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Preface

This issue of the Central Asian Journal of Management, Economics and Social Research is divided into several parts. The first part is devoted to 'Economy in transition'. Here, we publish a substantial selection of papers demonstrating the difficulties and the challenging situation of an economic system which is in a systematical evolution.

The second and third parts of the Journal include, for the first time, our different research projects.

The Procter&Gamble project came to the Research Center in February 2002, and three researchers have been involved in this short-term research; two of them from the Department of Economics. The two papers published here are related to the economic situation in Kazakhstan and in Uzbekistan. The KIMEP Research Center is grateful to have the assistance of the senior researcher, Dr. Mete Durdag, the ex-Word Bank advisor and Professor in the Resource Network (USAID) for conducting this project.

The INTRAC project started in October 2000 is the largest project of the Center since its establishment and is entitled 'Civil Society in Kazakhstan' which includes almost five instructors from the Department of Political Science and Public Administration. A special thanks should be addressed to all the researchers who have been working hard during two and half years for conducting this project and to our friend Dr. Simon Heaps, Senior Researcher at INTRAC, based in Oxford, UK, who has been guiding this research and the team from the beginning. The papers published here contain only a part of the project. The complete version of the research will be published by the Research Center in Russian and English.

All papers in this journal related to research grants are published with the permission of the relevant organizations.

Acknowledgment

I would like to express my gratitude first to all the members of the Editorial Board from KIMEP, Yale University, the University of Pennsylvania, USA, and to express my welcome to Dr. Shirin Akiner from the University of London, UK (School of Oriental and African Studies.) for joining us on the Board.

As the Editor-in-Chief of this Journal, I should express my thanks to Gulnur Bolyspayeva our Research Assistant. Before leaving KIMEP for studying in the United States, she was working hard to finalize this issue. Jan Tomczyk, Project Manager, Olga Peredero, Office Manager, and Nurseit Niyazbekov, intern, all from the Research Center, have also worked to finalize this version of the Journal. Special thanks are addressed to Scott Bailey, from the Political Science Department, who has undertaken the English editing.

Scholars and researchers from all Central Asian institutions, and from all other parts of the world, are welcome to submit articles for the fourth issue of the Central Asian Journal.

A. Hoodashtian, Ph.D.
Editor-in-Chief
Director of the KIMEP Center for Research and Development
Almaty, June 2002

The development of oil industry support infrastructure for international competitive advantage for the Republic of Kazakhstan

Tom CARDALE*

Introduction

The development of infrastructure in most of the mature oil and gas provinces around the world has, from necessity been incremental against each projects needs, with little co-ordination between projects, operators or governments. Although this is a practical approach the industry has learned that it has led to inefficient operations and lack of economy. Both could be improved by co-ordination and clear policy from the start, without obstructing the practicalities of incremental development or affecting the operation control needed by Production Sharing Agreement (PSA) operators. Infrastructure can be built when it is needed, but within a co-coordinated policy that leads to efficiencies. A host nation approaching the issue with the «clean sheet» that Kazakhstan enjoys cannot afford to ignore the opportunities to learn the lessons of other provinces. By co-coordinating the creation of infrastructure it can help to give its industry international competitive advantage. The economic efficiency of sharing infrastructure wherever possible has been clearly demonstrated in the upstream oil and gas industry. Infrastructure connected with logistics and the management of the industry's supply chain is a prime example of this approach. Working examples in other provinces prove that the operational problems can be successfully resolved through the use of third party ownership and management. It is in the national interest of host nations to the industry to see that this economic model is adopted and that there is the active involvement of local organizations and companies in the process coupled with the development of a management organization that ensures the necessary operational standards and financial security. Furthermore logistics infrastructure represents a development area in which the PSA operators and local interests can be constructively engaged on a co-operative project even if other more sensitive areas of direct infrastructure development need a different approach.

Shared logistics infrastructure

A Supply Base is a centre for the consolidation and distribution of materials to the oil and gas industry. It is typically a requirement for offshore-related operations when a specific port is the consolidation point for the shipment of all materials to, and returns of materials from, an offshore installation. It is equally valid for onshore operations where it may be necessary to consolidate materials prior to shipment or dispatch if operating sites are remote or the transportation link is critical.

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Cost sharing

Operators have used cost sharing as a means to minimizing costs. This occurs where more than one operating company and/or Service Company share facilities. The principle is well established in other oil provinces and is most commonly applied to supply bases, supply vessels, helicopters, materials control organizations and occasionally some aspects of procurement.

The cost reduction also benefits the host nations. It improves the take on produced oil and by lowering lifting costs it helps to make their oil province internationally competitive. The evidence of cost reduction is well documented. In 1993 BP and Conoco reported in a Society of Petroleum Engineers paper that their first move towards this operating method in the UK had demonstrated 27 % lower costs than the stand-alone operation. Improvements since then have increased this saving to more than 40 %. In the UK tax regime at that time the consultancy company Arthur D Little reported that each 10 % reduction in logistics costs results in a 4 % improvement to an operators post tax margin. This is a margin improvement that neither the operator nor the host nation can afford to ignore.

Methodology

The method for employing shared logistics infrastructure is that use of the facilities is presented as a service to the various users. In order to ensure satisfactory service standards, priority of use and full accountability this requires that the design, ownership and operation of the facilities must be positioned independently from the users. These requirements start to define the role of independent service manager. The involvement of the host nation's interests then suggest a form of partnership between the manager and the host nation in which the issues of *ownership, operation* and *national interest* are addressed in a balanced form which then leads to a *definition of the roles of the main stakeholders* as follows:

Ownership and operation

Ownership will be heavily influenced by financing requirements. Where finance from "multilateral" banks such as ERBD is available this should be used, as it will reduce the overall operating cost of the infrastructure through its impact on other finance costs. The terms associated with such finance or indeed with the use of other debt instruments from commercial banks, that are also necessary to lower the cost of the infrastructure, will require that the following risks are addressed by the sponsor.

- "Construction risk". Construction risk is the risk that the project/facilities will cost more than the budgeted amount used in the application for finance - the financier will not lend more to meet a cost overrun. The manager must see that the design meets the needs and that the project is properly managed within time and cost limits. The manager is unlikely to actually be the constructor. When design and operation are the responsibility of the same manager who is also connected to the financial return on the asset through a percentage of ownership, a management structure is created that ensures that the manager is held accountable for the performance of the facilities but has the necessary control and influence to manage his responsibilities.

- "Operating risk". Operating risk is the risk that the cost of maintaining and operating the assets is more than the budgeted amount used in the business plan. It is also the risk that the facilities fail to generate the necessary income because this was not forecast properly or because lack of service standards or lack of maintenance and development prevent them from attracting and sustaining the necessary levels of business. These risks would mean that the returns on the project are not sufficient to meet the loan repayments and/or equity investor's returns. To manage these risks the manager must be capable of ensuring that:

- The design of the facilities and assets should achieve the operational purpose within cost effective maintenance and operating costs.

- Service standards should incorporate systems and processes that optimize and sustain cost effective and profitable operations and service delivery.

- That there is an established Management Team. Financiers require an experienced management team for the project with a track record of managing and developing similar operations as a condition of obtaining favorable terms.

- That there is a security for the finance. The financiers will seek legal protection from state, quasi-state or private appropriations, and particularly changes to the tax regime. They will also require assignation of title to assets, including cash flow, to assure repayment of agreed debt during the period of the finance. If the arrangement that guarantees the security to the financier involves the state or other local interests it is right that the title to the assets reverts to the state or such other local interests after a period which generates the necessary returns to all parties.

National interest

The national interest is served firstly by the creation of infrastructure that lowers the cost for oil and gas operating companies in the country, and secondly, by the generation of opportunity for local companies and service and supply activity. Specifically:-

- That the policy of shared infrastructure addresses the oil companies cost issue. It also enables more advanced supply chain management practice (such as inventory sharing) that will lower their cost.

- Service Capability Development - the base manager encourages, assists and builds a local service capability through the transfer of skills and knowledge, training and personnel development, and management systems and processes.

- The existence of a purpose-built serviced facility for the industry's supply chain enables initiatives to develop other local service companies and suppliers to be promoted by national organizations and more closely integrated to the operators supply chains.

Stakeholders' roles

The preceding rationale provides the definition of role within the partnership between management and host nation interests as the major stakeholders in the enterprise, although major users of the facility are also stakeholders and have a role. These three main roles can be summarized:-

1. **The state and local interests**

- To provide property, personnel, and local resources from local companies
- To facilitate the implementation of principles/conditions of the Partnership Agreement by other state and regulatory authorities.
- To obtain the necessary licenses and permits.
- Liaison with government and regulatory authorities to ensure compliance with laws and regulations, because there must be respect for the laws of Kazakhstan.

2. The management company, the role is

- To arrange finance
- To provide management, marketing and commercial development.
- To provide technical guidance, design of facilities and processes, (but not the construction of the facilities).
- To prepare work programs and budgets.
- To ensure implementation of international service standards and integrate with GOST Kazakh Standards, Health Safety and Environmental Quality and to provide operational audit.
- To manage a program of technology transfer through continuous training and development.
- To ensure operating standards and procedures.
- To ensure facilities management and co-ordination/supervision.
- To provide or contract for plant and equipment with local companies.
- To provide and maintain computer systems and software.

3. The customer

- Some key customers may help to define the initial requirement for facilities and support its financing through «take or pay» contracts.

Conclusions

- There is a clear economic case for the use of shared logistics infrastructure in the upstream oil and gas industry. The cost efficiencies cannot be ignored by operators and are essential to the Republic of Kazakhstan in order to create a competitive environment for further international investment and to optimize the return on the nation's natural assets.

- Existing examples of this practice demonstrate that the operational problems and conflicts of interest can be resolved and that this is most efficiently done through the evolvement of third party service managers. This is a proven business solution in the oil and gas industry.

- The service standards and financing requirements lead to a definition of the role of a manager working in partnership with the host nation and PSA operators to ensure that the infrastructure is properly financed and operated in a manner that meets the needs of all its stakeholders and in particular the PSA operators whose efficiency it ultimately supports.

- The development is an area in which the operator's and industry's needs can be addressed within a collaborative approach to government policy without loss of control and as such is a useful project for mutual co-operation with PSA operators particularly as it an area that enhances the programs for development of local services and supply capability.

- The lessons learned in other oil and gas provinces such as the North Sea and West Africa show that co-ordination of policy for infrastructure development need not prevent incremental development but is essential to the eventual realization of an internationally competitive industry. The opportunity to adopt this approach is a unique advantage to Kazakhstan as it can adopt a co-ordinated policy from the start of its major infrastructure development. Shared logistics infrastructure is a practical example of this approach and an important area for a joint project between industry and government.

Demand for bank loans and credit bureau services in the Republic of Kazakhstan

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1. INTRODUCTION

In order to judge the potential viability of a Credit Bureau in the Republic of Kazakhstan ("ROK"), this study estimates the number of credit applications during 2000-2001, and projects changes through 2004. We assume that credit applications provide a good indicator of demand for Credit Bureau services, since the banking sector currently extends more than 90% of all credit within the ROK.[1] Beyond bank operations, Kazakhstan is fundamentally a cash economy, so that there is little reason to assess levels of non-bank demand for credit reporting.[2]

The National Bank of Kazakhstan (NBK), which supervises and regulates the banking sector, provided the primary source of information for this study. Its Credit Registry archives all data related to banking loans by borrower type and main characteristics, including size, interest rate, and duration.[3] We believe the information contained therein is complete and fundamentally unbiased.[4] Unfortunately, the Credit Registry's database does not track loans below one million *tenge* (about USD 6,500) for individuals and three million *tenge* for businesses. We correct for this information base gap in the analysis that follows below.[5]

Figure 1 and Table 1 summarize the principle results of this study. Figure 1 shows the expected demand for credit between 2001 and 2004. We anticipate that in 2004 the number of applications will be between 314,000 and 690,000. These numbers reflect a base year (2000) number of loan applications of between 171,000 to 225,000. Barring any unexpected volatility arising from exogenous factors, the number of applications is expected to increase on average between 16.4% and 32.4% over the period 2001-2004. These estimates do not take into account

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expected growth of retail business across all economic sectors and the anticipated high level of conversion of debit cards into credit cards. Besides banks, the largest users of credit bureau services around the world are entities that extend credit to customers at the consumer level; growth at present in Kazakhstan is very high, but from a very small base.

The remainder of this section discusses both principal empirical findings and briefly discusses the social importance of Credit Bureaus in a broad economic context. Section 2 then discusses patterns of bank loans; Section 3 estimates the number of borrowers in Kazakhstan, Section 4 provides further detail on the nature of banking sector loans, and Section 5 offers aggregate forecasts.

Figure 1. Expected Number of Loan Applications

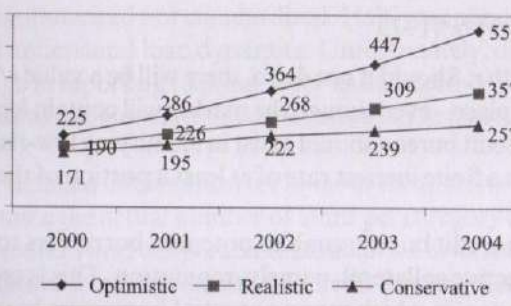


Table 1. Estimate of Quantitative Parameters of Demand for Bank Loans in 2000
(all units in thousands)

	Number of loans	Number of borrowers	Number of applications for loans	
			Total	Including those applying for the first time and those considered unreliable by banks based upon the results of previous applications
Optimistic scenario	181.0	57.0	238.0	224.6
Realistic scenario	181.0	54.9	196.5	189.9
Conservative scenario	181.0	54.9	196.5	170.9

1.1 The Economic Rationale for Credit Bureaus in a Transition Setting

Credit bureaus are important to financial development in that they provide a mechanism for increasing the quality of information on prospective borrowers that is known to potential lenders. This information reduces risk associated with lending, and therefore increases the supply of loanable funds. As the supply curve shifts out, total volume of loans will increase, and the cost of borrowing – the real interest rate r charged – declines.

This straightforward statement needs to be augmented on two counts in a transition society such as Kazakhstan. First, as r increases, the ability of borrowers to repay generally declines. This is true in part because the repayment burden is greater. In addition, the proportion of loans going to borrowers who intend to default *ex ante* will also rise. Thus, the total expected return R on a loan of size L will depend as well on the expected proportion $p(r)$ of the debt and principal repaid, and it is not inevitable that

$$R = p(r) * r * (1+L) \qquad (1)$$

will rise monotonically with r. Should it not do so, there will be a value $r^\wedge$ at which the market fails and no lending takes place – even though the market will contain legitimate borrowers as well. Establishment of a credit bureau should assist in identifying low-risk borrowers, thereby enabling the emergence at a finite interest rate of at least a portion of the market.

Perhaps most critically, a credit bureau enables potential borrowers to establish a valuable asset that can serve as effective collateral, namely, reputation. This is especially important in societies such as Kazakhstan in which many potential borrowers have limited physical or monetary assets to serve as collateral, and in which such real collateral is difficult to seize. It is true that a lender will not benefit from a borrower's destroyed reputation, but the borrower is hurt by a destroyed reputation as recorded by a credit bureau, since (s)he will be unable to secure future loans.

In the language of formal game and strategic behavior theory, credit bureaus create an asset of value to borrowers. Unlike physical or monetary collateral, reputation is automatically forfeited in the event of loan default. Being able to pledge this reputational asset thereby reduces moral hazard risk on the part of lenders by raising the cost to borrowers of what is known as post-contractual opportunism. In effect, establishing a credit history enables individuals and firms to make more credible repayment commitments by deliberately raising the cost of reneging on an initial loan agreement.[6]

Reputations should be of greatest value to financial market development precisely when other collateral is least effective, and when reputational loss is costly. The former condition is met in Kazakhstan, where the major physical asset, real estate, is difficult to attach. Rapid economic growth implies that reputational damage in the near future could be very costly in the sense of foregoing access to future loans and hence valuable business opportunities. Moreover, the national identity card and enterprise identity number systems make evading reputational loss in the event of default difficult.

These points all suggest that establishment of an effective credit bureau could play an important role in financial market development and growth of investment demand in Kazakhstan. However, establishing a credit bureau implies substantial start-up costs, and substantial information maintenance costs. For these reasons among others, very few middle-income countries have effective credit bureaus. The question to which we now turn is whether the potential for such a bureau exists in Kazakhstan.

2. BANK LOANS TO INDIVIDUALS AND LEGAL ENTERPRISES

The Credit Registry both maintains a monthly updated data base on the number and volume of loans and contingent liabilities in the economy arising from banking operations, and helps the NBK carry out its bank supervisory and regulatory functions. Information is in electronic form and can be manipulated by sector, loan size, and customer base. This report uses data for the two halves of 2000 and the first half of 2001 because of the general unreliability of earlier data, which were neither computerized nor standardized. Half-year periods were selected to be able to compare data and understand loan dynamics. Unfortunately, data for the year 2000 were limited due to a change in reporting requirements: as of December 25, 1999, banks no longer needed to report loans to individuals of less than one million *tenge*.

Given the absence of detailed information for loans in the first five categories of Table 2, it is problematic to determine the actual number of loans per category less than USD 5,000. This information loss also reduces intertemporal comparability. Fortunately, some banks during the first half of 2000 continued to sent all data to the Credit Bureau, thereby reducing the effective loss. Table 2 indicates the distribution of the number of short-term loans to individuals broken down by size. The table clearly shows that the banks for the most part stopped reporting loans less than one million tenge beginning in the second half of 2000.

Table 2 shows that the NBK Credit Registry captured only 32.5% of the total number of short-term loans that banks made to individuals in 2000. Based on interviews with banks, it is virtually certain that the unreported 67.5% represents a large number of borrowers. This assumption is borne out from data reported in bank annual reports as well, and is consistent with loan numbers reported to the Credit Registry before the reporting requirements changed in December 1999. On the other hand, some individual borrowers most certainly received more than one loan per year (especially in the cases of loan refinancing and credit card usage), and we attempt below to correct this situation to avoid double counting and overestimating potential applications for bank credit.

Table 2. Distribution of Short-Term Loans to Individuals: Credit Registry Data, 2000-2001

№	Intervals according to the size of loans granted, USD	1st half of 2000 (level of loan tracking significantly exceeded the required level)		2nd half of 2000 (level of loan tracking close to the required level)		1st half of 2001 (level of loan tracking close to the required level)	
		Number of Loans					
		units	%	Units	%	Units	%
1	Less than 100	1,173	36.2%	7	0.4%	14	0.5%
2	From 100 up to 200	523	16.1%	17	1.0%	14	0.5%
3	From 200 up to 500	176	5.4%	72	4.2%	162	6.2%
4	From 500 up to 1,000	103	3.2%	72	4.2%	219	8.4%
5	From 1,000 up to 5,000	432	13.3%	420	24.7%	645	24.8%
6	From 5,000 up to 10,000	329	10.2%	493	28.9%	614	23.6%
7	From 10,000 up to 50,0000	458	14.1%	565	33.2%	854	32.9%
8	More than 50,000	46	1.4%	57	3.3%	75	2.9%
	Total	3,240	100.0%	1,703	100.0%	2,597	100.0%
№	Intervals according to the size of loans granted, USD	**Value of Loans Granted (million tenge)**					
		Value	%	Value	%	Value	%
1	Less than 100	13	0.79%	0	0.00%	0	0.00%
2	From 100 up to 200	10	0.56%	0	0.02%	0	0.01%
3	From 200 up to 500	8	0.43%	3	0.13%	8	0.15%
4	From 500 up to 1,000	10	0.51%	8	0.26%	21	0.21%
5	From 1,000 up to 5,000	147	7.00%	168	4.07%	249	3.35%
6	From 5,000 up to 10,0000	372	13.69%	591	17.09%	695	13.53%
7	From 10,000 up to 50,0000	1213	49.28%	1,596	43.26%	2,316	38.71%
8	More than 50,000	662	27.73%	1,091	35.18%	1,703	44.04%
	Total	2,435	100.00%	3,458	100.00%	4,992	100.00%

Table 3 indicates that the level of reporting to the NBK of loans to individuals is low in comparison with loans granted to legal entities, especially given likely over-reporting of the former because of the lag in complying with the new threshold levels. While 41.6% of individual loans are short-term in duration, in money terms make up only 2.3%.

The procedure for estimating the number of loan applications was as follows:

1. The aggregate value of loans reported by the Credit Registry in 2000 was compared to the aggregate value of loans reported in the same year by the Department of Research and Statistics ("DRS") of the NBK.
2. In the event that DRS values exceeded those reported by the Credit Registry, we distributed the excess (prorated by the percentage breakdown of loans reported by the Credit Registry in each category) among the different loan categories that fell below the minimum threshold.
3. We assumed that the relative values of total loans reported in categories 1-5 for the first and second half of 2000 would have been equal if reporting requirements had been the same. We assumed further that the average rate of growth in categories 1-5 was the same as that observed in categories 6-7, where there was no distortion. We assumed that banks reported 100% of their portfolios (numbers and size of loans) in categories 6-7 for both periods accurately: in other words, the absolute numbers reported by the Credit Registry for categories 6-7 needed no adjustment unlike categories 1-5.
4. We calculated the number of loans in the first five categories by dividing the new adjusted value for total loans by the pre-adjusted average loan size reported by the Credit Registry per each category.
5. In order to estimate the number of borrowers, we first needed to recognize the difference between the number of borrowers and the number of loans (since one borrower can receive more than one loan per year). To estimate this gap, we organized borrowers into different groups and loans by period. Legal entities were divided into small, medium and large enterprises on the basis of business registry information, enabling us to infer the average number of loans per borrower per category.
6. To calculate the number of system-wide loan applications, we incorporate into our data set the largest bank's estimate of the number of applications they individually received at four different times over the past two years, as well as information from statistical agencies on small enterprises.
7. Projected future demands for short-term bank loans were based on macroeconomic and financial trends as discussed below.

Table 3. Bank Loans Traced by the Credit Registry, 2000

Indicator	All loans	volume		
		Short-term	Medium term	Long-term
Traceable loans as % of total loans				
Total loans	70.4%	56.0%	97.1%	96.2%
Loans to individuals	38.8%	32.5%	52.5%	45.8%
Loans to legal entities	71.8%	56.9%	100.0%	97.6%
Structure of traceable loans by categories of borrower				
Total loans	100.0%	100.0%	100.0%	100.0%
Loans to individuals	2.3%	2.3%	2.9%	1.3%
Loans to legal entities	97.7%	97.7%	97.1%	98.7%
Structure of traceable loans by duration				
Total loans	100.0%	70.6%	18.4%	11.0%
Loans to individuals	100.0%	55.4%	36.2%	8.4%
Loans to legal entities	100.0%	56.1%	28.6%	15.2%
Number of loans by category of borrower				
Total loans	100.0%	100.0%	100.0%	100.0%
Loans to individuals	42.5%	41.6%	44.1%	47.7%
Loans to legal entities	57.5%	58.4%	55.9%	52.3%
Number of loans by duration				
Total loans	100.0%	69.5%	25.6%	4.9%
Loans to individuals	100.0%	68.0%	26.5%	5.5%
Loans to legal entities	100.0%	70.6%	24.9%	4.4%

2.1. Loans to Individuals.

This procedure implies that there were approximately 69.2 thousand loans within the first five intervals, and 9.2 thousand in the sixth interval that were not reported: average loan sizes were USD 394.00 and USD 6355.00, respectively (Table 4). The close correspondence of the distribution curves of reported loans *vs.* total loans (Figure 2) for loans above USD 200 is encouraging. Note also the close correspondence between these curves and with those in Figure 3, which provides the distribution of workers in the formal sector of the economy according to the average monthly wage, and the distribution of the population according to the disposable per capita cash income. Clearly, the distribution curve of all loans corresponds more closely to the distribution curves of disposable cash income and average monthly wage than to the curve for total reported loans. The fact that almost 89% of the population receives less than USD 100/month in disposable cash income explains the immense demand for short-term loans, which are on average less than USD 100. Additionally, we believe that most micro lending (< USD 100) is extended to the 58% of workers in the formal economy who earn less than USD 100/month.

This analysis allows us to separate out and match specific income levels with loan sizes and will serves as a means to more accurately estimate application rates given wage information. The quantitative matching process is consistent with available information concerning the relationships between assets/income and loan size. There is virtually no doubt, for example, that all loans greater than USD 50,000 were made to individuals with incomes greater than USD 500/month. By implication no more than 0.2% of those permanently employed in the formal sector of the economy, can access loans in the USD 50,000 range.

Other characteristics of short-term lending to individuals in 2000 include the following:

- The number of short-term loans to individuals represents 42.2% of all loans reported to the NBK Average loan size is only USD 60.0. Loans to individuals in volume terms represent only 1.7% of total short-term loans reported. While loans ranging in size from USD 100 to 200 likewise represent an insignificant amount of total short-term loans, the number of such loans makes up 18.8% of the total number of loans (Table 4 and Figure 2).
- Unreported detailed data on loans by purpose suggest it is reasonable to assume that the structure of all short term loans to individuals in later periods (reported and non-reported to the NBK Credit Registry) corresponds to the structure of reported loans from the first half of 2000.
- The Credit Registry subdivides loans into two main categories: individuals and non-incorporated individuals or "private entrepreneurs". For this reason, debtor categories are structured to reflect individual and private entrepreneurial borrower habits. While loans to private entrepreneurs make up only 1.3% of the total number of loans, those same loans represent 10% of the total portfolio in terms of size. This can be explained from the statistical fact that most private entrepreneurs take out loans between USD 1000 and USD 50,000.

Figure 1. Distribution of Individual Short-Term Loans by Loan Size: Traceable Loans vs. All loans, including untraceable, 2000

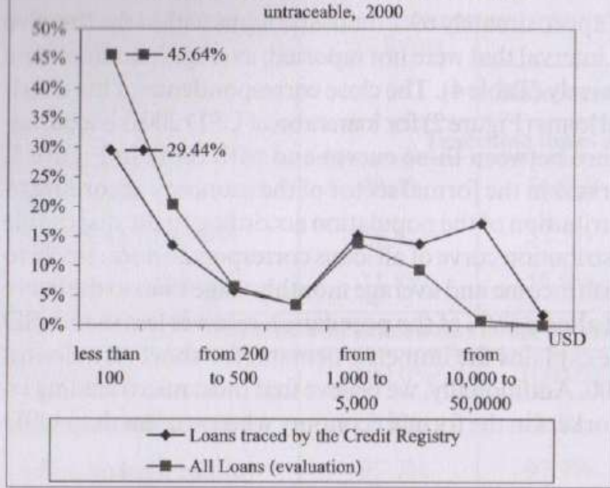
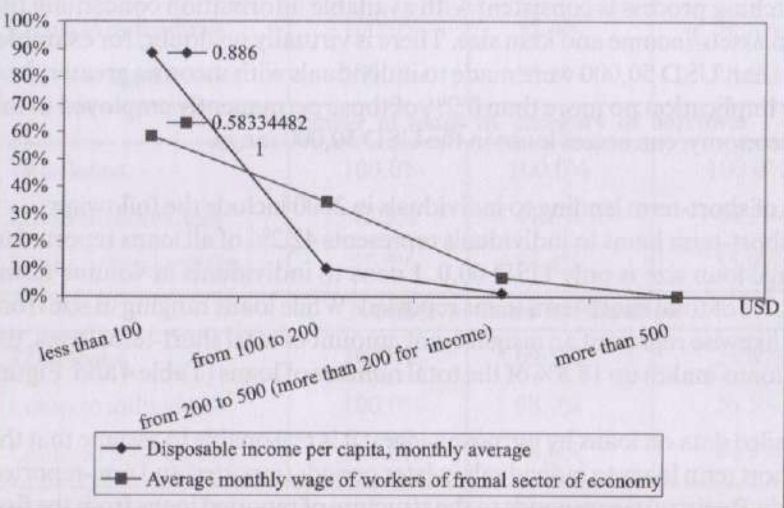


Figure 2. Distribution of workers in Formal Sector of Economy by Average Monthly Wage vs. Distribution of Households by Disposable Income, 2000



We use the same assumptions and methodology (taking into account reporting changes) to compare lending levels for other categories of borrowers. Our analysis considers a borrower group's distinctive portfolio structure. It bears mention that non-reported loans to individuals in 2000 exceeded the number of reported medium and long-term loans by 3.6 times and 2.6 times, respectively. Non-reported short-term loans to individuals exceeded the number of reported short-term loans by 16 times. The difference between reported and non-reported short term loans confirms the common assumption that as lending period increases the number of micro-loans declines.

Table 4. Distribution of Short-Term Loans to Individuals

№	Intervals according to the size of loans granted, USD	Loans trackable by the Credit Registry		All loans (Estimated on the basis of the following assumption: Distribution of the identified volume of non-trackable loans between intervals I and II prorated to proportions of trackable loans in these intervals)	
	Volume of loans granted				
		Million *tenge*	%	Million *tenge*	%
1	Less than 100	13	0.2%	301.87	1.7%
2	From 100 up to 200	10	0.2%	216.62	1.2%
3	From 200 up to 500	11	0.2%	176.44	1.0%
4	From 500 up to 1,000	19	0.3%	235.29	1.3%
5	From 1,000 up to 5,000	315	5.3%	3,342.85	18.4%
6	From 5,000 up to 10,000	964	16.3%	9,310.37	51.3%
7	From 10,000 up to 50,0000	2,809	47.7%	2,808.70	15.5%
8	More than 50,000	1,754	29.8%	1,753.55	9.7%
	Total	5,894	100.0%	18,146.00	100.0%
	Number of loans granted				
		Units	%	Units	%
1	Less than 100	1,180	23.9%	35,413	42.2%
2	From 100 up to 200	540	10.9%	15,790	18.8%
3	From 200 up to 500	248	5.0%	5,313	6.3%
4	From 500 up to 1,000	175	3.5%	3,110	3.7%
5	From 1,000 up to 5,000	852	17.2%	13,042	15.6%
6	From 5,000 up to 10,000	822	16.6%	10,063	12.0%
7	From 10,000 up to 50,0000	1,023	20.7%	1,023	1.2%
8	More than 50,000	103	2.1%	103	0.1%
	Total	4,943	100.0%	83,857.00	100.0%

2.2. Total Loans to Commercial Enterprises (Legal Entities)

Data on lending to legal entities show a similar structure, except that the average size of non-reported loans greatly exceeds the same indicator for loans to individuals. Tables 5-6 reflect the total number and volume of loans to legal entities according to both the Credit Registry and to our independent Estimate. Unfortunately, data on legal entities from the Credit Registry and the DRS are not broken down by type of enterprises. Only loans to small and medium enterprises (SMEs) are identified separately. The number of loans to medium and large sized companies are then determined residually.

Table 7 compares quantitative data on the demand for loans in 2000 from Credit Registry data and banking statistics. Note in particular the item "funds for replenishment of working capital in small and medium-size business," which represents an important component of loans to legal entities, and, in particular, to SMEs. Working capital loans to small, medium and large businesses, as reported by the Credit Registry, were 33%, 32% and 7%, respectively.

Table 5. Distribution of Short-Term Loans to Legal Entities (including small entrepreneurs) 2000

№	Loan Intervals, USD	On the basis of the Credit Registry		All loans (Estimated as in Table 4)	
	Volume of Loans granted				
		Million *tenge*	%	Million *tenge*	%
I	Less than 5,000	802.5	0.3%	3,097.3	0.7%
II	From 5,000 to 10,000	9,635.4	3.8%	36,799.0	8.3%
III	From 10,000 to 50,0000	55,866.4	22.2%	216,644.1	49.1%
IV	More than 50,000	184,994.7	73.6%	184,994.7	41.9%
	Total	251,299.0	100.0%	441,535.3	100.0%
	Number of Loans granted				
		Units	%	Units	%
I	Less than 5,000	1,250	18.0%	5,836	19.0%
II	From 5,000 to 10,000	2,508	36.2%	11,964	39.0%
III	From 10,000 to 50,0000	2,502	36.1%	12,223	39.8%
IV	More than 50,000	670	9.7%	670	2.2%
	Total	6,930	100.0%	30,692	100.0%

Table 6. Distribution of Long-Term Loans to Legal Entities (including small entrepreneurs), 2000

№	Loan Intervals, USD	On the basis of the Credit Registry		All loans (Estimated as in Table 4)	
	Volume of Loans granted				
		Million *tenge*	%	Million *tenge*	%
I	Less than 10,000	18	0.03%	186	0.27%
II	From 10,000 up 50,000	183	0.27%	1,717	2.45%
III	From 50,000 up 500,0000	5,597	8.20%	5,597	8.00%
IV	More than 500,000	62,466	91.51%	62,466	89.28%
	Total	68,264	100.00%	69,965	100.00%
	Number of Borrowers				
				Человек	%
I	Less than 10,000	41	9.4%	403	32.7%
II	From 10,000 up 50,000	51	11.7%	488	39.5%
III	From 50,000 up 500,0000	197	45.3%	197	16.0%
IV	More than 500,000	146	33.6%	146	11.8%
	Total	435	100.0%	1,234	100.0%

In order to more accurately estimate the demand for credit, we also surveyed the banking community in Kazakhstan. A questionnaire was aimed to supplement data from other sources in order to better gauge the demand for credit. Specifically, we asked banks to estimate application rates for different bank products and sectors, including for SMEs. The banks that responded represented approximately 97% of all banking credit activity in the economy. The responding banks as a group recorded 23,284 loans in 2000, of which 4,370 went to small enterprises.[7]

In general, definitional inconsistencies do not alter our bottom-line conclusions dramatically. We conclude that banks made approximately 129,000 loans in 2000: 73% to individuals and 27% to legal entities, which included 4.8% to unincorporated entities. The breakdown of total loans in 2000 (approximately 651 billion *tenge*) between individuals and legal entities was 4.2% and 95.8%, respectively. Some 18% of the loans to legal entities were to small entrepreneurs.

Table 7. Estimate of Number of Loans Granted by Banks in 2000

Borrower's name	Volume of loans granted, Million *tenge*				Number of loans, units			
	Total	Including:			Total	including:		
		Short-term	Medium-term	Long-term		Short-term	Medium-term	Long-term
	Credit Registry							
Individuals	10,638	5,894	3,849	895	7,265	4,943	1,925	397
including:								
Non-incorporated entrepreneurs	3,053	1,823	1,230	-	1,791	1,075	716	-
Others	7,584	4,071	2,618		5,474	3,868	1,209	
Non-bank legal entities	447,744	251,299	128,182	68,264	9,810	6,930	2,445	435
Including :								
a) small entrepreneurial entities	113,719	55,781	28,688	29,250	4,368	3,013	1,235	120
б)other legal entities	334,025	195,518	99,494	39,013	5,442	3,917	1,210	315
For reference: funds allocated for replenishment of current assets in small and medium-size business	162,494	37,071	87,611	37,812	3,126	83,857	784	31
Total	458,382	257,193	132,030	69,159	17,075	11,873	4,370	832
	Banking statistics				**Estimate**			
Individuals	27,425	18,146	7,326	1,954	94,040		8,774	1,409
including:								
Non-incorporated entrepreneurs (according to the Credit Registry data)	3,053	1,823	1,230	-	1,791	1,075	716	-
Others	24,372	16,323	6,096	1,954	92,249	82,782	8,058	1,409
Non-bank legal entities	623,873	441,535	112,372	69,965	34,371	30,692	2,445	1,234
including:								
Small entrepreneurial entities (according to the Credit Registry data)	113,719	55,781	28,688	29,250	4,368	3,013	1,235	120
Other legal entities	510,153	385,754	83,684	40,715	30,003	27,679	1,210	1,114
Including:								
Large enterprises	NA	NA	NA	NA	11,087			
Medium-size enterprises (according to the data from a survey of 11 banks: understatement of estimate)	NA	NA	NA	NA	18,916			
Total	651,298	459,681	119,698	71,919	128,411			

3. LOANS PER BORROWER AND THE TOTAL NUMBER OF BORROWERS

In order to go from and estimate of the number of loans to the number of borrowers, an estimate of the number of loans per borrower must be made. In addition, if the average loan size of non-reported loans is overestimated, then the estimate of 129,000 is low; the converse is true if the average loan size of non-reported loans is underestimated. In mapping this relationship, we assume that both individuals and enterprises engaging in short-term loans will have more loans per agent than those securing longer-term loans. While the frequency of repeat loans for each of six different durations is based on casual estimates from Kazakhstani bankers rather than definitive analysis, and while some borrowers may have loans with different durations, we have deliberately chosen repeat borrowing rates likely to understate the total number of borrowers. Assumptions concerning the total possible number of loans granted to one borrower within each of the above-mentioned intervals take into account interviews with bank credit departments, and assume that the longer a lending period, the lower the probability of one borrower receiving several loans each year. We also verified that when total loans (reported and non-reported loans) were subdivided into different lending periods, the structure of those loans within each period was identical to the structure of only reported loans. We concluded that in 2000, small businesses received approximately 2678 loans for a period of one year or less. In total, our estimates imply that commercial enterprises that borrow have about 1.13 loans per year, while personal borrowers have 2.21 loans, which is almost certainly an overstatement.

With respect to medium and long-term loans, we assumed that the total number of loans in these groupings equaled the number of borrowers in each grouping. We believe that the application of this assumption to small business would not appreciably distort estimates regarding small businesses due to this groups insignificant size. Banks in Kazakhstan appear generally unwilling to extend multiple loans to small enterprises. In practice, only large businesses receive more than one loan per year. Besides, such businesses quite frequently deal with several banks. In regards to large and medium businesses, the above information forced us to abandon the method applied to the class of small entrepreneurial entities, and instead use a method based solely on assumptions about the probable number of businesses that can access bank loans. As the number of large business loans is small, though, the estimate of total number of borrowers will not be greatly affected by different assumptions (Table 8).

Table 8. Estimation of the Number of Bank Loan Borrowers in 2000

Borrower category	Number of borrowers (individuals, enterprises)		Average number of loans extended per one borrower/ year	
	Optimistic estimate	Realistic estimate	Optimistic estimate	Realistic estimate
Individuals	48,209	48,209	2.0	2.0
Including:				
Unincorporated businesses (engaging in entrepreneurial activities without formation of a legal entity)	918	618		
Other	47,291	47,591		
Non-bank legal entities	8,763	6,663	3.9	5.2
This number includes:				
Small entrepreneurial entities	4,033	4,033	1.1	1.1
Other legal entities	4,730	2,630	6.3	11.4
This number includes:				
Large businesses	1,168	650	9.5	17.1
Medium businesses (based on polling 11 banks)	3,561	1,980	5.3	9.6
Subtotal	56,972	54,872		

The next step in assessing the potential market for a credit bureau is to estimate the total number of active enterprises in Kazakhstan. Official statistics track, on a monthly basis, the number of registered and operating legal entities based on size of the enterprise (Table 9). We assume that registered businesses not in operation – either temporarily idle or never active - cannot access bank credit. This assumption – equal to the difference between total registered businesses and total registered businesses that are actually operating – reduces the number of potential borrowers. Although this downward adjustment excludes some new firms that may be creditworthy, it is also true that not all companies in operation receive or apply for bank credit. We therefore estimate two scenarios. The conservative numbers are limited to businesses that have reported data to the statistical agencies: only 73% of large businesses and

40% of medium businesses met are more stringent criteria. These numbers are then reconciled with the estimates in Table 10 of the number of business loans taken by size category to determine the average number of loans per active firm. It thus appears that a single large business receives between 9 and 17 loans per year. A single medium sized business receives between 5 and 10 loans per year using the same criteria. Overall, the numbers of borrowers

Table 9. The Number of Registered and Operating Legal Entities, 1998-2000 **as of year end, units**

Type of Entities	1998 Registe-red	1998 Opera-ting	1998 Operating as % of number of entities registered	1999 Registe-red	1999 Opera-ting	1999 Operating as % of number of entities registered	2000 Registe-red	2000 Opera-ting	2000 Operating as % of number of entities registered
Small	86,696	63,368	73.1%	107,134	88,501	82.6%	125,566	97,939	78.0%
Medium	10,116	8,615	85.2%	11,295	10,208	90.4%	10,856	9,757	89.9%
Large	3,262	2,764	84.7%	2,481	2,030	81.8%	2,127	1,738	81.7%
Total	100,074	74,747	74.7%	120,910	100,739	83.3%	138,549	109,434	79.0%

Table 10. Estimate of the number of small enterprises that are regular bank customers

	Number of small businesses engaged in entrepreneurial activities*	Number of busines-ses reporting to Goskomstat	Number of businesses that gained profit		Actual quantity of businesses that were extended bank loans (estimated based on Credit Registry data)		Estimate of the quantity of businesses as regular clients of banks (stable contin-gent of borrowers)	
			Units	In % of businesses that sub-mitted reports	Units	In % of the number of businesses that gained profit	Units	Assumption: 20% of profitable businesses
1999	71,853	35,389	15,489	43.8%				
2000	87,005	43,405	15,524	35.8%	4,033	26.0%	807	20%

* - excluding government establishments, health and educational institutions, banks, insurance and public organizations

among large and medium sized businesses was approximately 1168 (650 under a conservative scenario) and 3561 (1980 under a conservative scenario), respectively.

It was difficult to find reliable figures for benchmarking purposes on individual short-term borrowers because of gaps in earnings and demographic statistical data. At an upper limit, since short-term loans are made mainly to households and small entrepreneurs, one could regard all seven million able-bodied employable people in the Republic of Kazakhstan as of year-end 2000 as the potential market. At the lower end, we also have assessed the number of individual short-term borrowers using the same methodology applied to SMEs.

By comparing the structure of individual and SME short-term loans, we note that loans with a 1-month tenure or less are concentrated with individuals (43%), and loans with tenure of 9 to 12 months are concentrated among SMEs (46%). These concentrated loan structures imply potential error in the ratio of loans to borrowers in some categories is inaccurate. We therefore based loans/borrower ratios on data made available by major banks both on loans and on the number of credit cards in circulation. We concluded that in 2000, there were 6,102 borrowers with short-term loans of up to one month. This number then can be compared to an estimated minimum numbers of credit cards (12,000) in circulation during the period. To summarize, in 2000 Kazakhstani banks extended loans to approximately 48,000 individuals, the majority of which (40,300) were short-term. On the whole, individuals represented 85% of all borrowers; legal entities made up 15%.

4. TIME TRENDS AND POTENTIAL DEMAND FOR BANK LOANS

As noted, we regard demand for bank credit as a proxy for the demand for Credit Bureau services. This assumption, given that banks currently dominate the credit markets, is reasonable, and also can provide a benchmark for estimating usage of credit bureau services from non-bank sources. The analysis thus far has been based on an estimate of regular clients (already known to the banks). However, demand for credit bureau services will also depend on the number of new applicants – those who have previously applied for banks loans and been denied credit, and those who have never before applied.

To estimate the number of applications banks receive for credit each year, we need to determine loan market size, turnover, and loan denial rates. Clearly, there is considerable movement in shares among categories of borrowers. Since late 1998, the rate of growth of SMEs has been quite rapid, given both strong government policies (support for small business) and a robust economy increasingly linked to international markets. Conversely, the number of large businesses has declined significantly over the same period, in part due to market consolidation.

Over the period analyzed, the number of new small enterprises significantly exceeded those that closed. In 2000, 17 small enterprises opened for every one that closed; for each large enterprise that opened, 10 closed. In contrast, the rate of reduction of large businesses in 2001 was 3.2%, as compared to 24% and 14% in 1999 and 2000, respectively, and the numbers continued to decrease modestly in the first months of 2002. Medium sized businesses showed significant growth over the first two quarters of 2001, declined through the 1st quarter of 2002, and appears to have since stabilized.

Given these numbers of firms, how many are regular bank clients? To maintain a conservative approach, we take into account only those companies that submit monthly financial statements to government authorities. Reporting businesses account for approximately 50-60% of total operating businesses. We make another cut and select only those companies that in their financial statements report a profit – in other words, all companies that report "sustained losses" for whatever reason are not counted. As a result, the number of enterprises anticipated to demand credit bureau services comprises only 40% of total registered enterprises.[8] This number is an understatement both to the extent that some currently unprofitable enterprises will seek bank loans, and to the extent that some profitable firms are not yet but will soon become bank clients After analyzing the data in light of the above assumptions, we conclude that approximately 325 large and 594 medium sized businesses are regular and creditworthy borrowers in the banking sector.

To determine the banking sector's regular small enterprises client base is more difficult. It is apparent that either the NBK Credit Registry is not receiving full information from small enterprises, or small enterprises that report a profit do not need or choose not to seek bank loans. This latter possibility seems more likely, and may explain why only 26% of enterprises reporting a profit received bank credit, or only 4% of total operating businesses (Table 10).

Given the importance of SME businesses in total demand for credit bureau services, it is worth reviewing additional material to assess potential demand. Two sources of information help to explain loan dynamics to SMEs from 1998 through 2001: a) an EBRD report summarizing loan activity under its SME Development Program, and b) the results of a questionnaire sent to the banking community requesting specific information regarding its SME lending programs. As of December 31, 2000, the breakdown of EBRD-funded loans to individual entrepreneurs, small companies, and medium enterprises (with up to 100 employees) was 55%, 32% and 2%, respectively. Reconciling these numbers with unreported bank survey data suggests that the NBK's Credit Registry information is substantially complete and accurately reflects loans activity and volumes.

