

**United Nations Development Program  
Kyrgyzstan**



# **Kyrgyzstan at a New Stage of Development**

**SEPTEMBER 2005**

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## Abbreviations

ADB	Asian Development Bank
BEEPS	Business Environment and Enterprise Performance Survey
CEC	Central Electoral Committee
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
FDI	Foreign direct investment
FEA	Foreign economic activity
GDP	Gross domestic product
GMCL	Guaranteed minimum consumption level
HIPC	Heavily Indebted Poor Countries
IFI	International financial institutions
IMF	International Monetary Fund
JK	Jogorku Kenesh (Parliament)
KAFC	Kyrgyz Agricultural Finance Corporation
KR	Kyrgyz Republic
KSE	Kyrgyz Stock Exchange
MHIF	Mandatory Health Insurance Fund
MP	Member of Parliament (Jogorku Kenesh)
NBKR	National Bank of the Kyrgyz Republic
NGO	Non-governmental organization
PIP	Public Investment Program
PRGF	Poverty Reduction and Growth Facility
SF	Social Fund
SME	Small and medium-size enterprises
SOE	State-owned enterprises
TB	Treasury bills
UMB	Unified Monthly Benefit
UNDP	United Nations Development Program
USSR	Union of Soviet Socialist Republics
VAT	Value added tax
WTO	World Trade Organization

## EXECUTIVE SUMMARY

- i. This document has been prepared by an international panel of experts organized by the UNDP. The main objective of this document is to present an updated concept of the political, economic, and social reforms to the newly elected President, the Government, the Parliament of Kyrgyzstan, and to the general public. The independent character of the expert panel ensures the non-political nature of the analyses, findings, and recommendations.
- ii. During the first years of its independence, Kyrgyzstan enjoyed a well-deserved reputation as the most free, most democratic and market-oriented country in Central Asia. However, more recently it started to shift towards authoritarianism; human rights were violated, as were the principles of free elections, freedom of political parties and the mass media, and independence of the judiciary. As a result, government agencies, judiciary, and law enforcement agencies were paralyzed by corruption and professional incompetence, while failing to carry out their duties and persecuting citizens and businesses, instead of protecting their rights and freedoms.
- iii. The events of March 2005 have created a unique opportunity to reform the Kyrgyz state, to increase the efficiency, transparency, and accountability of key state institutions, and to effectively guarantee human rights and freedoms. To achieve this objectives, a more balanced distribution of constitutional prerogatives among different branches of government and a more clear definition of the responsibilities of the President and the Prime Minister must be achieved; the prerogatives of the Prime Minister and the Government must be expanded at the cost of the President and his Administration, the Parliament must be formed on the basis of proportional representation with a threshold introduced for political parties; parliamentary capabilities and professionalism, especially in lawmaking, must be increased; effective guarantees for the independence of the National Bank of the KR, the Accounts Chamber, CEC, the Prosecutor's Office, the Constitutional Court and the entire judicial system are needed, and the responsibilities and powers of government agencies and local self-governance bodies must be clearly separated.
- iv. In the new Constitution, the priority of human rights and freedoms must be ensured by providing effective means (such as expanded opportunities for access to the Courts or the right to constitutional appeal) for protecting them to individuals and civil society organizations. The International Covenant on Civil and Political Rights must be a binding force in the internal legal system, including its direct application by the courts. The Constitution should also protect private property and freedom of entrepreneurship as the foundations of Kyrgyzstan's socio-economic system. The same concerns a stable currency and long-term fiscal equilibrium. On the other hand, the scope and substance of citizens' social rights should be defined by law.
- v. The post-revolutionary events of spring 2005 have exposed the deep paralysis of the judicial system. Comprehensive legal and judicial reform is needed to ensure that constitutional rights and freedoms are effectively enforced, to improve the entrepreneurial climate, and to avoid arbitrary behavior on the part of the public administration. This reform must encompass reforms of legal education, material and procedural legislation, reform of law enforcement agencies (prosecutor's office, police, national security service, etc.) and execution of court decisions, the penal system, and

legal services (including the Bar, notary services, etc.). An independent judicial system must include regular courts, magistrate courts, and specialized judicial and quasi-judicial bodies.

- vi. The main purpose of the administrative reforms is to improve the efficiency of government agencies and to focus them on providing basic public goods and services that cannot be supplied by the market mechanism. To achieve this, the government and public administration structure must be simplified, redundant and unnecessary functions eliminated, the number of personnel reduced, and the resulting budget savings used to increase the salaries of the remaining civil servants. Civil service reform, including local self-governance bodies, should be continued. The political neutrality and stability of the civil service must be ensured, including the drawing of a clear distinction between political and non-political positions. The selection of candidates for public service must be based exclusively on professional criteria and on an open, competitive mechanism. It is also necessary to modernize the professional training of civil servants, and to define clear principles for their professional careers and remuneration.
- vii. Local self-government is the public authority that is closest to the public. The prerogatives of local self-government (traditional issues of local significance) must be clearly defined, and the concept and mechanism for delegating authority and tasks to lower levels of public authority must be introduced, along with the transfer of financial resources needed to carry out these tasks. Local self-government units should approve their own budgets, and the expenses should be directed toward executing their own and delegated tasks, while revenues should be ensured through their own taxes and grants. A reform of the administrative-territorial structure of the country is necessary with a transition to a three-tier system: national government – regional administrations – local self-government.
- viii. Anti-corruption policy must include a variety of measures, in particular improved anti-corruption legislation, deregulation of business activity, and increased transparency of national and local budgets. However, the most important and effective instrument in this campaign is free access to information by individuals and NGOs and a free media that is independent of government and business interests.
- ix. The achievement of long-term sustainability of economic growth calls for low inflation, a stable national currency, and lowered budget and current account deficits. Fiscal deficit can be reduced by increasing state revenue and preventing unjustified increases in expenditures. Debt sustainability was restored only after the foreign debt of Kyrgyzstan had been restructured and partially written off by the Paris Club in 2002 and 2005. The agreement with the Paris Club specifies that this mechanism cannot be used in the future, and the sizeable debt to international financial institutions cannot be restructured or reduced. For this reason the capacity for settling the existing debt must be increased and new borrowing must be strictly controlled.
- x. In the area of fiscal management the suggested approach is medium-term program budgeting with funding linked to activity results. A clearer definition of expenditure priorities, refusal to make any non-monetary transactions and settlements (netting-out operations, barter, payment of in-kind benefits, etc.) and a transfer of many functions currently performed by the state to the private sector, are suggested.
- xi. Comprehensive tax reform is needed to increase budget revenues, even out the tax burden, and improve the business climate. This reform is expected to restore the standard system of VAT collection as the universal consumption tax, i.e. without sectoral exemptions and with an effective mechanism for refunding VAT paid during



earlier production/distribution phases. Other measures should include broadening of the tax base and introduction of a flat-rate personal income tax, introduction of a regressive scale of SF contributions, a major increase in SF contributions for farmers and those who pay lump-sum taxes, a gradual elimination of turnover taxes, increased excise rates on alcohol and tobacco products, improved environmental payments, introduction of a real estate tax, increased taxation of transport vehicles, increased taxes for using water and other natural resources. Two tax regimes are suggested for SME: a lump-sum tax (patent) for micro-businesses and a simplified tax for small businesses with turnover lower than the VAT registration threshold.

- xii. Taxpayers' rights and the rights of tax authorities should be carefully balanced and operations of the latter must have preventive, not punitive, character. They must be based on a presumption of good faith on the part of the taxpayer, limiting the number of direct contacts between tax authorities and taxpayers and defining the maximum percentage of businesses inspected annually (for example 3%).
- xiii. Other measures aimed at improving the business and investment climate should include establishing a clear hierarchy of legal acts (constitutional norms – international treaties – laws – executive orders), introducing the 'one stop shop' principle for the registration of legal entities, providing clear justification for refusal to issue a registration, solving the problem of voluntary exit from the market, creating a single and complete list of business activities requiring licensing, introducing a procedure for regularly revising this list using a 'guillotine' procedure, etc. The number and duration of inspections must be reduced while increasing their effectiveness. The authority of administrative bodies to conduct inspections must be explicitly established by law.
- xiv. Comprehensive measures must be taken to increase protection of property rights, creditors' rights and to improve contract enforcement. These measures should include improved execution of court decisions (especially in cases of recovering a pledged property), a shift from protecting specific groups of investors (insiders and minority shareholders) to protecting all categories of owners and ensuring the transparency of property deals. The powers of corporate bodies must be clearly distinguished in line with a continental (two-tier) model of corporate governance and a best practices code of corporate governance must be introduced. Complete equality in terms of the legal treatment of foreign and local investors, including property rights to land, must be ensured.
- xv. An improved investment and business climate is impossible without demonopolization, restructuring, and promoting competition in the infrastructure sectors. In particular, the energy, gas, and transport sectors must be restructured and privatized. Kyrgyztelekom must also be privatized and stripped of its monopolist status. The Government must move away from direct management of infrastructure enterprises and introduce stable and transparent regulatory mechanisms for these sectors. This involves tariff adjustment to the level guaranteeing a full cost-recovery and elimination of cross-subsidization.
- xvi. The reform of municipal services must involve their demonopolization, full recording of individual consumption of energy, gas, water, etc., and elimination of barter and netting-out operations. Tariffs must be increased to cover costs; payments collected must be only for services that were actually provided, and the targeted cash assistance should provide a social safety net for low-income consumers.
- xvii. So far privatization has been extremely politicized and, for this reason, it was nearly stopped. Hence, restarting the privatization process and completing it quickly requires lifting most of the legal and political bans and limitations that are now in force, selling

the shares that are still owned by the state and securing the property rights to land by privatized objects. In the case of enterprises remaining in state property, the possibility of attracting experienced foreign managers should be examined.

- xviii. The high degree of openness of the Kyrgyz economy must be maintained, while exports should be encouraged and diversified. Regional cooperation and the elimination of existing trade, transport and transit barriers would help to achieve this policy goal. For this reason, rapid accession of the neighboring countries to WTO is in the interest of Kyrgyzstan.
- xix. The educational system should be adjusted to the country's real budget capacities. State guarantees should be limited only to basic primary and secondary education. In the sectors of advanced secondary, vocational, and tertiary education the state should provide only personal grants for talented students from poor families. Equal conditions and opportunities for both state and private educational institutions to implement state education programs will increase competition in this sector and give students the right to freely choose their educational institutions. The possibility to privatize state educational institutions should also be ensured.
- xx. In recent years Kyrgyzstan has implemented a large-scale healthcare reform, which was one of the most profound and consistent reforms in the social sector in the entire region. To continue this reform, state funding of healthcare must be augmented by improved collection rates for MHIF contributions and an increased role for co-payment. State guarantees in cases when effective control of their implementation is impossible (for example, providing medications and meals to hospital patients) must be limited; MHIF, as the purchaser of healthcare services, should be separated from public and private suppliers and from the Ministry of Health, which is the governmental body responsible for healthcare policies and regulation of the medical services market; private medical institutions should be allowed to implement state health programs and provide medical services contracted by MHIF.
- xxi. Improved targeting is necessary to increase effectiveness of the social safety net. This involves, among others, improvement of the methods of evaluating aggregate family income, especially in the rural areas. The extra funds resulting from better targeting should be used to substantially increase the amount of benefits. Additionally, the number of welfare recipients must be reduced and the variety of non-monetary benefits and privileges should be replaced by direct cash payments.
- xxii. Unfortunately, the pension reforms implemented so far were not successful in balancing the assets and liabilities of the pension system in the long term: despite the favorable demographic situation in the country, pensions remain extremely low for the majority of pensioners and the number of pensioners is too big. To ensure stability of payments and increased pensions, the number of pension recipients must be limited to those who are truly unfit for work. For this purpose, changes must be introduced to pension legislation, including increase of the retirement age to 65 and abolition of pension privileges for various groups.

## **INTRODUCTION**

1. This document has been prepared by an international expert group organized on the initiative of the United Nations Development Program (UNDP). Its main purpose is to provide the newly elected President, Government, and Jogorku Kenesh, as well as the public inside and outside the country, with an updated mid- and long-term

development concept, containing proposals for political, economic, and social reforms. Broad discussion of the main points of this report organized by the UNDP in July 2005 helped take account of different perspectives and the experience of many experts, state institutions and civil society organizations, including a broad range of NGOs.<sup>1</sup>

2. The composition of the expert team, which consisted of both local and foreign specialists, guarantees an independent and politically neutral (non-partisan) character to the presented analyzes, conclusions, and recommendations. These should be associated neither with any political party program, nor with the opinions of individual political figures. The UNDP support notwithstanding, the contents of this document should not be viewed as the official opinion of this or other international organizations within the UN system. Furthermore, this document does not necessarily reflect the official position of the organizations that the individual experts work for or cooperate with.
3. After the March 2005 revolution, Kyrgyzstan found itself at a turning point in its history. Successful resistance against authoritarian trends by the Kyrgyz people has opened a political window of opportunity for far-reaching political reforms to modernize the public administration, economic, and social systems and make them more efficient. For the second time since its independence, Kyrgyzstan has a chance to build a truly democratic state, governed by the rule of law, open to the outside world, with a fully-fledged market economy able to provide sustainable growth in the long run, which can help to alleviate poverty. However, this is just a chance, and there is no guarantee of success. In the near future, the destiny of Kyrgyzstan – and maybe of the whole of Central Asia – will depend on how the new government and Kyrgyz society will use this window of opportunity.
4. Over the last 15 years, Kyrgyzstan has developed plenty of program documents on development and reform strategies, including those involving international organizations and international experts. In most cases, they contained sound recommendations. However, many have not been implemented for political reasons, while others have become outdated and need to be revised. To a large extent, this document uses the intellectual results of previous programs and recommendations – and particularly of those which have not been implemented – without necessarily claiming something completely new and non-orthodox. Rather, this document aims to augment and make many of the earlier proposed recommendations consistent with the new realities. We assume that the main value added of this report, compared to numerous documents prepared before, is a clear focus on the importance of political reforms and their interrelation with economic and social reforms. We are deeply convinced that the absence of these political possibilities to implement deeper reforms in the inefficient post-Soviet state has impeded economic and social transformation in Kyrgyzstan, as well as in other CIS countries.
5. The limited scope and short time for report preparation did not permit us to address all the essential problems of the country's development (for instance, environmental issues are not discussed in this report) and to propose detailed technical

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recommendations in all the policy spheres. Many of the problems and reform recommendations mentioned in this report need to be further discussed, taking account of specific expert input, before they can be implemented. This report presents general recommendations for reform in the country, which need to be further discussed in detail by various expert groups.

## Chapter 1. 15 years of Kyrgyzstan development in perspective

6. When Kyrgyzstan gained independence in 1991, the conditions of its development were largely determined by its natural resources, geographical location and the structural and institutional legacy of the Soviet era. The most significant initial conditions were as follows:
  - ◆ **geographic location:** landlocked and remote from major economic centers;
  - ◆ **agro-industrial structure of the economy:** most of the large industry worked for the needs of the whole Soviet Union (including military industrial facilities) and therefore was heavily dependent on suppliers and purchasers in other Soviet republics and on the USSR federal budget. As a result, it was unable to manufacture other competitive products; most agriculture was inefficient and non-competitive too;
  - ◆ **lack** of large quantities of easily extracted and exported **natural resources**;
  - ◆ well developed **social infrastructure** and relatively high living standard<sup>2</sup> of the population;
  - ◆ traditional rural culture and mentality significantly affecting the social consciousness and behavior;
  - ◆ lack of many of the institutions of an independent state (central bank, border guard, customs, etc);
  - ◆ lack of experience with independence, democracy and market economy.
7. After gaining independence, the above fundamental factors coincided with the consequences of **political** and **macroeconomic instability** (inter-ethnic conflicts, inflation, a severe shortage of consumer goods, etc.) of the late *perestroika* period and first years of independence. The dissolution of the USSR led to the **termination of Union budget subsidies**, an end to cheap **energy supplies** from other republics, crisis in inter-republican trade, collapse in the demand for military production, drastic change in relative prices, huge growth of transportation costs, and the need to solve the completely new tasks that the government and people faced. Heavy social and economic repercussions resulted.
  - ◆ **hyperinflation** and severe **output decline** led to the loss of half of the officially recorded GDP and three-quarters of industrial production; agriculture, trade and other services became the dominating sectors of the Kyrgyz economy;
  - ◆ decrease in real wages and social benefits, unemployment, and lack of experience with a market economy, which led to **increased poverty** (affecting more than 50% of the population) and **inequality**;

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<sup>2</sup> Compared to what it might have been without the USSR central budget subsidies.

