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**Assessing the
Prospects for
Small Enterprise
Development in
Kazakhstan**

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GEMINI

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Assessing the Prospects for Small Enterprise Development in Kazakhstan

by

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We have endeavored during the short period available for this study to assess and understand the situation in Kazakhstan as accurately as possible. Errors in fact and interpretation remain the responsibility of the team.

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INTRODUCTION

The paper presents the findings of an assessment of the factors influencing small enterprise development in Kazakhstan and outlines a strategy for assistance to this sector. The assessment was conducted for the Newly Independent States (NIS) Task Force of the Agency for International Development (A.I.D.) by a four-person team from the staff of Development Alternatives, Inc. contracted through the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project of the Bureau for Private Enterprise.

The field assessment was conducted over a two-week period from September to October 1992. In addition to reviewing recent reports on the country and economy, the team met with government officials, private business people, private and public sector support organizations, and training institutions. Although much of the work was concentrated in the capital city of Alma-Ata, additional interviews were conducted in the regional district of Taldy-Kurgan.

The principal finding of this assessment can be summarized succinctly:

There is a critical need to improve the environment for business development in Kazakhstan. The political economy of the country impedes the start-up and growth of private enterprise. The slow growth of private enterprise reinforces the government's perceived need to protect jobs and production in inefficient state-owned enterprises. This tightens the political brakes on the economic reform movement and further restricts economic opportunities for private actors. A.I.D. can contribute most to these challenges by helping to improve the voice of small businesses in policy debates and strategically assisting local organizations to improve and expand their services — finance, advisory, and training — to support business development.

THE CONTEXT FOR BUSINESS DEVELOPMENT IN KAZAKHSTAN

OVERVIEW

The Republic of Kazakhstan has embarked on a long and difficult transition from a dependent, socialist command economy to an independent, capitalist market-based system. The situation less than a year after independence is, not surprisingly, in serious flux. The centralized planning apparatus is in the process of being dismantled, but there is no alternative resource allocation mechanism yet in its place. A market system is beginning to emerge, but it is chaotic with few rules and little respect for private property. The process of privatizing and rationalizing the industrial and agricultural base of the economy has barely begun. The breakup of the Soviet Union and the concomitant economic crisis have placed additional problems squarely in the lap of the country's overburdened economic and political leadership.

Among the most serious challenges facing the nation is establishment of a functioning, stable, and equitable political economy. Kazakhstan is widely considered one of the most progressive of the Central Asian republics, but the process of change is being carefully managed and paced by the strong, well-entrenched Nazarbayev administration. Over 95 percent of Kazakhstan's economy remains in the hands of the state, and there are few signs of significant change in the near and medium term. The reported number of registered small businesses in the entire country is 20,000, and the vast majority of these — more than 80 percent — are owned by the state.

The slow rate of growth of the private economy reflects a discriminatory and dysfunctional economic environment that does not offer economic opportunities to a sufficiently broad base of potential entrepreneurs. These conditions will likely exacerbate the negative employment effects of the ongoing structural transformation because of the shortage of alternative employment or entrepreneurial options. Other countries such as Poland undergoing a similar economic transformation have seen much faster growth of small businesses, which served to reduce the social impact of restructuring and provided a foundation for broad-based growth of new enterprises.

A dynamic and growing small businesses sector is an essential element in the development of the Kazakhstan economy not only because of the need to generate productive employment opportunities, but because of the critical role of these firms in building a new, decentralized, market-based economy. State monopolies across all industry and service subsectors will gradually be replaced by a complex interwoven network of suppliers, producers, processors, and distributors. These firms will be a balanced mix of sizes and degrees of integration. The socialist mass market will become far more segmented, with market niches arising for a variety of small firms. Local economies will become decreasingly dependent on state monopolies, and a diversified structure of manufacturing and trade will grow. A political economy that is not attuned to the significance of small firms places itself at a great and possibly fatal disadvantage.

THE NATION AND THE ECONOMY

Kazakhstan, once infamous as the last stop for political and intellectual dissidents from Stalin and the tsars before him, is emerging as the most powerful of the Central Asian republics. The nation's status as a nuclear arms power and an oil giant, its outward-looking economic policies, and Western fears of Islamic fundamentalism have all earned the country attention since its independence in December 1991.

Stretching from the Volga region of Russia to the western borders of China, Kazakhstan is the world's ninth-largest country. At 2.7 million square kilometers, it is the second largest of the former Soviet republics, preceded only by Russia, and is one-third the size of the land mass of the United States. Of the former Soviet republics, it ranks fourth in population and third in terms of output, accounting for 4 percent of the Soviet Union's net material output in 1988. This vast territory is occupied by a multiethnic population of 17 million people — ethnic stability is maintained by a balance of 40 percent Kazakhs and 40 percent Russians. Nearly 100 different ethnic groups account for the remaining 20 percent of the population, including Koreans, Germans, Ukrainians, and Belarussians. President Nazarbayev, himself a rural Kazakh peasant, has appointed an almost entirely Kazakh cabinet, whereas the majority of industry remains concentrated in the hands of ethnic Russians. Fifty-seven percent of the population is urban. The country is divided into 19 regions and two cities, each with autonomous local authority. There are 18 cities each with more than 100,000 people, the largest being the capital city of Alma-Ata with 1.2 million inhabitants.

This mineral-rich country supplied 60 percent of the minerals of the former Soviet Union. In 1990, the country's proven mineral reserves represented over 90 percent of total Soviet Union reserves of chrome, and close to 50 percent of lead, copper, and zinc reserves. It produced 7 percent of the Soviet Union's gold and more than half its silver. Most important, however, are the country's oil reserves, estimated at 25 billion barrels, of which 9 to 10 billion are deemed extractable. Chevron has recently entered into a joint venture agreement with the Government of Kazakhstan, to invest \$40 billion dollars over 40 years to extract what could amount to one million barrels of oil a day. Other abundant natural resources include natural gas, coal, and iron ore.

With about one-fifth of the combined arable land of the former Soviet Union, Kazakhstan is a significant producer and exporter of agricultural products, the most important of which are grain, wool, and meat. Czarist Russia and the Soviet Union absorbed Central Asia gradually from the mid-1800s until the 1920s, and built a feudal colonial economy. Kazakhstan was maintained as a supplier of wheat, cotton, and raw minerals. Today, the country is trying to reverse its colonial legacy, whereby currently half the finished goods consumed in the country are imported, and almost three-fourths of exports are raw and intermediate goods.

