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PRIVATIZATION IN THE KYRGHYZ REPUBLIC

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Warsaw, September 1994

Materials published in this series have a character of working papers which can be a subject of further publications in the future. The views and opinions expressed here reflect Authors' point of view and not necessary those of CASE.

Paper was prepared under the *Project of Supporting Economic Reforms in Post-Soviet States*, carried out by **CASE – Center for Social and Economic Research** and sponsored by **George Soros**.

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Warsaw 1994

ISBN - 83-86296-17-8

Editor:

CASE - Center for Social and Economic Research
www.case.com.pl

INTRODUCTION¹

The privatization and denationalization program in the Republic of Kyrgyzstan has been given high priority in the Government's agenda. This program has its origins in the privatization law drafted at the end of 1991 (*Zakon* 20.12.1991; *Postanovlenie* 20.12.91) and adopted by President in January 1992 (*Ukaz* 13.1.1992). Initially the program got off to a slow start, but it quickly gained momentum when Parliament approved a new "Concept Note" in December 1992, calling for rapid sale of small-scale enterprises and mass privatization of medium to large-scale enterprises through competitive methods (*Kontseptsia* 1992).

The State Property Fund (SPF), or *Gosimuschestvo*, was established in July of 1992. Parliament assigned the SPF the task of carrying out the privatization program, making the SPF responsible for its design, the drafting of legislation, and the promulgation of regulations.

The whole process of privatization in the Kyrgyz Republic can be divided into two stages. The first one covers the time period between December 1991 and December 1993; the second stage began in January 1994. Each stage will be discussed separately.

¹ The CASE Project Team on Economic Reform and Privatization led by Professor Marek Dąbrowski visited Kyrgyzstan three times to review the economic reform and privatization processes. Dr. Marek Dąbrowski, Dr. Kazimierz Kloc and Dr. Julian Pańków participated in the first two visits, and Rafał Antczak and Dr. W. Jermakowicz in the third (*Sostoianie* 1994). CASE would like to thank the Government of Kyrgyzstan, its Ministries (particularly Foreign Affairs, Economy and Finance), the National Bank of Kyrgyzstan and especially the State Privatization Fund for their warm hospitality. CASE also gratefully acknowledges the help of the IMF, World Bank and Price Waterhouse offices in Bishkek/Kyrgyzstan as well as the financial support of the Soros Foundation.

Part one. **FIRST STAGE OF PRIVATIZATION, 1992-1993**

GOALS AND RESULTS

In January 1992, the Government of Kyrgyzstan introduced its first privatization program. The primary objectives of this program were the rapid denationalization and privatization of all economic sectors, as well as the formation of diversified forms of ownership. It was also assumed that the privatization process itself would initiate the formation of the market self-regulation mechanism, which would in turn induce changes in the social psychology of the majority of the population. The objective of this program was to privatize 35 percent of the Republic's state-owned assets within a two-year period, in this case by the end of 1993 (*Ukaz* 31.1.1992).

In 1992 all state-fixed assets were estimated at Som 95.4 million. The Privatization Program assumed that the total value of assets to be privatized or denationalized during 1992-93 will amount to, in real figures, about Som 33.4 million. This constituted about 35 percent of the total value of state-owned assets.

This was the plan. Its results are more than impressive. During the two year period, 33.15 percent of state assets were privatized, corresponding to a plan fulfillment of 94.3 percent. In comparison to the plans set by other post-communist republics in the former Soviet Union this represents an impressive achievement. The statistics corresponding to the Kyrgyzstan plan are displayed in Table 1.

According to official statistics 4,428 firms with a total founding capital of Som 31,630,383 were "privatized" during the first two years².

This enormous success in achieving the plan specifications is also cause for some skepticism. This success seems to indicate that the entire privatization process in Kyrgyzstan was very formal and conducted in an administrative way. The plans were set, and lower echelons of the Kyrgyz bureaucracy were responsible for meeting the corresponding goals. These lower level bureaucrats subsequently returned formal reports that the plan goals were met. How the plans were really executed is still unknown.

² The value of fixed assets is so low because it was valued at 1992 ruble prices, converted into Soms at the exchange rate of 240 rubles per som. Because of high inflation these assets were later revaluated three times: in 1991, 1992, and 1993. The value of fixed assets acquired were multiplied 29-34 times in 1991, in 1992 between 20-29 times and in 1993 between 5-10 times — in accordance with the type of asset (*Postanovlenie* 252, 1994). The new assets value is not shown in the statistics.

The authors' suspicion is confirmed by the fact that the statistics also seem to reflect the old habit of the socialist economy of surpassing plan targets at year's end and slowing down at the year's beginning. Privatization progressed most rapidly in the last quarters of 1992 and 1993, and most slowly at the beginning of each ensuing year.

Table 1. The Progress of Privatization in the Republic of Kyrgyzstan in 1992-1993.

Time period	Value of privatized assets (Thousand Som)	% of privatized assets	Value of privatized assets (Accumul)	% of privatized assets (Accumul)	Dynamic of privatization (%)
1992					
January-March	1145.1	1.20	1145.1	1.20	
April-June	591.6	0.62	1736.7	1.82	151.7
July-August	1755.8	1.84	3492.5	3.66	201.1
Sept-December	5610.9	5.88	9103.4	9.54	260.7
1993					
January-March	4561.2	4.78	13664.6	14.32	150.1
April-June	6317.0	6.62	19981.6	20.94	146.2
July-August	4122.3	4.32	24103.8	25.26	120.6
Sept-December	7528.9	7.89	31630.4	33.15	131.0

* Own calculations based on: (Calculation 1993; Calculation I 1994)

SECTORAL APPROACH

Kyrgyzstan's first two-year privatization program envisioned a sectoral approach to privatization. This means that, from the beginning, the Kyrgyz Government regarded each sector differently and set different privatization targets for each of them.

The highest priority was given to the privatization of the services and trade sector, followed by industry and agriculture. Some branches of the national economy were excluded from privatization — i.e. utilities, airlines, railways, enterprises with primarily defense-oriented output and mining. Land was also excluded from privatization. In the new constitution approved on May 5, 1993 Parliament declined to include the private ownership of land (other than plots for private houses and gardens).

Differences in priorities led to different paces of privatization in different sectors. The most rapid pace was noted in the consumer service industry, where 98.7 percent of firms were "privatized", and in trade and catering, where 81.5 percent of firms' assets changed owners. However these two sectors constituted only 1.9 percent of all government-owned assets. The two largest sectors, industry and agriculture, which together dominate almost half of the Kyrgyz economy (47.6 percent), were "privatized" to approximately 41 percent. The slowest pace was observable in the transport sector (24.5%) and in other branches such as communications and forestry (See Table 2).

Table 2. Breakdown of Actual Privatization by Sector

Sector	Value of all SOEs Som (in 1000s)	Aug. 10, 1993		Jan. 1, 1994			June 13, 1994
		#	%	#	Som (in 000s)	%	#
Industry	29335	217	36.7	258	11470.4	39.10	280
Munic. services	14245	.	20.4	.	6043.9	42.43	.
Consum. services	439	1700	84.0	1811	434.1	98.71	1869
Trade & catering	1450	1310	67.1	1626	1170.7	80.70	1715
Agriculture	16155	166	30.8	235	6674.7	41.32	292
Construction	4085	160	52.6	223	2757.9	67.51	273
Transport	4305	47	13.6	82	1056.2	24.53	90
Other branches	25408	103	2.7	192	1493.9	5.92	257
Total	95423	3703	24.5	4427	31101.9	33.15	4776

* Own calculations based on: (Calculation 1993; Calculation I 1994; Privatizatsia 1994)

As in the case of other post-communist countries this sectoral approach shows that the quickest privatization was achieved in the trade and services areas, the area of so-called "small scale" privatization, where the small size of the firms, the small amounts of capital needed for their purchase and the market orientation of the firms enabled the quicker pace of privatization. The slow pace in transportation is due to legislation which does not allow for sale of the state assets before they reach the level of full amortization (obsolescence). This is a significant deviation from the experience of other East European countries where the sale of transportation means took place relatively quickly.

Slow privatization in industry, agriculture, and transportation seem to confirm our thesis that the privatization in Kyrgyzstan in 1992-1993 had a formal and administrative character. In those sectors where sectoral ministries were either weak or absent — like trade, catering and services — privatization occurred at a rapid pace, the result of a lack of administrative resistance. In those sectors where ministries were very strong, the privatization process moved either much slower or not at all.

The next most striking phenomenon in Kyrgyzstan is the absence of privatization from the bottom — so-called organic privatization — where private owners establish their own private firms. This type of privatization has been the strongest factor in Poland's economic development and its absence is probably one reason why the privatization of transport and warehousing and distribution enterprises moved far slower than expected. A lack of local capital, a lack of entrepreneurial spirit and highly monopolized branches like warehousing and transportation are possible explanations for this fact.

PRIVATIZATION METHODS

The privatization program envisioned seven methods for sale or transfer of state assets:

- a. public cash auctions;
- b. competitive bids, understood as privatization through the acceptance of bids that include proposals for the future development of the enterprise;
- c. leasing with subsequent purchase;
- d. transformation into a joint-stock company (commercialization) with the sale of 25-75 percent of the shares to management and/or workers collectives. At least 25 percent of the shares in those JSCs were reserved to be distributed to the public in the framework of a mass privatization program;
- e. direct sale to individuals;
- f. direct sale to workers collectives, defined as enterprises that are owned 100 percent by employees; and
- g. "free of charge" transfer of assets (*Ukaz* 13.1.1992).

Statistics on the frequency of each method application in the privatization process are presented in Tables 3 and 4. The "free of charge" transfer method, which was used only once and is included in "other branches", is excluded from the statistics.

Table 3. The Number of Privatized Firms classified by Type of Property Transfer and by Sector.

Form of transfer	Lease	JSC Formation	Competitive Bidding	Auctions	Individuals	Collectives	Others	Total
Industry								
8.10.93	7	190				20		217
1.1.94	7	204			4	24	20	259
6.13.94	7	217			4	31	21	280
Cons. Services								
8.10.93	13	31	684		562	379		1669
1.1.94*	13	32	543	162	637	418	6	1811
6.13.94*	13	32	542	162	669	444	7	1869
Trade & Catering								
8.10.93	39	109	530		208	424		1310
1.1.94	39	201	421	95	241	490	44	1531
6.13.94	39	211	434	95	267	528	46	1620
Agriculture								
8.10.93	3	48	1		7	107		166
1.1.94	3	71	1		11	146	3	235
6.13.94	3	102	1		16	162	8	292
Construction								
8.10.93	2	125			2	31		160
1.1.94	2	161			4	46	10	223
6.13.94	2	196			6	54	15	273
Transport								
8.10.93		43				4		47
1.1.94		71				7	4	82
6.13.94		78			1	7	4	90
Other branches								
8.10.93	3	32	7		15	46		103
1.1.94*	3	38	19		27	92	12	192
6.13.94*	3	44	20		49	122	18	257
Total								
8.10.93	67	578	1222		825	1011		3703
1.1.94	67	778	1241		924	1223	99	4332
6.13.94	67	880	1254		1012	1348	119	4776
Total (in %)								
8.10.93	1.8%	15.6%	33.0%		22.3%	27.3	0.0	100
1.1.94	1.5%	18.0%	28.6%		21.3%	28.2	2.3	100
6.13.94	1.4%	18.4%	26.3%		21.2%	28.2	2.5	100

* Others also include one case of "free of charge" transfer.

