

3 Kyrgyz Republic

Elmira Zarlykova

3.1 Introduction

Kyrgyz Republic is small landlocked country situated at the center of the giant Eurasia to the south of Kazakhstan and northwest of China. Kyrgyz Republic is a multiparty and unitary Republic with a President and a bicameral Parliament. The following figures illustrates some basic socio-economic indicators of the Kyrgyz Republic as of end 1999:

Table 31

GDP per capita	225 US dollars (\$)
Country area	199,900 sq km (77.415 sq mi)
Population number	4.9 million
Capital	Bishkek (population 680, 000)
Life expectancy rate at birth	67.1 years (female), 63.1 years (male)
Adult literacy rate	98.7%

Nearly 95% of the country is mountainous: almost half of it at an elevation of over 3000m (9840ft) and three-quarters of it under permanent snow and glaciers. The dominant feature is the Tian Shan range in the south-east. Its crest, the dramatic Kakshaal-Too range, forms a stunning natural border with China, culminating at Pik Pobedy (7439m/24,400ft), Kyrgyzstan's highest point. The southern border with Tajikistan lies along the Pamir Alay Range. Lake Issyk-Kul, almost 700m (2300ft) deep, lies in a vast indentation on the fringes of the Tian Shan in eastern Kyrgyzstan.

In August 1991, the Kyrgyz Supreme Soviet reluctantly voted to declare Kyrgyzstan's independence. Six weeks later, the first President - Akaev was elected.

Major industries: Machinery, textiles, agriculture, food processing, timber, mining.
Major trading partners: CIS, Turkey, Germany

In 1993 Kyrgyzstan became the first CIS state to introduce its own national currency - som. The history of Kyrgyz Republic since independence is very short but very condensed and notable due to unprecedented challenge of transition from command economy to market oriented one.

3.2 Overview of Macroeconomic Activity

a) Independence and its challenges

After the collapse of the USSR in 1991, the Kyrgyz Republic inherited one of the least developed economies among all other Soviet republics. Limited in natural resources, constrained by inefficient industrial capacity and locked in the mountainous area the Kyrgyz Republic was and is facing the great challenge to develop efficient market structure and ensure sustainable real growth. Therefore, the Kyrgyz Republic has started on an ambitious program of economic reform. Although some of the policies of the former Soviet Union still prevail, the reforms that have taken place were both comprehensive and pursued in a relatively rapid move. They also reduced the role of government in the economy by introducing market forces, largely through mass privatization and price liberalization, and exposed the economy to competitive forces through liberal trade and investment environment. The goal of this broad agenda was to establish a market-oriented economy and was born by the necessity to deal with the shock caused by the

breakup of the Soviet Union, including its central planning, trade relationships, and importantly, the loss to the Kyrgyz Republic of budgetary transfers from the USSR's budget which had amounted to around 30 percent of its budgetary revenues.

b) 1991-1995: Output slump and hyperinflation

With the help from multilateral and bilateral donors, the Kyrgyz authorities moved quickly in the initial stages of the reform. As early as 1992, important changes were made to the legal framework (key business laws), most prices were liberalized, mass privatization began and the tax system was almost completely overhauled, with the introduction of a VAT and excise taxes. In 1993, a national currency, the som, was introduced, permitting the authorities to assume full responsibility for monetary policy, and which allowed for international trade to be settled in convertible currency. In 1994, the trade was liberalized as export and import licensing requirements were lifted, export taxes were reduced, and a uniform import tariff of 10 percent was introduced on all non-CIS imports. Also in that year, the government embarked on a comprehensive medium-term economic and structural adjustment program with the following key elements: stabilization of the economy through appropriate monetary and fiscal policies to lay the basis for economic growth, restructuring of the commercial banking system; the acceleration of privatization efforts and the conversion of those state enterprises not being privatized to joint stock companies; and the strengthening of the social safety net.

Despite such radical measures the output declined in the Kyrgyz Republic over initial period of transition and did not show positive growth until 1996. GDP contracted by about 50 percent between 1992 and 1995, and inflation showed triple digit figures in 1992 and 1993 with substantial decline in 1995 to 62% in 1994 and 32% in 1995.

Figure 3.1 Real GDP Growth in the Kyrgyz Republic: 1993-1999

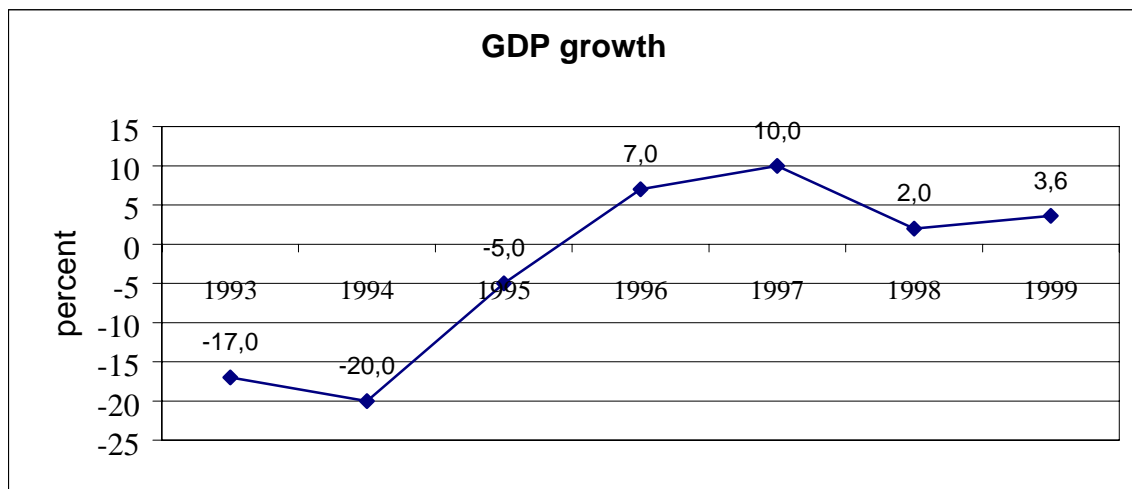
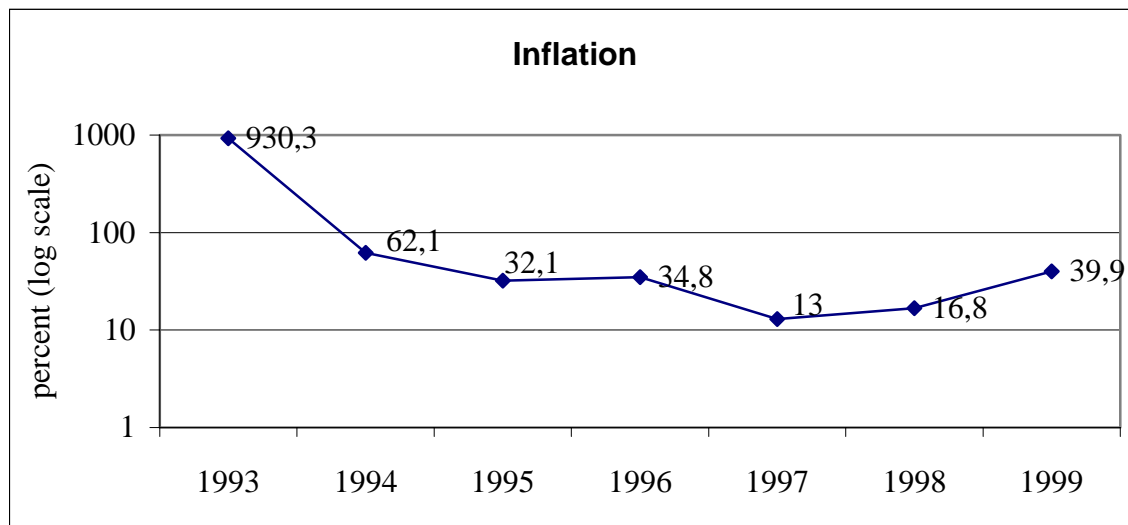


Figure 3.2 Inflation (CPI) in the Kyrgyz Republic: 1993-1999



c) Output recovery, sectoral reforms and fragility of developments: 1996-1999

Real GDP of the Kyrgyz Republic recovered strongly in 1996, with a growth rate of more than 7 percent. The main source of this increase was a strong growth of the agricultural sector, which continued the following year, and, combined with the startup of the Kumtor gold mine (which is considered as tenth biggest in the world), led to a real GDP growth of almost 10 percent in 1997. Economic growth in 1998 and 1999 proved rather modest compared with the previous two years. Real GDP expanded by 2.1 percent in 1998, rising to 3.6 percent in 1999. The increase in activity in the latter year was mainly due to agriculture, which contributed 4.5 percentage points to overall growth, and to a lesser extent trade and catering, as manufacturing, construction, transport and communications contracted. Agricultural production grew by nearly 9 percent while services expanded by 5 percent, thus continuing an expansion of that sector which began in the mid-1990s. The decline in manufacturing was likely due to a number of factors, such as exchange rate changes, which made low-quality Kyrgyz Products uncompetitive in most neighboring customer countries and a decline in value added from the Kumtor gold mine.

Following tight monetary conditions during 1997 and 1998, end-of-period **inflation** dropped to below 15 percent in 1997 from 35 percent at the end of 1996 (see Figure 3.2), and continued to fall during the first half of 1998.

However, after the Russia crisis and the substantial depreciation of the som, end-period inflation in 1998 reached 16.8 percent. During 1999, consumers price inflation accelerated, reaching almost 40 percent by year-end. A number of factors occurring through the year contributed to this outcome. First, price developments were affected by large liquidity injections because of rapid repayment of budgetary arrears accumulated in the previous year. Second, increases in excise tax rates and tariffs for electricity and hot water are estimated to have added more than 14 percentage points. Third increased prices for imported oil products and grain had a large impact as well. Finally, the nominal exchange rate depreciated by more than 13 percent over the year. Given 45 percent share of imports in GDP, the impact of such depreciation was about 6 percentage points.

Agriculture, contributing almost half of GDP, has become the main engine of growth in the Kyrgyz economy. During the early stages of transition, 49-year land use rights were distributed to farmers covering about half of all arable land, thereby officially dismantling the state farms. In 1995, the number of developments reduced state control over agricultural activity. Land use rights were extended from 49 years to 99 years and a unified land registration system was put in place. Nevertheless, the old management structures remained broadly intact due to deep-seated

practices, farmers' lack information about rights associated with the land use rights, lack of access to credit, and difficulties in splitting up, in an efficient way, large fields, infrastructure and equipment originally designed to operate on large farms. But, in spite of these shortcomings, positive effects on output materialized in 1996, as farmers gradually adapted to the new market environment.

The banking sector in general does not provide loans to the agricultural sector due to high loan losses in the past in this sector and the lack of a legal foundation to use land as collateral. This has left the sector short of working capital, even though a special credit institution, Kyrgyz Agricultural Finance Corporation, was established in 1996, supported by the World Bank.

Realizing the importance of the agricultural sector in economic development of the country, the authorities held a referendum in October 1998 to allow full private ownership of land, through an amendment to the constitution. The proposed amendment was approved, but an up to five-year moratorium on the sale of land was enacted to allow for appropriate modifications to the relevant laws. It is expected that the moratorium can be lifted within one to two years; until then, land can be traded via sales of land use rights.

Agricultural production in the 1998 was characterized by less favorable weather conditions compared to the two previous years, and, as a consequence, by a late harvest. In spite of this, overall growth continued, mirroring a broad based-increase in yields. In 1999, agricultural sector growth reached almost 9%. Lack of working capital is still a serious constraint for the development of the sector.

Developments in **manufacturing** production in 1996-1998 were marked by the start of commercial production at the Kumtor gold mine. Thus, while manufacturing output grew only marginally in 1996, it rose by about 40 percent in 1997. Besides Kumtor, this sharp rise also reflects increased production from two oil refineries that had invested in new technology. Excluding Kumtor and the oil refineries, growth of the sector would have been negative. The operation of the Kumtor mine only reached full production capacity by mid 1997, and the mine has accordingly also contributed to growth of the sector in 1998. Except for the production of coal, roofing sheets, cement, and light bulbs, the production of most other industrial goods declined during 1997. The strong production of these items has continued during the first half of 1998, while the production of coal has declined significantly, following the closure of loss-making mines. The growth in the production of construction materials partly reflects strong demand from Kazakhstan related to construction work in the new capital, Astana.

Progress in reforming the **energy sector** has been disappointing. Plans to privatize enterprises in the sector have repeatedly been delayed or have been nontransparent, and necessary increases in energy tariffs have been postponed or only partially been implemented. Accordingly, the financial status of the main energy company, KyrgyzEnergo, has been deteriorating rapidly with financial losses in 1998 of more than som 0,5 billion. It is estimated that theft of electricity by households increased from 50 percent of total household consumption in 1996 to more than 60 percent in 1997. Moreover, a number of special privileges and discounts exist, and only 15 percent of total production for domestic use was actually billed at and paid for at full tariff. It was estimated that the price of electricity would have to be increased by more than 200 percent to reach cost recovery levels. Understanding of these problems, the Government increased gas tariffs to market levels, and unified rates for privileged and non-privileged users. In addition, electricity tariffs were raised by 40 percent in the first half of 2000, and increase that exceeded inflation and depreciation and therefore should improve the financial position of the electricity company.

In 1995-96, activity in the **construction** sector was dominated by the investment phase of the Kumtor gold mine; this phase ended in 1997, and overall activity of the sector accordingly contracted by 17 percent. The slowdown of the sector continued in 1998, as the increase in the Public Investment Program (PIP) was not big enough to offset the decline related to the end of Kumtor construction. Accordingly, during the 1998, activity of the sector was only about half as

the same period the year before. Construction decreased further in 1999 to 3.9 percent share of GDP from 6.1 and 6.0 percent in 1995 and 1996 respectively.

According to the official statistics, the average annual growth rate for **transport** for 1996-97 was almost 8 percent reflecting an increase in road transport, and a decrease in transport by train, water (at lake Issyk Kul) and air. During 1996-97, the average annual growth rate for trade and catering was about 5 percent, while communications increased by an average of about 2.5 percent. During the 1998, trade and catering continued to perform well, with a growth rate of almost 8 percent.

