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## *Economic Reform Strategy in the Kyrgyz Republic*

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### ***Introduction***

The main goal of the strategy of economic reforms is to build a modern developed state in the Kyrgyz Republic (KR), which is based on democratic society, free economy and strong state power guaranteeing their successful development.

A developed democratic society implies that citizens of this country enjoy all democratic rights and freedoms, including the economic freedom and the right to receive complete information about political, economic, and any other events in the country and abroad. Another factor of a democratic society is social protection of citizens, characterized by a high level of income, education, and life expectancy. Unfortunately, by these factors, Kyrgyzstan is in the category of the poorest countries.

The main objective of a modern developed state is to ensure sustainable economic development. Sustainable economic development means economic growth and human welfare, with conservation of environment and prudent use of natural resources. Society development may be called sustainable if its needs are met without any damage to the needs of future generations.

### ***Economic Policy***

#### Theoretical justification

Since the early 1990s the countries of the former “socialist camp”, including Kyrgyzstan, entered a period of radical reforms in the economy, aimed at creating a new economic system. This period was named “transition” period, which is characterized by complex socio-economic processes that have put the modern economic theory in a very difficult position. Limited capacity of the modern economic theory became apparent. It was not able either to predict or to solve the problems of transitional economies. For example, the inflation forecast in the CIS countries showed thousand times smaller figures than the real ones. Such phenomena as non-payment crisis, huge production decline, corruption and criminalization of society in no way follow from the economic theory, i.e. they were absolutely unexpected.

The experience of transitional countries has shown that the hypothesis on spontaneous development of market behavior and market institutions has failed. And one should remember that the reforms in many transitional countries were carried out in accordance

with the recommendations of world-known experts. Most likely, the failures should be explained not by the level of the experts' professionalism; they lie much deeper.

These and many other facts demonstrate the deepening crisis of economic theory, which had become obvious even before the emergence of transitional economies. The reason for the crisis lies in the fact that currently economic theory, in particular, the economic theory of reforming the countries with transitional economies, has not been developed. Due to the undeveloped economic theory of reforming the countries with transitional economies and existence of a large number of different concepts, we inevitably come to the idea of replacing the principle of unity in theory by the principle of coexistence of competing concepts and their synthesis.

In any case, to select a rational reform strategy we need to demonstrate a balanced attitude to the theory and learn to understand the real capacities of the theory.

The solution lies in the realization of the principle of coexistence and synthesis of competing modern economic concepts, namely: institutionalism, economic liberalism, and Keynesianism. Thus, we are talking about building a mixed economic system. The mixed nature of modern economy, together with the variety of forms of property, is manifested and realized in the fact that market mechanism of self-regulation is complemented by the conscious influence by governmental and public institutions (structures) on certain areas, where the market has failed. In this peculiar "division of functions" each of the regulatory subsystems is responsible for implementing specific functions, according to the criteria of economic and social efficiency.

At present, the Kyrgyz Republic is a typical model of a small country with open economy. And as such, it is exposed to the strong influence of "external" economic factors, an example of which was the negative impact of the Russian economic crisis in 1998, as well as the world financial and economic crisis, which began in 2008.

In this regard, the issues of permanent tracking the global conjuncture and changes in the dynamics and structure of the world economy have become particularly important. There must be a permanent and comprehensive analysis of possible trends in the world development and their impact on the economic development of Kyrgyzstan, as well as the search for the ways to further improve economic and social policies.

Successful economic reforms require a comprehensive approach, implying reforms not only in economic but also political and social subsystems. Realization of an adopted integrated approach is possible only through active institutional reforms. "Institution" is defined as a set of rules and regulations, as well as the mechanism of their implementation, through which interactive relations between people and organizations are structured and simplified. Or, in other words, institutions are formal and informal constraints, developed by people, as well as the factors of coercion. Formal institutions include laws and constitutions, and informal ones include contracts and voluntarily adopted codes of behavior.

### ***Implementation of Economic Policies***

#### **Building a free economy**

The results of Kyrgyzstan's economic development during the independence period are not comforting and show that the economy of Kyrgyzstan is in a deep crisis. For example, the GDP level in 2007 was only 85 percent of its level in 1990, the last year of

stable development of the country. In addition, according to different estimates, from 25 to 50 percent of the economy is in “shadow”. Chronic unemployment and its high level also confirm the crisis state of the economy. The real unemployment rate in Kyrgyzstan with account of approximately 500 thousand labor migrants is 35 percent.

And even working people often cannot meet such basic needs as food, clothing, and services because of low wages and are among the poor (the poverty level in 2005 was 40 percent).

Unfortunately, the economy growth fell sharply in 2005-2006 compared to previous periods.

GDP growth rate in 2006 amounted to only 2.7 percent, while in 2005 the economic growth was not observed at all. Against this background, the GDP growth of 8.2 percent in 2007 and 7.9 percent in 2008 do not bring much optimism, taking into account that the economic growth in those years was accompanied by more than 20 percent of inflation.

Our country, to keep pace in its economic development with neighboring countries and trends in the world development, has to ensure economic growth of at least 8-10 percent annually. But the current state of political system, society, and economy in Kyrgyzstan makes it impossible. Decisive actions are required.

More than two hundred years ago, prominent economists substantiated that economic freedom is a foundation for any country's prosperity. They named the major components of the freedom of economic activity: good laws, reasonable taxes and peace.

Indeed, the world experience has shown that economic freedom is a determinant of economic growth and plays an important role in the global economy. Quantitative characteristics to measure the level of economic freedom in a given country have already been developed – economic freedom indices.

And it has already been proved that with the growth of the economic freedom index, population incomes grow as well, and the rates of their growth increase, regardless of the level of initial wealth.

