CENTIL.LAW

CENTIL OUTLOOK SERIES

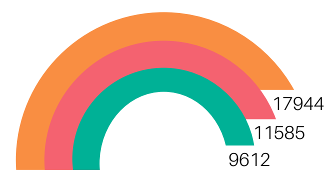
5 REASONS TO INVEST IN THE STANS & 4 CHALLENGES YOU SHOULD BE AWARE OF

INTRODUCTION: THE STANS IN INFOGRAPHICS

- **STANS:** Iran, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan
- **MIST:** Mexico, Indonesia, South Korea and Turkey
- **CIVETS:** Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa

Healthcare

	STANS	MIST	CIVETS
Physicians (per 1,000 people)	2.2	1.12	1.36
Health expenditure public (% of GDP)	2.57	3.23	3.26
Hospital beds (per 1,000 people)	4.6	2.4	1.5



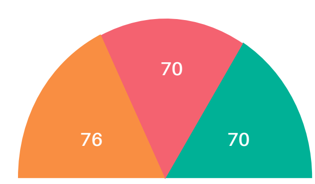
GDP per capita, PPP

Education

	STANS	MIST	CIVETS
Adult literacy rates, %	97	94	91
Education expenditure public (% of GDP)	4.24	4.05	4.57
Researchers & technicians (per 1 million people)	786	2537	673

Energy

	STANS	MIST	CIVETS
Electric power consumption (kWh per capita)	2581	2550	1413
Oil production ('000 bbl/day)	1364	333	522
Natural gas production ('bln m3)	84	5	12
CO2 emissions (metrics tons / capita)	6.9	4.6	3.7



Life expectancy, years

Bang for your buck

Five-star hotel room
- $151
- $161
- $157

Gasoline price per 1L
- $0.8
- $1.2
- $1.4

Meal for 2 person
- $20
- $20
- $25

Internet price (10 Mbps)
- $74
- $40
- $22

Taxi per 1km
- $0.37
- $0.37
- $0.57

INTRODUCTION

Since the acronym "BRICs" was created, investment banks, wealth managers and asset managers from high-income countries have been consistently seeking to tap the unexploited potential of the developing world. Over the past decade, the mass media and market analysts have coined different acronyms for various other combinations of emerging economies that could challenge the "once-charming" BRICs and act as the new pacemakers of global output.

Whilst the media and policymakers have largely emphasised that the BRICs countries were the key force behind global economic growth, the recent economic performance of these nations has been rather disenchanting.

The alarming signals from the "cool down" of the BRICs, undermined by a plethora of political and economic issues, are now outshone by the impressive economic outlooks of a new generation of high-flying economic superstars, including **MINT** (Mexico, Indonesia, Nigeria, and Turkey), **CIVETS** (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa), **MIST** (Mexico, Indonesia, South Korea and Turkey) and **CASSH** (Canada, Australia, Singapore, Switzerland and Hong Kong).

Although it seems that the investment pundits have constantly bet on a seemingly random collection of emerging economies that were "separated by the imposing bulwarks of geography, language, culture, politics, and history"[1], there is one very homogeneous group of countries that maintained brisk economic growth even during the aftermath of the global financial crisis, but which has been mostly overlooked (except, of course, Iran). These countries are the STANs: Iran, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

This article explores 5 reasons why investors should consider investing in the STANs, along with 4 challenges that interested investors should be aware of before moving into the region.

[1] Fortune, 2016

5 REASONS TO INVEST IN THE STANS

REASON 1: RESOURCES

The STANs are some of the world's largest suppliers of oil, gas and other natural resources and currently account for more than 24 percent of the global proven gas reserves.

Large proven gas reserves are located in Iran, Uzbekistan, Kazakhstan and Turkmenistan. Indeed, **Iran holds the world's second largest natural gas reserves**[2]. As of January 2016, its proven natural gas reserves stand at 1201trillion cubic feet (tcf). These resources are largely undeveloped due to the sanctions imposed on Iran's economy. Therefore, in the post-sanctions market there will be a significant recovery in Iran's oil and gas industry. We believe that the removal of sanctions will enable Iran to immediately increase its exports of gas to India and Pakistan.

