower prices for real estate led to tighter lending standards at commercial banks which hurt demand for real estate which further depressed prices - placing added pressure on the economy and setting back the prospects for recovery.

Every crisis, however, provides an opportunity for reforms and structural changes, which would otherwise have met resistance in better economic times. For instance, prior to the crisis, the banking industry lobbied actively against reforms aimed at reducing the industry's dependence on foreign



debt. Of course, the power of this lobby and the persuasiveness of its arguments have declined markedly since.

As the economy continues to recover, it is important to direct the recovery processes towards positive, lasting change. Specifically, we must establish mechanisms for reducing the economy's vulnerability to future external shocks. There will certainly be a great deal of debate about the exact nature of these mechanisms. However, some key issues that will be crucial to formulating an optimal economic policy for Kazakhstan are already clear.

The financial sector must be built on more stable foundations. Commercial banks must rely on more secure sources of funding, which entails that they must be subject to limits on external borrowing. At the same time, capital adequacy rules must be strengthened. We also need to increase efficiency of asset management of the National Fund. As we saw during the crisis - particularly in the case of sovereign wealth funds investing in US financial institutions - investing in foreign assets provides no guarantees of wealth preservation. Therefore, in some cases, it is advisable to allocate some of the National Fund's resources for developing the domestic economy. There is also the issue of denominating a proportion of the National Fund's assets in the national currency.

Furthermore there is an issue of the exchange rate itself. In the current environment, the stability of Kazakhstan's exchange rate is an important barometer of the overall state of the economy. But, as the economy recovers, there will be a need for a mechanism that would allow the Tenge to reach a more efficient equilibrium with other currencies.

3.5. RECOVERY OF KAZAKHSTAN'S FINANCIAL SYSTEM AND REDUCING THE SHARE OF DEBT FINANCING

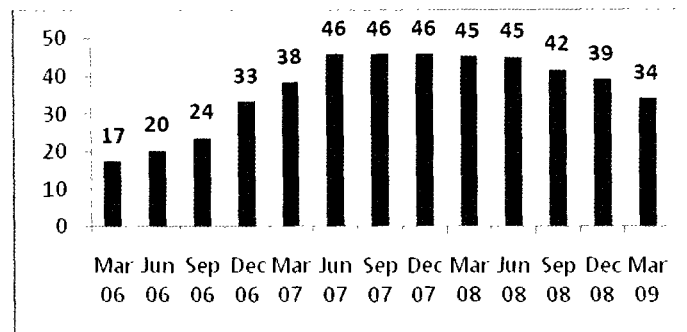
We can observe that even in countries which have always been considered archetypes of market economies, based purely on market principles, the crisis has required the Government to become not just a key player in the economy, but also the owner of enterprises in the financial and banking sectors. Since 2005, I repeatedly warned our banks about their



unbalanced growth policies based on accumulation of external borrowings. In the end, the Government had to rescue them from an untenable situation.

Between 2005 and 2007 Kazakhstan's GDP grew at an average rate of 9.6%. This growth was funded mainly by growing volumes of foreign direct investment and large loans procured by commercial banks on the international capital markets (Figure 1). The banking sector, therefore, played a central role in this economic growth. Banks dominate the financial system of Kazakhstan, holding 80% of its total assets.

External debt of commercial banks, in US\$ billions



Source: National Bank of Kazakhstan

Although in late 2006, the National Bank and the FMSA introduced several measures to reduce the volume of foreign loans by tightening bank reserve requirements and imposing greater liquidity requirements and limits on external borrowing, the consequences of the crisis could not be avoided. Admittedly, these actions occurred late and it was no longer possible to keep the economy from overheating.

The growth of the banking sector's total external debt accelerated in late 2006 and early 2007. Thus, the national economy's dependence on the inflow of foreign capital continued to grow. In 2007, Kazakhstan's commercial banks were almost completely cut off from external sources of funding. At this point, total foreign debt of commercial banks reached 44% of the nation's GDP. In the absence of external sources of capital, the banks had to significantly reduce the volume of loans by deleveraging their balance sheets.

The Government introduced several programs to support lending to certain sectors of the real economy by depositing in and lending to commercial banks. The Government provided KZT 350 billion of such support. In aggregate, the Government provided financial resources to commercial banks which represented 35-40% of the total financial base of the domestic banking system.

Falling real estate prices, drops in the demand for property and the lack of refinancing options due to tightening of the entire credit system caused a significant decrease in the quality of assets and a further deterioration in liquidity due to the higher demands placed on required reserves and the deterioration of banks' capital. In the second half of 2008, the Government began to consider the possibility of creating a distressed assets fund in order to address the issues related to the quality of bank assets. The Government sought advice from international experts on structuring such a fund. Samruk-Kazyna was given overall responsibility for managing the distressed assets on behalf of the Ministry of Finance. Citibank was appointed to advise the Government on structuring and managing the fund. However, by late 2008, the volume of distressed assets significantly exceeded the US\$1 billion that was earmarked for asset purchases.

The Government quickly realized that, besides establishing a distressed assets fund and protecting individual depositors by increasing the level of bank deposit guarantees from KZT 700 thousand to KZT 5 million, it had to prepare for large scale injections of capital into the banks themselves. In October 2008, the upper house of Parliament approved certain amendments to the Law on Financial Stability, which created a framework for the orderly nationalization of commercial banks in the event of acute financial distress via state participation in the banks' capital. Thus a legal framework was created that would facilitate a Government takeover of a private commercial bank in emergency circumstances.

Kazakhstan's authorities have also played a key role in restructuring several commercial banks that became insolvent as a result of the crisis. First, the Government passed a bank restructuring law which is consistent with international best practice. Although the FMSA could force a troubled bank into bankruptcy or to place it in conservation or in a special regulatory regime, there was no law that would allow the bank to implement a full



financial restructuring without the consent of all of its creditors. Thus any single creditor could block a restructuring even if it was supported by the overwhelming majority of creditors. Clearly, the previous legislation needed to be updated to meet the current realities.

Supervision of Kazakhstan's banking system should be primarily aimed at maintaining systemic stability so that risks can be identified early and dealt with efficiently. Improvements have been made recently to the regulatory framework. Corporate governance at commercial banks has also improved. However, a number of issues remain unresolved, such as poor internal risk management systems at commercial banks.

Beginning in 2007, the Government's vision for Kazakhstan's development was encapsulated in the long-term Strategy 2030. This strategy laid out the Government's main priorities for Kazakhstan's economic and social development. These priorities have not lost their relevance today and are guiding us to our fundamental aspirations - ensuring the prosperity, security and welfare of all of Kazakhstan's citizens. Strategy 2030 is divided into ten year periods with focused development plans for each period that set specific targets and corresponding deadlines. Currently, we are implementing the final elements of the development plan to 2010 and we have already formulated an ambitious agenda for the second decade of the 21st century.

To date, the country's economic development has been encouraging. With rapid economic growth prior to the onset of the crisis, many of the targets established by Strategy 2030 were completed ahead of schedule. For example, we succeeded in doubling GDP between 2000 and 2008, which was two years earlier than planned. Our economic successes have also had a positive effect on standards of living. The proportion of the population with incomes below the minimum subsistence level fell by 4 times (from 47% to 12%). The birth rate and life expectancy has increased, while maternal mortality rates have fallen significantly.

4.1. NEW OPPORTUNITIES AND PROSPECTS FOR ECONOMIC DEVELOPMENT

Currently we face a substantial challenge - rebuilding a stronger more competitive economy in a rapidly changing world. Yet, the global economic crisis has not simply placed obstacles in our path. It also represents an opportunity to break cleanly with the past and implement meaningful changes. This is an opportunity we must grab with both hands.

In order to achieve our development targets by 2020, the Government is focused on the following five key areas of activity:

- 1) Preparing for post-crisis development;
- 2) Achieving sustainable economic growth by accelerating diversification through industrialization and infrastructure development;
- 3) Investing in the future - improving the competitiveness of human capital to support growth and social welfare;
- 4) Providing the population with quality social services and housing;
- 5) Strengthening inter-ethnic harmony, national security and stability in international relations.

These areas complement and support each other. For the first key area, we will take steps to create an environment that enables effective economic development in the post-crisis period. Above all, this requires greater protection for property and investor rights, strengthening the financial sector and improving the business climate. The overriding objective here is to create the conditions for private investment and enterprise to thrive. We aim to have the most favorable conditions for conducting business in the wider region.

In the financial sector, it is vital to ensure the banking system relies less on external debt in its funding mix. In terms of improving the business climate, we face the challenge of reducing the costs associated with registering and operating businesses. Regarding the legal environment, increased transparency, more predictable enforcement of the laws, and the development of a stronger legal culture will improve investors' confidence in Kazakhstan.



The second key area of activity within our development plan calls for economic transformation - from a raw materials based economy to more diversified sources of national income. One of the key challenges here is to improve the currently low level of labor productivity. To do this, we must encourage industrial development and the adoption of new production processes.

Currently there are plans to implement 162 industrial projects worth a total of KZT 6.5 trillion. By 2013, these projects are expected to create more than 200 thousand new jobs. Considering the central role of agriculture in our economy today - around half the population lives in rural areas - as well as its great untapped potential, we must devote significant resources towards supporting this industry. This will include support for exporters and financing the purchases of modern equipment and new technologies.

At the heart of our transition to economic diversification is private enterprise. In this regard, the Government will launch a unified budget program for the development of entrepreneurship in the regions, which is called "Roadmap: Business - 2020". Under this program, the state will provide support to small and medium-sized businesses through subsidized interest rates on loans, partial credit guarantees, service support for conducting business, retraining and skills development, and youth training programs and public works positions.

As the process of economic development accelerates, we can expect greater regional development and specialization. In the western regions of Kazakhstan, for example, we can expect greater development among the oil and gas, chemicals, equipment manufacturing and shipping industries. Agribusinesses will be concentrated in certain northern and southern regions of the country. In addition, Kazakhstan will invest in emerging industries that have great domestic and international potential. These include information and communication technologies, biotechnology, and alternative energy. I expect such leading edge industries to develop in Almaty and Astana.



4.2. THE POTENTIAL FOR REGIONAL ECONOMIC INTEGRATION

A key indicator of the success of economic diversification will be the development of Kazakhstan's exports. This will contribute to regional economic integration, in which Kazakhstan actively supports. Since January 1, 2010, the Customs Union with Russia and Belarus became operational. The Customs Union will provide an impetus for greater economic cooperation between Russia, Belarus and Kazakhstan. This will reduce economic distortions between the three countries, encourage greater competitiveness of domestic producers and allow joint access to foreign markets. The establishment of a common customs area, which is home to more than 170 million people, opens up great new opportunities for Kazakhstan, Belarus and Russia. The sum GDP of the three countries totals around US\$2 trillion, whilst their cumulative industrial output totals US\$600 billion. Experts have estimated that the customs area could generate GDP growth of 15% among participating countries by 2015.

The Customs Union will also increase trade between member countries. Kazakh enterprises will now have greater access to markets in Russia and Belarus. Customs controls will be lifted at internal borders. Furthermore, by unifying customs tariffs across the Customs Union, Kazakhstan will be subject to higher tariffs on goods from third countries. This will help to give Kazakh goods a chance to occupy niches in the domestic market that had previously been dominated by goods from third countries, especially China.

A favorable investment and business climate in Kazakhstan, as well as a more liberal tax policy, can bolster the inflow of foreign investment into non-extractive industries within the Customs Union. We expect that this will be an additional supporting factor for Kazakhstan's accelerated industrialization. In addition, as already noted above, Kazakhstan's membership of the Customs Union will stimulate increased business cooperation between Russia, Belarus and Kazakhstan. This will create critical mass, giving members of the Customs Union a greater competitive edge on foreign markets.

Unifying customs tariffs will inevitably increase tariffs in Kazakhstan. But this will have a corresponding positive effect on state budget revenues. It is critical that these additional resources are put to productive use. The



Government intends to invest these resources in supporting domestic export-oriented industries, oriented both to the Customs Union and other external markets.

Of course, the Customs Union involves risks for certain sectors within Kazakhstan's economy. Kazakh producers may find it more difficult to compete with Russian companies, which provide higher quality and cheaper products. Currently, Kazakhstan depends heavily on imports of manufactured goods from Russia and China. Increased trade restrictions, weak domestic production, a lack of competitive products, as well as the elimination of internal tariff barriers and the harmonization of tariff policy could also stoke inflation.

To mitigate these risks, the Government is adopting a range of measures, including providing subsidies to local producers to increase their competitive edge in the Customs Union and beyond, providing access to credit, providing additional tax incentives for the non-extractive sectors, and investing in infrastructure to stimulate investment.

It is proposed that within two years, members of the Customs Union will deepen their integration through the formation of a common economic space. In addition, efforts to enter the World Trade Organization on terms that support the priorities of Kazakhstan's economic development will be accelerated.

4.3. INVESTING IN THE FUTURE

It is no accident that one of the key areas of the Government's development efforts is called "Investment in the Future." This program entails long-term investments in human development, such as education and health care, which includes promoting healthy lifestyles and boosting labor resources. Such investments do not always yield immediate impacts, but they can help us create a solid foundation for future development. Successful development depends primarily on the knowledge and social and physical well-being of its citizens. This is why one of our strategic priorities is to meet the current needs of citizens, including providing a social safety net for vulnerable members of society and providing quality public services. A critical task remains to reduce the proportion of the population living below the minimum subsistence level. By 2020, this proportion should not

exceed 8% of the total population. To aid this task, large-scale modernization of housing and communal services, including the installation of modern technologies and management principles, will be carried out.

We will also not lose our focus on maintaining the economic core of Kazakhstan. This includes household consumption and Government organizations, transportation and communication, energy and water utilities, payment systems, food production, trade in essential commodities, and maintaining a system of state reserves.

Our previous experience and current ambitions indicate that a return to the old economy is neither possible nor desirable. Consequently, we have derived the following seven principles to guide further development:

1. Artificial "overheating" within any sector of the economy (e.g., housing or agriculture) risks destabilizing the economy and triggering future crises. Investors require long-term market-based incentives, and not just cheap investment.

2. By supporting only medium and large business, we can help owners preserve their capital, but we cannot ensure economic efficiency. In addition, a small business without support may fall into the "grey economy" and move capital out of the banking sector.

3. By concentrating on investment projects in Astana and Almaty, we cannot ensure the stability of the entire country. Regional investment plans are required.

4. The key question for maintaining industrial production levels is not just access to financing, but rather the coordination, trust, and efficiency of economic cooperation between enterprises.

5. Investment must be led by the private sector and supported by the state, not vice-versa.

6. Aggregate demand will be shaped not only by average income, but also by the distribution of incomes. A larger, stronger middle class will strengthen the economy.

7. Short-term measures should also take into account long-term development.

These seven principles guide the Government's crisis mitigation measures as well as post-crisis policies.



4.4. RESPONSIBLE AND EFFECTIVE GOVERNANCE

We will continue to focus on supporting our domestic political stability, neutralizing threats and challenges to our national security, and creating an environment conducive to ethnic harmony, security and stability in international relations. It is difficult to overestimate the importance of a unifying national strategy. Such a strategy will allow us to engage every citizen of Kazakhstan in the work to address the socio-economic recovery of the country.

In order to successfully implement key aspects of Kazakhstan's development over the next 10 years, efficient and effective state institutions are required. Improving governance is the foundation for implementing all planned actions of the state in the five key areas discussed earlier.

Priorities for public sector reform include: 1) clearly defining the authority and responsibility of public bodies, including at different levels of Government; 2) improving the quality of public services via the development of higher standards and improving processes for better delivery of public services; 3) accelerating the reform of state services, including improved training for Government officials; 4) introducing the elements necessary for a fully-functioning and result-oriented public administration; and 5) improving the management of administrative reforms and strengthening accountability for the process of public sector reform.

