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Breaking Down Administrative Barriers to Entrepreneurship in Kazakhstan

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Kazakhstan's transition to a market-oriented economy began with the legalization of co-operatives in the Soviet Union during perestroika. This paved the way for private sector development after 1991, though small- and medium-sized enterprises (SMEs) faced significant societal, institutional, and political barriers to growth. In its formative years, small-scale entrepreneurship in Kazakhstan was characterized by highly variable growth dynamics. Attempts to control the formation of SMEs were likewise irregular: a consistent national strategy in support of SMEs was not established, nor were sector and regional priorities identified.

Nevertheless, the Government of Kazakhstan is concerned with the problems SMEs face, as illustrated by its efforts to form a favorable legislative environment, attract both foreign and domestic investment, and develop programs to support entrepreneurship. These and other support mechanisms are essential to building up the country's private sector, diversifying the economy, and sustaining economic growth.¹

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Introduction

In 1999, Kazakhstan was still in the beginning stages of its transition to a market-based economy. The transition had begun during perestroika in the late 1980s, when individuals were permitted to form their own businesses, called co-operatives. These entrepreneurial pioneers immediately attracted skilled workers from the state sector.

This paved the way for private sector development after 1991, though small- and medium-sized enterprises (SMEs) faced significant societal, institutional, and political barriers to growth. In its formative years, small-scale entrepreneurship in Kazakhstan was characterized by highly variable growth dynamics. In addition, a consistent national strategy in support of SMEs was not established, nor were sector and regional priorities identified.

Nevertheless, the Kazakh Government is working to develop its economy and SME sector by forming

a relevant and favorable legislative environment, attracting both foreign and domestic investment, developing programs to support entrepreneurship, and prioritizing policy objectives. These and other support mechanisms are essential to building Kazakhstan's private sector and sustaining economic growth.

Developing Entrepreneurship during Perestroika: The Co-operatives

Entrepreneurship is a source of innovation and a driving force for technological change.² Such innovation includes advances in manufacturing as well as management, marketing, and other ways of developing products and services. The most important innovation of all, perhaps, is the development of an entrepreneurial culture which allows people to take charge of creating their own future.

Small- and medium-sized enterprises create a significant share of the GDP in many of transitional

Building National Policy for the Promotion of SMEs in Kazakhstan

Problems/barriers

Financial

Lack of fixed capital (offices and manufacturing facilities, machinery and equipment, land, etc.), lack or shortage of circulating capital and/or financial resources

Recommended measures

- Grant entrepreneurs with sufficient financial assets the opportunity to take part in the final stage of the privatization of state property
- Develop a national program for leasing in Kazakhstan, joining the 1988 UNIDROIT Convention on International Financial Leasing adopted in Ottawa
- Provide entrepreneurs with information on the proper and productive use of privatized property
- Attract loans from international financial institutions (World Bank, International Monetary Fund, International Financial Corporation, European Bank of Reconstruction and Development, Asian Development Bank, UN, Red Cross, etc.) for the financial support of SMEs
- Stimulate commercial banks to offer credit to SMEs
- Prioritize the fair distribution of resources from the Fund for the Promotion of Small Entrepreneurship
- Develop the venture capital market

Institutional

Lack or inadequate development of entrepreneurship, insufficiently developed market infrastructure

- Support the growth of entrepreneurship
- Build the Unified Commercial Code of the Republic of Kazakhstan to include a Commercial Law and Entrepreneur's Code
- Compile a real estate cadastre of Kazakhstan
- Create a favorable environment for expansion of a network of legal, consulting, and auditing firms
- Support development of commercial banks specializing in credit and loans for SMEs
- Support the development of the stock exchange and trade houses
- Foster and support the hospitality, communications, and other service-oriented sectors
- Organize a network of business support centers, industrial clusters, and consulting services

Building National Policy for the Promotion of SMEs in Kazakhstan (continued)

Problems/barriers

Recommended measures

Educational

Shortage of systematic knowledge, skills, and experience regarding business organization and management

- Develop and implement educational programs on the foundations of entrepreneurship by revising the curricula of secondary and post-secondary schools, training young specialists, and providing continuing education opportunities for experts
- Improve technical assistance efforts by building a network of experts and using this network to disseminate knowledge
- Develop resource centers for entrepreneurs on business organization and management
- Establish consulting offices for entrepreneurs within the municipal government

