

Global Compact Policy Dialogue Report

“Promoting Stability and Growth in Central Asia through Expanded Business Opportunities”

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*Please note that this report was written by a consultant to the Global Compact Office and does not necessarily represent official views of the United Nations.

INTRODUCTION

This meeting for the countries of Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and Azerbaijan brought the UN Global Compact Policy Dialogue for the first time to Central Asia and the Caspian Basin. Participants – representing a wide range of interests from government, business, labour, NGOs and civil society, and UN agencies – shared ideas on how business can have a positive impact on socio-economic growth and stability in the region. Discussions focused on the advantages of partnerships between state and non-state actors in advancing the development agenda by jointly implementing solutions to social, economic, and environmental challenges.

The meeting followed up on UN Global Compact Policy Dialogue events in 2001-2002, where public and private actors worked together to develop general policies and guidelines addressing such issues as transparency, conflict impact assessment and risk management, multistakeholder partnership initiatives, and revenue-sharing regimes. By holding this meeting in Central Asia, the UN Global Compact launched the process of translating those policies and guidelines into practical recommendations and concrete actions adapted to the development context of a region that is steadily gaining prominence on the international scene.

THE ROLE OF SMALL AND MEDIUM-SIZED BUSINESSES

Since gaining independence in 1991, the countries of Central Asia have pursued different reform paths. Despite progress in terms of macroeconomic stabilization, enactment of new legislation, and privatization, there remains a significant reform agenda to be implemented by the countries of the region. Nevertheless, the transition economies of Central Asia offer significant opportunities for investment and growth in terms of access to resources, untapped markets and low-cost production capacity. Azerbaijan – also represented in the meeting – shares many of the basic attributes of the Central Asian countries, such as the transition to a democratic market economy, a significant natural resource base, and Turkic origins.

In assessing the region's current reform challenges the meeting considered a wide range of approaches, including the reduction of bureaucratic barriers to free market development, deepening administrative reform, combating corruption, strengthening democratic governance, and moving forward on structural improvements to the social system. However, the meeting devoted particular attention to the importance of expanding and strengthening small and medium-sized enterprises (SMEs) to ensure long-term economic growth and civil society development in Central Asia and Azerbaijan. In addition to being vehicles of job-creation and prosperity, SMEs broaden the base of stakeholders in their country's future, and facilitate the emergence of a middle class of property-owners and taxpayers.

The region faces challenges both in the area of poverty reduction and in the related issue of middle-class development. While numerous factors have handicapped efforts to meet

the challenges, such as ecological conditions, currency convertibility issues, and the struggle to modernize industrial structures inherited from the Soviet Union, the problem of insufficient support for SMEs stands out.

There are many, multidimensional reasons why SME development in the region has lagged. In Tajikistan, for example, a five-year civil war meant that no meaningful economic restructuring was undertaken there until after a ceasefire was signed in 1997. In Kazakhstan the government's priority has been to develop the hydrocarbon sector, and promotion of SMEs was relatively neglected until 1998. In some cases SME development has been retarded by the government's gradualist approach to economic reform. In other cases SME development has been distorted by the interests of particular individuals or groups on the basis of family, clan, or geographical allegiances. Unfortunately international donors have also occasionally contributed to problems by not always working in an efficient or coordinated manner, or ensuring that projects are sustainable after the granting period.

Yet for all the region's governments, greater emphasis on SME development represents a critical component of any rounded economic strategy. Worries were voiced at the meeting that the economies of Central Asian countries and Azerbaijan have been either eroding or developing in an unbalanced way, based on low-value-added natural resource extraction and leaving them highly vulnerable to external shocks. Kazakhstan, which between 1999 and 2003 reported impressive cumulative increases in per-capita GDP in the range of 40-50 percent, has grown its economy by concentrating on hydrocarbon and mineral exports in a way that, some analysts fear, could prove unsustainable. The same goes for Tajikistan, which has posted similar growth figures yet where 40 percent of GDP comes from exporting aluminum.¹

Recently there have been indications that Central Asian governments are reinforcing and deepening their commitment to SME development. Almost all the region's leaders have talked up SMEs repeatedly during the course of 2003.² The situation presents a window of opportunity not only to international organizations specifically advocating market reforms in the region, but also those concerned with advancing democratization, civil-society and human-rights agendas – issues with which the SME component of private-sector expansion is closely allied.

¹ Furthermore, both countries started from very low baselines. Per-capita GDP in Tajikistan is still only \$1,200 in purchasing-power parity terms, according to World Bank figures. Kazakhstan, at \$7,000, has only recently begun pulling even with Belarus or Russia.

² For instance in November 2003 Uzbek President Islam Karimov personally blessed the creation of a Liberal Democratic Party intended to represent entrepreneurs and businessmen. Also in November, the European Bank for Reconstruction and Development (EBRD) launched a project for financing SMEs in Tajikistan that won public praise from Tajik President Imomali Rakhmonov. In October, Kazakh President Nursultan Nazarbaev made a point of praising business at a forum of entrepreneurs, positing them as exemplars of civil solidarity and leaders in a civil society. According to Kazakh commentators, the speech emphasized Nazarbaev's new public interest in promoting a strong middle class.