Table 3.2 Share of GDP by the Main Production Sectors, 1993-1999

(in percent)

	1993	1994	1995	1996	1997	1998	1999
Manufacturing	25.1	20.5	12.0	11.1	16.5	16.3	18.3
Construction	5.4	3.4	6.1	6.0	4.5	4.5	3.9
Agriculture & forestry	39.1	38.4	40.7	46.3	41.2	36.1	38.3
Transport & communications	3.9	4.6	4.5	4.6	4.2	4.5	4.4
Others	26.5	33.2	36.7	32.1	33.5	38.7	35.1

Source: National Statistics Committee

From late 1995 until mid-1997, the minimum **wage** was kept constant at som 75 per month; as a result, the real minimum wage fell by more than one-third during this period. Average real wages also fell, but only by 10 percent. The minimum wage was raised to som 90 per month in mid-1997, and further to som 100 by January 1998. In total, the average real wage increased by about 1 percent in 1997 compared to 1996. Real wages further strengthened by 7 percent during first 10 months of 1998. The increase in the average wage during 1998 is mainly due to high wage concessions in commerce, and the communication and computer services sectors. The minimum wage has remained at the level of 100 som in 1999 and with the acceleration of inflation in that year, the real minimum wage declined by around 26 percent while average real wages fell by around 10 percent.

Overall **employment** rose moderately from 1996 to 1997 by about 2.3 percent, mainly reflecting a continued reduction in industrial employment that was more than offset by job creation in the agricultural sector as well as in the retail trade and catering sectors. Over the period 1998-1999, the growth of employment was 1.7 percent. Employment growth has not kept pace with the speed of rise of the working-age population. Unemployment continues to be a very serious problem, in spite of an official average unemployment rate in 1996 and 1997 of around 4 percent and 3 percent, respectively. The official unemployment rate reflects the number of recipients of unemployment benefits, but does not include an estimate of workers actively seeking jobs without receiving unemployment benefits. The World Bank-supported annual household surveys indicate that the rate of unemployment is probably much higher 20 percent. In spite of economic growth, the unemployment rate has probably not been reduced significantly, and unemployment thus continues to be a pressing social problem. Without substantial growth in employment over the medium term, efforts to reduce the high level of poverty will likely fail.

A large number of small and medium sized enterprises were privatized at an early stage of the transition process, but since mid-1997, when the World Bank supported mass **privatization** program was completed, the privatization of state-owned enterprises has slowed down considerably. In early 1998, parliament approved a new privatization strategy for the remaining enterprises. According to this strategy, enterprises can be privatized through a number of different means. A number of tenders for medium sized enterprises were announced during 1998, but only a limited number of bids were received due to high minimum prices, requirements to maintain employment at certain levels and other restrictions. The privatization of the large state-owned

monopolies has proven particularly slow. As a result of the slow progress, privatization receipts for the budget have been below expectations. The quality of the privatization in the Kyrgyz Republic can be questioned, with shortcomings in the area of corporate governance and limited post-privatization support in place. Accordingly, restructuring and reorganization of privatized enterprises has been slow.

The official estimate of the **private sector** share of GDP has increased from 66 percent in 1995 to 76 percent in 1997. However, this estimate is based on a very broad definition of the private sector, which defines an enterprise as private if it has been converted to a joint stock company, even though the government may still be the majority shareholder. Accordingly, the estimate is upward biased. The European Bank for Reconstruction and Development (EBRD) estimated the private share in GDP by mid-1997 at 60 percent, up from 40 percent in mid-1995. These figures seem more realistic.

A large number of **laws** conducive to economic activity in a market environment have been introduced, including a new bankruptcy law, a new civil code, a law on movable collateral, a new banking law, a new law on the budget, and changes in a number of laws to comply with the recent accession to the WTO. However, progress in drafting and passing a number of other important laws has been slow. These laws include the land code, the law on immovable collateral (land), and land registration law. **Implementation of laws** remains weak due to inexperience with the new legal environment, and lack of resources to guide and follow-up on the implementation process. Also the functioning of the courts is questionable, and court rulings are not published.

The **balance of payments** reveals that Kyrgyz Republic is a net importer with high share of exports of gold from Kumtor, and almost comparable portion of imports of energy resources like gas, petrol, and coal. The trade balance figures exemplifies a trend of changes in the trade directions with growing share of trade with non-CIS countries. The capital account items point out on large and rapid borrowing by the Kyrgyz Republic. It is clear that Kyrgyz Republic depends heavily on external environment and such factors like availability of external loans, exchange rate developments, macroeconomic situation of major partner countries can significantly influence balance of payments and overall macroeconomic situation. The amplitude of changes of trade balance relative to GDP is one of the supporting facts for that.

Table3.3 Kyrgyz Republic: Balance of Payments: 1993-1999

(mln. US\$)

	1993	1994	1995	1996	1997	1998	1999
Current Account Balance (including transfers)	-87.6	-116.8	-291.7	-424.6	-139.2	-322.8	-168.1
Trade Balance	-107.1	-119.0	-179.0	-251.7	-15.4	-170.5	-60.4
Exports (fob)	339.6	339.9	409.0	531.1	630.8	585.2	473.3
Imports (fob)	-446.7	-458.9	-588.0	-782.8	-646.2	-755.7	-546.9
Balance of Services	-42.0	-38.4	-156.0	-217.4	-126.1	-117.6	-84.9
Net income	-5.7	-22.0	-35.4	-39.4	-65.3	-76.1	-78.9
Net transfers	67.2	62.6	78.7	83.9	67.6	41.4	56.1
Capital Account Balance	-49	158.3	248.5	347.2	258.9	279.2	208.3
FDI	10	44.9	96.1	46.3	83.0	101.8	39.0
Net medium and long term borrowing	65.1	108.6	200.0	309.7	151.7	115.5	92.8
New loans	65.1	109.2	272.2	360.2	167.1	168.5	153.2
Repayment	0.0	0.6	72.2	50.5	15.4	53.0	60.4
Commercial banks		4.8	-3.3	-0.5	0.8	10.0	-5.8
Accounts abroad and other assets	-107.1	0.0	-44.3	-8.3	23.4	51.9	82.3
Errors and omission	-16.5	14.2	-80.9	48.6	-50.7	64.6	
Overall Balance	-136.1	55.7	-79.8	-20.5	45.6	-30.9	-1.4
Financing	136.1	-55.7	79.8	20.5	-45.6	30.9	1.4
Net foreign reserves	27.0	-18.3	46.9	1.5	-48.2	15.4	-20.0
Gross official reserves	-35.1	-32.1	0.3	-18.1	-82.6	12.8	-39.1
Net credits IMF	62.1	13.8	46.6	19.6	34.4	2.6	19.1
Exceptional financing (including arrears)			32.9	19.0	2.6	15.5	22.3
GDP	873.5	1 127.5	1 437.7	1 390.3	1 761.5	1 627.7	1 238.2
Public External Debt					956.6	1 177.3	1 339.0
Public External Debt as % of GDP					54.3%	72.3%	108.1%
Gross international reserves					141.8	130.4	162.1
in months of imports					1.8	2.3	3.2
Current Account Balance as % of GDP	-10.0%	-10.4%	-20.3%	-30.5%	-7.9%	-19.8%	-16.3%

Source: National Statistics Committee of the KR and National Bank of the KR

In 1996, the country was granted observer status at the **WTO**, and in 1997 reform of the civil service began, which entailed at the start, reducing government employment and improving efficiency through restructuring of public institutions. In 1998, the Kyrgyz Republic acceded to the WTO and remains the only republic of the CIS to do so thus far.

Despite comprehensive reforms backed by international financial institutions' funding and advice, recent developments, including those resulting from the financial crisis in Russia, have shown the economy to be less robust than expected. The **fragility** of the positive developments and trends has been exemplified in the consequences of the Russian financial crisis. During 1998, growth slowed down to about 2 percent reflecting the leveling-off of the Kumtor production, lower than the expected agricultural output and the impact of the financial turmoil in Russia. In 1999 the GDP growth improved slightly to 3,6 percent, but inflation peaked to the level of almost 40 percent. Indeed, the economy remains **vulnerable to external shocks**, as macroeconomic stability has not yet been achieved and foreign debt and debt service are now at worrisome levels. Moreover, there has been some slowdown in reform with the completion of small-scale privatization, and a lot of things remain to be done to create a more business friendly environment, including further reduction in licensing and inspection requirements and improvements in corporate governance.

C. Fiscal Position

The state budget covers the operations of the republican government and six regional oblast authorities. It reflects net transfers to extra budgetary fund (mainly the Social Fund) and state enterprises. Starting in 1998, the Public Investment Program (PIP) has been incorporated into the budget document. The Social Fund budget is prepared separately, but submitted together with the state budget to parliament for approval.

Since 1996 strong progress has been made in improving budgetary procedures. In May 1998 a new Law on the Principles of the Budget was passed, which establishes detailed budgetary procedures. These include a time frame for the submission to parliament of the draft budget and the submission of a "Report on Budget Policy and Strategy". Furthermore, they require consolidation of the Public Investment Program and all extra budgetary funds into the budget document, and the development of a medium-term financial planning horizon. The Government has also focused at restructuring intergovernmental fiscal relations and auditing.

The treasury system, established in 1995, consists of a central treasury department in the Ministry of Finance and 65 regional offices. In the treasury system, procedures have been established to ensure that all public revenues at the republican, oblast, and rayon are deposited into a single treasury account, and that the treasury must authorize all expenditures out of this account.

In order to improve the monitoring of budget execution, a Cabinet Budget Commission has been established. This commission is responsible for cutting expenditures in case of revenue shortfalls and in line with its mandate; it successfully implemented significant spending cuts in late 1997. From the beginning of 1998, the Ministry of Finance has issued monthly expenditure warrants to all spending units in line with the current revenue situation. These warrants establish the upper limit for expenditure on a commitment basis. However, the warrant system has not worked according to intentions due to difficulties in estimating revenues with sufficient accuracy, and because of unforeseen spending needs associated with natural disasters during the spring. Furthermore, in the fourth quarter of 1998 many spending units largely ignored the system, thus leading to the rapid buildup of expenditure arrears. In October 1998 a change in the Kyrgyz constitution strictly limited the power of Parliament in connection with changes in the budget. As a result, Parliament can no longer introduce changes to the budget unless the government agrees. This should facilitate future passage by parliament of supplementary budgets proposed by the government.

A new revenue sharing system has been established between the central and local governments. The old system was based on structures inherited from soviet era and included annual negotiations regarding the size of the allocations. It did not force a hard budget constraint on local budgets, resources were often misallocated in case of revenue shortfalls, and it could not guarantee essential services at the local level. Under the new system, each oblast receives 35 percent of revenues from income, profit and excise taxes collected on its territory. Oblasts receive earmarked categorical grants from the central government to maintain minimum services in health and education to pay for salaries, social insurance contributions and stipends in these sectors. Poorer oblasts receive transfers from the central government, calculated according to a fixed formula, to be able to provide general public services. To improve incentives for local governments to collect taxes, local excise taxes and fees can be adopted, and the national sales tax has been converted into a local tax. The new budget law also specifies the expenditure responsibilities of different levels of government. Since local governments do not have access to financing, local governments' budgets must be balanced.

Table 3.4 Kyrgyz Republic: Tax Revenue Assignment, 1999

	Republican Budget	Local Budget
Income tax	65%	35%
Profit tax	65%	35%
VAT	100%	
Excises	100% - import, 65% - domestic	35% - domestic
Land tax		100%
Road tax	100%	
Emergency fund	100%	
Retail sales tax		100%
Customs duty	100%	
Other taxes		100%

Source: Ministry of Finance

a) Budgetary developments

Despite reforms undertaken, the fiscal policies, and has been, perhaps the weakest pillar in the economic policy framework and given the relative size of the government, this has adversely affected overall economic performance. This weakness is due to a number of factors on the revenue side, the Kyrgyz Republic has been and remains one of the poorest countries of the Soviet Union. In the transition to a market economy these revenue sources have not been very strong as a result of slow growth, weak tax administration and distortions in the tax structure, which have contributed to a significant amount of underground economic activity. Such tax distortions involve exemptions from taxation of important activities like agriculture, and for some profits, loopholes in customs, etc. The weaker fiscal revenues have led to severe cuts in current expenditures, although there has been an ever growing public investment program and an attempt to maintain pre-independence levels of social services, support of the poor, and health and education. Fiscal outcomes have also been heavily influenced by relatively little progress in dealing with some of the important budgetary issues (for example, deciding on the appropriate size of the government, the optimal level of energy prices, and dealing effectively with certain large delinquent tax payers) and poor budgetary management and a lack of transparent legislation.

On the expenditure side, two distinct developments have been notable over the past five years. First, current and capital expenditure moved in opposite directions, leaving their combined share of GDP almost unchanged. Current expenditure decreased from 25 percent of GDP in 1995 to 20.5 percent in 1999, and over the same period capital investment rose from below 5 percent to 10.5 percent of GDP. Second, significant shifts took place within current expenditure. While between 1995 and 1999 expenditure on wages fell as a share of GDP from almost 10 to less than 6 percent, and that on transfers from about 7 to around 2.5 percent, interest expenditure climbed from less than 0.5 percentage point GDP to 3 percent of GDP (of which over 80 percent is on foreign interest obligations). These expenditure trends raise questions with respect to the medium-term fiscal outlook: Do these trends simply reflect the necessary structural changes of the transition process? Or do they present non-viable fiscal developments?

In general, a decline of current expenditure can be seen as a typical phenomenon of an economy that is in transition from plan to market, and therefore needs to reduce the size of the public sector. Indeed, the contraction of the Kyrgyz government's wage bill has been partly due to retrenchment in public sector employment, as ministries were reorganized, redundant positions eliminated and management techniques modernized.

However, expenditure savings also resulted from a fall in the real value of public sector wages, as high annual inflation rates were not matched by any wage increase during the last three years. Similarly, expenditure on transfers shrank not only due to the tightening of eligibility criteria and

the elimination of widespread privileges, also due to a decline in the real value of benefits in absence of effective indexation mechanisms.

