Policy Insights

Regional Policies to Support Diversification and Productivity Growth in Kazakhstan

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Policy Insights

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Foreword

Setting an enabling policy framework for regional development is one of the key challenges facing Kazakhstan. Kazakhstan has set itself ambitious targets for achieving strong and inclusive growth while shifting from a resource-intensive growth model to a more diversified, sustainable one. Reaching these goals requires reforms to support the development of new, competitive economic activities in the regions that can contribute to national growth while increasing local populations' well-being.

Since 2012, Kazakhstan has been co-operating with the OECD on the topic of regional development, including through the OECD Regional Competitiveness Project (RCP) conducted in the framework of the OECD Eurasia Competitiveness Programme. The project is financed by the Ministry of National Economy. It provides a combination of analysis, policy recommendations and capacity-building activities to support economic growth and diversification in the regions of Kazakhstan. This report was prepared within the framework of the second phase of the OECD RCP, which is implemented over a two and a half year period, from January 2018 to April 2020.

This report analyses regional performances against Kazakhstan's current regional policy objectives, and identifies the main challenges. It suggests avenues for reforms in areas critical to address these challenges. It draws on the work done under the RCP, secondary research and input from the Ministry of National Economy of Kazakhstan, but also on the OECD Territorial Review of Kazakhstan (2017), the OECD Urban Policy Review of Kazakhstan (2017), the OECD study on SME and Entrepreneurship Policy in Kazakhstan (2018), and the review on Decentralisation and Multi-level Governance in Kazakhstan. It is to be presented and discussed on the 18 March 2020 during a thematic session of the OECD Eurasia Week in Tbilisi, Georgia.

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Executive Summary

1.1. Main findings

Since 2010, Kazakhstan has conducted a regional policy focused on the development of growth centres that would act as engines of national economic growth. These include large agglomerations and designated sectoral clusters across the territory. Recognising the importance of all regions for national growth, the government has also worked to boost growth in remote areas, focusing mainly on SME development.

Kazakhstan's regional strategy **has given positive results in generating economic concentration**: the aggregate contribution to growth of the cities of Almaty and Nur-Sultan rose from 27.5% to 31.8%, enabling the realisation of agglomeration benefits and raising productivity there. Inequalities among regions are high by OECD standards, but lower than in other fast-growing emerging market economies. Moreover, inter-regional disparities in GDP per capita levels are declining overall, albeit with some exceptions. Inequalities in public services like education and healthcare nevertheless need to be addressed.

This approach **has not yet delivered economic diversification at sub-national level, however**. Outside the two largest agglomerations, growth is still driven largely by resource extraction. Between 2013 and 2018, resource-rich regions, Almaty city and Nur-sultan accounted for 74% of aggregate growth. Productivity levels are low and vary greatly across regions: Atyrau, the best-performing region in terms of output per worker, is 9.6 times more productive than the least productive region. In the OECD, the average ratio is 2.2.

One problem is that **the overall approach to diversification remains very "top-down"**. The country has moved in the direction of greater decentralisation of competences and resources, but further steps are needed. Regions remain heavily dependent on central priorities and incentives. They also have limited capabilities – organisational, financial and human – to develop locally grounded development policies. Current policies mainly reflect cluster approaches that focus on the development of designated sectors in specific locations. Such approaches fail to take sufficient account of local specificities.

1.2. Main recommendations

The implementation of place-based policies could help Kazakhstan strengthen local economic growth. The OECD approach to regional development emphasises work towards the realisation of each region's potential by relying on its specific strengths and assets, the use of complementary policies, and a multi-level governance model. To address current challenges, Kazakhstan needs to focus on two axes for reform.

First, the country needs to develop **place-based policy approaches and tools to support the development of economic activities based on local strengths and assets** and to realise **further agglomeration potential,** notably in large and secondary cities.

- **Adoption of the EU's "smart specialisation" framework and tools across different levels of government could foster more efficient and dynamic regional specialisation.** Kazakhstan should relax the constraints on the concentration of economic activities and offer more opportunities to identify and nurture nascent activities. The EU framework for smart specialisation – and in particular one of its core tools, the Entrepreneurial Discovery Process (EDP) –

could help Kazakhstan to evolve a bottom-up process leading to the identification of new economic opportunities grounded in local strengths and assets.

- **Stronger regional stakeholder consultations at regional and local levels would assist the articulation of more integrated programmes targeting local economic activities**. These should encompass all aspects of the cluster approach – innovation and technology diffusion, SME development, and investment skill policies. A greater private-sector role in such processes will be critical.
- **More can be done to foster cross-sectoral linkages and regional and local levels, in support of cluster development**. Regional technology transfer offices, for example, could enhance local linkages between business and research. To better link governments with academia and research institutions, the government should gradually increase the funding of research in public institutions. Financing rules and other policies can do more to facilitate the resource sharing and co-financing required in collaborating and joint initiatives.
- **Investments in connectivity and quality urban infrastructure will yield greater economic payoffs when embedded in broader regional development plans.** Physical infrastructure aspects are critical to connect Kazakhstan to foreign markets, and to realise fully the potential of agglomeration economies in the country. This includes the development of secondary national and regional networks needed to connect regions to the main overland corridors that are emerging across Eurasia. The government should also implement the recommendations delivered in the *OECD Urban Policy Review of Kazakhstan*.

Second, **the governance framework should be strengthened to deliver place-based policies**. In particular:

- **Subnational authorities need better regional/local data and fewer – but better co-ordinated – plans.** The digitalisation of the economy – including public services – should provide avenues to make this happen as well as the adoption of international standards and methodologies, such as the usage of the concept of *functional urban areas*. Finally, policy monitoring and evaluation indicators need to be fewer but better, and plans require better co-ordination, for example by improving cross-sectoral planning.
- **Further decentralisation can give regions and local authorities the scope to become much more effective promoters of economic development.** Election could be expanded to akims at all levels, and the role of the maslikhats in the budget process could be reinforced. Subnational governments could be provided more financial leeway and responsibilities, as well as training, technical assistance and guidance on local policy delivery, such as budget management.
- **Subnational development efforts would also benefit from better co-ordination, both within the government and between the state and the private sector and civil society.** Strengthened co-ordination across different levels of government and between akimats could be achieved through tools and platforms such as working groups and task forces involving an adequate level of representation from each stakeholder organisation. Increasing inclusiveness in the policy-making process requires strengthening the role of public councils by increasing their independence and enabling them to conduct more public hearings. Tools such as participative budgeting would enable to engage further with local citizens.

1. Introduction

Kazakhstan's future economic prosperity will largely depend on its success in addressing two inter-related challenges. The first is to diversify its economy and reduce its dependency on natural resource-related activities. The end of the commodity super-cycle, which culminated in sharply falling oil prices in 2014-16 clearly illustrated the "diversification imperative", as the country experienced a sharp currency devaluation, a drastic slow-down of exports and overall economic growth, and serious stress on public finances. The second challenge concerns productivity. Kazakhstan's labour productivity is currently half that of the upper half of OECD countries, notably due to distortions induced by the weight of State-Owned Enterprises in the economy (OECD, 2019[1]), and productivity growth has slowed significantly since the early 2000s. According to the World Bank, productivity growth's contribution to annual GDP growth went from 6 percentage points in the early 2000s to around -2 percentage points between 2014 and 2016 (World Bank, 2019[2]). The Bank finds that this slowdown originates in a slowdown in within-sector productivity improvements, as some of Kazakhstan's workforce has been reallocated to lower-value activities within sectors such as construction and services. Reversing the trend, and enhancing productivity growth through the reallocation of the labour force towards higher value-added activities, will require the creation of new sectors and economic opportunities.

The upgrade and expansion of the private non-oil sector, via increasing private investment – including FDI – and the development of entrepreneurship and SMEs, stand at the heart of Kazakhstan's diversification and productivity challenges. This is what the country designates as its objective of being a "competitive economy". Kazakhstan wants to become an attractive destination for multi-national companies looking to expand their operations in new markets and territories, considering this as a means to develop local industries and diffuse new technological and managerial models. It also aspires to become the birthplace of successful companies, capable of meeting domestic demand in goods and services, and taking leadership positions on international markets.

This does not mean that the authorities' attention should focus exclusively on policies targeted at investment, entrepreneurship and SME development, although they have their rightful place. Many other policies affect the environment in which the private sector can develop and contribute to ensuring that this development is conducive to higher living standards for all citizens. The creation of an enabling environment for businesses and SMEs often necessitates wide-ranging structural reforms. The OECD Policy Framework for Investment, for example, covers 12 different policy domains, including tax, competition, trade, finance, responsible business conduct, and public governance. It is not surprising, therefore, that co-operation between Kazakhstan and the OECD has consisted in a broad discussion on economic policies, and that all of its different components – or different policy fields – should be considered as the different pieces of a single puzzle.

Regional policy is specific because it does not consist in focusing on a specific area such as innovation, education or governance, but it rather considers the sub-national scale as its unit of analysis. Almost all states have two- to three-tier territorial-administrative systems (Thoenig, 2006[3]). For national governments, the importance of policies to support territorial development reflects two important realities: first, people's well-being is strongly influenced by where they live and work; and, secondly, it is often possible to identify opportunities and potential policy complementarities at local or regional level that are not apparent from national capitals. Leveraging this potential creates a double dividend of both

increased aggregated productivity and inclusion (OECD, 2019[4]). Rather than being a fixed set of policies, regional development policy aims to bring an integrated strategic framework to the implementation of a variety of policies targeting sub-national economic growth.

While there was once a prevailing tendency in most countries to focus almost exclusively on infrastructure development for lagging regions, it is now widely accepted that good regional development policy encompasses *all the major facets of good economic policy, except macroeconomic instruments*. That is, it concerns the alignment and co-ordination at regional level of policies concerned with such diverse topics as entrepreneurship and SME development, human capital, innovation, and the business environment. OECD (OECD, 2009[5]) shows how the impact of more "traditional" investments in infrastructure depends on how these other issues are addressed: undertaken in isolation, they often result in perverse outcomes, but when implemented as part of more complex policy packages, they can deliver good results.

In the case of Kazakhstan, a sound regional policy can help unlock growth potential in all regions and contribute to fostering sound local business environments, based on local specificities. In particular, regional policy can support the diversification of regional economies relying on natural resources, reveal growth potential in regions that are less well endowed, and help maximise the effects of agglomeration economies, notably urban areas. The most effective policies for diversification do not necessarily focus on specific *sectors*, but rather on developing and diversifying regions' *endowments* – the stock of local natural, human, physical and financial capital, which, in the case of Kazakhstan, varies significantly from region to region. The right mix of national and regional policies to identify and leverage this capital is essential. At the regional level, an integrated policy framework can help articulate the different components into a clear vision on the path towards diversification and better productivity. This is how regional policy can eventually contribute to the country's overarching objective to build a more diversified, sustainable economy, and become one of the top 30 global economies by 2050.

This paper discusses how Kazakhstan can improve its regional policy by adopting a more bottom-up, place-based approach in areas where a high degree of centralisation has sometimes prevailed. The next section provides an analysis of the country's regional performance and current approach to regional policy, and highlights outstanding challenges. Chapter 2 presents recommendations to further root policy actions in the local context of each region. Chapter 3 provides directions to enhance the governance framework and enable such locally rooted approaches. This is followed by a short conclusion.

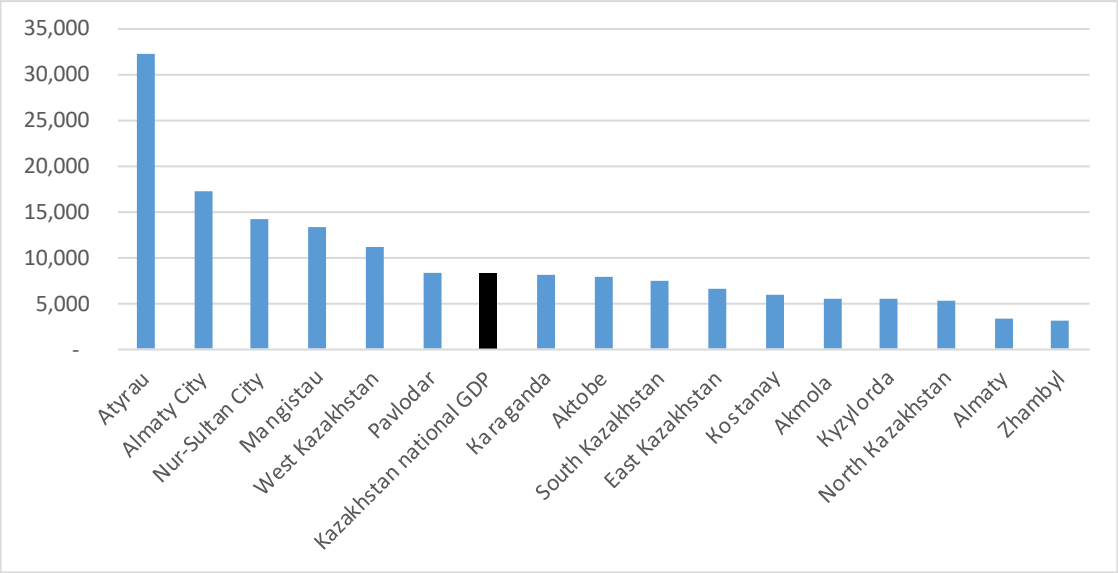
1.1. Despite some convergence in recent years, Kazakhstan faces large inter-regional disparities

1.1.1. Per capita gross regional product varies widely across regions

Gross regional product (GRP) per capita is the highest in the Western regions bordering the Caspian Sea (Atyrau, Mangystau and West Kazakhstan), where the main oil and gas deposits are located, and in the two largest cities, the former capital Almaty, and Nur-Sultan, the country's administrative capital since 1998 (Figure 1.1). The Pavlodar and Karaganda regions, which host the largest coal mines, also have per capita GRP levels on par with the national average. Ten of Kazakhstan's 16 regions have lower GRP per capita levels than the national average, despite the minerals concentration of two (Karaganda and Aktobe).

Figure 1.1. GRP per capita in Kazakhstan regions, 2018

In USD



Source: Author's calculation based on data from Kazakhstan's national statistics agency, www.stat.gov.kz (accessed 28 August 2019).

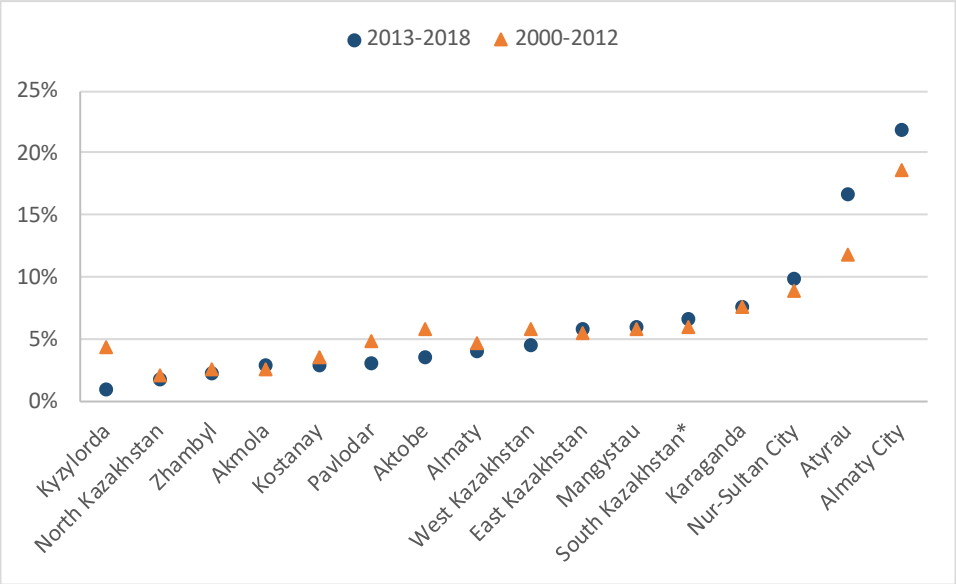
1.1.2. A few regions drive most aggregate growth

A region's contribution to national growth depends on two main factors: its dynamism, measured by its growth rate, and the size of its economy. The analysis of regional contributions enables to understand which regions are particularly important for national growth. OECD work has shown, however, that although big national hubs disproportionately contribute to and impact national growth in OECD countries, most growth still occurs outside the hubs: the combined performance of all the regions outside of these hubs is critical, and should not be neglected (OECD, 2011[6]).

In Kazakhstan, regional contributions to aggregate growth confirm the importance of the regions specialised in extractive industries and the two largest agglomerations of the country (Figure 1.2). The city of Almaty, Atyrau and Nur-Sultan accounted for nearly half of aggregate national growth between 2013 and 2018. Together, resource-rich regions and the two urban regions accounted for 74% of aggregate growth.

Figure 1.2. Contribution to national GDP growth by TL2 regions in Kazakhstan

Contribution share of each region, %



Note: (*) For comparability reasons, Shymkent is included in the South Kazakhstan region, although it acquired the status of city of national significance in 2018.
Source: Author's elaboration on data from Kazakhstan's national statistics agency, www.stat.gov.kz (accessed 28 August 2019).