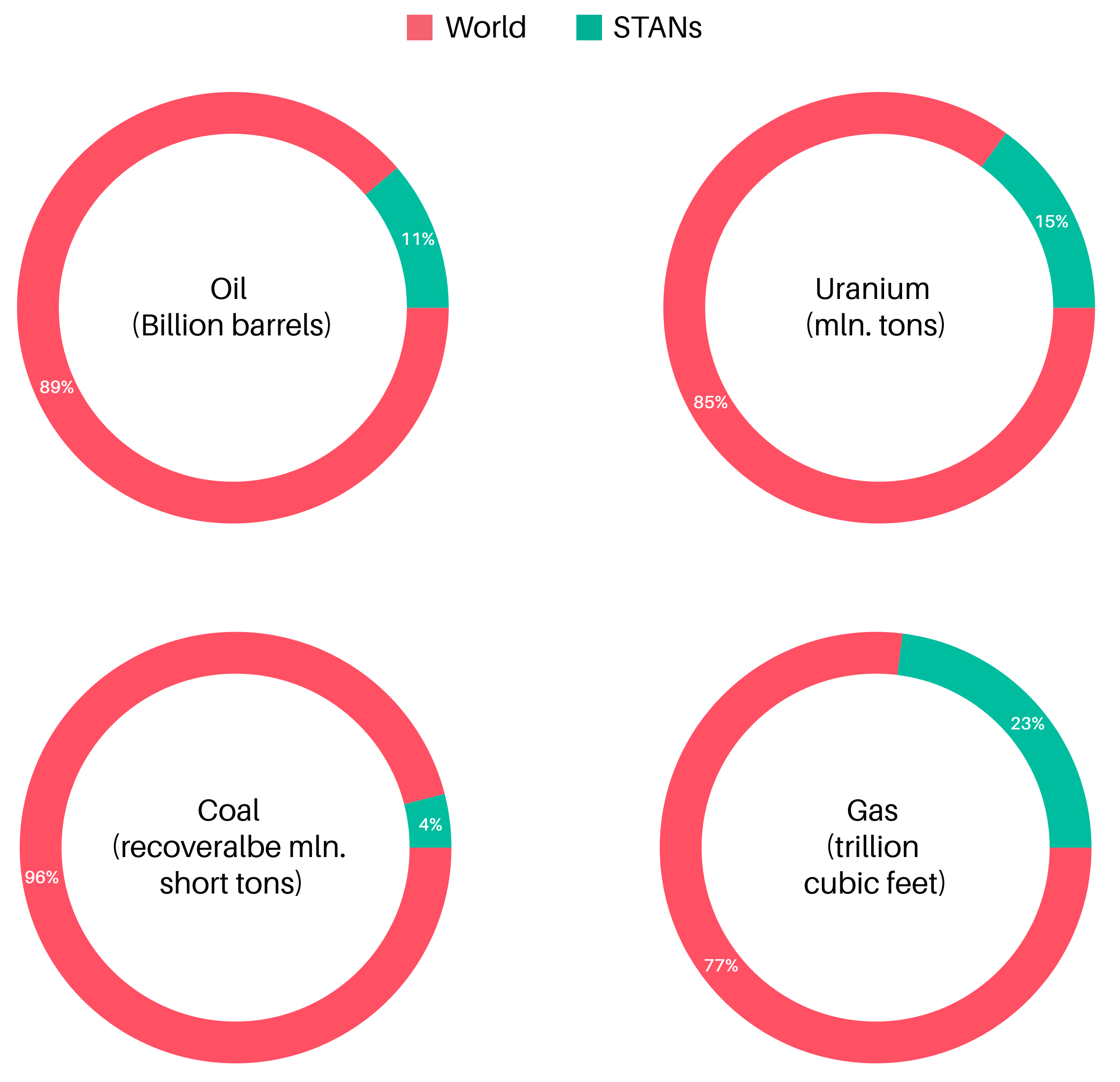
Similarly, **Turkmenistan has the fifth largest natural gas reserves**[2], with proven natural gas reserves equal to 265 tcf. However, unlocking this potential requires the Turkmen government to overcome two major challenges: the lack of high-quality pipeline infrastructure for delivering gas to important markets, and the removal of barriers to attract foreign investors. Turkmenistan also neighbours with Kazakhstan and Uzbekistan, which possess combined proven gas reserves of 150 tcf and mostly export gas to Russia and China.

