

# ***Breaking Chains: Informal Employment in CAREC and Kazakhstan's Escape from the Middle-Income Trap***

## **Abstract**

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### **Breaking Chains: Informal Employment in CAREC and Kazakhstan's Escape from the Middle-Income Trap**

This study delves into the pervasive phenomenon of informal employment within the diverse economies of the Central Asia Regional Economic Cooperation (CAREC) region. By examining the prevalence and impact of informal labor markets, particularly on vulnerable populations, this research aims to uncover the intricate dynamics that perpetuate socio-economic inequality and hinder progress towards high-income status.

Employing a comprehensive mixed-methods approach, the study integrates quantitative analysis of labor market data with qualitative insights gathered through interviews and case studies. Quantitative analysis includes examining labor force surveys, while qualitative insights are derived from interviews with key stakeholders, including government officials, employers, and workers' representatives, supplemented by in-depth case studies. By elucidating the challenges posed by informal employment, the research seeks to inform evidence-based policy interventions aimed at formalizing the informal sector, enhancing labor market conditions, and fostering inclusive growth.

Through its exploration of the relationship between informality and the middle-income trap, this study endeavors to offer actionable recommendations to catalyze the transition towards higher-income status in the CAREC region. By breaking the chains of informal employment, it aspires to pave the way for equitable and sustainable development, thus unlocking the region's full potential.

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## **List of Acronyms**

<b>ADB</b>	Asian Development Bank
<b>FDI</b>	Foreign Direct Investment
<b>GDP</b>	Gross Domestic Product
<b>GNI</b>	Gross National Income
<b>ILO</b>	International Labor Organization
<b>IMF</b>	International Monetary Fund
<b>NEC</b>	Nippon Electric Company
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>SME</b>	Small and Medium Enterprises
<b>WEF</b>	World Economic Forum

# ***Breaking Chains: Informal Employment in CAREC and Escaping the Middle-Income Trap***

## **Introduction**

The collapse of the Soviet Union marked a pivotal moment in world history, triggering significant geopolitical shifts both within the former USSR and globally. Among the challenges it exposed was the issue of boundary demarcation between the newly independent states. The Central Asian Soviet Republics, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan, had been established in the 1920s–30s through Soviet-led territorial divisions that often disregarded historical and cultural factors. Following their independence, these nations faced the complex task of building new national states (Rahimov & Urazaeva, 2005). Central Asian Countries have developed through significant struggles after their inception. Since the 1990s, the Central Asian republics have experienced periods of economic prosperity. However, their progress has stalled, trapping them in what economists refer to as the middle-income trap. One of the key reasons for this stagnation is the slow implementation of domestic structural reforms (Astana Times, 2025).

Kazakhstan, located in the northern part of Central Asia, shares borders with Russia to the north, China to the east, Kyrgyzstan and Uzbekistan to the south, and the Caspian Sea and part of Turkmenistan to the west. Kazakhstan declared its independence in 1991 following the collapse of the Soviet Union. As outlined in its Constitution, Kazakhstan is a parliamentary republic with the president serving as head of state. Nursultan Nazarbayev, a former Communist Party leader, became the country's first president in 1991 and was re-elected in January 1999, beginning a seven-year term (DHS, 1999). Kazakhstan has played a growing role on the global stage, hosting international forums and peace talks, while domestically prioritizing social development. Investments in education, healthcare, and infrastructure have aimed to improve living standards. However, issues like corruption and inequality persist, hindering broader progress. Gender equality initiatives have seen women take on more public roles, but full parity remains a work in progress (GrowthLab, 2024).

Kazakhstan's journey highlights its efforts to balance political stability, economic modernization, and international diplomacy while addressing deep-rooted structural challenges. Developing nations face two key growth challenges: initiating economic growth and sustaining it. For Kazakhstan, prompting growth is not a concern, as the economy has been expanding rapidly, backed by substantial foreign investment, particularly in the oil sector. However, maintaining this growth poses a more significant challenge. Historical patterns suggest that maintaining long-term growth is more difficult than achieving initial economic momentum. To ensure sustained development and reach living standards comparable to advanced economies, Kazakhstan must focus on institutional reforms. These reforms should aim to (i) build resilience to economic shocks and (ii) foster ongoing productive dynamism (GrowthLab, 2024).

Among the key economic issues faced by Kazakhstan lies the Middle Income Trap. The country has been stuck in it for quite some time. It basically hinders the country's growth by preventing it from switching the core products or services keep the economy moving, into more feasible and sustainable options. Informal economy and employment significantly contributes to a country's hurdles in the Middle Income Trap. Kazakhstan's informal economy is estimated to account for 32.1% of its GDP, which translates to approximately \$227 billion based on GDP at purchasing power parity (PPP) levels. This sizable portion of the economy reflects the country's significant reliance on informal sectors, which includes a wide range of unregistered activities. Such estimates highlight the challenge of addressing informality and its implications for economic policy and social welfare in Kazakhstan (World Economics, 2024).

## Scope and Methodology

This study examined countries relevant to the subject of Middle Income Trap for the purpose of establishing a cases study for Kazakhstan and other similar economies that are experiencing the similar issues. It also aims to establish the causes and effects of Kazakhstan's long standing Middle Income Trap problems and suggestions for the way forward.

The study basically compares similar economies across the globe that face or have escaped the Middle Income Trap and dives deep into the social, political and financial indicators that have proven to be vital in the measurement of the economic development of those countries. The exploratory analysis will be beneficial for the countries experiencing the scourge of Middle Income Trap and prevent them from reinventing the wheel.

## Middle Income Trap

The term "middle-income trap" was introduced by economists Indermit Gill and Homi Kharas to describe a pattern where countries achieve middle-income status but struggle to transition to high-income levels. This phenomenon has been particularly evident in regions such as Latin America and the Middle East, where economic growth stagnated after reaching middle-income levels. Gill and Kharas extended this concept to warn of potential slowdowns in the rapidly growing economies of East Asia, suggesting that these nations could face similar challenges without structural reforms to sustain their growth trajectory (Gill & Kharas, 2007).

Middle-income countries face a slippery slope of a challenge to advance economically. Since the 1990s, many have moved beyond low-income status and reduced extreme poverty, fostering a sense of progress. However, this perception is influenced by historically low benchmarks, such as the era when over two-thirds of the global population lived on less than a dollar a day. The goal for 108 middle-income nations, with per capita incomes between \$1,136 and \$13,845, is to transition to high-income status within a few decades. Yet, progress has been limited: since 1990, only 34 countries have made this leap, collectively representing less than 250 million people, roughly about the population of Pakistan (World Bank, 2024).

The outlook has grown bleaker in the past decade. Rising national debts, aging populations, increased protectionism in developed economies, and accelerating demands for energy transition have tightened the space for growth. For the 6 billion people in today's middle-income countries, the likelihood of achieving high-income status within a generation is getting increasingly remote. The pathway to prosperity has become steeper and more uncertain.

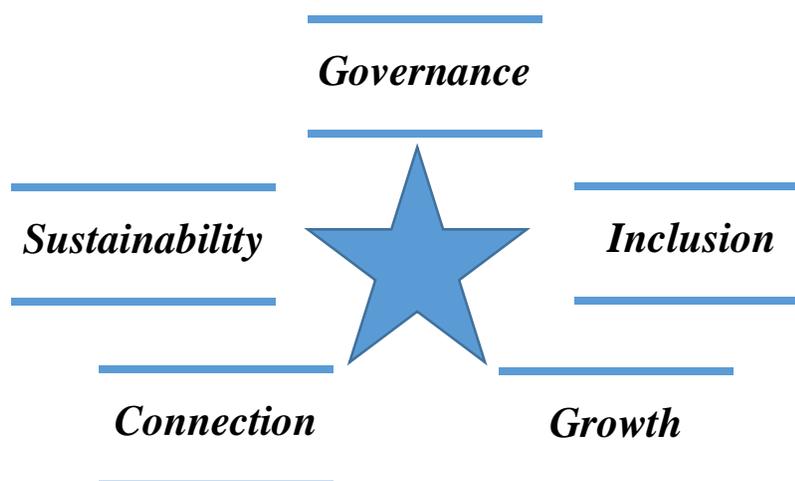
Transitions between growth strategies are not automatic as success hinges on how effectively societies balance the forces of creation, preservation, and destruction. This can be achieved by regulating incumbents, rewarding merit, and leveraging crises. Large corporations, state-owned enterprises, and powerful individuals can contribute greatly to economic value, but they can also hinder it. Governments must establish mechanisms that encourage competition, allowing new entrants to thrive without unfairly supporting small and medium-sized enterprises or demonizing large corporations.

Middle-income countries often have smaller pools of skilled talent compared to advanced economies and are less efficient in utilizing them. Therefore, they must improve both talent accumulation and allocation. While cheap and reliable energy has historically fueled economic growth, maintaining prosperity while addressing climate concerns will require greater focus on energy efficiency and reducing emissions. Challenges such as the rise of populism and climate change can present opportunities to dismantle outdated

systems and make space for innovation. Although crises can be painful, in democratic settings, they may foster the consensus needed for significant policy changes.

A few economies have successfully transitioned from middle-income to high-income status by regulating powerful incumbents, promoting talent through merit, and using crises to reshape policies and institutions that no longer serve their intended purposes. Today's middle-income countries must follow a similar path. The key question is how to do so. Given the complexities they face, the fundamental requirement for these economies is surprisingly simple: they must become more efficient in utilizing capital, labor, and energy. While this is no easy feat, advancements in economic analysis over the last few decades offer valuable insights into how to achieve it.