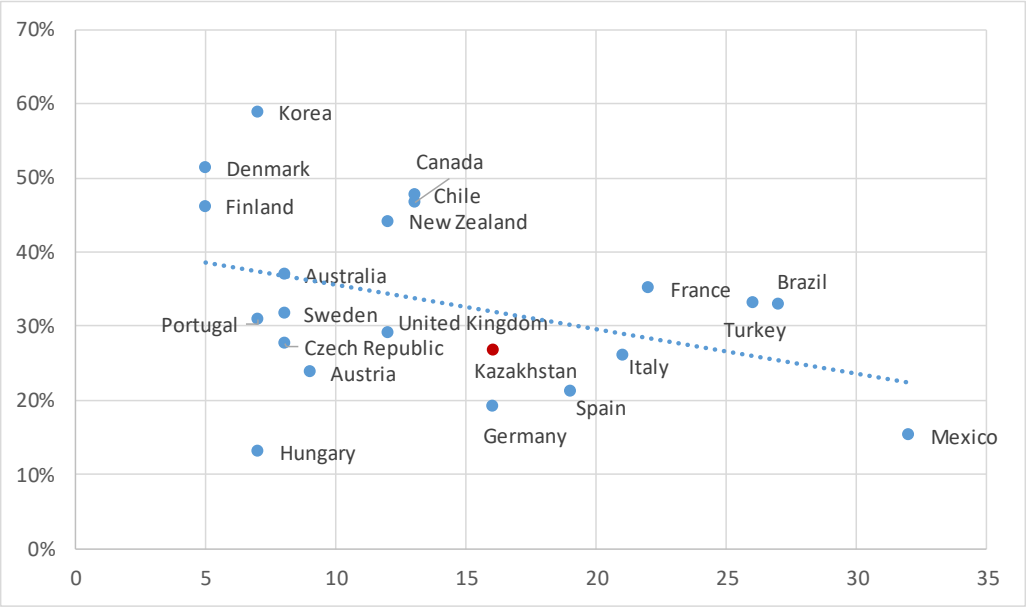
Between the two periods of 2000-2012 and 2013-2018, the contribution of the two main urban hubs to the national aggregate growth increased, while the combined contribution of regions specialised in extractive activities decreased. The aggregate contribution of Almaty city and Nur-Sultan rose from 27.5% to 31.8%, mainly due to the growth of Almaty's contribution. This trend does not take into account the performance of Shymkent, Kazakhstan's third largest urban area, which acquired the status of "city of national significance" in 2018, as its population reached one million; for the periods under consideration, Shymkent was still part of South Kazakhstan. The combined contribution to national aggregate growth of regions specialised in extractives, on the other hand, fell from 45.7% to 42.2%. Although Atyrau's contribution increased from 11.9% to 16.6%, as production began in the Kashagan oil field in the north Caspian, all the other extractive regions' decreased or remained the same.

There is still room for further agglomeration economies (Box 1.1). For a country of its size, Kazakhstan still has a relatively dispersed pattern of settlement and economic activity and its principal cities are not very large, although the country has been moving closer to OECD averages in the past few years. In the OECD area, large regional hubs typically account for disproportionate shares of aggregate growth. Taking the OECD as a whole, over the 1995-2007 period, large hubs representing about 4% of all regions accounted for almost one-third of aggregate growth (OECD, 2011[6]). Within countries, proportions tend to vary, depending on the number of regions (OECD, 2017[7]). In many OECD countries with a number of regions close to Kazakhstan's, the main regional hub's contribution to aggregate growth is higher than Almaty's (Figure 1.3). The OECD Urban Policy Review of Kazakhstan (2017[8]) highlights that Kazakhstan's three largest urban agglomerations account for 23.1% of the overall population, whereas in OECD countries, the average is

48.6%. The OECD Territorial Review of Kazakhstan (2017[7])also highlights that second-tier cities could contribute further to aggregate growth through agglomeration economies.

Figure 1.3. Main hub region's contribution to aggregate national growth in OECD countries

Contribution share in %, 2000-2017



Source: Own analysis based on the OECD Regional Statistics database, http://dotstat.oecd.org/?lang=en (accessed 29 August 2019).

Box 1.1. What are agglomeration economies?

The mechanisms that make it beneficial for firms and workers to be located close to each other are often summarised under the name *agglomeration economies*. Three main mechanisms work to produce them:

1. Mechanisms that deal with the **sharing** of:

- *Indivisible facilities* such as local public goods or facilities that serve several individuals or firms. Some examples, other than public goods, are facilities such as laboratories, universities and other large goods that do not belong to a particular agent but where some exclusion is implicit in providing them.
- The gains from the wider *variety of input suppli*ers that can be sustained by a larger final goods industry. In other words, the presence of increasing returns to scale along with forward and backward linkages allow firms to purchase intermediate inputs at lower costs.
- The gains from the *narrower specialisation* that can be sustained with higher production levels. Several firms specialise in producing complementary products, reducing overall production costs.

- *Risks*. This refers to the idea that an industry gains from having a constant market for skills. If there are market shocks, firms can adjust to changes in demand if they have access to a deep and broad labour market that allows them to expand or contract their demand for labour.

2. **Matching** mechanisms by which:

- Agglomeration improves the expected *quality of matches between firms and workers*, so both are better able to find a good match for their needs.
- An *increase in the number of agents trying to match* in the labour market also improves the probability of matching.
- *Delays are alleviated*. There is a possibility that contractual problems arising from renegotiation among buyers and suppliers will result in one of the parties losing out to the other party in a renegotiation. However, if the Agglomeration is extensive enough, agents can find an alternative partner.

3. **Learning** mechanisms based on the generation, diffusion and accumulation of knowledge. This refers not only to the learning of technologies, but also to the acquisition of skills.

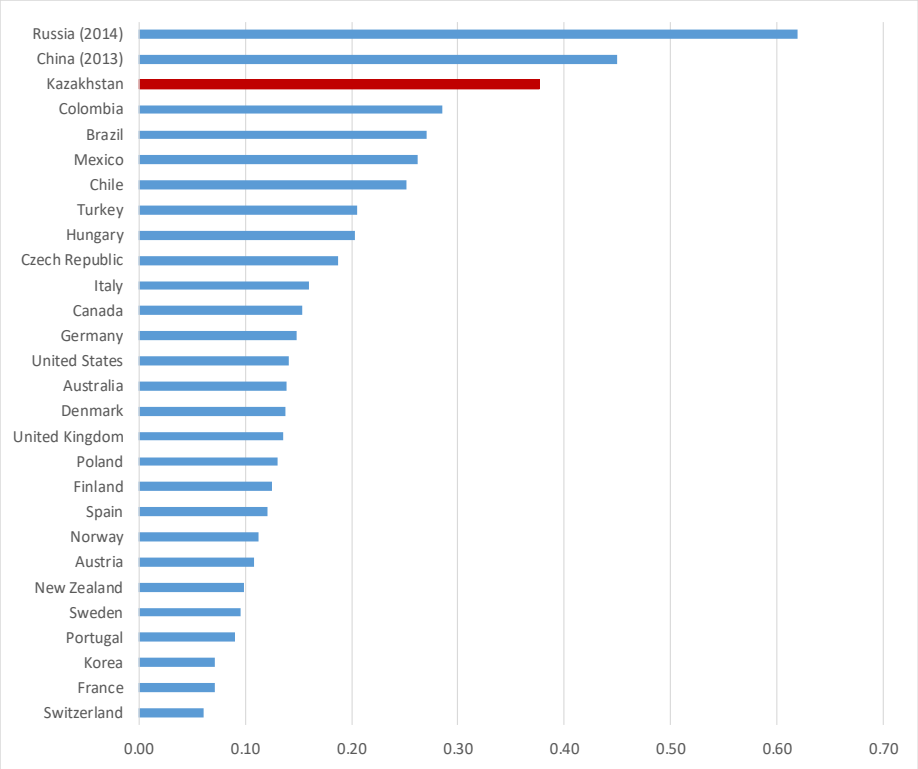
OECD metropolitan regions benefit from agglomeration effects and thus tend to display higher levels of productivity, higher rates of employment and higher levels of GDP per capita than other regions. These benefits, however, are limited by congestion costs, diseconomies of scale and oversupply of labour, among other potential negative elements, and many metro regions have in recent decades tended to underperform national economies.

Source: (Duranton and Puga, 2004[9]), (OECD, 2009[10]).

1.1.3. The level of inter-regional inequality is relatively high and roughly stable

Inequalities among regions are high by OECD standards, albeit not by the standards of fast-growing emerging economies (OECD, 2017[7]). In 2017, the highest GRP per capita (in Atyrau) was more than three times the national average, while the lowest (in Turkistan) was almost only a third. Regional inequality, measured as the dispersion of GRP per capita, is higher in Kazakhstan than in all OECD countries (Figure 1.4). Regional disparities are 2-3 times greater than in large OECD countries with low population density, such as Canada and Australia.

Figure 1.4. Gini index of regional inequality in selected countries

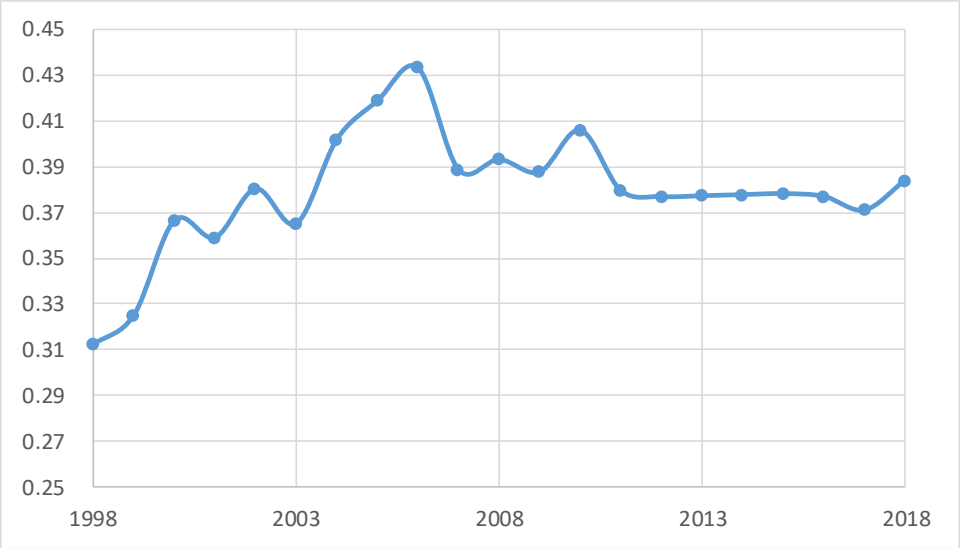


Source: Author's calculations; OECD Regional Statistics database, http://dotstat.oecd.org/?lang=en (accessed 29 August 2019).

Inter-regional inequality in Kazakhstan has been relatively stable since 2011 (Figure 1.5). It increased substantially between 1998 and 2006 as a result of the dynamic performance of the Nur-Sultan and Mangystau regions, while Zhambyl, Almaty and North Kazakhstan fell farther behind relative to other regions (OECD, 2017[7]). In their research on the impact of Kazakhstan's regional policy over the 1997-2017 period, Turganbayev and Diener (2018[11]) suggest that this divergence is the consequence of three factors. First, the rupture of traditional economic activities after the collapse of the Soviet Union. Second, a Soviet-led population and settlement distribution system that did not accord with the reorganisation of the Kazakh geo-economy. Third, competing and ill-coordinated central and local institutions. The trend reversed between 2006 and 2011, and there has been little variation in the last seven years. Turganbayev and Diener's research (2018[11]) also finds that GRP and employment converged over the period 2006-2017.

Figure 1.5. Historical evolution of regional disparity of GDP per capita, 1998-2018

Gini index of inequality of GDP per capita.



Source: Author's calculations; data from Kazakhstan's national statistics agency, www.stat.gov.kz (accessed 28 August 2019).

To a certain extent, inter-regional inequality is a normal phenomenon. In OECD economies, the *OECD's Regional Well-being Database* shows that regional gaps are wider when comparing multidimensional measures than income alone. In developing economies, inequalities tend to increase as a result of growing urbanisation and industrialisation. It is actually because of this very phenomenon that, in the 1950s, "regional policy" became a standalone policy field in the OECD (OECD, 2019[4]). Since the 1950s, however, the OECD approach has changed. Regional policy does not seek to bring all regions to the same level of development, but rather aims at revealing every territory's potential for growth, and making sure that no one is left behind because of where he or she lives. It actually values regional diversity, which it considers as potential for economic resilience (OECD, 2019[4]).

When it comes to access to public services, however, inter-regional inequality is very much a policy issue. Spatial inequalities in access to health and education services, for example, are a problem policy-makers need to address, in OECD and non-OECD countries alike. The OECD Healthcare review of Kazakhstan highlights striking regional inequalities on key health indicators such as infant and maternal mortality and recommends that the government address inequalities in access to healthcare services across territories – not only between regions, but also between urban and rural areas (OECD, 2018[12]). The OECD Secondary Education Review in Kazakhstan highlights inequalities between regions regarding access to education, as evidenced by the distribution of qualified teachers (OECD, 2014[13]). The government is already taking steps to address these challenges. For example, it is making efforts to modernise hospitals in all the regions and improve access to better healthcare for all citizens. The country is also undertaking policy initiatives aiming at developing the quality of its education system, including dedicated budget and support measures for the regions that need it the most (International Policy Digest, 2018[14]).

The level of inter-regional inequality in GRP per capita in Kazakhstan is not in itself an alarming indicator, provided its underlying dynamics show that the country as a whole is

moving in the direction of sustainable economic development. In a developing economy, when some regions are progressing faster than other thanks to a sustainable comparative economic advantage, or under the effect of agglomeration economies, growing inequalities can be seen as a normal phenomenon.

At some point however, the development of growth centres and agglomerations are expected to generate positive spill-overs in the rest of the economy, and the classical economic theory expects that once agglomeration economies have reached their optimum level, a cycle of agglomeration disincentives starts, and convergence happens, meaning that lagging regions catch up (Box 1.2). Although the reality often contradicts the theory, policy-makers seek convergence and aim to reduce high inequalities.

Box 1.2. Is the Williamson curve applicable to transition economies?

Rising inter-regional disparities in Kazakhstan reflect in part an observed regularity discussed in the literature on economic geography since the 1960s – the so-called "Williamson Curve". Williamson (1965) extended the Kuznets hypothesis, which describes the relationship between income inequality and development, to the explanation of regional disparities. Kuznets found that income inequality tended to increase at low levels of per capita income and to decrease at higher levels of development, forming an inverted "U" shaped curve (Kuznets, 1955).

Williamson found a similar pattern at the regional level: national development created increasing regional disparities in the early stages of development, but later on it led to regional convergence, resulting in an inverted U-shaped curve. The primary explanation for Williamson's finding is that, in a catching-up country, a few regions typically drive growth, and capital and skilled workers are increasingly drawn to them. Rapidly rising productivity causes growth to accelerate still further in these regions, leading to increasing regional disparities. Given the importance of agglomeration economies and the fact that rising investment goes with increasing concentration, there is an obvious link with urbanisation here: fast-urbanising regions will tend to pull away from others.

At later stages, higher factor costs and/or agglomeration diseconomies emerge in the leading regions, prompting capital to shift to places where the potential returns to capital deepening are higher (i.e. those with lower capital per worker). Knowledge spill overs and a shift from a growth model driven by capital deepening to one more dependent on human capital may also play a role in this reallocation of productive factors.

Recent research on Central and Eastern Europe suggests that the Williamson curve may not yet apply to some transition economies. Monastiriotis (2014) suggests that such economies could still be in a phase of development and restructuring where cross-regional inequalities become more acute and persistent. In other words, non-convergence would be attributable to "centripetal forces" instigated by the process of transition.

For Kazakhstan, this leaves open the question of when the Williamson turning point might be reached. It is possible that even very strong growth would only lead to a reduction in inter-regional disparities over the longer term. However, provided that growth is strong and broad-based, both geographically and sectorally, it could still provide a boost to prosperity even in lagging regions.

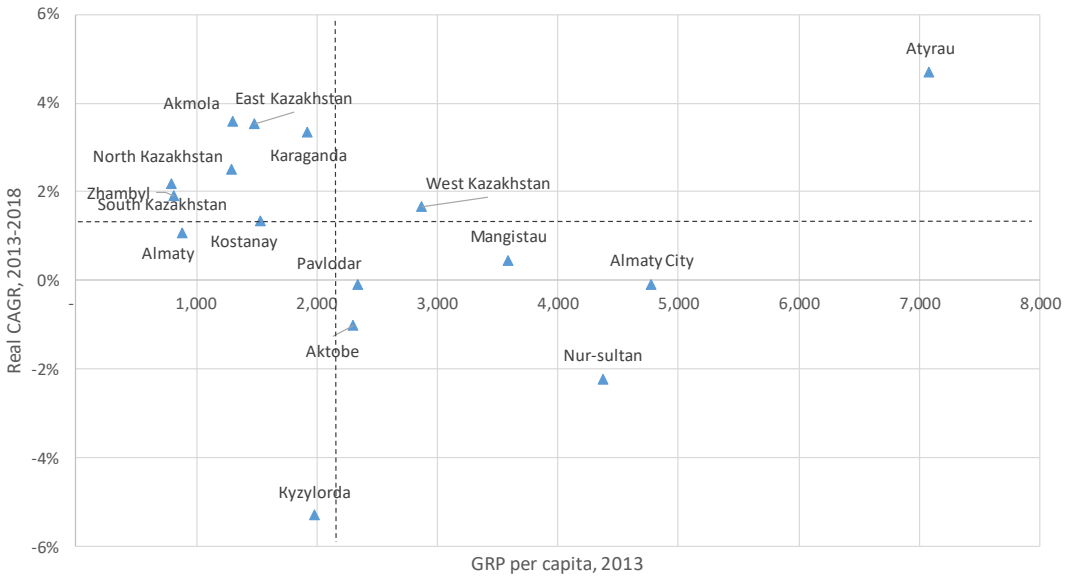
Source: (Williamson, 1965[15]), (Kuznets, 1955[16]), (Monastiriotis, 2014[17]).

Predominantly rural and intermediate regions can have great catching-up potential (OECD, 2012[18]). In developing countries, this can stem from agglomeration trends and their effects on the economy. Another explanation for this phenomenon, notably in more advanced countries, is that income levels of poor regions tend to catch-up with the levels in richer regions, thanks to the import of technical, technological and managerial innovations from more advanced economies.

