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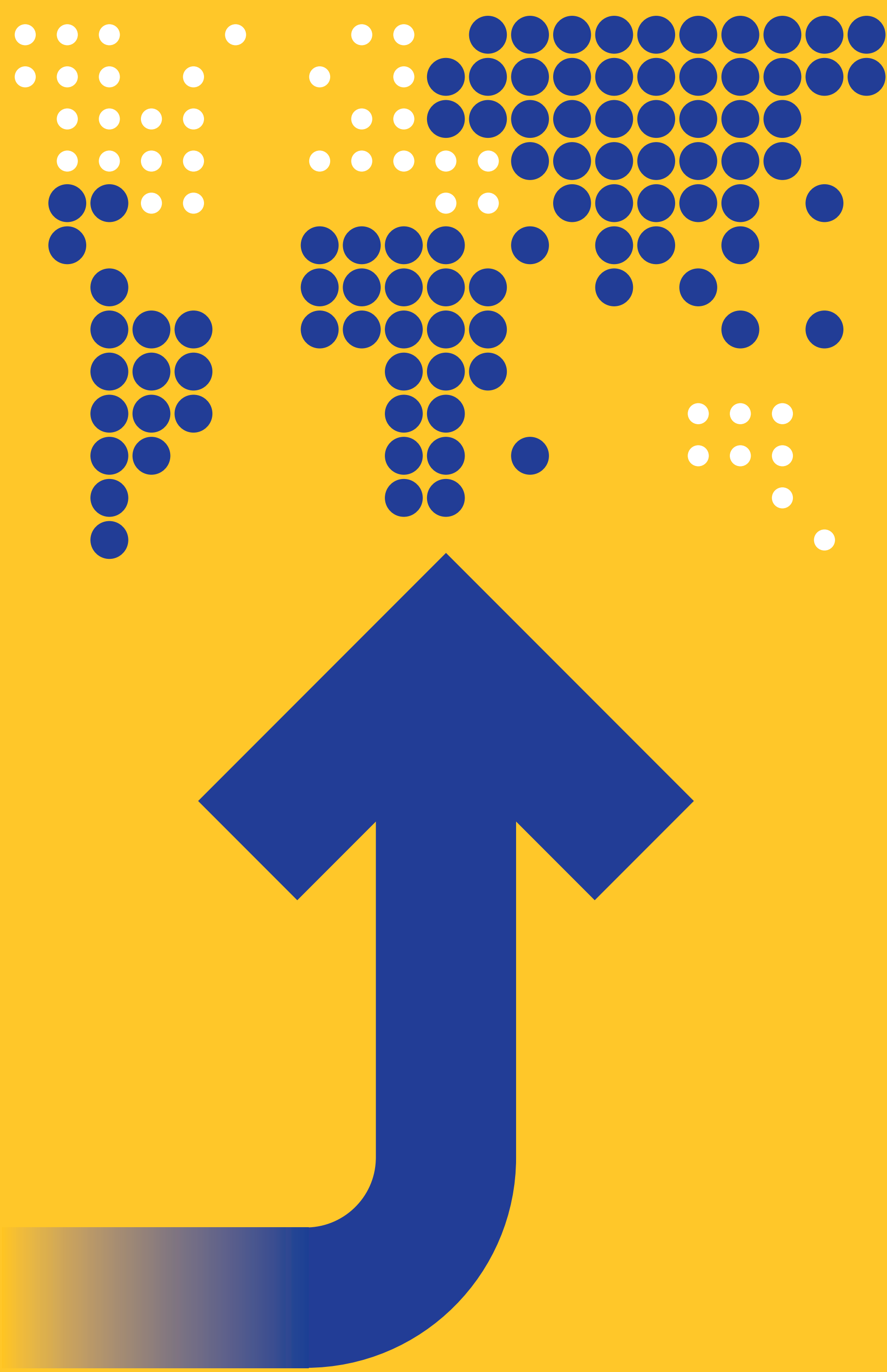

How Bad Are Central Asia's Business Environments and What Can Be Done About Them?

Dennis de Tray

Emerging Markets Forum
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Bringing people together to accelerate growth and well-being in emerging markets

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Dennis de Tray[1]

I. Introduction

A few years ago, then-President Festus Mogae of Botswana addressed a small group of Washington-based development experts on the economic and development issues facing his country. Botswana is one of Sub-Saharan Africa's rare middle income success stories. Its government and political processes are among Africa's most stable. It ranks 45th out of 181 countries in the World Bank's 2009 Doing Business survey, Sub-Saharan Africa's third best business environment after the island economy of Mauritius and South Africa. Even in the face of these achievements, President Mogae was concerned about his country's future. His first worry was not surprising: Botswana has one of the world's highest HIV infection rates, a major constraint to growth and prosperity. His second worry was less predictable. As he put it, "We have one of Africa's best business environments, yet, except for our extractive industries, foreign direct investment is not coming into our country. Our economy is still much too diamond dependent. What more must we do to attract international investment and to diversify?"[2]

Indonesia is also a development success story. Yes, the messy transition from Suharto to democracy set the country back, but less than many people predicted, and before that transition Indonesia was a true development superstar. Starting from economic, political and international bankruptcy in the mid 1960s, Indonesia averaged annual growth of more than 7% in real terms for the next 30 years. Income distribution improved, poverty plummeted. This "East Asian miracle" was produced on the back of prodigious foreign direct investment, much of it outside of extractive industries. For most of those 30 years, Indonesia was ranked as one of the most corrupt countries in the world by a host of international measures. Even today it ranks only 122th in the 2009 Doing Business ranking, and 111th in the Corruption Perceptions Index.

Botswana's and Indonesia's stories tell us two things about "business environments." First, they are a means, not an end. The "end" is diversified, long term private sector growth. Second, at the very least, scoring well on "doing business" surveys seems neither necessary nor sufficient to foster increased private sector investment and diversified growth. Other factors are obviously at work.

If private sector growth is the real concern behind the question this paper sets out to address, it makes sense to look first at what we know about determinants of private sector growth before we consider countries' business environments. The next section does this through the lens of the 2008 Commission on Growth and Development, in which both Botswana and Indonesia figure prominently. Guided by the Growth Commission findings, Sec. III looks first at the five Central Asian republics (Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan) through a conventional "doing business" lens, and asks what else is missing from the recipe—actually, as we shall see, recipes—for successful private sector growth and offers a set of suggestions for each country on how to encourage future private sector growth. Sec. III concludes with briefer overviews of four "neighboring" countries, Armenia, Azerbaijan, Georgia and Mongolia. The final section summarizes main messages, and providing answers to six specific questions set by the Emerging Markets Forum.

II. What determines private sector growth?

It need hardly be said that the ultimate goal of development—and development assistance—is to give people, especially the poor, better lives. For most countries, it is difficult to think how this goal could be accomplished without steady, diverse, sustainable, broad-based, equitable growth, what I call "good growth" from here on. The literature on determinants of good growth, which

1 The author is a Principal for the Results for Development Institute, United States

2 Oral remarks by President Mogae at a Center for Global Development luncheon, Oct. 11, 2006

almost always means private sector growth, is large and surprisingly inconclusive. The most comprehensive recent overview of what determines countries' growth is the World Bank sponsored Growth and Development Commission[3] chaired by Michael Spence. Of course, not everyone agrees with the Spence report conclusions[4], but it is a generally sensible overview of what we know—and don't know—about what countries need to do to grow, and, therefore, a good way of launching our review of Central Asia's business environments.

Spence and his blue ribbon panel spent two years searching for the secrets to growth. Their approach was to focus on countries that achieved at least 25 years of 7+% growth since 1950. There were 13, and only 13, such countries, which, in and of itself, says something about the challenge poor countries face. In its deliberations, the Commission discovered many paths to good growth, with different paths depending on country circumstances, including history, culture and geography, global conditions, and, fortunately for development economists, their own domestic policies. The Commission concludes, perhaps predictably, that, "Wedded to the goal of high growth, governments should be pragmatic in their pursuit of it….If there were just one valid growth doctrine, we are confident we would have found it." There is much that determines growth outside the control of individual countries, but, according to the Report, much that is within each country's control. But, they also found that what is within countries' control is not independent of factors outside of their control.

A sometimes implicit but important message in growth studies is that most everything matters. The Spence report is no exception. No one aspect of a country's policies or characteristics alone guarantees good growth. This may seem obvious, but it is nonetheless important to keep in mind as we review Central Asia's business environments. As Botswana and several of the countries discussed below show, you can get a lot of things right in your business environment and still not have the diverse, sustainable growth you need. Good growth requires not just a friendly business environment, but good quality human resources, cost effective and available infrastructure, and, importantly, access to sufficiently large markets to allow countries to produce at scale.

The Growth Commission's 13 Stars – What Do They Have in Common?

If anything confirms the Commission's basic finding that there is no one path to good growth, it is the diversity of the 13 countries that achieved high growth for extended periods. These countries are Asia dominated (9 of 13: China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Singapore, Taiwan, Thailand), but include one African country (Botswana), one Latin American country (Brazil), one Middle Eastern country (Oman), and one Mediterranean country (Malta). The 13 range in size from some of the world's most populous countries (China, Brazil, Indonesia) to an island economy with under a half million people (Malta). Only one of the stars is landlocked (Botswana), an important consideration for this study as all but one of the focus countries of have no direct access to the sea.

Even within the Asian group there are significant differences in starting points, contexts, histories. Politically these countries run—or ran—the gamut from democracy to dictatorship, although most had either dominant leaders or dominant political parties at the beginning of and during their high growth periods. Institutionally, the Asian successes contain the world's most professional (and highly paid) civil service (Singapore) and, at least during the period under review, among the most governance challenged (Indonesia). Underlying economic models range from openly dirigiste (China, and, to a lesser extent, Japan, South Korea) to about as free market as you can get (Hong Kong). It would seem that the "many paths to growth" hypothesis is pretty well supported, but

3 Commission on Growth and Development, The Growth Report: Strategies for Sustained Growth and Inclusive Development, The World Bank, 2008.

4 For a supportive view of the Spence report, see, Martin Wolf, "Useful dos and don'ts for fast economic growth," Financial Times, June 3, 2008. Not surprisingly, William Easterly finds the report less convincing. See, "Trust the development experts – all 7 billion of them," FT, May 28, 2008.

the important issue for Central Asia is not this diversity, but the common elements in these stories.

Many of the common elements, somewhat ironically, look a lot like the rules of success set out in John Williamson's now much maligned Washington Consensus[5], which the Growth Commission Report is said to replace. Among these are[6]:

1. Outward openness is the base for most successes. Inward looking strategies work for a while, but are not sustainable.
2. Product and factor markets must be open and flexible. Resources, most especially labor, must be mobile, and firms allowed to enter and exit if developing economies are to innovate, adapt, change and grow.
3. Macroeconomic stability is important, but, perhaps more revealing, it is microeconomics that drives the growth process.
4. Where labor is abundant, which is the case in most developing countries, growth is limited by the rate of investment.
5. Savings determine investment, but the source of savings matters. Foreign savings is not an especially good substitute for domestic savings.
6. "No country has sustained rapid growth without… keeping up impressive rates of public investment–in infrastructure, education and health."
7. "Policies must…be faithfully implemented and tolerably administered."
8. "Governments in the high-growth economies were not free-market purists. They tried a variety of policies to help diversify exports or sustain competitiveness."
9. "…growth strategies cannot succeed without a commitment to equality of opportunity…"
10. To be sustained, high growth needs "an increasingly capable, credible and committed government."

5 The origins of the Washington Consensus can be found in John Williamson, "What Washington Means By Policy Reform," Latin American Adjustment: How Much Has Happened? Edited by John Williamson. April 1990.

6 The order reflects their appearance in the Report's Overview. Quotes are from the Overview.

These 10 points are for the most part self evident, but it may be worthwhile pointing out how they relate to Central Asia's business environment. The first point, openness, is nuanced in the Report, as it should be, reflecting the long debate over the degree to which some of the East Asian successes constituted open economies. The second and third points are about various elements of the "business environment"—labor and factor market restrictions, the macroeconomic and microeconomic policies (rules, regulations, red tape), legal and financial systems. The fourth and fifth points concern the need for savings to fuel investment but with an important twist: countries that rely too heavily on international savings and investment are at a disadvantage—domestic savings play an important role in growth.

Points six through 10 are about government or government policies. Point 6, on the need for public investment especially in infrastructure, underscores the importance of governments doing what only they can do. Points 7 and 8 deserve emphasis because they deal with the incentives government creates for investment, a topic the next section takes up. The last two, on the need for equality of opportunity and for "capably, credible and committed government" are the weakest and least useful based on the 13 countries in question. This is not because they are wrong, but rather because they don't provide much guidance for governments or governance. On equal opportunity, the Report does point out that this is not the same thing as equal outcomes, but that rather misses the point. Brazil, one of the 13 success stories, has for years topped the list of the world's most unequal income distributions, and is hardly a bastion of equal opportunity.

As for governance, the range of governments and leadership among the 13 countries suggests a more complex and conditioned explanation for the role governance play in producing good growth. The presence in the list of several large governance-challenged countries among the 13 suggests that size, potential returns relative to risks, and policy predictability may dominate

Table 1 **Growth Commission Countries Plus Two**

	2007 Doing Business Ranking	Population 2007 (Millions)	Average GDP Growth 2000-2007	Average Net FDI 2000-2007 (% of GDP)
Singapore	1	4.59	5.9	14.9
Hong Kong, China	3	6.93	5.3	19.3
Thailand	12	63.83	5.0	3.7
Japan	15	127.77	1.7	0.2
Korea, Republic	19	48.46	5.2	0.8
Malaysia	23	26.55	5.6	3.1
Botswana	45	1.88	5.6	3.0
Taiwan*	46	..	..	..
Oman	65	2.60	4.5	1.4
China	89	1,318.31	10.1	3.3
Vietnam	93	85.15	7.6	4.6
Indonesia	122	225.63	5.0	0.2
Brazil	129	191.60	3.4	2.9
India	133	1,124.79	7.2	1.2
Malta	..	0.41	2.2	11.2

**World Bank WDI tables from which the economic data are drawn do not contain separate information for Taiwan.*

governance as investment decision determinants.