An indication of likely limited access of small businesses to bank loans appears in Table 11[9,10] We combine in this table information both on Kazakhstan and other transition economies. The results from questionnaires sent to 1,064 small businesses of East Kazakhstan region, 537 businesses from Karaganda region, and 78 businesses from Mangistau region show that Kazakhstani entrepreneurs also prefer to finance start up capital requirements through personal savings or partnerships rather than through bank loans. Only 7% to 13% of all small/medium enterprises are established (start-up capital) through bank loans in Kazakhstan. Those percentage levels are similar to Hungary and China. At the same time, the fact that small businesses

Table 11. Financing of private business: Results from surveys in Kazakhstan and other transitional economies

	Czech and Slovak Republics	Hungary	Poland	Russia (St. Peterburg)	Vietnam	Kazakhstan: East-Kazakhstan	Kazakhstan: Karaganda region	Kazakhstan: Mangistau region
Year study conducted	1992	1991	1991	1992	1996	1997		
Sample size (number of firms)	121	106	93	99	95	1064	537	78
Average firm size (number of employees)	42	44	32	74	200	9 (approx)	< 50	<50
Reliance on personal savings at start-up (%)	54	85	N/A	66	79	69.7	47	36
Bank loans at start-up (%)	66	9	N/A.	22	5	8.7	7	13
Received at least one bank loan	75	43	68	47	67	n/av	n/av	n/av

Table 12. Parameters of bank loan demand: Results of surveys of entrepreneurs engaged in small business activities

	Karaganda region	Mangistau region	East Kazakhstan region	Total
Sample size	537	78	748	1363
Need to raise a loan	41.0%	36.0%	41.0%	40.7%
Do not need to raise a loan	45.0%	39.0%	41.4%	42.7%
Applied for and received loan	14.0%	26.0%	17.6%	16.7%
The rate of approval of bank loan applications	25.5%	41.9%	30.1%	29.1%

mainly rely on internal resources accounts for the relatively low level of bank financing. On average, only one-third of businesses in need of borrowing received bank loans in the three regions (Table 12).

Further analysis of survey data show that banks reject a large percentage of loan applications from small businesses because of a lack of collateral or third party guarantees: small businesses' inability to meet collateral requirements accounted for 17.2% of loan application rejections. High interest rates and short loan tenure handicapped the ability of small businesses to receive loans by 23.3% and 12.5%, respectively. In addition, the banks indicated they had doubts as to the ability of 14.9% of their small businesses customers to repay outstanding loan balances. A Goskomstat (Statistics Agency of the Republic of Kazakhstan) study emerged with similar conclusions.

In the bank survey we conducted, most of the 11 banks that responded did not track loan applications. One large bank reported a loan approval rate of 34%, and for lack of an alternative we assume that rate holds for the entire banking sector. Informal surveys with other bankers suggest that this figure is reasonable. The relatively low loan approval rate indicates neither a lack of demand for bank loans nor inevitably poor quality of loan demand. Rather, low approval rates result from a combination of limited loan access mechanisms, compliance with regulatory requirements and red tape, as well as high and unpredictable interest expenses. The perception of weak balance sheets and managerial capabilities, which may in fact not be the case, lowers the loan application/approval success rate as well. High interest rates reflect the relatively high costs in assessing overall borrower risks.

Official data point to the social cost of low firm creditworthiness. The portion of investments for ongoing financing in small businesses in the republic made with borrowed funds amounted to 83% of total investments during the first half of 2001. The level of the indicator under analysis does not vary significantly by the size of the entity. The above testifies to the fact that, given an underdeveloped stock market and the low propensity of the population to save, a bank loan is the main source for small enterprises to finance growth – a very different pattern than for financing start-up operations.

Table 10 estimates the number of regular bank clients by assuming that only profitable firms, and only 20% of those, comprised this group. Such an approach is obviously subjective, but no viable alternative assumption exists. It seems likely that this assumption serves as a lower bound, and may well be a considerable understatement. The final steps in assessing loan demand are to estimate potential individual loan demand, and then to sum over all categories. Table 13 divides borrowers into individuals and legal entities. We assumed that the potential number of legal borrowers equals the number actually operating rather than the number registered. The potential number of physical persons involved in entrepreneurial activity is assumed to equal the number of licensed, small non-incorporated entities. The number of individuals, excluding those in the preceding category, is assumed to be 15% of the number of wage earners with an average monthly salary exceeding USD 130.

Table 13. Estimate of number of loan applications submitted in 2000

Borrower Category	Physical persons with the exclusion of non-incorporated persons, involved in entrepreneurial activities	Non-incorporated physical persons involved in entrepreneurial activities	Legal entities			Total of all borrower categories	Total approximate number of loan applications
	Wage earners	Self-employed population	Registered small enterprises	Registered medium-size enterprises	Registered large enterprises		
Number, thousands	3,500.0	2,670.0	125.6	10.9	2.1	6,308.5	
Probable borrowers	15% of wage earners: having an average monthly salary above USD 130	Non-incorporated individuals involved in entrepreneurial activities	Operating entities	Operating entities	Operating entities		
Number	525.0	42.9	97.9	9.8	1.7	677.4	

Potential borrowers (submitting loan applications)	30% of probable borrowers	30% of probable borrowers	Entities, which generated income during the reporting year	Active entities	Active entities	-	
Number	157.5	12.9	15.5	9.0	1.6	196.5	196.5
Actual borrowers	Estimate	Estimate	Estimate	Assumption 2: actual number of borrowers is equal to the number of entities which received income during the reporting year			
Number, thousands	47.3	0.9	4.0	1.98	0.65	54.9	
Coefficient of approvals of loan applications	30.0%	7.1%	26.0%	22.0%	40.4%	27.9%	
Non-approved loan applications, thousands	110.2	12.0	11.5	7.0	1.0	141.6	

These assumptions appear to be reasonable for Kazakhstan. Data on the distribution breakdown of wage earners suggest that in 2000, the percentage of employees earning a salary of more than of USD 130/month was 18% of the total number of permanent wage earners. By 2001, the situation had remarkably improved, following continued recovery after the late 1998 Russian crisis. The percentage in this higher income category increased to more than 30%, considerably exceeding 1998 pre-crisis level. Overall, Goskomstat data indicate that real wages increased by more than 30% between 1998 and 2001 in real terms.

When all components are summed, we estimate that the total number of potential borrowers in Kazakhstan as of 2001 to be 677,000 – some 11% of eligible adult individuals and legal enterprises. We assume that some 30% of qualifying (higher income) wage earners and also 30% of non-incorporated but licensed individual elf-employed persons are potential borrowers; the coefficient assigned to estimate the loan application rate for physical persons involved in entrepreneurial activity was 7%. Our estimate of the number of employed persons closely matches the number obtained on the basis of bank interviews, and serves as a basis for the assumption that the number of potential borrowers equals 30% of the number of total possible borrowers.

We can draw the same conclusion with regard to medium-size entities if we compare our estimate (40% in optimistic and 22% in conservative projections) to the relevant data from bank interviews. Lack of data do not allow estimation of large enterprise approval rates. In alternate optimistic (not shown) and conservative scenarios, we use 70% and 40% loan approval rates, respectively. As for small businesses, we restricted the number of enterprises to those which were both registered and generated income, while in the optimistic scenario we used all registered enterprises. As a result, the level of demand in the realistic scenario was only about one-fourth that in the optimistic scenario. However, the size of the coefficient in the realistic scenario (0.26) is consistent with the Goskomstat surveys of small businesses.

5. TOTAL CREDIT BUREAU DEMAND: PULLING IT ALL TOGETHER

Figure 1 sets out the level of potential loan demand for the year 2000. We estimate that physical persons and legal entities together submitted between 197,000 (realistic scenario) and 238,000 (optimistic scenario) loan applications to the private banks in Kazakhstan. These numbers serve as the basis for calculations and projections of the demand function for bank loans through 2004.

Table 14 reflects the levels of applications excluding the established and regular customer base of the banks. These figures estimate the number of customers who submitted applications for the first time, as well as the number of persons and enterprises who theoretically possessed the financial and legal characteristics to request a loan, but who were not yet able to pass the initial loan application screening threshold at a bank. With the existence of a Credit Bureau, it is reasonable to believe the banks would have at least requested a credit report to better assess a potential client's risk characteristics and repayment capacity.

Using 2000 as the base year, and taking into account expected macroeconomic trends and the development of credit markets in Kazakhstan, we estimated the potential demand for credit bureau services through 2004 (Figure 1).

The forecasts are based on an assessment of monthly wages and income levels trends in the formal sector (employed individuals) for the period 1998-2000 (Table 15), which sets out our assumptions regarding the growth rate for bank loan applications in the 2002 – 2004 period. Our analysis focused on changes in absolute numbers and on the proportion of employees in the formal sector who received a monthly salary of over USD 130. Forecasting growth for Kazakhstan's major urban centers is difficult. After the initial post-Soviet collapse in real incomes, slow and then rapid growth has resumed. By 2001, employees in the formal sector earning at least USD 130/month increased 50% from levels in 1999. However, the 2001 figure was still below the pre-Russian crisis 1998 figure. Given the extremely rapid economic growth (at annual rates above 10%) from 2000 through mid-2002 that has taken place, and the even more rapid growth in major urban centers, we estimate that the percentage of individuals who meet the US$ 130 threshold will range from 15% to 30% in 2002. Our assumptions regarding the behavior of legal entities fundamentally rely trends in the growth of enterprises by size. Because of strong government efforts at diversification and limited change to downward trends in the number of large enterprises, we believe the main inflow of new borrowers will come from small businesses and consumers and not from medium and large companies.

Table 14. Estimate of Number of Successful and Unsuccessful New Loan Applications, according to the results of previous applications in 2000.

	Number of borrowers, thousands. Total	including: regular	including: New or those who did not gain the credibility of banks	Coefficient of loan application approvals	Number of applications submitted, thousands. Total	Including the applications from those who submitted loan applications for the first time and who did not gain the confidence of banks according to the results of previous applications
			Optimistic Estimate			
Physical persons with the exclusion of non-incorporated persons involved in entrepreneurial activity	47.3		47.3	0.3	157.5	157.5
Non-incorporated physical persons, involved in entrepreneurial activity	0.9		0.9	0.1	12.9	12.9
Non-bank legal entities	8.8	1.7	7.0	0.13	67.6	54.3
Of these:			-			
small enterprises	4.03	0.807	3.2	0.07	57.0	45.6
medium-size enterprises	3.56	0.594	3.0	0.40	9.0	7.5

large enterprises	1.17	0.325	0.8	0.73	1.6	1.2
Total	57.0	1.725	55.2	0.24	238.0	224.6
Realistic Estimate						
Physical persons with the exclusion of non-incorporated persons involved in entrepreneurial activity	47.3		47.3	0.30	157.5	157.5
Non-incorporated physical persons, involved in entrepreneurial activity	0.9		0.9	0.07	12.9	12.9
Non-bank legal entities	6.7	1.725	4.9	0.25	26.1	19.4
Of these:						
small enterprises	4.0	0.807	3.2	0.26	15.5	12.4
medium-size enterprises	1.98	0.594	1.4	0.22	9.0	6.3
large enterprises	0.65	0.325	0.3	0.40	1.6	0.8
Total	54.87	1.725	53.1	0.28	196.5	189.9

Table 15. Assumptions concerning growth of number of bank loan applications for 2002-2004

	Annual rate of growth of number of bank loan applications in 2001-2002,%			Annual rate of growth of number of bank loan applications in 2003-2004,%		
	Optimistic scenario	Realistic scenario	Conservative scenario	Optimistic scenario	Realistic scenario	Conservative scenario
Individuals, except for non-incorporated entrepreneurs	30%	20%	15%	24%	16%	8%
Non-incorporated entrepreneurs	30%	20%	15%	24%	16%	8%
Non-bank legal entities						
Small enterprises	20%	10%	5%	20%	10%	5%
Medium-size enterprises	10%	5%	3%	10%	5%	3%
Large enterprises	5%	3%	1%	5%	3%	0%

Our goal in making projections for potential credit bureau demand is to be neither unrealistically pessimistic nor, especially, optimistic. As previously noted, estimates for the demand of credit bureau services in Kazakhstan attempt to isolate reasonable sources of demand, including first time applicants; companies that are operating and registered but have not yet met some specific bank application criteria; individuals with minimum income thresholds; and those individuals and firms who have failed to receive credit, either because of costs associated with risk assessment and repayment capacity for small margin loans, or failure to complete application forms in an appropriate manner. While we cannot be certain, it is likely that virtually all components of credit bureau demand have GDP elasticities at or greater than unity.

In the near future, additional structural changes are likely to further increase demand. These factors include:

- A decrease in social tax rates for individuals from 26% to 21%, and the introduction of a unified tax regime for VAT (16%) in place of the previous complex tiered system. Both reforms will either ease the tax burden or reduce paper work and red tape, which are barriers to obtaining credit.
- Simplification of tax procedures for small businesses (as of January 1, 2002), and lower personal income tax rates.
- A general decrease in loan refinancing rates primarily as a result of increased competition and market liquidity. Refinancing rates have declined on average several percentage points over the past two years and are expected to remain at competitive and increasingly accessible levels for retail, mortgage and consumer loans. The refinancing rate decreased from 11% to 8% starting on March 4, 2002. The underlying pressure for these declines stems from Government budgetary surpluses (the Government budget was in rough balance in 2000 and 2001, and is operating at a surplus of nearly 3% of GDP for the first five months of 2002), which has led the Government to plan to retire debt rather than float new debt issues. Combined with continued weak investment demand, this situation will force Kazakhstan's financial sector to aggressively seek new borrowers.
- The observed increase in the performance of the private banking sector in Kazakhstan due to continuing sectoral consolidation, the introduction of international accounting standards and deposit insurance, increased foreign investment, liquidity, and improved corporate governance. These features have dramatically increased savers' confidence in the financial sector, further increasing the supply of loanable funds.
- The introduction of government stimuli programs for small business and the increase availability of funding from international financial institutions.

In light of the broad economic growth underway, these features suggest that financial sector growth and hence credit bureau demand may be dramatic in the medium term. From the sheer standpoint of establishing a minimum level, Kazakhstan is already well above the threshold. For 2001, the demand for Credit Bureau services (number of applications) is estimated to be, at a minimum, 195,000, and possibly up to 286,000.

Indeed, given the broad level of demand for credit bureau services (including for several uses not detailed here), a level of approximately 200,000 profiles ordered at USD 1.50 per profile over a three year period would be sufficient to cover a large percentage of total operating expenses over the same period, assuming a state-of-the art credit bureau, and excluding any grant support for some start-up expenses.[11] Assuming instead a fee structure of USD 2.00 for regular credit reports and USD 3.00 for real estate and auto lien searches, and assuming demand and penetration as described in footnote 16 and above, the net present value of revenue for this period would be USD 2.478 million. Given reduced needs for technical assistance, marketing, and capital expenditures thereafter, as well as continued further demand growth and penetration, credit bureau services should be extremely *socially* profitable from the fifth year on – especially as the estimates exclude income from other products that a credit bureau would offer such as fraud detection for insurance companies, simple identification confirmation and batch request services. Whether a credit bureau is *privately* profitable will depend on its tax liabilities, the security of its database and physical assets, and of course the number of entrants into the market. The market may well support two or three private credit bureaus in the next few years, and the emergence of competition will raise total fixed costs incurred, lower each bureau's revenues and profits, lower total profits – and also lower credit report prices faced by consumers and commercial entities.

Kazakhstan has a huge unrealized potential for developing a solid and stable small business sector. Entrepreneurship is in its infancy. In contrast to highly developed countries, where small business employ 50% – 70% of the economically active population, Kazakhstan's small businesses officially employ less than 8% of the economically active population. There is no way to accurately capture this potential upside for the purposes of this study. Nor do we attempt to estimate application rates for Credit Bureau services outside the banking sector. Telecommunication, utility and insurance companies as well as merchants and the mortgage market are experiencing growth in line with overall economic development within the country. These sources of demand will all add to the total.

Endnotes

While a Credit Bureau's client base generally does extend beyond banks, including commercial enterprises utilities, and insurance and communications companies; it is also difficult to estimate these demands in a non-arbitrary manner. We therefore did not attempt to measure the level of applications from these sources, thereby deliberately biasing downward our estimates of potential Credit Bureau usage and market penetration levels.

The Credit Registrar has mainly functioned as a negative database although contains credit history and client demographic information. Decree No. 331 of December 31, 1999 "On Approval of Rules Concerning Credit Registry Maintenance" sets out the objectives and purpose of the Credit Registrar.

No effort was made to access confidential information, nor was it necessary for the purposes of this study. Aggregate figures and non-personal information was sufficient. We are grateful to Mr. Zhanat Bastanovich Kurmanov, former Deputy of Head of Department of Banking and Insurance Supervision and Ms. L. I. Varlamova, former Chief Economist of the Department of

Banking and Insurance Supervision, for information and valuable comments on earlier drafts of this paper.

[4] This study also relied on data gathered from the following sources: a) the Statistical Agency of the ROK, b) formalized questionnaires sent to the banking community, c) multiple face-to-face interviews with banking officials in Kazakhstan, d) various issues of the *Statistical Bulletin of The National Bank of Kazakhstan*, e) international publications and reports, and f) information generally available about SME and micro-financing activities.

[5] See Paul Milgrom and John Roberts, *Economics, Organization and Management*. (Upper Saddle River, NJ: Prentice-Hall, 1992); Avinash Dixit and Barry Nalebuff, *Thinking Strategically.* (New York: Norton, 1991).

[6] Because there is no single agreed upon definition for medium sized business in the Republic of Kazakhstan, the bank responses to the questionnaire may not have been entirely consistent. Moreover, the definition of a small enterprise in Kazakhstan (<50 workers), is different from what is generally accepted internationally (<100 workers). The law also defines "small entrepreneurs" and small businesses differently. The Credit Registry's (and the banks') "loan classifying codes" do not take these differences into account. Furthermore, the Statistical Agency of the Republic of Kazakhstan defines medium-size enterprises as those with at least 100 workers but not more than 250. As a result of these definitional differences, Table 10 presents data from different sources; below we attempt to reconcile some of the difference and explain their significance.

[7] Unfortunately, official statistics do not break down profitable companies by size. For this reason, data regarding the number of profitable medium and large businesses are tentative. The main source of information is taken from analytical supplements of Goskomstat's *Statistical Digests*.

[8] International Financial Corporation. 2000. *Financing Domestic Private Enterprises: China's Emerging Private Enterprises*. Washington, DC: IDC, p.47.

[9] Tables 17-19 cite the results of small business polls. See Zh. A. Kulekeev, Ed. 1999. «Small Businesses in Kazakhstan, 1996-1998.» *Statistical Review of the Republic of Kazakhstan Statistics Agency*. Almaty: Goskomstat, pp: 35-51.

[10] For detailed projections, see Javier Piedra, "A credit bureau business plan for the Republic of Kazakhstan" (Almaty: Pragma Corporation for USAID/CAR and the National Bank of Kazakhstan, July 2002). He assumes gradual growth in demand for credit profiles, with market penetration (proportion of transactions involving a credit bureau report) by the fourth year of operation ranging from 42% to 56% for bank loans to individuals and issuance of credit cards, and penetration of 14% to 18% for bank commercial loans, insurance applications, and real estate and automobile lien searches. Under this scenario, and assuming a 10% real discount rate, the net present value of fixed costs for the first four years of operation (USD 653 thousand), technical assistance (USD 494 thousand) and operating, and variable costs (USD 1172 thousand) sum to USD 2.319 million.

The Significance of Small Firms for the Kazakhstan Economy

Azhar B. BAISAKALOVA*

Abstract

This paper provides an analysis of some of the problems related to the establishment of a favorable environment for the development and growth of the small business sector in Kazakhstan. First, the problems in the small business sector are identified, then the results of the pilot study of the small firms located in the city of Almaty be described. The results from a survey on the main determinants of a small firm's survival and growth show some characteristics that are inherent to countries in transition.

Introduction

The small business sector is recognized worldwide as an important sector for economic growth and social and political stability for states that are in the process of transition to a market economy. A market economy implies the emergence of entrepreneurs with appropriate knowledge, skills, capital and who are eager to establish or to develop their businesses. In an independent Kazakhstan the first wave of entrepreneurs were involved mainly in trade. They purchased goods abroad (mainly, in Turkey, Russia, China, Pakistan, Arab countries and Germany, etc.) and sold them in Kazakhstan. Successful entrepreneurs opened shops and supermarkets, or invested their money in services, established hotels, restaurants and cafes, barbershops, beauty saloons and other establishments to provide services to the population. However, only a few of them are engaged in industry or in the agricultural sector of the economy. These sectors require not only special knowledge and skills but also competencies in economics and law. Moreover, they also need start-up capital (seed capital).

The formation and the development of the small business sector is declared to be one of priorities for economic reform in Kazakhstan. Therefore, the small business sector should be the focus of all stakeholders: entrepreneurs and managers, public policy makers and academics in our country. Government policy should be directed at eliminating barriers to entry, lowering transaction costs and minimizing monopoly profits by large firms.

Any attempt to examine the small business sector in Kazakhstan as well as in other post-socialist countries in Central Asia is hindered by a lack of systematic information on its size and structure. The data on small business status in Kazakhstan presented in different sources are inconsistent and fragmentary, especially related to different oblasts (administrative regions) of the vast territory of Kazakhstan. The task of the official statistical agencies was to monitor the performance of state enterprises in a stable planned economy. However, today

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they have difficulties in collecting accurate information on development of the private sector. Since 1991 the criteria for defining small enterprises and their legal and organizational forms as well as accounting and reporting systems have been changed several times. In Kazakhstan small enterprises are currently defined as those with less than 50 employees.

Small business environment in Kazakhstan

During the 1990s in most developed countries large firms that existed in mature industries have adapted, downsized, restructured, and reinvented themselves. They have become leaner, meaner and more entrepreneurial; their sales and profits have increased sharply (Acs et al., 1997). Similar processes though under different political and social and economic conditions could have been observed in developing and transition economies.

The small entrepreneurship development in transition economies is of high economic, political and social significance. It facilitates the formation of a competitive market environment that provides goods and services, flexibly responds to changes in demand and supply and introduces risky projects and innovations. It leads to the formation of a middle class ensuring stability in society. It also creates jobs and improves standards of living. In order to assess the role of our Government with the development of small entrepreneurs it is necessary to add such statistical public performance indicators as public support efficiency in the job creation; small enterprise tax payments, and budget allocation to support small entrepreneurship (Madiev et al., 2001).

The Laws, Resolutions and Decrees of the President of the Republic of Kazakhstan adopted since 1997 and the Government facilitated the development of small businesses in domestic market to some extent. During the period 1998-1999 the Kazakhstan Government programs of small privatization and privatization of the agricultural and industrial complex were implemented creating a basis for the development of a small and medium-scale business sector as well as a market economy in the country. During the period 1998-2000 the RK (Republic of Kazakhstan) Government had been working on implementing the Strategy for the Development of Kazakhstan. The Strategy envisaged the co-ordination of activities undertaken by national, public and donor entities; the establishment of an efficient system of crediting; the development of infrastructure for small businesses by extension of the network of small business centers, business-incubators, training and consulting, and leasing; compiling databanks specializing in small business servicing. During the period 1999-2000 the State Program for the Development and Support to Small Business in the Republic of Kazakhstan was implemented.

Central and local executive bodies have carried out a strict approach to ensuring the employment of local employees, when contracts and agreements are being concluded with foreign investors; quotas on import of foreign manpower have also been defined. During the last two years public works have been developed. Unemployed persons were involved with the census and military registration and enlistment offices, in city improvements and ecological cleansing of cities and towns and in the preparation of budget organizations for winter periods. Some

of them were engaged in seasonal agricultural and civil engineering work, in taking care of sick and old people, guarding of objects and loading and unloading works.

In order to improve public policy for providing support to entrepreneurs and with the development of small business undertakings, the Government of the Republic of Kazakhstan adopted a number of resolutions regulating the work of public inspection agencies.

The best practices in the small business development emphasize the supporting activities of all stakeholders, such as local governments, chambers of commerce, business associations, business incubators, entrepreneurs associations, colleges and universities, and networks of firms. Some of these features are being introduced in Kazakhstan as well. The Small Business Department in the Almaty Akimat acts as a coordinator of initiatives towards supporting and developing the small business sector. It also serves as a center for sharing experiences and knowledge for other cities and towns of Kazakhstan.

Small firms face the following difficulties: limited budgetary funds that do not allow the realization of the large-scale financial support for small businesses, the lack of access to credits, difficulties in obtaining start-up capital, and rigid bank demands and procedures.

The cluster of serious obstacles that hinder the development of the small business sector include the frequent changing of government regulations and red tape, the lack of efficient cooperation between public agencies, frequent interference and control on the part of public agencies, and the poor tax policy.

Other difficulties for the small business sector relate to the unstable general economic situation; unreliability of suppliers; unreliability of business partners; difficulties in acquiring raw materials and selling finished goods; the lack of sub-contracting by some of the large enterprises to small firms.

Although the formation and development of small businesses is one of the priorities of economic reforms that are taking place in the Republic of Kazakhstan the small business sector has not become an important sector in the Kazakhstan economy. Therefore, the small business sector deserves a more detailed and thorough investigation in order to obtain a comprehensive and consistent picture of its status today; to monitor the processes in the small business sector on a regular basis using methodologies appropriate for each region of the country; and to make recommendations for stimulating growth in this sector.

Empirical Studies

According to the US SBA Office of Advocacy (2001), small businesses generate most of new business entry and firm growth: small firms constituted about 75 percent of the employment growth and 90 percent of the growth in the 1990s. As Hart (2000) views small firms show faster growth than large ones, the author emphasizes the impact of numerous measures undertaken by western governments to support the growth of small firms. Small firms learn about their efficiency and cost levels over time – entering the market at less than minimum efficient scale and over time growing to reach it (Jovanovic, 1982). Young, successful firms grow rapidly and young, unsuccessful firms are likely to exit. Small firms stimulate the reallocation of resources from the state sector to the private sector (Kolodko, 2000).

Analysis of the size-growth relationship is usually used in the study of the evolution of market structure. The empirical evidence showed that the firm size distribution is lognormal (Ijiri and Simon, 1977), which complies with Gibrat's Law. Gibrat's Law states that growth rates are invariant to firm size. A mathematical and economic model (Kantarbayeva, 2000) confirmed empirical results about the asymmetric firm size distribution (Ijiri & Simon, 1977).

Recent evidence based on more complete data sets shows that Gibrat's Law is violated: within each age category the smaller firms grow more than proportionally with respect to larger ones (Lotti & Santarelli, 2001). In markets with negligible scale economies, firms are more likely to survive; but where scale economies are important, firms have higher probability to fail (Audretsch, 1999): the empirical evidence on survival and growth and on wages and firm size suggests that not only some of small and suboptimal firms become large and optimal over time, but some firms with initial low productivity and wage become high productive and pay high wages.

There is strong evidence on the relationship between economic growth and creative destruction, though creative destruction can not be considered a cause of economic growth (Reynolds, 1999). Klomp and Thurik (1999) analyze the effects of firm size and age on the creation and destruction of jobs and investigate whether any positive relation between net job creation and small firms is the result of differences in firm age. From the comparison of job flow rates for different size and age classes they show that gross job reallocation rates are highest for the smallest youngest firms; however, small firms do not outperform large firms with respect to net job creation.

Kangasharju (2001) finds that, as a whole, large firms create more jobs than do smaller firms. After controlling for observed and unobserved covariates, the regression analysis suggests that the growth rate of employment for individual small firms is higher than that for large ones. He concludes that the associate effect of size on the growth rate of individual large firms is negative, providing that other growth factors are controlled for.

Empirical studies of the likelihood of survival had shown that it was positively related to firm size and age (Mansfield, 1962; Hall, 1987; Dunne et al., 1989). Soete (1979) showed that the innovative activity positively correlated with the firm size in compliance with the Schumpeterian theory.

In many transition economies the small business sector has not contributed much in job creation and economy growth (Acs & Audretsch, 1993). The explanation of these is linked to existing institutional barriers, internal organizational and resource barriers, external market barriers, financial barriers and social barriers, which persist in the transition economies (Hanley,

2000; Broadman, 2000). Pissarides, Singer and Svejnar (2000) conducted the study of such barriers' impact on the firms' growth. Public-private partnership, user-oriented and participative approach on the part of local authorities are needed to underpin a sustainable and responsive institutional support structure (Bateman, 2000; Bukvic et al., 2000).

An empirical research (Bartlett & Bukvic, 2001) designed to shed some light on the main types of barriers, which continue to hinder transition and development, discovered the following as the most serious barriers: financial barriers, high level of bureaucracy, requirement for too many licenses, tax issues including social security payments and profits taxes.

Esentugulov et al. (2000) conducted a survey of small business sector in Kazakhstan in the year 2000. According to their data analysis, the age of 75.8 percent of small enterprises is between one and four years. There are two main reasons for this phenomenon. The first is related to an attempt to evade different kinds of fees and penalties as a result of numerous inspections by different state agencies, which sometimes abuse power. The second is connected with the change in a firm's competitiveness. In the year 2000 the main competitors for small enterprises were local small enterprises (52 percent), large private enterprises (21 percent), foreign companies (18 percent) and public enterprises (nine percent).

The proportion of firms with less than ten people declined from 66.3 percent in 1997 to 39.5 percent in 2000 and the proportion of firms of 21-50 employees' size was steadily increasing from 14.6 in 1997 to 29.1 in 2000. The average size of the small enterprise in 2000 was 18. Kazakhtan's labor force in small enterprises is still highly educated: 38 percent of employees have higher education, 28 percent – high vocational training and 34 percent finished high school (Esentugelov et al., 2000).

An evaluation of the relative importance of different factors in the small business sector is essential for understanding the future role of small firms in transition economies. Small firms in the economy of the countries show an increase in terms of their number, jobs created and value added. According to an evolutionary theory small firms should be considered as agents of change contributing to economic growth in countries. Governments are to implement policies encouraging the entry of new firms, support their survival, and promote their growth. This requires a clear vision of and understanding the main determinants of the firm's survival and growth.

Methodology

This study in accordance with the majority of similar transition studies, covers not only an analysis of the current status of the small business sector but also the changes in the sector that indicate adjustments to the changing business environment in Kazakhstan. The empirical data are based upon two main sources: questionnaires and interviews. Respondents are representatives of small firms including members of business associations or attendees at conferences convened by the Small Business Department of the Almaty Akimat (City Government).

As a result of a lack of systematic information at different levels as a consequence there are no reliable databases. Officially registered enterprises include non-active companies that do not indicate the existence of a parallel economy. Meeting the requirements of scientific sampling is an extremely challenging task in Kazakhstan as well as in nearly all the former post-socialist countries in Central Asia. In addition, managers and employees in post-socialist organizations are not all used to working with people from academia. Even managers, who respond, do not always precisely answer all of the questions that are in the questionnaire.

The target population for this study includes firms with no more than 50 employees in the city of Almaty. Almaty is the largest city in Kazakhstan and has most of the characteristics that are inherent to small business sector in Kazakhstan. Questionnaires were sent to small firm owners, managers, and employees and were collected after completion. Questionnaires were also distributed amongst members of the business associations and attendees at conferences held by the Almaty Akimat Small Business Department, where some of the personal interviews with small firm owners and managers had been conducted. Cross-checking the data from a number of published sources and national statistic registers has been used in order to complete a "triangulation".

The sample data includes: the number of firms, proportion, size and age distribution by sectors; on the respondents' status pattern; the needs of the labor market; personal views on the firm's prospects and the propensity of small firms to innovate. The different types of existing barriers and their rating by the respondents are scored in the 1 - 5 scale: from 1 for "creating huge problems" to 5 – "no problems". The respondents' rating of the different ways of the problem resolution is scored in the 1 - 7 scale: from 1 - meaning the most efficient way to settle problems, to 7 – representing the place of application of the last resort. The hypotheses on the relations between different variables are tested. The significance of the results is reported. The impacts of different variables on a firm's growth and survival are analyzed.

Pilot Study

The pilot study data contains information concerning business activities, respondents' status, firm employment size and age, firm competitiveness, firm development prospects, educational level of employees, annual revenue, annual output, propensity to innovate, barriers to business growth and the development and relationship with public inspection bodies. The sample size is 138. Response rate is 45 percent. Some data covers the period between 1999-2001.

The major sub-sectors of the small business activities include trade, industry, services, health care, education, and construction.

The size of firms has five classifications based upon the number of employees: 1-4; 5-10; 11-20; 21-30; and 31-50. The age of the firms is divided into five classifications: less than one year; 1-2 years; 3-4 years; 5-6 years and more than six years.

Each variable used in the model had some missing data, but the missing information was randomly distributed across all variables.

Our sample sizes were different for different research questions depending on the missing data. A check for bias in the final sample in each case was undertaken: firms included versus those that were not included in our final model were no different in terms of age, number of employees, or growth indicators.

Results

The results on the division by sectors and the proportion of employees in small firms by sectors comply fairly well with the official data. In spite of the different status of the respondents varying from rank-and-file employees (38 percent) to enterprise owners (16 percent) the quality of the sample data are rather good.

Most of the small firms are involved in trade, services and industry. In the year 2001 the mean number of employees in a small firm was 16.

According to the theories discussed above the age and size of firms are very important variables in the study of the firm growth. They are highly correlated so that the youngest firms tend to be the smallest (Kangasharju, 2001).

The firm employment size distribution is skewed to the right in agreement with the observations reported in the literature. An analysis of the size-growth relationship is usually used in the study of the evolution of the market structure.

The age distribution of small firms is also skewed to the right as a result of the three phenomena in our country. The first is related to attempts to evade different kinds of payments – fees, penalties and taxes. The second is connected with the change in a firm's competitiveness, ultimately leading to its failure. The third reflects the firm's growth and its transfer to the group of medium-sized or large enterprises.
The highest proportion of firms are one to two years old (about 30 percent); the second highest - from five to six years (about 25 percent) followed by the firms - from three to four years more (less than 20 percent). The proportion of firms in the age group "less than one year" is close to 15 percent and "6+" - less than 10 percent.

In spite of the high educational level of the labor force small enterprises need qualified specialists in management, marketing as well as in engineering. There is no consistent analysis of the labor market in the small business sector of the country. Among the main determinants of a new firm's survival, relevant expert consultancy, easy access to information, managerial competence, and sufficient marketing knowledge should be provided. In order to make small enterprises competitive information and consulting services should be provided at relatively low prices. Small enterprises need information on price changes, innovations, competitors, and legislation in the small business sector.

The survey discovered the needs of small firms: in staff training, qualification improvement, retraining and consulting services primarily in such relatively new fields for the countries in transition as marketing, management, accountancy and law. The probability of survival and growth of small enterprises is also dependent upon the skills and arts of managers and owners to cope with the legal environment, tax police and other public agencies.

The sample data indicates that the higher level of innovation is inherent to small firms in the age group from one to two years. The higher the propensity of the firm to innovate the higher the likelihood of its survival and growth.

Most of the respondents are optimistic about the future prospects of their firms prospects for growth. This reflects that the economic environment in the country is improving. The concerted efforts among the President the Republic of Kazakhstan, the Government of and local governments enabling the development of the small business sector has brought fruitful results.

However, our entrepreneurs still face different types of barriers and 17 types of barriers were listed. The most serious ones rated by the respondents as "creating huge problems' or "significant difficulties" include: customs, ISO (International Organization for Standardization) product certification and tender issues. These problems are caused by the lack of transparency, lack of loyalty and corruption on the part of responsible officials. It should be noted that recently these issues have been subject to discussions in local mass media and amongst the central and public agencies.

Although there are positive movements towards becoming a legal state it is interesting to note that when entrepreneurs and businessmen encounter such barriers they do not apply to courts or arbitrage in the first place. When our entrepreneurs and businessmen have problems with different state agencies, they rely, first of all, upon their influential friends' for assistance.

Summary

A model explaining firm growth is used based upon the standard approach in the literature, namely the firm size - growth relationship and the firm size – age - growth relationship. The impacts of different variables on a firm's growth and survival are also analyzed.

1. The first hypothesis stating that the average establishment size and change in employment is positively correlated is tested using ordinary least squares regression analysis. A model explaining firm growth is used based upon the standard approach, namely the firm size - growth relationship and the firm size – age - growth relationship (Ijiri & Simon, 1977; Bartlett & Bukvic, 2001; Jovanovic, 1982).

First the growth - size, and growth - size - age relationships are estimated for the sample. This basic model was supplemented with the barriers to growth reported by the respondents. It is

expected that serious barriers would reduce a firms' predicted growth rates from the basic benchmark model estimated in the first stage.

The firm growth variable was considered as a dependent variable and the firm size, age, barriers, innovativeness – as independent variables. The firm growth is defined as the difference between the number of employees in the year 2001 and in 1999.

The empirical results indicate that the growth-size model fits the data well: there is a positive relationship between growth and size of firm. The regression coefficient on size is significant at the 5 % level.

The simple linear regression analysis indicates no significant influence of the age on the firm growth in the sample.

An analysis of the effects of firm size and firm age simultaneously indicate that an introduction of the age variable does not significantly contribute to the explanation of the firms' growth.

2. The second hypothesis is about whether the various types of barriers have a real impact on the growth of firms (Bukvic et al., 2000; Bartlett & Bukvic, 2001). In alternative specifications, the effects of the different types of barriers are also explored. These variables did not yield any consistent parameter estimates and are dropped from the analysis.

3. The likelihood of firm survival depends among other variables on the propensity of the firm to innovate (Brock & Evans, 1986). The obtained relationship is significant at the 5 % level. The proportion of innovative firms in each age group is the highest for the firms existing between 3-4 years.

4. Size influences innovative activity at the firm level (Schumpeter, 1975): chi square tests were used to test the significance of the differences in the proportion of firms in each size group reporting innovation, i.e., whether or not the firm introduced either a product or process innovation in 1999-2001. In all cases, these differences were significant at the 5 % level.

5. The chi-square test has been used to examine whether there is a relationship between the firm size and the firm age (Lotti & Santarelli, 2001). The obtained result is highly significant with the p-value less than 0.001, meaning that there is a relationship between the two variables. Testing the difference between the two proportions provides sufficient evidence to conclude that the relative proportion of the smallest firms decreases with increasing firm age.

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The benefits of international portfolio diversification into developing countries: Kazakhstan case study

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Abstract

The main focus of the paper is to investigate the impact of financial developments in Kazakhstan on the characteristics of internationally diversified investment portfolios. The purpose is to show the attractiveness of the developing financial market as a result of changes toward a market economy. This is an descriptive study on diversification of portfolio investment including the developing markets in Kazakhstan.

Introduction

The move towards a market economy in many of the former Communist countries and increased globalization of international trade and investments create new opportunities for market participants, in terms of a wider range of financial instruments emerging and increased opportunities for international portfolio diversification. With the formation of the North American Free Trade Agreement (NAFTA), MERCOSUR, Single European Market (EU) and the Association of South East Asian Nations (ASEAN), there appears a real chance for international diversification of capital investments. New horizons for portfolio diversification are also opening in the Former Soviet Union countries. However, the recent world financial crises has revealed the necessity for using more comprehensive and sophisticated tools and techniques that will result in risk reduction and control. Only some of them are available for individual investors, due to their complexity or other features. Options, futures, forwards, and swaps are derivative instruments, used to hedge currency and interest rate risk, fluctuations in prices, and can be used by individual as well as by institutional investors[1]. By inclusion of these assets in the portfolio, investors can avoid some risk. There are different portfolio management strategies that can help to minimize risks, associated with investments in different securities. These strategies, developed by inclusion of asset or several assets in the portfolio, should be managed by professionals. The other way to decrease risk is to invest money into stocks of multinational corporations. This is the way to diversify your investments, though you do not have power to direct them. Among all investment instruments available in the modern finance theory, diversification[2] is still considered to be crucial (Gradmont & Soenen, 2001), (Harvey, 1995), (Poon & Lin, 2000).

Kazakhstan: A real case for international diversification

The capital markets of some developing countries are approaching the level, at which their securities would become interesting to international investors. Kazakhstan can be considered an attractive market for international investments. According to the World Bank classification[3] Kazakhstan belongs to the group of lower-middle-income economies[4]. These type of economies (along with upper-middle-income economies) are sometimes referred to as developing economies[5]. The economy situation in Kazakhstan can be characterized as steadily developing as it is supported by a stable political environment and the reaffirmation of the country's credit rating. As of May 2002 the following credit ratings were assigned to the country:

Rating type	Kazakhstan		
	Moody's Investors Service, Inc	Standard & Poor's	Fitch IBCA (FIBCA)
Long-term debt	**Ba2/Ba3**	**BB+**	**BB**[6]
Short-term debt		**B**	**B**
Eurobonds	**Ba2**	**BB**	**BB**

Source: www.moodys.com, www.standardandpoors.com, www.fitchratings.com

Current credit ratings granted to Kazakhstan reflect improvement of external liquidity, lowering of external debt, pronounced budget and monetary policy. Though, rating agencies point out negative aspects of the current situation, that slow down the development of the ratings, such as high centralization of decision making, slow democratic processes, institutional and legislative imperfections and weak economic structure.

Recent studies (Longin & Solnik, 1995), (Solnik, 1974, July/August), (Odier, Solnik, & Zucchinetti, 1995), (Harvey, 1995), (Solnik, Boucrelle and Le Fur, 1996), show low correlation of returns across developing markets, and also low correlation of developing with developed countries. So, this makes developing markets a good source for portfolio risk reduction, although the unstable nature of international equity returns correlation (Longin & Solnik, 1995) should be taken into account. The correlation of returns between countries depends on the varying levels of integration in their economies. The Kazakhstan economy has strong ties with some of the former Soviet Union countries, although Kazakhstan managed to avoid the adverse effects of the Asian and Russian crises (1998). The financial crisis in Russia was largely caused by the weakness of its capital markets and banking system. In comparison, Kazakhstan managed to lessen the effect of these shocks owing to the lack of a developed capital market, a well-functioning banking system, low level of involvement with the Asian and Russian financial markets, and partially as a result of strong protective mechanisms against adverse financial shocks developed by the National Bank of Kazakhstan and small compared to GDP foreign debt and equity involvement.

Serra (1999) concludes that there is only weak evidence that cross - country correlation has increased during the last fifteen years. Recent studies (Soenen and Johnson, 2000) discovered

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that increased import share, greater differential in inflation rates, real interest rates, and gross domestic product growth rate have negative effects on stock market co - movements. On the other hand, higher export share and greater foreign investment increase this co - movement. Applying these findings to Kazakhstan one can anticipate an increasing correlation of returns between Kazakhstan and some developed countries (e.g., Germany and the USA). This trend is triggered by the growth of foreign investments, increased export share (Germany 5.9 percent in 1999 in comparison to 6.2 percent in 2000, as a total of Kazakhstani exports), and decreased import share (US from 9.5 to 5.5 percent, Germany from 7.8 to 6.6 percent, and UK from 6.3 to 4.3 percent in 1999 and 2000 respectively)[7].

The Kazakhstan economic policy can be characterized by a strict monetary and fiscal policy. The promotion of an import substitution policy has improved the trade balance, i.e., exports increased from 28 percent in 1998 to 48 percent in 2000 of GDP. The main source of export revenues is the sale of natural resources (more than 50% of total export). Oil and natural gas reserves will be able to support economic growth for several decades as a result of current level of production being doubled. Proven oil reserves are 9 billion barrels, while according to recent seismic surveys the reserves could be as high 95 billion barrels. Conservative estimates of gas reserves are several trillion cubic meters.

Main import items are equipment, machine, transport, devices (more than 40% of total import), mineral products (13%), chemical, plastic, rubber (about 15%). Improvement in the trade balance from 1998 to 2000 was mainly attributed to the growth in volume of export by 63%, while import almost stayed at the same level.

The limited availability of export transportation routes is a major limitation on oil and gas exports. The Caspian Pipeline Consortium (CPC) has been completed and filled with oil and has an initial capacity of 28.2 million tons per year rising to 67 million tons per year (EIU, 2001, July). Other routes are under consideration but are complicated due to economic and/or political issues. The Turkish government does not want additional oil through the Bosphorus and Dardanelles Straits. Instead, it is promoting the Baku-Ceyhan pipeline: from Azerbaijani capital, Baku, via Georgia to the Turkish Mediterranean oil terminal of Ceyhan. The future Kazakhstan growth of exports largely depends on the development of various transportation routes, but for the nearest future it is secured having one transportation route. CPC is expected to double the existing oil export capacity by the end of 2001 or early 2002. The other benefit that can be derived from CPC is an opportunity to cut production cost by approximately $3 per barrel.[8] In addition to the oil and gas resources Kazakstan has large resources such as different metals, and as a result has become one of the leading producers of lead, zinc, and copper and also coal. Finally, the overall economic stability and trust granted by the world financial organizations largely depend on the ability of Kazakstan to meet its debt obligations. A key factor is export earnings because of the manner in which the debt burden was structured, the repayment of debt is scheduled to match the revenue from oil exports. As a result the Kazakstan economy is very sensitive any fluctuation in the world commodity prices, and oil and gas prices in particular. Considering this fact, Kazakhstani policy makers are trying to overcome this vulnerability by following a tight monetary and fiscal policy.

Serra (1999) shows that only national factors (specific to each particular country) cause a low correlation of developing countries with each other while industry and stock specific factors do not matter. Early researchers have tried to investigate the nature of low cross - country returns but the discussion is still under way. Some studies (Roll, 1992) reveal that the low correlations between countries are the result of different industry structures in each country represented by the different industrial composition of their stock market indices. On the other hand Heston and Rouwenhorst (1994) claim that industry factors play a minor role. They explain the difference in the cross - country returns as a result of local monetary and fiscal policies, and deviation in institutional, legal regimes, and regional shocks. Gradmont and Soenen (2001) performed a bi - level asset allocation strategy in evaluating the potential from investment into Central European equity markets. The first step of the allocation process employs diversification into established markets, developing markets, and into markets that comprise mixed portfolios. The second step utilizes international portfolio optimization across industries. Results show significant risk reduction at two levels, though they are dependent on the industry and risk/return preferences.

Taking into account the features of the Kazakhstani economy e.g., metals industry focused, dependence on world commodities' prices, export orientation with low-value added products (natural resources), one can expect comparatively low correlation of returns between Kazakhstan and industrialized countries.

Studies (Patel & Sankar, 1998) have revealed that, according to the risk/return profile, developing markets are more volatile compared to the developed markets. The other findings worth mentioning are the non - symmetric return distribution[9] for developing countries with the high probability of a shock; which makes the common measure of volatility, standard deviation useless, since it assumes that outcomes are distributed symmetrically towards the mean. Financial crises in emerging markets tend to continue longer than in developed markets, and they infect all closely located emerging markets (Patel & Sarkar, 1998). The explanation for these findings can be the contagious nature of financial crises that links even independent economies and erasing difference in returns between countries. The other arguments to support this finding are underdeveloped institutional structure of emerging markets, weak financial systems and backward economic protection policies. In addition, in comparison to developed markets returns in local stock market positively correlated to the local currency value, which can aggravate the situation in times of financial crises. It means that foreign investors will suffer more from currency risk, and will be forced to withdraw investments in emerging markets in order to save the capital investment.