In addition, the countries, where the index of economic freedom increased most, achieved the highest economy growth. The significant increase in the level of economic freedom in several countries in the past few decades has created an outstanding example of rapid economy growth. These examples include the economic success of postwar Germany and Japan, successful development of the “Asian tigers”, the impressive results of the development in China for more than 20 years and a number of other well-known examples. Liberal economic policies resulted in economic growth, improvement of the living standard, and reducing social tensions.

The Kyrgyz Republic is no exception, and a similar link between the index of economic freedom and economic growth exists here, too. However, the results are much lower than those of the countries, which have comparable figures of the economic freedom index, i.e. despite the implementation of basic market principles in the Republic, we are still very far from creating a real free economy.

Thus a well-expected question arises. Is it enough for us to make appropriate changes in legislation, aimed at increasing the index of economic freedom, to reach the desired economic effect?

The answer is obvious. No.

The problem is that in many cases we have not reached the desired extent of economic

freedom for our citizens, which is demonstrated on legislative level, because the adopted laws are not always implemented in the Republic. The analysis has shown that, indeed, the main factors in the further growth of the index of economic freedom are:

- growth of the rule of law index.
- increased level of protection of private property rights, including reduction of the risk of property confiscation and the risk of breach of contract.

Obviously, the lack or low level of legal protection of the private property rights, the arbitrariness of governmental officials, and the impunity for unlawful interference with business are the strongest restrictions of economic freedom, the freedom of an owner to conduct business within the legal framework, focusing only on the requirements of the market and the society.

Today, we can say that market economy in Kyrgyzstan already exists. However, the results of the functioning of our economy leave much to be desired, although we used to be ahead of other CIS countries in the pace of economic reforms. The reason for this was that market reforms were not accompanied by appropriate institutional changes that would ensure realization of the advantages of the innovations. On the contrary, this “gap” was a favorable environment for the well-known negative effects (corruption, crime and shadow economy), impeding economic development and causing mistrust of the reforms among certain parts of the population. Corruption, shadow economy, and crime, in the country reached the level, threatening national integrity and security of the country.

### ***Institutional Reforms. Strong State Power***

The institutional theory has already formulated the basic principle of the struggle with the above-mentioned ugly phenomena in our lives: the cost of laws implementation should be less than the cost of their non-implementation. And the more this difference is, the more successful the struggle will be. This fundamental principle should be born in mind both when reforming the state power and the economy, for example, in bringing the shadow economy out into “light”.

There had been an opinion in the Republic during the first years of independence that in order to build a market-based economy it was enough to destroy the control mechanism of the administrative-planning system, to actively liberalize the economy, and privatize most of the state-owned enterprises. The actual process of transition has proven to be much more difficult. Having quickly and successfully “destroyed” the old institutions, we were unable to quickly (in accordance with the pace of liberalization) establish the basis of market economy – diversity of institutions that would ensure the functioning of free economy. This is natural, because such institutions cannot be created quickly; especially the so-called informal institutions usually change very slowly.

Informal institutions are commonly understood as generally accepted stereotypes and standards of conduct, rooted in individual and mass consciousness. Informal institutions determine the character of actions taken by citizens, companies, organizations, and governmental institutions.

Under changing conditions in the society, informal norms and standards are changing gradually, as more favorable models of behavior for organizations and individuals are established. Thus, we need new progressive models of human behavior. But it is well known

that such behavior models emerge and are introduced in a society slowly; this process takes many years. Due to various objective and subjective reasons, this is particularly true for our country.

Since the institutions ensuring successful economic development are not established yet, the role of the state becomes more important. The lack of a well-developed state policy has led to the fact that the vacuum of market institutions is filled with pseudo-market structures, substituting for the functions of governmental bodies, i.e. in simple words, there is the process of liberalization of the state and privatization of its main functions. This is precisely what has happened in our country.

We must recognize that the privatization of state power took place in Kyrgyzstan, which is the main cause of failure of all the reforms. The main characteristic of the privatization of the state power system is the fact that it has become a common practice to buy and sell public offices. This applies to all branches of state power and public sector (health, education, etc.). What can we expect from such “public servants”? Of course, they mostly care about their personal enrichment rather than about improving the welfare of the people. Hence, it is clear why the main economic reforms, such as privatization of the state property, are implemented so terribly. So far, this privatization was carried out in such a way that, even at dumping prices, only those people, who had direct or indirect access to budgetary resources and foreign credits, or those, who managed to quickly fill their pockets by very suspicious methods, could buy state enterprises. This is how the typical figure of owner was formed, the main characteristic of which is not a productive, but a rent-oriented behavior, willingness to share the profits with officials and politicians, but not with the state treasury.

Now even Western economists recognize, and the experience of many countries has proven that private property is not always more efficient than state property. It is also true for the Kyrgyz Republic. For creation of market, competition is more important than privatization, that’s why the former must grow faster and thus provide conditions for the latter. Otherwise, privatization creates monopolistic structures, which close the road to competitive market.

Existence of state property or state ownership of the managing stock of enterprises’ shares, particularly in strategic industries of the economy, is necessary, and it requires changes in the policy of redistribution of the remaining state property in Kyrgyzstan. Today when most of the state property in our country has been privatized, and now it is time to privatize strategic sites, it is not the speed, with which privatization will be conducted, that is important, but its results. For this, we must first define the goals and objectives for further privatization and establish an institutional framework for their achievement, i.e. a set of reliable existing laws and regulations.

Only a strong state power may provide this. The question is how to create it?

We should begin with the nationalization of state power. If there is a need to nationalize something in our country, in the first place it should be the system of state power.

