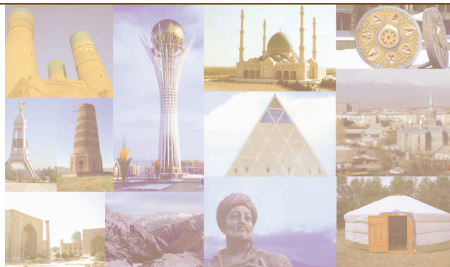


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KYRGYZSTAN

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Bimonthly article

Prof. Cholpon Nogoibaeva*

Highlights

Preliminary results of the country's economic performance were released in December 2008. According to official data, GDP for 11 months stood at more than 167 billion soms, representing a 7.5% increase attributable primarily to the gold mining, trade and communications sectors. According to a World Bank report, without gold mining, the net growth rate was 5.4%. The European Bank for Reconstruction and Development estimates that GDP growth for 2008 will be 6.5% in 2008. Business Monitor International (BMI) projects a rate of 5.6% because of a decline in fourth-quarter growth that stood at less than 4%. According to BMI, the burden of foreign debt -93% of GDP- in the context of a slowdown in economic growth threatens stability. Central Treasury preliminary data show that revenues of the consolidated budget for 11 months of 2008 grew by 30.9% compared to the same period of 2007. Tax revenues were the predominant source of national revenues for the state treasury. Inflation, according to the data of the National Statistical Committee, stood at 18.4% instead of the projected 12%, this indicator in CIS countries only being topped by Ukraine. The Kyrgyz som depreciated against US dollar by 10.7% over the past three months, representing -again second to Ukraine- the highest indicator of depreciation of national currency in the CIS.

The growth of imports exceeded the exports of goods and services by 2.5, resulting in a negative trade balance.

Starting in 2008, the production and distribution of electrical energy, gas and water decreased. The output of the mining industry took a dip as well. The volume of gross product in construction

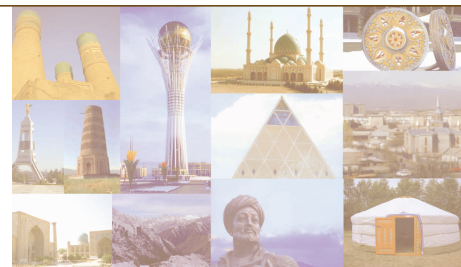
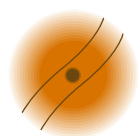
declined, as did the production of cotton and tobacco. The construction industry was adversely affected by the aftermath of the global financial crisis, and during the first 11 months of 2008 the growth rate was 88.3% of last year's figure. Taking all sectors into account, 36.8 % of businesses reported losses.

The nominal average salary in Kyrgyzstan was 5,190 som (\$130). Salaries grew by 40% in 2008. However, taking inflation into account the growth rate was 8.4%.

Corruption in Kyrgyzstan remains rife. According to Transparency International's 2008 corruption perceptions index, Kyrgyzstan ranked 166th out of 180 countries surveyed.

The most visible political events of November-December 2008 were the resignations of several members of the government and the unification of the opposition into the United People's Movement. In the second half of November, the Minister of Industry, Energy and Fuel Resources Saparbek Balkibekov resigned as did two deputy ministers of finance, the Deputy Minister and state secretary of the Minister of Foreign Affairs, as well as the Advisor to the President and former head of the Presidential Administration Usen Sydykov, who was an informal leader of the March 2005 events that brought the incumbent President to power. These resignations reached their apogee on the first working day following the lengthy New Year vacation with the resignation of the head of the Presidential Administration Medet Sadyrkulov, followed by the departure of his protégé Vice Prime Minister Elmira Ibraimova. Experts note several reasons for these developments, with the major contributing factors including the intensification of the fight to influence the President and the launch of the election race in

*President, Institute for Policy Analysis and Research, Bishkek.



which administrative resources represent a key component of success.

Internal affairs

November 2008 saw the intensification of activity by the political opposition, which held a series of discussions in the regions on the economic and political situation in Kyrgyzstan. About 1,000 people attended the meeting in the city of Talas.

Despite obstacles created by local authorities, 29 November saw a *kurultai* (gathering) of opposition political parties and movements in Bishkek that consolidated the political opponents of the ruling circles and united them into the United People's Movement (UPM). It also established an executive organ, the UPM Secretariat, which gives the opposition greater capacity for long-term activity and is an important step in its institutional development. The gathering approved a concept paper entitled 'Path to Justice' calling for a new political system in the country. The document, containing demands for political reforms was sent to the President.