In Kazakhstan, the mapping of regions according to their GRP levels and real GRP growth rates lead to the identification of four types of regions (Figure 1.6):

- The first group is composed of seven dynamic regions with lower-than-average GRP per capita, but higher than average real growth rates (upper left of the diagram). These regions seem to be following a convergence pattern as they are "catching-up" with the rest of the economy, with GRP/capita annual growth rates comprised between 1.3% and 3.6%, which can be qualified as moderate growth rates.
- The second group is made of the two regions with above-average GRP per capita levels and above-average real growth rates (upper right of the diagram). Atyrau and West Kazakhstan continue to follow a "divergent" path, above the national GRP/capita growth levels (respectively +4.7% and +1.7% per annum), thanks to their oil and gas activities.
- The third group is composed of three regions with above-average GRP per capita levels and below average real growth rates (lower right of the diagram). The two largest agglomerations of the country's GRP/capita report negative growth rates, although very limitedly in the case of Almaty (-0.1% per annum). Mangistau's GRP/capita level growth, on the other hand, remains positive (+0.5% per annum). In the case of the metropoles, at least, this reflects rapid population growth rather than lack of economic dynamism: new arrivals are typically less productive than incumbent residents, but if they are more productive in their new locations and have greater access to opportunity, this migration can still be positive for them and for the economy as a whole.
- The last group consists of less dynamic regions that are already below the national average of GRP/capita, and are losing further ground: the Almaty region and Kyzylorda. Their GRP/capita annual growth rates are respectively +1.1% and -5.3% per annum.

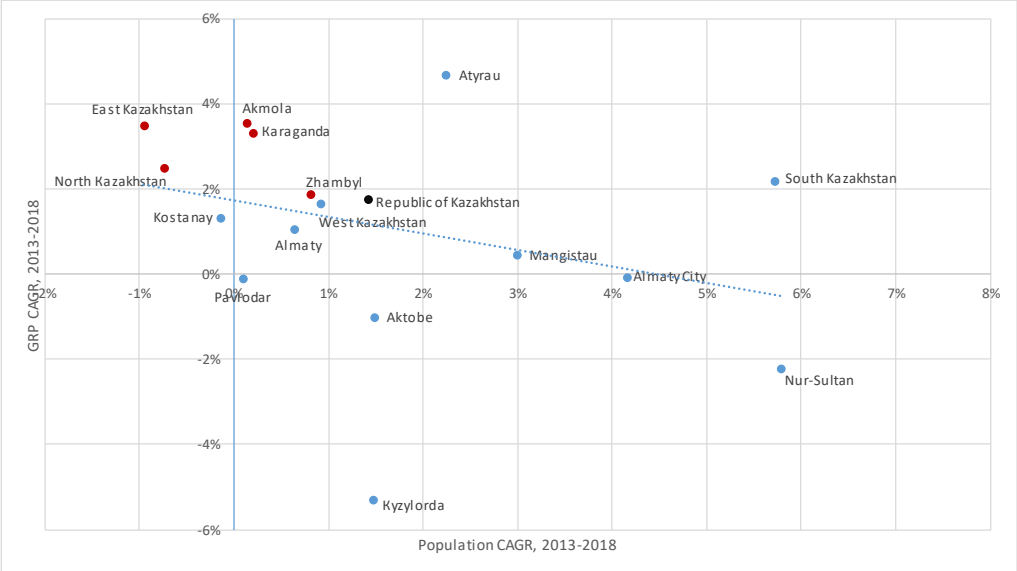
Figure 1.6. Regional growth rates of real GDP per capita, 2013-2018



Source: Author's elaboration on data from Kazakhstan's national statistics agency, www.stat.gov.kz (accessed 28 August 2019).

Looking at demographic dynamics, there appears to be a negative relationship between population growth and growth in GRP/capita (Figure 1.7). The five catching-up regions' populations have been comparatively stable between 2013 and 2018. Meanwhile, in large agglomerations (including Shymkent in South Kazakhstan), population growth has been negatively correlated with GRP/capita growth. This result is not very surprising and reflects influx of new workers with lower productivity levels than already installed populations.

Figure 1.7. Regional population growth and GRP/capita growth, 2013-2018.



Source: Author's elaboration on data from Kazakhstan's national statistics agency, www.stat.gov.kz (accessed 28 August 2019).

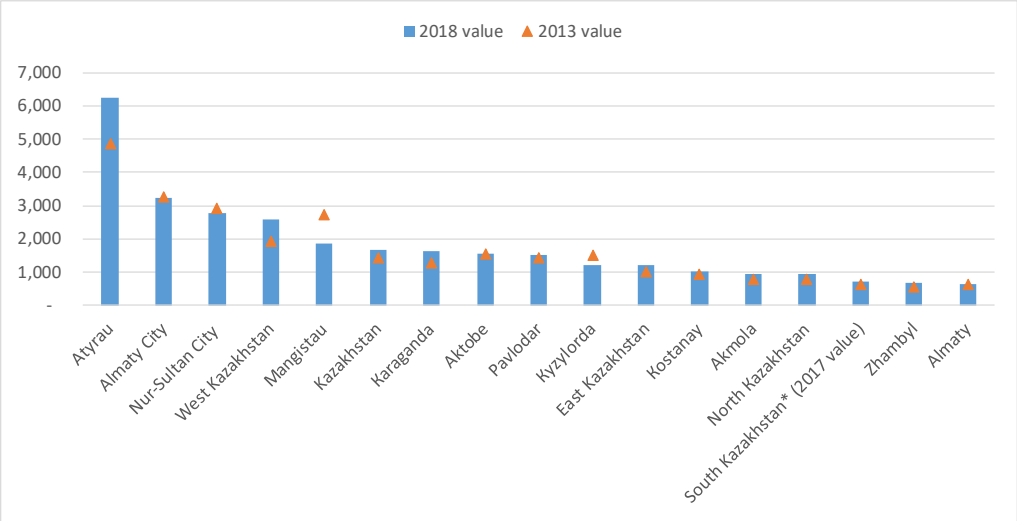
1.1.4. Productivity gaps are wide across regions

Overall, productivity levels increased slightly between 2013 and 2018, by 1.9% per annum on average, but this average masks some significant disparities (Figure 1.8).

Productivity differentials among regions are very high, and they have widened between 2013 and 2019 (Figure 1.8). On average in the OECD, labour productivity in the worst performing region of a country is 46% lower than the labour productivity in the best-performing region. Put differently, the best-performing region is 1.9 times more productive than the worst-performing region. In Kazakhstan, this ratio is close to ten, as Atyrau's output per worker (KZT 24,694) is 9.6 times higher than Almaty Oblast's (KZT 2,566). In 2013, by comparison, the best-performing region was 8.6 times as productive as the worst-performing one.

Figure 1.8. Output per worker in Kazakhstan regions

GRP / worker in KZT



Source: Author's elaboration on data from Kazakhstan's national statistics agency, www.stat.gov.kz (accessed 28 August 2019).

1.2. Better regional policies can help Kazakhstan identify and mobilise untapped potential in all regions

The OECD paradigm of regional policy has evolved, from making up for regional disparities through centrally organised transfers to enabling every region to achieve its economic potential. This paradigm change has led to new policy tools and approach, consisting in establishing a broad strategic vision adapted to the specificities of each place considered. In the case of Kazakhstan, this approach can provide powerful tools to identify and develop the underlying economic potential of each region, and contribute to tackling the country's diversification and productivity challenges. This section aims at presenting the OECD regional policy paradigm, and the ways it can help Kazakhstan in leveraging its regional potential for growth.

1.2.1. Effective regional policy requires a broad vision

Different countries define the scope, aims and instruments of regional development policy differently. It is therefore important to define precisely what it encompasses and to set the traditional instruments of regional policy in a broader context.

There is a widespread tendency to identify regional development policy with a specific set of instruments designed to compensate for inter-regional disparities or to promote the emergence of "clusters" or "growth poles". These largely involve vertical fiscal transfers to finance public investment in various forms of mainly "hard" infrastructure. In this vision, regional policy tends to focus on designated, often under-developed geographical areas.

Such instruments are indeed relevant to regional policy, but, as noted above, they are most likely to succeed when embedded in a broader understanding of regional development that has emerged in OECD countries over the last couple of decades (Table 1.1). This shift has involved a move from top-down, infrastructure-driven policies focused on lagging regions (in a sense, a sort of spatially targeted social policy) towards more integrated and market-

oriented approaches to solve national growth challenges (OECD, 2009[19]). This approach is needed precisely because one-size-fits-all economy-wide approaches so often fall short. Modern regional policies are about growth and competitiveness, not merely "equalisation of outcomes", and they apply to all regions, not just the laggards. They are thus an essential aspect of economic policy – not merely (as once they were in many countries) spatially targeted social policies with an effectively compensatory logic.

Table 1.1. Paradigm Shift in Regional Policy

	Traditional Regional Policies	New Paradigm
Objectives	"Balancing" economic performance by compensating for spatial disparities	Tapping under-utilized regional potential for competitiveness
Strategies	Sectoral approach	Integrated development projects
Tools	Subsidies and state aid	Development of soft and hard infrastructures
Actors	Central government	Different levels of government
Unit of Analysis	Administrative regions	Functional regions
➔	**Redistribution from leading to lagging regions**	**Building competitive regions by bringing together actors and targeting key local assets**

Source: (OECD, 2009[19]).

OECD (2011[6]) presents the main elements of a much broader "family" of policies to improve regional performance, including:

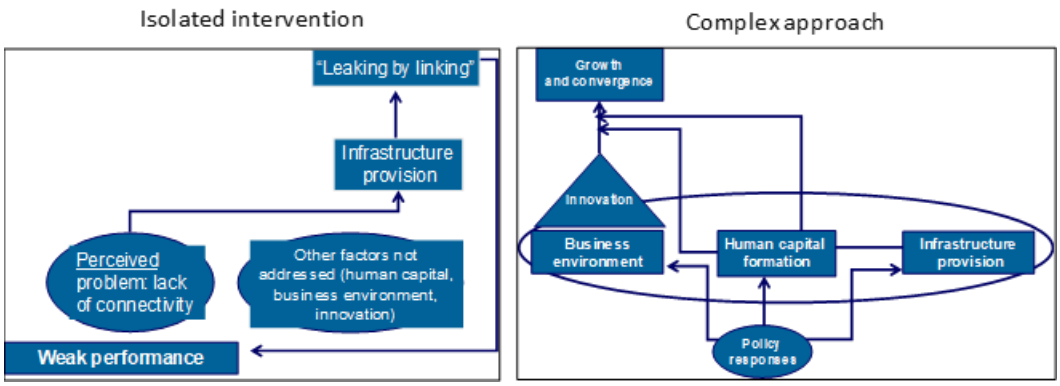
- a development strategy covering a wide range of direct and indirect factors affecting the performance of local firms;
- a focus on endogenous assets, as opposed to exogenous investments and transfers;
- an emphasis on opportunity rather than disadvantage;
- attention to policy settings ("rules of the game") and soft infrastructures (networks, knowledge platforms, etc.), as well as physical infrastructure; and
- a collective/negotiated approach to governance involving national, regional and local government along with other stakeholders, with the central government taking a less dominant role.

To put it very succinctly, regional development policy can encompass everything from human capital formation and innovation to competition, private-sector development and market regulation. Of course, this includes the traditional "regional policy" concerns with infrastructure, and traditional instruments continue to play an important role. The evidence suggests, however, that those instruments are most likely to yield good results when other elements of the policy framework are in place and investment projects are embedded within an integrated, cross-sectoral growth strategy.

Investment in hard infrastructure, for example, yields better returns in the presence of policies designed to improve human capital and knowledge creation efforts (OECD, 2009[19]). Pursued in isolation, large infrastructure projects can prove useless or even accelerate the exit of firms and workers from a region (Figure 1.9). Big investments in human capital formation may do little to stimulate regional growth unless other growth constraints, such as barriers to private-sector development, are addressed. If suitable

opportunities are not available locally, investment in skills may simply contribute to a brain drain. Such upskilling is good for those affected and may generate positive spill-overs in their home regions (remittances), but it does little to unlock regional growth potential.

Figure 1.9. The importance of an integrated approach to regional development



Source: Author's elaboration based on (OECD, 2009[5]).

1.2.2. It is also important to recognise the limits of regional development policy

This very broad definition of regional development policy implies that the potential of traditional regional development policy instruments to deliver improved performance depends to a great extent on the broader institutional and policy environment. This is particularly true in a relatively large but centralised country like Kazakhstan, where sub-national governments have limited fiscal and policy autonomy. Many of the binding constraints on growth that Kazakhstan's regions face fall within the competence of the central government and must be addressed at that level. This does not mean that regional development strategies and instruments are not important – they are. However, it is important to assess them with a realistic understanding of what they can achieve. Better regional strategies and improved targeting of investment funds are no substitute for better institutions and economy-wide policies. Indeed, many widely discussed regional policy initiatives highlight the need for further structural reform rather than mitigating it.

This reality was consistently reflected in the OECD Secretariat's contacts with businesspeople in the regions of Kazakhstan. Although many of them expressed strong views about regional development programmes and instruments, their primary concerns were cross-cutting challenges, chiefly to do with the country's business environment. These were largely, if not exclusively, within the competence of the national authorities. Many officials likewise confirmed in discussions with the Secretariat that the main barriers to investment were cross-cutting factors like bureaucracy and corruption.

1.2.3. An effective, place-based regional policy framework can help Kazakhstan trigger "diversification from the bottom" and foster productivity growth

A sound regional policy framework can help identify and develop regions' potential, leading to better human capital, more investment, a more vibrant entrepreneurship and SME environment, and higher value-added activities. As discussed above, regional policy cannot not address some of the cross-cutting issues relating to corruption, quality of the financial markets, competition policy and the regulatory framework. Place-based regional development policies are nevertheless essential because the evidence shows that optimising

the overall policy environment through structural policy reforms does not suffice to provoke economic convergence across regions (OECD, 2019[4]). Thus, place-based policies are a necessary complement to necessary national, structural reforms.

The first pillar of place-based regional policies is to identify the unique strengths or assets of a geographic location susceptible to generate competitive advantage. Place-based policies seek to leverage the unique regional strengths that can conduct to economic performance. These strengths can pertain to different dimensions: economic, geographic, institutional, cultural, knowledge-based, or infrastructure-based (Table 1.2). One of the key challenges of regional policy is to identify these strengths.

Table 1.2. Examples of Regional Strengths

Dimension	Specific Strength
Economic	-Existing industrial clusters -Specific skills among the workforce -Specialized supplier base -Large customer base
Geographic	-Resource availability -Availability of cheap renewable energy -Strategic location (e.g. along transport corridors) -Climate -Natural beauty
Institutional	-Well-functioning/ flexible institutions -Collaborative culture of working together
Culture	-Language skills -Traditions that can be marketed (e.g. local food) -Entrepreneurial traditions
Knowledge-based	-High-quality research institutions -Research specialization in valuable niches -Well-functioning co-operation between research institutions and the private sector
Infrastructure	-Transport infrastructure (e.g. ports, airports) -High speed data connections -Tourism infrastructure

Note: This table provides examples of regional strengths, but is not nearly exhaustive. A key challenge in place-based regional development is to identify the unique set of strengths of a region to use it productively.
Source: (OECD, 2019[4])

By and large, it makes sense to begin by taking stock of a region's relatively immobile assets, as highly mobile assets (especially capital and labour) will move if conditions are more attractive elsewhere. Thus, a region wishing to develop more human capital-intensive activities must do more than investment in education and skills – it must create conditions in which highly skilled individuals can not only work productively but also live comfortably. The point is not that the immobile assets must define the region's future and limitations, but they are most readily available to be leveraged for growth.

It is critical, however, to understand the notion of relatively immobile assets quite broadly. It encompasses far more than natural endowments. Critical infrastructures, for example, once created tend to remain: the nuclear and space science concentration of Krasnoyarsk, Russia, for example, exists for largely historical reasons, but now that it is there, the Russian authorities are unlikely to move it elsewhere, as this would entail enormous costs. Shared amenities, and even clusters, can constitute relatively immobile assets for a region. An individual firm may move here or there, but once a cluster takes shape in a place, the firm faces higher costs if it moves away and some outside firms may be drawn to it. The mobility

of the individual firms notwithstanding, the cluster itself is relatively immobile. Of course, if the cluster starts to decline (owing to policy errors, technological change or other exogenous development), then the costs of exit fall and there may even come a tipping point at which the cluster starts to fall apart.

There are two other critical pillars of placed-based policies' design and implementation. One is the use of complementary policies, or design of policy packages, in order to maximise regional strengths' individual returns on the local and regional economy. The third and last pillar is the use of multi-level governance arrangements to co-ordinate the objectives of different layers of government and to ensure appropriate engagement of non-state actors, particularly the local private sector, in the formulation of regional economic development strategies (Garcilazo, Oliveira Martins and Tompson, 2015[20]).

The implementation of the "new" OECD approach to regional development is a difficult task for all governments; it is, frankly, "implementation-intensive", and Kazakhstan has sometimes struggled with effective policy implementation, particularly at regional and local levels. Even so, the thinking behind this approach can help Kazakhstan's regions better identify their strengths and key assets, and design policy frameworks to leverage them. It offers a chance to diversify the economy by working "from the bottom up" and reaping the benefits of agglomeration economies. Kazakhstan has already started to adopt the new regional paradigm, and has developed a policy framework to encourage growth in all regions. Nevertheless, in Kazakhstan as in other countries, there is room to enhance the design and effective implementation of regional policies through a refined approach and improved multi-level governance.

1.3. Kazakhstan has partially integrated the new paradigm in its approach to regional policy, but challenges remain

Recognising the importance of its regions' contributions to national economic objectives, Kazakhstan has increasingly integrated regional development goals and measures in its national strategies and programmes. The current approach follows two main axes: the development of designated economic growth centres and sectoral clusters, on the one hand, and SME development in rural areas on the other. This section provides an overview of the country's policy framework for regional development and its main components, goals and objectives.

1.3.1. Kazakhstan's regional policy framework is essentially state-driven; it focuses on agglomeration economies and SME support in "lagging" zones

Kazakhstan's successive national strategies have been giving a growing importance to regional development. The government started giving priority to this topic in 2010, as it identified the development of "economic growth centres" as a key driver of economic diversification. Strategy 2050 (Kazakhstan's overarching national strategy adopted in 2012) and Strategy 2025 (a strategic development plan adopted in 2018) also refer to regional development as a priority. Strategy 2050 puts the emphasis on governance and inclusiveness, as it highlights the need to address "social imbalances" through better co-ordination of regional development programmes and policies, and decentralisation of responsibilities. Strategy 2025 brings together both dimensions of "growth poles" and reduction of inequalities. One of its seven key goals is to have "strong regions and urbanisation" by concentrating labour and financial resources in economic growth centres, on the one hand, and reducing inequalities or "imbalances" between regions, on the other.