Since the 1970s, the income per capita in the median middle-income country has remained less than a tenth of that in the United States. With increasing geopolitical, demographic, and environmental challenges, sustaining economic growth will become more difficult in the future. For middle-income countries to achieve advanced economy status despite these obstacles, they will need to accomplish extraordinary feats (World Bank, 2024). The few countries that managed to escape the trap used a five-fold policy to tackle it (Aldaz-Carroll, Brink, & Skrok, 2018).



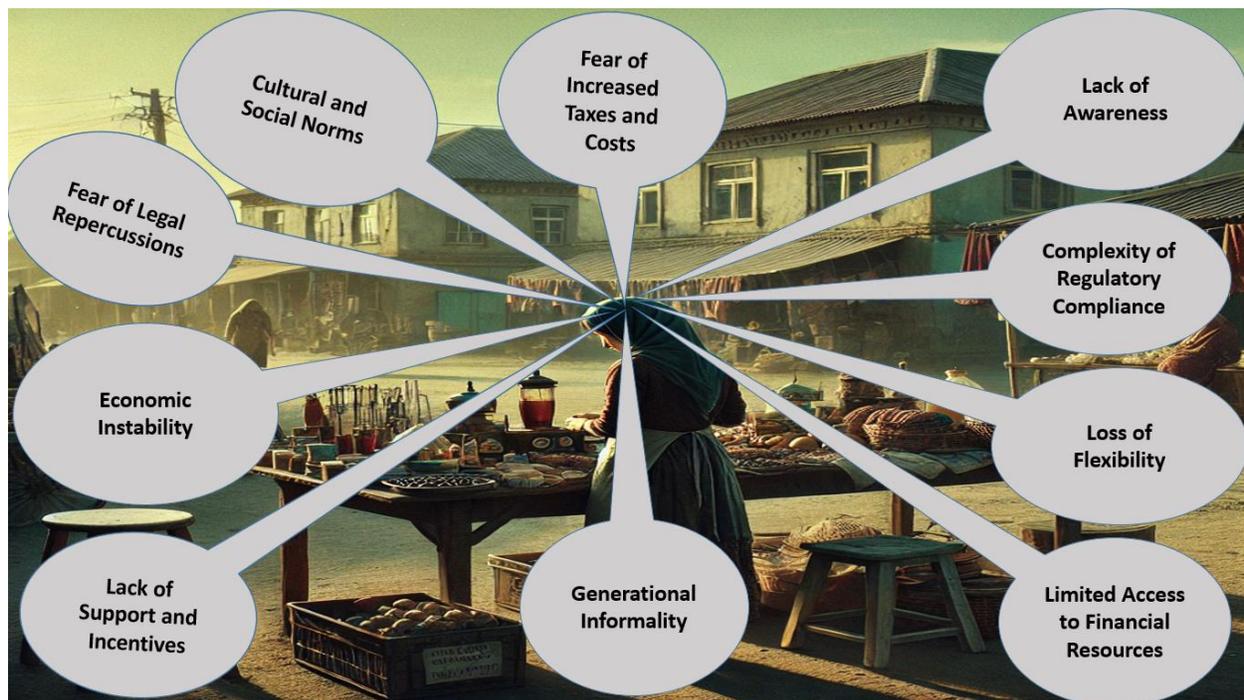
## **Informal Economy**

Half a century after the concept of informality emerged in the early 1970s, debates persist about its definition, measurement, and effective policy approaches for transitioning to formality. However, certain aspects have gained broad consensus internationally. Most notably, informality is widely acknowledged as a prevalent global phenomenon, underscored by increasingly accessible data.

The informal economy comprises activities with market value that are not officially registered. It encompasses a wide range of professions, from minibus drivers in Africa and street vendors in Latin America to hawkers at traffic lights worldwide. In developed countries, examples include gig and construction workers, domestic workers, and even registered firms engaging in informal practices. According to the International Labour Organization (ILO), approximately 2 billion workers, which makes up over 60% of the global adult labor force, are involved in the informal sector, at least part-time. While informality is a worldwide phenomenon, its scale varies significantly across and within countries. On

average, the informal economy accounts for 35% of GDP in low- and middle-income countries, compared to 15% in advanced economies. Regions like Latin America and sub-Saharan Africa exhibit the highest levels of informality, while Europe and East Asia report the lowest levels (IMF, 2021). This is because the informal economy operates outside official oversight, making its activities difficult to monitor. Moreover, participants in the informal sector often prefer to avoid being accounted for, as formal registration may expose them to taxes, regulations, or legal scrutiny that could compromise their livelihoods.

According to various studies, informal economy finds its roots in a society as a result of following causes:



- **Costs and Taxes:**

The foremost cause of growing informal economy is the fear of additional costs. It has been observed that if this cost barrier is lifted, the informal firms take the initiative to formalize their operations and labor (Mel, McKenzie, & Woodruff, 2013).

- **Lack of Support:**

Policies don't focus on reducing informality through gradual, targeted approaches that address its root causes, such as social exclusion and the economic incentives that drive individuals and firms to remain informal (IMF, 2021). This lack of support further enhances the scale of informal employment in a society. Policies should aim to expand access to opportunities in the formal sector, improve labor market conditions, and foster inclusive growth. Simply attacking the informal sector under the assumption that it is inherently illegal or tax-evading is counterproductive. Instead, creating a supportive environment with incentives for formalization can yield more sustainable and equitable outcomes.

- **Flexibility:**

Individuals may turn to informal employment for various reasons, including tax evasion and greater flexibility in working hours, especially in restrictive labor markets. Informal work can bypass formal labor regulations such as binding minimum wages, which can limit the availability of formal jobs. For those facing unemployment and long waits for formal opportunities, informal jobs often serve as an attractive alternative, offering immediate income and fewer bureaucratic hurdles. This

dynamic highlights the informal sector's role as a buffer against rigid labor market conditions and economic constraints (Ulyssea, 2020).

- **Generational Informality:**

There are certain benefits of individual nature that can be reaped from keeping oneself on the informal side of the labor demographics. If the younger generation observe the head of their household to have a fruitful journey in the informal labor cycle, they'd definitely prefer to stay on the safer side. Households may opt for informal employment to avoid contributing to social insurance or taxes, but this behavior can significantly impact government revenue, particularly in systems with a high degree of formal-informal labor market segmentation (Joubert, 2015). The extent to which individuals shift to the informal sector depends on how segmented the labor markets are.

- **Limited access to financial resources:**

For informal firms and entrepreneurs, limited access to finance is a significant obstacle, deterring their ability to improve productivity and scale operations. Broader financial inclusion tends to accelerate economic growth and reduce income disparity, as it enables businesses to invest in innovation and expansion, creating more jobs and economic opportunities. This dynamic highlights the significance of policies that improve financial access, such as microfinance initiatives, credit facilities, and regulatory reforms that integrate informal enterprises into formal financial systems (Deléchat & Medina, 2023).

- **Social and Cultural Norms:**

Informal labor also includes the labor working from the comfort of their homes. In many regions of the world, women are encouraged to work from homes. Informal economy suits those societies.

- **Fear of Legal Complexities**

Legal boundaries in the labor market, such as stringent regulations or binding minimum wages, are hypothesized to expand the size of the informal economy (Vuletin, 2008). This occurs because such restrictions can make formal employment less flexible and costlier for both employers and workers, incentivizing firms to operate informally and workers to seek jobs outside the formal division. In essence, when the costs or barriers associated with compliance are high, both employers and employees may find the informal economy a more viable alternative, despite its inherent risks and limitations.

- **Economic Stability:**

Understanding the drivers and effects of informality is vital for fostering sustainable and inclusive development. Informality significantly impacts economic growth, poverty, inequality, and gender disparities. While some individuals and businesses choose informality to avoid regulations or costs, the majority, around 85% of informal workers, find themselves in precarious jobs out of necessity, primarily due to limited opportunities in the formal sector (IMF, 2021). This involuntary informality has profound economic implications, such as reduced tax revenue, hindered access to social protections, and stunted productivity, all of which challenge equitable growth and development.

## **Informal Economy and the Correlation with Middle Income Trap**

The "middle-income trap" describes a scenario where a middle-income country struggles to advance economically. It faces challenges competing in labor-intensive industries due to relatively high wages and fails to scale higher value-added sectors due to low productivity. This results in sluggish economic growth, stagnant or declining wages, and an expanding informal economy. At

the core of the middle-income trap is inadequate development of domestic innovation capabilities. In Latin America, this issue stems from market-driven strategies that have led to poor productivity growth, rapid de-industrialization, reduced export sophistication, weak innovation performance, and insufficient investment in building necessary social capabilities. The current era of globalization exacerbates these challenges. Middle-income countries have less time to bridge the innovation and productivity gaps due to intensified competition and the rapid pace of technological advancements, making it harder to catch up with advanced economies (ADB, 2017).

Schumpeterian economic theory comprehensively examines what hinders and what helps countries engineer shifts in growth strategies (World Bank, 2024). The concept of creative destruction, initially explored by early political economists like Werner Sombart and Friedrich von Wieser, became synonymous with Joseph A. Schumpeter, an Austrian economist. Schumpeter popularized the term in his seminal work “Capitalism, Socialism, and Democracy”, where he described how visionary entrepreneurs drive economic transformation by introducing groundbreaking products and technologies that redefine lifestyles. He argued that consumer demand alone does not trigger innovations like railroads, electric lamps, or motorcars; rather, entrepreneurial vision and leadership are the primary catalysts for economic progress. Without change, he warned, societies stagnate.

