Kyrgyzstan
Country Overview

BASIC FACTS:

Capital: Bishkek
Area: 199,900 square kilometers
Population: 4.9 million (1999)
Currency: Kyrgyz som
Exchange Rate: $1 = 50.48 som (May 2001)
GNP: $ 1.4 billion (1999)
GDP Growth: 0.1% (1989-99); 2.1% (1998); 3.6% (1999)
GNP per capita: $300 (1999)
Inflation: 35.9% (1999)

EXECUTIVE SUMMARY

Kyrgyzstan is a small country emerging from decades of Soviet domination. Since independence, the country has begun a major transition toward a democratic political system and a market economy. The country is ranked as a strong reformer by international financial institutions. Significant achievements include lowering the inflation rate, successfully completing a mass privatization program, and establishing a strong currency that is freely convertible with no controls on capital flows.

Despite these achievements, the transition to a market economy is only partially complete. Property rights and the legal system are still weak. International accounting standards need to be introduced. International donors, including the U.S. Agency for International Development (USAID) are supporting programs to strengthen these areas. The IMF has a program in place supporting macroeconomic stabilization.

Kyrgyzstan remains very poor and most major imports are financed by international donors. Recently approved projects are in the areas of telecommunications, power system rehabilitation, agricultural credit, and road construction. Kyrgyzstan's major imports are fuel, vehicles, and machinery and equipment. Major exports are wool, cotton, mercury, electricity, and meat. Most major foreign investment projects have been in gold mining. Kyrgyzstan has eliminated its export tariff and has a low, uniform tariff of 10% on most goods. In 1997, a national procurement law was enacted, and a National Procurement Agency was established to exercise oversight on public procurement.

ECONOMIC OUTLOOK

The total collapse of the Soviet era economy in Kyrgyzstan helped to consolidate a political consensus that was strongly committed to reforming the economy along the market-oriented line. Kyrgyzstan has been one of the most progressive countries of the former Soviet Union in carrying out market reforms. In recent years, the reform policies began to bear fruit as inflation was brought down, from 88% in 1994 to 10.5% in 1998, the currency stabilized, and economic growth resumed. The mild economic recovery was led by light manufacturing and investment in gold mining. This recovery is threatened by the collapse of the Russian Federation's economy, with the banking sector being hit hard in early 1999 due to large foreign exchange exposure with a heavy domestic lending base. Kyrgyzstan posted inflation of 6.3% in the first five months of 2000. Inflation this year may be less than the 20% predicted in the joint statement of the government and the National Bank. Industrial output in Kyrgyzstan declined at an annual rate of 5.1% from January to April 2000.

The Government has successfully completed a mass privatization program that sold off many industrial and trade enterprises. Former state and collective farms have also been privatized. Under the privatization plan approved by the Council of Ministers, Kyrgyzstan is beginning to privatize sectoral enterprises, including mining, aviation, energy, telecommunications, agricultural enterprises, and publishing.

Government activity is focused on improving economic policies and institutions to promote the growth of the private sector. A new simplified tax code went into effect on July 1, 1996. Other important elements include enacting legal reform, adopting international accounting standards, strengthening property rights and property registration, developing the capital market, improving banking supervision, improving corporate governance, improving access to market information, and instituting an open trade and investment regime. These efforts enabled Kyrgyzstan to join the World Trade Organization in November 1998, becoming the first NIS country to do so.

BUSINESS AND INVESTMENT CLIMATE

The government attitude toward foreign investment is generally favorable, and government officials seek to attract foreign investment. However, sanctity of contracts and other such concepts are developing and not uniformly implemented. Individual investors can become involved in disputes over licensing, registration, enforcement of contracts, and the like, particularly at the middle and lower levels of officialdom. Corruption is a serious problem.