- ◆ poverty and instability promoted a quite significant outward **migration**;
  - ◆ noticeable deterioration of education, health care, culture and other **social services**.
8. However, during the early transition period, both the government and the people quickly adapted to the new conditions. An important achievement of this period was maintaining political stability in the country due to democratic and market-oriented reforms carried out by the Government and supported by the society. Kyrgyzstan became very open to the rest of the world and actively cooperated with international development and financial organizations.
  9. The complex institutional, economic and social reforms conducted in the first half of 1990s helped to build basic state institutions, overcome output decline, achieve initial macroeconomic stabilization, and prevent social services from total collapse. Privatization of SOE, de-collectivization in agriculture and external economic liberalization increased the **private sector** (represented mostly by the SME sector) contribution to GDP and employment to a level exceeding 50% and helped new social groups such as entrepreneurs, private farmers, and traders (including the so-called shuttle traders) to emerge.
  10. Unfortunately, these reforms were not always consistent and comprehensive enough. The state budget remained unbalanced; many structural reforms (privatization, restructuring of the infrastructural sectors, etc.) were incomplete; social commitments exceeded real financing possibilities, ineffective state institutions suffered transparency deficits, and corruption and nepotism were pervasive. All these flaws undermined the social and economic stability of the country and resulted in the **financial crisis of 1998-1999**, which had fairly harsh implications in terms of poverty growth, macroeconomic destabilization, external debt, etc.
  11. During the last few years, the socio-economic situation of Kyrgyzstan has improved, and poverty has fallen significantly. This was the result of many people managing to adapt themselves to the new conditions, and becoming able to assume responsibility for themselves and for the welfare of their families.
  12. A more responsible economic and social policy in the last few years has managed to reduce inflation to a low single-digit level, to create a more favorable tax regime for SME in the area of trade and services, to implement a complex health care reform, etc. Paradoxically, this positive direction of economic policy went hand in hand with growing authoritarian and anti-democratic trends in politics, which was the main cause of the rampant bureaucratization, inefficiency of major state institutions, pervasive corruption and nepotism. All this finally resulted in the spring 2005 revolution.
  13. The above-mentioned developments have shaped the current situation in Kyrgyzstan:
    - ◆ poverty has been reduced, but it is still high;
    - ◆ macroeconomic stabilization has been achieved; however, it is still too early to talk about long-term stability, since the country's economy remains vulnerable to internal and external shocks; the challenge of external debt has become less dramatic, but is far from being definitely solved;
    - ◆ generally, a new market-oriented economic structure has developed, but there are many economic sectors that need further market reforms and privatization;

- ◆ the economy has entered the path of economic growth, but its rate is not very high compared to other countries, while its long-term sustainability remains questionable. The economy of Kyrgyzstan is heavily dependent upon specific sectors (primarily gold mining and electric power generation) and the political and economic situation in neighboring countries;
  - ◆ many governmental institutions are adversely affected by bureaucratization, corruption, and nepotism;
  - ◆ the range of social services remains almost the same as during the Soviet period, but their quality has deteriorated significantly.
14. During its period of independence, the country has undergone a dramatic transformation and accomplished significant results. However, looking ahead, Kyrgyzstan will have to face serious development challenges, which should not be neglected:
- ◆ The most urgent and dramatic challenges relate to the broad area of **governance**. Modernization of the Kyrgyz state has been hampered by the gradual deviation from democratic standards, concentration of power in the hands of the President, manipulation of the election process, numerous human rights violations and restrictions on the media. In turn, inefficient state institutions, cumbersome and expensive territorial division, unstable legislation, widespread corruption and rent-seeking of government officials and civil servants have become the main barriers to economic and social development. If government fails to increase its efficiency, transparency and accountability, the country may become struck by chronic poverty and instability.
  - ◆ In the **economic** sphere, the sources of economic growth need to be diversified. The sources of post-adaptation recovery and catching-up have become mostly exhausted. Increasing productivity, integrating into the global economic system, improving access to international markets, reducing transaction costs by decreasing the regulatory burden, and better functioning of domestic markets are critical to sustainable economic growth.
  - ◆ In the **social** sector, there is a huge gap between the generous formal entitlements, largely inherited from the Soviet era, and the limited financial resources available. The current situation is not sustainable. Unless drastic measures are taken, the social sector will gradually collapse.
15. Kyrgyzstan is located in an **unstable part of the world** while its social and economic situation is highly vulnerable to external shocks and global and regional security threats. Therefore, to promote sustainable development, both the government and the people of Kyrgyzstan need to support responsible policy choices responding to the new challenges and new opportunities and to be ready to accept unpopular measures when necessary. At the same time, government must explain to the general public the importance and urgency of the proposed reforms as well as the potential negative consequences of their further postponement.

## Chapter 2. Democratization of the state

16. During the first years of its independence, Kyrgyzstan enjoyed a reputation for being the most free and most democratic country in Central Asia. However, at the turn of the century it experienced a gradual decline towards **authoritarianism**, moving

away from the system of constitutional checks and balances in favor of excessive presidential powers. Human rights were violated along with the principle of fair elections, freedom of political parties and movements, freedom of the mass media, and independence of the judiciary. As a result, government agencies and the civil service, judiciary and law enforcement agencies were paralyzed by corruption and professional incompetence, failing to fulfill their constitutional responsibilities and persecuting citizens and businesses, instead of protecting their rights and freedoms.

17. The revolution of March 2005 has created a unique opportunity to launch far-going **political reforms** with the goal of democratizing the state, increasing the efficiency, transparency and accountability of key state institutions, and providing an effective protection of human rights and freedoms. Implementation of this objective requires comprehensive and consistent actions, including changes to the Constitution, judicial, administrative and territorial reforms and decentralization of the state, increased transparency of state institutions and measures against corruption. The set of proposals presented below needs to be implemented as rapidly as possible because consolidation of the new administration may eventually reduce its commitment to far-reaching reforms, especially those that entail limiting the authority of the executive branch of government (including the President).

## 2.1. Constitutional reform

18. Four rounds of changes initiated by the former President during the last 15 years and implemented through referenda **have undermined the legitimacy of the current Constitution**. They have resulted in the **concentration of political power** in the hands of the President beyond the point of any separation of powers, including the right of veto, the right to sign and ratify international treaties, the right to issue decrees with the power of statutes and to conduct referendums (including referendums on changes and amendments to the Constitution), the right to dissolve the Parliament and to dismiss the Government, and broad rights to make personal appointments. With this concentration of authority the role of Parliament, Government, judiciary, local self-governance bodies, and other political and civil institutions has become largely formal.
19. The experience of Kyrgyzstan and other countries of the region shows the necessity of **limiting presidential authority**. While a purely parliamentary system currently seems unfeasible in Kyrgyzstan due to the lack of nation-wide political parties, a more balanced model of distributing constitutional authority among different branches of government and within the executive branch needs to be found.
20. Concerning the executive branch of government, it is necessary, first, to clearly define the responsibilities of the **head of state** (the President) and the **head of government** (the Prime Minister). Second, the responsibilities and authority of the Prime Minister and the Government must be increased. One of the proposed measures is to grant the Prime Minister the authority to independently form the Cabinet, including the heads of regional administrations and administrative departments. The President must be denied the power to dismiss the Prime Minister and the Government at his own discretion. An even more radical variant is possible: dismissal of the Prime Minister and Government is possible only when the Parliament passes a **constructive vote of no-confidence** (i.e. with the new Prime Minister elected at the same time).

21. Another proposal is to withdraw the **President's right to convene a constitutional referendum** since such a prerogative can easily lead to power abuse, manipulation and authoritarianism (which was demonstrated both in Kyrgyzstan and in many other countries). Presidential authority to **dissolve Parliament** must be limited, perhaps only to cases where Parliament proves to be unable to form the government and approve the budget.
22. To restore the balance between the President and the Parliament, it is necessary to define their powers to **appoint high-ranking officials**. Cooperation between the President and the Parliament is needed in the case of the Prime Minister, Chairs of the NBKR, the Accounting Chamber, CEC, Prosecutor General and Constitutional Court judges. Heads of the agencies, which should be independent of both the legislative and the executive branches of government (chairmen of the NBKR, Accounting Chamber, CEC, Prosecutor General and others) must be appointed for a fixed term and their earlier removal should be impossible apart from cases of criminal offence clearly defined by the Constitution and the law and according to the **impeachment** procedure.
23. The electoral system must be changed, and a transition to a party-based representation in the Parliament must be ensured. The 75 members of the Parliament are currently elected exclusively according to a 'first-past-the-post' principle in one-mandate constituencies. This may lead to the domination of regional, local, and private interests at the expense of the national one. The situation can be changed by switching to a **proportional** election system with **thresholds for parties**, which would help to develop the system of political parties. The principle of party representation will intensify the role of national programs and interests, decreasing the role of regional and clan affiliation.
24. The expanded authority and significance of the Parliament must be accompanied by an increase in its **capacity** to adopt smoothly the required legislation. According to the current Constitution, passing legislation requires a majority of over one-half of the constituent number of deputies. For some important laws, which have the status of constitutional laws, a two-thirds majority is needed. These majority thresholds give the minority vast opportunities for blocking decision-making and, in extreme cases, paralyzing the work of the Parliament. For this reason, it is suggested to follow the experience of many democratic countries, in which passing a regular law requires only a **simple majority**, i.e. a higher number of votes for the proposition than the number of votes against it, with over one half of the deputies taking part in the voting. One may consider introducing a separate category of '**organic**' legislation (like codes), which requires a higher threshold, for example an **absolute majority** (i.e. over one half of the constituent parliament membership). The **threshold of 2/3 of all votes** should be only applicable to changes in the Constitution and to conducting an impeachment procedure.
25. It is also necessary to improve **Parliament's functioning** and organization, particularly in the sphere of **lawmaking**. The new **parliamentary rules** should make mandatory three readings of any draft legislation, as well as its examination by a respective parliamentary committee, ban introducing changes and amendments during the last reading, separate the voting procedure from the debate on draft legislation, invite outside experts and representatives of civil society organizations to the discussion of draft legislation in a parliamentary committee, provide rules of **lobbying**, etc. The proposed measures should help to increase the transparency and



public credibility of the parliament and to prevent lobbyist manipulation of the legislative process and corruption of MPs.

26. In the new Constitution the priority placed on **human rights and freedoms** (not restricted to the citizens of Kyrgyzstan) must be ensured, endowing individuals and civil society organizations with an effective means for their monitoring and enforcement. These means may include better access to regular courts, the right of individual **petition** to the Constitutional Court in cases of violations or restrictions of human rights and freedoms by laws or subordinate legislation, and an increase in the prerogatives of the ombudsman, while obliging that person to cooperate with NGOs.
27. In the new Constitution the **charter rights and freedoms** must correspond to the major internationally recognized treaties, such as the Universal Declaration of Human Rights and the International Covenant on Civil and Political Rights. The latter must have binding force in the internal legal system including its direct application by the courts. The new Constitution should also clearly determine the **priority of international treaties and agreements** ratified by Kyrgyzstan over local legislation. Moreover, a clear **hierarchy of the domestic sources of law** must be established: ‘organic’ laws (if this idea is approved) — regular laws — executive orders and other subordinate legislation (only within specific authorization granted to the executive power by a concrete law).
28. The new Constitution should transfer the right to issue arrest warrants from the prosecutor's office to the courts and ban the death penalty, as well as the extradition of people suspected of crimes to countries where there is the threat of torture or the death penalty. These changes would improve considerably the protection of human rights. At the same time, any limitations to human rights and freedoms must be minimized and clearly defined by the Constitution without references to other laws in order to prevent gradual expansion of such limitations.
29. The Constitution should offer citizens the right to obtain **compensation** if their rights and freedoms are violated or if they suffer material damage as the result of illegal actions by the state. At the same time, **civil and criminal liability** for individual **government officials** for their decisions and actions must be introduced.
30. A guarantee of **free access to information** will increase civil society’s ability to control state institutions and to fight corruption. This primarily concerns all information about the activities of the government, including public spending by the national government and local governments. The Constitution should set reasonable limits on state secrets, protection of personal data of governmental officials, the responsibility for libel as well as the immunity of public functionaries so that the law will not mask the abuse of power or corruption.
31. The Constitution should also contribute to strengthening the **foundations of a market economy**. **Private property** (including private ownership of land) must be defined as the foundation of the socio-economic system and directly protected by a constitutional norm. Exemptions from this norm (expropriation for public needs with full material compensation) must be clearly regulated by law. The same holds true for **freedom of entrepreneurship** — only law can define legitimate exceptions to this principle. On the other hand, the scope and substance of citizens' social rights should be defined by law.
32. The Constitution should also protect a **stable currency** and **long-term fiscal equilibrium**. The first proposal requires increasing the **independence of the NBKR**

through granting personal stability to its Chairman and members of the NBKR Board. They should have guaranteed tenure except for impeachment in the case of serious criminal offence. It also seems reasonable to set constitutional **limits on the fiscal deficit and/or public debt** as a percentage of budget revenue or GDP and prohibit the NBKR from financing a budget deficit. The constitution should, on the one hand, oblige the authors of legislative drafts to present their immediate and long-term financial consequences both for the state and for economic agents while, on the other hand, it must prevent JK from passing laws that decrease budget revenue or increase budget expenditures without the approval of the Government.

33. The process of constitutional reform faces a number of serious obstacles and risks. On the one hand, democratization calls for ensuring a high degree of legitimacy for the new Constitution, which requires wide consultations with various constituencies and civil society. The need for the formation of a constitutional culture also suggests a slow process of consultations which can be used for raising the constitutional awareness by the population. On the other hand, there is a limited window of opportunity in which a relatively good and consistent Constitution can be adopted. For example, the presence of extensive prerogatives in the current Constitution could reduce the commitment of the newly elected President to transfer some of these powers to other state authorities. Moreover, the need to have the constitutional changes approved by two-thirds of MPs implies the risk of compromising their quality and consistency, because individual MPs or groups of MPs can demand specific concessions. For the same reasons it is not advisable to postpone decisions on some key constitutional issues and to delegate their regulation to special constitutional laws.

## 2.2. Judicial reform

34. Despite the reforms that have been implemented during the past fifteen years, the judicial branch is one of the weakest components of the Kyrgyzstan state system. Inadequate professional competence, high levels of corruption and the willingness of many judges to carry out the political orders of the executive power, has resulted in an increasing lack of trust in courts by the population as well as by economic entities. Consequently, judges are incapable of efficiently fulfilling their constitutional responsibility to protect human rights and freedoms, to protect property rights, to provide contract enforcement, and to control the legitimacy of administrative decisions. The post-revolutionary events of the spring of 2005 have revealed that the judicial system is paralyzed and that it fails to meet the responsibilities it carries in a democratic, rule-of-law state with a market economy. In part this situation is caused by the following:
- ◆ the continuing presence of judges who started their careers in the Soviet period and the political mechanisms of their appointment and dismissal;
  - ◆ the inferior quality of the system of **legal education** and the natural resistance of the legal community to any drastic changes, including those required by democratization and market reforms;
  - ◆ **inadequate financing** of the judicial system, including low salaries of judges and public prosecutors;
  - ◆ **non-transparent work** of the judiciary, lack of effective **enforcement of court decisions**.