Schumpeterian growth theory offers nuanced tools for understanding economic development through several key features:

### **1. Heterogeneous Agents:**

It emphasizes differences among firms (e.g., small vs. large, new vs. old) and workers (e.g., skilled vs. unskilled), extending this idea to energy sources (e.g., renewable vs. carbon-intensive).

### **2. Continuous Dynamics:**

Growth results from a balance between creation (e.g., innovation, investment) and destruction (e.g., outdated skills, firm closures).

### **3. Institutional Inertia:**

The theory examines forces that preserve societal and industrial structures, highlighting biases toward maintaining the status quo.

### **4. Constructive Crises:**

It identifies opportunities for transformation during economic and environmental crises, suggesting that well-designed policies can turn destruction into pathways for creation and growth.

## **Climate Change and Informal Sector**

The informal economy plays a vital role in sustaining urban life, serving as an essential backbone for the functioning of cities. It encompasses a wide range of unregulated and unregistered economic activities that contribute significantly to local and national economies (Dodman, Sverdlik, & Agarwal, 2023). From street vendors and small-scale traders to daily wage laborers

and home-based workers, a substantial portion of the global workforce depends on informal employment to sustain their families and communities. The informal economy is often associated with numerous challenges, as its very nature tends to create adverse conditions for both individuals and businesses. It can lead to a cycle of low productivity and persistent poverty, making it difficult for workers and enterprises to achieve financial stability and growth. To effectively support the transition to formal employment, a well-structured national strategy must acknowledge the significant disadvantages of informal work, which impose high costs on businesses, workers, and society as a whole. For unprotected workers, the drawbacks of operating in the informal sector, such as job insecurity, lack of social protections, and limited opportunities for advancement, far outweigh any potential benefits (International Labour Organization, 2014).

A large number of residents in low-income and informal settlements rely on the informal economy for their livelihoods. However, the lack of regulation in both their workplaces and living environments can expose them to numerous health risks (Brown, 2014). One of the biggest barriers to the transition of individuals from informal to formal economy is the cost. The complexity, cost, and time-consuming nature of regulatory procedures often discourage individuals and businesses from transitioning to the formal economy. This challenge is particularly prevalent among micro, small, and medium enterprises (MSMEs) and less-educated workers, who may lack the necessary resources or expertise to navigate bureaucratic requirements efficiently (Asia-Pacific Economic Cooperation, 2024).

The biggest issue that climate change creates is the health crisis in different shapes. One of such examples was observed in Indore, India, where informal workers are particularly vulnerable to climate-related hazards such as extreme heat and heavy rains, which exacerbate existing challenges like food insecurity, gender inequalities, and poor living and working conditions. For example, informal factory laborers often endure excessive heat due to enclosed, poorly ventilated workspaces and proximity to heat-emitting machinery (Agarwal, 2022). The findings of (Dodman, Sverdlik, & Agarwal, 2023) highlight key risk factors that make informal workers increasingly vulnerable, particularly when combined with the effects of climate change. These risks contribute to worsening health conditions and deepen socioeconomic exclusion. One major challenge is that extreme weather events, such as heatwaves and heavy rains, can prevent informal workers from earning a livelihood while simultaneously worsening their living and working environments. High temperatures, for instance, significantly reduce working hours and productivity, creating financial instability. Addressing these compounded risks is crucial to improving resilience and safeguarding the livelihoods of informal workers.

It is broadly acknowledged that the lack of safety net is arguably the most basic attribute of an informal employment. Climate change not only detrimentally affects the health of the individuals connected to informal economy but also causes them productivity losses because of extreme weather events. Overwhelmed by these aspects, the individual remains stuck in the vicious cycle of informal economy, never getting the opportunity to transition towards formal economy.

## Comparative Analysis

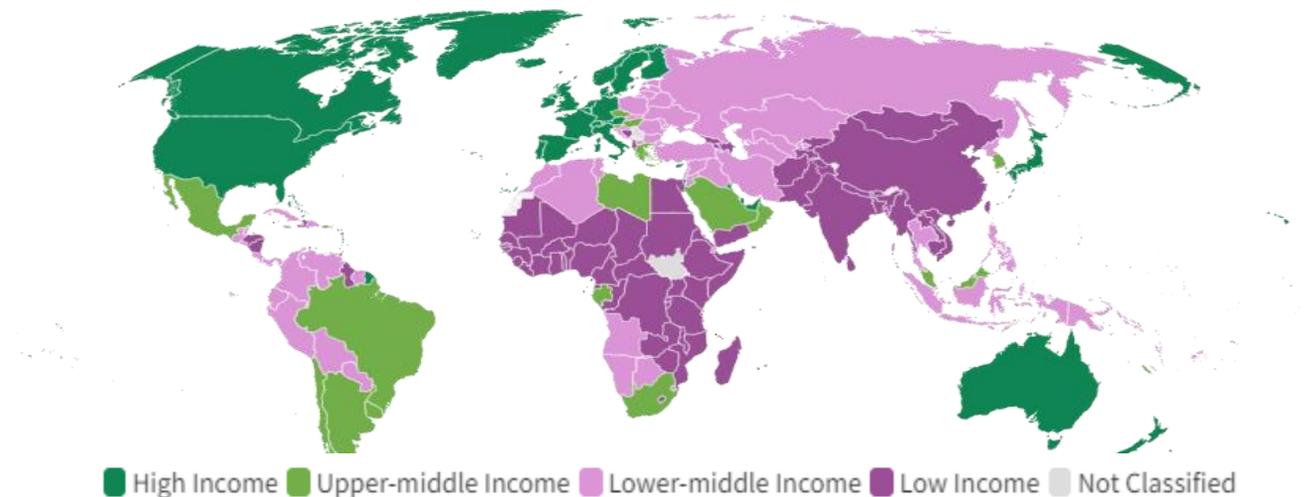
In recent decades, only a small number of countries have successfully transitioned from middle-income to high-income status. Among these are nations like Saudi Arabia, Latvia, Bulgaria, and South Korea, which have managed significant economic transformations. These countries' experiences highlight the challenges and strategies involved in such transitions, including factors like investment in education, infrastructure, and industrial development, as well as shifts in governance and policy (WEF, 2024). The World Bank classifies economies into four income groups for analytical purposes: low, lower-middle, upper-middle, and high income. This classification is based on gross national income (GNI) per capita, measured in U.S. dollars. To account for exchange rate fluctuations, the World Bank uses the Atlas method<sup>1</sup> to convert local currencies into dollars. This method helps provide a more stable measure of income, smoothing out the effects of volatile exchange rates.

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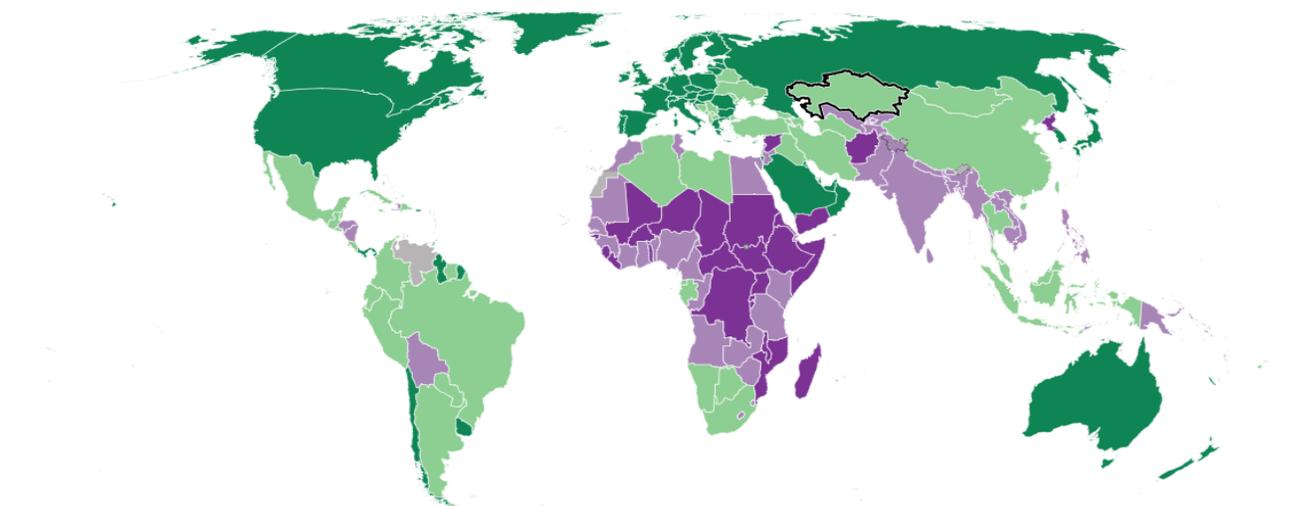
<sup>1</sup> <https://datahelpdesk.worldbank.org/knowledgebase/articles/378832-what-is-the-world-bank-atlas-method>

# Global Income Breakups

1994



2023



From 1960 to 2022, only 23 economies have been said to have escaped the middle income trap (Economist, 2023). Among the countries that have successfully countered the Middle Income Trap, the names of South Korea, Poland, Chile, Hong Kong, Taiwan, Singapore, Seychelles and Saudi Arabia are notable.