The essence of institutional reforms should be in strengthening the state power so that it could develop and strictly observe (first of all, itself) the most favorable “rules” for the functioning of the country’s economy, i.e. such a strong state must be a guarantor of economic freedom. The “strength” of the state should not be in intervention in the economy but in the creation and compliance by all with the conditions for functioning of free economy in the country. Such a strong state power should restore respect for the law, lost by the people

during the years of independence, respect for public bodies, and, most importantly, provide appropriate education for young people. This is hard work, because currently our young people demonstrate absolute legal nihilism. The effect will only be when the penalty for legal non-observance is inevitable for all offenders, not only for those “who are not with us.”

The country needs order. Order must be at all levels of power and society. Not “Stalin” order but the order based on the rule of law. Unfortunately, in Kyrgyzstan there is a wrong understanding of freedom as permissiveness. This should be immediately changed. All human democratic rights and freedoms must be exercised within the framework of adopted laws. Despite the apparent contrast, the terms of freedom and order are interconnected, or, more precisely, mutually dependent. Freedom of a person cannot be limitless, because in this case it would limit the freedom of another person.

Everyone in his activities should follow the “rules of the game” that exist in this society, which means that there is order in the country. And the more stable the order is in the country, the more fully the rights and freedoms of all people will be realized. That is, order is a prerequisite for realization of human rights and freedoms. Another point is that a strong state power should expand these legislative frames, as the market institutions are established, and new models of human behavior are formed and consolidated.

For the emergence and consolidation of new progressive behavior models, the role of top leadership is particularly important. The mentality of people is that they look at their leaders and their behavior models. For many people these behavior models serve as models for their own behavior, i.e. people simply copy them. Thus, new progressive models of the country’s top leaders’ behavior are decisive factors for the success of reforms. Probably, success of many “Asian tigers” was largely due to behavior models, demonstrated by paternalist leaders of these countries.

The success in bringing order to the country greatly depends on how the public servants themselves comply with laws. All people without any exception should observe laws. The principle “me, my family, and my environment can break the law, while the others cannot,” by which some leaders are guided, is deeply flawed and immoral, as its implementation begets the “second wave” of corruption, which destroys our society. It is clear that the fight against corruption in such conditions becomes meaningless.

Strong state power has another very important task ensuring participation of all citizens in economic processes. Otherwise, the market economy will benefit only a small part of the population, which, of course, causes disappointment about the ideas of market among the rest part of the population. This is the main reason behind capitalism failure in many developing countries.

Kyrgyzstan, with its small but well-educated population, has every chance to develop capitalism for all. Particular attention should be paid to the development of villages and small towns.

Thus, we have come to the conclusion that in transitional period the role of the state should be strengthened. I am talking about reforming all branches of state power.

### ***The Choice of Political System in Kyrgyzstan. Administrative Reform***

It should be noted that it is difficult to make the correct choice of political system for a transitional country in economic crisis, where social protest events happen quite often. The most

reasonable thing to do is turn to the world experience, which suggests that the choice should be made between a mixed and a parliamentary systems. And if there are several (more than two) dominant political parties, a mixed form of state power is preferable, where, under certain circumstances, the President has the right to dissolve the Parliament, and the Parliament has the right to dismiss the Government and impeach the President. When forming governmental bodies, it is necessary to abandon the principle “the winner takes it all” and adhere to the model of communal democracy, that is, when all major political parties are involved in government (for example, those winning more than 10 percent of the vote). Of course, a decisive role is played by the ruling political party, winning most votes, the program of which will be implemented. Naturally, this party will assume full responsibility for the success of the reforms.

As a small country, we cannot afford to have a large state apparatus. We must have a compact and efficient system of governmental bodies.

Numerous attempts to optimize the structure of governmental bodies and the number of public servants have not yielded positive results. On the contrary, there is a tendency to increase the number of public servants. And this is understandable. Under the current system, even with large number of workers, a head of a state body is not interested in reducing the personnel, as it makes no sense: wages remain the same while the amount of work per employee increases. It is therefore necessary to increase the rights of governmental bodies to distribute their budgets according to their own discretion. We know that in developed countries not only the budgets of governmental bodies, but also of their units (departments, divisions, sections), are specially planned. That is, employees of governmental bodies also may participate in the planning and using the budget. It promotes transparency in the system and significantly reduces possible abuse of the budget.

Also, it is very important to introduce program budgeting of governmental bodies when the budget is formed for several years in order to achieve certain policy goals, and state bodies should be granted greater autonomy for optimal use of budgetary funds. What can be done immediately is to cancel restrictions on the number of personnel in a governmental body and on material rewards for their effective work within the payroll.

All these measures will serve as an incentive to optimize the structure of governmental bodies and the number of governmental employees.

The improved work with personnel, without any doubt, is an important part of the activities, aimed at creation of a strong state power. It is necessary to develop and establish a system of training and education of civil servants and their promotion. This system should make the public service prestigious, that is, a civil servant must have a high status in our society, and the living standard of a civil servant and his family should be high as well. However, today's situation in our country is very far from that.

Unfortunately, consciously or unconsciously, Lenin's slogan “the salary of a public servant should be the same as that of an average worker” was introduced in the Kyrgyz Republic, though it is well known that even the Bolsheviks themselves refused from it.

As a result, even a member of the Government or a public official holding the same position cannot, for example, buy a car or an apartment, build a house, spend holiday abroad, pay for education of their children in private schools or universities on a formally established salary. It is clear that in this respect the principle of “the cost of laws implementation should be less than the cost of their non-implementation” has been ignored. As a result, public servants are often guided by their personal interests not less than national interests.

Therefore, a decisive criterion for the successful human resources policy is comparable wages and benefits for public servants and employees of private firms. Of course, I am not talking about the income of managers of large companies and transnational corporations.

The system of benefits for civil servants should be set up in such a way that they could be used not only as a reward for good work in a governmental body, but also it should have a cumulative character. That is, a conscientious civil servant should lack nothing during the period of his service in the Government, and also, which may be more important, he should have the assurance that he will have solid benefits and a decent pension in old age.

