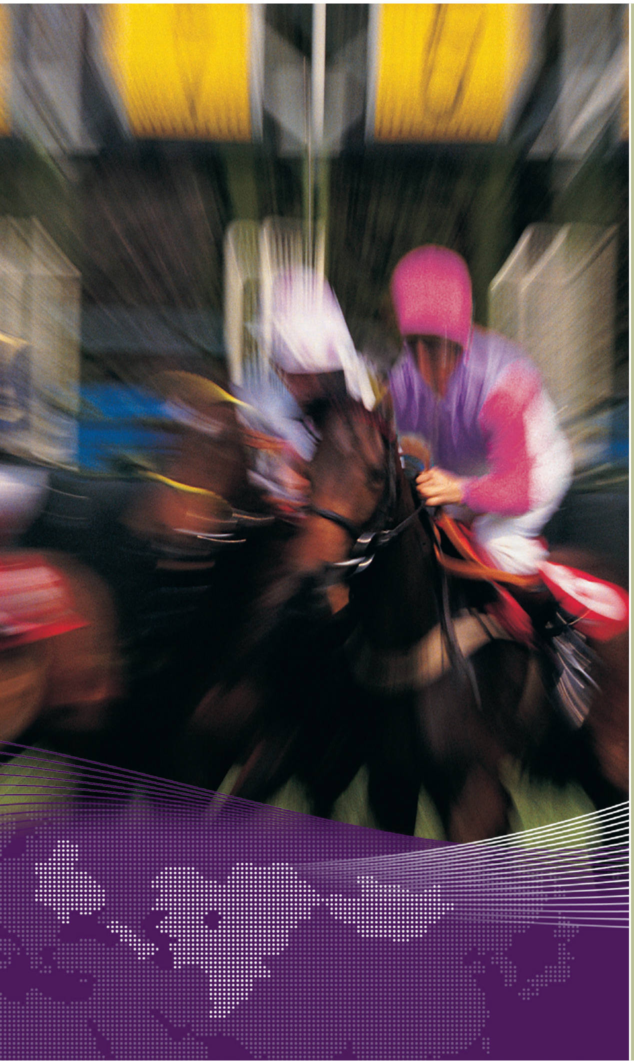
PRIVATE SECTOR DEVELOPMENT

Policy Handbook



Promoting Investment and Job Creation in Central Asia through Business Linkage Programmes

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PRIVATE SECTOR DEVELOPMENT POLICY HANDBOOK

Promoting Investments and Job Creation in Central Asia through Business Linkage Programmes

- INVESTMENTS AND COMPETITIVENESS IN CENTRAL ASIA -

MAY 2013

The OECD Central Asia Initiative

Launched in November 2008, the OECD Central Asia Initiative is part of the OECD Eurasia Competitiveness Programme, which aims to contribute to economic growth in Afghanistan, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan. Its objective is to share with the governments of the region the knowledge, experience and good practices of OECD countries to create a sound business climate for investment, enhance productivity and support entrepreneurship, develop the private sector, and build knowledge-based economies to render its sectors more competitive and attractive to foreign investment. Its approach comprises both a regional policy dimension, which entails peer dialogue and capacity building, and a country-specific aspect supporting the implementation of a number of prioritised reforms. A sector analysis is also included, covering the formulation of targeted policies and strategies requested at the industry level. Within the framework of the programme, public authorities, the private sector and civil society within these countries have been engaged in a dialogue and collaborative process to support policy actions and identify key barriers to competitiveness.

The participation of all stakeholders in the reform process, including foreign investors, is considered to be crucial for guaranteeing the effectiveness and transparency of the recommended policies.

FOREWORD

Since 2009, the OECD Eurasia Competitiveness Programme has worked with the governments of the Central Asia region to create a sound business climate for investment, enhance productivity, support entrepreneurship, develop the private sector, and build knowledge-based economies to render this region more competitive and attractive to foreign investment.

In a first step, this work has led to the development of a Competitiveness Outlook for Central Asia which was launched in January 2011 in Davos, Switzerland. The Competitiveness Outlook identified barriers that need to be dismantled for Central Asian economies to reach their full potential. It highlighted three major challenges to improving competitiveness: a deteriorating education system which is undermining the future of the region's human capital; a lack of access to finance for small- and medium-sized enterprises; and a need for better investment policy and promotion.

In a second step, building on these findings, the OECD in close collaboration with the economies of the region developed potential strategies to overcome these obstacles by focusing on one specific policy tool within each of these three areas. This handbook contains the conclusions related to investment policy and promotion and provides guidance for policy makers on implementing business linkage programmes (BLPs) as an effective measure to further increase investment promotion efforts. BLPs exist only in half of the Central Asian countries and are in an early stage of development. Further developing such programmes could contribute to integrating local SMEs into the supply chain of multinational companies.

Unless otherwise specified, this policy handbook is based on the proceedings of the OECD Working Group meeting on Investment Policy and Investment Promotion in Central Asia, held 24-26 April 2012 in Vienna, Austria, and the preparatory questionnaire "Business Linkage Programmes" self-assessment questionnaire, completed in 2012 by all *participants, except Turkmenistan. Given that no official information has been provided by Turkmenistan, this handbook does not contain any assessment of the specific situation in Turkmenistan and no policy recommendations are given. Secondary information on Turkmenistan has been included in this handbook, as available.*

The project was conducted in close collaboration with policy makers from the Central Asia region and was financially supported by the European Union.

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This policy handbook is the outcome of work conducted by the seven countries participating in the OECD Central Asia Initiative (Afghanistan, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan) and the OECD Eurasia Competitiveness Programme under the authority of the Central Asia Initiative Steering Committee, within the framework of the *Investment and Competitiveness in Central Asia* project which benefitted from the financial support of the European Union and Kazakhstan.

The policy handbook was written under the guidance of Anthony O'Sullivan, Head of the Private Sector Development Division (OECD DAF) and Antonio Somma, Acting Head of the Eurasia Competitiveness Programme (OECD DAF).

Strategic oversight was provided by the Co-Chairs of the OECD Central Asia Initiative, the European Union and France, by the Co-Chair of the Investment Policy and Promotion Working Group for Central Asia, Mr. Joachim Steffens, Representative of Germany to the OECD Investment Committee, as well as by OECD Deputy Secretary-General Richard Boucher.

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Acronyms and abbreviations

AISA	Afghanistan Investment Support Agency
AVET	Agency for Vocational Education and Training, Mongolia
BESI	Business entity of strategic importance
BLP	Business linkage programme
DAMU	Entrepreneurship Development Fund, Kazakhstan
FDI	Foreign direct investment
FEZ	Free Economic Zone
FIFTA	Foreign Investment and Foreign Trade Agency, Mongolia
GIZ	Gesellschaft für Internationale Zusammenarbeit
IT	Information technology
ITC	International Trade Centre
JICA	Japanese International Cooperation Agency
KAZNEX	Invest National Export and Investment Agency, Kazakhstan
MERT	Ministry of Economic Development and Trade, Kazakhstan
NADLoC	National Agency on Local Content Development, Kazakhstan
NGO	Non-governmental organisation
PFI	Policy Framework for Investment
R&D	Research and development
SBD	Small Business Development Group

SEZ	Special Economic Zone
SK Invest	Samruk Kazyna Invest, Kazakhstan
Uzinfoivest	Information Support & Foreign Investments, Promotion Agency, Uzbekistan
VET	vocational education and training
WTO	World Trade Organization

Executive summary

All countries from Central Asia would benefit from increasing their investment promotion efforts, for example by implementing business linkage programmes (BLPs). This handbook provides guidance on how to design successful programmes based on international good practices and examines the benefits and the status of implementation of BLPs in Central Asia. It offers recommendations tailored for each country, on the basis of a self-assessment exercise completed by the participating countries.[1]

International experience in BLPs gives guidance on how to design successful programmes

International experience shows how governments can design BLPs as a specific measures to promote FDI while maximising its benefits to the local economy. In the past, a significant proportion of FDI in both developed and developing countries has been in the form of "branch-plant" facilities with few linkages to the rest of the local economy. Such operations provide limited benefits to the host economy, conducting little or no R&D locally and importing components rather than buying locally. BLPs can provide an effective way to change this relationship, tying FDI more closely into the domestic economy, encouraging local sourcing of inputs, including labour, and strengthening relationships with domestic firms in research and product development.

BLPs can include elements such as databases detailing the products and capabilities of local SMEs and FDI, a framework for assessing and selecting participating companies, programmes for skills development (training schemes, exchange programmes, internships), promotional and marketing services, certification schemes, and incentives (tax or other) to encourage participation.

[1] Since no official information has been provided by Turkmenistan this handbook does not contain any assessment of the specific situation in the country and no policy recommendations are given. Secondary information on Turkmenistan has been included in this handbook, as available.

OECD good practice suggests a five-stage approach to developing a business linkage programme. Phase one defines the strategy of the programme by setting its objectives and establishing a process to identify suitable participants, *i.e.* potential local suppliers and foreign enterprises. Phase two proposes an internal organisational structure for the linkage programme. Phase three describes the diagnostic and promotional activities that essentially launch the programme. Phase four outlines the mechanisms that will assist in monitoring the results of the programme. Lastly, phase five examines how linkages facilitated by the programme might be sustained in the long-run.

Need to develop more sophisticated business linkage programmes in Central Asia

Formal BLPs are in place in **Afghanistan, Kazakhstan and Uzbekistan**. The BLPs in Afghanistan and Kazakhstan have taken a sectoral approach. In Afghanistan, the BLP is in the pilot phase and currently limited to extractive industries in the proximity of two mines. In Kazakhstan, projects exist for multiple sectors, including tourism, agribusiness, manufacturing, utilities, telecommunications, information technology, R&D, education and health services, and the arts and recreational sectors. The BLP in Uzbekistan has no specific sector focus. Stakeholder involvement in the existing Central Asian BLPs is still low throughout the region. However, in Afghanistan the investment support agency and the chambers of commerce were involved in establishing the database of local SMEs. In Kazakhstan, several government bodies participated in the pilot BLP project, including the Entrepreneurship Development Fund (DAMU) and KAZNEX Invest, as well as local chambers of commerce and international investors.

The three countries with already-developed BLPs should ensure that programmes are based on a comprehensive strategy that defines clear objectives and measurable targets. In addition, policy makers could consider the following guidance:

- Assess the effectiveness of existing business linkage programmes and follow up with further measures targeting key economic sectors in which business linkage programmes may have a high impact on the economy. Review or identify policy objectives to be achieved and carry out an assessment on policy barriers hampering the success of a BLP.

- Complement existing measures, as required, and develop missing key components of a BLP, such as a database to provide an overview of local companies that can be targeted by foreign investor based on a transparent framework for selecting eligible companies.

- Ensure that BLPs include a training component and take advantage of matchmaking activities between international companies and local suppliers, for example through staff exchange programmes, internship schemes and vocational education and training programmes that would expose local entrepreneurs to international good business practices.

Although the **Kyrgyz Republic, Mongolia and Tajikistan** do not yet have formal BLPs in place, all countries have at least some of the individual elements in place or under development. For example, Mongolia maintains a database on foreign investors and local companies interested in participating in BLP projects. All three countries actively promote their countries as an investment destination through investment promotion agencies that carry out roadshows, fairs and matchmaking events as well as media campaigns.

However, these countries do not yet take advantage of BLPs and need to develop complementary measures to improve the quality of local products to meet international product standards in order to attract foreign firms. In order to achieve this, training must be made a main element in BLPs to overcome the problem of insufficient local skills. Training programmes are particularly relevant as they tend to have a broader and longer-term impact beyond just the BLP itself. Progress in implementation would also be enhanced if BLP projects receive high-level support from policy makers.

The three countries with no formalised BLPs could consider developing pilot projects based on the following guidance:

- Identify economic sectors which would benefit most from the implementation of a BLP pilot project to focus scarce resources on sectors with a high economic development impact. A pilot project could more easily be implemented in a low-technology sector such as services, as technology-intensive projects, e.g. in manufacturing, would require significantly more resources and a longer timeframe for implementation.

- Develop a comprehensive strategy based on clear objectives and transparent eligibility criteria for company selection and set-up a database detailing products and capabilities of local SMEs and foreign investors to provide easy access to interested participants.

- Ensure that BLPs include specific measures to achieve their intended objective, such as a training component, exchange programmes, internship schemes and vocational education and training programmes that would expose local entrepreneurs to international good business practices.

Specific recommendations for each country are given in the country section on the basis of gap analyses carried out individually.

Chapter 1

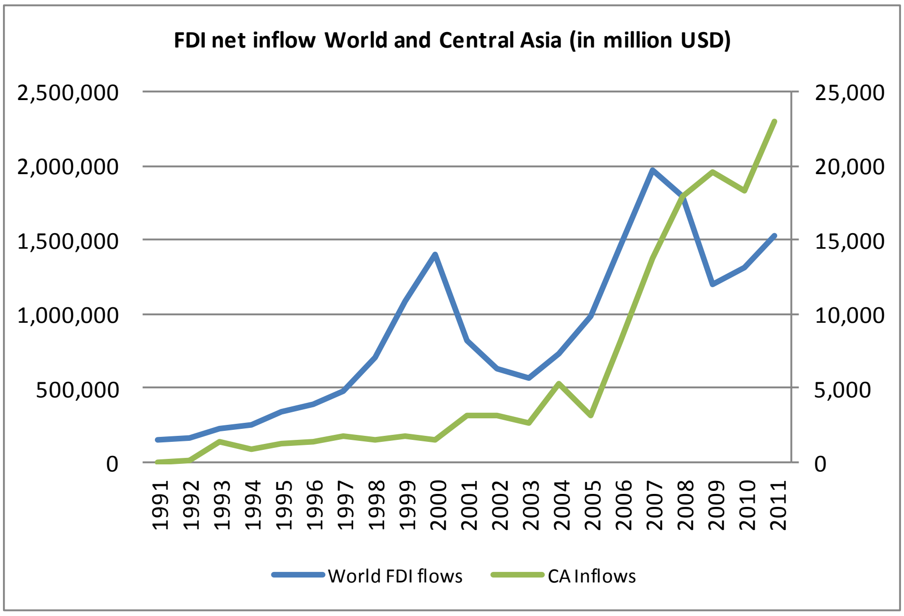
Baseline situation in Central Asia: Need to further promote FDI inflows

The level of foreign direct investment (FDI) in Central Asia has grown rapidly in recent years but remains low in comparison with investment flows to other developing and developed regions. Moreover, FDI has been focused on relatively few sectors and countries due to the availability of natural resources in some Central Asian countries. Even though investment policy frameworks have partially improved, countries in Central Asia need to strengthen their investment promotion efforts to attract more and better FDI.