* Own calculations based on: (Calculation 1993; Calculation I 1994; *Privatizatsia* 1994; *Kuponnyi* 1994)

A comparison of the use of property transfer methods shows that the "free of charge" transfer and the lease with purchase option were used only marginally. The most common was the sale to collectives method, which was used in 1348 cases (28.2%), followed by the competitive bidding method (1254 or 26.5%) and the sale to individuals method (880 cases or 21.2%). These three methods were closely followed

by the JSC formation method. Although this method constituted only 18.4 percent of all cases, it — because of the size of enterprises (as shown in Table 4) — covers practically two-thirds of all assets.

Table 4. The Value of Privatized Firms categorized by Type of Property Transfer and by Sector.

Form of transfer	Lease	JSC Formation	Compet. bidding	Auction	Sale to individuals	Sale to collectives	Total**
Industry							
8.10.93	4.3	10655.8				97.9	10758.0
1.1.94	4.2	11443.6	0.1		19.4	151.9	11738.3
Mun. Services							
8.10.93					2909.0		2909.0
1.1.94					6282.4		6282.4
Cons. Services							
8.10.93	7.9	151.8	52.9		31.1	120.7	364.4
1.1.94	7.9	143.8	52.5	2.7	41.7	155.1	434.1
Trade & Catering							
8.10.93	28.4	588.4	50.7		28.0	244.5	940.0
1.1.94	28.4	633.2	76.7	11.1	38.5	303.7	1181.7
Agriculture							
8.10.93	54.8	1646.6	4.0		6.5	3267.2	4979.0
1.1.94	55.0	2375.0	4.1		42.3	4137.8	6675.1
Construction							
8.10.93	2.6	2053.5			0.6	93.3	2150.0
1.1.94	2.6	2550.6			1.1	184.3	2759.0
Transport							
8.10.93		570.7				16.3	587.0
1.1.94		1011.1			13.2	26.6	1056.2
Other branches							
8.10.93	11.8	511.1	35.5		7.4	111.2	677.0
1.1.94***	11.8	880.7	311.5		44.7	233.3	1503.4
Total							
8.10.93	109.8	16177.9	143.0		2982.7	3951.0	23364.4
1.1.94	109.8	19038.2	434.9	13.8	6483.2	5192.8	31630.3
Total (in %)							
8.10.93	0.5%	69.2%	0.6%		12.8%	16.9%	100.0%
1.1.94	0.3%	60.2%	1.3%	.1%	20.5%	16.4%	100.0%

* Total also includes one case of "free of charge" transfer with a value of Som 2,400.

** Total could be higher than the actual sum of all methods listed due to lack of information concerning methods used in some privatization cases.

*** Own calculations based on: (Calculation 1993; Calculation I 1994)

The analysis of Table 4, for which only data from the first two periods is available, shows a quite different picture. The JSC formation dominated the privatization process in most sectors, encompassing 60.2 percent of total privatized fixed assets. This method was followed by the sale to individuals (20.5) and the sale to collectives (16.4%). Competitive bidding and auction methods, although frequently used, accounted only for a little more than one percent of all state-owned assets. Similarly, leasing played a very marginal role (.3%).

This also seems to confirm our suspicion that Kyrgyzstan is following a very administrative approach to privatization. In most cases the state converted SOEs into JSCs, transferred, at very discounted prices, part of shares to labor and reserved the rest of the shares for the future mass privatization program. The most classic and time-consuming case by case methods of competitive bidding and auction were used only in cases of small scale privatization.

A comparison of the number and the value of privatized firms indicates which method was used most in the various enterprise sectors (See Table 5).

Table 5. Average Size of Privatized Firms by Type of Property Transfer and by Sector

Form of transfer	Lease	JSC Formation	Compet. bidd.	Auction	Sale indiv.	Sale collec.	Total
Industry							
8.10.93	614.7	56083.2				4894.9	49576.0
1.1.94	595.0	56096.2			4854.0	6330.4	67875.6
Cons. Services							
8.10.93	610.9	4895.6	77.3		55.4	318.4	218.3
1.1.94	607.7	4494.9	78.3	16.6	65.4	371.1	239.7
Trade & Catering							
8.10.93	727.9	5398.5	95.6		134.7	576.6	717.6
1.1.94	728.2	3150.3	150.8	116.8	159.6	619.8	4808.7
Agriculture							
8.10.93	18256.3	34303.2	3983.2		924.7	30534	29994
1.1.94	18336.7	33451.2	4091.0		3848.1	28340	28404
Construction							
8.10.93	1290.0	16427.7			322.5	3010.0	13437
1.1.94	1276.0	15842.3			263.0	4006.3	12372
Transport							
8.10.93		13273.0				4065.0	12489
1.1.94		14241.1				3806.7	12880
Other branches							
8.10.93	3926.6	15973.0	5067.8		496.5	2416.6	6572
1.1.94	3933.3	23177.2	16395.8		1653.7	2535.9	7830
Total							
8.10.93	1638.2	27989.4	117.0		3615.4	3908.0	6309
1.1.94	1639.2	24470.7	228.1	133.4	7016.5	4245.9	7301
Total (in %)							
8.10.93	26.0%	443.6%	1.9%		57.3%	61.9%	100.0%
1.1.94	22.5%	335.2%	3.1%	1.8%	96.1%	58.2%	100.0%

* Own calculations based on: (Calculation 1993; Calculation I 1994)

There is no doubt that the transformation into a joint stock company method was applied in the privatization of larger firms, firms with a size four times larger than the average. Second is the direct sale to individuals (close to the average firm size), and third is the direct sale to collectives (half of average). The leasing, competitive bidding, and auction methods were generally used only in cases of small firms.

The sectoral breakdown of the methods reveals that the **industrial sector** was privatized mainly through transformation into joint-stock companies, whereby labor collectives acquired majority control — holding on the average 53 percent of the company shares. This method encompassed 82.7 percent of total privatized assets in this sector. In August 1993, none of these enterprises was privatized either through competitive bidding or through direct sale to the individual. The main industrial subsectors privatized included the electrical, textiles, food processing, chemical and petrochemical industries³.

In the **consumer service** sector the most frequently used method was the competitive bidding method, used in 705 cases (38.9%). The sale to collectives with 669 cases was second (36.7%) and accounted for 35.7 percent of fixed assets purchases. The transformation into JSC accounted for only 32 cases (1.7%) and for 33.3 percent off all fixed assets in this sector.

Privatization in **retail trade and catering** was carried out in two areas: privatization of trade and privatization of restaurants. As the former is larger, privatization encompassed 1239 shops and retail stores with a total value of Som 987,200. Privatization of restaurants involved 383 units with a total value of Som 183,600 (*Privatizatsia* 1994). Privatization targets in this sector were generally exceeded. Sale to collectives and competitive bidding (each 528 cases) accounted for two thirds of all methods (65.5%), but their role in terms of assets privatized was marginal. For example only 19.4 percent of total assets were sold through competitive bidding both to collectives and individuals. On the other hand the transformation into joint stock companies and leasing with option to purchase accounted for 80 percent of fixed assets, but only for 15.4% of all methods.

The scope of privatization in **agriculture** fell below the target. There are a several reasons for this. Until mid-1993 the Ministry of Agriculture was responsible for the privatization of agricultural property. The Ministry tried to break up state (*sovkhov*) and collective (*kolkhoz*) farms into small independent units in order to sell them. However, the ministry's attempts failed (*Kyrgyz* 1993). In mid-1993 the responsibility for privatization in the agriculture sector was turned over to the State Property Fund. The SPF is focusing on turning sovkhovy and kolhozy as entire entities into JSCs or selling them to collectives. As an result the number of joint stock companies increased in the period from August 10 to December 31 from 48 to 71 and the sale to collectives from 107 to 147. The fixed assets in agriculture under the control of joint stock companies increased from Som 1,646,600 to Som 2,375,000, and under the control of collectives from Som 3,367,000 to Som 4,137,800. At the

³ Within industry the largest number of firms was sold in food processing industry (77 firms — Som 2,548,700), followed by the electro-machinery industry (56 firms — Som 4,241,900); light industry (41 firms — Som 12,820,100), the construction material industry (37 firms — Som 1,033,700) and in other industries (47 firms — Som 825,900) (*Privatizatsia* 1994)

same time, the number of firms sold to individuals increased from seven cases to eleven, and the value of fixed assets sold to individuals increased sevenfold from Som 6.5 to Som 42.3 th.

The difficulties in privatization in the agricultural sector can be attributed to the heavy reliance on the existing production infrastructure, in particular on irrigation facilities; the lack of support facilities; and the absence of land property rights for individuals. The land in Kyrgyzstan may not be owned with the right to buy or sell. However long-term leases for 49 years with inheritance rights are permitted. Agricultural procurement, warehousing, food processing and other highly specialized medium-size and large enterprises were mainly transformed into joint-stock companies, whereby at least 40 percent of their shares were made available for sale to private farms and other agricultural enterprises.

The original privatization target in the **transport** sector was relatively low. Little progress has been made thus far, and no "market" mechanisms have been used in the process. While truck and passenger coach fleets of up to 150 vehicles were to have priority in the process of privatization, few were actually sold.

In **construction**, the privatization target of 50 percent was exceeded by 17.4 percent at the end of 1993. This privatization involved construction conglomerates providing a full range of services. They were transformed into JSCs with employee-owned property shares limited to 35 percent.

In the **municipal services** sector 126,280 of 247,600 state-owned housing units were privatized by October 1, 1993. This figure represents 51 percent of all state-owned housing units. At the end of 1993, the value of sold housing units totalled Som 6,282,000 (app. Som 50 per unit). In 1992 payments were made in cash. In 1993 they were made in cash and/or privatization vouchers (SMP) and with no charge to dwellers⁴. Thirty percent of the existing and newly built state-owned and community housing is reserved for contractual leasing to unprotected social groups, and to those with welfare privileges or not intending to own their home.