In 2008 the number of citizens petitioning the Ombudsman decreased, which the Ombudsman interprets as a sign that his office's operations have improved, although independent experts believe that this was the result of the deterioration of the human rights situation in the country and the people's distrust of the Ombudsman institution's ability to impact the current situation. In December, Kyrgyz human rights activists published a list of citizens that had been forced to leave the country for political reasons in the past two years. The list includes nine civic activists, journalists, human rights activists and public figures subject to persecution by authorities.

In addition, human rights activists disseminated a petition in which they criticized the new law on military service whose Article 27 contains a

provision allowing for the use of military forces in domestic law enforcement. The Coalition for Democracy and Civic Society believes that this provision "is introduced to frighten fellow Kyrgyz citizens who have a different opinion, to suppress freedom of expression" and contradicts the nation's Constitution that prohibits the use of Armed Forces in the resolution of domestic and political issues.

In late November, the Kyrgyz Government adopted a programme of privatization of state property for 2008-2012. The list of entities to remain in state hands includes only 10 enterprises, which triggered a lengthy discussion in Parliament and evoked severe criticism from the opposition. The Ata-Meken political party launched a petition to cancel the privatization of strategic enterprises in the energy sector, for which its activists became victims of persecution by law enforcement bodies.

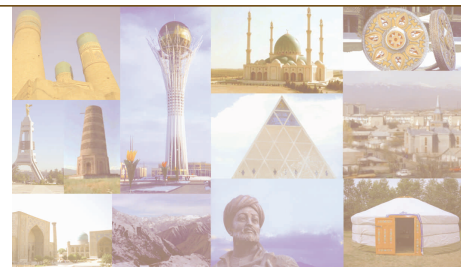
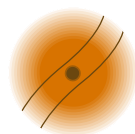
In November-December 2008, the system of governance saw changes that led to the creation of the President's Secretariat, and a proposal by the President for the creation of the Presidium of the Government.

Innovations in the information sphere of the country might include the daily news, appearing in November, about the level of water in the Toktogul water reservoir that caused many senior citizens to associate them with updates from the front during the Second World War.

As the year was ended, on December 25, Parliament passed amendments to the Law "On State Symbols" that now require citizens to rise and stand when listening to the national anthem and put their right hand to their hearts. According to sponsors of these amendments, such actions are supposed to improve the degree of patriotism among the Kyrgyz citizens.

Foreign and International policy

The end of 2008 was characterized by a higher degree



of activity on the part of Kyrgyzstan's partners, rather than on the part of the Kyrgyz Republic itself.

On December 23, the U.S. Department of State called on the Kyrgyz Government to make every effort to allow Radio Azattyk (Liberty) - a Kyrgyz version of Radio Free Europe/Radio Liberty- to resume broadcasting after going off the air in Kyrgyzstan in October. For Kyrgyz citizens, especially those residing in rural areas, Radio Azattyk is a source of independent information and a venue for debating acute issues. The Kyrgyz National TV and Radio Corporation that retransmit Radio Azattyk across the country initially stressed financial issues as the reason for discontinuing broadcasting, subsequently admitting that at issue was the perceived need to censor programming prepared by Radio Azattyk. According to the head of the Corporation, Melis Eshimkanov, a former Parliament and opposition member, Radio Azattyk's programmes are so negative and critical toward the ruling authorities that many high-ranking officials and politicians did not want Radio Azattyk to return to the national media space.

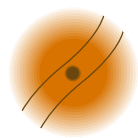
Leaders of opposition political parties, former members of parliament and ministers visited the United States in December where they met with U.S. Congress members, representatives of the trade division, Democratic and Republican parties, and the World Bank to discuss the current political and economic situation in Kyrgyzstan. Opposition leaders also presented the concept of a new political structure of Kyrgyzstan based on rule of law, division of powers between the branches of state authority and strengthening of the institution of parliamentarianism. According to a coordinator of the Political Movement "For Justice", former Minister of Foreign Affairs Alikbek Jekshenkulov, the visit was fruitful.