Only implementation of these measures will attract highly competent specialists to the bodies of state power and will stop the “brain drain” into commercial and other non-governmental structures and abroad.

On the other hand, the requirements for civil servants should become tougher, and corruption among them should be uncompromisingly punished. Only through realization of the above-mentioned measures, it is possible to achieve greater gap between law compliance and law noncompliance, which in its turn will reduce corruption in the country.

Establishment of an effective system of governmental bodies would not only save the state budget but also transform the culture of public servants from following narrow departmental interests to following wide national interests. For this purpose it is necessary to consolidate and simplify the state apparatus, enlarge agencies and remove the departments of double competence. For example, in France only one Ministry was responsible for the development of the economy – the Ministry of Economics, Finance and Industry. In our country, it would be useful in the initial period to entrust two ministries with the issues of economic development: Ministry of Economics and Finance and Ministry of Agriculture. The tasks of the state industrial policies and development of other sectors of the economy could be solved by public concerns and agencies, coordinated by the Ministry of Economy and Finance.

Creating an effective compact system of state power requires reforming the administrative and territorial division of the country and local governments. In doing so, it is necessary to take into account the principle “I govern what I am able to control.”

There are different versions of the administrative-territorial division of the country, but one thing is clear that in the short term we need to adopt a three-tier system, and in the long term, perhaps, a two-tier system. It is necessary to introduce an elective system of regional and local authorities, while preserving some supervisory functions of central authorities with a view that, in general, the state power is strong, i.e. there will be no vices that are thriving today. But the main control functions will be carried out by local and regional keneshes (councils), as well as by civil society. Thus, it is the realization of the general strategy of decentralization – moving the power down to the levels, where it is possible to use local institutions (companies, associations, trade unions, local authorities), to protect their own interests and distribute their own resources. Implementation of the decentralization strategy, contributing to the rapprochement of the people and the Government, certainly would help to reduce poverty in the country.

### ***Economic Development***

#### The real sector of the economy

Development of the productive sector is the most important factor of economic growth. The analysis has shown that the growth of agricultural production at 1 percent ensures the



growth of GDP at 0.4 percent, and the growth of industrial production at 0.13 percent. In addition, a large proportion of the employed population is concentrated in these sectors of economy. Therefore, development of these sectors could lead to employment growth and, respectively, reduce poverty.

The current energy and food crisis has demonstrated once again the urgent need for energy and food security of the country. Solving this problem requires a system of centralized management of those sectors of the economy. Gradually, when energy and food markets will be based on perfect competition and have a balanced position, the State will again delegate certain functions to the free market.

### ***Industry***

The success in bringing order to the country greatly depends on how the public servants themselves comply with laws. All people without any exception should observe laws. The principle “me, my family, and my environment can break the law, while the others cannot,” by which some leaders are guided, is deeply flawed and immoral, as its implementation begets the “second wave” of corruption, which destroys our society. It is clear that the fight against corruption in such conditions becomes meaningless.

Strong state power has another very important task ensuring participation of all citizens in economic processes.

Of course, in the industrial sector of the economy we may, as they say, “pounce” to well-known sources of growth, i.e. to develop the explored reserves of gold and other metals. But the question is whether it will benefit present and especially future generations of people in Kyrgyzstan. There is a danger that today’s generation will not benefit from it, while future generations will face enormous environmental problems. Indeed, we have had such a negative experience in abundance.

To meet the challenges of mining, it is necessary to form working and expert groups, within the framework of which representatives of governmental agencies, companies, legislators and representatives of scientific and technical departments could exchange views, making out the rational kernel, which can form the basis for the purposes of development and utilization of mineral deposits of the country.

This should be an individual approach, based on the analysis of the “benefits – costs” model, and this analysis should cover a long-term perspective, taking into account environmental impacts. In case of a positive solution, it is necessary to use modern environmentally friendly technologies, as well as establish a fund of “future generations” to cover the costs of implementation of the decisions of the current generation. To do this, we should revise the business taxation issues, in this case, the resource rent extraction.

A more promising natural resource for our country is clean water. As you know, today the price of one liter of clean water is almost the same as the price of one liter of gasoline, and it is quite clear that the shortage of clean water will become (if has not already become) a number one problem in the world.

Huge stocks of clean water is our strategic resource, and we must now solve the issues of its storage, use and export, using the achievements of modern science. It is necessary to resolve with our neighbors the issues of water use of the rivers, running through the territory of our states, taking into account the world experience in such issues. To comprehensively

solve the above-mentioned problems, it is necessary to establish, perhaps, in cooperation with international organizations and donor countries, a large research-scientific center for water and energy problems.

But we must also understand that the economy should be diversified, we cannot concentrate only on the production and use of natural resources. We need to develop production of wide range of export-oriented and import substituting goods.

Currently, there are two development trends in the industrial sector. The first trend, thanks to foreign investments and use of the latest technology, current products have become competitive and exportable. Unfortunately, the number of working enterprises is extremely low. The second trend is that production of low competitive products have accumulated in warehouses of different enterprises and remain unsold. As of January 1, 2008, the unsold goods have a total worth of over 3 billion soms. It is therefore necessary to solve the task of achieving sustainable growth of industrial production, and there are three possible strategies: "restoration growth", "catching up growth", and "breakthrough".

Restoration growth implies a high level of industrial production by loading of existing industrial capacities and previously trained workforce.

Two options for implementing the strategy of catching up development are possible. First, when the achievements of the leading countries are adapted to the reality of the country concerned.

