Do Initial Conditions Matter? A comparative analysis of SME Development in Russia, Kazakhstan, and Uzbekistan

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Abstract

This paper considers the economic factors behind major differences that emerged in the extent of development of SMEs in Russia, Kazakhstan, and Uzbekistan during the transition period. Taking into account problems of the Soviet-type centrally planned economic system as its initial conditions and using primary sources including laws and regulations, as well as data sources including the national statistical agencies for each country, the paper analyzes the determinants of development trends for SMEs across these three countries.

Special attention is paid to macroeconomic factors such as the initial level of development of cooperatives, the impact of transition policies on business activity, the initial level of industrialization, and some demographic factors related to both demand- and supply-side determinants of entrepreneurship that are implicated in either inhibiting or promoting SME development during the transition period in each country.

1. Introduction

Under the *perestroika* (restructuring) policy of the Gorbachev regime, which came to power in 1985 as the socialist economy was stalling, the Soviet Union began to move in the direction of introducing market elements into its centrally planned economy with a subsequent liberalization of economic activity. With regard to small and medium-sized enterprises (SMEs), when the Law "On Individual Labor Activity" came into effect on November 19, 1986, Soviet Union citizens were given the right to undertake economic activity for the purpose of profit. It was also decided to introduce new forms of ownership other than solely existed national ownership.[1] The legal equality of each of these new forms of ownership was also recognized.[2]

All this triggered a huge wave of entrepreneurship in the form of private economic activity of SMEs — the so-called "new small forms of management (*novie malie formi hozyaistvovaniya*)", further strengthened by enactment of a series of additional laws[3] and focused mainly on certain economic spheres such as light industry, catering, trade, housing management and public services, etc. that had been previously neglected under the socialist period. In particular, with the enactment of the Law "On Arenda (Leasing)" and the Law "On Cooperatives" in 1989, a significant number of employees ended up working for *arenda* (leasing) enterprises[4] or cooperatives that fell under the SME category.

This trend continued after the collapse of the Soviet Union in post-Soviet Central Asian countries such as Uzbekistan and Kazakhstan, while it subsequently weakened in other post-Soviet countries after 1994, especially in Russia, leading to major discrepancies emerging in the development of SMEs.

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[1] These new forms included citizen ownership, collective ownership (ownership by leasing enterprises, cooperatives, social and regional organizations, etc.), mixed ownership, and ownership by international organizations and foreign corporations.

[2] See Nishimura Y. (1995; p.114) for the details.

[3] These include the Law "On State-Owned Enterprise" (June 30, 1987), the Law "On Cooperatives" (May 26, 1988), the Law "On Arenda (Leasing)" (April 7, 1989), the Decree of the USSR Council of Ministers "Regulations on Joint Stock Companies and Limited Liability Companies" (June 19, 1990), the Decree of the USSR Council of Ministers "On Measures for the Development and Establishment of Small Enterprises" (August 8, 1990), the Law "On Ownership" (March 6, 1990), and the Law "On Enterprises" (June 4, 1990), among others.

[4] Arenda (leasing) enterprises are companies that engage in economic activity by leasing out fixed assets belonging to state-owned enterprises.

23 years have passed since the collapse of the Soviet Union and the declaration of independence by its former Soviet republics, which each chose to adopt political policies aimed at establishing the democratic rule of law based on a developed market economy. In the same way as for other post-Soviet countries, in Russia, Kazakhstan and Uzbekistan the implementation of transition reforms was accompanied by profound turning points in the political, economic and social spheres. During this transition from a centrally planned to a market-based economy, different economic approaches were adopted by the governments and reforms were implemented at differing speeds,[5] but the governments of the three countries shared a common ultimate goal — recovery of economic vitality through the development of SMEs, with special attention paid to reducing consumer goods shortages, structural imbalances and distortion of price systems, improvement of X-inefficiency and efficient redistribution of economic resources through promotion of new entry and competition (UN, 1995; Gibb, 1995; Smallbone and Welter, 2001; McMillan, 1995; Svejnar, 1991 etc.).

Notwithstanding these common goals, trends in the development of SMEs among these three countries subsequently diverged greatly. Moreover, very little prior field research has been conducted with regard to the reasons behind these huge divergences. The determinants of SME development remain unclear despite the significant role they have been credited with in the shift to a market economy.

Frequent amendments of data by the official statistical authorities in these three countries, as well as restrictions on the kinds of information publically released during the transition, partly explain the lack of comparative previous studies in this regard. Moreover, the role played by initial conditions as a determinant of SME development in these transition economies has not been the subject of specific focus.

Therefore, while taking into account various problems of the Soviet-type centrally planned economic system as its initial background, this paper considers the economic factors behind major differences which have emerged in the extent of development of SMEs in Russia, Kazakhstan, and Uzbekistan during the transition. Moreover, since microeconomic data is not

[5] Russia embarked upon a "shock therapy" approach as a transition strategy, with radical promotion of macroeconomic stabilization, privatization, price and trade liberalization. In the same manner, Kazakhstan was also pro-active in promoting transition reforms at a very fast pace. By contrast, the government of Uzbekistan preferred gradual approach in transition reforms, continuing to maintain a huge share of the economy as a state-owned sector.

available for business entry rates corresponding to early years of transition, this paper approaches this problem from the perspective of comparative economics, focusing on macroeconomic factors for the period of analysis (1991 to 2007).

This paper is organized as follows. Section 2 describes some differences observed in the legal definitions of SMEs and the effect these differences have on comparative analyses of SMEs among the three countries. Subsequently, the author undertakes a comparative analysis of SME development trends and levels of attainment in the three countries. In Section 3, the author examines the key macroeconomic factors that exerted significant impact on the development of SMEs during the early transition period. Finally, the author discusses this paper's conclusion, as well as identifying some research challenges that remain.

2. Trajectories of SME development during the transition period

In order to build an understanding of statistical differences observed in the development of the SME sector during the period of transition, the author first describes the differences in the definitions of SMEs in Russia, Kazakhstan, and Uzbekistan, and then considers the impact of these definitional differences on the comparative analysis of SMEs in these three countries.

2.1 Differences in definitions of SMEs

The official definitions of SMEs in Russia, Uzbekistan, and Kazakhstan were first established by laws and regulations in the early 1990s, and were amended several times thereafter. In Russia, legal provisions relating to SMEs were first established at the close of the Soviet era with the Resolution of the Council of Ministers of the Russian Soviet Federated Socialist Republic (RSFSR) of July 18, 1991, No. 406 "On Measures on Support and Development of Small Enterprises in the RSFSR". This Resolution set forth the newly established rights of enterprises. Companies with fewer than 200 employees in the industrial production and construction sectors, fewer than 100 employees in the science and scientific services, fewer than 50 employees engaged in other production activities, and fewer than 15 employees engaged in retailing, catering and other non-production activities were legislatively defined as Small Enterprises (SEs). Later, the employment limitations for SEs were modified

by the Law "On State Support of Small Enterprises in the Russian Federation" of June 14, 1995.

It should be noted that the same Resolution No. 406 established registration and bankruptcy proceedings and re-registration of existing economic entities as SEs, as well as the implementation of special taxation for SEs, all of which were “as stipulated by the RSFSR’s Law “On Enterprises and Corporate Activity”. Also, with the introduction of accelerated depreciation and tax exemptions for SEs, state agencies planned to share business information and offer other kinds of business support (including provision of production equipment) to SEs. However, this decision did not define specific details of the support measures for small enterprises activities — these were only described “as stipulated by law”. Moreover, since the aforementioned details were not also defined by any other Russian laws or regulations (these were links simply leading nowhere), in practice, SEs had to be handled in the same way as other economic entities. Therefore numerous additional laws and regulations were subsequently enacted.

As for Uzbekistan, the Law of the Republic of Uzbekistan “On Enterprises” as well as the Decision of the Council of Ministers “On Measures for the Continuous Development of Enterprise Activity” dated February 15, 1991, generally regulated all enterprises at the time, including the business activities of SMEs. However, the section related to the business activities of SMEs was defined only in very vague terms. For example, the second paragraph of Article 2 stated that “provisions relating to SMEs are to be determined by the government of the Republic of Uzbekistan” without specifically describing these business activities. In other words, since this Decision did not provide a definition or any other regulations specifically for SMEs, these were essentially handled in the same way as under the Council of Ministers Decision “On Measures for the Development and Establishment of Small Enterprises” established during the Soviet era.

Similarly, the Republic of Kazakhstan enacted the Law “On Protection and Support of Private Enterprise Activity” dated July 4, 1992. It regulated business activities of SMEs, but this Law also lacked any particular definition of SMEs. However, in contrast to Uzbekistan, this Law did classify “individual entrepreneurship” as a form of private economic activity (Article 4, paragraph 1).