Chinese officials addressed their Kyrgyz counterparts with a request that the ban on imports of Chinese

foodstuffs be lifted so as to "avoid adverse consequences for the dynamic development of trade between our countries," to cite Chinese trade counsellor Liu Chianiu. He noted that in 2007, trade between the two countries totalled \$3.7 billion, and in 2008 grew to \$6 billion. Re-exports totalled around 70-80% of the imported volume. Thus, in 2007 the Kyrgyz economy additionally received \$0.6-0.8 billion of added value from the re-exports trade. In 2008 the amount of added value likely increased to \$1.0-1.4 billion despite the sharp decrease in re-exports trade starting in November. This added value is comparable to the country's GDP in agriculture in 2007 - \$1.1 billion USD, which accounts for 30% of official GDP.

On 4 December 2008, Russia announced the need for a twofold reduction of quotas for migrants in 2009, which will be a major blow to Kyrgyz labour migrants for whom the Russian labour market is the number one destination. According to Russian statistics, about 400,000 people travel to Russia from Kyrgyzstan annually while independent Russian analysts put the number at twice that amount. In 2009, instead of the planned 3.7 - 3.9 million quotes, the Russian Government will only issue permits for 1.7 million labour migrants.

A similar situation has arisen in the Kazakh labour market, which is the second-largest importer of Kyrgyz labour. Kyrgyzstan is not prepared for such a rapid increase in unemployment resulting from jobless labour migrants who will most likely further swell the ranks of the unemployed, engendering risks of social disturbance and political instability. Analysts signal that the Ferghana Valley might become the epicentre of social tension, an area shared by Kyrgyzstan, Tajikistan and Uzbekistan - the primary exporters of labour. Also important are the remittances by labour migrants that, according to independent experts, account for at least 10% of GDP. Remittances from Russia and Kazakhstan sustain domestic demand and enable families of labour



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migrants to keep their heads above water. The Minister of Economic Development and Trade, however, thinks otherwise, claiming that the financial crisis in Russia only impacted 50% of Kyrgyz labour migrants, those mostly engaged in services, retail and construction sectors. The layoffs in these industries may lead Kyrgyz labour migrants to make the transition to other sectors of the Russian economy.

To coordinate and develop efforts to mitigate the effects of global financial crisis, the President of Kazakhstan Nursultan Nazarbayev took the initiative to host an informal meeting of leaders of Kazakhstan, Armenia, Kyrgyzstan, Russia and Tajikistan at the Borovoye resort 19-21 December. The presidents of the five countries decided to establish a joint anti-crisis fund of \$10 billion to assist these states in managing the consequences of the crisis. Regarding bilateral assistance, on 12 December, Prime Minister Vladimir Putin declared Russia's willingness to provide Kyrgyzstan with assistance amounting to \$2 billion, of which \$300 million will be earmarked for supporting the Kyrgyz budget.

The continuing support of the European Union materialized via the European Commission project on the development and continuation of judicial reform in Kyrgyzstan. 2.5 million euro is being earmarked for this project over an 18-month period. The Ministry of Justice of the Kyrgyz Republic will be the counterpart in this project on the Kyrgyz side, whereas GTZ, the German Technical Cooperation Agency, will act as the implementing partner. In addition, official EU representatives have expressed their concern to President Bakiyev regarding the enactment of the new law on freedom of religion and religious organizations that, according to European experts, is not consistent with European standards in the area of religious expression.

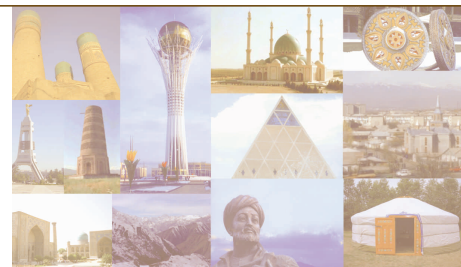
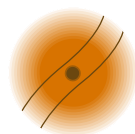
Economy and business enterprise

The global financial crisis impacted the Kyrgyz

economy; however, more serious consequences are expected in February-March 2009. According to Prime Minister Igor Chudinov, the low degree of integration of the Kyrgyz banking system in the global financial system has turned out to be a blessing in disguise in the current situation. However, the national economy's dependence on foreign trade and the decreased rates of economic growth in the major importing nations of Kazakhstan, Russia and China will soon reveal their adverse effect.

The country is still experiencing electricity cut-offs which negatively impacted the state of enterprises and business overall. An external factor motivating electricity outages appeared. Because Kyrgyzstan is connected to the Unified Energy System of Central Asia and through it with the CIS Unified Energy System, to avoid accidents on the high-voltage overhead lines, the Kyrgyz population is cut off during hours of maximum load.