By doing this, only one goal may be achieved: not to increase the gap. Of course, such a strategy of catching up development cannot be the main in our Republic. The second option implies not only adapting the achievements of the leading countries, but also searching for and finding new ways (institutions, mechanisms), which are unknown in more developed countries. This catching up development strategy enabled many countries, such as Japan, not only to reduce the gap, but also to become leaders in the development of their own industrial sector. All the above-described approaches should be used. In the short and medium-run, the strategy of restoration and catching up growth (the first option) should be used, while in the long-run, the priority should be given to the second option of the strategy of catching up growth, which ensures a "breakthrough" and achievement of the best results in the industrial sector development of the economy.

Active innovation policy could become the decisive factor. Unfortunately, analytical research of enterprises in the Republic has shown that most of the industrial sector enterprises do not pay due attention to innovation technologies.

In order to achieve profitability and increase the population solvency, it is necessary to develop and implement the updated state innovation program, providing for measures to enhance the innovation activities of enterprises. Moreover, these programs must provide for real preferences for enterprises, engaged in innovation activities. Also, the state must support, especially financially, research, development and engineering projects, as well as identify the priorities for their development.

### ***Agriculture***

The strategic goal of agricultural reforms is to achieve high profitability of agricultural production. The work of light, food and processing industry is largely dependent on the situation in agriculture. The global trend of sharp increase in the prices of agricultural products,

which was called “agflation”, actually opens a new opportunity for accelerated development of the agricultural sector of the economy. Our country has all chances not only to ensure its own population with food, but also to become an exporter of clean agricultural products.

Thus, our agricultural sector faces major challenges, meeting which will not only promote economic growth but also reduce poverty. We should primarily continue to support peasants and farmers to further increase agricultural production in the Republic.

Among the immediate measures there are:

- restoration of destroyed and construction of new irrigation systems throughout the country, which will allow to use about 100 thousand hectares of additional agricultural land;
- teaching methods of advanced agricultural techniques to as many farmers as possible, in order to preserve soil fertility and to obtain high yields, introduction of scientific schemes of crop rotation, effective use of mineral and organic fertilizers;
- further development of the micro-credit system, so that every needy farmer could have an access to loans for agricultural production;
- reaching a higher level of the seed production, especially the breeding of new high-yielding seeds of cereals, maize, potatoes, sugar beet, oilseeds, etc.;
- ensuring uninterrupted supply of quality seeds, fertilizers, fuel and lubricants;
- machines, equipment for mini-workshops on processing of agricultural products;
- organization of the veterinary service, restoration and creation of new breeding farms.
- building an advanced system for the implementation, processing and export of agricultural products, grown by our peasants. Unfortunately, recent experience has shown that the work, done in this direction, has been inefficient, and almost every year our farmers cannot sell or export their surplus production.

This is an incomplete list of works to be done without any delay.

### ***Service Sector***

Services is the most successfully developing sector in the economy of Kyrgyzstan. In fact, over the past twenty years, Kyrgyzstan from an industrial and agricultural country has turned into a service republic. Trade has been developing especially rapidly. The most pressing problem is the development of tourism.

### ***Tourism***

Development of tourism can become one of the main sources of the population’s income growth and reduction of poverty in the country. Currently, tourism constitutes only about 4 percent of the GDP, but the potential for its development is huge. Promising areas of tourism development in our country are:

- recreation tourism;
- up-market tourism;
- congress and business tourism;
- exotic and ethnic tourism.

But even here there is a danger of exploitation of the nature of our beautiful country without complying with the measures for environment protection. Kyrgyzstan, as a small country, cannot afford to choose the extensive way of tourism development, as a priority.

For example, it has been known since the Soviet times that the Issyk-Kul region by its physical characteristics cannot accept more than one million tourists per season without damaging the environment. Recent victorious reports on the tourist flow amounting to one and a half million people speak only about the indifference of the state authorities towards the environmental problem. We must develop organized tourism, which may be done, for example, within the framework of EurAsEC or EU programs of tourism promotion.

### ***Development of Entrepreneurship. Investment***

A priority task for employment and combating poverty in our country is the development of small and medium-sized entrepreneurship.

On the other hand, due to the known advantages, this category of enterprises is very beneficial to Kyrgyzstan as a small country with open economy. Kyrgyzstan is exposed to strong influence of “outside” economic factors, as we could see on the example of the strong negative impact of the economic crisis in Russia in 1998. The experience of Southeast Asia has shown that countries, the economies of which were more based on small and medium-sized enterprises, were subjected to less risk during the financial crisis of 1997-1998, and it was easier for them to find the way out of that crisis than for those, whose economies were mostly based on large companies.

Even today small and medium-sized business constitute about a half of production of the gross domestic product of the country. However, there are a lot of problems requiring immediate actions. Today, it is particularly important to develop the laws on governmental support for small business and on a simplified system of taxation, accounting and reporting for small enterprises.

For small and medium-sized enterprises it is necessary to establish more liberal rates of annual (or monthly) tax amounts depending on the kind of activity. If, by doing so, really effective tax rates are determined, then, as the experience of Russia has shown, it will lead both to increased tax payments and reduction of the load on small and medium-sized business and, consequently, to creation of real conditions for its intensive development.

One of the major limiting factors in the development of small and medium business, besides taxation, is the lack of financial resources among entrepreneurs. To address this problem, we must reform the banking system and improve investment policy.

Calculations have shown that population’s money in Kyrgyzstan constitute more than 30 billion som. It is a huge resource for investment in the economy. But the problem is that people don’t trust our banking system. And this distrust, unfortunately, is justified. Many bankruptcies of commercial banks, due to which the depositors were left without their savings, serve as a proof of it.

Now, we have to correct the mistakes made in the banking system. First of all, it is necessary to ensure the protection of deposits. This can be achieved in different ways, for example, through the creation of a special insurance fund. But the most important is to exclude artificial bankruptcy of banks. This can be achieved through stricter control over commercial banks by the National Bank of the Kyrgyz Republic. Naturally, the accountability of managers for the results of activities of commercial banks should be increased.