Investment is the main driver of growth in most developing countries, and will likely be so in Central and Greater Central Asia. With this in mind, the following section looks at the determinants of countries' investment.

Understanding investment incentives

As the Growth Commission confirms, when labor is abundant, investment flows set the limits to growth which means that if we want to understand growth we need to understand what determines investment. Of all the inputs into growth, investment is the most mobile. This is nearly as true for domestic investment as it is for international investment. The high mobility of investable funds means that investment flows are especially responsive to incentives.

As we consider Central Asia's private sector future, we need to think about two sources of investment incentives, how Central Asia's business environment stacks up against other countries in the competition for investment, and what Central Asia's neighborhood and other characteristics say about the types of investment companies will find attractive.

In terms of competition for investment and business, the Growth Commission's 13 stars show that countries with large domestic markets, abundant low-cost labor, and easy global access get by with considerably poorer business and governance environment rankings than do smaller, more isolated countries, natural resource rich countries excepted. Table 1 ranks the 13 Growth Commission countries plus countries that will soon make the cut (India and Vietnam) by their 2007 Doing Business scores.

The table makes no attempt at analysis, but it is suggestive of the notion that size and location matter a lot. If we drop Japan as not really relevant to this discussion, and Malta for lack of a ranking, the top five countries average 30 million people each, while the bottom five average nearly 600 million. Even more striking, the top two countries average less than 6 million people, the bottom two, nearly 660 million. On location, as I noted earlier, only one country among the 13 is land locked. The messages are clear: if you are small and not oil or diamond rich, you had better have an outstanding business environment. If you are small *and* land locked (and no diamonds), you are doubly damned.

In terms of the types of activities into which investment flows, if we want good growth, not just any investment will do. Developing countries in general, resource-rich countries in particular, often find foreign and domestic investment going into the "wrong" sectors. Funds flow into finance, quick return investments, real estate, service, when job-creating manufacturing and processing investments are what is needed, especially in agriculture-related industries.

Why is this so? The answer lies in part in the incentives investors face generated by real and perceived risks found in many developing countries. Most developing countries are characterized by new institutions, short policy track records, and uncertain politics. Even in dictatorships, future policies and property rights can be hard to predict. In these environments two types of investments will appeal: those that pay off quickly; and those in sectors in which foreign know-how and assistance are essential to domestic revenues, extractive industries mainly. Neither of these investment types generates the broad-based, labor-using growth developing countries want and need.

Developing countries' track records on policy consistency and respect of property rights lead investors to engage in the economic equivalent of profiling. They look at a country's characteristics and history, and assume that what has happened in the past in that and other similar countries is a good predictor of the future. This means that a developing country government truly committed to the irreversibility of its reforms may still be viewed with distrust, leading good policies, at least in the short run, to produce "bad" growth, or at least not good growth as defined above. Countries with histories of policy reversals face an even steeper uphill battle to convince investors that they really have seen the light.

The risk of reputational stasis underscores the need to look beyond stated policies and procedures as we consider Central Asian business environments. If we are seeking investment that delivers good growth, we need to consider what countries can do and are doing to get ahead of the reputational curve. Several of the Growth Commission countries may offer lessons in this regard. Indonesia, for example, managed to convince investors that its policies were sufficiently predicable and stable to support longer payoff manufacturing investments, this in a less than ideal business environment. How it did so is a longer story than space permits for here, but Indonesia's message is that there are ways to beat the reputation trap.

The Spence Growth Commission work carries important lessons for developing countries as they search for successful private sector development strategies. In the next section, we look first at what we know about Central Asia's business environments, and then consider what the region and each country needs to do to improve the prospects for future private sector growth.

III. Central Asia Business Environments: what we know, what to do

The following discussion divides "Central Asia" into the five core republics (Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan), and four countries that are a part of what might be called Greater Central Asia, Armenia, Azerbaijan, Georgia and Mongolia. As the main thrust of this review is on the five Central Asian republics, the main analysis is for these countries. The previous section makes clear that a review of Central Asia's business environments and how to improve them must be embedded in the context in which the five republics find themselves. The comparative data given in Tables A1 and A2 of the first Annex underscore the range of challenges the region presents.

Population among the five republics range by a factor of five, per capita income by a factor of six, savings rates by five, agriculture value added by six. The largest economy, Kazakhstan is nearly 25 times the size of the smallest economy, Tajikistan. And while the five do share a common history as past members of the former Soviet Union, they have chosen different development paths since independence, which puts them at very different points along the road to private sector development.

Central Asia's diversity makes a discussion of "the" Central Asia business environment neither easy nor especially useful. However, before we turn to the differences, let's focus for a moment on some important common features. All five republics are, of course, a product of 70 years of Soviet oversight and influence. Although at the crossroad of Eurasia, they are isolated by distance, and, as we shall see, by infrastructure and technology, from the global economy[7]. They are not in the best of neighborhoods, although this 'neighborhood effect" differs significantly among the five countries (Kazakhstan's borders with Russia and China give it access to important markets for its energy resources; Tajikistan's border with Afghanistan connects it with one of the world's most unstable and volatile countries). These common factors influence each republic's "business environment," but country-specific effects dominate.

The past decade has seen an explosion of competitiveness and business environment surveys, including but not limited to the World Bank's *Doing Business and Enterprise* surveys, the World Economic Forum's *Global Competitiveness Report*, and *Global Enabling Trade Report*, Transparency International's Corruption Perception Index, the Heritage Foundation's *Index of Economic Freedom*, Foreign Policy's *Globalization Index* and the EBRD's *Transition Report*. Several of these various assessments are pulled together by Michigan State University's *globalEDGE* program[8]. Annex 2 provides comparative tables from *globalEDGE*, updated where necessary by the most recent data. Annexes 3 and 4 give, respectively, Enterprise Survey data and results from EBRD's *Transition* Report. By way of summary, Table 1 presents three of the main indices for the Central Asian Republics and for four comparator countries, along with several key economic performance indicators (GDP growth, FDI flows and manufacturing value-added).

The numbers in Table 2 are not meant to suggest causality but they do illustrate the variety of relationships one sees in the data. The stories told by the three business environment measures are not always consistent, especially evident for the Kyrgyz Republic. As the Box on p. 15 shows, the just-released 2010 *Doing Business* rankings identify the Kyrgyz Republic as one of the top 10 reformers, a position the country also held in 2008. The Kyrgyz Republic's reform prowess has moved it into the top quartile of all ranked *Doing Business* (DB) countries. In contrast, the *Global Competitiveness Report* (GCR) paints a quite different Kyrgyz story, putting the country in the bottom decile of the 134 ranked countries, one place lower than in the 2008/09 survey. On the corruption front, Transparency International's *Corruption Perceptions Index* also has the Kyrgyz Republic in the bottom decile of the 180 ranked countries. So, who is right?

Doing Business, the *Global Competitiveness Report* and the *Corruption Perceptions Index* all have their supporters and critics. DB is a compilation of laws, regulations, and processes, the GCR a complex mix of factual data and opinion, CPI, as its name implies, a collection of perceptions. One interpretation of the Kyrgyz story is that it shows the difficulty countries face in closing the gap between creating laws, regulations and processes on paper, and building the institutions needed to implement these changes. If we add to this story the outcome variability among the 10 countries seen in Table 1, it seems clear that for small, geographically disadvantaged countries, the business environment as codified in a country's laws and regulations is not sufficient for private

7 Johannes Linn, "Kazakhstan's Future at the Heart of Eurasian Integration," Presentation at the Roundtable on The Future of Kazakhstan: Forming the National Policy Agenda, 8 November, 2005, Almaty, Kazakhstan

8 International Business Center, Michigan State University, globalEDGE (http://globaledge.msu.edu/)

Table 2 | Measures of the Business Environment

	2009			2000-2007 Averages		
	DB	GCR	CPI	GDP Growth Rate	Net FDI Flows (%GDP)	Manufact., Value Added (%GDP)
Central Asia						
Kazakhstan	63	67	145	10.2	8.5	14.7
Kyrgyz Republic	41	122	166	4.5	3.1	15.3
Tajikistan	152	122	151	8.7	5.7	27.6
Turkmenistan	..	..	166		5.4	10.1
Uzbekistan	150	..	174	6.0	0.9	9.9
Comparators						
Indonesia	122	54	111	5.0	0.2	28.4
Malaysia	23	24	56	5.6	3.1	29.6
Philippines	144	87	139	5.1	1.6	22.8
Vietnam	93	75	120	7.6	4.6	20.4

Notes: DB - Doing Business (out of 183)
GCR - Global Competitiveness Report (out of 134)
CPI - Corruption Perception Index (out of 180)

sector development. As common sense would suggest, it's what happens on the ground that counts.

A country's business rules and regulations and their implementation are part of the equation that determines good growth, but, so, too, is the neighborhood in which it operates. When Central Asia was a unified entity under Soviet rule, regional issues among the five republics were managed in Moscow. Independence removed Moscow as a regional coordinator. Before we turn to the individual republics, the next section discusses the region's lingering regional issues.

The regional dimension

It is not entirely the case that "united they stand, divided they fall," but it is hard to imagine a future in which the Central Asian republics' economies are not intertwined. Especially for the smaller republics, being a part of a larger Central Asia economic region is almost a *sine qua non* for survival. Yet, current trade and transport policies are designed more to isolate than to integrate. There are at least five regional issues that bear on the business environments of individual republics.

Transport. Transport that connects the Central Asian states with each other and with the outside world is a fundamental element of Central Asia's business environment. Central Asia's position at the crossroads of greater Eurasia will be of little use if its transport facilities do not support transit traffic. Roads need to connect, railways to join seamlessly. Most importantly, borders need to be cross-able, which, according to Doing Business, they are not. Central Asia's borders remain among the most costly in the world to cross. With cooperation, Central Asia can parley its centrality into effective links to outside markets. Land locked, isolated countries are at the mercy of their neighbors when they want to export anything but light manufacturing that can ship by air. A transit system that connects the great markets to Central Asia's north, east and south will be a system that, as well, connects Central Asian producers to outside markets.

Energy. As a recent study of Africa's private sector growth demonstrates[9], energy, or a lack thereof, can be one of the most critical bottlenecks to private sector development. Central Asia's energy resources are potentially prodigious, but not evenly distributed and not well developed. Two countries, the Kyrgyz Republic and Tajikistan, are blessed with abundant hydro power potential, two others, Kazakhstan and Turkmenistan, with substantial hydrocarbon reserves. The intelligent development of regional energy markets could do much to improve energy access and reliability, and lower its cost.

Water. Much of Central Asia's non-petroleum GDP is generated by agriculture, and much of that agriculture is irrigated. But, as with energy, water distribution among the republics is highly skewed, with the Kyrgyz Republic and Tajikistan generating the lion's share, and Turkmenistan and Uzbekistan consuming most of it. Historic water allocations from Central Asia's two great rivers, the Amu Darya and Syr Darya, are under stress, as is much of the inherited Soviet era water infrastructure. If and when Northern Afghanistan's agriculture develops, tensions around the allocation of the Amu Darya waters will be even greater. For nearly two decades the international community has worked with little success to improve water management and inter-country water cooperation. Climate change is already affecting the winter run-off which feeds the system. Without an efficient, cost effective and reliable water system, much of Central Asia's agriculture will not attract new investment.

Market. Central Asia's isolation is a constraint to global connectivity, but could and should be a boon to local producers. Central Asia's 60 million people represent a market almost as large as Thailand's. If Central Asia were, if not one market, then five well integrated markets, the region's attractiveness to entrepreneurs and investors would increase substantially. Yet, regional free trade agreements notwithstanding, the five countries now do more to isolate and protect their domestic markets than to integrate them. This has to change if Central Asia's non-extractive industries and non-energy investment is to take off.

Corruption. Business environments in Central Asia's five republics differ in many respects, but there is one unfortunate feature in which they have much in common: corruption. Not one Central Asian country ranks above the bottom fifth of countries in Transparency International's CPI. This is a problem each country must deal with, but it is also a regional problem. Reputation effects don't stop at borders. Even were one republic to succeed in cleaning up its corruption act, it would face an uphill battle convincing investors that it had seen the light if corruption in its Central Asian neighbors were as bad as ever. Some of the Growth Commission successes had high corrupt levels, but these were the big countries for which investors were willing to accept corruption to compete for high returns. None of the smaller countries succeeded until they dealt with corruption.

While it is difficult to imagine a flourishing Central Asian private sector unless these regional issues are dealt with, regional integration will not by itself generate vibrant private sector growth. Central Asia's republics must as well move aggressively to repair and improve their domestic business environments. The next part of this section summarizes what is good and what is not so good in each republic's overall private sector environment, and then considers what can be done to make things better.

The five republics

Kazakhstan – oil rich and struggling to diversify

Kazakhstan stands apart from the rest of Central Asia on a number of dimensions. Its economy is larger than the other four republics combined. It is significantly wealthier in terms of public savings and offshore assets. It has more sophisticated institutions, including the region's strongest financial system. It has legitimate, if not entirely democratic, political stability. It led the region in average

9 Vijaya Ramachandran, Alan Gelb, and Manju Kedia Shah. Africa's Private Sector: What's Wrong with the Business Environment and What to Do About It, Center for Global Development, 2009

growth for the past decade, averaging a highly respectable 10% a year from 2000-2007. Yet, Kazakhstan's senior decision makers are worried. To their credit, they recognize that too much of their good fortune rests on their hydrocarbon resources. They know they need to expand the country's economic base beyond oil, gas and minerals.