This raises questions whether these adjustments are sustainable or whether efforts need to be made to reduce employment further and to rationalize social expenditures more than has taken place.

Table 3.5 Kyrgyz Republic: Summary of State Government Operations, 1993-1999

	(mln. som)						
	1993	1994	1995	1996	1997	1998	1999
Total revenue and grants	848	2 098	2 702	3 727	4 973	6 151	8 609
as % of GDP	15.8%	20.8%	16.7%	15.9%	16.2%	18.0%	17.8%
Current Revenue	829	1 742	2 598	3 233	4 652	5 864	7 464
as % of GDP	15.5%	17.9%	16.1%	13.8%	15.2%	17.2%	15.4%
Tax revenue	796	1 639	2 422	2 968	3 847	4 867	5 973
as % of GDP	14.9%	13.6%	15.0%	12.7%	12.5%	14.2%	12.4%
Income tax & Profit tax	303	653	713	669	685	892	1 151
as % of GDP	5.7%	5.4%	4.4%	2.9%	2.2%	2.6%	2.4%
VAT	234	519	705	1 250	1 733	1 967	2 000
as % of GDP	4.4%	4.3%	4.4%	5.3%	5.6%	5.8%	4.1%
Excises and Customs duties	104	218	432	452	696	1 103	1 572
as % of GDP	1.9%	1.8%	2.7%	1.9%	2.3%	3.2%	3.3%
Land tax	5	58	73	122	278	291	199
as % of GDP	0.1%	0.5%	0.5%	0.5%	0.9%	0.9%	0.4%
Road tax and Emergency tax	89	62	217	239	319	422	566
as % of GDP	1.7%	0.5%	1.3%	1.0%	1.0%	1.2%	1.2%
Other taxes	61	129	282	236	136	192	485
as % of GDP	1.1%	1.1%	1.7%	1.0%	0.4%	0.6%	1.0%
Non-tax revenue	34	103	176	265	805	997	1 491
as % of GDP	0.6%	0.9%	1.1%	1.1%	2.6%	2.9%	3.1%
Capital revenue	1	53	49	293	126	90	149
as % of GDP	0.0%	0.4%	0.3%	1.3%	0.4%	0.3%	0.3%
Grants	0	303	55	201	195	197	996
as % of GDP	0.0%	2.5%	0.3%	0.9%	0.6%	0.6%	2.1%
Total expenditures	1 226	3 901	5 359	5 922	7 729	9 980	14 803
as % of GDP	22.9%	32.5%	33.2%	25.3%	25.2%	29.2%	30.6%
Current expenditure	434	2 752	4 032	4 925	6 589	7 900	9 887
as % of GDP	8.1%	22.9%	25.0%	21.0%	21.5%	23.1%	20.5%
Wages and social contributions	352	960	1 528	1 682	2 065	2 630	2 787
as % of GDP	6.6%	8.0%	9.5%	7.2%	6.7%	7.7%	5.8%
Transfers	39	818	1 119	1 098	1 070	1 196	1 238
as % of GDP	0.7%	6.8%	6.9%	4.7%	3.5%	3.5%	2.6%
Social Fund subsidy	43	77	91	293	446	344	300
as % of GDP	0.8%	0.6%	0.6%	1.3%	1.5%	1.0%	0.6%
Interest	0	24	68	284	520	715	1 436
as % of GDP	0.0%	0.2%	0.4%	1.2%	1.7%	2.1%	3.0%
Other		873	1 226	1 568	2 488	3 015	4 126
as % of GDP	0.0%	7.3%	7.6%	6.7%	8.1%	8.8%	8.5%
Capital Investment	159	586	771	897	1 157	2 244	5 104
as % of GDP	3.0%	4.9%	4.8%	3.8%	3.8%	6.6%	10.6%
Net lending		563	556	100	-17	-164	-188
As % of GDP	0.0%	4.7%	3.4%	0.4%	-0.1%	-0.5%	-0.4%
Surplus(+)/Deficit(-)	-378	-1 662	-2 789	-2 232	-2 763	-3 468	-5 814
as % of GDP	-7.1%	-11.6%	-17.3%	-9.5%	-9.0%	-10.1%	-12.0%
External Financing	50	1 173	1 467	1 620	2 450	3 046	7 084
as % of GDP	1.5%	8.2%	9.1%	6.9%	8.0%	8.9%	14.7%
Domestic Financing	329	489	1 321	613	362	196	-1 267
as % of GDP	6.1%	2.1%	8.6%	2.6%	1.2%	0.6%	-2.6%

Source: National Statistics Committee and Ministry of Finance

Total expenditure on education and health declined significantly. Both sectors experienced substantial retrenchments between 1995 and 1999, when overall expenditure on education fell from 6.5 to 3.9 percent of GDP and that on health from 3.7 to 2.3 percent of GDP. Yet, non-wage expenditure fell much less than overall expenditure, indicating that the drastic cuts largely stemmed from falling real wages and to some extent shedding of staff and has not necessarily been at the cost of the quality of the services. Over-staffing, duplication of facilities, and an overemphasis on non-essential services inflated spending in both sectors in the past and continue today.

The steep rise in capital expenditure has been almost entirely financed by external borrowing. Having started in 1994, the foreign financed public investment program (PIP) reached 9.5 percent of GDP in 1999, and accumulated for 65 percent of the external budget financing in the same year. Currently, some 50 foreign financed PIP projects are underway, including works such as construction of the Bishkek – Osh road, the rehabilitation of KyrgyzEnergo – state power company, the reconstruction of the Manas airport, irrigation rehabilitation and agricultural development projects, with an undisbursed pipeline in excess of \$450 million (or close to 40% of GDP). The large investment program has contributed to the rapid increase in the stock of public and publicly guaranteed debt in recent years. In 1999, the latter reached almost 100 percent of GDP (excluding IMF and Kumtor – related debt). Similarly, as noted above, debt service payments have increased substantially. Debt service by the budget in 1999 (including principal payments) amounted to 2.8 percent of GDP, absorbing 18 percent of fiscal revenue (excluding grants) and representing about 14 percent of current expenditure. Projections based on the general parameters underlying the medium term projection show that these ratios will worsen in the future. These projections show that the fiscal position is likely to remain under pressure, with little room for other expenditures, unless revenues can be raised or debt service expenditures reduced.

Reform of the public utility companies is a future necessary step to improve the fiscal position. The implicit subsidies for electricity, heating and gas were estimated to as much as 9 % of GDP in 1998.

Poor performance of these enterprises reflected the lack of cost-effective tariffs, an extensive system of privileges and low collection rates in general due to theft, the lack of metering and disconnection policies, and poor incentives to improve efficiency.

On the revenue side, tax revenues have shown an almost continuous decline. Tax revenue fell from 15 percent of GDP in 1993 to less than 12.5 percent in 1999. This ratio is low by international standard and among CIS countries. Indeed, with exception of excises, revenue as a share of GDP was lower for every tax category in 1999 than it had been four years ago, with income taxes generating only little more than half of what they had in 1995. In principle, the four major taxes – VAT, excise, income and profits – taken together should provide for a simple and transparent tax system. However, taxes and fees levied through various special legislative acts often impose heavy burdens on specific bases, whereas significant loopholes exist for others. Moreover, compliance costs are high because the tax code is new and still in flux.

VAT remained the most important revenue source, followed by income taxes and excises. In spite of significant improvements in administration, enterprises are only rarely credited for VAT paid on inputs. Accordingly, the VAT functions like a turnover tax. The share of excises in GDP increased rapidly to 1.5 percent thanks in part to the harmonization of excise rates on imported and domestically produced goods (except on beer, champagne, and cognac) and the reinstatement of the excise on gasoline products. Land tax revenues improved significantly on account of improved collection of arrears and a strong growth of the agricultural sector. The share of income tax in GDP declined from 2.9 percent in 1996 to 2.4 percent in 1999 (if we take a larger span the decrease is even more drastic with total share of income and profit taxes of 5.7 % of GDP in 1993) mirroring the declining activity in the industrial sector not exempted from income tax. The

government does not accept tax payments in kind, but more than 20 percent of tax revenues were collected through tax offsets in 1997-1998. This figure was reduced to about 15% in 1999 mainly due to the IMF's conditionality.

There has been a growing reliance on non-tax revenues. In the face of weakening tax revenues, non-tax revenue almost tripled since 1995, making up over 17 percent of total revenue (including grants). Next to government fees, and revenue for automobile registration, penalties etc, the so-called "special means" – still at zero in 1995 – have become the driving factor behind non-tax revenue over the past years. Local governments and institutions such as hospitals or universities in the form of additional fees demanded for their services typically raise these special means. Although it is common for revenue systems to have certain institutions charge fees from those who use specific services and therefore should cover the related costs (equivalence principle), the special resource measures in the Kyrgyz Republic stem from the lack of resources at the central level. Since special means are guaranteed to at least partially remain within the collector's own budget, the collection effort is strong and revenue creation comparatively high. However, the ad hoc levying of fees at the sub-national level clouds the transparency of the revenue system, and also raises equity concerns as additional fees are usually levied where they can be best enforced regardless of ability-to-pay considerations.

a) Extra budgetary activity: Social Fund and pension reform.

The pension system that the Kyrgyz Republic inherited from Soviet era was a pay-as-you-go system administered by the state. The state provided generous pensions that acted as both social assistance and social insurance, including for old age, disability, and survivors benefits. Revenues came from payroll taxes (39 percent) levied on employers (33 percent) and employees (6 percent). Additional financing came from budgetary transfers and borrowing from other funds within the Social Fund. Regular shortfalls in financing led to the accumulation of pension arrears.

In 1996 the government created the Social Fund, which was responsible for administering the Pension Fund, the Social Insurance Fund, the Employment Fund, and the Medical Insurance Fund. Although the Social Fund was created as a benefit and collection agency, each year a transfer was made from the budget to the Social Fund. The payroll tax was distributed between the individual funds with the Social Fund as follows: 32 percent to the Pension Fund, 2 percent to the Employment Fund, 2 percent to the Medical Insurance Fund, and 3 percent to the Social Insurance Fund. Due to increase in collections, the payroll tax was reduced to 38 percent in 2000 (31% paid by employers and 7% paid by employees) with a decline in the Social Insurance Fund contribution from 3 percent to 2 percent.

During the transition, the old generous system of pension administration became unsustainable for a number of reasons, including the collapse in employment and the acceleration of inflation. The high payroll tax rate led to distortions in the labor market. By end-1997, the average benefit equaled 60 percent of the average age, while the retirement age was 55 years for women (minimum of 20 years of work) and 60 years for men (minimum 25 years of work). Working pensioner received full pensions. Special pensions were also common. In addition, a significant number of labor compensation payments were excluded from payroll and wage tax collections. To address this problem, in 1997, the Kyrgyz Republic undertook a major reform of the state pension system, transforming it from an earnings related pay-as-you-go scheme to a contributory one.

The reform of the pension occurred in two stages. In October 1997, the first stage began with the introduction of the "Law on State Social Insurance", with goal to change scheme and create a partially funded system. In the second stage, in June 1998, the government enacted a significant amendment stipulating and increase in the retirement age by three years by June 2004 and 50 percent reduction in pensions paid to working pensioners. However, the reform effort ended up with an increase in the age by three years by 2007 and limiting the reduction of pensions paid to

working pensioners to only those earning above the average wage due to the Parliament's challenge.

3.3 Tax System

a) Organizational structure

National tax policy is under the general jurisdiction of the Ministry of Finance, which also has the State Tax Inspectorate and the State Customs Inspectorate as external organizations. While the Ministry of Finance is responsible for the designing of the tax policy and involved in the drafting of the tax legislation, the State Tax Inspectorate is in charge of domestic taxes administration and State Customs Inspectorate is in charge of administration of taxes on external operations like administration of VAT on imports, excises on imported excisable goods, customs duties.

b) Tax Law

The Tax Code adopted in 1996, gathered all the major taxes and the basic tax administration rules in one place, other than customs duties and the taxes on payroll. The policy decisions reflected in the Tax Code represented a significant improvement over the prior tax laws. The four major taxes – VAT, excise tax, income tax and profit tax – taken together provided the Kyrgyz Republic with a simple and transparent tax system. Each of the taxes had a relatively broad tax base. The rules for tax administration were strengthened and clarified.

The Tax Code was not perfect – and not tax law ever will be. Some issues, such as the treatment of international services under the VAT, were not adequately addressed. Also, the Code has been amended a number of times since 1996, and some of the amendments, such as exempting communal services from VAT, were steps backward. On the other hand, the repeal of the tax incentives in the Law on Foreign Investment was a significant improvement in the fairness of the tax system, as domestic and foreign investors are not treated alike.

The Tax Code covers the most of the existing taxes. However, some of the taxes and fees were not included in Tax Code, because of the existed intention to eliminate them gradually. These taxes are considered as distortional and have in some cases relatively high collection share and assigned directly to designate purposes. Such taxes are road tax for juridical entities stipulated in the “Law On taxes on enterprises, associations and organizations” of 1991, Extraordinary (Emergency) Fund stipulated in the “Law on contributions to prevent of and cope with extraordinary situations” of 1992, Mineral Development tax created and regulated under the government resolution “On contributions for development of mineral resources” of 1993, water resources usage fee stipulated by the “Law on water resources”, forest fee stipulated in the “Forest Code”, mineral resources usage fee stipulated by the “Law on mineral resources”.

c) Tax administration

The following definition of tax is used in Tax Code:

“A tax is a compulsory payment, collected from income/turnover, received by legal and physical persons and comprises collections, national duties (except for penalties, repayment of debts, payments for goods, services and works performed) to the state budget”.

The taxes in the Kyrgyz Republic are divided into statewide taxes and local taxes.

Statewide taxes are: 1) Individual income tax; 2) Profits tax; 3) VAT; 4) Excise tax; 5) Land tax; 6) Road tax.