Governmental

Inefficient bureaucracy, red tape, corruption, and extortion

- Provide more government services to assist entrepreneurs
- Eliminate incentives for corruption within government ministries
- Improve the efficiency and professional competence of the Kazakh judiciary
- Ensure observance of laws and regulations by introducing a simplified system of registration, insurance, licensing, bookkeeping, and approval. Each registering and inspecting body should have a list of the documents necessary for registration; these should be readily accessible for all applicants. Citizens should not have to pay for government services unless a charge is specified by legislation.
- Codify the services offered to SMEs by governmental bodies, banks, insurance companies, and notary and legal firms
- Improve the work of the Ministry of Internal Affairs so that it directly functions to improve the climate for entrepreneurship

Informational

Mass media inadequately reflects the problems faced by SMEs and is not concerned with promoting a positive image of private enterprise

- Publish business-relevant brochures, booklets, information pamphlets, and periodicals
- Report on actual problems and successes of SMEs; organize special broadcasts for radio and television
- Assist entrepreneurs and their private-sector associations in cooperating with their international counterparts
- Support international information exchange

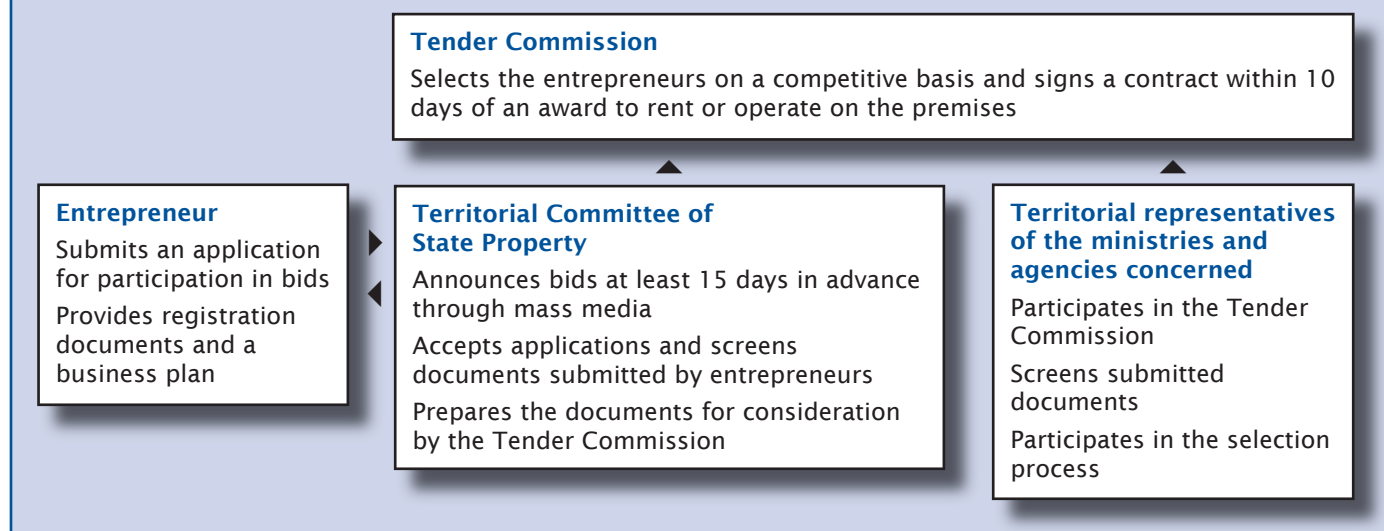
economies and face the challenge of growing fast enough to create the majority of new jobs.³ Through job creation, small firms make a significant contribution to the formation of a competitive, dynamic, and diverse economy, leading to an improvement in standards of living. Such entrepreneurial activity is essential for the development of the countries of the former USSR, just as it is vital elsewhere in the world.

In the early 1990s, many of the systems to record data about SME contributions in the areas of job creation and GDP growth were inadequate in the post-Soviet space. Even so, entrepreneurship was an integral part of the economic transitions take place following the collapse of the USSR, whether it took place with or without the permission of the state.