Kazakhstan's business environment ratings put it in the top one third of all DB countries and roughly in the middle of the GCR ranking. But there are some areas in which it fares much worse than this average. For its management of construction permits and border crossing, DB finds Kazakhstan far down the list. On construction permits, only 4 countries in the world rank lower than Kazakhstan (the government says this has now been fixed). When it comes to trading across borders, Kazakhstan is at the bottom of all countries. Even after a meteoric rise between the 2009 and 2010 rankings, it still stands only at 143 out of 182 countries.

The Enterprise survey data in Annex 3 raise as many questions as they answer. Tax rates are cited as the number one constraint in 2009, yet, according to the Forbes Tax Misery Index, Kazakhstan ranked 54th out of 65 countries in terms of the misery it imposes on its tax payers, meaning that only 11 of the Forbes-ranked 65 countries have less onerous tax regimes. In fact, were the Forbes tables to reflect recent Kazakhstan tax reforms, which reduced corporate taxes to a flat 20% from 30% with further reductions in the offing, the country would score even better. More than anything, this story warns against drawing conclusions from business climate surveys in a world of fast changing policies. With recent reforms, the tax system is not likely to be an issue in future surveys, leaving corruption as the top constraint.

What's good

- No major "resource curse" mistakes so far
- Next to big markets– Russia and China
- The hub of Eurasia
- Better than average (for the region) financial institutions
- Overall good macro management
- Strong and ambitious leadership

What's bad

- Smallish domestic market
- Stiff regional market competition (Russia, China)
- Perception of risky property rights, unreliable adjudication processes
- Isolated by its border policies
- High cost, low quality infrastructure, especially transport, IT
- Skill shortage in areas of possible economic expansion
- Dutch Disease a challenge

What can be done?

Because it has the resources and a relatively sophisticated public sector, Kazakhstan's future lies much more in its own hands than some of the other Central Asian republics. But with a small domestic market, how Kazakhstan grows depends critically on how quickly the country can improve its business environment and its connection to the rest of the world. Improving its business environment involves institutional development—simplified rules and regulations, better regulatory mechanisms, stronger financial and legal systems, better government—as well as infrastructure investment. Connecting to the rest of the world involves reducing the "economic" distance between Kazakhstan and the rest of the world. These are tough but doable challenges.

In the near term, Kazakhstan needs to push hard to signal that it is leveling the playing field for all investors, foreign and domestic, by simplifying regulations, strengthening adjudication procedures, clarifying property rights. Borders must be better managed, and those aspects of the DB survey where it falls down should immediately be fixed. To signal a long-term commitment to these changes, the development and enforcement of the underlying policies need to be transparent and open. On reducing the economic distance between

Kazakhstan and the rest of the world, the country must put national interests before special interests and open both Kazakhstan's skies and its telecommunications industry to all comers. No improvement in its business processes will offset the fact that, as of now, it is hard to get to Kazakhstan and costly to access the rest of the world from it.

In the medium term, Kazakhstan must work to professionalize its legal and banking systems through a program of transparency and training. It must also reduce the enormous cost of transport by completing its huge road building agenda and reforming its rail management system. And, to ensure long term success, it must do a much better job than it has done investing in its people.

Kyrgyz Republic – after an apparent good start, an uncertain future

At least on paper the Kyrgyz Republic seemed to be doing many things right when it first became independent. Its politics appeared to be more democratic and open than other Central Asian republics, its economic policies more market oriented (it was the first, and, to date, only, Central Asian member of the WTO), its president seemed committed to joining the world community as quickly as possible. Times have changed. With Mr. Akayev's "color revolution" ouster in 2005, the country's real and reputational risk has gone up. Since then, the country seems headed down a road paved with corruption, cronyism, and drug money.

As the Box on p. 14 points out, the Kyrgyz Republic is a test case of just how important the factors covered by the World Bank's *Doing Business* are in determining a country's private sector growth. The Kyrgyz Republic is a star DB pupil, ranking among the top 10 reformers worldwide for the past two years. In only three areas is it lagging: paying taxes, trading across borders, and closing a business. One of these, closing businesses, is easy to fix, the other two need policy and institutional change that will take time. Unfortunately, trading across borders and paying taxes are likely to be far more powerful determinants of Kyrgyz's private sector growth than how difficult it is to close a business.

I have already pointed out the different pictures the DB survey and Global Competitiveness Report paint of the Kyrgyz Republic, which suggests that the country's main problem is the country's implementation of its rules and regulations. Reforms do no good unless they are visible to businesses in their day-to-day activities. The Enterprise Survey data in Annex 3 raises yet another set of business environment issues: power shortages, finance, political instability, among others. In yet another demonstration of "everything is relative," while the republic scores near the bottom of the Corruption Perception Index, only 10% of respondents to the Enterprise survey identified corruption as one of their greatest constraints. This is consistent with a recent analysis of business environments in Sub-Saharan Africa[10], where, despite widespread corruption, electricity shortages were identified as the single most serious constraint to business growth in a number of countries.

What's good

- Active civil society
- Strong financial support from Russia
- Strategically important to the West (a part of the northern supply route to Afghanistan)
- Growing economic ties with its neighbors to the north and east.
- Hydropower potential, minerals.
- Good Doing Business scores

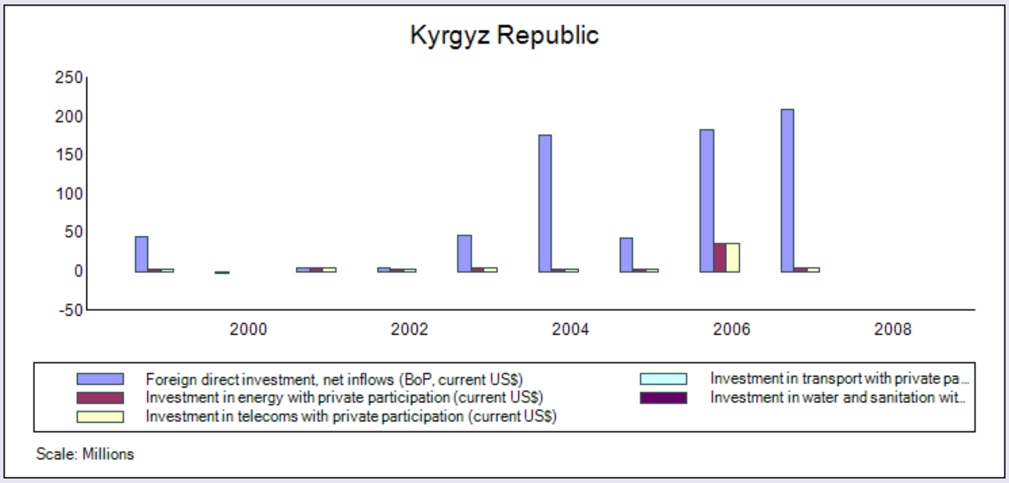
What's bad

- Weak and depreciating infrastructure, especially electricity
- Corruption
- Highly concentrated economy
- Uncertain political situation
- Backsliding on openness, human rights, democracy
- Drug mafia a serious problem, especially in the south

10 Ramachandran et al,

Box 1 | **The Kyrgyz Republic: A Test Case in the Making?**

Doing Business 2010 is out and the Kyrgyz Republic is celebrating. It is among the world's top 10 "reformers" as measured by the number of positions, especially impressive as it was a top 10 reformer in the 2009 version of the report as well. It now ranks 41st out of 183 countries, besting 7 of the Growth Commission successes + Vietnam and India (Table 1). According to *Doing Business*, the Kyrgyz Republic now has a better business environment than all but 16 mid-sized countries by population, beating out the likes of the Slovak Republic, Bulgaria, Hungary, Portugal, the Czech Republic, and Greece. Is all this hard work paying off where it matters, on the investment front? As the following table shows, based on FDI and private equity investment in the Kyrgyz Republic from 1999-2007, the answer is, "maybe." Work is under way to sort out what is driving Kyrgyz's FDI, much of which is of Russian or Kazakhstani origins.



Source: World Development Indicators

What can be done?

The Kyrgyz Republic is an enigma. It is an unlikely star performer in the Doing Business rankings, but, as one analyst put it, just how much the Doing Business scores are driving Kyrgyz FDI is the $100 million question to which no one has a clear answer. Much recent FDI has its origins in Russia and Kazakhstan, countries not known for their concern over the quality of business environments of the countries in which they invest. The Kyrgyz Republic's future does depend on its ability to integrate with its larger neighbors, so Kazakhstan and Russian—and Chinese—investments are in principle a good thing. But there are risks. Unless the Kyrgyz Republic wants to be owned by its neighbors, it will need to work quickly to reduce the country's high political risk so that it is able to attract a broader FDI base. The Belgium Export Credit Agency[11] gives the Kyrgyz Republic a worse political risk score in the medium term than Turkmenistan, not a great signal to investors.

The Kyrgyz Republic's main immediate challenge is reputational. The current government is not seen to have a clear vision for the future, and to be more interested in the short term gains to be had playing off US and Russian interests than in tackling the country's pressing development problems. Given its small size, difficult location, and weak institutions and infrastructure, the country's leadership must return to policy consistency,

11 www.ondd.be

clean up its governance act and seek international assistance in stemming the flow of drugs and drug money into and through the country.

Tajikistan – one too many constraints?

One of the world's most geographically isolated countries, Tajikistan is 2,000 kilometers from the nearest port, 93% mountainous, and in a tough neighborhood. High mountains separate it from the Kyrgyz Republic and China to the north and east. To the south, at least for now, its long border with Afghanistan creates more security and drug trafficking problems than it does trade opportunities. Its fourth neighbor, Uzbekistan, considers it a security risk and maintains tight controls over their shared border. While transit to and trade with Afghanistan, Pakistan, and Iran may someday be important in Tajikistan's economy, the country's access to export markets is likely to remain constrained for the foreseeable future.

In contrast to the Kyrgyz Republic, all business climate assessments agree that Tajikistan is not an attractive place to do business. Having said this, surprisingly, and somewhat ironically, Tajikistan ranks ahead of the Kyrgyz Republic (by one position) in the Global Competitiveness ranking. The bad news is that many elements of Tajikistan's business environment need fixing. The good news is, there is plenty of room for improvement.

What's good

- Abundant hydropower potential
- Potential transit country linking Afghanistan, Pakistan and India to the north

What's bad

- Geography (93% mountainous)
- Risks becoming a narco state
- Weak institutions
- Bad competitiveness rankings
- Weak government capacity, inconsistent leadership

What can be done?

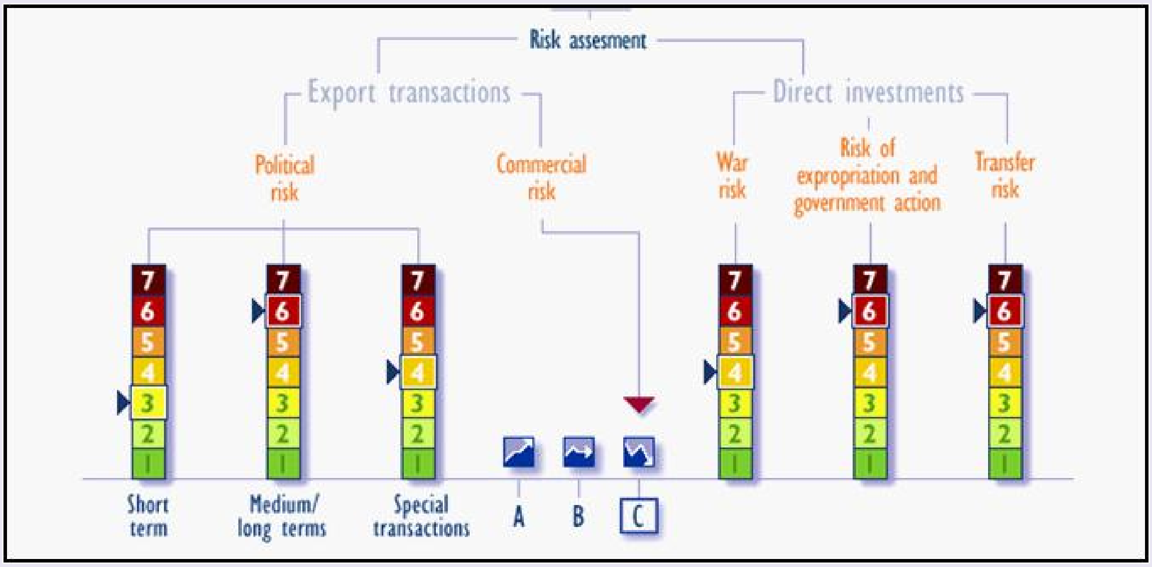
Tajikistan's geography has an important implication for its private sector growth strategy: in contrast to the export-led successes of East Asia, in the near and medium term it will have to rely on natural endowments and its domestic economy for growth. Electricity exports to the south offer great potential, but not until the security situations in Afghanistan and Pakistan improve. Small and medium scale enterprises will be the primary engine of growth in both rural and urban areas, putting special emphasis on the need to improve the business climate that affects local businesses. The international community can help but only if the country's leadership shows that it is serious about modernizing its institutions and improving its infrastructure. Russia and China, as key partners on commercial, development and security fronts, could play central roles but need to take a longer term development perspective in their dealings with the country.

Turkmenistan – where to start?

In 2004, during the waning reign of President-for-life Niyazov, I traveled to the port of Turkmanbashi on the Caspian Sea with the deputy governor of the country's central bank. In Turkmanbashi, we visited Turkmenistan's one and only oil refinery. I asked my host how much money the refinery lost every year, given that petrol sold for something like 10 US cents a gallon. He told me, no, on the contrary, the refinery made money. I asked him how that was possible given the incredibly low consumer prices for petroleum products in Turkmenistan. He replied that the refinery "purchased" petroleum feedstock at about USD10 per ton. When I asked why the government sold oil that was bringing in excess of USD350 per ton on the open market for USD10, he looked puzzled.