In April 1999, the Kazakhstani local currency (tenge) was allowed to float. This resulted in immediate devaluation of the currency by approximately 30% (during the first week), followed by a strengthening of the tenge during the following months to the level of approximately 10% per annum. Floating of the exchange rate was an appropriate policy for the further development of the Kazakhstani economy. The new exchange rate philosophy decreased but did not eliminate the need for Central Bank interventions. As a result this placed less stress on the country's foreign currency reserves.

In contrast to developed countries emerging markets have a less a diversified economic structure, since they rely on a few export-oriented industries, and to a large extent depend on imports. This can be attributed to the Kazakhstan economy which is focused as it is on the metal industry.

In studies by Poon and Lin (2000) on the Asian crisis, they found a positive relationship between correlation of returns and volatility and a negative relationship between correlation of returns and returns themselves. It means that in time of stock market downturns, both correlation and volatility are likely to increase erasing some of the benefits of international diversification (Harvey 1995). In this study researchers used the tail index based on the Extreme Value Theory to analyze the distribution of extreme returns particularly those that are included in the left tail. This approach corresponds with the recent trend in the finance industry in emphasizing the value-at-risk approach for risk management. Recently, other researchers such as Koedijk, Shafgans and de Vries (1990), Koedijk, Stork and de Vries (1992) and Longin (1996) used the Extreme Value Theory to study extraordinary events and the "tail index" to model the distribution of extreme returns.

Another peculiarity of developing markets is that their returns are more predictable by nature, compared to the developed countries (Harvey, 1995). Harvey also found, that returns in developing countries are more influenced by local information than in developed markets. The local information set being tested includes the lagged country US dollar returns, the change in the foreign exchange rate versus the US dollar, the dividend yield and a local short-term interest rate. This could be explained by the independence of developing markets from the rest of the world since global information does not drive returns in emerging markets. Therefore it means that the majority of investors perceive emerging markets as "closed markets", where everything is dependent on local activities and changes. Harvey (1995) used a conditional asset pricing model where the expected returns are the function of global and local information variables, while the world risk premium depends only on global information, and the conditional risk is a function of both global and local information. Using different sample and different local information variables, other than Harvey (1995), Ferson and Harvey (1993) report that for developed markets local information is important only for 6 out of 18 countries included in their research.

The existence of a stable political environment and favorable macroeconomic conditions are key factors in development of civilized financial markets. Researchers prove that a high return will not be considered attractive by foreign investors unless all market conditions are satisfactory. Hill (2000) claims that the main concern for investors in the developing markets is the possibility of the value of their investments to "be adversely affected by sovereign actions[10] or macroeconomic conditions[11]." This concern occurs because of the limited number of domestic companies willing and able to raise funds through foreign markets, or by attracting foreign investors, which makes developing markets less liquid and deep. This implied inefficiency in the market infrastructure is emphasized by the absence of incentives for local companies to enhance the quality of their offered financial products. The real world imperfections in these markets restrict investors' ability to enjoy costless or at least cheap gain from the diversification. At least four factors have been suggested to cause this difficulty: information cost[12], regulatory cost[13], agency costs[14], and excess claimant costs[15]. Lack of information disclosure does not add value to the emerging markets investment. Reliable information about companies' activities and perspectives is crucial for investment decision. Although, most emerging stock exchanges set disclosure requirements and audited financial statements, in order to be included in the official listing, investors are still considering information cost to be fairly high. International investors expect emerging markets to provide efficient regulatory environment, especially in the part of governing of the entry and exit of foreign investments. In addition, regulations give more favorable treatment of doing business one way but not the other. Agency cost concerns are present when the investment is made via investment funds. Investment funds managers often employ less risky strategy in order to keep their jobs. In the case of emerging markets, the "claimant" of a firms' capital can be sovereign or a government agency, whose claim sometimes may not have legitimate claims.

The Kazakhstani capital market is experiencing problems similar to those in most emerging markets: lack of transparency, limited access to information, low liquidity, high transaction cost, and inefficient regulatory environment. Financial crises in Mexico, South-East Asia, and Russia have pointed out the weaknesses of emerging financial markets.

Pension funds reform fueled the development of the Kazakhstani Capital Market. The development of private pension funds followed the introduction of state pension funds after the government defaulted on its official debt. A national private pension system was introduced in early 1998 mandating 10 percent payment from wages into different pension funds. Pension funds accumulated considerable amounts of money, which could be pooled for the portfolio investments. By the end of March 2001 net pension savings were worth Tenge 128.4 billion (4.9 percent of GDP), a 14 percent increase since the end of 2000 (EIU, 2001, July) The biggest portion of pension funds assets (61 percent of the total at the end of 2000) are held by 14 private pension funds (EIU, 2001, July). Strict requirements are set for pension funds investments: at least 40 percent of their assets should be in government securities, and no more that 40 percent in non-government securities and 10 percent in foreign securities. As a result, these requirements create imperfections in the functioning of the financial market.

Notwithstanding the emerging nature of the Kazakhstani capital market the country is proceeding with the development of a sound banking system and an efficient capital market. In comparison to other CIS countries, Kazakstan has a more developed financial infrastructure (reformed banking system, a new Tax Code and a new draft Customs Code) and stable political system that has resulted in the Kazakh capital market to become relatively attractive to foreign investors. Another positive development is the creation of a well-regulated capital market. The Kazakhstan Stock Exchange (KASE) is a non-commercial, self-regulated, closed joint-stock company. KASE was created in 1997 out of the merger of two exchanges (Kazakhstan Stock Exchange and Almaty Financial Instruments Exchange). The owners of KASE are commercial banks and investment companies. Trading and settlement procedures are designed in line with the G30[16] recommendations. The regulatory body for all securities is the Central Depository. All transactions are settled through the Central Depository, which holds accounts with all registrars.

Corporate securities traded on KASE are divided into two groups: official listing and non-listed securities. Companies, which register their securities in the official listing, have to be more transparent and require payment of a substantial fee compared to non-listed securities. Inadequate fees and transparency requirements under current economic conditions lead to considerable changes in the proportion of securities traded in the official listing and non-listing securities, in favor of non-listed. In January 1st 1999 the proportion of official to non-listing securities was 1.11, in comparison to 0.5 for December 31st 1999.

Trying to identify the risk of a country, researchers apply two methods, i.e., they identify country risk based on the local factors, or they take the position of the international investor, who purchases securities in a specific country. The most important source of risks for international investors is exchange rate risk. These model returns are calculated in investor currency through exchange rates. Harvey (1991, 1995) adopts the second view in two studies, describing developed countries in one, and, developing markets in another. Harvey (1995) argues that the global asset pricing models, which assume full integration of capital markets, are not able to explain the cross section of average returns in developing countries. He also found the influence of common risk factors on the developing markets' returns is not that significant. Therefore, there is a real need to introduce new risk factors that may interpret unexpectedly high returns in developing markets. Hence, the revised asset pricing models with new risk factors specific to these markets will succeed in predicting average returns.

Exchange rate risk

Investors face exchange risk whenever they decide to invest in a country other than their own. This risk appears only in international investments, since for foreign investors money that they use for consumption (cash outflow) and return received from investments abroad (cash inflow) differ in terms of currency. Exchange rate risk has an even bigger influence on the emerging markets, since domestic currency of these markets is fragile and usually devalued in comparison to established market currencies. Emerging markets currencies are usually subject to managed floating exercised by the Central Bank of a particular country. This means that a Central Bank reserves the right to intervene into the market place in order to adjust the exchange rate. Most of the developing countries are less diversified and to a large extent upon one source of income in terms of foreign exchange. As a result this weakens their exchange rate, and increases the volatility of the domestic currency.

Recent studies (Claessens, Dasgupta, & Glen, 1995) suggest that exchange rate changes have a strong effect on the local returns for emerging countries while they do not influence dollar returns. It has been proved (Grandmont-Gariboldi & Soenen, 2001) that hedging of this effect does not add value to international portfolios with the inclusion of established markets, emerging markets and the combination of both.

"Home bias puzzle": Theory and empirical evidence

World portfolio analysis suggests that rational investors should select securities advantageous by their characteristics in terms of risk and return trade off without making a difference between domestic and foreign stocks. However, empirical evidence reveals that domestic investors prefer to have holdings in domestic securities rather than foreign ones. "Home bias" puzzle has been recognized at least since Levy and Sarnat (1970). Nowadays, French and Poterba (1991) and Tesar and Werner (1992) have raised this issue.

Researchers frequently try to raise this issue by using models incorporating either portfolio holdings or outcomes of consumption realizations across countries. Using two models Lewis (1994) examined foreign exchange risk premium and came to the conclusion that investors prefer to hold their funds in domestic securities. The first partial equilibrium model, based on CAPM, assumes that domestic investors should make a choice on the level of investments into foreign securities according to their degree of risk aversion in addition to other variables. Applying January 1976 to February 1992 data on the US investors model suggests that at the moderate level of risk aversion investors should hold about 50 percent of their wealth in foreign securities, while empirical evidence shows figures of less than 10 percent. One of the explanations for this discrepancy can be that CAPM is not a very good description of the world. One of the first researches on the international CAPM were produced by Solnik (1974) and Stehle (1977) and thus found mixed results. Recently, Dumas and Solnik (1993) tested a conditional version of the model with returns in equities and deposits and covariances allowed varying with time. They found that exchange rate variability could explain equity returns, and that the international CAPM is not rejected by the data.

Other researches made in this area include Harvey (1991), Ferson and Harvey (1991), Campbel and Hamao (1992) who have used the CAPM as a benchmark to find the relationship between stocks in different countries. The overall conclusion on the tests of international CAPM indicates that a model based on relationships among returns especially when exchange rate risk is taken into account, has more explanatory power, in comparison to the model based on asset share data.

So, if international CAPM can be used to explain returns between domestic and foreign securities then the Home Bias puzzle should be solved by another means. Perhaps investors receive all benefits of diversification by investing domestically into equity of domestic multinational corporations? Multinational corporations can be the perfect source of risk reduction since a major part of their earnings come from abroad. Jacquillat and Solnik (1978) try to answer this question by regressing the returns of multinational corporations against the returns of stock indexes for a set of countries. They found that the coefficients of regressions for corporations and correspondent home stock indexes are close to one, which corresponds to an almost perfect correlation indicating no benefit for investors in terms of diversification.

The other source of domestic diversification is investments into different industries. Roll (1992) suggested industry-specific factors could explain international stock market indexes that are a perfect source of diversification. On the other hand, Heston and Rouwenhoerst (forthcoming) and Solnik and de Freitas (1988) showed that country-specific factors are a major source of risk. Mixed results suggest that diversifying across industries does not solve the "home bias" puzzle. The evidence for the preferences for domestic securities against foreign ones has been found not only in the USA (Lewis, 1994) but also in Japan, Germany, France and Britain (French and Poterba, 1991). Hence, is it a phenomenon of developed economies?

The second general equilibrium model used by Lewis (1994) implies that if investors have allocated their portfolios efficiently they will hold the same international portfolio whatever their country of residence. Therefore, we can conclude that in this case consumption growth rates will be equal across countries except for measurement errors and taste shocks. The author discusses possible explanations for this paradox such as the presence of non-traded goods and different market imperfections, and summarizes that these issues do not solve the problem. The conclusion drawn by the author is that both models suggest the significance of the "home bias" puzzle.

Traditionally, investors have considered only established equity markets of developed countries in their efforts for international diversification. Mull and Soenen (1997) proved that for developed countries the USA assets did not provide statistically significant increase in risk-adjusted return. Solnik (1974, May) concluded that additional benefit can be provided by diversification gains through investing abroad.

Conclusion

Recent investment flows into developing countries have increased dramatically in order to perceive financial or diversification benefit. Empirical evidence shows that developing markets have become more but not fully integrated with the world financial markets, this is a result of the underdeveloped market infrastructure and investors are trying to use even slight differences to get financial or diversification benefits. International diversification has always been a centerpiece in modern finance theory. Recent developments in emerging markets fueled interest in this topic and generated new studies exploring this new area. Empirical findings based on developing countries suggest that this markets posses some features that are precious to investors from developed countries.

However, one should not forget about "home bias puzzle" that neglects all inferences on possible gains from international diversification. Sometimes, decisions made by individuals can not be explained by theoretical models and assumptions about people's preferences.

As a result, further research is necessary. The research on international diversification is based mostly on the newly emerging markets of South - East Asia, Latin America, Central and Eastern Europe. No studies of Former Soviet Union countries have been undertaken. By observing the level of economic development of Former Soviet Union countries and the speed with which they move towards a market economy, one should be aware of the necessity of including this country in the world financial community. One of the first countries to have been

researched is Kazakhstan. Kazakhstan has a large growth potential accompanied with well-developed market infrastructure that can fuel international investors' interest as they are impatient to discover new investment opportunities.

Endnotes

[1] Though individual investors will have to pay fee to broker executing transactions, when institutional investors can do that without explicit cost (stock exchange membership cost is fixed).
[2] Investment in more than one security to enjoy the difference in return distribution.
[3] Source: www.worldbank.org/data/databytopic/class/htm
[4] Lower-middle income - $756-$2,995.
[5] Source: www.worldbank.org/data/databy topic/class/htm
[6] "BB speculative grade, indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade". Source: Fitch IBCA
[7] Source: IMF; TACIS; Kazakhstan Economic Trends; EIU
[8] Source: Duff & Phelps Credit Rating Co. «Credit Analysis: Republic of Kazakhstan», March 2000.
[9] Non-symmetric (skewed) distribution of outcomes anticipates that returns are not normally distributed around the mean, i.e., there is a skew of returns (one tail of the distribution considerably longer or drawn out relative to the other tail).
[10] Changes in legislation: tax, customs, banking, currency control, etc.
[11] Inflation, changes in interest rates, exchange rates, etc.
[12] Information costs are costs associated with obtaining and verifying information.
[13] Regulatory costs are costs imposed by the existence of regulation.
[14] Agencycosts are costs reflecting diverging incentives between agents and their principals.
[15] "Excess claimant costs" are expected costs of strategic claims made against the firm.
[16] Source: www.kase.kz

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Information disclosure and its role in determination of the cost of capital of firms: The relevance for Kazakhstan and Russian capital markets

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Abstract

The presented paper focuses on the issues related to information asymmetry and its influence on the cost of equity capital of firms. The review concludes that firms with lower information asymmetry are expected to have lower costs of equity capital. The rational is that information disclosure decreases the level of information asymmetry between the firm's managers and outside investors, thereby decreasing the level of uncertainty about the future cash flows of a firm. The decreased level of risk should be reflected in the reduced risk premium required by investors. In spite of the fact that the role of information disclosure in reducing the cost of capital of firms seems to be obvious, firms in many transition economies, including Kazakhstan and Russia are still reluctant to increase the level of their transparency. This may be explained by the existence of the factors that outweigh the benefits from the reduced cost of capital. In this context, the direction for further research is outlined in the present paper[1].

Introduction

Securities market development in many emerging markets, including Russia and Kazakhstan is one of the issues that attract the attention of policy makers and researchers. Achieving a reasonable level of the securities market development is critical both for growth of the domestic economy, and for attracting foreign investors.

The development of the emerging capital markets opens the possibilities for investors for diversification of the international portfolio's level of risk. Low correlations of emerging markets' returns with developed markets' returns suggest that securities' price changes in emerging markets are not affected by the price changes in developed markets. The shocks that may negatively affect developed markets, returns can be smoothed over by returns from investments in emerging stock markets (see, e.g. Harvey, 1995). The attractiveness of investments in emerging markets is augmented by their high returns (Claessens, 1995), which makes it possible to achieve more attractive risk return profiles, consequently shifting the international efficient frontier to more preferable levels.

The Russian stock market is the largest in terms of market capitalization among the transition economies. It dominates the securities markets of the Former Soviet Union (FSU) (91.3% of the total FSU capitalization), and accounts for about 47% of the securities markets capitalization[2,3] of the total of all these transition economies. Compared to the Russian stock market, which started to operate in 1991, Kazakhstan's stock market has a shorter history, starting in 1997. In 1999, the market capitalization of the firms, which traded at Kazakhstan Stock Exchange, was only USD 2.3 bln. Somewhat more active trading began around 2000.

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Some general points on the development of corporate securities markets in Russia and Kazakhstan

The development of the capital markets of the two countries has been shaped to a high degree by the historical and political conditions of the Former Soviet Union, in the 90s. In Russia, the primary privatization tool in the country was the distribution of vouchers to insiders of firms, which resulted in the concentration of ownership in the hands of company managers. Schleifer and Vasiliev (1996) point to the fact that high managerial ownership was necessary in order to secure political support for the privatization process. The positive effect of having majority owners is the establishment of incentives to monitor the performance of firms, which was a crucial factor at the beginning of economic restructuring. However, it is worth noting here that majority owners still do not show interest in making their firm(s) open to other potential investors.

In Kazakhstan, voucher privatization, in 1993-1995, through privatization investment funds, has not resulted in the development of organized secondary corporate securities market. Only the privatization of the largest enterprises in 1996, when some foreign investors got control shares over the original firms has laid the basis for the formation of the Kazakhstani corporate securities market. Nevertheless, the fact that having control over enterprises is critical for managing firms in Kazakhstan, has been a disincentive for companies to disclose information resulting in low market liquidity. Not until the pension funds and commercial banks turned to the large domestic investors and created opportunities for the companies to raise capital at low costs, has the liquidity of corporate securities market increased substantially.

The high ownership concentration in Russia and Kazakhstan, pointed out by Djankov (1999), results in the low information disclosure by firms as documented by Frydman, Pistor and Rapaczynsky (1996) and Kenzhgulzin, Dodonov, Saifullin and Amrinova (1998). Information disclosure induces additional costs, both direct (costs of placing securities and of preparation of information to be disclosed, audit expenses etc.) and indirect (some loss of competitive advantage due to the additionally disclosed information). Firms may benefit from the increased disclosure by decreasing the level of risk perceived by investors via the reduction of the uncertainty about their future cash flows to investors.

Low information disclosure may also be a result of the objective conditions of economic development. Competition among industries has not achieved the critical mass, when crowding out competitors becomes vital for companies. Companies ensure satisfactory returns to the owners not due to expansion of the business, but by exploiting other factors such as tax evasion, etc. Hence, the companies do not face any urgency for attracting external funds. Information disclosure, therefore, is not as crucial for firms yet.

The present paper focuses on the issues related to the influence of information disclosure on firms' cost of capital. The overview of literature presented suggests that firms do benefit from the increased transparency not only due to the improved image but also due to such material advantages as reduced cost of raised funds.

Factors that determine cost of equity capital and importance of information asymmetry

According to the fundamental single-factor Capital Asset Pricing Theory (Sharpe, 1964; Lintner, 1965), the rate of return on individual security includes the compensation for time value of money, or risk-free rate, and the premium for the risk of investment:

$$R_i = R_f + \beta(R_m - R_f) + e \qquad (1),$$

where R_i is rate of return on a security, R_f is the risk-free rate, R_m is the return on market portfolio, which consists of all stocks traded on the market and e is the error term, which represents idiosyncratic risk of the security. b represents the systematic level of risk. It shows the stock's price variability in comparison with the market portfolio and is determined as:

$$\beta = COV(R_i, R_m)/VAR(R_m) \qquad (2),$$

where $COV(R_i, R_m)$ is the covariance between the return on a stock R_i and the return on the market portfolio R_m; $VAR(R_m)$ is the variance of R_m.

By increasing the number of securities in portfolio, the idiosyncratic risk represented by e in formula (1) can be diversified. The systematic risk of a security is, then, the major factor that determines the expected rate of return on a security in the single-factor CAPM.

The traditional CAPM has been criticized for its incompleteness (e.g. Fama and MacBeth, 1973; Merton, 1987; Amihud and Mendelson, 1989) and the validity of the model has been questioned (e.g. Fama and French, 1992).

Arbitrage Pricing Model by Ross (1976) emphasizes multiple sources of systematic risk. Although the theory does not specify these risks, there were attempts to identify the factors that determine an investment's rate of return (Chen, Roll and Ross, 1986; Berry, Burmeister and McElroy, 1988 and others). The factors identified by Chen, Roll and Ross (1986) include growth rate in industrial production, inflation, spread between long-term and short-term interest rate and the spread between low-grade and high-grade bonds. Berry, Burmeister and McElroy (1988) add the growth rate in aggregate sales in the economy, and the rate of return on the S&P 500 to the list of the factors that affect the required rates of return. McKierman (2001) argues and provides the evidence from NYSE data that income uncertainty affects the investment climate and, hence, requires additional risk premium.

The above papers focus on the macroeconomic factors in identifying the factors of Arbitrage Pricing Theory. Another strand on research includes the firm-specific factors that may have impact on the rates of return. Fama and French (1992), Lakonishok, Shleifer and Vishny (1994) show that firms' growth opportunities are estimated by market and are reflected in consistent-

ly high earnings. They argue that the value premium in average returns arises because the market undervalues distressed stocks and overvalues growth stocks. Merton (1987) emphasizes the importance of firm size and availability of information about the security[4] for determining the rates of returns on securities. Amihud and Mendelson (1989) point to the importance of information asymmetry for in determining the rate of return, and show that the expected asset returns are positively related to beta and the relative bid-ask spread[5]. Relative bid-ask spread is defined as the ratio of the difference between the bid and ask prices on security to the security price, and is often used as a proxy of security's liquidity.

The model of Jacoby, Fowler and Gottesman (2000) incorporates the liquidity measures in the traditional CAPM. It demonstrates that the measure of systematic risk is affected by liquidity of securities. According to their model, expected return measured after liquidity costs of transacting a security[6] is defined as after-spread rate of returns and is determined as follows:

$$Re_{\text{after-spread}} = R_f + \beta_{\text{after-spread}} \times Rm_{\text{after-spread}} \qquad (3),$$

where $Re_{\text{after-spread}}$ is expected rate of return minus the transaction costs of trading a security, $\beta_{\text{after-spread}}$ is beta estimated taking into account the transaction costs and $Rm_{\text{asfter-spread}}$ is return on market less the transaction costs of trading the security.

Numerous studies suggest that information asymmetry is related to the liquidity of securities (Diamond and Verrecchia, 1991; Healy, Palepu and Hutton, 1995; Leuz and Verrecchia, 1999; Bloomfield and-Wilks, 2000). One of the important applications of Jacoby, Fowler and Gottesman (2000) model is that information asymmetry is shown to affect beta coefficient, the measure of systematic risk. In other words, information asymmetry has an influence on the level of systematic risk of companies, which explains why information asymmetry has an impact on the required rate of return.

The importance of information asymmetry in determination of the rate of return is well presented in the existing literature for the developed markets. Amihud and Mendelson (1986), Healy and Palepu (1993), Botosan (1997), Botosan and Plumlee (2000) document the decreased cost of equity capital resulting from the higher level of information disclosure. In the experimental studies of Bloomfield and Wilks (2000) increased information disclosure has been demonstrated as resulting in higher equity prices. Botosan (1997) studies U.S. firms characterized by a low degree of information asymmetry and show no significant influence of increased information disclosure on the cost of capital in the information-saturated environment observed in the U.S. stock market.

The above studies of the factors that affect the rates of return concentrate on developed securities markets. Still, there is a question of the applicability of the models used to describe the rate of return in the developed markets for the emerging markets. For example, according to Harvey (2000), returns in emerging markets are affected not only by systematic risk, but also by total risk measures[7], as opposed to the developed markets' returns. The studies of Harvey (1995) and Bekaert (1995) suggest that emerging and developed markets cannot be treated similarly and that the risk factors in the two types of markets differ.

The relative separation of emerging markets from developed markets suggests that non-availability of information is one of the most important causes of risk related to investments in emerging markets. Indeed, many emerging markets enjoyed a decrease in the cost of equity capital after they had liberalized their economies. Liberalization of capital markets is supposed to decrease the level of information asymmetry between the domestic and foreign investors that had been inflating the investments of foreign investors into the domestic companies before liberalization. Henry (2000) documents the abnormal returns of the emerging markets' aggregate equity prices prior to the implementation of the stock market liberalization. Errunza and Miller (2000) provide the evidence of significant decline in the cost of equity capital of the firms that obtain access to international capital markets by issuing American Depository Receipts (ADRs).[8].

In the context of the need for empirical research, the question of the measurability of the level of information disclosure arises. Since information asymmetry is not observable directly, researchers use various proxies. Botosan (1997), Botosan and Plumlee (2000), Healy and Palepu (1993) among others, use various indices of information disclosure as proxies of information asymmetry. Another strand of research notes that increase in information availability about a firm tends to lead to a convergence of opinions regarding the firm's expected future earnings. Therefore, the number of analysts following a stock and the variability of analysts' opinions about the future performance of stock are used as a proxy for the degree of information asymmetry. The third group of measures is based on the opinion that information asymmetry is most severe for firms with significant growth opportunities. Smith and Watts (1992) use the measures of a firm's growth opportunities such as price to earnings ratio, and market to book value as proxies of information asymmetry. All the information asymmetry measures above focus on the asymmetry between the firms' insiders (managers) and outsiders (investors).

Recently, researchers have begun to use market microstructure measures of information asymmetry to examine various issues in finance. For example, Lin, Sanger and Booth (1998), Wang (1999) use adverse selection component of the bid-ask spread to compare the levels of information asymmetry for the different stock trading systems. Brooks and Patel (2000) study the effect of seasoned equity offerings on the adverse selection component of bid-ask spread. Market microstructure measures of information asymmetry are also used in the studies of the role of financial analysts in reducing information asymmetry around firms (Ching, McInish, Wood and Wyhowski (1995).

The rational for using bid-ask spread decomposition models in measurement of the level of information asymmetry is that some traders may possess superior information about firms. Informed traders may use such information when trading with uninformed traders. In anticipation of the possible losses from the lack of information, uninformed traders set wider bid-ask spreads. The bid-ask spread represents the total transaction costs of trading a security. Such transaction costs are composed of inventory holding costs, order processing costs and information asymmetry costs. Inventory holding costs arise when a trader's inventory of a security is different from the desired level of inventory, which results in lost opportunities. Order processing costs are described as the clerical costs of carrying out a transaction, the cost of the dealer's time and the cost of physical communications necessary to carry out the transaction (Copeland and Stoll, 1990). Yet a large portion of spread is due to asymmetric information, which is estimated to be at a level between 8-13% of the spread (George, Kaul and Nimalendran, 1991) and as much as 43% (Stoll, 1989). The microstructure measurement of information asymmetry, then, focuses on the asymmetry between different types of investors, informed and uninformed ones.

Directions for further research

Although the importance of information disclosure for companies and its effect on the companies' cost of capital seem to be obvious, many firms still prefer those sources of financing which do not require that substantial information be revealed to the public. As mentioned above, firms in Kazakhstan and Russia are extremely tolerant about the disclosure of information. This may be explained by the existence of some factors in the developing markets, which bring some value to the companies, which in turn offsets benefits, such as the diminished cost of capital, arising from increased transparency. Since emerging markets' returns are often affected by the factors that differ from those in developed markets, the study of the relationship between the disclosure practices of Russian and Kazakhstani firms, and the cost of equity capital would be of interest. Also, the identification of the disclosure practices of Russian firms that are critical in determination of the cost of equity capital is very important from the practitioners' point of view. The findings could be of interest to managers of firms, especially in Russia and Kazakhstan, as well as to regulatory bodies for designing the regulatory environment of capital markets in transition countries. The issue of regulation regarding information asymmetry in the capital markets has always been a controversial question (Frost, Pownwall, 1994; Street, Bryant, 2000). The matter is becoming more acute in the economies in transition, where financial market regulation is in its development stage. Furthermore, the time series analysis of disclosure practices in capital markets in Russia and Kazakhstan could shed light on the development of these markets in the post-1998 crisis.

Endnotes

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[2] Source: S&P Emerging Stock Markets Factbook 2000

[3] Information availability in Merton (1987) is proxied by the number of investors who are involved in the trading of a given security.

[4] Inclusion of the bid-ask spread as an explanatory variable by Amihud and Mendelson (1989) significantly reduces the explanatory power of firm size and information availability in Merton's model.

[5] In Jacoby et al. (2000) model, liquidity cost of transacting security is given by Sj = (ask price – midpoint of spread)/midpoint of spread = (midpoint of spread – bid price)/midpoint of spread.

[6] Total risk is measured as standard deviation of return on security, $s2 = S [(r_j - r_{av})2/(n-1)]$, where r is return on security at time j, r_{av} is the average rate of return on security and n is the number of observations

[7] American DepositoryReceipt (ADR) is anegotiable certificate issued byaU.S. bank for share of stock issued by a foreign corporation. Using ADR, non-U.S. companies get an access to the U.S. capital markets.

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Foreign direct investors in Kazakhstan

Jan TOMCZYK*

Introduction

The foreign investor that is ascertaining the Kazakhstan market potential for his product or service for Kazakhstan is faced with several challenges: -

- Getting through the media hype, confusion, distortion and mass of written material
- What is the potential for investment?
- What is the investment climate?
- What are the important investment criteria?
- Do companies with foreign participation perform better than local companies?
- Timing: does the investor invest now or does it wait until the first Kashagan oil comes onshore in 2005 or wait further still until Kazakhstan joins the World Trade Organisation?
- How to develop an investment paradigm?

This is not an empirical survey of the investment climate but this brief review does provide some information for potential investors that has been obtained from academic sources. Portfolio investment is another issue altogether and one which I do not intend to address in this review. Investors are advised to seek professional investment, legal and tax before making any type of investment decision.

Getting through the hype

The person faced with the task of preparing a document or a Board Report about the investment potential in Kazakhstan could read investment information published by the EBRD, World Bank, Asian Development Bank, International Monetary Fund, Economist Intelligence Unit and contact his respective Commercial Office in the Embassy in Almaty.

The potential investor can subscribe to newswires and download the Internet. The investor can subscribe to several academic journals and oil and gas publications printed in Kazakhstan. As a result the potential investor is faced with a mountain of information to read and analyse. One option is to visit Kazakhstan and undertake an "on-the-ground" appraisal. This involves additional cost and one visit is never enough.

One alternative is to develop an investment paradigm that has a specific objective and includes specific criteria. The paradigm should have a start date and a milestone. The implementation of the paradigm could therefore be undertaken as a project using project management skills

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and practices in which the final, agreed, paradigm is the deliverable? The investor has the choice to develop the investment paradigm either in-house or contract it to a specialist company that has experience of preparing Kazakhstan Investment Paradigms.

What is the investment potential?

In the next ten years Kazakhstan needs to attract between US$65-70bn[1] of investment. During the last few years Kazakhstan received approximately US$12bn in investment making it the largest receiver of Foreign Direct Investment in Central Asia.

Estimated oil reserves are 2.8 million tonnes and gas reserves are 1.7 trillion cubic metres. With the discovery of the offshore Kashagan oil field in the North East Caspian Sea Kazakhstan could become the 5th largest producer in the world.

However, one author has stated that the myth of the munificent Caspian bonanza may have been overestimated[2]. The reason for this conclusion is that the oil reserves may have been politically bloated in US State Department reports[3]. Instead of 200 billion barrels in ostensible Caspian oil reserves (compared with Saudi Arabia's 250 billion) valued at US$4 trillion there may be about 20-30 billion barrels of proven reserves in the Caspian Sea and most of that is in the Kazakh portion of the Caspian Sea. The Caspian Basin may account for about 4-5 per cent of the world oil supply in 2010? These figures may still be large enough to interest some investors? But the lack of adequate export infrastructure is probably one of the most difficult challenges for sub-soil investors

Sub-soil investors are waiting to see which pipeline or pipelines are constructed. In December 2002 President Nazarbaev is reported as saying that the Baku-Tbilisi-Cehan oil pipeline "efficiency is not proven". Viewing this remark in context The London "Financial Times"[4] believes that this means that senior Kazakh officials now have a "hands-off" attitude leaving the choice of export routes to the oil companies.

The investor is interested in specific projects their value, timing, decision maker names, and tender dates. AGIP KCO, Tengizchevroil, Karachaganak, Hurricane Kumkol Munai JSC, ChevronTexaco and several other international operators are all making considerable investments in exploration and production. As a result of this investment several international contracting companies are now working in Kazakhstan. Downstream investment opportunities are available with the Atyrau Refinery refurbishment project. KazMunaiGas has several pipeline and pipeline repair projects.

What is the investment climate?

One option is to meet and collect information from the legal and accountancy companies that have offices in Almaty. They have the latest information on developments that can impact upon investment. The time spent in legal and tax due diligence is a worth while investment in

any market but more so in a transition economy. The legal and tax companies have expatriate and Kazakh experts that have many years of experience dealing with the legal and tax matters on an every day basis and have as a result developed an understanding of the investment climate issues.

It is easy to generalise and form opinions. According to two authors that have direct experience of working in Kazakhstan[5] "It is difficult to draw general lessons for transition economies on the management of attracting and managing investment from the Kazakh experience, just as it is difficult to group all former Eastern Block countries under the rubric of transition economies. Each of these countries has a different set of endowments and therefore are at various stages of the transition process"[6]

What are the investment criteria?

Investment decisions may include a comparison between Kazakhstan with other investment opportunities in different parts of the world. Investment money is looking for the highest return. The foreign direct investment criteria include macro-economic and regime stability as important considerations but which criteria should the investor include or discard in the case of Kazakhstan? Furthermore, the investor should consider the investment category and how the investment could help the country.

Dunning[7] lists the attributes of each type of inbound foreign direct investment that are most likely to enhance the competitive advantages of recipient countries: -

1. Natural resource seeking
2. Market seeking
3. Efficiency seeking
4. Strategic seeking

The country specific attributes affecting foreign direct investment (FDI) of Trans-National Corporations according to Dunning are: -

1. Those that impact chiefly on direct production costs and benefits
   - Spatial distribution of natural resources, created assets and markets
   - Input prices, quality and productivity (e.g. labour, energy, materials, components, and semi-finished goods).
   - Investment incentives and disincentives (including performance requirements, etc.).
   - Comparative economics of Centralisation vs. Decentralisation of different segments of the value chain, viz. production and marketing.

2. Those that impact chiefly on transaction and coordinating costs and benefits
   - Cross-border transport and communication costs
   - Artificial barriers (e.g. import controls) to trade in goods and services. For example

artificial barriers to trade might encourage defensive market seeking foreign direct investment but deter efficiency seeking FDI.
- Societal and infrastructural provisions (commercial, legal, educational, transport and communication).
- Differences in cross-country political ideologies, language, culture, business, customs and the ethos of competitiveness.
- Economic system and policies of host government. The organisational and institutional framework for resource allocation.
- The opportunities to exploit the agglomerate economies of industrial districts.

Dunning acknowledges that the organizational and transaction costs of economic activity have become more important and there is some evidence (Stiglitz 1989; Wallis and North 1986) that these are also positively related to the complexity of a nation's industrial structure: countries that can offer a business environment conducive to minimizing these costs, are, *ceteris paribas,* likely to gain an increasing share of inbound investment.

Furthermore, Dunning (1991) describes two surveys that were conducted on the determinants of Japanese direct investment in UK manufacturing and on the location of international offices. In both surveys, transaction and coordination cost related variables such as those to do with the following were found to be significant: -

- Interpersonal relations
- Information asymmetries
- Language and culture
- Searching for and working with subcontractors
- Learning about the quality of communications
- Adapting to local business practices and customer needs
- Bureaucratic controls

These variables ranked considerably higher as investment determinants than were traditional production cost related variables[8]. The investor may add import substitution, training, transparency, corporate governance, expatriate replacement and possible tax and customs exemptions if the investment meets the criteria for investment in the priority sector of the economy as additional variables for the Kazakhstan investment paradigm. Investors should consider import substitution as an opportunity rather than as a problem or a disincentive.

John Slater[9] states that ".... the key factor will be first and foremost be the provision of a stable macroeconomic environment on which rational investment choices can be made." In addition "Political stabilization is a prerequisite ... as successful experience in several foreign countries suggests, for the development of a partnership between the state, domestic industry and foreign entrepreneurship to coordinate legislation, strategic planning and ... direct state participation is seen to be necessary."

Since 1993 Kazakhstan has adhered to a macroeconomic stabilisation programme that includes a policy of monetary discipline and structural economic reforms. As a result Gross Domestic Product (GDP) grew by 9.8% in 2000 and is forecasted to rise to 10% by the end of 2001. Inflation is forecasted to drop to about 7% by the end of 2001 according to figures from Gregory Marchenko, Governor of the National Bank of Kazakhstan[10].

Do companies with foreign participation perform better?

The foreign company contemplating if it wants to and how it can access the Kazakh market needs to consider if the investment will benefit the company in terms of performance. The investor should also consider how the investment will benefit the host country.

Josef Konings'[11] analysis based upon the company level empirical results of his study in Central and Eastern Europe and upon the work of other surveys believes that there are three main benefits of foreign direct investment to a host country: -

1. The need for strategic restructuring in companies in the emerging markets[12], [13]. Most local companies were characterized by obsolete machinery and outdated production methods. To compete in a market environment, companies had to improve their efficiency by engaging in strategic restructuring: updating equipment and the production process. The assumption is that the foreign companies have the technological know-how and finance necessary to update the equipment and help to implement strategic restructuring. Foreign participation in local companies has the additional benefit that it can impose an efficient corporate governance in privatised companies, often privatised to insider workers / managers, who might block restructuring[14].
2. The effect that FDI has on hardening budget constraints. Foreign participation in local companies reduces the financial link between the government and the local company, which may lead to harder budget constraints and hence better performance[15], [16]. On the other hand there is evidence based upon a study of small and medium sized companies in Eastern Europe that the imposition of financial discipline is not sufficient to remedy ownership and governance related deficiencies of corporate performance[17]. Indeed the same survey shows that a policy of hard budget constraints cannot induce successful revenue restructuring, which requires entrepreneurial incentives inherent in certain ownership types (most notably, outside investors).
3. That foreign direct investment in emerging countries generates positive externalities to the local companies through a transfer of know-how and technology. Such spillovers can occur through various channels. Teece[18] states that the introduction of new products and production processes by foreign companies may benefit local companies through the accelerated diffusion of new technology. Other recent theoretical studies provide evidence that technological spillovers to local companies depends on the 'absorptive capacity' of local companies. Studies by Sanna-Randaccio[19] and Leahy and Neary[20] indicate that FDI always leads to an increase in the productivity of the investing company. However, FDI increases the host country's productivity only if the degree of the technological spillover

is high enough. The latter is more likely to be achieved in sectors characterised by intensive R&D or by companies that have a sufficient amount of knowledge at the outset. Konings (2001, p. 622) states that this has been suggested in other empirical work. Kokko[21] and Borensztein, Di Gregorio and Lee[22] suggest that positive FDI spillovers to local companies are only generated if the technology gap between the foreign company and the local company is not too large and if there exists a minimum threshold of human capital in the host country. In Venezuela Aitken and Harrison[23] have found negative overall spillovers from foreign companies to local companies. With regard to wages and wage growth workers[24] in industries with a higher presence of joint venture foreign direct investments enjoy higher wages. Furthermore, the magnitude of the foreign presence effect increases over time suggesting that workers in industries with greater foreign participation experience faster wage growth and that FDI appears to serve as a channel for diffusing knowledge. Konings[25] conclusion is that foreign companies do not perform better than local companies, except in Poland, one of the more advanced of the transition economies. To Konings this suggests that it may take time for ownership effects to have an effect on performance, due to lags in restructuring. During the early stages of transition increased competition from FDI dominates technological spillovers to local companies. The inefficient companies will lose market share due to foreign competition, which in the long run should increase the overall efficiency of an economy. In the later stages, when local companies have engaged in substantial restructuring and market competition has been established, the dominating competition effect seems to vanish.

Future considerations for the Kazakhstan Investment Paradigm

According to Desai and Goldberg[26] changes to the institutional variables will considerably improve the investment climate in the regions of a country, and these include: -

- Adjustments to the system of fiscal federalism by which oblast (regions in Kazakhstan) administrations would be allowed to retain tax revenues generated locally
- Legal improvements in the protection of property rights
- The provision of mechanisms for restructuring and ownership transformation in insider dominated companies

The objective of these reforms would be to: -

- Change the incentives that local governments, owners, and investors face
- Convince oblast administrations that a more sustainable way of protecting employment lies in protecting local investment
- To raise the cost of theft and corruption by insiders and local officials
- To allow investors to acquire controlling stakes in viable companies.

Kazakhstan is in the accession process into the World Trade Organization (WTO) and the result of membership should be an improvement in the investment climate, the signing of several international conventions that should improve trade facilitation and introduce additional reform and modernization in the customs service?

The adoption of international customs practices helps to constrain the opportunities for corruption whilst, more generally, the effective implementation of global trading rules allows countries to lock in domestic reforms and provides a valuable signal to companies operating in a country that open access to overseas markets for parts and other inputs will be maintained.[27]

Membership of the WTO[28] could be a signal to multinational corporations that a country has accepted a set of core values concerning international commerce, and as a result membership may be an important factor in being able to attract additional foreign direct investment. Whilst the opening of the domestic market is itself beneficial, another key aspect of the development process is access to overseas markets. Participation by Kazakhstan in the WTO provides a measure of certainty for domestic companies selling in overseas markets that overseas governments will not impose arbitrary measures that cut off access to those markets.

Conclusion

The potential investor faces along and challenging task to decipher the mass of information about Kazakhstan. There are different options but on of them should be to undertake sue-diligence.

The investment potential in the oil and gas sector is large and investors need to develop a Kazakhstan Investment Paradigm as the company model to access the Kazakh market. The paradigm should include the benefits to the company as a result of the investment but the paradigm should also include the benefits of the investment to the country. Import substitution is an important variable, amongst several, that needs to be incorporated into the Kazakhstan Investment Paradigm.

There are no easy solutions to ascertaining the right set of investment criteria. There are several indicative but conflicting studies concerning the issue of foreign company performance. Furthermore, the studies listed in this review are from Russia and Central and Eastern Europe and their results may not have relevance and comparisons with the realities in Kazakhstan? There is therefore a need for research to ascertain the level of foreign company technological and know-how spillover in Kazakhstan. The KIMEP Centre for Research and Development is undertaking a long-term study[29] that includes a survey of the effects of FDI on local companies.

The oblast level institutional variables are important and changes should improve the investment climate?

Membership of the WTO should lead to considerable improvements in trade facilitation, transparency, market access, simplification and harmonisation as well as increased FDI.

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Financial measures for developing the industrial sector of Kazakhstani economy

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Introduction

Soviet economic theory separated finance and credit, defining finance as a unilateral cash flow and credit as a bilateral cash flow. The unilateral cash flow presupposes a cash flow from one party (benefactor) to another (beneficiary) without any monetary counter-compensation by a beneficiary.

The examples of financial payments are taxes, other obligatory budget fees, insurance payments, state donations, subsidies, and other benevolent contributions. In the bilateral cash-flow relationship the creditor lends money to the borrower, who in turn pays back a principal amount and makes an interest payment.

For the purposes of this article, we will review both "finance" and "credit" measures for developing the industrial sector of the economy under "finance" measures.

I. Sources of economic growth

Although during past few years Kazakhstan has experienced significant economic growth[1], the physical and financial condition of domestic industrial enterprises remains one of the greatest problems in the modern economy of Kazakhstan. The wellbeing of the country's citizens depends on the performance of industrial sector as a producer of goods needed (consumption component of real GDP formula) and a potentially big taxpayer (government expenditures component).

The components of GDP (consumption, investments, government expenditures, and net export), are not the increase of investments into the industrial sector or that of consumption contributed most to the current economic growth.

Indeed, this can be explained by the continuing increase in volumes of exporting raw materials and high prices of oil[2]. However, despite an insignificant growth of other GDP components (but net export), we do have to acknowledge the relative affect on consumption[3] of increased real personal income and reduced taxes, and the influence of lowered taxes on investments[4].

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At present the Kazakhstani economy depends on export of natural resources, which consist of energy products (41%), non-ferrous metals (20%), ferrous metals (16%), and grain (6%). The development of non-ferrous industry and oil industry counts for 80% of industrial growth and 19% of economic growth (Kulahmetova, 2001).

The country's deviation toward the sale of available natural resources can be explained and justified only for a short period of time, when the country is going through recession, and hence it is still in need of quick money to introduce strategic investment programs. However, no developed country regardless of the availability of natural resources will choose to keep a long-term approach to the development of its economy based on the exploitation of raw-materials.

The continuous "withdrawal" of natural resources from exhaustible sources threatens the future of Kazakhstan and its citizens. It is time to change strategic economic priorities and develop financial measures to improve the physical and the financial status of domestic industrial enterprises working in the processing industry, agricultural sector, ferrous and non-ferrous metallurgy, and chemical industry.

II. Sources and allocation of investments

To develop the industrial sector, we need sources of investments and an appropriate policy to allocate investments to strategically vital industrial enterprises, which need them most. Kazakhstan does not experience problems with sources of investments, since it has a sufficient amount of both external and internal capital and savings. Moreover, there is a clear tendency of growth in external and internal sources of investments – foreign investments, bank deposits, capital of pension funds and insurance companies, retained earnings of oil and gas national companies.

The rise of internal savings followed the issuance of stimulating legislative norms – Rules of Obligatory Insurance of Personal Deposits[5], Law on Banking Commercial Secret, Law on Capital Legalization[6], etc. The major question today is how to allocate available investments to the industries vital for the growth of the Kazakhstani economy.

Low income rate of domestic producers results in their insolvency, inability to expand their activities, enter new markets, produce new goods both price and quality-competitive compared to similar goods produced abroad. Therefore, state and private financial aid is very important for effective performance of domestic industrial enterprises.

Direct state financial aid should be granted in the form of subsidies to the local enterprises representing industries deemed to be strategically vital for the economic growth of Kazakhstan and acknowledged as such in the state investment program[7].

Indirect state financial aid might be granted through discounts in taxation of industrial enterprises and banks investing into these enterprises, compensation to banks of a difference between market interest rate and discount interest rate under which banks lend money to the industrial enterprises, and state insurance of credit risks taken by banks lending these enterprises.

Direct private financial aid might be given by commercial banks in a form of both short-term and long-term lending to industrial enterprises under a special discount rate (later to be compensated by the government, i.e. in the form of tax credits), project financing of newly-established businesses in industrial sector, and establishing holding companies consolidating both industrial and financial capital.