Foreign investors must register their firm as a legal entity with the ministry of justice. In addition to such registration, expatriate employees must obtain a permit to work in Kyrgyzstan from the ministry of labor. Most typically, foreign investors form a joint venture together with a local entity. Although there are seldom overt obstacles to forming a wholly owned foreign venture, the binational joint venture formula has proved the most successful to date.

Kyrgyz law on foreign investments guarantees protection for foreign investors from expropriation, nationalization, and similar actions. It also protects against

bureaucratic delays within the Kyrgyz government structure. However, the laws affecting business in Kyrgyzstan are not absolutely explicit and are not always implemented fairly, consistently, or in concert with their stated aims. Kyrgyz officials and agencies often have wide latitude in interpreting law.

Banking laws do not overtly discriminate against foreign banks, which are afforded the same treatment as Kyrgyz banks. However, the structure of banking regulations tends to place a significant disadvantage on banks that do not meet the National Bank of Kyrgyzstan's requirement for minimum capital. To date, only three foreign banks - the Demir Bank, the Bank of Asia and the National Bank of Pakistan - are registered in Bishkek. Several other banks have majority foreign ownership.

It is widely believed that few proposals for large ventures escape the notice of the President's and Prime Minister's offices, as well as, for American firms, of the Kyrgyz embassy in Washington. Screening at these offices is believed to include such factors as the soundness of the proposing entity and the probable impact on the Kyrgyz economy of the project. Criteria for such screening have not been published.

Investment is sometimes complicated when different competitors feel compelled to negotiate with one and the same parastatal monopoly, placing the monopoly in an apparent conflict of interest vis-a-vis the different external competitors. Also, when a specific privatization scheme is envisaged, such a scheme often engenders debate in the parliament and elsewhere. Kyrgyzstan boasts a generally liberal investment regime. A broad base of effective commercial laws is now in place, although courts are only now coming to terms with this extensive new body of law and the laws are not always implemented fairly or consistently.

POLITICAL CLIMATE

Kyrgyzstan has an elected president who serves 5-year terms and may serve no more than two terms. The members of the parliament also serve 5-year terms. The current president, Askar Akayev, was elected to a second term in December 1995. The office of the presidency is very powerful in that it controls all executive and judicial branch appointments, mostly without parliamentary oversight. There has been an increasing tendency for the presidential apparatus to take over decision making authority from line ministries, further centralizing decision making power.

The foremost issue affecting the business climate is the ability of the government to successfully implement its economic reform program. On the whole, the population is supportive of reform, but vested interests, pervasive corruption, and old ways of conducting business are sometimes problems.

The parliament is a two-house chamber of elected officials whose main task is to draft and approve legislation and to ratify treaties. The current parliament is working productively on a wide variety of draft legislation. Political parties play only a minor role in Kyrgyz politics. The president is not a member of a party, and the majority of parliamentarians are unaffiliated. There are more than a dozen small parties, no one of which plays a decisive role. The largest party is the remnant of the former Communist Party.

In general, Kyrgyzstan is politically stable with a good record on human rights. The country has taken important steps toward achieving democracy, including multi-candidate elections for the presidency and parliamentary seats.

SOURCES OF FINANCING

The banking system is private and is supervised by an independent National Bank of Kyrgyzstan, the central bank responsible for monetary and exchange rate policy, government banking facilities, and relations with foreign central banks. The banking system, which is very weak and severely undercapitalized, has 14 operating banks. Only the former state banks have anything approaching nationwide coverage. Several small, new private banks are well run and are in good financial positions, but their activities are confined mainly to Bishkek. Real interest rates remain high, and long-term credit is unavailable. Most banks make a profit mainly from foreign exchange operations.

There are no foreign exchange controls for either trade or investment. Currencies are freely traded at market prices by several hundred licensed foreign exchange vendors. Short-term finance for trade is available at high interest rates. Most foreign entities do not seek credit in Kyrgyzstan because of its high cost. Export financing is difficult to obtain. Most imports are paid for by cash or cash transfer. Letters of credit are not commonly used. Nearly everything is done on a cash basis in the private sector. The U.S. Export-Import Bank does not finance exports to Kyrgyzstan.