The specifics of Kazakhstan's regional policy are contained in different national documents and programme, which together provide the detailed picture of the government's priorities and approach (Figure 1.9). Beyond the strategic directions set in national strategies, four main national programmes form together the core of Kazakhstan's policy framework for regional development:

- The Forecast Scheme for Spatial-Territorial Development until 2020 (referred to as the "Scheme" in this report), which aims to qualify regional characteristics, economic potential and challenges, and define priority objectives and measures for their long-term development. This scheme focuses on the development of "growth poles" in designated places and regional specialisation through the development of identified economic sectors in specific locations;
- The Programme for Regional Development (PRD), which focuses on the implementation of the Forecast Scheme by allocating roles and responsibilities to national and regional institutions, and providing detailed metrics for evaluation and monitoring. It also describes the budgetary and financing aspects;
- The State Programme of Industrial-Innovative Development (SPIID), Kazakhstan's industrial policy document. It has important implications for regional development because its vision relies on the emergence of activities of "critical mass" and "centres of gravity", that more or less refer to the notion of agglomeration economies. In particular, one of its main objective is to drive regional specialisation through the development of pilot regional clusters;
- The Business Road Map 2020 (BRM), which is one of the road maps resulting from the objectives set in the SPIID, with a focus on SME and entrepreneurship development. At the time this report was written, a 2020-2025 version of the Programme was being drafted. One of the main objectives of the BRM is the stimulation of entrepreneurship and SME growth in laggard regions, notably monotowns (single-industry towns), and rural regions.

The Ministry of National Economy is responsible for the design and implementation of the Scheme, the PRD and the BRM, while the then Ministry of Industry and Development (now the Ministry of Industry and Infrastructural Development) was assigned responsibility for the SPIID. Regional and local governments are consulted and provide their inputs in the elaboration of the plans. For example, they participate in the identification of existing and potential clusters in the regions.

Other sectoral plans intersect with regional development policy, such as those relating to urban design. They are not discussed in this report, which specifically focuses on the economic development of regions (for a detailed discussion on urban policies, see the *OECD Urban Policy review*, 2017).

Figure 1.10. Kazakhstan's key policy documents for regional development

Source: Adapted from (OECD, 2017[7]) (OECD, 2017[8]).

The government is currently (November 2019) finalising the new Forecast Scheme until 2030, which is the continuation of the Forecast Scheme 2020. This new Scheme will keep developing the "growth pole" policy and, in complement, it is to devote more attention to the development of border and rural areas, including monotowns (or single-industry cities).

Taken together, Kazakhstan's regional development policy initiatives rest on two main pillars. One pertains to economic specialisation via agglomeration economies, with the development of designated "growth poles", clusters, large industrial projects, and accelerated urbanisation. The other axis focuses on the economic development of rural regions and monotowns, essentially with measures to support entrepreneurship and SMEs. Infrastructure is an important component of all measures presented in the programmes discussed here. Infrastructure is a cross-cutting issue in Kazakhstan, because of the country's connectivity challenges with regards to its size, location, low population density, and climate, and because a sizeable part of the infrastructure stock dates to the Soviet era and is now obsolete. Plans and programmes therefore include large infrastructure investments deemed necessary to achieve their objectives. Implementation often relies on public-private partnerships as tools to attract large investments where needed.

The Scheme categorises Kazakhstan's regions into six macro-regions – based on their economic, natural and socio-demographic characteristics – and defines target sectors of specialisation for each macro-region. It also identifies five major urban agglomerations as "growth poles": Almaty, Nur-sultan, Shymkent, Aktobe, and Ust-Kamenogorsk. It describes these hubs as the centres of growth poles and potential locomotives for the other regions. Accelerated urbanisation and concentration of capital, labour, knowledge and consumers in the capital cities of all regions is also a key objective of both the Scheme and the SPIID. The government expects that such concentration will lead to higher value-added activities, innovation and development of specialised production factors.

This is an important and positive feature of Kazakhstan's regional policy: while still concerned with the plight of lagging regions, the authorities have embraced the economic potential of agglomeration and seek to facilitate rather than impede it. In much of the world, governments have often worked to *limit* agglomeration in an effort to maintain pre-existing

settlement patterns owing to the political and social challenges raised by rapid urbanisation. The problem is particularly acute in the former Soviet states, because the previous settlement pattern was defined by central planners rather than the decentralised choices of markets and firms. These countries have experienced dramatic changes in settlement patterns since 1990, and governments have often worked not to smooth or facilitate this adjustment but to restrict it, not least by making it harder for new arrivals to access housing and essential services in the major cities. Kazakhstan, by contrast, has actively fostered urban concentration.

Regional economic specialisation relies on the development of new high technology industries and sectoral clusters. The Scheme and the SPIID both determine specific locations as "centres for the development of high technologies" and designated locations where regions should develop clusters according to their identified competitive advantages. For instance, they recommend the creation of a cluster for grain processing in Kostanay.

The BRM, in accordance with the SPIID, focuses on sustainable and balanced regional growth through the support of SMEs and entrepreneurship. The key objective is to help lagging regions, particularly rural and border areas, single-industry towns and small cities. To this end, it provides financing and non-financial tools, such as training and support services, to SMEs in these zones. Regional co-ordination councils have a significant influence on the policy mix targeting SMEs, enabling adjustment to the regional economic development priorities (OECD, 2018[21]).

1.3.2. Regional and local plans follow targets and objectives set in national plans, which results in a fragmented, rather than integrated, vision

Regional governments, or *akimats*, are in charge of developing regional plans and programmes. As illustrated in Figure 1.9, their plans consist of two overall plans, the "Forecasts of Socio-Economic Development and Territorial Development Programmes" (or "Forecast Programmes"), and the "Territorial Development Programme" (or "Development Programme"), both adopted for five years. These programmes are approved by the regional *maslikhat* (regional council) and deal with socio-economic issues, public safety, infrastructure, ecology and land resources, and public administration. They set goals and targets at the regional and city level, and identify the necessary resources needed to reach these targets. Besides these two plans, *akimats* develop series of specific sectoral and project plans, such as the development of the livestock sector in Kostanay, or the creation of a medical cluster in Aktobe.

These plans clearly respond to national objectives and guidelines. They start by referring to the defined objectives set in national strategies and national plans. They make frequent references to objectives and targets established by the central government in their bodies as well, and point to achievements or expectations in meeting them. Measures and plans are regional adaptations of the national priorities. For example, the Development Plan of Kostanay starts with a long list of 34 objectives and 108 indicators relating to economic performance and implementation of specific measures or projects, all established centrally. Regional *akims*, directly appointed by the President, must report regularly on the implementation of national plans and associated indicators.

Regional plans and programmes are very detailed in their aims, objectives and assessments of the current situation, as well as measures and policies (means), but they are less explicit on resources and impact. In particular, sections relating to economic and territorial impacts of projects and measures are limited, and risk identification and measures to mitigate or monitor risks (such as financial, capability, or schedule) are lacking. This is notably the

case in the Aktobe plan for the development of a medical cluster, which does not mention the risks of developing a very large hospital, especially in the framework of a Public-Private Partnership. The monitoring part of plans essentially consists in indicators, but little room is left to adjustment or feedback processes (with local stakeholder consultation, for example). Finally, the plans are not very detailed with respect to resources (time and human capital), other than funding.

1.4. Conclusion: the current regional policy framework is not yet quite adapted to the delivery of place-based policies to leverage the potential of all regions

Diversification in regions has not yet started. Regional growth outside large urban agglomerations remains concentrated in oil-rich regions, including Atyrau and West Kazakhstan. While Figure 1.6 above shows clearly a degree of convergence in real GDP per capita, a number of regions are still falling behind and regional disparities have even begun to increase again (Figure 1.5). Furthermore, disparities among regions in accessing public services are high, including in education, which is particularly critical for the development of new economic activities and productivity growth.

Agglomeration economies have not yet fully realised their potential in Kazakhstan, both in the three largest cities and in the regions. Agglomeration economies contribute to the rise in productivity through economies of scale and scope and opportunities for more collaboration among economic actors leading to more innovation. Not reaping the full benefits of agglomeration economies is thus a lost opportunity for Kazakhstan.

Kazakhstan's current approach to regional policy remains relatively top-down, and does not yet quite enable the delivery of place-based policies. The development of new economic activities is very much constrained by strict definitions of locations and sectors where it is expected to take place, and the overall approach still needs to enable more implications from local stakeholders, governmental and non-governmental. While many countries face similar challenges, Kazakhstan's ability to seize the opportunities of enabling each region to build on their local strengths and assets will be pivotal in the country's success in diversifying the economy and increasing its labour productivity.

To address these challenges, Kazakhstan will need to focus on two axes:

- Developing place-based policy approaches and tools at regional level to support the development of economic activities based on local strengths and assets. The approach should acknowledge that some areas with potential may not have been identified at the national level, and that the entrepreneurial discovery process is essential to the emergence of competitive industries. This axis is the focus of the next chapter of this note.
- Enhancing the governance framework and making it more able to deliver place-based policies. This involves moving the agenda of decentralisation forward to achieve a more efficient multi-level governance. Such an enhanced governance framework will not only be enabling for the recommendations of this specific note, but it will also better equip Kazakhstan for the delivery of the policies adapted to the new challenges of the decades ahead – a requirement that many countries need to work on fulfilling as well. Chapter 3 of this note will provide recommendations to tackle this second objective.

2. Unlocking the growth potential in all regions to develop economic competitiveness

Current policies for the development of economic activities in regions of Kazakhstan are essentially government-driven, and local governments have strong incentives to respond to centrally defined objectives and incentives, rather than to identify and address local potentialities and constraints (OECD, 2013[22]).[1] In spite of recent efforts to involve local governments and stakeholders more in the policy process, the central government is still the main decision-maker. Regions must contribute to national industrial plans' targets, often built around sectoral objectives. The approach to cluster development is centrally driven, as objectives, means and expected results are defined in national plans. The resources to pursue these objectives consist largely of central subsidies and other transfers to lower-level public budgets. Finally, regional governments must report regularly to the central government on their actions and progress towards target objectives.

While a certain amount of nationally driven regional policy is the norm in all countries, Kazakhstan could benefit from adopting a more decentralised, place-based approach. This implies changes in governance, addressed in the next chapter, but also the adoption of concrete regional policy tools to foster the emergence – and strengthening of – local entrepreneurial ecosystems. These tools are the focus of this chapter.

As highlighted above, all regions are important for aggregate national growth – not just the "winning" regions with the largest agglomerations. Each region should thus be equipped with the tools to identify and maximise its specific potential, the idea not being to bring it to the same level of performance as the "best-performing" region of the country, but to bring it to its own, achievable level of performance. This is important not only for national economic growth, but also for the well-being of regions' populations that benefit from more economic opportunities and higher living standards.

Key place-based policy tools aim to build on existing regional strengths and assets while relaxing constraints for local economic actors. Entrepreneurs and SMEs are very often key targets of these policies. This does not preclude the delivery of policies to enhance connectivity and urban planning, as discussed in the first section of this chapter. It does, however, put a stronger emphasis on "soft" mechanisms and processes to enable smart specialisation innovation. The following sections suggest regional tools that could help Kazakhstan better identify and build on existing assets at the regional level, bring together different policy areas into comprehensive visions, including local tools to mobilise a high number of local economic actors, and foster linkages between the different sectors of the economy.

2.1. Infrastructure and urban planning

As noted in the previous chapter, there has been a pronounced shift in regional policy approaches in recent decades, away from the traditional focus on compensatory subsidies and physical (particularly connective) infrastructure. In keeping with that shift, this chapter

[1] Kazakhstan is by no means unique. Even in some highly decentralised OECD countries, central governments' budgetary power means that subordinate governments often have more incentive to align policies with perceived central priorities than with local needs or potential (OECD, 2013[75]).

concentrates mainly on the "softer" side of regional development policy, looking at issues like smart specialisation and innovation, which have become increasingly prominent in OECD countries as the paradigm shift in regional policies has taken hold (OECD, 2019[4])). Nevertheless, there are important issues to address on the "physical" side, with respect to connective infrastructure and urban development, in particular. This section provides an overview of those issues and potential solutions.

2.1.1. Connective infrastructure must be addressed at multiple scales

As chapter 1 emphasises, investments in infrastructure are most likely to deliver real growth benefits when undertaken in the context of complex policy packages that address other potential barriers to growth, particularly entrepreneurship, innovation and skills (OECD, 2009). Nonetheless, given Kazakhstan's location, landlocked status and dispersed settlement pattern, connective infrastructure will remain a critical part of the story. It must be addressed at a variety of different scales, though: macro-scale international initiatives like China's Belt and Road offer important opportunities, but these are unlikely to be realised if Kazakhstan neglects to develop the secondary national and regional networks needed to link its regions to the main overland corridors that are emerging across Eurasia.

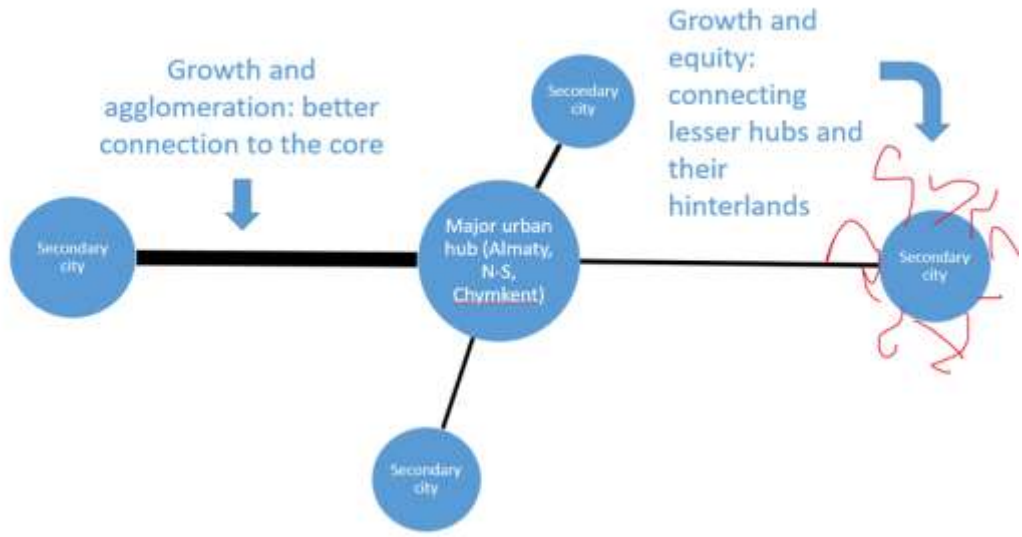
Thus, ITF (2019) proposes a number of relevant priorities for Kazakhstan:

- Select projects that foster *connectivity* to foreign markets (i.e., integration) rather than *transit*. Yet project appraisals rarely quantify connectivity, while transit is always valued as a benefit. Changing this will require more sophisticated appraisal methods relying on economic geography.
- Paying more attention to "last-mile" connectivity. National road networks that work as feeders and distributors to international corridors need more attention. In some cases, this will involve expansion and upgrades, while in others it implies a need for more investment in (chronically under-funded) maintenance. Fortunately, Kazakhstan is currently implementing a Road Asset Management System (RAMS), which should help, provided that the newly created RAMS is not treated as a stand-alone tool but is truly integrated into decision-making processes.
- Likewise important in this context will be intermodality. While rail provides the backbone for international freight flows, releasing its full potential for the country as a whole will require better co-ordination of rail and road.

The above considerations need to be built into policy-making and project selection.

In addition, from a regional development perspective, it is critical to not to overlook the role of secondary networks in helping regional cities generate agglomeration dynamics at lesser scales. The "growth and agglomeration" roads shown in Figure 2.1 will tend to facilitate agglomeration dynamics and the concentration of certain activities at the national level. However, there is an important role for less expensive – and less prominent – networks around the country's second-tier cities. Connectivity infrastructure should thus be part of the policy packages

Figure 2.1. Agglomeration, regional development and connectivity

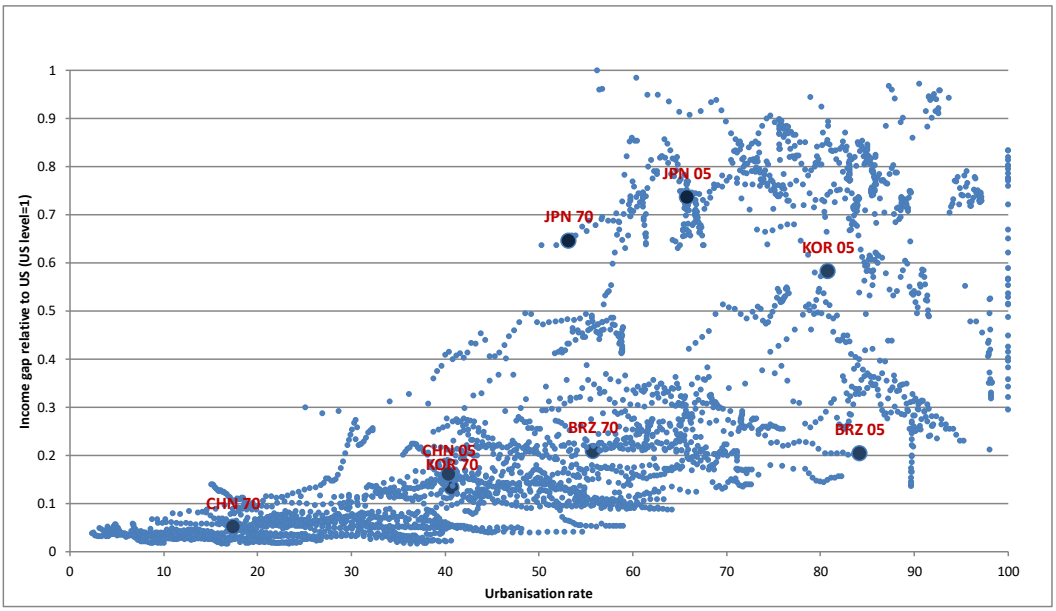


Source: Kremer, A. (2019), "Osnovnoi zakon ekonomicheskoi geografii", Presentation to Kastryčnicki Ekanamičny Forum, Minsk, 31 October.