In November-December 2009, the Ministry of Industry, Energy and Fuel Resources of the Kyrgyz Republic developed a programme to reduce the volume of non-payment for energy consumed. In 2008 non-payment represented 31.5% of the value of electricity consumed and the aim is to reduce this to 28%. According to the Minister of Economic Development and Trade, a 4% reduction of commercial losses would have had the same effect as the third-quarter energy cut-offs. A 5% decrease in losses would have enabled the Government to not have to extend winter vacations in schools that rely on electrical energy-based heating. The Government announced earlier this year that 852 schools would have to prolong the winter vacation by two months due to the electricity supply cut-off. The elimination of so-called commercial losses, according to independent experts, would have enabled the Government to save more than 1 billion kW-hours had the necessary actions been taken in advance, which would in turn have precluded the need for any cut-offs. Damages inflicted by the cut-offs have yet



to be calculated. However, the Minister of Economic Development and Trade has already voiced a figure of 6% of GDP. The damages in question result from reduced production volumes and under-rendered services, forgone profits and under-paid taxes, forgone revenues from sale of energy, malfunctioning equipment, transportation expenses, social and emotional damages sustained by citizens, etc. The Ministry of Economic Development and Trade believes that during the period September 2008–March 2009, budget losses from disruptions of energy supply will total around 685 million som. The aftermath of energy consumption limitations are already visible judging by companies' financial reporting. Growth rates decreased in budget revenue-generating industries such as manufacture of construction materials, food industry, processing, and textile industry.

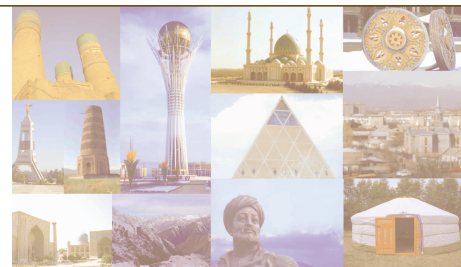
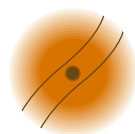
In order to improve conditions for doing business, on 6 November the Kyrgyz Government passed a resolution protecting businesses from unsubstantiated inspections by state controlling agencies. Simultaneously, a special inter-agency commission compiled an inventory of legislative and normative acts regulating the performance of entrepreneurial activities. Overall, in 2008 the number of inspections was reduced by 70%, which resulted in an additional 436 million som of direct investments in the economy according to the year-end report of the Ministry of Economic Development and Trade.

At the same time, the State Committee of the Kyrgyz Republic for Taxes and Charges came forward with an initiative to reduce by 70% the number of types of entrepreneurial activities conducted on the basis of the voluntary tax-patent. These actions were motivated by the fact that "the widespread maintenance of the patent-based system resulted in the refusal by entrepreneurs to maintain accounting" which, in turn, led to failures to pay VAT and budget losses. The Government supported this idea and

instructed the State Committee for Taxes and Charges, together with local government bodies and business associations, to monitor businesses during 2009 and submit to the Government proposals on the base amount of tax for the voluntary patent. This measure, along with electricity cut-offs and tariff rate increases triggered adverse reactions on the part of small businesses that mainly operate on the tax patent basis.

In December, for the first time in Kyrgyzstan, a private business filed a lawsuit contesting the state's electricity tariff policy for businesses. In Kyrgyzstan, businesses pay two electricity tariffs: one for actual energy consumed and another based on the estimates by authorities of businesses' energy needs given the economic activity undertaken – the so-called 'capacity' tariff. (Households only pay for electricity consumed.) The State Department for Regulation of Fuel and Energy Complex of the Ministry of Economic Development and Trade was the defendant in this lawsuit. The plaintiff argued that the government has a double tariff for business and that the 'capacity' tariff means that a business pays not for the energy actually consumed, but for the authorities' ideas of its energy needs. The dual tariff was introduced several months ago. Authorities envisioned that, thanks to this tariff, expenses of energy providers associated with the production and delivery of energy to consumers would be covered. On 8 January 2009, the court ruled against the plaintiff. Thus, it could be said that regulatory policy in Kyrgyzstan is contradictory and has yet to deliver results for the improvement of business environment.