35. A comprehensive legal and judicial reform is needed to ensure that constitutional rights and freedoms are effectively enforced, to improve the business and investment climate, and to avoid arbitrary behavior on the part of the public administration. On the other hand, it is necessary to understand that its successful implementation will require much time and long-term consistency. In particular, the reform must meet the following requirements:
- ◆ give society a sufficiently clear message about the fundamental nature of changes, which would result in an entirely new, competent and **independent judicial system**;
  - ◆ be **comprehensive**, including reform of the legal education system, material and procedural legislation, law enforcement agencies (prosecutor's office, police, national security service, etc.), the enforcement of court decisions, the penal system, and legal services (including the Bar, notary services, etc.);
  - ◆ ensure strict professional and moral criteria when **selecting candidates for judges** and limit opportunities for their dismissal; this would ensure that the **judges are independent and accountable** — individually, not corporately, and only against the law;
  - ◆ ensure smooth transition to the new system without compromising the quality of services provided to the public.
36. The reformed judicial system must include **ordinary courts** authorized to handle both civil and criminal cases within the Supreme Court system. It must also include a system of **magistrates' courts**. The authority of the latter should be quite limited (the judges of these courts do not necessarily have to be professional lawyers), but they should also take much of the load off the courts of general jurisdiction. In the long term, a transition to the **election of magistrates** would be appropriate. Along with these courts, which would form the core of the judicial system, it would be also advisable to create **specialized judicial and quasi-judicial bodies** (including private and public arbitration bodies, courts of arbitration, bankruptcy courts, administrative courts, tax courts, committees on labors disputes, etc).
37. The right to **appoint judges** to ordinary courts must be vested in the President, who would select them from candidates recommended by the Council of Justice (see Paragraph 40) and who have relevant training, legal and judicial practice, and an unimpeachable reputation. The appointed candidates would receive additional professional training.
38. To ensure that judges would be subordinated only to the law and would not depend on other branches of government, public or political forces during their term in office, **lifetime appointment** is necessary (until retirement or voluntary resignation). Should a judge commit a criminal offence or violate professional ethics (see Paragraph 40), a special procedure for dismissing the judge (similar to presidential impeachment) would be used.
39. Guaranteeing the independence and high social status of judges also requires a competitive level of remuneration. The same holds true for assistant judges and other employees of the judicial system. Financing of the judicial system must be increased to improve its administrative quality, the security of court premises, and to supply courts with modern technical equipment. Administration of the court system must be provided by the Department of Justice under the Supreme Court.

40. The new Constitution and the law on the judicial system should mandate the formation of a new collective body, the **Council of Justice**, which would consist of the most experienced and competent judges and representatives of the President, the Parliament, and the Ministry of Justice.<sup>3</sup> The Council of Justice will be responsible for:
- ◆ selecting candidates for judgeships and short-listing them for Presidential nomination (see Paragraph 37);
  - ◆ approving the professional code of ethics for judges (see Paragraph 38);
  - ◆ reviewing complaints against courts and individual judges;
  - ◆ reviewing disciplinary cases against judges.
41. To ensure that the **judicial proceedings** are **transparent** and comply with relevant laws, it is suggested to:
- ◆ introduce the institution of the **jury** for reviewing especially serious offences. The right to a ‘court of peers’ is one of the oldest institutions and it has proved to be very effective in ensuring that the courts are independent and conform to the principles of the law;
  - ◆ introduce the **mandatory publication** of all court decisions within a specified timeframe and make it necessary to issue legally valid copies of the court decision to the parties on the day the decision is made (in special cases, by a specified time on the following day);
  - ◆ secure the right to **public monitoring** of court proceedings and publication of the results of such a monitoring.

### 2.3. Public administration reform

42. Despite many changes in the structure of the Government and public administration organs, both at the central and regional levels, they remain largely non-functional and ineffective. The standards and quality of their operations fail to meet the needs of a modern state guaranteeing democracy and the rule of law and in which a functioning market economy is present. Public administration contains too many agencies and units and employs too many people who are poorly paid, often lack professional competence, and are frequently corrupt. Far too often its actions place a burden on individuals and businesses.
43. The main objective of the public administration reform (PAR) is to improve its efficiency and ability to provide basic **public goods**, while limiting its interference in the production and distribution of private goods by economic agents (see Section 3.2).
44. A major reason why the current system of public administration is ineffective is the lack of a clear **division of responsibilities** among executive bodies. Ministries and administrative departments combine political, regulatory, and control functions, along with the function of rendering public services. Sectoral ministries exercise

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<sup>3</sup> According to a Presidential Decree of 14th December 2004, the National Council of Justice under the President of Kyrgyz Republic was created. Its purpose is to select and propose candidates for vacant positions of judges in local courts and to certify local court judges. However, this council stems neither from the Constitution nor from legislation.

control over themselves, which creates organizational ground for corruption. Ministries lobby the interests of their subordinate entities in the budgetary and legislative processes. Multiple and overlapping functions between various ministries and agencies requires a complex co-ordination mechanism at the Government level. Technical and auxiliary functions are not separate from the civil service, resulting in excessive personnel in executive bodies and limited performance efficiency.

45. To increase the efficiency of the Government and central administration, further **simplification** of its structure is needed while redundant and unnecessary functions should be eliminated (especially those that contradict a democratic, market-based system). Its **size should be reduced**, and the budgetary funds that will be saved as a result of this reform should be used to increase the salaries of the remaining civil servants.
46. Following the constitutional reform and the transfer of some presidential authority to the Prime Minister and the Government (see Section 2.1), **the powers of the Presidential Administration** must be limited. In previous years this body has virtually gained the status of an independent public agency that often duplicates the responsibilities and tasks of the Government. The role of the Presidential Administration should be limited to the technical functions of the Head of State.
47. **Structural reorganization of the Government** and individual ministries/agencies should be carried out on the basis of a comprehensive and independent functional analysis (using the result of analyzes carried out during the previous years under various technical assistance programs). **Four types** of public administration bodies are suggested:
  - ◆ **ministries** — political organs in charge of designing and carrying out government policy and of coordinating the operations of state agencies, services and inspectorates working in the sphere of their responsibility (for example, Ministry of Finance, Ministry of Justice, Ministry of Defense); their number should be limited;
  - ◆ **services**, i.e. organs that provide services related to law enforcement and that are financed solely from the budget or through mandatory payments of economic agents (bailiffs' service, tax service, Customs);
  - ◆ **inspectorates**, i.e. controlling organs;
  - ◆ **agencies**, i.e. bodies that provide public services financed both from the budget and on a fee basis.
48. Rationalization of the general structure of the Government should be accompanied by the internal restructuring of each ministry or agency, including moving towards a **module-based** structure with the department as the main structural unit endowed with concrete task and prerogatives.
49. It is recommended that methods of **activity-based management** and **performance measurement** and **audit** be gradually introduced to public administration, which will allow the objective evaluation of the operations of each unit and civil servant. This should be followed by a shift from traditional item-based budget planning to program- and performance-based budgeting (see Section 3.1.3). Consequently, heads of government bodies and their internal units should receive more room for maneuver in determining their internal structure and staffing and way of spending the salary fund, as well as in shifting budgetary funds between spending items. This

would contribute to developing outsourcing of many non-political activities and functions to private (and non-profit) sector entities on a competitive basis.

50. When preparing the draft of any legislation, employing the methodology of Regulatory Impact Analysis is highly recommended. It can help to assess *ex ante* the effectiveness of public policy in **regulating economic activities** from the cost-benefit standpoint to prevent the adoption of legislation that would deteriorate the business climate or generate corruption (see Sections 2.5 and 3.2.1). This kind of analysis takes into account the consequences of government decisions and regulations both for the budget and for businesses and the society. Furthermore, the existing practice of preliminary online publication of draft legislation must be expanded and a requirement to publish all legislative drafts (for example, on the Ministry of Justice website) must be introduced.
51. Along with the structural reorganization of the Government and public administration, the **civil service reform** that was started several years earlier must be continued, involving also local self-government. Special emphasis must be placed on:
  - ◆ political neutrality and the stability of the civil service, where a clear distinction is made between political positions (where an appointment is related to the party composition of the Government and parliamentary majority) and non-political positions within the civil service corps;
  - ◆ selection of candidates for public service based exclusively on professional criteria and an open competitive mechanism; it is also necessary to modernize the professional training of civil servants, to set clear principles for their professional career and to base remuneration on their skills, work experience and performance.
52. The **legal procedures of administrative decision-making** should be clearly defined by the Administrative Code and the Administrative Procedural Code along with the procedures for appealing these decisions in court (and through a specially created system of administrative courts – see Section 2.2).

## 2.4. Local self-government and decentralization

53. At present, the legislation that regulates local self-government in Kyrgyzstan features many shortcomings and inconsistencies. As a result, independent local self-government has not yet emerged. Although the local authorities and their heads are elected by popular vote, the funding of public services rendered by local self-government is far from perfect. In fact, there is no system of local taxes; local self-government bodies are hierarchically subordinate to government bodies; resources are arbitrarily distributed to different levels of the budget system, depriving municipal authorities of incentives to increase efficiency of the supplied public goods.
54. Local self-government is the public authority that is closest to the public and, therefore, it can be considered as an institution of self-organization of society and a form of civil society. For this reason, the system of independent self-government bodies — vested with their own prerogatives, financial resources and accountability with respect to their electorate — must be further developed and consolidated. Taking into account small populations and the limited economic potential of many

rural *aiyl okmotu*, which make them incapable of fulfilling the expected tasks and responsibilities, their territorial consolidation seems to be unavoidable.

55. The **functions and prerogatives of state administration and local self-government must be clearly delimited by the Constitution**. The relevant law must clearly define the prerogatives of local self-government (traditional issues of local significance) and introduce the concept and mechanism of delegating powers and responsibilities to lower levels of public authorities (for example, secondary education), along with the transfer of financial resources needed for carrying out these tasks.
56. In the proposed concept local self-government bodies would **approve their budgets independently**. The expenditures would be directed for financing their own and delegated tasks while revenues would be generated through local taxes and grants from the national budget. It is suggested that revenues from local taxes, together with the grants and revenues generated by municipal property, will be fully allocated to the local budgets **without any requisitioning** by state authorities. Implementation of the delegated tasks must be accompanied by the transfer of the relevant financial resources from the state budget. Generally, expenditure responsibilities must be consistent with revenue assignment.
57. The system of budget grants must be further improved. In particular, the size of both **specific ('categorical')** and **equalization grants** must be calculated on the basis of already existing objective criteria of revenue potential and expenditure requirements. The specific grants should finance the delegated tasks while a formula-based equalization grants will supplement local sources of income in order to implement the local tasks. This system must include incentives for local self-governments to augment their own revenue capacities.
58. Along with providing stable financial sources to local self-government and increasing its budgetary autonomy, it is necessary to strengthen its accountability and responsibility. If the financial sustainability of a local self-government unit is under threat as a result of decision(s) taken by its organs, the Government must reserve the right to interfere by introducing temporary **external financial administration**.
59. To make public administration more efficient and less expensive, we propose to introduce a **three-tier** structure of public administration: **the Government – regional administrations – local self-governance bodies**. Within this structure regional administrations will play the role of delegations of the national government financed from the national budget. Thus regional units of the national government must be delegated the power to manage respective parts of the state budget funds along with a clearly defined mandate to provide certain public services.

## **2.5. Fighting corruption and increasing the transparency of the state**

60. Corruption is a major social, economic and political problem in Kyrgyzstan and a serious obstacle to its further development. International ratings (for example, Transparency International) regularly place Kyrgyzstan among **the most corrupt countries in the world**. Anti-corruption programs prepared by local and international experts in recent years have failed to yield the expected outcome since the former authorities did not take these recommendations seriously and were not able to implement them properly. The same can be said about the **United Nations**

**Convention against Corruption** signed by Kyrgyzstan in December 2003 (as the first CIS country) and ratified in June 2005.

61. The Decree of the Acting President on the National Strategy to Combat Corruption in the Kyrgyz Republic, signed on June 21, 2005 together with an Action Plan, gives hope that the new leadership of the country has an adequate understanding of the problem and of the immediate threat it creates for the society and for the state. The **Strategy and the Action Plan** are intended to combat the roots of corruption and not just their consequences. They recognize that corruption is not only a crime but also a complex social problem. Several proposed measures can have a great potential impact: improving anti-corruption legislation, liberalizing the procedure of issuing licenses for businesses (see Section 3.2.4), and increasing the transparency of the national and local budgets. Yet there are some issues that need further examination and discussion.
62. The Strategy proposes establishing a **special unit** responsible for formulation and coordination of anti-corruption policy. However, this idea needs to be further discussed. The importance of such a unit should not be overestimated by assigning too many tasks to it. In particular:
  - ◆ a new controlling organ vested with very extensive powers would inevitably become an instrument for advancing someone's corrupt or political interests. It should not be forgotten that any authority needs a system of checks and balances no matter how noble and sincere are the original ideas and people pursuing them;
  - ◆ the new body should not and cannot be vested with any **independent political or administrative power**. It must be clear to everybody that anticorruption measures are initiated, implemented and supported by the highest political leadership of the country, who take personal responsibility for the results. Therefore, the new anticorruption unit should be a part of the Presidential Administration or the Prime-Minister's Office, and not an independent or semi-independent body;
  - ◆ the anti-corruption unit cannot be regarded as a **part of the security forces/law enforcement agencies**. For this reason its institutional and physical location must be different from those of the security agencies, such as the Security Council. The agency must be easily accessible and open to the public and to civil society organizations;
  - ◆ it seems appropriate that the anti-corruption department would employ **civil servants**. Therefore, representatives of civil society should not be viewed as part of the new unit or participants in decision-making. Instead, there must be specific mechanisms (legal, communicational, staffing) created, which through this unit enable all (and not just government-selected) NGOs, experts and citizens to get full information about the anti-corruption plans and activities of government institutions, to make recommendations and to perform effective monitoring;
  - ◆ criminal **investigation of corruption-related crimes** must not become the responsibility of any special body placed outside the law enforcement system (although specialized units can be established within this system), as this would lead to duplication of functions, ineffective expenses and constant fights between the special 'anti-corruption' body and general law enforcement agencies. On the other hand, the new anti-corruption unit within the Presidential Administration or Prime Minister's Office should focus on policy recommendations for decreasing corruption in law enforcement agencies and for increasing their effectiveness in the investigation and prosecution of corruption-related crimes.



63. The most important instrument to keep government agencies accountable is **free access to information**. In addition to relevant amendments to the Constitution (see Section 2.1), a special law is needed to make all information kept by government agencies — except that which is legally defined as state, personal, or commercial secret — truly accessible to each individual. Such information must be provided without delay to any individual, NGO or media upon their request. The proposed measures are closely linked to the task of creating an ‘electronic government’.
64. It must not be forgotten that demands to take emergency measures against corruption and political manipulations associated with their implementation have, in many historical instances, created a social and ideological pretext for renouncing democracy and establishing dictatorships. Consequently, when planning and implementing anti-corruption measures, ‘witch-hunting’ must be avoided and human rights must be protected, with the presumption of innocence strictly observed. The anti-corruption fight must lead to strengthening democratic institutions rather than undermining their still weak foundations. The belief that authoritarian regimes are better at fighting corruption is but an illusion.
65. **Free and independent** — from the authorities and from business — **mass media**, capable of providing **professional investigative journalism**, is the most effective instruments for fighting corruption. Reorganization of the **state television channel** cannot be limited to just a change of the channel's name (as has happened in some other post-communist countries). The public television should get a stable source of financing without annual interference by the Government or Parliament. The management of public television should not be accountable to any public institutions and the journalists and producers should enjoy complete professional freedom from the management of the TV. Commercial advertisements on public television should be banned. The taxation system, telecommunications regulations, and rules regarding commercial advertisements in the private media must be adjusted to strengthen their independence and minimize the risk of corruption.
66. Although fighting corruption is difficult and it is impossible to achieve substantial results quickly, the Government should demonstrate its determination to move in the right direction and show tangible results of its effort. Several **symbolic, simple and illustrative measures** can play a key role in mobilizing public opinion and building trust in the intentions of the new government, for example:
- ◆ immediate reform of the **traffic police (GAI)** based on experience of other post-communist countries that have achieved tangible results within few months;
  - ◆ abolishing **special license plates** on government vehicles. This simple step would send a very important message to high level public officials and to the people that government is determined to fight the privileged treatment of public officials;
  - ◆ rapid elimination of the shortage of **new passports**.
67. The anti-corruption campaign must not destroy the **traditional culture**. It is evident that in most cases corruption has become an established life-style of Kyrgyz society and corrupt beliefs have penetrated the social consciousness. Thus, it is critical to separate carefully the corrupt habits that would lead to a national disaster from behavior that constitutes a genuine feature of the national culture. For example, there is nothing wrong with one’s desire to help her/his relatives. However, private - not public - resources must be engaged for such support.