FDI inflows to Central Asia are growing but remain concentrated in extractive industries

FDI inflows to Central Asia are growing faster than the world average and have increased by 25% between 2010 and 2011, compared to a 16% increase of global net FDI inflows across the same period. Nevertheless, the region's global share remains very low (1.5% of global net FDI inflows in 2011). Kazakhstan still holds the largest stock of FDI (72% of FDI in Central Asia has been invested in Kazakhstan) but its relative importance is decreasing as inflows to Mongolia, Uzbekistan and Turkmenistan are picking up. In 2011, 56% of FDI inflows went into Kazakhstan (compared to 82% in 2009), Mongolia received 20%, followed by Turkmenistan (14%), Uzbekistan (6%) and the Kyrgyz Republic (3%). Less than 1% of inflows went to Afghanistan and Tajikistan (UNCTAD, 2012).

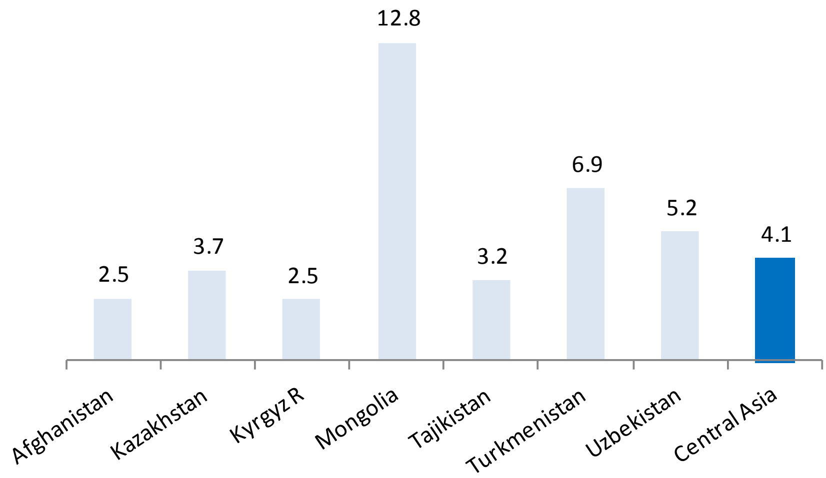
Figure 1.1. FDI net inflows: World and Central Asia (in million USD)



Source: UNCTAD Statistics

Across Central Asia, FDI stocks quadrupled between 2005 and 2011. The highest relative increase can be noted in Mongolia in which FDI strock levels increased 12.8-fold over this period. A significant expansion above the Central Asia average also took place in Turkmenistan (6.9-fold) and Uzbekistan (5.2-fold). In Kazakhstan, stock levels more than tripled stabilising at a relatively high level; in Afghanistan, the Krygyz Republic and Tajikistan stock levels more than doubled, however, only from a very low level. These three countries will require higher growth rates to obtain a significant share of FDI in Central Asia.

Figure 1.2. FDI stock levels in Central Asia in 2011, expressed as multiples of the 2005 levels



Source: UNCTAD statistics

Despite these high growth levels, FDI stocks across Central Asia are mainly concentrated in the mining and energy industries (UNCTAD, 2012). FDI in extractive industries tends to generate only modest increases in local employment levels compared with investments in other, more labour-intensive industries. To maximise the benefits of inward investment for the local economy, Central Asian policy makers will have to find the right policies to attract more 'quality' FDI and strengthen the links between FDI projects and the domestic economy. Further investment policy reforms and investment promotion efforts should therefore be oriented towards sectors in which additional investment may help create benefits for the local economy through increased employment, knowledge transfer and the development of related industries.

Investment policy frameworks have partially improved

Investment policy plays an important role in contributing to an environment that is attractive to investors and that enhances the benefits of investment to societies. The principles of transparency, protection, and non-discrimination in particular are important features of an investment-friendly business environment. In addition to putting in place a sound regulatory framework, the active promotion of foreign investment can also constitute a powerful way to support the overall development and competitiveness of the local business sector. While domestic firms are by far the largest investors in developing and transition economies, foreign investment can support the transfer of technology, skills, expertise and access to international markets.

In order to promote their attractiveness to foreign investment, some Central Asian countries have been active in recent years in improving their investment policy regimes. These have included steps to improve legal protection of investors' rights, such as guarantees against expropriation, offering legal treatment that is equal to that afforded to domestic companies, allowing free and unfettered repatriation of profits and capital and easing restrictions on the employment of foreign nationals. These are positive steps that have resulted in improved investment environments in most Central Asian countries, accompanied by higher levels of inward investment.

However, despite these improvements, there is still scope for further gains. Continuing barriers include the high number of ministries involved in regulating foreign direct investment, lengthy registration procedures and the difficulty of finding reliable local partners. Profit repatriation can also be problematic, as can financing and payment delays. In a number of economies in Central Asia, restrictions on cabotage also continue to create obstacles to air and ground transport, thus inflating transport costs.

One of the tools that can be used to assess remaining barriers to investment is the OECD FDI Regulatory Restrictiveness Index, which focuses on the policy environment for investment and offers a sector-specific assessment of current investment restrictions (see annex). Moreover, it allows for cross-country comparisons and provides a benchmarking tool for measuring reform and assessing its impact. Index data are only available for Kazakhstan, the Kyrgyz Republic and Mongolia. The index indicates that Kazakhstan and Mongolia are roughly in line with the average for non-OECD economies, but are more restrictive than the average for OECD members. The Kyrgyz Republic, on the other hand, is roughly in line with the average for OECD countries, and compares reasonably well with neighbouring economies such as China, Russia and Ukraine.

A second OECD tool that can be used to identify remaining investment obstacles is the OECD Investement Policy Review, conducted in 2011 for Kazakhstan (see annex). The recommendations of the review of Kazakhstan include the suggestion that the government should take steps to ensure that local content requirements are made more flexible and realistic; that local content and expatriate employment requirements should be made more transparent, and complemented by effective supply side policies to increase the quantity of local inputs and raise their quality; and that regular evaluations of policies should be conducted to assess their effectiveness. Improvements to the country's infrastructure would also provide considerable benefits in a country as large and remote as Kazakhstan. In addition, the review recommends measures to improve access to financing for SMEs, steps to improve the consistency and clarity of policy by preventing overlaps when drafting new legislation, increasing public consultation on proposed laws, streamlining the existing institutional framework for investment promotion and improving enforcement of rules protecting intellectual property rights

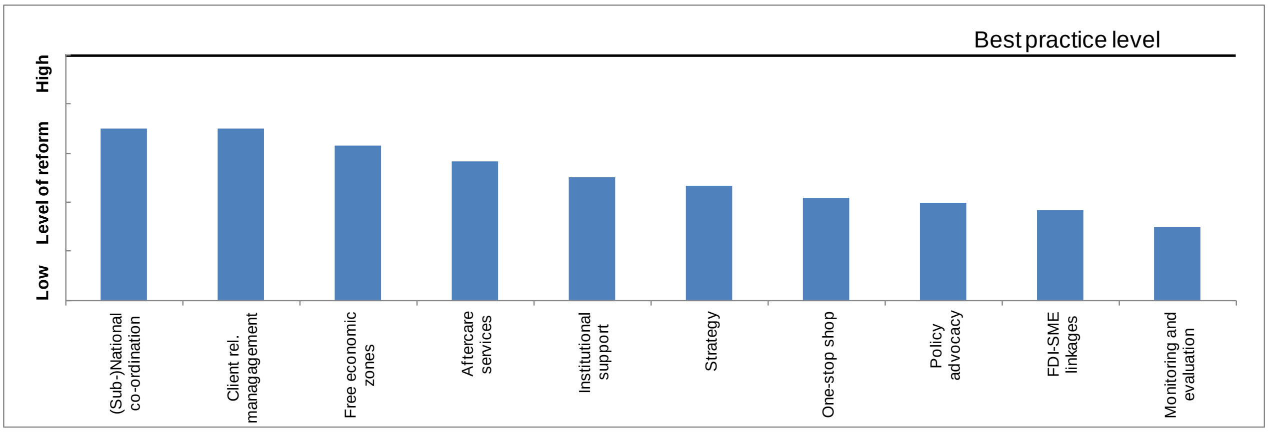
Future policy reviews will examine other Central Asian economies to provide guidance for policy makers on reducing investment policy restrictions.

Need to strengthen investment promotion efforts

In addition to the enhancement of their investment policy, governments can take a number of concrete steps to promote the influx of foreign investment (the "quantity of FDI") and maximise its benefits (the "quality of FDI"). These may include media campaigns, business forums, support through an investment promotion agency, establishing special economic zones, directly contacting potential investors, or establishing business linkage programmes to foster knowledge and commercial linkages between foreign companies and domestic suppliers.

In the first *Central Asia Competitiveness Outlook* (OECD, 2011), the OECD presented the results of a policy assessment on investment promotion reforms carried out among Central Asian policy makers and private sector representatives. Overall, the results showed that investment promotion activities across Central Asia are not yet targeted enough to add true value for foreign investors. Investment promotion agencies in most Central Asian economies focus mainly on marketing activities and providing investor support services. However, to be efficient, agencies should rather create clear links with industrial and competitiveness policies to strengthen a country's competitiveness based on a coherent strategy and targeted policy tools that can help to achieve specific objectives (OECD, 2011).

Figure 1.3. Perceived level of investment promotion reform in Central Asia



1. "Best practice" represents the benchmark used in the assessment which corresponds to the OECD and non-OECD best practice. *High* represents a level of reform that meets best practice, *low* – lack of reform.

Source: OECD *Policies for Competitiveness* Assessment (2010)

One of the key policy tools that governments can use to forge linkages between foreign businesses and local companies to maximise "spill-over" effects supporting economic development are FDI-SME business linkage programmes. The assessment found that investment promotion agencies in Central Asia do not yet use such linkage programmes to actively attract foreign investors while also supporting the development of small and medium-sized enterprises. Schemes that specifically help SMEs benefit from the presence of foreign investors can be introduced at a relatively low cost while showing quick results and long-term benefits. Experience suggest that the facilitation of creating linkages can lead to sustainable business networks which are invaluable to both foreign investors and domestic companies (OECD, 2004).

Chapter 2

How to develop business linkage programmes in Central Asia to promote FDI and job creation

Business linkage programmes (BLPs) can serve as a critical conduit for the transmission of skills, know-how and technology from foreign companies to the local economy. This is relevant in Central Asia where, due to low levels of industry development and resource availability, most FDI has tended to be directed towards resource extraction industries that run very self-contained operations in host countries. For example, Chinese companies often bring their own workers in to work on projects. Consequently, there is little spill-over effect of this investment into local economies in terms of employment, knowledge transfer and related industry development. BLPs, if set up the right way, can constitute an effective way to address this issue. As opposed to more coercive measures, such as local content requirements or import restrictions, BLPs are soft mechanisms that are not ruled out by international trade agreements. Instead of forcing multi-national enterprises (MNEs) to co-operate and share knowledge with local enterprises, the programmes serve as government-sponsored information source and linkage that increases MNEs' business opportunities in the host country.

BLPs must be placed in conjunction with existing FDI strategies

BLPs are part of governments' overall efforts to attract FDI and to improve its positive effects to the local economy. In order to be effective, BLPs must fit into governments' strategic approach and the local environment. Figure 2.1 depicts the location of BLPs within overall efforts to improve the investment climate. BLPs are thus influenced by both a country's strategic FDI attraction, such as a competitive advantage due to abundance in natural resources or a highly skilled workforce, as well as policies that aim at strengthening the absorptive capacities of local enterprises. The latter refers to improvements in local enterprises' technological and managerial capacities, as well as the educational level of the workforce.

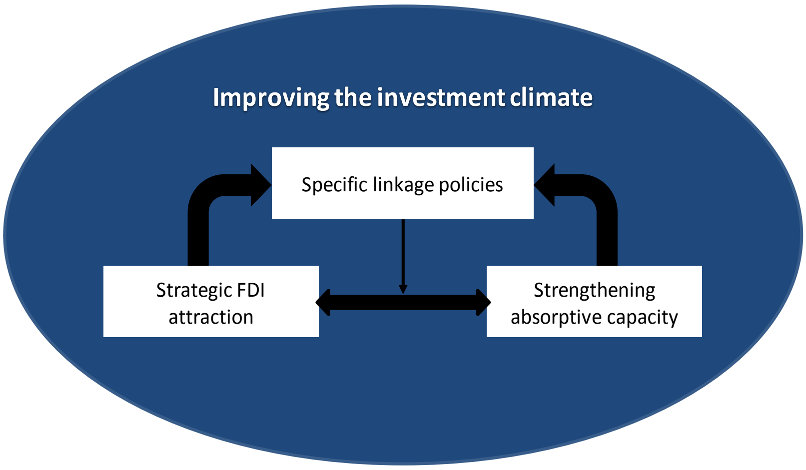
Box 2.1. Case study: FDI strategy and BLPs in Singapore

Singapore is a success story based on its economic growth history that pushed the city state to becoming a developed country. A huge share of this growth is based on FDI, MNEs now account for more than two thirds of the country's manufacturing output. The foundations for the crucial role of FDI were already laid in 1961, when the Economic Development Board (EDB) was established. The board served as a connection point in between different ministries in order to increase FDI inflows in strategic industries. The country has no restrictions on foreign ownership, except in some strategic sectors. However, these requirements were further relaxed in the past years. Generally, investments take place in a stable institutional environment characterized by a low level of corruption. In addition, the country possesses a highly skilled workforce and a good infrastructure, as well as government policy and programmes that started to emphasise the relevance of SMEs beginning in the 1980s.