Therefore, the governments of these three post-Soviet countries continued to further elaborate the legal framework and principal laws governing SMEs were subsequently enacted, which granted a legal foundation for the business activities of SMEs. These included Article 3 of Federal Law No. 88 “On State Support for Small Enterprises in the Russian Federation” (dated June 14, 1995; revised July 24, 2007); Article 3 of the Law “On State Support of Private Entrepreneurial Activity ” in the Republic of Kazakhstan (June 19, 1997), which was revised under Law No. 124-111 “On Small Enterprise Activity” (January 31, 2006); and the Law “On Additional Measures to Develop and Promote Small And Medium Enterprises” in the Republic of Uzbekistan (dated April 9, 1998; revised August 31, 2003).

An outline of the various definitions of SMEs as defined in these laws and regulations is given in Table 1. It must be noted that neither Kazakhstan nor Russia offered any definition of “Medium Enterprise (ME)” — both small and medium-sized enterprises were lumped together as “Small Enterprises” in these countries.[6] Moreover, in all three countries, those SMEs obliged to register with the state (including agricultural enterprises) are handled separately from those individual labor concerns able to engage in economic activity without needing to establish a legal company (including individual agricultural farms).

Furthermore, the following differences in the legal SME definitions among the three countries should be considered during performing the comparative analysis. First, as Table 1 shows, in both Russia and Uzbekistan the legal upper limit on the number of employees needed for recognition as an SME is defined as 100 employees (although this varies according to the industry), whereas in Kazakhstan the upper limit is a universal 50 employees regardless of industry—a scant half of the other two countries.

Second, classification of SMEs according to scale of enterprise is only undertaken in Uzbekistan, with SMEs in Uzbekistan being further subdivided into three groups: medium, small, and micro enterprises. In addition, Uzbekistan is the only country among these three lacking regulations on capital investment ratio: that is, restrictions on ownership by non-SME entities (such as government agencies, large companies, or foreign corporations). In

[6] The official definitions of SMEs vary under the laws of the three countries as described above, but for convenience of reference, this paper refers to all these as "SMEs," including those in Russia and Kazakhstan.

Kazakhstan and Russia, the total limit on ownership share by non-SME entities is required to be less than 25%.

Third, only Kazakhstan has regulations relating to ownership of small enterprises (general partnerships, limited partnerships, additional liability companies, limited liability companies and manufacturing cooperatives). These have not been established in Uzbekistan or Russia.[7]

Due to these various differences in definitions, when comparing the size of the SME sector in the three economies it is important to note that SMEs in Kazakhstan will tend to be underestimated in comparison to Russia, and that SMEs in Uzbekistan will tend to be overestimated in comparison to the other two. In other words, certain cases would be excluded from the small business statistics due to the capital ratio regulations of Russia and Kazakhstan despite belonging to the SME category in terms of scale; thus, if comparison is made purely in terms of scale, SMEs in both countries will tend to be underestimated when compared to Uzbekistan. In addition, since joint stock companies etc. are excluded under the regulations on types of ownership in Kazakhstan, the scale of the SME sector in Kazakhstan will tend to be subject to further underestimation.

Taking into account these definitional differences, in the next section the author seeks to grasp the differences that occurred in the levels and trends of SME sector development in these three countries.

2.2 Presence of SMEs in national economies

Firstly, if we look at the presence of the SME sector within each national economy a decade after the start of transition (in 2002), it is clear that Uzbekistan was foremost among the three countries, with its SME sector accounting for 34.6% of its GDP and 53.5% of its total number of workers (see Table 2). In contrast, in Russia and Kazakhstan both these figures remained relatively low, with SMEs accounting for no more than 23% of GDP and no more than 18% of total number of workers for each country.

However, in light of the differences in definition among the three countries as described above, the SME sector of Kazakhstan may have been underestimated here. If we were to

[7] In Russia and Uzbekistan, all ownership of companies belongs to the SME category.

calculate the percentage of SMEs using the quantitative criteria of "fewer than 100 employees" (as in Russia) to define an SME, instead of Kazakhstan's actual upper limit of "fewer than 50 employees", the share of SME sector in its GDP would probably increase to more than 22.4%, bringing it much closer to the share of SMEs in Uzbekistan.[8] Considering also that the SME sector of Kazakhstan tends to be underestimated due to differences in the types of ownership (joint-stock companies are not included in SMEs), we can imagine that the actual scale of SMEs in Kazakhstan is even closer to that of Uzbekistan. Russia continued to show the lowest level of the SME sector development among the three countries. Moreover, this ranking of the levels of SME development among the three countries showed no change 15 years after the start of transition. In 2006, SMEs accounted for 42.1% of Uzbekistan's GDP and 69.3% of its total number of persons employed in the economy, with these figures being 22.0% and 31.8% respectively in the case of Kazakhstan, while Russia still had the lowest levels at 20% or less.

Moreover, the data on SME sectors announced by each State Statistical Agency actually include individual farms and individual labor activity. If individual farms and individual entrepreneurs are excluded from data calculations for SMEs, the presence of SMEs in the economy of each country would be even smaller. As Table 3 shows, if we calculate in this way Russia still has the lowest GDP share of SMEs, with a level not exceeding about 12%. Even in Kazakhstan, although the GDP share of SMEs temporarily increased to 18.0% in 2004, this subsequently declined and has not demonstrated stable growth thereafter. In contrast, in Uzbekistan, the share of SMEs as a percentage of GDP continued to expand, reaching 23.5% in 2006.

As described above, among these three countries Uzbekistan overwhelmingly has the greatest presence of SMEs within its national economy—even after taking into account statistical differences due to definitions, it is highly probable that Uzbekistan's SME sector has achieved the highest level of attainment among the three countries during the first 15 years of transition. On the other hand, it has become clear that Russia has the lowest level of SME development, even lower than Kazakhstan.

[8] However, since the data for companies in Kazakhstan with fewer than 100 employees have not been published, an exact calculation cannot be made.

Next, let us consider the structural composition of SMEs by industry type in these three countries. As can be seen from Table 4, in the 10 initial years of transition SMEs in all three countries were concentrated in the trade and services sectors rather than the manufacturing industry. In Russia in particular, 66% or more of SMEs were active in the trade and services sector. Moreover, this trend remained unchanged by 2006.

Similarly, the main focus of SME activities in Kazakhstan was also in trade and services during the initial transition period. However, in Kazakhstan, over time the proportion of SMEs in the trade sector fell from 48.2% to 43.0%, and in the service sector from 15.2% to 8.4%. On the other hand, the proportion of SMEs engaged in manufacturing expanded from 12.8% to 19.7%, and in construction expanded from 10.5% to 17.7%. Thus, in Kazakhstan, as transition progressed, the proportion of SMEs engaged in the manufacturing and construction industries came to exceed that of SMEs engaged in the services sphere. The absolute numbers of SMEs also increased, with SMEs in the manufacturing increasing from 9,000 companies up to 22,000 companies and SMEs in the construction increasing from 8,000 up to 19,000 companies—greater than twofold increases for both industries.

In contrast to Kazakhstan and Russia, 40% of the total number of SMEs in Uzbekistan were concentrated in the agricultural industry as of 2001, with this number rising to over 70% by 2006. The number of SMEs engaged in agriculture rose from 72,000 to 244,000 companies over this five-year period—a greater than threefold increase. Additionally, the proportion of SMEs engaged in trade and services in Uzbekistan (which demonstrated high rates of growth in the 10 initial years of transition) was reduced to less than half. Looking at the absolute numbers (Table 4), we can see that the number of SMEs engaged in the trade sector fell from 46,000 to 44,000 companies, while the number of SMEs engaged in the services sector fell sharply from 30,000 to 19,000 companies.

Incidentally, the factors underlying this significant development of SMEs in trade and services in most post-Soviet republics particularly at time of initial transition have been considered in previous studies. Factors implicated in this SME development include the following five points.