68. Apart from blaming and punishing people involved in corrupt practices, it is essential to demonstrate publicly both achievements and effective methods of fighting corruption. It is not enough to show the arrests of high-ranking officials on television; it is much more important to demonstrate effective anticorruption measures, which citizens could repeat on their own, without armed police units. For instance, a competent and respected NGO could announce that it will place its representatives at the entrance to the passport office to help people do the required paperwork without making additional payments. Another example would be NGO help in registering criminal offences in parallel to the police. Supported by the media, these simple campaigns could have many positive effects, including restoring self-confidence to the society.

## **Chapter 3. Sustaining Economic Growth**

### **3.1. Achieving macroeconomic stability**

#### **3.1.1. Maintaining macroeconomic sustainability**

69. In 1996, after a major decline (by almost 50%) caused by a transformation shock and loss of the transfers from the USSR budget (see Chapter 1), GDP started to recover. In 1996-2004 the average annual rate of GDP growth amounted to 5.2% with the following characteristics:
- ◆ growth rate was unstable, varying between 0% in 2002 and 9.9% in 1997;
  - ◆ growth was concentrated mostly in a few sectors, such as gold mining, agriculture, trade, and some other services; a major role was played by a couple of major investment projects funded from external sources (Kumtor, road construction, telecommunications, etc.);
  - ◆ nearly all GDP growth went to private consumption, while government consumption experienced only a minor increase, and exports (without gold) and capital investments fell as compared to 1995.

As the earlier sources of growth have started to lose importance (the gold reserves at Kumtor have been slowly depleted, agriculture is facing major productivity problems, etc.) they should be diversified in order to ensure the long-term sustainability of economic development.

70. Long-term sustainability of economic growth requires stability of the national currency, as well as keeping fiscal and current account deficits under control. Throughout the 1990s the country experienced macroeconomic instability (initially hyperinflation, then high inflation, several episodes of currency devaluation, a current account deficit exceeding 20% of GDP, etc.), which was caused by a deep fiscal disequilibrium (in some years the budget deficit reached 17% of GDP). More responsible fiscal and monetary policies carried out in 2000-2004 have helped to improve the macroeconomic situation, reduce annual inflation to less than 5% and the budget deficit to 5% of GDP, diminish the current account deficit, and stabilize the national currency. However, the problems of long-term macroeconomic sustainability are far from being solved — the fiscal deficit is still high and the ability of Kyrgyzstan's economy to accommodate possible external and internal shocks needs to be further increased.

71. **Responsible macroeconomic policy** is a key condition to ensure sustainable economic growth. Its main objectives in the medium-term are as follows:

- ◆ to ensure currency and price stability, and
- ◆ to continue reduction of the general government deficit, including the PIP and SF.

**Responsible monetary policy** oriented towards long-term price stability should be continued. In institutional terms this requires further strengthening of the NBKR's independence - both through the constitutional amendments (see Section 2.1) and respective changes in the law on NBKR. The dynamics of money supply cannot exceed the increase in demand for money. A managed float regime with selective central bank interventions aimed to smooth the fluctuations of the *som* exchange rate seems to be justified in the current circumstances. This policy has contributed to substantial increases in the international reserves of the NBKR in the last couple of years, helping to prevent the danger of speculative attack during the revolutionary events of Spring 2005. At the same time, the NBKR should resist the pressure of some economic agents in favor of *som* devaluation.

72. Reduction of the fiscal deficit requires both increasing budget revenues (see Section 3.1.2) and keeping expenditure dynamics under control, including changes in their structure (see Section 3.1.3). The current budget must be balanced in the short-term, while new borrowing within the PIP must be further reduced. This is closely connected with the strategy of public debt management and attracting foreign aid (see Section 3.1.4).

### 3.1.2. Increasing budget revenue and eliminating tax inequality

73. In recent years general government revenues (including SF) have increased somewhat, reaching 23.0% of GDP (20.4% of GDP in 2001). Compared to other countries, including CIS members, budget revenues in Kyrgyzstan remain very low.

74. Taxes are the key component of budget revenues and their collection has increased recently, resulting in an increase in total revenues mentioned in the previous paragraph. However, Kyrgyzstan's **tax system** in its present form represents numerous flaws:

- ◆ it is too **complex and complicated** with many privileges and exemptions and high basic rates;
- ◆ it has **lost its inner logic**, exhibiting numerous legal inconsistencies and non-transparent administration;
- ◆ the **tax burden is unevenly spread** among economic sectors and various types of taxpayers.

75. The so-called special means, generated mostly out of charges for paid services provided by the budgetary organizations, constitute the main component of non-tax revenues. The current principles of planning, accounting, redistributing, and spending these special funds lack transparency and hinder the development of the education and healthcare sectors (which are the main generators of special funds – see Sections 4.1 and 4.2), and contribute to an increased regulatory burden and corruption in public administration (various administrative fees constitute the second largest source of special funds).

76. The state retains a significant stake of property in the form of agricultural land, key enterprisers in the energy sector, telecommunication, transport, and some other

industries (see Section 3.3.1). At the same time budget revenues generated by this property are insignificant.

77. To increase fiscal revenues and eliminate tax inequality, comprehensive **tax reform** is necessary. This reform should:

- ◆ simplify the tax system;
- ◆ decrease basic tax rates and broaden the tax base, enabling simplification of tax administration;
- ◆ more equally distribute the tax burden among various categories of taxpayers;
- ◆ reduce tax privileges and exemptions;
- ◆ introduce equal treatment of domestic and foreign owned enterprises;
- ◆ eliminate discretionary decisions on the part of tax authorities regarding the terms of taxation and the extent to which taxpayers must fulfill their obligations.

Tax policy will be successful only if the tax administration is reformed to achieve a balance between the rights of the taxpayers and tax authorities and to reduce corruption among tax and customs officials (see Section 3.2.5).

78. The key components of the tax reform must include:

- ◆ restoring the **standard system of VAT collection** as a **consumption tax** that promotes investments and exports, both of which are needed by Kyrgyzstan's economy. In this standard set-up, VAT is collected at each production and distribution stage and at each stage the producer can promptly receive refund of VAT included in the price of material resources/services used. The refund procedure should be clearly determined by the relevant law and it should not require discretionary decisions of the tax authorities. To achieve the above goal **VAT exemptions must be eliminated for sectors producing primary products** (agriculture, gold mining, and some others) and problems with **VAT refunding** must be solved, especially for export operations (this requires realistic budget planning of VAT refunds). The registration **threshold** (in terms of annual turnover) for VAT taxpayers must be raised, allowing the tax authorities to concentrate their efforts on controlling major taxpayers.
- ◆ broadening the tax base (by eliminating the existing exemptions) and introducing a **flat rate of personal income tax**;
- ◆ introducing a **regressive (double-rate) scale of SF contribution**: a basic rate and a zero rate after crossing a certain threshold of annual income. To increase administrative efficiency and fiscal discipline the SF contribution should be changed into a social tax and responsibility for its collection moved from SF to the tax authorities. A significant increase in SF contributions for farmers and lump-sum taxpayers is also needed to eliminate the current tax inequality and improve pension insurance and medical coverage of these important groups;
- ◆ maintaining the simplified tax and accounting rules for SME while increasing transparency of this sector. The special tax regime for SME must be harmonized with VAT rules, i.e. the right to its use should depend on taxpayer's annual turnover and whether the concrete SME employs workers. Consequently, two tax schedules are proposed: a **lump-sum tax** for micro-businesses (family enterprises without hired workers, which do not need to keep books for tax purposes) and a **simplified tax** for small businesses with proceeds below the VAT registration threshold;

- ◆ gradual **elimination of turnover taxes** (contributions to the emergency situation fund and road tax). In the medium term exemptions from these taxes must be eliminated, the targeted character of these taxes must be abolished, and all these taxes must be consolidated into one with the aggregate rate reduced to 1%. In the long run this kind of taxation must be abolished completely;
  - ◆ increasing the rates of the **excise tax** on alcohol and tobacco products and improving their administration; a better coordination of tax rates with neighboring countries is also required in order to eliminate cross-border legal and illegal arbitrage;
  - ◆ increasing the **water tax** (a fee for using water resources); this payment must become closely linked to the actual economic costs of water use for irrigation and other business purposes and it must promote more efficient use of water resources;
  - ◆ improving **environmental fees**;
  - ◆ introducing a **real estate tax** and substantial increase of **taxation on owners of transport vehicles**; these measures would redistribute the tax burden towards the middle- and high-income sectors of the population;
  - ◆ increasing the fiscal role of taxes on **natural resources**, which are less mobile and which cannot be easily evaded (non-agricultural land tax, severance tax, mineral replenishment tax);
  - ◆ **eliminating** and banning **tax regimes** based on **individual decisions** of tax authorities or individual agreements between the taxpayers and tax authorities.
79. Financing operations of public administration agencies out of **fee-based services** must be discontinued and replaced by budget financing. The government should stop its attempts to **centralize a portion of proceeds from fee-based services** of education and medical institutions (leaving all revenues to their disposal) and to redistribute resources from more to less efficient institutions. Also reform of the legal status of institutions providing these services is necessary, and new forms of financing services in the education and healthcare sectors are required (see Sections 4.1 and 4.2). All the paid social services should be the subject of income taxation, regardless of ownership status of their providers. Non-tax revenues can be boosted by increasing the efficiency and transparency of using (or selling) state property.

### 3.1.3. Rationalization of public expenditures

80. The reduction of general government deficits in the beginning of the 2000s was achieved mostly by cutting public expenditures,<sup>4</sup> primarily for PIP, public administration, defense and law enforcement agencies, and various sectors of the national economy. All social expenditures have increased: in 2004 they exceeded 50% of all public spending. Unfortunately, all government programs are chronically under-financed (comparing to their real needs) because of political inability to define realistic and feasible spending priorities. This would involve abandonment of many spending commitments inherited from the Soviet era, which cannot be sustained in today's circumstances. The above mentioned under-funding leads to the poor quality of many public services, deterioration of basic infrastructure, and the spontaneous forced substitution of insufficient public financing with private financing. This usually disadvantages the poorest sectors of the population.

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<sup>4</sup> Precisely speaking, decrease of expenditure-to-GDP ratio and a slight increase in real terms.

81. **Reduction of total public expenditure** (in terms of percentage of GDP) must be continued. The structure of public expenditures and methods of their programming require a comprehensive reform. Such a reform should include:

- ◆ increased financing of the **priority spending programs**; this can only happen through a redistribution of resources from low-priority areas which would require taking tough political decisions to stop completely the financing of non-priority programs;
- ◆ moving from input-based budget planning (for example, number of teachers and doctors employed, the volume of electricity consumed, etc.) to program- and performance-based medium-term budgeting with account taken of the planned outputs (for example, number of students taught, number of cases of medical help, etc.);
- ◆ stopping immediately any form of **non-monetary settlements** (netting-out operations, barter, payment of in-kind benefits, etc.) between the budget and businesses or individuals; this should limit the inefficient use of budget funds and reduce corruption;
- ◆ establishing a close **relationship between the quantity and quality of services** supplied by the public agencies **and the size of their budgetary financing**; this would require a system of independent quality control for all kinds of public services;<sup>5</sup>
- ◆ **transferring** many of the **tasks and responsibilities** currently formally performed by the public sector **to the private sector**, combining budget financing with the fees of service recipients in a maximally transparent manner and eliminating unofficial payments to the service providers; where the government contracts out private sector services a fully competitive and transparent environment must be guaranteed;
- ◆ using private audit companies to **audit** the use of public funds; audit results should be widely published in the media and accompanied by information supplied by relevant ministries on measures taken to eliminate observed shortcomings. The resources of the Accounting Chamber and internal audit service of government agencies should be used for a thorough analysis of expenditure programs, for evaluating their efficiency (performance-based audit) and for working out proposals to improve the legislative framework and program design;
- ◆ reducing **public investment expenditures** within the PIP financed out from external borrowing and limiting new loans only to the projects with a clearly determined perspective for repayment and self-maintenance; investment projects in the social sphere can be only funded either from own funds or from foreign grants.

#### 3.1.4. Sustainability of foreign debt

82. Kyrgyzstan began its independence with no foreign debt; by the end of 2004 the country's foreign debt had reached nearly USD 2 billion, or 89% of GDP. After the financial crisis of 1998-1999 and the drastic devaluation of the *som* (the result of huge and unsustainable fiscal and current account deficits — see Section 3.1.1) the country became unable to service regularly this debt. Debt sustainability was restored only after debt restructuring and a partial debt write off by the Paris Club in 2002 and 2005. This mechanism cannot be used in the future because the 2005 agreement with the Paris Club includes the provision that the Government will not request any further restructuring. Apart from the Paris Club, other creditors include the IFI, primarily the World Bank, ADB, and IMF. Servicing of this part of the debt will require considerable budgetary resources soon (in the second half of this decade)

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<sup>5</sup> For example, the testing system for secondary school graduates that is already operating.

after the grace period of many of these loans expires. While IFI provided concessionary loans on very preferential terms, their writing off is virtually impossible.<sup>6</sup> Therefore, Government cannot count on any future significant debt restructuring and should follow a firm strategy of foreign debt management that would prevent the danger of a future debt crisis.

83. Such a strategy (which the Government has already started to implement) should focus on simultaneous implementation of two tasks:
- ◆ increasing the government's capacity to repay the external debt, which implies raising budget revenues (see 3.1.2) and proceeds from privatization (part of which should be used for repaying public debt). It is also important to improve the current account balance by increasing exports;
  - ◆ strict control of **new borrowing**; in particular, borrowing intended to finance current budget expenditures should be eliminated as it does not help in structural changes and provides negative incentives to mobilize domestic resources. It is equally important to decrease borrowing under the PIP, in accordance with the PRGF.
84. While solving the external debt problem it is possible to mobilize additional external resources for important and under-funded public programs, which have not only national but also global impact, such as ecological ones. This could be accomplished through the mechanisms of debt-for-development and debt-for-environment swaps.
85. Further **foreign aid** inflow should not lead to **increasing the country's indebtedness**. The support to structural reforms by international donors can be provided through grants instead of credits. The grant component should be increased by up to 50% in the case of external financing of the PIP as it was declared during the Consultative Group meeting in 2002. Under the PIP only preferential loans for profitable projects should be considered. Moreover, it would be desirable to allocate an increasing share of external aid to the private sector (credits to enterprises without government guarantees), NGOs (grants for social development) and local self-government.
86. The decreasing size of new external borrowing should be substituted with FDI and domestic investments. To make this substitution possible, the government should provide potential investors with political stability, better governance (see Chapter 2), and a favorable business climate (see Section 3.2), while maintaining macroeconomic stability (see Section 3.1.1) and accelerating privatization (see Section 3.3.1).