President Nursultan Nazarbayev, elected in the first presidential elections after independence was declared on December 25, 1991, is considered among the most politically astute leaders in the region. Having toured the Pacific Rim, he concluded that a country with an authoritarian past and a collapsing economy must go through a period of authoritarian rule. He has openly advocated "authoritarian modernization," which is modeled after the approach of Singapore's Lee Kwan Yew. Nazarbayev's methods have been characterized as pragmatic since he has come to power, touring the world and distilling what works best to develop a development model appropriate for the nation. He has realized that Kazakhstan does not have to undertake each painful step toward development, but can learn instead from the international economic laboratory. Although he has selected the economic models of Singapore and South Korea as rational ones to pursue, he has surrounded himself with economic and policy advisors from the United States, Germany, and Turkey. The link to Turkey is strong, given Kazakhs' view of Turkey as a kindred spirit culturally, linguistically, and religiously. Muslim Kazakhstan's leaning is clearly toward the more secular Sunni Islam of Turkey rather than toward the fundamentalist Shi'ite Islam of Iran.

Nazarbayev's economic reform strategy is not one of shock treatment; rather, he has given his nation five years to evolve into a full democracy and a market economy. He has conjured the term "social market economy" to articulate what he would like to achieve for his nation. It should be noted that Kazakhstan was the first of the Central Asian republics to create free economic zones, to establish

tax incentives for joint ventures and foreign investments, and to enact the privatization law. The country also sits at the helm in establishing a Central Asian Common Market.

THE FORCES INFLUENCING ENTERPRISE DEVELOPMENT

Unclashed after 70 years of communist rule, Kazakhstan is now challenged with taking charge of its destiny almost overnight and developing an environment hospitable to private enterprise and initiative. The obstacles it faces — continued dependency on the structure of the former Soviet Union, a colonial legacy as a primary resource base, a slow process of privatization coupled with little or no emerging private sector, and a deep suspicion of the market and its forces — are factors not unique to Kazakhstan but are true for all of the former Soviet republics. However, Kazakhstan is uniquely equipped among its Central Asian neighbors to meet its challenge in having elected a popular and powerful authoritarian leader committed to market reforms. He actively seeks counsel on policy reforms, and therefore offers some assurance that sound advice will be acted upon. Three broad categories of influences define the context for private enterprise development:

- The vestiges of the old union;
- A dysfunctional economy; and
- A deep-rooted mistrust of market capitalism.

Vestiges of the Old Union

Despite the official disintegration of the former Soviet Union, the vestiges of the old system prevail. Suppliers, markets, and the currency remain the same. Under the former Soviet Union, Kazakhstan was a supplier of raw materials in exchange for processed goods and consumer items from other republics. Kazakhstan has not developed new markets for its raw materials nor new suppliers, continuing to depend on the old markets and suppliers. Furthermore, Kazakhstan is part of the "ruble zone." Using the ruble as a medium of exchange for dealing with the former republics has led to imported inflation, a payments crisis, and the lack of paper currency. As long as Kazakhstan remains in the ruble zone, it needs to align monetary, foreign exchange, and trade policies with Russia.

The Soviet colonial system of using the Central Asian republics as raw material resources specializing in one or a few commodities while processing or adding value in Russia or elsewhere and then exporting finished products to these countries has created a deficient and unintegrated industrial and manufacturing sector. The Soviet Union also followed a policy of not developing vertical or horizontal integration in any one country; rather, oil would be extracted in Kazakhstan, processed in another republic, and refined in yet a third republic. Consequently, no single powerful and well-developed industrial sector emerged in Kazakhstan.

The dominance of the state economy perpetuates itself. "The independence [and equal rights] of a private business stops at the doors of the state-owned enterprises," explains one of the handful of successful private entrepreneurs in Alma-Ata. Although one encounters rhetorical support for market liberalization and economic reform at every bend, one becomes quickly aware that only the surface has changed — that old systems have been reincarnated with new names, and that the old system and the old power remain very firmly entrenched, with vested interests in disguising the status quo.

A Dysfunctional Economy

Having embraced a policy of economic liberalization and market reform in its nine months of independence, Kazakhstan is now in the precarious chasm between post-command and premarket economies. The private sector has not yet arisen to fill the gap in services resulting from the dismantling of state services. The economic environment is not conducive to the emergence of the private sector.

Kazakhstan's privatization process is essentially at a standstill, and the current business environment crowds out start-up ventures before they get off the ground. There is no noticeable progress in privatizing or in restructuring state-owned enterprises. Of more than 30,000 state-owned enterprises, only 1,500 of the smallest have been privatized. More than 90 percent of all manufacturing output is by the state; the private sector is only a tiny contributor to the economy. In the unlikely event that entrepreneurs survive the initial steps of starting a business, they become entirely dependent on a deteriorating state-controlled command system as no alternative exists for markets, inputs, or access to credit.

According to close observers of the economic reforms, many Western economists have grossly underestimated the task of transforming the NIS economies. Some feel that it might take several decades to reach the current level of the Turkish economy.

Deep-Rooted Mistrust of Market Capitalism

After 70 years of rhetoric on the evils of private enterprise, a general suspicion of private business lingers in Kazakhstan. What private enterprises arose in the former Soviet Union were thwarted by the official system and forced to operate outside the law. There is little understanding of the concept of entrepreneurs. Entrepreneurs are often presumed to be engaged in criminal activities. This attitude, combined with the view that many entrepreneurs are profiteers and tax avoiders, has given people a poor opinion of the private sector.

"He who sells something he has not produced is lying" is a communist adage still guiding the majority of Kazakhs, meaning that it is not honest work to act as an intermediary or trader. This mentality creates a systematic bias against trading activities and principles associated with concentration of wealth such as profits. Because of the virtual absence of long-term credit for investment in capital equipment, most of those who own small and private businesses in Kazakhstan are traders. People involved in trading activities are considered to be only profiteers or exploiters and are held in contempt by most of the population because traders are deemed to provide no value-added service, as opposed to manufacturing or producing something. The few entrepreneurs that succeed in generating reasonable profits quickly encounter problems with employees, the community at large, and government authorities. Employees demand that profits be distributed following old principles of collective ownership. Community members are envious and in some cases sabotage profitable enterprises. Government authorities move quickly to create new taxes and indirect mechanisms designed to get this profit back into the hands of the people.