The Government's development plan for 2020 contains a large number of specific targets. This is a deliberate feature of the plan which will enable the country's leaders and citizens to monitor and evaluate the success of the plan, tracking its specific outcomes. Civic participation and engagement in this plan is an important component to ensure its overall effectiveness.

5. RECOVERY TRAJECTORY

The trajectory of recovery in the world economy remains the subject of great debate among economists. Various scenarios are being considered, including sharp resumption of growth (the so-called "V" shaped recovery), followed by recession (the so-called "W" shaped recovery), stagnation (the



so-called "L" shaped recovery), and slow growth (the so-called "U" shaped recovery), and other variations. While the contours of post-crisis development remain unclear, it makes little sense to try to predict the future in detail. But common sense dictates that we should be cautious in our approach, acknowledging that the road ahead will not be smooth and can hold many sharp turns.

5.1. THE ECONOMIC CYCLE AND THE RISK OF RENEWED CRISIS

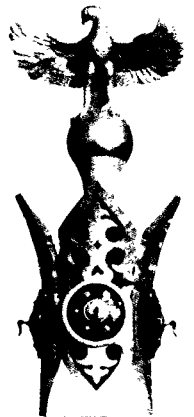
Studies of the dynamics of the world economy over the last century indicate that the global economy is cyclical. Phases of economic growth are periodically replaced by the phases of recession. All this suggests the inevitability of economic crises, which have different durations and depths according to the nature of their origin. For example, there have been 19 cycles in the US economy since 1950, with the periods of recession lasting an average of 1.5 years. In the world economy, there have been 11 cycles since 1970, with an average frequency of recession of 2-3 years.

History is also littered with financial crises. Despite differences between crises, we can nevertheless draw several general lessons from previous major crises. Thus it is clear that:

- 1) Globalization is making financial cycles more difficult to manage;
- 2) Early intervention by central banks is more effective at dealing with the effects of crises than later intervention;
- 3) The magnitude of the impact of a financial crisis is sometimes difficult to determine;
- 4) It often difficult for regulators to keep up with financial innovations that may lead to a crisis.

And there is one more important lesson: history shows that during economic booms, investors often underestimate the risks of a crisis emerging, instead expecting continued rapid economic growth. As a consequence, we can observe new bubbles and economic imbalances emerging in the global economy.

Signs of recovery in the global economy are certainly encouraging. But the optimists, I believe, should remain cautious, and any talk about the end



of the crisis is premature. Many experts consider 2009 as the most difficult period of the current crisis. It is believed that the worst of the crisis is behind us, and the world community has successfully managed to avoid the worst case scenario. Nevertheless, it is projected that the global economic recovery will be slow and uneven. Some countries may lack the funds for additional anti-crisis measures, while others will have to hold back funds due to the risk of inflation. Many developed countries including the US have huge domestic and external debts, which makes further borrowing by those countries problematic. As a result, the prospects for introducing more stringent measures in domestic fiscal and monetary policy are being considered by many countries. There remains a risk of a liquidity and capital shortage and with it the reduction of investment activity. All this in the coming years could negatively affect the economic growth of both individual countries and the world at large.

One of the conditions for restoring economic growth is the revival of the credit markets. In the event of a liquidity shortage in the future, as described above, banks around the world will have to seek alternative internal and external sources of funding in order to provide credit. Credit growth after the crisis is unlikely to reach pre-crisis levels. Banks in this new environment will be more inclined to tighten their lending standards. Thus, future growth will be constrained.

Therefore, we must radically revise the existing principles of financial and economic management to meet current market demands and try to avoid, or at least try to mitigate, the impact of future crises. The following three measures can help reduce the sensitivity of Kazakhstan's economy to global cycles:

1. Tighter performance management of existing contracts for the use of natural resources;
2. Stimulating the development of domestic demand;
3. Protecting the domestic market from unfair competition.

1. Natural resource contracts should be subject to stringent performance management criteria.

- The Government has cooperated with natural resource companies in reducing the costs of doing business. Now it has the right to demand the



unconditional implementation of contracts in terms of investment, environment, employment and localization of costs.

- Land use regulations should ensure that available arable land and other lands do not suffer damage due to improper use of state property. Plans for crop rotation should be developed and universally enforced. Non-compliance should lead to fines or the termination of contracts. This will bring about a real turnover of more land.

- Along the same lines, contracts for forest management and water management need to be developed.

- By singling out bona fide users, we can provide financial assistance for their activities (crop rotation, development of mineral resources or forests).

- For smaller contracts for land use, subsoil use, etc., there needs to be better cooperation between landowners and a subsequent renewal of contracts for the newly created entities.

- The objectives for contracts involving natural resources should be to increase production of raw materials (including from renewable sources) and to reduce the costs of raw materials production.

2. Stimulating domestic demand is intended to accelerate the turnover of goods and services in the real economy. It is understood that the public sector, including national companies, has an important role to play in supporting economic activity.

- Development institutions should be involved in investment projects to support national companies and other private investors who have contracts with the state.

- State education and health care providers should be supplied more by domestic producers of goods and services.

- Greater effort should be made to distribute domestically produced products.

3. Protection against unfair competition is designed to eliminate consumer products that are harmful to consumers and do not promote the growth of domestic small and medium-sized businesses, fair competition, or support price stability.

- In the near term, sub-quality products should be eliminated from the local market. This means strengthening enforcement of quality certification standards. This applies to both domestically and foreign produced goods.



Standards should be developed for dyes, textiles, garments, footwear, construction materials, food and other goods.

- Contraband products should be confiscated before the results of the trial. The courts must decide on their disposal.
- All products, produced locally or imported, should have product labels. The use of information that misleads the consumer should be prohibited.

5.2. THE PARADOX OF EMERGING MARKETS: INCREASED VALUE AND GROWTH OF INSTABILITY

Investors once again have started to pay attention to emerging markets, but capital flows have been uneven. A sharp change in investor sentiment can lead to the withdrawal of capital. Therefore, developing countries interested in achieving sustainable growth must pay great attention to the stability of borrowed funds.

Kazakhstan rose to meet the challenges of the first half of 2009. The Government continues to manage the economy actively, which has yielded positive results: Kazakhstan achieved positive GDP growth in 2009 amounting to 1.2%. Kazakhstan's achievement of positive, albeit modest, growth can be considered a significant success for the country, given that GDP declined in our neighboring countries. Russia's GDP fell by 7.9% in 2009, while Ukraine's economy declined by 15.1%. However, despite our recent economic achievements, we have no room for complacency: the situation in the global economy remains volatile.

One source of risk for the world economy, paradoxically, comes from the emerging markets. This is despite the fact that they have supported world economic growth during the crisis. Emerging markets have experienced rapid transformation and development, a process which has taken developed nations decades and sometimes longer. Such rapid development cannot occur without frictions, and a period of rapid growth may give way to economic stagnation or even decline, while the economy and the population struggles to adapt to new conditions.

The volatility of economic growth in emerging markets also will have an impact on trends in the world commodity markets, which in turn will affect



our economy. However, to reduce the potential negative impacts in Kazakhstan, the Government has launched a number of programs, including those aimed at accelerating economic diversification. In the medium term, expectations for economic growth are largely focused on the extractive industries. However, experience has shown that this growth is not stable and the post-crisis development of Kazakhstan's economy requires sources of growth beyond its natural resource base.

6.1. A BASIS FOR THE NEW "JUMP" - EDUCATION, JOB RETRAINING, REINDUSTRIALIZATION

Developing human capital and improving the quality of life of citizens is a major long-term priority for Kazakhstan. Human capital will enable Kazakhstan to modernize its economy and improve its competitive edge in the world. The main strategy for developing human capital is to increase the quality and accessibility of education. It is clear that a top-notch physical infrastructure in conjunction with a poorly-educated work force will not be able to support Kazakhstan's diversification. It is also clear that the country's labor resources will lose its best-educated citizens, who, without access to adequate employment opportunities, infrastructure or information technology, will be forced to seek jobs outside of Kazakhstan. Therefore, I am looking at these problems as a whole. By 2020, Kazakhstan plans to have the human resources necessary for developing a diversified economy and also to have the infrastructure in place to serve local entrepreneurs and exporters.

Education, from preschool to high school, is a critical factor for human capital. Without an educated workforce, we cannot develop modern infrastructure, establish effective state institutions, and ensure a favorable business climate. Improving the education system, especially in terms of quality, is among the country's main priorities in the coming decade. By 2020, the education system in Kazakhstan will have undergone



comprehensive modernization. It will provide opportunities not only for learning at every level, but also for enhancing professional skills and acquiring new knowledge and skills on an ongoing basis throughout life.

A system of pre-school education and training will provide opportunities for the schooling and nurturing of all children, regardless of place of residence and social status. Accomplishing this ambitious task requires harnessing the available potential of public-private partnerships and alternative forms of preschool education, such as mini-centers and private family nurseries.

Secondary education will be upgraded to a 12-year model of education, providing universal compulsory education for ten years and specialized training for two years. The content of training programs will be revised in order to devote more attention to developing the qualifications needed in life, such as finance and economics.

The technical and vocational education system will transition to a system that better corresponds to the requirements of the modern labor market, while educational standards will be developed on the basis of professional standards through a national qualification system. On the whole, a system of electronic training (e-learning) will be offered for technical, vocational, and higher education programs. Institutions of higher learning will be provided with greater academic autonomy. Principles of corporate management will be incorporated in education management practices. Improving the quality of educational services will also be ensured by improving education financing, introducing elements of corporate governance in educational institutions, including citizen engagement, and establishing an independent body to monitor the quality of education. The teaching profession will be one of the most prestigious in the country thanks to strong social support from the state.

The education system will be built so that young people become active members of society and the engines behind social, political and economic transformation. This will require engaging the younger generation in order to encourage greater patriotic consciousness, and an appreciation for civic responsibility and active community involvement.



The state will continue to work to ensure accessibility to education for children with health problems, children from families with low income, and at-risk children. We will build an effective system to protect the rights and interests of children and to address and prevent domestic problems, such as abandonment, neglect, delinquency and crime.

One of the important priorities of education development in the forthcoming ten-year period will be to establish a new university in Astana. It is a great honor for me that the public has insisted on naming the university's national research and educational complex after me. The new university will offer world-class quality education in engineering, medicine, science, public policy and business, combining learning with research activities.

In terms of expanding and modernizing the infrastructure base of the economy, the state has given priority to the development of transportation, communications and power systems. Given the geography of Kazakhstan, the development of transport infrastructure is particularly important for increasing the mobility of its citizens and the country's integration into the global economy. With the acceleration of globalization, the strategic importance of communication technologies and information technologies is increasing. In recent years, the rapid development and adaptation of information and communication technologies are becoming important factors in the modernization of society, affecting not only on economic indicators, but also the way people live. For Kazakhstan, this task is made even more urgent by the fact that Kazakhstan has a large territory with a dispersed population and locations of economic activity.

The pace of economic growth and the declared objectives for economic diversification have placed significant pressure on Kazakhstan's energy sector. To meet the needs of the population and realize plans for industrialization, it is necessary to produce and consumer energy more efficiently. The Government is currently developing a program for energy efficiency. Considering its national interests, Kazakhstan should also become self-sufficient in energy production.



6.2. NEW BENCHMARKS FOR MODERNIZING THE SOCIETY AND ECONOMY OF KAZAKHSTAN

It seems to me that for Kazakhstan and other developing countries to achieve sustainable development, we must live and work in a way that reduces the burden on natural resources and the environment. However, to contribute to the solutions of pressing global environmental problems, we must not be limited to the role of "studious pupil" of advanced industrial countries. Rather, we can make our own conceptual contribution to problem solving that is based on our unique experience, balancing industrial, scientific and technological development with national interests.

Kazakhstan's development plan for the period until 2020 aims to reduce the economy's vulnerability to future economic crises. This will be accomplished by means of economic diversification and accelerated industrialization and infrastructure development. The resistance of the Kazakhstan's economy to future economic crises will be strengthened by broadening the economic base. Influenced by the successful experience of other developing countries, particularly in East Asia, Kazakhstan is planning to implement a massive program of accelerated industrialization, which will include active steps to diversify both the public and private sectors. Plans for infrastructure development will focus on upgrading the power generation, transportation and telecommunications industries, which are essential for diversifying Kazakhstan's economy and attracting foreign investment into the country.

Diversification efforts have been split into two main phases. In the first phase (2010-2014), diversification will be supported primarily via the accelerated development of seven priority areas, five of which involve industry and two of which involve infrastructure. These seven areas comprise:

- Agriculture and food processing;
- The construction industry and the production of building materials;
- Refining and oil and gas sector infrastructure;
- Metallurgy and manufacturing of fabricated metal products;
- Chemicals, pharmaceuticals and defense industries;
- Energy production, including nuclear power and alternative energy;
- Transportation and telecommunications.

Further sectors that will receive support include tourism, aerospace and engineering. During the second phase (2015-2019), ancillary industries to the seven priority sectors listed above will receive support. Greater emphasis will also be placed on developing local technologies. State support for these sectors will be carried out openly and transparently, with the condition that all participants who receive state support must also assume commercial risks.

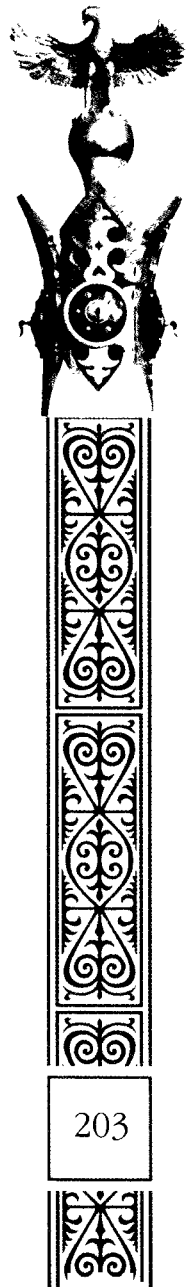
The successful diversification of the economy is inextricably linked to the country's sustainable development. Production of renewable energy is one area that holds out great promise. We will create an environment that stimulates the development of wind, solar and geothermal energy. Technologies will be introduced for the more efficient use of water resources, both in terms of generating additional electricity and providing the population with water.

An important aspect of diversification will be optimizing the governance of sustainable development and introducing a "green" policy. We must move towards a low-carbon economy by attracting investment, addressing environmental problems, reducing pollution risks to the environment, increasing the responsibility of enterprises that use natural resources to reduce emissions, and creating an integrated waste management system.

Plans for industrialization will be linked with plans to build centers of economic growth in order to foster regional development and make the most efficient use of local labor resources. The formation of centers of economic growth will be coordinated along with policies for migration, housing, infrastructure development, education and health.

6.3. CONDITIONS FOR ACTIVE CIVIC PARTICIPATION IN MODERNIZING THE NATION

I am convinced that a nation's international competitiveness is determined, above all, by the level of health, intelligence, and education of its citizens. Citizen involvement and the quality of human resources are the fundamental factors that drive national progress. Human capital is the engine of innovation and productivity.



In order to realize their full social, political and economic potential, the citizens of Kazakhstan must be healthy, educated, socio-economically secure, and live in a stable, peaceful and democratic society. Investments in human capital and in encouraging active civic participation in the country's development will deliver long term returns.

By 2020, Kazakhstan intends to reduce the number of people living below the minimum subsistence level by four times. As a result, vulnerable groups in society, such as women, children and young people will feel more secure and capable of achieving better social outcomes. Quality education, from kindergarten to the university, will be available throughout the country. The population's health will significantly improve. Health services will meet the highest international standards and they will be available to the entire population. The people of Kazakhstan will adopt healthier lifestyles, reduce smoking and abstain from alcohol abuse. We must focus our efforts on creating incentives for citizens to choose these lifestyles. In order to actively participate in social, political and economic life, the population must be confident that the state offers reliable social support. The state has a duty to provide its citizens with effective social security and high quality public utility services.