Small businesses operating during perestroika developed in the form of co-operatives. A co-operative

is defined as a jointly owned enterprise engaged in the production or distribution of goods or services, operated by its members for their mutual benefit. Co-operatives are distinguished from conventional businesses, where ownership rests with capital investors and control is exercised by those owners or authorized managers. Co-operatives aim to maximize the income of each member rather than maximizing overall profitability; members of co-operatives are primarily interested in personal income rather than in expanding output through risky investment in innovation.

The adoption of the law “On Cooperatives in the USSR” in 1988⁴ created many new opportunities. People could have a “second job” in addition to their public-sector position, or could be employed solely by a co-operative. Co-operatives were legal economic entities with certain rights and were registered with local administrations. This sector became attractive

Figure 1: Procedure to Transfer Unused Fixed Capital to Entrepreneurs

for many skilled workers, who left the state sector in search of better opportunities. Many co-operatives produced high-quality goods at a lower cost through a more efficient use of personnel and equipment.

The co-operative movement developed quickly. In 1987 there were 13,900 co-operatives with an output of 350 million rubles; in 1988 the number grew to 77,500 with an output of about 6.1 billion rubles; and in 1989 there were already 210,000 co-operatives producing goods and services worth more than 41 billion rubles. The number of people engaged in the co-operative sector reached five million in 1990.⁵

Formation and Development of the Private Sector in Kazakhstan

Entrepreneurship in Kazakhstan developed under complex and unfavorable socio-economic and political conditions, when a serious macroeconomic crisis led to a severe drop in the standard of living. Today, the private sector still faces a number of obstacles to development. These difficulties are connected with insufficient financial resources needed to build momentum for wide-scale development of entrepreneurship. Nevertheless, the government is concerned with the problems of SMEs, working to form a favorable legislative environment, attracting both foreign and domestic investment, and developing programs to support entrepreneurship.

Many challenges occur due to the fact that there are still strong societal prejudices against business ownership and earning a profit. In Kazakhstan, there is no tradition of customer service or work under fluctuating demand and competition. Would-be entrepreneurs have few practical skills to find a niche in a saturated market by offering a better-quality product or service. They also have incomplete knowledge of modern marketing and management techniques. Additionally, entrepreneurs are often associated with the questionable transactions that took place during socialism and privatization.

The skills and qualifications of the majority of workers are high, but they are accustomed to executing orders and implementing someone else's plan. People are not used to cooperating professionally, gauging risk, taking initiative, and assuming personal responsibility for their work. In the market environment, these qualities are absolute requirements for the success of a business, but are often considered in post-Soviet society to be "hideous hypocrisy." Even after hiring skilled and diligent workers, the entrepreneur must spend several years developing a new mentality within his or her workforce.

Despite these challenges, entrepreneurial initiatives have become more common and entrepreneurship has a more stable and trustworthy reputation. Entrepreneurs have begun to more confidently assert their interests.