Local taxes are: 1) Health resort tax; 2) Tax on advertising; 3) Collection from dog owners; 4) Collection for the right to hold local auctions, lotteries, competitions and exhibitions for

commercial purposes; 5) Collection for parking; 6) Tax for the right to use local symbolism; 7) Collection for refuse disposal from the territory of built up areas; 8) Tax collected from persons growing flowers in greenhouses and selling them to the population; 9) Hotel tax; 10) Tax on the right to hunting and fishing; 11) Tax collected from tourists leaving for countries outside the CIS; 12) Taxation of video saloons, public concerts and shows; 13) Tax on paid services to the population and retail sales; 14) Tax paid for premises or parts of premises not used for production, trade and social purposes; 15) Tax from owners of transport facilities.

The following deductions and contributions have not been clearly defined in terms of being either taxes or non-tax payments:

Contributions to Emergency Situation Fund, Contributions for development of mineral resources, Insurance premiums to extra budgetary funds payable by employers (Pension Fund, Social Insurance Fund, State Employment Fund, State Compulsory Health Care Insurance Fund), Mineral resources usage fee, water resources usage fee, forest fee.

Special tax regimes

Special taxation of small businesses and free economic zones shall be regulated by appropriate Kyrgyz Republic Laws.

Implementation and elimination of taxes. Procedure of introducing amendments and additions to the Tax Code. Instructions. Retroactive power.

- The right to implement or eliminate a tax on the territory of the Kyrgyz Republic rests solely with the Parliament of the Kyrgyz Republic.
- All draft laws on amendments to the Tax code shall be evaluated by the Ministry of finance of the Kyrgyz Republic, prior to their consideration by the Government and Parliament of the Kyrgyz Republic.
- Draft laws on implementing or eliminating taxes, tax exemption shall be adopted given the Kyrgyz Republic Government agrees to it.
- It is prohibited to include tax issues in other laws.
- Amendments to the Tax code adopted in the established manner shall come into effect only 15 days after their official publication, unless otherwise provided in the legal acts.
- Tax legislation acts implementing new taxes, raising tax rates or otherwise causing deterioration of taxpayers' situation have no retroactive effect.
- The Ministry of Finance of the Kyrgyz Republic shall issue instructions on the Tax Code application and inform taxpayers of these instructions through mass media.
- Instructions shall come into effect only after they are approved by the Government of the Kyrgyz Republic and shall be in effect until they are repealed.

International agreements:

Provisions of International agreements and other acts ratified by the President of the Kyrgyz Republic or Jogorku Kenesh shall take precedence over the provisions of the Tax code.

Tax administration. Legal basis of the Tax administration activity. Basic functions of the Tax administration.

- The Kyrgyz Republic Tax administration consists of the State Tax Inspectorate of the Kyrgyz Republic under the Ministry of Finance and its local offices.
- Functions of implementation of the Tax code provisions are performed by tax officers authorized by the heads of appropriate tax offices.
- The legal basis of the Tax administration activity is the Constitution of the Kyrgyz Republic, the Tax code of the Kyrgyz Republic and other laws of the Kyrgyz Republic that do not contradict the Tax code of the Kyrgyz Republic.

- The basic functions of the Tax administration are tax collection ensuring compliance with the Tax code provisions, study of its efficiency and influence on market economy development and participation in developing drafts of international tax agreements.

Taxpayers

Taxpayers are legal entities and individuals (physical persons) who are obliged to pay taxes and collections under the Law.

Legal entities according to the Kyrgyz Tax Code are:

- Legal entities established under the law of the Kyrgyz Republic;
- Foreign legal entities, companies and other corporate establishments set up under the Law of foreign states and international organizations;
- Permanent establishments of foreign legal entities shall be determined proceeding from non-resident taxpayer's permanent location where it conducts its economic activity through a permanent establishment in full or in part.

Physical persons are Kyrgyz Republic citizens, foreign citizens, persons without citizenship, and individual businessmen / physical persons registered in the established manner and conducting business activity without establishing a legal entity

“*Resident taxpayer*” is any person, staying in the Kyrgyz Republic for 183 days or more during a calendar year or a person, who established a body of his own actual management in the Kyrgyz Republic under the Laws of the Kyrgyz Republic.

“*Non-resident taxpayer*” is any person, staying in the Kyrgyz Republic for less than 183 days during any calendar year, implementing business activity and receiving income from a source in the Kyrgyz Republic.

Some of the rights and duties of taxpayer stipulated in the Kyrgyz Republic’s Tax Code are:

Rights

- To claim loss compensation caused by incorrect actions of authorized officials of the Tax Administration
- To receive written clarifications from tax offices and other authorized government agencies regarding compliance with laws on taxes and collections.
- To obtain information from tax offices on current taxes, tax laws and other acts, rights and obligations of taxpayers, tax office and tax officials' authorities
- To defend one's interests in court and superior Tax administration bodies

Obligations

- To have to pay taxes and collections under the Tax code.
- To get registered with the tax office where it is required by the Tax code.
- To keep records of income/ expenses and objects of taxation in the established manner.
- To file with the tax offices and their officials documents required for tax assessment and payment in the established manner.
- To keep books for 6 years for legal entities.
- To keep books for 3 years for individual taxpayers.
- To apply to a tax office in order to be issued a tax identification number (within 10 days).
- To enter his TIN in any declaration, notification or other document used for the purpose of complying with the Kyrgyz Republic’s Tax Code.

Assessments, terms, notification

A taxpayer shall determine the amount of receipts for the purposes of taxation with the following methods:

- 1) on the basis of invoices;
- 2) on the basis of payments;
- 3) on a combined basis.

The Tax Inspectorate shall make an assessment of the tax due at the amount shown by the taxpayer in tax declaration. If the Tax Service considers the assessment to be incorrect, it may reassess the tax and serve a notice on the taxpayer about the changes introduced in accordance with Code.

A taxpayer is required to pay the tax shown as payable by the date stated in the assessment notice. The notice has legal force given it does not contradict the. It must contain the taxpayers name, taxpayers identification number, date of issuance of the notice, tax issue to which the notice relates, amount of tax assessed, requirement for tax payment within 30 days, place the payment shall be made, method of payment, summary statement of appeal procedures.

The Tax Service is entitled to apply penalty, from the date when the incorrect assessment was revealed, except in such cases when it occurs through the fault of the Tax Service. Additional tax assessment or refund shall be made for the period beginning from the date of the last audit up to the date when overpayment or underassessment was revealed.

Appeals against tax service decisions

Each taxpayer is entitled to appeal against tax office acts that do not refer to legal instruments, decisions taken by officials, where the taxpayer believes that such acts and decisions encroach on his rights.

Acts, decisions of tax officials may be appealed against:

- With the Tax Administration no later than 30 days from the day the decision was taken. If a taxpayer is dissatisfied with the decision of the tax body concerning his appeal, the taxpayer is entitled to appeal to a higher level body;
- A taxpayer, who disagrees with the Tax Administration final decision or that of a superior body, may appeal to the appeal to an appropriate court in the manner stipulated in the arbitration proceedings legislation.

d) Tax Structure

Individual Income Tax

Table 3.6 Kyrgyz Republic: Individual Income Tax Collection, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 399	30 686	34 181	48 321
General tax receipts	1 638	2 423	2 968	3 847	4 867	5 973
<i>Income tax, total</i>	225.1	283.6	288.3	318.3	405	546
% of GDP	1.9%	1.8%	1.2%	1.0%	1.2%	1.1%
% of total tax receipts	13.7%	11.7%	9.7%	8.3%	8.3%	9.1%
<i>Income tax withhold by employers</i>	218.08	277.63	272.02	267.03	331.53	441.25
% of GDP	1.8%	1.7%	1.2%	0.9%	10.0%	0.9%
% of total tax receipts	13.3%	11.5%	9.2%	6.9%	6.8%	7.4%
<i>Withhold by tax bodies</i>	7.02	5.97	16.28	17.57	15.47	30.75
% of GDP	0.06%	0.04%	0.07%	0.06%	0.05%	0.06%
% of total tax receipts	0.43%	0.25%	0.55%	0.46%	0.32%	0.51%
<i>Income tax from patents</i>				33.7	58	74
% of GDP				0.11%	0.17%	0.15%
% of total tax receipts				0.88%	1.19%	1.23%

Source: State Tax Inspectorate

Nature of tax

Aggregate annual income minus deductions provided by the law. For individual taxpayers-residents - income received in the territory of the country and outside. For individual taxpayers-non-residents - income received at the source located in the Kyrgyz Republic.

Payers of income tax:

Physical persons – residents and non-residents of the Kyrgyz Republic

Table 3.7 Kyrgyz Republic: Income tax rates, end of 1999.

Amount of aggregate annual income	Tax rate
Up to 5 times the minimum annual wage	5 percent from income amount
From 5 times to 20 times the minimum annual wage	Tax amount from 5 times the minimum annual wage plus 10 percent from amount exceeding it
From 20 times to 100 times the minimum annual wage	Tax amount from 20 times minimum annual wage plus 20 percent from amount exceeding it
Over 100 times the minimum annual wage	Tax amount from 100 minimum wage plus 33 percent from amount exceeding it

Source: State Tax Inspectorate

Expenses subject to deduction

For private businessmen:

- Expenses connected with receiving of income, including production expenses;
- Actual business trip expenses (excluding per diem, the norms for which are established by the law);
- Monthly deductions in the amount of four-month minimum salary during a year; Monthly deduction per each dependent of a family – one minimum monthly salary;
- For special categories of taxpayers (invalids; persons with the state honorable title, war veterans, etc.) a deduction is provided in the amount of one minimum monthly salary a month, or a year;
- Expenses on interest payments on debt liabilities;
- Deductions for scientific researches, experimental design and planning survey works; Deductions to reserve funds; Depreciation charges on capital assets; Deductions on expenses for repairs; Deductions of expenses pertaining to extraction of mineral resources; Expenses for non-material assets; Deduction of expenses pertaining to the growth of the main production means;
- Contributions to the Social Fund under the KR Government;
- Losses of realization of securities; Losses pertaining to economic activity of previous years;

For physical persons, those are not private businessmen:

- Monthly deductions in the amount four-month minimum salary during a year;
- Monthly deduction per each dependent of a family – one minimum monthly salary;
- For special categories of taxpayers (invalids; persons with the state honorable title, war veterans, etc) a deduction is provided in the amount of one minimum monthly salary a month, or a year;

Tax benefits:

Members of farms, their unions, associations and other agricultural formations, for which land is the main production means and income source, pay only land tax.

Non-taxable types of income:

- Income in the form of inheritance, gift received by one physical person from another; or as a humanitarian aid;
- Income of physical persons from realization of livestock and poultry;
- Income from realization of fruits and vegetables grown on a household plot of a taxpayer;
- Subsidies, compensations, pensions, benefits, stipends and transfers from the KR Government;
- Interest and winnings on bank deposits or T-bills, dividends;
- Cost of accommodation in sanatorium and resort establishment, rest houses, sanatoriums-dispensaries, children's healthy camps;
- Incomes of officers of the Ministry of Internal Affairs, Ministry of National Security, Ministry of Defense in the form of money allowance, compensation for military titles and long service;
- Incomes from sales, exchange or other types of disposition of property of a taxpayer.

Profit tax

Table 3.8 Kyrgyz Republic: Profit Tax Collection, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
Total tax receipts	1 638	2 423	2 968	3 847	4 867	5 973
<i>Profit tax, total amount</i>	426.2	414.5	364.7	338.7	452	568
% of GDP	3.55%	2.57%	1.56%	1.10%	1.32%	1.17%
% of total tax receipts	26.02%	17.11%	12.29%	8.80%	9.29%	9.50%

Source: State Tax Inspectorate

Nature of Tax

Aggregate annual income minus deductions stipulated by the law.

For legal person taxpayer-resident - income gained on the territory of the country and outside. For no-resident taxpayer - income gained from the source of income in the Kyrgyz Republic.

Profit tax payers:

Legal persons - residents of the Kyrgyz Republic, except for legal persons for whom land is a fixed production asset and principle source of income.

Legal persons - non-residents of the Kyrgyz Republic

Tax Rates

Table 3.9 Kyrgyz Republic: Profit Tax Rates, end of 1999

Payer	Income type	Rate
Legal persons – residents; Legal persons – non-residents with a permanent establishment in the KR;	Aggregate annual income minus deductions under the KR TC	30 %
Societies of invalids of categories II and I, enterprises of the Kyrgyz Society of deaf and blind, where deaf and blind comprise at least 50 % of the employees. The list of enterprises shall be determined by the Government of the KR	Profit	0 %

Legal persons – residents (<i>legal persons – non-residents with regards to interest received in connection with the permanent establishment operation in the Kyrgyz Republic - non-resolved issue</i>)	Interest	5 %
Legal persons - non-residents with regards to income that is not connected with the permanent establishment in the KR	Dividends and interest Insurance premiums on risk insurance and reinsurance contracts Telecommunication or transportation services in international communication and transportation between the KR and other states Royalties, income paid for rendering services (including management services, consultation services, lease) and other income.	10 % 5 % 5 % 30 %

Source: State Tax Inspectorate

Deductible expenses

- Expenses incurred in connection with producing income, including all operational expenses in connection with the production of income;
- Actual traveling expenses (except daily allowance with regards to which the rates shall be determined by the Government of the Kyrgyz Republic);
- Amounts transferred to institutions, organizations and enterprises of education, science, culture, sport and health care to cover capital expenses in accordance with the approved estimate of expenses in the established order;
- Deduction of interest paid on a credit;
- Deductions for scientific research, experiments, designing and exploration expenditures; Depreciation charges for capital goods; Deductions for expenses on repairs; Deductions for expenses incurred in connection with extraction of natural resources; Deductions with regards to intangible assets; Deduction of expenses incurred in connection with capital assets increase;
- Deduction to the social fund of the Government of the KR;
- Losses arising from disposal of securities; Losses incurred in connection with economic activity; Reserves to which potential credit and leasing losses are charged; Contributions channeled to insurance reserve funds established by insurance organizations.

Tax preferences

Tax exempt are: profits of voluntary organizations with respect to the income arising from their charity activities; profits of corrective labor institutions of the Government Department of Punishment Execution of the Ministry of Home Affairs of the Kyrgyz Republic; dividends received by legal persons - residents of the KR; profits of investment funds.

Aggregate annual income of legal persons shall decrease by the amount of an asset transferred without compensation, including money donated to non-commercial charity organizations, in the amount not exceeding 2% of a taxpayer's taxable income.