ENCOURAGING PRIVATE SECTOR DEVELOPMENT

Indicators developed by the EBRD and used to measure progress in privatization, enterprise restructuring and finance sector reform show Central Asia lagging behind other countries entering transition with similar baseline conditions. In most of the region, private sector share still officially constitutes less than half of all economic activity. Admittedly such statistics do not include the informal or “gray” sector of the economy, which in some parts of the region is thought to account for much, perhaps even a majority, of the business turnover. If local business and regulatory climates are improved, the hope is that many entrepreneurs will be encouraged to become legitimate businesspeople, with a corresponding increase in the number of registered SMEs.

That said, significant legislative and institutional barriers must be overcome for the region to present a more business-friendly environment. Some of the obstacles primarily affect foreign businesses and investors, such as the problems they face in Kazakhstan where regularly changing legislation and warnings that the government may retrospectively revise the terms of contracts have contributed to a nervous business climate. Other obstacles in the region, faced by foreigners and locals alike, include non-transparent regulatory frameworks, punitive taxes, intrusive inspections, complicated registration and licensing procedures, and excessive red tape. Lack of access to credit and financing services is also a problem. Few of Central Asia’s banks have been restructured to handle SMEs. Facing undercapitalization and imperfect competition within credit markets, banks tend to focus their resources on large companies. Strictures against private ownership of land have tended to block the emergence of private business in the agricultural sector. Finally, corruption remains a serious challenge throughout the region.³ Around the world, high levels of corruption are associated with low investment, slow economic growth, unproductive government spending, and combined incidence of income inequality and poverty. The combined effect of these shortcomings has been to discourage companies and entrepreneurs from dealing with local state agencies.

International organizations have adopted both “big-picture” approaches and more targeted approaches to promoting SMEs (and more generally private sector development) in the region. Examples of “big picture approaches” include encouraging governments to operate in a more transparent way, or to redouble efforts to fight corruption. The pay-off in such strategic approaches must be long-term. Examples of more targeted, tactical approaches to expanding private business focus on training and capacity-building. They may include courses on marketing and book-keeping, or seminars explaining licensing procedures or the administrative and legislative requirements to start a business. It is also important to make information more widely available to help people identify business opportunities. UNDP, EBRD, USAID, the International Trade Center (ITC), EC and the OSCE are all engaged in such work in the region, with UNDP currently preparing a strategy for developing SME programmes in Central Asia.

³ In Transparency International’s Corruption Perceptions Index 2003, Kazakhstan and Uzbekistan are rated equally in 100th place out of 133 countries; Tajikistan is in 124th place. Encouragingly, Kazakhstan has declared its intention to join the newly-tabled United Nations Convention Against Corruption.

At the same time, given the undeveloped state of the banking sector, there is a need for microfinance institutions and credit unions to help promote entrepreneurship and the concurrent creation of new jobs in the region. Large corporate actors and foreign investors in the region can play a key role too in encouraging SME development by engaging with local stakeholders, suppliers and service providers to create new business openings. Yet just as it is also important for the national economies of the target countries to become more balanced, efforts are needed to diversify the activities of SMEs. In Kazakhstan, for instance, trade and service-based businesses make up between one half and three-quarters of all SMEs. Consequently some assistance agencies are working to promote production and processing-based businesses in sectors ranging from agriculture to arts and crafts and tourism.

THE CASE FOR REGIONAL COOPERATION

There have been at least eight regional economic initiatives launched since 1992, of which only two have survived in any meaningful form, the Eurasian Economic Community and the Central Asian Cooperation Organization. Competition, rather than collaboration, has proved the dominant dynamic in the region since the collapse of the Soviet Union. Yet the countries of Central Asia as well as Azerbaijan should have a vested interest in regional cooperation, not only for the advantages it would bring but because of the costs involved in continuing not to cooperate. The countries are interdependent in terms of transport infrastructure, energy, and water resources, to name the most obvious linkages. Uzbekistan and Tajikistan both sell and buy one another's electricity. The whole region ultimately depends on rivers that emanate from the mountains of Kyrgyzstan and Tajikistan. The hydro-potential of those two countries, properly tapped, could fully satisfy the hydroelectric needs of Central Asia and neighboring areas. Drug trafficking and organized crime are regional challenges that none of the countries can cope with on its own.

Central Asia's developing and transition economies possess a combination of resources, low-cost production capacity, and untapped markets on some 55 million consumers that should be a powerful draw for investors if trade barriers were dropped to reduce the expense of transporting goods across borders in the region. Also, the costs associated with poor transport links and a lack of investment in infrastructure currently add significantly to the cost of trade. Upgrading infrastructure is part and parcel of reducing the costs of transporting goods between the countries of the region. Thus there is a strong business case for private sector actors and investors who could benefit from increased access to be more engaged in developing the transport sector in the region, improving transit of goods and opening up markets.