Indirect private financial aid might be given by banks in a form of contributions to special funds established to support industrial enterprises in processing, agricultural, ferrous and non-ferrous metallurgical and other sectors.

III. Current Status of the Industrial Sector

The industrial enterprises of Kazakhstan might be divided into five groups. The first group consists of big domestic enterprises under partial foreign ownership, and hence it cannot count toward a potential recipient of any type of domestic financial aid.

The second group is represented by national companies, which become quite active on the stock exchange as a potential source of investments. National companies receive indirect state financial aid in the form of postponed payments of taxes or dividends approved by the government under special development programs.

The third group includes high-rating state or private-owned companies officially recognized as financially stable. The shares of such companies are sold on the stock exchange to investors looking for asset liquidity such as pension funds and insurance companies, etc.

This group is very limited. At this point it includes Kazakhtelecom, HSBK, Ust-Kamenogorsk titanium-magnum factory, BankCenterCredit, "Kazakhmys", "Mangistaumunaigas", "Kazchrome", and "Aluminum of Kazakhstan". Due to their stability the companies of this group can easily borrow from banks or allocate their stocks another stock exchange.

The biggest potential recipients of financial aid are the fourth group of industrial enterprises. This group includes big and medium-size companies under ownership or management of domestic strategic investors.

The fifth group consists of small businesses. Their activities are rated as risky, and their financial results are difficult to predict (Panorama, 2001, June 29). Commercial banks might express interest in financing this group provided that state or international financial institutions will secure their loans. This group of industrial enterprises might become a potential recipient of state financial aid as well.

The domestic (not foreign) investments flow mostly to processing industries. This occurs because the scale of these industries is limited, and they are not associated with a receipt of big income. This can be explained by the limitations of the internal market and high competition in external markets. Therefore, mainly domestic business, which does not have sufficient financial the resources and hence cannot work with natural resources, is involved in financing processing industry.

Foreign investors are interested in financing mining and refining industries owing to their probable high-income rate. The high level of investments in mining and refining industries resulted in prevailed net export component of real GDP.

IV. Direct State Financial Loans

The prominent German economist and policymaker L. Erhard (1991) objected to a direct interference of the state in private economic affairs. However, he believed that a modern state economic policy has to be based on the appropriate selection and use of state financial instruments to promote economic growth.

The government might give loans to industrial enterprises. This practice was widely applied in the administrative economy of the former Soviet Union. The state loans were granted to a defined borrower through a central bank, commercial banks, or special funds.

The mixed type of state loans is centralized lending by a central bank through credit auctions. Under this system prior to a receipt of loans from a central bank participating commercial banks must define their potential borrowers. These loans have a certain designation, and they are given only to solvent borrowers. A bank determines the solvency of potential borrowers by analyzing liquidity of their collateral, their financial status, and project of loan consumption.

State loans might also be granted through special funds. In 1998 the Kazakhstani government established the Fund of Financial Aid to Agricultural Sector under the supervision of the Ministry of Agriculture. The major purpose of this Fund is to develop and operate state support programs to render financial aid to agricultural sector. The monies set aside in the republican budget to provide free financial aid to farmers is allocated by the Kazakhstani Ministry of Finance through this Fund.

Another example of state support is lending to small and medium-size businesses and farmers through the specially established Fund for Developing Small Business. The sources of this Fund are the loans of the European Bank for Reconstruction and Development, Asian Development Bank, and other international financial institutions. The Fund is a borrower and operator of Kazakhstani Ministry of Finance. It is responsible for the selection of authorized commercial banks and use of these monies for purposes specified (Davidova & Raimanov, 2000).

In 1999 the government made an effort to resolve the issue of financing industrial enterprises by establishing the Kazakhstani Development Bank. The purpose of this Bank is to finance long-term investment projects that have low-income rates.

There are some projects (construction and reconstruction of railroads, highways, water ponds, oil and gas pipes, etc), which cannot be financed by private business (commercial enterprises and banks) because of the big scale of these projects, their low profitability, and long payback period. Such projects are to be procured by the Kazakhstani Development Bank

However, the establishment of such a Bank does not close a problem because first of all the Bank cannot lend to all the enterprises in need of finance, and secondly, the Bank is not guaranteed from failures just like any commercial or state entity. Along with the Development Bank, both the government and commercial banks must activate lending to industrial enterprises. Only in case of consolidated efforts and activation of all the finance measures, we are able to improve financial status of domestic industrial enterprises and hence provide economic growth of Kazakhstan and increase the wealth of its citizens.

V. Indirect State Financial Aid

Indirect state financial aid might be granted by giving tax benefits, discounts on energy tariffs, and rental payments; securing loans given by commercial banks, etc. In Germany and France, for example, municipalities along with tax benefits give a special budget compensation for every new job opening.

TAX DISCOUNTING

The major instruments of state financial regulation are tax policy and other financial measures.

We suggest having a discount rate on corporate income tax paid by industrial enterprises making investments and banks lending to industrial enterprises. This discount rate should stay effective within a payback period associated with a definite investment project.

For some industrial enterprises undertaking investment projects it might be expedient to give a discount rate on property tax.

However, prior to introducing any tax discounts it is required to establish a clear procedure for giving a discount rate on taxes and impose an appropriate control over use of these discounts. Otherwise, any privileges in taxation granted to enterprises or banks might result in semi-legal avoidance of taxes by them.

To illustrate, in 1998 both banks and other enterprises of the Russian Federation had been deliberated from tax on income as a result of positive exchange-rate differences. As a result, in one of the Russian regions (Nizhegorodskaya Oblast), of all the branches of Moscow banks, few small, and none of medium-size or big banks had paid corporate income taxes.

STATE CREDIT RISK INSURANCE

The establishment of a state fund for insuring credit risks incurred by banks lending to industrial enterprises will allow the resolving of the problem of default and hence reluctance of banks to finance low-income industrial enterprises.

Commercial banks are not interested in funding such a fund because they can avoid the problem of default by simply not lending to the industrial enterprises (something that they actually do). Therefore, the only alternative for establishing such a fund is to involve the government as a main founder of such a fund (100% state-owned, or partial ownership with private share).

VI. Private Financial Loans

BANK LOANS

Banks might contribute to the development of the industrial sector by project financing. Project financing presupposes security of bank loans by the project itself, that is, by revenues, which newly established or reconstructed enterprise expects to receive in future. It means that a bank can receive a profit in long term. As a rule, a newly established enterprise becomes a daughter company of a bank. It will allow a bank to control the financial policy of an enterprise and give it both long-term and short-term loans.

After the completion of establishment or reconstruction, a control portfolio is given to a major customer, but a certain share remains in the bank's assets (about 10-15% of charter capital). Since the bank took its fair share in the activity of the enterprise, the latter has a stable credit history and a good relationship with the bank. Therefore, a transfer to another bank for service is highly unlikely (Lubyagina, 1997). Project financing gives a bank a feasible potential for long-term receipt of income from enterprises. The promotion of project financing must be one of the finance measures to help developing the industrial sector of Kazakhstan.

HOLDING COMPANIES

We see industrial holding companies as potentially profitable institutions capable of developing the industrial sector of Kazakhstan and contributing to its economic growth. Industrial holding companies are quite stable because first of all they involve not only intra-branch, but also inter-branch affairs and second, they include different highly-capitalized financial institutions such as banks, insurance, investment companies and pensions funds, etc.

Industrial holding companies might become an effective instrument for consolidating bank capital, allocating investments to industrial enterprises strategically vital for the wealth of Kazakhstan, changing priorities of banks to lending to the industrial sector, keeping up with high competition, providing conditions for stable development of banks and enterprises, creating new jobs, and accelerating industrial modernization.

Industrial holding companies equipped with high technologies and contemporary management and supported by the government have a potential of becoming transnational companies producing highly competitive goods on both domestic and international levels.

VII. Everybody likes the carrot. Do we need the stick?

In the preceding sections we reviewed some ways of stimulating the industrial development through providing low-interest loans, tax concessions, and similar instruments. We also mentioned that there should be control over the use of funds provided on a preferential basis. Eventually it is the public that pays the difference between the market interest rate and the rate on preferential loans, and the public pocket is not bottomless. Therefore an interesting question is: How comprehensive and tough should the control be?

The main considerations include: -

Provision of loans at a lower than-market interest rate needs rationing. That is, some criteria for loan provision should be set. As far as we know, in Kazakhstan there are no officially accepted criteria. The priority industries have not been determined either (general statements like "we want prosperity" or "we want to support national producers" don't count).

Preferential loans may create higher-than-normal profits. How can we make sure that they will not be withdrawn in the form of dividends, instead of being used for company expansion? Project financing as a means of controlling the use of funds is of limited applicability in the case of financing large companies. The activities of large companies are so complicated that it is potentially dangerous to allow commercial banks to control their financial activity.

As international experience shows, subsidization sometimes generates overinvestment. What is the right way of government intervention that allows one to avoid it?

One additional problem arises when imported products are crowded out by domestic products, because of protectionism, and the lack of competition results in the low quality of domestic products.

Here are some answers that can be found in the literature about the countries of South-East Asia: -

1. Setting and promulgating official criteria will decrease corruption and increase efficiency of government programs through public participation. As for the determination of priority industries, the government should not wait until the so-called "comparative advantages" have been developed. In other words, comparative advantages are the result of a purposeful industrial policy rather than its prerequisite.

2. In Japan, during the decades of high growth of its economy, shareholders by law had limited influence on corporate decisions. This fact allowed corporations to use more funds for corporate developments and pay out less dividends. To follow the Japanese way, we would have to change the corporate laws. Such a change would reduce the incentives for shareholders and increase the need for government regulation.

3. Instead of controlling the implementation of separate projects, the government of South Korea in many cases controlled the rate of growth of exports of companies. Earnings from exports were allowed to be used only for imports of inputs (capital equipment, technologies, raw materials, and intermediate goods), instead of the imports of consumer products.

4. When supporting private companies, it is important to concentrate on the final objective of increasing GNP, as opposed to increasing investment, and make private companies to be ready to rely more on their internal funds than on government help.

5. To improve the quality of domestic products, the government of South Korea pushed domestic producers into the international market. Export promotion is preferable to import substitution also because increasing export means earning hard currency which can be used for purchases of new technologies. Besides, it allows the country to increase production and contain consumption at the same time.

The institute of General Trading Companies, invented in Japan and developed further in South Korea, answers many questions about the right combination of government support and control. The firms supported by the government had to fulfill government plans set in terms of export and companies growth. The companies that failed to comply with the government requirements lost their right for government support. By subsidizing a few large companies, government preserved its efforts in controlling the results.

Conclusion

Finance measures for developing the industrial sector of the Kazakhstani economy include delivery of state and private financial aid to the end user and control of its appropriate consumption. Any aid will be effective only if it reaches the end user and is consumed for the purposes stated originally. Since demand for financial aid is very high, a single supplier of financial aid (such as a commercial bank, or the government) is not able to meet it. Only the consolidation of both state and private financial efforts will bring to a desired result of improving the technical and financial status of the Kazakhstani industrial sector.

Endnotes

[1]The recovery from the negative consequences for economy of former soviet republics following the collapse of the Soviet Union begins in 1996. Since 1996 Kazakhstan experiences the economic growth, which reached its maximum of 11% in year 2000.

[2]Kazakhstani government associates the current economic growth (in particularly, its peak in year 2000) with the effective realization of the Import-Substitution Program introduced by the government in 1998. However, the analysis of statistical data on volume and structure of imports allows for the drawing of an opposite conclusion. To illustrate: in 1998 the volume of imports increased. The significant reduction of imports in 1999 can be explained by the introduction of the free exchange rate, which resulted in the devaluation of the national currency and hence the reduction of solvent demand. In 2000 the import of foods, gasoline, diesel fuel, ferrous-metal goods and others increased.

[3]According to official statistical data, in the first half of 2001 real personal income of Kazakhstani citizens increased by 11%. The rise of income presupposes the rise of consumption. Moreover, the recovery of 121 big enterprises resulted in 121 thousand job openings, which could contribute to the increase of consumption. This data alone deviates from the real picture because an increase of income was followed by an increase in prices.

[4]The increase of investments is associated with the relatively positive investment climate in Kazakhstan. The experts say that more than 80% of all the direct investments received by Central Asia had been made into the economy of Kazakhstan. The World Bank included Kazakhstan in the list of 20 countries attracting most investments. The total amount of investments received during the 10-year period of Kazakhstani independence exceeds US$11 billion.

[5]On November 5, 1999 the Board of the Kazakhstani National Bank approved Rules of Obligatory Collective Insurance of Personal Deposits in Commercial Banks.

[6]At the end of May of 2001 the Kazakhstani president issued the Law on Legalization of Capital, which lasted from June 14 to July 14 of 2001. According to official data of Kazakhstani National Bank, this action allowed returning to Kazakhstan US$480 million. The question of what portion of legalized capital would stay in Kazakhstan remains open.

[7]The comprehensive investment policy of Kazakhstan is defined the Strategic Development Plan of the Republic of Kazakhstan till 2010 developed by the Kazakhstani Agency for Strategic Planning. The investment policy section of this Plan gives a detailed analysis of current investment status, states strategic goals, and defines an action plan.

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The problems of forming general power markets of Central Asia

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Introduction

The past years have witnessed sustainable tendencies in the development of the world power engineering to its globalization and regionalization. These processes are reflected by means of creation of the inter-state regional power markets and transnational unions of the fuel and energy direction. It is an obvious fact that none of the countries of the world over well-provided for by fuel and energy resources and which is not participating in the integral international processes in the sphere of power engineering is unable to provide sufficiently to the own economic security and stable rates of development of the national economy.

It is not accident that American war-political presence in Central Asia is related with such priorities of doctrine of neo-globalization as:

1. Necessity to increase the level of resistance of the economics of USA and its strategic allies from the conjuncture oscillations in the world power industry markets.
2. Utilization of the significant Fuel and Energy Resource reserves, and at first water-land and mineral-raw potential of Central Asian countries to reach the own new geo-economical purposes.

It is intended that a global strategic competition will be carried out under the one-pole polarization in the geo-economical resistance of USA, Russia and China in the hard competitive fight for the primary power and raw material resources of the world economy, overall control in the international energy and raw markets.

Central Asia is becoming an experimental ground where the effective economical-political technologies will be developed and the methods of leading by the USA of a new energy war for the sake of supremacy in transnational and regional markets. Then models of neo-globalization will be copied in other areas of the world.

In this situation the Central Asian countries can and must use the objective preconditions for strengthening of its positions in the world economy, establishment of a new presence in the regional cooperation and flexible tactics of partnership with leading economical powers, who have strategic interests in Central Asia.

Among the perspective purposes in forming of the general energy markets of Central Asia are:

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- Maintenance of the wide inflow of foreign investments needed for ensuring the operational state and development of the base of the fuel, producing and energy transmission.
- Creation of stable and reliable resources of delivery of Fuel and Energy Resources (FER) to the internal and foreign markets.
- Reaching of a secure and non-discrimination transportation and transit of the power units through the third countries' territory.
- Development and performance of the coordinated political line in the international power carrier markets.

In addition the geographical location of Central Asia, opportunity to create the transportation and energy "corridors" in the Indian Ocean area of water enables an access of the capacious markets of South-Eastern Asia, Mediterranean for the energy carrier and other raw resources of the region. Also, a diversified, but unevenly located on the Central Asian territory, resource base of power industry creates a large scale opportunities of exchange – trade of FER in the regional market and creation of the common energy systems with the boundary areas of China and Russia, where there the signs of a sustainable economical growth.

Among the negative factors are:

- Insufficient pass capability of the trans-boundary transport-communicative and energy links, low exploration of the significant parts of the fuel and power potential of Central Asia (Ustuyrt plateau, Aral shelf and adjacent territories and so on).
- Low level utilization of FER in all stages of the production cycle, critical highest level of the tear of the manufacturing capacity in the sphere of the fuel-energy complex, critical insufficiency of the investments, lack of the enough reserves in construction of the new and technical re-equipment of the present power units.

1. Energy potential of Central Asia

Central Asian countries – regional education, having a territory of about 4 million Sq. km, population 55,35 million people (2000). The datum on scale of the resource power potential of Central Asia is given in the table №1.

The foreign and national expert characteristics define the part of Central Asia in the structure of the world energy resource potential by:

- the explored reserves of coal about 4%;
- the explored reserves of oil 2%. The preliminary evaluations of the oil reserves, were not included, exploration of the Kazakhstani part of Caspian shelf and adjacent territories (North Kazakhstan and others), which lead Kazakhstan to the five leading oil power of the world.
- the natural gas reserves – 4,5%.
- uranium reserves – 20%.
- economical effectiveness of the hydro-potential – 5,5%.

Temporary limits of FER exhaustion in Central Asia in 1998 were estimated as:

- by coal, under the extraction of 62 million tons per year – more than 600 years;
- by oil, under the extraction 45,2 million tons per year – about 65 years;
- by natural gas, at the production 88,4 billion cube meter per year – about 75 years.

The considerable opportunities lie in the utilization of the untraditional and renewable sources of energy (URSE), including the development of the small hydro-energy in the mountain rivers, which are able fully satisfy the demands for electric energy in the internal markets of Central Asia.

In our evaluation and forecast, we have in the near future among the system compounding factors and its transport-communication infrastructure the nuclear projects in the power industry. It is high point in the objective necessity for the development of the international cooperation in the growth of the up-to-date industry of Central Asia, providing the forwarding rates of the nuclear development in the Asian sub-continent. In these purposes, it was reasonable to create on the basis of the National Center of nuclear researches (city of Kurchatov, Kazakhstan) the International Nuclear Energy Center and resource preserving technologies from the version of the technopolis ("Silicone valley"), with the introduction of the economical and legal regimes similar to the free economical zones (China), and bridged sub-station for the rapid development of the nuclear power components, aimed for the utilization not only in Central Asia, but in South-East.

A special attention deserve the problems of the hydro-energy resource effectiveness of Central Asia, international cooperation on harmonization of the contradictory economical interests in utilization of the flow off the trans-boundary rivers, balancing on the compensation basis of their power and land-improvement irrigation components.

The water and water resources in Central Asia are always the subjects of large and small conflicts. At the observance of the energy regimes of the aqua-system regulation of Zailiy Alatau, Tian-Shan, Pamir-Alaiyskiy mountains is seriously suffered due to the spring-summer low water-level of the irrigated agriculture, fishing and other branches of the agriculture sector of Central Asia.

Now we have the unique geopolitical conditions for the creation of the inter-state hydro-land-improvement systems on the overall extension of the channels of the trans-boundary rivers in the Central-Asian region. It is supposed that under the aegis of international organizations (United Nations, EU and others), on the initiative of the leading economical powers (China, Russian and USA) will be used an integration model where the water-land potential and FER of Central Asia functions as the united regional economical complex of the world economy.

The following is below for the benefit of this geo-economical novation:

1. China, Uzbekistan, Afghanistan and other Asian countries have reached the tolerance limits of the ecological-economical loads on the limited squares of the land, e.g. on the production of the grain-crops. So, Uzbekistan at the population of more than 25 million people can produce more than 4 million tons of grain. Its production growth to the level of "grain independence" is limited by low water resources and biological potential of the grain lands. At the same time Kazakhstan has a principal opportunity to create the water-land concessions on the separate unsprayed fields and degraded lands, which enables to solve the industrial problems on the extensive part of the Asian sub-continent, create the work places for the over-workforce regions of Central Asia and China.

2. Low water-level suffered by Central Asia needs non-trivial approaches to the maintenance of the stable economical development of this sector of world economy. So, Tadjikistan occupies the eighth place in the world on hydro-energy potential – 317 milliard kilowatt per hour/year (after China, Russia, USA, Brasilia, Congo, India and Canada). Otherwise the effective part of it is used only by 5-6%. The same situation is in Kyrgyzstan. Though, starting from the general regional and global economical interests of Central Asia there must be made land-improvement and irrigation assignments for its benefit. The losses of the national economics must be compensated by the users of the water resources, irrigated land fields.

It is well-grounded to return to the problems of carrying over to Central Asia of some part of the Siberian rivers inflow. It is important to accept our address of this conference to the executive organs of Central Asian Countries and SOS on organization of the work group of experts for the detailed study of the ecology-economical consequences of this global project, technical and economical conditions of its fulfillment.

2. The conditions of forming of general energy markets in Central Asia and participation of countries of the region in the integration projects of the world power industry

The dynamics of production and consumption of the primary FER in Central Asia is in the table № 2. Country structure of production of FER is quite different from the structure of the internal use. The basis of the fuel and energy balance of Kazakhstan is compounded by coal, Kyrgyzstan and Tadjikistan – hydro-energy, Turkmenistan and Uzbekistan – oil ad gas sector. Energy independence (self-sufficiency) of the country or region is defined by the level ratio of its annual production and use: in Central Asia – 1,47; Kazakhstan – 1,81; Turkmenistan – 2,33. Other countries of the Central Asia are the net-importers of the energy resources. For the past years in Central Asia except Turkmenistan, were appeared the tendencies of a sustainable semi-annual growth of GDP (Gross Domestic Product). In Kazakhstan and Uzbekistan is quite significant. (4-7%). Prognosis of the World Bank is in the table № 3 for the years 2020. In this macro-economical situation of Central Asia, it is forecasted that the growth of energy carrier export will be a huge stimulant of the economical revival. The energy inter-dependency of Central Asian countries was due to the terms of united national complexes of USSR and establishment of the general energy regional market became the vitally important necessity (energy security, optimization of the fuel and energy balance structure, increase of the FER export as the leading branch of specialization and so on.).

As the first steps on regionalization of the power markets should be regarded the creation of the International Power Industry Consortium of Central Asian countries with the participation of Russia, offers on creation of the electrical power exchange for the countries of the region. But the regionalization processes as before oriented on the untraditional users and historically existing users of FER. In essence a new Russian and Central-Asian policy is formed on strengthening of the transit dependency of FER export from Central Asia.

However, recently a whole number of new, perspective and potentially capacious markets are on the world energy map. All these circumstances dictate a necessity to search new scenarios in forming of the regional energy market and participation of Central Asia in development of new routs and communications for the FER transportation.

Among them are regarded and realized such directions as:

1. Creation of transport corridor Europe-Caucasus-Asia and trans-Caspian water-pipeline system (Caspian Pipeline Consortium, Baku - Dzheikhan and so on.).
2. Transit of the Central-Asian oil to the little Asian countries (Iran) and defined area of water of the Persian Gulf, harbors of Pakistan and so on.)
3. Construction of a 1800 mile oil-pipeline West Kazakhstan – China.
4. Building of gas pipeline from Turkmenistan to Pakistan through Afghanistan (from the gas deposit Divlatbad till the Pakistan city Multan) in the framework of the Central-Asian Gas-line Consortium with its cost 2-2,7 milliard dollars USA. But the project operator Unocal company already in 1998 have had announced about the guarantee absence on finance and works were stopped, and so on.

But due to a anti-terrorist operation in Afghanistan and by the efforts of the world community on liquidation of the centers of the international terrorism and extremism, the geopolitical situation in Central Asia and of the significant territory of the Asian sub-continent (from the geographical parallel Caspian-Aral-Ili-Balkhash aqua-system to the defined water land of the Indian ocean – Persian Gulf) has been considerably stabilized.

In addition there was signed in March of 2002 an agreement between the power industry and financial companies of Iran and India on construction of two gas-pipelines (on the bottom of the territorial waters and land rout in Pakistan).

In these circumstances the most actuality gains the unification of the Central Asian efforts, their integration with the rapid developing "Dragons" and "Tigers" of South-Eastern Asia in the joint exploration and exploitation of the FER region. It is intended that the aim of the process of integration on Asian sub-continent on such scenario will enable the creation of the parity in the world economy, harmonization of the doctrine of neo-globalization with national interests of new industrial and financial centers to the world.

It is supposed, that executive structures of Central Asian Countries and SOS could act with the efficient geo-economical initiatives on unification of financial, raw material and material re-

sources of the countries – the members of these regional international unions in the purposes of strengthening of their collective energy security ad support of the high rates of the economics growth.

3. Financial problems of development of the local and regional power markets, participation of Central Asian countries in the world energy integration

Central Asian countries are located in the terms of the system economic crisis due to low rates of the structural and institutional transformations. They are still influencing in the export sectors as the raw marked direction. Fuel and energy complex may become an "engine" that is able to support Central Asian countries to overcome the crisis and stagnation, and provide the sustainable economical development even in the medium-urgent perspective.

Otherwise, it is not enough for the national economics of Central Asian countries of the internal investment resources. So, in Kazakhstan for the creation of the gas-transportation and distribution network connecting the gas deposits of the country with the main centers of the gas use by evaluation of the experts USD 1 milliard investment is needed. The expenditure on plan construction of the liquefied natural gas (city of Atyrau) might be as 500 million dollars. The construction of the three nuclear energy blocks of 640 megawatt of established capacity will cost about 6 milliard dollars. The construction of the Samgutdinskiy Hydro Electrical Station № 1 in Tajikistan is the fifth stage of the Vakhshskiy hydroelectric stations (670 Mwt) is estimated over 500 million dollars.

By the forecast evaluation of the foreign experts on the whole Central Asia during the coming 20 years need in investments defined by different scenarios of the world economics development may cost 85-120 milliard dollars.

Now, when Central Asia happened to be in the center-complication of the geo-economical interests of USA and its strategic allies and their potential competitors for the new and perspective world markets, the international community became up to the virtual dilemma: where will go the energy flows from Central Asia? The forthcoming appearance of the world economy will depend on the answer to this question.

Besides the global macro-economical problems there are the priority and urgent tasks in the system of forming of the united energy system and creation of the general energy market of the region, they are:

- Realization of the united principles of tariff and price policy, providing the equal competitive opportunities of the national Fuel and Energy Complexes;
- Forming of the coordinated scientific-technical and technological policy in the sphere of production of FEC, inter-state and transnational financial funds, accumulation means for performance of the complex projects with the primary utilization of the internal investment resources;

- Performance of the obligatory procedures of certification and standardization for production and use of FER;
- Reaching the optimal fuel-energy and water-land balances with taking into account of each countries' interests and conclusion on this basis of two or multilateral contracts in accordance with the Energy Charter and International Convention on utilization of the flow of the trans-boundary rivers and other reservoir.

Table 1. Used Energy Potential of Central Asia.

Energy resources	Kazakh-stan		Kyrgyz-stan		Tajikis-tan		Turkme-nistan		Uzbe-kistan		CA	
	2000	2020	2000	2020	2000	2020	2000	2020	2000	2020	2000	2020
Coal, billion tons	34,1	34,1	1,34	1,27	0,67	1,0	-	-	4	4	40,4	40,0
Petroleum, billion tons	2760	2760	11,5	10,2	5,4	10,0	75	75	81	81	2932,9	2936
Gas, billion cubic meters	1841	1841	6,54	6,2	9,2	10,0	2860	2860	1875	1875	6591,7	6592
Uranium, thousand tons	601	601	-	-	-	-	-	-	83,7	83,7	684,7	684,7
Hydro-potential, T.W.H. per year	27	27	52	99	317	317	2	2	17	17	413	460
Non-traditional and Renewable resources of energy, T.W.H. per year	66	66	-	-	18,4	18,4	-	-	-	-	84,4	84,4

Comments:
1. The volume of prospected reserves are presented for coil, petroleum and natural gas;
2. The estimation of prospected reserves with costs of output up to 130 dollars per kg is given for uranium;
3. Fuel and energy balance of Central Asia in 2000 was : 22,3% - for coal, 21,2% - oil, 53,2% - natural gas, 3%-hydroenergy, 0,3%- Non-traditional and Renewable resources of energy and net – import of energy.

Table 2. Production and Use of Fuel and Energy Resources in Central Asia, million tons of equivalent fuel

	1992	1994	1995	1996	1997	1998	1999
Kazakhstan	149,2/ 96,2	118,1/ 88,3	107,4/ 72,4	102,2/ 62,2	96,7/ 56,5	94,2/ 53,2	91,7/ 50,7
Kyrgyzstan	6,2/ 5,2	5,3/ 3,8	4,9/ 4,1	4,8/ 4,2	4,6/ 3,9	4,5/ 3,4	4,4/ 4,0
Tajikistan	5,7/ 10,7	5,4/ 11,0	5,3/ 9,8	5,3/ 9,0	5,2/ 8,6	5,2/ 8,5	5,2/ 8,5
Turkmenistan	77/ 24,5	47,4/ 18,2	42,4/ 17,4	44,6/ 17,2	24,8/ 16,2	22,5/ 15,7	36,2/ 15,5
Uzbekistan	53,9/ 64,3	66/ 65,9	71,4/ 62,2	73,4/ 63,9	76,6/ 65,7	79,5/ 68,6	82/ 70,7
Central Asia	297,4/ 200,9	242,2/ 187,2	231,4/ 165,9	230,3/ 156,5	207,9/ 150,9	205,9/ 149,4	219,6/ 149,5

Comments:
1. Production/ Use
2. For period 1992-1999 the demand for primary energy carrier in Central Asia was decreased approximately for 50 million tons of equivalent fuel or for 26%.

Table 3. The forecast of gross domestic product for 2002 at purchasing-power parity of national banks in dollars US.

Country	Quantity of population, million men	Volume of gross domestic product, billion dollars US	Gross domestic product per person, dollars/per person
Kazakhstan	17,67	89-99	5037-5580
Kyrgyzstan	6,072	5,6-6	919-1018
Tajikistan	11,0	10-11	935-1035
Turkmenistan	5,1	12-13	2353-2608
Uzbekistan	37,0	93-103	2522-2792
CA	76,84	210-233	2735-3029

Comments:
1. Table № 3 is compiled on the base of the forecasts of World Bank (1999) and extrapolation of growth rate of population for the period from 2010 till 2015.
2. Growth of GDP for the period from 1999 till 2020 may come to 68-86% in Central Asia.

Table 1. The perspective purposes in forming of the general energy markets of Central Asia

1	Maintenance of the wide inflow of foreign investments needed for ensuring the operational state and development of the base of the fuel, producing and energy transmission.
2	Creation of stable and reliable resources of delivery of FER to the internal and foreign markets.
3	Reaching of a secure and non-discrimination transportation and transit of the power units through the third countries' territory.
4	Development and performance of the coordinated political line in the international power carrier markets.

Table 2. The negative factors in forming of the general energy markets of Central Asia

1	Insufficient pass capability of the trans-boundary transport-communicative and energy links, low exploration of the significant parts of the fuel and power potential of Central Asia (Ustuyrt plateau, Aral shelf and adjacent territories and so on).
2	Low level utilization of FER in all stages of the production cycle, critical highest level of the tear of the manufacturing capacity in the sphere of the fuel-energy complex, critical insufficiency of the investments, lack of the enough reserves in construction of the new and technical re-equipment of the present power units.

Table 3. The portion of Central Asia in the structure of the world energy resource potential.

1	The explored reserves of coal about 4%;
2	The explored reserves of oil 2%. The preliminary evaluations of the oil reserves, were not included, exploration of the Kazakhstani part of Caspian shelf and adjacent territories (North Kazakhstan and others), which lead Kazakhstan to the five leading oil power of the world.
3	The natural gas reserves – 4,5%.
4	Uranium reserves – 20%.
5	Economical effectiveness of the hydro-potential – 5,5%.

Temporary limits of FER (Fuel and Energy Resources) exhaustion in Central Asia in 1998 were estimated as:	
6	By coal, under the extraction of 62 million tons per year – more than 600 years;
7	By oil, under the extraction 45,2 million tons per year – about 65 years;
8	By natural gas, at the production 88,4 billion cube meter per year –about 75 years.

Table 4. The problems of forming of the united energy system and creation of the general energy market of the region

1	Realization of the united principles of tariff and price policy, providing the equal competitive opportunities of the national Fuel and Energy Complexes;
2	Forming of the coordinated scientific-technical and technological policy in the sphere of production of FEC, inter-state and transnational financial funds, accumulation means for performance of the complex projects with the primary utilization of the internal investment resources;
3	Performance of the obligatory procedures of certification and standardization for production and use of FER;
4	Reaching the optimal fuel-energy and water-land balances with taking into account of each countries' interests and conclusion on this basis of two or multilateral contracts in accordance with the Energy Charter and International Convention on utilization of the flow of the trans-boundary rivers and other reservoir.

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Sources of Kazakhstan inflation

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Introduction

Nature of Kazakhstan inflation to the same extent the substance economic policy, that it capable of ensuring its suppression has been being for a number of years the subject of scientific and political discussion. All variety of reasons interpretations of Kazakhstan inflation can be reduced to two extreme points of view:

a) the inflation has non-monetary or at any rate not only monetary nature;
b) the inflation is the monetary phenomenon.

We consider how much non-monetary explanation corresponds to economic reality in Kazakhstan.

Non-monetary inflation interpretations

Among factors, which are bringing inflation, the following reasons are named more often than not.

1. Structure of Kazakhstan economy

Structure of Kazakhstan economy does not allow overcoming inflation rapidly and it condemns Kazakhstan to exist for years in high inflation conditions. Of its own essence the argument about the "technological backwardness" of Kazakhstan economy also is related to such explanation.

From the point of view of its structure, Kazakhstan economy, as however any other one, possesses definite inimitability. Also undoubtedly that technological level of many Kazakhstan productions (although far from everyone) is not in accordance with the world samples. However is it the reason of inflation?

After the USSR had disintegrated, many formed Soviet Republics inherited the similar economic structure, however its inflation growth rates were highly different. Obviously that Russian economy is the most similar to Kazakhstan one. However inflation rates in Kazakhstan

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were higher than in Russia: 18% higher in 1992, more than 2.5 times in 1993, much more than 5 times in 1994, but in December 2000 inflation growth rates in Kazakhstan had been being 10% lower than in Russia.

Obviously that technological level of Belarus economy not lower than Kazakhstan or Russian ones. However that fact had not ensured more lower inflation growth rates in Belarus.

If in 1992 the growth of prices in Belarus was lower than 1.5 times in comparison with similar Kazakhstan indicator, in 1993 it had been being more than 1.3, in 1994 – 5, in 2000 – 2.4 times.

At the same time the technological level of Kyrgyzstan economy and its structure, obviously, had not been comparing with Russian, Belarus and Kazakhstan ones. However in 1994 inflation growth rates in Kyrgyzstan were lower 2.5 times than in Russia, 22 (!) times than times in Belarus, 13 times than in Kazakhstan. In 2000 inflation growth rates in Kyrgyzstan had been being 5.5 % higher than corresponding indicator in Kazakhstan.

Factor of the economic structure does not make it possible to explain inflation growth rates changeability for months. Quite obviously that economy structure is not capable of changing so rapidly to say that there is the only reason in Kazakhstan for transition from relatively low inflation level (94.1% - in 1991) to very high (2962.8% - in 1992), then to achieve reduction inflation level more than twice (2169.8% - in 1993, 1156.8% - in 1994) and at last, reduce it to two-digit number (26% - in April 1995).

Structural and technological factors are capable of explaining neither inflation growth rates distinctions among AIS – counties nor inflation fluctuation for months in any of these countries.

2. High level of the monopolism

If this factor is to consider decisive one for inflation growth rates then it should be recognise that the level of monopolism in Trans-Caucasion republics and Belarus was much more higher then in Kazakhstan and Russia; in Kazakhstan and Turkmenistan more than dozens times in comparison with Uzbekistan and Tadjikistan. In Moldova it was more than 76 times in comparison with Estonia and in Turkmenistan - 312 times in comparison with Latvia. Then it should be suppose that in 1992 monopolism level had grown several times in these countries, after all the monopolism became reduce in certain ones, and in others - grow. Obviously that such inflation interpretation doesn't hold water.

Reference to high monopolism level, as the source of inflation, that often uses not only in AIS - countries, but also in many countries of Eastern and Central Europe, does not take into account one very significant circumstance. Exactly, that since national economy have opened any, the largest national monopolists had been becoming very modest producers not only in the world market, but in its own national one. So in conditions of internal and external economic liberalisation the decisive factor their policy is not the tendency to monopoly conduct, but embittered competition struggle for own survival, which rules out the possibility to fix monopoly prices.

Equally, fluctuations of inflation growth rates for months in Kazakhstan and in AIS - countries deprive the following affirmation any serious sense: as if fluctuations of monopolism levels are in their nature.

3. Disintegration of economic relations as a result of a disorder USSR

If correctly this position, the paces of inflation should be proportional to intensity of links between republics before disintegration USSR. And consequently its minimum level should be supervised in Russia, in the least degree (concerning GNP) depending from their neighbors. The best growth rates of the prices should be supervised in the Baltic States, Moldova, Belarus, to the greatest degree depending upon from deliveries from remaining Unit. Actually all has taken place on the contrary: the paces of inflation in countries of Baltic and Moldova have appeared by the lowest, and in Russia, in Ukraine, in Kazakhstan - one of the highest.

4. Inflation of costs, in particular rise in price on power carriers

If to suspect existence of so-called inflation of costs, predetermined any other inflation, naturally there is a problem: and whence this inflation of costs undertakes, which factors call it, what is its nature?

Probably, alone case, at which one the similar argument of inflation on a micro level has though any right to existence, introduces a rise in price on mass import of goods, for example power carriers, specially if their fraction in balance of consumption of the country - importer is great enough.

However, at first, by virtue of low specific weight of import in GNP and secondly, that of Kazakhstan is the exporter of power carriers, it to a lesser degree qualifies as this rule is. At the same time in the Baltic countries which have tested the most acute price shock after instantaneous transition on imported power carries on the world prices, the paces of inflation have appeared in tens times below, than at power exporters - Russia, Kazakhstan, Turkmenistan.

5. Psychological reasons, inflationary waiting. The prices grow with rate of propagation of inflationary waiting

The inflationary waiting really exist, their operating only adjusts a rate of inflation, but does not determine the baseline inflationary background as the inflationary waiting will emanate from the last and present expertise of the economical agents.

Why, for example, the announcements of the government officials about a decline in the rate of inflation at the end of 1994 and then in April - May 1995 have not impressed on it indispensable psychological affecting, and it has decreased in that proportion, what was expected from it?

6. The decrease of inflation is instituted by non-disbursement of a wage

There is no doubt, that the non-disbursements of the money incomes constrain progressing inflationary processes. How many? The held accounts of affecting of delays in the wage on paces of inflation have shown that the delays really influence variation of paces of inflation. However, the fraction of this factor in its common level did not exceed 3 % in 1992, 12 % in 1993, and-11% - 14 % in 1994. What factors determined remaining 86-97 % from a common level?

Apparently, that not any of non-monetary interpretations of inflation are not capable to explain its nature.

The monetary nature of the Kazakhstan inflation

Pursuant to the monetary approach, the inflation is a money phenomenon, and its dynamics is instituted by an amount of money in economics.
The price level in economics is predetermined by an amount of money, reverting in it. This position is described by a classic equation of interchanging [1]: $\mathbf{M \cdot V = P \cdot Q}$,
whence follows: $P = M \cdot V / Q$,
where P - average price of commodity;
Q - volume of production;
M - money supply;
V - velocity of circulation.

The major reason of beefing-up of inflationary processes consists in quicker growth of a nominal money supply as contrasted to by growth of a national product in physical expression:

$$i_p = \frac{i_M \cdot i_V}{i_Q}$$

wher i_p - index of the prices;
i_M - index of a money supply;
i_v - index of velocity of circulation;
i_Q – index of a substantial product.

Knowing these variables, it is possible not only to explain dynamics of inflation, but also forecast its progressing on the future.
The availability in the formula of argument is does not change the money nature of inflation.

As in rather short periods of time in conditions of inflation of variation in dynamics of a substantial product are not essential, the major factors defining rate of inflation appear bulk of a money supply, speed of its circulation and also temporary lags, during which the move of a money supply causes changes in paces of inflation.

Further we attempt to maneuver an equation of inflation of more communal nature, where the inflation is introduced as a function from the factors of growth of a money supply.

The equation of financing of a deficit of the budget represents a simple identity, pursuant to which one all state financing is under construction.

$$d=cg+b+f, \qquad (1)$$

where cg - credits issued to a National Bank to government in percentage in relation to GNP;

b - sale of the state bonds in percentage to GNP;

f - foreign loans to government in percentage to GNP.

Let economics operates without interference of the National Bank in dynamics of the course of exchange, as a result of which first line reserves do not vary, that is DR=0. Apart from the credits to government, the National Bank credits business banks (cb). Thus, the balance of the National Bank can be recorded as follows:

$$\frac{\Delta H}{P \cdot Q} = cg + cb, \qquad (2)$$

from here, with allowance for formulas (1), we will receive:

$$\frac{\Delta H}{P \cdot Q} = d - b - f + cb, \qquad (3)$$

where H - money base.

Further equation of inflation, where the inflation equals to the sum of growth rates of money base and rates of change of velocity of money [1] looks like:

$$i = \frac{\Delta H}{H} + \frac{\Delta V}{V}, \qquad (4)$$

Let's substitute an equation (3) in an equation (4), we shall receive the basic equation of inflation:

$$i = \frac{P \cdot Q}{H}(d - b - f + cb) + \frac{\Delta V}{V}. \qquad (5)$$

Thus it is necessary to pay attention to the following moments:

1. All credits of the National Bank, in what to the shape they were issued, equally call inflation, though and with miscellaneous speed. Any credit of the National Bank spawns consumer demand, which one was not earlier. In result the inflationary impulse irrespective of is receivable, whom the credit - business bank for consequent transfer to the plant or government for payment of the salary to the workers of budget sphere was initially issued to.

2. For inflation the budget deficit as such matters not so much, how many is that its fraction, which one is covered with the help of the credits of the National Bank. That is for inflation matters not so mach **d**, how many **(d-b-f)**. Differently, the inflationary effect of a budget deficit can be eased, at least on time, with the help of the internal or exterior loans.

3. For arguments **b** and **f** there are relevant quantitative restrictions, though in the given equation it directly is not mirrored. Or else, the government can not indefinitely resort to all to the new and new loans to diminish inflationary effect generated by the credits of the National Bank on covering of a deficit. The creditors will cease to produce in a duty to insolvent government; they will overlap limitations on the sizes either **b** or **f** depending on an dependence of solvency of government.

4. At more high speed of the circulation of money or lower demand for substantial money the rate of inflation is increased at a stable level of the credits of the National Bank.

If to hold on to the «credit» point of view on inflation (according to this theory inflation it is possible to introduce as a function of growth of the credits, namely $i = \frac{\Delta C}{C}$, (where C - the credits),

that equation (5) will look so: $$i = \frac{P \cdot Q}{C} \cdot (d - b - f - cb). \qquad (5a)$$

From the formula it is visible, that from «the «credit» point of view of variation in velocity of money (DV/V) for inflation have no any value.

If to allow for a role of the course of exchange in an inflationary process, that is

$$i = a \cdot \frac{\Delta C}{C} + (1-a) \cdot \frac{\Delta E}{E}, \qquad (5б)$$

where a - fraction of the Kazakhstan goods and services, which one are not plant of export of import, and their prices do not depend on magnitude of the course of exchange;

(1-a) - fraction of the goods, the prices which one are subject to influencing of the course of exchange;

$\frac{\Delta E}{E}$ - variation of the course of exchange,

that equation (5) will accept an aspect:

$$i = a \cdot \frac{P \cdot Q}{C} \cdot (d - b - f + cb) + (1 - a) \cdot \frac{\Delta E}{E} \qquad (5в)$$

This is the same equation (5 a), only here is taken into account influencing the course of exchange.

Let's esteem a case, when the national Bank regulates the course of exchange, so its first line reserves vary. Then equation (4) will look like:

$$i = \frac{P \cdot Q}{H} \cdot (d - b - f + cb) + \frac{\Delta R}{H} + \frac{\Delta V}{V} \qquad (5г)$$

where DR - first line reserves of the National Bank.

This is the same equation (5), except that the accumulation of first line reserves carries on to a growth of inflation, as augments a money supply.

Reverting to the listed above four posts, we can assert, that they are applicable to any situation. As to influencing on inflation of such factors, as variation in velocity of money, effect of accumulation of first line reserves, and also dynamics of the course of exchange, they remain a subject of scientific disputes. At the same time all explorers agree with the thesis about inflationary effect of growth of the credits of a national Bank. That fact does not call doubts also, that the financing of a deficit by not monetary facilities can on short time reduce a rate of inflation.

For understanding the basic sources of inflation we shall return to an equation (5a):

$$i = \frac{P \cdot Q}{C} \cdot (d - b - f + cb)$$

Higher deficit of the budget in percentage to GNP **(d)** augments inflation in such extent, in what it is financed by the credits of the National Bank. However inflation can be reduced in such extent, in what deficit of the budget will be financed by drawings on internal **(b)** and exterior **(f)** the markets. At last, plotting scale of effect of each of the evocative here factors on inflation depends on magnitude of a credit multiplicator (PQ/C).

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Foreign direct investment in Uzbekistan: An overview of its determinants and consequences

Mete DURDAG*[1]

Introduction

After gaining independence in 1991, Uzbekistan has experienced a persistent recession until 1996 and modest economic growth thereafter. Uzbekistan recovered its 1991 level of GDP by year 2000 and attained about 3% growth in 2001. Both 2000 and 2001 have been difficult years because of declining export earnings due to lower prices of gold and falling export volumes of cotton, the two major export products of Uzbekistan. Adverse effects of September 11 terrorist events on world trade and investment climate have hit Uzbekistan particularly harshly as it is situated in a critical location in the conflict area. Such economic developments, coupled with increased dialogue with the USA and other major western countries on international political and security issues, have led the GOU to reconsider the gradualist reform strategy that it has been following since independence.