THE STATE OF SMALL BUSINESSES IN KAZAKHSTAN

Small businesses' contribution to the economy is a marginal 2 to 4 percent of total production. To date, more than 75 percent of all small businesses are partially state-owned. The current business environment is a prohibitive barrier to small-scale manufacturing. Consequently, practically all small enterprises are in the trade sector, buying and selling consumer goods and women's clothing. Kazakhstan's Law on the Freedom of Economic Activity granted equal rights to all enterprises regardless of ownership structure. Ratified and signed by President Nazarbayev in December 1990, the law was designed to level the playing field for all private businesses. In practice, the law has yielded little substantive change for the fledgling Kazakh private sector.

Approximately 20,000 small businesses have been registered since the law was signed. The number of companies registering as small enterprises is reportedly increasing by 30 percent annually. These numbers are suspect, given blurred distinctions among various forms of state and private enterprises, which prohibit reliable assessments of the scale and significance of the existing small businesses sector in Kazakhstan. Thus, if a company registers itself as a small company, then it is counted as a small enterprise; conversely, if the firm does not list itself as a small enterprise on the registration form, then it is not considered a small businesses. The word "private" is often used interchangeably with "small," and the definition of small varies by industry. Under decree 432, the Government of Kazakhstan defines small businesses in terms of number of employees and does not take into account sales, assets, or shareholder capital. The size of a small businesses varies according to different sectors as follows:

Construction/Industry	200 workers
Other Industry	50 workers
Non-Industry (agriculture)	25 workers
Trade/Retail	15 workers

Current data collection and reporting are characterized by confusion and arbitrary distinctions based on artificial preferences rather than ownership structures. There are currently 11 categories under which firms are categorized by registration officials: limited partnership, collective enterprise, small enterprise, cooperative, small private enterprise, corporation, auction company (joint-stock), concern, broker, joint venture, and association. Registration officers are unable to differentiate among the categories.

Although there is a lack of accurate records, which are only as of this year being computerized, it is estimated by registry officials that women owners and managers account for 30 percent of new business registration. These women are expected to occupy the most significant role in the yet-to-emerge services sector.

CONSTRAINTS ON SMALL BUSINESSES DEVELOPMENT

A would-be private entrepreneur faces nearly insurmountable constraints to starting a business. Access to nearly every business prerequisite — licenses, premises, inputs, markets, funding — requires political connection. As a result, business is predicated on access to politically acquired assets.

Capital

Access to sources of finance for business start-up are limited. Apparent widespread cash shortages and undeveloped equity markets limit the ability to generate equity capital. The banking system does not work for small businesses. Bank loans are primarily issued to shareholders and close acquaintances with deep pockets at prohibitive interest rates as high as 120 percent for terms of three to six months. Virtually all start-up businesses are engaged solely in trading activities where risks are low and loans can be cycled quickly. Given the overall business climate, however, the difficulty of obtaining financing is understandable. Many businesses have odd explanations for their sources of start-up capital and are linked to state enterprises or have key political connections.

Registration

For those able to locate start-up funding, obtaining a business license is a challenge. In theory, this process has been simplified to facilitate small businesses development; in practice, it lacks a set of clearly defined approval criteria, and, like any other process in a former communist regime, it lacks the transparency needed to substantially reduce uncertainty for new entrepreneurs. Even at this initial step, small enterprises are competing with well-connected and -subsidized state-owned enterprises that can afford to buy preferential treatment to re-register their companies and prevent the emerging competition from ever getting to the market.

Securing Premises, Services, and Inputs

All existing factory space is currently owned by state enterprises. The general managers of these *kombinants* operate on the incentive system of the former Soviet Union, whereby the number of factory employees determines the managers' titles and salaries. These managers, believing they have no vested interest in changing the incentive system, resist divestiture of any kind. An entrepreneur thus faces prohibitive transaction costs in bribes and waiting time to secure appropriate factory space. In the event that premises are obtained, there is the rapid discovery that all the firms engaged in doing renovation work are state owned. These firms often require exorbitant bribes in hard currency in addition to insisting on full payment in advance. Unable to turn to an alternative system, the entrepreneur is forced to play the game, thus greatly increasing the risk of the project and threatening the viability of the enterprise. The same situation is encountered when attempting to source needed raw materials and spare parts.

Auxiliary Services

Kazakhstan does not have an adequate number of skilled accountants, lawyers, and bankers to support the private sector. Given the dearth of available services, an enterprise is forced to develop the auxiliary services necessary to support its activities. For example, Caravan, a private holding company providing informational services, has invested in legal, insurance, printing, and distribution services and, most recently, a bank to support its primary activity of publishing an English-language business journal and two weekly newspapers.

Low Skill Base

Kazakh entrepreneurs typically lack managerial and entrepreneurial skills, having been conditioned for decades to operate under a system without appropriate incentives. Business acumen in marketing, accounting, competitive pricing, quality control, distribution, and advertising is virtually nonexistent.

Legal Framework

Continual changes in legal and financial regulations make it difficult for an entrepreneur to operate or plan for the future. Administrative directives and decrees issued to implement laws are often confusing and in some cases appear to contradict the law itself. In some instances, local decrees contradict the national decrees. The commercial legal system is not transparent and lacks reliable mechanisms for enforcing contracts and resolving disputes. There is no bankruptcy law and no means for dealing with company insolvency.

Lack of Information

Enterprise owners and managers do not understand and lack sufficient information about changes in the financial and legal systems and the effect these changes have on their businesses. They have no adequate forum or method to publicly disseminate the changes in the financial and legal system. They also lack access to market information, commodity prices, transportation links, and the like.

Erosion of Purchasing Power

The economic instability of Kazakhstan has led to high inflation, a decrease in real earnings, and reduced consumer income and purchasing power, thereby restricting markets for products and services.

Gender Bias

A woman entrepreneur faces additional constraints in accessing credit and other services necessary to operate a business, given prevailing attitudes such as that articulated by the Deputy Director of the Union of Small Businesses: "A woman cannot be a serious businessman." In this patriarchal and sexist society, the role of women is defined primarily within the household. Despite socialist promises of gender equality, women work double-time — full-time both within and outside of the home. Decision-making power is unequivocally concentrated in the hands of men, even in the banking industry, where women make up 80 percent of the work force. Women are disproportionately affected by the dismantling of state-operated social programs such as child care and subsidized food. Dismantling programs shifts the burden for the services to women, placing greater demands on them and further reducing the time they can devote to operating an enterprise.

THE STATE CONSTRAINT

As evidenced by the previous discussion, the state's stronghold on the private sector is firmly entrenched. At every stage — from registering a business to obtaining commercial space to applying for a loan — entrepreneurs depend on and compete with the state. A few specific examples follow:

- The state printing monopoly charges private publishers 28 percent more than it charges state publishers.
- Russia restricts ruble payments from Kazakhstan. All ruble payments to Russia must go through the State National Bank, which gives first priority to state enterprises, thus depleting the ruble payment quota.
- Most inputs are imported from Russia, and state enterprises, because they are accorded priority over inputs, often purchase inputs and then resell them to the private sector at much higher prices.