Later, as we were walking back to the airplane that would take us on the hour flight back to Ashgabad, I asked how much a ticket for this flight cost. He said the local equivalent of about USD1.50 (admittedly at black market rates). Again I asked how in the world the

Figure 1 **Turkmenistan Risk Assessment**



Source: Belgium Export Credit Agency. Columns are self explanatory with the exception of Commercial risk, where "C" represents "high risk. For a full explanation, see www.ondd.be

government could afford to run an airline that charged such low fares. "Now you understand why we have to buy oil at USD10.00 a ton," was his reply. More than any other Central Asian republic, Turkmenistan continued the prices-be-damned, command-and-control economy inherited from the Soviet system when it became an independent state.

Turkmenistan has never had anything resembling a market economy, so, even asking about its business environment seems a bit pointless, which may explain why it has no Doing Business ranking and most of the Turkmen entries in Annex 2 are blank. Many important prices in the economy were controlled in Niyazov's time, and remain so today. There are isolated islands of economic sanity, but these are mainly ring-fenced export-oriented manufacturers with close ties to the power structure (and often fed by subsidized inputs). EBRD's *Transition Report* (Annex 4) designates Turkmenistan its "minimum transition country", giving it the lowest possible rating for 6 of the 9 areas assessed.

While there is much we do not know about Turkmenistan, those in the business of assessing risk, for example, the Belgium Export Credit Agency, ONDD, consider it a high risk place to do business, as the following ONDD assessment shows. High political risk coupled with high expropriation transfer risk mean that outside investors will seek exceptional returns before they will come to Turkmenistan.

What's good

- Abundant natural resources, especially gas
- A new political regime that has shown tentative signs of opening up
- A reasonably well educated population
- A spectacular, if surreal, capital city

What's bad

- Enough natural resource wealth and income to avoid economic reform for some time
- A highly concentrated economy (hydrocarbons

and cotton)
- A government with little capacity to understand and institute needed reforms
- No formal private sector to speak of
- Crumbling infrastructure outside of Ashgabad

What can be done?

Where does one start in improving Turkmenistan's business environment? One starts with the recognition that it will take many years to create the institutions needed to support a market economy, and for the Turkmen people to adapt to the new system. Shock therapy of the post-Soviet Russian type will not work.

Turkmenistan's near-term future is not about getting its business environment right, or, at least not in the narrow, Doing Business or Global Competitiveness sense. It is about a slow, steady cultural change. Oil and gas are natural starting points, but these investments need to be joined with firm but realistic efforts to influence the broader business environment. Here, the multinational petroleum companies that will help Turkmenistan exploit its petroleum wealth will play a key role, possibly more important than multilateral development institutions. The multinationals will have to walk a difficult line that gives them access to Turkmenistan's lucrative gas reserves but does so in a way that contributes to Turkmenistan's longer term economic growth and stability.

Uzbekistan – much going for it… except the policy reform it needs

When I arrived in Central Asia for the World Bank in 2001, I came straight from Vietnam, one of the two "also rans" among the Growth Commission report successes. As I took my first tour of the region, I was stunned at the development challenges, especially the apparent lack of entrepreneurial activity, which had been so prevalent in Vietnam. The one exception was Uzbekistan. The hustle and bustle of the Ferghana Valley reminded me of Vietnam. With a population of close to 27 million, Uzbekistan seemed ripe for development beyond its Soviet legacy of cotton.

What happened over the next seven years has been a mix of good news and bad news. After avoiding the major economic downturn other Central Asian economies suffered after independence, Uzbekistan has done well growth-wise, especially in the last few years, but the economy remains too dependent on cotton and natural resources, and too controlled. Gold, cotton and energy (gas) accounted for nearly 60% of Uzbekistan's 2007 exports. The government's efforts to industrialize and diversify are not based on comparative advantage analysis. As an example of this, its fledgling automotive industry is heavily subsidized, sells mainly to Russia, and has been hard hit by the global economic downturn (early 2009 saw an 85% drop in Uzbek automotive exports to Russia).

What's good

- Relatively large internal market
- Strong fiscal position, good macroeconomic discipline
- Significant reserves to support reforms and infrastructure investment
- Historically entrepreneurial population

What's bad

- Remains a closed, opaque economic system
- Market institutions still in their infancy
- Current growth driven by high commodity prices, subsidies and special deals.

What can be done?

As with Kazakhstan, Uzbekistan's private sector future is much more in its hands than is the case for the smaller Central Asian countries. For Uzbekistan, an improved "business environment" in the wider sense of policies aimed at promoting sustainability, diversification, improved legal and banking systems, clearer property rights, less government interference, would make a major difference to investment and growth. The challenge will be credibility. The Karimov government has demonstrated unease with free market mechanisms,

Table 3 **Greater Central Asia Countries**

	2009			2000-2007 Averages		
	DB	GCR	CPI	GDP Growth Rate	Net FDI Inflows (%GDP)	Indust., Value Added (%GDP)
Armenia	43	97	120	11.75	5.53	39.25
Azerbaijan	38	51	143	17.37	13.80	56.35
Georgia	11	90	66	7.56	8.52	24.57
Mongolia	60	117	120	6.48	7.03	29.51

Notes: DB - Doing Business (out of 183)
GCR - Global Competitiveness Report (out of 134)
CPI - Corruption Perception Index (out of 180)

preferring old Soviet-style control. Yet, the gains from a move toward freer markets could be, and likely would be, substantial. Were the government to decide to open up the economy, the international community would have a significant role to play. Uzbekistan has a competent government, but not one that fully understands private sector policies. Knowledge transfer from other CIS members further along in the reform process would be essential. If Uzbekistan's leadership began opening up the country's economy, Central Asia would have a second growth pole after Kazakhstan with significant benefits to the rest of the region.

The Greater Central Asia countries[12]

The core Central Asian republics have historically been linked to neighboring countries by trade, transport, conflict and conquest. This larger region is part of what has come to be known as "Greater Central Asia[13]," which, in turn, is seen as the hub of the Eurasian "super continent[14]" that stretches from Europe to the Pacific, from the Arctic Circle to the Indian Ocean. This section looks briefly at four countries that are to varying degrees a part of this Greater Central Asia: Armenia, Azerbaijan, Georgia and Mongolia. Two important members of the Greater Central Asia grouping, Afghanistan and Pakistan, are not covered as their current circumstances make analysis of longer term development issues especially problematic. Nor does the section deal with the larger neighbors, China, Iran, Russia, Turkey, although each will most certainly play a role in the economic development of the countries covered here.

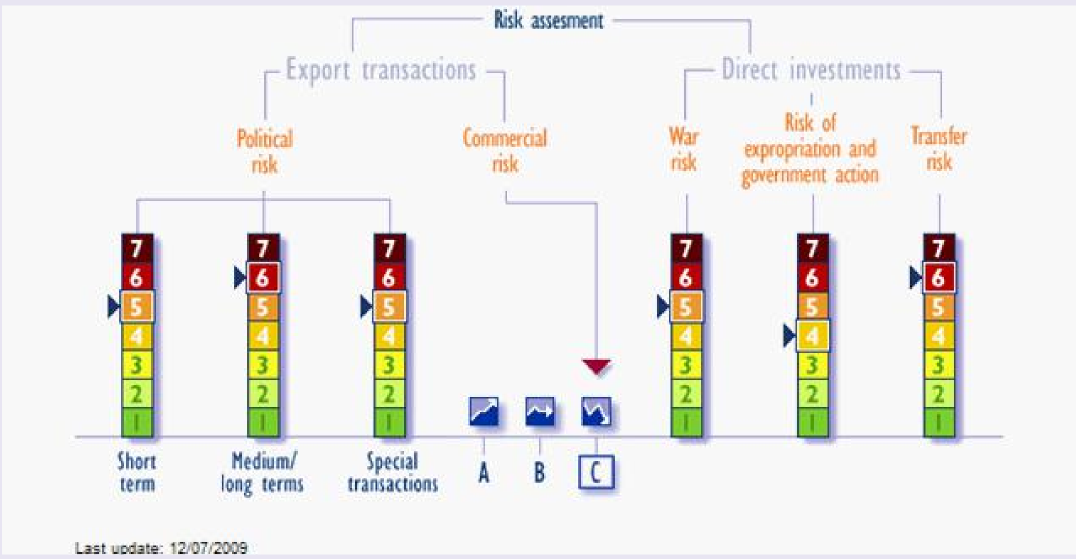
Armenia – a need to expand economic horizons

Armenia has been hard hit by the global recession. According to the Asian Development Bank's *Outlook 2009* Update, GDP declined by over 16% in the first half of 2009, the construction industry collapsed, and exports fell by nearly half in the first quarter of 2009. The punishment Armenia took and is taking from the recession provides a window to the challenges it faces as it seeks to develop its private economy. The global crisis hit Armenia through a combination of dramatically reduced exports, declining remittances and consequent declines in domestic demand. There is no single answer to these challenges, but diversification of exports and sources of remittances will surely help.

Looking across the various measures of Armenia's competitiveness and attractiveness to investment, the pictures that emerges is one of a country that has made progress is some areas, for example easy of doing

12 In discussing consequences of the global recession, this section draws on the Asian Development Report's Outlook 2009 Update, September, 2009.
13 S. Frederic Starr, "In defense of Greater Central Asia," Policy Paper, Central Asia-Caucasus Institute, Silk Road Studies Program, September, 2008.
14 Johannes Linn and David Toimkin, "The New Impetus towards Economic Integration between Europe and Asia," Asia Europe Journal, Apr 2006.

Figure 2 **Georgia Risk Assessment**



Source: Belgium Export Credit Agency. Columns are self explanatory with the exception of Commercial risk, where "C" represents "high risk. For a full explanation, see www.ondd.be

business, but continues to struggle with endemic corruption, political stability and a weak market structure. The four top ranked constraints firms face in Armenia identified in Enterprise Survey data[15] (Annex 3) are the competition from the informal sector, tax rates, political instability, and access to financing. These are symptoms of the same overall malady, an unstable political environment that promotes informality, undermines the tax base pushing rates up, and creates a risk profile that is unattractive to investors and financiers.

One message for Armenia from these surveys is that business climate reforms need to be accelerated to attract international investment. With a population of just 3 million people, Armenia must integrate with the rest of Eurasia and the world if it is to continue to grow. To do this will require a world-class business environment. But non-business climate factors may well ultimately determine Armenia's economic future. Continuing to develop its relations with Turkey will be key to diversifying its export market, and reducing dependence on Russia and the north.

Azerbaijan

Azerbaijan is a study in "everything is relative." Its economy has been hit by the global recession, but most countries around the world would be delighted to have Azerbaijan's 2009 growth (a positive 3.6% for the first half year) and current account (projected at a 15% surplus) numbers. Like Kazakhstan, Azerbaijan has done a lot of things right, but faces enormous challenges weaning itself off of its hydrocarbon dependency.

Azerbaijan's economic and policy performance since 2000 is impressive. In the first few years following the break-up of the Soviet Union, its economy shrank by 50% with growth recovered to just over 5% per year in the last half of the 1990s. In the first eight years of this decade (2000-2007) it has averaged annual growth of more than 17%. Its business climate measures are better

15 World Bank/IFC 2009 Enterprise Survey data can be found at www.enterprisesurveys.org.

on than Kazakhstan's. It even bests the Kyrgyz Republic in the 2009 Doing Business ratings. It has the top Global Competitiveness ranking among the nine Greater Central Asian countries, better than all but Malaysia among the four comparator countries. So, why isn't its economy diversifying?

The four top constraints to businesses from the *Enterprise* surveys provide a hint at the remaining challenges. These are: access to finance, tax rates, corruption, and the informal sector. It is surprising and puzzling that tax rates rank at or near the top of the list of constraints to firm growth in Azerbaijan. Surprising because oil revenues provide the wherewithal for a low domestic tax regime; puzzling because, like Kazakhstan, the country does not score that badly on the Forbes "Tax Misery" index. All four *Enterprise* constraints point to an economy in which institutions are still work in progress. Lack of finance, corruption, tax problems, a too-large informal sector are symptoms of weak public and private institutions.

Georgia

Georgia ranks 11th out of 183 countries in the 2009 Doing Business survey, 62nd on the Tax Misery scale, suggesting it has done about all that it can on the deregulation front to improve its business climate. Yet, the Global Business report puts it in the bottom half of the 134 ranked countries. Three factors stand out as barriers to business development from the *Enterprise* survey (Annex 3): access to financing, political instability, and electricity. The first two are likely closely linked: Georgia's recent problems with Russia and its internal political struggles exacerbated the effects of the global economic crisis, and raised its country risk profile in international markets. It is noteworthy that the Belgium Export Credit Agency finds some aspects of Georgia's political risk profile more alarming that Turkmenistan, not a good sign to investors.

The contrast between Georgia's high business environment score, on the one hand, and its more cautionary Global Competitiveness ranking coupled with serious concerns about political risk on the other suggest that its path to economic stability and growth will be dominated by more by geopolitics than by economic policy.

Mongolia

Mongolia is a country of extremes. It is a sparsely populated (2.6 million people), large land-locked country (second in area after Kazakhstan) with fewer people per hectare than any other sovereign nation. Its harsh climate, fragile soils and uneven development have drawn 40% of its population to Ulaanbaatar, the world's coldest capital city. Its economy is highly concentrated and natural resource dependent, as evidenced from the hit it has taken from the global recession when the price of copper, its primary export and budget provider, dropped by nearly 70%.

Copper prices have since recovered much of their loss (up nearly 140% from their low at the end of 2008), but Mongolia's basic challenge remains: to use its considerable natural resource wealth to underpin economic diversification through non-extractive-industry private sector growth. As with Turkmenistan, Mongolia's private sector future depends in important ways on the companies that exploit its natural wealth. The recently-signed agreement with Ivanhoe Mines and Rio Tinto covering the Oye Tolgoi copper and gold mining complex is seen as a breakthrough agreement that will provide a framework for a host of other strategic mining agreements throughout Mongolia[16]. These agreements are a start, but only a start. The breadth and depth of the recession's impact underscores Mongolia's need to diversify its economic base. Over the medium term, human resource development and Ulaanbaatar's infrastructure will play pivotal roles. In the near term, how Ivanhoe, Rio Tinto and other international extractive industry companies seek to integrate into and support Mongolia's economy will be the dominant force shaping private sector development.