In contrast to gas reserves, the STANs' oil reserves are somewhat less significant, and are equal to 11 percent of global oil reserves. The key holder of these reserves is of course Iran (4th in the world) with its proven reserves standing at 158 billion barrels.

Some of the STAN economies are also rich in other types of natural resources, such as gold, copper, zinc, iron ore, and uranium. According to a U.S. geological survey[3], **Uzbekistan ranks 9th in the world for its gold reserves** (1700 tonnes) and its gold mines produce on average 100 tonnes per year. Neighbouring Kazakhstan trails only Australia as the world's second largest uranium reserve holder, with 878 thousand tonnes of reasonably assured uranium reserves[4]. What's more, **Kazakhstan delivers more than 40 percent of global uranium output**, with the STANs' share of global uranium reserves accounting for over 15 percent.

The STANs have **tremendous renewable energy potential**, especially from wind, solar, hydro and biomass. However, their renewable resources remain largely untapped reserves to this day. For example, electricity production from renewable sources in the STANs remains below 5 percent of total output. This is considerably lower than other countries with similar climatic conditions. For example, Brazil generates more than 8 percent and Morocco more than 5 percent of their total electricity from renewable sources[5]. According to a recent study, "the number of sunny days in Uzbekistan is very high with more than 300 sunny days a year... Approximately 75 percent of the country consists of deserts, which is favourable for solar PV and solar thermal power utilization"[6]. Thus, abundant renewable energy resources can foster green economic growth and offer equitable access to modern energy services in an ecologically friendly manner. However, in order to tap this potential, policymakers should focus on building capacity, increasing access to finance, and establishing stringent standards and quality assurance frameworks.

Figure 1. STANs' share of global reserves of oil, uranium, coal and gas



[2] World Development Indicators, 2016
[3] U.S. Geological Survey, Mineral Commodity Summaries, January 2016
[4] OECD Nuclear Energy Agency & International Atomic Energy Agency, 2014
[5] The World Bank
[6] Potential of Renewable Energy Sources in Uzbekistan

REASON 2: BRISK ECONOMIC GROWTH

These countries **enjoyed an average GDP growth of 6.6 percent** between 2000 and 2014. Among the STANs, Turkmenistan followed by Uzbekistan were the fastest growing countries in the region during this period. Between 2010 and 2014, **the annual growth rates of Turkmenistan and Uzbekistan averaged 11.1 and 8.2 percent, respectively**. The growth performances of other countries also significantly improved, but were more volatile.

On a global scale, the growth rates of the STANs by far exceeded the growth rates of the global economy and selected developing economies, allowing incomes to rise and inequality to decline substantially. Whilst the majority of emerging countries struggled to sustain modest economic growth at the peak of the global financial crisis, the STANs maintained an annual growth rate of more than 6 percent. Recently revised country projections for 2016 show that the majority of the STANs are expected to grow at around 5-6 percent annually (Uzbekistan - 6.9 percent, Turkmenistan - 6.5 percent). Moreover, with the lifting of Western sanctions Iran's forecasted 2016 GDP growth rate is around 5-6 percent.