Entry into the private sector is restricted to those with powerful state connections. Through a process popularly known as privatization by the nomenklatura, government ministers attempt to convert their disbanded ministries into joint-stock companies and appoint themselves to key positions.

THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR SMALL ENTERPRISE DEVELOPMENT

The effective operation of a market-based system depends on the existence of a clearly defined body of commercial laws and a well-functioning network of institutions that together can administer legal agreements, provide reasonably secure and predictable enforcement of such agreements, and provide the entrepreneurial community with a variety of needed services. Although the Government of Kazakhstan has taken several concrete steps to create a market economy, the country still lacks an adequate legal code for private property and business transactions.

Recently drafted commercial legislation is limited to the authorization and definition of specific forms of business activities. The drafted measures fail to provide the clarity or detail required by the private sector. Furthermore, the lack of adequate enforcement mechanisms limits new market activities to agreements between parties that know and trust each other well. Continual changes of the government apparatus during this period of transformation exacerbate the erosion of confidence in property rights laws by casting doubt on the longevity and credibility of newly created agencies in charge of private enterprise development. In addition, there are no institutions that can intermediate on behalf of entrepreneurs and represent or advocate their interests. Furthermore, there is a paucity of training and technical institutions that can provide direct assistance in business development.

Given the existing legal and institutional structure described above, there is no institution that provides the interface between policy makers and small businesses. Kazakhstan would benefit from A.I.D. efforts to develop this important linkage. Because there is no obvious institution either in or out of government from which these efforts can be directed, potential projects are likely to be most effective if they are managed from an independent project management unit.

THE GOVERNMENT

The government apparatus in Kazakhstan is in a state of flux. No clear lines of authority have been established, and many agencies are competing for power. The incomplete "Kazakhification" of the government worsens this confusion. Currently, the executive branch depends on the analysis and advice of four presidential committees: the State Committee of the Republic of Kazakhstan on Support of New Economic Structures and Restriction of Monopolistic Activity (The Anti-Monopoly Committee or AMC), the State Committee on State Property (SCSP), the Tax Committee, and the High Economic Council. The AMC is the designated authority to address policy and regulatory issues affecting small businesses. All of these committees are at the level of the Cabinet of Ministers.

Under the Law on the Development of Competition and the Restriction of Monopolistic Activity, the AMC was set up in June 1991 to "curb unscrupulous competition and coordinate the activities of other state bodies in the development of competitive markets." Its functions include conducting market analysis, examining draft laws, and coordinating antitrust government efforts. The AMC has also been charged with managing a fund for small enterprise development, the Enterprise Support and Competition Development Fund, which is designed to be used for subsidized loans or grants to entrepreneurs in the manufacturing sector. By the end of June 1992, 86 million rubles had been disbursed under the fund.

The AMC lacks the technical skills, actual authority, and financial resources to carry out its mandate; thus, it is quickly losing credibility and is expected to lose its existing structure and status by the end of 1992. Current plans are to merge part of the AMC with the State Committee for Privatization. It is unclear what will happen to the remaining part of the AMC. It is also unclear which government body will be responsible for small businesses upon completion of the President's ministry consolidation process.

The SCSP is in charge of reorganizing the state industrial sector and overseeing Kazakhstan's privatization process. Representatives of the SCSP acknowledge that their mandate places no particular emphasis on small businesses development. The Tax Committee is responsible for the enforcement of tax decrees and the collection of taxes. The High Economic Council is charged with analyzing and drafting new laws for Kazakhstan.

BUSINESS LAWS

As of October 1992, three laws govern small businesses in Kazakhstan:

- The Law on the Development of Competition and the Restriction of Monopolistic Activity;
- The Law on Freedom of Economic Activity and Development of Entrepreneurship in Kazakh Soviet Socialist Republic; and
- The Law on Property in the Kazakh Soviet Socialist Republic.

These laws call for the expansion of property ownership and property rights. However, they do not detail specific ways for entrepreneurs to protect themselves from violation of their rights. Specific regulations are yet to be written in areas such as contract law and intellectual property. For example, to date no efforts have been made to develop a detailed contract law that would guide the transfer of property ownership. In the case of the Law on the Development of Competition and the Restriction of Monopolistic Activity, the law places the burden of enforcement on the Anti-Monopoly Committee; however, committee members indicate that they are ill-equipped to comply with specific mandates such as conducting competitive analysis or analyzing and drafting antitrust laws. Entrepreneurs report discrepancies and contradictions in laws and their regulatory decrees. Whereas a law may be passed legalizing entrepreneurial activity, a decree may also be issued that constrains the law with unreasonable tax restrictions.

REPRESENTATIVE INSTITUTIONS

Currently no independent and autonomous intermediary institution exists to represent the interests of small businesses in the policy-making process. The President's Council of Entrepreneurs was recently created and designed to be a policy-level audience to the ideas and initiatives of the many "unions" now claiming to represent small businesses. However, private or would-be entrepreneurs generally feel that government policies are hindering rather than benefiting their growth by their constant metamorphoses and lack of transparency. Even high-level officials within the Government of Kazakhstan have described the Council of Entrepreneurs as a way to quiet any voice for small entrepreneurs.

Unions have been formed, each claiming to be the advocate and voice of the private sector. In reality, these organizations are repackaged remnants of state collectives representing state enterprises. They are politically connected and have a vested interest in furthering their own political and business investments. The unions themselves have significant business activities. They collect annual dues ranging from 500 to 100,000 rubles from their membership base. In return, they provide protection and access. The unions are generally headed by former party officials, who lure members with the promise of access to inputs, services, loans, and markets reserved for the politically connected. They have been characterized as "a cleaner mafia to protect their members from the real mafia."

The rapid growth in unions is partially explained as a response to potential foreign funding. Unions appear to be responding to a set of incentives other than expanding their membership base with the promise of market-oriented customer-driven services. Aside from attempting to improve the image of entrepreneurs and to offer limited services such as training, union leaders have a very restricted knowledge of how to further the interests of the private sector. Because the definitions for small and private businesses are still not clear in Kazakhstan, union membership tends to be mixed, based less on common business interests than on allegiance to the perceived political power of the union leaders.

Presently, four major unions claim to represent the interests of small businesses:

- Union of Small Businesses;
- Union of Entrepreneurs;
- Union of Cooperatives; and
- Small Farmers' Union.