### 3.2. Creating a Favorable Business and Investment Climate

87. In recent years the Government of Kyrgyzstan has emphasized, on several occasions, the importance of implementing reforms that would create a favorable investment climate. The short-term programs known as 'investment matrices' have led to ambiguous results. On the one hand, many laws aimed at improving the investment climate have been adopted but, on the other hand, as surveys show, local and foreign entrepreneurs believe there has been little progress in decreasing the regulatory burden.

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<sup>6</sup> The IFI do not write off their claims except for the HIPC initiative for the world's poorest countries; however, Kyrgyzstan is not one of them.

88. Unfortunately, the reforms aimed at the elimination of corruption (see Section 2.5), effective implementation of already adopted laws, and transparent governance have not been fully implemented. The government does not fulfill its regulatory functions effectively.

### 3.2.1. Stability and Predictability of the Legislation

89. The legal system in Kyrgyzstan lacks stability and predictability, which causes uncertainty in the business environment and leads to higher investment risks and costs. Although the law ‘On Legal Normative Acts of the Kyrgyz Republic’ adopted in 1996 regulates the procedure for drafting and publishing laws, this act is far from perfect, and subject to continuous changes and amendments.
90. The legal system has the following disadvantages:
- ◆ it contains **duplicating** and, in some cases, **contradictory** legal norms based on various principles of law; it also includes legal gaps and too many references to other acts;
  - ◆ there are some **legal collisions**, particularly **contradictory cross-references** between different laws. In particular, the law ‘On Production Sharing Agreements in the Mining Sector’ and the Tax Code contain empty cross-references in determining tax rates;
  - ◆ executive orders often **distort and contradict** the law;
  - ◆ many laws represent **narrow sectoral and corporate interests**. In some cases, laws contradict declared government policy in a particular sphere.
91. Stable and predictable legislation is one of the conditions for improving the business and investment climate. Therefore, it is important to change the law ‘On Legal Normative Acts of the Kyrgyz Republic,’ which would:
- ◆ provide a clear **hierarchy of legal acts** and introduce obligatory legal, financial and economic expertise to the projected draft laws, including the Regulatory Impact Analysis (see Section 2.1 and 2.3);
  - ◆ set reasonable dates of entering into force for new laws.
92. It is also important to decrease instability and uncertainty with respect to the future legal and regulatory regime. In order to achieve this, the following steps should be taken:
- ◆ informing public about drafts of new legal acts through the media and Internet (see Section 2.3);
  - ◆ continuing the policy of **joint effort** by representatives of public administration, civil society and the private sector on drafting new legislation;
  - ◆ attracting public interest to the legislation process in JK (see Section 2.1); Parliament should inform the private sector about new legislation initiatives through a monthly bulletin and website updated daily.

### 3.2.2. Registration of Legal Entities

93. Despite considerable progress in the sphere of business registration and the promises of previous governments to create favorable conditions for establishing new enterprises, Kyrgyzstan still lags behind many developed countries in terms of the



number of procedures, time and costs needed for registration. The law ‘On State Registration of Legal Entities, Branches or Representation Offices of Legal Entities, and Individual Entrepreneurs’ is far from perfect.

94. Major shortcoming of the current registration procedures are as follows:
- ◆ excessive and, in some cases, duplicating requirements for documents required by state registration organs;
  - ◆ necessity of too frequent visits to government agencies in charge of registration;
  - ◆ length of the registration process;
  - ◆ high registration costs and lack of unified and transparent list of registration fees, which results in additional official and unofficial payments;
  - ◆ absence of efficient legal procedure for fast voluntary exit from the market.
95. There is a need to adopt a new law ‘On State Registration of Legal Entities, Branches or Representative Offices of Legal Entities, and Individual Entrepreneurs’, which shall:
- ◆ implement a **‘one stop shop’** principle where all necessary documents are submitted to one public institution; within a limited period of time, maximum one week, an entrepreneur gets the whole package of registration documents, including those confirming registration in other government agencies;
  - ◆ create a single order and procedure for **state registration of legal entities** and a single **state register**, as well as the rules of access by market participants of the market to the register data;
  - ◆ eliminate situation where many administrative organs are engaged in the registration process;
  - ◆ clearly determine reasons for **refusal to issue a registration** and introduce a single **pricing list for registration services**;
  - ◆ address the issue of voluntary **closure of a firm**; the law should determine a liquidation procedure and should remove legal entities to be closed from all respective registers (in the State Tax Inspectorate, the Social Fund, etc.).

### 3.2.3. Inspections

96. As business surveys demonstrate, numerous inspections are one of the major problems in relationships between entrepreneurs and the government. Inspections have either a repressive character or are a source of illegal money for inspectors. Although Presidential decrees set certain limits on the number of inspections, according to the BEEPS surveys of 2002 and 2003 the rate of bribes taken during inspections, as well as the duration and frequency of inspections in Kyrgyzstan, is one of the highest in the CIS.
97. Procedures for conducting inspections are regulated by numerous ‘sectoral’ laws and administrative instructions. As a result, there is no single and clear regulation for the scope, duration and frequency of inspections. Moreover, the same inspection tasks are duplicated by several administrative organs. There is no clearly defined responsibility for inspecting agencies and their officials for violations of the law and rights of the inspected firms. The inspection bodies demand payment from enterprises for controlling them instead of being financed out of the state budget.

98. In order to ease the burden of inspections, it is important to decrease their number and duration and increase their effectiveness. For this purpose, the law ‘On Protection of the Rights of Businesses during Inspections and Auditing by Authorized Organs’ should be adopted. This law shall rest on the following principles:

- ◆ the power of any government agency to **conduct inspection** can be **authorized only by the statute**; all other authorizations derived, for example, from executive orders or sectoral instructions are unlawful and have no legal effect in relation to controlled firms;
- ◆ **presumption of good will** of the inspected entities;
- ◆ contradictions and lack of clarity in the legislation cannot be interpreted against inspected entities;
- ◆ the purpose of inspections should only be **to establish facts**, i.e., to find out whether economic entities meet all the standards required by law; all the requirements being subject of inspection should be publicly known.

99. The new law shall:

- ◆ **minimize the number of inspections** carried out by inspecting organs on their own initiative;
- ◆ clearly stipulate the **rights and obligations of the inspected entities**;
- ◆ guarantee accountability of the inspection agencies to society; this implies that these agencies should regularly publish reports on the results of their inspection activities.

#### 3.2.4. Licensing System

100. Although the list of activities requiring licenses has been shortened, the licensing system continues to suffer several flaws:

- ◆ some activities require special permission even though they are not listed by the current law ‘On Licensing’;
- ◆ there are significant contradictions in the current law On Licensing, as well as in other laws regulating licensing procedures;
- ◆ the law does not clearly stipulate the grounds for denying a license.

101. In order to improve the licensing system, a new law shall be adopted, which would clearly stipulate a list of requirements and terms for licensing. This will help avoid the situation where a licensor has the right to demand a large number of documents, which confirm compliance with unfounded requirements laid down in departmental instructions. It is advisable that the new law should:

- ◆ determine a **single and detailed list** of activities requiring licenses for reasons of national security, public order, environmental protection, and protection of property rights, life and health of citizens; all other activities should be excluded from this list and free of a licensing regime;
- ◆ **review regularly the list of licensed activities** based on the ‘guillotine’ procedure; under this procedure if government agencies cannot justify the necessity of continuing a licensing regime with respect to individual activities, the latter will be excluded from the licensing requirement.

### 3.2.5. Tax and Customs Administration

102. Most of the business opinion surveys show that entrepreneurs are mainly concerned about the bad quality of tax administration. Changing this situation is key to improving the business and investment climate. The net positive effect of tax inspections is insignificant due to high non-productive expenses incurred by the private sector.
103. The reform of tax administration should follow the following principles:
- ◆ **preventive** instead of **repressive** character of its activity;
  - ◆ presumption of taxpayer **good will**; any lack of clarity in the tax legislation must be interpreted in favor of the taxpayer;
  - ◆ **minimization** of a number of **direct contacts** between taxpayers and tax administration;
  - ◆ **compliance** of laws and executive orders regulating the activity of State Tax Administration **with the Constitution**.
104. Tax administration should harmoniously combine their preventive and fiscal functions:
- ◆ **sanctions should not be applied** against a taxpayer if tax administration made an error in determining tax liabilities;
  - ◆ **sanctions should be mitigated** if an accidental error was made by a taxpayer;
  - ◆ **sanctions should be tougher** against taxpayers who intentionally evade taxes.
105. It is important to **decrease the number of tax inspections** and to abandon attempts to control all enterprises. This will allow increased effectiveness of tax inspections and reduce the number of tax inspectors. It seems that 3% is a reasonable maximum percent of enterprises to be inspected every year (randomly selected).
106. There is a need to take drastic measures aimed at better protection of taxpayers' interests and decreasing corruption in tax administration, including:
- ◆ developing and implementing internal regulations guaranteeing a **uniform standard** of services provided to taxpayers;
  - ◆ speeding up the process of taking decisions that are vital for taxpayers;
  - ◆ developing an Ethics Code for tax inspectors;
  - ◆ training tax inspectors.
107. The new Customs Code of the Kyrgyz Republic, which meets international standards, came into effect at the beginning of 2005. Thus, it is too early to provide an overall assessment of the new legislation. Nevertheless, a great emphasis should be put on the following problems:
- ◆ Customs officers often violate the Customs Code, they lack professionalism and they are not familiar enough with current customs regulations;
  - ◆ lack of transparency in the work of the Customs administration;
  - ◆ underdevelopment of Customs-related services;
  - ◆ imperfect Customs procedures.

108. Further improvement of the Customs administration operations should take into consideration the following proposals:
- ◆ the Custom Code regulations should be directly applicable by Customs officers whose decisions must fully comply with this law;
  - ◆ increasing transparency in the work of the Customs administration: all interested parties should have access to the information they need; cooperation between the Customs administration and the business community should be developed;
  - ◆ training Customs officers; in addition, all Customs posts, including the remote ones, should be supplied with all relevant normative documents.
109. It is important to develop Customs-related services such as Customs brokers, Customs carriers, duty-free shops and stores and to avoid monopolization in this sphere. This will allow:
- ◆ minimized personal communication with Customs officers, which will decrease their temptation to abuse their power;
  - ◆ speeded up Customs procedures.
110. In order to simplify and speed up Customs procedures, it is important to:
- ◆ develop a mechanism of **preliminary decisions** regarding import, i.e. before the imported commodity actually arrives on Kyrgyz territory, which would prevent delays in its distribution;
  - ◆ solve the problem of preparing and distributing **Customs cargo declarations** to enable each economic agent to obtain them;
  - ◆ optimize the Customs registration procedure and inspection of transport vehicles and cargo, among others, through a joint inspection post organized by the agencies responsible for radiological, veterinary and transport control;
  - ◆ supply tax and Customs administration with computer and telecommunication equipment allowing electronic processing of tax, import and export declarations.

### **3.2.6. Protection of Property and Creditors' Rights, and Contract Enforcement**

111. The effective protection of private property rights must be considered as a very important responsibility of the government in a market economy. Although the Constitution recognizes private property and declares its protection, this attitude is not necessarily shared by the entire society, which was demonstrated by the mass looting in Bishkek on the night of March 25, 2005 and the unlawful take-over of private and public land and other property following the revolutionary events.
112. Many government agencies violate private property rights by issuing unlawful executive orders and other departmental acts. According to the Code on Administrative Responsibility, people violating these rights should be punished. In practice, however, they have never been brought to justice.
113. In spite of the adoption of many important laws, such as the laws 'On Collateral' and 'On Arbitration,' they are not fully implemented. Lack of an effective legal mechanism for enforcing court decisions undermines the reputation and efficiency of the judiciary (see Section 2.2). In particular, there are numerous legal and operational problems with recovering pledged property.

114. Although the Law ‘On Joint Stock Companies’ was adopted in 2003, property and investor rights are still poorly protected because:
- ◆ the legislation favors small shareholders and insiders at the cost of large outside investors, in spite of the limited economic potential of small investors in the Kyrgyz economy. At the same time, the experience of other CIS countries demonstrates that minority shareholders can be used by financial-industrial groups to conduct hostile takeovers. Insiders, in turn, do not usually have sufficient capacity to improve the work of their enterprises;
  - ◆ there is no requirement to increase charter capital when additional shares are issued, which signals incorrect information about the real financial potential of companies and limits their liability to creditors;
  - ◆ the legislation does not clearly stipulate the role and functions of the Board of Directors, which weakens protection of interests of major categories of shareholders and the company itself.
115. There is the need to work out and implement a comprehensive package of measures to **protect property rights and creditors interests** and to improve **contract enforcement**. The Government should do everything possible to convince investors that their property rights will be effectively protected, that the ‘revolutionary’ redistribution of property has been definitely stopped and will never be repeated again and that property taken over illegally will be returned to its legitimate owners.
116. The Prosecutor’s Office should work more effectively on identifying and repealing acts drawn up by any government agencies and local self-governance bodies, which violate legislation on business activities. This requires a joint effort by civil society and government agencies.
117. Government officials and civil servants must become subject to administrative responsibility if they:
- ◆ violate or fail to comply with laws which protect investment and business activity;
  - ◆ interfere in private business, especially in the case of unlawful demands, including demands to pay fees, which are not clearly determined by law;
  - ◆ fail to register executive orders, as stipulated by law.
118. Better protection of property and creditors rights requires effective enforcement of the court decisions. For this purpose the Law ‘On Judicial Execution and on Status of Law-enforcement Officers’ needs to be revised with attention given to the specific problems of recovering pledged property. There is also the need to distinguish the procedure of valuation and public sales of pledged and non-pledged property. This law cannot contradict the norms of the Civil Code and the Law ‘On Collateral’ with respect to the organization and carrying out of public sales, guarantee fee, deadlines for announcing the sale, etc.
119. It is necessary to protect more effectively property rights at the enterprise level and this requires:
- ◆ moving attention from protection of specific group of investors (like insiders or minority shareholders) towards protection of all categories of owners and ensuring **transparency of all property rights transactions**; this requires, for example, reducing the right to buy shares in new issues, repealing provisions that stipulate the possibility of restoring previous proportions in the ownership structure after issuing

new shares, re-registering closed joint-stock companies as open joint-stock companies or, at least, determining the maximum amount of the charter capital for the former; and increasing the responsibility of shareholders for initiating corporate conflicts;

- ◆ clearly determining and delimitating **functions and powers between corporate governing bodies**, following a **continental (two-tier)** corporate governance model, mandatory formation of a Board of Directors in all joint stock companies, strengthening its role as the representative of the interests of shareholders and the company itself, introducing the institution of the independent members of Board of Directors, and clearly defining the prerogatives of the auditing commission;
- ◆ introducing the Code of Best Practices for Corporate Governance containing concrete recommendations for how to organize the work of corporate governing bodies; in spite of the voluntary character of this document, the company should be obliged to explain in its annual statements and offerings circulars which provisions of the Code are not adopted and why;
- ◆ **additional issue of shares** shall increase charter capital.

### **3.2.7. Promoting Foreign Investments**

120. In spite of the official declarations, the legal regimes for domestic and foreign investors are not the same. According to the Law ‘On Investments,’ foreign investors have the same rights as domestic ones ‘except for cases stipulated by law.’ This implies that, in fact, foreign investors are not subject to the same treatment as domestic ones.
121. This provision leads to discrimination against foreign investors in a number of laws. For example, the Law ‘On the Sustainable Development of the Issyk-Kul Biosphere’ forbids foreigners from owning tourist and recreational facilities. Moreover, the same law creates the opportunity to nationalize the property of foreigners, which openly contradicts the Constitution of the Kyrgyz Republic.
122. There are restrictions with respect to foreign ownership of land. Foreign residents cannot purchase land plots in towns and populated areas. Furthermore, this restriction is also imposed on domestic companies where the share of foreign investors is more than 20%.
123. In order to be able to attract more effectively foreign investors, they must be given the same legal status as domestic investors, which requires modifying the above mentioned laws accordingly.