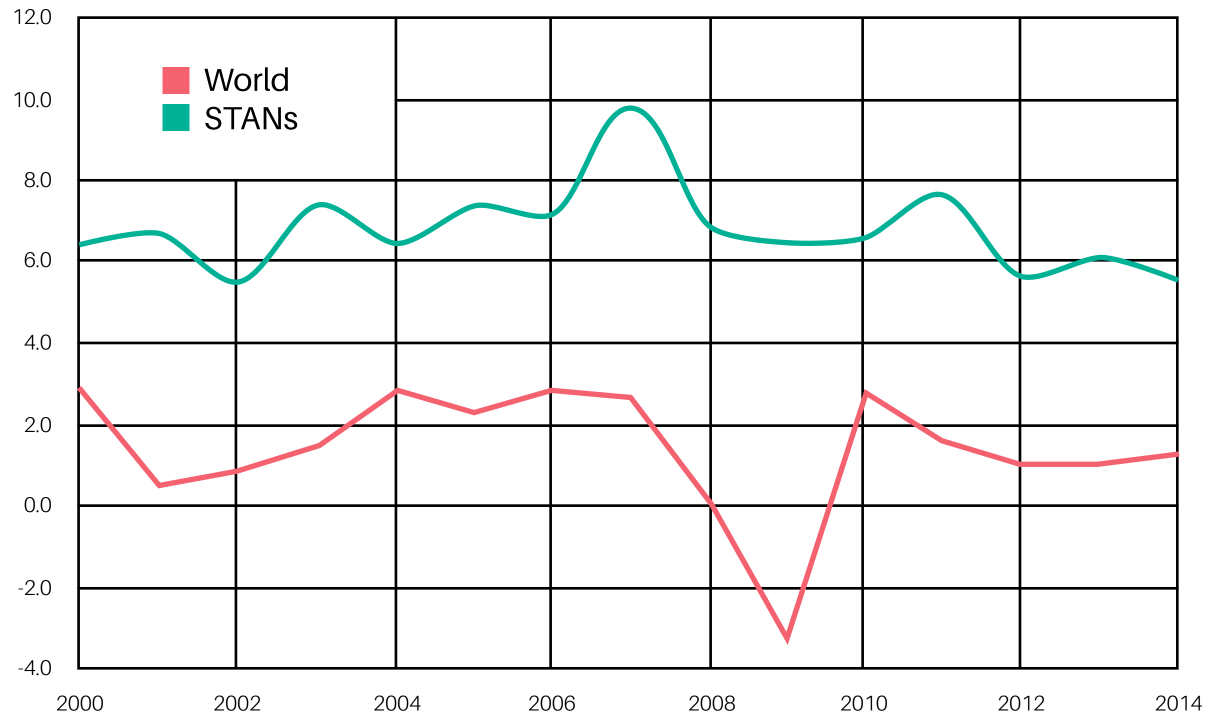
The robust output growth of the STANs in the past decade seems to be related to stable demand and favourable prices for **primary exports**. The World Bank (2014) reports that total natural resources rents relative to GDP are approximately 31.5 percent for Kazakhstan, 32 percent for Turkmenistan, 29 percent for Iran and only 20 percent for Uzbekistan. Within 2000-2014, these resource-rich countries have largely enjoyed rapidly rising global prices for the commodities that are abundant in the region. The booming resource sector **attracted massive inflows of foreign direct investment (FDI), which generated new working places, improved infrastructure**, rapid export growth and, consequently, increased per capita income levels.

We believe that another reason for the higher GDP growth rates may be the convergence effect as the **STANs were considerably below the other emerging economies in terms of GDP per capita**. For example, the average level of GDP per effective worker in the STANs - a measure of labour productivity - slightly exceeded $25,000, and ranged from $6676 in Tajikistan to $50,434 in Iran. Such discrepancies were largely reflected by the GDP structure in the STAN economies, which have substantially transformed over the past decade. For example, lower labour productivity was observed in countries with a higher share of agriculture in the GDP.