Firstly, the service industry was underdeveloped in the first place under the centrally planned Soviet economy. However, with the introduction of market elements associated with

the liberalization of economic activity during the transition period, various niche markets[9] that existed extensively throughout the service sector were filled by SMEs.[10]

Secondly, since domestic/foreign price differences became readily apparent with the abolition of the system of controlled prices under the planned economy, the commercial sector expanded dramatically through transactions aimed at drastically increased profit margins.[11] In other words, in the transition countries of the former Soviet Union, with the change in price systems during the period of transition (i.e. the change from centrally controlled prices to market-based pricing mechanisms), by engaging in commercial activities rather than manufacturing, SMEs sought out transactions resulting in the kind of huge transaction fees and profit margins not seen in advanced countries with developed market economies. This can be seen as a phenomenon unique to the transition period.[12] In the same way, a large volume of so-called *chelnoki*, or "shuttle trading" (generated by an imbalance between domestic and foreign prices) can be indicated as another reason for this.[13]

Thirdly, given the situation of high economic and political risks and uncertainty during the transition period, rather than committing to the long-term investments required by the manufacturing industry, SME entrepreneurs preferred to work in the commercial sphere, which is profitable with shorter-term investments of smaller amounts and lower risks.[14]

Fourthly, securing access to the raw material resources required for manufacturing was difficult during the initial stages of the transition period due to the extensive presence of large-sized state-owned (former) socialist enterprises (SOEs) maintaining a monopolistic access to industrial resources and materials.

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[9] Possible niches for SMEs might include regional or hierarchical niche markets, various kinds of industries, consumer goods, or price levels (Hwang 2002).

[10] See McIntyre (2001) and Bateman (1997) for the details.

[11] See Smallbone and Welter (2001) for the details.

[12] SOEs particularly in former Soviet Union republics were entirely covered with small and medium enterprises, and by purchasing their products at producers' prices, drove the proliferation of SMEs greedy for high-percentage brokerage fees and profit margins in the consumer markets (Smallbone 1997, p.167; Hodov 2002, p.150).

[13] When foreign trade activity was liberalized in the early stages of transition, groups of SMEs engaged in trading activities focused on consumer goods shortages and the differences between domestic and foreign prices. Due to chronic and significant shortages of consumer goods during the Soviet era, these "shuttle trading" activities mostly centered on goods from China and Turkey, importing large amounts of goods for daily use such as clothes, shoes, shampoo, soap etc. (Drnovsek, 2004; Bateman, 1997).

[14] See Gib (1995), Brown (1997) for the details.

Finally, in many cases SMEs and entrepreneurs faced serious problems with financial resources as well. For this reason, it has often been observed that when launching their enterprises, many SMEs started out by selling goods, which tends to require only relatively small amounts of capital (usually self-funded or borrowed from family or friends).[15]

Thus, several common points as outlined above can be observed in the development of SMEs within the national economies of these three countries during the initial transition period. However, a comparison of changes to the industrial structure between the two points in time showed the proportion of SMEs engaged in agriculture nearly doubling in the case of Uzbekistan in particular, whereas SMEs engaged in trade and services decreased by half. As described above, the development of SMEs within these three national economies differs significantly, with Uzbekistan demonstrating the highest SME sector development, followed by Kazakhstan, and then Russia.

Based on this, the next section discusses development trends for the SMEs in all three countries as demonstrated over the 16-year transition period.

2.3 SME development trends and trajectories

What sort of common features and differences arose in SME development trends and trajectories after the collapse of the Soviet Union in Russia, Kazakhstan, and Uzbekistan?

Tables 5 and 6 show comparisons of the rates of growth in the number of SMEs and the number of persons they employed in the three countries from the initial stages of transition. It can be observed that for the first 16 years of transition, certain tendencies and trends emerged in SME development in each of the three countries. Although a temporary downturn can be observed in Russia in particular, the expansion of the SME sector in all three countries can be confirmed overall.

Table 5 indicates a downturn in the development of SMEs in Russia during the 1990s. For the period 1992 to 1994, although the number of small companies rose from 560,000 to 897,000 (an increase of 60%), this number subsequently decreased by 16,000 in 1995, with the trend continuing to flatten through to 1999, ranging between 840,000 to 890,000 companies

[15] See Drnovsek (2004), Бэйтмен (1997) for the details.

and never once exceeding the 1994 level. Moreover, although the number of SMEs and the number of their employees did increase every year after 1999, when compared to the other two countries, it can be seen that the rate of growth for SMEs in Russia has remained at the rather low level of 3% or thereabouts.

In contrast to Russia, the number of SMEs in Kazakhstan increased by about 33,000 over a six-year period—from 12,000 companies in 1992 to 45,000 in 1998, with the number of SME employees also increasing by approximately 90,000. Kazakhstan's rate of growth after 1999 was lower than Uzbekistan's, but on the whole, the country was showing stable growth.

During the same period, SMEs in Uzbekistan demonstrated the most significant increases. Specifically, the number of SMEs in Uzbekistan increased by more than twelve-fold between 1992 and 1998. If we look also at the number of SME employees, Uzbekistan achieved an approximately six-fold increase—from 40,000 in 1992 to 237,000 employees in 1998. It should also be noted that after 1999, looking at the real numbers of SMEs and their employees, both numbers tripled in the first eight years of transition, demonstrating a remarkable trend of expansion in the SME sector.

Thus, viewed on the whole and disregarding some years of negative growth, it is clear to see that some discrepancies are evident among Uzbekistan (with the highest rate of SMEs growth), Kazakhstan (with the second-highest), and Russia (in which SMEs did not show sustained growth).

On the other hand, from Table 5 we can see one common point—that in all three countries SMEs grew very rapidly from the initial stage of transition through to 1994, with the number of SMEs increasing by 60% in Russia, 30% in Kazakhstan, and 180% in Uzbekistan. Previous studies have pointed out several factors behind the rapid increase in SMEs common to post-Soviet countries during the initial stages of transition, but the following three points are particularly representative.

Firstly, as mentioned in the previous section, following the abolition of the centrally planned economic system and trade liberalization, new small businesses started to rapidly enter numerous vacant niche markets and new types of industries.[16]

[16] See Radaev (2001), etc. for the details.

Secondly, the restructuring of SOEs, which was accompanied by “small privatization,” was another causal factor here. “Small privatization”—i.e. the privatization of small and medium-scale production units/companies integrated into the SOEs—was one of the key strategies of transition reform in the three countries.[17] The number of SMEs increased rapidly due to the "small privatization" of restaurants, kiosks, retail stores, repair stores, and other education/welfare/leisure facilities, which were re-registered as new independent SME, as well as spin-offs from the SOEs, which were pro-actively created during the initial stages of transition in each country. However, it should be noted that following the completion of this “small privatization,” the number of such SMEs entering markets due to privatization subsequently decreased.

Thirdly, the legalization of the informal economy (numerous small and medium companies doing business in gray or informal sectors dating from Soviet times) was facilitated by extensive liberalization of economic activity.[18]

Furthermore, decreases in the numbers of SMEs and the numbers of SME employees were observed in Kazakhstan and Russia from 1994 to 1995, in Uzbekistan in 1996, and once again in Russia in 1998. As described later, the impact of macroeconomic factors at the time was an underlying cause of these decreases.

3. Main factors influencing SME development in Russia, Kazakhstan, and Uzbekistan

Very little discussion has been made in the previous literature of why the aforementioned differences occurred over the first years of transition in these three countries. In this section, the author focuses on comparative analysis of the macroeconomic factors that caused the differences in the levels of SME development in Russia, Kazakhstan, and Uzbekistan. These include initial level of cooperatives, impact of transition policies, levels of industrialization at the start of transition, and differences in some demographic determinants among the three countries.

[17] See Scase (2000), Hodov (2002), etc. Moreover, as Iwasaki (2004, pp. 135-146) discusses, although the Uzbek government was quite reluctant to privatize SOEs themselves, “small privatization" progressed rapidly, particularly within the trade and services sphere.

[18] See Yasin (2003), Scase (2000), etc. for the details.

3.1 Initial level of the development of cooperatives

One of the main factors that influenced SME development during the early years of transition was the initial level of cooperatives, which served in these countries as the foundation for new SMEs. As mentioned in Section 1, the *perestroika* reforms subsequent to 1986 added new market elements to the planned economy of the Soviet Union, accompanied by a wave of "new small forms of management".

Particularly typical of this new economic activity were the cooperatives, which demonstrated remarkable development as a result.

Table 7 shows the number of cooperatives in the three countries, as well as the number of their employees. In the RSFSR, the number of employees of cooperatives showed about a tenfold increase (up to 708,200 employees) during a one-year period over 1988 to 1989, with numbers increasing from 69,700 to 3.512 million employees in the three years from 1988 to 1991—more than a fifty-fold increase. In the Republic of Kazakhstan, we can see that the number of cooperatives increased from 452 to 12,000 companies over 1988 to 1991, with the number of employees also showing a sharp increase from 5,300 to 276,300 employees. In the Republic of Uzbekistan, the number of cooperatives increased from 550 to more than 9,000 companies, with the number of employees also increasing from approximately 10,000 to 268,500 employees.