While many SME-MNE linkages developed naturally due to the high levels of FDI and the educated workforce, linkages were further promoted through government policies, most importantly by the Local Industry Upgrading Programme (LIUP). The programme was established in 1986 and aimed at supporting the transfer of knowledge from MNEs to local SMEs. It is divided in three stages, where the first stage aims at an overall improvement of operational efficiency of SMEs, i.e., making SMEs capable for partnering with MNEs. The second phase is concerned with introducing and transferring processes from MNEs to SMEs while the third and final phase aims at establishing joint product, process research and development with foreign affiliates' partners. The majority of existing MNE-SME linkages evolved from this successful programme, which was initially based in the electronics sector but then expanded to other industry areas.

Source: UNCTAD (2011)

Figure 2.1 Location of BLPs in a general FDI strategy



Source: UNCTAD (2010)

BLPs can be categorised into five main types, namely backward linkages, which are business linkages that occur between MNEs and local suppliers, business linkages to technology partners, business linkages to competitors, forward linkages to customers, and business linkages that result from spillover effects. The first type, backward linkages, refers to MNEs buying products or services from local suppliers. Linkages with technology partners are joint ventures, licensing agreements, or strategic alliances between the MNE and local partners. This type of linkage is beneficial in that it establishes access to technological and managerial know-how for the local firm while MNEs benefit from local partners' access to authorities, institutions, and markets. Linkages with competitors take place when a large entrant into a national market puts incumbent enterprises under pressure to enhance production, distribution and marketing. The fourth type are forward linkages with customers, established through MNEs that outsource the distribution of their brand name products or through MNEs that offer extensive after-sales service. The last type, overall spillover effects, refers to demonstration effects, while there are also human resource spillovers as local employees are trained by MNEs (OECD, 2010).

Establishing BLPs can be a good practice to transform FDI into sustainable quality employment

In the past, a significant proportion of foreign investment in both developed and developing countries has been in the form of "branch-plant" facilities with few linkages to the rest of the local economy. Typically attracted by government subsidies or tax breaks, this type of operation was often self-contained, sometimes even importing the company's own labour force. Such operations provide limited benefits to the host economy, conducting little or no R&D locally and importing components rather than buying from local suppliers. BLPs may provide an effective way to change this relationship, tying FDIs more closely into the domestic economy, encouraging local sourcing of inputs, including labour, and strengthening relationships with domestic firms in research and product development. Linkage programmes produce benefits for the host country, local SMEs and MNEs. For the host country, these include stronger economic activity, higher employment, an increase in local knowledge and capabilities, substitution of imports and an improvement in the balance of payments, and a stronger business sector. For the foreign investor, the potential rewards include lower production and transport costs, increased flexibility, better adaptation to local markets and better access to local markets. Domestic SMEs stand to benefit from improvements in output and quality standards, an increase in know-how and management capabilities, and a more diversified customer base. By increasing the competitiveness and know-how of local companies, BLPs, as well as linkages between local SMEs and MNEs in general, can thus serve as a tool to provide a country with sustainable growth and quality employment. The positive effect of these linkages is not only limited to first-tier suppliers as these SMEs sometimes extend the knowledge transfer to other second-tier suppliers.

Several studies discuss the beneficial effects of well engineered BLPs in developing countries. BLPs are seen as the best tool to enable countries to enhance their competitiveness while gaining access to international markets, finance, technology, management skills and specialised knowledge (UNCTAD (2010). However, these transfers are usually hard to obtain as market failures, financial shortcomings and low quality or lack of experience in dealing with foreign partners may undermine SMEs' abilities to establish meaningful linkages with MNEs. Therefore, government intervention becomes necessary to create an enabling framework for these co-operations (OECD, 2006). Studies underline the importance of adjusting FDI strategies and BLPs to country- and context-specific conditions. In any case, these programmes must be based on local needs and demands in order to be successful (UNCTAD, 2011). While well designed BLPs are beneficial, this is not necessarily the case. Bad designed or intransparent BLPs may enforce established clientelistic networks or particular interests, especially as, by definition, the BLP requires a selection of companies. Kuznetsov and Sabel (2011) thus recommend delegating the implementation of BLPs to an independent agency. Clear and transparent selection criteria are also helpful.

The components of business linkage programmes

BLPs are formal institutions assembling some of the following elements in a consistent manner (Box 2.2.):

Box 2.2. Key elements of business linkage programmes

1. Databases detailing products and capabilities of local SMEs and foreign investors
2. A framework for assessment and selection of participating companies
3. Programmes for skills development (training, curriculum reform)
4. Exchanges with foreign companies (company visits and exchanges, internship schemes)
5. Promotional and marketing services (including matchmaking events, roadshows)
6. Certifications
7. Incentives (tax and other) to encourage participation

Databases are a key component of BLPs. They are an important tool for keeping track of potentially interested companies and their capabilities. Governments can thus facilitate co-operation by gathering and disseminating information on linkage opportunities in one centralised and accurate database. Establishing a database also requires governments to audit SMEs honestly and critically on their potential to co-operate with MNEs.

A framework for assessment and selection of participating companies is necessary to ensure that informed choices are made in the selection of participants to the BLP. It is critical for SMEs to meet MNEs' requirements in terms of quality, performance, delivery and standards compliance. These requirements could thus serve as selection criteria for participating enterprises. A framework for assessment is also an important tool for the evaluation of programmes, as it can be the basis for the development of objective criteria for the measurement of project impact.

Programmes for skills development and human capital development intend to increase the number of graduates in the field in question and to raise qualification by providing training to employees. The development of efficient vocational education and training (VET) systems with programmes that follow modern curricula is crucial to achieving long-term impact and raising the qualifications level of SME employees. As the availability of a skilled labour force with the ability to manufacture high-quality products is often crucial to foreign investors, the VET system plays a key role in facilitating the development of linkages.[2] Besides training in technological skills, the training of managerial capabilities is of high relevance. In addition to fostering technological and managerial skills, the entrepreneurial development and individuals' entrepreneurial capabilities should be assessed and fostered at all levels of education.

Exchanges with foreign companies are another activity frequently conducted within the framework of BLPs. These include study trips and exchanges between domestic SMEs and foreign companies. The goal of these exchanges, and even more so of the internship schemes, is to expose SME managers to international management techniques and establish contacts between local and international firms. Exchanges and plant visits may also serve as

[2] The VET systems and their progress in Central Asian countries are discussed in more detail in OECD, 2012b.

steps toward a matchmaking approach where the government is working closely with both the buyer and supplier in order to reach supply agreements.

Promotional and marketing services are frequently a part of BLPs. This includes the organisation of matchmaking events, road shows, exhibitions and fairs. During these events, foreign companies may establish contact with domestic enterprises from their sector, often supported by the country's investment promotion agency. Promotional services can also serve as a tool to increase both overall and targeted FDI inflows.

Certifications are another element that has an impact on BLPs, especially in technology-intensive areas such as the IT sector. In formalising skills, certificates help international companies find suitable domestic partners. Certificates can also serve as a tool for programme monitoring, as they are a clear indicator and make the assessment of training needs easier.

Tax and other incentives can be another instrument to encourage participation in BLPs. For example, a company participating in a BLP might benefit from a tax break for R&D activities within the linkage programme. Local clusters or business parks with special tax regulation may also induce higher co-operation and linkages between MNEs and local enterprises.

Other factors impact on the willingness of companies to participate in BLPs. These factors include the ease of access to finance for SMEs that could become suppliers or the existence of local content requirements that oblige foreign companies to use a certain percentage of local products or hire local employees. While local content requirements can be a useful tool to strengthen the local economy and facilitate technology transfer, they are outlawed under the WTO trade-related investment measures (TRIMs). Most countries in Eurasia are either members of the WTO or negotiating accession and are thus bound not to implement local content requirements or will be so in the near future.

BLPs are formal institutions combining some or all of the elements listed above. Their shape varies with the sector they target and the approach they pursue. For example, a BLP targeting high growth SMEs in the IT industry might focus on training and skills development, whereas a BLP in manufacturing might focus on organising matchmaking events. There is no single model for BLPs. As a result, programmes can be heterogeneous and difficult to compare.

Box 2.3. Case study: Petrobras and SEBRAE, Brazil

Petrobras, Brazil's semi-public MNE in the energy sector has an ongoing co-operation with the country's Service of Support to Micro and Small Enterprises (Sebrae). The co-operation aims at increasing the competitiveness of local SMEs in areas where Petrobras is operating. The focus on SMEs is especially relevant as they form a huge part of the Brazilian economy; 99 % of formal enterprises are SMEs, they account for 26 % of salaries and 57 % of formal jobs. Funding for the co-operation is split equally between Petrobras and Sebrae. Projects undertaken consist of four elements:

i. The identification and mobilisation of large suppliers and other institutions in the local value chain that can participate.

ii. The evaluation of opportunities and requirements for small suppliers, as well as a research of what potential small suppliers exist and what these suppliers are in need of.

iii. Provision of capacity-building to the local enterprises in co-operation with private and public education institutions.

iv. Facilitation of ongoing co-operation by establishing a network and a database of participating firms.

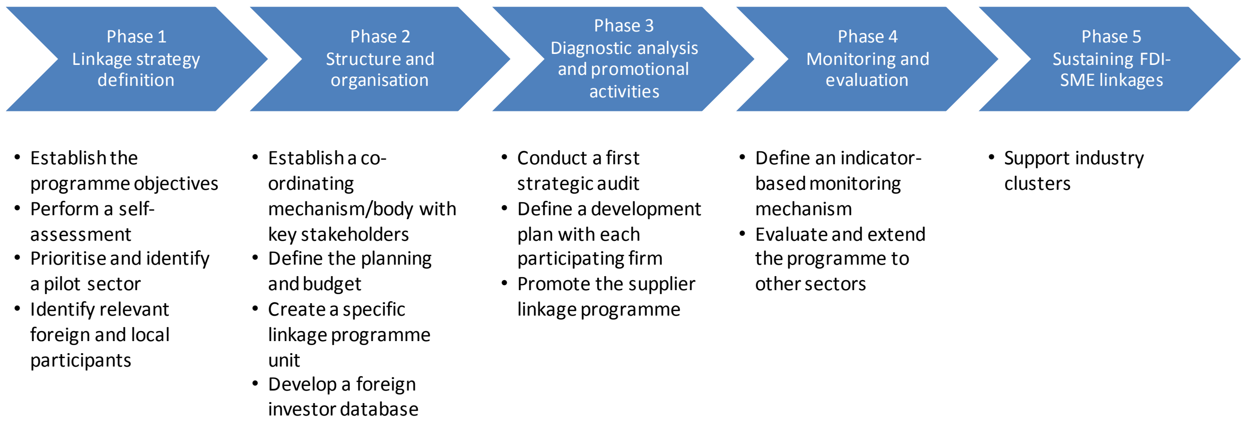
Initiated in 2004, the programme has qualified more than 2,500 SMEs in order to meet the demands for co-operating with Petrobras. Overall, the projects within the co-operation created more than R$ 2 billion (around USD 1 billion) in business potential.

Source: Petrobras (2012), Jerkins et al. (2007)

The process of establishing a business linkage programme

OECD good practice suggests a five-stage approach to developing a business linkage programme. The five stages are illustrated in Figure 2.2. Phase one defines the strategy of the programme by setting its objectives and establishing a process to identify suitable participants, *i.e.* potential local suppliers and foreign enterprises. Phase two proposes an internal organisational structure for the linkage programme. Phase three describes the diagnostic and promotional activities that essentially launch the programme. Phase four outlines the mechanisms that will assist in monitoring the results of the programme. Lastly, phase five examines how linkages facilitated by the programme might be sustained in the long run.

Figure 2.2. The five-stage approach



- Phase 1: Linkage strategy definition

The first phase of a BLP is establishing clear programme objectives. These should focus on such aspects as how the programme will help develop domestic SMEs, promote a specific economic sector or anchor existing foreign enterprises. Phase 1 should also include an assessment of any measures that are already in place and an evaluation of their effectiveness. In order to focus the programme on its policy objectives, a few sectors where private sector interest is highest should be targeted initially. Of these, one sector should be selected as a pilot project and, before moving to other sectors, the programme should be refined. Using a pilot programme allows the selection of the economic sector that has the greatest potential for success and where local suppliers are best suited to meet the needs of foreign investors in terms of the quality of locally produced products and services.

- Phase 2: Structure and organisation

The second phase involves a series of steps to assist in the creation of an operating and organisational structure to implement the BLP. An advisory body should be created in order to provide oversight and direction for the programme. It should include private sector representation, chambers of commerce, government ministries with economic portfolios, investment promotion agencies and the head administrator of the linkage programme. Next, the planning and budget for the linkage programme should be defined, covering operations over a three- to five-year time horizon. Establishment of a team of experts to implement the programme and report to the co-ordinating body should be the next priority, followed by the development of a foreign investors (FDI) database which could be used to track and identify foreign enterprises with an interest in participating in a supplier linkage.