Finally, a large share of economic growth in the STANs was driven by the substantial outflow of labour force to neighbouring countries and Russia. For example, according to the World Bank (2016), in 2015 the remittances from labour migrants accounted for 28.8 percent of Tajikistan GDP, making it the most remittance-dependent economy in the world. Similarly, remittances accounted more than quarter of Kyrgyzstan's GDP in the same year, with nearly 16 percent of Kyrgyzhouseholds receiving remittances[7]. As a result, remittances became the country's second large source of foreign currency in the Kyrgyz Republic, the first beingthe export of goods. A similar situation can be observed in Uzbekistan.

However, we believe that the current downturn in Russia and the oil price shock will substantially undermine the remittance and resource-dependent STANs. For example, the flow of remittances into Tajikistan and Kyrgyzstan decreased by more than 65 percent in 2015[8]. Consequently, in these small open economies, such a substantial **decrease of external inflow of currency may have negative implications** for consumption, investment and consequently private sector development.

Figure 2. Growth rates of the STANs compared to the World, in percentage



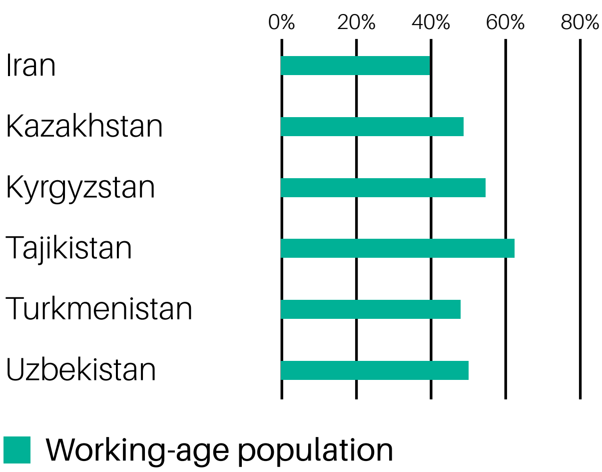
[7] Remittances and Poverty in Central Asia and South Caucasus (ADB)
[8] Central Bank of Russia

REASON 3: SOCIO-DEMOGRAPHIC ENVIRONMENT

Along with stable GDP per capita growth, the STANs have also enjoyed substantial improvements in social indicators. Since the collapse of the Soviet Union the average **life expectancy in the STANs has increased from 66 to 70 years**, whilst the improved quality of healthcare provisions decreased the average infant mortality rate more than two-fold, from 60 per 1,000 live births in 1991 to 27 per 1,000 in 2015.

Recent empirical evidence suggests that the dependency ratio in the STANs exceeds that of the CIVETS & MIST countries, suggesting a **potential rise in the share of the working-age population** in the coming years. The current average dependency ratio in the STANs is 43 children per 100 working-age people. This implies significant demand-and-supply potential in the STANs' markets.

Figure 3. Working-age population share in the STANs



Whilst the urbanisation rate in other developing economies has increased over the past decade, the urbanisation rates within the STANs have remained mainly constant since the 2000s. According to data from the United Nations Population Division, the average share of the urban population in the STANs accounts for 46 percent and is much lower than the 62 percent found in the BRICS. Such trends make us believe that further demographic transitions in the **STANs will trigger an additional source of economic growth**. On the other hand, the existing levels of urbanisation indicate the continuing importance of agriculture in the provision of employment in the STANs.

Turning to quality of life, for the last couple of years policymakers in the STANs have made a number of efforts to improve the quality of public services and civil servants in ensuring enhanced living conditions. A number of indicators attest to the success of these policies in significant enhancing living conditions over the past decade. For example, the STANs enjoy one of the lowest crime rates among developing and emerging economies, with 4 murders per 100,000 people compared to 14 per 100,000 in the BRICS. Such improvements in crime rates and living standards, in turn, have led to higher levels of life satisfaction across the STANs. In terms of life satisfaction index, **Uzbekistan tops the happiest nations globally**, with life satisfaction at 7 points on a scale of 1-8.

Finally, the majority of the STANs that inherited the Soviet education system enjoy 99 percent adult literacy rates and score approximately 0.700 on the Human Development Index. This is somewhat above Middle Eastern Countries (0.686), but slightly below the global average (0.711).