16 Arshad Sayed, World Bank Country Manager, Mongolia, personal communications.

IV. Summing up

In commissioning this paper, the Emerging Market Forum asked five questions about Central Asia's business environments. Below my answers based on the preceding analysis:

- What is the reality of the business environment in Central Asia? Is it as bad as its reputation?
  Because of their starting conditions, yes. The Central Asian republics are not blessed with either large domestic markets or easy access to trading partners, which means their business environments, must be near the top of the list to attract international capital and move local capital into job creating new businesses. Right now, these countries rank way below where they need to be.

- What are the best ways to improve Central Asia's business climate country-by-country and region-wide?
  Recommendations for individual countries differ, but all depend on convincing investors that Central Asia's governments understand the need for an arms-length, neutral relationship with the private sector. Current practice has created a "credibility deficit" that will take considerable effort to close.

- How can private business and civil society best exert their influence to improve the business climate, public administration and governance in Central Asia?
  The potential role of domestic private business and civil society as agents of change varies among the five republics, from modest to very little. This will change over time, but in the meantime Central Asia's abundant natural resources may offer a gateway to improved private sector environments. Multinational companies can play a key role in nudging Central Asian states toward better business environments beyond their own market niches if these companies avoid the temptation to accept bad policy regimes in the name of short-term profits. In the near term, Eurasia region's powerhouses, Russia, China, Turkey, even Kazakhstan, are likely to continue to dominate FDI inflows. These countries and their main private investors need to come to the table when the future of Central Asia's private sector is discussed.

- Is the link between political system and public sector governance a strong one? I.e., can authoritarian regimes as they are prevalent in Central Asia, provide credible assurances that they will improve economic governance and the investment climate?
  As the Growth Commission work shows, the link between political systems and good governance is not strong. This holds for Central Asia as well. Accountability through democratic institutions is a long-term goal, and will be a long time in the making in Central Asia. Poor governance will continue to feed the credibility deficit. As with other aspects of these five countries, the ability of leaders to provide credible assurances varies. Some of Central Asia's leadership has the stature to provide credible assurances. But others will need help, which is where the international community comes in (see the next point).

- Is there much that outsiders can do to help improve a country's governance and investment climate?
  Better governance, better business environments, policy credibility and coherence are inherently internal matters. But outsiders can help. When governments show real

commitment to improving their business environments, outsiders can provided advice and experience, helping countries triage the many demanding policy challenges they face. It is, however, critical that this assistance be driven by the demands of the recipient country, and be tailored to local realities. When governments have made the move to better business environments, the international community can contribute to reducing the "credibility deficit" by underwriting policy changes though guarantees that make it costly for governments to reverse course in the future and signal government commitment to reform continuity. Of course, the international community has a reputation to keep as well, and needs to be quite sure that countries are serious about reforming their business environments.

- What specific actions could be recommended by the Eurasia Emerging Markets Forum for the various relevant actors in Central Asia (including, private entrepreneurs, national and sub-national governments, international partners, etc.) or what follow-up might be initiated by the Eurasia Emerging Markets Forum to help promote a better investment climate in the region?
The country-by-country assessments given above provide guidance to the Forum on ways in which it can help improve Central Asia's business environments, as do answers to the questions above. Specifically, the Forum could serve as the catalyst to push regional gatherings, especially CAREC, the Central Asia Regional Economic Cooperation organization, to intensify efforts to reduce regional constraints. Although already on CAREC's agenda, the most pressing regional issue from a business perspective is the need to encourage trade among the five republics by lowering the cost of crossing borders. This is a quintessential regional issue. Getting things right on one side of a border is of little use if the other side remains problematic. Transport, critical for regional cooperation for obvious reasons, is a second CAREC focus area.
The Forum is also well situated to push for a coordinated improvement in countries' business environments, and especially on reducing corruption, to offset the guilt-by-association problem of having neighbors who are far behind on the reform front. The Forum could also use its convening power to bring together communities of interest among the key players, entrepreneurs and civil society, national and sub-national governments, international partners, or to encourage others to do so. Two caveats: first, unless these partnerships find a way to go beyond talk, the business environment will not change and private sector development will continue to languish. Second, the Forum must proceed under full knowledge of the regional institutions already in place. The problem is not a lack of regional institutions, but the effectiveness of existing institutions.

If there is one message from this overview, it is that the "attractiveness" of a country's business environment is situation dependent. When potential rewards are high, a less than ideal business environment may be just fine, but for smallish economies in geographically challenged locations even "above average" business environments may not be enough to induce good growth. If the Central Asian economies recognize this reality as they set out to improve their business and policy environments, their private sectors will become the foundation not only for stable and equitable growth, but for a prosperous and secure region that rediscovers to its historic roots as a center of trade and commerce.

Annexes

Annex 1 Central Asia and Greater Central Asia Comparative Statistics

	Year								
	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP per capita, PPP (constant 2005 $)									
Armenia	2294	2523	2860	3261	3601	4098	4633	5261	5611
Azerbaijan	2490	2715	2981	3290	3594	4496	5981	7395	8102
Georgia	2342	2483	2649	2974	3181	3520	3885	4403	4526
Kazakhstan	5406	6146	6748	7351	8001	8699	9529	10259	10458
Kyrgyz Republic	1501	1569	1556	1651	1748	1728	1765	1894	2023
Mongolia	2029	2069	2143	2264	2470	2609	2798	3056	3297
Tajikistan	1002	1092	1179	1285	1405	1480	1562	1659	1761
Turkmenistan	2322	2758	3149	3634	4198	4678	5141	5663	6138
Uzbekistan	1632	1679	1725	1777	1892	2001	2121	2290	2455
GDP ('000 constant 2000 US$)									
Armenia	1911564	2095074	2371337	2703324	2987173	3402390	3851505	4379161	4676944
Azerbaijan	5272617	5794606	6408835	7126624	7853540	9926874	13351646	16696100	18499278
Georgia	3057453	3204378	3379780	3753520	3973376	4354806	4763429	5355514	5462625
Kazakhstan	18291991	20761409	22796027	24916058	27308000	29956876	33162261	36113702	37269341
Kyrgyz Republic	1369692	1442657	1442406	1543812	1652293	1649393	1700572	1840211	1981279
Mongolia	1089190	1121359	1174432	1256697	1390226	1491069	1618659	1784132	1942188
Tajikistan	860550	948326	1034624	1140156	1261012	1345500	1439685	1551981	1674587
Turkmenistan	2904663	3497985	4050666	4743330	5559183	6281877	6998011	7809780	8575139
Uzbekistan	13760374	14338310	14911843	15538140	16734577	17905997	19213135	21038383	22931837

Annex 1

Central Asia and Greater Central Asia Comparative Statistics

	Year								
	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP growth (annual %)									
Armenia	5.9	9.6	13.2	14.0	10.5	13.9	13.2	13.7	6.8
Azerbaijan	11.1	9.9	10.6	11.2	10.2	26.4	34.5	25.0	10.8
Georgia	1.8	4.8	5.5	11.1	5.9	9.6	9.4	12.4	2.0
Kazakhstan	9.8	13.5	9.8	9.3	9.6	9.7	10.7	8.9	3.2
Kyrgyz Republic	5.4	5.3	0.0	7.0	7.0	-0.2	3.1	8.2	7.7
Mongolia	0.5	3.0	4.7	7.0	10.6	7.3	8.6	10.2	8.9
Tajikistan	8.3	10.2	9.1	10.2	10.6	6.7	7.0	7.8	7.9
Turkmenistan	18.6	20.4	15.8	17.1	17.2	13.0	11.4	11.6	9.8
Uzbekistan	3.8	4.2	4.0	4.2	7.7	7.0	7.3	9.5	9.0
Gross savings (% of GDP)									
Armenia	4.1	10.3	15.9	17.5	25.2	29.4	34.3	31.1	26.8
Azerbaijan	17.3	19.7	22.3	25.4	23.7	42.8	47.5	47.4	32.5
Georgia	18.2	24.0	22.1	21.6	24.8	22.2	15.5	14.9	8.8
Kazakhstan	20.1	21.3	23.1	24.9	27.3	29.1	31.4	27.9	38.7
Kyrgyz Republic	14.7	17.2	16.9	10.1	15.4	12.0	10.5	6.6	..
Mongolia	..	11.7	12.6	22.7	31.2	36.7	40.4	38.9	..
Tajikistan	4.6	5.0	10.3	11.8	11.0	12.3	11.0	13.2	15.7
Turkmenistan	48.9	35.0	40.6	30.5	24.3	33.7	..	..	..
Uzbekistan	17.9	18.6	21.5	28.9	34.5	40.1	41.4	38.7	36.0

Annex 1 Central Asia and Greater Central Asia Comparative Statistics

	Year								
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross capital formation (% of GDP)									
Armenia	18.6	19.8	21.7	24.3	24.9	30.5	35.9	37.8	38.1
Azerbaijan	20.7	20.7	34.6	53.2	53.5	41.5	29.9	20.1	23.0
Georgia	26.6	30.3	28.5	31.3	31.9	33.5	30.9	34.6	31.0
Kazakhstan	18.1	26.9	27.3	25.7	26.3	31.0	33.9	35.6	34.6
Kyrgyz Republic	20.0	18.0	17.6	11.8	14.5	14.3	23.8	26.0	..
Mongolia	29.0	25.7	26.7	35.5	34.5	37.0	35.1	40.2	..
Tajikistan	11.5	9.8	13.8	13.1	14.9	14.8	13.7	22.0	20.1
Turkmenistan	34.7	31.7	27.6	25.4	23.1	22.9	..	..	..
Uzbekistan	16.3	19.6	20.3	20.2	24.4	26.5	23.8	19.4	18.5
Trade (% of GDP)									
Armenia	73.9	71.6	75.9	82.2	69.5	72.0	62.6	58.3	54.5
Azerbaijan	77.4	78.2	92.8	107.6	121.5	115.8	105.3	96.6	93.2
Georgia	62.7	63.3	71.6	78.3	79.7	85.3	89.9	89.3	90.0
Kazakhstan	105.7	92.8	94.0	91.5	95.7	98.3	91.6	92.0	101.4
Kyrgyz Republic	89.4	73.7	82.9	83.9	93.8	96.4	120.8	134.6	..
Mongolia	127.2	125.6	130.1	132.5	144.1	132.5	125.0	130.0	..
Tajikistan	199.7	146.4	141.6	136.9	128.2	78.9	80.9	87.1	75.0
Turkmenistan	176.4	158.3	122.5	118.9	121.2	112.8	128.9	110.6	84.4
Uzbekistan	46.1	55.7	60.2	67.8	72.9	66.5	64.9	70.5	73.5

Annex 1 Central Asia and Greater Central Asia Comparative Statistics

	Year								
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Agriculture, value added (% of GDP)									
Armenia	25.5	28.3	26.0	23.7	24.7	20.9	20.5	20.3	17.8
Azerbaijan	17.1	16.1	15.2	13.5	11.8	9.9	7.5	5.9	5.9
Georgia	21.9	22.4	20.6	20.6	17.9	16.7	12.8	10.9	10.4
Kazakhstan	8.7	9.4	8.6	8.4	7.6	6.8	5.9	6.1	6.2
Kyrgyz Republic	36.7	37.3	37.7	37.1	33.3	31.9	32.8	33.6	..
Mongolia	32.7	29.3	24.2	23.5	25.4	24.7	21.9	23.0	..
Tajikistan	27.4	26.2	24.7	27.1	21.6	24.0	24.8	21.4	18.0
Turkmenistan	24.4	24.4	22.0	20.3	19.6	..	..	..	..
Uzbekistan	34.4	34.0	34.3	33.1	30.8	28.0	26.1	24.0	23.4
Manufacturing, value added (% of GDP)									
Armenia	24.1	22.3	20.9	21.2	21.0	23.8	18.8	16.7	14.7
Azerbaijan	5.6	6.7	8.1	9.4	8.9	7.0	6.1	5.2	..
Georgia	13.0	13.1	13.7	13.9	13.4	13.7	12.7	12.3	12.0
Kazakhstan	17.7	17.6	15.6	15.3	14.2	12.8	12.4	12.4	12.3
Kyrgyz Republic	19.5	19.0	14.3	14.6	17.1	14.4	12.6	11.3	..
Mongolia	4.6	6.1	4.7	4.9	4.1	4.1	3.9	4.5	..
Tajikistan	33.7	34.1	34.2	31.3	24.3	23.7	19.3	20.0	16.5
Turkmenistan	10.6	14.6	15.3	18.6	21.7	..	..	..	..
Uzbekistan	9.4	9.5	9.2	9.2	10.2	9.1	10.8	12.6	12.3

Annex 1 **Central Asia and Greater Central Asia Comparative Statistics**

	2008			
	Population, total	Rural population (% of total)	Life expectancy at birth, male (years) - 2007	Population ages 0-14 (% of total)
Armenia	3077087	36.1	70.2	20.5
Azerbaijan	8678851	48.1	63.8	24.6
Georgia	4364461	47.3	67.1	17.1
Kazakhstan	15674833	42.1	60.9	23.7
Kyrgyz Republic	5277900	63.7	63.5	29.7
Mongolia	2632387	42.8	63.9	26.5
Tajikistan	6836083	73.5	64.1	37.5
Turkmenistan	5028041	51.4	59.0	30.1
Uzbekistan	27313700	63.2	64.0	30.1