- Phase 3: Diagnostic analysis and promotional activities

Having established the basic operating and organisational structure of the programme, the third stage is to proceed with a diagnostic analysis of the local firms participating in the programme. Concurrently, the linkage programme should be promoted to foreign enterprises by organising activities and events to bring as many potentially interested foreign enterprises and local SMEs together in face-to-face meetings. The purpose of the diagnostic analysis is to identify the areas within the set of selected local suppliers that need upgrading. This involves conducting a first strategic audit of participating local SMEs to identify deficiencies that need to be rectified, followed by the drafting of a development plan that addresses these deficiencies.

- Phase 4: Monitoring and evaluation

The next phase is to develop an indicator-based monitoring mechanism to track the performance of the linkage programme, both in terms of the quantity of contracts generated between local SMEs and foreign investors and the quality of these linkages. Good linkages should increase supplier productivity, improve quality, intensify the amount of technology used and shift the supplier to higher value products, although separating the effect of the BLP from other factors is difficult. A satisfactory evaluation of the pilot scheme can then be followed by the extension of the programme to other sectors.

- Phase 5: Sustaining FDI-SME linkages

The objective at this point should be to strengthen the supplier relationships between investors and local SMEs so that future collaboration can lead to higher value-added business activities. An advanced form of sustaining business linkages involves supporting industry clusters, including encouraging links between participants in the BLP and universities or research institutes. Steps can also be taken to facilitate and support greater business collaboration between foreign companies and local SMEs in product development and innovation.

Overview of business linkage programmes in Central Asia

Even though the concept of BLPs is fairly new to countries from Central Asia, governments from the region consider BLPs as important initiatives. Nevertheless, in most Central Asian countries business linkage programmes have not yet been established or are only in an early stage of development.

BLPs are in place in three countries

Formal BLPs are in place in Afghanistan, Kazakhstan and Uzbekistan. The BLPs in Afghanistan and Kazakhstan pursue a sectoral approach. In Afghanistan, the BLP is in the pilot phase and is currently limited to extractive industries in the proximity of two mines. In Kazakhstan, projects exist for multiple sectors, including tourism, agribusiness, manufacturing, utilities, telecommunications, information technology, R&D, education and health services and the arts and recreational sectors. The BLP in Uzbekistan has no specific sector focus. Stakeholder involvement in the existing Central Asian BLPs is still low. However, in Afghanistan the investment support agency and the chambers of commerce were involved in establishing the database of local SMEs. In Kazakhstan, several government bodies participated in the pilot BLP project, including the Entrepreneurship Development Fund (DAMU), KAZNEX Invest, as well as local chambers of commerce and international investors.

Individual elements often exist even where no formal BLP has been established. In Central Asia, several countries hold databases on SMEs or foreign investors; in the case of the latter, these are often administered by the investment promotion agency. Four economies in Central Asia maintain databases on local companies interested in participating in BLP projects. Uzbekistan collects data on the volume of investment attracted and on the existing business relationships between investors and domestic firms. In Kazakhstan, information on SMEs is split between the National Agency on the Development of Local Content, DAMU and the akimats (local and regional governments). Mongolia has recently launched a project to establish a database of local suppliers. Afghanistan's database is administered by an non-governmental organisation (NGO). Programmes or databases are overseen by the Ministry of Economy (Uzbekistan, Afghanistan), the Ministry for Foreign Economic Relations, Investment and Trade (Uzbekistan), the National Agency for Local Content Development (Kazakhstan), the Tax Service (Tajikistan), the State Statistics Office (Tajikistan) and the Foreign Investment and Foreign Trade Agency (Mongolia).

Promotional activities are generally conducted by the investment promotion agencies of the countries that organise events to promote their country as an investment destination in general. In those countries, where BLPs are in place, the responsible institutions can actively reach out to potentially interested SMEs. This strategy is not as widespread as general promotion events. However, it is pursued, for example, in the case of the Kazakh BLP in the IT industry.

Table 2.1. Status of implementation of business linkage programmes

	Afghanistan	**Kazakhstan**	**Kyrgyz Republic**	**Mongolia**	**Tajikistan**	**Turkmenistan**	**Uzbekistan**
Existing BLP?	Yes	Yes	No	No	No	n/a	Yes
Level of priority	High	High	High	High	High	n/a	High
Sector specific?	Yes	Yes	n/a	n/a	n/a	n/a	No
Information tools	Database	Database	n/a	Database	n/a	n/a	Database
Involvement of stakeholders	Yes	Yes	n/a	n/a	n/a	n/a	No
Promotion activities	No	Investment promotion events	n/a	Investment promotion events	n/a	n/a	Investment promotion events

Source: OECD (2012), Eurasia Competitiveness Programme, Questionnaire completed by Central Asia experts.

Challenges to BLP development in Central Asia remain

All of the countries included in the survey attach a relatively high priority to developing BLPs. But in most economies from Central Asia, projects are still in their very early stages, and developing them further beyond the pilot phase remains a challenge.

A number of issues need to be addressed by Central Asian countries that at present are an obstacle to developing sustainable linkages:

- Most countries need to improve the quality of their local products in order to attract foreign firms. This can be achieved by offering training programmes that help SMEs upgrade the skills of their staff or by aiding SMEs in embracing internationally-recognised quality standards.
- Moreover, information about BLPs needs to be centralised and made available to interested parties. Progress in implementation would also be enhanced if BLP projects received high-level support from policy makers.
- As mentioned above, so far only Afghanistan, Kazakhstan and Uzbekistan have BLP projects in place. Of these, only Uzbekistan’s has been in place for some time. In Afghanistan and Kazakhstan, BLP projects are still in their pilot phase. Before extending these projects to other sectors, the development of an assessment framework would contribute to an objective evaluation of the projects and allow for a more informed selection of future participants.

The following section provides an overview of the status of BLPs in each Central Asian country that participated in the survey, a gap analysis of the main components of BLPs, and country-specific recommendations.

Assessment and policy recommendations: Central Asian countries with already-developed formal BLPs

Formal BLPs have been established in Afghanistan, Kazakhstan and Uzbekistan. The following section provides an assessment by country and gives recommendations on how to further develop existing programmes.

Afghanistan

In BLP development, Afghanistan pursues both a sectoral approach, by linking extractive industries to the local economy, and an economy-wide approach through the donor-funded Building Markets Afghanistan project. For the government of Afghanistan, BLPs are interesting as they are a potential tool to raise local content that is far below international standards at present. The BLP in the mining sector, for instance, is designed as a means to elevate the share of locally produced goods.

Experience with BLPs

In Afghanistan, a BLP with a focus on the mining sector is being established as a pilot project. In terms of organisational structure, the BLP is being overseen by the Ministry of Economy and involves the Afghanistan Chamber of Commerce and Industries and the Afghanistan Investment Support Agency (AISA). A private consulting company is tasked with establishing the project. The plans for this project were presented in 2010 and the BLP will be part of the Afghanistan National Development Strategy. Within the strategy, the government is working on a National and Regional Resource Corridor Programme to develop the infrastructure necessary to take advantage of the country's mineral resources. According to the government's plans, major FDI projects to exploit mineral resources should become the motor of local development. To this end, they include a BLP to develop the capabilities of local suppliers. The "resource corridor" project will include a number of mining and energy projects over the coming years, starting with the development of a copper mine at Aynak and iron ore deposits at Hajigak. As well as the mines themselves, these projects will require the development of rail infrastructure and additional power supplies in order to process and transport the output. In future, the development of the gas field in Sheberghan and oil deposits in Amu Darya could also include associated infrastructure investments.

The aim of the projects associated with the “resource corridor” is to maximise the benefit of the infrastructure investments, by, for example, building branch and feeder lines to augment the main rail routes. Once the infrastructure is established, it will be easier to develop industrial parks and free economic zones along the corridor in a bid to stimulate involvement by local companies.

Specifically, the BLP programme associated with the “resource corridor” will aim to develop the capacity of local SMEs to enter the resource value chain, as well as developing agriculture and agri-business along the corridor. To this end, the BLP will include matchmaking activities and aims to facilitate access to finance for companies participating in the project. The BLP should lead to technology transfer to local Afghan companies and increase the number of SMEs that meet international technical standards. As the project is still in an early phase of its development, more specific information on company selection and assessment is not yet available.

Another BLP was created with the assistance from the Canadian International Development Agency (CIDA) within the Building Markets Afghanistan project under the Peace Dividend Trust. The project’s aim is to support local companies in finding business opportunities and, by facilitating access to locally produced goods, contribute to economic growth and long-term stability. The project has a training component and for training delivery relies on the co-operation of other organisations such as the Afghanistan Chamber of Commerce and Industries. The Chamber, for example, provides training for entrepreneurs on public procurement. In addition, the project promotes matchmaking events with the purpose of facilitating contacts between businesses and informing them about upcoming business opportunities across a wide number of sectors.

Elements of BLP development

Several of the key elements of BLPs described in Box 2.1 (Key elements of business linkage programmes) are present in

Afghanistan, including a database of local suppliers, matchmaking events, certifications, and encouraging foreign investors to source locally (elements 1, 5, 6 and 7, as described below).

- As part of the Building Markets Afghanistan project, a supplier **database** was developed – the Supplier Directory – which contains comprehensive information on local companies according to sector and location. Information is regularly updated and verified by on-site visits. This initiative should be extended to other sectors of the economy.

- **Matchmaking and other promotional events** are regularly organised by the investment promotion agency, AISA. Established in 2003, AISA serves as a one-stop shop for investors and has a network of regional branches to offer services to foreign investors tailored to the specific conditions in the respective regions. The agency's activities include organising investment promotion events and fairs and conducting media campaigns. AISA also initiates matchmaking between investors and local companies (AISA, 2012).

- A key issue in terms of capturing the benefits of resource sector investment will be to ensure that local SMEs are capable of producing products of a high enough quality to meet the requirements of inward investors. To enable this, the government has launched a quality management service to improve and enforce national **standards**.

- Foreign investors in Afghanistan are not subject to a **local content requirement**. However, the NATO Afghan First Policy encourages the preferential use of local content for public procurement, as long as it meets certain quality and security standards. AISA adheres to this policy in its investment promotion activities and encourages foreign investors to source locally whenever possible. In a publication on the Afghan First Policy, NATO states that priority issues to be resolved are the identification of suitable local suppliers, certification and skills development among entrepreneurs if the initiative is to be sustainable.

Progress is still limited on elements 2, 3, and 4 (a framework for assessment and selection of participating companies, a programme for skills development, and exchanges with foreign companies).

- At present, there is no **assessment framework** in place that would facilitate selection of suitable companies in the participation of the planned BLP in the mining sector. Neither have criteria for the evaluation of programme success been defined.
- **Human capital development** in general is considered a key challenge for the government of Afghanistan. The education system has suffered under years of Taliban rule and war, and many people lack basic skills such as literacy. Additionally, there is a severe shortage of qualified workers in many sectors where there is increased demand due to the pace of reconstruction. Relevant for BLPs is the lack of entrepreneurial skills among business owners. Therefore, future projects in Afghanistan would profit from including a training component (for a detailed analysis of the VET system in Afghanistan see OECD, 2012b).
- Regular **exchange programmes and company visits** between local SMEs and foreign investors do not exist.

Recommendations

Early steps in the development of a BLP programme in Afghanistan need to be followed up by further measures. With regard to the OECD's five-step approach, Afghanistan has introduced some of the elements of Phase I (linkage strategy definition), but has as yet not performed a self-assessment of existing measures in place. However, it has identified the mining industry as a promising sector for a pilot programme and has begun to build the necessary information tools.

- As a starting point, an evaluation of existing measures would help to identify current gaps and to establish policy objectives to be achieved through a business linkage programme. These could be formulated in a **strategy** which identifies key economic sectors in addition to the mining industry in which business linkage programmes may have the highest impact on the economy.

- An **assessment framework** could then be developed to identify and assess suitable domestic companies to participate in a linkage programme in the different target sectors, including the mining industry. A corresponding **database** should be established to provide an overview of local companies that can be targeted by foreign investors.

- A **co-ordinating body** would need to be established to oversee the programme. Such a body should include representatives of the various stakeholder groups including the Ministry of Economy, the Afghanistan Chamber of Commerce and Industries and AISA.

- A **skills shortage assessment** should be carried out among the Afghan population, to identify suitable education and training measures that could be emphasised in the development of the BLP. Initiatives in this field would have a positive long-term impact beyond the duration of the programme.

- Identified skills shortages could be addressed through specific matchmaking activities between international companies and local suppliers, including **staff exchange programmes, internship schemes** and **vocational education and training programmes** that would expose Afghan entrepreneurs to international good business practices.

- The government may consider offering **tax incentives** to foreign investors as a means to increase interest in participating in a BLP. However, such incentives should be targeted towards the specific objectives outlined in the strategy and need to undergo a thorough cost-benefit analysis as outlined in the OECD checklist for foreign direct investment incentive policies (OECD, 2003).

Kazakhstan

Several business linkage programmes are in place in Kazakhstan. They focus on areas as diverse as human capital development for the IT sector or fostering access to finance for potential suppliers to oil companies.

Experience with BLPs

Formal BLPs have already been established in a number of sectors in Kazakhstan, including tourism, agribusiness, manufacturing, utilities, telecommunications, R&D, education and health services, and the arts and recreational sectors. A first example of a BLP is a training programme for businessmen, launched by the Ministry of Economic Development and Trade (MERT) and the Entrepreneurship Development Fund (DAMU) in 2011. The “Business Links” programme provides advice and support to companies on forming strategic alliances and joint ventures. This programme focuses on the provision of training to senior managers of SMEs in priority sectors of the economy. After completion of the training, the programme further aspires to support participants in establishing contacts with foreign enterprises. USAID and GIZ participate in these programmes and, for example, provide trainers for the seminars. Formally, training schemes are operated by the private company Turan Profi and financed by DAMU. The programme is designed to provide training to 500 entrepreneurs annually. During the first year of the project, field trips have been offered to participants from the healthcare, food processing, agribusiness and IT sector.