REASON 4: IMPROVING BUSINESS CLIMATE

The rapid economic growth in the STANs was accompanied by a number of **business-friendly reforms and, consequently, business climate improvements**.

In general, the STANs boast low cost requirements for starting a business: it costs only 5.9 percent of GDP per capita to start a business in the STANs. In 2015, Uzbekistan introduced a new form for property records, which incorporated information on all encumbrances, restrictions and tax arrears. The adoption of this new form eliminated the requirement to obtain three separate non-encumbrance certificates. At the same time, it introduced or improved online procedures by successfully **launching a number of one-stop shops** that provide public services to entrepreneurs and by streamlining registration procedures. This initiative was implemented within the framework of Presidential Decree UP-4725 dated 15 May 2015, "On the measures to ensure reliable protection of private property, small business and private entrepreneurship and remove barriers to their rapid development."

Similarly, Tajikistan introduced the electronic submission of customs declarations for both exporters and importers. It also made tax payments for companies easier by introducing an electronic filing and payment system for corporate income tax, VAT and income taxes.

Kazakhstan simplified the procedures associated with starting a business by **eliminating registration fees for small- and medium-sized enterprises**, reducing registration durations and eliminating the legal requirement to use a company seal. The Kazakh **government also simplified construction permits** by eliminating the requirement to obtain a topographic survey of land plots.

As a consequence of these reforms, Kazakhstan is ranked 41 globally in the World Bank's most recent 'Doing Business' Report and represents one of the top 10 improvers of 2015. In the same report, Uzbekistan jumped up by 16 positions.

REASON 5: TOURISM AND CULTURE

Although the direct contribution of tourism does not exceed 2 percent of GDP, we believe that it remains one of the most overlooked drivers and unexplored areas of economic growth for all the STANs. Despite having well-known tourist attractions such as the Silk Road, with the ancient cities of Samarkand and Bukhara, so far the STANs have failed to entice high-spending tourists from high-income countries. The vast majority of tourists in the STANs remain visitors from the former CIS countries.

Lack of knowledge, poorly developed tourism infrastructure and services, along with complicated visa regimes seem to be the main obstacles in attracting more visitors from developed economies. Still, policymakers in the STANs seem to be starting to recognise the tourism industry as a potential source of overall economic performance.

Additionally, the potential success of the tourism industry can be attributed to the STANs' geographic location, cultural resources and unique historical heritage. As an indicator of this, the recent Global Tourism Competitiveness Report ranked the STANs highly across a number of categories: Iran ranks No. 1 in terms of price competitiveness across 141 counties, whilst Kazakhstan is in the top 10 countries in terms of low costs to start a tourism business.

Finally, the STANs may be considered an attractive tourist destination due to their upscale health, hygiene and qualified labour force. Indeed, the STANs rank highly in the Global Tourism Report in terms of low HIV prevalence rates, a high level of access to improved sanitation and the availability of hospitals and physicians.

4 CHALLENGES TO KEEP IN MIND

CHALLENGE 1: INFRASTRUCTURE INVESTMENTS

It seems that one of the main challenges undermining stable economic performance in the STANs is the lack of modern physical infrastructure meeting the current requirements of the business sector. Greater economic activity, enhanced efficiency and increased competitiveness are hampered by inadequate transportation, communication, water and power infrastructure. Currently, the STANs fall below the global averages in the Logistic Performance Index - calculated by the World Bank and Turku School of Economics. At the same time, nearly 14 percent of companies in Kyrgyzstan cited transportation as a major obstacle to growth. Similarly, poor access to electricity was reported as one of the key factors undermining growth in Kazakhstan (14.7 percent), Tajikistan (26.8 percent) and Uzbekistan (11.8 percent). Inadequate supply of infrastructure was also among the top 5 most cumbersome factors for doing business in Iran, according to the recent Global Competitiveness Report. For example, in Iran it takes 4 weeks on average to obtain electrical connection from the day of business establishment. Although these figures are considerably lower than in countries such as Russia (120 days) or Mongolia (93 days), they are still higher than in other emerging economies (for example, Morocco - 14; Turkey - 8; China- 7).