A promising direction in modern Kyrgyzstan is the activities of credit unions. Accumulating the money of people and using the benefits from the state and international

organizations, credit unions can transfer them, bypassing intermediaries and thus reducing the costs and increasing money efficiency, for the development of small and even very small businesses.

Another source of funding for the development of small and medium businesses are non-state pension funds, which, in addition to accumulation of workers' savings, act also as a source of investment for businesses. The level of capitalization of citizens' contributions is raised when there is an opportunity to inherit pension contributions, as well as to early withdraw them.

It is necessary, taking into account the experience of other countries, to create all necessary conditions and provide governmental support for the development of private pension funds. The dynamics of demographic processes in the Republic shows that the load on the working population is growing, and will keep on growing. Increased pressure on the country's budget could be reduced by development of private pension funds and the development of a mixed pension system.

The model of investment activities, prevailing in the Kyrgyz Republic, is imperfect. Neither the stock market (there is only one Stock Exchange in the Republic), nor the banking system perform their functions of accumulating domestic savings and their transformation into investment. The bulk of the capital investments are made at the expense of foreign investment (loans, direct investment, technical assistance and grants) and the financial resources of enterprises themselves.

Sustainable development of Kyrgyzstan's economy is heavily dependent on the effective use of foreign economic assistance, provided by international financial institutions and donor countries. We believe that in our external borrowing policy we should attract credit and loans only on favorable terms, government guarantees should be provided only for nationally significant projects, grant funds should be used for technical assistance. In recent years there has been a trend when the Government stopped providing guarantees to obtain foreign credits. Priority has been given to attracting foreign direct investment, which is absolutely correct, because the debt of our country is quite an impressive sum, comparable with the GDP.

But it seems that a strong state power, if necessary, should assume responsibility for attracting favorable foreign loans to achieve a breakthrough in any sector of the economy.

In accordance with the main principles of the investment policy, credits should be directed primarily at the rapid development of industrial and social infrastructure, without which the dynamic growth of the economy is impossible.

Among important areas of public investment there are also the restoration of the productive sector of the economy through the support of privatized enterprises and newly created small private enterprises, financing the agricultural sector, in particular, solving the problem of providing credits to numerous farms. Investment resources are necessary to finance environment protection measures.

Creating favorable environment for private investment requires a well-coordinated state policy. The necessary for it components include provision of information, investment services and many other things, which create favorable conditions for investors. To accomplish these tasks, it is very important to create a "service center", which will provide potential investors with full package of services and will "promote" Kyrgyzstan in the world investment market,

provide foreign investors and possible local partners with full information, as well as the services on organization of business in the Republic, including management of projects.

One of the main forms of foreign direct investment is the establishment of joint and foreign enterprises. The investments attracted by them have a substantial impact on the economy of the country. However, it is necessary to improve the ways of identifying the proportion of Kyrgyz investors in the statutory funds of joint ventures, and this requires to develop a scientifically based methodology for assessing the real price of buildings, equipment, land, contributed by the Kyrgyz side in the statutory funds of enterprises with foreign investments. The solution to this problem is of fundamental importance for further privatization. Foreign credits are an important factor in the development of investment activities of enterprises, so it is necessary to attract foreign financial resources in the form of long-term credits with low interest rates that do not make credited enterprises permanently dependent on foreign companies. It is also important to get foreign credits as earmarked cash under the condition of credit reimbursement by production supply (compensation agreements).

It is also advisory to stimulate the transactions, in which a foreign partner supplies the machinery, equipment, technology and complete plants in exchange for reciprocal supply of production, manufactured on the supplied equipment and machinery.

It should be noted that today's situation requires the acceleration and coordination of work of all concerned agencies to create conditions for foreign partners, interested in investment into the economy of Kyrgyzstan.

## ***Social Policy***

### Theoretical justification

Social policy of our country in its essence should be a continuation, or more accurately, a further development of the economic policy to implement the provision on Kyrgyzstan as a welfare state, enshrined in the Constitution of the Kyrgyz Republic. This approach to social policy will help us to avoid populism in this important matter and really solve the problem of improving the living standard of the population and reducing poverty.

There have been many opinions on the strategy of economic growth and poverty reduction in the world literature. There are two approaches: the first one says that it is just enough to develop the economy as a whole, which will automatically lead to poverty reduction; and, according to the second approach, there must be a strategy of economic growth, which should be directly aimed at poverty reduction.

The first approach is based on the "trickle-down" theory. The theory implies a vertical income flow from the rich to the poor. Profits, as a result of economic growth, at the beginning come to the rich, while the poor begin to receive their profits when the rich spend their income. Thus, the poor get profits indirectly, through the vertical flow from the rich. The second approach is based on the theory of "Pro-Poor Growth" ("the growth, accompanied by poverty reduction"). The level of poverty depends on two factors: average income and income inequality. Increase in the average income reduces poverty, while enhanced inequality increases it.

Economic growth raises the average income (or consumption), but at the same time, it can increase or decrease inequality. Growth (decrease) of inequality implies that the proportional revenues, received by the poor, are less (more) than those, received by the

rich. Thus, the growth may be considered “pro-poor” when it is accompanied by inequality reduction. The analysis has shown that Kyrgyzstan should definitely stick to the strategy of economic growth accompanied by income inequality reduction. Indeed, in recent years, since 1996, there has been an increase in the gross domestic product, with the exception of crisis years of 1998 and 2005.

At the same time, despite the Government’s efforts, social development issues have not been properly solved. So, for example, there are still too many poor people, income differentiation of the population is increasing, and the size of shadow economy is alarming.