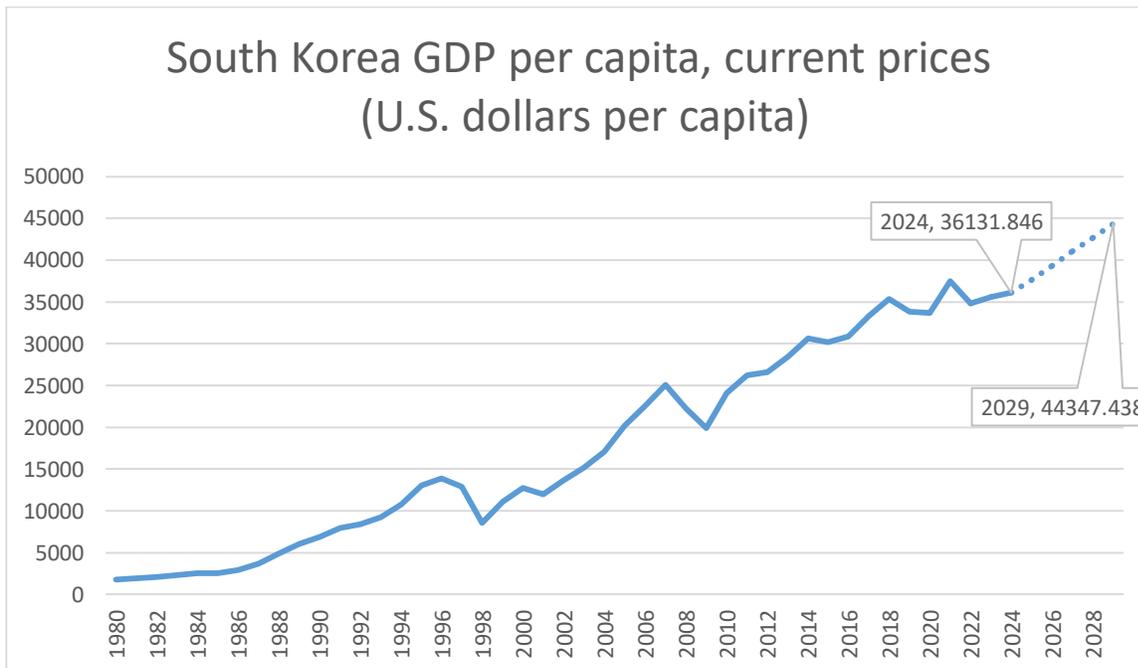
## South Korea

South Korea's economic transformation began with a straightforward policy approach that prioritized public investment and incentivized private sector growth. By the 1970s, this evolved into an industrial policy aimed at encouraging domestic firms to adopt advanced foreign technologies and improve production methods. Companies like Samsung exemplified this shift. Originally a noodle manufacturer, Samsung

ventured into electronics, producing TV sets for local and regional markets. To achieve this, it licensed technologies from Japanese firms such as Sanyo and NEC. This success created a demand for skilled engineers, managers, and professionals. In response, South Korea's Ministry of Education set ambitious targets and increased funding for public universities to develop the expertise required by domestic industries. Today, Samsung stands as a global innovator and one of the world's leading smartphone manufacturers (World Bank, 2024).

South Korea has made significant strides in leveraging foreign technology to drive domestic innovation. In 1980, the productivity of the average South Korean worker was only about 20% of that of their U.S. counterpart. By 2019, this figure had surged to over 60%, reflecting a threefold improvement. This remarkable progress underscores South Korea's ability to adopt, adapt, and enhance global technologies to fuel its economic growth and technological advancement (World Bank, 2024).

On October 22, the International Monetary Fund (IMF) announced that South Korea's gross domestic product (GDP) per capita for 2023 is projected to surpass those of Japan and Taiwan. According to the IMF's World Economic Outlook, South Korea's GDP per capita is estimated at USD 36,132 this year, a 1.6% increase from USD 35,563 in 2022. The 2021 figure stood at USD 37,518, before declining to USD 34,822 in 2022 and rebounding this year. In comparison, Japan's GDP per capita is projected at USD 32,859 in 2023, reflecting a 3.1% decrease from USD 33,899 in 2022. This marks a notable economic shift in the region, with South Korea overtaking Japan in GDP per capita terms (Korea.net, 2024).



Source: (IMF Datamapper, 2024)

The policy analysis of South Korean escape from the ditch of Middle Income Trap highlights four focal points of the strategy (Trang, 2021).

## **1. Effective and Adaptive Government Intervention:**

A key factor in Korea's escape from the middle-income trap was its government's adaptive, consistent, and effective regulatory role. The government adjusted economic priorities to align with structural shifts, rising incomes, and evolving economic challenges, reflected in its seven five-year economic plans implemented between 1961 and 1996. These plans, while indicative, strongly influenced the economy through strategic regulation.

Korea excelled at balancing market mechanisms with government planning. When markets fell short of achieving national objectives, the government intervened decisively. Conversely, it reduced involvement when markets performed efficiently, including privatizing state-owned entities.

From 1962 to 1996, Korea's economic philosophy emphasized government-led industrialization as the pathway to development. A standout feature was its export-oriented industrialization strategy, adopted under President Park Chung Hee (1961–1979). By prioritizing industrial exports, Korea simultaneously advanced modernization, industrialization, and global integration, laying the foundation for its remarkable economic success.

## **2. Self-Driven Industrialization Policy**

Korea's industrial policy was central to its development, steering the nation toward industrialization and modernization. From its early stages, the government provided robust protection and support for strategic industries. Key sectors like cement, fertilizer, and petrochemicals benefited from a comprehensive use of monetary and financial policies designed to foster their growth and competitiveness. This targeted support not only shielded these industries during their formative years but also enabled them to become cornerstones of Korea's economic transformation, driving structural changes and sustained industrial advancement.

## **3. Skilled Human Resources**

Korea's remarkable economic development is strongly linked to its emphasis on education and a highly qualified workforce. As a resource-scarce nation, Korea leveraged its abundant human capital, driven by a cultural emphasis on learning. From the outset, the government prioritized education as a strategic cornerstone for national development, establishing it as the foundation for economic growth and modernization. This focus on cultivating talent and knowledge equipped the workforce with the skills needed to drive industrial and technological advancements, ultimately transforming Korea into a global economic leader.

## **4. Focus on Science, Technology, and Innovation**

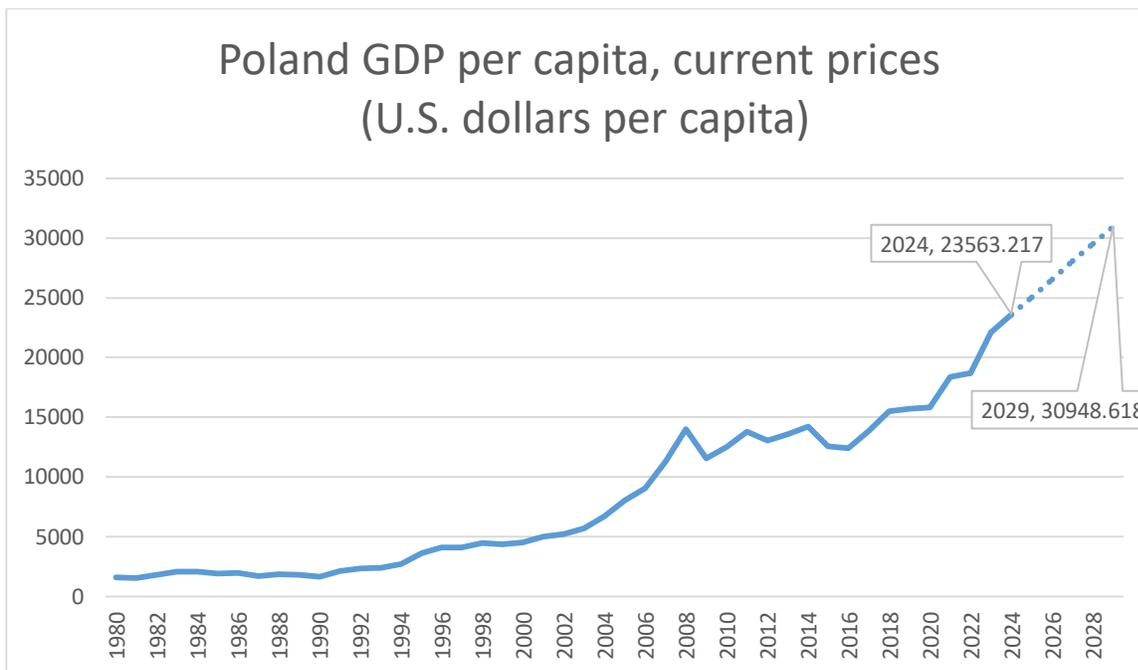
Since the 1960s, Korea has prioritized science and technology in its economic strategies. Early efforts built infrastructure for technological growth, while later policies targeted the development of key technologies. This evolving focus helped Korea transition from industrialization to becoming a global innovation leader.

## **Poland**

Poland's economic trajectory is unique due to its socialist history and membership in the European Union (EU), the largest economic bloc globally. Despite these distinct factors, its rapid income growth

demonstrates a transition similar to South Korea’s progression from discipline to infusion and finally to innovation. In the early 1990s, Poland shifted from a planned to a market economy, increasing its per capita income from 20% to 50% of the EU average. Its strategy began with strict measures to reform large state-owned enterprises (SOEs). Subsidies were cut, access to bank loans tightened, and import competition was liberalized. These reforms even affected iconic institutions like the Stocznia Gdańsk shipyard, the birthplace of the Solidarność (Solidarity) movement. By enforcing budget discipline, Poland set the stage for comprehensive SOE reform, where managers prioritized profitability and market share while preparing for privatization (World Bank, 2024).