Cooperatives were not legally defined as SMEs, but when viewed via **the quantitative criterion** of their number of employees, it can be seen that these tended to be small and medium-sized enterprises, with each cooperative employing fewer than 30 persons on average. The activities of cooperatives arising during the *perestroika* period served as a foundation for the later SME sector. In particular, following the collapse of the Soviet Union, between 1992 and 1994 cooperatives were mandatorily re-registered as SMEs, and this contributed to the proliferation of SMEs in the early stages of transition in the statistics of all three countries.

As Ioffe (1999) has pointed out, the labor productivity of cooperatives was five to six times higher than SOEs engaged in the same industries. In addition, features of cooperatives such as management control systems, hiring of employees, and a salary payment system incorporating bonuses were utilized to achieve the prototypical SME in the modern sense. It is

also believed that cooperatives introduced new business models and corporate culture during the early transition. In propagating new management methods they also achieved a demonstration effect, thus successfully encouraging other new entrants. In other words, the successful example of cooperatives was one factor that inspired an entrepreneurship among Soviet citizens, who until that point had believed free economic activities too difficult to achieve.

Viewed from this perspective, the initial condition of a high level of cooperatives at the start of the transition period can be interpreted as follows: countries with a high initial number of cooperatives displayed a higher level of SME development in the initial period. However, on the other hand, having compared **the qualitative aspects** of most of the cooperatives founded at the end of the Soviet era against the companies newly founded after the start of transition, it is worth emphasizing that major differences exist between the two.

The majority (approximately 80%) of cooperatives were established based on management resources that belonged to SOEs, and rather than producing real products and services, they used freshly-obtained pricing rights to snatch up the assets and profits of state-owned enterprises, which was known as *perekachka* ("tunneling"). Through so-called *perekachka*, they took products and raw materials obtained at "state prices" from SOEs and provided these to consumer markets at higher "market prices"—thus, converting these to cash (*obnalichka*) was their main economic activity.[19] Moreover, depending upon these qualitative differences, some cooperatives also served as barriers to entry for new enterprises established subsequently.[20]

It can therefore be argued that when viewed as forerunner businesses for SMEs, a higher level of development of cooperatives was connected to a higher initial level of SME development. However, if we consider cooperatives that already existed and were economically active at the start of transition as "first-mover" enterprises, and compare these with the new "second-mover" enterprises that entered the market after the start of transition, we can see that these "first-mover" cooperatives had gained clear competitive advantages. As a result, it was difficult for newly established "second-mover" enterprises to enter markets in

[19] Богданов и Орлов (2009), Чеберко и Хорошилова (2006), Бойко и Мессенгиссер (2005), Hodov (2002), Radaev (2001).

[20] See Гойсан (2008) for the details.

which cooperatives already existed. Thus, a high initial level of cooperatives will function as a disincentive for the development of newly established enterprises.

Two factors in particular can be indicated as causes of the first-mover advantage of the cooperatives that arose during the first years of transition. One of these is the cooperatives' advantage in human capital. The other is the cooperatives' absolute cost advantage. Both factors are explained below.

Firstly, the majority of the cooperatives that served as the foundation for SME development during transition were a result of so-called *nomenklatura* business—that is, the economic activities of employees of state-owned enterprises in retail, leisure facilities, restaurants and other spheres, as well as civil servants, bureaucrats, and managers of SOEs during the socialist era.[21] Since these entrepreneurs had acquired essential skills, knowledge, and management experience under the socialist system (despite the fact these were state-owned companies/organizations), they were more competitive than those entrepreneurs launching completely new private enterprises, who had no managerial experience of marketing, accounting, or business planning.[22]

Thus, considering this human capital advantage, we can argue that the higher the initial level of cooperatives development, the harder it was for newly launched enterprises to enter markets or to create new businesses after the start of transition reforms.

Secondly, using vast personal networks (both domestic and abroad) formed through their working experiences for the SOEs under the socialist system, the ex-civil servants, ex-bureaucrats, and ex-managers of large companies starting their own businesses as cooperatives acquired ample opportunities to buy up any necessary raw materials and gain exclusive access to financing, market information, business infrastructure, and so on at low costs.[23] This was possible due to the background of social and economic turmoil at the start of the transition period, with its underdeveloped market institutions and imperfect legal

[21] For the details see Orlov (2003). He describes how the majority of the cooperatives that initially emerged were established within state-owned enterprises or scientific laboratories, and how these were principally supplied by and traded with state-owned enterprises and other state institutions.

[22] For more details, see Brown (1997), World Bank (2002), Scase (2000), Smallbone and Welter (2001), Yasin (2003).

[23] See Scase (2000), Smallbone and Welter (2001) for the details.

framework. This business environment actually strengthened the non-competitive aspects of new entrants and SMEs.

Thus, given incumbents' absolute cost advantages[24] in terms of resources, we can argue that the higher the initial level of cooperatives development, the greater the barrier to entry[25] faced by newly launched SMEs.

In particular, using personal networks acquired under the old regime, these entrepreneurs arbitrarily prevented access to business information and managerial resources and deliberately established high administrative barriers while working toward their own interests (rent-seeking, in many cases). This created circumstances strongly discouraging competition, and had a negative impact on the economic activities of newly launched SMEs during the transition period. Moreover, though these *nomenklatura* entrepreneurs possessed knowledge and management experience acquired at state-owned companies and organizations under the old regime, they had no experience in sales, marketing, accounting, or business planning within a market-based economy. Therefore, in many cases they demonstrated resistance to the introduction of market mechanisms and were very reluctant to change, seeking by any available means to prevent new entries and to constrain the development of SMEs that might become their market rivals.[26]

If we look at the density of cooperatives in the three countries, calculating the number of cooperatives per 1000 people for the 1990 population, we can see that Uzbekistan had 0.47 cooperatives per 1000 people, whereas Kazakhstan had 0.76 and Russia had 0.91 cooperatives—levels approximately twice that of Uzbekistan for the same period. In other words, particularly in Russia the initial condition for the development of SMEs was characterized by a high level of activity by cooperatives, which tended to restrain market competition and led to a less contestable business environment. In contrast, Uzbekistan had the

[24] Absolute cost advantage is when incumbent (existing) firms are capable for some reason of producing at low cost in absolute terms; that is, when the cost curve for incumbents is lower than the cost curve of new entrants. This occurs when incumbents exclusively own certain resources or rights (Odagiri, 2001, p.77).

[25] A barrier to entry is a cost that must be borne by a firm that seeks to enter an industry (new entrant), but not by firms already in the industry (incumbent) (Stigler, 1968, p.85).

[26] See Smallbone and Welter (2001), Gib (1995), Dallago (2002) for the details.

lowest level of cooperative density among the three countries; hence the lower entry barriers at the start of transition and consequently a more significant rate of SME growth.

Thus, we can argue that compared to Uzbekistan, higher levels of development of cooperatives (with their human capital advantages and absolute cost advantages in terms of resources) at the start of transition in Russia and Kazakhstan served as a disincentive for new business entrants, leading to lower SME growth rates.

3.2 The impact of transition policies on SME development

Table 8 shows decreases at specific points of time both in the overall number of SMEs and in the number of persons they employed in Russia (1994-1995 and 1998), Kazakhstan (1993-1994), and Uzbekistan (1996). In this section, the author seeks to shed light on the implementation at that time of macroeconomic policies, which is another factor specific to the transition period known to have affected the SME development in the three countries.

First of all, as a result of radical transition reforms carried out in Kazakhstan and Russia—the so-called "shock therapy" approach—the national economies (and particularly the mining and manufacturing industries) of Russia and Kazakhstan experienced a severe downturn during the first years of transition when compared to Uzbekistan, which had adopted more gradual reforms.[27] In particular, the real GDP growth rates for 1994 compared to the previous year showed a significant decline of 28.1% for Kazakhstan and 20.9% for Russia, while Uzbekistan showed an almost imperceptible decline of 2%.[28] Additionally, the level of real GDP in 1995 for Russia was 54% of its 1991 level, with Kazakhstan at 48% of its 1991 level, while Uzbekistan remained at 98% of its 1991 level.

At the same time, Kazakhstan's introduction of its own currency and its withdrawal from the ruble zone starting from 1993 caused severe problems for both incumbents and newly launched companies at that time, leading not only to higher entry barriers but also the withdrawal of many existing SMEs from markets. In particular, the Kazakhstan economy's dependence on Russia at the time was very high, with many SMEs in particular enjoying close

[27] For more details about differences in transition policies among post-Soviet republics, see Iwasaki and Suzuki (2010).
[28] CISSTAT (1999).

trade relationships with Russian companies. Imports from Russia into Kazakhstan in 1995 were at the very high level of 71.6%, with exports even higher at 82%. However, despite Kazakhstan's introduction of its own currency (the *tenge*), since the Russian ruble was the currency previously used to settle transactions with Russian firms, continued use of the ruble was demanded by Russian businesses, which did not accept the new *tenge* currency. Therefore, since exchange of currency incurs both time costs and monetary costs, the introduction of the new currency bogged down settlement of trade transactions for Kazakhstan's companies and had an enormous effect on SMEs in particular. By way of contrast, imports from Uzbekistan to Kazakhstan were 10.2%, with exports at 5.3%.