Second, an FDI-SME linkage programme is being established by the Ministry of Transport and Communications with the involvement of other stakeholders. The programme, operated by the Holding Zerde, focuses on the transfer of skills and knowledge from foreign investors to local companies and builds on matchmaking activities. The focus of the project is the IT sector and the majority of its activities are linked to human capital development; this is a key area to build capacity in technology-intensive sectors (see Box 2.2).

A third example of a BLP, operated by the private sector, is the Small Business Development Group (SBD), established by the oil company Tengizchevroil. Supported by the UNDP, the programme's initial aim was to foster SME development and to alleviate poverty in the Atyrau region. More recently, the group's activities have been refocused onto developing entrepreneurship skills and facilitating access to finance for SMEs that could be potential suppliers to Tengizchevroil's operations in the Atyrau region. In partnership with local banks, SBD covers the administrative costs incurred by the bank so that interest-free loans can be provided to select SMEs. According to the UNDP report, at least six SMEs supported within the framework of the project have become suppliers to Tengizchevroil.

Elements of BLP development

Historically, there has been a strong focus on matchmaking between potential investors and local SMEs in Kazakhstan's investment promotion activities. However, more recently the government has adopted a more comprehensive approach to fostering business linkages, including the establishment of education programmes for entrepreneurs, internships schemes at foreign companies and supplier databases.

- A supplier **database** of companies exists in the IT sector for instance, and one covering food processors is under construction. A database of local suppliers working with investors in the extractive industries is already in place under the supervision of the National Agency on Local Content Development (NADLoC). Local governments (akimats) also provide information on local SMEs, based on data collected by DAMU. However, there is no comprehensive database of local firms and foreign investors covering the whole economy.

- In the context of the ongoing project to develop a BLP in the IT sector, there is strong emphasis on **company selection and company assessment.** This will enable the provision of the most relevant development activities to each local company through a technical and managerial assessment process.

- The **training programme** developed as part of "Business Links" consists of a two-week course covering general topics such as business plan development and writing, time management and negotiation techniques. In a second block, participants receive training more adapted to the characteristics of the sector they operate in, with a focus on the legal basis of international trade and how to find suitable foreign partners. Participants also receive support and advice on practical topics such as business planning and the development and presentation of a business project. Tengizchevroil helps develop qualified suppliers by setting up educational forums, providing loans, and working closely with companies to help them adopt international standards. In the context of the IT BLP, the government intends to provide local IT training in collaboration with international IT companies, to increase the technical level of local IT specialists. In parallel, it aims to provide local business and management training to enhance "soft" skills and business processes (Box 2.2.).

- Successful participants in the MERT-DAMU programme have the opportunity to complete an **internship** at a company active in their respective field in either Germany or the US. Project co-ordinators on the side of DAMU advise participants on matters such as technology transfer, joint venture establishment and franchising or application formalities for grants provided by foreign and international organisations.

- **Promotional and marketing services** are carried out by the national agency on investment and export promotion (KAZNEX Invest), which was founded by the government in 2010. Its key tasks are the attraction of investment, the development and implementation of measures to improve the business climate, the creation of a legal framework and other conditions favourable to the attraction of investment, and other issues related to attracting foreign investment. Another institution engaging in matchmaking and other investment promotion activities is Samruk Kazyna Invest, a subsidiary of the sovereign wealth fund Samruk Kazyna (SK). SK Invest organises road shows and networking events and actively promotes investment projects by reaching out to potential investors. SK co-ordinates its activities with the Investment Committee of the Ministry of Industry and New Technology and KAZNEX Invest. However, the division of responsibilities is not always clear. Generally, SK focuses on all areas excluding agribusiness and KAZNEX Invest has a strong SME focus. In addition, in 2011 the government launched a campaign in both the domestic and foreign media aimed at informing potential investors of the opportunities available in Kazakhstan and improving the country's image.

- **Local content requirements** (part of element 7) in Kazakhstan apply to investments in the subsoil sectors and for public procurement. Failure to comply can result in fines or the termination of contracts, which may act as a deterrent to foreign companies.

Box 2.4. A business linkage programme to develop human capital in the IT sector

The government of Kazakhstan is currently starting the implementation of a business linkage programme focusing on human capital development in the IT sector, with the support of the OECD.

Context and rationale

As part of a Sector Competitiveness Strategy project undertaken with the OECD, the Government of Kazakhstan asked the OECD Eurasia Competitiveness Programme to support competitiveness through the development of human capital in the IT sector. The creation of a business linkage programme specifically aimed at developing the IT sector was decided in November 2010.

The IT sector was chosen based on several factors. First, government, foreign firms and local firms need high-quality business services, which creates an opportunity for several segments of the IT industry. Second, growing the currently underdeveloped IT industry could create numerous, high-skilled jobs. Finally, developing the IT industry would induce positive productivity effects on the rest of the economy.

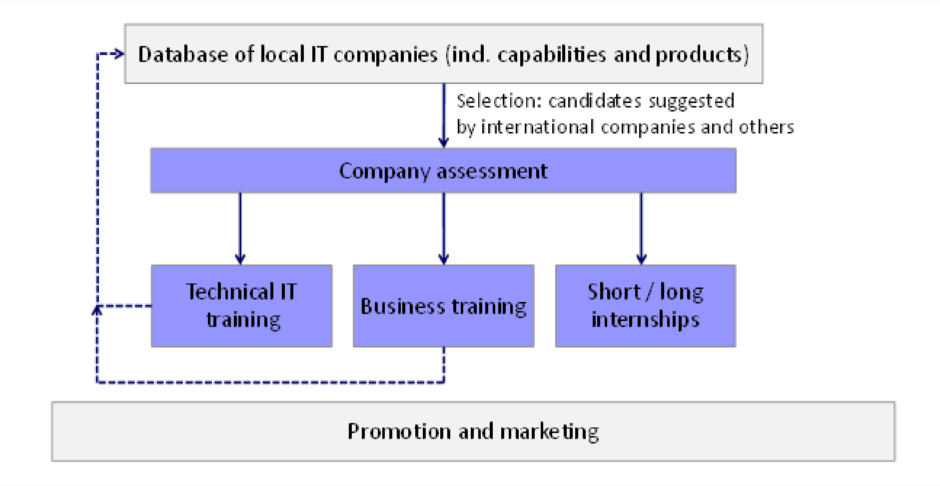
The programme's philosophy is to "walk on both legs", aiming to jointly address two market inefficiencies:

a skills gap preventing international and local companies from collaborating due to insufficient skills in local companies;

an information gap preventing international companies from navigating the local industry, even when the appropriate skills are available locally.

Programme specifics

The programme is made up of six complementary modules, each playing a specific role:



- **database of local IT companies,** including details on most IT companies in the country, to centralise the information on capabilities available;
- **company selection and company assessment** to enable the provision of the most relevant development activities to each local company through a technical and managerial assessment process;
- **local IT training** offered in collaboration with international IT companies to increase the technical level of local IT specialists;
- **local business and management training** to enhance "soft" skills and business processes, which are also needed to close deals with international firms;
- **internships abroad** to expose top management and technical leaders to global business practice, build relationships and develop skills further;
- **promotion and communication** to publicise results achieved and promote the sector.

To enable the programme to evolve and to increase focus, it is designed as a series of 12-month sessions focusing on a limited number of participants. The design of the pilot programme for the first year of operation has been finalised and the programme pilot is currently being set up by National ICT Holding Zerde, under the supervision of the Ministry of Transport and Communications.

Recommendations

Kazakhstan has progressed further than most economies in Central Asia in terms of establishing BLPs. At this stage, it would be useful to conduct an assessment of the effectiveness of measures taken to date and set clear objectives for future BLP development.

- As a first step, a comprehensive BLP **strategy** with clear policy objectives should be defined. Taking a sector-specific focus would allow for a targeted approach tailored to the needs of individual sectors. This approach would also ensure spending limited resources on key sectors with a high impact on economic development.
- At present, informational tools focus mostly on the extractive industry, but could be developed for other key sectors as well. The next step in this process would be the development of a more **comprehensive national database** of enterprises that

are interested in participating in FDI-SME linkage programmes. This will require the identification of potential participants, both amongst local firms and potential foreign investors.

- A **framework for assessment and selection** of participating companies could be introduced in all BLPs, similar to the one in the IT sector. This would allow identifying enterprises based on a transparent procedure and a number of eligibility criteria.

- Continue to systematically include **training** components in the development of BLPs, as in the cases of the MERT-DAMU programme and the Ministry of Transport and Communications IT programme. Programme operators may also want to consider to extend the geographic reach of the programme to suitable candidates outside the Almaty and Astana areas to widen the pool of potential applicants.

- DAMU could advocate for the systematic inclusion of long-term **internships, foreign exchange programmes** and company visits in all BLPs to support implementation of the 'Business Roadmap 2020' which acknowledges that internships abroad may help foster entrepreneurship in Kazakhstan.

- The government could consider clarifying the allocation of responsibilities between KAZNEX and Samruk Kazyna on **investment promotion** activities. The multiplication of different institutions with sometimes overlapping responsibilities is costly and may confuse new foreign investors (OECD Investment Policy Reviews: Kazakhstan, 2012). Sector-specific matchmaking events should continue to be promoted and could be prioritised over economy-wide roadshows.

- **Local content requirements** could be revised in order to make them more flexible and realistic, imposing the least possible cost on businesses. Requirements concerning local content and expatriate employment should also be made transparent, and be complemented with effective supply-side policies to raise the quantity and quality of local inputs.

Uzbekistan

The Uzbek government's focus on SME development in recent years has yielded positive results, notably a rise in SME activity, accounting for 54% of Uzbekistan's GDP in 2011 (2000: 31%) according to official statistics. However, so far efforts to link local SMEs with foreign enterprises have been limited and broadly based, with no sector-specific focus. BLPs in place are part of the State and Regional Investment Programme, the Programme for the Development of Industry, and the Programme on Localisation of Production. The goal of these programmes is the promotion of new technologies and skills, and the strengthening of inter- and intra-industrial co-operation.

Experience with BLPs

An example of a recently established BLP in Uzbekistan is the case of General Motors (GM) Uzbekistan, a joint venture between GM and the Uzbek company Uzavtosanoat, that actively aims to develop local SMEs into suppliers to its plant in the Andijon region. The programme has several components, including a framework for company selection and training. Even though strict quality review procedures apply to all proposals by potential suppliers and the average review process takes six months, over 100 local companies are currrently suppliers to GM Uzbekistan. In order to increase the availability of skilled employees to the automotive industry, Turin Polytechnic University opened a branch in Tashkent in 2009.

The combination of improvements in the legislative regime regarding foreign investors, tax breaks and incentives offered in the country's free economic zones and the investment promotion efforts of Uzinfoinvest has proved relatively successful in boosting FDI in recent years. According to Uzinfoinvest, in 2011 large foreign investors embarked on 144 new investment projects totalling USD 3.3 billion in commitments. This compares with just USD 890 million in 2006.

Elements of BLP development

In Uzbekistan, BLP development has already passed its initial stage. The country is well advanced in the areas of training, promotional activities, and local content requirements (elements 3 and 5).

- BLPs in Uzbekistan typically have **a training** component.
- A strong focus of BLPs in Uzbekistan is on **matchmaking** between investors and local producers. This practice is supported by the investment promotion agency Uzinfoinvest, established in 2007 which reports to the Ministry for Foreign Economic Relations, Investments and Trade. Like most such agencies, Uzinfoinvest is responsible for creating and sustaining a positive international image of the country overseas by pursuing advertising campaigns and promotional events abroad, including exhibitions, forums, presentations, conferences and workshops. The agency's tasks include raising awareness of businesses and the media of the economic and resource potential of the country, providing information to support foreign investors in identifying potential investment projects and guiding them through the legal framework relating to foreign investment. This includes providing information on existing investment incentives and benefits. It also establishes contacts between foreign investors and local entrepreneurs to facilitate mutually beneficial investment projects. The most prominent matchmaking event so far is the International Industrial Fair and Cooperation Exchange that takes place in Tashkent annually. The main goals of the fair are the promotion and showcasing of local products, the establishment of co-operation between international and Uzbek companies and the attraction of foreign investors to the country. In 2011, international companies from 58 countries were represented at the fair.
- Even though **local content requirements** are formally not in place there is a government localisation programme that actively seeks opportunities to substitute imports with locally manufactured goods. Technology transfer and local sourcing are explicitly stated as goals by the government. Local companies receive preferential treatment in public procurement. Additionally, in strategic projects, there is an obligation on the part of the investor to hire and train local

workers. Individual investment agreements generally include obligations on the part of foreign investors regarding the hiring and training of local workers and the use of locally-produced goods.

Progress is still limited with regard to the development of a database, a framework for assessment of companies and certification (elements 1, 2 and 6).

- At present, there is no BLP **strategy** and no monitoring mechanism in place that could help to determine the impact of existing BLPs in the country.
- Despite the existence of BLPs, a **database** of suppliers is not in place in Uzbekistan; neither is a **framework** for the assessment and selection of participating companies.
- **Certification** is not a component of BLPs in Uzbekistan.

Recommendations

Uzbekistan could consider taking the following actions to develop a comprehensive approach toward BLP development:

- Linkage programmes should be associated with a **strategy** that outlines policy objectives and priority actions. Ideally, such a strategy would target pilot sectors which were identified based on their potential to generate a positive economic development impact.
- A **framework for assessing and selecting** suitable companies could be developed, in order to ensure that informed choices are made in the selection of BLP participants. This should be linked to a **database** containing potential suppliers that can be targeted by foreign investors. Such a database should be organised by sector to increase the likeliness of finding a match.
- The impact of **training programmes** offered as a component of BLPs could be further increased if it was complemented by **internship offers** providec by multinational companies and

regular long-term **exchange programmes** with (potential) partner companies.