Uzbekistan: Selected Economic Indicators

	1993	1995	1997	1998	1999	Est. 2000	Proj. 2001
GDP (% change)	-2.3	-0.9	2.5	4.4	4.1	4	1.0
Consumer prices (ann. av.% change)	534	305	59	18	29	28	28
Current Account (US$ millions)	-429	-21	583	-38	-154	-19	na
Government balance (% of GDP)	-10.4	-4.1	-2.4	-3.0	-1.8	-1.0	5.0
Trade balance (US$ millions)	-378	237	-72	171	125	317	na
Total FDI (US$ million, cash & net)	48	-24	167	226	201	231	na
External debt stock (USS$ millions)	1039	1771	2594	3484	4289	4150	3900
Unemployment (% of labor force)	0.3	0.4	0.4	0.5	0.6	na	na
Exchange rate (ann. av. Soum/US$)	1.0	33.0	90.3	130.9	260.8	521.6	795.6
Gross reserves, excl. gold (end-yr, $mil)	856	815	374	533	783	na	na

Source: EBRD, Uzbekistan Investment Profile 2001, April 2001

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The gradualist reform strategy, accompanied with the policy of attaining early self-sufficiency in energy and food and with largely successful efforts to redirect key exports (e.g., gold and cotton) to international markets, has helped Uzbekistan to avoid the dramatic output collapse and drastic fall in living standards experienced by other CIS countries in the first half of the 1990s. Uzbekistan's real GDP declined by only 14 per cent during 1991-93, compared to a CIS average of almost 40 per cent. On the other hand, the gradualist reform strategy has caused Uzbekistan lag seriously behind most other transition economies in opening up its economy to outside world and in adopting a market-based economy. This has resulted in suspension of the IMF's Standby Arrangement and curtailing the assistance programs of other major donors, including the World Bank, EBRD, ADB, and USAID.

The low level of economic liberalization in Uzbekistan has been accompanied with a relatively limited inflow of foreign direct investment (FDI), with cumulative net FDI from 1993 to 2000 amounting to only just over US$ 1.0 billion. More recently, the country has attracted only US$ 200 million in FDI in 1999 and US$ 230 million in 2000. In terms of cumulative FDI per capita over the period of 1989-2000, Uzbekistan's US$ 28 stands by far at the bottom of the list of other transition economies[2]. Uzbekistan's more recent performance also compares dismally with most of other transition economies.

FDI Flows to Transition Economies

Some transition economies have been particularly successful in attracting large amounts of FDI. A consensus has already emerged in economic literature on the main determinants of FDI in the transition countries. Such determinants include domestic and potential export market size; natural resource endowment; skill endowment; unit labor costs; progress in transition reforms; and economic and political stability. The impact of the last two determinants (i.e., the investment climate) on FDI inflows is particularly highlighted with reference to the good performance of the Central European transition countries compared to the weak performance of Balkan and CIS countries, which are less advanced in market-based reforms.

Cumulative FDI per capita, 1989-2000

	US$.		US$.
Hungary, Czech Republic	1900-2000	Bulgaria, Romania	300-400
Estonia	1350	Armenia, Turkmenistan,	
Croatia, Latvia	900-1100	Albania	150-170
Lithuania, Poland, Slovenia,		FR Yugoslavia, Kyrgyzstan	120-130
Slovak Republic	650-800	Bosnia &Herzegovina, Ukraine,	
Azerbaijan, Kazakhstan	500-600	Moldova, Belarus, Russia, Georgia	70-100
		Uzbekistan	28

Source: L. Krkoska, Foreign Direct Investment Financing of Capital Formation in Central and Eastern Europe, EBRD Working Paper No. 67, December 2001.

Recent research on the determinants of FDI flows to transition economies concludes that FDI is driven primarily by progress in transition and macroeconomic stability. It is true that investors' decisions would be based on profit calculations and countries' economic potentials, but the feasibility and sustainability of such potential profits would be assured by economic reforms and stability. With the beginning of disintegration in the socialist block in late 1989, the countries of central Europe have quickly initiated programs for liberalization, privatization and institutional change. Serious reform attempts in the former Soviet Union took place only after its break-up in 1991. FDI flows to those countries, which were more successful in their market reforms and macroeconomic stabilization, started to pick up with a two- or three-year lag. Hungary, and to a lesser extent Czechoslovakia, were the first to receive significant FDI flows in 1991, both in the form of acquisitions within their privatization programs. Poland, Russia, Kazakhstan and some smaller countries (Estonia, Slovenia) began to attract FDI during 1992-94. Hungary attracted the largest amount of FDI per capita (with its FDI/GDP ratio exceeding 10 per cent) outside the developed economies in 1995, and Poland attained the top place in 1996 with FDI flow doubling for two years in a row. From 1997, large privatizations with foreign participation in the telecom and oil sectors began to increase strongly FDI flows into Russia. On the other hand, several countries of Central Asia (leaving out the two oil and gas economies of Azerbaijan and Kazakhstan), the Caucasus and the South-eastern Europe, which have been lagging in market reforms and economic stabilization, have so far failed to prove attractive to foreign investors.

Uzbekistan's Experience with FDI

Uzbekistan has rich natural resources such as gold, gas, and cotton. It is also generously endowed with rich deposits of uranium, silver, copper, lead, and other non-ferrous metals. It has over 30 per cent of regional oil reserves; 55 per cent of coal reserves; and 75 per cent of gas – the second most important gas producer in the CIS. The country, with 24 millions of population, is the largest consumer market in Central Asia. Uzbekistan is situated at the crossroads of the ancient Silk Road between China and Europe and, as such, has a unique geographical location to become a hub for the entire Central Asia region. It pursues an independent foreign policy line and distances itself from CIS policies, which are dominated by Russia. It has instead been focusing on increased bilateral ties and good relations with its neighbors.

To attract FDI into Uzbekistan has been one of the main priorities of the government's economic policy. The government has adopted two important acts to replace old legislation: Law on Foreign Investments (April 30, 1998, revised on August 20, 1998), and Law on Guarantees and Measures to Protect Foreign Investors' Rights (April 30, 1998). Several Presidential decrees have also been issued to facilitate various aspects of FDI in Uzbekistan, including to Encourage the Creation and Activity of Enterprises with Foreign Investment (May 31, 1996); to Promote Small and Medium Business Development (January 31, 1997); to Develop Securities Market and Extend Foreign Investors Participation in the Securities Market (March 31, 1997); to Promote Export-oriented Production of Enterprises with Foreign Investments (August 26, 1997); and to Promote Implementation of Investment Projects (January 19, 1998). A

1996 law offers various incentives to investors to develop free economic zones, but no FEZs have yet been established. At the end of April 2000, the President issued a decree granting more favorable conditions (e.g., exemptions from a range of taxes and customs duties as well as a seven-year tax holiday) to attract FDI in the oil and gas sector.

The extremely low level of FDI in Uzbekistan compared to that in other transition countries cannot, obviously, be explained by the country's relative endowment situation, or by lack of interest in FDI on the part of GOU. On the contrary, Uzbekistan seems to be more favorably endowed with natural and human resources and better located to attract FDI than many transition economies. Regarding the government's interest in FDI, wide-ranging incentives offered to FDI are so generous and extensive that, if anything, they may be thought creating duplication and confusion between different legislation. Explanation for low level of FDI in Uzbekistan, therefore, lies in the failure to establish an investment climate conducive to domestic and foreign investors. Particularly, the continuation of foreign trade restrictions, limitation of firms' full access to their foreign exchange earnings (i.e., foreign exchange surrender requirement), and the multiple exchange rate system discourage potential foreign investors. The lack of confidence in the legal framework by businesses, caused by haphazard and arbitrary exercise of the authorities' regulatory power, further weakens the interest of foreign investors in Uzbekistan.

Improved Prospects for FDI

The recently improved dialogue and cooperation between the GOU and the major western countries, led by the USA, has extended beyond international political and security issues and provided a convenient vehicle to develop a new economic reform drive by the GOU with support from the IMF and other major donors. The GOU has already been implementing a "staff-monitored" program (SMP)[3] in the first half of 2002 in order to prepare the ground for a new reform program to be prepared in the summer that can be supported by technical and financial arrangements with the IMF, the World Bank and other members of the donor community.

The key objective of the SMP is to ease progressively restrictions and regulations on economic activity and allow greater scope for market forces to set prices and determine the allocation of resources. In this context, the government has been gradually lifting all restrictions on access to foreign exchange for current account transactions and moving towards exchange rate unification by the end of the SMP. The state procurement policies for agricultural products will be reformed to scale down its coverage and alleviate its adverse effects on production and prices. The program also aims at enhancing the efficiency of the banking system by eliminating all directed credits and moving to a more market-based allocation of credit and by removing all restrictions on cash withdrawals by individuals and enterprises. With respect to price policy, the SMP envisages to gradually reduce the number of monopolies and monopoly products and to abolish price margin regulations, which were introduced on socially important goods. The government has also been making progress within the SMP to further liberalize foreign trade by streamlining and rationalizing the import tariff system, reducing the number of goods subject to export bans, and abolishing the system of ex ante registration of import contracts.

Finally, the SMP states unequivocally the GOU's commitment to continue the macroeconomic and structural reform efforts beyond mid-2002 so as to achieve macroeconomic stability, sustainable growth and poverty reduction over the medium-term. In this context, the program particularly emphasizes the following:

- The government will progressively dismantle remaining restrictions and regulations to facilitate the ability of economic agents to do business;
- The Central Bank of Uzbekistan will conduct a managed floating exchange rate policy; and,
- The government will continue to implement the comprehensive privatization program for 2001-2002 as well as the de-monopolization and enterprise restructuring program initiated in early 2001 of such sectors as electric power, cotton processing, oil and gas, coal, chemical industries, furniture production and railway transport.

The new reform drive of GOU will certainly create, after a certain wait-and-see period, a significantly improved business environment for FDI. At the same time, however, increasing FDI flows will make strong contribution to the success of Uzbekistan's macroeconomic and structural reform efforts over the medium-term. This contribution will result not only from FDI's role in capital accumulation but also from its upstream and downstream linkages and demonstration effects. It can, for instance, force higher standards of product quality and supply reliability upon local producers through its procurement management, with a benefit of learning externalities for other purchasers. In monopolized markets, FDI may have power to impose greater competition. Foreign investors' standards of technology and corporate governance can be transmitted via demonstration effects. Advanced marketing methods of the foreign investor can have an impact on the distribution systems, marketing logistics, and competition in the economy of Uzbekistan. FDI in banks can have particularly positive effects on the development of credit evaluation skills and financial discipline in the banking sector.

Most Promising Areas for FDI

The GOU launched an ambitious privatization program in 1998/99 in order to attract FDI, but the initial results have not been encouraging because of concerns about the business environment in Uzbekistan and the government's reluctance to give up control. Also for most part of 1998 and 1999, international market conditions were not favorable for the privatization of large enterprises. Efforts to privatize commercial banks have also encountered delays, as no state bank was able to meet the government requirement that the state share be reduced to 50 per cent or lower by mid-1999.

The stalled privatization program is expected to gain momentum in 2001-2002 with plans to privatize about 600 enterprises, including the oil and gas monopoly Uzbekneftegas; telecom provider UzbekTelecom; two large cement companies; Uzcable, the largest cable producer in Central Asia; Tashkent Chkalov Aviation Production Association, and Almalyk mining metallurgical combine. However, the state is not prepared to lose management control in any of these concerns. In the banking sector, the dominant position of the National Bank of Uzbekistan is the main obstacle to privatization in the sector. Currently, efforts are being made to privatize the NBU by selling 40 per cent of its shares to foreign investors, and Asaka Bank as a pilot case if strategic investors can be found.

The large and powerful multinational companies could deal with an unfavorable investment climate through their ability to establish direct access to the top authorities in the country and through having support of their home government(s) in case of any dispute. Several of such large FDIs have already established themselves in such key sectors as gold, cotton ginning, tobacco, and automotive. These sectors, however, still offer good opportunities for more FDI, which could now find it easier to enter. With expected improvement in the business environment, as explained in the previous section, the new drive for privatization can attract significant flow of FDI into Uzbekistan if the government shows convincingly that it has also undergone a major change of heart about ownership and governance issues. This is particularly important for attracting FDI to an extensive range of activities, creating maximum employment and income earning opportunities for the economy. These activities range from such labor-intensive projects of agricultural production and agro-processing to the high technology and capital-intensive projects in the oil and gas and the telecommunication sectors.

Conclusion

Despite its endowment with rich natural and human resources and favorable location, Uzbekistan has received the lowest level of FDI over the 1990s compared to all other transition economies. The main explanation for this lies in the economic policy of the government, which has been characterized by a cautious approach to structural reforms and reliance on administrative measures and government control in economic activity. Notwithstanding its positive results in avoiding drastic falls in production and living standards, the government economic policy has created an economic environment that was not conducive to investment in general and FDI in particular.

The new reform drive launched by the GOU from the beginning of 2001 is expected to significantly improve the business climate for FDI. Such improved business climate, coupled with technical and financial support from the IMF, the World Bank and other major donors, would no doubt encourage both domestic and foreign investors to take part in Uzbekistan's newly revitalized privatization program. Equally important, however, would be an increased interest by FDI in the medium- to large-scale projects, most probably jointly with local capital, in the development of new areas with good potential for integration with international markets. The outcome, however, would very much depend on progress the government would make in implementing the market-based reforms and macroeconomic stabilization policies.

Endnotes

1 The author thanks Mr. Kamol Inomhojayev of the Ministry of Macroeconomics and Statistics, Uzbekistan for his valuable assistance.

2 Since no official data on FDI in Uzbekistan are available to individual researchers, this paper draws on secondary sources, mainly the works of the international economic agencies. $28 of cumulative FDI per capita received by Uzbekistan, quoted from an EBRD working paper, however seems to be on the low side. Based on some partial information on the subject available in other international and government sources, this figure could be as high as $60, but this would not alter the crucial point that Uzbekistan ranks at the bottom of the above table.

3 A staff-monitored program is an informal and flexible instrument for dialogue between the IMF and a member country on its economic policies. The full text of the SMP program for Uzbekistan (Memorandum of Economic and Financial Policies for the period January 1 – June 30, 2002) was made public on February 7, 2002 through IMF website (www.imf.org).

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Perspectives of sustainable development of Kazakhstan: What are the implications for multinationals?

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The purpose of this paper is to analyze the factors that affect the economic growth of Kazakhstan and predict the rate of GDP growth for the country and the consequences for domestic demand. The methodology focuses on public policies and the natural endowment of Kazakhstan. By putting Kazakhstan in an international perspective we describe three scenarios of possible course of events. Because of insufficient statistical data the projections are of purely conjecture.

Will Asian tigers industrial organization methods be applied in Kazakhstan?

During the Soviet era, the Communist Party was the sole ruler of the USSR. Despite the fact that in 1986 Kazakhstan was the first among the Soviet republics to show signs of nationalist and anticommunist sentiments, democratic movements did not develop in Kazakhstan to an extent sufficient to influence the course of events in the post-Soviet era. After the demise of the Soviet Union the same communist leaders came to the power. The first president of Kazakhstan, N. Nazarbayev, did his best to ruin the remnants of the Communist Party and strengthen his position.

Soon after the collapse of the Soviet Union, the ruling elite eliminated opportunities for wide scale corruption for lower-level bureaucrats but transparency at the highest level is still questionable. Now the government seems to be influenced by a group of very rich people. A characteristic feature of this group is that they are very good in politics and not so good in business, especially with regards to corporate governance.

They have an opposition on the part of businessmen, who might have benefited from the early confusion but these days do not receive any direct or indirect financial support from the government. Owners of large independent companies feel that they need subsidies and other forms of government support to attain a critical mass necessary to expand in international markets. The "Strategic Plan for the Development of Kazakhstan", developed in 2001 by the Agency for Strategic Planning under the leadership of K. Kelimbetov, was a concentrated expression of this point of view. The dismissal of four high government officials, including Kelimbetov, in November 2001 means that the opposition has been defeated. N. Nazarbayev in his interview said that large national companies would have to manage on their own. Thus, at least until 2006, the year of presidential elections, subsidization as a means of developing large corporations will not be used.

In Japan and South Korea subsidies to national companies, being a market imperfection, were combined with a pervasive system of administrative incentives for national producers to increase exports. The government of Kazakhstan assumes a liberal market approach instead. Government intervention in the form of import tariffs and quotas is more pronounced in the case of import substitution. In the absence of statewide practices of intensive microeconomic methods of growing national businesses, most national companies are confined to the domestic market and investment by national companies by itself is not likely to provide the target rate of GDP growth of 7-8%.

Private saving as a source of domestic investment

In a less developed country, investment by national companies depends on the ability of its government to stimulate saving and mobilize national businesses for an aggressive growth strategy. Here we look at policies designed to increase domestic saving. More exactly, we mean forced saving policies, which increase saving at fixed interest rates. Examples include:

a) reducing the supply of consumer loans by raising interest rates or administratively prohibiting loans for consumption purposes,
b) import tariffs on selected consumer commodities,
c) reducing social programs (medical and unemployment benefits and social security system), to induce individuals to save more,
d) limiting residential construction,
e) imposing high property taxes,
f) forcing employees to save into pension accounts.

Using forced saving policies, the governments of South-East Asian countries were able to increase savings up to 30-35% of GDP. Since the Kazakhstan government does not apply a full range of such policies, the saving rate of 30-35% will not be achieved, despite the target set by the President.

In Kazakhstan, the law obligates employees to save into pension accounts. In June 1997, the government reformed the pension system by moving from a PAYGO system to a system of mandatory savings. Following the introduction of pension funds in January 1998 as part of the pension reform, a large amount of savings in Kazakhstan is being accumulated in the pension funds. Total assets managed by pension funds are estimated to achieve about 8% of GDP by the end of 2002, 10% of GDP in 2003, and 12% of GDP in 2004 (IMF).

However, one should not be very optimistic about the savings provided by the pension reform. It has been successful in accumulating substantial savings in pension funds but, by putting a 45% cap on investment in low-rated corporate securities and a 40% minimum on investment in government securities, it effectively diverts pension funds from investing in the domestic

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private sector. Moreover, the country's landlocked position necessitates investment in pipelines and other infrastructure outside its borders. An additional drain of domestic resources is the ambitious construction of public buildings in the new capital Astana.

The recent economic performance

The first years of the transition period were characterized by a significant decline in industrial output that reached its trough in 1994. Real GDP declined by 44% between 1990 and 1994. The recession was halted in 1995, and in 1996 there was a growth in real GDP by 0.5% and by 2% in 1997. It was expected that output would continue to grow in 1998, but the economy was hit by external shocks (crises in Asia and Russia and decline in prices of raw materials). However, the recovery of world prices of primary commodities, in particular oil, in 1999-2000, plus devaluation of tenge in April 1999 resumed the growth of the economy that was 1.7% in 1999 and 9.8% in 2000. In 2001 Kazakhstan experienced growth in real GDP by a further 13.8%, which was the best figure since the country became independent.

The growth of per capita GDP in the fourth quarter of 2001 amounted to about USD 362 that is 15.4% more than in the corresponding period of 2000. The total 2001 GDP per capita reached USD 1507 in 2001, which is the best indicator since independence.

Chart 1. GDP per capita (in USD); 1994-2001

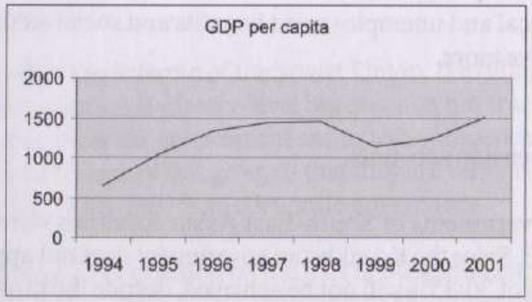
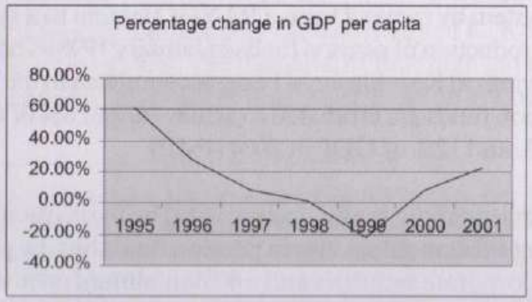


Chart 2. Change in GDP per capita; 1995-2001



Growth in output resulted in increases of nominal and real wages. So, in 2001 the average monthly wage at large and medium enterprises amounted to KZT 17,500 or USD 119, which is 22% higher than the 2000 average level in nominal terms or 12.5% in real terms. Almost all branches of the economy exhibited real increase of wages. The highest growth in real wages was observed in such sectors as agriculture, construction, public administration (especially customs activities), rent and services. Although the highest increase in wages was observed in the regions dominant in extraction of natural resources, the average increase of wages in all regions varied between 22% and 48% compared to the previous year.

Oil exports and FDI as a source of current growth

The volume of FDI depends on the environment created for foreign investors and is governed by several strategic motives, of which the following are relevant to Kazakhstan: search for natural resources, search for political stability, and the desire to hold a strategic position in Central Asia. While the investment by national companies has been low so far (about 70% of the capital is obsolete and worn out), the FDI volumes (about $1 bln. per year) put Kazakhstan ahead of China on a per capita basis.

The growth of the economy has been driven mainly by foreign direct investment to hydrocarbon industry and oil exports. Since independence, Kazakhstan has already attracted approximately $10 billion in foreign investments. At present, the oil industry accounts for about 30% of government budget revenues, and FDI continues to go mainly to oil and gas industry. N. Balgimbayev, former president of Kazakhoil, the national oil and natural gas company, said in October 2001 that Kazakhstan planned to attract an additional $65-$70 billion in investment to its promising oil and gas sector over the next 10 to 20 years.

Kazakhstan has boosted its oil production from 530,000 barrels per day (bbl/d) in 1992 to 803,000 bbl/d in 2001, with a 415,000 bbl/d drop in the first years of the transition period. The opening of the Caspian Pipeline Consortium (CPC) last year was very important in connecting Kazakhstan's oil with international markets. It is expected that the CPC will handle up to 1.5 billion bbl/d. As a result of the CPC, the costs of transportation of oil will be reduced considerably, with the accompanying increase in profitability and tax revenues.

Western investors are searching for new opportunities in Kazakhstan. For instance, Hurricane Kumkol Munai JSC expects to increase production to 200,000 bbl/d over the next two years, and reduce transportation costs by half. Production in the giant Tengiz basin is expected to reach 415,000 bbl/d by 2005 and 750,000 bbl/d by 2010. After Tengiz, Kashagan is expected to attract the attention of foreign investors. The estimated reserves of Kashagan is at least 10 billion barrels. Kazakhstan is expected to auction off close to 100 offshore blocks in the area this year. In addition to AgipKCO which is exploring Kashagan, various Western oil ompanies are expected to bid on the rights around Kashagan.

Oil revenues and their use

Oil revenues reached 0.9% of GDP in 1999, and estimated 6.1% in 2000. Owing to the rapid increase in the share of the oil sector in the economy, the volatility of the world oil prices is becoming the most important factor explaining the fluctuations of government revenues in Kazakhstan. Between 1998 and 2000, a period for which reliable official data is available, the share of the central government tax revenues in GDP fluctuated between 16.9% and 21.1%.

Owing to the lack of a well-developed analytical framework and the volatility of oil and commodity prices, revenue projections, in particular regarding corporate income taxes (CIT), are characterized by a high uncertainty in Kazakhstan. In 1999, the actual revenue from CIT was 55% higher than the budget projections, and in 2000 it was higher by more than 200%.

In January 2001, President N. Nazarbayev issued a decree establishing the National Fund (oil revenues fund) to enable the government budget to be less vulnerable to changing prices for commodity exports. By the end of 2001, $1.78 billion has been accumulated in the National Fund (about $77.5 per capita). Extra budget revenues, taxes from oil companies, and signing bonuses and royalties paid by foreign partners in joint ventures are allocated to the Fund.

One of the generally accepted practices in less developed countries is to channel hard currency earnings from raw materials exporters to those industries, which most need hard currency for importing capital equipment and technologies. In Kazakhstan, such a channel has not been created. Instead, a part of the oil revenues is put into the National Fund, which is supposed to invest in high-rated international securities. Therefore, the country is likely to suffer from the Dutch Disease (that is, the inability to use the proceeds of the extraction industry for restructuring the economy).

It is fair to say that the dependence of Kazakhstan economy on oil is less critical compared with countries of the Persian Gulf, such as Saudi Arabia where oil revenues make up around 70-80% of state revenues and 90-95% of total Saudi export revenues. The economy of Kazakhstan is more diversified (although very much dependent on prices of other primary commodities such as metals). Russia is the main trading partner of Kazakhstan.

After private saving, public saving is the second most important component of a successful growth strategy. For instance, because of subsidizing consumption, Saudi Arabia has a high level of domestic debt (about 100% of GDP). In comparison Kazakhstan prefers to save the oil proceeds in the National Fund.

Perspectives for future growth

We consider a massive domestic investment the main pre-requisite for a fast GDP growth. Domestic investment consists of two parts: investment by national companies and foreign direct investment (FDI).

In the group of countries, which relied mainly on internal sources of funds and on public borrowing from international financial organizations, South Korea and Taiwan set a good record of 10% growth in the long run. In the group of nations, which achieved the same highest rate by additionally attracting wide-scale foreign private investment, China is the leader.

The landlocked position of Kazakhstan will invariably hinder its efforts in achieving the same growth rate (for example, transportation costs constitute up to 50% of total cost in case of grain and coal). In addition to high transportation costs, the cost of oil production is comparatively high in Kazakhstan. While exploration and development costs are relatively low (because of the huge size of the projects), production costs are significant because of the difficulty in producing from fields with large amounts of corrosive high-sulfur associated gas. Production costs (per barrel) have come down for large projects, especially at the huge Tengiz project (from $5.00 to $2-2.5) owing to increases in the scale of production. Still, they are higher than in Saudi Arabia and Kuwait, where the marginal cost of production of an additional barrel of oil is very low. Therefore an 8% growth rate is a reasonable upper estimate in the long run (this is the target rate set by the government). Given the experience of major oil producing countries, a 2-3% rate of growth is a sensible lower estimate.

We expect that FDI will remain strong in Kazakhstan over the medium term. According to the latest report of the Economic Intelligence Unit (EIU) on FDI in 27 transition countries. An improved business environment across the region will be the main drive of FDI. The projections are based on the EIU's business ranking model. This model captures the current and future trends in business environment and generates ranking for the past five years and the next five years. The projections for FDI in selected transition countries are shown in Table 1 (see Annex).

Rankings of attractiveness of the business environment are presented in Table 2 (see Annex). The EIU's model of business ranking model is based upon the examination of 10 categories: political environment, macroeconomic environment, market opportunities, policies on free enterprise and competition, policy on foreign investment, foreign trade and exchange controls, taxes, financing, the labor market, and infrastructure. We can see from Table 1 that the operating environment is expected to improve from 4.30 to 5.59 for Kazakhstan, behind only some Central European countries and Baltic states.

The favorable investment climate in Kazakhstan is determined by the following factors. The authoritarian character of the political regime contributed to political stability. The market reforms realized so far provide for a stable macroeconomic environment. The current legislation does not discriminate against foreign investors. This includes repatriation of profits and possibility of 100% foreign ownership of companies in Kazakhstan. The efficiency and the soundness of the financial system, which are not so important for countries with considerable government intervention and regulated prices and are very important for international investors, is closer to international standards than in other Central Asian republics. Through open market operations, the National Bank of Kazakhstan maintains exchange rates that favor exports. More importantly, while import substitution is an issue, crowding out international investors, especially in high tech industries, is far beyond the desires of the government and the possibilities of national producers.

Further, the fears that the aftermath of the September 11 terrorist attacks would have negative impacts on the FDI inflows into the country did not materialized. As a result of September 11, the strategic importance of the region has increased and this will enhance the attractiveness of the Central Asian region, and Kazakhstan in particular.

Conclusions

We consider that two main factors affect economy growth: FDI and the growth of national businesses. The situation when both FDI drops and national businesses do not grow into large internationally competitive corporations are very unlikely. We take it for granted that the oil sector will grow at approximately the rate of growth as the world demand for oil.

With regards to FDI there are two possibilities: -

1) FDI is limited mainly to the raw materials industry and additionally,
2) foreign investment is undertaken in other industries.

In the first case, the foreign sector of the economy is expected to grow by 6% on average. In the second case because of the small size of the domestic consumer and labor markets, Kazakhstan can host at most several export-oriented subsidiaries of multinational corporations. This can provide an additional 2-3% growth.

The growth of national enterprises depends on the governments' industrial policy.

A) If the stress is made on small and medium-size businesses, they will supply mainly to the domestic market, including multinationals operating in Kazakhstan. The national sector's growth will be at most 3%.
B) If the government drastically changes its behavior by introducing forced saving policies and providing additional stimuli for national corporations, then the national sector may grow at a rate of up to 8%. However, the high degree of government intervention that is necessary in this case will preclude multinationals from developing industries other than raw materials.

By combining the possibilities 1)-2) and A)-B), we describe three scenarios: -

Scenario One: FDI mainly in raw materials industry and sluggish growth of national companies.

The expected real GDP growth rate is 3%. FDI in the extraction industry is the main source of growth, with national businesses filling other niches. With their expertise, technologies, superb products, and access to international financial markets, multinational corporations dom-

inate the domestic market. The difference between the oil sector and other sectors becomes more and more noticeable. All symptoms of the Dutch Disease are present. The reason why national companies grow slowly is that private saving is low (because forced saving is not applied), the micro incentives for businesses to grow have not been put in place, and investment by national companies is low. This happens in part because the oil proceeds are not used to increase private investment but are spent by either public or government. Lack of transparency in government budget formation and fiscal accountability is conducive to corruption at highest levels of government. Under this growth rate, the expected real wages increase is about 2-3%.

Scenario Two: a few foreign companies decide to operate production facilities large enough to provide economies of scale.

This is possible only if the government continues with its liberal market approach. The role of the national capital under this scenario is still limited, and the overall GDP growth is expected to be 5-6%. It could be expected that real wages will increase by 4-5%. The prospects for multinationals' sales on the domestic market are as good as under Scenario One.

Scenario Three: The government decides to increase the national sector's share in the GDP and maximize the rate of growth.

Given the size of national businesses, the only way to achieve this objective is to intervene heavily. The forced saving policies will limit the domestic market. Subsidization of national companies will require a high degree of market regulation. Multinationals will find it unattractive to invest in industries other than the extraction one. The GDP may grow in this case at a highest rate of 8%. This scenario may happen if the opposition becomes strong enough. An officially subsidized group of companies will be interested in increasing transparency and fiscal accountability. The total gross investment can increase to 16-17% starting 2002, as compared to 14% in 1999 and 11.5% in 1998. Under such an optimistic scenario, the expected increase in real wages is 6%.

Given the current openness to FDI and public policy, Scenario Three has a very low probability. We think that the other two scenarios are equally likely. The outcome will depend on how much political and economic dependence is admitted by the government. In both cases, the domestic market remains pretty much accessible for foreign producers.

Annex

Table 1. Foreign Direct Investment Inflows, selected transition economies, 1996-2005.
($ millions, annual averages)

Country	1996-2000			2001-05		
	Total	% of GDP	$ per head	Total	% of GDP	$ per head
CEE	12,955	4.4	195	16,120	4.0	243
Czech Republic	3,463	6.4	337	4,960	6.9	486
Hungary	2,029	4.4	201	2,030	3.0	205
Poland	6,528	4.3	169	6,900	3.2	178
Slovakia	699	3.5	129	1,640	6.9	303
Slovenia	236	1.3	119	590	2.4	296
Balkans	3,023	3.2	55	4,530	3.8	81
Albania	73	2.4	19	180	3.7	44
Bosnia & Herzegovina	67	1.5	18	340	5.7	82
Bulgaria	594	5.1	74	950	5.6	121
Croatia	882	4.4	196	940	3.6	194
Macedonia	70	2.1	35	180	4.8	90
Romania	1,115	3.0	50	1,350	2.9	60
Yugoslavia	222	1.3	21	580	3.7	54
Baltics	1,173	5.5	154	1,270	4.1	169
Estonia	310	6.3	214	350	4.7	243
Latvia	403	6.7	164	470	5.5	198
Lithuania	460	4.4	124	450	3.1	121
CIS	**6,699**	**1.7**	**24**	**10,540**	**2.1**	**37**
Armenia	112	6.1	30	130	6.0	34
Azerbaijan	681	17.5	86	450	7.4	55
Belarus	239	1.8	24	210	1.6	21
Georgia	152	3.0	28	160	2.7	29
Kazakhstan	**1,289**	**6.7**	**86**	**1,300**	**5.2**	**88**
Kyrgyz Republic	59	3.7	13	90	5.0	18
Moldova	72	4.9	17	120	6.8	28
Russia	3,246	1.1	22	6,600	1.7	46
Tajikistan	25	2.3	4	30	2.2	5
Turkmenistan	94	3.1	20	130	2.2	26
Ukraine	596	1.5	12	1,060	2.1	21
Uzbekistan	135	0.9	6	250	2.2	10

Source: EIU (August 2001), Transition newsletter, World Bank, October-November-December 2001.

Table 2. Business Environment Scores and Ranks, 1996-2005

Country	2001-05		1996-2000		2001-05/1996-2000	
	Total rank	Regional rank	Total score	Regional score	Change in score	Change in rank
Estonia	7.40	1	6.86	1	0.54	0
Hungary	7.26	2	6.42	2	0.83	0
Poland	7.07	3	6.22	3	0.85	0
Czech Rep.	7.01	4	6.18	4	0.83	0
Slovenia	6.96	5	6.08	5	0.87	0
Lithuania	6.95	6	5.74	7	1.21	1
Latvia	6.88	7	5.87	6	1.01	-1
Slovakia	6.57	8	5.46	8	1.11	0
Croatia	6.33	9	5.23	9	1.10	0
Bulgaria	5.94	10	4.03	17	1.91	7
Kazakhstan	5.59	11	4.30	13	1.29	2
Russia	5.49	12	4.12	14	1.36	2
Armenia	5.34	13	4.50	10	0.84	-3
Azerbaijan	5.28	14	4.35	12	0.92	-2
Romania	5.24	15	4.10	15	1.14	0
Yugoslavia	5.23	16	2.79	27	2.44	11
Macedonia	5.21	17	4.47	11	0.73	-6
Albania	5.09	18	4.01	19	1.07	1
Ukraine	4.95	19	3.27	23	1.69	4
Georgia	4.87	20	4.01	18	0.86	-2
Moldova	4.78	21	4.04	16	0.74	-5
Kyrgyz Rep.	4.77	22	3.75	22	1.02	0
Bosnia & Her.	4.66	23	3.98	20	0.68	-3
Belarus	4.16	24	3.91	21	0.25	-3
Tajikistan	3.55	25	2.81	25	0.74	0
Turkmenistan	3.46	26	3.05	24	0.41	-2
Uzbekistan	3.18	27	2.80	26	0.38	-1

Source: World Bank, Transition newsletter, October-November-December 2001.

Endnotes

1 This paper is based on the project under the same name implemented by the authors for Procter & Gamble Central Asia. We are grateful to Procter & Gamble for the permission to publish our findings.

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APPENDIX I

About PROCTER & GAMBLE Project at KIMEP

The Procter & Gamble Company manufactures and markets a broad range of consumer products in many countries throughout the world. It markets approximately 300 brands to nearly five billion consumers in over 140 countries and which opened a Representative Office in Kazakhstan (1994), Uzbekistan (1996), Kyrgyzstan, Turkmenistan and Mongolia (1998).

The main P& G brands that are successfully competing in the region include Tide, Ariel, Myth, Pantene Pro-V, Head & Shoulders, Wash & Go, Always, Alldays, Tampax, Pampers, Comet, Fairy, Safeguard, Camay and Blend-a-Med.

The success of the company is directly linked with its purpose: «We will provide products and services of superior quality and value that improve the lives of the world's consumers.»

For the relatively short period that P&G has operated in the Central Asia, a lot of positive initiatives were started under corporate sustainable development projects. Beginning from 1998, in co-operation with the Ministries of Health, Education & NGOs («Bobek», «Healthy Generation Fund»), the three educational programs related to hygiene and healthy life style got their «ticket to life», when hundreds thousands of pupils and young mothers pass as a result of the health lessons.

From the first day of its operations in Central Asia, P&G has supported many positive initiatives by local scientists. A number of the scientific conferences and congresses were sponsored by P&G, and as a result, the publication of scientific magazines «Dermatology News», «Dentistry» and «Pediatrician» have become «engines» for modern science.

The Procter & Gamble at KIMEP

Procter & Gamble supported in February 2002, a short-term research grant on foreign direct investment and its impact on Uzbekistan's local economy, as well as the analysis of oil revenue countries' growth rate with application to Kazakhstan. The project was implemented by KIMEP faculty members Kairat Mynbayev.

Procter & Gamble also is sponsoring for 2002-2003, a large research project at the KIMEP Research Center on 'Local Content for the Republic of Kazakhstan'.

External donors and civil society in Central Asia: Really strengthening it or making it in their own mirror image?

Simon HEAP*

Abstract

This paper begins with an exploration of the conceptual issues surrounding the notion of civil society. Civil society refers to that space in which organizations and individuals occupy between the level of the family and the State but which enjoy a degree of autonomy from the State and the market. A strong Civil Society provides a means by which the interests of citizens are a powerful counterbalance to state power and market forces. A weak Civil Society is one that is ineffectual at representing the interests of citizens and of providing any countervailing power to the State. In terms of the role of a strengthened civil society in relation to the State and formal power and authority, there are two contrasting schools of thought. One views the relationship as essentially oppositional; this view lies behind the arguments that civil society must be strengthened in order for it to serve as a buttress against the State and to redress the massive imbalance between State and citizen. A second view sees Civil Society and the State as complementary rather than as antagonistic; the strengthening Civil Society cannot be done independently of the State and certainly not at the expense of the State.

Many development agencies are now focusing on strengthening Civil Society by building the capacity of NGOs to spearhead the process. In Central Asia, as elsewhere in the developing world, the donor agenda has tended to support environmental, human rights and democracy groups, most of which are located in capital cities. One issue emerging in Central Asian civil society development is the degree to which NGOs form themselves into the image expected by external donors. This 'mirror effect' causes NGOs to project themselves in ways which meet external expectations and obtain resources, despite not always fitting their own view of what their mission should be. As donors command the resources, they also shape the priorities, promote certain values and cultivate particular institutional forms such as projects and micro-credit groups. Skewed in favour of legally-registered NGOs, civil society strengthening of civil society in central Asia will take time. Critical to the process will be the emergence of a mature and robust set of national NGOs that are able to assume local leadership in driving the development process.

Civil Society: Conceptual issues

A broad and general definition of the term is that civil society *refers to that space in which organizations and individuals occupy between the level of the family and the State but which enjoy a degree of autonomy from the State and the market*. However, while there may be some

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agreement on this basic definition, there has been much debate over whether or not civil society can or should be more precisely defined. Essentially there are two views regarding what types of organizations should be considered as part of civil society: the exclusive view and the inclusive view.

The exclusive view attaches ideological value to civil society. It equates civil society with democratisation and only those organizations that are actively supportive of democratic processes are considered to be part of it. Many other types of organizations are excluded from this definition of civil society on the grounds that they do not actively engage with the State but instead are inward looking or have a largely parochial outlook. Religious groups with a fundamentalist outlook, ethnic associations and local traditional organizations would all be excluded from civil society under this interpretation. The types of organizations that would be included are those familiar in the Western liberal democracies: voluntary organizations, popular fronts, trade unions and professional associations and, of course, NGOs. NGOs in the last decade have received a greater percentage of a shrinking pile of bilateral aid – at the expense of government. Such organizations are engaged in negotiating on behalf of their members or third parties in relation to the State and in doing so are thought to make the State more democratically accountable to its citizens.

The problem with this exclusive view is that civil society becomes limited more or less to formal, modern organizations, which actively and explicitly represent the interests of their members in relation to the State. Traditional, cultural and informal associations would be excluded. There is a danger that if a Western concept of civil society is applied to other societies in the South, huge areas of 'association life' will be overlooked, with the result that only a small fraction of the population would be engaged in civil society. In other words, outsiders are more likely to focus on the most visible, recognizable and familiar organizational forms, and ignore others, which may have much stronger local legitimacy as organizations representative of civil society.

The alternative inclusive view includes a much broader range of organizations within civil society. This approach recognizes the fact that the relationships between civil society and the State are highly complex and operate at multiple levels of engagement. Rather than equating civil society with democracy, it is necessary to identify what elements within civil society are likely to promote democracy, and equally, what elements of civil society are likely to resist it. It means that the term 'strengthening civil society' must be qualified - with a statement of which types of organizations within civil society are to be strengthened. For example, civil society organizations can play an important role in the following areas of national life:

- building a social consensus for economic reforms, and encouraging positive alignments within civil society - and between civil society and government - that push for long-term development.
- promoting institutional transparency and accountability, combating corruption, and broadening the base of decision-making.

- combating inequality and exclusion, promoting and protecting human rights, and influencing the quality and distribution of economic growth.
- delivering social and economic services.
- improving natural resource management and environmental protection.
- building constituencies for poverty-reduction, sustainable development and international co-operation.

Civil society has come to be synonymous with profound social change. The term came to the fore during the collapse of communism in Eastern Europe as many countries embraced democratic change. Popular people's movements were instrumental in bringing down oppressive regimes and promoting democracy. The term civil society was increasingly used to refer to 'people power'. Elsewhere the political liberalization that was taking place in the South also reflected the important role played by ordinary citizens in acting together to protest against authoritarian government and to campaign for democracy. Hence within the context of promoting a liberal democratic state, we can ask the question 'what role has civil society to play?' In this respect we would argue that civil society has a critical role to play in building a link between government structures and society at large. This is, and will be in the foreseeable future, of critical importance for those seeking to promote effective social change (Hearn, 2000).

In terms of the role of a strengthened civil society in relation to the State and formal power and authority, there are two contrasting schools of thought. One views the relationship as essentially oppositional, antagonistic and conflictual. This notion is found in Western liberal thought in which the Civil Society is seen as the means by which individuals are protected from incursion of the state and by which state power is limited. This view lies behind the arguments that civil society must be strengthened in order for it to serve as a buttress against the State and to redress the massive imbalance between State and citizen power. A second view sees Civil Society and the State as mutually interdependent and complementary rather than as antagonistic. This view regards Civil Society and the State as neither fully autonomous nor fully self sufficient. According to this view, the strengthening Civil Society cannot be done independently of the State and certainly not at the expense of the State (Robinson, 1995; Clayton, 1996).

Both views have their protagonists and they are reflected in the strategies of different development agencies. The practice to-date suggests views across the whole spectrum. It also suggests that many initiatives may well have been launched in the name of the 'strengthening of civil society' without a clear perspective of what the ultimate objective might be. Indeed views on civil society are often governed by the realities of the State and the use of state power in particular countries. The first model of Civil Society is seen as more appropriate for societies with a very strong, pervasive State, such as former communist regimes. In such societies, Civil Society has taken on a confrontational position in relation to the State in order to demand democratic transition. Where the State is very powerful, the primary role of Civil Society is to challenge this power. In other countries where the State is relatively weak and fragile, the second model may be more appropriate. In order to promote long-term democratic governance. In such instances both the State and Civil Society need to be strengthened. A weak State will not be able to provide the political stability and legislative framework in which a civil society can develop.

A strong Civil Society provides a means by which the interests of citizens are represented in relation to the State and the market, therefore providing a powerful counterbalance to state power and market forces. A weak Civil Society, on the other hand, is one that is ineffectual at representing the interests of citizens and of providing any countervailing power to state hegemony. The strengthening of Civil Society, therefore, is not only to encourage an increase in the number of organizational forms in a country - though in some cases this may be important - but rather to support processes that will make the State and the market more democratically accountable to citizens (Fowler, 1996).

In the past decade there has been a greater willingness to recognize and promote the comparative advantage of NGOs to deliver public services at local level. Given tight (and tightening) public sector budgets, NGOs are perceived by donors and reformist central governments alike to have the added advantage of not representing a recurrent cost for the state. This small State/large NGO sector scenario is now challenged, however, on the grounds that it has failed to replace key state functions for the equitable delivery of services. The focus on NGOs as "the magic bullet" has given way to a broader debate on the scope of civil society as a political and development actor, giving rise to competing interpretations of what constitutes civil society and how it relates to the state both ideally, within theoretical constructs, and pragmatically, in specific contexts (Beauclerk and Heap, 2001, pp. 1-2).

The concept and practice of strengthening Civil Society

The 1980s witnessed a major new development focus and initiative on the part of international aid donors. The decade heralded an era of structural adjustment and state institutional change programmes. These aimed at both reforming the policies and structures of government and also at strengthening citizen participation and promoting organizations that could serve as a countervailing power to state domination. In the 1960s and 1970s many international and national NGOs had already been promoting strategies of more effective community participation and organization – principally in Latin America and the Asian sub-continent. However, it was in the 1990s that many of these activities became consolidated into strategies of development intervention built around the strengthening of movements and organizations that represented a range of different societal groups and that could serve as the basis for more pluralist democracies and replacing state hegemony.

These strategies have resulted in a widely expressed broad purpose of development interventions built around the notion of 'strengthening civil society'. In the past five or six years the term has become extensively used to explain the overall purpose of the development work, not only of national and international NGOs but also of both multilateral and bilateral donors. Most, if not all, of the major international NGOs and multilateral/bilateral donors explicitly embrace the 'strengthening of civil society' as a major overall purpose of their development thinking and strategies. Many recent studies (Robinson M, 1995; Robinson W, 1996; Carothers, 1999a and 1999b; Biekart, 1999; Siddiqi, 2000; DANIDA, 2000) attest to the increasing influence of civil society strengthening in the strategies of key development actors. They also show how in the latter part of the 1990s considerable sums of money were spent on this purpose.

Generally the 1990s were dominated by market-orientated development strategies aimed at strengthening the capacity of private sector institutions to contribute to poverty reduction. But the past few years have witnessed the growing recognition by donor agencies of civil society as an important counterweight to some of these strategies. Recognizing the importance of representative groups, donor agencies have begun to seek to actively engage with civil society. The result has been specific policies and programmes that involve engagement with organizations and institutions within civil society. Within the space of a few years, the strengthening civil society has become one of the major objectives of development agencies - both multilateral/bilateral donors and NGOs. As a result many development agencies are now focusing their development co-operation on strengthening Civil Society, either by building the capacity of NGOs to spearhead the process or by direct support to other organizations in Civil Society, such as trades unions, professional and business associations, women's organizations, and youth groups. In particular international NGOs sympathize with the idea that a vigorous civil society that could take the lead in promoting justice and greater equality, but the relationship of NGOs with other organizations of civil society is not unproblematic.