Building on this foundation, Poland attracted investments, introduced advanced technologies, and focused on raising productivity. Its entry into the EU common market in the 2000s accelerated this process, spurring foreign direct investment and facilitating technology transfer from Western Europe. Poland also expanded tertiary education, increasing enrollment from 15% in 2000 to 42% in 2012. The skills and experiences Poles gained within the EU created additional avenues for infusing global knowledge into the domestic economy, further bolstering its development (World Bank, 2024). Poland’s per capita GDP suffered only one significant drop in the last four decades. The country’s per capita GDP stands at USD 23,563 in 2024 and at this trajectory it is expected to reach USD 30,948 by year 2029.



Source: (IMF Datamapper, 2024)

Poland relied on a five-fold policy to escape the Middle-Income Trap (Aldaz-Carroll, Brink, & Skrok, 2018).

### **Governance:**

Poland's economic and political success stands out for its combination of rapid economic growth and a resilient democratic system. Unlike the Asian Tigers, Poland achieved sustained growth within the framework of a vibrant democracy that embraced a shared vision of a socially responsible market economy. This vision ensured remarkable policy continuity across 17 successive governments since the country's

democratization. Key to Poland's success was the effective sequencing of reforms. The country transitioned rapidly from economic liberalization to establishing foundational democratic institutions at both local and national levels.

### **Growth:**

To foster economic growth, Poland not only facilitated the efficient reallocation of resources through market mechanisms but also focused on expanding these markets. This was achieved through targeted reforms and significant investments in human capital, which yielded substantial improvements in educational performance. By prioritizing education, Poland enhanced workforce skills and productivity, creating a solid foundation for sustained economic growth and greater resilience in the face of challenges.

### **Sustainability:**

Poland promoted economic stability through a well-structured yet adaptable fiscal framework that effectively controlled deficits and limited debt accumulation. This approach was complemented by a flexible exchange rate system, supported by a credible monetary policy centered on inflation targeting. These measures provided Poland with the flexibility to respond to economic fluctuations while maintaining fiscal discipline. Additionally, Poland's comprehensive reforms in the financial sector played a crucial role. The country effectively restructured, regulated, and supervised its banking and financial systems, ensuring soundness and stability. As a result, Poland avoided banking crises that have plagued many economies during times of global financial instability, further reinforcing its economic resilience.

### **Inclusion:**

Poland prioritized inclusive growth by ensuring equitable access to quality education for individuals across income groups and regions. This investment in education contributed significantly to increasing both business opportunities and worker earnings. Poland's approach to economic development combined competitive and open markets that provided a conducive environment for firms and job creation with policies aimed at social equity, such as regular increases in the minimum wage. This balance of market dynamism and wage growth fostered a more inclusive and robust economic model.

### **Connection:**

Poland achieved economic integration through a phased strategy: first, cutting tariffs to ensure competitive pricing; then reforming soft infrastructure, like regulations, ahead of EU accession; and finally, utilizing EU funds to develop hard infrastructure, boosting connectivity between domestic and external markets. This strategic sequencing accelerated growth and integration into the global economy.

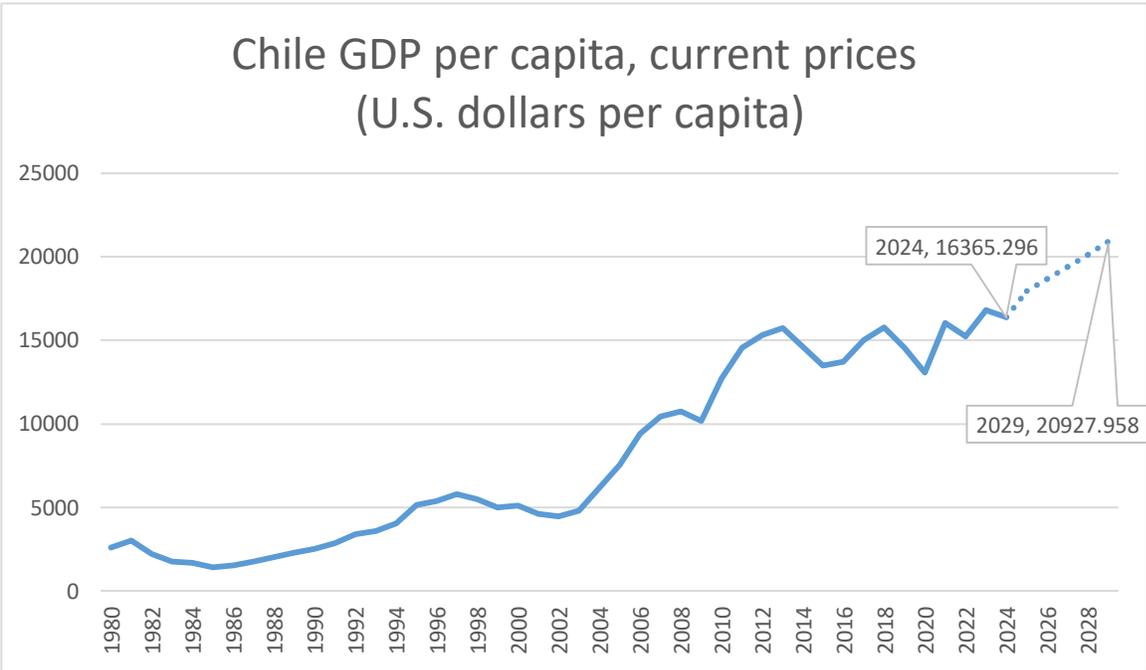
## **Chile**

Chile's economic success shares key characteristics with other high-income transitions. In 2012, it became the first Latin American country to achieve high-income status, following its 2010 accession to the Organisation for Economic Co-operation and Development (OECD). Since the 1960s, Chile has significantly diversified its exports, reducing mining's dominance from four-fifths to about half of its total

exports. This progress has been driven by strategic knowledge transfers from advanced economies, supported by public and private initiatives. The Chilean Agency for Exports Promotion (ProChile) has played a vital role in empowering small and medium enterprises (SMEs), which accounted for one-third of the export value added between 2013 and 2016, with large domestic exporters contributing the remainder.

Additionally, Fundación Chile, a private nonprofit established in 1976, has facilitated technology transfer to enhance local industries. A notable achievement is its adaptation of Norwegian salmon farming technologies to Chilean conditions, which positioned Chile as a global leader in salmon exports. These efforts reflect Chile's effective combination of public-private collaboration and innovation-driven strategies in its economic development journey (World Bank, 2024).

The country's GDP per capita stood at USD 16365.3 and at this rate, it is expected to reach USD 20928 by the year 2029.



Source: (IMF Datamapper, 2024)

If one studies the case of Chilean escape from the Middle Income Trap, it appears like a four-phased strategy (Lebdioui, Lee, & Pietrobelli, 2020).

**Industrial Policy and Market Forces:**

Chile's success is not solely attributable to market liberalization. Industrial policies played a vital role in fostering non-traditional, resource-based sectors, challenging the narrative that liberalization alone drove its progress.

## **Technological Adaptation for High-Value Activities:**

Chile upgraded commodity sectors such as salmon farming and fresh fruit exports by adapting foreign technologies to local needs, avoiding heavy dependence on foreign-dominated global value chains.

## **Copper Sector Limitations:**

While high copper prices in the 2000s supported Chile's growth, efforts to add significant value in the copper industry remain modest, with much of the output exported as raw copper ore.

## **Strategic Foreign and Local Dynamics:**

Chile effectively balanced foreign direct investment (FDI) to access knowledge and technology while recognizing its limitations. Managing local-foreign interfaces strategically has been crucial for sustainable development.

## **Central Asia and Middle Income Trap**

Central Asia, comprising Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, and Turkmenistan, is a region with significant development potential. It boasts a combined GDP of approximately \$347 billion and a growing population of 77 million, strategically situated between Asia and Europe, making it a critical connector for trade and geopolitics (Astana Times, 2024).

Central Asia is the world's largest landlocked region, with Uzbekistan being one of only two double-landlocked countries globally. The absence of access to seas and reliance on surrounding nations for transit create significant barriers to international trade (Eshov, Ismailova, & Kuldasheva, 2023):

### **1. High Transaction Costs:**

The lack of maritime transport forces these economies to depend on land-based transit, which is costlier and less efficient than maritime shipping.

### **2. Dependence on Transit Countries:**

Exports rely heavily on neighboring nations for access to global markets, exposing Central Asian economies to potential rent-seeking behaviors and political instability in transit nations.

### **3. Transportation Costs:**

Isolated geographic positions contribute to high logistics expenses, making goods less competitive in international markets.

### **4. Economic Impact:**

Landlocked status restricts full participation in global trade, curbing economic potential despite the region's resource wealth.

## **Geographic Importance**

The region's geographic position and its natural and human resources position Central Asia as a key player in global economic networks, with promising prospects for sustained growth driven by demographics and structural transformation.

## **Economy**

The economies of Central Asian countries exhibit distinct structural differences. Kazakhstan, representative of upper-middle-income countries, is predominantly driven by Services and Industry, with Agriculture contributing minimally. Turkmenistan's economy is similarly industrially focused, leveraging its rich mineral resources, particularly natural gas. In contrast, Kyrgyzstan, Tajikistan, and Uzbekistan, characteristic of lower-middle-income nations, maintain a significant reliance on Agriculture as a major GDP component, alongside developing Industry and Services sectors. These variations underline the region's diverse economic landscapes and developmental priorities (Eshov, Ismailova, & Kuldasheva, 2023).