### **3.2.8. Improving Infrastructure and Competition in the Sphere of Infrastructure Services**

124. Infrastructure is one of the least reformed sectors of the Kyrgyz economy, with very little competition. Almost all the infrastructure sectors are natural monopolies. The low quality of infrastructure services contributes to a perception of poor business and investment climate in the country.
125. The telecommunications sector has been only partly reformed. Even though private communications operators have emerged, Kyrgyztelekom still dominates the market. As far as the electricity industry and air transportation are concerned, these spheres have only undergone functional separation of production, distribution and network services activities. In spite of the preparation of a government program, the restructuring of the natural gas industry has not started yet, and water supply and

railway transportation are the least reformed infrastructure sectors. The reform in housing and public utilities was only formal. Urban transportation is the most reformed sector of infrastructure.

126. Among post-communist countries Kyrgyzstan has one of the lowest levels of private sector participation in infrastructure; there is practically no privatization. This leads, together with an obvious shortage of budget support to maintain and develop infrastructure, to chronic under-funding and technical decay, which affects the quality of services provided and threatens the very possibility of service provision. For example, frequent power cuts increase business losses. In the electricity and water supply industries under-funding, combined with poor management, leads to huge losses and theft done both by service providers and consumers.
127. The insufficient coverage with transport networks makes it difficult to transport people and goods, especially to remote regions: the existing railroad network is extremely poor, roads are of bad quality and poorly developed, and the civil aviation infrastructure is no better.
128. Many sectors have highly distorted tariffs, i.e. they are too low to cover the cost-recovery level of the services provided, and this prevents the infrastructure from being upgraded and developed; in telecommunication, electricity supply and air transport there is cross-subsidization that makes it difficult to attract investments and develop competition. There is no system of measuring the actual consumption of many public utilities. Payment collection for electricity is low, and the quasi-fiscal deficit of the electricity industry is very high.
129. Competition in infrastructure services is limited due to the lack of an efficient regulatory system. The autonomous regulatory bodies have been created only in telecommunications (State Agency for Communications), electricity (State Agency for Energy), and at the municipal level (in Bishkek) also in public transport (Transport Inspectorate). However, their autonomy is purely formal, as they cannot conduct their own policies and are not free of political pressure (see Section 3.3.2)
130. Infrastructure reform is also hindered by political factors, such as the government's negative attitude to it and the population's fear of potential tariff increases.
131. The business and investment climate cannot be improved without reform of the infrastructure services, increasing competition in these sectors, their financial rehabilitation and the development and improvement of service provision. To achieve these goals a whole range of measures should be implemented:
  - ◆ **demonopolization and restructuring;** it is necessary to define which sectors of the infrastructure are real natural monopolies and which could be opened up to competition; the main criteria should be based on technical considerations. In particular, it seems necessary to complete the restructuring of the energy sector by its gradual privatization, to restructure the natural gas sector (with separation of transportation and distribution entities), to deprive Kyrgyztelekom of its monopoly status and privatize this company, and to ensure competition in the area of housing and public utilities;
  - ◆ **restructuring of the transport sector** and developing and diversifying transport infrastructure, including its international component (see Section 3.3.2) by attracting domestic and foreign capital to transport people and goods, maintain and modernize the transportation network/infrastructure and transportation facilities, which envisages the provision of equal conditions to all participants in the transport market. In

particular, it is advised to ensure the access of independent operators to the railroad network and to widen private participation and competition in the air transport by privatizing airports and state-owned companies as well as by attracting foreign airlines to operate both internationally and domestically;

- ◆ the government should abandon **direct management of the infrastructure** and introduce stable and transparent **regulatory mechanisms**; in demonopolized industries it is necessary to ensure the equal access of all economic agents to the service market. Implementation of these tasks should be delegated to autonomous regulatory bodies capable of establishing ‘the rules of the game’ and effectively preventing violation of market participants’ rights (see Section 3.3.2). The regulatory agencies must be independent of pressure exerted by various interest groups (which can be ensured by guaranteeing them a high degree of independence in financial and personnel issues), have highly qualified personnel, function transparently and fully inform all the parties concerned;
- ◆ **attracting private investments** through privatization of state-owned infrastructure enterprises (upon completion of their demonopolization), free access of private investments to construction of new (including competitive ones) infrastructure units and networks, establishing joint ventures with their consequent privatization. Implementation of big investment projects requires funding from abroad through foreign grants and international consortia;
- ◆ **reforming tariff policy**: increasing tariffs to the full cost-recovery level (calculating only real costs that take into account subsidies, losses, etc.) with the simultaneous introduction of maximum tariffs by an autonomous regulatory body; reduction of cross-subsidies; measuring individual consumption (if this has not already been done), and increasing payment transparency by abolishing the netting-out operation and barter transactions. Only services actually supplied (water and heating in particular) should be charged; tariff increases should be compensated by targeted social assistance to the vulnerable groups of the population. All these measures will improve financing of infrastructure enterprises and create incentives to reduce their losses;
- ◆ increasing **payment discipline** by applying all possible means, including cutting service delivery and judicial procedures; privatization of these sectors and reduction of the financial burden to the poor by providing targeted assistance will also help to strengthen payment discipline.

132. The investment climate also depends on structural changes, i.e. transparent and efficient privatization of state-owned property, enterprise restructuring (see Section 3.3.1), increasing private sector participation in individual markets, and abolishing overregulation and restrictions with respect to various groups of investors (see Section 3.3.2).

### 3.3. Structural changes

#### 3.3.1. Privatization and restructuring

133. The privatization process has become highly politicized and unpopular, which has led to populist calls to limit or even stop privatization and to review past privation transactions (this was one of the slogans of the March revolution). In Kyrgyzstan, there are several influential groups which are not interested in privatization: some rent-seeking government officials and enterprises, a disoriented population. This



reduces the pace of privatization and creates the real threat of re-nationalization and/or administrative redistribution of privatized property under the pretext of correcting previous privatization abuses.

134. The demand for property to be privatized is limited due to:
- ◆ **lack of domestic capital** (both large and small-scale investors);
  - ◆ **low economic attractiveness** of property to be privatized, due to decapitalization, lack of development perspectives, poor economic and financial conditions of enterprises, and their indebtedness;
  - ◆ **discrimination against foreign investors** (see Section 3.2.7); this and other above mentioned reasons result in a lack of interest among first-class international investors in participating in the privatization process in Kyrgyzstan.
135. Privatization policy is not effective due to the following reasons:
- ◆ privatization is aimed to achieve **too many** and, sometimes, **contradictory objectives**, which make their accomplishment very problematic;
  - ◆ existence of too many **limitations** on conducting privatization – there are many sectors where privatization is limited or prohibited for political and ideological reasons, or for sectoral and group interests; in particular, this refers to monopolistic sectors that provide infrastructure services (see Section 3.2.8).
136. As a result, privatization is still far from being completed, and the level of privatization of individual sectors and industries is uneven. Some of them are almost totally privatized (trade, catering, consumer services, banking) while others are practically untouched by the privatization process (infrastructure, social services, electricity industry). So far, everything which could be privatized relatively ‘easily’ (in the political and technical sense) has already been privatized. As a result, the following type of assets continue to remain publicly owned:
- ◆ those for which there is no demand (this relates to both minority and controlling blocks of shares);
  - ◆ those that have not been privatized due to the above mentioned political and ideological reasons or because to do so would contradict sectoral and group interests;
  - ◆ those that must not be privatized because of their public importance.
137. Privatization of enterprises has not been accompanied by privatization of the land plots these enterprises are located on. Though the privatized enterprises have been given the right of land use and, in practice, such a right can be subject to market turnover, the process is too complicated and difficult for many enterprises to implement their business strategies.
138. In most cases privatization did not result either in the better functioning of enterprises or in their take-over by more efficient owners, due to a distorted institutional and legislative environment (see Section 3.2) and inefficient corporate governance regime:
- ◆ ownership structures are not efficient and transparent enough with an excessive role for **insiders** (managers) and external owners who are tied up with the socialist past; this makes overcoming the legacy of ‘socialist enterprise’ difficult: managers’ ways of thinking have been formed in the planned economy, there is a lack of market experience and low corporate governance culture;

- ◆ enterprises adaptation to the distorted external institutional and legislative environment has led to the strengthening of **non-market behavior** (barter transactions, non-payment culture, in-kind wages and salaries, etc), which have been difficult to get rid of subsequently (though recently the role of such behavior has decreased significantly);
  - ◆ **external environment** (lack of real estate tax and effective bankruptcy procedures, limitations on a free market turnover of property rights) does not stimulate owners and managers to increase the economic efficiency of their enterprises, including the option of selling them to more effective owners;
  - ◆ lack of effective separation of **ownership, management and supervision** functions: owners usually directly participate in the management of enterprises;
  - ◆ extremely weak and distorted **supervision**: boards of directors very often play purely a formal role; they represent the interests of the owners only and do not protect the interests of the company as such;
  - ◆ **legal regulation** of corporate governance does not define and distinguish clearly enough the functions, rights and responsibilities of enterprise governing bodies;
  - ◆ weak and distorted **role of the state as owner**: in fact, the State Property Committee does not exercise effective ownership control of state-owned enterprises and blocks of shares that belong to the state, which leads to the situation of ownership vacuum, informal control of managers and government officials, and asset stripping.
139. A comprehensive approach, which includes improvement of the privatization strategy, efficient organization of the privatization process and creation of a favorable institutional and legal environment, is required to overcome the above analyzed obstacles.
140. The goals of privatization should be well defined and balanced:
- ◆ the main goal of privatization should be **to improve the economic performance** of enterprises to be privatized (economic goal);
  - ◆ **the social and political basis** of reforms should be widened by strengthening a layer of private owners interested in further market-oriented changes (political goal);
  - ◆ the Government should **give up management of state-owned enterprises** and concentrate on providing public goods (systemic goal);
  - ◆ **fiscal goals** (proceeds from privatization) are important but should not dominate the privatization policy;
  - ◆ it is desired to forget about **production and social goals**, excluding the possibility of funding of social reforms out of privatization proceeds.
141. To achieve the economic goal of privatization it is necessary to:
- ◆ transfer property to more **efficient owners** who may finance investments, facilitate access to new technologies and international markets, improve corporate governance, etc.;
  - ◆ create a favorable institutional and legal environment (see Section 3.2), which will stimulate more efficient use of privatized assets.
142. To achieve political goal it is required to increase the level of acceptance of privatization by the society mainly by ensuring its high transparency, accountability

and tangible positive results for the population. The public opinion should receive fair information about all the expected results of privatization, both positive and negative. It is very important not only to neutralize opponents of privatization but also to enlarge the number of long-term supporters of privatization (and market-oriented reforms, in general).

143. It is important to depoliticize the privatization process. The Parliament should adopt only general principles of privatization without micro-management of their implementation. Independence and accountability of the Government (the State Property Committee) and its transparency should be strengthened.
144. The Government should not play an entrepreneurial role. Its influence on the economy (to the extent justified by the provision of public goods) should be exercised through legislation establishing general 'rules of game' instead of through ownership control, and budget revenue should be generated by tax collection instead of by dividends.
145. The above considerations call for the rapid completion of privatization which requires:
  - ◆ **removing the majority of existing bans and limitations** on privatization, in particular with respect to the majority of infrastructure objects (their privatization should be preceded by demonopolization and changes in regulatory mechanisms), science and culture, alcohol production, gold mining and certain other natural resources industries;
  - ◆ **selling** the remaining blocks of shares that are still owned by the state; in the case of low demand (especially, for minority blocks) these shares should be sold through auction without a minimum initial price.
146. Existing social sector and educational institutions can be transformed into non-governmental, non-commercial organizations supervised by the public boards of trustees and into private enterprises having access to budget financing (see Chapter 4 for details). The Government should retain the right to issue licenses and control the quality of services provided.
147. Attracting efficient owners should be stimulated by:
  - ◆ improving the general business and investment climate;
  - ◆ guaranteeing **equal opportunities** to domestic and foreign investors;
  - ◆ **active searching** for first-class international investors.
148. Privatization should be perceived as a long-term, stable policy, and its results as final ones. The latter can be reviewed only in cases of evident violations of the law and under the condition of maximum observance of property rights, in accordance with the following principles:
  - ◆ such cases must be subject to judicial procedures;
  - ◆ the emphasis must be put on the **administrative and criminal** responsibility of people violating the law (mostly government officials) instead of on re-nationalization;
  - ◆ if the buyer of privatized property has acted in good faith, re-nationalization must be excluded;
  - ◆ if the buyer of privatized property did not act in good faith but s/he already sold her/his shares to another investor acting in good faith, he must reimburse the damage caused to the state under the procedure established by law; good-faith buyers of shares

on the secondary market should not be held responsible for violations of privatization procedures made by the primary buyer or a state official;

- ◆ introduction of strict time limitation on the review of past privatization deals.
149. It is necessary to improve corporate governance in privatized enterprises, in particular in the area of property rights protection and share turnover (see Section 3.2.6). This requires the following measures:
- ◆ developing the **capital and labor markets** to ensure their transparency; the latter should be applied not only to joint-stock companies quoted on the stock exchange but to all of them;
  - ◆ ensuring maximally free-market-based redistribution of property, which will help to redistribute shares in favor of the most efficient owners and prevent the formation of oligarchic structures;
  - ◆ developing a **corporate governance culture** aimed, first of all, at overcoming the post-Soviet model of business behavior (see Paragraph 138);
  - ◆ using the bankruptcy mechanism as an important tool of enterprise rehabilitation and restructuring;
  - ◆ adopting other measures to improve corporate governance and to protect property rights (see Section 3.2.6)
150. In enterprises with a significant state-owned shareholding (blocking and higher), which are to be privatized in the future but — for various reasons — cannot be sold immediately, a procedure for management buy-in should be applied. In relation to enterprises that are not subject to privatization, one can consider employing experienced foreign managers.
151. It is important to strengthen the State Property Committee's supervisory capacity over the privatization process and the property that is still owned by the state:
- ◆ **concentrate all supervisory functions** in one agency, i.e. in the SPC instead of the popular idea of handing over some of these functions to sectoral ministries;
  - ◆ **develop the professional skills** of SPC staff;
  - ◆ organize professional training for those members of the Board of Directors who represent the interests of the state;
  - ◆ ensure a thorough **examination** of business plans and the reputation of potential strategic investors;
  - ◆ effectively **monitor** investors' and management groups' compliance with the terms and conditions of privatization deals and management contracts;
152. In case of enterprises having a special importance for the national economy, the complete loss of control over which is not desirable, one should use the mechanism of the 'golden share' instead of keeping the controlling block of shares by the state. The 'golden share' gives the right of veto on the most important strategic issues:
- ◆ changes and amendments to a joint-stock company charter;
  - ◆ reorganization and liquidation of a joint-stock company;
  - ◆ conclusion of the most important economic contracts, which require the approval of the shareholders' general meeting according to the company charter;

This right should be exercised at the General Meeting of Shareholders, and a SPC representative should be elected to the Board of Directors in an advisory capacity. Using the 'golden share' mechanism will placate those who are afraid of losing state control over these enterprises but will limit government interference to a minimum.

153. The existing legislation covers all the important aspects of the privatization process and the institutional environment for enterprises. However, its quality is mixed. The legislation on privatization, especially the Program of State Property Privatization in the Kyrgyz Republic, needs substantial improvement (in particular, those provisions that deal with the goals of privatization, its limitations, methods and management of the privatization process). The quality of legislation that regulates corporate governance and the stock market is significantly higher. Nevertheless, it also needs to be amended in accordance with the above recommendations.