The general privatization process was strongly supported by the Kyrgyz Government. The State Property Fund offered citizens financing packages with 25 percent down payment and up to three-year loans -- a solution similar to the Polish leasing method with the option to sell. In addition, there was an array of special advantages offered to some employees to help them buy their enterprises' assets. These included the sale of shares or assets at reduced prices, rebates for employees of enterprises located in certain remote areas and income tax deductions corresponding to

⁴ While the State Privatization Fund may issue housing privatization vouchers, the actual implementation of the housing program was carried out by local housing bureaus or enterprises which control specific housing facilities (*Kyrgyz 1993*).

the amounts of assets purchased by agricultural enterprise employees. Additional financing was also available from banks, but solely to worker collectives purchasing enterprises. Most of such financing packages were granted without objective criteria and on an individual basis approved by a six person board of the SPF.

VOUCHER PRIVATIZATION PROGRAM

In order to encourage broad participation of the population in the denationalization and privatization process, the Kyrgyz government launched the Voucher Privatization Program (VPP) in 1992 (*Polozhenie* 10.1.1992). The basic instrument in this program was a voucher, in the form of a "Special Means of Payment" (SMP) as the basic bidding instrument. The Government envisioned that each citizen would be guaranteed assets in proportion to his or her "economic contribution" to the Republic. The VPP assumed that:

- a. each Kyrgyz citizen may receive, upon request, until January 1, 1994, a privatization voucher known as a "Special Mean of Payment" (SMP). This period was later extended until September 1994.
- b. each SMP has a specified value based on the individual's wage and length of service. The value of the voucher for a person over 16 years of age is calculated as $P=(1,000 + .5AB)$ — where P equals the value of the voucher, A is the average monthly salary calculated from any consecutive 5-year period during the last 15 years and B is the length of work service. Those without work experience — like children or unemployed wives — were judged by the same formula and received vouchers equal to Rub 1,000. A number of other rates applied to pensioners, the disabled, orphans, widows, and other disadvantaged groups.
- c. SMPs were personalized and could neither be transferred (except to close relatives) nor traded.
- d. SMPs could be tendered in exchange for 1) housing currently occupied by the voucher holder, 2) shares of state and municipal enterprises in the framework of sale to collectives or individuals, 3) shares in joint-stock companies or 4) other municipal entities subject to privatization.
- e. SMP was designed to guarantee a fixed asset value, in prices of 1982 equal to the nominal price of a SMP.
- f. SMPs have a limited validity time which was expected to expire on January 2, 2000.

The manner in which SMP values were determined rewarded those employed in the industrial sector most. Their salaries were significantly higher than those of employees in other sectors. Employees of the social sector, students and pensioners were also disadvantaged. The government believed that providing remuneration based on past efforts would be fairer than standardizing the values.

In practical terms the VPP created shares with total worth of Som 13.3 million. What about SMP? As of December 1993 SMP had been distributed to approximately 3.4 million of citizens (76% of the population). The average value of SMP translated to 12 Som. This meant that the SMPs in circulation had a total value of Som 41 million. This also meant that the number of vouchers issued exceeded the value of state-owned fixed assets reserved for the mass privatization program by three and a half times. The vouchers with a total value of Som 41 million were expected to redeem shares of property worth Som 13.3 million⁵. This imbalance was incorporated into the program (*Sostoianie* 1994).

Without a doubt the Voucher Privatization Program was a complete failure.

From all 3.4 million SPMs issued only approximately five percent had been tendered by December 1993. Those tendered were used by workers to pay for shares purchased through their workers collectives and for housing. The small percentage of SMP tendered over the two-year period can be explained by the fact that the public had not been educated in either the mechanics nor in the philosophy behind the privatization, and thus did not understand the SMP as an instrument of value. Moreover the mechanics of the tender process itself were so cumbersome that it only allowed employees of given enterprises to tender their SMPs for shares in their own enterprises through an internal subscription process rather than to make the shares universally available.

OUTCOME OF THE FIRST STAGE OF PRIVATIZATION

Despite its speed and formal advancement, privatization in the Kyrgyz Republic has — for the most part — failed to create more efficient economic entities. There are a several reasons for this.

First, the predominant method of privatization were the JSC formation and the transfer of shares to the labor collectives (in most cases without the right to resell). This was true for 98 percent of all fixed assets being "privatized." The state retained 47

⁵ Until May 1993 all calculations were made in Russian rubles. The Kyrgyz currency Som was introduced on May 4, 1993. The exchange rate imposed was Som 1= Rub 240. Thus, calculating in rubles, the expected total value of the vouchers was Rub 12 billion and the total expected value of fixed assets was Rub 3.2 billion. In May 1993 the exchange rate was Som 7 per US\$1.00, and one year later was Som 12.1 per US\$ 1.00.

percent of shares in most enterprises converted into JSCs. The shares held by the state were given into the trust of existing branch ministers or state concerns, which, officially, should serve as large state holdings. Due to branch character these newly forming institutions, as a rule, resisted the privatization process and had negative effects on new owners' behavior. In all these firms virtually nothing changed. With the exception of small retail and service establishments, most of the "privatized" enterprises remained under the direct influence of ministries or concerns which have practically continued to play the key role in pricing, profiling the production, procurement and allocating financial resources⁶.

Second, the arbitrary and free distribution of shares to existing state managers and the transfer of these shares to labor collectives without a competitive process or market-oriented pricing of shares have been a common element in this conversion. This was done in order to satisfy what was perceived as a social obligation on the part of the State, but led to a merely cosmetic transformation of the enterprises. The existing management retained control. Therefore the new "owners" aren't behaving as real owners, willing to take risk and show entrepreneurial spirit.

Third, about one third of the new JSCs were created as "closed form" companies, whereby a shareholder was not permitted to sell his/her share while leaving the company. The share had to be returned to the collective. This has hindered much needed labor restructuring, the emergence of effective ownership and the creation of a secondary market for enterprise shares. A similar tendency was also visible in Russia.

Fourth, the privatization program was implemented in a very subjective manner. Only a six member Board of Directors at the State Property Fund determined the manner in which each enterprise was privatized. Prices were often adjusted to accommodate what collectives indicated they were willing or able to pay, and shares were allocated to owners, in what appeared to be highly random fashion.

Fifth, restructuring and adjustment to evolving market conditions have been discouraged by "profile" restrictions on privatized enterprises. These are clauses in privatization contracts that constrain new owners in their business decisions regarding such matters as product choice and employment levels.

Sixth, although approximately 76 percent of SMPs were distributed among the population by December 1993, voucher privatization through SMP auctions had not, until that time, been initiated. Large segments of non-employee citizens have been left

⁶ As the "Concept" (*Kontseptzia* 1994) reveals, the state owns, on the average, 59 percent of all fixed assets, 7.7 percent of assets belong to cooperatives and other forms of social ownership, 9.2 percent to kolkhozes, 9.3 percent to labor collectives, and 14.3 percent is owned commonly by the state and labor collocates. Only .5% of fixed assets belong to private individuals.

out of the privatization process. This has led to a perception that the privatization program has turned into an unfair distribution of national wealth to influential groups such as enterprise managers and labor collectives.

Seventh, as no bankruptcy legislation was passed until the end of 1993, the State Privatization Fund was unable to deal with enterprises operating at a loss.

Eighth, the Kyrgyz Government failed to educate its population about privatization in general, its privatization program in particular and its expectations on how privatization should lead to the creation of market economy (Isaev 1994).

Ninth, the Kyrgyz privatization program was carried out in an extremely difficult environment with significant gaps and inconsistencies in the Republic's legislation. This is a result of a lack of coordination between the President, government, Parliament and the SPF. Resolutions and decrees were issued which contradicted each other, and certain issues were never addressed.

As written above, the privatization process in the Kyrgyz Republic of 1992-1993, although very rapid, has not been conducive to the development of effective private ownership and profit-oriented management.

Part two. **SECOND STAGE OF PRIVATIZATION, 1994-1995**

In response to the criticism and an analysis of the results of "corporatization" (rather than privatization) and in an effort to build on the 1992-1993 program, the State Privatization Fund developed a new program of privatization for 1994-1995 (*Postanovlenie* 12.1.1994)⁷.

The basic goals of the privatization in 1994-1995 are: first and foremost the formation of a strong strata of private owners whose interests should match those of the state, increasing the participation of the largest groups of the Kyrgyz society in the privatization process through the introduction of a new type of mass privatization program and helping inefficient firms recover (*Kontseptsia* 1994).

In the new privatization program it is explicitly expressed that the **quality of the privatization** is more important than the speed, the opposite of the situation 1992-93. The process should be transparent and carried out according to objective measures.

Over the next two years the State Property Fund intends to privatize an additional 20-25 percent of state assets. The enterprises selected for this program are divided into five categories:

1. small scale firms employing up to 100 individuals,
2. medium scale firms employing 100 to 1,000 individuals,
3. large scale firms employing over 1,000 individuals,
4. entities which will be "corporatized", and
5. enterprises for which the Government would like to attract foreign investment (*Privatization* 1994).

1. Small Scale Privatization

The SPF has proposed that small scale enterprises be privatized through auctions and in very rare cases through competitive tenders with the use of both cash and privatization coupons. This should exclude the influence of subjective elements in

⁷ The State Property Funds "Program of Denationalization and Privatization for 1994-1995 was accepted by Parliament in January (*Postanovlenije* 12.1.1994), but not enacted by Government until March 14, 1994. The description of the program incorporates all other adjustments from the Presidential Decree of February 10 and the Governmental Resolutions of February 24-28, 1994 (*Kontseptsia* 1994).

decision-making. More than 300 enterprises or units will be privatized this way. The competitive biddings are expected to be completed by the end of 1994.

2. Medium Scale.

Medium scale privatization covers those enterprises which employ between 100 to 1,000 individuals. This group of enterprises can be divided into two sub-groups: smaller and larger medium-sized enterprises.

In the former group, where the fixed-assets value per one employee is lower than Som 50, the enterprises will be privatized through auctions or competitive tenders as in small scale privatization.

In the latter group, where the fixed assets value per employee is higher than Som 50, firms will follow the ensuing procedure. First of all, State Owned Enterprises (SOEs) will be transformed into JSCs. For enterprises included in this program 25 percent of the shares will, as before, be reserved for the mass privatization program; and 5 percent of the shares will be transferred free of cost to the individual members of the workers collective. This is different from the previous program in which shares reserved for employees were sold to them on preferential terms. The remaining 70 percent will be privatized on the basis of competitive privatization projects. These projects can be submitted by any foreign or domestic party interested in becoming a strategic investor in an enterprise or any portion thereof. These parties may include investors, management, suppliers and clients. Some shares may remain in state possession in order to be later sold on the stock exchange (*Primernyj* 1994). Such privatization projects should include such information as the proposed distribution of shares, capital investment, staffing expectations and projected financial statements.