By 2020, the Kazakh language will feature more prominently in all spheres of society. The country's many ethnic groups and followers of different religious beliefs will continue to live in conditions of internal stability, security, peace and harmony.

Kazakhstan's development as an independent sovereign state depends on internal political stability and national security. Major efforts will be aimed at reforming and strengthening the civil service and state institutions, and neutralizing threats and challenges to the national security. The preservation of peace, harmony, stability and the sustainable development of the Kazakh society are the long-term priorities in the domestic sphere.

The process of modernizing the country will continue. It is expected that by 2020, a stronger legislative base will develop in Kazakhstan, political parties will have more responsibility and the system of local Government will work more efficiently. Democratic institutions and civil society institutions



will be strengthened and will be fundamental to the socio-political system of a sovereign Kazakhstan.

The Government intends to seek greater public involvement in implementing development programs and other state activities. Greater transparency will be provided in respect of the legislative process and the delivery of public services: clear lines of responsibility will be drawn to each initiative. Thus, the public will be provided with the information necessary to assess the performance of state programs.

Greater public awareness of the functions performed by the state is the foundation for building a more constructive relationship between the Government and the citizens it represents. We must develop more effective feedback mechanisms in order to increase public involvement in state policy.

6.4. REACHING A NEW LEVEL OF INTERNATIONAL COMPETITIVENESS

Economic crisis offers an opportunity to lay stronger foundations for the future. Kazakhstan intends to become one of the 50 most competitive countries by the year 2020. In order to achieve this objective, the Government is focused on improving the business climate, and strengthening the legal and financial systems. This will create favorable conditions to stimulate investments and improve competitiveness.

A favorable business climate will also support the economic diversification process. Transparent and robust legal and financial systems also play a critical role in supporting entrepreneurship.

Independent international assessments of Kazakhstan's business climate demonstrate that, despite some progress, there is still work to be done to further improve the business environment and fight corruption. The Government is working hard to lower the costs of doing business both for domestic entrepreneurs and foreign investors. The Government is also fighting corruption by strengthening administrative procedures and improving their transparency.



Regarding Kazakhstan's financial system, we must learn from the current crisis and apply the lessons to long term effect. First of all, borrowing should be based on strict prudential standards and transparency requirements, no matter how favorable credit conditions may be. Commercial, financial and foreign currency risks must be managed within acceptable limits. Second, access to the international capital markets must be managed within prudent limits for external debt. Third, the domestic savings rate must be supported to allow the economy to generate greater domestic resources for economic growth. In order to facilitate this process, the domestic financial system must be secure, transparent, and well regulated and it must also be perceived as such. Fourth, the country's budget systems should be more resilient to potential economic crises. Finally, economic diversification is critical insulation against future economic downturns.

The financial system will play a leading role in intermediating investments for the country's industrialization and economic development. The Government is working with the private sector to restore the fortunes as well as the credibility of the financial system. Government support will continue during the process of recovery. However, the Government will gradually reduce its direct role in the sector, focusing instead on regulation and enforcement.

To build a competitive financial industry, regulatory and supervisory functions must be improved. Special attention will be paid to the rights of consumers, creditors and investors. Corporate governance standards will be strengthened. Also, in the post-crisis period, one of the key priorities will be providing proper incentives for encouraging competition within the financial sector.

The future model of state regulation of the financial system will focus on robust prudential standards. The requirements for equity, liquidity and reserves in the banking system will be tightened.

A reliable legal system is a prerequisite for sustainable development. If the public and investors do not trust the legal system, costs of business rise, it is more difficult to attract long term investments and standards of living suffer. A reliable legal system means the inviolability of the rule of



law and strict adherence to due process. This will give the public confidence in their rights and allow investors to make decisions with certainty.

Overall, development of the financial and legal systems and an improved business climate will allow Kazakhstan to successfully compete for investments in the non-extractive sectors of the economy. Thus, it will facilitate the industrialization and long term development of the country.

The global financial system may have averted meltdown, but the crisis has nevertheless changed the international financial landscape. These changes will have a significant impact on Kazakhstan's financial sector over the medium-term as follows:

- Developed countries exerted pressure on local banks to repatriate savings from abroad;
- Lending standards were tightened at financial institutions around the world, particularly in developing countries. As a result, Kazakhstan faces constraints in attracting foreign portfolio and direct investments.

Currently, the quality of loan portfolios at Kazakhstan's commercial banks has fallen to levels not seen since the late 1990's. Work is underway to improve the transparency of the banking sector and provide support for the payment system. Most commercial banks maintained uninterrupted operations during the crisis thanks to the quick and decisive actions taken by the National Bank, FMSA and the Government.

In 2009, the direction of investments into Kazakhstan's financial assets changed from net inflows to net outflows. Weaknesses in our balance of payments accelerated the fund outflows. It became clear that the corporate sector faced a major challenge to meet its scheduled debt redemptions. The Government is working hard to create an appropriate macro-prudential framework which will prevent such imbalances from building again. These measures, matched with strict fiscal discipline, will allow Kazakhstan to improve its sovereign ratings.

Supporting and strengthening the banking sector remains an important priority for the Government. Aside from improved capital adequacy



requirements, stricter corporate governance practices must be observed by bank management. Transparency must reach international standards. Remuneration of bank managers and staff must be linked more closely with performance. Incentives must be structured to align the interests of staff with long term company performance. Stricter requirements need to be introduced regarding the role of independent directors and the personal liability of boards of directors.

Improving the access to financing for agricultural producers is another important challenge for the financial sector. Currently, the main providers of finance comprise:

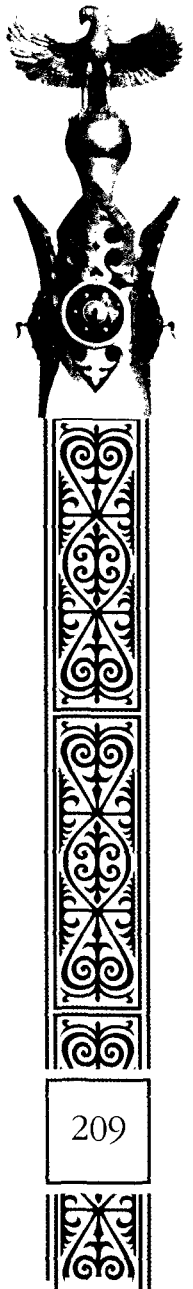
- Commercial banks which provide working capital funding, financing for annual harvests and corporate loans;
- The National Holding KazAgro, which provides financing to large and medium sized agricultural producers for the purchase of equipment and materials,
- Development institutions which finance downstream agricultural projects.

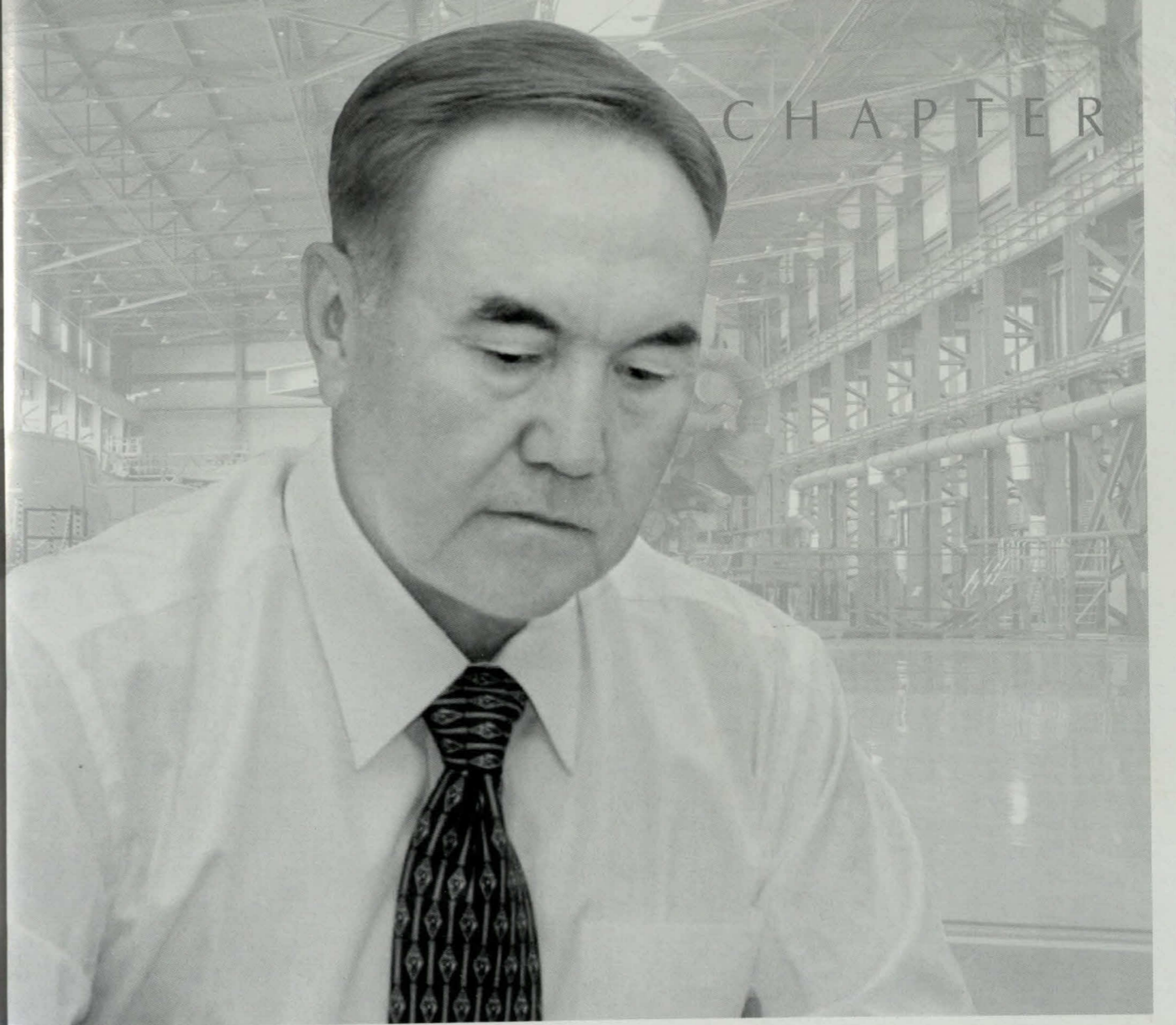
I do not believe there is an urgent need to create a bank dedicated to the agriculture sector given financial institutions currently provide a range of financial products to medium and large agricultural companies. However, access to funding remains an issue for small agricultural business as well as medium-sized farms in remote regions. Given the distances to urban centers involved and the highly seasonal demand for funding, transaction costs are too high for financial institutions to service these customers effectively.

Since rural villages need cash less than they need the timely delivery of equipment, fuel and raw materials, as well as transportation of agricultural products to warehouses and distribution points, it is sensible to employ the experience of dozens of developing countries that use the national postal system to provide financial services. Specifically, Kazpost, thanks to its own freight forwarding, telecommunication and financial services, can solve the problem of financing small and medium-sized enterprises in rural areas with transportation and material support provided by KazAgroMarketing and telecommunications support from the Ministry of Communications and Information.



Over the next 2-3 years, work will be done to provide small and medium-sized agricultural businesses with comprehensive financing and logistical support. Preliminary assessments demonstrate that demand for credit in rural areas amounts to approximately KZT 100 billion. At the same time, we will improve communications in rural areas and deliver a variety of social services, including better healthcare and education, to remote regions. Rural areas will also receive faster delivery of social services. Further, the Road Map will generate employment. As a result of these measures, living standards will be vastly improved.





NEW PROSPECTS FOR KAZAKHSTAN AND
LESSONS FOR THE WORLD COMMUNITY





Today, new centers of power shape the trends that affect global development. It is becoming clear that the entire system of relations in the global community is undergoing major changes. In this regard, the main goal for the next few years is not only to overcome the crisis with minimal losses, but also to ensure that the Eurasian community will become an even greater force in the world economy and politics of the 21st century.



NEW PROSPECTS FOR KAZAKHSTAN AND LESSONS FOR THE WORLD COMMUNITY

The viability of Kazakhstan's model of modernization - tested by the recent crisis - shows that our ideas and our experience in the field of socio-economic development can be useful to other countries that are looking for opportunities for rapid breakthrough to a higher level of economic development and national prosperity.

The global crisis caused a lot of anxiety. However, each passing day and month give us unique and wonderful opportunities for self-renewal, while simultaneously leaving us less time for the practical realization of these rare chances. I am convinced that our world has never before had such incredible opportunities for self-renewal.

For Kazakhstan, it is important to become a country that is ready to overcome possible future economic crises, that is prepared for global competition, and whose citizens are actively participating in social and economic development. In the near future, we must not only overcome the crisis period, but to emerge from it ready for further breakthrough. The world is not static. The only way to retain your achievements and successes is to quickly move forward. All crises tend to pass. And this crisis will be over in a year or two. After the crisis, the world will change. We must take our rightful place in this new world order.



1.1. THE ROLE OF CENTRAL ASIA AND KAZAKHSTAN IN THE NEW GEOPOLITICAL BALANCE

Central Asia, including Kazakhstan, is at the epicenter of geopolitical interest of the major world powers due to its strategic location as a "bridge" between the developed West and the rapidly developing East, as well as the source of hydrocarbons needed by various states. This statement is equally true for both the nearest neighbors in the region - China and Russia - as well as for more distant influential players - the United States and the European Union.

Central Asia is included in the geopolitical interests of both Russia and China. Russia is interested in protecting its southern borders from illegal immigrants and drug trafficking. Therefore, she considers Kazakhstan and Central Asia as a geographical buffer zone. Moscow is also concerned about the situation of the Russian-speaking population in the region. During the crisis, Russia was given a chance to strengthen its political and economic influence in Central Asia.

China, for its part, is focused on the hydrocarbon resources of the region. In addition, Beijing regards the Central Asian republics through the prism of opposition to separatism and extremism along its western border. Before the crisis, as well as at the present time, the countries of Central Asia were in desperate need of technology and, especially of financial resources. In this context, many see a much-needed investor in the rapidly developing China. Following the construction of pipelines and roads that would connect China with Central Asia, Beijing may designate the region a zone of its strategic interests.

China seeks to strengthen friendly relations with Central Asian states through international and regional organizations, such as the Shanghai Cooperation Organization ("SCO"). The alliance between Moscow and Beijing within the SCO framework contributes to stability in Central Asia.

The rapidly-developing economy of China affects the geopolitical and economic situation in Central Asia. In addition to seeing it as a key source of



commodities, China views Central Asia as a transit corridor to Europe, which may come in handy for countries in the region due to Chinese investment in local infrastructure development. Moreover, due to insufficient development of domestic production of consumer goods, the Central Asian countries see China as a major supplier of affordable consumer goods. The economic impact of China in Central Asia may eventually grow. This development is advantageous for us, and it must be fully utilized in the context of a trustworthy relationship between our countries.

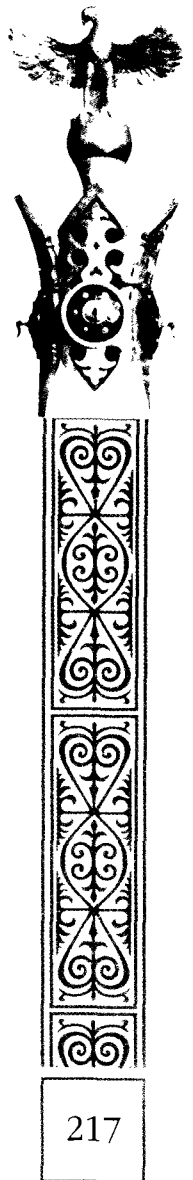
Russia is increasing its influence in the region, but does not have sufficient resources for a consistently effective policy. Therefore, Kazakhstan's accession to the Customs Union is an example of sound foreign policy and is based on geopolitical considerations. With this step, the economic influence of Russia in Kazakhstan will increase, balancing the growing expansion of Chinese companies on the domestic market.