It should be noted that factors such as the instability of the Russian economy at the time also had a negative impact on the development of SMEs in both Russia and Kazakhstan. Due to hyperinflation in Russia and the accompanying rise in interest rates, many Russian companies were plagued by overdue payments and cash flow shortages.[29] For this reason, hard currency (international settlement currency) was increasingly preferred for transactions with foreign companies.

Settlement by hard currency was also strongly preferred in transactions with Kazakhstan business partners. However, there were relatively few SMEs in Kazakhstan capable of supporting the demand for settling payment in foreign currency, which led to many enterprise-to-enterprise relationships breaking down.[30]

In other words, the shrinking of the national economies of Russia and Kazakhstan at the time, the confusion regarding settlement of transactions in Kazakhstan with business partners from other post-Soviet states followed by the increasing business risks, and other problems caused by the hyperinflation and instability of the Russian economy are believed to have had a braking effect on SME development in these two countries.

Secondly, we can suggest another macroeconomic factor that affected the development of SMEs in the three countries—the problem with control of the trade and foreign currency exchange system. As pointed out in the latter half of Section 2.2, due to the underdevelopment of services in transition economies, the existence of various niches, the manifestation of

[29] For more about the effects of hyperinflation in Russia on SMEs, see Бэйтмен (1997), Radaev (2001), Ioffe (1999).

[30] Yasin (2003), Бэйтмен (1997).

differences between domestic and foreign prices, and mass occurrence of shuttle trading (*chelnoki*), as well as the scarcity of management resources and aversion to long-term investment under conditions of high uncertainty, SMEs developed with a particular focus on the trade and services sector during the early stages of transition in all three countries. However, if we look at the composition of SMEs by industry in 2000 (Table 4), we see that in Russia and Kazakhstan, more than 60% of SMEs are still concentrated in the trade and services sector. While Uzbekistan's percentage of SMEs concentrated in these industries was still fairly high at 43.5% in 2001, this proportion reduced to no greater than 18.5% by 2006. We argue that this reduction was a result of Uzbekistan's control of its trade and foreign currency exchange system.

In particular, in Russia and Kazakhstan trade liberalization had been actively furthered through the abolition of forced sale of foreign currency by firms to banks, the introduction of legislation on the national currency exchange principle involved in international trade, and the abolition of the trade license system. On the contrary, from the mid-1990s the government of Uzbekistan embarked on a strategy of import substitution industrial policy under strict state control, such as strengthening the trade license and quota system for trading companies, as well as introducing approval scheme for international trade contracts, while still maintaining the control over its trade and currency exchange system.[31]

As a result, in Russia and Kazakhstan, against a backdrop of economic and social chaos and uncertainty caused by the implementation of radical reforms, as well as scarcity of management resources and high-level inflation, entrepreneurs launching new SMEs tended to choose to enter the relatively simple sphere of trade and services, which tend to be profitable in the short term with low risk, rather than the manufacturing industry, which requires long-term investments. Furthermore, with the significant liberalization of trade and economic activities in the domestic markets of these two countries, so-called "*shirpotreb*" (daily use commodities) imported at low prices (particularly from neighboring China and Turkey) began to enter

[31] ICG and IFC reports, WB (2002) etc.

domestic markets in large quantities,[32] making it difficult for SMEs in the manufacturing sector to compete in price against these cheap imports.

Unlike Kazakhstan and Russia, in the domestic market of Uzbekistan, which promoted domestic products over imported products through strict import restrictions and development of its domestic industries, since its entrepreneurs' price competition against cheap imports was relatively weak, in some ways entering sectors of industry other than trading and commerce was relatively easy.

Furthermore, one macroeconomic factor arising in 1996 that prevented the development of SMEs engaged in trading in Uzbekistan was the problem with foreign currency exchange. In Uzbekistan, the Resolution of the Cabinet of Ministers "On Measures for Enhancement of Control of Foreign Currency Use when Implementing Foreign Trade Transactions" dated March 13, 1996, and the Resolution of the Cabinet of Ministers "On Efficient Use of Foreign Currency Used for Import of Consumer Goods" dated November 16, 1996[33] abolished the existing licenses regarding foreign currency settlement by companies and generated a fresh re-issue of preferential rights for conversion of foreign currency for certain companies, as well as making it mandatory for foreign-exchange banks settling via foreign currencies to apply for hard currency (necessary amounts only) in advance.[34] This sequence of events had an impact on regulatory enforcement – it massively complicated the procedures for trading transactions and gave rise to large additional transaction costs, which greatly inhibited the entry of SMEs into foreign trade. In addition, this not only prompted the exit of existing SMEs engaged in foreign trading activities, but also impacted negatively on SMEs in the manufacturing industry, which was dependent on imports of raw materials, intermediate goods, and capital resources.

Thirdly, the effects of the financial crisis in 1998 caused by Russia's incomplete institutional transition can be indicated as another macroeconomic factor that hindered the development of SMEs in Russia. Looking at the number of SMEs in Russia at the time of this financial crisis

[32] In particular, the new tariff system introduced in Russia in 1992 imposed lower import duties on imports from countries given MFN (Most Favored Nation) preferential status by Russia, relative to the normal 5% tariff (or double that for non-MFN preferential countries). (Nakayama & Uegaki, 2001)

[33] These Cabinet decisions were most likely established because of the worsened international balance of payments. In other words, because imports (mostly of daily use consumer goods) into Uzbekistan in 1995 surged to around double (from US$2.897 billion to US$4.721 billion), the government decided to limit free convertibility of currency.

[34] For details, see Kan (2005).

(Table 9), there were 861,000 companies in 1997 and 868,000 companies in 1998, which seems to indicate little if any negative impact from the financial crisis. However, looking at the SME data by industry we can see that the financial crisis had a remarkably significant impact on particular spheres of the economy. The service industry was particularly strongly influenced by the decrease in consumer demand and consequent reduction in the sales market caused by the financial crisis.[35] For example, significant decreases were observed for information processing services (compared to the previous year, the number of firms was -18.8% and number of employees was -16.1%), daily life services (-18.6% and -23.2%, respectively), technical and scientific services (-11.6% and -16.1%), and wholesale trade (-7.7% and -7.0%).[36]

In addition, the more dependent SMEs were on foreign trade and imported goods, the more significant was the impact of the crisis. In fact, the ruble currency depreciated to one-third against the dollar, and since the price of imported goods rose sharply, the total number of persons employed at SMEs also decreased by 307,000. According to data from the Russian Federal State Statistics Service, even the number of part-time contract employees fell from 1.311 million workers in 1997 to 0.476 million workers in 1998—a reduction of about two-thirds.

Thus, the macroeconomic factors arising from each country's transition strategy and implemented policies did not always exert a positive impact on the development of SMEs. This was a determinant in the differences that arose in the development levels of SMEs across the three countries.

3.3 Initial level of industrialization

The initial level of industrialization at time of transition can be considered as another factor that led to differences in the level of development among SMEs in the three countries.

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[35] For details, see Kan (2005).

[36] On the other hand, as a result of the fall in imports and rise of commodity prices, an advantageous situation occurred for regional producers processing domestic raw materials. Among small enterprises, which permit greater flexibility, some companies rapidly converted to production of goods as an alternative to imports, which enhanced the demand for their products. For instance, the number of companies engaged in agriculture (16%), the mining/industrial sector (1%), transport/communications (2.3%), and social security/insurance (11.7%) actually increased. (Kan, 2005)

Looking at the number of persons employed in the industrial sector in each of the three countries in 1991 as a share of total employment in the economy, we see that Russia had the highest share at 30.3%. In contrast, the shares of workers engaged in the industrial sector in Kazakhstan and Uzbekistan were 14.3% and 14.7%, respectively—roughly half that of Russia. Moreover, looking at per capita industrial production in the three countries in 1991, Uzbekistan had the lowest level at 800 rubles/person, while Kazakhstan had 1,400 rubles/person, and Russia had the highest level at 3,500 rubles/person—more than four times higher than that of Uzbekistan.

In countries with developed market economies, level of industrialization usually correlates positively with the development of SMEs; but in Russia, Uzbekistan, and Kazakhstan as they underwent transition from a centrally planned socialist economy to a market-based economy, initial level of industrialization had a negative correlation with the growth rate for SMEs. We argue that the cause of this is in the post-Soviet centrally planned socialist economic structure.