Eliminating Barriers to Entrepreneurship

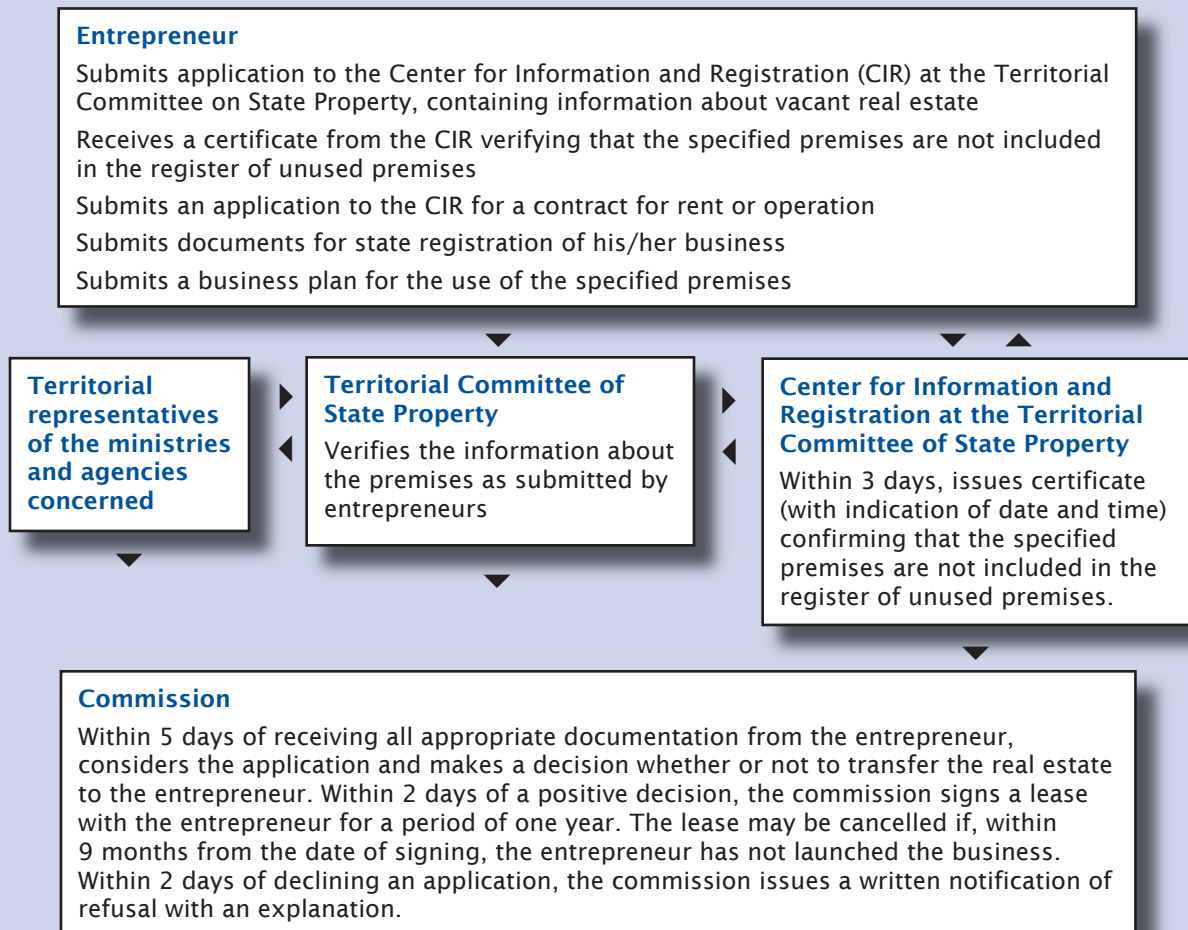
In its formative years, small-scale entrepreneurship in Kazakhstan was characterized by highly volatile growth dynamics. Attempts to control the formation of SMEs were likewise irregular: a *consistent* national strategy in support of SMEs was not established, nor were sector and regional priorities identified. This was due largely to the fact that feedback from entrepreneurial structures was neither solicited nor offered, and there was initially no attempt on the part of government to monitor SME development.