The European Union has its own strategy towards the region and intends to increase its economic influence in Central Asia. However, the increased Russo-Chinese influence puts Western companies at a disadvantage in the region. At present, future geopolitical competition is developing between Russia, China, the United States and the European Union for influence in Central Asia. In this regard, Central Asian countries can receive significant benefits in terms of foreign direct investment.

The world will change after the crisis. Kazakhstan must take its rightful place in this new world order. In this context, there is a need to conduct cautious foreign policy in order to support the peaceful development and mutually beneficial balance of interests with global powers, primarily those located in Eurasia.

1.2. EURASIA'S PLACE IN THE EMERGING MULTIPOLAR GLOBAL SYSTEM

An important modern trend is the transformation of a unipolar political system into a multipolar world order. New centers of power are emerging today that affect larger global development. Along with the development of multiple poles of power, regionalization will increase as a process, which



will be supported by regional markets. New continental groupings will take shape. The role of Eurasia increases sharply in these processes, and with time, this region will be a center of world development in the political, economic and cultural sense.

Following the collapse of the Soviet Union, it was customary to consider the world as unipolar, with the United States as the sole superpower. However, the foreign policy pursued by the United States was sometimes seen as too straightforward, prompting criticism from many countries. It is noteworthy that the current conflicts are not only among traditional opponents (United States and Russia, United States and China, United States and the Islamic world), but can take place implicitly between the European Union and the United States. As we can see, almost all of America's opponents are located on the Eurasian continent.

The crisis played a significant role in this process, and had caused major changes in the global system, while encouraging the trends towards formation of the multipolar world. This has manifested itself in the emergence and growth of economic, financial and industrial strength of the new players in the Asian part of Eurasia - China and India. At the same time, we are witnessing the return of Russia to the world stage as a global player and potential "axis" of Eurasia.

Currently, numerous political and economic reports contain the acronym "BRIC", which stands for the largest developing economies around the world - Brazil, Russia, India and China, three of which are located in Eurasia. Due to their high macro-economic indicators and their growing financial strength, these countries could transform global monetary system, freeing it from the domination by the United States.

The interests of the European part of Eurasia - that of the European Union - are also focused on the Eurasian continent and are strongly intertwined with those of Russia and Asia in general. Today's Europe must realize that the future can be built only on the basis of equal relationship and on Eurasian integration. In order to accomplish this, European countries should step up their foreign policies and should stop playing the role of passive observer. Japan already realized this trend, and its government has been active economically and politically in cooperating with two regional



Asian leaders: India and China. Despite the crisis, China is continuing - and even intensifying - its economic expansion by acquiring the assets of foreign natural resource companies, which will support even greater economic growth.

The Eurasian landmass contains the majority of world's developed economies. It is also a host to a substantial proportion of the global nuclear arsenal. The populations of two Eurasian countries - China and India - account for almost half the world's population. Thus, it becomes apparent that Eurasia plays a key role in the new multipolar world. It should also be noted that there is an apparent shift of relative wealth from the West to the East, and this trend will only increase in the future. Nevertheless, it is clear that the United States will retain the role as one of the global leaders, though they will have to share influence in the world with new centers of power.

Thus today, new centers of power shape the trends that affect global development. It is becoming clear that the entire system of relations in the global community is undergoing major changes. In this regard, the main goal for the next few years is not only to overcome the crisis with minimal losses, but also to ensure that the Eurasian community will become an even greater force in the world economy and politics of the 21st century.

In 2010, Kazakhstan assumed chairmanship of the Organization for Security and Cooperation in Europe ("OSCE"). The OSCE is the largest regional security organization in the world, bringing together 56 States, including European states, United States, Canada, countries of Central Asia and the South Caucasus. The organization focuses on a wide range of issues, including arms control, preventive diplomacy, confidence-building measures, human rights, election monitoring, as well as economic and environmental security. OSCE considers security as an integrated concept and operates in three "dimensions" - military-political, environmental-ecological and human.



OSCE missions and field offices operate in South-Eastern Europe, Eastern Europe, Caucasus and Central Asia, with an estimated 2010 budget amounting to more than EUR150 million.

The history of this organization began in 1970, when the Conference on Security and Cooperation in Europe ("CSCE") was first convened - a multilateral forum for dialogue between East and West. The Helsinki Final Act of 1975 established the basic principles of behavior of CSCE states-participants towards their citizens, as well as among themselves. Until 1990, the CSCE functioned as a series of meetings and conferences which determined the organization's rules and obligations, with periodic reports on their implementation. The turning point for the forum was the Paris Summit of 1990. The Paris Charter for a New Europe set the goal to contribute to the management of the historic changes in Europe and to respond to new challenges that emerged after the end of the Cold War. Several agencies and institutions were created to solve these problems, with regular meetings taking place; the official meetings were given systemic nature. At the Budapest Summit in 1994, it was decided to rename the CSCE to the Organization for Security and Cooperation in Europe (OSCE).

Kazakhstan became a member of the OSCE in January 1992. At the OSCE Permanent Council, which took place in early February 2003, Kazakhstan for the first time stated its claim for the OSCE chairmanship. CIS countries acted as the initiators for the nomination of Kazakhstan as a candidate. Finally, at the 15th meeting of the OSCE Council of Foreign Ministers in Madrid, held in November 2007, it was decided that Kazakhstan - the first among post-Soviet countries - will assume the chairmanship in 2010.

In accordance with the organization's official mandate, the OSCE chairman coordinates the work of major legislative organs of the organization - all Summits, the annual meeting of the Council of Ministers, the weekly meetings of the Permanent Council and subsidiary organs. Having initiated the idea of convening the Summit of the Heads of State in 2010, which was reflected in the documents of the Athenian Council of Foreign Ministers, Kazakhstan began exploring the conceptual and organizational issues of the Summit. This initiative is especially significant in view of the fact that the last summit of the Organization took place ten years ago - in 1999, in Istanbul.

Among the major OSCE activities scheduled for 2010, it is important to note the actions of the Parliamentary Assembly; the annual conference on security issues; the Economic and Environmental Forum; a meeting on implementation of commitments in the human dimension; the high-level Conference on Tolerance and Non-Discrimination; the Conference on the Prevention of Terrorism; the Conference to commemorate the 20th anniversary of the Copenhagen Document; as well as others. For 2010, Kazakhstan has made a schedule of multilateral and bilateral consultations that involve all OSCE member-states. The OSCE will hold regular consultations in Vienna and other capitals with the European Union, Council of Europe, the CIS, and other international organizations and associations.

Kazakhstan's chairmanship of the OSCE is a serious test. We honestly want to showcase Kazakhstan to the entire world. Kazakhstan's experience - where ethnic harmony and tolerance thrive - is very important to others. It is necessary to focus on security, combating terrorism and extremism as part of the OSCE work. Working within the OSCE is useful for Kazakhstan itself, especially for the strengthening of civil society.

International observers are paying great attention to Kazakhstan's chairmanship of the OSCE. It is believed that Kazakhstan has chosen a very ambitious role in seeking to lead this organization. Thus, Kazakhstan will be able to announce the successful completion of one stage of its modern history - this was a phase of consolidating the country's independence in all aspects. In addition, Kazakhstan has shown the world that it intends to actively participate in solving international issues and problems. OSCE Secretary General Marc Perrin de Brichambaut expressed the hope that Kazakhstan's chairmanship "opens new horizons for the OSCE and that Kazakhstan's experience will contribute greatly to the further development of this organization."

There are different views surrounding what Kazakhstan should focus on during its chairmanship. Some believe that Kazakhstan should focus on the situation in Afghanistan and assist in settling so-called "frozen" conflicts between numerous European countries - in particular, the conflict between Russia and Georgia, since Kazakhstan has good relations with both countries. Kazakhstan may be equally well placed to address the problem of Nagorno-Karabakh. Others believe that the most important issues today are European



energy security, as well as security of water supply and ecologies of different regions.

Of course, all of these and other pressing international issues will be addressed as part of Kazakhstan's chairmanship of the OSCE, since our goal is to ensure a balanced approach in all three key "dimensions" outlined earlier. Kazakhstan has already accumulated some experience in Afghanistan, including not only military but humanitarian cooperation. We plan to use this experience to build a humanitarian component, aimed at the return of Afghan citizens from armed confrontation to a peaceful and constructive life. Kazakhstan seeks to enhance the contribution of the OSCE in support of global efforts towards nuclear disarmament. Much attention will be given to the fight against drug trafficking and counter-terrorism.

In the framework of economic and environmental concerns, we believe it is essential to focus on the development of the transport industry by member-states in order to provide a basis for the most effective post-crisis economic development. Work will also continue on the regulation of migration and energy security.

With regard to the human dimension, the key issues are the promotion of tolerance and intercultural and interfaith harmony, the protection of human rights, the prevention of human trafficking, and promotion of gender balance.

In general, we will strive to improve the effectiveness of the use of the OSCE's exclusive capacity in solving international problems. To accomplish this, it will be necessary to create a more effective dialogue and interaction among the OSCE member countries, and to increase the level of trust and cooperation within the organization.

At the same time, Kazakhstan's chairmanship of the OSCE has stirred a lot of criticism. There is a perception that the Government of Kazakhstan is looking at the OSCE chairmanship as an international public relations stunt, and not as a means to develop democracy. I hope that I have sufficiently demonstrated our goals in the video message at the inaugural meeting of the OSCE Permanent Council in Vienna. Addressing the wider international audience, I said that Kazakhstan is taking the high mission of the

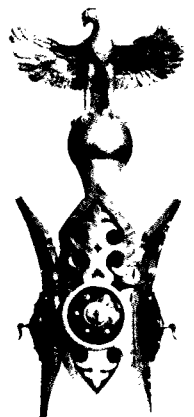


chairmanship of the OSCE with great responsibility, and that the need for resolving the most urgent problems which are now facing the OSCE was always the cornerstone of our foreign policy. Since its independence, Kazakhstan has made a real contribution to strengthening regional and global security. The closing of the Semipalatinsk nuclear test site was a historic decision for our country - a voluntary abandonment of the fourth largest nuclear missile arsenal in the world and the complete destruction of its infrastructure.

At the same time, I, with deep regret and anxiety, watch the efforts of some countries to become nuclear powers. The threat of nuclear war is not decreasing but increasing every year. The amounts of money spent by these parties on war, conflicts, and arms races are truly astronomical. A mere tenth of that amount would be sufficient to peacefully resolve many conflicts. One such method would be to invest in integration processes and the establishment of strong economic ties. The structure of negotiating processes is simple and efficient: to seek and to discuss only matters where a constructive consensus is possible. All disputes and controversies should be postponed until better times. Controversial issues should be "laid to rest" and when the time comes, they will be discussed with the participation of an impartial third party.

The most important priority for Kazakhstan is the sustainable development of Central Asia. The growth of our economy has a positive impact on the entire region. Our model of interethnic and interreligious harmony is the real contribution of Kazakhstan to the global process of inter-confessional interaction.

The motto of Kazakhstan's chairmanship will be four "T"s - trust, tradition, transparency and tolerance. The first definition means trust in each other, which is much needed. The second is the commitment to the fundamental principles and values of the OSCE. The third is the maximum openness and transparency in international relations, free from double standards and lines of division, and is aimed at constructive cooperation in addressing the challenges and security threats. Finally, the fourth definition is a reflection of global trends in strengthening intercultural and inter-civilization dialogue, which assumes greater importance in today's world.



The year 2010 - the year of Kazakhstan's chairmanship of the OSCE - is marked by several important dates: the 35th anniversary of the signing of the Helsinki Final Act, the 65th anniversary of the end of World War II, the 20th anniversary of the Paris Charter for a New Europe, and the 20th anniversary of the Copenhagen Document. These dates are a cause for serious analysis of the OSCE's future and its global role. Kazakhstan's activities at the OSCE chairmanship will focus on further strengthening of this organization in the name of security and cooperation over a vast area which ranges from Vancouver to Vladivostok.

I would like to address some critical issues as we start the active phase of the chairmanship in such an influential international organization as the OSCE, such as the fate and prospects of the OSCE itself and its place in the emerging world order. Will the OSCE, in its present form, adapt to the dynamic realities of the 21st century? The organization must deal with the most complex and urgent problems of the modern world. Kazakhstan assumes the OSCE chairmanship with an understanding of these realities. We are keenly aware that one year is not enough to address all the issues effectively. We do not support any drastic changes in the organization, but do not intend for it to be static either.

As the leader of a sovereign state, I consider the chairmanship of the OSCE not only as a strategic national project and evidence of the increased international prestige of the country, but also as an opportunity to breathe new life and impetus into the organization. In this regard, I turn to the OSCE's origins and the critical stages in its history. What is the reason for its international success? What are the main lessons from its activities? How can the "Helsinki Spirit" be revived and strengthened?

THE CSCE - AS A GLOBAL FACTOR OF DETENTE

In 1973, in Geneva and in Helsinki, the CSCE was established, consisting of 33 European countries, as well United States and Canada. It was a turning point for the entire world, when the CSCE combined the efforts of states belonging to the North Atlantic Treaty Organization and the Warsaw Pact, as well as neutral European countries.

This was one of the most complex and critical periods in modern history, when the tension between two opposing military-political blocs reached



boiling point. The Cold War could have easily become a "hot" conflict under more adverse conditions. It took sheer political courage for the leaders of major world powers to avoid a nuclear apocalypse and to make steps towards rapprochement.

The most important outcome of this work was the Final Act, signed in Helsinki in 1975. The CSCE marked a triple breakthrough in the geopolitics of the 20th century. First, there was a breakthrough in preventing the threat of escalation of the Cold War into a nuclear conflict. Second, it was the first example of successful institutional dialogue between East and West. Third, it was a breakthrough in terms of cooperation between two competing ideologies and worldviews.

By and large, The CSCE played a global role in the bipolar world, contributing to simultaneous progress on all the above-mentioned issues. However, no single political forum can indefinitely maintain the greatest level of influence and significance in world affairs, and the CSCE is no exception to this rule.

Allow me to articulate it like this: 1975 laid the foundation not just for the "spirit", but the "brand" of the Helsinki process. This brand has been tarnished and lost part of its force over the past few decades. The goal of the current policy makers is not just to revive this brand, but to give it new luster and energy.

THE OSCE DURING THE COLLAPSE OF THE BIPOLAR WORLD

The late 1980's and early 1990's witnessed epochal changes: the collapse of the Soviet Union, the dissolution of the Warsaw Pact, the reunification of Germany, and the breakup of Yugoslavia. At that time, the CIS was established with direct participation of Kazakhstan.

During that complex and contradictory period, CSCE played a stabilizing role by taking important steps to strengthen confidence and security, and provided support for democratic and market reforms, across Central and Eastern Europe and Eurasia. It is enough to mention the Paris Charter for a New Europe, the Treaty on Conventional Armed Forces in Europe, and other strategically important documents created at that time.



Over the past decade, CSCE was transformed from a forum for political dialogue into a transnational organization - the OSCE. In 1996, the reinvigorated organization adopted the "Declaration on a Common and Comprehensive Security Model for Europe for the 21st Century", which stressed the need to build a united, peaceful, democratic and undivided Europe.

At the same time, it is impossible not to acknowledge that the organization has gradually paid less attention to the military-political issues, while significantly increasing economic cooperation activities during the same period.

THE OSCE IN THE MIDST OF MODERN GEOPOLITICAL REALITIES

The beginning of the 21st century was marked by a serious and profound transformation of the entire structure of international relations. The vulnerability of nation-states to extremism has become the impulse for multilateral cooperation in combating transnational threats to global and regional security.

Another challenge to international security was the undermining the Nuclear Non-Proliferation Treaty regime, and expansion in the number of the so-called "nuclear threshold states" that either strive to obtain nuclear weapons, or have already done so.