The protracted economic reform, which was accompanied by unemployment growth, declining living standards and increased poverty, has forced some parts of the population to doubt the correctness of the chosen development path. The weakness of state power in combating corruption and violation of law has also contributed to this. Tactical errors do not enhance either public confidence in the reforms, implemented in the economy. In this regard, it is important to restore and enhance the people’s support and trust in the reforms. This can be achieved only by enhancing the state power and establishing a free economy that provides all with equal rights and opportunities to participate in and benefit from the economic processes, taking place in our country.

On the other hand, the essential point is the choice of a development strategy aimed at poverty reduction. Otherwise, people will be more and more convinced that capitalism provides privileges to only a small selected part of the population. This raises the problem of formulating such a program of economic development that would ensure a stable economic growth and corresponding social development, in particular poverty reduction.

### ***Implementation of Social Policies***

A pragmatic approach to the implementation of social policy is to begin addressing this problem by ensuring energy and food independence of the country. This task formulation will enable us to identify the necessary steps to reform the economy and its institutional sectors in order to address pressing social problems. In doing so, we must understand that at the current transitional stage, the above problem can be solved only if there is a strong state power.

As we know, Kyrgyzstan is an agricultural country, about 65 percent of its population lives in rural areas, and about half of all working citizens are employed in agricultural production. About 70 percent of the poor live in rural areas. Therefore, a well-developed agriculture plays an important role in stimulating economic growth, increasing rural employment and, consequently, reduction of poverty. An analysis of poverty phenomena clearly shows that it is necessary to implement the Integrated Program of Development of villages and small towns of the Republic.

Kyrgyzstan has an opportunity not only to ensure its own food security, but also to become an exporter of environmentally clean agricultural products. To solve this problem, we don’t have to create new models; we should only take into account the international experience and remember our own experience.

In developed countries, agriculture is not a market sector; it is a budgetary sector, wholly or partially subsidized by the state. In average in 24 developed countries budgetary subsidies

account for 50 percent of the cost of produced agricultural products, while in Japan and Finland they account for 80 percent. Budget allocations to agriculture the USA are about 100 billion dollars. On average these countries annually allocate 30-50 thousand dollars per farmer, while in Kyrgyzstan money is allocated only for spring planting in the amount of 7-15 US dollars per hectare, or 30-40 US dollars annually per farm.

In developed countries there is no free market for agricultural products, as there is a rigid state planning of agricultural production. In Kyrgyzstan, on the contrary, the state has withdrawn itself from the problems of selling and production of agricultural products, which from time to time leads to overproduction (onion in 1998, potatoes in 2000, beans and tobacco in 2002-2003) or to its deficit.

Measures, taken by the Government of Kyrgyzstan, aimed at reducing the rates of growth in consumer prices, have not yielded the desired results, as the country is highly dependent on the global market, which is experiencing unprecedentedly high prices, especially for grain. And this global trend of food prices growth continues. According to the joint research done by the Organization for Economic Cooperation and Development (OECD) and the Food and Agriculture Organization (FAO), from 2008 to 2017 the world will experience a sharp turnabout in food prices. By preliminary estimates, pork and beef will cost 20 percent higher, sugar – 30 percent, grain, corn and skimmed milk powder – 40 percent. During the same period the price of butter will increase by 60 percent, and cooking oil – 80 percent. But, as I have already mentioned, this global trend of rising food prices opens new opportunities for the accelerated growth of the agricultural sector of the economy of Kyrgyzstan and, consequently, reduction of poverty in the country.

And this will require a significant shift of the “center of gravity” of economic reforms towards the regions of the country. The aim of it is to actively develop the economy of the regions, so that residents of the regions get involved in economic processes and, consequently, increase their income.

Virtually all projects must undergo expertise concerning their impact on the development of the region(s) where they will be implemented. This includes the projects, aimed at increasing agricultural production and growth of manufacturing industries, as well as the projects on developing deposits.

We need to introduce a payment mechanism for the use of natural resources based on a principally new price model, as well as on the economic justification of the profits distribution and protection of the interests of the territory (region, Republic) and of the enterprise, which develops this deposit. There are serious problems with the use of land and other natural resources of the territories, where the developed deposits are located. It is necessary to eliminate the established social view that the population of the regions is implicated in natural resources of their region.

Regarding energy security, we must not entrust this function to the private market.

We must take into account the emerging global trend of creating powerful public energy companies. For example, in China the public oil giant PetroChina has become the largest company in the world, which costs more than one trillion dollars. In Russia, the state-owned “Gazprom” has turned into the world’s largest gas company. Largely thanks to the “Gazprom”, the most important social issue of gas supply has been successfully solved for the population of Russia. One could only guess how and at what price a private company would be able to solve such a task.



It is obvious that in Kyrgyzstan, our water-energy complex may become the basis for establishment of a major company, which would be able to solve social problems. Such a public company could play a key role, for example, in the rehabilitation and modernization of the whole destroyed irrigation system, as well as in an essential task of providing the entire population with clean drinking water.

Quality growth can be achieved through the above-mentioned measures, aimed at the formation of a free economy and economic growth, as well as through further improvement of microfinance and micro-credit system and the development of credit unions.

Indeed, there was a time when around 100 thousand people annually could improve their living standard, thanks to the micro-credits, which they had received, so that they were no longer considered poor. Therefore, it is obvious that the state must encourage micro-credit activities and make them accessible to everyone.

The State must constantly provide social support for the poor, who cannot afford to keep own business. They are people with disabilities, students and low-wage workers of public bodies that make up about 10 percent of the population and must receive sufficient direct support by the state to maintain a decent life.

In the context of Kyrgyzstan, this is the only condition when the achieved economic growth can be called “Pro-Poor Growth”, i.e. aimed at reducing poverty. On the other hand, social development (poverty reduction), as a result of investing in human capital, will give a tremendous impetus for economic growth.