### **3.3.2. Making markets more efficient**

154. Many product and service markets in Kyrgyzstan continue to be monopolized. This is particularly true of markets for infrastructure services (see Section 3.2.8) where:

- ◆ government regulation either has the form of direct management or does not exist at all;
- ◆ the role of the autonomous regulatory bodies is weak: they cannot conduct an independent policy and be free of political pressure (see Section 3.2.8); in addition, the anti-monopoly committee has lost its independent status and become subordinated to the Ministry of Economic Development, Industry and Trade;
- ◆ too large a part of the Kyrgyz economy is monopolized;

155. Despite increased competition brought by foreign-owned banks (particularly from Kazakhstan) and the considerable recovery of the financial sector after the 1998-1999 crisis, financial markets in Kyrgyzstan remain underdeveloped:

- ◆ the level of financial intermediation remains rather low compared to international standards, which can impede further development of the Kyrgyz economy;
- ◆ terms of credit (high interest rates, short maturity periods, high collateral requirements) remain too tough for many potential borrowers;
- ◆ agriculture credit is mostly extended by the Kyrgyz Agricultural Financial Corporation (KAFC), refinanced mostly through IFI loans: unavoidable termination of the previous sources of refinancing may lead to changes in its loan portfolio structure and reduction of credit to the highly risky agricultural sector;
- ◆ the non-banking financial sector (securities market, micro-finance agencies, insurance companies, investment and non-state pension funds, etc.) is poorly developed; the same is true for a modern payment system based on debit and credit cards;
- ◆ the Kyrgyz Stock Exchange (KSE) has been given too much authority: all share transactions must be registered with the KSE; nevertheless, the KSE role is limited by the lack of stock market participants: the population has no money, and there are practically no institutional investors; as a result, KSE does not implement any of the most important functions of the stock market, i.e. market evaluation of enterprises and provision of capital.

156. There are no incentives to increase the effectiveness of the public utilities market due to the lack of real consumption measurement, the lack of payment transparency and its monopolistic nature (see Section 3.2.8)
157. The land market is limited and remains a source of public tension:
- ◆ despite the fact that the idea of private property in the form of land is very popular in Kyrgyz society, almost nobody accepts the concept of a free land market;
  - ◆ after the March 2005 revolution some spontaneous illegal seizures of state and private land plots took place;
  - ◆ there are significant regional disproportions in land ownership that are perceived by the society as unfair;
  - ◆ there are significant limitations on free market land turnover;
  - ◆ there are limitations on foreign investment (see Section 3.2.7);
  - ◆ privatization of enterprises has not been accompanied by privatization of the land plots on which these enterprises are located (see Section 3.3.1);
  - ◆ there are no General Development Plans for individual territorial units with clearly defined target land use;
  - ◆ there is no clear procedure for changing target land use.
158. Government decisions on developing the real estate market do not work in practice. This market has a low liquidity due to a lack of demand and the unresolved problem of legal titles for the land plots on which enterprises are located. Development of mortgage lending under the current level of the population's incomes seems to be unrealistic.
159. The state ownership of cultural institutions has not helped to protect the cultural values of the country. This sector is chronically underfinanced and underdeveloped.
160. The development of the tourism services market is limited by the progressive technical decay of the traditional sanatorium-and-spa facilities inherited from the Soviet era and the extremely low quality of infrastructure. Politically motivated freezing of privatization in the tourist industry and restrictions on foreign investments (see Section 3.2.7) have made serious restructuring of this sector impossible.
161. Development of the markets and their more efficient functioning requires their demonopolization, larger private sector participation, free access for different categories of investors and more efficient regulation. If there are cases where complete demonopolization is impossible (existence of natural monopolies), it is necessary to introduce an efficient regulatory regime and antimonopoly monitoring. In the long-run, all monopolies except really natural ones should be restructured and then consequently privatized. In the transition period (before full privatization) it is recommended to reinforce their management with the help of management buy-ins (see Section 3.3.1). It is also crucial to create equal access to markets for all investors, including foreign ones.
162. Efficient regulation of natural monopolies requires:
- ◆ transition from direct management of natural monopolies to formation of **autonomous regulatory bodies** creating general and equal 'rule of games' for all participants in the specific market (see Section 3.2.8); in addition to the already existing regulators in the

telecommunication and electricity sectors, it is recommended to establish bodies regulating water supply and railroad transport;

- ◆ determination of which objects should remain as monopolies, and which should be demonopolized, based mainly on technical criteria; this means that preserving monopolies in telecommunication, transport, electricity and housing and public utilities is unjustified.
163. Further development of the financial sector should increase its openness and competitiveness, attracting more savings and facilitation of investing from both domestic and foreign sources, and easing investors' access to financial resources. Financial sector reform should involve:
- ◆ continuation of structural reforms agreed with the IMF and other IFIs aimed at **privatizing** the remaining state-owned financial institutions (KAFC and SCS), **strengthening banking and financial supervision**, increasing minimum capital requirements for banks, improving the existing payment system, etc.;
  - ◆ attracting **foreign investors** to invest in the Kyrgyz financial sector;
  - ◆ elimination of any forms of direct state participation in the financial sector business, including extensions of soft loans to state-owned and private enterprises, granting guarantees for credit lines received by commercial banks from foreign banks and organizations, participation in any deposit insurance system, creation of state mortgage companies, etc; state support to the financial sector should be concentrated on protecting **creditors' rights**;
  - ◆ improving **farmers' access** to credit (which may be reduced after KAFC restructuring and privatization) by removing those provisions of the land legislation that limit market turnover of agricultural land, which, in turn, makes land less attractive as collateral.
164. The stock market should be developed in order to become a source of financial resources for enterprises, a tool for their market valuation and one of the most important channels of property redistribution. To achieve these goals it is recommended to:
- ◆ promote the development of the **entire stock market** and not only the stock exchange, and strengthen the transparency and property rights protection of **over-the-counter transactions**;
  - ◆ turn the stock exchange into a **high quality and transparent** institution following closely all the standards related to public offerings (this also concerns listings of state-owned minority blocks of shares); at the same time, the KSE should be released from the obligation to take part in over-the-counter transactions;
  - ◆ stimulate development of **institutional investors** such as investment funds and (in future) pension funds to create stable demand for securities;
  - ◆ develop a market for **debt instruments** (corporate and Treasury bonds, etc.).
165. The reform of the public utilities market should include its demonopolization, measuring retail consumption by individual households and charging only for actually delivered services, abolishing barter transactions and netting-out operations, increasing tariffs to a cost-recovery level together with using the targeted social assistance to compensate poor sectors of the population (see Section 3.2.8).
166. Reform of the real estate and land market should include:

- ◆ enabling privatized enterprises to own the **land plots** on which they are located; a special procedure should be offered to enterprises which were privatized earlier (either give them the right to buy this land or transfer it for free or for a reduced price);
  - ◆ preparing **general development plans** of territorial units by regional administration and local self-government, which will define the targeted use of land;
  - ◆ creation of transparent procedures for changing the targeted use of land;
  - ◆ abolishing restrictions for foreigners.
167. It is necessary to deregulate and commercialize the market of cultural facilities, with simultaneous stimulation of various kinds of non-government support in this sphere.
168. Development of market for tourist services should include:
- ◆ privatization of hotels, sanatoria and resort houses and centers;
  - ◆ ensuring equal access to this industry for domestic and foreign investors;
  - ◆ development of the transport infrastructure;
  - ◆ further liberalization of the visa and registration regimes for foreign citizens.

### **3.4. Foreign trade and external economic relations**

#### **3.4.1. Export promotion and maintaining an open economy**

169. Since the beginning of its independence, Kyrgyzstan has adopted a liberal trade policy, which was natural for a small country with an unfavorable geographic location. The Kyrgyz economy enjoys low tariff and non-tariff barriers in import<sup>7</sup>, lack of export barriers and freedom of people and capital movement across the country's borders. The country's liberal trade policy and its unwillingness to resort to protectionism were confirmed in 1998 when Kyrgyzstan joined the WTO. Additionally, Kyrgyzstan belongs to all regional trade and economic agreements.
170. For many years trade and current account deficits were substantial and their financing was provided by the IFI loans. Recently, the current account deficit significantly decreased and transfers from abroad (both external grants and workers' remittances) have begun to play a more important role. FDI, though less important so far, plays an increasing role in the balance of payments (8% of GDP in 2004). However, taking into account the country's investment needs, their volume is still insufficient.
171. Recently, Kyrgyzstan's exports have significantly increased – in 2004 its USD equivalent was by 2/3 higher than in 2001. This growth was mostly generated by gold exports and kerosene supplies to the Manas international airbase. These two components are unsustainable and may significantly decrease in the mid- to long-term.<sup>8</sup> Tourist services have become another important and rapidly growing source of export proceeds. On the other hand, trade barriers introduced by Kazakhstan and Uzbekistan and high transit costs through these countries form a significant barrier to further export expansion.

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<sup>7</sup> Except for the barriers created by predatory behavior of public administration (see Section 3.2).

<sup>8</sup> Gold exports have started to fall in 2005.



172. In the future, Kyrgyzstan should maintain the openness of its economy and a liberal trade policy while expanding, diversifying and increasing the competitiveness of its exports. The latter requires:
- ◆ reducing production and transaction costs and improving the access of domestic goods and services to external markets;
  - ◆ **avoiding import substitution policy and stimulating exports** through exchange rate management, export subsidies or import barriers because such measures would only lead to the loss of scarce domestic resources and their inefficient allocation (their redistribution from efficient producers and poor groups of the population to inefficient producers and corrupt officials).
173. Regional cooperation can help in removal of existing trade, transport and transit barriers and, therefore, contribute to trade promotion. To improve regional cooperation it is necessary to:
- ◆ support the WTO accession of neighboring countries which will make trade relations with them more predictable;
  - ◆ develop and diversify the **transport infrastructure** (roads, railroads and air connections) that connect the country with the outside world; of particular concern are the large international road rehabilitation projects, which should be continued, and the agreement with Kazakhstan on the extension of foreign airlines' flights from Almaty to Bishkek, which should be reached (see Section 3.2.8);
  - ◆ simplify, increase transparency and unify **customs rules and procedures of border crossing** in cooperation with neighboring countries; fight corruption in Border Guard and Customs service;
  - ◆ **simplify transit** through all countries of the region (including transit through Kyrgyzstan), including the complete implementation of the TIR Convention provisions.
174. To make exports cheaper it is necessary to:
- ◆ introduce a transparent system of **VAT refund** for exporters, which will not require discretionary decisions of fiscal administration (see Section 3.1.2); make necessary budget provisions, which will enable smooth process of refunding;
  - ◆ abandon the outdated system of **standards** that prevents Kyrgyz products from accessing international markets;
  - ◆ abolish the existing **export licenses** for scrap metal and avoid the emergence of new export and import limitations, except those which are related to national security (radioactive substances, weapons, etc.).
175. Effective information and marketing system would help Kyrgyz producers and exporters in identifying foreign partners and, therefore, improve their access to international markets. This may include support to private wholesale, logistics and trade information companies, which can benefit from the economy of scale and reduce trade and transit expenses. Other export-promotion measures can include:
- ◆ strengthening legal guarantees for contract enforcement (see Section 3.2.6);
  - ◆ decreasing the regulatory burden (see Section 3.2);
  - ◆ creating a competitive environment (including foreign companies' access to the Kyrgyz market);

- ◆ information and trade promotion support provided by the Kyrgyz embassies and trade representative offices;
  - ◆ removing the excessive tax burden on large companies (see Section 3.1.2).
176. In order to ensure the free flow of goods, services, capital and people to and from Kyrgyzstan and to strengthen the country's security, it is necessary to actively participate in global and regional agreements and organizations which aim to develop international cooperation — despite the fact that some of these organizations have never proved to be effective. For a small country like Kyrgyzstan it is better to develop cooperation with bigger neighbors within the framework of international organizations and multilateral agreements and rules. Alongside this, Kyrgyzstan should develop bilateral economic relations with all its neighbors (including Russia, China, and the Central Asian countries), with developed countries (US, EU, Japan) and rapidly developing economies outside the region (Turkey, India and others) in order to accelerate the country's integration into the world economy, to increase productivity and to reduce the vulnerability of the Kyrgyz economy to external shocks.

### 3.4.2. Labor migration

177. Labor migration of Kyrgyz citizens to Russia, Kazakhstan and some other countries is playing an increasingly important role in the country's economy. It is estimated that between 200,000 and 500,000 Kyrgyz people work abroad or are self-employed in trade or service professions. Migration significantly mitigates the problem of unemployment inside the country and serves as an important source of foreign exchange inflow (second only to exports). Labor migrants' transfers have become one of the most important factors contributing to poverty reduction in the last few years but they have not yet been used to finance domestic investments to a significant extent. The majority of migrants who work in Russia and Kazakhstan have neither proper registration nor employment permits, which makes them legally and socially very vulnerable (they do not have legal protection and access to basic social services). Taking into consideration the negative demographic dynamics in recipient countries and positive demographic dynamics in Kyrgyzstan, outward labor migration should be viewed as a long-term phenomenon and an important factor contributing to the country's economic development.
178. It is worth maximizing the advantages and neutralizing the disadvantages of migration through:
- ◆ negotiating with the governments of recipient countries a **favorable legal status** for Kyrgyz migrants that will ensure them normal working and living conditions; this status should include the right to work permits, protection of personal and property rights, terms of taxation and access to the social infrastructure, etc.;
  - ◆ focusing the attention of secondary, vocational and higher education on providing the skills and knowledge that are in demand in both the domestic and foreign labor markets; the educational system of Kyrgyzstan should offer people who want to work abroad the possibility to learn the languages of, and basic information about, the countries (their history and culture, the legal status of immigrants, etc.) that are the main destination of labor migration flows as well as to train for professions and obtain qualifications which are in demand in these countries;

- ◆ building an **employment infrastructure** for Kyrgyz citizens who wish to work abroad to ensure the protection of their rights and compliance with the laws of Kyrgyzstan and destination countries;
  - ◆ development of a **financial infrastructure for servicing migrants**, which would reduce the costs of money transfers and ensure their use not only for consumption, but also for saving/investment purposes.
179. It will be impossible to win a favorable status for Kyrgyz migrants abroad if one fails to establish favorable conditions for foreign citizens in Kyrgyzstan. They should be given the same labor, personal and property rights and responsibilities (including taxation) as those enjoyed by Kyrgyz citizens.

## **Chapter 4. Improving the effectiveness of social services and social policy**

### **4.1. Education**

180. The last 15 years have been very difficult for the Kyrgyz educational system. While almost 100% of children remain in the system of basic school education (1-9 grades), the quality of education has fallen sharply due to under-funding and the resulting outflow of qualified teachers (from the country and from the sector), and the deterioration of materials and technical supplies within schools — in particular, insufficient supplies of textbooks and teaching aids. The curricula are, to a great extent, outdated and need to be reviewed. On the other hand, higher education is experiencing a boom, the number of universities has quadrupled, and the number of students has also sharply increased. Most of this increase is driven by commercial education (although tuition fees are low even by Kyrgyz standards). The high demand for tertiary education can be explained by high unemployment among youths, the collapse of secondary vocational schools, young persons' desire to move to cities from rural areas and their interest in public service careers where a university diploma is a mandatory employment condition. However, as with the primary and secondary educational systems, the quality of tertiary education has fallen, and the majority of graduates cannot find jobs in their area of specialization.
181. Due to chronic under-funding, educational institutions have increased their volume of commercial services. However, due to the lack of effective public supervision over the quality of such services, grades and diplomas are often for sale, harming the country's economy and public morale.
182. While an extensive network of orphanages and boarding-schools for children who are fully supported by the state engages a significant portion of the entire education sector budget, this remains in poor shape and does not contribute to the normal social development of these children upon finishing school.
183. Further development of the education system requires reforms in both the content of education and the organizational and economic foundations of this system. An open public debate is required to update curricula and education methods.
184. The organization of the educational system should take into account the real possibilities of both public and private financing:
- ◆ state guarantees should cover only basic secondary education; public funding of complete secondary, vocational and tertiary education should be continued only for

gifted children from poor families by offering them personal grants that would ensure them equal opportunities; remaining young people should be given the possibility of education exceeding the basic guaranteed level on a paid basis;

- ◆ providing equal development opportunities to **both public and private educational institutions**, including equal access to public funding to carry out state educational programs; stimulating competition in the area of secondary education by giving students the right to choose educational institutions;
- ◆ gradual transformation of state educational institutions into **non-state institutions** managed by boards of trustees composed of parents, representatives of local self-government, civil society, etc. (including management of school property); it is also necessary to foresee the possibility of **privatizing** educational institutions;
- ◆ introduction of a clear and transparent system of **tuition fee collection** and legalization of all informal payments;
- ◆ educational institutions should be granted more freedom **over allocation of financial resources** which they receive, while strengthening **public supervision** over the quality of educational services provided (including the participation of civil society organizations) and the efficiency of using public support;
- ◆ state financial support to students of pedagogical specialties should be conditioned on their availability to teach in schools for a certain period of time after their graduation; keeping young specialists in rural schools requires offering them incentives such as land plots and housing;
- ◆ supporting **family orphanages** and a **patronage system**, which could at least partly replace public orphanages and boarding-schools and make integration of orphan children into society easier.