As interest in civil society of actors in development processes has grown, as has the concept filtered through into documents, public statements and strategic plans. Furthermore specialized civil society units, newly appointed civil society advisers and civil society strengthening programmes are all now recognizable features of many development agencies. We have reviewed the documentation and public statements of development agencies ranging from the World Bank to a number of the major European NGOs and we have found many examples of discrete civil society programmes. The World Bank has changed the name of its NGO Unit to the Civil Society Unit as has the United Nations Development Programme (UNDP) (World Bank, 2000; Siddiqi et al, 2000; UNDP, 2000, chap. 7); the United States Agency for International Development (USAID) has followed the shift in direction (Robinson, 1996; Carothers 1999a), and the British Department for International Development (DFID) has a Civil Society Department (DFID, 2000). American Philanthropic Foundations have committed millions of dollars to monitor democratic reform and support local organizations with the Ford Foundation, for example, establishing a Governance and Civil Society Division (Van Rooy, 1998; Klose, 2000).

Much of the civil society literature continues at the level of broad processes of democratization and good governance but there is a dearth of evidence in terms of the success, or otherwise, of programme-based interventions to strengthen a particular segment of civil society. Essentially we know very little – other than in quantitative terms – of how successful development agencies are at promoting and "measuring the outcomes, of the following kinds of objectives of civil society strengthening programmes:

- strengthening organizational capacity of formal and informal autonomous organizations;
- building and strengthening horizontal alliances between civil society actors and organizations;
- developing advocacy capacity and strengthening intermediary channels in civil society;
- providing access to transitional political space; and
- contributing to building citizenship: developing civic consciousness, democratic leadership and a general sense of social responsibility" (Biekart, 1999, p. 221).

INTRAC's Research Project on Civil Society in Central Asia

INTRAC is an NGO Support Organization based in Oxford, UK, but running the largest British civil society programme in Central Asia. Additionally, it is conducting a three-year research project into Civil Society in Central Asia with a grant from DFID's Social Science Research Unit. The aim is to continue to strengthen on-going INTRAC efforts to analyse the emergence of civil society in Central Asia in order to better understand the dynamics of Civil Society Organizations in Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.

INTRAC and its local researchers[1] have sought to make the current mapping exercises of Civil Society in Kazakhstan and Kyrgyzstan as wide as possible in scope. There is more to Civil Society than just NGOs: non-organizational forms as well as borrowers groups; Community Based Organizations; cooperatives; student, professional and consumer associations; cultural organizations; foundations; interest groups; religious groups; social and sports clubs; trades unions; and NGOs involved with youths, women and pensioner movements, and those working in the fields of human rights, education, welfare, environment and service delivery.

Does Civil Society even exist in Central Asia? According to the UNDP's Regional Bureau for Europe and Commonwealth of Independent States:

> Even in the late 1990s, many of the [ex-Soviet] countries lack strong institutions on which civil society is usually based - a confident, well-functioning parliament, accountable local government, a responsible and well-established press, strong independent and well-respected trade unions and so on (1997, p. 103).

Abdumannob Polat, the chair of the local Human Rights Society, believes 'the basis for creating civil society does not yet exist in Uzbekistan' (Polat in Ruffin and Waugh, 1999, p. 135). In Kazakhstan, however, the underlining philosophical conception of Civil Society appears locked into Marxist-Leninist ideology and what can only be described as Kazakh consciousness. In other words, a mixture of old-style thinking perpetuates and permeates current nation-building exercises run by the President and Central Government. So the creation of Civil Society in Kazakhstan has to overcome years of ideological indoctrination that continues to persist in the public discourse, and ethnic loyalties. In attempting this, do ethnic loyalties have to be destroyed, or could they constitute a foundation for the formation of a unique Kazakh

Civil Society? (INTRAC-KIMEP, 2002) The research seeks to test such claims across Central Asia.

External Donors and The 'Mirror Effect'

By identifying those factors encouraging and constraining the development of CSOs, INTRAC's research will pay specific attention on the role of external donors. The fundamental question is whether "the tens of millions of dollars, pounds, marks and francs" (Starr S. F. in Ruffin and Waugh, 1999) spent by Western governments in the past ten years strengthening Civil Society in Central Asia have gone to waste when you see authoritarian regimes in place, and increasingly securely in place?

Donors operating in Central Asia are many and varied. They can be classified under three groupings: multilateral/bilateral organizations, foundations and International NGOs. The former list includes the Asian Development Bank, Royal Danish Foreign Ministry (DANIDA), Euorpean Union (EU), Know How Fund, UNDP and USAID. Foundations like Eurasia, Frederick Ebert, ISAR (Initiative for Social Action and Renewal), Konrad Adenauer and Soros provide support to local Civil Society. International NGOs include Counterpart Consortium, HIVOS (Humanist Institute for Co-operation with Developing Countries), INTRAC, SCF (Save the Children Fund), Helvetas, Swiss Coalition, and the Red Cross and Red Crescent Societies

A major issue that has emerged in the debate on civil society in the past decade has been to do with the role of development NGOs in Civil Society. Sometimes NGOs, as one of the largest and more visible kind of organization of civil society, have been treated as synonymous with it. Furthermore the funding of development NGOs has often been categorized as support for civil society. However, development NGOs are but one group of organizations within civil society and generally their record of building alliances with other organizations such as mass movements, trade unions and human rights groups is not impressive. Indeed many NGOs have been reluctant to take a more political role in relation to the State and prefer to focus on service provision. Furthermore, support for development NGOs in the South does not necessarily lead to strengthening Civil Society. Indeed it can often lead to the undermining of Civil Society if local organizations and decision-making structures are by-passed. Furthermore many NGOs are funded from external sources, and lack local legitimacy and accountability. They may not be sustainable in the long run. As Carothers (1999a, pp. 220-21) points out: "a large percentage of the NGOs that the United States and other donors have funded in the name of strengthening civil society are almost entirely dependent on foreign financial support and would fold if it became unavailable". The Regional Director of Counterpart Consortium, recognises this locally in Central Asia:

> The availability of international support, whether in the form of technical assistance or funding, has certainly been a motivating factor for the formation of NGOs. There are charismatic leaders in Central Asia who organize NGOs that are completely grant driven and grant fed, and although they may have creative and needed projects their intentions are to obtain equipment and receive salaries. The donors, in their haste to deliver funds and repeat success, approve projects without appropriate methods of project monitoring or without a real understanding of the capacity of the NGO to complete the project or satisfy the contract (Cooper, 1999, p. 219)

In Central Asia, as elsewhere in the developing world, the donor agenda has tended to support environmental, human rights and democracy groups, most of which are located in capital cities. As donors find it easier to deal with professional leaders and representative, which command English and Russian and are at ease with Western Europeans and North Americans, they implicitly reinforce the urban, elitist tendency of civil society (Howell, 2000, p. 13).

The growing influence of Islam and the concomitant flourishing of mosques and religious gatherings provide a key cornerstone of Civil Society development. Yet donors rarely include Islamic organizations within their definition of civil society or within their range or organizations to support, "not least because it is assumed that Islam is incompatible with pluralism and democracy" (Howell, 2000, p. 15). Self-justification for such partiality is evident:

> People in Central Asia felt the Islamic fundamentalist movement to be a foreign import and that it did not deserve the media attention that it was getting. Women in particular dislike the idea of a Muslim government, and although there have been some inroads made in refugee communities by fundamentalists, most people do not support or take an interest in Islamic fundamentalism (ISAR, 1998).

Given the terrorist attacks of September 11th 2001, a review of these exclusive positions is underway. While too early to judge in practice, the notion of Islamic civil society is on the radar of donor thoughts and actions.

There is a distinct contrast between American and European donor interventions to strengthen Civil Society in Central Asia. American groups take a political view of support for Civil Society stressing good governance, democracy, the free market and civic duty, through both official programmes of USAID and private initiatives like the Soros Foundation:

> Civil society is the connective tissue that transitional countries need to join the forms of democracy with their intended substance, to ensure that new democratic institutions and processes do not remain hollow boxes and empty rituals (Carothers, 1999a, p. 248).

American democracy promoters have made few efforts to understand civil society on its own terms in complex traditional societies in Africa, Asia and the Middle East. They basically ignore the clans, tribes, castes, village associations, peasant groups, local religious organizations and ethnic associations as essentially unfathomable complexities that do not directly bear on democratic advocacy work. "Democracy promoters pass through these countries on hurried civil society assessment missions and declare that 'very little civil society exists' because they have found only a handful of Westernised NGOs devoted to non-partisan public-interest advocacy work on the national scale" (Carothers, 1999a, p. 249). Yet, there were also some signs that Kyrgyzstan's formal commitment to democratisation had paid off, evident in the fact that during the mid-1990s USAID was providing 16 times as much per head to Kyrgyzstan as it was to the much more authoritarian Uzbekistan (Anderson, 1999, p. 78).

European groups and UN agencies, on the other hand, look to NGOs as partners or vehicles for relief - coal, baby milk and fuel handouts and refugee assistance - and developmental activities such as credit, poverty reduction and advocacy campaigns.

One issue likely to emerge in INTRAC's research is the degree to which NGOs form themselves into the image expected by external donors. This 'mirror effect' (Heap, 2001) causes NGOs to project themselves in ways, which meet external expectations and obtain resources, despite not always fitting their own view of what their mission should be. As donors command the resources, they also shape the priorities, promote certain values and cultivate particular institutional forms such as projects and micro-credit groups. The processes are in turn invigorated as local NGOs "formulate proposals around the perceived interests of donor agencies, adding a dimension here, inserting environmental issues there and adopting donor discourses of empowerment, participation, sustainability and income generation to lend credence to their proposals" (Howell, 2000, p. 17).

One organization quantified the 'mirror effect' in 1997. More than 200 active environmental NGOs dedicated slightly more than 1 million man-hours to environmental issues in Central Asia. They compared these figures to donor reports in order to figure out what more then 500 full-time activists in Central Asia did in 1997. In total, USAID, Counterpart Consortium, Frederich Ebert Foundation, Soros, ISAR, and TACIS provided 597,000 hours of training to environmental activists, in addition to funding for NGO conferences. In their own reports, the NGOs recorded 130,000 hours of travelling. So 727,000 hours, or slightly less than 65% of the time of environmental activists was spent in 1997 in conferences and training. The remaining time was occupied with answering e-mail from American school children (47,000 hours), writing grant proposals (200,000 hours), plotting to destroy competing NGOs (23,000 hours), learning computer skills and games (37,000 hours) and direct implementation of projects to improve the environment (132,000 hours) (Sievers, 1998).

Although they might protest their individual predicaments too much when they do have choices to make in their working lives, the 'mirror effect' has taken its toll on NGO activists (all quoted in Sievers, 1998):

> It's really embarrassing. People ask me about my organisation Catena Ecological Club and the Turkmenistan environment. I have no clue. I haven't seen my family in seven months. I live in Almaty and Bishkek,

> now. The problem is that these conference coordinators don't coordinate between themselves. I mean, if they really want to make a difference, they should make it possible for us to get two weeks off a year! Attending conferences is rough work! (Andrei Aranbaev, Ashgabat).

> I've had to go to 37 countries this year. I mean, my passport's in shreds and my back's killing me from those long plane trips and coach[es] (Oleg Tsaruk, Tashkent).

> The unseen tragedy of what the international community is pushing down our throats is that they're taking years off our lives. One day vodka and the next sherry. One day meat potatoes and the next quiche with some unknown sauce. It almost makes you want to just get the work done and go home instead of struggling to fritter away your per diem in exotic bars and restaurants (Yusup Kamalov, Nukus).

These patterns undercut NGO's claims to represent local communities. In fact, NGOs have become more reflective of donors than of local populations. In order to combat this, funders need to shift their emphasis away from NGO development. We need to broaden funding sources and ensure that community participation is always a large aspect of the projects that we support (ISAR, 1998). Yet the American Initiative for Social Action and Renewal in Eurasia (ISAR) is not untypical of donors who actually see this 'mirror effect' as an inherent, necessary state of affairs which demands perennial NGO metamorphosis:

> The influx of foreign aid has left its own stamp on the sector, and local NGOs have had to keep up with the ever-shifting priorities of international donors. Last year, for example, funders targeted the Aral Sea; now Caspian Sea projects are in vogue. *Organizations need to be highly flexible to match the changes in funding trends.* The current emphasis is on NGO development, and since funders like tangible outputs, as many as 60 NGO newsletters currently circulate and there has been a recent glut in NGO resource centres (ISAR, 1998, emphasis added).

Even this situation will not go on for much longer. The United States Agency for International Development (USAID) is pulling out of Central Asia in a couple of years time. Its NGO arm, Counterpart Consortium, is seeking to indigenise and make local offshoots sustainable within this short, ever shortening, and time span.

Conclusion

A major issue that has emerged in the debate on civil society involved a number of political and ethical questions about the desired role of external agents in developing and strengthening civil society. For some "the notion of external agents creating, supporting and strengthening civil society rings very much of interventionism, of neo-colonialism in a seemingly woolly, friendly garb" (Howell, 2000, pp. 19-20). Fox (1995) argues that few of these external agents – mainly the representatives of international NGOs – have a coherent vision, strategy or policy toward the strengthening of civil society. The issue is not that external agents should abandon programmes to strengthen civil society but that they should think more strategically, analytically and 'modestly' about their possible contribution to processes of political and social change in other countries. International organizations should ensure that their expatriate staff, who bring mind-sets and pre-conceived ideas from other areas of the world, are willing to develop new strategies in partnership with local staff who have the political and social history knowledge of the area within which they work. International organizations need to be constantly monitoring the work they do, bearing in mind that the transference of skills from other parts of the world may not be appropriate even from one Central Asian state to another (Garbutt, 2001).

The promotion of civil society by official donors in pursuit of Good Governance developed on the understanding that reform would not take place without improved systems of government. Support for civil society followed in recognition that transition towards democratically elected governments did not in itself guarantee a more democratic culture and evolved concepts of complementarity rather than counter-balance, once the legitimacy of the state as a key development actor was rediscovered (as it was by the World Bank in 1997). This model has been refined (World Bank, 2000) towards empowerment (a traditional civil society preserve) and the need for state and social institutions to be responsive and accountable to poor people – that is, a shared obligation on civil society and the state.

Ask external donors in the region as to what they fund, and virtually all will reply, NGOs, only NGOs. No other form of CSO gets a look in. Skewed in favour of legally registered NGOs, civil society strengthening in Central Asia, like so many other parts of the world, is partial and lob-sided. Fowler (2000) suggests that donors will be disappointed if they rely on NGOs as a point of entry for engaging and mobilizing wider civil society towards social agendas. A different approach is needed "encompassing a broader approach to CSOs". The reasons for this are various and generalized: NGOs tend to operate exclusively with their intended beneficiaries, forming a civic enclave; outbreaks of contentiousness are a defining feature of the civic arena; the lack of well-developed and harmonious networks; and alliances against authoritarian or military regimes rarely last once the regime has fallen: "Typically, success in replacing military with civilian regimes is rarely accompanied by wide, sustained and structured civic interaction. Particularistic interests tend to re-emerge" (Fowler, 2000). Such patterns are common in the former Communist states and Africa, where a history of the suppression of civil society combined with weak CSO links to define constituencies to undermine legitimacy and effectiveness.

Ultimately, civil society has to develop and be strengthened "as a result of locally driven processes" (Howell, 2000). This is an important warning and one that influences both the perspective on 'strengthening civil society' and also the approach that external agents take.

Indeed Robinson (1995) has referred to the problem of raised expectations as external agents sometimes swamp local NGOs. The notion of developing civil society cannot be introduced in isolation rather it is inextricably linked to the development of state and market (Garbutt, 2001). The strengthening of civil society in central Asia will take time and critical to the process will be the emergence of a mature and robust set of national NGOs that are able to assume local leadership in driving the development process.

About INTRAC in Central Asia:

INTRAC (International Non-Governmental Organization Training and Research Centre) is conducting a three-year research project into Civil Society in Central Asia with a grant from the UK's Social Science Research Unit. The aim is to continue to strengthen on-going INTRAC efforts to analyse the emergence of civil society in Central Asia in order to better understand the dynamics of Civil Society Organizations (CSOs) in Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.

Endnotes

[1] Aliya Kabdieva, Aigerim Ibrayeva, Dina Sharipova and Gulnur Bolyspayeva at the Centre for Research and Development at KIMEP, Almaty, Kazakhstan; Bermet Stakeeva and Bakyt Baimatov, in Bishkek, Kyrgyzstan; and Alisher Kasymov in Tashkent, Uzbekistan. Tajik researchers will be chosen soon.

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Leadership Styles and Management Practices in Non-Governmental Organizations of Kazakhstan

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Abstract

The study examines leadership styles and management practices of NGO located in Almaty. The article discusses the major problems faced by NGOs and analyses progressive changes resulting from improvement to their management.

Introduction

The role of non-governmental organizations is crucial for the development of democracy in society. The impact of NGOs is usually measured as a result of their involvement in resolving social problems. The strategy of the national support for NGOs in the Republic of Kazakhstan was approved in 2002. As a result of this document there is now a need to improve the legislative basis for NGOs, strengthen the relationships of NGOs, on the one hand, and the governmental bodies, donors, business entities, on the other hand. Efficient management is required to resolve these problems. Special attention should be paid to the improvement of the organizational structure, strategic developing, coordination of activities and supervision. The author attempts to understand what the elements of an effective leadership style are and how leadership features influence the activities of NGOs.

Review of Leadership Theories

There are many interpretations of leadership. Leadership can be defined as the ability to influence a group toward the achievement of goals. Leadership is a dynamic process. It is important at all levels of the organization. Good leadership helps to develop the integration of individual and group goals. One of the interesting topics of debate in recent years was the difference between management and leadership. Most experts think that management and leadership are different. Management is about coping with complexity. Good management brings about consistency and order. Leadership is about coping with change. Leaders establish direction by developing a vision of the future (Kotter 1991).

Leadership can be of a few types. The authoritarian style is characterized by accumulation of power in the hands of one manager. In such cases manager personally makes decisions and his staff has no opportunity to reveal initiatives. The leader of the democratic type tries to resolve problems together with colleagues and regularly updates them about the operational situation (Rue 1992).

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Among the most recent approaches to leadership is attribution theory of leadership, charismatic leadership theory, visionary leadership, transactional vs. transformational leadership.

Transactional leaders guide or motivate their followers in the direction of established goals by clarifying role and task requirements. Transformational leaders are similar to charismatic leaders but are distinguished by the ability to bring about change, innovation, and entrepreneurship. Transformational leaders motivate followers to not just follow them personally but to believe in the vision of corporate transformation, to help institutionalize a new organizational process.

The transformational leader must successfully achieve the following activities: creation of a new vision, mobilization of commitment and the institutionalization of change. Such a leader has both the ability to articulate and communicate a vision that identifies superordinate goals for an organization, and the charisma to energize and motivate people to accomplish these goals (Bass 1990).

NGO leadership sometimes is seen as an inherently personal and participatory activity in which leaders interact and engage on a personal and emotional level with colleagues, staff and volunteers. A.Fowler argues that the highly personalized management styles of many NGO leaders is a natural consequence of the attitude of staff to each other, of high levels of commitment and of a shared sense of ownership. (Smillie and Haileymnuy76 2001). Fowler and Uphoff identify consistency and commitment to a moral purpose as the common characteristics of the successful NGO leader. Fowler suggests that a key trait is "their adherence to moral principle" and their "enduring, consistent drive, rather than charismatic personality" which inspires and mobilizes those with whom they work. (Ibid).

There has only been one study on gender difference in leadership with the Leadership Practices Inventory (Kouzes & Posner 1990). Using self (manager) and subordinate ratings on the LPI, significant gender differences were observed on two of the five LPI subscales. Female managers were more likely than male managers to practice Modelling the Way, described as displaying consistency between views that are espoused and behavior that is practiced, and Encouraging the Heart, summarized as giving positive feedback to the individual and team. No significant differences were found on the subscales of Challenging the Process, in other words, nontraditional thinking, Inspiring a Shared Vision, that is communicating a vision of the future and Enabling Others to Act, described as participatory decision making.
Transformational leaders motivate personnel to do more than was originally expected.

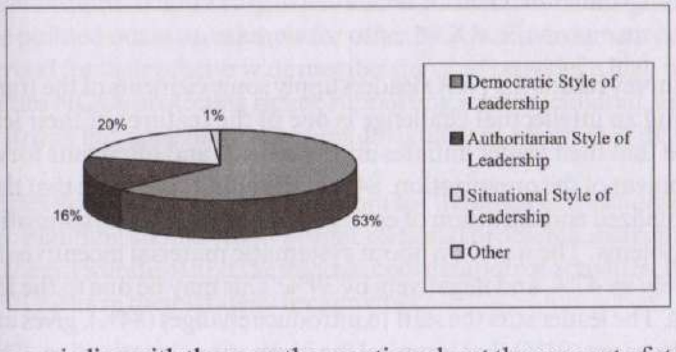
Analysis of Leadership Styles and Management Practices in Non-Governmental Organizations

Eleven NGOs in Almaty were surveyed during April/May 2002. 97 questionnaires were delivered and 64 of them were subsequently returned. The majority of the respondents (75%) have a higher education. The respondents mainly included economists, reporters, trainers, translators and lawyers working in NGOs.

The situational approach is focused on the significance of the situation when different management practices are studied. This approach emphasizes that the situation is the basic feature in the analysis of efficient management characteristics.

83% of our respondents believe they have efficient management. 63% of them consider that their manager displays a democratic style, 16% - that he/she is authoritarian whilst 20% display a situational style, (1% - other).

Chart 1: Style of Leadership in NGOs

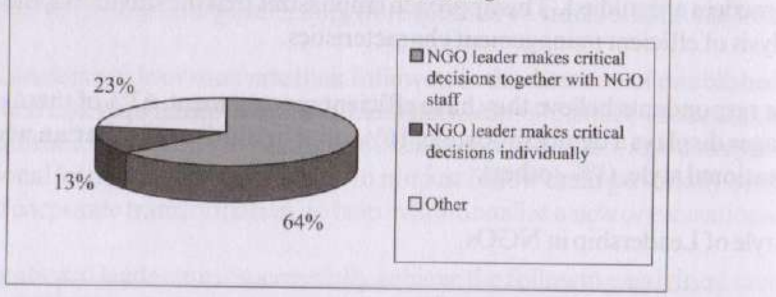


Their responses are in line with those on the question about the amount of staff involvement in decision making. 64% of respondents believe that their leader makes critical decisions together with the NGO staff, 13% of respondents think that their leader makes decisions individually and 23% write other options. "Other options" are explained as consultations with experts and the decision depends on the situation.

In general, the evaluation of the leadership style by leaders themselves coincides with the evaluation undertaken by their staff. For instance, an NGO leader considers himself as authoritarian, and 60% of his staff write that their leader has an authoritarian style, the others 40% write that the same leader uses the situational approach.

The question whether all decisions taken by an NGO are implemented is responded in the following way: 61% say "Yes, implemented", 14% "No, not implemented", and 25% answer that they are implemented as often as possible.

Chart 2: NGO Decision Making



According to the survey results the NGO leaders apply some elements of the transformational leadership. Meeting an intellectual challenge is one of the features of their leaders. 86% of respondents stated that their leader initiates improvements and often puts forward the ideas leading to development of the organization. 84% of the NGO staff write that their leader carries on the individualized consideration of each staff member of the organization and assists with resolving problems. The question about systematic material incentives for the staff is responded positively by 47%, and negatively by 39%. This may be due to the financial instability of the NGOs. The leader stirs the staff to introduce changes (84%), gives an opportunity to work out new decisions (91%) that is typical for inspirational motivation. This way NGOs use such elements of the transformational leadership as intellectual stimulation, inspirational motivation and individualized consideration.

It is noteworthy to touch upon the «leader» phenomenon at NGOs. Often NGO leaders are bright personalities, qualified and enthusiastic people envisaging in detail the goals and objectives of their organisations. NGO leaders are energetic and enthusiastic (92%), with developed communication skills (92%). The majority of NGO staff confirms that their leader supports and develops norms and values of the organization (86%).

91% of the respondents think their organization is a united team of like-minded persons that display a positive psychological culture in the NGOs. Upon the opinion of 88% of respondents the staff makes additional efforts to achieve the goals of the NGO.

Arrangement and planning of NGO activities as well as improving the NGO structure are crucial aspects of NGO management. The organizational structure is the basis for further managerial actions. In 1995 the association of experts in sociology and politology of Almaty carried out a sociological survey among the leaders and active members of NGOs under the project on "Social partnership for sustainable development: state, tendencies, prospects". The aim of the survey was to create a social "portrait" of NGO representatives. 75 people were questionnaired. The question if NGOs have documents where their structure is fixed is positively answered by 54% of respondents, negatively by 14% respondents and no answer is given by 32%. The question about distinct differentiation of responsibilities in NGO structure

was positively responded to by 32% people, negatively by 40%, no answer for 28%. (Report 1996:104-105).

Our survey shows that the majority of all NGOs have the organizational structure that is fixed by documents (91%) and distinctly differentiates responsibilities between the staff members (88%). In other words during the recent 7 years NGOs have established the basics for their further development.

Organizational development is a critical part of management of any NGO. Mostly NGOs are small-scale organisations. It is not easy to name a NGO that has made significant progress and which could be pointed out as an example for other NGOs. Environment protection NGOs is often characterised for their relative wide membership that provides a high potential for recognition. Sometimes NGOs protecting rights, supporting women, children, and the disabled are considered as strong but none of them has made significant progress in its sector.

The long-term development strategy is significant for the efficient functioning of the organizations. Strategic planning should resolve organizational problems, distribution of resources, adaptation to the environment and the internal coordination of activities. It is significant that many NGOs (91%) have their strategy for activities.

However there are NGOs that refuse to keep internal records of their activities, to estimate and monitor their work. They take this decision by underlining the innovational nature of their activities that, as they believe, does not allow them to compare their achievements in the past with current activities. But self-assessment is valuable as it helps to reveal positive and negative aspects of NGOs and allows the developing of strategy. The strategy is not always fully developed in an NGO, as NGOs do not have stable financial basis for their activities.

97% of respondents positively answered on the question about self-assessment of their NGOs. It is noteworthy to consider the experience of self-assessment gained by the «Baspana» association. «Baspana» tried to cover and objectively assess all of its aspects and activities. They had a collective discussion of the organisational chart, the strategy, style of its management, and the existing systems. The aims of «Baspana» are to improve housing and social conditions for people that are experiencing low living standards (the homeless, the unemployed) by training/retraining them. They apply the credo «Assist Yourself!» to establish a democratic lawful society. «Baspana» pursues the following principal strategies to achieve it's goals: -

- To allow people to actively follow the credo «Assist Yourself!»;
- To develop and apply non monetary-consuming construction technologies;
- To develop and implement loan projects targeted to the low living standard categories of the population.

The analysis of its weak and strong features in their strategy facilitated the revealing of ways to resolve problems. Their analysis of the monitoring system, budget planning, reporting scheme, applied incentives and penalties is interesting. They analysed specific relationships with the environment and found probable dangers caused by it and the ways to mitigate the danger.

The management philosophy in «Baspana» is the participation of all the personnel in decision making, their eagerness to apply new methods and approaches, to provide the necessary conditions that benefit the development of the potential of its members.

Highly qualified staff is a crucial element for successful management. According to the survey results 89% of respondents believe that the qualification level of their personnel is sufficient, and 11% think that the qualification level is not high enough. Nevertheless, the organizations regularly train their personnel (91%) and hire qualified people (88%).

Coordination of the organization activities is a critical part of their management style. However, there are NGOs that do not approve of co-ordination of their work and consider co-ordination as an attempt to interfere with the internal work of the NGO and an attempt to govern their activities. Co-ordination between NGOs could unite their efforts in lobbying for their interests. Lack of co-ordination is evident though NGOs do know more about the other NGOs in their sector and they frequently communicate with related organisations. 58% of respondents give a positive response to the question about the necessity for the coordination of NGO activities. NGOs have different understandings of the notion "coordination of activities".

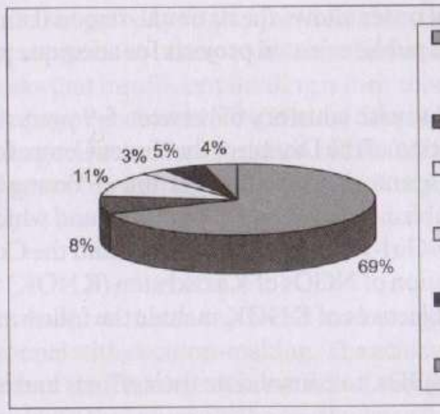
Furthermore, efficient feedback is essential for the successful functioning of any organization, especially under changing external and internal environments. Feedback is established when the implementation of decisions is supervised. 94% of personnel admitted that there was feedback between them and their leader.

Supervision is another major management function. Supervision allows the NGO to check whether the decisions are correct or not and as a result allows the NGO to correct them. Many NGOs (88,2%) have developed the system of supervision over the way their personnel fulfil their functions.

In June the Ministry of Culture, Information and Public Concordance carried out a sociological survey on the major tendencies of the developing third sector. 300 experts in the social sector were questionnaired. The results show that 50,3% of respondents evaluate the efficiency of NGO interaction with state bodies is "rather low" (26,2% say that the efficiency is "low"), whereas 9% consider that the efficiency is "rather high". Only 3% of the experts believe that it is "high". 11,2% did not answer this question. (Interaction of the state and NGOs of Kazakhstan: the experience of cooperation 2002:7-8).

The results of the Ministry survey match the results of this survey. The evaluation of the government attitude towards NGOs by the personnel of NGOs is of interest to this survey.

69% of our respondents consider that the attitude of the government towards the non-governmental sector underestimates the role of NGOs, 8% consider it as an opposition, 11% believe



that the parties are eager to cooperate, 3% think that it is a partnership, 5% - «other », 4% do not answer.

The activities of the Feminist League are example of the successful collaboration between NGOs and governmental bodies. In January 1999 the National Commission on Family and Female Affairs replaced the Council on Family, Female and Demographic Policy. This was originally a consulting body.

The National Commission on Family and Female Affairs was established as a response to the pressure from the Coalition on Female Election Initiatives during the election period. As a result the Coalition was founded by the Feminist League. The League has established strong links with the National Commission and considerably effects its activities. (Report on Feminist League activities, 1999).

The Association of Young Leaders is another example of the successful collaboration of the government and an NGO. In 1999 the Concept of the State Youth Policy was adopted in the Republic of Kazakhstan. It was officially stated that the state should collaborate with the non-governmental organizations for youth and children, as they promote the role of the younger generation in social and political processes needed to establish a democratic civil society.

Implementation of the "Strategy of the State Support for the NGOs of Kazakhstan" might improve the relationships between the state and the non-governmental sector. The strategy defines the priorities of the state support for the NGOs: -

- To develop the legislative basis of the state support for NGOs;
- To develop the Program of the State Support for NGOs of the Republic of Kazakhstan and the methods for its implementation. (Interaction of the state and NGOs of Kazakhstan: the experience of cooperation 2002:15).

The state support in the form of social order allows the national, regional and local governmental bodies to implement social and public oriented projects for adequate payment (ibid).

Usually the most active NGOs are those with a history of between 5-9 years of activity as the Feministic League, the Public Association of the Disabled, the Kenes Centre for Social Adaptation and Labor Rehabilitation, «Baspana», and the Association of Young Leaders. At the same time there are organisations established between 1-3 years ago and which have already made significant progress such as the «Girl-Friends» Crisis Centre and the Confederation of NGOs of Kazakhstan. The Confederation of NGOs of Kazakhstan (KNOK) was established in March 2000. The main goals and objectives of KNOK include the following: -

- To co-ordinate the activities of NGOs, to consolidate their efforts and amalgamate resources;
- To establish systematic communication with the Government, ministries, and agencies on the principles of social partnership on critical problems of the society, and the structure and mechanisms to resolve them;
- To promote legislation and amend the laws in the Parliament of the Republic of Kazakhstan;
- To develop an adequate comprehension of the role, capabilities and actions of NGOs as well as their power to resolve the problems of society and assist the governmental bodies;
- To provide the third sector with information about their activities and to exchange gained experience;
- To develop international relationships.

The members of the Board of KNOK expressed their strategy declaring that they would rather unite the active ones, those that need the promotion of the public sector, and are doing their best to provide for sustainable development rather than increase the statistical number of NGOs. KNOK comprised 107 member-organisations by September, 2000.
The Government expressed its support to KNOK in the following manner: -

- To establish the Council on Public Relations with the Sector continuously acting under the auspices of the Government;
- To establish consulting centres for people at the corresponding ministries and agencies aiming to develop co-operation within the sectors;
- To establish regional Councils on NGO co-operation with governmental bodies;
- To introduce the practice of Public Hearings on the socially critical issues by the governmental bodies;
- To develop jointly projects on social protection of the population based on the unified state policy towards socially vulnerable categories of citizens.

There is a lack of genuine partnership among NGOs. Partnership would be facilitated if there was an exchange of experience. Close co-operation would definitely help many NGOs to re-evaluate and increase their capabilities.

70, 1% responded negatively to the question about the sustainable development of NGOs without donor support. In other words their financial stability is one of the pressing issues. 79% of NGOs say that insufficient funding is their most serious problem. Many organisations remark that the major problems of NGOs are caused by the underdeveloped legislative basis, insufficient management, underestimation of NGOs by governmental bodies, small number of members, no support by the population, and lack of joint information exchange.

Conclusion

The survey results show that many NGO leaders apply democratic leadership style actively involving personnel with decision-making. The achievements of many NGOs are often due to the personalities of their leaders who are full of energy and enthusiasm, who have developed communicative skills that promote the spiritual worth of the organization and ensures a favorable moral environment. In addition, NGO leaders use some elements of the transformational leadership. Our respondents emphasize that leaders of NGOs initiate improvement and often put forward new ideas that increase the number of members and assist the personnel in resolving their individual problems. NGOs use such elements of transformational leadership as intellectual stimulation, inspirational motivation and individualized consideration.

Some management functions of NGOs are well developed, in particular many of them have worked out the strategy for their development, and they assess their activities, supervise and ensure feedback with the staff. However, not enough attention is paid to the coordination of NGO activities and strengthening the links between NGOs and the state.

Regardless of the current problems NGOs are making progress, they participate in discussions of laws and provide real support to the citizens. To increase the efficiency of NGOs it is necessary to consolidate their activities, to work out a distinct strategy, to analyse their capabilities in providing sustainable development, to develop training centres, to provide consulting services for the NGOs, and co-ordinate the activities of NGOs.

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Historical roots of third sector development in Kazakhstan

Aigerim IBRAYEVA*

Introduction

Third Sector development in the Post Soviet Union countries is an important concern of many scholars and intellectuals around the world. During the last ten years a significant amount of research was carried out on this particular issue. The central notion of most of the research is that despite the fact that the Non-Profit sector has taken root in CIS countries, Third Sector Development faces many challenges to overcome past legal, cultural, and institutional biases to enable effective development.

The initial years of "perestroika" provided hope of building a real civil society in a short period of time, but these expectations did not come about. Most researchers agreed that the absence of institutional structures that are not organized or directed by or dependent on the states' leaders or apparatus, and the lack of understanding on the part of individuals are the main problems, and challenges for the new independent states. Furthermore, for a hundred years, the countries were under authoritarian rule that left little space for non-governmental bodies. According to the Regional Bureau for Europe and CIS, 1997:

> Any tradition or movement of that sort was mostly crashed in the Soviet era. Even in the late 1990s, many of the countries (CIS) lack strong institutions on which civil society is usually based - a confident, well-functioning parliament, accountable local government, a responsible and well-established press, strong independent and well-respected trade unions and so on (Regional Bureau for Europe and CIS, 1997, p. 103).

Conditions bequeathed to the CIS countries and especially to Kazakhstan, as a result of their Soviet experience have characteristics of their political culture that in many ways is unrecognisable to people in Western countries. It is a political culture that western scholars cannot relate to their own experiences, and if they wish to help build civil society in this region, they must take into account this political culture rather then viewing the current situation through the prism of Western experience.

Before starting the analysis of the development (or lack of development) of Civil Society in Kazakhstan it is important to define the interpretation of Civil Society. The author defines Civil Society as all organisations, both formal and informal, that fall out of the range of governmental or business activities. In Kazakstani politological encyclopedia a civil society is a society where the individual with his system of needs, interests and values is a subject of the historical process (Kazakstani Politological Encyclopedia, 1998, p. 76). In this definition «the civil society" coincides with the notion of "a democratic society". The civil society is the product of historical development. A highly developed civil society is one of the conditions of democracy. The essence of civil society is expressed in its relations with the state.

Therefore legal entities in the Republic of Kazakhstan that fall out of the scope of business or governmental structures can be considered as part of civil society, but also informal and perhaps illegal organizations that permeate the substructure of the society should be taken into account.

The question still remains, however, does Civil Society exist in the Republic of Kazakhstan today? What has been the trend of its development since the collapse of the Soviet Union in 1991? What has the government done on a constitutional and or legal level to encourage the development of a Civil Society in the Republic? What has the NGO community in Kazakhstan done to encourage the development of Civil Society in the Republic? And more consequentially, what has the NGO community done in the Republic to discourage the development of Civil Society?

This raises a simple yet serious question; did Civil Society exist in Kazakhstan during the Soviet system? While the answer semantically depends upon the given definition of Civil Society, it is clear that the Soviet government co-opted and replaced the vast majority of institutions and organizations which we would commonly view as foundations of Civil Society, understanding Civil Society as essentially oppositional, antagonistic and conflictual. From 1917 until 1991 the Soviet Union went through very distinct periods of development. From 1917 until 1921 the Soviets isolated themselves from the vast majority of the world through a foreign policy based upon world revolution — and as such little development occurred within the sphere of domestic civil society. During the Stalinist period Civil Society was all but destroyed (possibly except during the Second World War when Civil Society was needed to enforce loyalty to the state as evidenced in the reopening of Russian Orthodox Churches — which in itself supported the state). And this lasted until the era of Gorbachev. It was not until the fall of the Soviet Union that Civil Society in its infancy came into existence due to the fact that many NGOs simply began to co-opt governmental functions in the entire former Soviet Union.

In light of this, the main objective of this article is to examine the legacies of the Soviet Union which has brought Kazakhstani society to its present point. These Soviet legacies continue to affect the ability of Kazakhstan to improve the situation. In addition to political culture, the mix of paternalism and autocratic traditions make it hard for informal NGO's to flourish. Besides the historical traditions, there is also the impact of the reform process. The destruction of former institutions that were intermediaries between central government and individuals has not been followed by the establishment of alternatives. This has created a social and institutional vacuum that has led to the sense of insecurity felt by many people who are nostalgic for a happy communistic past.

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Third sector in Soviet time

Without any doubt, the Soviet State offered many services to its citizens. In the areas of housing, education, healthcare, transport and the provision of employment, Soviet achievements were indeed remarkable. The policies behind them were all tightly controlled by the universal mechanisms of the Communist party whose membership was strictly vetted and from whose political precepts little or no deviation was tolerated.

At this point, in order to understand the current situation in Kazakhstan, the historical roots of third sector development deserve some attention. The Soviet period is characterized by the State monopoly in every sphere of life: economics, politics, and social sector. It was expressed through the creation of highly centralized policy and strict control over policy implementation. Soviet society was characterized by isolation from the outside world. Authoritative bodies of that time tried to create a society with its own norms and values. Thus, the ideological machine was created, whose main feature was the realization of the main goal – the construction of communism.

A "hierarchy of merits" was created, which assumed movement from the bottom to the top according to people's needs. Every individual born at that time was automatically involved in this system. Establishment and development of NGOs (or their prototypes, further as 'public organizations) in Kazakhstan, had started when the country was a part of the Soviet empire. Public organisations were under strict state control, and with a few exemptions were restricted in their independent development. Beginning with the 30's all officially established organisations were subsidiaries or counterparts of the existing governmental structures. All public organisations were created based on the resolution of the Communist Party and different state agencies, and served the purpose of central control. The state inhibited the participation of individuals in establishing private and autonomous groups. The officially sanctioned organisations were financed by the state and closely tied to party organisations. As with youth organisations and the adult party which were characterised by obligatory volunteerism.

The Leninist Pioneers' League was created on 19 May 1922, on the second conference of Leninist Young Communist League of Russia. According to the definition given in the *Big Soviet Encyclopaedia* (1971), 'Leninist Pioneers League of the Soviet Union is a mass voluntary communist organisation of children and teenagers of 10-15 years old (Prohorov, 1971, p. 357). By the end of the 1930s almost every school in the USSR had a pioneer organisation. Within each organisation different occupational entities (hobbies clubs) such as biology, military, sport, medicine and art were established.

The development of the Pioneer movement played an important role in the media. In total, the Pioneers League published 28 newspapers, among them one of the most popular was the "Pioneers' Truth." In addition, there were 35 pioneers' magazines issued every month. ("Young engineer", "Young Biologist", "Young Technician", and "Pioneer") (Monahov, 1972, p. 32) The number of members to the Leninist league increased continuously. During the stages of its activity there were about 20,000 members and by the end of the 1970s, 23 millions. (Prohorov, 1971, p. 361).

Another powerful 'non-governmental' organisation aimed to achieve societal goals was the Leninist Communist League of the Soviet Union. According to Apresian (1969) it was a 'Mass social-political organisation of Soviet young people. This organisation was an active assistant and reserve of the Soviet Communist Party' (Apresian, 1969, p. 27). It was established on the 29th of October 1918. Members of this movement were greatly involved in such policy implementations as collectivisation of agriculture (which was later considered as a social and economic disaster), the great surge of industrialisation (which depended on forced labour), the five years plan system, and several others. The organisation had its own newspapers and magazines (226 magazines and newspapers). Every year four million young people joined the Leninist Communist League. By the end of 1971 their number reached 28,156,924 (Prohorov, 1971, p. 177).

Another interesting example is the trade unions. Their role in the Great October Revolution is well known. Lenin, the inspirer and ideological leader of the October Revolution, stressed the significance of trade unions in Soviet society. But trade unions were rather weak until the 1930s. Until that time trade unions ran their activity separately from each other and were relatively independent from the state. Beginning with the 1940s the process of centralising their development was intensified, with decisions on their development made by planners in Moscow. Gradually, all existing trade unions were amalgamated into one organisation with a strong structure.

During the Soviet period changes occurred not only in the structure of the trade unions but the functions of trade unions suffered a great transformation. They became one of the most significant bodies to promote the decisions and policy of the Communist Party. Party affiliation of trade unions was seen as an advantage for the planned (command) economy (Polite-Economy Reference Book, 1975, p. 146).

Trade unions lost their initial mission of protecting the rights of workers from the abuse of power by the administration. Central policy made the trade unions an important part of the process of maintaining enterprise production. The representatives of trade unions were part of a 'troika" (three) in each enterprise: the representatives of administration, trade unions and communist party. This "troika" was to fulfil the state economic plan and other policies. Trade union officials were subjects of double accountability: to their superiors in the Central Council of Trade Unions and to the Communist party. The function of the trade unions was to distribute social services, to control payment of wages and pensions and the benefits from Social Insurance Fund (sickness, maternity, and disability). They distributed free passes to vacation centres, resorts and pioneer camps. They were also responsible for the construction and maintenance of these facilities.

In addition to these organisations professional organisations existed to maintain some form of cultural, intellectual and political autonomy. Among them there were professional associations such as Association of Surgeons, Association of Architectures, Association of Teachers, Association of Scientists, and so on; sport associations, and associations of disabled people. All these associations and organisations were established and supported by the State. (The law which regulated the third sector in Kazakhstan was issued on 30 August 1930, "On Public Organisations and Unions") (Ponomarev, 1994, p. 2).

But some intellectuals in Kazakhstan were able to begin voicing critical opinions of life under the Soviet regime. In 1961, they organised the informal organisation "Zhas Tulpar". The leader and inspirer of this organisation was a son of a famous Kazakh writer Murat Auezov. Most of the members were Kazakh students who studied in Moscow. They met regularly for more then six years to discuss such issues as collectivisation, repression, and ethnic discrimination. Other informal organisations which existed in the same period. But most of them existed for not more than one year. Among them were such organisations as "Sary-Arka", "Zhas Kazakh", Molodoi rabochii", "Front Osvobozhdeniya Turkestana" and others (Ponomarev, 1994, p. 2).

Soviet legacies

The second issue that needs to be studied is the Kazakh and ethnic identity in the Republic. While the concept of Civil Society in the Soviet Union was abhorrent to the leadership class, ethnic identity and tribal loyalties continued to persist during the Soviet period and certainly gained momentum and strength since the establishment of the Republic.

Tribalism, though rudimentary in most societies, is a fundamental aspect of the modern Kazakh national consciousness, as it provides a basis for tribal division. Most western scholars argue that tribalism is associated with political instability is largely responsible for the survival of Kazakh society through various periods of history (Narbekova, 1999, p. 167). According to Roger Kangas (1995, p. 273), during the pre-Soviet period in this region power was defined as set of social and traditional norms and values developed over a long period of time. These norms dictated behaviour and communal interaction. Politics included the process of family ties and loyalties that occupied the upper classes of society. The lower classes were excluded from the decision-making process.

During the Soviet period tribes played an important role, representing a strong sphere of familial relations and provided a flexible basis of societal organizations outside of the party-state. Roger Kangas (1995, p. 273) argues that in Soviet time the structure was almost the same as it used to be in a region. In spite of the Soviet strategies, the regionally based tradition of fealty and loyalty existed. Often collective farms were organized around old tribes and clans structures, ruled by one leader, as it used to be in the pre-Soviet period. Furthermore, the signs of tribalism can be found in modern Russia. Russian periodicals often refer to Eltcin's family, representing both relatives and powerful public officials and businessmen who actively participated in the decision making process.

When Kazakhstan gained its independence, the Soviet-era management collapsed, and tribal communities became the fundamental institutions for the survival of individuals and families. Leaders associated with traditional tribal-based communities and clans have emerged in every sphere of a society occupying high positions both in political and business structures. By that time, tribal communities lost their historical role as independent institutions. They became a basis for political organizations and tribal membership gave an opportunity to occupy a high rank position.

If we consider an alternative view, we may assume that civil society in Kazakhstan can be built on a tribal basis. Political dynamics still relies on customs and the family network. In these conditions, clans could be able to unite a people through family ties or ties of friendship and encourage them to work together toward a resolution of society's problems.