Source: World Bank Group: World Development Indicators

Annex 2 **Competitiveness Rankings**

CENTRAL ASIA	
Kazakhstan	
Corruption Perceptions Index	120 out of 180
Ease of Doing Business Rankings	63 out of 183
E-readiness Rankings	66 out of 70
Freedom of the Press	170 out of 194
Global Competitiveness Report	67 out of 134
Global Enabling Trade Report	72 out of 118
Global Services Location Index	-
Index of Economic Freedom	76 out of 155
Inward FDI Potential Index	46 out of 140
Tax Misery & Reform Index	54 out of 65
The Globalization Index	-
Kyrgyz Republic	
Corruption Perceptions Index	162 out of 180
Ease of Doing Business Rankings	41 out of 183
E-readiness Rankings	-
Freedom of the Press	156 out of 194
Global Competitiveness Report	122 out of 134
Global Enabling Trade Report	109 out of 118
Global Services Location Index	-
Index of Economic Freedom	70 out of 155
Inward FDI Potential Index	110 out of 140
Tax Misery & Reform Index	-
The Globalization Index	-
Tajikistan	
Corruption Perceptions Index	158 out of 180
Ease of Doing Business Rankings	152 out of 183
E-readiness Rankings	-
Freedom of the Press	168 out of 194
Global Competitiveness Report	122 out of 134
Global Enabling Trade Report	104 out of 118
Global Services Location Index	-
Index of Economic Freedom	114 out of 155
Inward FDI Potential Index	93 out of 140
Tax Misery & Reform Index	-
The Globalization Index	-

Annex 2 **Competitiveness Rankings**

Turkmenistan	
Corruption Perceptions Index	168 out of 180
Ease of Doing Business Rankings	-
E-readiness Rankings	-
Freedom of the Press	193 out of 194
Global Competitiveness Report	-
Global Services Location Index	-
Index of Economic Freedom	152 out of 155
Tax Misery & Reform Index	-
The Globalization Index	-
Uzbekistan	
Corruption Perceptions Index	174 out of 180
Ease of Doing Business Rankings	150 out of 183
E-readiness Rankings	-
Freedom of the Press	189 out of 194
Global Competitiveness Report	-
Global Enabling Trade Report	105 out of 118
Global Services Location Index	-
Index of Economic Freedom	130 out of 155
Inward FDI Potential Index	98 out of 140
Tax Misery & Reform Index	43 out of 65
The Globalization Index	-
GREATER CENTRAL ASIA COUNTRIES	
Armenia	
Corruption Perceptions Index	120 out of 180
Ease of Doing Business Rankings	43 out of 183
E-readiness Rankings	-
Freedom of the Press	64 out of 191
Global Competitiveness Report	97 out of 134
Global Enabling Trade Report	61 out of 118
Global Services Location Index	-
Index of Economic Freedom	28 out of 155
Inward FDI Potential Index	73 out of 140
Tax Misery & Reform Index	-
The Globalization Index	-

Annex 2 | Competitiveness Rankings

Azerbaijan	
Corruption Perceptions Index	143 out of 180
Ease of Doing Business Rankings	38 out of 183
E-readiness Rankings	69 out of 70
Freedom of the Press	73 out of 191
Global Competitiveness Report	51 out of 134
Global Enabling Trade Report	76 out of 118
Global Services Location Index	-
Index of Economic Freedom	107 out of 155
Inward FDI Potential Index	64 out of 140
Tax Misery & Reform Index	36 out of 65
The Globalization Index	-
Georgia	
Corruption Perceptions Index	66 out of 180
Ease of Doing Business Rankings	11 out of 183
E-readiness Rankings	-
Freedom of the Press	57 out of 191
Global Competitiveness Report	90 out of 134
Global Enabling Trade Report	-
Global Services Location Index	-
Index of Economic Freedom	32 out of 155
Inward FDI Potential Index	102 out of 140
Tax Misery & Reform Index	62 out of 65
The Globalization Index	-
Mongolia	
Corruption Perceptions Index	120 out of 180
Ease of Doing Business Rankings	60 out of 183
E-readiness Rankings	-
Freedom of the Press	34 out of 191
Global Competitiveness Report	117 out of 134
Global Enabling Trade Report	93 out of 118
Global Services Location Index	-
Index of Economic Freedom	78 out of 198
Inward FDI Potential Index	71 out of 140
Tax Misery & Reform Index	-
The Globalization Index	-

Annex 2 Competitiveness Rankings

COMPARATORS	
Indonesia	
Corruption Perceptions Index	111 out of 180
Ease of Doing Business Rankings	122 out of 183
E-readiness Rankings	68 out of 70
Freedom of the Press	114 out of 194
Global Competitiveness Report	54 out of 134
Global Enabling Trade Report	47 out of 118
Global Services Location Index	6 out of 198
Index of Economic Freedom	119 out of 155
Inward FDI Potential Index	100 out of 140
Tax Misery & Reform Index	47 out of 65
The Globalization Index	69 out of 198
Malaysia	
Corruption Perceptions Index	56 out of 180
Ease of Doing Business Rankings	23 out of 183
E-readiness Rankings	34 out of 70
Freedom of the Press	141 out of 194
Global Competitiveness Report	24 out of 134
Global Enabling Trade Report	29 out of 118
Global Services Location Index	3 out of 198
Index of Economic Freedom	51 out of 155
Inward FDI Potential Index	40 out of 140
Tax Misery & Reform Index	49 out of 65
The Globalization Index	23 out of 198
Philippines	
Corruption Perceptions Index	139 out of 180
Ease of Doing Business Rankings	144 out of 183
E-readiness Rankings	55 out of 70
Freedom of the Press	97 out of 194
Global Competitiveness Report	87 out of 134
Global Enabling Trade Report	82 out of 118
Global Services Location Index	8 out of 198
Index of Economic Freedom	92 out of 155
Inward FDI Potential Index	77 out of 140
Tax Misery & Reform Index	49 out of 65
The Globalization Index	38 out of 198

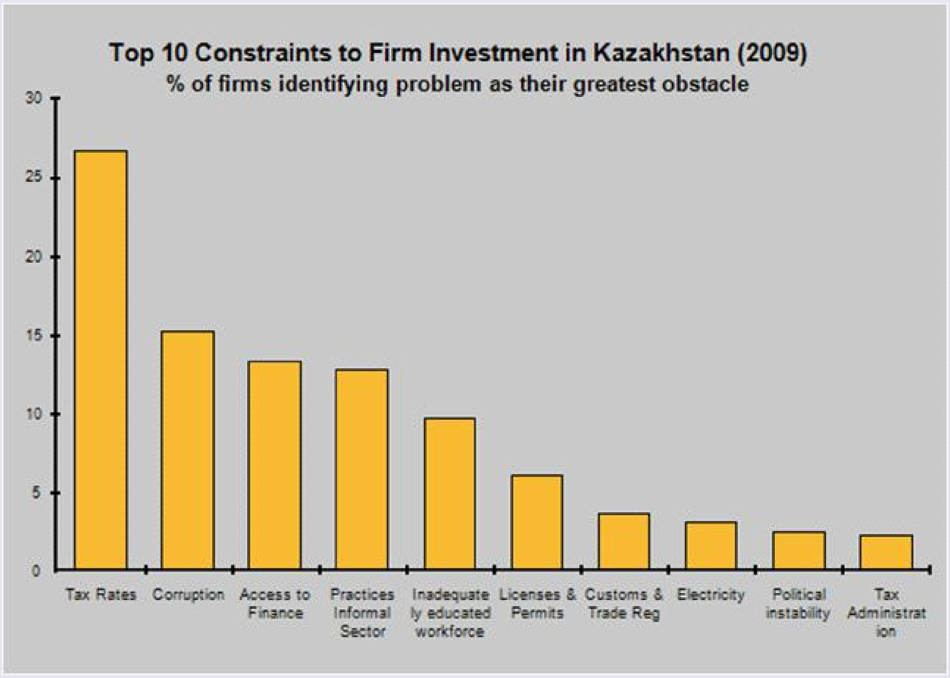
Annex 2 | **Competitiveness Rankings**

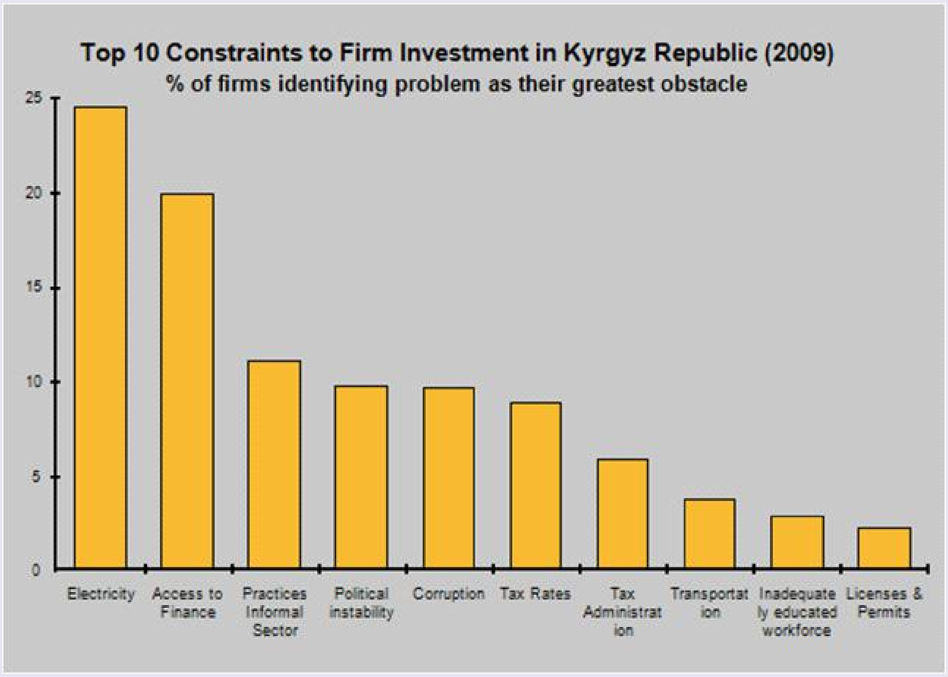
Indonesia	
Corruption Perceptions Index	120 out of 180
Ease of Doing Business Rankings	93 out of 183
E-readiness Rankings	65 out of 70
Freedom of the Press	178 out of 194
Global Competitiveness Report	75 out of 134
Global Enabling Trade Report	91 out of 118
Global Services Location Index	19 out of 198
Index of Economic Freedom	135 out of 155
Inward FDI Potential Index	80 out of 140
Tax Misery & Reform Index	41 out of 65
The Globalization Index	48 out of 198

Source: International Business Center, Michigan State University, globalEDGE (http://globaledge.msu.edu/), updated where necessary to most recent surveys. For all but the Tax Misery series, low numbers are good, high numbers bad.

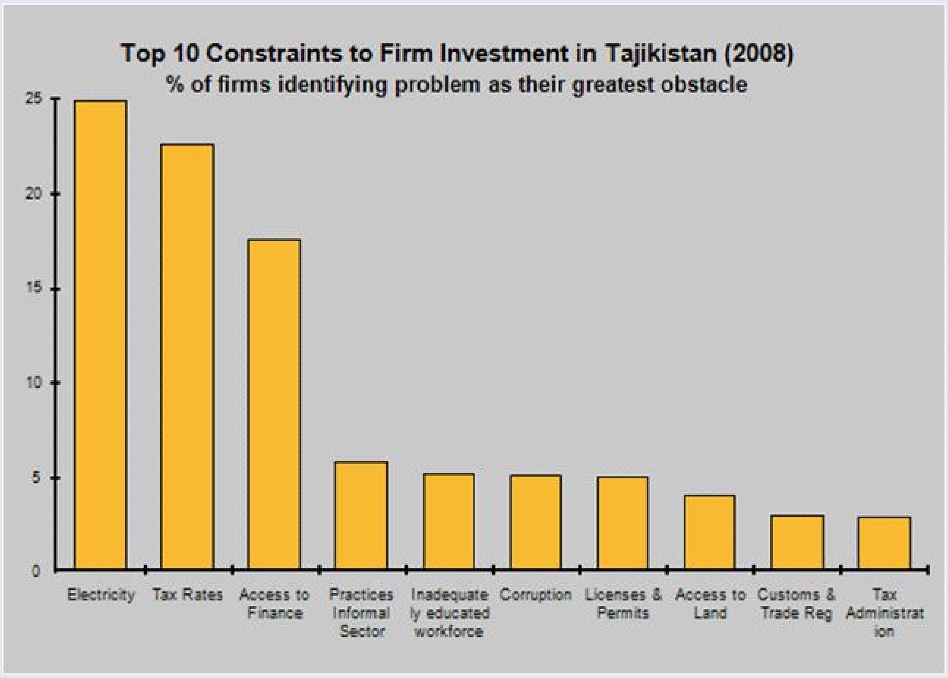
Individual series:

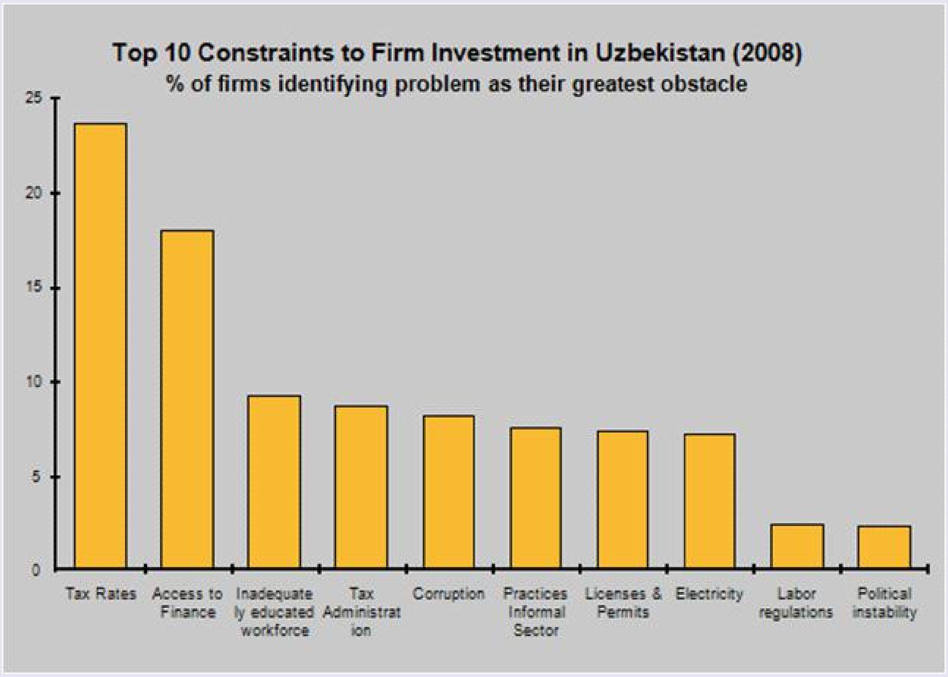
Corruption Perception Index – Transparency International
Ease of Doing Business – World Bank
E-readiness – Economist Intelligence Unit
Freedom of the Press – Freedom House
Global Competitiveness Report – World Economic Forum
Global Enabling Trade Report – World Economic Forum
Global Services Location Index – A.T. Kearney
Index of Economic Freedom – Heritage Foundation
Inward FDI Potential Index – UNCTAD
Tax Misery & Reform Index – Forbes
Globalization Index – A.T. Kearney