CHALLENGE 2: TRADE FACILITATION

In order to diversify the economy and foster productive sectors through structural transformation, the STANs must solve the issue of trade facilitation. Despite natural resources remaining one of the most important sources of exports in these countries, it seems that Uzbekistan was more successful in diversifying its exports portfolio over the past few decades than the other countries in the region. In fact, Uzbekistan is the only country among the STANs that was able to create an automobile industry cluster contributing more than 7 percent of its total exports.

Furthermore, all of the STANs, but not Iran, are landlocked, which further increases transportation costs and undermines the competitiveness of exported commodities. A combined average cost per container (including transportation costs incurred from geographical location along with the costs for documentation, customs clearance, technical control, in-land transportation costs, customs-broker fees, terminal handling charges) in the STANs is $5107, compared to $1741 in the BRICS and the global average of $1551. Consequently, due to their geographical and historical legacies, the STANs' main trading partner over the past decade has traditionally been Russia.

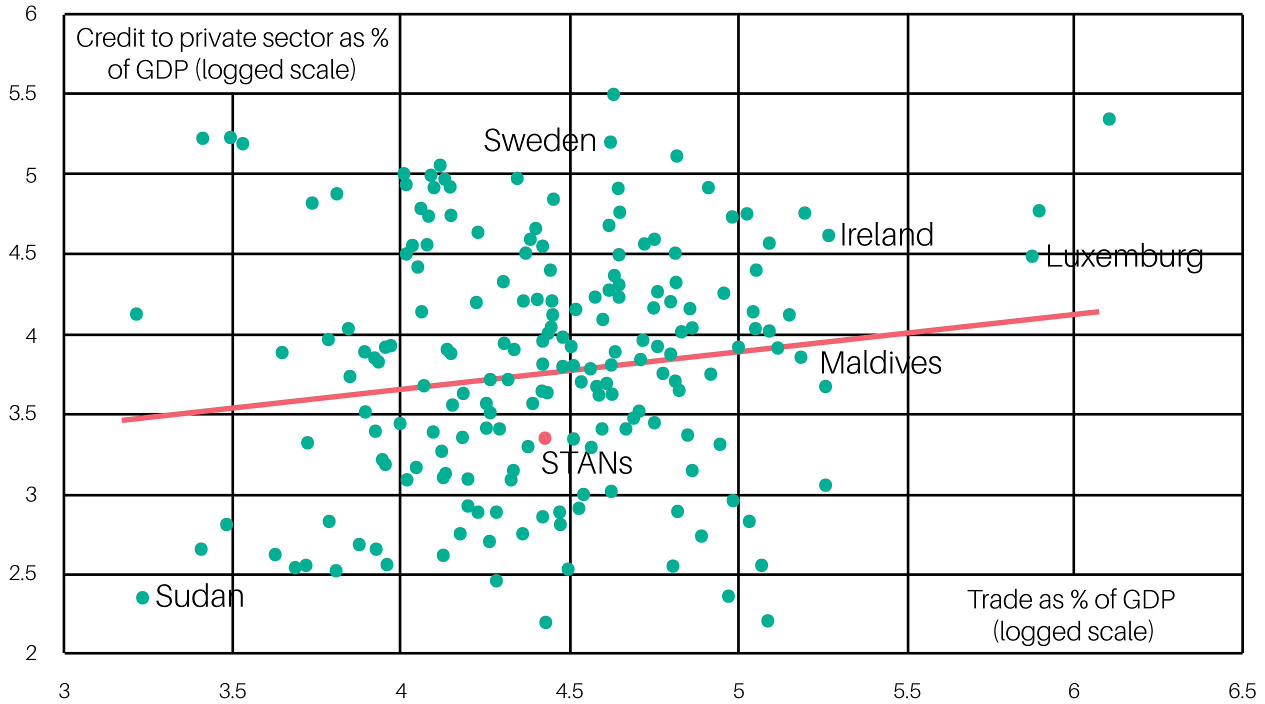
High trade costs and the mediocre quality of trade infrastructure have been constraining the overall trade openness of these countries. Average openness to trade (i.e. trade as % of GDP) among the region ranges from 43 percent in Iran to 125 percent in the Kyrgyz Republic, which is considerably below similar countries. Therefore, low-level infrastructure investments along with high trade costs serve to impede the further integration of the STANs into the global trade network.
As a result, only a fraction of private sector firms exports their products and services: according to the World Bank, only 5.2 percent of Kazakh firms are considered as exporters.