Another important factor in discussing of civil society in Kazakhstan is ethnic and national identity. Patricia Carley in her work "Soviet Legacy in Central Asia" argues that ethnic or national identity was simply unknown among the majority of the population until the twentieth century. People were differentiated according to their way of life (nomadic) and religious identity (Islam) (Carley, 1995, p. 295).

The situation changed quickly after the creation of the USSR. Strong and systematic measures were taken in order to achieve the following goals: absolute control of political and military power by Russian Bolsheviks; large scale economic extraction as well as the creation of economic dependency upon Russia'; systematic destruction of traditional Muslim society and culture; and creation of a new alternative Soviet society to replace the old one (Shahrani, 1994, p. 59).

The weakness of national identity before the Soviet period helped the Russification policy to penetrate deeply in the societal structure. The forced settlement of the nomadic population resulted in the loss of traditional norms, values, and even identity.

The Russian language became the political and administrative language throughout the USSR. It became a language of record keeping and a language of knowledge. Russian language proficiency became a necessity for education, culture, and advancement in urbane professions. In addition to that, negative attitude toward native culture and language became common in urban areas. All educated people were supposed to speak only Russian.

As a result a significant number of middle-aged people do not speak their native language, and are Russian native speakers without the possibility of adopting Russian nationality. People who were able to speak their native language have a limited vocabulary, because the Kazakh language has not been developing for the last 70 years and does not have a comparative lexicon for political and scientific terminology in the Russian language. (Naby, 1994, p. 41).

In addition, important element of identity was religion. Soviet policy makers considered Muslim cultural values, institutions and traditional identities dangerous to the Soviet regime. For this reason, it was important to destroy all forms of traditional Islamic social identities and institutions and replace them with the symbols of new Communist state. According to Nazif Shahrani (1994, p. 63), three steps were made to implement this policy: fragmentation of the Asian region; cultural isolation from the historic past and from Muslim societies; and destruction of religious beliefs and values.

Islam along with all other religions was not tolerated. It was believed that such social actions as attacks on Islam would facilitate the modernisation of the region and destroy pre-Soviet culture. In the late 20th century, all mosques were closed or even destroyed. As an alternative numerous soviet institutions were put in their place in order to introduce new cultural norms and values, such as soviet schools, peasants unions, Pioneer and Komsomol youth organizations, women clubs, atheist clubs and so on. All these institutions served to inspire social and political conformity to the Soviet norms through a system of rewards and punishments (Shahrani, 1994, p. 66).

Conclusion

The effect of the Soviet regime in Kazakhstan has been pronounced. The result has been that people in Kazakhstan have been left with the Soviet mentality. They cannot become nomads again, most of the populations are atheists, half of the population does not speak their native language, and do not keep Kazakh cultural traditions. Therefore only element of national identity left is tribalism.
Kazakhstan did not have to fight for independence. It came suddenly and unexpectedly as a consequence of the collapse of the Soviet Empire. No political movements called for political independence from the former USSR. In effect, Kazakhstan was forced into independence. Moscow has left Kazakhstan in charge of its own problems. The real challenge is the formulation and implementation of a culturally appropriate model for the development of Kazakhstan that would ensure political freedom, social justice and the building of a national identity. Kazakhstan has suffered for more than a century of oppressive colonial rule. It was among the last nations to gain its national freedom and independence. Kazakhstan has an opportunity to choose between different development models and strategies for its national development. What will it choose?

Thus, in one sense it is possible to argue that Civil Society in Kazakhstan does not rest upon the creation of community organizations but rather upon ethnic identity. The difference is not a semantic one due to the fact that the population of the Republic is only approximately fifty percent Kazakh meaning that it would be difficult to sustain the idea of Civil Society upon the predominate ethnic group.

At the present time, the underlining philosophical conception of Civil Society in Kazakhstan remains locked in two different worlds. The world of Marxist-Leninist ideology and the world of what can only be described as Kazakh consciousness. So the creation of Civil Society in Kazakhstan, at the present time, faces two distinct obstacles, how to overcome years of ideo-

logical indoctrination and how to overcome tribalism and ethnic loyalties. But do tribalism and ethnic loyalties need to be destroyed? Could they by themselves constitute a basic foundation for the formation of a unique Kazakh Civil Society?

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APPENDIX II

About INTRAC Project at KIMEP in brief

The International NGO Training and Research Center (INTRAC) is UK-based NGOSO (non Governmental Organisation Support Organisation). INTRAC was formed in 1991 to provide training, consultancy and research services to NGOs. INTRAC's mission is to promote social justice and sustainable development. INTRAC seeks to improve NGO performance by exploring NGO policy issues, and providing NGO management and organisational development consultancy and training.

INTRAC has sponsored a three-year project at the KIMEP Research Center on Civil Society in Kazakhstan.

The research project "NGOs and Civil Society in the Republic of Kazakhstan"

Overall the research did the following:

- Mapped, monitored and analyzed the emergence of Civil Society in Central Asia and both its potential **role** and **impact** upon development both nationally and regionally;
- Deepened INTRAC's established **understanding of the dynamics** of CSOs in transitional states;
- Identified those **factors encouraging and constraining** the development of CSOs in Central Asia. In this respect, specific attention was placed on the role of external programming involved in fostering CSOs establishment;
- Began the process of developing the **institutional capacity** of a number of strategically located CSOs to undertaken **policy-related research** that would feed into and inform policy-making on critical development issues in the region from a CSO perspective.

Essentially the research sought to feed directly and continually into ongoing Civil Society development activities in the region. The approach stressed focused and relevant research exercises that would be expected to produce useable results within a short period of time.

Trust in institutions in Kazakhstan[1]

Philip M. NICHOLS*

Abstract

Trust in basic institutions is critical for the development and continuance of market-oriented democracies. Trust in institutions helps actors obtain information and enforce rights more easily and at lower costs. Trust also facilitates participation in the democratic process. A survey conducted in Kazakhstan in 1998 finds that the majority of Kazakhstani do not trust four critical institutions: the legal/judiciary system, elected politicians, broadcast news, and printed news. Mistrust of institutions is found among respondents who perceive themselves to be wealthy, middle income and poor and among respondents who live in urban and rural settings, although respondents who perceive themselves to be wealthy are somewhat more likely to trust these institutions. Persons involved in the creation of institutions in Kazakhstan must be cognizant of this mistrust, and should envision means of creating trust in their development plans.

Introduction

Trust is an essential component in the development and operation of market-oriented democracies. In particular, trust in and use of certain institutions facilitates economic relationships by lowering the transaction costs associated with obtaining information, enforcing those relationships and creating predictability among the parties. Certain institutions also enhance informed participation in democratic processes.

This paper reports the findings of a survey conducted in Kazakhstan in 1998, part of which asked respondents to evaluate the degree to which they trust four basic institutions in Kazakhstan: the legal/judiciary system, elected politicians, broadcast media news, and print news. The survey finds that most Kazakhstani do not trust these institutions.

This finding has important ramifications for those concerned with the creation of market and democratic institutions in Kazakhstan. Not only must structural issues be considered; those who are involved in policymaking should also consider strategies for fostering trust in the institutions that they are shaping.

Trust as a Component of Market-Oriented Democracies

> Trust is a social good to be protected just as much as the air we breathe or the water we drink. When it is damaged, the community as a whole suffers; and when it is destroyed, societies falter and collapse.
>
> Bok, 1978: 28

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Much of the recent literature on trust and development has focused on trust among business actors in a given community (for a comprehensive survey of the literature see Moore, 1997). Persons such as Putnam (1993), for example, vigorously argue that "social capital" is responsible for the economic prosperity of the West (Sako, 1992; Lane and Bachmann, 1996). On a more local scale, Platteau (1994a, 1994b) demonstrates that social trust contributes to the viability of small enterprises (see also Moore, 1994). In this context trust is a foundation of, an integral component of, and a product of social capital. As Fukuyama (1995, p. 26) famously noted, "social capital is a capability that arises from the prevalence of trust in a society or in certain parts of it."[2]

Trust in institutions, however, still constitutes a critical aspect of the development and operation of market-oriented democracies. Market transactions are limited by the transaction costs of obtaining information, enforcing relationships, and achieving predictability (Williamson, 1975; Humphrey and Schmitz, 1998). Actors can avoid these costs by trading only with persons whom they know and with whom they have traded repeatedly. Village markets often exemplify this type of trading (Thorbeke, 1993). Such a system, however, leads to high production costs – due to a lack of specialization – and a limited number of choices for the actors (North, 1990; Landa, 1994; Nichols, 1999). A broader trading network can be created consisting of actors who share social or kinship ties, and thus who can more easily gather information about one another and who can reputationally enforce relationships (Greif, 1989). These systems, however, also limit the choices of the actors by limiting their relationships to those with whom they share the appropriate quality (Greif, 1993; Landa, 1994; Nichols, 1999).

Consumer choice and economic efficiency are enhanced by allowing actors to choose from the greatest number of possible relationships[3]. Actors can attempt to self-enforce all economic relationships and laws can even be developed to facilitate self-enforcement, but such is at best a stop gap measure (Black and Kraakman, 1996). Ultimately, actors who desire the ability to create the greatest possible number of relationships among the greatest possible number of people will have to rely on institutions (Coase, 1960). Institutions, such as courts and the legal system, lower transaction costs by placing enforcement in the hands of specialists backed by the authority of the state (North, 1991; North, 1996). Placing enforcement in the hands of a trustworthy and impartial state allows actors to create economic relationships even among strangers with some assurances of accurate information, enforcement and predictability (Greif, 1993; Landa, 1994; Nichols, 1999).

Similarly, democratic processes are limited by the information available to and the participation of the electorate (Cohen, 1994; Kasoma, 1995; Bogart, 1996). Institutions such as print and broadcast news, therefore, are vitally linked to democratic processes. In the context of Eastern Europe, Carey (1996) hypothesizes that competitive but honest news sources promote democracy while state-controlled media promote authoritarianism. In Latin and North America, newspapers have been found to foster senses of community and to inculcate understandings of democracy (Morduchowicz et al., 1996; Hindman, 1998). In general, Kim (1998) finds a positive association between use of news media and social trust.

The benefits of institutions such as a legal system or news media only accrue if those institutions are trusted and used. Wade's classic study of an irrigation department in a southern state in India demonstrates the effect of distrust in government. Local farmers, who assumed that government warnings regarding potential water shortages were issued simply so that irrigation officials could extract payments from farmers, paid no attention to those warnings and were unable to plan for real water shortages (Wade, 1982; Wade, 1984). Similarly, to the extent that persons in a polity feel that they are not meaningfully informed, then those persons tend to disengage from the state-run civil society and create their own or the system itself degrades into a dictatorship (Kasoma, 1995; Kim, 1998).

Law in particular constitutes a critical institution for the creation and preservation of social capital and for the creation of meaningful business relationships. When business actors do not trust the law to support their economic relationships, they create their own less efficient and less inclusive institutions (Landa, 1994: 102). When civil actors do not trust the law, they create their own systems that are substantially inefficient and that function in tension with the official legal system (Rose, 1999). When law itself is perceived as untrustworthy, the general result may be a degradation of social capital (Pildes, 1996; Mishler and Rose, 1998).

Empirical work has been done elsewhere that is pertinent to the trust of institutions in Kazakhstan. A comparison of levels of trust in institutions in an established market-oriented democracy (Norway) and a nascent system (Tanzania) found that levels of trust are much lower in the newer system (Jacobsen, 1999). Jacobsen attributes this finding to the newness of the institutions; finding that institutions are not trusted in Kazakhstan does not validate but is consistent with his hypothesis.

The Survey

The questions regarding trust in basic institutions were part of a much larger survey that focused primarily on Kazakhstani attitudes toward certain government activities (Nichols, 2000). That survey was comprised of seventy-six questions divided into eight parts. The survey was conducted in Kazakhstan in April and May of 1998. The survey was administered by Sange Research, and was administered in rural and urban locations in every area of Kazakhstan. Seven hundred and one surveys were completed. The author of this paper conducted interviews throughout Kazakhstan.

The questions in the survey were modeled on a survey conducted in Sierra Leone by John Sahr Kpundeh in 1992 (Kpundeh, 1995). Eventually this will allow for comparisons between the two studies. The questions were modified to fit conditions in Kazakhstan, and some questions were added. Sange Research translated the questions into Russian and also changed some questions, either so that they were comprehensible in Russian or so that they fit conditions in Kazakhstan. The Russian version was translated back into English for the use of this paper.

Results of the Survey – Trust in Institutions

The survey asked respondents to indicate their level of trust in four basic institutions: the legal/judiciary system, elected politicians, broadcast media news, and printed news. The general responses to these questions are also sorted by whether the respondents considered themselves to be wealthy, middle class or poor, and by whether the respondents lived in an urban city or a rural village.

The legal/judiciary system. Most Kazakhstani do not trust the legal system. Forty percent either fully trust or trust with caution; sixty percent either do not really trust or totally distrust the legal and judiciary system. In other words, a striking majority of Kazakhstani does not trust one of the primary means of enforcing legal rules.

How much do you trust the legal/judiciary system in this country?

	Freq.	Percent
Fully Trust	40	6%
Trust with Caution	238	34
Don't Really Trust	309	44
Totally Distrust	113	16
Total	700	100%

When respondents are sorted on the basis of their perceived wealth, there is a difference in the level of trust stated by those who perceive themselves to be wealthy, although the difference is – barely – not statistically significant.[4] Fifty-eight percent of the respondents who consider themselves to be wealthy fully trust or trust with caution the legal system, as compared with less than forty-two percent of those who perceive themselves to have medium incomes and only thirty-seven percent of those who perceive themselves to be poor.

How much do you trust the legal/judiciary system in this country?

	Which type of person do you consider yourself?			
	Wealthy	Medium Income	Poor	Total
Fully Trust	8%	4.0%	8%	6%
Trust with Caution	50	37.5	29	34
Don't Really Trust	17	43.0	47	44
Totally Distrust	25	15.5	16	16
Total	100%	100%	100%	100%
(n)	(12)	(364)	(321)	(697)

Pearson chi2(6) = 12.6002 Pr = 0.050

When asked if the law is interpreted differently for the rich than for the poor, however, the difference in answers is significant. While a majority – fifty-nine percent – of the respondents who identify themselves as wealthy agree with this statement, it is a much smaller majority than the eighty-six percent of middle income or the ninety-three percent of those who perceive themselves to be poor who agree with the statement.

In this country, there are two interpretations of the law - one for the rich people, the other for the poor.

	Which type of person do you consider yourself?			
	Wealthy	Medium Income	Poor	Total
Completely agree	16.67%	39%	46%	42%
Agree	41.67	47	47	47
Don't agree	25.00	13	6	10
Absolutely don't agree	16.67	1	1	1
Total	100%	100%	100%	100%
(n)	(12)	(361)	(322)	(695)

Pearson chi2(6) = 44.5555 Pr = 0.000

When respondents are sorted on the basis of whether they live in urban or rural settlements, the difference is far less stark, and is roughly consistent with the general results.

How much do you trust the legal/judiciary system in this country?

	Type of Settlement		
	City	Village	Total
Fully Trust	6.5%	5%	6%
Trust with Caution	33.0	35	34
Don't Really Trust	42.5	47	44
Totally Distrust	18.0	13	16
Total	100%	100%	100%
(n)	(386)	(307)	(693)

Pearson chi2(3) = 4.6110 Pr = 0.203

Similarly, when rural and urban respondents are asked if there is a different interpretation of the law for the rich, the answers are roughly congruent.

In this country, there are two interpretations of the law - one for the rich people, the other for the poor.

	Type of Settlement		
	City	Village	Total
Completely agree	40%	45%	42%
Agree	47	47	47
Don't agree	12	7	10
Absolutely don't agree	1	1	1
Total	100%	100%	100%
(n)	(386)	(306)	(692)

Pearson chi2(3) = 5.5505 Pr = 0.136

Elected politicians. Kazakhstani trust elected politicians even less than they trust the legal system. Only twenty-seven and a half percent of the respondents state that they fully trust or trust politicians with caution, and of that group less than two percent state that they fully trust politicians. More than seventy-two percent of the respondents state that they do not really trust or totally distrust politicians. Elected politicians, therefore, are the least trusted of the four institutions inquired of in this survey.

How much do you trust those politicians who occupy elective offices or run for the elections?

	Freq.	Percent
Fully Trust	12	1.5%
Trust with Caution	181	26.0
Don't Really Trust	319	46.0
Totally Distrust	188	26.5
Total	700	100%

Interestingly, there is a statistically significant difference in the level of trust given to politicians when respondents are sorted by perceived wealth. Those who consider themselves wealthy are significantly more likely to trust politicians. Indeed, fifty percent – half – of the respondents who perceive themselves to be wealthy state that that they trust politicians, as compared with thirty-one percent of those who perceive themselves to be of medium income and only twenty-two percent of those who perceive themselves to be poor.

How much do you trust those politicians who occupy elective offices or run for the elections?

	Which type of person do you consider yourself?			
	Wealthy	Medium Income	Poor	Total
Fully Trust	17%	1%	2%	1.5%
Trust with Caution	33	30	21	26.0
Don't Really Trust	42	46	45	46.0
Totally Distrust	8	23	32	26.5
Total	100%	100%	100%	100%
(n)	(12)	(364)	(321)	(697)

Pearson chi2(6) = 29.0762 Pr = 0.000

Sorting respondents on the basis of type of settlement also yields a significant difference. Those who live in rural settlements are more likely to trust politicians. Thirty-four percent of respondents in rural settlements state that they trust politicians, which is significantly higher than the twenty-two percent of urban respondents who state the same.

How much do you trust those politicians who occupy elective offices or run for the elections?

	Type of Settlement		
	City	Village	Total
Fully Trust	1%	3%	1.5%
Trust with Caution	21	31	26.0
Don't Really Trust	46	46	45.5
Totally Distrust	32	20	27.0
Total	100%	100%	100%
(n)	(385)	(308)	(693)

Pearson chi2(3) = 17.3118 Pr = 0.001

When respondents are sorted on the basis of whether they work in the government or private sector, there is little difference between the two sets of answers. More than seventy percent of the respondents who identified themselves as government workers stated that they did not trust elected officials, almost as many as the seventy-six percent of private sector workers who state the same.

How much do you trust those politicians who occupy elective offices or run for the elections?

	Occupation		
	Government	Private Sector	Total
Fully Trust	2.0%	2%	2%
Trust with Caution	27.5	22	26
Don't Really Trust	48.5	46	47
Totally Distrust	22.0	30	25
Total	100%	100%	100%
(n)	(275)	(165)	(440)

Pearson chi2(3) = 4.0927 Pr = 0.252

Broadcast media news. Kazakhstani do not trust television or radio to report the news fully, precisely and objectively. Forty-five of the respondents state that they fully trust or trust with caution the broadcast media; fifty-six percent state that they do not.

How much do you trust the opinion that radio and TV report the news fully, precisely, and objectively?

	Freq.	Percent
Fully Trust	42	6%
Trust with Caution	274	39
Don't Really Trust	305	44
Totally Distrust	79	11
Total	700	100%

Sorting respondents by perceived levels of wealth does not produce significant differences in these responses; mistrust of the broadcast media is consistent across perceived income levels. The most interesting differences in the responses is that those who perceive themselves as wealthy are more likely to fully trust and less likely to totally distrust broadcast media than are those who perceive themselves as middle class or poor. The total percentage of self-perceived wealthy who trust and mistrust broadcast media, however, is consistent with the total percentage of self-perceived middle class and poor.

How much do you trust the opinion that radio and TV report the news fully, precisely, and objectively?

	Which type of person do you consider yourself?			
	Wealthy	Medium Income	Poor	Total
Fully Trust	17%	4%	7%	6%
Trust with Caution	25	40	39	39
Don't Really Trust	50	45	42	44
Totally Distrust	8	11	12	11
Total	100%	100%	100%	100%
(n)	(12)	(363)	(322)	(697)

Pearson chi2(6) = 6.2724 Pr = 0.393

Sorting respondents on the basis of their settlement, on the other hand, does yield different responses. Urban respondents are somewhat more likely to state that they trust broadcast media. Interestingly, however, rural respondents are much less likely to state that they totally mistrust broadcast media.

How much do you trust the opinion that radio and TV report the news fully, precisely, and objectively?

	Type of Settlement		
	City	Village	Total
Fully Trust	6%	5%	6%
Trust with Caution	41	38	39
Don't Really Trust	39	49	44
Totally Distrust	14	8	11
Total	100%	100%	100%
(n)	(385)	(308)	(693)

Pearson chi2(3) = 10.1861 Pr = 0.017

Print media news. Kazakhstani do not trust the print media to report the news fully, precisely and objectively. Forty-seven percent of the respondents state that they fully trust or trust with caution print news; fifty-three percent do not really trust or totally distrust print news. It is interesting to note that although a majority mistrusts printed news, of the four institutions mentioned in this survey printed news is the most trusted.

How much do you trust the opinion that printed press report the news fully, precisely, and objectively?

	Freq.	Percent
Fully Trust	52	7.5%
Trust with Caution	275	39.5
Don't Really Trust	304	43.0
Totally Distrust	69	10.0
Total	700	100%

Sorting respondents by perceived levels of wealth yields significant differences in responses. Although far more respondents who perceive themselves to be wealthy fully trust print media, the self perceived wealthy actually mistrust print media more than do the self-perceived medium income or poor.

How much do you trust the opinion that printed press report the news fully, precisely, and Objectively?

	Which type of person do you consider yourself?			
	Wealthy	Medium Income	Poor	Total
Fully Trust	16.67%	4%	11%	7.5%
Trust with Caution	16.67	42	37	39.0
Don't Really Trust	50.00	45	42	43.5
Totally Distrust	16.67	9	10	10.0
Total	100%	100%	100%	100%
(n)	(12)	(363)	(322)	(697)

Pearson chi2(6) = 17.7284 Pr = 0.007

Sorting the respondents on the basis of the type of settlement does not yield any significant differences; responses from those in urban and rural areas were similar.

How much do you trust the opinion that printed press report the news fully, precisely, and objectively?

	Type of Settlement		
	City	Village	Total
Fully Trust	8%	7.0%	7.5%
Trust with Caution	40	38.0	39.0
Don't Really Trust	40	47.5	43.5
Totally Distrust	12	7.5	10.0
Total	100%	100%	100%
(n)	(385)	(308)	(693)

Pearson chi2(3) = 5.7204 Pr = 0.126

Conclusion

The majority of Kazakhstani do not trust four of the primary institutions of a market-oriented democracy. To the extent that there is a degree of trust, it is among those who perceive themselves to be wealthy; such respondents are more likely than others to trust the legal system and elected politicians and are more likely to fully trust broadcast and print media. On the other hand, rural and urban responses are for the most part similar, except that rural respondents are more likely to trust elected politicians.

These findings are significant to those engaged in the process of creating market-oriented and democratic institutions in Kazakhstan. A critical element in the viability of such institutions is missing. Moreover, to the extent that these institutions are not trusted, they will not be used. Economic actors will not be able to enter into all of the economic relations that are available to them, and the electorate may not be able to fully participate in the democratic process. Market and democratic institutions may suffer, and social capital in general may be lost. Those who are involved in the creation of institutions in Kazakhstan, therefore, must envision ways of creating trust in these institutions.

Endnotes

[1] Funding for this research was provided by the Lawrence and Carol Zicklin Center for Business Ethics Research.

[2] Although Goto [1990, p. 82] makes this point with reference to transnational trade, his reasoning applies to this general observation.

[3] Using an alpha level of 0.05 for significance testing.

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Support for anticorruption measures in Kazakhstan

Philip M. NICHOLS* [1]

Corruption impedes development and transition in at least three ways. Corruption obviously diverts resources from their best use, and it distorts decision making by those charged with implementing change. Corruption also undermines support for change. Combating corruption should therefore be a priority in the creation of market-oriented democracies.

Actions to curb corruption must occur on several fronts: international, transnational, country-wide and local (Leiken, 1996). Effective efforts to combat corruption, therefore, must have the support of a variety of constituencies. In all cases, however, the support of the people who actually reside in and make up a polity is critical to anticorruption efforts (Pope, 2000; Eigen 1998; Kpundeh 1998; Grabosky 1990).

This paper concerns itself directly with that requirement: local support for anticorruption measures. The author of this paper conducted an extensive survey in Kazakhstan in 1998, part of which asked respondents questions regarding their support for the undertaking of anticorruption measures in Kazakhstan. Empirically determining whether that support exists is a critical aspect of undertaking real measures in Kazakhstan, and also casts light on the understanding and perception of corruption by the people of Kazakhstan.

The survey finds, as a preliminary matter, that respondents believe corruption to be widespread. Kazakhstani respondents also perceive corruption to be harmful, which places them in accordance with the theoretical literature on corruption. With respect to the critical question of support for anticorruption measures, the survey finds that Kazakhstani respondents do support such measures. This support is indicated in responses to questions framed in different ways, each of which is discussed in this paper. The support for anticorruption measures is extremely robust, and is exhibited evenly across groups with different characteristics. Indeed, it is impossible to identify a set of characteristics that meaningfully identifies the respondents most likely to support anticorruption measures. This paper discusses the few cases in which comparison by single characteristics yield significantly different responses, and explains that even in these cases the support for anticorruption measures is strong.

The Survey

The questions regarding support for anticorruption measures were part of a much larger survey that focused primarily on Kazakhstani attitudes toward and perceptions of corruption (Nichols, 2001). That survey was comprised of seventy-six questions divided into eight parts. The survey was conducted in Kazakhstan in April and May of 1998. The survey was administered

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by Sange Research, and was administered in rural and urban locations in every area of Kazakhstan. Seven hundred and one surveys were completed. The author of this paper conducted interviews throughout Kazakhstan.

The questions in the survey were modeled on a survey conducted in Sierra Leone by Sahr John Kpundeh in 1992 (Kpundeh, 1995). Eventually this will allow for comparisons between the two studies. The questions were modified to fit conditions in Kazakhstan, and some questions were added. Sange Research translated the questions into Russian and also changed some questions, either so that they were comprehensible in Russian or so that they fit conditions in Kazakhstan. The Russian version was translated back into English for the use of this paper.

Respondents' perceptions of the extent of corruption

As a threshold issue, the majority of respondents believe that a great deal of corruption exists in Kazakhstan. The majority of respondents, over seventy-three percent, believe that bribery is necessary to resolve business issues; interviews indicated that this belief is based largely on firsthand experience or on the experiences of relatives or close friends. Indeed, firsthand experience with business matters was far more prevalent among interviewees than experience in political matters.

Do you agree with the statement that bribery is the practical necessity for quick resolution of business issues?

	Freq.	Percent
Absolutely agree	232	33%
Agree	283	40.5
Don't agree	146	21
Absolutely not	39	5.5
Total	700	100%

Nonetheless, the majority of respondents, almost fifty percent, also believe that bribery is necessary for the resolution of political issues. Perhaps because respondents lack firsthand experience in politics, seventeen percent of the respondents indicate that they are not sure.

Do you agree with the statement that bribery is the practical necessity for quick resolution of political issues?

	Freq.	Percent
Absolutely agree	96	14%
Agree	248	35
Don't agree	185	26
Absolutely not	55	8
Not sure	116	17
Total	700	100%

Given the perception that bribery is necessary to accomplish both business and political tasks in Kazakhstan, one would expect a perception that bribery is widespread. The respondents do in fact believe that corruption is widespread, the majority of respondents believe that the majority of government officials accept bribes. Only seventeen percent of the respondents disagree with the statement that the majority of government officials accept bribes; only two percent completely disagree, as opposed to thirty percent who completely agree.

Give your opinion about the following: The majority of government officials accept bribes.

	Freq.	Percent
Completely Agree	211	30%
Agree	372	53
Don't Agree	107	15
Absolutely Don't Agree	10	2
Total	700	100%

In short, there is a widespread perception among respondents that corruption and bribery are endemic in the political structure of Kazakhstan.

The Effects of Corruption and the Perception of Corruption

The vast majority of scholarly literature finds that corruption is harmful. Corruption warps decisionmaking: rather than basing an economic decision on price and quality of a good or service, a government official bases the decision on the quality of the bribe (Nichols 1999a; Schliefer and Vishny 1993; Bader and Shaw 1983, p. 627). Corruption also diverts resources: first by inducing suppliers to use their resources to improve the quality of bribes rather than to reduce price or improve quality (Sporkin 1998:280; Tanzi 1998; Kauffman 1997; Alam 1989), second through the approval of unnecessary projects (Nichols 1999b; Werlin 1973), third through the efforts of government officials to hide their corrupt activities or to generate more demand for illicit activities (Alam 1995; Schleifer and Vishny 1993), and fourth through the outright theft of state resources (Mbaku 1994; Nichols, 1994:63; MacKenzie 1993). Corruption degrades bureaucratic structures by driving out honest bureaucrats (Tanzi 1998; Thoumi 1987; Johnson 1975) and through the sale of public office to unqualified (and usually unscrupulous) applicants (Wade 1985; Wade 1984; Wade 1982). Empirically, it has been found that countries with corrupt governments attract less foreign capital than countries with less corrupt governments (Campos, Lien and Pradhan, 1999; Wei, 1997a; Wei, 1997b; Mauro, 1996; Mauro, 1995). Historically, it has been noted that corrupt regimes are unstable and usually collapse, causing social disorder as they do so (Earle, 2000; Nichols, 2000; Nichols, 1999b; Brademas and Heimann, 1998; Rose-Ackerman, 1996; Clark, 1995; Rose-Ackerman, 1978).

Perceptions of corruption are as harmful as corruption itself. Susan Rose-Ackerman describes the general effect of perceptions of corruption: "Citizens may come to believe that the government is simply for sale to the highest bidder. Corruption undermines claims that the government is substituting democratic values for decisions based on ability to pay" (Rose-Ackerman 1996:44). The belief that corruption is widespread causes people to mistrust government institutions, to disengage from the public sphere, and to substitute their own institutions for government institutions (Rose-Ackerman, 1999; Cragg, 1998; Boswell, 1996; Werlin, 1973). Most critically for transition economies such as Kazakhstan, a belief that corruption is widespread undermines support for and may actually lead to opposition to market and democratic reform (Nichols, 1999b; Buscaglia, 1996; Leikens, 1996; Gray and Jarosz, 1995).

The respondents' perceptions of the effects of corruption mirror the theoretical and empirical literature. When simply asked if corruption harms Kazakhstan, ninety-three percent respond that it does; sixty-four percent believe that corruption does a lot of harm.

How does bribery harm Kazakhstan?

	Freq.	Percent
A lot of harm	452	64%
Enough harm	200	29
Some harm	39	6
No harm	9	1
Total	700	100%

When asked about specific behaviors, respondents also find that corruption is harmful. Ninety-one percent respond that a state employee who accepts bribes harms Kazakhstan.

In your opinion, which of the following may or may not harm the society in general? State employee who accepts bribe from local entrepreneur.

	Freq.	Percent
A lot of harm to society	249	36%
Some harm	386	55
No harm	66	9
Total	701	100%

Respondents also find the converse to be harmful; eighty-six percent of the respondents also believe that a private entrepreneur who pays bribes causes harm to Kazakhstan. Blame for the damage caused by corruption seems to be shared between both the bribe giver and the bribe taker.

In your opinion, which of the following may or may not harm the society in general? Entrepreneur who gives bribes to ensure preferential treatment during contract bidding?

	Freq.	Percent
A lot of harm to society	246	35%
Some harm	358	51
No harm	95	14
Total	699	100%

Respondents are equally critical of a local leader who accepts bribes but uses them to do good for the local community; eighty-two percent of the respondents believe such behavior to be harmful to society. This belies the theory sometimes circulated in Western literature that corruption is an accepted means of capital accumulation that facilitates local development (see Harsch, 1993).

In your opinion, which of the following may or may not harm the society in general? Local "boss"/government official who accepts a bribe, but does a lot of good for the community?

	Freq.	Percent
A lot of harm to society	159	23%
Some harm	416	59
No harm	125	18
Total	700	100%

Respondents even found the bribing of a traffic policeman to be harmful. While the percentage finding this behavior to be harmful – sixty-six percent – is smaller than with respect to other behaviors, it still constitutes two thirds of the respondents. Moreover, this majority again contravenes another theory sometimes circulated in Western literature, that small bribes paid to policemen and other petty officials is an accepted method of compensating those officials for low salaries (Salbu, 2000).

In your opinion, which of the following may or may not harm the society in general? Bribing a traffic cop?

	Freq.	Percent
A lot of harm to society	83	12%
Some harm	377	54
No harm	239	34
Total	699	100%

The antagonism toward bribe taking traffic police is interesting for at least two reasons. On one hand, rather than appreciating a short cut around traffic regulations, respondents find these bribes to be harmful. On the other hand, however, this is the behavior that the largest percentage of respondents found to be not harmful.

Overall, the theoretical and empirical literature on corruption characterizes corruption as a harmful activity. The respondents comport with the literature; corruption in general is believed harmful by an overwhelming majority of respondents, and even the "least" harmful behavior is found harmful by more than sixty percent of the respondents.

Support for anticorruption measures

The fact that people find a behavior harmful does not necessarily mean that people support government action that would curtail that behavior. In particular, if a behavior is considered to be an integral part of a culture, then it is unlikely that people will support controls on that behavior (Landes, 1998; Olson, 1996). In the case of corruption, however, Kazakhstani respondents emphatically support anticorruption measures.

Three questions in the survey explicitly deal with anticorruption measures. The most general of these asks respondents to rank how important the government should consider combating corruption. A majority – fifty-six percent – indicate that combating corruption should be of the highest priority for the government, and ninety-six percent of the respondents indicate that the fight against corruption should be at least a significant priority.

How important should the government consider the fight against corruption?

	Freq.	Percent
Top priority	392	56%
Significant	282	40
Secondary	27	4
Total	701	100%

When asked more specific questions, a majority again supports combating corruption, although the percentages are somewhat smaller. Seventy-eight percent, for example, support the creation of a special agency dedicated to fighting corruption. Only six percent of the respondents absolutely do no support the creation of such an agency.

Should there be a special law enforcement agency dedicated to fighting corruption?

	Freq.	Percent
Completely Agree	273	39%
Agree	273	39
Don't Agree	110	16
Absolutely Don't Agree	43	6
Total	699	100%

Similarly, a law that would require political candidates to disclose income and assets also receives support from a majority, seventy-six percent, of respondents. Only five percent of the respondents absolutely do not favor such laws.

Should all persons running for elected office be required by law to declare their personal income and savings?

	Freq.	Percent
Completely Agree	224	32%
Agree	310	44
Don't Agree	134	19
Absolutely Don't Agree	32	5
Total	700	100%

Clearly, the great majority of Kazakhstani respondents in general strongly support anticorruption measures for Kazakhstan. The robustness of this support becomes evident when attempts are made to isolate the groups most likely to support or not support anticorruption measures.

The robustness of support for anticorruption measures

One of the more interesting aspects of support for anticorruption measures is the fact that such support is spread evenly throughout the respondents. In an attempt to find the characteristics of respondents most likely to most support or not support anticorruption measures, two subgroups of respondents were formed: one subgroup that answered each of the three questions discussed above in the most positive way possible and one group that answered each of the three questions in the most negative way possible. Using a variety of multiple regressions, no characteristics or groups of characteristics were found that were statistically significant (using a probability level of more than five percent) in describing either of these groups.[2] Support for anticorruption measures is embraced evenly throughout the population represented by the respondents.

Even when single characteristics of respondents are evaluated with respect to single questions, few statistically meaningful differences (again using a confidence level of .05) are found in support for anticorruption measures. Sorting respondents by gender, for example, yields no statistically meaningful differences in support for anticorruption measures. Given the different roles played by men and women in traditional cultures, differences might have been expected. Similarly, sorting respondents by education yields no meaningful difference. Again, given the influence that education has on worldviews (Johnson, 1992), differences might have been expected.

The differences that do appear are interesting and worthy of study. In no case, however, do the differences indicate that a group sorted by a single characteristic does not support anticorruption measures.

Kazakhstan prides itself on being a multiethnic nation, and indeed experiences less ethnic tension than some of its neighbors. Meaningful differences do appear, however, in support for anticorruption measures when ethnic Kazakh respondents are compared to ethnic Russian respondents. A higher percentage of ethnic Russians assign top priority to the fight against corruption.

How important should the government consider the fight against corruption?[3]

	Kazakh	Russian
Top priority	51%	68%
Significant	44	31
Secondary	5	1
Total (n)	100% (370)	100% (196)

Pearson chi2(12) = 25.9898 Pr = 0.011

Similarly, a higher percentage of ethnic Russians agree that a special agency should be formed to fight corruption, and a meaningfully higher percentage of ethnic Kazakhs do not support the creation of such an agency.

Should there be a special law enforcement agency dedicated to fighting corruption?

	Kazakh	Russian
Completely Agree	36%	46%
Agree	39	41
Don't Agree	17	10
Absolutely Don't Agree	8	3
Total (n)	100% (368)	100% (196)

Pearson chi2(18) = 41.7328 Pr = 0.001

The differences in responses are statistically meaningful, but should not be overblown. With respect to both questions, a large majority of both ethnic Kazakhs and ethnic Russians support anticorruption measures, and with respect to both questions only a minority of both ethnic Kazakhs and ethnic Russians oppose the measure. The differences are only in the degree of support for anticorruption measures.

Interviews conducted by the author shed no light on the reasons for these differences. Someone observers outside of Kazakhstan might suggest that because ethnic Kazakhs hold the majority of government positions, they are less likely to support anticorruption measures. Such speculation is not supported by this survey. Ethnic Kazakhs are just as likely, if not more so, to find corruption and specific acts of corruption to be harmful. Moreover, when respondents are sorted by employment, another set of meaningful differences is found – government employees are more likely to support anticorruption measures.[4]

When asked the general question of how important the government should consider the fight against corruption, sixty-one percent of those who indicate that they are employed in the government sector answer that it should be a top priority, as compared to forty-eight percent of those indicating that they are employed in the private sector. Again, it must be noted that less than ten percent of both government and private sector employees state that the fight against corruption should be a secondary priority.

How important should the government consider the fight against corruption?

	Occupation		Total
	Gov't	Private Sector	
Top priority	61%	48%	56%
Significant	36	44	39
Secondary	3	8	5
Total (n)	100% (276)	100% (165)	100% (441)

Pearson chi2(2) = 9.6468 Pr = 0.008

When asked the more specific question of whether persons running for office should be required to disclose their income, government employees again support such a requirement by a larger majority (seventy-eight percent) than do private sector employees (sixty-seven percent). Again, it should be noted that majorities in both categories support such a measure.

Should all persons running for elected office be required by law to declare their personal income and savings?

	Occupation		Total
	Gov't	Private Sector	
Completely Agree	33%	26%	30%
Agree	45	41	44
Don't Agree	20	24	22
Absolutely Don't Agree	2	9	4
Total (n)	100% (276)	100% (165)	100% (441)

Pearson chi2(3) = 11.8218 Pr = 0.008

Interviews conducted by the author do indicate some reasons for the strength of government workers' support for anticorruption measures. The majority of government workers with whom the author spoke are bureaucrats with limited control over public goods. Many of these bureaucrats are deeply committed to building viable institutions in Kazakhstan, most are well educated, and most would like to perform the job they have taken. Some of these people have positions of rank but no power over a business's or a person's daily life, and thus are in no position to extract a bribe even if they were inclined to do so. Others lack power altogether, performing support services for those that do. Even though both types of government employees do not have the type of authority that can be abused in exchange for a bribe, they are in close proximity to officials that do. They witness firsthand the effects of any corruption that

occurs within the government. Conversations with these government employees indicate their concern and frustration with the effects of what they have witnessed and their desire to change the system in which they work.

Just as Kazakhstan is a multiethnic nation, it is also encompasses a multiplicity of religions. Meaningful differences also appear when respondents are sorted by religion. Larger percentages of Christian and atheist respondents state that fighting corruption should be a top government priority.

How important should the government consider the fight against corruption?

	Religion					Total
	Muslim	Christian	Jewish	Other	Atheist	
Top priority	49%	65%	50%	40%	63%	56%
Significant	45	33	50	60	36	40
Secondary	6	2	0	0	1	4
Total (n)	100% (359)	100% (180)	100% (4)	100% (20)	100% (135)	100% (698)

Pearson chi2(8) = 24.7766 Pr = 0.002

Again, these differences are only differences in degree of support for combating corruption. In every category, less than ten percent indicate that the fight against corruption should be of secondary importance.

While ethnic and religious diversity are more frequently discussed aspects of Kazakhstan, the differences between rural and urban populations are just as important. Differences in levels of support for anticorruption measure appear when respondents are sorted by the place of settlement. When asked whether a special agency should be created to fight corruption, the percentages of city and rural respondents that agree are essentially the same. A higher percentage of rural respondents, however, completely agree.

Should there be a special law enforcement agency dedicated to fighting corruption?

	Type of Settlement		Total
	City	Village	
Completely Agree	34%	44%	39%
Agree	43	35	39
Don't Agree	16	16	16
Absolutely Don't Agree	7	5	6
Total (n)	100% (384)	100% (308)	100% (692)

Pearson chi2(3) = 9.0659 Pr = 0.028

On the other hand, when asked whether persons running for office should be required to de clare their personal income, it is the urban respondents who completely agree in a larger per centage. Interestingly, urban respondents also disagree in a larger percentage.

Should all persons running for elected office be required by law to declare their personal income and savings?

	Type of Settlement		Total
	City	Village	
Completely Agree	36%	27%	32%
Agree	38	52	44
Don't Agree	20	18	19
Absolutely Don't Agree	6	3	5
Total (n)	100% (385)	100% (308)	100% (693)

Pearson chi2(3) = 16.6919 Pr = 0.001

Interviews shed some light on these differences. Rural interviewees were more likely to rely on direct government action to remedy a problem. They saw some value in disseminating information to individual persons, but ultimately felt that resolution of the issue of corruption (and many other issues) depended on a degree of power that they as individuals do not have. Urban interviewees, on the other hand, felt much more of a direct connection to government. For many, this meant that disseminating information about candidates for public office would empower individual citizens and could act as a curb on candidates' behavior. For a few, however, giving the government the power to force people to publicly disclose their incomes created a dangerous precedent for the relationship between the government and the individual.[1] This was especially true with respect to the sometime sensitive question of personal income.

Anticorruption measures as a moral issue

Most analyses of corruption focus on the economic and structural harm. Corruption can also be looked at, however, as a moral issue (Pope, 2000). Indeed, both Islam and Christianity condemn corruption in unequivocal terms (Nichols, 1997:321, citing the Qu'ran and the Bible). This survey, however, does not indicate that religious proscriptions play a large role in support for anticorruption measures.

Respondents were not only asked to indicate their religious affiliation, they were also asked about the importance of that religion to themselves. When intensity of religious feeling is measured against support for all three of the anticorruption measures asked of in the survey, little if any correlation is found. In keeping with the earlier discussion sorting respondents merely by religion, christians in general have a .157 greater probability of supporting anticorruption measures. However, among those christians who indicate that religion is highly important to their lives, probabilities for support actually fall. Muslims are less likely than the general population to support the three measures, and while Muslims who indicate that religion is highly important to their lives are slightly more likely to support the anticorruption measures, their probabilities are still lower than those of the general population.

In interviews, many people spoke at length of the economic or structural harm of corruption, whereas religious proscriptions almost never were spoken of. Many Kazakhstani did, however, speak at least in part in terms of right or wrong. In particular, a number of young Kazakhs stated that they did not want to become part of the government for fear that they would become "bad" or "immoral" people.

Implications of the findings

Respondents as a whole find corruption to be harmful to Kazakhstan. Respondents find harm not only in general but also with reference to specific acts of corruption. Interviewees suggested that corruption is harmful to both Kazakhstan's economic development and to the functioning of the government. There is no credence to any suggestion that corruption is accepted in Kazakhstan, is part of Kazakhstan's business culture, or is considered a "normal" means of accomplishing tasks.

Respondents also perceive corruption to be widespread throughout Kazakhstan. This perception should be particularly troubling to those who are attempting to create a stable country. Given the harm that most respondents see flowing from corruption, and given the fact that most see it as wrong, the perception that corruption is widespread could have destabilizing effects on the country. People are less likely to support democratic reforms if they believe those reforms are a sham, and are less likely to support market reforms if they believe that the market is subverted.

The responses indicate, however, that there are measures that the government can take that will be widely and deeply supported. These actions include a special agency dedicated to fighting corruption, such as the agencies that exist in Hong Kong and Singapore, and a requirement that all candidates for public office declare their income, as is now contemplated in some Latin American countries. Enactment of these measures would almost certainly bolster public confidence in government; failure to take meaningful action could alienate some of the population.

Endnotes

[1] This paper updates a portion of an earlier paper by the author that compared privatization techniques used by the five Central Asian countries (Nichols, 1997a).
[2] In the case of the negative group, some characteristics dropped out because of collinearity and others because they predicted failure or success perfectly.
[3] The complete data set also includes respondents who characterize themselves as ethnic Uzbek, Kyrgyz, German and Ukrainian as well as four respondents who characterize themselves as "other."
[4] The sorting of respondents by whether they work in the government sector or the private sector must be caveated. In interviews, many people indicated that they had difficulty placing themselves in one category or another. Many people who hold public positions also work in the private sector in order to supplement their income. Indeed, of the seven hundred and one respondents, two hundred and sixty failed to answer this question at all. Nonetheless, if it is accepted that those who responded did so on the basis of where the majority of their professional time is spent, interesting differences appear. Respondents employed in the government sector support anticorruption measures in higher percentages than those employed in the private sector.
[5] Many other thoughtful reasons were given, of course, for not supporting a requirement that candidates for public office reveal income. Some interviewees, for example, were concerned that qualified candidates would not run for office if faced with such a requirement. Some thought that if candidates were treated *a priori* as corrupt they would not have high self-expectations if they were elected to office. Some thought that the requirement would create unmanageable paperwork.

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Formation of new settlements in Kyrgyzstan and their social conditions (sociological analysis)

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Introduction

The transition to market relations has given birth to a new socio-territorial structure of sovereign Kyrgyzstan, which is inseparably linked with socio-economic problems of innovation and integration of Kyrgyz society into the international socio-economic space. This factor mainly defines the scientific and practical importance of studying the questions of formation of new settlements, predominantly around large cities of the Kyrgyz Republic, and industrial centers.