An inter-ministerial committee including independent experts is to evaluate the projects submitted. This committee is composed of representatives of the Ministry of Finance, the Ministry of Economy, the Branch Ministry, the local administration and at least two experts. Selection is based on a two-tier system in which price is the primary criteria. In cases where there are multiple bids within the 10-15 percent range of the highest bid, additional factors such as caliber of management, the impact on employees, the proposed investment and proposed changes in the product line are considered.

The following criteria are applied during project evaluation (*Postanovlenie* 323, 1994):

- the size of offered investment. The larger and the more long-term oriented the investment, the more points it receives - up to 40 points
- entry into new markets or an increase in the existing market share - up to 35 points

- starting a new type of import substitution production - up to 30 points
 - introduction of new technologies, - up to 30 points
 - settlement of new management, new accounting control and training of employees - up to 25 points
 - price offered by the project authors - up to 20 points
 - job security or training in the case of job reduction - up to 20 points.
- Total 200 points

Those criteria can be changed, augmented or reduced in accordance with the type of enterprise (*Postanovlenie* 12.5.1994)⁸.

Approximately 275 enterprises will be privatized through a competitive projects program in a number of rounds.

3. Large Scale Privatization.

Large scale privatization involves those SOEs which employ more than 1,000 individuals. These enterprises are expected to be converted into joint stock companies during the first half of 1994. Within one year following its conversion, each enterprise is expected to file its own privatization project. These enterprises will then follow the procedure shown in the case of medium scale privatization.

4. Corporatization (Corporate Governance method)

Certain entities which may not be privatized at a later date — like railways, Kyrgyzstan Airlines etc — will remain State-Owned Enterprises, but with a corporate governance structure. Under corporatization an entity is expected to remain state-owned, but function independently from the government. In other words the enterprise will receive a Board of Directors, but will be not formally converted into the JSC structure. The Board of Directors of such state-owned enterprises will consist of 5-9

⁸ The first example of auction involves the case of the *Tokmoskaia Valialno-Voilochnaia Fabrika*. The following information about the firm was given: the type of activity, size of the production for the first three months of 1994, number of employees and the criteria of the projects evaluation. Five criteria were applied: the size of offered investment during a two-three year period (up to 40 points); the possibilities of entering new markets or expansion in existing markets (up to 35 points); plans to start a new type of import substituting production or to develop new technologies (up to 30 points); introduction of new management, new accounting and training (up to 25 points); and planned number of retained employees as well as job training for released employees (up to 20 points) (Fond 1994). In comparison to the standard valuation procedure presented in *Postanovlenie* 323 (1994), new production and new technology were combined as one and the high prices offered by bidders were omitted. The maximal number of points was lowered to 150.

executive and non-executive members. A general director (CEO), an assistant director for economics, and an assistant director for technology serve as executive members. The non-executive members should be in the majority and include representatives of the SPF, the Ministry of Finance and independent experts. The SPF will negotiate the management contracts with such boards for the management of those companies. Approximately 32 firms should be included in this program.

5. Privatization with foreign participation

The State Property Fund is in the process of designing a program to attract foreign investment to certain enterprises. Approximately twenty enterprises have been targeted.

OTHER MEASURES UNDERTAKEN BY THE GOVERNMENT

In February 1994 a governmental decree introduced several important measures to improve the privatization program. These include:

- a mass commercialization program to convert all state owned enterprises into open joint-stock companies within four months; retroactively converting closed joint-stock companies into open joint-stock companies within a period of two months (allowing shareholders the right to sell their shares to citizens outside the company);
- adoption of the State Property Fund's resolution eliminating "profile" restrictions in previous privatization contracts as well as in future contracts;
- transfer of enterprise shares remaining in state possession from branch (line) ministries to the SPF and privatization of these shares. These shares were to be auctioned starting March 1, 1994;
- enactment of regulation on the operation of Investment Funds and registration of shares in those Funds (investment funds were introduced on April 21, 1994); and
- definition of the criteria to be applied in the selection among competing privatization proposals, the most important of which should be price.

CAPITAL MARKET DEVELOPMENT IN THE KYRGHYZ REPUBLIC

The development of an efficient capital market that creates a fair financial environment, leads to a rational allocation of capital to investment projects and

mobilizes domestic savings is vital to the success of the entire economic reform and especially to that of privatization.

There are two major tasks which have to be fulfilled. First, there is an urgent need to establish an effective and efficient policy framework for the development of the capital market. This requires both the development of a coherent regulatory policy and legal framework and the establishment and strengthening of government and quasi-government regulatory institutions. Second, it is imperative for the Government to facilitate the development of appropriate security market infrastructures which would secure and promote the trading of shares on the secondary markets. This involves the establishment of a State Securities Agency — *Gosagtzzenbumag*, the Kyrgyz version of the Securities and Exchange Commission — , Clearing and Settlement Organizations, Depositories, a Custody, a Common Back Office, a Stock Exchange, and other appropriate capital market providers. While many tasks are best left to the market, the Government has a key role in setting the rules and facilitating the development of a vital infrastructure, specifically such things as trading, clearing, and settlements systems.

The Kyrgyz Government together with Price Waterhouse developed the idea of the *Gosagtzzenbumag* (already established), the Clearing and Settlement, the Depository, the Custody and the Stock Exchange (building has already been adapted). Institutions which are being considered for development are the Common Back Office, Over the Counter Trading and other capital market institutions.

The American stock exchange model was accepted. The stock exchange may be established by no less than ten legal entities as a joint-stock company. These legal entities must have a license from professional securities market participants. The stock exchange is presently being registered with legal bodies and getting a license for activities in the State Agency for Securities (*Gosagtzzenbumag*). The exchange should assume its work in July 1994 with trading in privatization coupons. All other institutions should assume their work in September 1994. The stock exchange will then list shares of companies successfully privatized to that date⁹.

The reasons that the Kyrgyz Stock Exchange has not yet been established are connected with the fact that there is not yet any mechanism for the regulation of securities. The firms establishing the stock exchange also expect to receive privileges in trading their securities, a practice not allowed by the *Gosagtzzenbumag*.

⁹ By January 1, 1994 144 joint-stock companies with authorized capital of Som 112.8 million had issued securities. 67 of them are of the open type and 77 of the closed type. In the course of the 1993 year, 68 joint stock companies issued 2,359 stock shares to be sold at nominal cost for a total of Som 36.3 million. Of these stocks 90 percent are ordinary registered stocks and 10 percent are preferred ones. 1,548 stocks were sold for Som 25.9 million. The major emitters are JSC Arpa, JSC Komvolnootu and commercial banks (Investment, 1994).

COUPON PRIVATIZATION PROGRAM

In February 1994 the State Property Fund, with the assistance of USAID, started exchanging SMP — which, as written before, had been represented by a non-transferable piece of paper — for a secured bearer-based coupon¹⁰. Therefore this new program will be called the Coupon Privatization Program (CPP) (*Polozhenie I*, 1.12.1993), in contrast to the first stage of the program designated the Voucher Privatization Program.

The new coupons are denominated in points and are distributed in the same proportion as the SMP in order to build upon the program the Kyrgyz Government began during the first stage of privatization. While SMPs could be applied both in the closed (by employees) or in the open subscription (during auctions within 25 percent limit), the coupons in the new program can only be used during coupon auctions within the open subscription. Coupons were printed in the United States (under a USAID-sponsored privatization program). Significant emphasis is being placed on ensuring transparency and consistency amongst the various components of the program.

The main ideas of the program are:

- a. the conversion of the ruble-based SMP to physical points-based bearer securities — coupons. In order to avoid the complicated process of indexation (of both the SMP and the enterprise values), coupons are denominated in points. Two exchanges take place. First, SMP which are denominated in rubles are exchanged into soms, and soms are then exchanged into coupon points. The exchange rates applied are as follow: Rub 200 = 1 Som.= 100 coupon points. On the average each citizen receives coupons for 1,200 points, or Som 12. Coupons are in issued in 500 and 100 point denominations.
- b. the physical vouchers are distributed through the 52 regional centers and approximately 400 branches of the Kyrgyz Savings Bank (a.k.a. ElBank) network. Distribution started in early February and was scheduled to continue through June 30, 1994. However the process was extended until the end of September to increase broader participation in the program¹¹.

¹⁰ Coupons are denominated in points like the coupons issued in the Czechoslovak "Kuponove Privatizace" Program, while vouchers are instruments denominated in currency. The high-ranking officials of the Kyrgyz SPF used to say that their program is based on the Czechoslovak experiences, which is generally untrue.

¹¹ As of mid-April 1994 approximately 8 percent of the population had collected their coupons (4% in Bishkek; 14% in Chui Oblast; 3% in Osh; 10% in Jalai-Abad; 14% in Issyk Kul; 13% in Naryn and 10% in Talas. At the beginning of July, approximately 17 percent of the population had exchanged their SMPs into coupons, which is still a low number (Mass 1994).

- c. since many of the citizens lack the information and confidence to invest their vouchers independently, investment funds are expected to play a significant role in the privatization process . Until July 3, 23 such funds were officially licensed, and a number of others were created. Investment funds are organized according to U.S. practices¹².
- d. to enable the SPF to distribute the reserved 25 percent of the state shares in enterprises privatized as joint stock companies for coupons. For this purpose the SPF organizes the coupon auctions. Pilot auctions started in Bishkek on April 25 and in the three regions on May 10. The first nationwide auction began on June 3, 1994 with the auctioning of shares in three large firms.
- e. In the final phase of the process of coupon privatization the transfer of ownership will become valid for each enterprise when it enters the new shareholder information into a corporate register. An audit program has been developed to provide a guarantee to the public that the process is fair, open, and transparent. The audit component is to play a significant role in each phase of the program — conversion, distribution, investment funds, auctions, etc.

The ability of Kyrgyz privatization authorities to change the main goals of the program during the program's execution has to be commended. When SMPs proved to be unfit instruments, due to the difficulties in exchanging the SMP for shares in the privatized companies and the high rigidity of the system, the government decided to convert SPMs into more applicable coupons, a very courageous decision without example in other programs. In end effect the Kyrgyz SPF received an instrument which is more flexible than the Russian voucher. While the Russian voucher is not divisible and must be traded as a whole, the Kyrgyz coupon holder can designate the points on a single coupon simultaneously for different shares, in other words the holder can diversify his or her investment. This change within the program finally activated the mass privatization process.

COUPON AUCTIONS

Coupon auctions are to serve as the mechanism of share distribution among coupon holders. They should secure free access to the privatization process and at the same time ensure the broad distribution of state assets among the population. Coupon auctions are important as institutions of the primary market.

¹² Investment funds in Kyrgyzstan were established by the initiative of the SPF. By the end of June 1994 23 funds were registered and they accumulated SMPs from more than 30 thousand citizens with a total sum of Som 1,460,000 or 146 million points, which constitutes approximately 3.6 percent of all investment points. The minimal possible founding capital was allowed at Som 50,000 (app. USD 5,000). They operate either as typical funds issuing their own shares and exchanging them for coupons or as venture capital funds purchasing coupons and making investments at their own.