The OSCE is experiencing problems such as the changes in the military-political balance on the Eurasian continent, the existence of so-called "frozen conflicts" and the difficulties with the Treaty on Conventional Armed Forces in Europe - these and other issues have become a major concern for the OSCE member states.

Finally, the global financial and economic crisis that has affected virtually the entire world, has once again demonstrated the need for combined efforts by all countries - including OSCE member states - to create a new, more just and predictable world order.

Therefore, I wish to draw attention to another important trend, which is characteristic not just of the OSCE, but the global processes in general:



the modern world is contributing to the inequality among states in solving problems that are equally important for us all. Even today's leading powers are beginning to realize that this situation is neither productive nor fair. In this regard, the expansion of the G-8 Group to G-20 format was a positive development, but that fact, by and large, does not radically alter the situation.

I believe that everyone should understand a simple fact: the very logic of global development requires strengthening the role of medium-sized states, which constitute the majority of countries in the modern world. In my opinion, the role of such states is to seek global strategic decisions on a consensual basis.

Today, the OSCE, covering a huge geographical and political space, is rightfully considered one of the most influential institutions in the world. At the same time, the Achilles' heel of the OSCE is the fragmentation of its three dimensions, and a lack of inclusion of the Eurasian potential in the organization's development processes.

Over the past 35 years, many international organizations, as well as entire nations, have disappeared from world history. Simultaneously, a host of new organizations and associations radically changed the political map of Europe. At the same time, the OSCE intensified its cooperation with new, very powerful and dynamic regional organizations. The emergence of the CIS, Collective Security Treaty Organization ("CSTO") and EurAsEC mark a completely different reality than during the Soviet times. The emergence of the SCO means the emergence of a new structuring mechanism for a huge part of the OSCE space. Additionally, new and innovative projects have emerged, such as the Conference on Interaction and Confidence Building Measures ("CICA")--, a prototype for an Asian collective security system, along with other security structures. Based on the European experience that includes practical achievements of the OSCE, the CICA is rapidly moving towards the institutionalization of its activities and is gaining increasing acceptance on the Asian continent.

Therefore, the OSCE should build on the existing good practices of working with other regional structures. Vigorous interaction with other regional projects can breathe new life into OSCE's work, and can open new horizons and chart a new direction for the organization. With support from



other states, Astana could become a reliable platform for this kind of inter-institutional and supra-regional dialogue.

KAZAKHSTAN'S CHAIRMANSHIP OF THE OSCE: CONTINUITY AND INNOVATION

I would like to stress the following: Kazakhstan comes to the organization as a follower of traditions. We clearly realize that the OSCE's core activities are based on already-established principles, standards and regulations, which Kazakhstan is not going to refuse or seek to alter, since they embody the very spirit of the organization. Kazakhstan will ensure the proper continuity of Greece's chairmanship of the OSCE.

I believe that Kazakhstan's chairmanship of the OSCE can launch a new era in relations between East and West, and can serve to strengthen mutual trust. Having established commercial and constructive relations with all states located to the east and west of Vienna, Kazakhstan can become not just an active, but also an effective mediator between the various parties in conflict situations.

I am convinced that the OSCE is the optimal forum for discussions of the most difficult security problems. In this regard, we attach particular importance to the "Corfu Process" which will certainly boost understanding of security as a comprehensive and indivisible issue across the vast geographical expanse of the OSCE.

In my opinion, the organization should not refuse the open and principled discussion of strategic initiatives, including the Treaty on European Security.

Another major threat of our time is the problem of extremism, which was faced by almost all OSCE member countries to a varying degree. Therefore, when talking about global security issues, the organization cannot but respond to terrorism and extremism, which, like cancer, is affecting the entirety of modern civilization step by step.

In general, it is important to recognize an obvious but very significant historical fact - namely, that the OSCE has long-ago transformed from a



continental European organization to an entity with a transcontinental scope of responsibility and work. Today, it is composed of European, Asian, Caucasus and North American countries.

That is why today it would be more proper to discuss not just European, but Eurasian security. At present, it is nearly impossible to ensure the security of Europe without considering the Asian dimension of security. Safety in the modern world, including in Europe, consists not just in security from a potential conventional military attack, but defense from possible terrorist attacks and inter-ethnic and inter-religious conflicts.

The security of our countries is inseparable from the security of our neighbors, even if they do not belong to the OSCE. In this regard, Kazakhstan, as the acting chairman, is also making maximum efforts to counter new challenges to the OSCE sphere of influence and is a co-sponsor of a number of important projects in combating terrorism and various forms of illegal trafficking, as well as efforts to strengthen borders.

43 out of 56 OSCE member states are in some way involved in military operations or in the economic reconstruction of Afghanistan. However, it should be recognized that it is difficult to solve the Afghan problem without involving regional organizations. The OSCE must find its niche, its role in this big effort, and in this sense, Afghanistan could become a bridge between various regional organizations.

By focusing on the process of rehabilitation and post-conflict reconstruction of that troubled country, Kazakhstan supports coalition efforts in Afghanistan. At the same time, we remain convinced that there is no military solution to the Afghan problem. Like many other countries, Kazakhstan is genuinely interested in a stable and peaceful Afghanistan, and will concentrate its efforts primarily on humanitarian projects. Thus, despite the global financial crisis, we have decided to allocate US\$50 million for the education of 1,000 Afghan citizens in various civilian occupations at Kazakh schools. Other OSCE member states could develop similar programs in various fields.

In this context, the role of an important pan-Asian forum must be noted - the CICA, whose security objectives are similar to the objectives of the



OSCE. Afghanistan is a full member of the CICA and participates in a number of its initiatives - for example, in the fight against drug trafficking, as well as in countering new challenges and threats. Cooperation between OSCE and CICA could potentially turn into a global system of security in Eurasia - I think it is worthy modern goal.

The OSCE includes not only European, but also Asian countries. However, the "OSCE" abbreviation does not account this fact. Perhaps we should think about changing the name of the OSCE to the OSCEA - Organization for Security and Cooperation in Europe and Asia.

At present, when the entire world is struggling with the effects of the global financial crisis and is trying to build a post-crisis development strategy, the topics of global economy and ecology are emerging as primary areas of discussion. While many OSCE members are actively discussing these issues of concern at the G-8, G-20, SCO levels, the crisis and anti-crisis issues were not discussed at any level within the official OSCE framework.

I am convinced that more serious attention to the "secondary issues" will provide a meaningful impetus to the OSCE's work. Solving complex environmental security issues will be important during Kazakhstan's chairmanship, since a successful resolution of these problems is inconceivable without combining the resources and concerted efforts of the entire organization. At issue are not just the Aral Sea and the Semipalatinsk test site, but also many other problems across Central Asia, Europe and other regions of the OSCE.

Among the priorities for Kazakhstan's chairmanship are issues related to the development of OSCE's transportation and communications capacity. Due to a variety of geographical, historical and economic features, the Central Asian region has huge trade and transit potential and is well placed to act as a stable and secure bridge between the East and West. In this context, particular importance is allocated to the "Road to Europe" program, which involves issues of transit, transportation and logistics.

Kazakhstan is building a Western China to Western Europe road corridor. Together with other large-scale projects, this corridor will facilitate the speedy revival of a 21st century "Great Silk Road".



The "third basket" of issues traditionally occupies a strategically important place in the OSCE. Kazakhstan, of course, will give full attention to these issues during its chairmanship of the organization. It is true that security across the OSCE regions is impossible without respect for and the protection of fundamental democratic freedoms and human rights.

Kazakhstan's unconditional commitment to democratic values is evidenced by important steps aimed at further improving the country's legislation governing elections, political parties, media, and self-government. It should be noted that Kazakhstan adopted a National Plan of Action on Human Rights for 2009-2012, as well as the Concept of Legal Policy for 2010-2020. Recently, I signed into law the Statute on Gender Equality. We also intend to intensify the fight against domestic violence and to make substantial changes to legislation that protects children's rights.

It is difficult to ignore the rise in interethnic and interreligious problems across the OSCE, specifically those related to illegal labor migration and integration of ethnic Diasporas in the host societies.

There is an ongoing conflict between the well-established European system of values and cultures of fast growing ethnic Diasporas. Equally acute problems likewise arise in the Asian part of the world.

An entire group of newly independent states, which emerged at the turn of two centuries, initially focused on integration into the modern world. These new states have chosen the path of freedom and democracy.

However, I would like to make a distinction between political aspirations and civilization models. Today it is clear that the "one-dimensional world" and "universal civilization" are outdated ideas. The lifestyles, traditions, culture and ethnic history of different regions of the world should not be ignored - otherwise, a fundamental crisis would take place which will have roots in the social, cultural, and religious rejection of the Western model of development. It is equally fair to say that the values of Western civilization must be respected by other world regions, as well as by ethnic Diasporas in Western societies.

As demonstrated by the global financial and economic crisis, there are no absolute economic stereotypes, nor are there error-proof political ideas.



We are convinced that many of the modern world's most pressing problems can be solved only through collective efforts, and only on the basis of consensus.

Kazakhstan, as a multinational and multi-confessional state, is committed to the ideas of intercultural and inter-civilization dialogue, and intends to use the powerful voice of the OSCE to effectively combat nationalism, religious intolerance, racism, xenophobia and anti-Semitism.

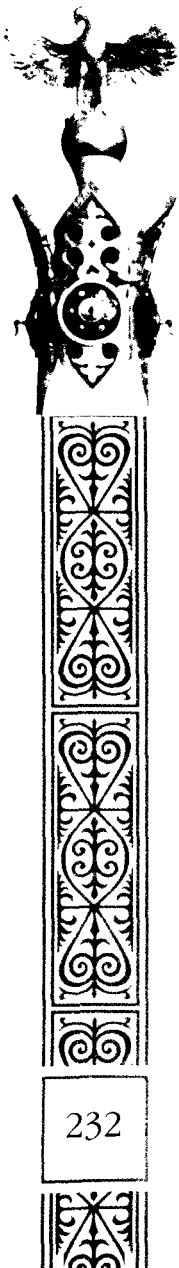
Kazakhstan will implement these noble objectives not only within the scope of the OSCE, but also in the framework of its upcoming chairmanship of organizations such as the CICA, SCO, EurAsEC, and the Organization of Islamic Conference. Let me remind you also that the United Nations adopted a special resolution at the urging of Kazakhstan that proclaims 2010 the International Year of Rapprochement of Cultures.

Our goal is to share our experience with partners in the OSCE in the sphere of interethnic and interreligious cooperation. The planned 2010 OSCE Conference on tolerance and nondiscrimination should play an important role in this effort. As a secular state with a predominantly Muslim population, as well as a member of the Organization of Islamic Conference, Kazakhstan, as the OSCE chairman, feels a special responsibility to bring together different civilizations for a better understanding between East and West. In practical terms, this overall objective would promote dialogue between the OSCE and the Organization of Islamic Conference.

This year marks the 35th anniversary of the signing of the Helsinki Final Act, as well as the 20th anniversary of the Paris Charter for a New Europe and the 65th anniversary of the end of the Second World War. The convergence of these events is deeply symbolic in nature and imposes special obligations on the OSCE and its current chairman.

We believe that the best way to understand these historical milestones in light of "the spirit of our times" would be to host the long-awaited Summit of the OSCE Heads of States in Astana, the young capital of Kazakhstan, located in the heart of Eurasia.

It should be reminded that the previous OSCE summit in Istanbul was held ten years ago, in 1999, although the Charter of the organization



designates that such summits should be held every two to three years. In this regard, we are sincerely grateful to Russia, France, Italy, Spain, Austria, Turkey, Serbia, Slovenia, Belarus and other members of the OSCE that actively supported the idea of holding this summit in Astana.

This important forum should discuss pressing and urgent international matters, such as the creation of unified security architecture, the implementation of the "Corfu Process," as well as the rehabilitation of and assistance to Afghanistan. In addition, Kazakhstan proposes to include in the summit agenda the development of the Program of Action for interethnic and interreligious cooperation.

The success of a Summit of the OSCE Heads of State would be a symbol of rebirth of the Helsinki spirit in the context of new historical conditions. The summit will give leaders of the member states a unique opportunity to compare notes and identify key priorities for the foreseeable future.

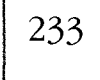
We have taken over the OSCE chairmanship with clear intentions and are ready to find solutions to concrete problems facing the organization. Kazakhstan assesses its capabilities realistically, but sets for itself the highest possible benchmarks, the achievement of which will be useful for the country and the OSCE as a whole.

Kazakhstan is counting on a successful 2010 chairmanship of the OSCE, realizing that success not only effectively promotes its national interests, but promotes the entire organization's effective adaptation to rapidly changing conditions of the 21st century.

Kazakhstan considers it necessary to achieve a more developed international legal status for the OSCE and intends to continue coordinating our joint work to develop the relevant documents.

We are realists and are keenly aware that the process of upgrading the OSCE is not confined to this year - that it is a long term task - and Kazakhstan, as an active member, is ready for painstaking and long term work to make it happen.

Kazakhstan calls on all countries that participate in the OSCE to demonstrate their readiness to act for the common interest, for the sake of



collective goals and priorities, implementation of which will support and strengthen the credibility and respect for the organization.

The OSCE must prove to the entire world that it was effective not only during the Cold War, but remains an actively developing structure that is closely interconnected with today's politics and economics.

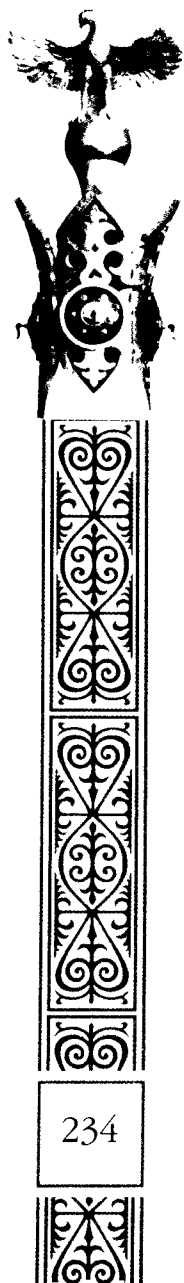
Kazakhstan's first steps as the OSCE chairman indicate serious preparation of the country for this important mission. This opinion is shared by many international experts. According to these commentators, the foreign media has published hundreds of articles, analytical estimates and projections, the leitmotif of which is as follows:

- Kazakhstan's first steps at the OSCE chairmanship indicate serious preparation of the country for this important mission;
- Kazakhstan has proposed and is implementing a clear, concrete and ambitious program of action which has already infused new dynamism into the OSCE's work;
- The proposal of Kazakhstan's President to host the 2010 Summit caused a stir across the entire organization and is currently discussed as an opportunity to give new impetus to the OSCE;
- Kazakhstan's chairmanship of the organization is a powerful incentive for further convergence of this country with Europe and for continuing consolidation of democratic standards.

All this imposes on us a large responsibility and requires systematic and effective cooperation of all state bodies.

3.1. MITIGATING THE RISKS ASSOCIATED WITH INTERNATIONAL FINANCIAL MARKETS AND THE WORLD'S RESERVE CURRENCIES

Considering the cyclical nature of the global economy's development, it is necessary to take measures that mitigate potential negative impacts of new financial and economic crises. One of the problems that are fraught



with potential risk is the global reserve currency. It seems to me that the currency markets today are not conducive for true competitive activities for all international members. I think the current crisis has proven that no national currency can effectively function as a global currency, while at the regional level there is a place for the creation of supra-national inter-state monetary units, issued by a supra-national interstate center. In a sense, the financial collapse of Iceland and the stabilizing role of the Euro have demonstrated that regional currencies could be key in reducing the risks for relatively small economies.

Another important source of risk is the volatility of capital flows. When problems develop in global capital markets, investors begin to withdraw assets from emerging markets, leading to additional pressure on the economies of these countries. For example, during the current crisis, world stock markets fell on average by more than 50% over a very short period of time. Assets either decreased in price, or were frequently devalued, which exerted additional pressure on financial institutions. This vicious circle affected both production and services industries across the entire world. The negative results from these events were significant weakening of business activity and problems with liquidity of privately-owned banks.