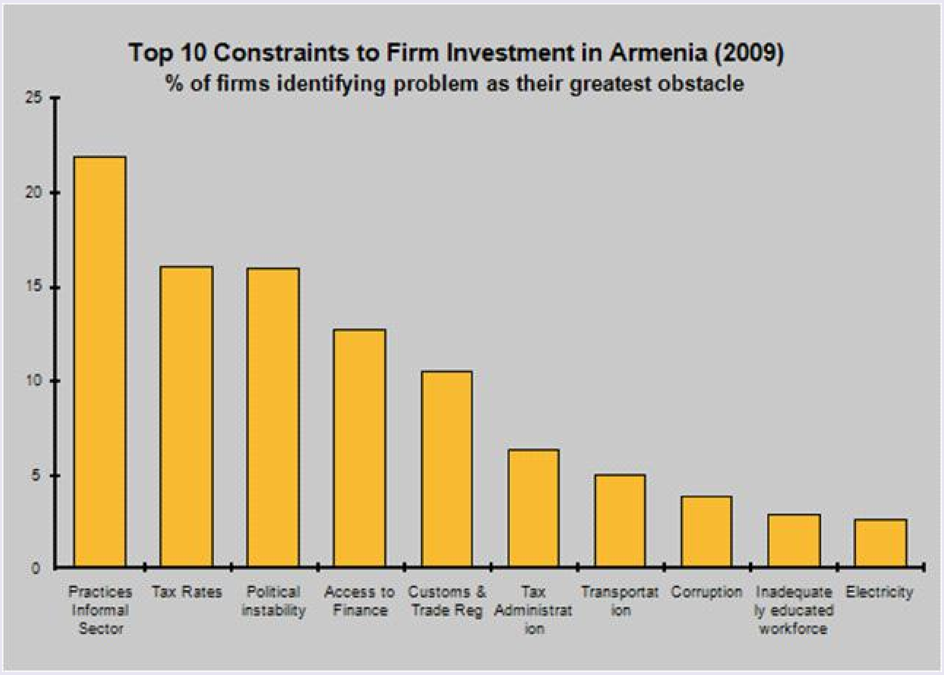

Top 10 Constraints to Firm Investment in Kazakhstan (2009)
% of firms identifying problem as their greatest obstacle
30
25
20
15
10
5
0
Tax Rates
Corruption
Access to Finance
Practices Informal Sector
Inadequately educated workforce
Licenses & Permits
Customs & Trade Reg
Electricity
Political instability
Tax Administration

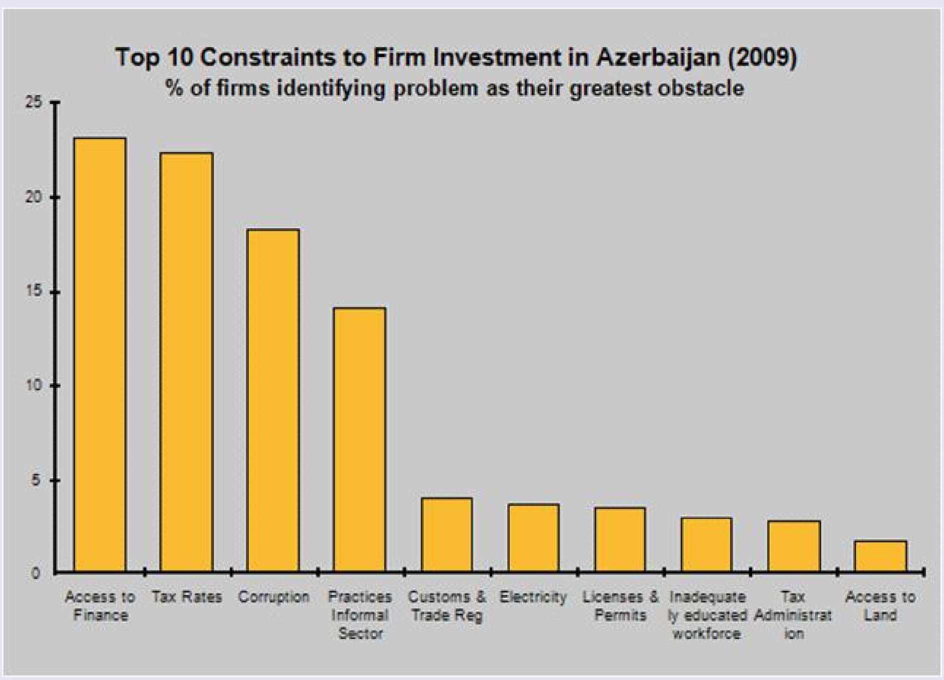

Top 10 Constraints to Firm Investment in Kyrgyz Republic (2009)
% of firms identifying problem as their greatest obstacle
25
20
15
10
5
0
Electricity
Access to Finance
Practices Informal Sector
Political instability
Corruption
Tax Rates
Tax Administration
Transportation
Inadequately educated workforce
Licenses & Permits

Annex 3 **Enterprise Survey Data Central Asia**

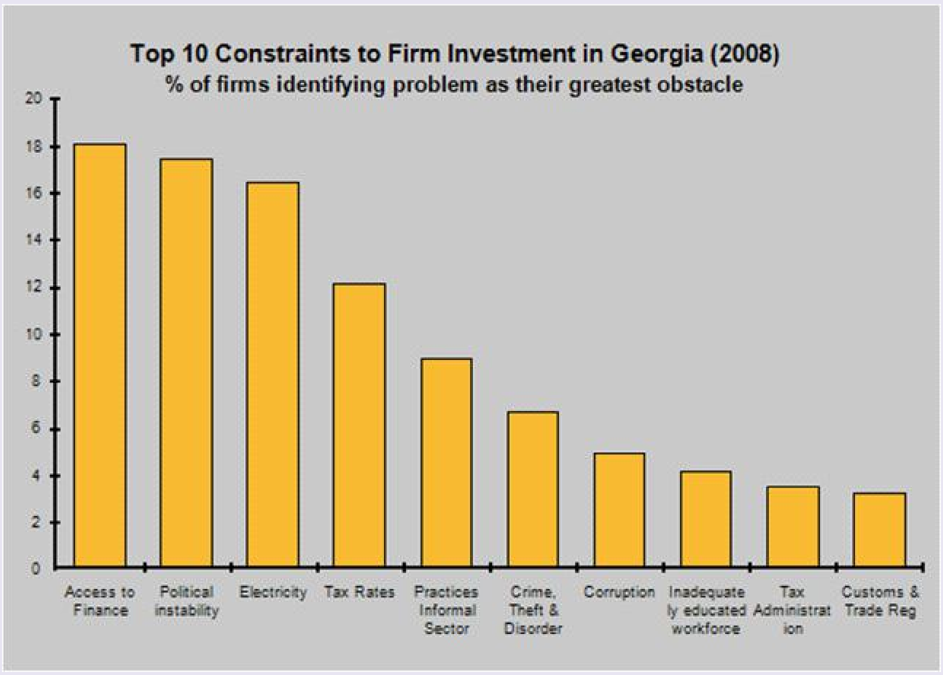


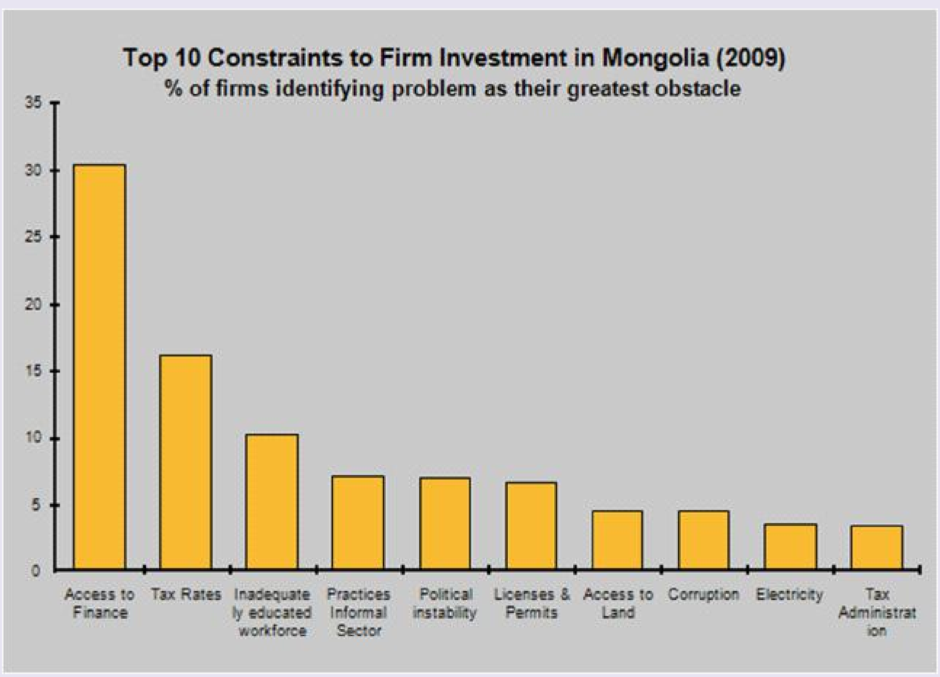



Top 10 Constraints to Firm Investment in Armenia (2009)
% of firms identifying problem as their greatest obstacle
25
20
15
10
5
0
Practices Informal Sector
Tax Rates
Political instability
Access to Finance
Customs & Trade Reg
Tax Administration
Transportation
Corruption
Inadequately educated workforce
Electricity

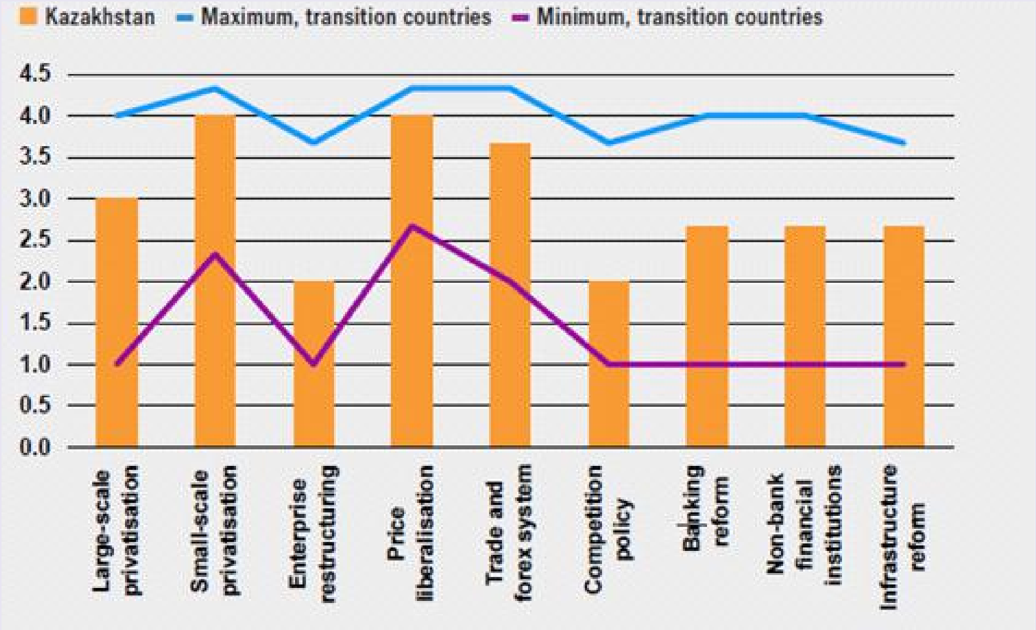

Top 10 Constraints to Firm Investment in Azerbaijan (2009)
% of firms identifying problem as their greatest obstacle
25
20
15
10
5
0
Access to Finance
Tax Rates
Corruption
Practices Informal Sector
Customs & Trade Reg
Electricity
Licenses & Permits
Inadequately educated workforce
Tax Administration
Access to Land