The Second National Forum of Business Associations held on 17 December resolved to initiate amendments to the new Tax Code expected to enter into force on 1 January 2009. The review of certain provisions of the new Tax Code was planned for late December 2008. The new Code, from a business perspective, needs to simplify sales and property taxes and eliminate the multiplicity of interpretations of several articles that can lead to illegal actions on part of state



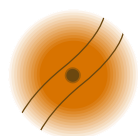
controlling bodies. State bodies expect to participate in the drafting of amendments to the new Tax Code. During the forum, the National Alliance of Business Associations (NABA) suggested that the moratorium on inspections of small business be extended for the period 1 January– 31 December 2009. NABA believes that the extension of the moratorium will enable the Government to minimize the aftermath of the global financial crisis on business. The 2008 moratorium saw tax collections grow by 50% as opposed to 2007, and budget receipts increase by 4858.5 million som - 47.7%- against the same period in 2007. According to findings of an express survey conducted by NABA, businesses operating in the retail and textile industries reduced their inspections-associated expenses by 7-10% of their total sales turnover.

On 19 December, Parliament passed the draft Law “On National Budget in 2009 and Projections for 2010-2011” in a second reading. Members of parliament questioned the Minister of Finance Tajikan Kalimbetova on the expenditure side of the budget. According to the Minister, it was the first time that a budget forecast had been made for a three-year period with budget revenues estimated on the basis of the new Tax Code. GDP real growth rates are projected at 6.0% in 2009, 6.1% in 2010, and 6.2% in 2011. As the Minister reported, the primary preconditions for the development of industry include the launch of Jerui and Taldybulak Levobrezhnyi gold deposits and an increase in the volume of gold production at the Kumtor gold mining site. Inflation is projected at 13% in 2009, 12% in 2010 and 10% in 2011. The budget provides for more than 4 billion som for economic development initiatives. The social sector will remain a priority. Overall, in the national budget for 2009, expenses for healthcare, education and social security will account for 39% of the total and will rise to 45% by 2011. The share of state sector expenses will decrease to 5.6% in 2009, and to 1% in 2011. On 24 December, the Government of Kyrgyzstan adopted the Anti-

Crisis Measures Programme (ACM). These measures will be implemented in five major directions: budget sustainability and macroeconomics, banking system stability, food and energy security, economic growth through support of domestic demand, and targeted protection of vulnerable groups of population. As the head of the Ministry of Economic Development and Trade noted, the goal of this programme is to minimize and prevent a crises in the national economy and ensure a 5% GDP growth in the year 2009.

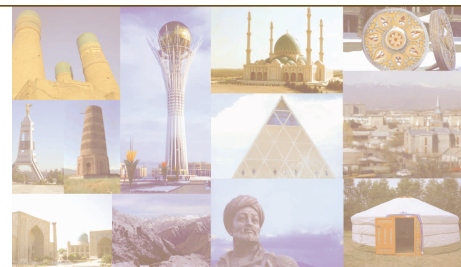
The energy sector’s main issues include “the successful passing of the [winter] heating season,” although the Ministry of Economic Development and Trade noted that it also needs to urgently resolve the issue of energy imports. Regarding food security, the Ministry suggested growing agricultural crops of strategic importance to supply the food processing industry with raw materials and continue the enlargement of farms. The most comprehensive measures in the anti-crisis programme include measures to sustain economic growth by supporting domestic demand. The implementation of these measures will require about \$700 million. According to the Ministry’s estimates, the bulk of these funds could be provided by international organizations.

On 25 November, the Board of Governors of the World Bank approved an \$11 million loan to Kyrgyzstan for food and energy security. In addition, the IMF approved an 18-month programme of \$100 million under the exogenous shocks facility aimed at reducing inflation, maintaining an adequate level of foreign exchange reserves and sustaining economic growth. Some \$20 million is expected from the United Nations Development Programme. To support the budget, the Government expects to use \$300 million provided by Russia. In addition, the UN, World Bank, Asian Development Bank, European Bank for Reconstruction and Development, and Islamic Development Bank are willing to provide funds to be utilized for specific projects. The Ministry has also identified sources of savings, notably reducing



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expenditures on non-priority budget line items. This could free up 10 billion som which will be diverted to investment projects.

A 5 December conference marking the tenth anniversary of Kyrgyzstan's membership of the World Trade Organization summarized results of the nation's trade relations with other WTO Member States. Kyrgyzstan is Central Asia's only WTO member. Over the 10 years of its membership in WTO, Kyrgyzstan managed to launch multiple fundamental reforms in trade policy at legislative and institutional levels. Kyrgyzstan provided its businesses with freedom of trade and created opportunities for the development of manufacture and access to foreign markets, as well as opening access to its domestic market creating a competitive environment for its domestic producers. Today, Kyrgyzstan maintains trade and economic relations with more than 100 countries of the global trade community, of which more than 90 are WTO members.

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