In this sense, it is necessary to draw appropriate lessons from the 1997 Asian financial crisis. The two most important factors that contributed to the crisis, were, first, the unrestricted flow of short-term capital from abroad, which resulted in an increase in the ratio of external debt to GDP of the four largest economies of South-East Asia from 100% to 167%, in just three years (from 1993 to 1996); as the crisis started, the ratio increased to more than 180%. The second factor was the speculative investment nature of this capital, which was primarily directed at the real estate sector, leading to the formation of a bubble that burst with the collapse of the Thai baht, triggering a chain reaction in the region.

History repeated itself a decade later, when the inflow of speculative capital into the real estate sector - especially in the United States - in the form of high risk mortgage securities, again caused the formation of bubbles that burst; this time, it led to a global financial, and then economic crisis.



In most European and Central Asian countries, the increase in the spread of state bonds in 2008 surpassed all previous records since the beginning of financial turmoil in 2007. The exceptions were Kazakhstan and Russia, where there has been a massive and timely intervention by the central banks; other regional currencies depreciated sharply, almost completely losing the gains acquired during the preceding two years. Additionally, there was a significant reduction in the capital inflow to the region. These events were directly related to the deteriorating situation in international financial markets and heralded more difficult financing conditions in the future.

It must be noted that in the fall of 2008, many analysts ranked Kazakhstan second after Iceland among the most financially "dangerous" countries that were at risk of serious banking turmoil. The Kazakh Government had US\$15 billion (US\$10 billion of which were from the National Fund) available to stabilize the situation in the banking sector. The banking sector in many other countries of Central and Eastern Europe was also vulnerable and at risk in terms of external deficits and dependence on foreign capital flows. The governments of these countries tried to regain the trust of depositors and investors, raising the guarantee on retail deposits in accordance with international norms, or tried setting unlimited government guarantees on deposits placed with commercial banks.

Prior to 2007, the Kazakh banking system had virtually unlimited access to the international capital markets, which led to excessive borrowing. In the fall of 2007, as the problems emerged on the American mortgage market, attracting and refinancing of foreign debts of Kazakh banks has become more expensive and complicated, which in turn dramatically affected domestic banks. The state was forced to take an ownership stake in the four systemic commercial banks: the Government acquired controlling equity interests in two banks, and a 25% interest in the remaining two.

Recent developments and the behavior of financial players during the crisis indicate the need to limit dependence on short-term, volatile capital flows at the regulatory level, and to focus on stable, long term loans and foreign investment.

Recent events demonstrate that attempts either to regulate capital flows, or to determine minimal capital requirements and other banking provisions,



do not produce desired results, since there is no actual limitation of risk-taking behavior by financial management. It appears that the main focus should be on developing mechanisms to minimize the possibility of such conduct in the future, because often the measures put in place to reduce risk by establishing quantitative constraints lead to opposite results. Thus, under the Basel I framework, risk-weighting (20%) applied to credit risk for all external loans of up to one year led to Western banks being more generous with short-term loans to developing countries. These requirements included 100%-wide risk-weights for loans exceeding one year, which were issued by financial institutions to countries outside the OECD - i.e., to all countries except the developed Western economies. This led to an influx of short-term capital into Asia, which caused the formation of bubbles in various markets, and, as a result, led to the financial and economic crisis. Despite the changes implemented in the subsequent Basel II framework, the situation has not changed at the start of the current crisis, whose effects we have recently experienced.

This crisis has demonstrated that it will be very difficult for legislative measures that regulate financial markets to "catch up" with the dynamics of these markets. Therefore, it is necessary to focus on developing measures to reduce risks in their broadest sense - which includes the human factor. Steps in that direction can include compulsory licensing of both legal and actual entities that participate in the financial markets - this measure has already been introduced in Kazakhstan. Financial markets oversight requires not so much a financial police, but a proactive financial monitoring authority that would monitor developments and trends, and identify new risks, and take preventive measures to avoid their escalation.

Perhaps if such a monitoring authority existed, the risks entailed by multitrillion off-balance sheet derivatives and other liabilities would have been detected in a timely manner, thus preventing or significantly alleviating the global financial crisis. Such an authority could also monitor the extent to which market participants actually comply with legislation and required norms. Such information would have significantly enhanced the effectiveness of the existing financial markets oversight. Any rapid and significant increase in risk requires a standard set of measures developed in advance - a kind of rapid response option, which would rapidly eliminate such risks at the onset.



However, any adoption of measures to regulate and maintain the stability of financial markets at the national level is insufficient in today's globalized environment, as demonstrated by the current crisis. It is time to join forces and create a brand new financial architecture, the core of which could be a global agency for regulation and supervision of financial markets.

3.2. A NEW GLOBAL FINANCIAL ARCHITECTURE

Globalization has already led to the integration of financial markets and institutions, and established a playing field with its own rules, which, in many respects, were self-regulating. Unlike tangible goods, financial capital became virtual «goods» in the sense that financial flows cross borders and continent-wide distances in a matter of seconds, bypassing real-time effective controls. The movement of capital across the globe, and the overall globalized nature of the financial sector, has made its regulation at the national level as obsolete and inconsistent with the realities of the 21st century. A gap has formed between the supranational character of financial markets and attempts to regulate and control it at the national level. Agreed-upon international regulatory standards do not have the force of international treaty obligations - they are only recommendatory in nature, making their adoption and implementation only voluntary. All this makes it possible for banks, hedge funds and other financial institutions - particularly those with extensive international branch networks - to use the difference in the regulatory framework and regulatory practices of various states to their advantage in order to escape from control over their activities.

The extent of the global economic crisis was demonstrated by the futility of a number of economic policies that were based on unconditional faith in free markets. The theoretical underpinnings for the failure of the "global economic model" lie in the artificiality of certain existing scientific concepts, and in the insolvency of some elements of modern Western "academic science."

Other causes for the inability to manage world economy are not just the fragmented, counter-cyclical measures adopted by the leading states, but also the chosen organizational form of development. A "developer" model of economic growth has been imposed on the global economy, when the



development of entire countries was defined by major subsidiaries that in turn were funded by large investment entities.

The collapse of the global investment banking system brought about the realization of the harm of financial and mortgage speculation, causing all countries to rehabilitate national economies and explore new concepts of growth. 2009 was marked by a severe global economic recession, disruption of international trade and the devaluation of traditional financial instruments, including freely exchanged currencies.

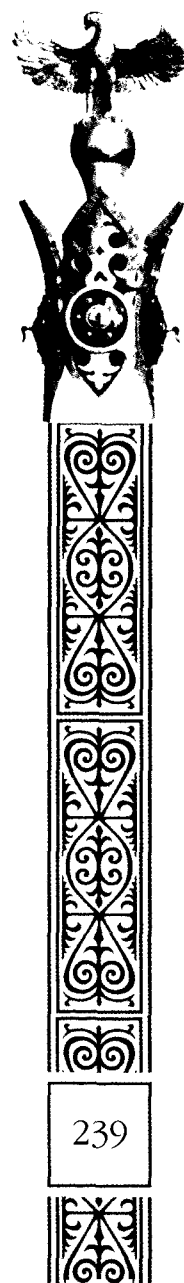
Given Kazakhstan's problems, the Government promptly moved to the regime of "manual control". This was our only choice. We could not wait for other countries - previously perceived as leaders - to overcome their own numerous mistakes. Today starts a new period of solving economic problems in the interests of Kazakhstan and not of specific organizations.

The policy of "manual control" is already recognized by international experts. Many elements of this policy have become a hallmark of the new, Kazakh model of management and an example of economic reconstruction under conditions of the global recession.

The ongoing global crisis that is shaking entire countries and continents to their very foundations is unprecedented. It is radically changing the world order and its economic foundations. Therefore, there is a need for an innovative approach for analyzing and understanding the crisis that also questions established dogmas and stereotypes.

In this regard, it is counterproductive to seek out guilty parties. It is more important to focus on identifying the underlying defects in the system that produced such powerful global cataclysms, and most importantly - on finding ways to eliminating such defects. For this, we must have the courage to admit that we are on the threshold of creating a radically new model of the world economy, politics and global security.

We have no other choice if we are to effectively use this unique chance to overcome the imperfections of the Old world and build a New one. It is clear that this will require enormous efforts of the entire world community, the mobilization of intellectual and material resources and a lot of time. We



have to build a new logic and develop new general rules for this period, which can be called the "great period of transition." But first we must try to identify the root causes of this global crisis and its origins.

I would argue that the root of the international financial and economic crisis which has shattered the dreams of literally hundreds of millions of people worldwide lies not just in the sub-prime mortgage market in the US or in the greed of bankers and others in the global financial services industry (as obviously damaging as these factors have been) but also in a fundamental, what I will call "genetic," defect in the world currency system.

The essence of the problem is that the issuance and circulation of world currencies such as the US Dollar does not meet the basic criteria of a rapidly changing global economic and political landscape. Where is the fairness, for example, of a single country pursuing monetary policies designed to meet its own domestic needs and priorities but whose decisions based purely on domestic affairs affects the everyday lives of hundreds of millions if not billions of people and the fortunes and fate of other nations?

In the eyes of those who are basically forced to use and rely on a de facto, not de jure, global reserve currency, the current situation smacks not only of unfairness, but it has no legal standing. Where are the mechanisms that should guarantee legality, responsibility, accountability and control? To put it bluntly, they simply do not exist, and will not exist unless there is a concerted global effort to find an enduring solution that would minimize the risks of the world plunging into yet another cataclysmic economic meltdown.

A radical update of our thinking can begin by giving clear-cut answers to the following seven simple questions which can guide us to rehabilitating the global reserve currency system. These questions address this issue head on and in a radical manner.

1. Is the de facto existing world reserve currency regime de jure lawful? It is obvious that in the absence of an international law on world reserve currencies signed by heads of a majority of the countries and ratified by the majority of parliaments of these countries one cannot talk about lawfulness in this matter.

It would be more correct to characterize the existing world reserve currency regime as “pre-legal” because it de facto appeared before any global law of world reserve currency which could have given it legality de jure.

That is why a currency of the New World should exist on the basis of an international Law of World Currency signed by the Heads of majority of the countries of the world and ratified by the majority of parliaments of these countries. Here one thing is clear that it would be unproductive to use national currency of any country of the world as a world reserve currency. This law should define in clear and unequivocal terms the supranational and interstate status of this world currency and principles of issuing it by specially constituted World Issue Centre. Such a system could become the basis for an absolutely lawful and legitimate world currency being adopted for the first time in the history of mankind.

2. Are the procedures followed by issuers of the world’s reserve currencies democratic? It is absolutely clear that none of the citizens of the world are participating in either decision making, or in the activity of reserve currency issue. That is why the current process of issuing global reserve currencies of the Old World is not democratic from any point of view.

In this regard all the stakeholders, i.e. the users of the New World currency could create, according to the Law of World Currency, democratic bodies for controlling its issue and the issuers, and such bodies should operate strictly according to democratic procedures.

3. Is the supply and demand of the world’s reserve currencies competitive and free?

It is obvious that the markets for global reserve currencies are not competitive and cannot be recognized as such until international institutions have been created which will be responsible for setting and supervising the rules of competitive activity of all the participants of this market.

This type of obligatory competitiveness could be ensured and be strictly supervised by a special inspection body, such as, the World Antimonopoly Currency Committee.



The existing markets for global reserve currencies do not provide equal rights to all potential issuers. It is well-known that in a free market, unique privileges for specific market participants or specific restrictions on others are prohibited. These characteristics are not observed within the existing international markets for reserve currencies. Consequently, the market cannot be described as free. The market for the New World currency could be supervised by a World Committee on Market Freedom. In this market no individual or group of issuers should enjoy any unique or exorbitant privileges.

4. Is the world reserve currency market civilized?

In a civilized market the rules of the game are decided and observed by all on the basis of a general agreement (between the sellers and the buyers) without harming individual interests. It is quite apparent that this situation does not exist in international markets for reserve currencies. Hence, today's market cannot be called as civilized.

In the market of the New World currency the rules of the game should be legally decided and observed on the basis of a general agreement between all its participants.

5. Can the system of issue for world reserve currencies be controlled by its main stakeholders (countries, companies and citizens) and the world community as a whole?

No, the current market does not permit control by its main stakeholders, or by the world community as a whole.

In this sense the system of issuing reserve currencies is absolutely uncontrolled. All the main stakeholders of the New World currency (countries, companies and citizens) should have the right to create permanently operational instruments for controlling the generation, issue and circulation of the New World currency with special provision made for such instruments in the above-mentioned proposed law. The activities of each issuer should also remain within the control of all the three branches of power: the legislature, the executive, and the judiciary.



6. Is the system of issuing global reserve currencies in international markets answerable to its main stakeholders and to the entire world community? The issuers of global reserve currencies are not answerable either to their main stakeholders or to the world community as a whole. In this sense the issuers of global reserve currencies are absolutely irresponsible, and this is one of the main reasons behind the global economic crisis.

All legitimate and lawful issuers of the New World currency should be fully answerable to its main stakeholders and to the entire world community for their actions (or inactions). This is legally and practically possible only through a body like a World Currency Arbitrage.

7. Is the system of world reserve currencies effective and results-oriented – is the system consistent with the development goals for mankind and the world as a whole?

The practical operation of the system of world reserve currencies has placed stable world development in jeopardy (as well as the existence of a uniform world currency). This clearly demonstrates that the present system is totally ineffective.

Actions of the issuers of the New World currency should fully correspond with the key goals and values of the development of the world and mankind. This new system should be consistent with the highest goals and objectives of sustainable development and prosperity. These principles should form the basis of the system of a New World currency, and also guide its operation and enforcement.

Honest replies to these seven simple questions reveal the unacceptable situation that persists in the system of world reserve currencies.

The key word that defines the new stage of global development we are experiencing today is "transit." The main goal and mission of this transit period are to preserve wealth and place the global economy on a sounder footing. In particular, this includes moving away from imbalances in international currency markets which distort the underlying value of global currencies and hurt the competitiveness of individual countries.



Kazakhstan, along with its partners in regional and continental integration (CIS, EurAsEC, SCO, etc., among others) has long been in line with the global trend of the first quarter of the 21st century - the formation of regional integration groupings. All these groupings could, in varying degrees, have the opportunity to become regional zones with centers which issue their own supranational inter-state currency.

Kazakhstan, together with its partners in the EurAsEC and SCO, is ready to gradually create favorable conditions for creating a regional currency in Eurasia

Such a currency union, given the special and unique composition of its issuers (EurAsEC and SCO states, and their neighbors India and Pakistan), would integrate with the Euro area and with other regional currency zones.

These issues must be on the agenda of all major political and economic institutions, summits and forums - UN Security Council, UN Special Session, Group of Eight, Group of 20, the World Economic Forum in Davos, and others.

Finding a practical solution to this issue requires a clear plan for radical renewal. We must realize that none of today's institutions, organizations and summits can be considered productive and effective if they do not develop and implement plans for a radical renewal.

The growing global crisis gives us unique and wonderful opportunities for self-renewal with each passing day and month, and simultaneously leaves us less time for the practical realization of those rare chances.

When talking about the possibilities of regional integration to overcome the global crisis, we should hold our national governments responsible for the effectiveness of these changes. Over the past two decades, CIS countries have gained unique experience in transition and renewal that no other states in the world possess. They must now fully use their former crisis management experience. Like all newly independent states, Kazakhstan has repeatedly overcome the most difficult times. After the collapse of the Soviet Union, we have experienced in practice the pain and difficulty of reforms. Back then, we solved problems that seemed impossible. Back then, we have won - so why not win again?

