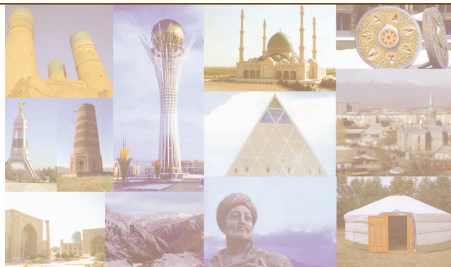


CENTRAL ASIA OBSERVATORY

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The Central Asia Observatory (CAO) was established in 2007 by three institutions that are interested in the area: Casa Asia, CIDOB Foundation and Royal Institute Elcano



CASA ASIA

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KYRGYZSTAN

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Bimonthly article

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Highlights

Major highlights of September - October 2008 include the adoption of the new Tax Code, the hosting of the meeting of CIS Heads of State in Bishkek, the holding of the session of the Interstate Council of the Member Countries of the Eurasian Economic Community (EAEC), the President's annual address to Parliament and the Nation, and country-wide rolling blackouts, affecting both residential and industrial sectors.

September marked the first time in seventeen years of Kyrgyz independence that an intentionally engineered nationwide outage was implemented. The length of the power cut was 6-18 hours per day, depending on the region, and even applied to schools, kindergartens, elderly care institutions and health care centres. The major reasons for the crisis were the critically low level of water in the Toktogul Reservoir, the poor condition of power-generating and power-transmitting facilities (wear of 40-50%), losses of power of up to 45%, and poor management of energy companies. Independent experts have also singled out the following factors: unjustifiably high export of electrical power to neighbouring countries, water discharge during the summer season for irrigation purposes in Uzbekistan and Kazakhstan, and one of the highest levels of corruption in the energy industry. Power outages have adversely affected small and medium business –the backbone of manufacturing and service sectors– and households.

On 2 October 2008, the Kyrgyz Parliament approved the new Tax Code, marking the completion of six years' work by various parliamentary and working groups, ministries, agencies and international donors. This is considered to be a major event, one

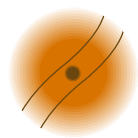
whose ramifications will spread beyond the national economy. The authors of the document and members of Parliament believe that the new tax law will enhance the competitiveness of the national economy and that it marks an important achievement in terms of strengthening the framework of the overall business environment.

President Bakiyev described the 9 October Summit of CIS Heads of State as a turning point in the Commonwealth's history, an event that has injected new life into this organization. The Heads of State discussed future directions for the development of the CIS, common CIS strategy for the period 2009-2020, and water and energy problems. The participants agreed to devote 2009 to solving the energy problems of the member states.

The session of the Interstate Council of the Member Countries of the Eurasian Economic Community (EAEC) took place on 10 October, its primary purpose being to find ways and means of harmonizing the legislation of the member states with a view to expediting the establishment of a common economic space and customs union.

The Annual Presidential Address to Parliament and the Nation was delivered on 17 October at the joint session of Parliament, the Council of Ministers and representatives of civil society. Given the high degree of government centralization and the concentration of power in the President's hands, the Address is a key policy document that provides the country with guidance for the year ahead. This year's Address concentrated on the economy, reflecting the overall course of action that should be followed to roll back political reforms and emphasize economic development. The major sections of this year's Address were the privatization of the national energy

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system (power distribution companies), the introduction of independent management companies in the energy sector and further increases of electricity tariffs, the consolidation of agribusiness into large agricultural corporations, additional measures to improve the business environment, and the establishment of the Public Chamber with a mandate very similar to the Russian counterpart. Internal affairs

Elections to local legislative government bodies (local kenesh elections) took place on 5 October 2008. Even though the latest revision of the Constitution, adopted in December 2007, significantly curtails the rights and authority of local kenesh members, major political party representatives participated in the elections. Regrettably, for the first time in recent years, the Central Election Commission of the Kyrgyz Republic did not grant permission to representatives of the National Democratic Institute and the International Republican Institute to observe the elections. Local NGOs granted observer status documented multiple instances of election laws being violated, and some were even planning to submit their observations to the courts of first instance. Criticism of the elections was supported by the opposition leaders, who labelled the results pre-programmed. Talking to journalists, the head of the CEC described the elections as well executed and the violations as insignificant. Most independent analysts believe that given low voter turnout -especially in the urban districts- the primary outcome of these elections is further debilitating the institution of local government Kyrgyzstan.