## **Impact of Russia-Ukraine Conflict**

Russia remains a crucial economic partner for Central Asian states, serving as a key trade ally despite China recently emerging as the region's dominant trading partner. While China now leads in trade volume, Russia remains the second-largest partner for Kazakhstan, Uzbekistan, and Kyrgyzstan. The region primarily exports agricultural products, metals, minerals, cotton, and textiles, maintaining strong economic ties with Moscow. Another significant factor reinforcing Central Asia's dependence on Russia is labor migration. Millions of workers, particularly from Uzbekistan, Tajikistan, and Kyrgyzstan, seek employment in Russia.

Most Central Asian migrants engage in low-wage, seasonal jobs, especially in Russia's construction sector. In 2021, remittances from these workers accounted for 35% of Tajikistan's GDP, 33% of Kyrgyzstan's, and 13% of Uzbekistan's (Ubaydullaeva & Genauer, 2024).

Russia-Ukraine war disrupted the rules-based international order, triggering a global economic, political, and security crisis. Among the regions most affected by the conflict are the Central Asian Republics (CAR), which share deep-rooted historical, economic, political, and trade ties with Russia.

Following the onset of the war, global oil and natural gas prices surged, significantly benefiting energy-exporting nations in the region, including Kazakhstan, Turkmenistan, Tajikistan, Kyrgyzstan, and Uzbekistan. While this price spike brought short-term economic gains, the broader geopolitical instability posed new challenges for Central Asia's economic and political landscape (Near East South Asia Center, 2023).

Owing to shared cultural heritage and deep-rooted socio-economic connections established during the Soviet era, Russia has long been a primary destination for labor migrants from Central Asia, particularly Uzbekistan, Tajikistan, and Kyrgyzstan. Official statistics indicate that nearly five million workers from these three nations are currently employed in Russia. However, the actual figure is likely significantly higher, as many migrants engage in the informal economy, making their presence difficult to track through official records (FairPlanet, 2023).

IMF observed that a decline in remittances from Russia and rising cost of living could push an additional one million people into poverty in the region (IMF, 2022). According to the International Organization for Migration (IOM), remittances from Russia contribute a significant chunk of the gross domestic product (GDP) of Central Asian countries. However, Western sanctions have significantly affected Russia's labor market, leading to widespread job losses and wage reductions for migrant workers. As a result, many labor migrants are struggling to sustain their income levels, which in turn reduces the flow of remittances back to their home countries, impacting the economies that rely heavily on these funds (FairPlanet, 2023). The informal sector remains deeply affected.

Not all was detrimental for the CARs as one of the most significant shifts in regional trade dynamics is the rerouting of hundreds of millions of dollars in goods through the five Central Asian states to circumvent the strict Western sanctions imposed on Russia. After Russia's invasion of Ukraine, many analysts predicted that the Central Asian states would be forced to take sides or risk facing sanctions. However, that scenario did not materialize. Instead, these nations have adopted a careful multivector balancing strategy, navigating their relationships with Russia, the West, and other global powers to safeguard their economic and political interests. Trade with Central Asia and the Caucasus has surged as an unintended consequence of the war. With Russia cut off from direct imports of key goods from Europe, much of this trade has been rerouted through Central Asia, where governments have shown little hesitation in handling restricted goods. This redirection has created a significant economic windfall for the Central Asian states, fueling their economic growth and development.

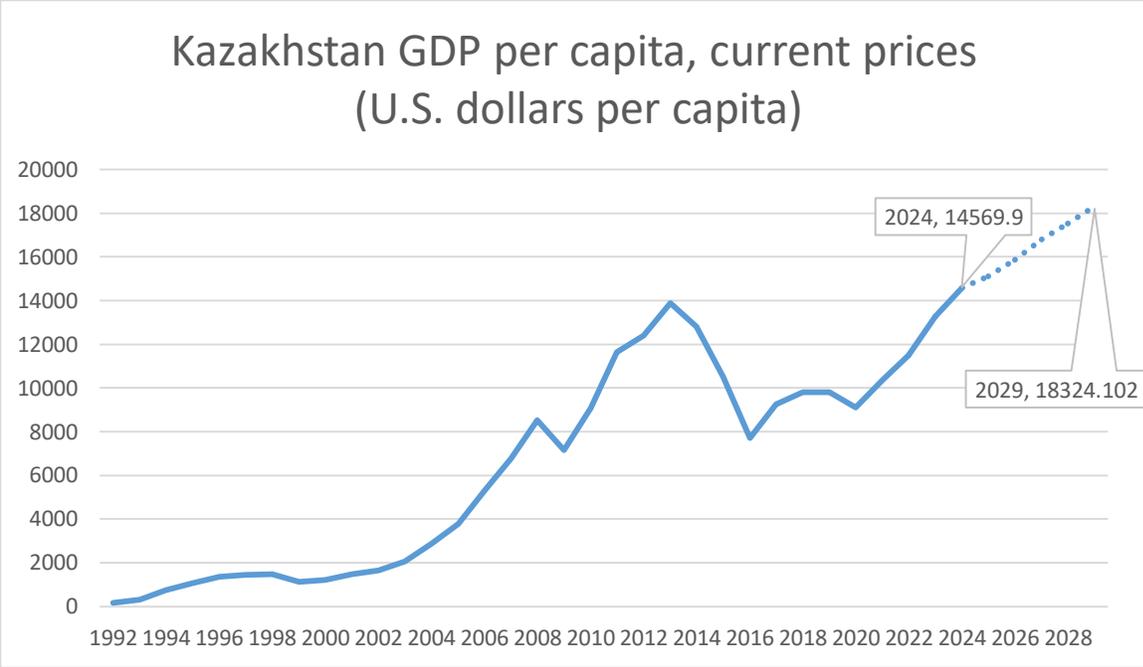
For example, Kazakhstan's imports of office machinery from Europe tripled to nearly \$1 billion between 2021 and 2023, likely driven in part by the establishment of new offices and factories catering to Russia's growing demand. Overall, EU exports to Central Asia surged by €46 billion in 2023, marking a 50% increase from 2021. Notably, this figure accounts for nearly three-quarters of the decline in European exports to Russia over the same period, underscoring the region's evolving role as a trade conduit (Ben Aris, 2024).

Russian trade with CARs has increased dramatically in past few years. However, in the long run, Russia's economic influence in Central Asia may weaken. As the Russian economy contracts due to ongoing conflict and international sanctions, its ability to sustain trade and investment in the region could decline, potentially shifting Central Asia's economic focus toward alternative partners (Ubaydullaeva & Genauer, 2024).

## **Kazakhstan and Middle Income Trap**

Since the 2000s, Kazakhstan has seen substantial economic growth, driven by market reforms, mineral resource extraction, and significant foreign direct investment. These factors have helped elevate the country to an upper-middle-income status, significantly improving living standards and reducing poverty. The growth has been fueled by the strategic development of the oil and gas sectors, along with a shift towards market-oriented policies that have attracted investment and fostered economic diversification. As a result, Kazakhstan has made significant strides in poverty reduction and infrastructure development, improving its position in global economic rankings (World Bank, 2024).

Kazakhstan's GDP per capita started in 1992 from humble USD 168.6. The economic instability of the collapse of USSR may have a lot to do with it. But the country kept on improving at a stable pace. Kazakhstan's GDP per capita stood at USD 14570 and at this trajectory, it is expected to touch the mark of USD 18324.1 by the year 2029.



Source: (IMF Datamapper, 2024)

In terms of Labor productivity, Kazakhstan holds the highest position among its Central Asian counterparts.



Source: (ILO, 2023)

The rise of Kazakhstan's informal economy in the 1990s was a direct result of the collapse of Soviet central planning, which left significant economic gaps and prompted many to seek livelihoods outside the formal framework. By 2000, following the privatization of enterprises and the start of a prolonged increase in global oil prices, expectations were high for an economic recovery that would boost incomes and reduce

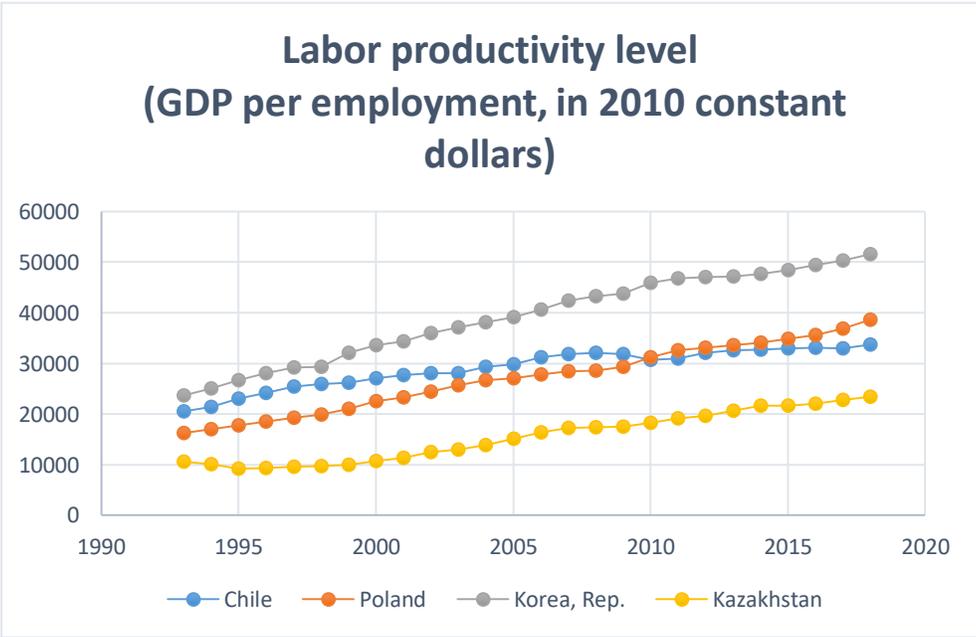
informal employment by facilitating transitions to formal sectors. Contrary to these expectations, the informal economy grew alongside GDP expansion, highlighting structural challenges in formalizing employment despite economic growth (Mussurov, Sholk, & Arabsheibani, 2018).