The auctions are organized by the local SPFs, which are set the auction dates, establish the auction procedures, publicize the auction, ensuring that all valid bids which were received in time are admitted, determine the striking price and prepare the auction protocol. Some basic rules are applied:

- a) all bids (orders) have to be filled. When more bids (points) are received than shares designated for the program, the shares may be split (in other words divided into a few new ones)¹³.
- b) Shares are sold at the striking price.
- c) Unsold shares are returned to the seller to be later sold in the framework of cash auctions (*Polozhenie II*, 1.12.1993).

The first three auctions were organized as pilot auctions by Price Waterhouse.

The first auctions were organized during the period April 25 — May 10, 1994, on a regional basis with four centers: Bishkek, Jalap-Abad, Osh and Karakul. The second and partially nation-wide coupon auction took place July 3-17. The third coupon auction, again nation-wide, was to take place July 3-20, 1994. The results of the third auction are not yet known.

Each auction will be discussed from three aspects: the supply of shares, the demand for shares, and the results of the auctions.

a. Supply of shares

The **first auction** incorporated 25 percent of the shares of 34 JSCs of regional importance, enterprises with a total capital value of Som 1,265,420. The **second coupon auction**, this time partially nation-wide, involved ten joint-stock companies with a total capital of Som 2,709,080 and designated capital with a total value of Som 677,200 for privatization. This was twice as much capital as that covered in the first auction. This time the nominal price of each share was lower than in the first auction, and thus 3.6 times more shares were designated for privatization than during the first auction.

Three of the largest companies displayed over-regional character and were traded in the whole republic. They were: JSC Kyrgyzrasnooptorg, JSC Kyrgyzkomlnotu and JSC Santekhma. The largest in terms of founding capital as well as the best known was JSC *Kyrgyzski Kamvolno-Sukonnyi Kombinat (Kyrgyzkomlnotu)*.

¹³ Share splitting is regulated by the Decree No.321 of the President of the Republic of Kyrgyzstan from 1993 (*Ukaz 321*, 1993).

Table 6. Coupon Auctions (Supply Side)

JSC	# of all shares. Total	Founding Capital. Total	# of shares designated for CPP (25% of all shares)	Nominal price of one share	Capital esignated for CPP (25% of all cap.)
1st Auction					
TEPLICZNYI	18550	371000	3710	25	92750
KANAI	10530	42120	2106	5	10530
ARPA	6950	55600	1390	10	13900
SALKIN	5410	108190	1082	25	27050
BISH KEKSUT	85275	341100	17055	5	85275
MEBELSCHIK	2000	40000	400	25	10000
SALAM	20795	83180	4159	5	20795
BISHKEKSTROIMAT	18685	224220	3737	15	56055
Total 1st Auction	168195	1265420	33639		316355
2nd Auction					
KYRGYZRAZNOOPTORG	8895	177900	1779	25	44475
KYRGYZKOMLNOTU	490000	1960000	98000	5	490000
SANTEKHMA	26375	105500	5275	5	26375
GUL-AZYK	4980	19920	996	5	4980
BURANA	52755	211020	10551	5	52755
AZIA-WEST	1500	60000	300	50	15000
PROGSISTEMASERVIS	1695	33900	339	25	8475
AK-ZHOL	5590	111800	1118	25	27950
ULAR	5000	20000	1000	5	5000
AZIA	2260	9040	452	5	2260
Total 2nd A.	599050	2709080	119810		677270
2nd/1st	3.6	2.1	3.6		2.1
3rd Auction					
ZAV.-SVERL	102050	408200	20410	5	102050
BILAK	91605	366420	18321	5	91605
AZAT	1016200	4064800	203240	5	1016200
ALTYN-KUSH	301400	1205600	60280	5	301400
KEREGE	120970	1451640	24194	15	362910
ORGPRIMINSTRUMENT	1370	5480	274	5	1370
AGROHIMOBLSLUZHIVANIE	795	31800	159	50	7950
KYRGYZREKLAMSERVIS	630	2520	126	5	630
DILGIR	4500	18000	900	5	4500
PROMONTAZH	5200	20800	1040	5	5200
Total 3rd A.	1644720	7575260	328944		1893815
3rd/2nd	2.7	2.8	2.7		2.8

* Own calculations based on: (*Ob itogakh I 1994; Ob itogakh II 1994; Kuponnyi 1994*)

The **third coupon auction**, again nation-wide, was to take place July 3-20, 1994. Again shares of ten JSCs with a total capital of Som 7,575,260 were to be placed on auction, over two and a half times more total capital than in the second auctions. 328,944 shares were prepared for trading, almost three times more than in the second auctions.

The comparison of all auctions shows that in each subsequent auction the number of shares and capital grows with the geometrical progression (See Table 6).

b. Demand for Shares

During first auction a total number of 277 orders were placed, with the total number of 17,317,000 points. The largest number of points (17,300 or 52 percent) was sent to the Kyrgyz capital city Bishkek; the lowest to Jalap-Abad. Per order 62.5 points were sent from Bishkek, which makes approximately 50 persons per order. The largest number of orders was sent for shares of *Bishkeksut* (94), the lowest for JSC Salam and Salkin. The highest number of points per order was sent for JSC Salkin, the lowest for shares of JSC Kanai. Because of the large imbalance, the splitting of shares was necessary.

Table 7. Coupon Auctions. Demand Side.

JSC	# of orders	# of Points	Points/ Order	# New Shares	New Nominal	Split (1:x)
1st Auction						
TEPLICZNYI	29	3071900	105927.6	63095	1.47	17
KANAI	21	132400	6304.8	14831	0.71	7
ARPA	48	1360700	28347.9	13900	1.00	10
SALKIN	12	4015800	334650.0	41615	0.65	38
BISHKEKSUT	94	7056100	75064.9	224408	0.38	13
MEBELSCHIK	20	192300	9615.0	2000	5.00	5
SALAM	12	1111800	92650.0	46211	0.45	11
BISHKEKSTROIMAT	41	376400	9180.5	67536	0.83	18
Total 1st Auction	277	17317400		473597		
2nd Auction						
KYRGYZRAZNOOPTORG	105	7795200	74240.0	79420	0.56	45
KYRGYZKOMLNOTU	773	13966500	18067.9	295181	1.66	3
SANTEKHMA	98	3010800	30722.4	31777	0.83	6
GUL-AZYK	47	1179600	25097.9	12146	0.41	12
BURANA	15	69600	4640.0	10551	5.00	1
AZIA-WEST	56	5508300	98362.5	55556	0.27	185
PROGSISTEMASERVIS	31	752800	24283.9	7847	1.08	23
AK-ZHOL	68	2765600	40670.6	27950	1.00	25
ULAR	8	438600	54825.0	9091	0.55	9
AZIA	44	1552500	35284.1	16143	0.14	36
Total 2nd Auction	1245	37039500		545662		
2nd/1st Auction	4.5	2.1		1.6		

* Own calculations based on: (*Ob itogakh I 1994; Ob itogakh II 1994*)

On the average, one old share was exchanged for eleven new shares. The lowest rate of splitting was recorded in the case of *Mebelschik* (Furniture Factory), five new shares to one old one, and highest in the case of Salkin, 38 new shares from one old share.

During the **second auction**, 1245 orders were submitted (4.5 times more than in the first auction), representing 37,039,000. points. This is a 210% increase in points in comparison to the first auction.

Very characteristic for this auction was that 1215 bidders from all 1245 bidders were physical persons. From the total number of 37 million points, 16,300,000 points (44 %) were ordered by physical persons. 29,000 points were sent by order. This makes approximately 20 physical persons per order, two and a half times lower than in the first auction. This shows that more individual investors entered the market in this auction round as well as a growing investment interest on the part of Kyrgyz population. This represents a significant change from the first auction.

The largest number of orders was for shares of the JSC *Kyrgyzski Kamvolno-Sukonnyi Kombinat*. 773 bids were sent for shares of this Kombinat, more than 50 percent of all bids. (7 orders came from investment funds, 37% of all points). High demand existed also for shares of JSC Asia (one share of Som 5 value — 3,400 points) and JSC Asia West (one share of Som 50 value — 18,400 points). The lowest demand was expressed for *Chuiski gosspekhoz* JSC Burana. One coupon of 100 points was traded for 15 shares, each with a value of Som 5..

The bids for supra-regional enterprises were also sent to regional auction centers. From 1245 orders being placed, enterprises of this character collected 976. Of this 976 the largest number was sent from Bishkek (741 orders), followed by Karakol (118 orders), Osh (28 order), Jalap-Abad (38 orders), Naryn (30 orders) and Balykschi (21 orders). Due to this strong imbalance one share was split into an average of 13 shares. While shares of Asia West were split into 185 shares, shares of JSC Burana, because of a lack of demand, were not split at all. In the latter case, more than 5 percent of shares remained unsold and therefore in state possession..

c. Auction results

In the **first auction**, which was of regional character, 1251 orders were sent, representing 29,400,000 points. The largest number of points (17,300,000 or 52 percent) was submitted from investors from the Kyrgyz capital city Bishkek; the lowest from Jalap Abad. At the same time, 25 percent more shares were designated for privatization in Jalap-Abad than in Bishkek, these Jalap-Abad shares having a total value of Som 407,500 (See Table 8).

Therefore, for a 100 point coupon it was possible to acquire the capital of less than two som in Bishkek, while in Jalap-Abad it was possible to purchase Som 19.0 for the same coupon — ten times more. Such regional differences of coupon purchasing power forced the organizers to extend the program to the national level.

During the first auction, it was possible to receive an average of five shares for each coupon. The highest rate was recorded in the case of Bishkekstroimat, whereby 17 shares were exchanged for a single coupon; the lowest in case of JSC Arpa, Salkin and Mebelschik. At the same time it was possible to acquire the fixed assets value of Som 4.1 for each 100 point coupon. The highest value per coupon was recorded in the

case of Bishkekstroimat, the lowest in Salkin. In other words, JSC Salkin attracted the greatest interest, and JSC Bishkekstroimat (construction material) the least.