### ***Employment***

During the current transitional and subsequent periods, the State plays a big role in addressing another critical problem – regulation of employment issues, or the creation of an effective labor market.

A study of employment problems combined with demographic trends in the Republic has revealed the need to take decisive actions to reduce, or at least, maintain unemployment at a low level.

The population of working age has significantly increased for the past years. This trend is due to the fact that, beginning with 2000, a significant number of adolescents, who were born in the mid 1980s when the country witnessed a surge in birth rate, entered the category of working age citizens (about 130 thousand births on average per year during 1983-1987). For instance, 104.1 thousand of the 16-year-old teenagers were added to the number of working-age population in 2000, 109.3 thousand – in 2001, 111.9 thousand – in 2002, 117.2 thousand – in 2003 and 118.8 thousand people – in 2004. In the coming years (until 2010) the number of entrants in working age will be 117–118 thousand people annually. Then in 2010-2012, even maintaining current levels of mortality and migration, their numbers will fall to 113 thousand per year (the generation born in 1993-1995 – 115 thousand on average per year). In 2013-2016 the number of young people of this age will decline due to the fertility decline in the late 1990s and will be about 100 thousand people on average per year. In the more distant perspective, this trend of growth may resume in connection with the fertility increase. According to the UN Population Fund, due to this trend there is currently a so-called “demographic window.” Provided that there are sufficient investment in health and education and appropriate economic policies, this generation

of young people will be able to realize their potential and contribute to economic growth of the country.

It is clear that if in the coming years we will not achieve a decisive breakthrough in economic development and will not be able to provide jobs for young people, we can forget about stability in our country. In doing so, as the world experience has shown, we should focus on accelerating the development of small and medium-sized business.

From our point of view, in order to address the problems of youth employment we must solve two more important tasks. First, it is necessary to urgently restore, in a modernized form, the system of vocational technical schools, as there is a great demand for specialists with secondary special education in the Republic. However, the skills requirements are much higher than during the Soviet period. Therefore, the system of vocational schools should be modernized, and not just restored. This task, perhaps, is hard to solve using only internal resources. To achieve this goal, we need additional credits from international financial institutions and donor countries.

Second, it is necessary to carry out sound policies regarding the labor migrants from our Republic into Russia, Kazakhstan, and other countries. It is important now to reach agreement with the Governments of Russia, Kazakhstan, and other countries on the expanded opportunities for citizens of Kyrgyzstan to work in these countries.

However, it is clear that the main factor in increasing employment and reducing poverty is economic growth.

### ***Conclusion***

The analysis has demonstrated that the GDP level in 2008 did not yet reach the level of 1990, which was the last year of stable economic development of the country. There is a need for decisive actions to ensure economic growth and poverty reduction.

Economic reforms should leave nobody aside. If this happens, those who stayed on the sidelines will be among the poor or work in the shadow economy. Thus, poverty and shadow economy are the costs of the implemented economic reforms. And the level of these phenomena should show us the degree of necessary correction of economic policy.

The protracted economic reform, which was accompanied by unemployment growth, declining living standards and increasing poverty, has forced some of the people to doubt the correctness of the chosen development course. The weakness of state power in combating corruption and violation of law has also contributed to this. In this regard, it is extremely important to restore and strengthen people's confidence and support of the reforms. This can be achieved only by strengthening the state power and establishing a free economy that provides all with equal rights and opportunities to participate in and benefit from the economic processes, taking place in the country.

The Kyrgyz Republic, as a democratic country, should establish a mixed economic system. The main principles of this system are:

- free enterprise;
- free pricing system (excluding the monopolists);
- free competition;
- state regulation.

However, it is necessary to keep in mind that this is not a mechanical "mixing" of

market mechanisms and public administration, it is rather their organic combination. State regulation should not replace or suppress market mechanisms. This combination should provide such level of economic freedom, which is sufficient for sustainable economic growth.

To achieve this goal, great importance is given to the right choice of a development strategy for the next 10 years to ensure sustainable economic growth and address social problems, particularly poverty reduction. The results of this work have brought to the conclusion that it is necessary to actively continue the implementation of institutional reforms. Institutional reforms should create a truly free economy and its guarantor, a strong state power.

Only then can we expect the results to be achieved. And apparently, the above-described combination of market mechanisms and state regulation has been achieved in many developed countries of the world. And we, citizens of Kyrgyzstan, have no right to miss a historic opportunity to build a developed democratic state. In conclusion, it is necessary to emphasize once again that success of the reforms will depend on whether we will be able to build a strong state power, supporting the ideas of liberalism.

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## *Сдача и приемка результата строительных работ по договору подряда*

После того как строительство по договору строительного подряда завершено, процесс сдачи и приемки выполненных строительных работ проходит в порядке, который установлен действующим законодательством и самим договором строительного подряда.

Должное исполнение своих обязанностей сторонами договора строительного подряда заканчивается в момент, когда подрядчик сдает результат строительных работ, а заказчик принимает их. На основе этого С. А. Верб говорит, что сдача и приемка строительных работ означает выполнение подрядчиком договорных обязательств, а значит, заказчик обязан оплатить их (2).

Юридическую важность момента сдачи и приемки строительных работ отмечает В. Г. Вердников, который считает, что сдача и приемка работ значит выполнение подрядчиком договорных обязательств и принятие их исполнения заказчиком, а так же то, что заказчик одобряет качество строительных работ. Более того, в собственность заказчика переходит сам предмет подряда, а вместе с ним и риск гибели результата строительных работ (11, с. 170).

По мнению И. Л. Брауде важное значение процедуры сдачи и приемки результата строительных работ, кроме обязанности произвести за них расчет, заключается в том,