The **Union of Small Businesses** was created in the spring of 1990 and has approximately 3,500 members, mostly traders. In principle, members are small businesses, but currently small businesses means companies that define themselves as such when registering. The Union of Small Businesses is headed by a former people's deputy that represented Kazakhstan in the Communist Party in Moscow. He is open about his political ambitions and sees the union as a sound platform for creating an alternative political voice. Although the union's mission is to represent small businesses, representatives admit that at present most of their time is allocated to running the organization's own trading operations.

The **Union of Entrepreneurs** was founded in 1988 in response to the Law of Cooperatives, which allowed the creation of private cooperatives. Officials report membership at 2,000. Members are also small businesses, again mostly traders. More than the other unions interviewed, the Union of Entrepreneurs has a clear strategy to advance the interests of small businesses through the establishment of an alternative political party. Aside from operating its members' trading businesses, this union is very active in publishing an independent paper and in airing aggressive television campaigns that create a political voice for entrepreneurs. Union leaders describe their next major challenge as convincing their members to channel financial resources to support key political figures in the assembly that appear to support small businesses.

The **Union of Cooperatives** was established in 1988 as an organization for newly permitted cooperatives. Membership is restricted to cooperative ventures and is currently estimated at 2,500 but reported to be dwindling. As cooperatives reorganize and re-register their companies as joint-stock companies, private enterprises, or small businesses, the newly registered firms join another union. The union leadership is composed of former party members.

The **Union of Small Farmers** was organized in 1990. Currently, union leaders claim to have more than 9,000 members, most of which are farms that together account for 2.2 million hectares. Nearly half of the farms are located in the southern part of the country, with relatively small average holdings ranging from 5 to 150 hectares. The farms in the north are much larger, with holdings between 400 and 2,500 hectares each. The main mission of this union is to lobby the Government of Kazakhstan for subsidized loans and other farmer programs. Union leaders are particularly eager to receive funding for minifactories they feel are necessary in every town in the country as the old centralized processing system falls apart. The head of the union is a former Communist Party leader.

TRAINING INSTITUTIONS

Until recently training institutes teaching market economics have been absent. Entrepreneurs report that there are no consulting firms or resource institutions that could provide advice on technical or management areas. Currently 19 separate organizations claim to provide management training, but most of these companies are operated by moonlighting university faculty or offer only short seminars or management-related courses. Training provided by faculty is of little value because the state education system is highly theoretical and steeped in Marxist economics. Two training institutions that have the potential to play a role in management training for private sector managers are the Kazakh Institute of Management and Economics (KIME) and the recently established Kazakh-American International Business Institute (KAIBI). Both of these programs are too new to fully assess their merits.

KIME was established on January 1, 1992, to develop a cadre of future managers and scholars trained in market economics and business. KIME offers two-year degree programs: Master's in Business Administration and Master's in Economics. In addition to the degree programs, KIME has short-term training courses for professionals. One of KIME's aims is to train economists to become economic teachers and conduct independent research. KIME instructors are from the United States and Europe. Although current faculty members are largely volunteers, KIME plans to expand into a full-service professional institute and pay competitive salaries in the near future. The London Business School, the European Community, and the British and Canadian governments have already pledged support to KIME.

KAIBI is a joint venture formed in 1991 between a Southern Baptist organization and a Kazakh training center that offers short-term courses in business, business English, and computer skills. KAIBI's focus is to teach ethical business practices. The business curriculum consists of an eight-week program that includes a broad smattering of marketing, accounting, management, and other business principles. The business English program has been the most popular to date. KAIBI currently has an American faculty of 8, 4 in the English department, 3 in the business department, and 1 in the computer department. KAIBI aims to have a full-time faculty of 70 in the near future. The eight-week courses range in cost from 10,000 to 25,000 rubles. KAIBI is perceived by many as a religious organization, particularly because the classroom is used for religious teachings.

FINANCIAL INSTITUTIONS

In Kazakhstan, there is no history of institutionally providing financial services to private enterprises. Although there are informal financial markets in the country, they are linked to ethnic groups (the Koreans, for example) or to the growing "mafia" that controls much of the business support

services. The commercial banking system in Kazakhstan is embryonic and chaotic. The banking system does not serve the needs of the small businesses sector but rather exists to serve state-owned enterprises on terms that have very little to do with financial markets.

Banking Sector

Kazakhstan does not have a properly functioning banking system in place. The banking system is composed of the National Bank of Kazakhstan (NBK), a government savings bank, and commercial banks. NBK acts as the country's central bank and is responsible for establishing money and credit policies, licensing of commercial banks, regulating and supervising the banking system, and managing foreign exchange and exchange rates. The State Specialized Savings Bank, previously a "Union" bank, has a quasi monopoly on household deposits with all deposits guaranteed by the government.¹ Most of the funds of the State Specialized Savings Bank are placed with the NBK. At the beginning of 1992, the NBK reported that there were 70 commercial banks, 6 of which were private. In the first nine months of 1992, licenses were issued to 145 commercial banks. The number of branches in the banking system is 810, with only 6 banks having multiple branches. The banking sector is depicted below:

National Bank of Kazakhstan		
State Specialized Savings Bank	Commercial Banks	145
	Cooperative	11
	Commercial (J/S)	40
	Commercial (Ltd)	50
	Private	44

Commercial banks are subdivided into three categories: cooperative, commercial (joint-stock and limited shareholding), and private. Cooperative banks came into existence in 1987 under the Law of Cooperatives, which allowed cooperatives to form banks. Joint-stock commercial banks and limited shareholding (meaning no single shareholder has more than 35 percent ownership of the bank) commercial banks are defined as owned by corporate entities. A private bank is one owned by one or more individuals. Only about half of the licensed private banks are operating. The initial capital

¹ In the former Soviet Union the structure of the banking system consisted of Gosbank as the central bank and five specialized banks: the Savings Bank (Sherbank), the Foreign Trade Bank (Vneshtogbank), the Bank for Construction and Industry (Promstolbank), the Agricultural Bank (Agroprombank), and the Social Sector Bank (Zhilsotsbank). These specialized banks were called Union banks and operated throughout the Soviet Union with territorial branch offices in each of the republics. When the Soviet Union was dissolved, the Union banks were likewise abolished, and the territorial branch offices became separate financial entities in each republic.

requirements vary according to the category of commercial bank; 500,000 rubles for cooperative banks, 5 million rubles for commercial banks, and 50,000 rubles for private banks.