Value Added Tax

Table 3.10 Kyrgyz Republic: VAT Collection, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
Total tax receipts	1 638	2 423	2 968	3 847	4 867	5 973
VAT, total	518.5	705.1	1 096.7	1 684	1 967	2 259
% of GDP	4.31%	4.37%	4.69%	5.49%	5.75%	4.67%
of total tax receipts	31.66%	29.10%	36.95%	43.77%	40.42%	37.82%
VAT on domestic output, total			958.8	1 101	959	1 006
% of GDP			4.10%	3.59%	2.81%	2.08%
% of total tax receipts			32.30%	28.62%	19.71%	16.84%
VAT on imports, total			137.9	583	1 008	1 152
% of GDP			0.59%	1.90%	2.95%	2.38%
% of total tax receipts			4.65%	15.15%	20.71%	19.29%

Source: State Tax Inspectorate

Nature of Tax

VAT taxable supplies are goods, works and services provided in the Kyrgyz Republics territory and VAT taxable import are goods works and services imported to the Kyrgyz Republic territory. Control over VAT levying on domestic goods, works and services is carried out by the State Tax Inspectorate; and on imported goods, works and services – by the State Customs Committee.

VAT payer

VAT payer – is a legal entity or physical person, which is registered or required to register for VAT.

A person whether legal or physical, carrying out business activity is obliged to register, if within 12 calendar months total turnover of VAT taxation object exceeds the registration threshold amount. Registration threshold is established by the Kyrgyz Republic Government and since July 1999 has become 300 thousand soms.

VAT rate

VAT payment is made at the rate of 20% in case of taxable suppliers and taxable imports of goods other than excise tax, and at the rate of 0% in case of export of goods to far-abroad countries, and CIS countries that apply a country-of-destination principle to Kyrgyzstan, in other words, do not impose VAT on goods that are exported to Kyrgyzstan. Zero-rated VAT provides for compensation of VAT paid or payable for material resources, used for creation of taxable suppliers.

Exempt supplies

Kyrgyz Republic Tax Code establishes a special type of supplies, which are VAT exempt:

- supply of residential buildings or of leases of residential accommodation, with the exception of leases of hotel type accommodation, boarding house, sanatoria and leases of structures for parking or storing cars and other vehicles.
- supply of land with the exception of leases of land for parking or storing transport facilities;
- supply of agricultural produce by agricultural producers; supply by an agricultural producer of processed agricultural produce grown by this agricultural producer;
- supply and export of golden alloys and refined gold;
- financial services; supply of insurance or of pension, or of other related services, including management of insurance and pension funds.

- supply of services by the system of municipal, rayon (in rural areas) transport, except for taxis, which are associated with conveyance of passengers within cities, villages and to suburban destinations and by water, rail, and motor transport;
- supply of postal services by the Post Office and services on delivery of pensions and benefits;
- supply of public utilities (electric energy, gas, radio, TV antenna, hot and cold running water, heating, etc.);
- supply or transfer of property of state enterprises by way of privatization;
- supplies of goods, works and services by non-commercial organizations to health care, education, science, culture and sports institutions; supplies of goods, works and services by non-commercial organizations for the social protection and welfare of children or low income old people;
- supplies of services by organizations of health care, education, science, culture and sports; supplies of services by philosophical organizations with a view to spiritual welfare;
- supplies of specialized goods for invalids.

If transfer of the right to carry out business activity or part of it is made by a taxable subject and this activity is a subject to VAT at the moment of the transfer, this transfer is not a supply of goods, works or services.

Exemptions from VAT on imports

The following goods, belongings and other articles are exempt from VAT:

- goods supplied for rendering assistance when eliminating the consequences of natural calamities, war conflicts and accidents;
- goods supplied as humanitarian aid in the manner determined by the Government;
- imported goods which were earlier exported by the same importer;
- goods imported temporarily under a bond that they will be exported unchanged within 12 months;
- goods in transit via the territory of the Kyrgyz Republic;
- goods intended for official use by foreign employees and equated representations, and goods for personal use of the members of diplomatic, administrative and technical staff of such representations, including members of their families, and not for resale.
- pharmaceuticals in accordance with the list approved by the Government; educational supplies, school accessories and scientific publications; baby food;
- goods which are imported exclusively to be used as capital assets by the importing subject and not for supply by that subject to any other subject.

Zero-rated supplies

The following goods are zero-rated VAT supplies:

- export of goods, unless it is an export to the states applying the country-of-origin principles to the KR, and with the exception of export of golden alloys and refined gold;
- supply of goods or services pertaining to international transportation of passengers, luggage or cargoes;
- supply of goods or services provided to diplomatic and consular representations in the country;
- supply of goods and services to an international organization under international agreements to which the Kyrgyz Republic is a party.

Excise tax

Table 3.11 Kyrgyz Republic: Excise Tax Collection, 1994-1999

(mln. som)

	1994	1995	1996*	1997	1998	1999
GDP	12 019	16 145	23 400	30686	34 181	48 321
Total tax receipts	1 638	2 423	2 968	3 847	4 867	5 973
<i>Excise tax, total amount</i>	172.6	298.2	243.4	449	722	1 265
% of GDP	1.4%	1.8%	1.0%	1.5%	2.1%	2.6%
% of the total tax receipts	10.5%	12.3%	8.2%	11.7%	14.8%	21.2%
<i>Excise tax on domestic goods</i>		112.6	141.3	278	407	657
% of GDP		0.7%	0.6%	0.9%	1.2%	1.4%
% of the total tax receipts		4.6%	4.8%	7.2%	8.4%	11.0%
<i>Excise tax on imports</i>		185.6	102.1	171	315	601
% of GDP		1.2%	0.4%	0.6%	0.9%	1.2%
% of the total tax receipts		7.7%	3.4%	4.5%	6.5%	10.0%

Source: State Tax Inspectorate

Tax Nature

Excise taxes are imposed on the production of goods on the territory of Kyrgyz Republic and on the importation of excisable goods into the territory of the KR. Exports of excisable goods shall not be subject to excise tax.

Taxpayers

All legal persons and all physical persons who produce excisable goods on the territory of the KR, or who import excisable goods, or who carry out gambling business on the territory of the KR, shall pay excise tax to the budget.

List of excisable goods and current rates

Goods, if produced on the territory of the KR or imported into the territory of the KR, shall be excisable: ethyl alcohol for human consumption and rectified ethyl alcohol made from raw foodstuffs - 70 som/l; vodka - 40 som/l; liqueurs and vodka products - 40 som/l; fortified drinks, fortified juices and balsams - 40 som/l; wines - 10 som/l; cognacs - 25 som/l; sparkling wines - 20 som/l; packed beer - 3 som/l, non packed beer - 2 som/l; wine-making staff - 2 som/l; cigarettes with filter - 70som/1000 units; cigarettes without filter - 15som/1000 units; other goods containing tobacco - 4 som/kilo; jewelry made of gold, platinum or silver, in percentage of the whole sale price and of customs value - 15%; processed or non-processed fur hides (other than hides of mole, rabbit, deer, dog and sheepskin) - 5%; wearing apparel made of natural fur, including coats, short coats, jackets, capes, stoles, scarves, headgear, collars, fur coats and fur pieces (other than apparel made of hides of mole, rabbit, deer, dog and sheepskin) - 5%; coats, short coats, jackets, capes trimmed with fur (other than mole, rabbit, deer, dog and sheepskin) - 5%; clothes made of natural leather - 5%; items made of crystal, lighting and appliances made of crystal - 20%; firearms and gas weapons (other than those procured for the needs of state agencies) - 20%; oil products - 3000 som/ton; coffee and cocoa - 10%; rugs and rug articles (except rug type floor cover) - 10%.

The rates of excise tax (taxes) are to be annually adopted on the proposal of the Government of the Kyrgyz Republic by the Legislative Assembly of the Parliament as a separate law, and to be approved by the People Representatives Assembly.

Exemption from excise taxes on imports

Goods imported by physical persons shall be exempted from excise taxes to the extent prescribed by the Government of the Kyrgyz Republic.

The imported goods listed below shall be exempted from excise taxes:

- 1) excisable goods necessary for the operation of vehicles used for international conveyance of cargoes, baggage and passengers during the transportation process, transit stays, and those acquired abroad for the purpose of emergency repairs in cases of crash (breakage of a vehicle);
- 2) goods having been damaged before crossing the customs border of the Kyrgyz Republic and which therefore cannot be used as goods and materials;
- 3) goods imported as humanitarian assistance in accordance with the procedure determined by the Government of the Kyrgyz Republic;
- 4) goods imported for the purposes of charity by the state, government and international agencies, including technical assistance;
- 5) items confiscated or with no owner, and items claimed as inheritance by the State;
- 6) goods intended for official use by foreign diplomatic and similar representations and personal use of the members of personnel of such representations, including members of their families residing with them, and exempt to the extent required by relevant international agreements to which the Kyrgyz Republic is a party;
- 7) items in transit through the customs border of the Kyrgyz Republic exempted under the Customs regime established by the Customs legislation of the Kyrgyz Republic, other than "Release of goods for free circulation" regime.

Social Insurance Deductions

Table 3.12 Kyrgyz Republic: Social Insurance Deductions, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
State Social Fund receipts (with subsidy)	713	1 314	1 869	2 369	2 584	3 026
% of GDP	5.93%	8.14%	7.99%	7.72%	7.6%	6.3%
Pension fund (without gov. subsidy)	483	905	1 308	1 626	1 866	2 206
% of GDP	4.0%	5.6%	5.6%	5.3%	5.6%	4.6%
Social insurance fund	87	155	202	170	159	191
% of GDP	0.72%	0.96%	0.86%	0.55%	0.46%	0.40%
Employment fund (without gov. subsidy)	28	52	66	86	101	132
% of GDP	0.23%	0.32%	0.28%	0.28%	0.3%	0.27%
Health care insurance fund				41	115	201
% of GDP				0.13%	0.33%	0.41%

Source: Social Fund

The Social Fund of the KR Government collects taxes for four specialized funds (accounts): 1) Pension fund; 2) Social insurance fund; 3) Employment fund; 4) Compulsory Medical insurance fund.

Taxpayers:

Payers are legal entities and physical persons residents and non-residents of the Kyrgyz Republic

Rates of insurance premiums payable to the KR Social fund for 2000.

For employers - enterprises, institutions and organizations regardless of their organization and legal types and type of ownership - 31% of all types of income paid to their employees, each

month, including: 25.5% to Pension fund, 2% to Social insurance fund, 1.5% to Employment fund, 2% to Compulsory healthcare insurance fund.

In addition to that employers shall make contributions to the Employment fund amounting to foreign employee's wages but no less than 10 minimal wages, except for employers, who hire foreigners for a limited period of time for agricultural works, and international organizations, diplomatic representative offices and missions.

For employers - public organizations, whose members are invalids and/or pensioners, - each month from all types of income payable to employed invalids and pensioners – 10.5 %, including: 5% to Pension fund, 2 % to Social insurance fund, 1.5% to Employment fund, 2% to Compulsory health care insurance fund.

For farms insurance premiums tariffs shall be established at 1/4 of the basic land tax rate each quarter, including: 85% to Pension fund, 5% to Social insurance fund, 5% to Employment fund, 5% to Compulsory health care insurance fund.

For individuals engaged in individual business (labor) activity without establishing a legal entity - 38 % of three times minimal wages, further recalculated based on aggregate income received according to the results of a calendar year (indicated in an income declaration), including 32% to Pension fund, 2% to Social insurance fund, 2% to Employment fund, 2% to Compulsory health care insurance fund.

For pensioners and invalids engaged in individual business (labor) activity without establishing a legal entity - each month 13% (for invalids of categories I and II - 11%) of three-times minimal wages, including: 7% to Pension fund, 2% to Social insurance fund, 2% to Employment fund, 2% to Compulsory health care insurance fund.

Individuals engaged in individual business (labor) activity on a patent basis shall pay insurance premiums by purchasing insurance policies according to the procedure prescribed by the KR Government.

For employed citizens - monthly from all types of income assessed to employees regardless of the source - 7 %, including 6.5 % to Pension fund and 0.5% to Employment fund.

For employed invalids of categories I and II - monthly to Pension fund from all types of income assessed to employees regardless of the source - 2 %.

For invalids and pensioners, employed in public organizations - monthly from all types of income assessed to employees regardless of the source – 2.5 %, including: 2% to Pension fund and 0.5% to Employment fund.

Insurance premiums from employees, whose wages are less than three minimal wages established in the KR, shall be paid by their employers - insurers, except for public organizations of invalids and/or pensioners.

Exemptions

Invalids of categories I and II engaged in individual business (labor) activity without establishing a legal entity are exempt from assessment and payment to the Employment fund of the full amount of insurance premiums. All types of payments to employees: i) invalids of categories I and II, ii) hired for jobs newly created during a calendar year, where it is certified by the population employment office shall be also exempt.

Land Tax

Table 3.13 Kyrgyz Republic: Land Tax Collection, 1994-1999

(mln. som)

	1994	1995	1996*	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
Total tax receipts	1 638	2 423	2 968	3 847	4 867	5 973
<i>Land tax, total</i>	58.2	72.9	122.4	269	291	199
% of GDP	0.48%	0.45%	0.52%	0.88%	0.85%	0.41%
% of total tax receipts	3.55%	3.01%	4.12%	6.98%	5.98%	3.33%
<i>Land tax from physical persons</i>	12.8	17.3	16.7	35	20	21
% of GDP	0.11%	0.11%	0.07%	0.11%	0.06%	0.04%
% of total tax receipts	0.78%	0.71%	0.56%	0.91%	0.41%	0.35%
<i>Land tax from legal persons</i>	45.3	55.6	105.6	234	271	178
% of GDP	0.38%	0.34%	0.45%	0.76%	0.79%	0.37%
% of total tax receipts	2.77%	2.29%	3.56%	6.08%	5.57%	2.98%

Source: State Tax Inspectorate

Nature of tax

Objects of taxation are plots of land.

Payers of land tax

Payers of land tax are legal entities or physical persons land users

Tax rates

The amount of land tax with respect to agricultural areas should be determined on the basis of quality (fertility) of soils, location and size of the land lot.