- Introducing **certification standards** would help signal to foreign investors that local suppliers meet minimum standards such as quality, fairness, and environmental protection. The government could consider undertaking an assessment of relevant international certification standards by sector and introducing those standards in existing BLPs.
- Existing **local content and local hiring requirements** as well as rules regarding the preferential treatment of local companies should be made transparent to not act as a deterrent to foreign investment.
- Should the government consider offering **tax incentives** to encourage the participation of foreign companies in BLP programmes, these should be targeted towards the specific objectives outlined in the strategy and would need to undergo a thorough cost-benefit analysis as outlined in the OECD checklist for foreign direct investment incentive policies (OECD, 2003).

Assessment and policy recommendations: Central Asian countries where formal BLPs have not yet been established

Formal BLPs are not in place in the Kyrgyz Republic, Mongolia or Tajikistan. However, all these countries carry out investment promotion activities that encompass different elements of BLPs. The following section provides a gap analysis by country and gives recommendations on how to further develop existing measures into comprehensive BLPs.

In general, the Kyrgyz Republic, Mongolia and Tajikistan could consider establishing a BLP to support SME development and encourage foreign investment. A first BLP could be a limited pilot programme, with a strict sector focus, in order to make best use of limited resources. Ownership by the participating multinational company is important for success. Therefore, consultations with the companies could take place prior to the launch of the programme to assess their needs and, if possible, the BLP should be designed jointly. Implementation should follow the five-step process (Figure 2.1.) from the beginning, using the informational tools and agencies that have already been put in place as a starting point for the formulation of a BLP programme. The seven key elements of BLPs (Box 2.1.) should be considered carefully. Criteria for project evaluation should be developed, including measurable targets and time-specific goals. These will help ascertain the BLP's effectiveness and enable progress.

The Kyrgyz Republic

The investment promotion activities of the Kyrgyz Republic encompass a number of measures to support SMEs and foreign investors, in particular through investment policy reforms to establish a more favourable policy regime. However, these activities do not have the establishment of FDI-SME linkages as an explicit goal and a BLP has not yet been established in the Kyrgyz Republic. There is no systematic programme to encourage greater foreign investment or to help local SMEs link with foreign investors.

There have been some recent moves to attract investment to specific sectors in the Kyrgyz Republic. For example, the Ministry of Finance has taken steps to create "tourism clusters" by identifying places with tourism potential and "linking controls" to simplify investment in the sector and attract public-private partnerships. However, due to lack of resources further development of the tourism cluster is currently on hold. Despite these plans, no strategy has yet been drafted that could serve as a basis for further measures.

BLP development

While no formal BLP is in place in the Kyrgyz Republic, all elements in Box 2.1., with the exception of element 2 (a framework for assessment and selection of participating companies), exist in the country to some degree. Progress has been made with respect to developing local supplier databases, education, exchanges with foreign companies, skills development and certifications, promotional activities and incentives.

- In a recent bid to boost local SMEs, the government of the Kyrgyz Republic has begun to develop a **database** of local businesses which is in an early stage of development.

- With regard to **education**, large companies regularly participate in VET delivery by providing workplace training for the students of specific VET schools. However, it is mostly major national companies that participate in VET governance. The views of foreign investors or the needs of local SMEs are not regularly taken into account. (For a more detailed analysis of the VET system in the Kyrgyz Republic see OECD, 2012b.) Therefore, the impact of current VET systems on prospective linkage programmes is quite limited at present.

- Large companies offer managers from SMEs the opportunity to gain professional experience through **internship schemes**. Companies offering this opportunity include the engineering company Dastan, the tobacco company Reemtsma Kyrgyzstan, the banks Demirbank and Amanbank, Coca-Cola Bishkek Bottlers, Gazprom Neft Asia, beverage manufacturers Adysh-Ata and Shoro and tea manufacturer Beta Kyrgyzstan International. Kyrgyz entrepreneurs are also eligible to apply for two US programmes aimed at training business leaders and senior and mid-level specialists in companies in the United States: the Special American Business Internship Training Program for business leaders and the Cochran Fellowship Program that is aimed at specialists from the agribusiness sector.

- Internationally recognised **certifications** are awarded to entrepreneurs upon completion of skills development trainings which are carried out with the assistance of international partners. Programmes targeting entrepreneurs are conducted, for example, through the Kyrgyz Republic-Japan Center for Human Development, supported by the Japanese International Cooperation Agency (JICA). There are other projects supported by the German Agency for International Co-operation GIZ and the International Trade Centre (ITC).

- Investment **promotion activities** take the form of events and fairs that are held on a regular basis.

- **Incentives** are in place to attract foreign investors to the Kyrgyz Republic. The Ministry of Economic Development and Trade, which formulates and implements the unified macroeconomic, financial, tax and customs policies of the country, has established four free economic zones (in Bishkek, Maymak, Naryn and Karakol) that offer special legal treatment and provide certain benefits to foreign businesses. These include total or partial exemptions from a range of taxes, duties, levies and charges for the whole period of operation in the Free Economic Zone (FEZ). Export of goods manufactured in the FEZ, import of goods into the FEZ and re-export of goods are totally exempt from any tax duties, quotas or licensing.

Recommendations

Establishing a BLP in the Kyrgyz Republic would complement existing investment promotion activities through a comprehensive approach. A pilot project could initially focus on a low-technology sector – for example the service or tourism sector. Projects in light manufacturing would require more resources and training to meet international quality standards and are therefore more difficult to realise. In the Kyrgyz Republic, the tourism sector might be an area for a first BLP, as the government is committed to promoting the sector and no advanced technology is required.

- Once a pilot sector with high potential economic impact has been identified, a **database** of suitable domestic companies should be set up in order to provide an overview of potential participants. The Kyrgyz government's initiative to develop a database of local businesses could serve as a basis. Selection of participants should be based on a set of clear eligibility criteria and a transparent process.

- The ongoing involvement of national companies in VET governance would be a good way to ensure that **skills** supplied meet labour market needs. Local SMEs should also be involved in the process. In addition to curriculum reform in the VET system, bilateral initiatives such as the ongoing Kyrgyz-Japan Center for Human Development highlight the importance of systematically including a training component within BLPs, as training can help align local skills to international standards.

- The BLP should also promote programmes that facilitate **exchanges** with foreign companies. The two existing programmes which support the training of Kyrgyz entrepreneurs at US companies could serve as a model for the development of **internship schemes** or company visits. These schemes can expose local entrepreneurs to the standards of their international partners.

- **Certification scheme**s could be introduced to help confirm that local suppliers meet minimum standards such as quality, fairness or environmental protection, making them eligible for a BLP. Ongoing initiatives such as the Kyrgyz Republic-Japan Center for Human Development, projects supported by GIZ and the ITC which award internationally recognised certification upon completion of training could serve as a model for future BLP certification schemes.

Mongolia

Although no specific business linkage programme is in place in Mongolia, the country considers the development of a full-fledged BLP a high priority. The necessary groundwork has been started by the Mongolian Foreign Investment and Foreign Trade Agency (FIFTA) as part of its investment promotion activities. There are also examples of business-level measures to encourage investment and other initiatives that could serve as elements of a future BLP.

A potential point of departure for the development of a BLP is the Oyu Tolgoi mining project. At present, more than 450 domestic enterprises are involved in the development of this copper mine. An initiative to support local enterprises is embedded in the larger community development programme of the mining consortium, focusing on the communities around Khanbogd, Manlai, Bayan Ovoo and Dalangzabad in southern Mongolia. The aim of the programme is economic diversification and enterprise development. Its components include training for skills development, product development, marketing and facilitating access to finance. An NGO supports the selected businesses by providing training, facilitating contacts with large enterprises and offering consulting services. In the first half of 2011, 53 businesses received support within the framework of the project.

Elements of BLP development

Even though there is no formal BLP in place, all elements in Box 2.1. with the exception of element 2 (a framework for assessment and selection of participating companies) exist in the country to some degree.

- FIFTA, tasked with promoting Mongolia as a destination for investments, has recently begun the process of developing a local suppliers' **database**. The database will include domestic companies that are actively seeking opportunities to co-operate with foreign investors. Among the data collected are specifications of goods and services provided by SMEs, the capacity of each enterprise and the number of employees. Professional organisations are important partners to FIFTA in gathering information on their members. Initially, the database will focus on companies operating in the three strategic sectors defined by the Strategic Foreign Investment Law (Law of Mongolia on the Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance): the mineral sector (including the oil and gas industries), banking and finance, and media, information and telecommunications.

- Mongolia has prioritised the reform of its system of vocational education and training (VET) in order to equip graduates with **skills** in line with the requirements of the labour market (for a more in-depth analysis of the VET system in Mongolia see OECD, 2012b). Employers are strongly involved in VET provision, granting scholarships, organising and sponsoring or co-sponsoring educational courses and participating in internship schemes. Despite successful attempts to update curricula and the growing awareness of the importance of education, training does not yet play a systematic role in the plans to establish a Mongolian BLP.

- There is no special programme designed to train managers from SMEs in large enterprises or to fund exchange trips abroad. However, some business associations conduct this kind of activity on a small scale. For example, the United Association of Mongolian Employers conducts **training programmes** for SMEs in Germany and the Mongolian National Association of Metallurgy and Machinery Industry supports trips for trainees to Japanese companies.

- In order to promote awareness of business opportunities in Mongolia, FIFTA regularly organises bilateral and international foreign investment and business forums, seminars, round table meetings and exhibitions. During these events, FIFTA organises **matchmaking** meetings among foreign investors and Mongolian SMEs and organisations. In recent years there have been between 15 and 20 such events per year in Mongolia and abroad, including in the USA, the UK, Australia, Italy, Germany, South Korea, the Czech Republic and Japan. During these events FIFTA has promoted the 26 projects identified by the government as being top priority.

- FIFTA and the Agency for Vocational Education and Training (AVET) are involved in plans to introduce national standards to SMEs. Additionally, the adoption of international technical and quality standards is encouraged and supported by initiation competitions on job skills. **Certifications** are given to VET graduates upon completion of the training programme. Higher-level certification awards are issued jointly with the employers.

- **Incentives** for foreign investors exist in Mongolia. Since the 2002 Law on Free Zones, the government has established three free trade zones (Zamin-Uud, Altanbulag and Tsagaannuur) located in areas close to the borders with Russia and China. The free zones offer incentives in the form of lower tax and customs duties. In addition, in June 2012 the Mongolian parliament passed the Strategic Foreign Investment

Law that contains provisions on local content. The law states that local businesses should receive preferential treatment for procurement in the three strategic sectors. However, the exact regulation is still to be specified by government decree. Other restrictions apply to the employment of foreign workers in mining: employers must prove that the foreign employee is a specialist whose work cannot be done by a Mongolian national.

Recommendations

A promising area in which to develop a pilot BLP in Mongolia could be the mining sector. The initial focus could be on developing local suppliers to mining companies. This could help to enhance the role of local SMEs in the fields of transport, maintenance and environmental services.

- Once a pilot sector has been identified, a **database** of suitable participating companies should be created in order to provide an overview of potential participants. The database of SMEs and their products, currently under construction by FIFTA, could serve as a cornerstone of participant selection to the BLP. The selection of participants should be based on clear criteria and a transparent process.

- The ongoing reform of Mongolia's VET system should focus on narrowing the gap between **skills** supplied and skills demanded by companies, both local and foreign. In addition, bilateral training programmes such as those in place with Germany and Japan should be encouraged at the level of the BLP, and could take the form of **internships or company visits**. Such activities can expose local entrepreneurs to the standards of their international partners.

- The Mongolian government is considering putting in place more **local content requirements** in its three strategic sectors. For the exact draft of the regulation, all stakeholders including foreign investor associations should be consulted in order to avoid designing local content requirements in a way that would deter investment. Local content requirements should be complemented with effective supply-side policies to raise the quantity and quality of local inputs.

Tajikistan

There is no BLP being developed in Tajikistan, but some elements are being implemented that could contribute to BLP development at a later stage.

Elements of BLP development

The Chamber of Commerce and Industry as well as the State Committee on Investments and State Property Management play an important role in organising matchmaking and investment promotion events in the form of business forums, fairs and roadshows. The Chamber of Commerce and Industry organises fairs and roadshows to promote Tajik products and participates in major international exhibitions. It is also charged with the mission to enhance the quality of products and to engage in the provision of training to Tajik entrepreneurs.

- **Education and training** is supported by a number of programmes. One key project of the Tajik government is the development of the banking sector, and training provided to bank employees in general and financial management is an important element of the project. Also, a better developed banking sector with a focus on microfinance should facilitate access to finance for SMEs. The education system in Tajikistan is in need of modernisation of facilities and curricula. In the field of VET, there is a lack of qualified teachers and a mismatch between graduates' skills and the requirements of the labour market. As a result, graduates do not find jobs that match their qualifications. This skills mismatch could be countered by providing more training (the VET system in Tajikistan is described in depth in OECD, 2012b).

- **Tax incentives** to foreign investors exist in Tajikistan. The State Committee on Investments and State Property Management is responsible for legislation affecting the foreign investment sector, investment promotion and measures to encourage entrepreneurship. It has established four free economic zones in Pyanj, Soughd, Dangara and Ishkoshim. Companies investing in these zones are given an exemption from profit tax for a period of between two and five years, depending on the size of the investment.

On the other hand, little has been achieved in the way of developing a database of local suppliers (element 1), putting in place a framework for assessment and evaluation of companies participating in a BLP (element 2), exchanges with foreign companies (element 4) or introducing certification (element 5).

- A **database** of local suppliers or foreign investors does not exist in Tajikistan. Also, there is no framework in place that could help selecting participants for future BLPs or in their evaluation.

- **Exchanges with foreign companies** and **internship schemes** are not yet in place. There are no specific **certification schemes** promoted by the government.