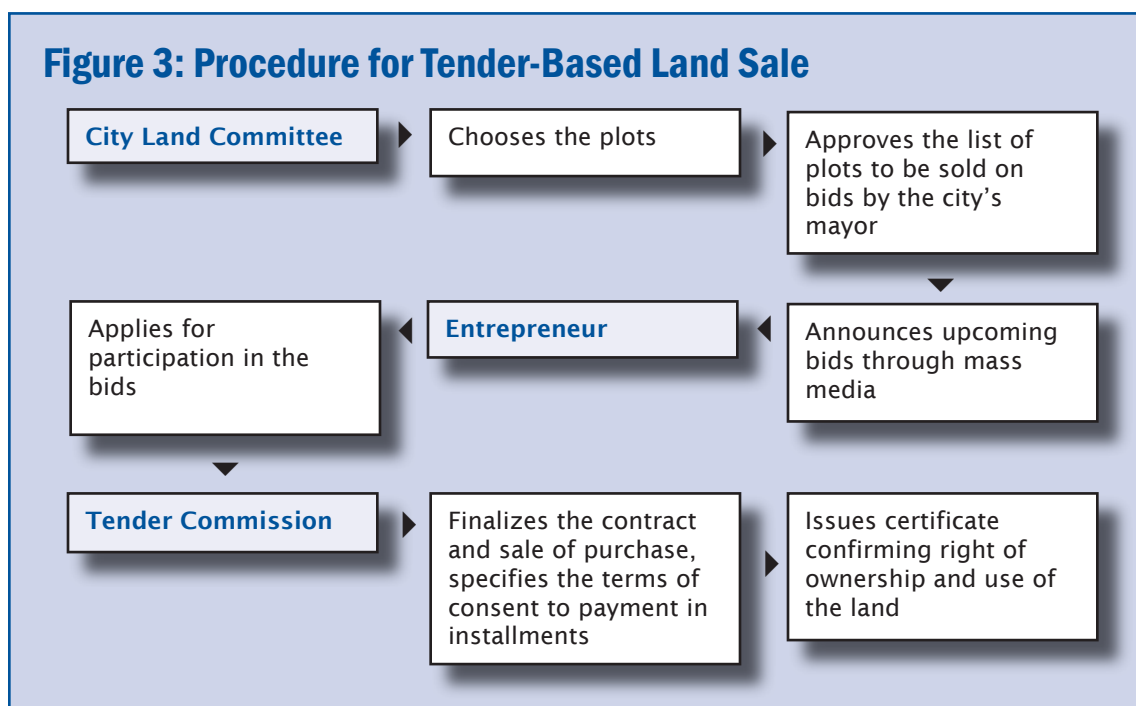
SMEs have faced scarcity of capital, insolvency, downward trends in living standards and human resource development, and a contraction of the population’s purchasing capacity. Additionally, official statistical data do not fully capture private sector

activity; informal activity such as street vending, small-scale manufacturing, consulting, tutorial services, and other non-registered services is widespread. Characterized by direct cash payment without receipts or invoices, the informal economy hampers effective government accounting and monitoring, despite efforts taken by tax inspectors and police.

In this environment, Presidential Decree No. 3036 of 18 July 1996, “On additional measures on the realization of governmental guarantees of entrepreneurial activity,” was much needed. The decree provided citizens with additional state guarantees supporting liberalization and entrepreneurial activity and also protection from bureaucratic intervention. Yet, for a full scale development, a comprehensive strategy to support SMEs is essential (see pages 2 and 3 for recommendations on developing such a strategy).

Figure 2: Procedure to Transfer Unused Real Estate to Entrepreneurs





One of the most serious problems for Kazakh entrepreneurs is related to the shortage or total lack of fixed capital. The targeted sale and simplified leasing procedures of the state-owned fixed capital that has not yet been privatized would go far to address this problem. It would include the sale or transfer of buildings and land that are unused or inefficiently used – particularly the sites of stagnant construction projects. Figure 1 outlines a model for the transfer of this type of fixed capital to private entrepreneurs.

A related problem is that a considerable amount of fixed capital that had been privatized in the initial stages of reform is currently idle; quite often, buildings, land, and equipment are wasted or rendered useless due to mismanagement. At the same time, many legitimate and willing entrepreneurs lack access to fixed capital. The state should encourage new proprietors to use or sell privatized property.

In 1997, a procedure was developed to regulate the transfer of such real estate to entrepreneurs who were first to submit reliable information about unused premises. The premises are leased to the entrepreneurs with the possibility of future ownership, provided that they engage in productive economic activity and create new jobs. Figure 2 maps the process of allotting the unused industrial real estate to SMEs, while Figure 3

shows the procedure for the tender-based sale of unused land.

Strengthening the Voice of Business

Today, entrepreneurs in Kazakhstan are beginning to work together to identify their needs and draw up concrete recommendations to present to the Government. One group that has been instrumental in this process is the Kazakhstan Forum of Entrepreneurs (KFE), which was formed in order to facilitate the exchange of ideas and information between the government and SMEs. In 2006, KFE, headed by CIPE partner the Almaty Association of Entrepreneurs, conducted a series of surveys and roundtable discussions to determine entrepreneurs' attitudes towards various economic issues in Kazakhstan, such as the shadow economy, the current tax policy, licensing, and other topics.⁶

KFE discovered that the main factors that hinder the development of small businesses in Kazakhstan are the structure of the economy, as well as the legal and institutional framework governing small business activity. Currently, the economy is heavily dependent on the extraction and sale of natural resources, so the value-added sector – to which most SMEs belong – receives little investment. However, it is the value-

added sector that will sustain Kazakhstan over the long-term and will provide jobs for its citizens. While oil and natural gas are key contributors to Kazakhstan's economic growth, the Government should realign its priorities to support the SME sector, as well.