Table 3.14 Kyrgyz Republic: Land Tax Rates, established for 2000

Names of oblasts and rayons	Rates of land tax (soms/hectares)				
	Ploughed irrigated land	Dry-farming land	Perennial plants	Hayfields	Pastures
Kyrgyz Republic (average)	225.0	54.5	114.6	23.9	6.6
Talass oblast (average)	229.7	46.4	109.7	11.0	5.2
Chui oblast (average)	264.4	61.4	132.6	25.3	9.3
Issyk-Kul oblast (average)	227.0	83.0	115.4	23.0	8.1
Naryn oblast (average)	140.3	50.3	-	23.6	4.8
Osh oblast (average)	245.1	44.0	103.7	27.6	8.2
Jalal-Abad oblast (average)	255.6	40.9	137.8	21.8	9.1

Source: State Tax Inspectorate

Basic rates of land tax and payment procedure shall be annually established by the Government of the Kyrgyz Republic and adopted by the Legislative Assembly as a separate law on an approval of the Peoples' Representatives Assembly of the Jogorku Kenesh of the Kyrgyz Republic.

For built-up areas and agricultural areas defined by the Legislative Chamber of the Parliament of the Kyrgyz Republic as high mountainous and remote areas, the tax privilege of 50% of the basic rate of the unified agricultural tax shall be established for a specific area when paying land tax. Regarding lands being on lease, land tax should be paid by the lessor at the rates determined by Code.

Terms of land tax payment

Annual amount of land tax for the right to use agricultural areas should be paid by land users in the amount of 10% - before June 25, in the amount of 35% - before September 25, and in the amount of 55% - before December 25 of the current year.

Exemption from land tax

Tax shall be not charged in respect of:

1) lands used as reservations, natural, national and dendrology parks, botanical and zoological gardens, reserves, nature preserves, objects of historical and cultural significance, non distributed areas of the reserve, areas occupied by the tracing boundary zone of the state, populated built-up areas of general use, areas occupied by protective plantations, of the water and forestry funds, except those provided for agricultural use or other entrepreneurial activity; 2) lands for cemeteries; 3) cattle tracks and cattle stopping places; 4) lands of enterprises, organizations and establishments, financed from the budget; 5) lands of organizations of invalids, participants of the war and persons of a similar status and charitable organizations, and corrective labor institutions of the Government Department of Punishment Execution; 6) lands belonging to the Society of blind and deaf; 7) lands of enterprises, establishments, organizations and individuals, received for agricultural purposes in a run down condition (requiring re-cultivation) for a period set by local authorities (keneshes).

Land tax preferences

The following categories are exempt from payment of land tax for the use of personal plots; gardening plots of the dacha partnerships:

- 1) invalids and participants of the Civil and Great Patriotic Wars, military persons, having participated under international agreements in the wars in Afghanistan and other countries, persons having taken part in eliminating the damages caused by the Chernobyl disaster, invalids from childhood, invalids of Categories I and II and persons having been awarded honorary titles;
- 2) members of the of military persons' families and employees of law enforcement bodies who perished or disappeared while performing their duties (under-age children);
- 3) people of pension age;
- 4) families having 4 and more children under-age.

Road Tax

Table 3.15 Kyrgyz Republic: Road Tax Collection, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
Total Tax Revenue	1 638	2 423	2 968	3 847	4 867	5 973
<i>Road tax</i>	59.9	76.0	77.8	99	128	177
as % of GDP	0.50%	0.47%	0.33%	0.32%	0.37%	0.37%
as % total tax revenue	3.65%	3.14%	2.62%	2.59%	2.63%	2.96%

Source: State Tax Inspectorate

Tax Nature

The tax amount paid is earmarked and assigned to the republican budget. The road tax revenue is used for financing of road construction, road maintenance and repair. It is used for roads of general state importance.

Taxpayers

Road Tax applied to enterprises, associations and organizations, or any other legal entity based on turnover on manufacturing and construction enterprises, and commodity turnover, for warehouses.

Exemptions

The following legal entities are exempt from road tax:
Organizations that are financed by the government budget are exempt from paying road tax, agricultural producers, health resorts, Society of deaf and blind, road construction and repairing companies and so forth.

Extraordinary (Emergency) Situations Fund deduction

Table 3.16 Kyrgyz Republic: Emergency Situations Fund Deduction, 1994-1999

(mln.som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
Total tax revenue	1 638	2 423	2 968	3 847	4 867	5 973
<i>Extraordinary situations fund deduction</i>	103.5	140.0	159.2	202.4	288.5	383
% of GDP	0.86%	0.87%	0.68%	0.66%	0.84%	0.79%
% of Total tax revenue	6.32%	5.78%	5.36%	5.26%	5.93%	6.41%

Source: State Tax Inspectorate

Nature of Tax:

Applied to enterprises associations and organizations as a percentage of turnover.
The Government every year determines assignment and usage of revenue from extraordinary situations fund deductions. In case of excess of revenue over expenses of this fund the by the end of the year cannot be withdrawn and used for other purposes than specified earmarked ones and shall be carried over to the next year.

Taxpayers

Taxpayers are all manufacturing, transportation, construction enterprises and other legal entities except agricultural producers.

Tax rates

Tax rate is equal to 1,5 percent of turnover/sales of goods and rendered services.

Customs Duties

Table 3.17 Kyrgyz Republic: Customs Duties Collection, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
GDP	12 019	16 145	23 400	30 686	34 181	48 321
Total tax revenue	1 638	2 423	2 968	3 847	4 867	5 973
<i>Customs duties collection</i>	46	134	206	245	381	415
% of GDP	0.38%	0.83%	0.88%	0.80%	1.11%	0.86%
% of Total tax revenue	2.78%	5.53%	6.93%	6.37%	7.82%	6.95%

Source: State Tax Inspectorate

Nature of Tax:

Levied on non-excisable goods

Tax Rates: 10 percent flat rate for non-oil goods, 20 percent rate for computers.

Exemptions:

- Goods imported from CIS-countries if produced within the CIS.
- Goods produced by companies located in Free Economic Zones.
- Imports of property for the use of an enterprise with foreign participation according to the Foreign Investment Law.

Other Taxes

Tax from the Owners of Transport Facilities

Table 3.18 Kyrgyz Republic: Transport Facilities Owner Tax, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
<i>Tax from owners of transport facilities, (mln. soms)</i>	1.4	1.4	1.8	3	5	7
% of GDP	0.01%	0.01%	0.01%	0.01%	0.02%	0.01%
% of total tax receipts	0.08%	0.06%	0.06%	0.08%	0.11%	0.11%

Source: State Tax Inspectorate

Taxpayers

Payers of tax from the owners of transport facilities are the citizens of the republic, foreign persons and persons without citizenship in possession of transport facilities.

Tax rates

Tax rates are 9 som per horse power for cars, 5.4 som per horse power for motorcycles and scooters, 15 som per horse power for lorries and buses, 4.5 som per horse power for motor-boats.

Minerals development deduction

Table 3.19 Kyrgyz Republic: Mineral Development Deduction, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
<i>Minerals development deduction</i>	17	22	22	34	23	19
% of GDP	0.14%	0.14%	0.09%	0.11%	0.07 %	0.04 %
% of the Total tax revenue	1.05%	0.92%	0.73%	0.88%	0.47 %	0.33 %

Source: State Tax Inspectorate

Taxpayers

Payers of deduction are all mineral resource users – legal entities.

Tax rates

Rates are established by the government resolution and depend on the sort of mineral excavated and used. Rates of deduction are subject to change by the Government. The current rates are varies from 2% of value of minerals extracted or used. This deduction is earmarked, that

is revenue collected is used for the purposes of geological and mineral explorations, equipment for exploration and so forth.

Tax on Paid Services to the Population and Retail Sales

Table 3.20 Kyrgyz Republic: Tax on Paid Services and Retail Sales, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
<i>Tax on Paid Services to the Population and Retail Sales</i>	53	167	114	83	151	187
% of GDP	0.44%	1.04%	0.49%	0.27%	0.44 %	0.39 %
% of the Total tax revenue	3.23%	6.90%	3.85%	2.16 %	3.10 %	3.12 %

Source: State Tax Inspectorate

Taxpayers

Taxpayers are legal and physical persons.

Tax Rates

At present, the uniform rate established at 2 percent of retail sales turnover and costs of services provided, the tax rate shall be established by local authorities (keneshes) proceeding from the cost of services provided to the population, from retail sales turnover and should not exceed 2 percent.

Health Resort Tax

Table 3. 21 Kyrgyz Republic: Health Resort Tax Collection, 1997-1999

(mln. som)

	1997	1998	1999
<i>Health resort tax</i>	2.743	0.898	0.906
% of GDP	0.01 %	0.00 %	0.00 %
% of the total tax receipts	0.07 %	0.02 %	0.02 %

Source: State Tax Inspectorate

Taxpayers

Payers of health resort tax are physical persons arriving in health resort areas. The Government of the Kyrgyz Republic shall determine the list of health resort areas.

Tax rate

A local authority on whose territory health resorts are situated shall determine the tax rate. The rate cannot exceed 5 % of the minimum monthly wage established by the law for each day of living.

Collection from Owners of Dogs

Table 3.22 Kyrgyz Republic: Collection from Dog Owners, 1997-1999

(mln. som)

	1997	1998	1999
<i>Dog owners tax</i>	0.018	0.060	0.064
% of GDP	0.00%	0.00%	0.00%
% of Total tax revenue	0.00%	0.00%	

Source: State Tax Inspectorate

Taxpayers

Payers of this collection are physical persons keeping dogs in houses of common use. The owner of a guard dog can be exempt on the basis of the necessity of keeping this dog.

Tax Rates

The rate of this collection should not exceed 2 minimum monthly wages per head for a year.

Right to Hold Local Auctions, Lotteries, Competitions and Exhibitions for Commercial Purposes

Table 3.23 Kyrgyz Republic: Right to Hold Local Auctions, Lotteries, etc. 1997-1999

(mln. som)

	1997	1998	1999
<i>Right to hold local auctions, lotteries, competitions, exhibitions</i>	0.986	1.274	1.170
% of GDP	0.00%	0.00%	0.00%
% of Total tax revenue	0.03%	0.03%	0.02%

Source: State Tax Inspectorate

Taxpayers

Collection shall be paid by those who hold (sellers of goods) local auctions and lotteries, competitions and exhibitions held for commercial purposes.

Tax rates

The amount of collection should not exceed 10 percent of the prize fund of commercial competitions and exhibitions, of the amount of disposed goods bidden to the auction, or of the amount of sold lottery tickets.

Tax collected from persons growing flowers in greenhouses and selling them to the population

Table 3.24 Kyrgyz Republic: Flower Tax Receipts, 1997 – 1999

(mln. som)

	1997	1998	1999
Tax collected from persons growing flowers and selling them	0.031	0.068	0.080
% of GDP	-	-	-
% of Total tax revenue	~0%	~0%	~0%

Source: State Tax Inspectorate

Taxpayers

Payers of tax are physical persons growing flowers in greenhouses and selling them to the population.

Tax rate

Tax amount shall be determined by a local legislature, the procedure and date of a tax payment - by the local government.

Parking Fee

Table 3.25 Kyrgyz Republic: Parking Fee Receipts, 1997 – 1999

(mln. som)

	1997	1998	1999
Parking fee	1.357	3.136	3.025
% of GDP	0.0%	0.01%	0.01%
% of Total tax revenue	0.04%	0.06%	0.05%

*Source: State Tax Inspectorate**Taxpayers*

Legal and physical persons parking their cars in places specially equipped or provided for these purposes by local state authorities should pay collection.

Tax Rates

The collection rate shall be established by the decision of rayon or city authorities depending on the extent to which the place is equipped and the duration of parking, but not exceeding 3 percent of the minimum monthly wage.

Tax for the Right to Use Local Symbolism**Table 3.26 Kyrgyz Republic: Right to Use Local Symbolism, 1997-1999**

(mln. som)

	1997	1998	1999
Tax for the Right to Use Local Symbolism	0.001	0.001	0.012
% of GDP	0.00%	0.00%	0.00%
% of Total tax revenue	0.00%	0.00%	0.00%

*Source: State Tax Inspectorate**Taxpayers*

Taxpayers are both legal entities and physical persons producing goods with local symbolism applied. The right to apply local symbolism shall be provided by the local state authority (kenesh).

Tax Rates

The tax rate should not exceed 0.1 percent of the sold goods value.

Collection for Refuse Disposal from the Territory of Built-up Areas.**Table 3.27 Kyrgyz Republic: Collection for Refuse Disposal, 1997-1999**

(mln. som)

	1997	1998	1999
<i>Collection for Refuse Disposal from the Territory of Built-up Areas</i>	2.124	4.915	6.143
% of GDP	0.01%	0.01%	0.01%
% of Total tax revenue	0.06%	0.10%	0.10%

*Source: State Tax Inspectorate**Taxpayers*

Collection payers are both legal and physical persons (owners of buildings).

Tax Rates

Collection rate should be determined by local authorities in towns and rayons, by meetings of the people inhabiting villages and settlements, proceeding from the area allotted to an enterprise and number of those employed at it (for legal persons), the size of a house and number of its inhabitants (for physical persons), but should not exceed 25% of a minimum monthly wage.

Hotel Tax

Table 3.28 Kyrgyz Republic: Hotel Tax Receipts, 1997 – 1999

	(mln. som)		
	1997	1998	1999
Tax on persons staying at hotels		0.657	0.695
% of GDP		-	-
% of Total tax revenue		0.01%	0.01%

Source: State Tax Inspectorate

Taxpayers

Taxpayers are the persons staying at hotels.

Tax rates

Local authorities are in charge of determination of tax rates, however it cannot be in excess of 3 percent of minimum. Lump sum tax that is imposed in the areas where health resort tax is not levied.

Right to hunt and fish

Table 3.29 Kyrgyz Republic: Right to Hunt and Fish, 1997-1999

	(mln. som)		
	1997	1998	1999
<i>Tax on Right to hunt and Fish</i>		0.235	0.240
% of GDP		0.00%	0.00%
% of Total tax revenue		0.00%	0.00%

Source: State Tax Inspectorate

Taxpayers

Payers of tax are physical persons who are engaged in hunting and fishing.