Today, we have more resources and opportunities for such a victory. More than ten years ago, we formed the National Fund by setting aside a

significant portion of revenues from raw material exports. It was created for the needs of the population, as a pool of savings for future generations, and to perform stabilization functions in case of crises. At present, this fund is working to its full potential, allowing us to maintain fairly stable progress in realization of basic economic and social programs.

It is clear that we cannot cope with global challenges of our time on our own - to do so will be incredibly difficult, perhaps impossible. That is why we are committed to integration, both global and regional - this is one of the priorities of our anti-crisis measures.

The globalization of financial markets requires a global approach to regulation. As the global financial crisis demonstrated, unregulated financial markets pose a threat not only to global economic stability and the welfare of the population, but also to the operation of the markets themselves. In this sense, the following advice by Adam Smith is applicable to the current situation: "The emperor, wishing to keep his estate in such a condition as to make it easily defensible at all times, should not only guard against the excessive multiplication of paper money which ruins the very banks which produce them, but such an increase in their numbers that leads to their control of most of the circulation in the country."

The time has come for the political leaders to take decisive action to protect the economic interests and welfare of their citizens from the unbridled pursuit of personal gain and destructive speculation. "We cannot sit idly by as this again will inevitably lead to a situation where our citizens will, as now, have to be content with a small order," said a famous philosopher John Rawls, "in order to protect others from the consequences of their lack of foresight or self-discipline."

3.3. STABILIZATION OF FINANCIAL MARKETS - MAINTAINING A BALANCE BETWEEN THE METHODS OF DIRECT REGULATION AND MARKET MECHANISMS

One of the lessons from the current crisis is the fact that without adequate regulation, market forces may be ineffective in the medium term. However, excessive regulation can also retard the growth of the financial sector and,



as a consequence, slow down the entire economy. Therefore, it is necessary to find a balance between regulatory intervention and market processes for the development of a stable financial system. However, given the economic and financial integration of Kazakhstan, the structure of our financial system will depend heavily on global financial regulation trends.

Kazakh banking system's vulnerability to external shocks increases as a result of underdevelopment of the domestic money and capital markets. The development of capital markets would promote economic growth by improving the quantity and quality of investments and create favorable conditions for the growth of financial savings. Companies acquire an expanded range of potential sources of investment financing in well-developed capital markets. In that case, bank loans cease to be the dominant source of financing, which, respectively, reduces the risks associated with future credit driven recessions.

To ensure a diversity of funding sources, Kazakhstan eventually needs to develop its domestic capital markets, since banks, limited in attracting long term foreign loans, in turn, are unable to issue long term loans in local currency. It is risky to depend on external borrowings as it increases vulnerability to external shocks. There is a need to find and develop stable internal channels of financing. This will not be easy, but it is the only way to improve Kazakhstan's financial sector and put it on a solid foundation.

The decision made in early February 2009 by the Government and the National Bank to establish state control over two systemic banks (Alliance Bank and BTA Bank) was correct and timely, although at the time, there were many different opinions on this issue. As the largest shareholder in these two banks, the Government negotiated a restructuring of their foreign debt. The restructuring of Alliance Bank's obligations has now been finalized. An agreement in principle has been reached with external creditors of BTA Bank. As a result, the total debt of these two banks will be reduced from US\$15 billion to US\$5 billion. This achievement is fundamentally important for the stabilization of the Kazakh banking sector.

The stability of the financial sector plays a crucial role in mitigating the negative effects of the cyclical nature of economic development. The National Bank, together with Kazakhstan's FMSA, has prepared a concept for the post-



crisis development of Kazakhstan's financial sector. The counter-cyclical regulation and supervision of the country's financial sector are some of the basic principles of this document. This principle implies tighter regulation and oversight in times of economic growth and relaxation of the rules in times of recession.

During a period of severe liquidity shortages for all Kazakhstan's banks, the National Bank and the FMSA reduced the amount of compulsory reserves to 2.5% for Tenge and to 1.5% for Dollar deposits, which led to an increase in the total reserves in the banking system. The National Bank tried to ease credit restrictions, gradually reducing the interest rate refinancing from 10.5% in December 2008 to 7% in September 2009. These measures supported the BTA Banks and Alliance Bank during their restructuring, while other banks must still rely on borrowing from the National Bank. It is clear that further coordination is needed between effective supervision of financial markets and monetary policy.

Kazakhstan's financial system remains fragile, and must be put on a firm and sustainable footing. It is clear that the focus should be on restoring confidence in the country's financial system, while simultaneously phasing out continued support by the public sector, enabling a gradual reduction in public spending, increasing savings from future oil revenues and allowing for more flexibility in the exchange rate. We must make full use of internal resources prior to attracting foreign loans. With this approach, we can develop domestic financial markets and improve the use of financial resources. It is equally important to study and implement the best achievements of Islamic banking.

4.1. THINKING ABOUT THE FUTURE

The economic crisis has demonstrated for the entire world how far we are from understanding global economic processes and their management in real time. Over the past quarter-century, economic theory remained



ambivalent - that is, it offered only analysis and scenario selection, rather than new solutions. However, some new approaches have become apparent, and, above all, they are based on actual observation of economic life, rather than on attempts to squeeze this life into the framework of available formula or ideology.

In particular, the difficult experience of slow growth in Japan under conditions of low inflation suggests that the dogmatic understanding of inflation as the archenemy of economic growth is not fully adequate. Some inflation is a natural process that can be a symptom of a healthy economy, while inflation's absence is not necessarily a sign of economic health. The issue here is what level of inflation answers society's goals, and it should not be the same everywhere at all times. Frederick Hayek's statement that "society's history is a history of inflation, and, as a rule, of inflation established by the government for governmental purposes," may remain valid, with the exception that the history of overcoming economic crises is also the history of government actions, rather than actions of academic economists. As acknowledged by the critics, low inflation is necessary for the mobilization of all economic resources, and is inextricably linked to the achievement of rapid economic growth.

In a democratic society, government has the duty to act in the public's interest and within its democratic mandate. Therefore, one of the approaches which must to be examined by our macroeconomists is the possibility and desirability of "manual control" of inflation processes in public's interest.

In any case, the history of last crisis exposed a shocking factor - private companies and investment banks were not only unprepared for the crisis, but failed to properly counter it, and appealed to their governments for help. Governments then assisted these corporations with public funds, which will require repayment and oversight. Where is the guarantee that private corporations will not exploit these public bailouts in the flames of the crisis?

While in theory the central bank's independence from the executive and legislative branches makes sense, the economic reality is more complicated and does not allow for the sacrifice of hundreds of thousands of jobs because of the inflexible understanding of macroeconomic



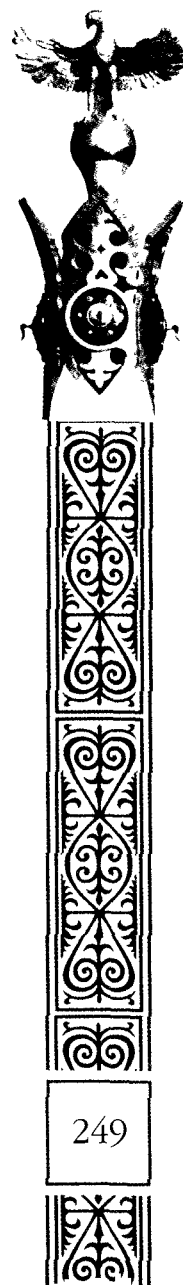
management. If we can draw a general lesson from the crisis, it is that a politician has no right to hide behind economic formulas and avoid decision-making responsibility. The world has forgotten this lesson, which was well understood by Franklin Delano Roosevelt, who saw political responsibility for economic and legal calculations.

Another important political lesson of the crisis is the need to review the means and methods of mitigating the impacts of crises on the families of our citizens. At the beginning of our journey as an independent nation, we somewhat naively adopted various concepts and methods, which, as we were assured at the time, were key to economic progress of developed nations. Over time and through our own experience, it became clear that every successful country has come to its current standard of living through unique experience - and we are also destined to undertake a very unique path to our prosperity.

In particular, in our current economy, it is of limited use to build up national foreign exchange reserves and create economic policies that solely rely on the private sector in hard times, because our companies are still far from being considered stable, and as yet are not efficient economic entities that have passed the test of severe competition; so far, they have a relatively weak structure of corporate governance and, most importantly, support only a very narrow network of social and economic interests. Taking this into consideration, our policy has to be increasingly aimed at supporting families, rather than corporate entities, as is the case, for example, in the United States.

What is now fashionably called "automatic macroeconomic stabilizers" is, in essence, an attempt to replace the political will and responsibility with soulless economic terms. These "stabilizers" (or laws and regulations) that allow most vulnerable citizens to receive support through government programs in the event of an economic downturn, must be the basis of political training for macroeconomic shocks. They are even more important than industrial diversification, since in global crisis, even the most diversified economies are unable to maintain their standard of living, and remain solvent due to huge debts.

Small countries such as Kazakhstan cannot afford to mortgage the future of its people every time another major player on the global capital markets loses their bets and causes demand to collapse.



Another option that we, Brazil, China and some other countries have partially applied is the adoption of critical economic decisions under special emergency powers that allow for economic policy's turnaround by administrative, rather than legislative actions. It is also obvious that this method does not allow the market economy to adjust in time and does not promote confidence among market participants, government and consumers. It is far more effective to have prepared, legislatively-designed fiscal and other mechanisms that come into force at the time of severe economic downturn.

There is a reason why I brought up Japan at the beginning of discussion about the lessons of the crisis. In recent years, much has been written about the stagnation of the Japanese economy, and in my conversations with government leaders, the issue of Japan's exit from the prolonged crisis was raised repeatedly. But no one wanted to admit that the Japanese recession, despite its exclusivity, carries lessons for us all. The collapse of the speculative schemes of the second-largest economy of the world, and the subsequent long period of zero-interest rates, anticipated what would happen in the United States and some European countries in 2008-2009.

Then why none of the politicians of these countries had advisers who could have learned the lessons from the Japanese experience before the collapse of the markets? In addition to the political considerations, two other factors probably played a role: first, an unshakeable belief that all economic problems can be solved with good economic growth, as measured by GDP; and second, the substitution in the political consciousness of the growth of people's living standards by the rise in profitability of companies. Let us examine each of these factors separately in order to think about new approaches to political and economic decisions.

High rates of economic growth that are close to the true economic potential can paint an overall positive macroeconomic picture. For countries such as Kazakhstan, these growth rates were natural in connection with an initially low growth level, and were desirable in order to attract new capital. However, on their own, GDP growth rates say little about the sustainability of economic development, long term direction of modernization, the future competitiveness and social equity of distribution.



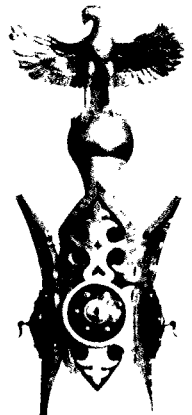
By the end of 2009, at the insistence of French President Sarkozy, the question of the suitability of the gross economic indicators for measuring the state of the economy was raised on the G20 agenda in Pittsburgh. What earlier seemed an unshakeable indicator of economic success suddenly was seen as fetish of sorts, unsuitable for making important political decisions. The financial crisis laid bare the abstract nature of many statistical indicators, from GDP to credit agency ratings, to the debt levels of European countries like Greece.

We remember the inflated indicators of the past centrally planned economies, and should be particularly critical and analytical in approaching the simplistic figures that try to reduce the life of such a complex organism as the world market to several convenient formulas. GDP growth solves the socio-economic challenges only when there is a deep understanding of its components, its growth problems, the mechanisms for its maintenance and forms of citizen participation in the formation of GDP, as well as its distribution through the consumption of both the current and future generations.

The Japanese example demonstrates that despite virtual absence of economic growth during an entire decade, the country maintained its leading position among the most powerful economies in the world and continues to be the base for many highly successful innovative companies. When analyzing the lessons of the crisis, we should not, of course, try to replicate Japanese economic realities, but also can conclude that we cannot treat all countries with a single standard and cannot designate all funds for the resumption of GDP growth at the price of enormous sacrifices. Quantitative growth should not be a substitute for quality development, otherwise various bubbles are inevitable.

The second factor that masked the onset of the recession was the rise in corporate and share prices. Only very responsible politicians like German Chancellor Angela Merkel were clearly aware that earnings growth does not necessarily mean growth in economic well-being of the country. Over the past 25 years, the most advanced corporations have shifted to a global system of procurement and supply, as well as a global system of accounting of profits and losses.

Thus, the profitability of companies has become less dependent on the state of affairs "at home", since the "home" could at any moment become a



jurisdiction where taxation or other conditions allowed for minimization of payments to the public sector. The success of many major companies was no longer synonymous with the success of countries where they were established. The leaders of major corporations no longer felt responsible to societies and did not feel oversight by the state, while state officials saw before them only a small fragment of the activities by these large companies; the state also lost the ability to judge the compliance with the basic laws of fair competition, standards of corporate governance and fiscal responsibility.

We are faced with the question of how, as we strive to get out of a severe economic crisis, we can on one hand preserve the ability of businesses to unite countries and continents in a flexible system of production and consumption, while on the other hand, avoid a break in the fundamental social contract between society and business, which underlies the method of corporate entrepreneurship.

In my opinion, the focus of international analysis should be the existence and form of corporate governance that prevailed over the last four centuries, since they no longer address societies' problem and oftentimes are neither the sole nor the most effective ways of combining venture capital. And in no way do I actually propose to disband the corporations or load them with social functions.

On the contrary, the financial crisis, as well as the previous crises caused by the collapse of "Enron" and the wave of bankruptcies of the first Internet-based companies, led to the growth in the number of rules, as well as increase in civil and criminal penalties, accounting and supervision laws, social obligations and the like - all of them ultimately failed prevent the 2008-2009 crisis, or mass tax evasion, or the immediate outflow of capital for speculative reasons, or the need to buy corporate debt with public funds.

It is obvious that the relationship between investors, managers and society is fundamentally distorted. The structure of most companies is dictated by the law of one country, or even a single state, while these companies operate globally in a completely different environment that creates a gap between the legal forms and practical business content. There is a complete separation of business from the society in which it operates, i.e. senior corporate managers do not feel part of any social environment,



and therefore do not think about devastating consequences of their actions on society.

In the current wave of globalization, major companies lost the understanding and value of citizenship and this loss was followed by the actual loss of citizenship. Rather than invent new and complex mechanisms for monitoring the same corporate interests and trying to regulate who pays whom, the policymakers of the leading countries should have initiated a review of the forms of corporate existence in order to find ways to connect business solutions to real social conditions and problems. A few timid attempts in this direction were made in the UN and in several states, while the current crisis may give policymakers and investors enough courage and impetus for major corporate modernization.

The global financial and economic crisis has demonstrated not only the strong, but also the weak sides of this model. In this sense, the current crisis is not only financial and economic, but is also the crisis of ideas about ways to improve the existing model and ways for creating a fundamentally new global financial system.

Henry Kissinger said: "Understanding what is already known is the task for the experts, but to understand what is yet to take place is the task for politicians." Naturally, politicians from different countries should learn different lessons from the crisis. However, one conclusion is obvious to all, namely: the 2008-2009 crisis is a link in the chain of formation of new international economic and political balances and, hence, the only lessons that matter will be those that help us prepare for the shocks of tomorrow without fear or prejudice, and with open eyes. I and my country are ready for change, and we are ready to change according to our own, as well as mutual, benefit.

An important trend today is the global transformation from a unipolar political system to a multipolar world order. Today, new centers are forming on the world stage that impact on global development.

A new historical period is starting that will have competing models of economic and political development.



The processes of regionalization will intensify along with the development of multipolarity. New regional markets are forming, where most of the goods and services will be produced and consumed. Continental integration groupings are also taking shape.

The protection of national economies within the same geographical space is becoming a trend in global development. We are seeing examples of that in Latin America, the Gulf region, and East Asia. Previously, this process began in the Euro area.