2.1.2. Better urban planning can make Kazakhstan's cities greener, as well as more efficient.

As noted above, recent OECD work strongly suggests that Kazakhstan could benefit from further agglomeration, something the authorities themselves also recognise. However, it is important to emphasise that the economic benefits of agglomeration will not flow automatically from greater concentration of population. There is more to agglomeration than density or concentration. Agglomeration benefits reflect the ease with which people can interact or transact with large numbers of other agents. It is thus possible to increase agglomeration without increasing density by, for example, removing transport bottlenecks in a given place, so that agents can move more easily around the city. At the same time, one can achieve very high densities with little agglomeration benefit if cities are not well designed and managed. Figure 2.2 illustrates this important reality: taken together, the empty space in the upper left of the figure and the crowd of data points in the lower right suggest that no country grows rich without urbanising but many urbanise while remaining poor. This is why the quality of urbanisation is so important.

Figure 2.2. Income and urbanisation, 1970-2005



Source: World Bank, World Development Indicators; UNDESA (2014), World Urbanization Prospects: The 2014 Revision, United Nations Department of Economic and Social Affairs, OECD calculations.

In many places around the world, large conurbations do not really function as cities, precisely because they are characterised by poor internal connectivity, fragmented labour markets, failure to co-ordinate land-use planning and poor provision of infrastructure and essential services like electricity, education and sanitation. In short, such cities experience a dysfunctional density that is neither economically efficient nor environmentally sustainable. The key to realising agglomeration benefits, then, is creating cities that function well as economic systems. The *quality* of Kazakhstan's urbanisation will thus be critical to ensuring its economic benefits. It will also have a huge impact on the environmental footprint of the country's rapidly growing cities.

At present, much new urban development is characterised by extreme functional segregation, the development of large superblocks, organised around an arterial grid of roads that are often both wide and relatively far apart. This reduces internal connectivity, makes cities less pedestrian-friendly and tends to encourage the use of private automobiles. It also reduces the integration of urban labour markets and makes cities less liveable for the elderly and for those who cannot afford private cars.

The state of public transport reinforces the factors favouring the development of car-oriented transport systems with all the environmental and congestion externalities that they bring, especially in Nur-Sultan and Almaty. Public transport is mostly provided on buses, the majority of which are old, inadequate and polluting. Only Almaty City has a metro line, with plans to build a tramline. Low fuel prices and parking space for cars provide further incentives for private vehicle use and limit cities' income for public transport improvements. Moreover, transport routes do not cover the entire urban territory, and the frequency of service is often unreliable. In the absence of origin and destination surveys and integrated ticketing system, planning is not based on the best possible assessments of

emerging demand. As a result, new routes overlap heavily with existing ones (OECD, 2017[8])).

This is starting to change. Nur-Sultan and Almaty have developed policies to encourage the modal shift from private cars to public transport and improve service quality. The inauguration of Almaty City subway system in 2011 was a landmark. Both Almaty and Nur-Sultan are working to develop modern light-rail transit systems (LRT) in the next few years, and both are renewing their municipal bus fleet and introducing integrated electronic ticketing systems.

Further desirable steps include building economic indicators into planning processes, which are often governed mainly by physical units (land, population, densities, etc.), and designing road networks to better support foot traffic and public transport. Managing urban density at smaller scales could allow more transit-oriented development, more multi-functional urban spaces and greater competition among developers, making new urban developments more liveable. It would also facilitate a better connection between densification and infrastructure development (e.g., with higher densities close to public transport interchanges).

(OECD, 2017[8]) finds that integrating land-use, environment, transport and housing, joint teams working on strategic planning could help save costs and improve policy co-ordination; too often, these issues are addressed in silos. Clear guidelines, rules and procedures for policy integration set out by the national government are an important part of this process. Kazakhstan could promote the use of joint teams working on strategic planning to maximise the accumulated experience in government.

(OECD, 2017[8]) thus identifies several specific priorities for the reform of urban planning and economic development in Kazakhstan:

1. A shift from unified and technocratic policies, standards and norms of urban design to more flexible and locally based practices. A top-down approach to urban planning and design is not appropriate for balancing public and private development interests in the economic realities of the market. There is a disjuncture between urban planning and development, because citizens and local market players are often excluded from formulating policy.
2. A shift from reactive, problem-driven approaches, such as narrow, sectorial policies to multi-sectoral urban policy packages. This implies combining land use, housing, public utilities, transport, and green policies for urban development. Further legislative and institutional changes are needed to make it easier to address urban development issues in an integrated manner. Economic planning and physical planning, in particular, should be better co-ordinated.
3. Designing urban and territorial development policies to reflect settlement patterns and economic flows, rather than administrative boundaries. For example, rural communities adjacent to large cities are typically excluded from the official procedure of planning and management of urban development. Cities are treated separately from the neighbouring rural and other urban areas. However, (OECD, 2013[23]) draws attention to the benefits of more integrated approaches, aligning regional and urban development instruments, which in many places are not coherent.

2.2. Kazakhstan could use the EU's smart specialisation framework to better identify regional strengths and assets

2.2.1. Kazakhstan's current approach to regional specialisation heavily relies on a limited number of centrally-defined clusters

In 2006, Kazakhstan shifted its approach to regional development by focusing on "growth poles", with the objective to focus public resources and efforts in the most dynamically developing cities and regions identified as potential "growth engines" (Turganbayev and Diener, 2018[11]). By doing so, it aimed at driving and benefitting from agglomeration effects, enhancing productivity and enabling smart specialisation, but also increased connectivity. The development of growth poles would enable Kazakhstan to "expand beyond its current role as a provider of natural resources and transit zone, to become an economic and technological service centre and hub of Eurasian trade" (President of the Republic of Kazakhstan, 2006[24]).

Kazakhstan has adopted a cluster approach to achieve what it refers to as "regional specialisation". The Concept for the formation of promising national clusters until 2020, adopted in 2013, states that cluster policy is the most important tool for the implementation of the SPIID. As part of this approach, Kazakhstan has defined six territorial clusters specialised in narrow economic sectors (Figure 2.1). The strategy also comprises one national cluster that aims at diversifying the economy of Western regions through the adoption of new technologies and inclusion of more small enterprises in the oil and gas sector. This national cluster encompasses three "sub-clusters" in Aktobe, Atyrau and Mangystau. The development of the six regional clusters involves co-operation with international partners (Eurasian Development Bank, 2019[25]).

Figure 2.3. Territorial Clusters in Kazakhstan

Construction Cluster, Karaganda Region	Pharmaceutical Cluster, Turkistan Region	Furniture Cluster, Almaty City
Improve the quality of building materials, works and services and to master new trends in the construction sector • Mastering the construction of energy-efficient and smart facilities, and development of the building reconstruction and modernisation sector • Analysis of prospective markets • Creation of a competence centre and a certification centre • Cooperation with Spanish construction companies	**Increase the domestic market share to 20% and initiate export activity** • Development of herbal medicinal products and nutraceuticals • Establishment of a research laboratory • Establishment of a Competence Centre • Mastering local herbal substances • Studying the export market • Organisation of an exhibition of herbal products involving Korean firms and companies	**Double the domestic market share and initiate export activity** • Development of the contract furniture sector • Quality improvement through standardisation • Creation of a Competence Centre with an emphasis on interior design • Creation of show-rooms in Nur-Sultan, Almaty and Shymkent • Carrying out a study of board materials • Cooperation with designers and developers
Flour Mill Cluster, Kostanay Region	**Milk Processing Cluster, Akmola Region**	**Tourist Industry Cluster, Almaty City and Region**
Diversify the export market of flour mill products • Facilitating the development of the services market: diagnosis and repair of modern milling equipment • Attraction of EU grant resources for value chains (VC) creation • Organisation of monitoring studies of the status of the mill products market in the prospective importing countries • Facilitating the use of new technology to expand the product range	**Supply the domestic market with products of higher quality and ensure food security** • Attraction of EU grant resources for VC creation • Study the sustainable use of forage and other lands • Establishment of a Competence Centre • Study the dairy products market • Process audit of enterprises • Better market positioning of the local brand	**Improve the quality and availability of tourist products and services** • Assistance in the development and implementation of minimum standards and a quality assessment system in the tourist industry • Creation of a Competence Centre taking into account the needs of businesses • Assistance in the improvement of statistical record-keeping in tourism • Making the regional tour operators' and other tourist organisations 'services more digitally accessible by launching an online/portal

Source: Qazindustry.

These territorial clusters were developed according to a methodological framework defined by the Kazakhstan Industry Development Institute (KIDI), now "Qazindustry" (Kazakhstan Industry and Export Center), with the support of the World Bank. The methodology took into consideration quantitative and qualitative information on existing clusters in which the firms were willing to co-operate. The methodology involved a number of dimensions for potential assessment, including value chain development, the existence of an enabling environment (infrastructure development and availability of financial resources), the anticipated socio-economic impact of the cluster, and the prospects of development of the cluster. The selected clusters receive targeted state support, such as subsidies, grants, and non-financial measures. Although regional business associations and local executive bodies should play a key role in the development of regional clusters according to the terms of the SPIID, they were not involved in the identification of pilot clusters.

Although Kazakhstan's current approach can lead to the growth of existing sectors with positive outcomes in its target regions, it is very selective and misses some of the key elements of place-based policies. This strategy builds on existing economic activity, which presents the benefit of focusing resources, and positive results can drive local and national economic growth. However, it does not follow the logic of a place-based policy in the sense that, first, it targets a limited number of regions and leaves out the others. Second, it focuses on specific sectors rather than regional strengths and assets. Targeting narrow sectors can prevent policies from detecting and taking into account nascent activities that actually bear potential. Third, it takes a rather "silo" approach that can lead to a low level of policy co-ordination across sectors and of participation from private stakeholders and citizens. A

more effective approach would focus on diversifying and strengthening a region's endowments – its natural, human, physical and financial capital.

Many countries have been facing the exact same challenges when seeking to develop frameworks for regional specialisation. The EU has developed the "smart specialisation" framework in response to such criticisms of past regional interventions, including lack of engagement with the private sector, insufficient analysis of regional assets, and subsequent unrealistic expectations (European Commission, 2013[26]). The study of the smart specialisation framework, and in particular its approach to the identification of regional strengths, can be useful for the government to complement its current cluster strategy.

2.2.2. The smart specialisation could help regions develop place-based policies for diversification

Smart specialisation is a place-based policy approach that aims to transform regional economies around new, knowledge-based activities. This is different from the goal of most cluster approaches, which is to increase the performance of members of the cluster ((European Commission, 2013[26])). Smart specialisation builds on a region's strengths and comparative advantages. It targets *activities* rather than sectors, focusing on R&D and innovation. For instance, instead of targeting tourism, smart specialisation might focus on the potential of new ICTs to develop different sectors, leading to the development of, for example, a booking website to improve tourist services and reduce queuing (Janez Potočnik's Expert Group, 2009[27]).

The Entrepreneurial Discovery Process (EDP, Box 2.1) is a central element of smart specialisation. This bottom-up process identifies priorities for investment in research and innovation (Marinelli E., 2017[28]). It involves the quadruple helix of government, industry, academia and civil society. To encourage the EDP, policy-makers typically use participatory models, which include working or focus groups, public-private committees, and websites for citizen participation and consultation. They rely on evidence-based practices such as SWOT analysis, surveys, and studies on scientific and technological trends (Gianelle et al., 2016[29]).

Once policy-makers have identified focus areas of the smart specialisation through the EDP process, they draft a document outlining the proposed strategy. This document lays out public and private investment plans (European Commission, 2014[30]). Box 2.1 details the smart specialisation strategy developed by the region of Malopolskie, in Poland.

Box 2.1. Smart specialisation in the region of Malopolskie, Poland

For the 2014-2020 period, the region of Malopolskie in Poland carried out an EDP, which consisted of three stages and led to seven smart specialisation priorities. The process was led by the regional government's Department of Economic Development.

The first stage was a technological foresight exercise led by the Krakow Technology Park. It involved analysis of data, discussing ideas with local stakeholders on future technological developments with a strong potential in the region and the necessary policy issues. Through 25 meetings bringing together some 1,000 people, this stage provided an analysis of the region's strengths, its research and innovation capabilities, human capital and skillsets, and

future aspirations. It led to the formulation of ideas to support specific innovations and technological developments in the region.

The second stage involved an evaluation of the technological development ideas to identify a small number of potential smart specialisations for the region. Particular emphasis was placed on the capacity of the region to exploit R&D potential in the region's Higher Education Institution (HEIs).

The third stage was a public consultation on the potential smart specialisations through public meetings with local stakeholders.

As a result of this process, seven smart specialisation priorities were selected: life sciences, sustainable energy, information and communication technologies, chemical industry, manufacturing of metals and metal products as well as products made of mineral non-metallic materials, electrical engineering and machine-building industry, creative and leisure-related industries.

For instance, in chemistry, specific programmes aim to implement new chemical compounds, and solutions in the field of chemical engineering. 128 applications have been selected for funding. Examples of applications include the development of new forms and ingredients of medicine, fertilizers and plant protection products.

Source: (OECD, 2019[31]), (Maloposka, 2018[32]).

In some respects, the process involved is as important as the conclusions. There is no guarantee that smart specialisation processes will quickly reveal clearly defined recipes for success in the short term. But by bringing together public and private actors, focusing on entrepreneurial discovery and the valuation of local assets that the authorities may previously have overlooked, they help establish an on-going process in which local and regional development decisions are embedded in broad-based local knowledge, which makes for better evidence and thus improved policies in a wide range of fields. In some cases, they may also reveal information held by some actors that (without their being aware of the fact) is of value to others. As Dani Rodrik puts it, industrial policy should not worry about the right tools such as credits and subsidies, or about which industry should be promoted. It is about "getting the *process* right, […] in which private and public actors come together to solve problems in the productive sphere, each side learning about the opportunities and constraints faced by the other." (Rodrik, 2004, p. 3[33]) In Kazakhstan, this means that public authorities should accept longer-term experiment and some level of risk-taking, as opposed to short-term, outcome-oriented initiatives. This is critical for sub-national governments and local firms to establish and move up a learning curve.

As a starting point, Kazakhstan could conduct a pilot EDP in one or more regions that are not covered by the cluster development programme: East Kazakhstan, Kyzylorda, North Kazakhstan, Pavlodar, West Kazakhstan and Zhambyl. This could create conditions for entrepreneurial surprises. Such an exercise could offer an opportunity to grant regional *akimats* with more freedom and ownership on the process than usual, and supervision from and reporting to the central government would remain limited. The timeline could be established by *akimats*. Stakeholder engagement is extremely important in this process, so *akimats* could be encouraged to conduct this exercise on a voluntary basis, with the incentive to participate in international workshops and events on the topic of smart specialisation, build their capabilities and mentor other regions at a later stage. This initiative would thus contribute to the development of local skills and competencies that are necessary for a more decentralised governance model as detailed in Chapter 3 of this

report. Regional governments in Kazakhstan, like central institutions in the country, already steer and deliver a high number of projects relating to economic reforms, with relatively tight schedules and constrained resources. Carefully assessing the needs in financial and human resources to conduct such projects will be important. International co-operation with experts, peer foreign governments and economic development organisations can also support the process.

Another way to implement this approach is to explore opportunities at the local level in the framework of existing plans. For example, OECD work in the Aktobe region has found that the current development plan of a medical cluster essentially focuses on the technical aspects of establishing a large university hospital – such as the location, buildings, number of beds. It however misses a potentially promising aspect of developing or expanding new economic activities around the medical hospital, such as general facilities management, hospital waste collection and management outside of the hospital, private ambulance services, or equipment and consumable supply. Private sector benefits and participation in the plan is not even mentioned, other than the need to find large investors to contribute in the PPP hospital development projects. In a similar vein, the local authorities mention in the discussions the challenge of finding locally the human resources needed to work in the hospital, but this problem – and its possible solutions – do not appear in the plan. Setting up an EDP in the context of the medical centre development in Aktobe could lead to the identification of hidden opportunities, and even solutions to known problems and challenges.

2.3. Kazakhstan could benefit from more integrated regional policy frameworks

2.3.1. Kazakhstan's current approach to regional development entails gaps and co-ordination failures

Like many countries, Kazakhstan's overall approach to regional policy entail gaps and co-ordination failures. As noted above, regional development and sectoral plans tend to consist of detailed responses to centrally defined objectives and incentives. As a result, these plans do not always provide an integrated vision of a region's path toward growth with identified, specific local priorities. Moreover, co-ordination between national and regional plans sometimes seem to be lacking. For example, in Kostanay's Development Programme 2016-2020, there is no mention of the flour mill cluster presented in Figure 2.2. This is revealing of a lack of alignment between actors, or co-ordination failures, that need to be addressed through both governance changes (addressed in Chapter 3 of this note), and regional policy approaches and tools, addressed in this chapter.

The delivery of regional development plans in Kazakhstan also encounters a number of problems relating to the implication of target audiences. National and local governments have been trying to increase the participation of private sector stakeholders and citizens in economic development projects, but they sometimes face a lack of interest or even resistance. This lack of responsiveness can come in large part from mistrust in public institutions, and a perception that these initiatives do not really target agents' interests. As a result, initiatives are often led by partners that are already well connected, and support tools tend to be used by a small group of agents, who may not be those with the greatest need. Moreover, information available on Kazakhstan's Regional Development Map of

Entrepreneurship[2] indicates that policy instruments' target audiences have a low level of awareness of the existence of these instruments.

2.3.2. Kazakhstan could develop integrated visions for the development of pilot local economic activities, as step towards scalable capabilities

Kazakhstan would benefit from encouraging regions to build integrated visions and comprehensive policy packages for regional development. Such policy packages would be based on the usual ingredients of cluster approaches, namely education, technology diffusion and innovation, SME and investment policies. Currently, all these policy areas are part of Kazakhstan's economic development plans, but the vision remains fragmented. Indeed, plans developed for a specific activity occasionally lack an integrated vision, i.e one encompassing all policy areas needed to develop the activity. For instance, the Aktobe Medical Centre's strategic development plan would benefit from integrating other aspects that are important for regional development, such as urban planning and transport. The livestock development plan in Kostanay is another example of a very narrow, sector-specific vision. This plan is a regional declination of a national plan for the development of the livestock sector and seeks to answer centrally defined objectives. It would benefit from integrating other dimensions, such as the way that this plan can contribute to the development of rural areas or the training of local breeders, to provide a broader, place-based view of its regional economic gains.