## 4.2. Health Care

185. Regarding the health situation of the Kyrgyz population, the quality of the health care system leaves much to be desired. Widespread poverty is accompanied by bad nutritional and living conditions and increased numbers of tuberculosis cases and other dangerous diseases. The level of financing of the health care system remains insufficient with negative consequences for the quality and accessibility of medical services. Patients' informal payments to doctors have become a common practice. Patients are also expected to finance medicines and food in hospitals. Under these unfavorable conditions the government, with the support of international organizations, has implemented a large-scale reform, probably the most comprehensive and consistent in the entire social sector. The most important elements of the new system are:

- ◆ transition to performance-based funding of health care institutions (number of patients and medical cases served);
- ◆ introduction of **co-payments** that have led to a reduction in the unreasonably high demand for health care services (typical of the Soviet era) and a reduction of informal payments (although these have not been completely eliminated); however, co-payments have not yet become an important source of health care financing, covering only a small part of total expenses;

- ◆ formation of a **single payment agency**, i.e. the Mandatory Health Insurance Fund (MHIF); this Fund is financed both from the budget and the part of SF contribution and is the only customer for the majority of health care institutions; its name nevertheless reflects the intention to build an insurance-based system of health care financing, rather than the real state of things. In case of a serious illness people must continue to spend substantial amounts of private money for informal payments to medical institutions and their staff;
  - ◆ list of basic medical services granted for free.
186. The effectiveness of the health reform has been decreased by reduced budget financing. The Social Fund also frequently uses contributions to MHIF to finance pensions. The result is a paradoxical situation in which the most reformed sector is de facto ‘punished’ by the government.
187. Further development of the health care system should be aimed at deepening and continuing the above mentioned reforms while taking into account the country’s limited financial resources. To achieve these goals it is necessary:
- ◆ to increase public funding of the health care system with a simultaneous improvement in collection of MHIF contributions and an increased role for co-payments in financing this sector;
  - ◆ to consider the possibility — in the long-term — of separating MHIF as the buyer of health care services from the public and private suppliers of these services and the Ministry of Health Care as a government body, which defines state policy in health care and regulates the medical services market. MHIF can play effectively the role of a single contracting and payment agency only being organizationally **independent**;
  - ◆ to strengthen control over implementation of the **state guarantees** program and, simultaneously, to abandon such guarantees in those cases where effective control is impossible. This refers, in the first instance, to providing patients with medicines and food in hospitals: for the majority of them the principle of self-supply, which is actually applied now, should be legalized; poor patients would receive medicines and food financed from the budget as part of the social aid program (implemented by NGOs selected on a competitive basis);
  - ◆ to introduce **differentiated workload norms** for medical workers depending on the place where the medical services are provided, in order to make service provision in remote areas more attractive economically;
  - ◆ to engage **private medical institutions** in implementing public health programs (immunization, medical services to schools, kindergartens, prisons, military units, etc.) and provision of medical services contracted by MHIF; this will stimulate competition and increase the quality of health services;
  - ◆ to promote **a healthy lifestyle**, which should become an important part of health policy. This should be the joint task of medical and educational institutions, local self-government and civil society organizations.

### 4.3. Social protection

188. After the reform of the social protection system in the second half of the 1990s the following have become its basic components: a unified monthly benefit (UMB), a monthly social benefit, a system of privileges and benefits in kind for certain

categories of the population, nursing homes and social services provision at home. More than one half of the country's population (even those people who are not poor) enjoy social protection services. The UMB, aimed at poor families with children, is the most important and the best targeted element of social protection. Nevertheless, eligibility criteria, which are defined in terms of household income, represent some important methodological weaknesses leading to an excessive number of UMB beneficiaries. On the other hand the average size of UMB per household (less than 100 soms a month) is extremely low.

189. Further reform of the social protection system should aim at increasing its effectiveness and ability to fight poverty. This can be done only through better targeting and limiting the number of recipients to those who really require support – children, the disabled, and other vulnerable groups of the population. To achieve this goal it is recommended to undertake the following measures:
- ◆ taking into account the fact that the majority of the Kyrgyz population is involved in agriculture and their income has mostly an in-kind character, there is a need to improve the **methodology of assessing a family's aggregate income, which is used to calculate the amount of the UMB**; in addition to the estimated income from land, the profit-generating capacity of livestock and manpower and other household assets should be taken into account. These potential income sources should be calculated on the basis of territorially differentiated and annually updated norms, which take into account real productivity of these assets. The recommended change will limit the number of recipients and significantly increase the size of benefits for those who do not have real income. The guaranteed minimum consumption level (GMCL amounts to 140 soms per person per month,<sup>9</sup> which is extremely low), that is used as a criterion for UMB eligibility, should correspond to its name and reach at least the extreme poverty line. The estimation and approval of norms should be carried out by the relevant state bodies (Ministry of Labor and Social Protection, Ministry of Agriculture and the National Statistical Committee) on the basis of statistical survey data and should not be approved by the Parliament;
  - ◆ the **role of local self-government** in providing social assistance should be increased; local authorities are significantly better informed about the real welfare of every household, and they can be authorized to issue some benefits in complicated and disputed cases and deal with other types of social support;
  - ◆ various **in-kind benefits and privileges** should be replaced with **cash benefits**; in addition, the number of their recipients should be reduced to those categories of the population who really need them (the handicapped, etc.); these changes should be coordinated with pension reform aimed at improving the situation of those pensioners who have really lost their capacity for work (see Section 4.4).

#### 4.4. Pension system

190. The pension system inherited from the Soviet era was costly and unsustainable — largely on account of a low retirement age and numerous privileges for different categories of the population. The reform carried out in the second half of the 1990s increased the retirement age to 63 for men and 58 for women — both are to be introduced gradually until 2007. Furthermore, individual pension accounts and a

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<sup>9</sup> GMCL will be 175 soms a month from January 1, 2006.

notionally defined contribution system under which the size of the insurance part of each individual pension depends on the total amount of contributions paid by each future pensioner during her/his working life were introduced. The above measures, accompanied by improvements in administering pension collection and payments, eliminated the chronic pension arrears observed in the 1990s.

191. Unfortunately, the pension reforms implemented so far were not successful in balancing the assets and liabilities of the pension system in the long term: despite the favorable demographic situation in the country (low dependency ratio), pension benefits remain extremely low for the majority of pensioners and the number of pensioners is too big. Pension Fund revenues are insufficient to cover even such low-level pension benefits, and the Fund needs regular transfers from the state budget. The effort to mobilize the required revenues by establishing high contribution rates has proved not very effective and has led to avoidance in paying SF contributions, an artificial reduction of official wages and salaries, and a shift of business to the shadow economy. This was the reason why contributions to the pension fund have been reduced from 32% to 29% of payroll in the period of 2000-2005, though this did not eliminate incentives for tax avoidance. Pension Fund revenues are also low because contribution rates for many categories of the population (farmers and those who pay lump-sum taxes) are extremely low. This is problematic because these groups represent large parts of the population, but they generate low revenues for the insurance component of their future pensions.
192. Another source of pension system unsustainability is the still low retirement age, especially for women (compared to international standards), and the continued existence of numerous pension privileges (for high mountain regions, for mothers with many children, for people working in difficult conditions, for employees of airline companies, etc.), which allow some groups of the population to retire even before the age of 50.
193. Further pension reforms should aim to increase the size of pension benefits up to a level that ensures decent living standards for elderly people who are not able to continue work and to achieve the long-term fiscal sustainability of the pension system. This requires increasing revenues of the pension fund and decreasing expenditures. Proposals concerning changes in contribution rates and the collection system aimed at increasing SF revenues and decreasing administrative expenses are described in detail in Section 3.1.2.
194. Ensuring the stability of payments and significant increases in the size of pension benefits in the mid- and long-term perspective requires decreasing the number of pensioners to those who cannot really continue working. A complex package of changes needs to be introduced to the pension legislation:
  - ◆ there is no rational explanation for continuing gender differences in terms of retirement age, especially if one takes into account the fact that the average life expectancy of women in Kyrgyzstan is significantly higher than that of men. Thus, it is reasonable to increase **women's retirement age** up to that of men, which will also allow women to accumulate a significantly higher insurance part of their pensions;
  - ◆ at present, the average period of receiving a pension<sup>10</sup> in Kyrgyzstan is quite long - even if compared to developed countries - and clearly does not correspond to the

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<sup>10</sup> Defined as the difference between the life expectancy of the persons who reached the retirement age and the retirement age.

country's economic capacity; on the other hand, the majority of people who reach the retirement age are still able to work and, actually, often continue to work officially or, more often, unofficially. For the above reasons, the **retirement age should be increased** to 65 (or any other age justified by actuarial simulation), i.e., up to the age when the majority of people really lose their ability to work;

- ◆ the main task of the pension system is to provide decent living conditions for elderly people in proportion to their contribution to the system, which means that it should not and must not be used as a redistribution tool (except for the basic part of the pension), for rewarding public achievements or for compensating for difficult working and living conditions. Taking into account private sector domination in the economy, employers, and not the government, should be responsible for maintaining decent working conditions and providing compensation for working in unfavorable conditions; in turn, social assistance should be provided by a public system of social protection instead of the pension system. For these reasons, the existing system of **pension privileges**, i.e., a lower retirement age or special formula for calculating seniority should be **abolished** and replaced, if necessary, by higher wages and well-targeted social benefits.
195. Many countries have introduced a fully-funded pension system, where mandatory pension contributions are transferred to private pension funds, which invest them to maximize their future rate of return. This allows the individual contributions of each person to the pension system to be assessed with a high degree of accuracy. Besides improving the pension insurance system, such a scheme also helps to mobilize domestic savings, which can potentially be invested in the country's economy. However, the risks connected with the investment process should be carefully monitored and their acceptable level for pension funds must be much lower than for other investment funds. This requires the availability of no-risk or low risk assets, instruments for risk hedging and other features typical of developed financial markets. The underdeveloped Kyrgyz financial market (see Section 3.3.2) does not meet these criteria yet. In turn, investing pension fund assets abroad, which could significantly reduce risks, means capital export, which is hardly acceptable for a country that is experiencing a great capital shortage. Besides, there must be a certain minimal size of pension savings to allow their efficient low-cost management and risk diversification. Otherwise, most of the pension contributions will be spent for pension fund management. From this point of view the idea of introducing a pilot fully-funded pension pillar on the basis of approximately 1/30 of all pension contributions, i.e., \$2-3 million per year, does not seem to be reasonable. Introduction of a fully funded pension system component in any form will become rational only when the country's financial sector matures, i.e., when it is able to provide pension funds with diversified no-risk or low-risk financial instruments.
196. Under conditions where the Pension Fund depends on transfers from the state budget, it makes no sense to keep it off the budget. For this reason it is reasonable to integrate the Pension Fund (as well as other Social Fund components) into the budget; this will increase transparency and reduce administrative expenses.



## APPENDIX: MAIN INDICATORS OF SOCIO-ECONOMIC DEVELOPMENT OF THE KYRGYZ REPUBLIC

	1992	1996	2000	2004
<i>Macroeconomic indicators</i>				
Real GDP index (1990 = 100)	79.4	54.3	66.6	80.4
Real GDP average annual rate of growth, %	-10.9 <sup>11</sup>	-9.5 <sup>12</sup>	5.2 <sup>13</sup>	4.8 <sup>14</sup>
Consumer prices index (December to December), %	2132.7	134.8	109.6	102.8
<i>Public sector</i>				
State budget revenues, % of GDP	17.3	15.9	15.2	19.5
Tax revenues, % of GDP	15.1	12.7	11.7	14.9
State budget expenditures, % of GDP	31.2	24.8	25.4	24.5
Public investments, including PIP, % of GDP	...	3.8	8.1	4.5
State budget deficit, % of GDP	-13.9	-8.9	-10.2	-4.5
<i>Social sector</i>				
Human development index	0.72	0.69	0.72	0.73 <sup>15</sup>
Poverty level, % of the total population	...	50.7	52.0	39.3 <sup>15</sup>
Basic secondary education coverage, % of the total number of children of the corresponding age	91.0	89.4	95.9	94.8 <sup>15</sup>
Life expectancy, years	68.1	66.5	66.4	65.3
Infant mortality, per 1000 newborn children	31.5	25.9	22.6	20.9 <sup>15</sup>
State budget expenditures on education, % of GDP	5.0	5.2	3.5	4.6
State budget expenditures on health, % of GDP	2.9	3.1	2.0	2.0
State budget expenditures on social insurance and social welfare, % of GDP	3.4	3.8	1.7	2.8
<i>External sector</i>				
Economic openness, % of GDP	83.2	77.9	77.3	75.3
Current account balance, % of GDP	-4.3	-23.0	-10.4	-3.4
Total external debt, end of year, % of GDP	0.0 <sup>16</sup>	66.6	124.6	95.1

<sup>11</sup> Average for 1991-1992.

<sup>12</sup> Average for 1993-1996.

<sup>13</sup> Average for 1997-2000.

<sup>14</sup> Average for 2001-2004.

<sup>15</sup> 2003.

<sup>16</sup> 1991.

	<b>1998</b>	<b>2000</b>	<b>2004</b>
<i>EBRD index of structural reforms</i> <sup>17</sup>			
Price liberalization	4.3	4.3	4.3
Foreign exchange and trade liberalization	4.0	4.3	4.3
Small-scale privatization	4.0	4.0	4.0
Large-scale privatization	3.0	3.0	3.7
Enterprise reform	2.0	2.0	2.0
Competition policy	2.0	2.0	2.0
Infrastructure reform	1.3	1.3	1.7
Banking sector reform	2.7	2.3	2.3
<i>Index of Economic Freedom, Heritage Foundation</i> <sup>18</sup>			
General index	4.00	3.78	3.36
Including:			
Trade policy	4.00	4.00	4.00
Fiscal burden of government	4.00	3.75	3.10
Government intervention in the economy	5.00	4.00	2.50
Monetary policy	5.00	5.00	3.00
Capital flows and foreign investment	3.00	3.00	3.00
Banking and finance	3.00	3.00	3.00
Wages and prices	4.00	3.00	3.00
Property rights	4.00	4.00	4.00
Regulation	4.00	4.00	4.00
Informal market activity	4.00	4.00	4.00

Sources: National Statistical Committee of the Kyrgyz Republic;  
UNDP;  
World Development Indicators, The World Bank;  
EBRD;  
Heritage Foundation

<sup>17</sup> 1 – no progress, 4.5 – standards and performance typical of advanced industrial economies.

<sup>18</sup> 1 – best, 5 – worst.