There are numerous sources of project financing. The Overseas Private Investment Corporation (OPIC) is open in Kyrgyzstan. The Central Asian American Enterprise Fund will finance projects through both loans and equity, and is very interested in co-financing with U.S. companies. The European Investment Bank finances private sector projects in Kyrgyzstan by member countries. The EBRD also provides project financing in Kyrgyzstan and the U.S. is a member of EBRD. The Asian Development Bank, the World Bank, and IFC finance projects in Kyrgyzstan, including public projects in agriculture, transport, energy, telecommunications, and education.

TELECOMMUNICATIONS

Recently in Kyrgyzstan a new agency for communication was established, and also the first telecommunication project was implemented which improved the situation for competition and investment opportunities in the Republic. Further projects are planned with the World Bank and other funding institutions.

The Ministry of Communication of the Kyrgyz Republic merged with the Ministry of Transportation and Communication in 1997. Currently, the Department of Communication under the Ministry of Transportation and Communication is the Kyrgyzstani NTIA (National Telecommunications and Information Administration), which develops the telecommunication policy of the Republic. This department operates: KyrgyzTelecom, covering electrical connections; Kyrgyzpochtasy, covering postal services; and also the Republican Industrial Union, covering radio-relay main

lines and TV and Radio Broadcasting. The state commission of the Kyrgyz Republic on radio frequencies is overseeing a new national agency for communications.

On October 15, 1997 the Kyrgyzstani President issued a decree establishing the National Agency for Communications (NAC). The new agency regulates electrical and postal connections, including the radio-frequency spectrum. The major tasks of the agency are as follows: licensing and certifying in the telecommunication sector; supervising the quality of telecommunication services and equipment; protecting free competition in the communication area; developing national communication standards; and coordinating in the area of communications.

KyrgyzTelecom controls a large communication network as the national operator of the Kyrgyz Republic and provides telephone and telegraph services throughout the territory of Kyrgyzstan. Currently KyrgyzTelecom is responsible for laying 184 kilometers (114 miles) of Transasian- European fiber-optic line within Chui Oblast (like state) of Kyrgyzstan for the Shanghai-Frankfurt connection.

Currently KyrgyzTelecom has a monopoly on all international connections. According to the requirement of the World Bank, the company must hold its monopoly position until 2003, when all credit funding must be returned to the World Bank by the company. At the same time, one of the requirements for the Kyrgyz Republic to obtain membership in the World Trade Organization is to de-monopolize KyrgyzTelecom. In this situation, the Kyrgyzstani NAC is responsible for monitoring KyrgyzTelecom to ensure that the company does not exploit its monopoly position. For example, KyrgyzTelecom may not invest its international profits to finance other telecommunication services.

In terms of teledensity, penetration in the Kyrgyz Republic is 7.5 lines per 100 people, just half of the rate of other countries in the region such as Russia, Belarus, and Ukraine. KyrgyzTelecom has an installed capacity of 475,266 lines, but only 365,801 lines are utilized. Just over 72% of lines are installed in urban areas. The majority of the network, however, uses analog rather than digital switches with only 31% of the installed capacity being digital.

In the Kyrgyz Republic there are opportunities for foreign investors to develop telecommunication services. The potential cost to develop adequate telecommunication services in Kyrgyzstan was estimated at US$ 0.5 billion by Kyrgyzstani experts in 1995. The World Bank has agreed to allocate US$ 20 million for another telecommunication project which will provide digital connections for all *rayon* (county) centers and rural areas of Kyrgyzstan. At high level meetings, President Akayev has frequently announced his plan to obtain the first Kyrgyzstani satellite called "silk satellite". The Department of Communication is looking for a grant of US$ 3.6 million to modernize the postal service in Kyrgyzstan.