A further incentive should be the proximity of Russia, India and China, putting Central Asia at the nexus of three of the world's largest and most rapidly growing emerging markets. Geography implies that, over time, Central Asia could be a hub linking transport communications and production infrastructures for these three major centers. Such

considerations drive any potential investor to look at Central Asia not in terms of its constituent nations alone but from a regional perspective. For companies thinking of locating themselves in Central Asia, regional cooperation – perhaps eventually regional integration – lowers risk associated with such dominant issues as political instability, energy, water and other natural resources.

REACHING ACROSS BORDERS AND SECTORS

Most strategies on encouraging regional cooperation in Central Asia and the Caspian Basin have focused on the need for governments to work together. Yet a precept embodied in the Global Compact is that governments cannot hope to solve all problems on their own. Business has a key role to play in partnership with government and other non-state stakeholders in addressing broader development problems.

A potential model for the region of a partnership between business, government and civil society, discussed at the meeting, is the Business Development Alliance (BDA), a non-profit organization in Azerbaijan. Supported by local businesses and agencies, foreign embassies and non-governmental organizations, oil companies, international finance organizations, and the government of Azerbaijan, it provides a multi-sectoral forum to promote private sector development, identify partners and mechanisms to implement business ideas, and recommend policy and legislative changes to the government. The BDA also arranges roundtables, trainings, and study trips, and compiles databases of companies and financing sources for SMEs.

Similarly, Kyrgyzstan has created a unique institution in the form of a Consultative Council on Foreign Investment (CCFI). The council is comprised of the prime minister, the president's advisor on foreign investment, the head of the International Finance Corporation, three foreign investors and a representative of the diplomatic corps. A mixed public-private agency, the council's mandate is to oversee the implementation of existing government measures regarding investments and recommending improvements in order to attract more.

KEY FOLLOW-UP PROPOSALS/ RECOMMENDATIONS

- I. Promote regional dialogue on improving economic cooperation – include the private sector in high-level government discussions and involve the private sector in UN system development work.**
 - There must be a more concerted effort to include the private sector into high-level discussions on regional cooperation, which to date have mostly been conducted with senior members of government. A regional, cross-sectoral dialogue of this nature could occur with the facilitation of European and American Chambers of Commerce in the respective countries and under the umbrella of the Global Compact or the UNDP.

- The UNDP Resident Representative in Kazakhstan suggested that a side event for the private sector could be organized to coincide with the next ADB Ministerial Meeting, which will likely take place in autumn 2005.
- The involvement of the private sector in UN system development work should be increased. Using tools such as Public Private Partnerships for the Urban Environment (UNDP/CDG), Growing Sustainable Business for Poverty Reduction Initiative (UNDP/PSD), the Global Development Alliance (USAID), UNDP Country Offices will seek greater involvement of the private sector in development issues. UNDP should establish mechanisms for regular consultation with private sector groups.

II. Encourage SME development, and link larger companies with SMEs.

- UNDP is in the process of developing an SME strategy for Central Asia. The Bratislava Regional Centre and the Sub-Regional Economic Reform Advisor will finalise the strategy in early 2004, and use this as the springboard for SME-support activities in the region.
- The meeting participants suggested putting together a manual or reference guide of “good practices” in SME development, possibly incorporating case studies that could be used for training purposes. (A description of the approaches taken by Azerbaijan’s BDA or Kyrgyzstan’s CCFI, a discussion of Kyrgyzstan’s solution to simplifying licensing procedures for companies, or an analysis of micro-credit institutions in Tajikistan—all represent the type of material that might deserve inclusion in such a work.) Ideas could be taken from Central Asia and the Caspian area, or other parts of the world whose experiences could be profitably applied to conditions in the region.
- There should also be direct attempts to exchange information on good practices, either in conference sessions devoted to the topic, or perhaps by establishing a “good-practices network” and database that could serve as a regional mechanism for sharing ideas and experiences on a sustained basis.
- In the same spirit, it was highlighted that SME development strategies for the region should engage government and business in true public-private partnerships. Governments in the region, while displaying a new commitment to fostering SMEs, should be encouraged to share perspectives with the corporate sector with dialogues established on the basis of equal respect and responsibility.
- Another potential model whereby corporate actors could take the lead in encouraging SME development in the region would be by organizing “icebreaking convoys” of companies. To press for the removal of barriers in the market, a large company with local clout could lead the way and support smaller companies, including its own suppliers and service providers. Local business associations, European and American Chambers of Commerce, or German

business clubs established in the region are further examples of actors that could join the convoys.

III. Support Government efforts on transparency and anti-corruption

- Transparency and anti-corruption are issues where the interests of the UN and the private sector generally converge. Discussions with European and American Chambers of Commerce show that these issues are of concern to their members. UNDP Country Offices should liaise with Chambers of Commerce to identify opportunities for cooperative activities on these issues.