Specifically, right up to the economic transition, the national economies of the three republics (integrated under a unified Soviet Union) were no more than parts of the so-called inter-industrial relationship of the Soviet industrial complex. In other words, a high level of industrial concentration and large-scale conglomeration of extremely specialized state-owned companies centered on the heavy industrial sector were strongly promoted in the Soviet Union economy. While Russia's economy had a strong emphasis on heavy industry and military industry, in Central Asia the level of industrialization was relatively low, with the agricultural sector accounting for an overwhelming proportion. Uzbekistan in particular was essentially a country of monocultural agriculture, and was a major producer and supplier of raw cotton for the rest of the Soviet Union countries (supplying at least 80% of the total amount).

Moreover, the Central Asian republics primarily produced not finished products, but rather agricultural machinery and semi-finished consumer goods for the entire Soviet Union. Simultaneously, more than 60% of consumer goods (and an even higher proportion of investment goods) were being transferred to Central Asia from other Soviet republics. Accordingly, the Central Asian countries maintained closely interdependent relationships with other Soviet republics, with a particularly high degree of integration into the Russian economy. Furthermore, services were not recognized as commercial goods and the supply side was

emphasized more strongly than the demand side, making this economic system very strongly oriented toward material goods.

Therefore, following the abolition of the centrally planned economic system, most of the tight economic interrelations among post-Soviet republics were severed or broke off, which revealed numerous acute problems such as strong structural imbalances and chronic shortages of consumer goods in each republic's economic system,[37] and made essential the conversion to industrial structures capable of meeting more diversified needs. Niche services now existed which had not been provided under the old regime—in particular, insurance companies, financial institutions, business consulting, etc., which opened up a vast scope of business chances for entrepreneurs.[38]

Thus, newly launched SMEs became sources for supply of consumer goods and new services—particularly in Kazakhstan and Uzbekistan, which had comparatively low levels of industrialization at time of initial transition, and where the shortages of consumer goods and structural imbalances of each national economy were more severe. In other words, the lower the level of initial industrialization, the more business chances existed in the economy, such that this was a factor actually facilitating new business entry in Kazakhstan and Uzbekistan.

3.4 Demographic characteristics: supply side factors

The demographic characteristics of the three countries should be highlighted as another economic factor that led to differences in the extent of SME development. As already confirmed by many studies in developed economies, the share of rural population in the national economy is considered a potential source of low labor costs when considering the production cost aspect.[39] The former Soviet states of Russia, Kazakhstan, and Uzbekistan are no exception.

In particular, relatively low average wages in rural areas during the initial stages of transition were a common feature in all three countries. One reason for this is that following implementation of transition reforms, economic and social problems grew more serious, with

[37] There were particular shortages of consumer goods essential for daily life (tissues, pencils, soap, bicycles, etc.), and quality of public services was also poor. (Brown, 1997, p.12)

[38] Smallbone (1997), Smallbone, Welter and Isakova (2001), OECD (1999).

[39] Jarvis and Dunham (2003), Okamuro (2005).

significant reduction of state subsidies and shrinking of the *goszakaz* (state order)[40] procurement system that existed under the old system, especially for the agricultural sector. Income disparity was also a factor, with employment opportunities in rural areas being fewer in comparison to urban areas.

Therefore, viewed as a source of low labor costs, regions with a higher share of rural population were relatively more advantageous locations for establishment of new SMEs. In fact, looking at rural population as a percentage of total population in all three countries (averaged over an 11 year-period), this was at 26% in Russia, where the SME sector was relatively sluggish, and at 45% in Kazakhstan. By contrast, Uzbekistan, which demonstrated a relatively high rate of SME growth, also had the highest share of rural population at 60%.

Moreover, particularly by comparison with Kazakhstan, which has been historically characterized as a nation of nomads,[41] there is a traditionally strong attachment to agriculture as a farming people in Uzbekistan. Thus, in addition to this, given Uzbekistan's high share of rural population acting as a source of low labor costs, there were more business opportunities and a greater supply of potential business founders in the agricultural sector, facilitating the relatively strong development of SMEs in Uzbekistan's agricultural sector.

Furthermore, considering the fact that internal rural-urban migration in Uzbekistan has been restricted by decrees and state policies so that migration of managerial resources was free only within specific regions, it was not easy for entrepreneurs in rural areas to found new enterprises in other areas. This factor strongly promotes new business entries in rural areas in Uzbekistan by comparison with Kazakhstan and Russia. The legal framework described here is the barrier of the *propiska* (residency permit and internal migration recording) system, which also existed during the Soviet era, but was defined once more by the provisions of the Presidential Decree No. 2240 "On improving the system of passports of the Republic of Uzbekistan" (dated February 26, 1999). By contrast, the traditional *propiska* system was

[40] However, in the case of Uzbekistan, examining official rates, we see that state orders for cotton and grain underwent a reduction from 85% in 1992 (for both commodities) to 30% for cotton and 25% for grain by 1997, while orders for other goods were abolished completely (Iwasaki, 2004). However, the state order system is substantially retained even today through a variety of industrial management mechanisms.

[41] For more details on the forced settlement of the nomadic population in Kazakhstan in the early 1930s, see Chapter 3 of Iwasaki, Uyama & Komatsu (2004).

abolished completely in Russia and Kazakhstan after the start of transition, with both countries declaring their commitment to the principle of freedom of internal migration.[42]

Also, the government policy inhibiting rural-urban migration of the population (*politika zakrepleniya naseleniya na sele*) as indicated in the State Support Program for the Development of Small Businesses and Private Entrepreneurship in the Republic of Uzbekistan (dated August 25, 1995) was intended to keep farming people firmly established in agricultural regions, while also fostering a class of "necessity entrepreneurs" from within their numbers.

3.5 Demographic characteristics: demand side factors

The rate of population growth during the transition period in the three countries is another economic factor responsible for bringing about differences in the degree of SME development. Expansion of the consumer market due to population growth is a factor in promoting the entry of new business, as has been pointed out in many studies on SMEs undertaken in developed countries.[43] For Russia, Kazakhstan, and Uzbekistan during the transition period, this determinant also had the potential to strongly affect the extent of SME development.

In fact, looking at the change in total population numbers in the three countries compared against 1991 levels, we see that the population growth rate in Uzbekistan was +21% in 2002, representing an increase of 4.29 million people in the initial decade of transition. In contrast, in Russia during the same period, the rate of population growth was -2% (a decrease of 3.4 million people), while in Kazakhstan it was -9% (a decrease of 1.52 million people). Both Russia and Kazakhstan demonstrated a negative year-on-year rate of population growth after 1992.

In other words, if we regard population growth rate as a determinant of potential demand and expansion of market size, it is possible that this has contributed significantly to the increase of SMEs in Uzbekistan, which has demonstrated a high rate of population growth. Particularly considering Uzbekistan's remarkably high share of young people—40% of the

[42] However, more flexible "registration systems" were introduced instead in both countries. For more information, see Law of the Republic of Kazakhstan No. 204-I "On Migration of Citizens" (dated December 13, 1997; amended December 20, 2004), as well as Section 5242-1 of the Russian Federal Law "On the Right of Russian Citizens to Freedom of Movement, the Choice of a Place of Stay and Residence within the Russian Federation" (dated June 25, 1993; amended July 18, 2006).

[43] Wennekers et al. (2005), Okamuro (2005), Orr (1974).

total population is aged under 16 years—and its high share of rural population (as outlined above in Section 3.4), Uzbekistan's high annual rates of population growth alone would mean sustained expansion of demand for groceries and the necessities of daily life.

Thus, under the government's strict restrictions on imports (as mentioned in Section 3.2), the structural imbalance of the economy and commodity shortages that were ongoing since the Soviet era (as noted in Section 3.3) and the expansion of demand due to high population growth after the start of transition provided a wealth of business opportunities for new entry and SME development in Uzbekistan.

On the other hand, it appears that in Russia and Kazakhstan, in addition to reductions in market size and reductions in potential demand due to decreases in population during the same period, high rates of population decrease also brought about reductions of labor supply. In fact, looking at the annual average number of persons employed in the three countries from 1991 to 1998, we see that this continually decreased from 7.72 million to 6.3 million people in Kazakhstan and from 73.85 million to 63.64 million people in Russia. By way of contrast, the number of workers in Uzbekistan increased during the same period from 8.32 million to 8.8 million people.

In this way, increases or decreases of the population can serve as an indicator to better understand aspects of potential consumer demand and market size, as well as labor supply. This is certainly one of the leading factors mentioned in this paper that brought about differences in the extent of SME development in Russia, Kazakhstan and Uzbekistan during economic transition.