NBK has granted licenses to 13 commercial banks to conduct foreign exchange activities. Six banks have general or full licenses that permit them to conduct both internal and external foreign exchange transactions; the other seven banks have licenses enabling them to handle foreign exchange transactions only within Kazakhstan.

The rapid growth in the banking system has not led to enhanced competition or increased efficiency in the allocation of credit. The former state banks have remained largely specialized, and the new banks are small and lend to only a few enterprises that are usually their shareholders or their main depositors. The new banks often have been established only to benefit from the refinancing facilities and other banking privileges extended by the NBK.

Sectoral specialization is an important feature of Kazakhstan's banking system, especially for the long-established banks. The three largest banks in the country — the Agroprombank, Turanbank, and Kredsotsbank — lend almost exclusively to separate sectors: the Agroprombank to industrial and agricultural enterprises, Turanbank to construction establishments, and Kredsotsbank to companies involved in housing management and municipal facilities. Banking system loans totaled 48.4 million rubles at the end of 1991. The combined loan portfolios of these three banks accounted for 79 percent of total banking system loans (Agroprombank 49 percent; Turanbank 19 percent; and Kredsotsbank 11 percent). Almost all of the loans these institutions make are extended to state-owned enterprises that are essentially bankrupt. It is rumored that the leverage of these banks is around 35:1, which is 50 percent higher than permitted under current regulations.

The financial soundness of many of the commercial banks is questionable. A number of banks, particularly those that emerged from the former system, have insufficient capitalization, a significant portfolio of nonperforming loans, and dangerous mismatches of maturities and foreign exchange exposure.

Commercial banks are more interested in raising funds through equity or borrowing from the state rather than working to mobilize savings. Commercial banks rely heavily on the NBK for funding through refinancing and are not encouraged to mobilize resources directly. As of the beginning of September 1992, banking system loans totaled 350 million rubles, of which 80 percent (280 million rubles) were provided by refinancing facilities of the NBK.² Only 20 percent of total bank lending (70 million rubles) was accounted for by deposits.

Financing for Small Businesses

There is ample evidence worldwide, regardless of the level of economic development of a country, that small businesses do not have easy access to financial capital for start-up operations. Commercial banks typically are reluctant to finance start-up businesses because of the inherent high risk of failure associated with such a venture. Financing business start-up is a role customarily filled by

² The rapid expansion in total lending since the end of 1991 is largely attributed to inflation, not to economic growth in real terms.

venture capital firms that specialize in providing equity and debt. Traditionally, small businesses obtain start-up capital from family, friends, or informal sources. Once a business is established and has a proven track record, it is more likely to obtain funds from a commercial bank.

The difficulty in Kazakhstan is threefold. First, funds available from family or friends are insufficient. The limited levels of savings by the majority of the population are quickly being eradicated by rampant four-digit inflation. Savings that might otherwise be available for investment are held back to cover basic living expenses. Second, those small businesses that are established do not have a source of long-term funds for investment purposes. Kazakhstan has not developed a mechanism to address the need for venture capital. Loan terms from commercial banks average three months, an insufficient term for investment capital. Under the communist system, except for a small part of the population that could amass wealth, the majority had relatively similar levels of income. Thus opportunity for intermediation between those with excess funds and those requiring funds is virtually nonexistent. Third, small businesses' access to any source of funds from commercial banks is limited. For the most part, commercial banks lend to shareholders or state-owned enterprises. To get access to funds, small businesses must resort to bribes to pay "expeditors" for assistance, or they are forced to turn to the informal sector, utilizing linkages with state-owned enterprises or the local mafia.

Commercial banks provide financing for the private sector but only at high interest rates (currently averaging 75 percent per annum) and only for short periods (generally up to three months). The short-term financing available from the commercial banks precludes a private business from obtaining investment capital for equipment. Instead, the interest rates and short loan terms are attractive only to persons engaged in trading activities who can capitalize on profitable activities that have rapid turnover and can be operated with relatively small amounts of money.

Small businesses' lack of access to credit is exacerbated by a payment crisis in the country. Funds are not actually transferred between parties; only paper entries are made. State-owned companies do not pay for goods, nor do they receive payment for goods sold. In lieu of cash payments, trade credits are issued to creditors. Few banks will honor the trade credits because of the bankrupt nature of the state-owned enterprises. There is a further problem of a lack of currency notes in circulation. Often companies do not have sufficient cash to pay workers' salaries.

Long-term credit for would-be entrepreneurs is in extremely short supply. In an attempt to address this constraint, the Government of Kazakhstan has established a fund, currently housed in the AMC, that is designed to provide long-term credit (two to three years) to small businesses at preferential rates (half the rate of interest charged by commercial banks). To date, the fund has disbursed loans to 37 businesses with an average loan size of 2 to 3 million rubles. These loans involve a high transaction cost because processing takes two to three months.

There are serious operational weaknesses in the banking system, including the absence of operating procedures for performing basic banking functions. Most banks lack the managerial and technical skills needed to operate in a market environment. Bankers are unfamiliar with fundamental lending techniques such as loan analysis and evaluation. These problems are compounded by the fact that accounting standards have not been established in Kazakhstan: Arbitrary and artificial values attached to inventories and obsolete equipment make it difficult to determine the value of a business. There is also a lack of bank supervision as well as a lack of foreign exchange regulation and control.

The inadequate legal and regulatory framework and the lack of trained commercial bankers make it difficult to work directly with the banking sector to improve financial services to the private sector. Technical assistance and training are currently being provided or have been promised to the NBK or the banking system as a whole. Donors include the International Monetary Fund, World Bank, U.S. Treasury, European central banks (Great Britain, Belgium, and Germany), and individual banks from Turkey, Great Britain, and Germany.

In the near term, the financial sector is not going to play a significant role in small businesses financing. Few people have the necessary capital to start businesses of their own, and the biases of the banking system make such funding difficult to obtain unless one is a shareholder in a bank or belongs to an association that operates a bank. Commercial banks cannot be expected to be the main source for start-up capital. Businesses are going to have to rely on other sources of funds for start-up and use retained earnings for expansion. This constraint influences the pattern of business development but is unavoidable for now. Encouragement of trade and commerce will result in relatively quick accumulation of earnings that can be used for diversification into manufacturing.

A STRATEGY FOR ASSISTING SMALL BUSINESSES IN KAZAKHSTAN

The factors constraining small businesses development in Kazakhstan are systemic and, for now, structural. Supplying a single missing ingredient will not unfetter entrepreneurship, nor will uncorking strategic bottlenecks support dramatic business growth. The economic, social, and political climate in Kazakhstan remains at odds with the emergence of entrepreneurial private enterprise.