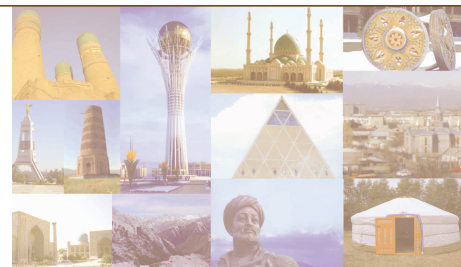
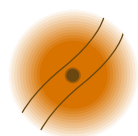
Freedom of information is another issue that is sparking tension. The Central Election Commission, for example, failed to officially release the results of the 2007 parliamentary elections, in direct violation of the law. On October 14, the Kyrgyz Institute of Media Representatives made a statement outlining its belief that as of 2009, Kyrgyzstan may

well start controlling Internet resources. Also worrying was the refusal to issue the head of the Norwegian Helsinki Committee with a Kyrgyz visa.

Foreign and International policy

The overall strategic thrust of Kyrgyzstan's foreign policy is defined as "multi-vector", diversifying partner relations and maintaining equidistance from global powers. The policy is defined as balanced and pragmatic. Kyrgyz Republic defines its major partners as the neighbouring states, Russia, China, United States, European Union, Japan, India and Turkey. Another priority of the nation's foreign policy is to strengthen cooperation with the Commonwealth of Independent States (CIS), the Collective Security Treaty Organization (CSTO), the Eurasian Economic Community (EAEC) and the Shanghai Cooperation Organization (SCO).

In 2008 Kyrgyz Republic chaired the CSTO and CIS meetings, which contributed to forging closer cooperation with member states, primarily Russia. Kyrgyzstan's orientation towards Russian investment and military aid was demonstrated during the 6 September session of the CSTO's Collective Security Council in Moscow and during the 9 October Summit of CIS Heads of State in Bishkek, when Russian President Dmitriy Medvedev visited Kyrgyzstan. Major matters discussed with President Medvedev included regional security, more efficient use of the Russian military base in Kyrgyzstan, training of Kyrgyz officers and Russia's military-technical assistance to Kyrgyzstan. The Kyrgyz government is also interested in attracting Russian investment to the energy sector, namely the construction of the Kambarata-1 and Kambarata-2 hydroelectric power plants. At the conclusion of Medvedev's visit, the parties signed a Kyrgyz-Russian energy cooperation treaty. A more pronounced orientation towards Russia in Kyrgyzstan's foreign policy is related to Russia's new international policy, which now aims to bring former republics of Soviet Central Asia



within its zone of political influence. European Union Assistance.

From the early years of Kyrgyzstan's independence, the European Union has been providing financial and technical assistance to the country. Projects valued at more than EUR 107.95 million have been implemented in the country, most of them being grants donated through the TACIS Programme (Technical Assistance for the Commonwealth of Independent States). Most EU projects were aimed at reforming the public administration and state finance system. In 2007, the TACIS Programme was superseded by the DCI, Development and Cooperation Instrument.

EU support can be explained by the nation's foreign policy, which aims to "promote relations with the European Union, especially with the Federal Republic of Germany, as a leading partner and donor." Priorities also include cooperation with the European Bank for Reconstruction and Development in enterprise development and business environment improvement, and with the Organization for Security and Cooperation in Europe (OSCE) in "the fields of promoting security, addressing environmental issues and promoting sustainable development, respect for human rights and democracy." The EU's new strategy in Central Asia places special emphasis on water and energy-related issues, which are, in fact, the most important for the countries of the region, Kyrgyzstan in particular. System-level problems exist in the region's hydro-energy sector, which is threatening the life-support system of the region's population and having an adverse effect on the business sector. Kyrgyzstan must find a solution to the water-distribution problem with Kazakhstan and, most importantly, with Uzbekistan, and address the matter of its dependence on Russian, Kazakh and Uzbek hydrocarbons.

Speaking at the European Union - Central Asia

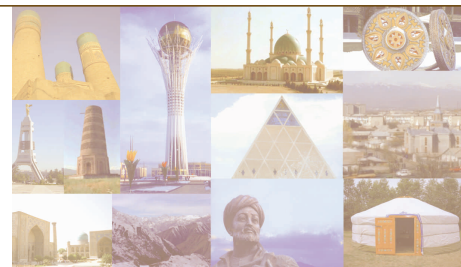
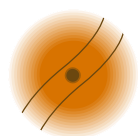
Forum on 19 September 2008, foreign minister Ednan Karabayev stated Kyrgyzstan's position concerning the problem and expressed the country's desire to cooperate with the EU and European businesses in using Kyrgyzstan's water-energy resources. An official delegation of the Inter-Parliamentary Cooperation Commission of the European Parliament visited Bishkek on 27-31 October to discuss opportunities for cooperation between the EU and Kyrgyzstan in a wide range of areas, including human rights.

The participants also discussed the regulatory impact analysis tools used by the European Parliament and opportunities for implementing this experience in the Kyrgyz parliament. Kyrgyz MPs were invited to attend a training seminar in the European Parliament and in November 2008 representatives of all parliamentary parties will visit Strasbourg.