Recommendations

Tajikistan could consider implementing a pilot BLP in a low-technology area, such as for example, the service sector. Projects in industry or related sectors require more resources and training to meet international quality standards and are therefore more difficult to realise. The BLP could be run by either the government or a private operator. In the case of Tajikistan, the investment promotion agency Tojinvest or the Chamber of Commerce and Industry should be involved in BLP development, as they already have experience with some BLP elements such as matchmaking and training.

- Once a pilot sector has been identified, a **database** of suitable participating companies should be created in order to provide an overview of potential participants. The national investment promotion agency, Tojinvest, which is charged with encouraging and supporting investment as well as helping to develop local SMEs, could take the lead in developing a database of local suppliers. A framework defining clear criteria for selection of participants should be developed.

- A **skills gap** analysis in the target sector would help to identify skills shortages and skills demanded by foreign companies. The ongoing involvement of national companies in VET governance would be a good way to ensure that curricula are in line with labour market needs.

- Programmes that facilitate **exchanges** with foreign companies should be promoted in BLPs, for instance through internship schemes or company visits. Such programmes can expose local entrepreneurs to the standards of their international partners.

- In order to encourage the participation of foreign companies in BLPs, the State Committee on Investment and State Property Management could consider introducing relevant **tax incentives** in the future based on a thorough cost-benefit analysis as outlined in the OECD checklist for foreign direct investment incentive policies (OECD, 2003).

Conclusion

The countries of Central Asia have taken a wide range of measures in recent years to attract more and better quality FDI. For example, one-stop shops for customs-related procedures have been established, bilateral investment treaties have been concluded and national legislation to guarantee foreign investors national treatment has been improved. All countries covered in this handbook now have an investment promotion agency in place that organises investment promotion events and media campaigns, and offers a wide range of services.

Table 2.2. Status of the application of selected investment policy and promotion tools in Central Asia

IPP Tool	Afghanistan	Kazakhstan	Kyrgyz Republic	Mongolia	Tajikistan	Turkmenistan	Uzbekistan
Business Linkage Programme	Yes	Yes	No	No	No	n/a	Yes
Legislation to protect investors' rights	Yes	Yes	Yes	Yes	Yes	n/a	Yes
Special Economic Zones		Yes	Yes	Yes	Yes	n/a	Yes
Business forums, conferences, road shows	Yes	Yes	Yes	Yes	Yes	n/a	Yes

Tax incentives and exemption from duties		Yes	Yes	Yes	Yes	n/a	Yes
Improved business climate		Yes			Yes	n/a	
Media campaigns	Yes			Yes		n/a	
Support through IPA or other agency	Yes			Yes		n/a	
Directly contacting potential investors		Yes		Yes		n/a	

Source: OECD (2012), Eurasia Competitiveness Programme, Questionnaire completed by Central Asia experts.

However, more emphasis should be put on establishing FDI-SME business linkage programmes as a way to promote foreign investment, and to tie FDIs more closely to the domestic economy. The analysis shows that all countries in Central Asia give a relatively high priority to developing BLPs. However, in practice BLPs exist only in three of these countries and most are in the early stages.

Table 2.3. Status of the application of the seven key elements of BLPs presented in Box 2.1.

Elements	**1**	**2**	**3**	**4**	**5**	**6**	**7**
	Databases	Framework for assessment and selection of participating companies	Skills develop-ment – training	Exchanges with foreign companies	Promo-tional activities	Certification	Incentives – taxes, flexible local content requirements
Afghanistan	Initial stage	Nonexistent	Initial stage	Nonexistent	Good	Initial stage	Initial stage
Kazakhstan	Initial stage	Initial stage	Good	Good	Good	Initial stage	Could be improved
Kyrgyz Republic	Initial stage	Nonexistent	Initial stage	Initial stage	Good	Initial stage	Initial stage
Mongolia	Initial stage	Nonexistent	Initial stage	Good	Good	Initial stage	Initial stage
Tajikistan	Non-existent	Nonexistent	Initial stage	Nonexistent	Good	Nonexistent	Initial stage
Turkmenistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	Non-existent	Nonexistent	Good	n/a	Good	Nonexistent	Could be improved

In establishing BLPs, policy makers in Central Asia should take advantage of OECD guidelines (the five-step approach), based on the experiences and good practices found in OECD and non-OECD countries. In particular, Central Asian governments should consider the following elements for the development of successful linkage programmes:

- BLP development should follow a comprehensive approach, based on a well-designed **strategy** with clear objectives and criteria for project evaluation. Taking a **sector approach** would help focus scarce resources on sectors with a high economic development potential and successful **pilot projects**. Those countries that do not yet have a BLP in place and intend to launch one should therefore consider focusing on one pilot sector first. A pilot project would ideally target the service sector, as technology-intensive projects in manufacturing require significantly more resources and a longer timeframe.

- Information tools, such as **databases** need to centralise relevant information on potential partners , business opportunities and eligibility criteria for the selection process to provide easy access for interested applicants and ensure a transparent process;

- **Training** components need to be included as a main element in all Central Asian BLPs to ensure availability of skilled local employees and to ensure that local production meets international quality standards. The introduction of internationally recognised **certificates** that are awarded upon completion of trainings can help formalise these skills and develop comparable qualifications.

- In all Central Asian economies, **investment promotion** agencies and other institutions should actively promote opportunities provided by BLPs during roadshows, fairs and matchmaking events as a differentiating factor for foreign investors.

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Annex

Implementing OECD tools to assess the investment policy environment in Central Asia

In the first *Central Asia Competitiveness Outlook* (OECD, 2011), the OECD highlighted the need to reform the foreign direct investment (FDI) policy framework further, for instance by implementing two OECD instruments, the OECD FDI Regulatory Restrictiveness Index and the more detailed analytical instrument, the Investment Policy Review:

- The OECD FDI Regulatory Restrictiveness Index is used to identify screenings and other discriminatory approval procedures which may limit inward FDI flows.
- The Investment Policy Review is based on the OECD Policy Framework for Investment (PFI) and assesses the degree to which the country adheres to international standards in its investment policy and how it complies with the principles of liberalisation, transparency and non-discrimination.

Both OECD instruments have been applied in some countries of the Central Asia region to evaluate the investment policy regimes in place, and to measure existing restrictions on the activities of foreign investors that may act as barriers to FDI. The OECD FDI Regulatory Restrictiveness Index applied to Kazakhstan, the Kyrgyz Republic and Mongolia, allows for an assessment of regulatory hurdles to investment by sector. The OECD's Investment Policy Review, conducted for Kazakhstan, constitutes a detailed assessment of the policies governing investment.

Figures indicate that Kazakhstan and Mongolia are roughly in line with the average for non-OECD economies; however there are a number of sectors in which restrictiveness could be reduced. The Kyrgyz Republic, on the other hand, is roughly in line with the average level of restrictiveness in OECD countries.

The OECD FDI Regulatory Restrictiveness Index applied to Kazakhstan, the Kyrgyz Republic, and Mongolia

This section is the result of a project conducted by the OECD Investment Division in order to identify screenings and other discriminatory approval procedures that may limit inward FDI flows. The project was led by Stephen Thomsen of the OECD Investment Division.

The OECD FDI Regulatory Restrictiveness Index focuses on the policy environment for investment and complements the World Bank's indicator by offering a sector-specific assessment of current investment restrictions. Moreover, it allows for cross-country comparison and provides a benchmarking tool for measuring reform and assessing its impact. Of the Central Asian economies, index data is available for Kazakhstan, the Kyrgyz Republic and Mongolia.

Box A.1. The OECD FDI Regulatory Restrictiveness Index

The OECD FDI Regulatory Restrictiveness Index looks at the statutory framework in place in a country at any given time. It measures all discriminatory measures affecting foreign investors, including any restrictions on market access or departures from the principle that foreign investors should be afforded the same treatment as domestic firms. It does not, however, attempt to assess differences in the way rules are actually applied in practice, or the quality of the institutions involved. Nor does it take into account other aspects of the policy environment such as the degree and impact of state-ownership in particular sectors. The index measures four categories of restriction on the activities of foreign investors:

- limits on equity-ownership in individual sectors;
- measures aimed at screening foreign investors;
- restrictions on the nationality of key personnel, such as managers and company directors; and
- any other types of restriction, including those on land ownership and the repatriation of profits.

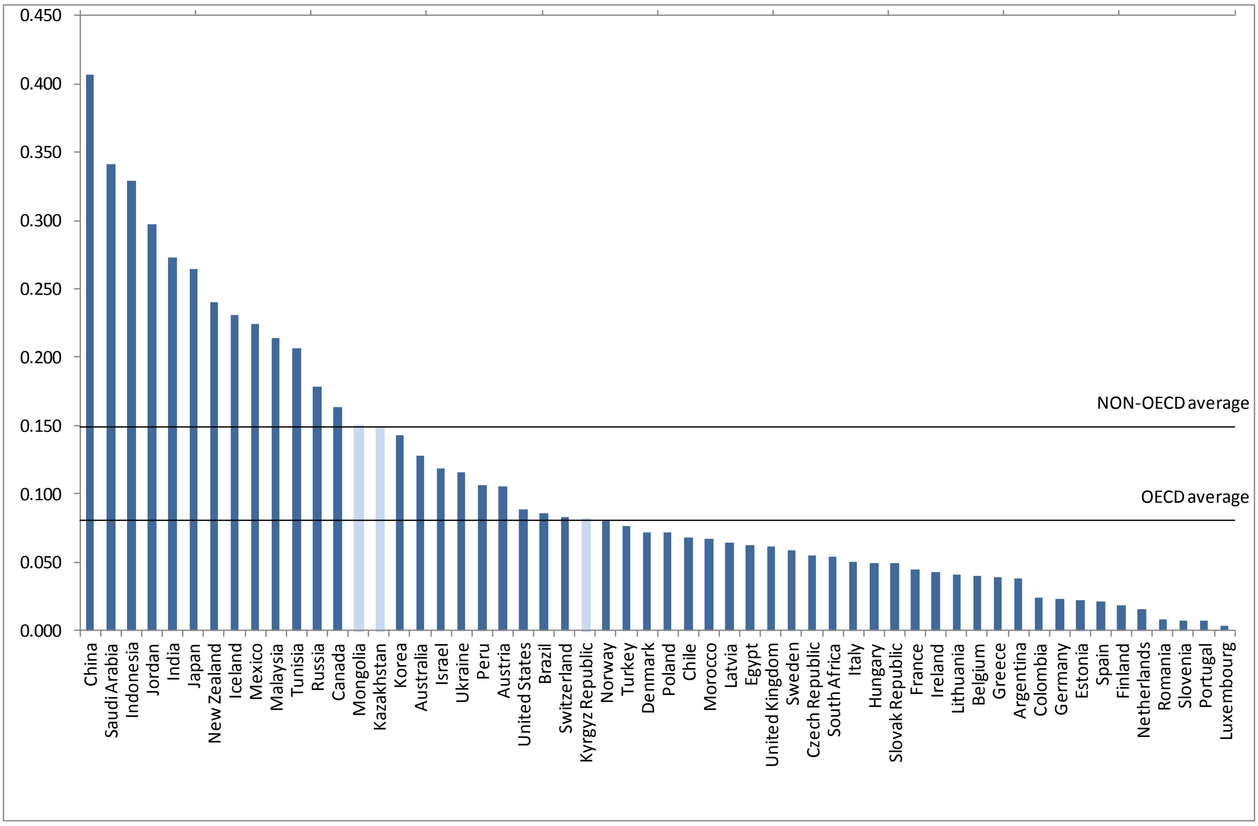
Each of these restrictions is given a score based on an assessment of its importance, and an aggregate score is derived by weighting the scores for individual sectors. The index considers 22 different industrial and service sectors covering most of the economy. It is calculated for a wide range of both OECD and non-OECD countries. The index can be used to compare FDI regulatory restrictiveness across countries or to measure changes in restrictiveness over time. It allows an assessment of the relative success of a country in attracting FDI for a given level of restrictiveness, highlighting whether a country is over or underperforming. It also allows a more dynamic analysis of the effects of liberalisation on FDI flows over a given period.

The FDI Regulatory Restrictiveness Index is calculated for OECD member countries that adhere to the OECD Code of Liberalisation of Capital Movements and the National Treatment Instrument, plus a number of non-members that adhere to the OECD Declaration on International Investment and Multinational Enterprises. In addition, the OECD calculates the index for a number of other countries for which there is sufficient information derived from Investment Policy Reviews and other international sources.

Figures indicate that the Kyrgyz Republic is roughly in line with the average for OECD countries, and compares reasonably well with neighbouring economies such as China, Russia and Ukraine. Kazakhstan and Mongolia, on the other hand, are roughly in line with the average for non-OECD economies, but are more restrictive than the average for OECD members (Figure A.1.). The reasons for these results are analysed in more detail with the help of the FDI

Restrictiveness Index and the Investment Policy Review in the following section.