Table 8. Coupon Auctions in the First Round in All Regions

Place of auction	Capital	# of orders	# of points	points/order	capital/coupon
Bishkek	316.3	277	17300	62.45	1.9
Osh	277.6	147	5900	40.14	4.6
Jalap-Abad	407.5	262	1900	7.25	19.0
Karakul	196.7	565	4300	7.61	4.6
Total	1198.1	1251	29400	23.50	4.1

* Own calculations based on: (*Ob itogach I 1994*)

Table 9. Auction Results

JSC	New # of shares	Shares sold	Shares left	Rate	Value/Coupon	Value/Share
1st Auction						
TEPLICZNYI	63095	61438	1657	2	2.94	5.88
KANAI	14831	14564	267	11	7.81	2.84
ARPA	13900	13607	293	1	1.00	4.00
SALKIN	41615	40158	1457	1	0.65	2.60
BISHKEKSUT	224408	211683	12725	3	1.14	1.52
MEBELSCHIK	2000	1923	77	1	5.00	20.00
SALAM	46211	44472	1739	4	1.80	1.80
BISHKEKSTROIMAT	67536	63988	3548	17	14.11	3.32
Total 1st Auction	473597	451833	21764	3		5.24
2nd Auction						
KYRGYZRAZNOOPTORG	79420	79102	318	1	0.57	2.24
KYRGYZKOMLNOTU	295181	280422	14759	2	3.33	6.64
SANTEKHMA	31777	30226	1551	1	0.83	3.32
GUL-AZYK	12146	11986	160	1	0.42	1.64
BURANA	10551	10414	137	15	74.81	20.0
AZIA-WEST	55556	55444	111	1	0.27	1.08
PROGSISTEMASERVIS	7847	7578	269	1	1.09	4.32
AK-ZHOL	27950	27659	291	1	1.00	4.0
ULAR	9091	8862	229	2	1.11	2.20
AZIA	16143	15855	288	1	0.14	0.56
Total 2nd Auction	588930	527548	18013	1	1.8	4.60
2nd/1st Auction	2	0.9	1	0.5	0.41	.87

* Own calculations based on: (*Ob itogakh I 1994; Ob itogakh II 1994*)

In the **second auction** it was possible to acquire an average of 1.8 shares for each coupon, one third of that of the first auction. Some inter-firm differences existed. In the case of JSC Asia-West it was possible to purchase one share for one coupon, in the case of JSC Burana 15 shares. For 100 point coupons, it was generally possible to acquire an average fixed assets value of Som 1.8., with large differences between firms. In case of the JSC Asia-West Som .27 was acquired, and in the case of JSC Burana Som 74.81 (See Table 9). The exchange rate and purchasing power of each coupon shows the highest attractiveness of shares in JSC Asia-West and the lowest in JSC Burana (See table 9).

In comparison to the first auction the second auction witnessed a reduction of the coupon's purchasing power. The average exchange ratio fell from five shares in first auction to one share in the second auction. The value of assets acquired per coupon fell from 4.1 to 1.8. However both figures are still very high. A simple comparison of the total potential demand in the Republic and the total potential supply of shares in all Kyrgyz enterprises shows one coupon should acquire one third of a share with a value of Som .3. The fact that in the two auctions yielded such positive ratios is a result of the fact that only 17 percent of the population acquired their coupons. Therefore the real demand was six times lower than the potential one. It can be expected that these ratios will be less attractive in subsequent auctions — a result of this disproportion between potential demand and existing supply. This imbalance has been recognized by the SPF. In the report from the first auction, the SPF noted that high disproportions between each region were a result "first of the lack of a secure securities market infrastructure — e.g. a stock exchange where the civilized exchange of coupons could take place — and second of the very limited number of coupons in circulation" (*Ob itogakh I 1994*). The reduction in coupon purchasing power in the second auction seems to confirm the latter.

d. The cash auctions

The shares left unsold at the coupon auctions can be sold through direct sale to potential strategic investors. Local divisions of the SPF decide who can acquire these shares. The number of shares offered at cash auctions is calculated as the difference between the total number of shares and the number of shares distributed at closed subscriptions and voucher auctions. It is assumed that no more than 30 percent of the shares can be sold this way and exclusively for cash.

The first cash auction took place on July 12, 1994. Eleven joint stock companies with open character submitted their shares for sale. Since the final results are still unknown, the authors present only general information about the firms and the issue prices demanded by the sellers. Because all these enterprises were transformed into JSCs in 1993, the closed subscription involved from 50% (in the case of Kyrgyzkomlnotu) to 75% of all shares (in the case of Santekhmontazh, Burana, Ular and Asia). On the average, the closed subscription encompassed 55.5 percent of the total shares of the firms selected for auction, 2.5 percent more than the average of all

firms transformed into the joint-stock companies. The voucher auctions involved an average 23.5 percent of all shares. On the average, a little more than 20 percent of total firm shares were designated for the cash auctions (See Table 10).

Another interesting phenomenon was the way the prices were set. On the average, each share was priced at a level of Som 24.27, 5.1 times higher than the average nominal share price. Since the fixed assets value is expressed in prices of 1982, the organizers had to apply a coefficient of assets reevaluation in order to increase the nominal value of each share. The corresponding *Postanovlenie* (152, 1994) determined the basis for the calculation of this coefficient — the rate of inflation. This meant that that the nominal 1982 assets value should be multiplied by an average of 16 times (*Ob itogakh*, I 1994). In the case of cash auctions the organizers applied a coefficient between 3 to 5 times lower than that proposed by the decree in order not to discourage the potential bidders and in the expectation that this price would settle at the new, higher level during the bidding process.

Table 10. Results of Cash Auctions

JSC	Total # of new shares	% of shares for closed subscription	% of shares for voucher auctions	# of shares for cash auctions	% shares for cash auctions	Issue Price per Share	Issue Price/Share Price	# of Rounds
SALKIN	41615	65.00	24.42	4402	10.58	7.95	3.1	1
MEBELSCH.	2000	70.00	24.00	120	6.00	58.33	2.9	1
KYRGYZRAZN OOPTORG	79420	50.00	24.90	20728	26.10	7.86	3.5	3
KYRGYZKOML NOTU	295181	50.00	23.75	802896	27.25	66.41	10.0	3
SANTEKHMA	31777	70.00	23.78	387	1.22	10.32	3.1	1
GUL-AZYK	12146	75.00	24.67	40	0.33	4.99	3.0	1
BURANA	10551	75.00	19.74	27	0.26	72.91	3.6	1
PROGSISTEMA SERVIS	7847	75.00	24.14	852	10.86	12.91	3.0	1
AK-ZHOL	27950	60.00	24.74	4265	15.26	12.07	3.0	2
ULAR	9091	75.00	24.37	57	0.63	5.24	2.4	1
AZIA	16143	75.00	24.54	74	0.46	8.08	14.4	1
Total	533721	55.53	23.53	111241	20.84			
Average	48520	10113	20.84	5295	8.99	24.27	5.1	

* Own calculations based on: (Fond 1994)

The authors did try to determine what type of rules had been applied in the individual JSC price setting. Clearly only one factor was taken into account — the nominal share price value, calculated as the number of total founding capital divided by the number of new split shares. In the average, the nominal share price was multiplied by three to achieve the new issue price per share. In those cases where

nominal share price was below one, the coefficient was increased (see JSC Asia case, for which the coefficient was increased to 14.4), and in cases where the nominal price was extremely high, the coefficient was set at a lower level (as in the case of *Mebelschik*). However there were many exceptions to this general rule. For example, although the nominal share price of JSC *Kyrgyzkomlnotu* was Som 6.64, the issue price per share was set at the Som 66.41 (a coefficient of 10). In another extreme case, the nominal share price of JSC *Ular* was 2.20 (below average), and the SPF applied a coefficient of 2.4 (also lower than average). In any case, some basic rules did exist, and they regulated the setting of the issue price. The market price, however, could have been quite different from that set by the SPF.

RESTRUCTURING PROBLEMS

Since the dissolution of the Soviet Union many enterprises, including those which have been privatized, have lost their markets. Drastic changes in relative prices have created a negative value-added situation in many enterprises, leading to large financial losses (1993 Through 1994)¹⁴. These losses have been financed in part by increasing arrears, particularly to state-owned enterprises supplying petroleum and electricity¹⁵. Because energy companies are unable to collect their receivables and are simultaneously not permitted to withhold supply, they are unable to pay other state companies that import energy products. This, in turn, produced a web of inter-enterprise arrears that put the Government's stabilization efforts and the financial health of many enterprises into jeopardy. Downsizing or liquidation of many large enterprises, temporary cessation of operations until new markets are found or traditional markets are recovered and a substantial increase in long-term unemployment all appear to be unavoidable.

One widely held misperception is that enterprise problems are temporary and stem from lack of financial resources. This politically appealing explanation, which also serves the interests of enterprise managers and others with vested interests in resisting changes, appears to have prevailed over the efforts to initiate the necessary adjustments.

¹⁴ According to Gulmira T. Kempirbaeva, a department head of the SPF, the production in the first quarter of 1994 was at the 50.1% level of that in the first quarter in 1993. The machinery industry was struck especially hard. Its production in the first quarter of 1994 was about 19.4 percent of that in the first quarter 1993. It is interesting that larger losses were observed in the state owned firms than in the stock companies (14.0% vs. 21.3%). This may indicate that the commercialized companies are either more efficient than those which stayed under full state control or that only significantly healthier state firms were converted into JSCs.

¹⁵ As noted in World Bank Report, the bills unpaid to the energy complex as of July 1993 represent 70 percent of all outstanding bills (Kyrgyzstan 1993).

The old structures and instruments formerly used to administer the command economy and especially the state enterprises have been only partially dismantled. New structures capable of exercising constructive transitional control over state enterprises should be created in order to support stabilization and market transformation. To achieve this, enterprise restructuring should proceed on several fronts:

1. corporatization, imposition of a Board of Directors in the joint-stock companies and in the state-owned enterprises;
2. pre-privatization enterprise restructuring;
3. post-privatization enterprise restructuring; and
4. dealing with "big loss makers."

1. Corporatization.

Management autonomy is the most important objective of internal governance in a commercially oriented JSC or SOE. Only then can accountability be realized. According to the SPF managers, this will be achieved by a board of directors that acts as the top management, rather than a mere supervisory body. A typical anglo-saxon model of corporate governance (similar to that of Russia) has been imposed. The board is given full autonomy to appoint, supervise and dismiss executive management. The board is accountable to the owner(s) and represents the link between the owner(s) and executive management. In this latter role, one of the board's tasks is to negotiate with the State (as the owner) in order to determine the appropriate speed for the transition to competitive market behavior. The board is also to negotiate how much autonomy should be granted to the enterprises.

2. Pre-privatization Restructuring.

The severe external shocks inflicted on the Kyrgyz economy since the breakup of the Soviet Union have required massive adjustment at the enterprise level. Many metal works, machinery and agricultural equipment, electro-machinery and electronics enterprises were integrated in Union-wide production chains and consequently oversized for the Kyrgyz market. Moreover, the viability of production units was maintained by a highly distorted relative price structure, a price structure characterized by unrealistically low energy prices. Government oversight of such enterprises should be temporary, though it may last several years. In the meantime, the oversight role will focus on enabling these enterprises to be run as successful businesses which can later be sold. Many of these enterprises will have to restructure, liquidate, or down-size by shutting down operations with no potential for future viability and spinning off excess or unproductive assets.