Tax Rate

The tax rate shall be determined by local authorities (keneshes) and should not exceed 30 percent of the minimum monthly wage stipulated by the law. The tax should be paid when getting authorization (permission) from the societies of hunters and fishermen.

Tax Collected from Tourists Leaving for Countries outside the CIS.

Table 3.30 Kyrgyz Republic: Tax on Tourists leaving for non-CIS countries, 1997-1999

	(mln. som)		
	1997	1998	1999
<i>Tax Collected from Tourists Leaving for Countries outside the CIS</i>		0.604	0.318
% of GDP		0.00%	0.00%
% of Total tax revenue		0.01%	0.01%

Source: State Tax Inspectorate

Taxpayers

Payers of tax are physical persons leaving for countries outside the CIS.

Tax Rates

The tax rate shall be established by local keneshes and should not exceed 20 percent of the minimum monthly wage stipulated by the law. Tax should be paid when receiving exit documents.

Taxation of Video Saloons, Public Concerts and Shows

Table 3.31 Kyrgyz Republic: Video Saloon, Public Concerts and Shows Tax, 1994-1999

(mln. som)

	1994	1995	1996	1997	1998	1999
<i>Tax on Video saloons, Public concerts, Shows</i>	0.06	0.01	0.67	0.94	1.32	0.85
% of GDP	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
% of Total tax revenue	0.00%	0.00%	0.02%	0.02%	0.03%	0.01%

Source: State Tax Inspectorate

Taxpayers

Taxpayers are legal and physical persons owning video saloons, holding public concerts and shows at open-air grounds, stadiums and sports palaces, and holding video demonstrations in these places.

Tax Rate

The tax rate shall be established by local authorities depending on the number of seats at open-air grounds, stadiums, and sports palaces, in video saloons.

Tax Paid for Premises or Parts of Premises Not Utilized for Production, Trade and Services

Table 3.32 Kyrgyz Republic: Tax Paid for Premises not Utilized for Production, Trade and Services

(mln. som)

	1997	1998	1999
<i>Tax on premises not utilized for production, trade and services</i>		0.05	0.08
% of GDP		0.00%	0.00%
% of Total tax revenue		0.00%	0.00%

Source: State Tax Inspectorate

Taxpayers

Taxpayers are legal and physical persons.

Tax rate

The tax rates shall be established by local keneshes and may be differentiated proceeding from the location of immovable property, utilities and occupied area but should not exceed 0.4 % of the balance value of premises or part of the premises that are not utilized for production, trade and services.

The Government of the Kyrgyz Republic shall determine the procedure of tax assessment.

Tax amount should be transferred to the appropriate budget each month on or before the 20th day of the month following the reporting one.

3.4 Country Specific Issues

Poverty alleviation challenge

The Kyrgyz Republic, with GDP per capita of \$255 in 1999 is among the poorest countries of the CIS (only Tajikistan, is poorer). As to geographic distribution of poverty, recent survey shows that while the majority of the poor lives in rural areas, the increase in poverty is proportionally higher in urban areas. In 1996, the rural poor made up nearly 59 percent of the total population while in 1998 they accounted for 71 percent; over the same period the urban poor increased from 37 percent to nearly 51 percent. Naryn and Osh regions (there are 6 regions called oblasts in Kyrgyz Republic – Naryn, Osh, Djalal Abad, Talas, Issyk Kul, Chui and recently 7th - Batken oblast has been established by splitting Osh and Djalal Abad; Bishkek, the capital city, has same status as oblasts) remain the poorest regions (85-90 percent poverty rates), while the area around Bishkek experiences the lowest level of poverty (below 30 percent).

A major influence on poverty developments relates both to the labor market and the lack of an adequate social safety net. On the other hand, without significant employment and real wage growth, real incomes will not rise fast enough to lift substantial numbers of population out of poverty. Indeed, the ration of average wages to the guaranteed minimum level of consumption is reported to have declined from 125 percent in 1996 to 95 percent more recently. The government each year, tacking into account the fiscal and economic situation, determines the guaranteed level of consumption to ensure a basic income for needy families or individuals. On the other hand, social assistance is meager, much below subsistence levels.

There are several forms of social assistance, but the unified monthly benefit is one of the most important for poverty alleviation:

- The unified monthly benefit is given to poor families, citizens with children, students, unemployed pensioners, and disabled citizens provided that the average income per capita in their families does not exceed the guaranteed level of consumption. The benefit is determined as the difference between minimum guaranteed level of consumption currently (100 som ~ \$2) and the average aggregate income of the family/citizen, with a maximum benefit of som 100 per month.
- State social benefits are categorical cash benefits payable to orphans, certain groups of invalids, and retirees ineligible for pensions. Social beneficiaries also qualify for housing and utility privileges.
- Privileges are pricing discounts of up to 100 percent for a wide array of goods and services for 11 broad categories of individuals. The central government budget is to reimburse providers, but this is sometimes delayed, partial, or nonexistent. The cost of privileges financed from the budget was about som 180 millions in 1999, about half for energy price discounts.

At present the policy instruments are limited, being severely constrained by the fiscal situation and high external debt service requirements. Poverty reduction will remain one of the most important challenges facing the government in coming years.

To sum up the shortcomings and future tasks the following list can provide basic points:

- 1) Existing programs to cope with poverty are proved to be more like statements without real objectives, goals and actions. There is a need to develop phased goals of short-term and medium term poverty reduction strategy with clear responsibilities of sectors.
- 2) Without substantial actual and potential output growth it would be hardly achievable to alleviate poverty in speed fashion. To pursue such goal the sound macroeconomic and structural policy is of crucial importance.

- 3) A severely limited resource of government is one of the impediments at present and will remain such, unless the reforming of social assistance is considered.
- 4) Transparent and sustainable fiscal program is not in place. Such a program will have to be in place and to be forward-looking, with a view towards increasing low ratio of revenues to GDP.

Ailing Banking System

The Kyrgyz banking system experienced severe difficulties in the second half of 1998 and in 1999 leading to the closure of several of the country's largest financial institutions and a general loss of confidence in the banks. These problems were partly linked to the decline in economic activity and the large depreciation following the Russian crisis, but were deteriorated by inadequacies in banking supervision and the regulatory framework, which did not allow enforcement of appropriate accounting standards and prudential norms. Moreover, weak bank management and interference by shareholders, as well as governance issues played an important role.

History of Banking System prior 1998-1999 crisis

Even before the onset of banking crisis in the second half of 1998, the financial system had been burdened by a number of interrelated problems, mainly stemming from the roots of the Former Soviet Union's system. The market banking system was underdeveloped, with banks offering limited services and the economy at large suffering from low financial intermediation. Banks were generally ineffective at mobilizing savings and allocating credit, and lending remained reared to the short term. With large share of directed lending to loss-making state farms and enterprises, by late 1993 the basic underlying weaknesses in the banking system were becoming increasingly apparent. However, the system's insolvency problem could not be discerned promptly because of non-uniform accounting practices and the weak monitoring capacity of The National Bank of The Kyrgyz Republic (NBKR). After the adoption of regulations in 1995 requiring on-site inspections of all banks and provisioning for doubtful loans, combined with some improvements in bank supervision, the full scale and depth of the problem became evident with one half of all commercial banks showing negative net worth, and over 60 percent of banking sectors loans considered unrecoverable.

At the end of 1995, Government introduced a comprehensive financial sector reform program, supported by the World Bank. Under this program called Financial Sector Adjustment Credit (FINSAC), the authorities liquidated the two out of four biggest insolvent banks and two others were restructured, through private recapitalization. A collection agency, (Debt Restructuring Agency – DEBRA) was established to recover the non-performing loans of these banks and part of the loans was written off. Moreover the significant improvement to the legislative and regulatory framework were introduced, including Banking Law, new Central Bank Law, the Collateral Law, the Bankruptcy Law. A new Chart of Accounts for all banks became mandatory in 1997.

By mid-1998, the above reforms had led to some turn around in financial intermediation and a small core of well-established banks emerged. This was followed by increase in confidence in banking sector as measured by the currency-deposit ratio and the money multiplier. Indicators of financial intermediation, such as broad money and credit to the economy grew by 12 percent and 50 percent, respectively in the six months of 1998.

Nevertheless, a number of weaknesses remained. Bank regulation continued to be insufficient and not strictly enforced. This was not only the result of institutional weaknesses, but also a side effect of the fact that, despite the efforts by the authorities and major technical assistance programs by several donors, financial reporting in the banking sector and even more so in the

non-banking sectors was often opaque and inaccurate. This made it difficult for the NBKR to detect and act upon problem bank signals in time. With regard to the commercial banks themselves, the liberalization of the financial markets increased banks' ability to engage in risky operations, but they continued to face difficulties in the hiring of staff trained in risk assessment, accounting and administration. Not surprisingly, lending continued to be largely short-term and for trade purposes, and at times was often noncommercial.

Factors of crisis

It was against this background, that, in August 1998, the Kyrgyz banking system was hit by the Russian financial crisis. Both directly and indirectly through its effects on the economies of neighboring countries, this crisis negatively affected the Kyrgyz economy. The decline in economic activity led to a worsening in the profitability of banks' customers, particularly large borrowers and state enterprises, and there was a significant increase in the volume of overdue payments in the banking system. A worsening balance of payments combined with the population's reaction to changes in the ruble/dollar exchange rate in Moscow, led to a sharp depreciation of the som, raising banks' foreign liabilities and exposing their balance sheets. As confidence in the currency deteriorated, residents converted part of their som deposits into cash dollars and nonresidents repatriated their deposits, which led to higher borrowing costs for borrowers.

This process continued in 1999 as well, with the public holding more currency than deposits. The ratio of currency to deposits reached 115 percent in 1999, compared with 105 percent in the previous year. At the same time, despite the withdrawals, foreign currency deposits rose relative to domestic currency, and demand for money fell sharply as the crisis worsened. Stocks of government T-bills dried up by more than two-thirds. The NBKR's reserve requirement policy further squeezed the bank's liquidity because reserves had to be kept in soms for both domestic currency as well as foreign currency denominated deposits. Meanwhile, banks' capital eroded because of the increase in the size of the non-performing loan portfolio and also because funding costs rose along with the public's perception that bank deposits were no longer safe investments. One important factor for the increase in the bad loan portfolio was that whereas a sizable portion of the loans had been denominated in foreign currency, most of the borrowers did not have earnings in foreign currency nor did they have the means to cover their foreign exchange risks.

Given the large share of lending denominated in foreign exchange in the banking sector, credit risk associated with the foreign exchange risk exposure of borrowers is important but difficult to assess, because there are no organized markets for hedging against exchange rate risks. Net exposure of commercial banks to foreign exchange risk—as measured by the difference in assets and liabilities denominated in foreign exchange—increased very sharply in the first quarter of 1999. Commercial banks have taken steps to reduce their net exposure, primarily by increasing foreign exchange assets.

Regarding portfolio quality, the ratio of problem loans to total loans also increased sharply in the first quarter of 1999 to reach 36.1 percent.

Another major source of bank instability and the principal cause for the insolvency of some of the banks was the concentration of credit, far in excess of prudential norms, in particular to the petroleum and natural gas sectors. By February 1999, the banking sector had extended credit lines totaling som 800 million, or 40 percent of banking sector loans, to companies involved in the petroleum business against collateral in securities issued by the government to the state oil and gas company, KyrgyzGas Munaizat, which run up substantial losses, partly because subsidies on gas for households were not compensated from the budget, but also due to mismanagement and fraud. Eventually this company went bankrupt and large share of the bank loans probably will not be recovered.

The fact that several banks had not focused on maintaining strong balance sheets, but instead had often based their lending decisions on considerations other than commercial, including under pressure by the powerful vested interests of shareholders, bank management, and state enterprises was only one side of the coin of non-performing loans and their impact on bank solvency. The other side of the insolvency was that the insolvent banks had little incentives to avoid riskier projects, since any losses in excess of the already depleted capital would be borne by depositors and the public sector.

Although the reliability of accounting practices was improved under the FINSAC program the proper classification of bank assets in accordance with established criteria proved very difficult, because of shortcomings in off-site supervision and inordinate delays in on-site examinations. The Bank Supervision Department of the NBKR had limited ability to detect and evaluate problem loans at an early stage and problems were frequently not detected until much later when the on-site examinations were carried out. On-site inspections themselves did not take place on a regular basis, and thus supervisors were not able to enforce the constitution of adequate provisions for non-performing loans.

Governance problems cut across several sectors and played a major role and were not limited to those mentioned above. There were many instances of fraud, connected lending and other violations against the banking laws. Perhaps the most glaring examples were those of shareholders of several problem banks, who through various mechanisms rapidly withdrew funds to leave behind banks with zero or negative capital. At the same time, the weaknesses in the judicial framework made it difficult to enforce the banking laws, even when the banks were willing to take legal action.

On this ground, banking system capital eroded sharply and asset quality deteriorated, despite efforts to address the problems. As of end-1999, eleven licensed commercial banks out of 21 were making losses. Adversely qualified loans (Substandard, Doubtful and Loss) amounted to over 32 percent of total loans, compared with 12 percent at end-1998. These low quality loans represented 70 percent of capital and loan loss provisions, and with the inclusion of "watch" loans, the aggregate of such loans exceeded total bank capital and loss reserves. Loans overdue from individuals and legal entities were awfully high at 37 percent of total loans.

Policy Response

The NBKR's response to the banking crisis has had several dimensions including closing the largest insolvent banks, requiring shareholder capitalization of the remaining problem banks, requiring the banking supervision department to enforce basic prudential regulation more forcefully, strengthening supervision governing commercial banks' classification of non-performing loans and related provisioning requirements, and providing liquidity to the system.

During the 1999 the NBKR placed Kramds Bank and Maksat Bank under conservatorship and repeatedly asked for the recapitalization of the bank by its shareholders, closed Mercury Bank, the largest bank in the country and started liquidation proceedings. In addition, the NBKR restricted the operations of the fourth largest bank, Bishkek Bank and after unsuccessful attempts of shareholders to recapitalize began proceedings for the liquidation. The four large banks mentioned above accounted for about 50 percent of assets of the banking system. Overall, the NBKR extended over som 230 millions in liquidity support to the banking system during 1999.