4. Conclusion

This paper considers the economic factors involved in the significant differences arising in the extent of development of SMEs in Russia, Kazakhstan, and Uzbekistan during the transition period, taking into account various problems of the Soviet-type centrally planned economic system as its initial conditions.

Very little previous research has been conducted into the actual situation, and since microeconomic data is not available for business entry rates corresponding to the early years of transition, this paper approaches this problem from the perspective of comparative economics.

It focuses on macroeconomic factors for the period of analysis (1991 to 2007), using primary sources including laws and regulations, as well as data sources including the national statistical agencies of each country, to analyze the determinants of the development trends for SMEs across these three countries

The paper argues that since the implementation of transition reforms, despite the shared common historical preconditions, clear and significant differences arose with regard to the level and trajectory of SME development in Russia, Kazakhstan and Uzbekistan. In particular, even after taking into account differences in statistical definitions in each country, it can be confirmed that Uzbekistan enjoyed the highest degree of SME development from the start of transition, followed by Kazakhstan, then Russia. Moreover, while the share of SMEs engaged in the simple trade and services sector increased in Russia, in the case of Uzbekistan particularly it is apparent that the SME share in trade and services decreased by half, while the share of SMEs engaged in agriculture nearly doubled during the same period.

Among various macroeconomic determinants implicated in either inhibiting or promoting SME development, the initial level of cooperatives and development *of arenda* firms, as well as factors arising from transition policies, appeared to particularly inhibit the development of SMEs across Russia and Kazakhstan. On the other hand, Uzbekistan was relatively favorably positioned with regard to its initial level of industrialization triggering the development of SMEs and its demographic characteristics (such as its relatively large share of rural population and young people, positively influencing the supply side of entrepreneurship), as well as its high population growth rate during the transition period. These all had an extremely strong impact on demand side factors, and hence led to a higher level of SME development in Uzbekistan.

To conclude, in comparison with Russia and Kazakhstan, since SMEs in Uzbekistan began to develop from a lower starting point, they eventually demonstrated the highest rate of growth. The opposite was true in the case of Russia.

However, given the massive economic and social transformations in all three countries, there were certain factors influencing SME activities that were unable to be fully explicated in this paper. For example, there is further need for rigorous examination into the impact of SME promotion policies at each stage of the transition period, as well as other factors including

SME financing and administrative barriers that arose under complex conditions during the institutional transition. The author intends to address these concerns in detail in future.

Table 1. Differences among legal definitions of SMEs in Russia, Kazakhstan, and Uzbekistan

	Russia*	**Kazakhstan***	**Uzbekistan*****
Form of activity	Individual entrepreneur Small enterprise	Individual entrepreneur Small enterprise	Individual entrepreneur Small, medium, and micro enterprise
Number of employees (ppl.)	<100: Industry, construction, transport <60: Agriculture, scientific and technological sectors <50: Wholesale and other production sectors <30: Retail and public services	<50: all sectors, excluding such spheres as gambling, show-business, etc.	**Medium enterprise:** <100: Mining and manufacturing <50: Construction <30: Agriculture, wholesale, other production sectors <20: Retail, services and other non-production sectors **Small enterprises:** <40: Mining and manufacturing sectors <20: Construction, agriculture, and other production sectors <10: Scientific/academic sphere, retail, services and other non-production sectors **Micro enterprises:** <10: Manufacturing, agriculture, other production sectors <5: Retail, services and other non-production sectors <10: Scientific/academic sphere, retail, services and other non-production sectors
Non-SME ownership share	<25%	<25%	None
Provisions	None	general partnerships,	None

on ownership type		limited partnerships, additional liability companies, limited liability companies and manufacturing cooperatives	

Source: Created by the author, based on the Federal Law No. 88 "On State Support for Small Enterprises in the Russian Federation" (dated June 14, 1995; revised July 24, 2007); the Law "On State Support of Private Entrepreneurial Activity " in the Republic of Kazakhstan (June 19, 1997, revised January 31, 2006); and the Law "On Additional Measures to Develop and Promote Small And Medium Enterprises" in the Republic of Uzbekistan (dated April 9, 1998; revised August 31, 2003).

Notes: * Following revision of the definitions in 2007, the categories of "micro enterprise" and "medium enterprise" were introduced in Russia. As a result, since 2008 enterprises employing from 101 to 250 workers have been classified as medium enterprises, while those with less than 15 employees have become micro enterprises. Furthermore, following the government decision dated July 22, 2008, the upper limits on sales turnover (or the balance sheet value of assets) were set by the Government of the Russian Federation for each category of small and medium businesses.

** In Kazakhstan, following the 2006 revision of the legal definitions, an upper limit on average annual total assets (60,000 times the MCI: monthly calculation index, or approximately US$ 500,000) was introduced as the basis for the definition of small business.

*** As a result of the 2003 legal revisions, the category of "medium enterprises" was abolished in Uzbekistan – however, because the upper limit defining a "small enterprise" was raised to 100 employees, this is believed to have had no major statistical impact on the number of active small enterprises. The upper limit for small enterprises in Uzbekistan after the legal revision was set at under 100 employees for most of the manufacturing sector, under 50 employees for the agriculture and construction sectors and some parts of the manufacturing sector, and under 25 employees for the retail, R&D, and other non-manufacturing sectors. For micro enterprises, the upper limit was set at under 20 employees for most of the manufacturing sector, and under 10 employees for trade and services sectors.

Table 2. Share of SME sector in main economic indicators (%, 2002 and 2006)

	Russia		Kazakhstan		Uzbekistan	
	2002	**2006**	**2002**	**2006**	**2002**	**2006**
Share of SME in GDP	23	n/a*	22.4	31.8	34.6	42.1
Share of SME in employment	14.3	17.8	17.7	22.0	53.5	69.3

Source: Created by the author, based on statistical issues of the Russian Federal State Statistics Service (2002 - 2007), The Agency of Statistics of the Republic of Kazakhstan (2002 - 2007), and the State Committee of the Republic of Uzbekistan on statistics (2002 - 2007).
Note: * The Russian Federal State Statistics Service did not calculate or make available data on the share of SME sector in GDP after 2002.

Table 3. Share of SMEs (individual farms and individual labor activity are not included) in GDP (%, 2002 to 2006)

	2002	**2003**	**2004**	**2005**	**2006**
Russia	10~11*	9.8	12.5	12.0	11.6
Kazakhstan	12.0	15.0	18.0	16.0	15.0
Uzbekistan	15.7	16.5	18.6	21.5	23.5

Source: Created by the author, based on statistical issues of the Russian Federal State Statistics Service (2002 - 2007), The Agency of Statistics of the Republic of Kazakhstan (2002 - 2007), and the State Committee of the Republic of Uzbekistan on statistics (2002 - 2007).
Note: * The Russian Federal State Statistics Service did not calculate or make available data on the share of SMEs in GDP before 2003. These are the estimates by different analytical agencies.

Table 4. Number of SMEs by industry (2001 and 2006)

	Number of SMEs (ten thousand firms)						Composition (%)					
	Russia		Kazakhstan		Uzbekistan		Russia		Kazakhstan		Uzbekistan	
	2001	2006	2001	2006	2001	2006	2001	2006	2001	2006	2001	2006
Mining and Manufacturing	12.5	13.2	0.9	2.3	1.7	2.1	14.8	12.7	12.8	19.7	9.5	6.0
Construction	12.2	11.7	0.8	1.9	0.9	1.3	14.5	11.3	10.5	17.4	5.6	3.7
Agriculture	1.3	3.1	0.6	0.7	7.2	24.4	1.6	3.0	7.8	6.2	40.7	70.6
Trade and Catering	38.8	48.5	3.7	4.9	4.6	4.4	46.0	47.0	48.2	43.0	26.2	12.8
Communication and Transport	2.3	5.0	0.4	0.6	0.1	0.4	2.7	4.9	5.5	5.4	0.8	1.1
Services	17.2	21.7	1.2	0.9	3.1	1.9	20.4	21.0	15.2	8.4	17.3	5.7
Total:	**84.3**	**103.3**	**7.7**	**11.5**	**17.8**	**34.6**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Created by the author, based on statistical issues of the Russian Federal State Statistics Service (2003 - 2008), The Agency of Statistics of the Republic of Kazakhstan (2002 - 2008), and the State Committee of the Republic of Uzbekistan on statistics (2002 - 2008).