CHALLENGE 3: ACCESS TO FINANCE

While excess leverage and capacity along with surging debt posed a problem for certain developing economies, access to finance in the STANs seems to remain a deterrent. Recent evidence shows that domestic credit to the private sector does not exceed 25 percent of GDP in Tajikistan and Kyrgyzstan. Similarly, the provision of credit to the private sector in Kazakhstan has fallen from 50 percent in 2009 to 34 percent in 2014.Not surprisingly, the latest Global Competitiveness report cites access to financing (including access to loans, liquidity and foreign exchange) among the key problems faced by the private sector in the STANs. Often only a fraction of firms in the STANs receive access to bank loans or lines of credit.

Judging by overall financial development, we observe that the STANs are nearly 20 percent below their potential level based on their level of development. Our estimations show that if these countries can increase their supply of credit to global averages then the level of merchandise trade may surge by 12 percentage points relative to GDP (Figure 4).

Figure 4. Financial development compared to trade openness, global data



CHALLENGE 4: INSTITUTIONAL ENVIRONMENT

Finally, the quality of institutional and legal frameworks is the backbone for the economic performance of any country, including the STANs. Still, there remains much room for improvement in terms of the institutional environments of these countries. This improvement may be achieved if the policymakers of these nations pursue further market-oriented reforms, improve the rule of law, enhance government efficiency and ensure the transparency of public institutions.

In virtually all of the STANS, government involvement in the economy remains significant. Judging by government spending, a sub-indicator of the Economic Freedom index of the Heritage Foundation, the STANs rank very high, indicating significant government presence in overall economic activities. For example, Kazakhstan scores 87.7 and Iran scores 93.2. This considerably exceeds countries such as Brazil (55.2) or South Korea (69.7).

As a result, we believe that such high levels of government involvement in the economy may crowd out private investment and impair private sector development.

CENTIL.LAW

Centil advises within the jurisdictions of Iran, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, and is one of the largest law firms in the region. The firm's core team has been established in 2003 and since then has been advising on banking and finance, energy, M&A, and infrastructure projects across the region.

www.centil.law

CENTIL'S CENTRAL ASIA RESEARCH GROUP (CARG) provides consultancy and analytical support on a broad array of issues, including market and sector-specific analyses, impact assessment and policy design, capacity building, and, business consulting for entities operating in or considering entry into the Central Asian region and Iran. Our consultancy and recommendations are grounded not only in international and regional best practices, but also in our expertise in data modeling and analysis.

Our network of consultants includes professionals with rich and diverse backgrounds, from private sector companies, international organisations, government institutions and the academic sphere. Importantly, all members of our team have either lived or currently live in the Central Asian region. They therefore bring unique and relevant perspectives and experiences to analysing and understanding the complex relationships and processes that underpin publicly available data and observations.

AUTHORS:

Oybek Yuldashev — oybek.y@centil.law
Director | CARG

Rauf Salahodjaev — rauf.s@centil.law
Senior Analyst | CARG

Bekhzod Omanbayev — bekhzod.o@centil.law
Junior Analyst | CARG

Otabek Suleimanov — otabek.s@centil.law
Partner

Zosia Demkowicz — zosia.d@centil.law
Marketing & Press | UK and USA