Notwithstanding the above actions, the absence of an overarching strategy for bank restructuring, together with a lack of a shared understanding between the NBKR and the government in dealing with the banking system problems, have resulted in significant delays in taking appropriate and timely actions. As a result, for most of 1999 confidence in the banking system did not improve. Finally, while prudential regulations for the banking system are in line with international practices, as mentioned earlier, the enforcement has proven difficult.

Further steps

Recognizing the limitations of its earlier approach, the NBKR (with assistance from the IMF) designed a plan that aims to address the banking sector's problems in a more comprehensive way. The main elements of the plan, which has been approved by government, include: (i) the formation of a high level policy committee to supervise bank restructuring; (ii) a shifting of bank resolution and restructuring functions from the NBKR to a separate bank restructuring agency; (iii) identification of supporting legal and institutional arrangements; (iv) a complete assessment of banks; (v) continued progress on strengthening bank supervision and oversight; and (vi) development of clear criteria for liquidating, restructuring, and recapitalizing banks. A timetable has been established to complete these main elements.

Future Challenges

- (i) The difficulties in the banking system in the Kyrgyz Republic in 1998 and 1999 have underscored the weaknesses inherent in moving from a state controlled banking system to a more market orientated one in an environment that did previous not have adequate supervisory and regulatory agencies. They also highlight the importance of continued vigilance and ensuring that supervisors have adequate capacity to monitor banking operators. Furthermore, a proper functioning legal system that allows enforcement of regulation and tackling of governance problem, will be necessary.
- (ii) The NBKR has gained experience in dealing with failed institutions, and there is much greater recognition now that there should be effective and timely intervention whenever a commercial bank has a large build-up of problem loans. But, one of the lessons of the banking crisis is the need to consider the moral hazard problem, created by knowing that banks are such an important part of the payments system and the need to protect depositors. Thus bank rescue packages will have to ensure that heavy penalties, as deterrents to others, are inflicted on those banks that are bailed out.
- (iii) There is considerable pressure in the Kyrgyz Republic to establish a deposit insurance system. At this stage, it will be important to ensure that the banking system is in better shape before starting a deposit scheme and risking depletion of its resources at the outset.

Fiscal Policy Issues

Woeful budget deficits, worrisome public debt level

Table 3.33 Kyrgyz Republic: Government Fiscal Deficits, 1993-1999

	(mln. som)						
	1993	1994	1995	1996	1997	1998	1999
Total revenue and grants	848	2 098	2 702	3 727	4 973	6 151	8 609
as % of GDP	15.8%	20.8%	16.7%	15.9%	16.2%	18.0%	17.8%
Total expenditures	1 226	3 901	5 359	5 922	7 729	9 980	14 803
as % of GDP	22.9%	32.5%	33.2%	25.3%	25.2%	29.2%	30.6%
Surplus(+)/Deficit(-)	-378	-1 662	-2 789	-2 232	-2 763	-3 468	-5 814
as % of GDP	-7.1%	-11.6%	-17.3%	-9.5%	-9.0%	-10.1%	-12.0%
External Financing	50	1 173	1 467	1 620	2 450	3 046	7 084
as % of GDP	1.5%	8.2%	9.1%	6.9%	8.0%	8.9%	14.7%
Domestic Financing	329	489	1 321	613	362	196	-1 267
as % of GDP	6.1%	2.1%	8.6%	2.6%	1.2%	0.6%	-2.6%

Source: National Statistics Committee and Ministry of Finance

Large fiscal deficits were and are one the most anxious problems of government sector. On the ground of rigidity of total expenditure towards decrease (although there was some change in structure of expenditures with increase of capital expenditures and decrease of current expenditure) and with tax exemption of agriculture, which is accounted for the largest 36-38% share of GDP, it is not surprising that for the period from 1994 to 1999 the budget deficit figures were at woeful level of no less 9% percent of GDP. The other proximate reason for existence of such deficits was government's inability and sometimes even reluctance to cut substantially expenditures in view of broad availability of ready funds with very concessional terms from international financial institutions. As seen from the figures of deficit financing, the external loans share for deficit cover was more than 70 percent since 1996. Moreover this figure exceeded 100% for 1999 (because of negative domestic financing).

The Kyrgyz Republic was very successful in borrowing, especially of cheap loans. This mainly can be attributed for the early democratic reforms, and good faith in dealing with international donor community. However, due to the unprecedented speed of borrowing that resulted in some ineffective bilateral nonconcessional loans and large array of concessional ones the external debt by the end of 1999 exceeded 100 percent of GDP. It put very severe strains on fiscal position of the Kyrgyz Republic. The following table shows the profound effect of borrowing.

Table 3.34 Kyrgyz Republic: External Debt Service

(in percent)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
% of GDP	4.5	5.4	5.4	3.4	3.9	3.9	4.4	4.3	4.5
% of fiscal revenue (no grants)	31.3	32.8	30.9	18.7	20.1	20.0	22.4	21.5	22.6
% of current expenditure(+amortiz.)	21.6	27.4	28.6	20.3	22.1	22.3	24.2	23.3	24.8

Source: IMF's projection

The figures do not include IMF loans and loans that were borrowed by state shared joint venture "Kumtor Gold Company". If we add these figures the profile will look sadder. Such projections show that the fiscal position is likely to remain under pressure, with little room for other expenditures, unless revenues can be raised or debt service expenditures reduced.

In such a situation the following steps are of primary goals:

- the reform of public utility sector,
- civil service reform (by some estimates the civil servants are accounted for about 15-20% of employed population), and
- slowdown of public investment program borrowing with simultaneous increase in efficiency of selection of few viable projects of highest priority.

Revenue side issue

On the revenue side, tax revenues have shown an almost continuous decline. Tax revenue fell from 15 percent of GDP in 1993 to less than 12,5 percent in 1999. This ratio is low by international standard and among CIS countries. Indeed, with exception of excises, revenue as a share of GDP was lower for every tax category in 1999 than it had been four years ago, with income taxes generating only little more than half of what they had in 1995. The sum of VAT, income tax, profits tax, excises, and customs duties accounts for the share of no less than 80 percent of total tax revenue for any year since 1993.

In principle, the four major taxes VAT, excise, income and profits, taken together should provide for a simple and transparent tax system.

Table 3. 35 Kyrgyz Republic: Revenue Side, 1993-1999

	(mln. som)						
	1993	1994	1995	1996	1997	1998	1999
Total revenue and grants	848	2 098	2 702	3 727	4 973	6 151	8 609
as % of GDP	15.8%	20.8%	16.7%	15.9%	16.2%	18.0%	17.8%
Tax revenue	796	1 639	2 422	2 968	3 847	4 867	5 973
as % of GDP	14.9%	13.6%	15.0%	12.7%	12.5%	14.2%	12.4%
Of which Income & Profit taxes	303	653	713	669	685	892	1 151
as % of GDP	5.7%	5.4%	4.4%	2.9%	2.2%	2.6%	2.4%
VAT	234	519	705	1 250	1 733	1 967	2 000
as % of GDP	4.4%	4.3%	4.4%	5.3%	5.6%	5.8%	4.1%
Excises and Customs duties	104	218	432	452	696	1 103	1 572
as % of GDP	1.9%	1.8%	2.7%	1.9%	2.3%	3.2%	3.3%
Non-tax revenue	34	103	176	265	805	997	1 491
as % of GDP	0.6%	0.9%	1.1%	1.1%	2.6%	2.9%	3.1%
Capital revenue	1	53	49	293	126	90	149
as % of GDP	0.0%	0.4%	0.3%	1.3%	0.4%	0.3%	0.3%
Grants	0	303	55	201	195	197	996
as % of GDP	0.0%	2.5%	0.3%	0.9%	0.6%	0.6%	2.1%

Source: Ministry of Finance

Indeed by the time of introducing in 1996 the Tax Code was, in an opinion of most experts, proved to be the best one among all other CIS states' tax laws. It was reasonably simple and comprehensive. However, a bit later a bunch of various exemptions eroded tax base specified in Code. Taxes and fees levied through various special legislative acts often impose heavy burdens on specific bases, whereas significant loopholes exist for others. Moreover, compliance costs are high due to lack of consistency in tax policy.

The authorities are in the process of considering a number of measures to improve the tax system and raise revenue collection. First, the authorities have begun to work on the draft of a modernized system for presumptive taxation of small businesses, which will improve the existent patent system. Second, the authorities are considering a switch to the destination principle in trade with Russia, which should increase VAT revenue significantly, since the Kyrgyz Republic is a net importer from Russia. The destination principle is already applied with respect to most countries except for a few in the CIS.

Inclusion of agriculture to the tax base could be very positive as well for state finances, although very difficult to implement politically in view of coming Presidential elections. Elimination of loopholes and lifting exemptions are unavoidable measures if revenue raise and increase fairness and competitiveness.

The Customs Code has proven to be too detailed, complex, and difficult to understand both for the customs administration and the trade community. There are a wide variety of exemptions from customs duties and taxes available to importers. In 1999, the revenue foregone from these exemptions was estimated to be around 50 percent more than the revenue collected. The necessity of Customs Code to be overhauled has become obvious and been recently phased out by government for the nearest 1-2 years.

The lack of supervision and incentives ignites smuggling and fraud. It was estimated that revenue loss due to smuggling of only imported tobacco is about 40 percent. The State Customs Inspectorate (SCI) is faced with complex verification responsibilities, particularly related to the

WTO valuation agreement, rules of origin, and tariff classification. In order to enhance customs revenue by making best use of their scarce resources, the SCI has recently established a small post-release verification and anti-smuggling teams. These teams are expected to enhance revenue and contribute to the modernization of customs administration.

One of the phenomenon emerged is a growing reliance on non-tax revenues. In the face of weakening tax revenues, non-tax revenue almost tripled since 1995, making up over 17 percent of total revenue (including grants). The so-called “special means” – still at zero in 1995 – have become the driving factor behind non-tax revenue. In the face of budget constraints the most of the line ministries and local authorities were and are enticed by having their own revenue source which is not difficult to underreport and very difficult to track. Since special means are guaranteed to at least partially remain within the collector’s own budget, the collection effort is strong and revenue creation comparatively high. However, the ad hoc levying of fees at the national and sub-national level clouds the transparency of the revenue system, and also raises equity concerns as additional fees are usually levied where they can be best enforced regardless of ability-to-pay considerations.

Fiscal Transparency issue

Fiscal transparency is one of the key aspects of good fiscal management and governance, because it requires policy makers to be open about the structure and functions of government, fiscal policy intentions and projections, and the public sector accounts. Fiscal transparency strengthens accountability and can enhance policy credibility, the benefits of which will be reflected in lower borrowing costs and stronger support for sound macroeconomic policies by a well-informed public

At this stage, the Kyrgyz Republic appears to have a somewhat mixed experience in adhering to the principles of transparency. With regard to the roles and responsibilities within government sector, while there is some clarity of roles between different levels of government, there is considerably less of a distinction vis-à-vis the government and the private sector. The government's involvement in the economy is considerable and not well defined. Faced with a lack of revenues at the central level, there has been a proliferation of special means derived from fees and charges that do not adhere to the principle of cost recovery. Further, some public institutions engage in nontransparent quasi-fiscal activities. Although the legal framework for fiscal management is somewhat laid-out, administrative accountability is far behind, and it is acknowledged that taxpayers, for instance, have expressed difficulties in understanding the tax code and administrative practices.

The law on budgetary principles although was designed and enacted in 1998, has become insufficient to ensure early involvement in budgeting process President and parliament; and that is more deficient this law is lack of programmed approach to the budgeting, and makes the efficiency assessment almost impossible (whether budget funds were used effectively and what programs and goals were achieved).

The Kyrgyz fiscal authorities publish fiscal execution information through monthly statistical bulletins, and year-end reports are forwarded to the legislature and the auditor within six months of the year-end (although there is no formal commitment in law to publish fiscal information). Thus, some deal of public information concerning fiscal activity of the government is made available to the public. However, this information is incomplete in a number of respects. The Social Fund, which is significant both in fiscal terms and in its role in social policy, is not included in the budget, although a separate statement of the Fund is provided to the Parliament; information on contingent liabilities is not available; the government's equity participation in private companies is not clearly reported in public statements (although some information on this is provided to a limited extent); and a public statement on the financial assets of the government is lacking.

With regard to the conducting budget preparation, execution and reporting, including policy objectives, assumptions, and identifiable major risks, in an open manner, the budget is formulated on the basis of three-year rolling estimates of revenues and expenditures and there are some general statements made on medium-term priorities. The budget classification system provides information by economic and functional classification and by administrative agency. Even so, important elements of transparency are missing as well, such as a clear statement of assumptions used in formulating the budget, an elaboration of risks, and the difficulty in tracking expenditures at lower levels of government.

Public and independent scrutiny of fiscal information is more or less in place, although there is no legal basis for this to occur. The constitution only requires the Chamber of Accounts (the public auditor) to report to the President and the legislature on the state of the public accounts, but there is no institutional arrangement to ensure that its recommendations are followed.

3.5 Conclusion

The Kyrgyz Republic is undergoing the great challenge of the transition to the market economy. During past nine years since independence the country introduced national currency, established its own tax structure, created two-tier banking system and privatized almost 60 percent of state property. Development of basic market friendly legislative and regulatory framework entailed the emergence of viable private sector. After 1995, the Kyrgyz Republic's economy has shown positive real growth.

The convertibility of currency for current account transactions, liberal trade policy, and active reforms were paid out – the Kyrgyz Republic has, first among CIS countries, gained access to WTO. Despite significant improvements on the macroeconomic, structural and legislative grounds the positive developments are proved to be uneven and fragile. This was revealed in the course of financial crisis spilled over Russia. Although, recovery is taking place the further problems of:

- reducing fiscal deficits/matching revenue with expenditures (through revenue side)
- fiscal transparency improvement
- banking sector enhancement
- overall poverty alleviation

have to be addressed in adequate and timely manner. These tasks are of crucial importance for the bright future of reforms initiated nine years ago.

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