The environment for business development in Kazakhstan offers the full menu of challenges facing small firms in developing and developed countries: limited access to financial services, poorly articulated or monopolistic markets for inputs and output, limited access to technology and information, legal and regulatory problems, poorly developed business services; and so forth. Those daring to face these hurdles do so without much experience in market-based economies and often must do so with the albatross of partnership with the politically connected.

The recommended course of action for A.I.D. is to immediately initiate concrete assistance activities with local institutions that are prepared to play significant roles in either public and private sectors dialogue (advocacy) or are moving toward developing direct assistance programs (financial services, advisory services, information dissemination, and training) for small firms. These initial activities will produce concrete results that better the environment for small businesses development and will also open new opportunities for more aggressive program support for successful institutions and approaches.

FORMULATING A STRATEGY

There is much that can be done to accelerate the growth of small enterprise in Kazakhstan. To choose from the activities that were deemed technically possible and likely cost-effective, several additional criteria were used:

- **Quick Start-up.** Activities were selected to minimize the need for protracted start-up that would delay initiation of concrete program interventions.
- **Salability.** The program and activities should be amenable to different levels of effort over time. In this case, the initial activities are limited in scale and scope, but they will likely lead to more involved activities as they demonstrate their potential.
- **Manageable Risk.** The program was designed to minimize the risk of association with unstable government units and relatively unknown private bodies. There is not a sufficiently well-developed institutional history in Kazakhstan to justify selecting exclusive partners on the basis of a limited initial visit to the field.
- **Low Management Cost for USAID.** The signals were clear that the program must not make excessive calls on the scarce management and support time available from the NIS Task Force or USAID/Alma-Ata. Efforts were made to transfer responsibility for most management functions to third parties.
- **Visibility.** The proposed activities should offer visibility to U.S. foreign assistance to distinguish it from the activities of other donors.

STRATEGIC OBJECTIVES

The proposed program focuses its efforts on two primary objectives:

- To contribute to improving the environment for enterprise development by enhancing the interaction of the public and private sectors so that policy and regulatory formulation and the implementation process are informed by the interests and voice of small businesses; and
- To contribute to improving the services available to small businesses by selectively strengthening the methodologies and capacities of intermediary institutions.

ENHANCING THE VOICE OF SMALL BUSINESSES THROUGH ADVOCACY

Most of the actors in the political economy of Kazakhstan have a good deal to learn about the operation of a private economy and the role of small businesses. The structures and processes of advocacy will be slow to develop and will reflect the interests of the most powerful economic groups rather than those of the business community at large. It is possible, however, to accelerate the emergence of ideas and institutions on both sides (public and private) to improve the quantity and quality of the discussions on key policy and regulatory reform issues.

As noted earlier, there are several institutions that would like to be designated as the exclusive representative of the small businesses community to the government, but most devote far more attention to securing their power base than to representation. Nonetheless, these groups expect to play a role in providing information to the government about the impact of policy and regulations on business as well as about other constraints on business entry and growth. At the same time, the government is trying to sort out how it can best deal with these institutions and the input they may offer.

Over the longer run, there is much that can be done to improve relations between the public and private sectors. A.I.D. has learned a great deal about how this interaction unfolds on the public sector side from its long-term work in Poland. In the short-run, however, a number of activities can initiate informed dialogue on priority issues. Dialogue is perhaps the most important stimulant for the development of longer-term advocacy relationships.

The advocacy component of the program has two elements. They are related, but conceptually distinct. The first deals with the quantity and quality of information available for the dialogue; the second deals with the dialogue itself.

Fueling the Dialogue: Good Information and Analysis

Very little concrete information and analysis on enterprise development matters reaches policy makers. The project can make a major contribution to the evolution of the policy and regulatory environment by supporting the production of the following kinds of inputs:

- **Policy and Regulatory Reform Analyses.** The project can support studies of the impact and consequences of alternative policy and regulatory changes (including tax policy, licensing, and privatization) or the documentation of constraints (such as entry, licensing, registration, and

access to finance). No existing groups are able to sponsor work of this nature that goes beyond the anecdotal.

- **Basic Market Economy Information.** Serious misconceptions about business, business development, and the market economy must be removed from the policy-making process as quickly as possible. The rejection of the importance of marketing and distribution functions in building an economy is one misconception; the other is the belief that building a self-sufficient economy is better than building an economy that finds its comparative advantage.
- **Firm-level Action Research.** Good dialogue comes from hands-on experience at the firm level. The project should selectively identify, carry out, and document a number of firm-level assistance efforts. Interventions should be closely coordinated with local or other sources of technical assistance. These activities are to serve primarily as a vehicle for making specific cases to influence policy reform. Lessons from these pilot efforts will be channeled into policy reform designed to break structural bottlenecks in the small businesses environment.
- **Information Exchange.** Kazakhstan has been closed off from the West for a long time. Exposure to the ways of operating capitalist market economies can be a strong force in influencing the development of ideas. The program can serve as a conduit for external seminars, occasional study tours, or other modes of international information exchange.
- **Business Census.** There is not a reliable base of information on small businesses other than registration data, whose accuracy is questionable. Collection of statistically valid census information on the small businesses sector will serve a number of useful roles at this stage in the development of the economy.

Promoting Good Dialogue

In addition to providing information and analysis, it may be possible to help promote active dialogue among the various actors in the public and private sectors. An external advisor or agency can occasionally serve as a bridge in local idea exchanges. Moreover, it is important to build into this program clear linkages between the gathering of information and the promotion of its use. Three ways to ensure that the work of this component is as influential as possible are the following:

- **Linking program activities with local institutions.** Wherever appropriate, the work suggested above will be carried out in conjunction with a local institution that has the interest and capacity to use it.
- **Promoting round-tables and seminars.** Well-organized and -planned meetings that are attended by the right people can be useful tools in the advocacy process.
- **Dissemination.** The project should be able to support various forms of information dissemination such as video, television, radio, and newspaper.

STRENGTHENING SERVICES AND SERVICE INSTITUTIONS

The number of institutions offering services to small businesses will grow rapidly over the next several years. This increase will reflect both demand by small firms for particular types of services and supply of donor and other external resources for small businesses development. USAID can play an important role by encouraging and assisting initiatives that have the greatest chance for long-term success and significant impact. A.I.D.'s greatest comparative advantage is not to establish and operate new assistance programs, but to assist others in designing, refining, and operating their own efforts.