Figure A.1. Key findings of the FDI Regulatory Restrictiveness Index: The Kyrgyz Republic in line with OECD average, Kazakhstan and Mongolia more restrictive than the OECD average



1. As of September 2012.

2. Closed = 1; Open = 0.

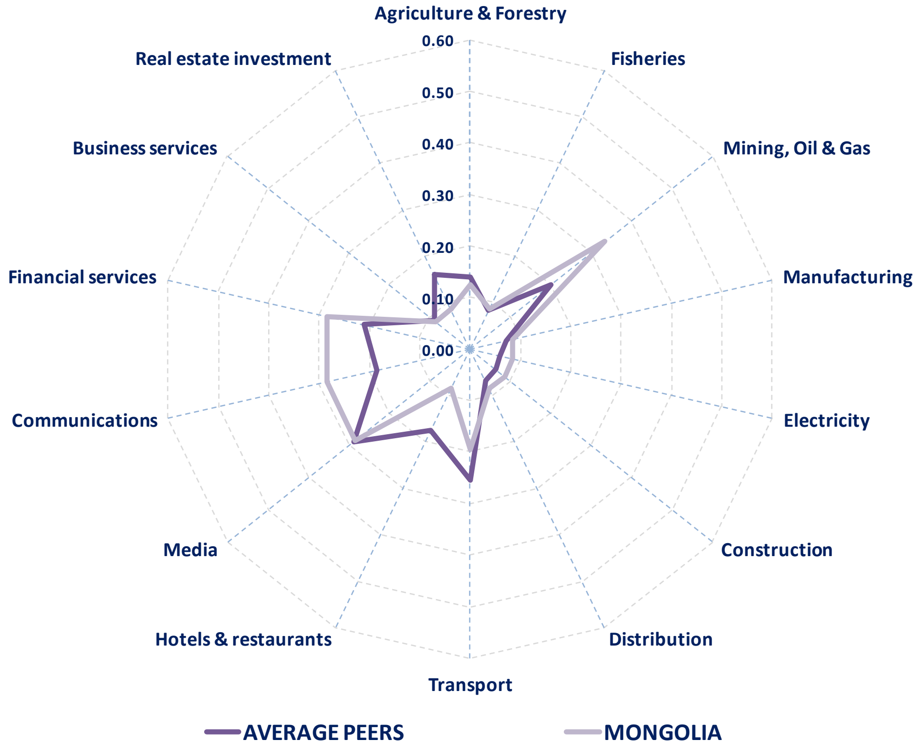
Source: OECD Investment Division.

In **Mongolia**, the main sources of restrictiveness are existing quotas on foreign employment (labour force and specialists), a ban on foreign ownership of land (although leases are possible) and the requirement for local incorporation (a foreign company cannot enter the market through a branch; it needs to establish a subsidiary). The Foreign Investment Law of Mongolia requires all foreign investors to show a minimum of USD 100 000 in assets (cash, working stock, property, etc.) registered in Mongolia as a precondition for registration. In addition, some sector-based restrictions persist in mining and quarrying and in transport.

Concerning the former, only legal entities registered in Mongolia are able to hold exploration and mining licenses (incorporation requirement). In the latter, air cabotage is prohibited, and foreign carriers providing international services cannot operate domestic services.

Additional restrictions were enacted on 17 May 2012 by the Parliament through the Law of Mongolia on the Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance (minerals, including Oil & Gas, Banking & Finance, Media & telecommunications). Government approval is required for the acquisition of, or the right to acquire, 33% or more of the shares in a business entity of strategic importance (BESI) by a foreign investor. Government approval is also required if as a result of a proposed acquisition of an interest in an BESI, a foreign investor has the right, regardless of percentage of equity interest to: (1) solely appoint the executive management or a majority of the board; (2) veto decisions of the executive management or board of directors, or (3) determine or implement decisions and/or operations. Approval from the Parliament is required if a foreign ivnestor is to acquire an interest above 49% in a BESI and the value exceeds 100 billion Mongolian tugrugs (approx. USD 76 million). A notification is required in the case a foreign investor acquires an interest in a BESI of between 5% and 33% (Figure A.2.).

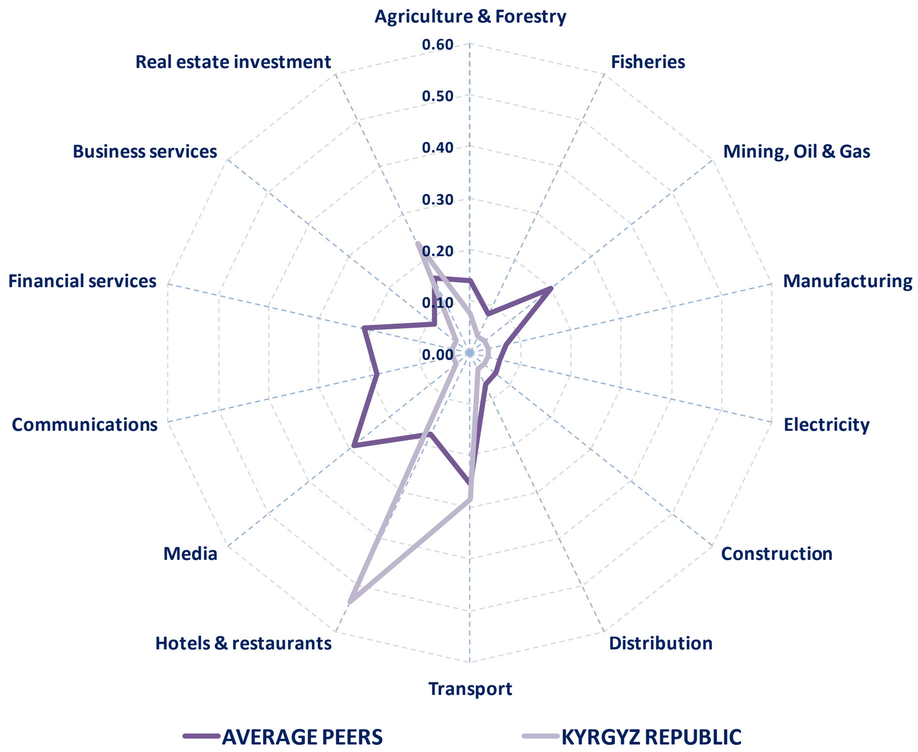
Figure A.2. Mongolia maintains higher FDI restrictions in mining, oil & gas, financial services and communications in relation to peer countries



1. As of September 2012.
2. Peer average includes Russia, Kazakhstan, Ukraine, Mongolia and Kyrgyz Republic.
3. Closed = 1; Open = 0.
4. *Source:* OECD Investment Division

In the case of the **Kyrgyz Republic**, restrictions exist in the following three sectors: transport, hotels and restaurants, and real estate investment. In the transport sector, cabotage restrictions prevent foreign trucks and buses from carrying domestic cargo and passengers. Air transport is subject to a foreign equity cap of 49% (Article 113 of Air Code of the Kyrgyz Republic). In the hotels and restaurants sector, tourism and recreation objects may not be transferred into foreign ownership. In real estate, while foreign persons may lawfully own a property, when buying a dwelling a foreigner has to apply for a permit from the Commission for Habitation Disposal. The application proceedings take two months, as the Commission needs to refer certain enquiries to the enforcement authorities. If there are no grounds for refusal, the applicant will then be granted the permit (Figure A.3.). In terms of horizontal restrictions, the government does not allow the acquisition of land by foreigners (individuals or legal entities) but leases of up to 50 years are possible. Furthermore, government procurements offer preference to locally-owned firms (Law on Public Procurement).

Figure A.3. The Kyrgyz Republic maintains higher FDI restrictions in real estate, transport and hotels & restaurants in relation to peer countries.



1. As of September 2012.
2. Peer average includes Russia, Kazakhstan, Ukraine, Mongolia and Kyrgyz Republic.
3. Closed = 1; Open = 0.
4. *Source:* OECD Investment Division

In summary, the calculation of the Regulatory Restrictiveness Index shows that the Kyrgyz Republic is open compared to their peers; the country is close to the OECD average on the index. The analysis indicates that regulations do not constitute the most serious hurdles to FDI attraction in the Kyrgyz Republic. In Mongolia, the calculation shows that the country introduced higher

FDI restrictions in sectors of strategic importance; the country is more restrictive than the OECD average and close to the non-OECD average. If governments are planning to raise restrictions towards investment, like Mongolia at present, they should do so using international good practice in order to minimise the burden on investors. Beyond regulations, both government should also focus on other issues that could have a negative impact on FDI, such as implementation of rules, transparency and corruption. Generally, reforms with the biggest impact on FDI would be those targeting the business environment. It is towards these areas that the government should direct their policy reforms in order to maximise theinvestment inflows and the benefits of FDI.

The OECD Investment Policy Review of Kazakhstan

Summarised from OECD (OECD 2012), OECD Investment Policy Reviews: Kazakhstan 2012*, OECD Publishing. Based on the OECD Policy Framework for Investment, it assesses the country's ability to comply with the principles of liberalisation, transparency and non-discrimination and to bring the investment agenda closer to recognised international standards.*

The OECD Investment Policy Review is a second tool used in evaluating investment policy regimes. In 2011, the OECD conducted its first review of a Central Asian country. The review was prepared in close co-operation with the government of Kazakhstan. It highlights the positive role that FDI has played in helping the economy to recover from the economic downturn it suffered after independence but also notes that there remains further work to be done in terms of improving the investment environment and reducing FDI restrictiveness.

Progress has been achieved in the areas of administrative procedures and regulatory reform in recent years

Kazakhstan has taken a number of steps in recent years to improve the investment environment. These measures included reforms to ease the burden of red tape and simplify administrative procedures. The 2007 Licensing Law reduced the number of licensed activities from more than 400 to 100 and requires that licensing requirements for any new activity should be established by law. In

2008, the government began a process of regulatory reform to simplify the registration and permit systems, and to streamline licensing, certification and accreditation procedures. State registration was simplified in 2010, making it easier to establish and operate SMEs. These measures included a more straightforward system of registration for small enterprises. Under the new system, the government set a target of being able to register branches and representative offices in no more than one working day. It also reduced minimum capital requirements for new companies to very low levels (USD 1 000 for limited liability companies). The government has also reduced the number of registration procedures from 8 in 2008 to 6 in 2011 and the time required to perform them has declined from 21 to 19 days.

However, restrictions remain for foreign investors

However, despite foreign companies enjoying the same legal rights and protections, some restrictions remain. The constitution provides foreign companies with the same rights and protections as domestic firms but leaves room for other legislation to override these provisions. Although investors can repatriate profits freely, there are still some restrictions on incoming investment. For example, although investment is welcomed in most sectors, there are equity limits on foreign ownership in the fixed-line telephony, mass media, and air transport and pension fund industries. Foreign entities are also not allowed to own agricultural land (although leases are possible), and there is a local incorporation requirement in the maritime transport sector. Local content requirements – rules that require multinational firms to use a certain percentage of locally produced goods or local services – are applied to some sectors in Kazakhstan. Local content requirements are bound to increase the local benefits of FDI, including by leading to technology transfer; however, some firms have found them difficult to comply with as in some industries the share of local content required can be as high as 90%. Although Kazakhstan has an Investment Law from 2003 governing both foreign and domestic investment, many other pieces of legislation concern foreign investors. In the oil and gas sector, for example, the main laws and regulations governing the sector are the Subsoil Law and the Tax Code. Other prominent legislation includes the National Security Law, Laws on Arbitration, the Law on Special Economic Zones and rules on hiring foreign personnel.

In addition, there is room for improvement in obtaining work permits and facilitating the employment of foreign workers. In February 2011, the government adopted amendments to existing legislation that tightened the rules governing work permits. These included a ban on the secondment of foreign staff and lower limits on the permitted level of foreign staff. As of 2012, foreign employees in category 1 (executives and technical experts) are limited to 30% of the total. For category 2 and 3 employees (managers, specialists and skilled workers), only 10% can be foreign staff. Investors frequently struggle to find enough qualified staff to meet these requirements and to find suitable local suppliers to meet content requirements for other inputs.

These remaining restrictions are part of the reason that Kazakhstan scores 0.137 on the OECD FDI Regulatory Restrictiveness Index on a scale of 0 to 1 (0=open; 1=closed), which is better than China or Russia but worse than Ukraine and some of the other Central Asian countries.

Further improvements are needed on investment incentives, infrastructure and access to finance

The Investment Policy Review of Kazakhstan identified a number of policy recommendations and options. These include:

- ensuring that local content requirements are made more flexible and realistic, imposing the least possible cost on businesses;
- ensuring that requirements concerning local content and expatriate employment are also transparent, and complemented by effective supply-side policies to increase the quantity of local inputs and raise their quality;
- conducting regular evaluation of policies to assess their effectiveness.

The review also urged the government to adopt international good practice regarding investment policies related to national security. Although the government is obviously keen to safeguard national security interests, policy should be designed and implemented to ensure the smallest possible impact on investment flows. In this respect, it should be guided by the principles of non-discrimination, proportionality, transparency and accountability as recommended by the OECD Guidelines for Recipient Country Investment Policies Relating to National Security adopted by the OECD Council in May 2009.

The review recommends that foreign investors should be allowed greater access to land in the agricultural and forestry sectors, given that agri-business is a priority sector but that Kazakhstan has more regulatory restrictions than the OECD average in this area. It also recommends that the government continues to pursue its reform agenda in the telecommunications sector and allows the sale of shares in major banks to foreign investors.

Investment incentives also need to be made as transparent and cost-effective as possible, including those that apply in Special Economic Zones (SEZ). The OECD's *Checklist for Foreign Direct Investment Incentive Policies* (2003) provides guidance for governments to carry out a thorough analysis of the costs and benefits of the incentive system in place. The need to reduce corruption is another priority area. Kazakhstan is a party to the Istanbul Anti-Corruption Plan, which recommends measures such as enhancing law enforcement, improving the independence of the judiciary and increasing transparency in public procurement. The OECD also recommends steps to improve corporate governance in state-owned companies, particularly in view of the size and influence of the public sector in Kazakhstan.

Improvements to the country's infrastructure would provide considerable benefits in a country as large and remote as Kazakhstan. Existing infrastructure is inadequate and outdated, and infrastructure investment is a key priority of the government. However, the process has so far been relatively slow. In this regard, involving private sector investors in infrastructure projects, including through the use of public-private partnerships (PPPs), would be beneficial. Private investment capital could provide the necessary financing to accelerate the process of upgrading existing infrastructure.

The review also recommends measures to improve access to financing for SMEs, which currently play a smaller role in the economy than in OECD countries. In addition, it suggests steps to improve the consistency and clarity of policy by preventing overlaps when drafting new legislation, increasing public consultation on proposed laws and streamlining the existing institutional framework for investment promotion. Better enforcement of rules protecting intellectual property rights would also help to encourage inward investment.