The most important component of this process is the redistribution of forms of ownership, reinforcement of social mobility of individuals and social groups, development of migration processes within, and interclass differentiation on a territorial level. The development of these changes influences the social structure, as well as the lifestyle of the population, and determines the regime and character of reproduction of corresponding socio-territorial communities. Considering the above outline, the actuality of the selected theme grows not only in the field of administering the tough processes of establishing new settlements, but also in the fulfillment of tasks related to the development of Kyrgyz society.

Today, research into social problems of development of new settlements is particularly urgent because without it, it is impossible to provide the necessary opportunities for increasing and utilizing the range of the intellectual potential of society's members. By the development of democratic forces, improvement of production, and improvement of social and national relations, it is possible to make a huge account of everybody's capabilities. Each individual of any social and national group, and territorial stratum, needs the best conditions for self-assertion and provision for contributing productively into the development of a democratic society. Moreover, these development processes are closely related to the increase of professional and moral potential of each individual, his or her health, and capabilities for intensive work.

The formation and realization of politics for developing the settlements within conditions of market relations is a significant factor for public administration at various levels (republican, district). This holds true even at the level of separate settlement.

As international experience has shown, the concretisation of changes in society, and the rise of new settlements in suburban areas as a result of internal migration processes is a regular phenomenon. However, in the present day conditions of higher scales of migration of rural population to cities, the intensified process of urbanization starts to take a contradictory character, the demographic and socio-economic consequences of which are unpredictable.

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Formation of new settlements

Kyrgyzstan, like other post-soviet states, has become a sovereign state dealing independently with its problems and socio-economic issues. Currently, 65% of the population lives in the rural areas of Kyrgyzstan.

Living in the emerging conditions of market relations', the inhabitants of Kyrgyz villages have been trying to adapt to the new conditions, and are more involved in the "village-city" migration flows. This phenomenon has created the conditions for the appearance and development of new settlements around Bishkek and Osh cities, which became the focus of a sociological research conducted by us in 1999. The main body (grand total) of new settlers consists of 32000 inhabitants from 28 settlements. Our research covered a total of 686 respondents (from Osh-286, from Bishkek-400), the sampling of whom was made on strict criterias of quota territorial sampling.

As already mentioned the collapse of the Soviet State brought significant changes to the lives of people of Kyrgyzstan. The all-scale liquidation of 'kolhozov' and 'sovhozov', interruption of work at many enterprises and state organizations created the conditions for migration of rural inhabitants. Especially strong was the growth of the flow of movement from villages to cities. At the same time the cities already had problems with adequate accommodation. As a solution of the problem, land was provided for building new accommodation. According to the decree of the president of Kyrgyz Republic "About main directions of state youth politics in Kyrgyzstan in modern conditions" 28.01.19921 and special enactment of Kyrgyz Government, land had been allotted for new settlements in the outlying districts of the cities in order to provide accommodation to people, who did not own houses. Nowadays, there is a reinforcement of initiatives in forming new settlements in Kyrgyzstan.

All in all, Bishkek is surrounded by 22 new settlements such as Kok-jar, Archa-beshik, Ak-Orgoo, Ene-say, Tynchtyk, Kelechek, etc. 6 settlements – Ak-Tilek, Kyzyk-Kyshtak, Uchar, etc, surround Osh. Many immigrants from different areas of the republic have settled in these regions.

Analysis shows that the first place among the settlers, in terms of numbers, is taken by the natives of Naryn district. Among them the biggest number is composed of people with secondary or secondary special education. (This is the most important group in the analyzed sample, by its numerical weightgroup). The immigrants of Osh take the second place, which is the biggest district in the southern region of the state. Majority of these people is specialists with unfinished or finished higher education, additionally with secondary education; the rest are people with secondary special education. As it is seen from the analysis of the research data, newcomers from Bishkek to other settlements make up the smallest part of immigrants.

By the level of education there is a big portion of educated among newcomers to new settle ments. Because of liquidation of the workplaces related to the level of education, the numb of people possessing higher education searching for new jobs has increased sharply. This ob servation is confirmed by the academician R. I. Zaslavskaya who claims that "from the villag es to cities migrates the youngest educated part of inhabitants of rural areas". Responden with lower education are less exposed to migration.

Comparative analysis has shown that among the immigrants of new settlements around Os newcomers from nearby regions are predominant, whereas around Bishkek is a large numbe of newcomers have migrated from far regions. "It is very interesting that the population of al the districts prefer to move to Bishkek and Chu district. Osh district attracts a large number o the population from southern regions, particularly from Batken district".

It is possible to conclude from the materials of the research that the immigrants from fa regions of the republic compared to the inhabitants from near regions are more inclined t travel. Among immigrants of new settlements by the level of education, the majority is com posed of respondents with unfinished higher education, and completed higher education.

The research without the analysis of intensiveness of migration of various socio-demograph groups, particularly of age groups, would be incomplete since it is age structure that influenc qualitative and quantitative characteristics of migration. The necessity of observation of indi cators of migration by age structure is firstly tied to the fact that the main part of immigran consists of able-bodied people. Consequently, the intensity of migration tells upon the forma tion of available workforces, and the observation of groups of immigrants younger than th able-bodied age allows for conclusions regarding potential abilities of new settlements.

One of the demographic characteristics of immigrants is their age (Table #1). As is seen fro the table, the biggest part of immigrants to new settlements are the respondents aged 30-3 years. At this age people start families, get jobs, and become interested in improvement o their living standards.

Table 1. Arriving to new settlements by age (in % to the number of respondents)

Where did you come from to this settlement?

	Until 29 years of age	30-39	40-59	Older than 60	Total by the sample
Bishkek	3,4	4,9	15,6	15,4	7,7
Osh district	6,9	21,3	15,6	7,7	18,4
Djalal-Abad	3,4	8,7	7,3	7,7	7,7
Chu district	13,8	16,3	20,8	7,7	16,9
Naryn district	34,5	22,1	15,6	38,5	21,9
Issyk-Kul	27,6	15,6	15,6	15,4	16,4
Talas district	6,9	10,6	9,4	7,7	9,9
Total	7,2	65,6	23,9	3,2	100

Market relations have influenced far mountain regions. Respondents of this age made up 65,9% of the immigrants who came from Naryn district. Among immigrants from Osh district there are more people of this age – 75,9%. "Among the districts losing their population because of internal migration, Naryn district is worth noting. As a result of migration, this district lost 6,9% of its population during the year preceding the census.. It is followed by Talas district – 4,6% and Issyk-kul – 3,7% of all the population lost. The negative balance is found in 3 districts – from 1 to 2%. On the other hand, 1,6% arrived at Chu district and 8,2% to Bishkek".

These data show the significant movement from rural areas to urban, especially from northern mountain regions to Chu district and the capital of the republic.
Consequently, the aspiration to improve living conditions by means of migration to cities is typical for the inhabitants of far regions. It is possible to forecast that it will increase.

Inhabitants of new settlements are people with different professions. Majority of immigrants of new settlements possessing engineering professions (engineer, driver, and builder) came mainly from the far regions of Osh district. Moreover the majority of respondents from agricultural professions (agronomist, zootechnician, veterinary) had arrived from far regions of the republic – e.g. Naryn district. (Table #2). There are almost no people with the same professions among questioned respondents from other regions. Among the migrants of this region the second place is occupied by accountants, economists (27,7%), followed by the respondents who do not possess professions.

It follows that, as a rule, immigrants to new settlements from far regions possess different professions. They are more active and inclined to search for "where things are better".

Table 2. Migrants to the new settlements according to their specialization

Where are you from?

	Without specia-lization	Teacher Doctor	Engineer, driver, builder	Agrono-mist, zoo-technician, veterina-rian	Accoun-tant, econo-mist	Total in the sample
Bishkek	1,2	9,4	9,4	0	6,4	7,7
Osh disrict	14,6	20,8	32,8	18,8	10,6	18,4
Jalal-Abad	12,2	8,3	6,3	0	4,3	7,9
Chui district	15,9	17,7	12,5	0	23,4	16,9
Naryn district	23,2	15,6	18,8	50	27,7	21,9
Issyk-kul	22,0	16,7	7,8	25	19,1	16,4
Talas	9,8	10,4	12,5	6,3	8,5	9,9
Total	20,4	23,9	16,0	4,0	11,7	100

The migration of young people to the capital, and to the new settlements, is mostly characterized by the inhabitants of Narinskoi and Issykskoi oblasts. «It is not accidental, that during the last ten years, migration from villages to the big cities has become the main problem of young people.»

According to the age, the most passive migrants are respondents over the age of 60. «People of the older generation, in most cases, prefer not to leave their location. They need help to reach a great age and to grow old and grey at their usual place. The government must organize travelling trade, medical, consumer, and cultural services in order to create normal conditions for old people's lives". «So, for older people it is difficult to adapt at the new place of residence and to new conditions of climate, compared to the adaptability of young people". To be more objective, older people have less opportunities to migrate. Nevertheless, 35% are people who came from Narinskoi oblast. «Among the older generation about 40% males and 50% females have the practice of migration. The generation which was born in 1920 tends to be more mobile, whereas the generation which was born after 1930 is less inclined to move.».

According to the data from our research, the migration of a large number of married inhabitants to new settlements has contributed to the creation of new lifestyles and is stipulated for further development.

Social position of inhabitants at the new settlements

Radical structural transformations, which were carried out in Kyrgyzstan with the aim of laying the foundations of a market economy and its effective functioning, have brought in their wake stratification among the main members of society. In 1998, the proportion of poor among the population was 55% and the proportion of extremely poor people was about 20%. The specific gravity was significantly reduced, while the income of a small portion of society (4-6%) is 10-12 times higher than the income of the poorest part of the population.

The economic difficulties of reforms and costs, and also the crisis phenomena in the economy strengthen more and more the break between the two above-mentioned groups of society. And from indecision regarding such socio-economic problems as inflation, unemployment, criminality, etc. the poorest layers of the population suffer the most. Social guarantees, represented by the state, do not provide sufficient support and help rendered per head is too inadequate.

The transition from administrative managerial control of the economy to market relations has affected social life of the population. In this connection previously unknown problems have appeared in society: "The reforms which are being carried out in society are directed to the maintenance of a high-grade of life for people. But, unfortunately, people"s day-to-day existence is becoming more and more burdened. The deterioration of living standards at various layers of the population has very specific reasons. For instance, socio-economic development is subordinated to bureaucratic procedures and thus the meaningless promises do not change anything. Respondents attitude to this situation is as follows: an overwhelming majority of the respondents with general secondary, higher and incomplete higher education connect the improvement of their living standards with the transition of the republic to market relations and business in commercial sphere. People with incomplete higher and with higher education consider that even a small wage rise contributes to the improvement of their lives, and those who have incomplete secondary education connected improvement in their lives to the realization of reforms and the results of their commercial activity.

During the years of reforms significant part of the able-bodied population has been marginalised due to the budget sphere turning into the sphere of business. Services and trade because of a lower and all-time restricted salary have also suffered. The negative factor is the massive outflow of young, able-bodied population to the shuttle business, thus the most active part of labor force has been diverted from the financial sector of the economy to the spheres of science, education and public health service. That has caused significant reduction in the share of employees in public health service from 8,8 % in 1993 up to 5,4 % in 1998, in housing and communal services and in non-productive kinds of household service of the population - from 2,6% down to 1,4%. On the one hand, such situation really is negative when the branches lose young generation. And on the other hand, thus the young generation raises their living standard.

Table 3. The attitude of the respondents to possible ways of increasing their living standard according to their education

Withwhat do you connect the improvement of life?

	Incomplete secondary education	Secondary education	Specialized secondary education	Incomplete higher and higher education	Total
Increase of the salary	0	3,8	7,1	11,8	8,2
Work in the private firm	0	4,8	8,8	10,6	8,2
Commercial activity	12,5	12,5	20,4	18,6	16,9
Work in official body	0	2,9	6,2	8,1	6,4
Realization of reforms in life	12.5	11,5	3,5	8,3	8,7
Transition to the market relations	12,5	9,6	16,8	20,3	16,9

Among the social problems the large potential danger is represented by unemployment. The number of the registered unemployed in the country had reached 77,3 thousand on January 1, 1999. Thus the official rate of unemployment from 1995 has increased from 0,1 % to 4,4 % from the number of the economically active population. Keeping in view the people who are not completely employed in manufacture, while at the same time are on forced leave, and also people who are not employed but actively looking for jobs, the general potential of unemployment in the Republic of Kyrgyzstan is more than 200 thousand people or 11 % of the economically active population, which exceeds the official rate of unemployment by almost 2,5 times.

The reasons of poverty in Kyrgyzstan are caused by the crisis of former economic system, its difficulties in implementing reformations, the disintegration of economic communications of the former Soviet Union, bankruptcy and preservation of the majority of the industrial enterprises, growth of unemployment, inflation, lack of experience in economic activities of the general population, passivity of its significant part, and pressure of dependent psychology.

The major reason of poverty became fall of the real incomes from labor-intensive activity and reduction of all wages. Over the years of reforms real wages have fallen more than twice in comparison with 1991, with the average level remaining below the minimal consumer budget. It is due to decreases in the manufacturing industry, and high inflation. In spite of the fact that the minimal consumer budget by itself represents a small set of products, goods and services for satisfaction of essential needs of the people, its monetary size has appeared now unattainable neither for average wages of employees in economy nor for mean income of the population. Average wage in republic has lagged behind the minimal consumer budget.

Materials of our research confirm that the transition period to socio-economic situation of the people has the negative influence, which is rendered by unemployment. The majority of respondents, about 19,7%, hold the opinion that the deterioration in living standards is the result of unemployment.

One of the basic purposes of this research is to define social problems of families in new settlements. The level of income in each family has determined the standard of living. The determination of respondent's financial position by their educational level is shown the following:

Table 4. Estimation by the respondents of their family's financial position according to their level of education (in % to number interrogated).

How do you estimate the financial position of your family?

	Incomplete secondary education	Secondary education	Specialized secondary education	Incomplete higher and higher education	Total
We live below the breadline, haven't money evenfor food	0	45,8	23,7	15,2	14,7
In poverty, hardly enough for food	2,1	27,4	30,8	19,8	36,4
Relatively well-provided for food	2,6	20,9	30,1	23,2	38,1
We live in prosperity, well-provided for money	2,3	11,6	18,6	33,7	10,7

From the research data we can see that 38,1 % of respondents consider their family's financial position as average. The majority of inhabitants who specialized in secondary, incomplete higher and higher education gave such estimation.

36,4 % of respondents who participated in the research have estimated their position that today they live in poverty and have financial problems, to the extent that they don't have enough money for food. As we see from the table, many such respondents also have secondary education and specialized secondary education.

«The poverty represents low level of financial position which is not enough for normal life-support of the man and his family». « Problems of the poor class was and remains aggravated in a post-Soviet space, in Russia, Kyrgyzstan, Kazakhstan and other states of CIS. In these countries the percent of the poor, which are connected to a low level of material life, is rather high. According to the data of sociologists, even in Russia about 40 % of the population live in poverty».

The President of the Republic of Kyrgyzstan A.Akaev has noted: «In the present time more than 60 % of our population live poorly, among them 18 % in poverty». As you can see from our research, a majority of those who have secondary education are in the poorest condition. A half of the respondents are in a seriously hazardous position. However, as you can see from the table, with the increasing process of educational level the number of poor is reduced. Respondents who live in material prosperity and abundance are people with incomplete higher and higher education. It means that people with a high level of education adapted quickly to new conditions of the market and are exposed to the risks of poverty are less. Considering by the groups of population, who is regarded as poor? Professor M.S. Azhenov pinpoints this question: «Firstly, underpaid workers and employees who have lower level of qualification and education.

Secondly, it is unemployed who do not have or almost do not have sources of income. They always seek job and when they find, some engage with small commerce, which gives them an opportunity to survive.

Thirdly, almost all of them are pensioners. In modern conditions the average pension does not exceed 3 thousand, with exception of pensioners-militarymen. Most pensioners live very poorly.

Fourthly, poors are the students of higher and secondary special education institutes most of who do not have other sources of existence except stipend, which is not given regularly.

Fifthly, it is possible to ascribe to the poor class the biggest part of humanitarian intelligentsia – teachers, doctors, artists, scientists and many other professional groups, who have low salaries and do not have any other sources of income. They become poorer due to the impact of increases in prices of necessary products and goods.

Sixth, many unsuccessful businesspeople, entrepreneurs frequently fall into the category of poor. They become bankrupt and lose all their money when their business collapses. In the conditions of market relations, society always experiences the pauperization of some and enrichment of others. The number of poor gets higher and higher in our society." Currently, about 80% of the total poor population in the republic lives in the rural areas. According to the information of "Monitoring of poverty", the biggest number of poor and very poor population (8,5%) engage in agriculture because the process of farming is still at the stage of establishment and demands huge material expenses from the population.

More than half of the respondents falls under the category of poor. The majority of people of different professions perceive poverty as the main problem of life. "As a result of the sharp decline in real income, and reduction of employment, able-bodied citizens compose the main mass of poor". "Poverty gives birth to crime, which is related with spiritual fall, lack of morals. Because of this there are many criminals among poor people. The poorer the society, the more there is crimes. This means that in spirit-moral plan such society is uncongenial for a normal person. Consequently, many people leave this country for other developed countries."

As it is seen from the material of the research, the significant part of families – 42,3% live relatively on an average level. j of respondents evaluate their living standards in the same way. And the families which do not experience such difficulties in life and who believe that they live advantaged lives compared to other families, make up the minority. Overall, the consequences of poverty are more reflected in the new settlements.

Conclusion

In the conditions of Kyrgyzstan, the formation of new type of settlements demands equivalence of regional conditions of vital functions, and the consequent levels and regimes of migration of population caused by these conditions. In order to properly understand these processes and learn to influence them in the direction needed for society, it is necessary to make clear not only the general principal approaches to the problem, but also the regional features of socio-economic and demographic development, character of changes in relocation of population, and importantly, how these changes are influenced. This requires in-depth researches of specificity of relocated migrant population, and social, economic and demographic correlations in the development of settlements on the territories of the republic, and separate economic regions of the country.

Settlement plays a role as a lower chain of hierarchical socio-territorial structure made by territorial communities of different rank. It is the only type of territorial community, which forms entire microenvironment of population habitation. Thereby, the type of the settlement plays decisive role in formation and differentiation of concrete conditions of vital functions corresponding to territorial group.

Our research has shown that the formation of new type settlements is related with the solving of many tasks: economic, social, cultural, demographical, architechturo-building, organizational and legal.

On the basis of generalization of theoretical and empirical data about formation of new settlements in Kyrgyzstan in the process of market relations, we came to following conclusions:

1. By the level of education, among newcomers to new settlements there is a high ratio of prepared specialists. Level of unemployment has increased because of the reduction of workplaces corresponding to the population's level of preparation, especially for possessors of higher education in the cities.

2. The high ratio of newcomers to the new settlements from far regions testifies the increasing role of trade-industrial centers in the market conditions.
3. The majority of inhabitants of new settlements relate to the able-bodied age group of 30-39 years old. This age became mostly active in migration and because of this, despite the farness of their regions, people of this age are more inclined to migrate.
4. People from different professions usually become the inhabitants of new settlements. As a result of material difficulties people move to new settlements, with the goal of improving their living conditions.
5. More than 30% of inhabitants of new settlements are unsatisfied with their standards of living. The worsening of life conditions is mostly experienced by incomplete families (divorced, widows). The cause of this is seen in the unemployment and the high costs of products and goods.

In conclusion, we can formulate some recommendations from the general result of outlined material, which are based on the need to form renovated forms of settled communities in Kyrgyzstan. They would be capable to satisfy the demands of the communities as well as the needs of inhabitants of the settlements.

Implementation of the recommendations is designed on the government and organizations of local government and on the initiative of inhabitants of new settlements. The contents of the recommendations are as follows:

- In connection with the growth of extensive urbanization and on the basis of further concentration of society's efforts, there is a need for a new settlement conception, which would be able to activate the optimal variants of development of systems of settling in the period of transformation of Kyrgyz society. Its basis should be private property on land and wide investments in the industry of reprocessing of agricultural production, removal of hidden unemployment in Kyrgyz villages and their agrarian overpopulation, renunciation of typical programs of administering the employment and transition to sectorial and territorial forms. This would require a lot of researches of peculiarities of settling of population, social and demographical correlation in the development of settlements and their territorial infrastructure.
- The conditionality of migration flows from far territories into the urban settlements of low self-employment of inhabitants of rural areas assumes the need for realization of complex set of measures at the individual and institutional levels. This means the establishment of an efficient administration system, higher opportunities for self-employment, and the development of main components of activities of agricultural territories. Decrease of inflow of immigrants to cities will allow to minimize social problems in new settlements.

  Considering the difficulties of solving the social problems in new settlements, a tri-lateral unification of efforts is necessary to stabilize the situation there:

Firstly, unification of governmental institutions in formulating and carrying out balanced policies in various spheres of vital functions of new settlements;

Secondly, unification of all bodies of local governance, whose activities should be directed at improving life conditions and solidarity of inhabitants of new settlements;

Thirdly, expressing active adaptation to market conditions and entrepreneurial initiative by the inhabitants of new settlements.

We do not pretend to have done a final and exhaustive interpretation of the problems we have put forward. We also would like to emphasize that they in their very interconnectedness cannot be solved solely by one special science, because they are by nature very complex.

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Paradoxes of the Kazakh language revival

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Introduction

With the disintegration of the Soviet Union, resentment of Russians and of the Russian language surfaced in various parts of the disintegrating empire. Confrontations involving the Russian-speaking populations of the Baltic republics remain unresolved to the present day. The issue of the Ukrainian language revival still dominates the agenda of Ukrainian nationalists. Other manifestations of linguistic nationalism include less violent, but nonetheless, equally pervasive exclusions of the Russian language from public space in the Caucasus and the adoption of Latin script instead of the previously used Cyrillic script in Uzbekistan.

However, this sweeping tide of indigenous language revivals that has reigned over the Post-Soviet space notwithstanding, the language resurrection process seems to lack the same mobilizing intensity in Kazakhstan. According to both international researchers and local commentators, the revitalization of their mother tongue for Kazakhs did not become an overtly contentious issue as it has for Estonians and Ukrainians.[1] Despite the active engagement of the state in reinforcing the usage of Kazakh, progress in the revival of the language is still minuscule when compared to Georgia or even to neighboring Uzbekistan. My inquiry proposes an explanation for this peculiarity of linguistic nationalism dynamics in Kazakhstan by regarding the language as a set of symbols.[2] Reviewing historical circumstances that imbued both Kazakh and Russian with symbolism, I argue that positive symbols associated with the Russian language, lack of incentives to learn the Kazakh language, and, subsequently, the lack of a threat posed to the cultural identity of Kazakhs influences the current dynamics of the language revival in Kazakhstan.

Current dynamics of the Kazakh language revival in Kazakhstan

It has been mentioned earlier, that the dynamics of titular[3] language revival in the post-communist countries features one commonality: the state. The state, which has, in most cases, been dominated by the members of indigenous groups, became actively engaged in the politics of language resurrection. Along with other USSR republics, Kazakhstan first affirmed the status of Kazakh as the "state" language in 1989, later followed by the 1993 constitution's article on languages, which confirmed the 1989 law, yet also designated Russian as the 'language of international communication'" (Laitin, 1998, p. 2). To ensure the ascendancy of the titular language, the government of Kazakhstan has begun a campaign of institutional promotion of Kazakh. A number of legislative acts were adopted to reintegrate the Kazakh language into the public sphere. Fifty percent usage of the "state" language quota was set for mass

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media, mandatory language tests for government positions were instituted and the conduction of official documentation in Kazakh was enforced. The move towards the Kazakh language has also been marked by a rising number of educational institutions that undertake instruction in Kazakh.

Linguistic nationalism appears to have been launched by the state in Kazakhstan as it has in other post-Soviet countries with large Russian populations. However, despite these institutional measures, the discourse of the Kazakh language revival lacks vitality. The Kazakh language enforcement remains "on paper", while the Russian language continues to dominate public space.[4] Many researchers, including Dave Bhavna, have undertaken investigations to explain the established situation.[5]

An explanation generally provided to account for weak language revival in Kazakhstan relates to the established pattern of ethnic distribution in the country. When considering general statistical data across the former Soviet Union republics, a peculiar feature of ethnic composition in Kazakhstan becomes immediately visible. As a consequence of various Soviet resettlement policies, Kazakhstan has been a country where ethnic Kazakhs did not constitute a majority until 1997. Besides the smaller share of ethnic Kazakhs in the overall population of the republic, the number of Kazakhs fluent in their own language had declined as well. According to William Fierman (1997, p. 5), "Kazakh scholars estimate that around 1990, between 25% and 40% of the republic's Kazakhs had little or no mastery of their "own" language" (p. 3). Thus, the Kazakh language has approached an almost near abandonment according to demographic factors.

However, the presence of such a threat to the survival of the Kazakh language could have also easily fueled a sense of trauma, triggering a rise in anti-Russian sentiment among Kazakhs and propelling the tide of linguistic nationalism as happened in Ukraine. However, this has not occurred in Kazakhstan, which makes one ponder about the possible explanations for such dynamics of linguistic revival. A psychocultural approach to the investigation of the language revival could explain the peculiar nature of language resurrection in Kazakhstan.

Psychocultural approach

The term "psychocultural" was first introduced by the political scientist, Marc Ross, to compliment the current theoretical framework that attempts to explain ethnic conflicts by emphasizing identity dynamics (1993). According to Ross, psychocultural interpretations are defined as "the shared, deeply rooted worldviews that help groups make sense of daily life and provide psychologically meaningful accounts of a group's relationship with other groups, their actions and motives. Hence, examination of a language through the psychocultural approach and viewing it as a symbol could provide many insights to the intensity of feelings or their absence regarding it. Given that both Russians and Kazakhs have come to coexist with each other, symbols related to them also evolved, that are to be defined in relation with each other. In order to determine the symbolism behind the Kazakh language, it would be useful to base its analysis on a comparison with the Russian language. In addition owing to the ability of symbols to carry multiple meanings, the same language could potentially invoke different emotions in Kazakhs and Russians.

Positive symbolism of the Russian language

The Russian language has been primarily associated in scholarship as the titular language of Russians. Yet, throughout the Soviet Union era, the communist authorities promoted Russian as the language of international communication. This Slavic language reached and "conquered" every corner of the vast territory of the former Soviet Union. Russians, the carriers of this language, enjoyed the privilege of feeling 'at home' everywhere when crossing the territory of the 'great Motherland' because they did not need to learn local languages. As Edward Schatz wrote, "Soviet-era internationalism reserved a special role for Slavs (especially ethnic Russians) as the missionaries, emissaries, and technical specialists of Soviet rule" (p. 83). The languages of the indigenous people were mostly disregarded, often displaced by Russian and sometimes even forgotten. Such a dynamic resulted in the emergence of a set of symbols attributed to the Russian language and capable of invoking intense feelings among various ethnic groups.

In Kazakhstan, Russian was viewed as the language of enlightenment, of education and of higher social status. Many positive qualities were attributed to it, and it was utilized as a tool that facilitated upward mobility. The integration of the Russian language into Kazakh society dates back to the eighteenth century when the leaders of several Kazakh tribes accepted the protectorate of the Russian Empire from a potential Dzhungar invasion. The language spread with the stationing of exiled Russian intellectuals on the Kazakh steppes, as well as the later influx of the young. Russian speaking professionals who came to Kazakhstan as part of the virgin lands cultivation project during Krushchov's rule in the 1960s. Together these factors resulted in a situation in which the Russian language gradually became a symbol of enlightenment and progress.

This image of the language as a symbol of enlightenment and progress was further implanted into the identity of Kazakhstanis by the educational system. Even textbooks used in schools that instruct in Kazakh portray the Russian language as the messenger of knowledge. After independence, the Kazakh literature textbooks retained accounts of prominent Kazakh intellectuals who, having been schooled in the universities of Moscow and St. Petersburg, would emphasize the merit of learning Russian as the language of progress.[6] The message behind such a presentation implies the placement of much value and stress upon knowing Russian – the language of the intelligentsia. Generations of Kazakhs were raised and socialized on a worldview centered on the Russian language as the symbol of education. Thus, for many Kazakhs, the Russian language, besides its primary purpose of communication, also symbolizes education.

The great Kazakh authors of the past were not the only ones who created an incentive to speak Russian. Many current Kazakh intellectuals write and publish in Russian despite the knowl-

edge of their mother tongue. The role of such implicit emphasis on the Russian language is amplified by the fact that the majority of these intellectuals are considered to be in opposition to the current government apparatus, which is known to be an active proponent of an overall "Kazakification". Criticizing the oppressive and non-effective politics of the state to revive the language as a move backwards, 'to the age of darkness and ignorance'; these intellectuals reinforce the message that Russian still remains the language of progress.

As the accompaniment of the Russian-born professional strata, the language also became viewed as a marker of higher social status. Many Russians, who came to Kazakhstan as part of Khrushchev's project on the virgin lands cultivation, belonged to the professional or intellectual class and they subsequently never learned to speak Kazakh. Thus the Russian language came to signify educational and urban status, both of which were attributed to the higher social classes, while Kazakh was automatically shifted back into the position of the language of "those people from the *auls*[7]". As David Laitin describes (1998), "The Russian language has spread into every nook and cranny of urbanized and high-status Kazakh life" (p. 135). Such demarcation of social status by Russian is still prevalent in today's society. Given the feature of a high-status indicator, Russian has, therefore, become viewed as a tool for upward mobility.

In fact, most of Kazakhstan's current leadership was schooled in Russian, and was able to be recruited into the government. Laitin (1998, p.6) describes the established mechanism of learning Russian in order to gain access to the ruling strata in the following way:

For Kazakhs, the motivation to learn Russian was to become, in Abram de Swaan's formulation, 'monopoly mediators' standing between Russian rule at the center and Kazakh society in the periphery. Those who learned Russian and developed other forms of cultural capital enabling them to earn the trust of Soviet officials were not only able to get higher education (unavailable in Kazakh) but were also able to advance to positions of local or regional authority" (Laitin, 1998, p. 71).

In such a manner, the local political elite confirmed and reinforced the perception of Russian as the language of the discourse led by the state and the medium of empowerment. Thus, the state also functioned as a provider of incentives, which promoted the infusion of Russian with importance and has made the language considered to be a way for attaining social advancement.

Learning the Kazakh language?

Given the nature of the symbols behind the Russian language, in contrast the Kazakh language has been subsequently allocated a peripheral role. Until the early 1990s the mother tongue of one-third of Kazakhstan's population was confined to informal usage in households and to rural areas, where people had very little access to Russian schooling. Having always been placed in contrast to Russian, the Kazakh language came to be viewed as signifying a "lower" status, a language of the rural people that were schooled only enough for the purpose of becoming "milkmaids or kolkhoz[8] workers" (Laitin, 1998, p.136). This set of symbols behind the Kazakh language could provide an explanation as to why even ethnic Kazakhs prefer to use Russian.

Yet, with all the changes that have happened in the last fifteen years in Kazakhstan, the nature of the symbols behind the Kazakh language have evolved in many respects. One of the more significant messages that the Kazakh language began carrying could be a constant reminder of the loss of their previously 'special' status to the Russians because prior to the break-up of the Soviet Union they rarely had to assimilate into the local culture. Ethnic Russians in Kazakhstan still retain the memories of their past social position of the entitled and deny acknowledging a shift from their former privileged status to the state of minority. Many Russians vehemently deny the possibility of learning Kazakh. As Dave Bhavna describes, "Still in 1992-1993 it seemed quixotic for non-Kazakhs- over half of the country's population then- to learn a language that had so little prestige" (p. 5). Russians view the idea of assimilation as practically impossible: "In Kazakhstan, whenever job possibilities are involved, many Russians cannot undertake the study of the Kazakh language seriously"(Laitin, 1998, p. 121). Some of them attribute their unwillingness to the incompetence of Kazakh as a language: «the Kazakhs don't really have a language; they merely have dialects» (Laitin, 1998, p. 121). They deny the need to learn the language that they perceive as "undeveloped" and "inadequate". Another objective statement is: "It is absurd to transform a spiritual folkloric language into a technical one" (Laitin, 1998, p. 121). In addition to being previously viewed as an 'unnecessary" language to learn, with enforcement of the Kazakh language revival by the state, Kazakh becomes a reminder, a symbol of the lost status for non-Kazakhs.

Another important factor that adds to the symbolism behind this language is that Kazakhs themselves are ambivalent about their own language. As Fierman (1997) describes it, "the Kazakhs themselves are very divided about the appropriate status for Kazakh and Russian in their country, and even about the relevance of the Kazakh language to ethnic identity" (p. 3). Dave Bhavna (1996) characterizes the state of mind for Kazakhs by the following dilemma: "Should [Kazakhs] transfer their children to the 'inferior' Kazakh schools, demonstrating their ethnic loyalty; or should they continue sending the children to Russian schools, and be exposed to in-group stigma, especially from the large influx of their rural fellow countrymen to the cities? (p. 8). These issues precipitate ambivalent feelings about the Kazakh language not only for Russians but also for ethnic Kazakhs.

In view of the current situation, the government is seeking to promote a language revival might engage in the practice of artificially imbuing Kazakh with importance. Yet, despite the established legal framework, where knowing the Kazakh language would improve one's chances for a government job, economic incentives also seem to be weak. As Laitin observes: «There are no clear signals that jobs depend on knowing Kazakh. As Slava Kozlov, a young Russian engineer who himself planned to learn Kazakh, told: "The only way to get a good job is breaking through family networks. No one," he said, "will lose his job because he doesn't know Kazakh. But on the other hand," he insisted, "no one will get a good job just for learning Kazakh" (p. 118). Therefore, despite the government's attempts to stimulate the use of the language by means of motivation such as the prospect of jobs, this particular economic incentive does not seem to have resulted in additional learning of the Kazakh language.

The lack of strong mobilizing emotions that could revive the use of the Kazakh language could also be explained by the lack of a threat to the Kazakh cultural identity through the language. Choosing to speak Russian instead of Kazakh could have been viewed less as subverting their identity for Kazakhs. When explaining his hypothesis about the correlation between the level of elite incorporation and language/culture assimilation, David Laitin suggested «In the case of low [elite] incorporation (Kazakhstan), there are higher levels of titular separation from Russian culture (where language learning is instrumental, and not a basis for a more complete cultural shift) and therefore greater attempts to invest in a separatist future than was the case of high elite incorporation (Ukraine), where linguistic assimilation coincided with other forms of cultural blending, and where there were fewer attempts by parents in the Soviet era to invest in a separatist future" (Laitin, 1982). In other words, in contrast to Ukraine, where assimilation into Russian culture took on a more pervasive character, the knowledge of Russian had been rather functional for Kazakhs. The laxity of Kazakhs about their language preservation could be due to the lack of threat to their cultural identity by the dominance of Russian in public spheres. The linguistic revival has not triggered powerful emotions among ethnic Kazakhs because language has mostly been seen as a matter of social status.

The nature of the existing sets of symbols behind both Russian and Kazakh languages could provide one with an answer to the puzzle of why the process of language revival is taking a course of development, which is emotionally and culturally different from the processes taking place elsewhere in the former Soviet Union. Historically evolved 'benign' character of symbols behind the Russian language as 'the carrier of progress and enlightenment' could provide an explanation as to why there is so little resentment towards using it among ethnic Kazakhs. Another factor behind the languid character of the Kazakh language revival is attributed to the lack of economic incentives for both ethnic Russians and ethnic Kazakhs. An absence of a perceived threat to the cultural identity of ethnic Kazakhs in the established dynamics of the relationship between these two languages could serve as an additional explanation as to why domination of the public sphere in Kazakhstan by the Russian language is tolerated. Owing to the fluid and changing nature of symbols, however, it is possible that their nature could gradually shift under the influence of the state policies or other factors?

Endnotes

[1] David Laitin (1998) documents this particular feature of the Kazakh language revival in his massive comparative study of the language politics in the Baltic states, Ukraine and Kazakhstan.
[2] By symbols here I mean the set of ideas that the Kazakh and Russian languages might represent for people in Kazakhstan. Anthony Steven's definition is particularly relevant to my explanation: "A symbol is an image or a thing which acquires its symbolic value through the meaning and emotions it evokes in us" (Stevens, 1999, p. 12).
[3] Titular is a term that implies that the carriers of titular status are those after whom the republic is named.

[4] According to Nazira Esenbayeva (1999, April 2), "Today the Kazakh language enjoys a proud status of the national language but in practice is only its pitiful shadow since there are few spheres where it can really be used" ("When Will the Kazakh Language Become Really a State One?", Vremja po Grinvichu, April 2, 1999).

[5] Dave Bhavna devoted her dissertation to the study of the language revival process in Kazakhstan ("Politics of Language Revival: National Identity and State Building in Kazakhstan", December 1996).

[6] Abay Kunanbaev, Chokan Valikhanov, and Ibray Altynsarin could certainly be considered among this group of intellectuals.

[7] A Kazakh word for a village.

[8] «Kolkhoz" is translated as "collective farm" from Russian.

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The Debate Program as a new technique for civic education in Kazakhstan

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The development of modern Kazakhstani youth is occurring in conditions of post soviet reality, that is characterized by the prevalence of criticism of the Soviet mode, amongst a society that displays anticommunist views. At first, it would seem that these conditions should prepare the younger generation to accept a democratic orientation. However, the situation is complicated by the conditions of a protracted economic crisis in which the younger generation has become one of the most socially vulnerable segments of the population. The basic rights for education, employment, and leisure seem to have become a rather illusive. There is a danger, therefore, that the democratic reforms and free market may as a result not be so attractive to the younger generation? As a consequence, it has become a priority to help the younger generation to understand and accept the democratic values.

The development of any democratic society supposes an active participation of its citizens in the state decision-making process. In this respect the importance of developing rational thinking abilities among the younger generation is important. It will help them not to readily accept to hyperbole one sided opinions and should help to reduce manipulating the views of the younger generation. It conduces to working out personal attitude toward the current events in society and these should be an opportunity for the individual to form their own opinion as to current events in society that will as a result help strengthen social values and interaction.

Kazakhstan is a multinational state with the social stability being one of the important characteristics. The Debate movement in Kazakhstan contributes to the solution of the given problems by institutionalizing tolerance and respect towards the opinions of others and different cultures.

Taking into consideration the attitude of the younger generation that is characterized by passivity and a lack of interest in the public and political life debate is an excellent method to develop social and creative activity by discussing current issues.

While preparing for the debate high school students thoroughly research a wide range of information on Economics, Political Science, Culture, Philosophy and History and as a result become acquainted with various points of view on the same issue.

The one of the most important problems of today in the post-soviet countries is the creation of a democratic culture.

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The American philosopher John Due stated that the existence of democratic institutions does not guarantee real democracy, «the democracy should be base on «human nature «, is unique because only personalities that are democratic in thought and operation can be a reliable guarantee of it. On this basis he built the concept of democracy as «lifestyle». The main task, by Due, is the education of the man as much as possible who is fitted to the conditions of life in society.

Democratic values, knowledge and skills should purposefully be developed. School, university, non-governmental educational structures as NGO's, should appear as the building blocks of civic education. The task of these structures should be common to all - creation of the citizen that the man has acquires a defined system of values and orientation, and finds skills necessary for the execution of the functions as a citizen.

In the book by the President of the Republic of Kazakhstan Nursultan Nazarbayev, «On the eve of XXI century» the perspectives of political development of the country is the creation of a civil society (Nazarbayev, 1996, pp. 126-127).[1] Construction of a civil society and its evolution as a development in many respects depends upon the NGO. The non-governmental organizations play a significant role by involving the population in the life of the country, protecting of interests of the people and rendering voluntary charitable services to the socially unprotected stratums of society. Many NGO's, who are working in the sphere of education in different countries bring with them significant contribution to the development of education, directing the professional community for the solution of difficult problems. The few educational NGO's in our Kazakhstan also work in this direction, maintaining and spreading the experience of democratic reforms in education, involving society in the process of change. But educational NGOs, that include the National Debate Center Public Foundation, is not only capable of offering new technologies of teaching, but also renders an effect on the process of civic education in the younger generation. The solution involves the task of creating a civil society that where necessary helps the young generation to realize their place in society, to overcome infantilism, to develop moral values of democracy, such as the ability to compromise, tolerate, and respect ones fellow man. The attitude of modern youth is characterized by passivity and the absence of interest in the public and political life of the state. One way to motivate the young people is to show, that the problems of the today's society are their problems. This is the subject the Debate Program, allows the younger generation to argue to most of the urgent problems of modernity to develop creative and social activity.

The Soros Foundation in Kazakhstan initiated the Program in April 1996 in order to introduce innovation and transformation of humanitarian education. Today the Debate program is developing on the foundation of the National Debate Center Kazakhstan, which opened in Almaty in August 1998. In November 1998 it was registered as an NGO, as the National Debate Center Public Foundation. The National Debate Center conducts elementary and advanced seminars on basic principles of debating, provides information on topics for discussion, hosts Regional and National Tournaments, and holds a Summer Debate Camp.

The following are some of the features of the program-

- The Debate program operates in all 14 oblasts with 14 regional coordinators.
- The Centers are all located in local schools and universities that have donated office space to the program.
- Debate teachers and coaches are all volunteers.

The mission of the Soros Foundation includes the affirmation of the principles of an open society, society based on a higher level of derivation, culture, legal protection of each person and ethnic minority, based upon the tradition of tolerance for each other's judgment. But the process of creation of an open, civil society starts, first of all, with the creation of the citizens of such a society. Therefore, the National Debate Center sees the mission in the creation of a new generation of young people that are socially mature, and capable to think critically and to live actively.

The modern schools and universities give insufficient attention to civic education and do not provide the youth with knowledge about all complicated social, ethical and political problems, with which the country grapes. The program provides young people with the possibility to develop an interest and to reach an understanding of the modern social and political events, and to be tolerant to opposite ideas and provides debating skills to deal with complicated and contradictory problems. During the preparation for debates the students research the various sides of a selected problem.

The Debate Program is an effective resource in training critical thinking. The skills of critical thinking will help young people not to accept on the first basis ideas that are thrust upon them but will not as a consequence deter vested interest to manipulate them. It will help young people to create their own attitude to events, and occurrences in society, to define their own place in it and to develop their level of social activity.

The Debate Program enables young people to study problems that are influential in their life and in the life of the society, in which they live. The participants of the Debate Program come to understanding that free open argument is a necessary pre-condition for the development successful and sustainability of a democratic society.

The Debate promotes creative activity for the schoolchildren and students, the preparation for them requires an acquaintance with a great many materials on different issues, conducting research that enables them to define the point of view on a problem and then to compare their point of view of the opponent and to defend it during the game. The Debate promotes the extension of the school person's perspectives and development of common culture, skills of public speaking and the ability to respect the judgment of other people.

The target group of the Debate Program is the university and high school students. However, the program also has an indirect effect on the teachers of schools that are involved in the training process. The involvement in the program for them is a good school for civic education. The teacher whose past training on the usage of the techniques of Debate are removed from an authoritarian method of training and use a technique of Debate as an occupations that allows the debaters to consider their ideas during learning their subject matter or other subjects.

To make the Debate Program more effective we are working with different state and non-governmental institutions. The following are the institutions with which we work and describe our collaboration:

- **The Ministry of Education and Education Departments**
  Approval of the syllabus for the debate course for high schools and they made recommendations to regional education departments to introduce it in schools as an optional subject. Now a lot of our trainers in all regions who before taught debate for free have an additional payment.

- **Teachers training institutes of different level: Republican, Oblast and Cities**
  Collaboration in organizing and providing beginner seminars. This year we have a joint project with the Republican Teachers Training Institute to organize advanced seminars in Oblasts centers.

- **National TV Agency**
  Public Foundation "National Debate Center" and "Khabar" TV Agency are working already with joint project TV Debate in the Russian language "The City of the future". The first telecast took place on October 23, 1999. From March 18, 2000 this program works in life casting and provides to people an opportunity to participate in the program and on ways to enhance the issues. The result is about 100 life TV debates. The National Debate Center is responsible for content and quality of the debate. The TV Debate «The City of the future» provides a forum for students to develop an interest in and an understanding of current social and political events, tolerance of opposing ideas, and an ability to discuss controversial issues. It has a very high rating point among republican TV programs and is very popular among the population, not only in Almaty city, but all over the country and not only among young people, but among the elder generation as well. Questions debated by students include minority rights, state welfare policies, criminal justice and infrastructure versus the environment. These important issues, which every society faces, are not taught within the state-mandated curricula.

Based on public opinion, the executives of this project came to a conclusion about the necessity to create a TV youth talks show called "Azamat" in the Kazakh language. It is an independent TV project with its own unique scenario and national color. The program has a model for public forum that comprise "Hyde Park" elements.

The TV Debate is a powerful means of encouraging critical thinking, personal and informed expression, and tolerance for the opinions of others. The TV Debate offers students the opportunity to examine issues affecting their lives and their communities. Participants come to understand how free, open discussion is a prerequisite to the successful establishment and long-term preservation of a democratic society.

- **Ministry of Culture, Information and Public Consensus**
  NDC has a strong and developed collaboration with the Ministry, which considers the Debate program as a very effective method of working with youth. This year it organized student regional tournaments at its own expense and also organized and financed a summer student camp. It was a joint project and National Debate Center was in charge only for debate tournament and training of students.

- **The Parliament of Kazakhstan Republic**
  NDC has a current joint project with the Parliament of Kazakhstan Republic, which we named as «public assistants of parliamentarians». We think that this is a very important project because some students who are involved in debates will take part in real analysis of real state low projects. The project was started from September and the NDC has already sent to the Committee of Parliament amendments and proposals to the project of labor law and to the "project about grain". In January 2001 we have a trip to the Capital to work in the Parliament. This project is closed to the Lyndon Baines Johnson congressional internship program, established in 1973 to employ students. Our project will be a volunteer one and the most important issue is that students may have the opportunity to undertake legislative research. This is a unique opportunity to see the inside workings of the Parliament at first hand. This project serves for students as a means to gain invaluable experience, political awareness and involvement in the democracy building process.

In emerging democratic societies Debate Program is more likely to be used as a new technique in civic education, in creating democracy culture, in formation of civil society rather then simply an educational tool.

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