A NEW STRATEGY IS NEEDED

This shift has encouraged Kazakhstan and our CIS neighbors to verify the viability of our development strategies and to determine our place in the complex interconnection of global and regional interests in Eurasia.

The CIS countries have to find adequate answers to history's new challenges. 16 years ago, in March 1994, I initiated the establishment of a Eurasian Union in the walls of the Moscow State University. My proposed concept was based on a voluntary, equitable integration, as well as joint political-economic development of post-Soviet states, and the general promotion of the CIS countries to strong positions around world.

This idea was received ambivalently back then, which perhaps was natural. In the first years of independence, all CIS countries experienced euphoria from finally acquiring a long-awaited sovereignty.

However, this idea has not lost its relevance over time. Moreover, over the years, it has gained broad support, both among politicians and in the social circles of the CIS countries.

The real embodiment of the Eurasian initiative was the work of a number of inter-state structures, such as EurAsEC, CSTO, SCO and others.

Today, when all CIS countries are seeking ways to counter the global crisis, when it is impossible to single-handedly overcome economic problems, fate once again confirms the relevance of the Eurasian integration concept.

Today, I am even more convinced that in the long term, Eurasian integration has no alternative.



"Well-being is like a tender, but reckless mother, who spoils her children," warned Seneca. In the previous favorable environment, we often closed our eyes to the factors that hindered the integration processes within the CIS. Today, we have no right to do so. Only by working together can we achieve sustainable economic development of our states.

The consequences of the global crisis are dispelling many illusions. In the current situation, we should not wait for assistance. Yesterday's donors today have to deal with their own, much larger problems. If we do not take care of ourselves, then no one will care for us.

THREE DIMENSIONS OF EURASIAN INTEGRATION

In putting forward the initiative to establish a Eurasian Union, I was aware that this process could take place several decades. Still, we have done a lot in 16 years. Most importantly, the theory of Eurasian integration was translated into practical action.

Today we can speak of three-dimensional integration of the Eurasian region - economic, military-political, and cultural-humanitarian.

Following the Asian financial crisis of the late 1990's, many post-Soviet countries realized the need for closer convergence of their economies. As a result, the EurAsEC was formed. To date, this is the most promising structure of interstate integration among the Eurasian regional associations.

Significant steps to establish a regime of free trade in goods were taken within the framework of the EurAsEC. This has increased the volume of trade of the participating countries of the Community by 3.5 times, and the total volume of mutual investments - almost by 5 times.

Real mechanisms of financial integration were created within the framework of the EurAsEC. For example, today, the Eurasian Development Bank is funding a number of projects in Kazakhstan, Russia, Belarus and Tajikistan.

At the February EurAsEC summit in Moscow, a number of breakthrough projects were adopted, such as the creation of joint US\$10 billion anti-crisis



fund, as well as the creation of an international high technology center. These structures are designed to soften the blow of the global crisis on the economies of the community members.

Specific economic projects were discussed and adopted under the auspices of the EurAsEC, such as the creation of a common energy system, joint cooperation in the field of peaceful nuclear energy, the construction of Eurasian transport routes and others.

A Customs Union was formed by three countries - Kazakhstan, Belarus and Russia. The next step could be a EurAsEC monetary union and the establishment of a Eurasian supra-national monetary unit.

None of these initiatives existed 16 years ago. Of course, much remains to be done. But I am convinced that the established structure, the implementation of joint projects and outlined prospects for joint cooperation bring us closer to the creation of a genuine Eurasian economic union.

The second dimension of the Eurasian integration process - military-political - is associated with the work on regional security.

At the end of the last century, members of the 1992 Collective Security Treaty adapted the document to address the new threats to global and regional stability.

Now the treaty enters a new phase in its development. A decision was made at the Moscow summit to establish a collective rapid-reaction force. This is a concrete step in the strengthening of military security in the vast region of northern Eurasia.

The Joint Air Defense System, growing military-technical cooperation, joint exercises of military units within the CSTO framework - all are part of a single defense space currently in the process of formation.

The creation of the CIS Anti-Terrorist Center was an answer to the threat of international terrorism. Law enforcement agencies of our countries are strengthening joint efforts against cross-border crime, drug trafficking, and illegal migration. These are also important components of the Eurasian integration, which emerged over the past 15 years.



Today, the "Asian vector" of Eurasian security includes such frameworks as the SCO and the CICA. Their development would be impossible without the support and active participation of many post-Soviet countries.

"The European direction" of Eurasian security is associated with the activities of the OSCE that we chair this year.

Kazakhstan is a collective protege of the CIS countries for this post, so for us it is not only an honorable mission, but also a great responsibility. As chairman of the OSCE, we will strive to ensure that the world's largest continent - Eurasia - would become a common space of peace and understanding among people.

There is a third dimension, the significance of which now comes to the fore.

The efforts by the presidents and governments are not enough in the integration process.

In recent years, the Eurasian idea has been accepted by many intellectuals in the post-Soviet countries. The Eurasian Scientists' Club was created. The Eurasian Media Forum and Eurasian Academy of Television and Radio are working on the formation of a common information space, while the Eurasian Association of Universities is working on a similar educational effort.

Today, our challenge is to build a rich intellectual heritage and use this knowledge for innovative development of the region, and we should urgently do so. Therefore, the cultural and human dimension of the Eurasian integration process is becoming extremely important, especially at this stage, which, in my opinion, should be developed along the following lines.

First, the task of quick transition to innovative development – we must support the scientific community in carrying out this task. That is why the year 2010 is declared the year of science and innovation in the CIS. We need to develop the interaction of scientists within the framework of the Eurasian Club of Scientists. The Center for High Technology and The Eurasian Bank of New Technologies should be open to cooperation with all interested research centers in the CIS.

In the near future, we should identify specific and most promising areas of research and collaboration that include space, nanotechnology, information technology, energy and energy efficiency.



We need to think of the mechanism that would promote innovation to the markets of our countries and other regions of the world. We are willing to finance the participation of Kazakh scientists in research projects in Russia, Ukraine and other CIS countries.

Second, we must work together to create a new quality of education - in fact, we should create a common Eurasian educational environment.

Kazakh universities, in turn, are open to students from CIS countries. We annually allocate education quotas for the citizens of Kyrgyzstan, Tajikistan and Turkmenistan.

The "Erasmus Mundus" program is very popular in the European Union. It aims to promote cooperation in higher education and freedom of movement for students and postgraduates. We can create a similar Eurasian program that would bear the name of Leo Nikolayevich Gumilev.

Perhaps we could create "Eurasian chairs" at leading educational institutions of CIS countries, which could unite scholars and students, with the Eurasian National University offering necessary guidance to colleagues.

A wise man once said: "while the world as a whole moves forward, the youth have to start at the beginning every time." Therefore, thirdly, special attention should be given to working with young people.

Without efforts in this direction, a new generation of our citizens may lose the connecting thread that unites our people. We must not let this happen. We need to systematically support various forms of youth exchanges, as well as cooperation between youth organizations and youth leaders between our countries. Why not teach the languages of the CIS peoples at our universities? It is the richest stratum of the culture of the Eurasian space, which I hope will be kept up by future generations!

Fourth, we must not forget about the formation of a common Eurasian identity based on shared values of cultural and linguistic diversity. This implies promotion of various Eurasian cultural projects: festivals, master classes, exhibitions and conferences.



Of particular importance is a common concern about the strengthening of spiritual and moral values in our societies. To this end, we should create a platform for meetings between representatives of relevant associations.

Fifth, it is necessary to ensure maximum freedom of movement for citizens of our countries. At one time, Kazakhstan has proposed the initiative "Ten simple steps for the common people." I think that in the near future, we should take all necessary measures to remove obstacles to free interaction between the people of our countries. These are basic, but at the same time, crucial factors such as a free crossing of borders, access to sources of information, as well as access to education and health services in all countries.

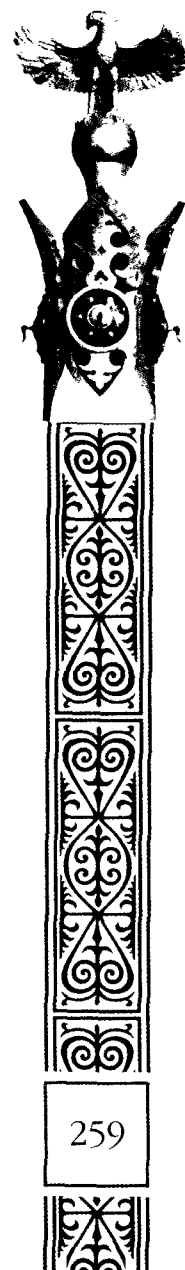
The most perfect political and economic integration effort is doomed to failure if it is not supported by the energy of active individuals. That is what connects various states with thousands of strong threads. Our main goal is to preserve and develop this energy.

I am deeply convinced that the Eurasian community can become a global force in the world economy and politics of the 21st century if it is based on equality, voluntariness and mutual interest.

The world is changing. New alliances are forming against the backdrop of serious economic challenges and international security issues. Global trade and economic processes and close collaboration between states blur boundaries, deepen relationships and create new opportunities. Kazakhstan, like most other emerging democracies, is looking to the future with cautious optimism that is based on the difficult lessons of history. Politics always has consequences, and alliances can provide both the freedom of action and its absence. Such leaders of superpowers as Presidents Barack Obama and Dmitry Medvedev can, with one stroke of a pen, reverse a decade of estrangement, setting in motion the forces and processes that affect us all.

Kazakhstan and Central Asia, located between Russia, China, Iran and Afghanistan feel, like no other, the effects of such influence. Here, a light breeze in diplomatic relations between countries such as Russia, the United States and China can have the powerful impact of a storm, and it certainly makes us think about our role and influence in these relationships.

Some countries prefer to brandish weapons to attract more attention and get a concession here or there. Certainly, their tactic allows them to be in the



center of international attention. Other countries are putting pressure on America and the Western democracies to the very limit, and then retreat for the next round of strategic pressure in their quest to take a place in the nuclear powers club. However, the emerging democracies such as Kazakhstan, although not in the media spotlight, are playing a responsible role in world affairs, which is much more important for the welfare of all freedom-loving nations.

The initiative of Presidents of Barack Obama and Dmitri Medvedev to reduce their countries' nuclear arsenals by one third once again recalls a role for Kazakhstan. Our nascent democracy's decision exactly 18 years ago to shut down the Semipalatinsk nuclear test site and the subsequent decision to liquidate the Soviet legacy - 104 SS-18 intercontinental ballistic missiles, each carrying ten nuclear warheads - influenced the current size of these arsenals. For historical comparison: it is believed that North Korea, which is watched by the entire world today, possesses enough plutonium to create no less than a dozen nuclear bombs.

By retaining nuclear weapons, Kazakhstan, perhaps, could have become a more influential player in this potentially volatile region, and, of course, would be much better known globally. Some even tried to persuade us not to abandon our nuclear arsenal. However, our decision was guided by more important considerations, including understanding the role and responsibility of emerging democracies. Our main goal was to create a new economic and political model in Kazakhstan, and we firmly believed that our future prosperity depended on security, trade and investment relations with the West.

Our task was to implement what I would call "creative leadership"; that is, pragmatic and constructive interaction with numerous, and often very complicated, forces in our region. It is this philosophy has led us to renounce nuclear weapons and to actively develop relations not only with the United States, but also with Russia, China, Iran and, indeed, all countries wishing to cooperate with Kazakhstan.

We celebrated the anniversary of that decision on August 29. The philosophy of "creative leadership" that inspired us to adopt that decision continues to benefit both Kazakhstan and our international relations. The commitment to democratic values, as well as to the rule of law, transparency, tolerance and free trade has allowed us to create a stable state with an established and well-educated middle class. This stable foundation enables us to play an important role in the international arena through strategic



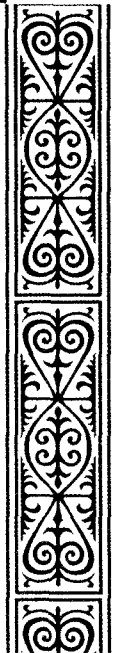
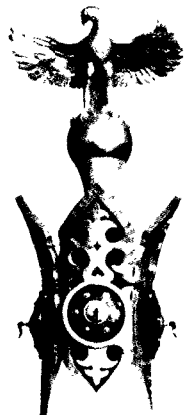
collaboration that provides opportunities for interaction with countries, which are often neglected or are generally not inclined towards cooperation.

Democracies firmly support each other by sharing common values of freedom and peaceful development. That is why following the September 11 attacks which shocked all humanity, Kazakhstan stands shoulder to shoulder with the United States in combating international terrorism and continues to provide much-needed assistance in efforts to stabilize Afghanistan.

As an emerging democracy that preaches "creative leadership", Kazakhstan is in a position to encourage dialogue even between the warring parties. One example of our achievement is the 3rd Congress of Leaders of World and Traditional Religions, held in Kazakhstan, which brought together religious leaders of almost all countries and religions to uphold tolerance and understanding. Similarly, our willingness to establish an international nuclear fuel bank under IAEA leadership that would allow Iran and other countries to openly and honestly implement their energy programs finds support from leaders of the United States, Russia and China.

That is how fledgling democracies can contribute to world affairs. The "newcomers" in the global arena of freedom can be the catalysts for creating a climate for the adoption of truly pragmatic decisions, because they are not carrying deep-rooted, sometimes dogmatic, contradictions of the past. President Obama understands this well. Two weeks after his election, he called me to discuss regional cooperation, the measures for nuclear nonproliferation and energy cooperation. During this conversation, and in his subsequent speeches, President Obama has made it clear that he values pragmatism as the foundation for civilized conduct of state affairs.

Some have suggested that such an approach is clearly inconsistent with the objectives of the new turn in foreign policy, promised by President Obama. But I think such criticism is unwarranted, since pragmatism is needed in nation-building. Pragmatic policy causes a positive reaction from partners much sooner than the so-called "ideological crusade." This challenge is well understood by emerging democracies, which must undertake in a decade what America has spent more than 200 years perfecting. Creative leadership is our important contribution, as well as a key example that we can give to others.





ALL TOGETHER

The world economic crisis seems to be on the decline. There are figures that contribute to the optimistic mood. A marked recovery is noted in the investment and banking environments and in the global economy in general. But the problem is global enough not to unreasonably idealize the situation. The Davos World Economic Forum is predicting the second wave of full-fledged crisis with dire socio-economic consequences for the world in the near future. The global cataclysms may, in particular, lead to the growth of public debt to mitigate the crisis in developed economies. The financial crisis and the subsequent recession have created a more fragile environment, in which risks that are left unattended can become tomorrow's crises. I consider myself neither an optimist nor a pessimist. Today, one thing is clear: in a rapidly changing world with its simultaneous globalization and fragmentation, a global response to global challenges has yet to be formed.

How will the financial world look like tomorrow? Everyone agrees that it should be different - but how different, and how to build it? What will be the principles regulating global financial markets after the crisis? What role will individual countries and international institutions play in the future global financial architecture? Would there be a trend towards the formation of regional currencies, or will a new world currency, not tied to any of the national currencies, be created? Is the world ready to create supra-national institutions of oversight and regulation? Will new international financial institutions be created?

In short, it is essential for the best economic minds, government and business leaders to argue, discuss and try to better understand the causes and mechanisms that nearly led to complete economic collapse. We, the Kazakhs, have already incorporated our ideas into a common search for the optimal model of the global financial and economic architecture. And if such a process would not be complimentary, or excessively "politically correct", then we would need to come to tough conclusions and revise many of the seemingly irrefutable truths.

For us, in Kazakhstan, the lessons of the crisis became an additional incentive for constant renewal and development. As part of our Strategy 2030, we have successfully implemented our goals over the past ten years and have clearly articulated specific tasks and objectives for the next stage, until 2020. We carefully analyzed and calculated all our possibilities for the next decade. And we continue to build an independent, prosperous, and politically stable Kazakhstan - a new Kazakhstan in the new world.

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N. A. NAZARBAYEV

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