The day-to-day problems that entrepreneurs face are caused by the governmental institutions and regulations by which they must abide. These obstacles, such as a confusing taxation system, an inability to gain access to finance, and cumbersome registration procedures, have resulted in the development of a thriving shadow economy. Based on KFE's findings, the existence of a shadow economy is caused by:

- high taxes and fees that are imposed on formal sector businesses;
- an imperfect legal structure, full of loopholes, that allows the shadow economy to grow;
- an increase in fees faced by entrepreneurs after leaving the informal sector; and
- difficulties registering new or informal businesses.

A major problem is the difficulty of both registering and running a private enterprise. Approximately 75 percent of entrepreneurs described complications when obtaining business licenses. These difficulties are caused by confusing application procedures and complicated tax forms, and can be fixed through a simplification of the forms and processes. One of the solutions suggested by roundtable attendees was the establishment of business support centers, which would explain the regulations and help entrepreneurs comply with them.

Conclusion

Despite all of the problems faced by small business today, the overall business climate in Kazakhstan has improved significantly in the recent years. This has been seen in strong economic growth, the adoption of pro-business legislation, and in the slow change in attitude regarding the idea of business ownership. However, many laws and regulations are flawed and contradictory, allowing corruption and the shadow economy to thrive.

The priorities that have already been identified by the Kazakh government in support of SMEs serve as a useful reference point for governmental bodies, domestic and foreign investors, and international financial institutions. Maximum assistance to SMEs in the form of financial capital includes urging financial institutions to allocate special resources for the SME sector. Current legislation should be modified to eliminate clauses that discriminate against entrepreneurs in the form of bureaucratic barriers and illegal extortions through inspections. Also, ensuring international technical assistance would expand the training and consulting programs currently implemented in Kazakhstan, including the dissemination of information explaining the rights and duties of SMEs.

On a more structural level, the elimination of institutional barriers and special measures to promote entrepreneurship must be implemented for the success of SME development. Kazakhstan depends on its entrepreneurs to propel the economy forward.⁷

Therefore, entrepreneurs themselves are the true key to effecting lasting reform in Kazakhstan. Organizations like the Almaty Association of Entrepreneurs and the Kazakhstan Forum of Entrepreneurs have taken the important first step of bringing businesspeople together to identify problems, brainstorm solutions, and publicly share these ideas. Now, entrepreneurs must continue to express their needs to the government so that a better business environment, governed by a coherent regulatory framework, can flourish. This will also help establish working democratic governance mechanisms whereby the business community can work with the government in an open manner to shape the legal and regulatory climate and create a competitive economy that stretches far beyond the natural resources.

Notes

¹ Parts of this paper are based on the earlier Discussion Paper #492 by Kantarbayeva, A.K., U.E. Shukeyev, and T. Tsukatani, "Entrepreneurial Environment in Kazakhstan: Elimination of the Existing Barriers," Institute of Economic Research, Kyoto University (February 1999).

² Schumpeter, J. *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, tr. by R. Opie. (New York: Oxford University Press, 1969). Original work published Cambridge, MA: Harvard University Press, 1934.

³ Birch, D.L. *Job Creation in America: How Our Smallest Companies Put the Most People to Work*, New York: Free Press, 1987; Kantarbayeva, A.K. and A.T. Mustafin, "The Theory of Entrepreneurship and Evolutionary Economics," *Voprosy Ekonomiki* (Russian Economic Reviews). (No. 11, 1997) pp 106-120.

⁴ see "Zakon kooperatsii v SSSR," (On Cooperatives in the USSR), USSR Supreme Soviet (26 May 1988).

⁵ *Izvestiya*. (5 March 1990) p 5.

⁶ Forum predprinimatelei Kazakhstana, "Razvitie predprinimatel'stva, tenevaia ekonomika i korruptsiia, vstuplenie v VTO (analiz i isslendovaniia)." (Almaty, 2006).

⁷ Say, J.B. *Catechism of Political Economy*. (New York: A.M. Kelley, 1967). Reprint of work first published 1821.

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