The capabilities required to develop such plans need time to develop. To start establishing the approach, Kazakhstan could rely on pilot regions identified in the entrepreneurial discovery process proposed in the previous section of this chapter. These regions could select one priority economic activity identified in the EDP and develop a comprehensive development plan for this activity.

A comprehensive vision for the development of a pilot economic activity enables to understand the strategic intent local stakeholders agree on for their activity, and means and tools to achieve their objectives. The pilot activity can be any economic activity with potential and local interest, and can be very niche. The region of Normandy, in France, has established a plan for its equine sector, with the vision to cultivate its positioning as a "land of equine excellency[3]". Recognising the importance of the sector for its regional economy and acknowledging threats to its model (such as the rise of VAT rates on service activities and sector fragmentation), the region convened local stakeholders to design a plan that would help address these threats and overcome challenges to reinforce the sector. Each priority entails dedicated objectives, actions and indicators. Box 2.2 below provides an overview of the plan.

Box 2.2. Normandy's plan for its equine sector

In 2017, the region of Normandy launched a new policy plan to support its equine sector and help it overcome a number of factors that challenged its model. The regional government had relied on the Council of Horses of Normandy, an organisation created by professionals to act as a platform for public-private dialogue, to launch a wide consultation

[2] http://www.businessnavigator.kz/ru/

[3] *"Terre d'excellence du cheval"* in French

among local stakeholders. This consultation had resulted in the identification of 10 priorities for the economic activity, organised into 6 challenges, and offering an integrated and comprehensive vision for the activity's development.

- Challenge 1: train new generations of professionals
  - Priority 1: develop high quality curricula
  - Priority 2: attract new talents
- Challenge 2: enhance enterprises' competitiveness
  - Priority 3: enhance the competitiveness of equine farms
  - Priority 4: enhance the competitiveness of industrial and service companies
- Challenge 3: develop excellent higher education and research for the benefit of the equine sector
  - Priority 5: develop an "equine campus"
  - Priority 6: develop the European Equine Center into a globally-known cluster
- Challenge 4: increase the value and commercialise horses born in Normandy
  - Priority 7: make Normandy the largest market of athlete horses
  - Priority 8: increase the value of local equine races
- Challenge 5: develop the attractiveness of the region abroad
  - Priority 9: develop a communication and lobbying plan and implement a bold event strategy to make Normandy the land of equine excellency
- Challenge 6: develop tourism around horse-related activities
  - Priority 10: build an offer of international tourism based on local know-how

Source: (Région Normandie, 2019[34]).

As shown in the example of Normandy, an integrated vision articulates actions in several policy areas that together reinforce each other's effects, relying on a mix of dedicated tools. The equine sector development plan of the Normandy region lays out a vision that encompasses education and training, research and development, firm competitiveness, international visibility and attractiveness, and market development. Measures are diverse, from the opening of a health clinic for horses to the implementation of a guarantee fund for tenant farming. The result of such a plan is that all individual actions contribute to the same objective of strengthening the economic activity. It is also interesting to note that the plan mentions the creation of dedicated policy tools, but also the use of already existing national and regional instruments, such as financing tools. In this spirit, when developing similar plans, regional authorities could seek to use existing support measures, financial and non-financial, and channel them to serve their objectives.

The consultation and inclusion of a large number of local stakeholder is a key success factor for the implementation phase of such a plan. It prevents lack of engagement and co-ordination failures, increases trust (especially if actors feel that their contribution was taken into account), and raises the level of ownership. Normandy's plan for its equine sector heavily relies on the Council of Horses of Normandy, an organisation created by sector

professionals to operate as a public-private dialogue platform, which operates as the steering body of the overall plan and direct operator of a number of actions. The Hippolia cluster, the only government-certified national competitive cluster for the horse industry, also actively contributes to the project through a "sectoral contract" that aims at fostering partnerships between large companies and SMEs, and create new dynamics within an economic activity. The approach also notably includes local private sector operators, academia representatives and public organisations for investment attraction and tourism. For example, Kostanay's initiative to expand and upgrade its livestock sector focuses primarily on large fattening units and large slaughterhouses, and much less on small breeders. A better integration of small breeders in the plan would increase opportunities to raise productivity in small farming units and decrease risks associated with the raise of crossbred animals (e.g. the first generation should not be used for reproduction). . Similarly, Kazakhstan pilot regions would benefit from bringing together as many agents as possible in their initiatives to develop comprehensive development plans in local economic activities. Awareness campaigns and incentives such as labels and awards could be used to reach wide audiences.

2.4. Actions to create a more collaborative framework in the regions would enable Kazakhstan to foster more linkages in its local economies

2.4.1. Co-operation and collaboration between actors from different economic spheres face a number of challenges in Kazakhstan

Triple and quadruple helix approaches are at the heart of initiatives such as clusters and smart specialisation undertakings. The "triple helix" commonly designates the collaboration between governments, academia/research, and the private sector to foster innovation and entrepreneurship. It is a concept often put at the heart of cluster approaches. The EU smart specialisation approach adds an additional dimension, making for a "quadruple helix", where civil society is included as an actor and ICT is the basic enabling technology. In all cases, these concepts rely on the principle of close interactions between stakeholders from different spheres whose collaboration can lead to the creation of new economic value.

In Kazakhstan, linkages between stakeholders in different spheres face a number of challenges. Many actors do not see the upside in co-operating – an action that requires time and resources – and lack incentives to do so. Even when they are willing to co-operate, some stakeholders have difficulties in overcoming challenges and disincentives such as Key Performance Indicators (KPIs) that do not value co-operation, lack of framework for shared resources, and inadequate institutional settings.

Kazakhstan is working to bring education and research institutions and private sector firms closer together, notably through technology parks. These parks comprise universities, R&D institutions and private sector companies, and aim to support business incubation. The parks shape regional scientific and industrial infrastructure and provide facilities for the implementation of innovative projects and technology commercialisation (OECD, 2017[35])). Furthermore, the government offers technical support and training to researchers to promote university-industry collaboration (The Astana Times, 2019[36]). In addition, the government aims to enhance commercialisation of new technologies created by universities and research organisations. The 2015 law on Commercialisation of Results of Scientific and Technical Activities and its amendment in 2018 gives researchers rights in the commercialisation of its research.

Despite these efforts, university-industry collaboration remains quite low, as evidenced by Kazakhstan's ranking of 75th in the world (World Bank, 2017[37]). As universities and science-industry links are considered as key drivers of regional development, regional governments are becoming increasingly involved in knowledge transfer policies (Guimón and Paunov, 2019[38]).

2.4.2. National and regional governments in Kazakhstan could take further steps to enhance linkages between education and research institutions and private businesses

Experience from other OECD countries suggests that collaboration between academia and the private sector can play a key role in stimulating innovation and enhancing economic growth (OECD, 2017[35]). For example, the direct contributions of universities and public research institutes to patenting are growing faster than those from private sector firms (OECD, 2019[39]).

In Kazakhstan, research-business linkages could be enhanced at the regional level to deliver a place-based support to innovation. There is little evidence of collaboration between the private sector and researchers that does not go through the government (Dnishev, Alzhanova and Alibekova, 2015[40]). Given this central role, the government could enhance the impact of its role by facilitating greater and more systematic involvement of the regional level in knowledge transfer. For example, regions in Kazakhstan could further complement central government's initiatives at the local level. They could provide close support to innovation actors and their networks, in particular innovative business firms and intermediary organisations (OECD, 2017[35]).

In particular, regional authorities can support innovation through intermediary organisations that support business innovation (OECD, 2018[41]). Intermediary organisations are public, private or not-for-profit organisations that deliver policies on behalf of national or sub-national government (OECD, 2016[42]). They can include business associations, NGOs, chambers of commerce and technology transfer offices. Through its Fostering Productive Innovation Project supported by the World Bank, Kazakhstan is developing its network of technology transfer offices (TTOs) - or "commercialization offices" as they are called in the country - in its major universities. It could also envisage grouping TTOs in regions to build on common resources. For instance, in Colombia, six regional TTOs have been created since 2013 through alliances among universities, research institutes and firms. The aim of these TTOs is to build critical mass to provide high-quality specialist services to drive research and innovation, development of the private sector and contribute to regional development (OECD, 2019[39]). The German example described in Box 2.3 below further provides a case study for creating innovation networks.

Box 2.3. Establishing innovation networks in Germany

Germany established the InnoRegio programme in the late 1990's with the specific goal of addressing innovation in East Germany, through the creation of innovative networks with specific abilities and technologies with competitive and regional advantages, with an all-encompassing triple helix approach. It was of vital importance for small and medium sized companies to strengthen their innovative ability through new forms of co-operation with science and research generation.

The Federal Ministry for Economics and Technology and the Federal Ministry for Education and Research sponsored the programme. The network approach was particularly appropriate in Eastern states, because while the research and university systems were relatively strong, there was little to no co-operation between universities, research institutes and SMEs.

InnoRegio was advertised by the Federal Ministry for Education and Research as a broad, open-themed competition. The InnoRegio jury selected 23 networks of companies, educational and research institutes and local governments. The selected applicants received the InnoRegio label and DM 300,000 to develop the network and prepare projects of their choosing. The federal ministries provided advice and support.

One of the clusters created as a result of InnoRegio was the Berlin-Buch HealthRegion. Currently, about 25 partners made up of health institutes, universities and pharmaceutical companies form a regional network, which is focused on basic and clinical research, clinical practice, continuing education and the service sector. In particular, oncology, neurology, and pharmacology are studied.

In a 2002 review of InnoRegio, Eickelpasch found that, among the main findings noted that during development, external moderation helped significantly to establish and foster the networks. InnoRegio participants believed they are more capable than competitors are more often than companies in eastern Germany in general. In InnoRegio networks, there is also a larger share of companies with capacities in research and development than in eastern Germany in general.

Source: (Innovation Strukturwandel, 2019[43]), (OECD, 2007[44]).

In addition, SMEs face challenges in developing structured approaches to collaborating with higher education institutions (OECD, 2007[45]). To foster innovative business start-ups from universities and research institutions in Kazakhstan, it would be helpful to expand early-stage growth funding (OECD, 2018[21]). SME development could also be supported through co-operative education partnerships to better connect the world of SMEs and that of university graduates. In Ireland, for example, the government export development agency (Enterprise Ireland) provides "innovation vouchers" that SMEs can use to fund exploration of a business idea or technology in collaboration with academia ((Enterprise Ireland, 2019[46]). The same agency also runs a graduate programme that matches high-potential university graduates with a promising SME.

2.4.3. Kazakhstan would also benefit from better frameworks for linkages between governments and academia and research institutions

Effective partnership between academia and the public sector can help drive economic growth in a number of ways when relevant levels of public authority are engaged. Two

main ways could be explored in Kazakhstan to create effective linkages with academia: government as *investor*, and government as *partner*. In practice, these roles can and should overlap. The outcome of effective co-ordination structures benefit universities themselves, the public sector as a whole – and citizens.

First, as investors, governments can help drive the innovation agenda in universities as a way to improve economic growth and the attraction of global talent and investment. Universities themselves can be engines of growth through revenue generation: in the United Kingdom, universities generated a GBP 52.9bn gross value added contribution to GDP in 2014-15. In addition, public funding invested in universities generated a clear and positive outcome for the broader economy. For example, for every 100 full-time jobs created within universities themselves, another 107 jobs in other industries are created across the UK (Universities UK, 2017[47]).

This demonstrates the return-on-investment that universities can bring to the economy as a whole. Governments use a number of instruments to spur innovation in universities, such as direct funding, sponsoring specific research streams, and incentivising student take-up of relevant courses (e.g. STEM subjects). Kazakhstan should gradually increase the level of institutional funding for research at universities and public research institutes (OECD, 2017[35]). Indeed, most university research is financed through competitive schemes, which undermines the financial stability needed for longer-term planning and more strategic research projects (OECD, 2018[41]).

Second, the government can be engaged as an active partner of universities. The purpose would be to align government objectives (e.g. economic growth) with university objectives (e.g. new technology development) through regular dialogue at a variety of levels. Universities that are able to rely on government support are in turn able to better plan strategic or longer-term initiatives such as campus development and the attraction of teaching talent. Government, in turn, that are attuned to the evolving needs of universities in the era of growing student mobility and digital technologies, are better able to appreciate the secondary or knock-on effects of how universities can contribute to the economy and society as a whole.

Governments can also help academia by fostering co-operation between universities and entities that can carry on research, such as hospitals. Appropriate legal frameworks are needed to enable co-operation between hospitals and universities. Such a framework could regulate issues such as use of hospital material, fees of teaching doctors and projects for collaborative research. Current experience shows that the establishing of University hospitals in Kazakhstan is difficult due to the absence of a proper institutional setting that facilitates the collaboration. Even with a high degree of willingness to co-operate, agreements are hard to reach when resources are constrained and KPIs put pressure on cost efficiency. This is notably the case in Aktobe, where the will to collaborate between the hospital and the regional medical university is very strong, but the operating frameworks hinder the cooperation. Incentives and budgets, for example, are not designed to encourage such cooperation – rather the contrary, as the question of the incurred costs can weigh on both organisations' bottom lines, with no formal upside. The conditions of practitioners' pay for the training of students, for example, is one of the big challenges. Adopting a formal operating framework for university hospitals at the national level could help in this regard. Box 2.4 below details the formal framework of co-operation in French University Hospitals (CHU).

Box 2.4. *Centre Hospitaliers Universitaires* (university hospitals) in France

In 1958, France created the *Centre Hospitaliers Universitaires* (CHU), which are public university hospitals. CHUs have a triple mission of care, education and research and establish a permanent link between hospitals and universities.

A contract is established between the hospital and the university. It regulates several issues such as determining a specific category of the university hospital personnel who are employed by both the university and the hospital. In addition, the practical component of the curriculum for medical students is jointly organised by the faculty of medicine and the university hospital, establishing synergies between theory and practice.

This organisation is critical for conducting research. The pooling of resources that result from integrating the university and the hospital enable for a more efficient conduct of research and clinical trials. It is also attracts physicians in university hospitals and keeps them all day long within the hospital as they receive a double income (from the hospital and from the university) and are able to conduct a controlled private practice within public university hospitals.

Source: OECD Eurasia Competitiveness Programme, Regional Competitiveness Project – Phase II, presentation from the AP-HP.

3. Improving the governance of regional policies in Kazakhstan and better tailoring them to local needs and priorities

Kazakhstan has made progress in involving regional and local governments in regional development policies. Nevertheless, central government priorities still drive current regional policies in Kazakhstan, as reflected in several sectoral policy programmes and plans. This chapter begins with an assessment of how Kazakhstan can improve its overall regional policy framework by adapting it to local needs and priorities. It then highlights the progress that the country has made in advancing its decentralisation agenda, and addresses the need for further decentralised governance supported by adequate financial and human resources. Finally, the last section will address how regional policy-making in Kazakhstan would benefit from further co-ordination between policy-makers and more inclusion of civil society and the private sector.

3.1. Better data and greater co-ordination between different sectoral plans could contribute to a more integrated and informed framework for regional policy

Data is fundamental for the development of an evidence-based policy-making, to make policy adjustments when necessary, to improve service delivery and know where to invest. In addition, co-ordination between sectoral plans ensures that policy objectives are aligned and thus guarantees efficiency and consistency. This section will assess Kazakhstan's current governance framework for regional policy and provide recommendations on developing better sub-national information systems, aligning plans and designing comprehensive strategies to tackle local issues.

3.1.1. Kazakhstan's current governance framework for regional policy is fragmented and concentrated at the top

A high level of fragmentation

The current regional development framework in Kazakhstan is based on several sector programmes and strategies. This results in a fragmented, sectoral approach that contributes to a lack of coherence between policy objectives, and a gap between objectives and dedicated resources.

Many national programmes discuss regional development. This may be the symptom of an "inflation of strategies", i.e the existence of too many strategies (OECD, 2016[48]). Such "inflation" makes it difficult to build links between programmes and leads to a lack of coherence between policy objectives in the programmes. For instance, the Forecast Scheme and the Programme of Regional Development focus on developing growth poles to maximise the human and economic potential of cities. In contrast, the Business Road Map aims to help rural towns, small towns and mono-industry towns (OECD, 2018[21]). These diverse objectives can lead to different policy effects and hinder the realisation of the programmes' objectives if the complementarities have not been well identified and articulated. The point is not that Kazakhstan must choose between fostering agglomeration and working for the development of rural areas and smaller towns and cities. It is rather that the pursuit of these objectives requires co-ordination in order to avoid contradictory efforts.

A proliferation of strategy documents also implies that many resources are needed to draft and update them, with all the human resources, time spent on meetings, and co-ordination between the different ministries and levels of governments that this entails. It can also make it difficult for stakeholders to know what they need to implement.

A top-down approach to regional development

The central government is still the main policy-maker for regional development. Kazakhstan's approach to designing, planning, monitoring and evaluation in this area remains vertically driven. As described in Chapter 2, the central government formulates industry plans and designates economic sectors for development and their locations, instead of promoting bottom-up development. Furthermore, local economic plans are very much driven by performance development indicators defined by the Ministry of National Economy (OECD, 2017[8]).