External technical assistance is needed to solve the restructuring problems of these firms, especially to prepare and execute a realistic business plan. The Government is promoting the establishment of an agency similar to the Polish

Investment Development Agency, an agency in the form of a venture capital fund with the participation of local and foreign investors, including the IFC. It is assumed that this new agency should not be involved in active restructuring¹⁶. However the concept of such an agency is still in deliberation.

3. Post-privatization Restructuring.

Many privatized enterprises are also in need of comprehensive restructuring in order to adapt to the new market environment. They also face serious constraints in acquiring the financial resources and technical support required for effective restructuring. At present the commercial banking system does not have the capacity to assist restructuring enterprises or to provide long term financing. Capital market institutions that provide equity capital have not yet emerged. The Government is considering the establishment of temporary institutions to support privatized enterprises until the commercial banks acquire the technical and financial capacity to serve these enterprises. With the assistance of international financial institutions and foreign investors the Government intends to set up an intermediary agency to channel external funds to privatized enterprises, particularly to those with export potential. This agency will gradually phase itself out as commercial banks and private financial institutions emerge which can take over its lending activities. The name and concept of this institution is still unknown.

4. Dealing with "big loss makers"

By Presidential Decree the government established the Enterprises Reform and Resolution Agency (ERRA) with a life span of four years in order to address the problems of the 29 large public sector enterprises operating at a loss. These enterprises have been identified and most are expected to immediately cease operation once the ERRA becomes operational in the second half of 1994. These enterprises will no longer have any access to bank credits. The Government will set aside budget funds equivalent to about 1 to 2 percent of GDP for the transitional costs associated with the care and maintenance of the enterprises which have ceased operations, for the settlement of enterprise debts to the budget, to other enterprises and to commercial banks and for the cost of retrenchment. It is expected that a number of these enterprises will be liquidated once diagnostic studies have been completed.

The ERRA will be a small agency employing long and short term consultants — e.g. longer term financial management specialists, industrial management specialists, short term sectoral specialists and experts in business analysis, liquidation procedures,

¹⁶ A distinction is made between "passive" and "active" restructuring. The passive includes debt resolution, closing down unprofitable parts of business and organization and staffing changes. On the other hand, active restructuring includes new investment.

engineering practices etc. — to conduct studies and to prepare and assist the implementation of restructuring programs.

All restructuring actions undertaken by the ERRA will focus on the rationalization and down-sizing of enterprises, spinning off excess or unproductive assets, debt reduction and restructuring the capital base. Restructuring efforts will be limited to a small number of large enterprises in financial distress whose survival is critical for the survival of other enterprises (though inter-enterprise areas) or the banking system (via non-performing loans). Until the time restructuring plans are worked out and implemented, those enterprises which are in most financial distress, it is expected, will cease operations and be put under a "care and maintenance" program which will limit further financial losses. Additionally, enterprises placed in the agency's care will be denied access to credits through the banking system. Funds for ERA are to be allocated through the budget.

The Kyrgyz Government approach to the restructuring seems to be very administrative and formal. The expectation that the establishment of few new institutions with domestic and foreign experts will solve the efficiency problems of post-socialist mammoths is very illusory. Furthermore, the distinction between passive and active restructuring, although intellectually appealing, is difficult to observe in practice. The Enterprise Reform and Resolution Agency should use both, a practice which seems to reward "big loss makers" for their inefficiency. It is easy to imagine that all other enterprises in the pre-privatization stage will try to join the "big loss makers club". With such unclear criteria this should not be hard to achieve. On the other hand this would lead to further ambiguity and increase the political pressure on the SPF.

FOREIGN DIRECT INVESTMENT

1. General provisions

Foreign direct investment (FDI) in the Kyrgyz Republic can take several forms:

- participation in joint ventures
- foreign enterprises
- securities holding companies
- special purpose monetary deposits
- scientific and technological production
- intellectual property (Foreign 1991,1993)

To date, only the first two forms of foreign investment have been activated: the establishment of joint ventures (J-v) and establishment of foreign enterprises (J-e). The role of foreign capital in the privatization process has been nil.

The Kyrgyz Government still pursues a very administrative way of FDI registration. All firms have to be registered by the State Committee on Foreign Investment and Economic Assistance of the Kyrgyz Republic (*Goskominvest*). If at least 50 percent of the total volume of investment indicated in the registration documents has not been invested within 12 months of the date of state registration, the state organization responsible for registration can declare the investment invalid and may order its liquidation.

The Kyrgyz Government gives significant tax benefits to foreign investors. If foreign investments were made in the form of a freely-convertible currency, equipment or raw materials and exceeded 30 percent of the enterprise's capital fund or the total sum embarked for cooperative activities; or if the foreign investor owns no less than 51 percent of the stock profits, the activities shall be tax free. The tax holidays are given for manufacturing and construction activities for a period of five years; and for the extraction or processing of mineral resources, agriculture, transportation, or communication for three years from the date of j-v registration.

After expiration of the initial tax-free period, taxes levied on profits may be reduced by 50 percent for profits reinvested in the Kyrgyz Republic; by 25 percent if at least 50 percent of the enterprise's products and services are exported and again by 25 percent if at least 50 percent of the production is derived from imported raw material and components or at least 20 percent of the profit is spent on professional training (Foreign 1993).

Imported material goods, earmarked for capital investment during the period of formation are free from import duties. The transfer of cash is free, but should be indicated in the customs declaration. The Kyrgyz Republic also guarantees foreign investors' rights and provides other forms of legal protection. In case of nationalization or expropriation by the Government the investor is entitled to compensation corresponding to the real value of the nationalized or requisitioned property.

Speaking generally, the conditions offered by the Kyrgyz government are rather favorable. Provisions granting 3 to 5 years of tax holidays, the duty-free import of raw materials and components for use in production and the free transfer of profits are very liberal. This, however, has only had a limited impact on the real figures of FDI in Kyrgyzstan.

2. FDI is statistics

During the time period from 1990, when the first formal joint-venture was registered, to June 1994, 342 firms with foreign participation were established with a total founding capital of Som 91,732,294. This is a mere US\$ 7.6 million, also a very low sum in comparison to other post-communist economies. Approximately 71 percent of this foreign investment is located in industry, followed by trade and services. In the industrial sector, the largest capital was invested into the meat processing industry (2 establishments with Som 1,072,000), pharmaceutical (2 units with Som 630,438), tobacco industry (1 units with Som 416,000), food processing industry (5 units with Som 333,000), cereals production (2 units, Som 316,666). Interesting is the marginal presence of the textile industry (1 unit, Som 1000) and of the furniture industry (1 unit, Som 357). Being in the proximity of China probably makes the production of these goods unprofitable. The leather industry, the flagship of the Kyrgyz economy and a sector with a high growth potential, is also represented marginally with one j-v with a capital of Som 32876.

Table 11. Foreign Direct Investment in the Kyrgyz Republic (Data for 1994 from June 22, 1994).

Sector	1991		1992		1993		1994		Total	
	#	Som	#	Som	#	Som	#	Som	#	%
Industry	13	198.5	50	11000.0	84	51323.7	40	2932.4	187	55%
Trade	2	50.0	13	3634.6	41	958.6	36	874.5	92	27%
Banking Finance		0.0	1	12.7	2	99.0	1	1.4	4	1%
Insurance		0.0		0.0	1	20.0		0.0	1	0%
Tourism	1	0.5	2	30.9	3	60.0		0.0	6	2%
Transport		0.0	1	30.0	2	12.1	1	10.0	4	1%
Publishing	1	0.0		0.0		0.0		0.0	1	0%
Communi- cation		0.0	1	3000.0	1	5.0	3	16.9	5	1%
Services	1	0.1	1	500.0	9	13599.4	5	53.4	16	5%
Others		0.0	1	1000.0	10	1227.9	15	1069.6	26	8%
Total	18	249.1	70	19208.3	153	67305.7	101	4969.3	342	100
%	5%	0%	20	21%	45%	73%	30%	5%	100	

* Own calculations based on: (*Sovremennoe* 1994)

The number of new FDI engagements is growing from year to year. While a mere number of 18 firms were registered (at that time as Soviet-foreign joint ventures) in 1991, there were 79 firms registered one year later and in 1993, 153 firms. It can be expected that in 1994, this number will exceed 200 establishments. However there is a decreasing tendency observable in the capital inflow in 1994. It is estimated that the total capital invested in 1994 will amount to one sixth of that of 1993.

3. Size of the FDI Invested per Firm

Along with the growth in the number of new j-vs, a decrease in the size of investment per firm is observable. While the average capital invested per firm was Som 505,700 in 1992, then one year later it was Som 236,900 and in the year 1994

only Som 21,500 per firm. In other words, the average capital invested per firm in 1993, fell to half of that of 1992, and in 1994 to one tenth of that in 1993. (See Table 12).

Table 12. The Average Size of FDI in the Kyrgyz Republic by the Sector and by the Year

Sector	1991	1992	1993	1994
Industry	15273	220001	610996	73309
Trade	25000	279585	23382	24292
Banking & Finance		12700	49504	1428
Insurance			20000	
Tourism	500	15467	20005	
Transport		30000	6036	10000
Communication		3000000	5000	5648
Services	50	500000	1511042	10682
Others		1000000	122790	89133
Average	4082.3	505775	236875	21449
%	100%	12390%	47%	9%

* Own calculations based on: (*Sovremennoe* 1994)

On the average, the capital invested in a single firm is very small: Som 268,223 (\$22,351). This represents one third of that invested in Poland or one fourth of that invested per firm in the Czech Republic. The declining tendency shows that in 1994, an average Som 21,449 (\$1,787) was invested per firm, which suggests that these are investments in very small units like kiosks or booths. On the other hand, the declining tendency seems to show that the process of "denationalization of FDI" is in progress. The period in which large project agreements were made between the government and foreign large firms has ended. A new period has begun, a period in which physical persons from abroad willing to put their foot into a land of new opportunities are establishing small private firms. This is a good indicator that the situation in Kyrgyzstan is normalizing itself and seems to be confirmed by the sectoral comparison of capital investments. A decline in investment size is especially observable in the industrial sector. Trade generally defended its position and its share in overall investment is growing.

4. The Geographical Distribution of New Foreign Firms

The geographical distribution can be analyzed from two different points; from the destination of investment and from the source of investment.