As part of the official visit of the European Parliament delegation, a first meeting within the framework of the Human Rights Dialogue between the Kyrgyz Republic and the European Union took place in Bishkek on 28 October. As part of the Dialogue, the European Union intends to provide the Kyrgyz Republic with analytic data and advice, and share best practices with Kyrgyzstan in the area of human rights.

Economy and business enterprise

The national economy is presently characterized by dwindling economic growth in almost all sectors, as outlined in the October report of the Ministry of Economic Development and Trade. A particular slump is unfolding in the construction industry (explained by lack of operating capital and stricter requirements for borrowing imposed by Kyrgyz banks in the wake of the global financial crisis). The volume of (retail) trade, carriage and industrial output have also decreased, contributing to the overall decline in GDP.



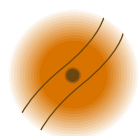
According to official government statistics, inflation in the first nine months of 2008 was 15.6%, although a number of independent analysts put the figure at 22-25%, the highest inflation in the CIS. Price increases affected mostly foodstuffs (wheat, meat, milk, vegetables). On average, producer prices increased by 26.5% in the first nine months of 2008, with wheat prices rising 94% and milk 37.9%. As for industrial products, the highest price increase was registered in the production and distribution of electrical power, natural gas and water, showing a monthly increase of 4.8% over August 2008. Monthly inflation in the services sector in September amounted to 3.7%, with the highest price increase corresponding to educational services, at 21.8%. One of the major elements of the service sector in Kyrgyzstan is transport, where inflation amounted to 48.5% for the year to September.

On 28 October, the National Bank of the Kyrgyz Republic published its forecast of inflation for 2009, putting it at 12-15%, including 15-20% for bread, 20% for electrical power, 20-45% for thermal energy and water-supply, and natural gas, 30-40% of current prices.

As for foreign trade, the volume has increased mostly as a result of trade with CIS countries. Trade with the EU amounts only to 9.6% of the country's foreign trade volume, ranking fourth behind Russia, China and Kazakhstan, but ahead of Uzbekistan and Tajikistan (countries with a common border with Kyrgyzstan). Among the EU states, the Kyrgyz Republic's primary trading partner is the Federal Republic of Germany (a five-fold increase in the volume of Kyrgyz-German trade, fuelled primarily by German imports). Kyrgyz trade with Italy, France and Poland has also increased, but the lion's share of Kyrgyz foreign trade is with the top three countries, amounting to 57.2% of the overall volume: Russia 34%, China 12.5% and Kazakhstan 10.7%. Most Russian and Kazakh imports are processed hydrocarbons.

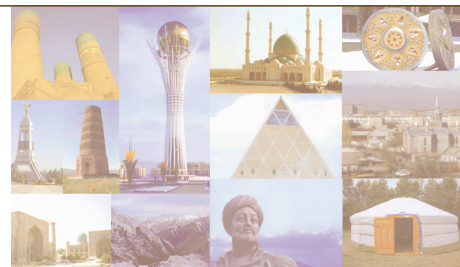
Kyrgyzstan's foreign trade balance for September-October 2008 is still negative, and has grown by 60% compared to the previous year. Kyrgyz Republic aims to be recognized as a "free market economy" in international ratings, to which end it has undertaken significant steps to improve its business environment. The most important step was the adoption of a new Tax Code, which will reduce the number of taxes from 16 to 8 and reduce the value-added tax rate from 20% to 12% as of 2009. The Unified Tax Rate for Small Business will be decreased from 10% to 6%. Two new types of taxes are being introduced - real estate tax and land tax. Taxpayers shall be allowed to e-mail their tax declarations, with no physical presence required for filing tax declarations. The business community has supported the new Tax Code, even though it was critical of the practice of maintaining two types of indirect taxes - value-added tax and retail-sales tax. "No other country in the world does this; countries use either VAT or sales tax. In terms of tax administration, sales tax is much more efficient than VAT, as it is calculated as a simple percentage of revenue, whereas VAT involves subtracting, adding and refunding. VAT is also more prone to fraud", - says Business AKIpress.

Another highlight was the approval of modifications to the Law on Business Rights. The modifications introduce the principle of good-faith and non-interference of government authorities into business operations. Whether the law will improve the situation with protection of investor rights is yet to be seen. Kyrgyzstan presently ranks 102nd among 141 countries in the property rights protection index, with an overall Doing Business rank of 68, 31 places up from last year's rating. Kyrgyzstan ranks 60th in the overall Economic Freedom Rating.



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Country profile

Population - 5.286 million

GDP per capita - KGS 24,900 (USD 691)

GDP growth rate - 5.7%

Inflation rate - 15.6%

Average monthly income, nominal - KGS 1350 (USD 37.5)

Minimum consumer basket (per month per capita)
- KGS 3536 (USD 98.6)

Unemployment level - 11.2%

The opinions expressed here are those of the authors and do not necessarily reflect the positions of the Central Asia Observatory (CAO). The institutions that constitute the CAO are not responsible for the use of these contents.