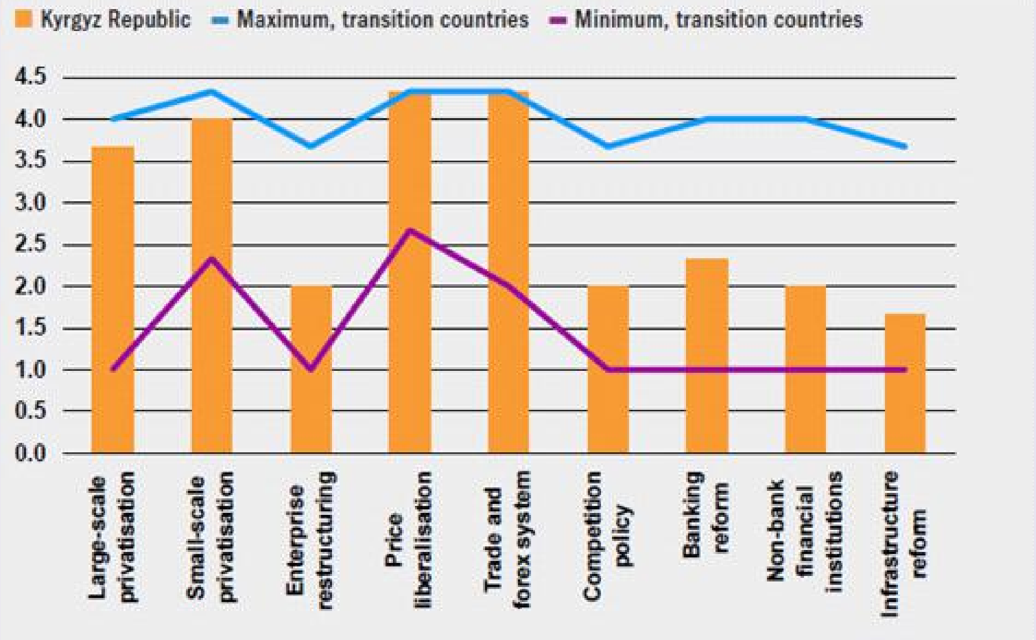
Annex 3 **Enterprise Survey Data Greater Central Asia Countries**





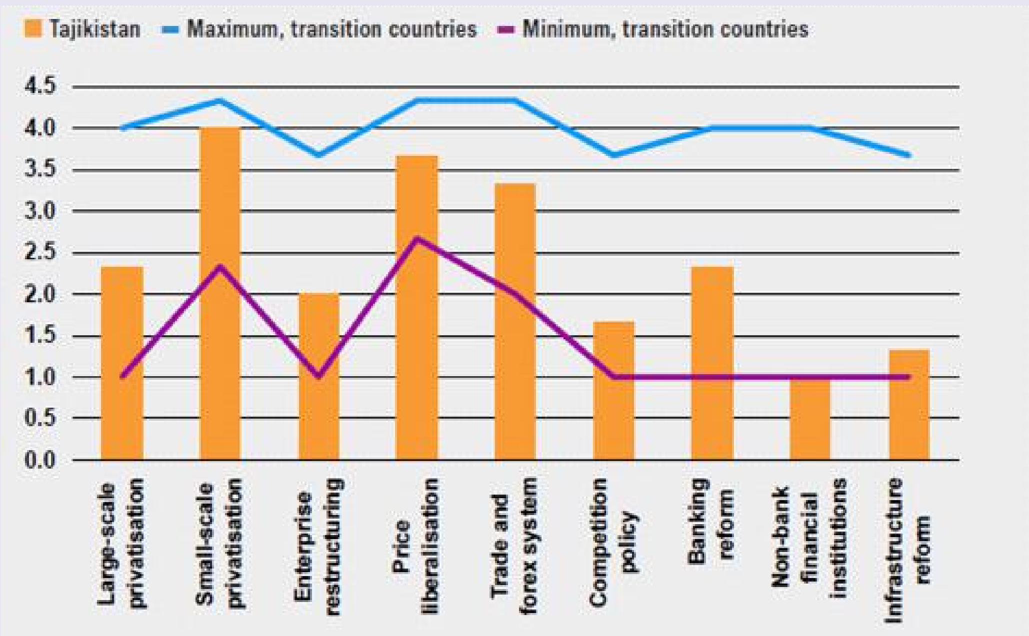
Annex 3 **EBRD Transition Indicators, 2009**
Central Asia

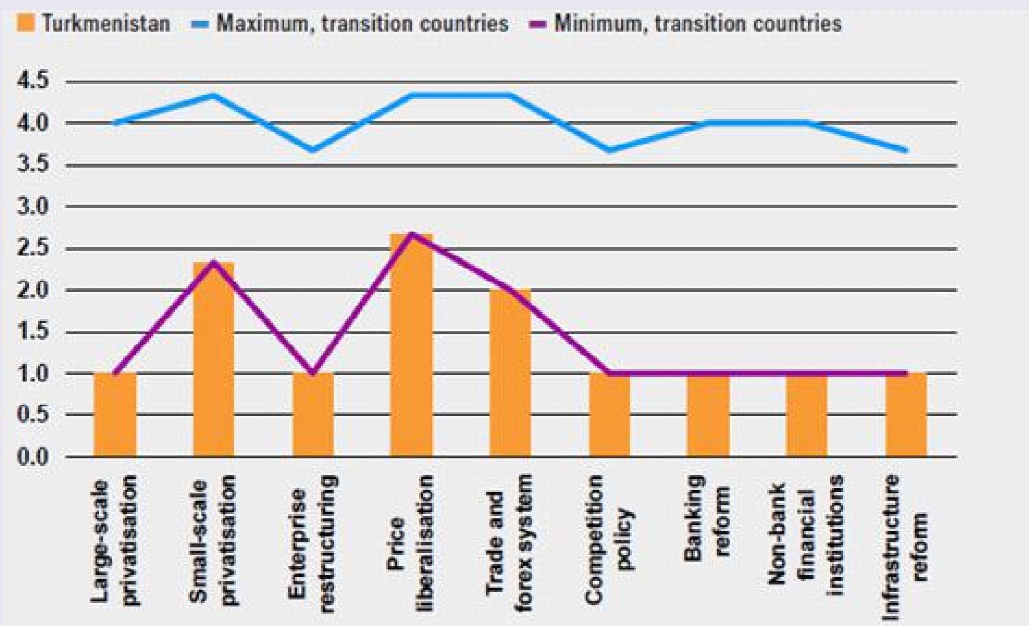




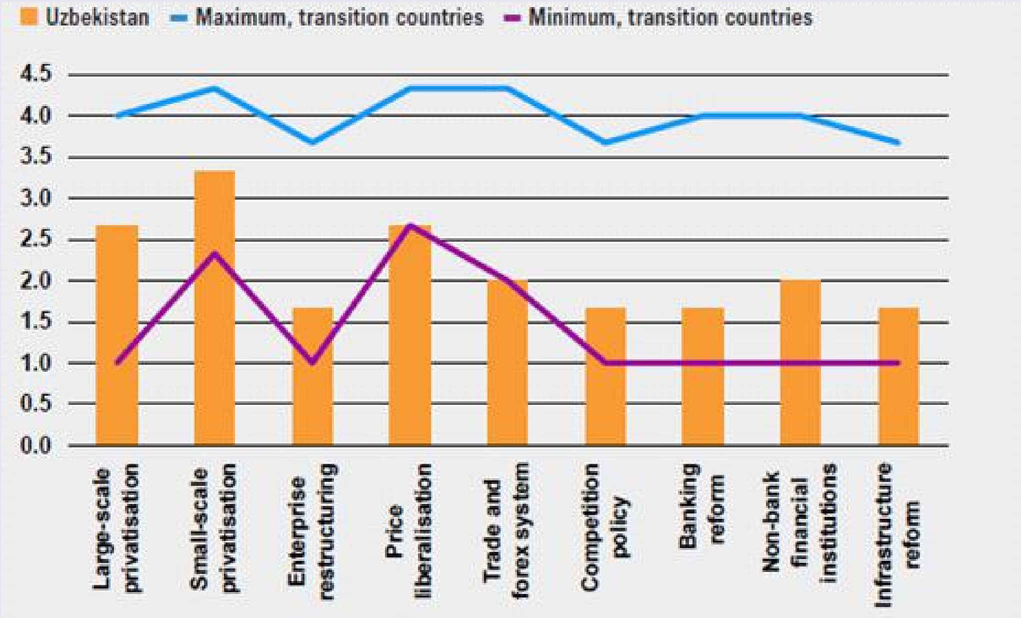
Annex 3

EBRD Transition Indicators, 2009
Central Asia

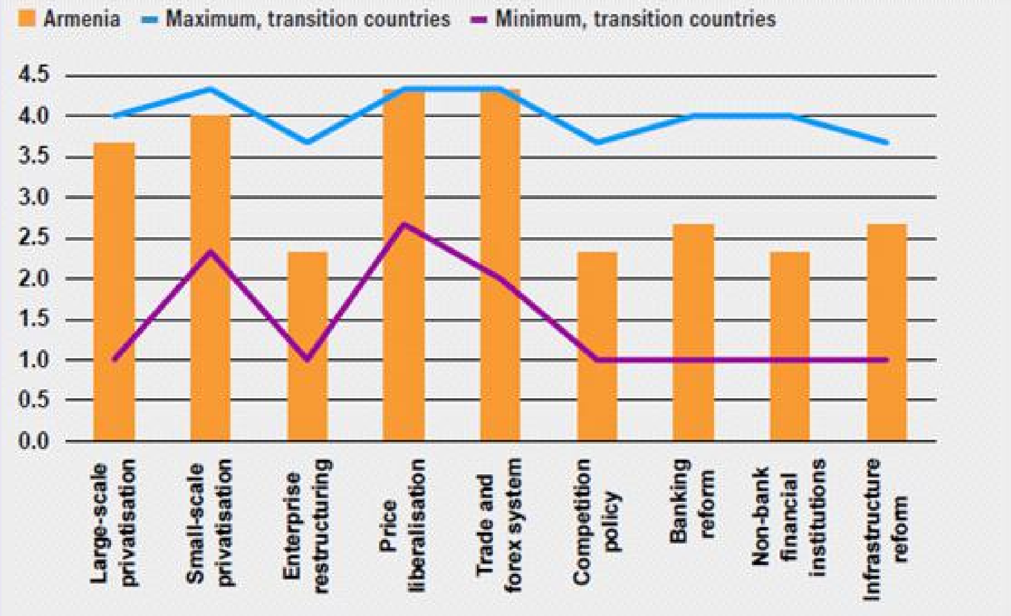




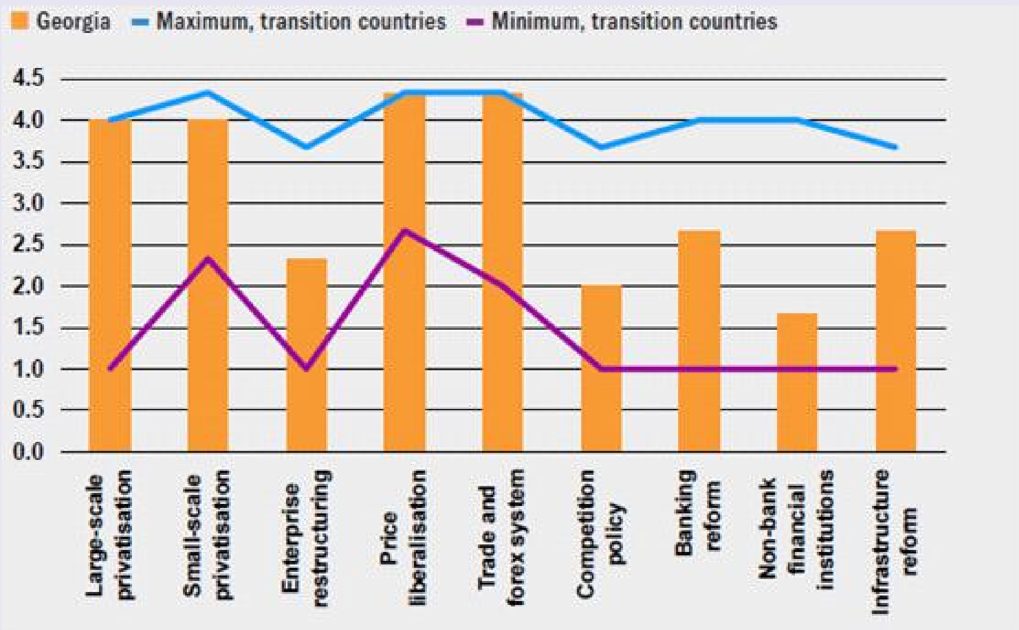
Annex 3 **EBRD Transition Indicators, 2009**
Central Asia

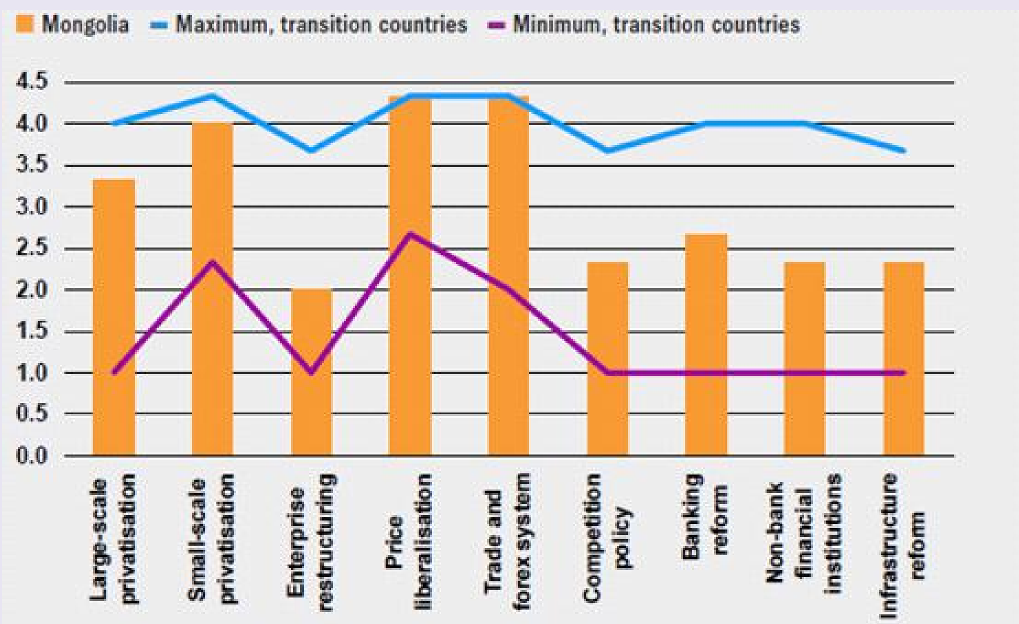


Annex 3 **EBRD Transition Indicators, 2009**
Greater Central Asia Countries



Annex 3 | **EBRD Transition Indicators, 2009**
Central Asia





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