## Kazakhstan’s Comparison with the Former Middle Income Countries

The best way to analyze the ground realities of Kazakhstan’s economic outlook, we must compare the current numbers of Kazakhstan’s economy with the countries that have managed to escape the Middle Income Trap. Kazakhstan is undoubtedly ahead of its Central Asian counterparts in many economic aspects but to ascertain its way forward, Kazakhstan must look up to the exemplary countries.

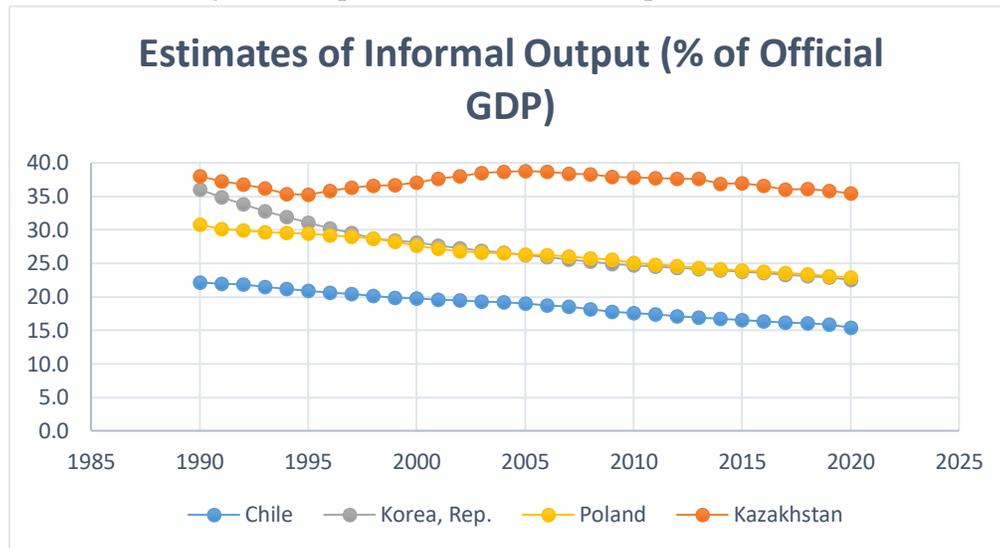
### Labor Productivity Comparison

In terms of labor productivity, South Korea soars consistently and significantly higher than the competitors. The constant increase in labor productivity has been an important driver in the country’s escape from the Middle Income Trap. Chile had a good run until 2009 when it had a slight slump and Poland went ahead of them. Poland is improving its labor productivity at a swift rate and stands just behind South Korea. The fact common about all the compared countries is that their labor productivity is climbing. The difference is in the magnitude. Kazakhstan’s labor productivity is also rising but they are far behind the likes of Poland, Chile and South Korea.



## Informal Output Comparison

Informal output represents the economic contribution of the informal sector, which operates outside of formal regulatory and institutional frameworks. This includes unregistered businesses, untaxed activities, and unregulated employment. The chart below displays the percentage of informal output in the GDP of the countries that have managed to escape the Middle Income Trap and Kazakhstan.



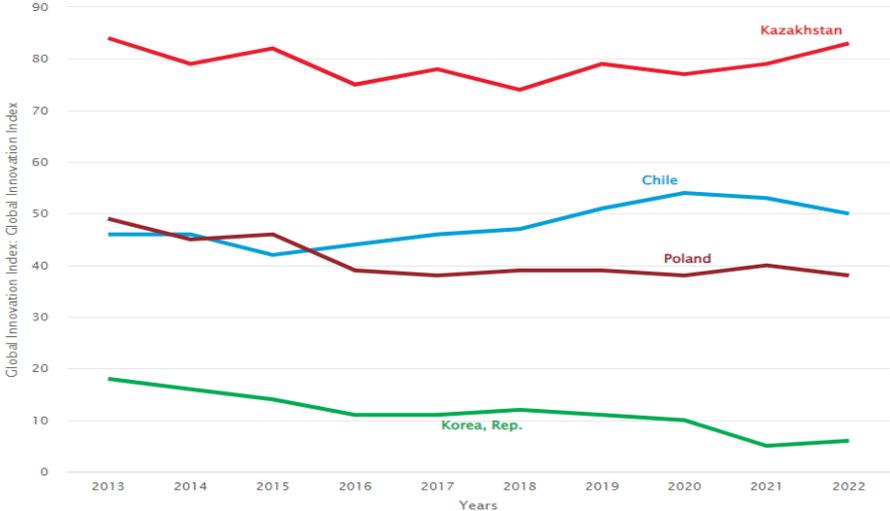
*Source: (World Bank, 2024)*

As we can see, the share of informal output in Kazakhstan's GDP has been consistently higher than the other compared economies while the same of Poland, Chile and South Korea has been on the decline at a near constant trend. South Korea's informal output share in the GDP has been the lowest among the compared countries.

# Global Innovation Index Comparison

In the Global Innovation Index comparison, Kazakhstan ranks the lowest as compared to Poland, Chile and South Korea. The rank has been getting lower consistently since the year 2020. As expected by the sustainable development of South Korea in the recent decade, the country's rank is among the top ten in the index.

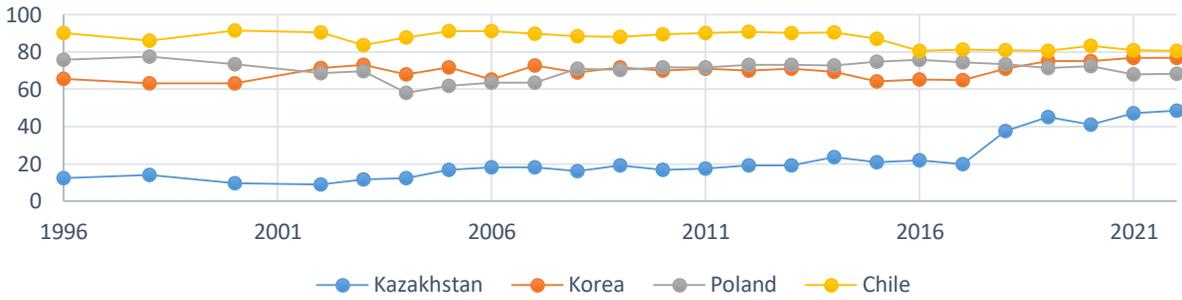
Global Innovation Index: Global Innovation Index



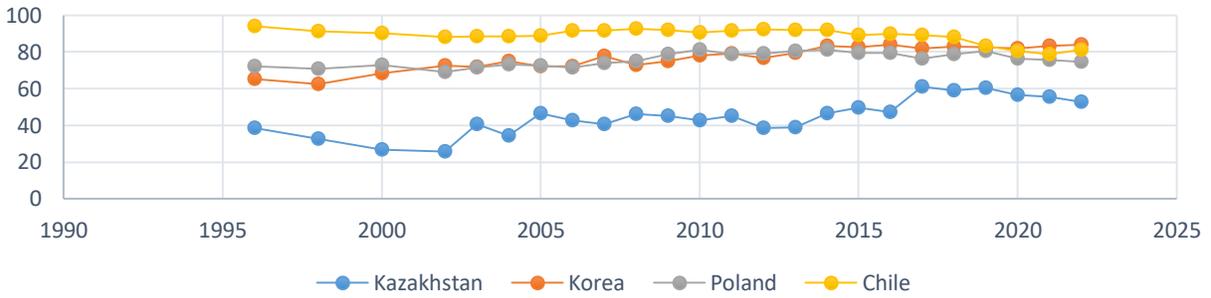
# Social Indicators Comparison

In terms of Control of Corruption, Kazakhstan has been miles behind South Korea, Poland and Chile but in the recent years, the Central Asian country has improved its position in this regard significantly. Kazakhstan has made a giant leap towards betterment in Corruption Control in 2017. Same is the status with Regulatory Quality which seems to be connected to Corruption Control. Kazakhstan is lacking on that front as well. In terms of Rule of Law, Kazakhstan is behind the countries in comparison but it is gradually catching up. Kazakhstan has a lot of ground to cover in the realm of Voice and Accountability as it is miles behind Poland, Chile and South Korea. There is little to separate South Korea, Poland and Chile in terms of Voice and Accountability although Chile remains slightly ahead. Kazakhstan saw a giant leap in the realm of Government Effectiveness in 2014. After which, it gradually aught up to Poland, Chile and South Korea while South Korea remains at the top among the compared economies.