The central government's overall SNG performance monitoring and measurement practices are quite demanding and could be reassessed with a view to streamlining them.[4] For instance, the central government defines a list of economic indicators that regions should reach. Indeed, the long-term forecast detailed in the Forecast Scheme 2020 establishes a list of sectors, such as mining, agriculture, real estate, and the targets that each region should reach. As a result, the assessment of *akims* by centrally defined Key Performance Indicators limits their ability to implement locally based policies to respond to local needs (OECD, 2017[8]). The Akimat of Kostanay reports twice a month on their livestock development plan, for which it is required to fill a table with a relatively high number of indicators. On the other hand, *akimats* have reported difficulties in reaching targets set by the national level as they can have little control over some of them (e.g. for mortality rates). Although monitoring and evaluating public policies is a fundamental function of all governments, including, in many countries, performance assessment of central governments over subnational governments, it is crucial that the impact of the monitoring is also considered. Too much monitoring and reporting can become as inefficient as no reporting at all. In the case of Kazakhstan, it seems that the number of indicators and reporting frequency could be re-evaluated to make sure that resource allocation to the reporting and evaluation is efficient, and the volume of information collected can be strategically used for improvement or to support building evidence bases. In particular, the government should consider the risk that a large part of the policy-making becomes a "tick the box" exercise. Finally, measurement practices should target local outcome, and not only central objectives. In the case of Kostanay for example, this would consist in measuring how the development of livestock exports benefits the local economy (such as intra-sectoral productivity, additional tax revenues, FDI attraction and development of export-related jobs).

3.1.2. Kazakhstan needs to implement better sub-national information systems to inform the regional policy-making process and align plans

To improve the overall policy framework for regional development, Kazakhstan should rely on better quality data when possible, i.e. data that are accurate, reliable, and based on international standards for comparability. This would greatly help Kazakhstan take into account the local level and address its specific policy challenges.

[4] Decree on the System of Annual Evaluation of the Effectiveness of the Central Government and Local Executive Bodies of *Oblasts* and the Cities of Republican Status.

Better sub-national information systems based on local needs

Information systems that provide consistent, reliable and relevant information at the local level to conduct the policy-making process would respond better to local needs, constraints and opportunities. Kazakhstan should improve the data collection at national and local levels, including sector-specific data, and make sure they are up to date (OECD, 2018[41]). There are five immediately possible ways for Kazakhstan to improve data collection at national and local levels.

First, there is a need to collect better sub-national data and develop better indicators at a sub-national level. Administrative data, i.e the set of units and data derived from an administrative source, exists, but regional data to assess the performance of regions at different territorial levels is lacking (OECD, 2017[7]). The collection of sub-national data could be enhanced through new sources of statistical information obtained through the increased digital flow of data. New sources include open source packages and platforms, mobile phone data, commercial data. It can help overcome data limitations that statistical offices face and help understand better the local economic situation. For example, Statistics Netherlands works with a private mobile phone provider to produce precise commuting data for a better understanding of functional areas (OECD, 2019[49]). In Kazakhstan, the Committee of Statistics accessed the databases of mobile connection operators in 2017, which allowed it to update its register system and revise contact data about the respondents (OECD seminar discussions in Nur-Sultan, Kazakhstan, July 2019). It would be useful to replicate this kind of activity in other areas to have access to better data.

Secondly, relevant information collected by national authorities should be systematically shared with regions. This will allow regional authorities to adopt measures tailored to local information. For instance, local authorities in Kazakhstan have reported that they would benefit from knowing information that the central level has on the value of land and property of enterprises, so that they can plan their budget (OECD seminar discussions in Nur-Sultan, Kazakhstan, July 2019).

Thirdly, it would be useful to set fewer and more relevant indicators that *akimats* have a realistic possibility of meeting. Indeed, too many indicators can be counterproductive and result in a “box-ticking” exercise (OECD, 2018[50]). In addition, well-being indicators at the regional level are necessary to have an understanding of human welfare and how it can be improved through local policy-making. For instance, the region of Southern Denmark has put in place a “Good Life” framework to help the regions and its municipalities identify their strengths and weaknesses and monitor their progress (OECD, 2014[51]). The draft Forecast Scheme 2030 mentions that in developing indicators for regional standards, it will take into account indicators such as the OECD Better life index, the Mercer Quality of Living Survey and the UN Human Development Index.

Fourth, Kazakhstan should continue to apply international standards and methodological best practices as scopes for data definition, development and collection. For example, based on earlier recommendations, Kazakhstan is starting to use the OECD-EU methodology of Functional Urban Areas to better adapt policy-making to the local level (Box 3.1).

Box 3.1. Functional Urban Areas: definition

A Functional Urban Area (FUA) consists of a densely inhabited city and of their commuting zone, whose labour market is highly integrated in the city. This aims to go beyond administrative boundaries to identify areas where people live and work. It allows authorities to get a better understanding of how an area develops and determine its planning, helping it support job creation and making regions more competitive (OECD, 2017[7]). It also provides a possible comparison between cities at a national and international level. OECD usually views FUAs as urban centres with more than 50 000 inhabitants. Kazakhstan raised the number to 100 000 inhabitants. OECD identified 26 FUA in Kazakhstan, accounting for 55% of the population (OECD, 2017[8]), whereas the draft Forecast Scheme 2030 mentions that 18 cities can be considered as FUA, with a total population of around 11.2 million people.

Sources: (OECD, 2017[7]) (OECD, 2017[8]).

Fifth, the regions in Kazakhstan would benefit from better assessing local assets and needs. An effective local economy assessment shows the financial, technical and other resources that the strategy can use (Rodríguez-Pose and Wilkie, 2017[52]). It assesses a region's resources, infrastructure and human capital, and develops a plan according to its needs and assets, linking policies in order to achieve objectives. For instance, regions need to know what human capital exists in their region when designing strategies aimed at boosting the competitiveness of firms. In Kazakhstan, regional programmes assess the local strengths and weaknesses of economic sectors (see below). It would be useful to better assess the local capacities and needs to be able to link different policy areas and adapt to evolving circumstances. An example is how the region of Styria in Austria managed to overcome an industrial crisis through a good diagnosis of the local situation and the formulation of a bottom-up strategy bringing together the public sector, the private sector and civil society (Rodríguez-Pose and Wilkie, 2017[52]).

Better aligning plans and designing comprehensive strategies to tackle local issues

By better aligning national and regional plans pertaining to related policy issues and promoting comprehensive strategies to tackle local problems, Kazakhstan's overall regional policy would gain in coherence and efficiency. As highlighted in the introduction, regional economic growth is driven by a combination of interconnected factors such as infrastructure, human capital, labour market, innovation, productivity, agglomeration and connectivity.

Better aligning plans that have related policy issues would enhance the realisation of their objectives. For instance, to ensure a continued focus on the growth hub objective, better alignment is needed between the programmes for spatial development such as the Forecast Scheme and the Programme of Regional Development, and the spatial development part of the Business Road Map (BRM). As the SME and Entrepreneurship Review of Kazakhstan recommends, this could be done by creating a dedicated BRM for high-potential SMEs in the five cities designated as national growth pole hubs (Almaty, Aktobe, Nur-Sultan, Shymkent, Ust-Kamenogorsk). This is something to consider for the next version of the programme that is extended until 2025.

Furthermore, programmes developed at the regional level could further establish linkages to national programmes. *Akimats* develop Programmes of Territorial Development (PTD) that aim to implement the socio-economic policy at the regional level. PTDs analyse the socio-economic development of the region, indicate goals and set indicators to track them. These plans have to respect the national strategic development plans, such as the Forecast Scheme and the Business Road Map. For example, it details measures implemented in the framework of the BRM, such as interest rate subsidies on bank loans. For monitoring and implementation purposes, it would be useful to increase links between the different levels of programmes. For instance, regional programmes could refer to the objectives set out in the national programmes throughout the regional programme. This is the case with the national Concept of Industrial Development 2020-2025, which specifically refers to the targets set out in Strategy 2025, indicating how the Concept will implement the Strategy's goals. This makes it easier to build linkages between programmes. Additionally, a PTD refers to the indicators in the State Programme of Industrial-Innovative Development relating to labour productivity, making the links explicit between indicators and programmes. This could be replicated in all regional and national programmes.

To tackle local problems efficiently, it is useful to develop a comprehensive strategy that cuts across different policy areas. An example is land-use management (Box 3.2). Indeed, land-use management has an impact on several policy areas such as transport, housing and economic development. A comprehensive plan can accommodate different policy objectives by laying out the use of land and its development goals. Good co-ordination between cross-sectoral policies and spatial planning is necessary for better-managed urbanisation and maximising agglomeration effects. For example, by relaxing building restrictions in larger cities, cheaper housing would become available. This would in turn increase the size of the agglomeration, raise average productivity and open higher productivity jobs for new workers, thus maximising agglomeration benefits (OECD, 2017[53]). In France, communes are co-operating by establishing joint land-use plans to ensure consistency across sectoral policies (Box 3.2).

In Kazakhstan, more comprehensive land-use management is needed, as the current approach is sectorial. For instance, land use planning should be taken into account when designing housing and economic development policies. Good zoning practices would also help Kazakhstan reconcile diverse policy measures such as enhancing competition between businesses and the protection of the environment. A way to do so would be to use the Urban Zoning Registry as a regulatory tool for socio-economic planning. The national government could help city governments to use the Urban Zoning Registry.

To enhance links between different policy domains, Kazakhstan needs to improve the capacity for cross-sectoral planning. This could be done through the creation of urban planning institutes at the regional or local level. These institutes analyse data for policy and programme decision-making, gather knowledge from academic sources to support policy design and evaluation. They also train personnel of the urban authorities (OECD, 2017[8]).

Box 3.2. Joint land-use planning in France

In France, communes are encouraged to adopt joint land-use plans (*plan local d'urbanisme intercommunal*, PLUi) to respond to challenges that go beyond the level of the commune

(housing, biodiversity preservation, urban sprawl). These plans aim to ensure consistency across sectoral policies and reduce suburbanisation and peri-urbanisation.

The PLUi takes into consideration the directives from the national and regional level as well as the local conditions for development. There are four parts to such a plan: a presentation report, a sustainable development planning project, the ruling or zoning, and map annexes.

These plans are legally binding and take priority over other local government policies and actions. The municipal council that gathers all the mayors adopts them. Citizens are involved in the process through workshops, public meetings or surveys.

Source: (OECD, 2017[54]).

3.2. Kazakhstan needs to advance its decentralisation agenda to enable regional policy-making that answers better citizen needs

In the past years, Kazakhstan has moved forward its decentralisation agenda through several reforms. It could go further in order to take into account local specificities. In this regard, it will be essential to strengthen the sub-national level, through increasing its democratic legitimacy, providing more financial leeway to sub-national governments and building capabilities at the sub-national level.

3.2.1. Kazakhstan could take further steps in its decentralisation process

Kazakhstan has taken several steps toward decentralisation. This has long been a government priority, as Strategy 2050, the 100 Concrete Steps to Implement Five Reforms and a series of laws adopted show.

The Law on Local Government and Self-Government of 23 January 2001 defines local government competencies. It determines the roles and responsibilities of *maslikhats*, *akims*[5] and *akimats*. *Maslikhats* are local representative bodies elected by direct suffrage for five years. They approve plans, economic and social programmes of development of its territory, the local budget and reports on their execution. They exist at the regional and district or city level.

There was a major step with the Concept for the Development of Local Self-Government adopted via presidential decree of 28 November 2012. The Concept aims to develop the local government system. To do so, it expanded the financial independence of lower levels of government, increased citizen participation and introduced elections for *akims* at the lower levels.

The law of 14 June 2013 on "Introduction of Revisions and Additions in Legal Acts in Demarcation of Authority between Bodies of State Governance" brought two important novelties. The first is the indirect election of *akims* for towns with district (rayon) significance, villages and rural districts. Rural a*kims* are elected through *maslikhats.* The first election took place in August 2013. Another election took place in August 2017, and 1416 rural *akims* were elected (ECHO, 2017[55]).

[5] The *akim* is the head of the local executive body and represents the president and government of Kazakhstan. The *akim* is responsible for implementing state policy within the local territory.

The second novelty is that the law gives more control to locally elected *akims* and communities over their local budget. Now, rural *akims* have more rights to determine their own revenue sources. It also enhances the participative nature by giving citizens the right to participate in the monitoring of local budgetary funds (OECD, 2017[7]).

In line with the Concept of 2012, a law of 11 July 2017 "On Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan Concerning the Development of Local Self-Government" aims to implement an independent budget at the level of cities of district significance, villages and rural districts. It also aims to expand the powers of local self-government in the budget process.

Despite these advances in decentralisation, there is room to enhance the application of a principle of subsidiarity in Kazakhstan and move forward the agenda toward a true multi-level governance system. Sub-national governments play the role of implementation bodies of central government policy (OECD, 2017[56]) and have limited responsibility and accountability about local development policies. Furthermore, the President, the Government and a higher *akim* can reverse decisions and orders of *akims* (Constitution, article 88.4). There is no one multi-level governance model, and the design and implementation of such as model is often a challenge, in OECD as in non-OECD economies.

In addition, subnational governments have limited legitimacy and accountability to citizens. The effectiveness of the elections of rural *akims* has been debated (OECD, 2017[7]), as the degree of control exercised by the central government has remained substantial. Candidates need to be approved by district *akims*, who are appointed by (and represent) the central government. There were discussions in the first half of 2018 on reforming the law to allow for direct elections of *akims* at the rural level, but the Senate decided to postpone this measure. Importantly, the *akim* election did not include *akims* at the oblast and district levels, who continue to be appointed by the central government and are tasked to implement its policies. The president can appoint *akims* of *oblasts*, who in turn appoint the *akims* of districts. *Maslikhats* vote merely to confirm the president's choice in the case of *oblast akims*.

Box 3.3. Responsibilities of regional governments in Kazakhstan

Regional governments are responsible for:

- implementing regulatory, executive and supervisory functions, ensuring solutions to problems of local significance according to their administrative-territorial unit;
- ensuring the implementation of the national policy, in accordance with development needs of the region;
- adopting regulations, to ensure the solution to problems of local significance and realisation of state policy in the relevant territory;
- managing public property;
- developing plans, economic and social development programmes of the territory, local budget and ensuring their implementation;
- monitoring and supervising the activities of individuals and entities within their territory;

- participating in providing services for the protection of public order and security in the territory;
- providing public services of local importance;
- other powers delegated to local executive bodies by the legislation of Kazakhstan.

Source: (OECD, 2017[56]).

3.2.2. Strengthening the sub-national level would deliver more effective policies

Increase the democratic legitimacy of subnational governments by empowering local subnational governments

Subnational governments are the level of government best adapted to know the local conditions, thus having an information advantage over the central government. To make sure that regional development policies are adapted to the local level, it is necessary to empower subnational governments. Doing so requires increasing their democratic basis, notably through the elections of *akims* at all levels and enhancing the roles of *maslikhats*.

Kazakhstan could expand elections to *akims* at all levels. *Akims* at oblast and rayon levels remain appointed by higher levels of government. This means that the central government still has control over local decisions, as the *akims* are vertically subordinated to the central government (OECD, 2017[8]). Their accountability to the central government and not to the citizens can explain that *akims* are not always interested in gaining popular support, and limits their interest in solving local problems (OECD, 2017[8]). An election of *akims* would help build ties with the local communities, as the fact that they are appointed means that they have sometimes little to no connection to their regions (OECD, 2017[56]). An option would be to elect *akims* through the *maslikhats,* thus reinforcing the democratic basis of subnational governments (OECD, 2017[8]). The experience of Poland would be useful, as the *marshals* (head of regions) are elected by the regional assembly.

Furthermore, the election of *akims* implies fixed terms of office. This allows for better responsiveness to changing local needs as *akims* are periodically changed every fixed term (four years for rural *akims*). Kazakhstan could go further and establish fixed mandates for *akims* at all levels and consider establishing term limits for elected *akims* (OECD, 2017[56]).

Maslikhats should put into practice the competencies given to them by law. Despite the powers allocated to them in the Constitution and laws, in practice the powers they have are more limited (OECD, 2017[56]). They exercise little influence over the decisions of *akims* and *akimats*. *Maslikhats* rarely launch the procedure of non-confidence of *akims* provided for in the Constitution, and confirm the President's choice. It is important that *maslikhats* can put in practice the competencies given to them, as they are the local representative bodies.

Moreover, increasing the role of *maslikhats* in the budget process would promote local self-government. In addition to approving the budget, *maslikhats* could be responsible for discussing, monitoring and evaluating the execution of the budget (OECD, 2017[8]). This role could be reinforced through the creation of an independent research unit that would provide information to the *maslikhat* on public finance issues, such as an analysis of the *akimat*'s budget proposal and policy proposal, as well as tax analysis. As the creation of such units require funds, Kazakhstan could create one in *oblasts* and then consider it in medium-size cities of district significance. As an example, the Independent Budget Office

in New York City provides city officials and the public with information on the NYC budget and economy, notably through a fiscal outlook, an analysis of the preliminary budget and of the executive budget (OECD, 2017[8]).

Provide more financial leeway and responsibilities to subnational governments

To ensure effective decentralisation, it is necessary to transfer new funding capacities in line with the extension of competencies to the local level. Indeed, the fiscal dimension is often "the weak or even missing link of decentralisation" (OECD, 2019[57]). Subnational governments need own-source revenues in addition to grants and shared tax revenues.

Local authorities in Kazakhstan have little authority with regard to taxation (OECD, 2017[56]). Local and regional budgets do not have stable sources of income and are largely dependent on transfers from the central government (OECD, 2017[7]). The central government finances approximately 60% of sub-national government spending, in the form of revenue assignments, targeted transfers and equalisation grants (Beazley, Downes and Nicol, 2019[58]). Funding flows are earmarked (OECD, 2017[56]).

Kazakhstan is taking important steps to decentralise budget management in line with the 100 Steps programme (OECD, 2018[41]). Since 2018, an independent budget has been established at the level of cities of district significance, villages and rural districts with a population of over two thousand people (Amendment to the Law on Local Self-Government adopted in July 2017). In 2020, this budget will be implemented in all the rural districts. This budget will include a number of tax revenue streams: individual income tax, property tax, land tax, vehicle tax, and payment for outdoor advertising. Non-tax revenues include fines imposed by rural *akims*, voluntary fees of individuals and legal entities, income from the communal property of a city of district significance. The budget will continue to include revenues of transfers from the district budget (Budget Code of Kazakhstan).