Table 13. The FDI according to the Oblast in Different Years

Oblast	1991		1992		1993		1994		Total	
	#	Som	#	Som	#	Som	#	Som	#	Som
Chui	11	207.3	36	7528.9	101	18329.2	89	4912.7	237	30978.1
Jalap-Abad			5	1483.1	2	52.9			7	1536
Naryn			2		6	481.5			8	481.5
Osh			3	44.1	12	738.6	4	10	19	792.7
Issyk-kul			3	806	1	13.9			4	819.9
Others	7	41.8	21	9346.7	31	47689.7	8	46.5	67	57124.7
Total	18	249.1	70	19208.8	153	67305.8	101	4969.2	342	91732.9

* Own calculations based on: (*Sovremennoe* 1994)

The analysis of destination shows that the largest number of new firms was established in Chui area, located in the northern part of the Republic, where the country's capital Bishkek is also located. Two hundred and thirty-seven firms (two-thirds of all firms) are located in this area. This confirms the disproportions between different regions. This area also attracted one third of all invested capital. The largest firms, in turn, are located in the Issyk Kul Oblast, rich in mineral resources, where first large Kyrgyz-Canadian gold mine is seated.

An analysis of sources of capital shows that the People's Republic of China is the absolute leader, having established 103 units in Kyrgyzstan. The presence from this country has been steadily increasing, from four in 1991 to 25 in 1994. The United States occupies second place with 35 establishments, followed by Russia, Turkey, and Germany¹⁷. These five countries account for two-thirds of all foreign establishments.

¹⁷ The United States presence in Kyrgyzstan is not surprising. The United States provides strong support for all privatization and democratization efforts in the Republic of Kyrgyzstan. Institutionally, USAID is very strongly involved in the privatization process.

(There is no data available on the capital invested)¹⁸. One fifth of all these firms have been established exclusively as foreign firms with 100 percent of capital coming from abroad. China is again the leader in this classification with 15 firms. In percent, Kazakhstan, Russia and India dominate in this exclusively foreign investment. The first two have close ties with Kyrgyzstan from the Soviet era.

Table 14. FDI by Country and Year (F-e — exclusively foreign enterprise; j-v — joint venture.

Country	1991		1992		1993		1994		Total		
	fe	j-v	fe	j-v	f-e	j-v	f-e	j-v	#	%	% f-e
China		4	1	18	11	44	3	22	103	30.1	14.6
USA	1	1	1	11	3	9	2	7	35	10.2	20.0
Russia					4	14	2	14	34	9.9%	17.6
Turkey		3		8	2	12	2	5	32	9.4%	12.5
Germany		3		2		10	1	8	24	7.0%	4.2%
Great Britain				3		4	1	3	11	3.2%	9.1%
Kazakhstan					2		3	4	9	2.6%	55.6%
India			1	1	1	1		4	8	2.3%	25.0
Israel						3	1	3	7	2.0%	14.3
South Korea			1	3	1			1	6	1.8%	33.3
Bulgaria		2		1		1		1	5	1.5%	0.0%
Switzerland		1		2		2			5	1.5%	0.0%
Others	1	3	8	8	9	25	7	2	63	18.4	39.7
Total	2	17	12	57	33	125	22	74	342	100	20.2

* Own calculations based on: (*Sovremennoe* 1994)

What are the reasons of the limited foreign presence in Kyrgyzstan? The poor transportation and communication infrastructure, the inability to own land, the everpresent dominance of the state sector and the impression of a backward economy

¹⁸ In the Republic of Kyrgyzstan there are three Polish firms present; two of exclusively Polish capital (Capital Fond and Astra) and one as a Kurgyz-Polish joint-venture (Kyrgyzpol). All three are located in Bishkek.

are just a few reasons. In spite of all these deficiencies, the Republic of Kyrgyzstan has a chance, through its perseverance and liberal approach to reforms, to become the "New Switzerland of Central Asia" (as it is proclaimed in official declarations). A start has been made; the effects will follow.

RECOMMENDATIONS

1. Until enterprises are fully privatized, the state will retain some interest in enterprises. Its portfolio would require a continuous oversight function. There are many indications that the government intends to delegate its oversight function to line ministers, in particular to the Ministry of Industry, Trade and Material Resources. This is done according to the Government resolution (February 1994) which authorizes holding companies -inter alia in the form of line ministries — to temporarily manage the state held packages of shares. In our opinion, this idea to delegate the shares to line ministries holdings is an unsatisfactory arrangement. These holdings tend to petrify the structure and decrease the firm's chances of survival. On the other hand, these new ministerial "overseers" exhibit interventionist approaches towards the firms whose shares they hold. The Government should therefore delegate these functions to the State Privatization Fund which should become the exclusive body responsible for supervision of existing JSCs. The SPF, in turn, should minimize any administration influence on the activities of the JSC. It is recommended that the following instruments be used in the execution of oversight functions:
 - a. the standardization of by-laws and rules of the establishment and organization of JSC. This standardization is particularly needed in the case of corporate governance bodies like: general assemblies, supervisory boards and management boards.
 - b. elasticity in the delegation of authority to different corporate governance bodies in accordance with the different levels of competence, experience, quality of management and financial results.
 - c. influence of the SPF on the JSC only through the supervisory boards and personnel policy. The direct influence of the SPF on promotion or demotion policy within the management board or within the JSC should be prohibited.

- d. the SPF should, in case of the JSCs where its interest is lower than 70 percent, regard its shares as non-voting shares with veto rights limited only to the decisions concerning equity sale.
2. The application of the Anglo-Saxon model of one tier corporate governance, where the board of directors acts both as the supervisory board and as the top management body may work efficiently in the United States, but not in the Kyrgyz Republic. In a country without a long tradition of professional business behavior and with the absence of a code of ethics, a one tier board allows for the accumulation of all power in the hands of a single person playing the role of the chairman of the board, president, and CEO. In practice, this leads to excessive control over the organization and a lack of any supervision on the part of the government. The Russian experiences are very educational in this respect. The authors are of the opinion that a two tier continental system with a separate supervisory board and management would be more appropriate to the Kyrgyz conditions. It would create the clear distinction between supervision and management. The operational effectiveness of a one tier system cannot outweigh its deficiencies.
3. The success of the transformation process depends highly on the quality of the people involved in the process. As the experience of other countries show, the crucial role in the firms recovery and transformation is played by the members of supervisory and management boards. Kyrgyzstan does not have any experience in a market economy, the candidates to the supervisory boards are familiar neither with the corporate governance concept nor with the fact that they are accountable to the shareholders. Therefore, it is necessary to provide educational and training programs for supervisory and management boards' members of the JSC, SOE and private firms as well. These will teach them how to read financial statements, how to compete on the markets, how to make a strategic business plan, how to prepare marketing strategy and what their responsibilities towards shareholders are, etc.
4. A comparison of the shares value reserved for the coupon privatization program (Som 13.3 million) and the potential demand for these shares (approximately 41 million) shows the strong imbalance between the two. This means that, for one 100 point coupon worth Som 1, it should be possible to acquire average fixed assets with a value of Som .32 (one third of the nominal price). If the minimal nominal price of each share is Som 5, this will require a further share split of each old share into 15 new shares. As shown in this report, this is not a problem right now, because of the low demand for shares, but it will become a problem in the near future. This could lead to social instability and undermine the credibility of the whole program. It is recommended that the portion of shares reserved for coupon privatization be increased from 25 percent to 49 percent. This would speed up the privatization process (together with

employees 54 percent of shares would be distributed after coupon auctions) and eliminate the imbalance between supply and demand for shares.

5. The new privatization program foresees the sale of shares according to formula 5-25-70; five percent for employees, 25 percent for coupon auctions and 70 percent for strategic investors. The experience of other countries (particularly of Russia) shows that a two level price system can emerge. Higher prices are paid for shares sold for the coupons, while lower prices are paid for shares distributed through competitive bidding. This would create the feeling of preferential treatment of strategic investors buying shares in the framework of competitive bidding. In the authors' opinion, coupon privatization should be carried out first, and prices established this way should become the issue prices for negotiations with strategic buyers.
6. There are many areas of the Kyrgyz economy which are highly monopolized. Large branch holdings as well as vertically and horizontally integrated complexes (*Kombinats*) have survived all stages of economic reform to date. Demonopolization of transport, warehousing and distribution enterprises is urgently needed. All these concerns and conglomerates should be broken up in order to increase competition and economic efficiency. If necessary, prior fragmentation studies should be performed to guide this process. Unfortunately, the Anti-Cartel Agency does not have enough power and has been steadily losing its influence in all subsequent steps of Government restructuring. Following the last changes in May 1994 this Agency became a department in the Ministry of the Economy (*Postanovlenie* 26.5.1994). This raises some doubts about the perseverance of the Kyrgyz authorities in promoting a competitive market economy.
7. The idea of establishing the ERRA as a restructuring agency awakes many doubts. The Agency will be subject to strong politic influence and will tend to support ailing businesses. The number of firms under the ERRA supervision will increase and more and more support will be required. The Agency will be politically forced to play an active restructuring role and finance those enterprises which are in a very bad financial position. It is pity that the East European approach of bank rehabilitation and enterprise restructuring was not adopted by the architects of the Kyrgyz reform program. The authors are of the opinion that the main restructuring task should be carried out by independent commercial banks. New legislation allowing debt-to-equity swaps and debt trade is necessary.
8. In all post-socialist countries the spontaneous 'bottom up' process of new firms creation is observable. In the Kyrgyz model of privatization more emphasis should be put on the financial, legal and organized support of new entrepreneurial activities. The need for a Small Business Administration Agency is clearly visible.

9. The Kyrgyz Parliament has passed the "Insolvency Law" which allows for bankruptcy and liquidation of non-viable companies. In the authors opinion, this law is too **formalistic**. It requires the liquidation of a firm when its financial results over a period of three months are in the red and do not show any improvement. In reality, many of these firms will have to continue to function at least a few years because of unemployment, political pressures or the "need to satisfy consumer market needs." Thus the authors recommend the rapid development of procedures and institutions required for effective implementation of the law and their immediate implementation. A resolute implementation of insolvency procedures in a number of SOEs would have a "demonstrative effect" which, in turn, would support other measures aimed at establishing financial discipline in the economy and increasing pressure on the SOEs faced with budget constraints.
10. A lack of motivation on the part of management boards is a strong barrier to fast and effective restructuring and privatization. In many cases, managers feel that it is safer to keep their old position and play a sort of survival game than to head into the unknown created by the privatization process. Therefore, it is recommended that the idea of management contracts be introduced, whereby the managers agree to restructure the enterprise and carry out its privatization. This is also chance for the creation of future owners, personally interested in successful restructuring. The Polish experiences in such matter could be very educational.
11. The Kyrgyz Government should be more interested in attracting foreign investors to establish firms in Kyrgyzstan. The SPF together with GOSMOINVEST should establish a Foreign Investment Agency, an independent corporation with responsibility for promoting, informing and assisting in the creation of joint-ventures. This Agency should operate as a financially independent corporation and be financed by clients interested in establishing new ventures as well as by general foreign financial support.

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