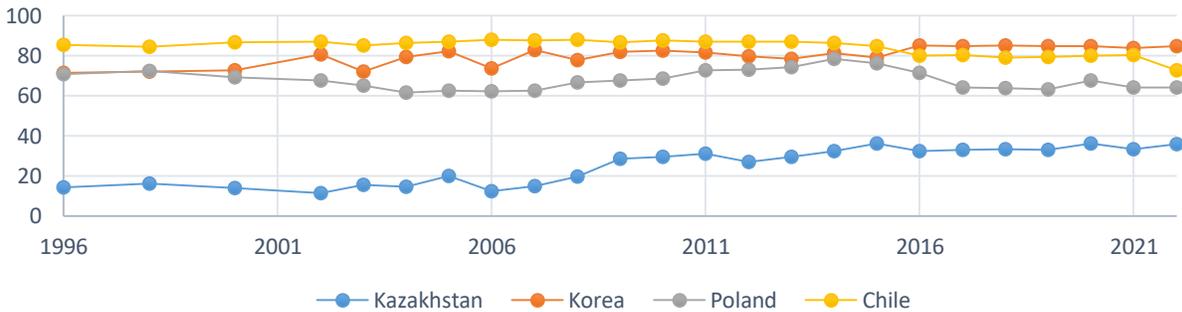
### Control of Corruption: Percentile Rank

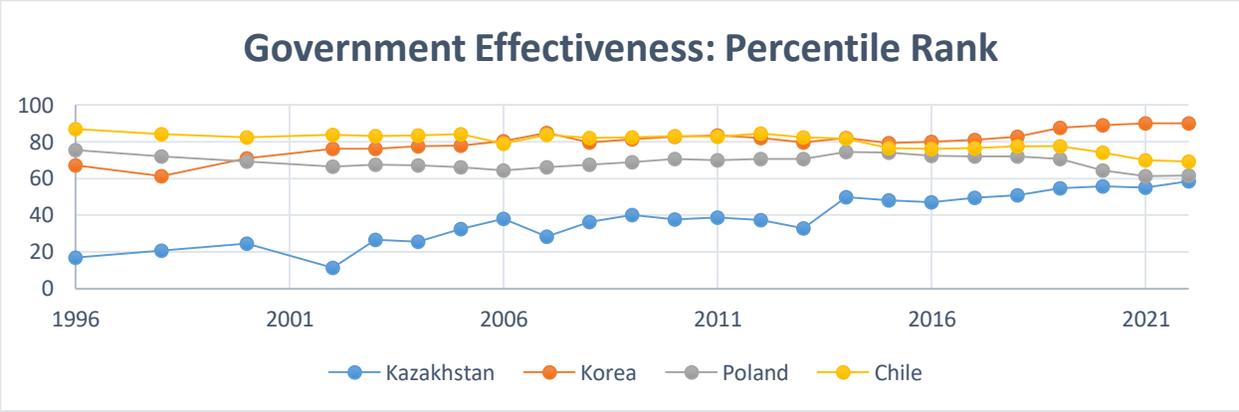


### Regulatory Quality: Percentile Rank



### Rule of Law: Percentile Rank





## Policy Recommendations

A thorough analysis of the tactics employed by South Korea, Poland and Chile discloses numerous common success factors. Each country recognized and tackled the structural obstacles restricting their economies from developing. Their policies were not just strategically fashioned but were also thoroughly enforced through strong governance mechanisms. These countries prioritized reforms within institutions, investment-friendly policies, and anti-corruption measures, guaranteeing that economic policies were effectively implemented and not mired by bureaucratic inefficiencies or vested interests.

For Kazakhstan, a similar policy approach is crucial. The government should hatch a long-term economic transformation plan that directly addresses barriers to productivity, industrial diversification, and investment growth. Strengthening governance structures, ascertaining policy continuity, and curbing corruption will be critical in nurturing investor confidence and driving sustainable economic progress. By following a well-executed reform program, Kazakhstan can position itself for long-term success and effectively transition into the ranks of high-income nations.

The key lessons Kazakhstan can learn from Chile, Poland and South Korea include:

### High Value Manufacturing

Kazakhstan should strategically refocus its manufacturing and production base toward high-value manufacturing and advanced technology industries in order to break free from the middle-income trap. This transformation would involve moving beyond reliance on raw material exports and low-value-added

production toward sectors that generate greater economic complexity, innovation capacity, and global competitiveness. Chile, South Korea, and Poland have successfully undertaken similar transitions by investing in R&D, promoting technology-driven industries, upgrading workforce skills, and integrating into high-tech global value chains. By following such a path, Kazakhstan can diversify its economy, boost productivity, and secure consistent long-term growth.

## **Investing in Innovation**

Kazakhstan should prioritize significant investments in education, research and development (R&D), and digital transformation as key drivers of productivity and innovation, learning from the experiences of South Korea, Chile, and Poland. These three countries successfully escaped the middle-income trap by modernizing their education systems, establishing a strong innovation ecosystem, and embracing emerging technologies to enhance their capacities. In contrast, Kazakhstan continues to lag behind, ranking the lowest among the four nations in global innovation and digital readiness indices. Worryingly, Kazakhstan's ranking has displayed a consistent decline since 2020, signaling an urgent need for reform. South Korea's sustained investments in human capital and technology over the past decade have propelled it into the top ten of global innovation rankings, demonstrating that a long-term, well-funded commitment to these areas can yield remarkable economic development. If Kazakhstan follows a similar path, it can position itself as a competitive player in the global innovative economy.

## **Governance Reforms**

Kazakhstan should focus on institutional reforms, good governance, and the reduction of corruption, as these are fundamental pillars of sustained economic progress and are deeply interconnected with all other indicators of development. Effective governance not only ensures fair competition and transparent business practices but also promotes investor confidence, which is essential for long-term growth. Historically, Kazakhstan has lagged far behind South Korea, Poland, and Chile in key governance indicators such as Control of Corruption, Regulatory Quality, and Rule of Law. However, notable improvements have been seen in recent years, especially in corruption control, where Kazakhstan made a significant leap forward in 2017. This improvement suggests that targeted policy interventions can yield measurable results. Nonetheless, the country still faces considerable hurdles. The experience of South Korea, Poland, and Chile shows that consistent and effective reforms in governance and institutions are essential to creating a stable environment in which innovation, investment, and economic diversification can flourish.

## **Trade Ties and FDI**

Kazakhstan needs to consolidate its regional trade relationships and significantly increase foreign direct investment (FDI) inflows to accelerate economic growth and diversification. This will require creating more strong and mutually beneficial trade agreements not only with neighboring countries but also with strategic global partners, as well as adopting a more diverse and pragmatic foreign policy that balances relationships across different economic groups.

## **Strengthening SMEs**

Kazakhstan should strengthen its small and medium-sized enterprises (SMEs) and promote a culture of entrepreneurship to diversify its economy and move beyond the middle-income trap. A vibrant SME sector

can serve as a buffer against the global shocks by broadening the economic base, creating jobs, and driving innovation in both traditional and emerging industries.

The experience of Chile offers a clear example of how targeted SME promotion can play a decisive role in economic transformation. Chile's escape from the middle-income trap was heavily linked to the empowerment of SMEs, assisted by proactive government policies and institutions. The Chilean Agency for Exports Promotion (ProChile) efficiently integrated SMEs into global value chains, providing market intelligence, export training, and international networking opportunities. As a result, SMEs contributed to one-third of the export value added between 2013 and 2016, with large domestic exporters accounting for the rest.

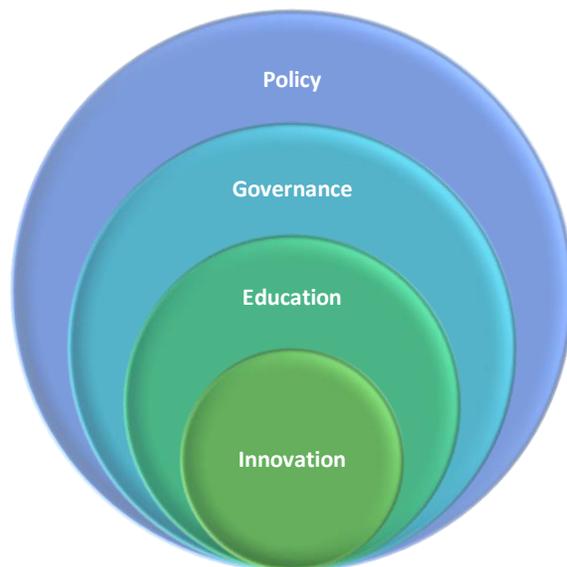
## Economic Diversification

Kazakhstan should reduce its heavy reliance on raw materials and natural resources by strategically diversifying its economy into manufacturing, services, and digital sectors. For decades, oil, gas, and mineral exports have been the very backbone of Kazakhstan's economic growth. While this resource-based model has brought substantial revenues, it has also made the country highly vulnerable to fluctuations in global commodity prices, which can cause sudden economic slowdowns, fiscal deficits, and currency instability.

## Conclusion

Kazakhstan has the most vibrant and fruitful economy as compared to its Central Asian counterparts but it remains a middle income country. As suggested by evidence, developing through the middle income phase to a higher income bracket is not a simple task. Countries spend decades in the middle income trap trying to claw their way out of the cycle. Only a handful of countries have managed to escape the middle income trap. Those countries include South Korea, Poland and Chile. These countries had been in the same spot for decades where Kazakhstan is today. These countries are the prime example for Kazakhstan if the country wants to escape the middle income trap.

A thorough study through the strategies employed by South Korea, Chile and Poland to escape the middle income trap shows that their approaches had a few points in common.



They all focused on a policy that would eradicate the core problems that prevented their advance into the higher income bracket. Those policies were backed by a robust governance system that enforced the policies to the letter and encouraged the investors while restricting corruption. They also focused on developing their workforce by educating their local labor. Skilled labor results in better labor productivity. Another point that they all have in common is the emphasis on innovation. Simply put, high-tech products produced by skilled labor backed by a vigorous government enforcing a business friendly policy, would yield better results. Kazakhstan needs to learn from their footsteps if the country wants to avoid reinventing the wheel.

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