Table 5. Number of SMEs and the number of persons employed in SME sector (1992 to 2007)

Number of SMEs (ten thousand firms)																
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Russia	56.0	86.5	89.7	87.7	84.2	86.1	86.8	**115.2	114.1	110.9	114.6	115.7	121.5	123.7	128.8	142.3
Kazakhstan	1.2	1.6	1.3	1.8	2.5	3.5	4.5	6.3	**11.0	13.5	15.4	16.8	19.9	20.8	21.2	22.5
Uzbekistan	0.4	1.0	2.8	4.1	4.1	4.5	5.1	**12.6	14.9	17.8	23.6	23.0	23.8	26.9	34.6	39.2
Number of persons employed in SME sector (ten thousand ppl)																
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Russia	430.0	670.0	877.0	894.5	*626.9	651.5	620.8	**648.6	659.7	648.4	722.0	745.9	781.5	804.5	858.3	923.9
Kazakhstan	22.02	19.27	14.88	18.60	22.24	32.19	31.14	34.07	**65.1	74.0	82.5	86.1	93.0	103.9	106.2	112.9
Uzbekistan	4.0	10.3	28.1	39.4	23.4	23.6	23.7	**64.8	74.5	80.2	93.1	104.5	134.9	138.7	184.8	236.2

Source: Created by the author, based on statistical issues of the Russian Federal State Statistics Service (1991 - 2008), The Agency of Statistics of the Republic of Kazakhstan (1991 - 2008), the State Committee of the Republic of Uzbekistan on statistics (1991 - 2008), and Khalmurzaev (2000).

Notes: * The definition of SME in Russia before 1995, in accordance with the Resolution of the Council of Ministers of the RSFSR of July 18, 1991 № 406 “On Measures on Support and Development of Small Enterprises in the RSFSR”, stipulated fewer than 200 employees in the mining and construction, fewer than 100 employees in the science and scientific services, fewer than 50 employees in other production sectors, and fewer than 15 employees for the trade and non-production sectors.

** Subsequent data includes agricultural farms (krest'yanskie hozyaystva), but does not include individual entrepreneurs (individual'nie predprinimateli).

Table 6 Number of Self-employed in the USSR (ten thousand ppl, 1987 to 1990)

	1987	1988	1989	1990
USSR	427.2	734.2	672.6	673.8
Russia	194.1	346.5	328.4	342.7
Uzbekistan	20.7	32.2	29.5	28.6
Kazakhstan	15.4	25.1	25.6	25.1

Source: Narodnoe Khozyaistvo SSSR 1990.

Table 7. Number of cooperatives and their employees in Russia, Kazakhstan, and Uzbekistan (1988 to 1991)

	Number of cooperatives (ten thousand firms)				**Number of employees* (ten thousand ppl)**				**Number of employees per 1 cooperative (ppl)**			
	1988	**1989**	**1990**	**1991**	**1988**	**1989**	**1990**	**1991**	**1988**	**1989**	**1990**	**1991**
USSR	1.392	7.754	19.308	24.536	15.58	139.7	485.5	609.8	11.2	18.0	25.1	24.9
Russia	0.733	3.889	10.217	13.459	6.97	70.82	268.8	351.2	9.5	18.2	26.3	26.1
Uzbekistan	0.055	0.323	0.899	0.978	1.01	7.16	25.1	26.9	18.4	22.2	27.8	27.5
Kazakhstan	0.045	0.457	0.980	1.244	0.53	7.25	22.5	27.6	11.7	15.9	23.0	22.2

Source: Created by the author, based on statistical issues of the State Committee on Statistics of the USSR (1989 - 1991).

Note: * Data includes part-time employees.

Table 8. Growth rates of the number of SMEs and the number of persons employed in SME sector (1992 to 2007)

Growth rate of the number of SMEs (1992 = 100%)																
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Russia	100.0	154.5	160.2	156.7	150.3	153.8	155.0	205.7	203.8	197.9	204.7	206.6	216.9	220.8	230.0	254.0
Kazakhstan	100.0	134.2	105.8	145.8	206.7	295.0	375.8	528.3	918.3	1125.8	1282.5	1399.2	1660.8	1730.0	1762.5	1876.7
Uzbekistan	100.0	246.0	699.8	1022.3	1014.8	1129.0	1277.5	3140.0	3732.5	4442.5	5910.0	5740.0	5937.5	6715.0	8652.5	9797.5
Growth rate of the number of persons employed in SME sector (1992 = 100%)																
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Russia	100.0	155.8	204.0	208.0	145.8	151.5	144.4	150.8	153.4	150.8	167.9	173.5	181.7	187.1	199.6	214.9
Kazakhstan	100.0	87.51	67.57	84.47	101.00	146.19	141.42	154.72	295.41	335.97	374.52	391.10	422.52	471.62	482.38	512.58
Uzbekistan	100.0	257.3	702.5	984.8	583.8	590.0	591.3	1619.3	1863.3	2004.5	2328.0	2612.8	3372.5	3467.3	4620.0	5905.0
Growth rate of the number of SMEs (previous year = 100%)																
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Russia	100.0	154.5	103.7	97.8	95.9	102.3	100.8	132.7	99.1	97.2	103.4	100.9	105.0	101.8	104.2	110.4
Kazakhstan	100.0	132.0	78.9	137.8	141.7	142.7	127.4	140.6	173.8	122.6	113.9	109.1	118.7	104.2	101.9	106.5
Uzbekistan	100.0	246.0	284.5	146.1	99.3	111.3	113.2	245.8	118.9	119.0	133.0	97.1	103.4	113.1	128.9	113.2
Growth rate of the number of persons employed in SME sector (previous year = 100%)																
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Russia	100.0	155.8	130.9	102.0	70.1	103.9	95.3	104.5	101.7	98.3	111.4	103.3	104.8	102.9	106.7	107.6
Kazakhstan	100.0	87.5	77.2	125.0	119.6	144.7	96.7	109.4	190.9	113.7	111.5	104.4	108.0	111.6	102.3	106.3
Uzbekistan	100.0	257.3	273.1	140.2	59.3	101.1	100.2	273.9	115.1	107.6	116.1	112.2	129.1	102.8	133.2	127.8

Source: Created by the author, based on Tables 2 - 5 above.

Table 9 Main indicators of SME activity in Russia (1997 to 1998)

Industry	Number of SMEs (thousand firms)			Number of employees (thousand ppl)			Gross output*			Fixed capital Investment*			Revenue*
	1997	1998	Change (%)	1997	1998	Change (%)	1997	1998	Change (%)	1997	1998	Change (%)	1998
Mining and Manufacturing	134.8	136.1	1.0	1494.6	1357.6	-9.2	67895.4	63084.8	-7.1	5668.7	3669.7	-35.3	-4725
Agriculture	11.9	13.8	16.0	158.1	138.7	-12.3	2245.9	2657.8	18.3	224.7	208.5	-7.2	-1829
Construction	142.1	137.5	-3.2	1568.9	1344.9	-14.3	67579.3	67275	-0.5	9038	6132.4	-32.1	2516
Communication and Transport	21.3	21.8	2.3	242.1	183.4	-24.2	13564.5	10782.8	-20.5	1075.4	504.1	-53.1	-7808
Wholesale trade and Catering	372.8	386.1	3.6	2067.2	2202.9	6.6	102487.4	71113.5	-30.6	3346	5608.8	67.6	-5971
Retail trade with manufacturing purposes	14.3	13.2	-7.7	97.4	90.6	-7.0	7984.2	5219.9	-34.6	475.7	244	-48.7	603
Information processing services	6.4	5.2	-18.8	27.4	23	-16.1	1353.7	1273.8	-5.9	51.4	23.1	-55.1	-49
Other commercial activities	36	35.2	-2.2	163	193.6	18.8	12389.2	7707.5	-37.8	422	732	73.5	-2763
Daily life services	11.3	9.2	-18.6	84.1	64.6	-23.2	1075.4	1559.7	45.0	31.3	26.5	-15.3	67
Healthcare and social security	15.4	17.2	11.7	76	100.6	32.4	3060.7	4954.3	61.9	201.5	139.7	-30.7	-265
Education	7	6.7	-4.3	43	42.6	-0.9	1340	1279.8	-4.5	41.3	44.5	7.7	-260
Science and scientific research	43.9	38.8	-11.6	174.3	146.3	-16.1	9796.8	9202	-6.1	242.4	688	183.8	406
Governmental, public and other organizations	43.9	47.2	7.5	318.7	319	0.1	12283.8	15797.1	28.6	1284.6	1248.9	-2.8	-8472
Total:	**861.1**	**868**	**0.8**	**6514.8**	**6207.8**	**-4.7**	**303056.3**	**261908**	**-13.6**	**22103**	**19270.2**	**-12.8**	**-28550**

Source: Created by the author, based on Maloe Predprinimatelstvo v Rossii 1999, 2001, Regioni Rossii. Sotsialno-Ekonomicheskie Pokazateli 1998, 1997.

Note: * Billion rubles in 1997, million rubles in 1998.

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