The levels of transfers from the central level are determined on an annual basis. This results in uncertainty for local administrations and makes long-term planning and investment more difficult. A regular review of the fiscal transfer system to ensure predictability of transfers to local executive bodies would be useful. Such a review could be achieved by basing the transfers on a rolling three-year average of economic activity and government revenues and expenditures. Changes should not result in any major change to the amount of the general transfer (OECD, 2017[56]). In addition, an increase of revenue transfers to sub-national governments would enhance their capacity to plan and would be conducive to better public investment (OECD, 2017[7]).

Build capabilities at the sub-national level

As the decentralisation process in Kazakhstan advances, it is necessary to strengthen capabilities at the sub-national level and make sure that subnational governments have the necessary skills to carry out their tasks, notably in view of ensuring effective public investment. It is also important to design good evaluation mechanisms to ensure that policy-making is tailored to the local needs.

First, local governments may lack the necessary human resources and skills to conduct new competencies devolved to them. It is thus necessary to provide training to sub-national civil servants, for instance on utilities management, public procurement, evaluation, managing public private partnerships, etc. The central level can support this training through technical assistance, training and guides (OECD, 2017[7]). For instance, in order to ensure effective

implementation of the reform of the budget at the rural level, it would be fundamental to train local staff in budget management. There is currently a shortage of these skills in some regions in Kazakhstan and the approach of "learning by doing" is not always enough.

The recently adopted OECD Recommendation on Public Service Leadership and Capability could help Kazakhstan equip public workforces with the skills, leadership and people management systems needed. The Recommendation is based on a set of commonly shared principles that have been developed in close consultation with OECD countries. It presents 14 principles under three mains pillars (Figure 3.1). For instance, one of its principles relates to continuously identifying skills and competencies that transform political vision into services that deliver value.

Figure 3.1. Principles of the OECD Recommendation on Public Service Leadership and Capability

Source: (OECD, 2019[59]).

Furthermore, strengthening capabilities at a local level would give the skills necessary to sub-national government to conduct an effective public investment strategy. Kazakhstan should design and implement investment strategies tailored to the places the investments will occur (OECD, 2017[7]). As part of the investment strategy, the planning process should be based on common principles (Mizell and Allain-Dupré, 2013[60]). First, it should be tailored to local specificities. In addition, the investment planning should also be results-oriented, designed according to national and sub-national goals. Investment priorities should also be realistic and well informed. A place-based assessment could help to prioritise policy objectives according to local needs. Finally, the investment portfolio should be forward-looking.

Evaluation mechanisms have to be defined when designing policies, as monitoring and evaluation play an important role in linking policy objectives and outcomes and assessing a policy (OECD, 2018[50]). Prior to an evaluation, a typology of three indicators should be put in place: input, output and outcome indicators (OECD, 2017[53]). Input indicators focus on the resources used in the implementation of a policy, indicating the costs associated with a policy but not mentioning its benefits. Output indicators summarise the results of a policy in terms of the means that a policy uses to achieve its intended effects, for example the

construction of a school. Outcome indicators assess the effectiveness of the policy, what the policy aims to achieve, for example educating more children. This policy evaluation process should be part of decision-making and is a fundamental part of the policy cycle. However, reporting on outcome indicators can take time since policy results are not always immediately visible.

In Kazakhstan, regions report on the outputs of activities, rather than on the outcomes. They focus on the number of people that received training or the number of grants allocated, rather than on the results of these activities. Results could include the assessment of how a training resulted in the performance of SMEs, or if a new activity started after a firm received a grant. This would be more useful to know whether the policy measure was effective or not. For example, during an OECD seminar in Nur-Sultan, it emerged that a school was built in a rural zone of Kazakhstan, which incurred maintenance costs that were too heavy for the village budget. Fewer students than planned attended the school. A report was made beforehand but there was a lack of analysis on the actual outcomes. An *ex ante* evaluation of this project at a local level could have taken into account the number of current and future students, and its maintenance costs. It is also useful to see what other local practitioners have put in place to see which policies have been effective (Box 3.4).

Box 3.4. What Works Centre for Local Economic Growth

In 2013, the United Kingdom created the "What Works Centre for Local Economic Growth". Its mission is to analyse which policies are most effective in supporting and increasing local economic growth. It is an independent organisation run by the London School of Economics, Arup and the Centre for Cities, and financed by the UK Government.

The Centre helps local practitioners to deliver effective and evidence-based policy. It also helps them build the evidence base themselves by piloting and testing new approaches. Its support includes workshops and online guides, and case studies of evaluations around the world that have been successful. It covers ten policy areas affecting local economic growth, such as business support, employment training and innovation.

Source: (OECD, 2017[53]), (What Works Centre for Local Economic Growth, n.d.[61])

3.3. Better regional policy-making requires increased co-ordination between policy-makers and greater inclusion of the civil society and private stakeholders

3.3.1. Developing horizontal and vertical co-ordination mechanisms

Horizontal and vertical co-ordination across and among levels of government would help ensure a more comprehensive regional policy framework in Kazakhstan.

The degree of horizontal collaboration between ministries and central bodies is low in Kazakhstan (OECD, 2017[7]). A closer co-ordination would be useful to ensure there are no co-ordination gaps. This would help align objectives and ensure effective public spending. To do this, the OECD Review of the Central Administration of Kazakhstan 2014 recommended specific actions such as the rotation of civil servants and setting up ministerial posts for cross-cutting issues. Existing co-ordination mechanisms exist in Kazakhstan at the central level, but they seem to be too formal and at a high level of government (OECD, 2017[62]). An example is the national mechanism for co-ordinating the

Sustainable Development Goals (SDGs), which includes a Co-ordination Council on SDGs under the Deputy Prime Minister, five inter-sectoral working groups, and an SDG Statistical Office established within the Committee of Statistics (United Nations in Kazakhstan, n.d.[63]).

There is also a need for horizontal co-ordination among sub-national levels of government, which would enable the diffusion of good practices. Such a co-ordination could include regular meetings dedicated to specific topics, for instance on procurement or SMEs and entrepreneurship. For example on public procurement, it would be useful to share experiences of contractors, as it would allow for providers that had a poor performance to be diffused across *akimats*. This could be done through regular meetings or a dedicated platform (Box 3.5). Regular meetings can include bottom-up meetings like communities of practice, or top-down ones such as meetings organised by the central government at regular intervals. A more institutionalised relationship could take the form of a contractual arrangement between *akimats*. An example in Kazakhstan is the signature of a memorandum of understanding between Almaty and Nur-Sultan on inter-regional co-operation on issues such as the construction of hotel complexes, public-private partnerships and the development of free economic zones. These relate to joint projects and exchange of best practices.

Box 3.5. A web platform for the public procurement system in Galicia, Spain

In Spain, the region of Galicia launched a web platform to manage its public procurement system (http://www.conselleriadefacenda.es/es/sicon). It aims to integrate all public entities and private companies in a one-stop-shop for public procurement.

This platform promoted benchmarking and knowledge transfer among different regional institutions. It relieved the workload of administrative work related to formal procedures for small entities (regional services or small municipalities).

Public tenders in the region are published on the platform. Companies can register for pre-approval and access past successful tender applications, ensuring transparency. It has also increased competition as the number of tender applicants has gone up. Another result has been the reduction in contracting costs for municipalities.

Sources: (OECD, 2016[64]), (Hulbert, 2012[65]).

Vertical co-ordination among levels of government should also be strengthened. One way to do so is through contracts for regional development, based on agreed priorities, objectives and procedure for financing, evaluation and reporting (OECD, 2017[7]). Contracts help to adapt policies to territorial characteristics. They can delegate the implementation of public investment tasks to subnational governments, leading to their empowerment (OECD, 2013[22]). Other vertical co-ordination mechanisms include dialogue platforms, fiscal councils, standing commissions and intergovernmental consultation boards (OECD, 2019[57]).

An example of effective vertical co-ordination in Kazakhstan is the co-ordination between national and regional level on SMEs and entrepreneurship. The national level, in particular the Ministry of National Economy, is responsible for co-ordinating SME and entrepreneurship support in the regions. At the regional level, *akims* head Regional Co-ordination Councils, who are responsible for setting the priorities of their regions and

approving BRM 2020 projects. These Councils are composed of government officials, development institutions, business organisations, second-tier banks, independent experts and entrepreneurs. They provide consulting and advisory functions. In addition, Regional Programme Co-ordinators co-ordinate the implementation of the Business Roadmap (BRM) at the level of regions (OECD, 2018[21]). The BRM also provides for the existence of Local Programme Co-ordinators, who are part of a structural unit of the city or district determined by the *akim* of the region. They provide support to entrepreneurs on the preparation of documents necessary to participate in the programme. These mechanisms are useful for co-ordinating issues related to SME and entrepreneurship development, while ensuring some flexibility for the regional level.

3.3.2. Increasing the participation of civil society and the private sector

To develop a bottom-up approach to policy-making, it is essential to involve citizens. Step 97 of the 100 Concrete Steps relates to empowering citizens to participate in the decision-making process through the development of local governance. This can be done by enhancing the role of public councils, and increasing the participation of civil society and the private sector.

Enhancing the role of public councils

Public councils represent the interest of civil society (Law of November 2, 2015). They have several tasks, such as the discussion of draft budget plans, draft strategies and plans, and regional development programmes. They also discuss the reports of executive bodies on the achievement of target indicators and draft legal acts related to rights and freedoms of citizens (OECD, 2017[62]). Their recommendations have to be considered by state bodies. Public councils also have a control role over the public administration, through monitoring, hearings and examinations.

Ministries, public bodies accountable to the President, and local authorities, establish public councils. This is a step forward for citizen engagement in Kazakhstan. However, at least three concerns can be raised related to their independence and the influence of their role in decision-making (Beazley, Downes and Nicol, 2019[58]), as well as their lack of dedicated budget.

First, public councils are composed of two-thirds civil society and one-third public officials. The large number of public officials involved makes their role of controlling the state body difficult, as the councils and the entities they monitor are not independent from each other (OECD, 2017[62]). Public officials who are part of public councils can exert pressure on other members on issues that matter to their work and influence their decisions (Knox and Janenova, 2018[66]).

Furthermore, their independence is undermined by the fact that the composition of the working group that selects the civil society representatives must be approved by the head of the state body (OECD, 2017[62]). Similarly, the composition of the public council must be approved by the state body or local executive body. Both issues have been raised as affecting the independence of public councils. Indeed, representatives from the regions have mentioned problems related to the procedure for selecting public council members (UNDP, 2018[67]). In Ireland, members of a Citizens' Assembly were randomly selected from the voting population. They were broadly representing of society in terms of gender, age, social class and regional spread, as reflected in the census. This experience was successful and shows that a random selection of people to be part of citizens' assemblies is effective, ensuring transparency and independence of the process (OECD OPSI, n.d.[68]).

In Kyrgyzstan, public councils (formerly public advisory boards) are civil society institutions created in 2010 that have encountered success. Their members are not representative of the broader population but come from different sectors of employment, such as the business sector or leaders of NGOs (Huskey, 2013[69]). The Commission that selects the members of the public councils is composed of one-third of representatives of the government agencies and two-thirds of representatives of civil society (Law on Public Councils of the State Bodies, n. 74, 24 May 2014).

Second, public councils have focused mostly on commenting on draft legislation, which has overburdened their work and limited their ability to represent civil society effectively, not least because such activity is largely reactive rather than proactive (Knox and Janenova, 2018[66]). The public authorities still set the agenda. An example of a successful public council action is in the area of transport in the city of Nur-Sultan. Through several public hearings, people raised their problems. Based on these hearings, the public council gave recommendations to the *akimat*. As a result, regulations were adopted in the area of management of passenger transport and roads (Knox and Janenova, 2018[66]). Public councils are more effective when they have the ability and means to listen to civil society concerns and provide recommendations to the local government. In Kyrgyzstan for instance, public advisory boards have put in place regular "office hours" or public meetings outside of the capital to explain their work and collect feedback from citizens (Huskey, 2013[69]).

Third, public councils have no dedicated budget, which means that their members pay for the expenses incurred during their work (Knox and Janenova, 2018[66]). The lack of dedicated funds can hinder their ability to effectively carry out their work. It would be useful for public councils to have a budget to cover their work expenses, such as covering travel costs.

Enhancing citizen engagement

Citizens should have a say in policy-making, as governments alone cannot face complex challenges. Public engagement is a way for governments to improve their policy performance by working with citizens, civil society organisations and businesses to improve policy outcomes and the quality of public services. It allows governments to better understand people's needs, reduce the risk of conflicts and enhance trust. In addition, public engagement is recognised as a driver of innovation and value creation in the private and public sectors as citizens are becoming more and more active in the public domain (OECD, 2009[70]). In order to involve citizens in Kazakhstan, it would be useful to develop public consultations mechanisms and develop participatory budgeting.

Kazakhstan has worked to improve citizen participation in its decision-making. The open government portal launched in 2016 consists of five websites: open data, open legislation, open dialogue, open budget and evaluation of state bodies' effectiveness (World Bank, 2018[71]). The Open data platform[6] aims to develop dialogue between the government and citizens. It is composed of a blog platform, online discussions, surveys and a page that allows citizens to send feedback on the quality of the mobile phone network. Citizens can ask questions to central government authorities and local executive authorities (*akims*). However, the effectiveness of this platform depends on how the ministers and *akims* use it. The gatekeeping role of officials also hinders the platform's objective (Knox, Janenova and O'Connor, 2019[72]). In addition, the open legislation allows citizens to participate in the

[6] https://dialog.egov.kz/

discussion of draft legal acts. However, the discussion on this platform is limited as out of 691 draft legal acts in public discussion, only 619 public comments have been made and 201 total responses (statistics from October 2019). To increase the involvement of citizens, awareness-raising campaigns and dissemination programmes could be carried out to ensure that citizens are aware of the possibility of providing input to policy-making (OECD, 2017[62]).

In addition, it would be useful to allow the citizen free access to meetings of the *akimats* and *maslikhats* or more effective dissemination of meeting dates, agenda and decisions. Regarding urban planning, national and sub-national authorities could also promote more participatory processes, with citizens participating in forums, public hearings or send opinions by mail or online (OECD, 2017[8]).

Another tool to increase citizen engagement is participatory budgeting. This mechanism allows citizens to have impact on policy-making through the allocation of budget. There has been an introduction of participatory budgeting in Kazakhstan at the local level of government, but it has been difficult to implement. Procedures setting the participation of citizens in the discussion of how budget should be spent has not been established (Beazley, Downes and Nicol, 2019[58]). Kazakhstan could take the example of the *budget participatif* of the municipality of Paris. Citizens give ideas for investment projects on a website, the municipality then determines its feasibility, and if so, citizens vote on the proposals (OECD, 2017[62]).

Public consultations require political and administrative will (OECD, 2016[73]). The procedures to involve citizens in decision-making should result from a strategic and consistent approach and not be a merely box-ticking exercise that would not be effective and hinder its purpose.

Increasing the involvement of the private sector

Private sector dynamism is critical to successful regional development. The involvement of the private sector in regional and local economic development policy discussions is therefore critical.

The private sector is not sufficiently consulted in policy-making in Kazakhstan. It is necessary to involve it in order to take into account its views and develop a business-friendly environment (OECD, 2018[41]). This would lead to better implementation of policies, as different stakeholders are actively involved in contributing to policy development. It also enhances transparency, which is important for anti-corruption efforts, and improve investment implementation.

In Kazakhstan, consultations could be extended beyond business associations to involve businesses that are not members of such organisations. This could be done through online consultations or roundtables between Ministers and senior executives. For instance, Canada sought advice from citizens and the private sector on maintaining its long-term economic growth through the 2010 Cross Canada Roundtable Series. The private sector provided guidance on achieving fiscal balance towards economic recovery (OECD, 2011[74]).

4. Conclusion

Kazakhstan's industrial policy to enhance sectoral productivity, drive economic diversification and boost aggregate national growth would greatly benefit from place-based policies at the regional level. Recent policies for regional development have enabled some concentration, notably in the country's two largest agglomerations. However, it still has not led to the emergence of new, productive economic activities outside the extractive sector. While the current approach to support the development of six clusters offers an opportunity to focus resources, it falls short of creating enabling local conditions for smart specialisation in every region. This paper does not claim that its suggestions will make smart specialisation happen overnight in every territory, but it demonstrates why and how Kazakhstan can - and should - set a public-private dialogue setting that can lead to the discovery of local strengths and assets, and ways to leverage them. This is the country's best chance to identify policy actions that can correct market failures hindering entrepreneurial development and liberate untapped potential.

Central to the definition of place-based policies is good governance. Kazakhstan has made progress in increasing the involvement of regional and local governments in regional development policies. It could move forward the decentralisation agenda by enhancing the democratic legitimacy of sub-national governments and building sub-national capabilities. In addition, better data and co-ordination between national and regional plans would ensure that regional policies are more tailored to local needs and priorities. It is also necessary to increase the participation of the civil society and the private sector in the decision-making process.

The directions for reform laid-out in this paper require a common and strong will from all government stakeholders, and their alignment on the vision, objectives and targets. The will and alignment are needed to overcome the challenges that Kazakhstan faces to realise this agenda for reforms. The most pressing ones are the currently low local capacities for change and steering of a new approach, risk-adversity in the public sector – tolerance for risk being a crucial element of an entrepreneurial culture –, and the need for a more bottom-up, inclusive approach. The work to remove these obstacles will necessarily take time, which is why it is important to focus on the process, rather than on the short-term outcomes.

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REGIONAL POLICIES TO SUPPORT DIVERSIFICATION AND PRODUCTIVITY GROWTH IN KAZAKHSTAN

For national governments, the importance of regional development policies reflects two important realities: first, people's well-being is strongly influenced by where they live and work; and, secondly, it is often possible to identify opportunities and potential policy complementarities at local or regional level that are not apparent from national capitals. Leveraging this potential creates a double dividend, increasing both aggregate productivity and inclusion.

This Policy Insight discusses how Kazakhstan can improve its regional development policy by adopting a more bottom-up, place-based approach in areas where a high degree of centralisation has sometimes prevailed. It suggests the development of place-based policy processes and tools to support economic activities based on the identification and mobilisation of local strengths and assets, and to realise further agglomeration potential. It also discusses ways to strengthen a multi-level governance framework that enables the delivery of such policies.

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