Rather than limiting the scope to particular categories of services at this stage, it is preferable to explore a wide array of potential initiatives. The two broad restrictions would be that financial services be based on commercial principles and that nonfinancial assistance meet fairly strict standards of cost-effectiveness. Similar to the advocacy component, the service component offers a seedbed of short-term activity that can be expanded upon as the programs of USAID and other donors develop.

This component can operate in at least two ways. Initially, the project could work on specific assistance methodology issues across institutions and programs. Small businesses finance might be a good area for initial work, but other topics might also be pursued. The project would be equipped to bring in short-term advisors to provide technical assistance to institutions on a particular subject matter. Alternatively, or as follow-up, the project may reach a point at which there is a clear basis to select one or two institutions for more concentrated attention.

Technical Assistance to Institutions and Programs

The most interesting starting points for the institution-led component of the program are in the training, advisory, and information dissemination areas. All of the unions are ready and willing potential partners for training. The question is: Whom are they going to train or advise to do what? It will be necessary to focus A.I.D.'s efforts on the technical content of these efforts as well as on developing the institutional capacity to effectively design and implement training and assistance efforts.

For the methodology-led portion of the work, the most likely starting point is financial services. At this stage, however, it is advisable to move cautiously in dealing with financial services. Credit programs are very risky in the absence of a broad institutional awareness of the issues involved in small businesses finance. One of the key facts that must be understood is that the vast majority of small businesses must get started and running without access to formal financing. Over time, A.I.D. may want to get involved in providing assistance to a formal or informal institution entering into the finance business. Such assistance should be restricted to technical assistance and not capital.

Limited Direct Assistance to Individual Firms

The proposed program does not concentrate on providing direct assistance to individual firms. This position is somewhat controversial and deserves explanation. In general it is not cost-effective to provide direct assistance to small firms because the flow of benefits from a single small enterprise rarely justifies the cost of providing useful support. One of the defining characteristics of the small enterprise development field is this: what you can do when working one-on-one does not make good sense. One

important contribution that the project will be able to make to those institutions choosing to offer individualized firm-level assistance is to assist in developing strategies for improving either the cost-effectiveness of the services or their commercial viability.

However in several situations — when delivery costs are held down or benefits are magnified — direct assistance might be a viable and interesting programming option. Three of the possible justifiable cases include the following:

- The solutions to the problems of a single firm may help remove a bottleneck affecting a large number of existing or potential entrepreneurs. For example, the project may assist a firm in resolving a particularly sticky regulatory or property rights issue (rights to underground water, for example) that can be used as a precedent for regulatory or legal reform.
- To assist a number of small firms, it may be necessary to provide assistance to an individual large firm. Assistance may affect the market for inputs or outputs of the small firm or might facilitate the start-up of a number of small firms out of the ashes of a large-scale privatization.
- Direct assistance would be justifiable in cases where there is a vital single missing ingredient that keeps an entrepreneur from capturing a real opportunity, and where the costs of service delivery are low and the benefits relatively certain.

Of course, if full cost-recovery rates are charged to the firms receiving assistance, the issue is moot. It is only when one-on-one assistance involves a subsidy that there is concern. Beyond the issue of cost-effectiveness is the more complex question of who makes the decisions on how competitive advantages are distributed. The hows and whys of such allocations always become apparent. In an ethnically diverse environment like Kazakhstan, it is best to avoid the potential pitfalls of allotting subsidies.

IMPLEMENTATION ISSUES

Management in the Field

The program described here is clearly predicated on hands-on management at the field level. A team of one or two long-term advisors could start a program that ends up with 6 to 10 significant ongoing activities at a time.

The Tools

The most important tools available to the team will be resources for short-term technical assistance, travel money, and funds to cover other direct costs of meetings, dissemination, and training.

Where possible, the program should be coordinated with that of other donors and ongoing U.S. assistance projects or programs to leverage resources. Examples would include the Peace Corps, International Executive Service Corps, and Volunteers in Overseas Cooperative Assistance.

The Institutional Home

It was the team's view that linkage of the long-term program manager with a local institution was critical to the success of the program. As the work proceeded and the likelihood of finding a suitable base diminished, the search turned to ways of securing the advantages of an institutional linkage without actually doing so. These advantages include letters of invitation and sponsorship for visas and other official arrangements, and linkages into the local economy to obtain access to housing, office space, transportation, and the like. Logistics are not trivial matters in Kazakhstan.

Serious consideration was given to four alternatives:

- **The government.** Attachment to the government offers the advantage of immediate legitimacy and addresses logistical support issues. However, the type of attachment can make or break the program's credibility with the private sector. Structuring the kind of loose linkage that is able to provide all of the advantages of government association and minimizing the public sector perception requires time-consuming negotiation and deal making that will slow start-up and implementation. Moreover, the current flux in the organization of the parts of the government that deal with business make it unlikely that firm agreements could be made for quite some time.
- **Existing local institutions.** The pros and cons of associating the project with an existing local institution were closely evaluated. Two possible candidates emerged — the Union of Small Businesses and the Kazakhstan Institute of Management and Economics. It became clear that neither group had a sufficient operating history or track record to clearly define its character and interests relative to the proposed program or to have its role and legitimacy defined in the minds of others. The medium-term stability of both groups was not altogether clear. Furthermore, both groups were far from being able to describe their views of such a linkage except to send a fairly clear signal that they wanted money and the status associated with external assistance. Moreover, the choice of one of these institutions could jeopardize the program's ability to work with other (competitive) local groups.
- **Full institutional independence.** Some of the loudest (and respected voices) insisted that it was far too early and risky to develop linkages with the government or other existing institutions in the private sector. It was better at this stage for the implementors to rent an office, hang up a shingle, and get to work. Although the rationale for this neutrality is sound, neutrality is not a viable option operationally. Having loose, shifting associations with the local players works well as an assistance strategy but is a disadvantage when it comes to arranging travel logistics and support within the country. In the advocacy and support roles raised above, too, some association likely will be required.
- **Linking with USAID.** The best way around these concerns is to maintain relative independence but to operate under the umbrella of USAID. This offers a neutral vantage point, linkages to the government, and an ability to reach the private sector.

In summary, Kazakhstan's transition from a command to a market economy is proving a long and painful battle. The constraints that the private sector and small businesses in particular face are crippling even before the start-up stage. However, given the systemic nature of these problems, A.I.D. assistance is best aimed at key leverage points to improve the policy and institutional environment and move the agenda for the private sector forward. By improving the policy and regulatory environment, and by strengthening and assisting those local institutions most willing to shape their nation's future, A.I.D. could play an invaluable role in assisting Kazakhstan through the transition phase and beyond.

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ANNEX
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