

**Joint Kyrgyz Government/WB/IMF Workshop**  
**“COPING WITH SHORT-TERM RISKS AND VULNERABILITIES**  
**AND ACCELERATING LONG-TERM GROWTH”**

**Second Day Roundtable: “Immediate Measures to Improve the Business Environment”**

**Ministry of Economic Development and Trade (MEDT)**

**Bishkek, 26 June 2008**

**Key Messages**

It was generally agreed that the Kyrgyz Government in the past few months has shown **serious commitment to reforms** by taking important steps to improve the country’s business environment (BE). At the same time, all participants cautioned that, although a good start, reform measures would need to be extended and deepened.

Overall a number of general principles were agreed for the design and implementation of BE reforms:

- Be focused, selective, prioritize. – Don’t try to do everything at the same time but sequence reforms.
- Be consistent. – Make sure that different reform measures complement each other as much as possible. When amending or introducing legislation, ensure that existing legislation is amended so as to avoid contradictions.
- Be transparent and communicate reforms to those who are affected by them. – Let government agencies be monitored by third parties. Mobilize bottom-up support for reforms.
- Make sure that reforms are being implemented. – Build capacity at the agency level.
- Work towards strengthening the enforcement of legislation. – Establish effective complaints’ mechanisms.

**Major Bottlenecks in the Kyrgyz Business Environment**

Initial presentations by Talai *Asylbekov* (IBC), *Lyaziza Sabyrova* (ADB), and *Minister Akylbek Japarov* (MEDT) noted some of well known problems in the business environment:

One of the key issues identified was the **lack of transparency** in the development and implementation of policy which affects businesses. In particular there was a clear need for the government to inform the business community about relevant decisions that have been taken, and how these are to be implemented.

A second issue emphasized was the problem of **access to finance**. The Kyrgyz Republic finds itself in a vicious circle of adverse selection. The high risks present in the Kyrgyz market (and the lack of capacity of banks to adequately measure risks) fuel high interest rates (since banks have to add a risk premium to cover potential losses); high interest rates, in turn, imply that only high-risk businesses have an incentive to take a credit.

Finally there was general agreement with *Minister Japarov’s* point that the **poor legislative framework** is a major impediment to the emergence of a vibrant entrepreneurship in the Kyrgyz Republic. The areas which are in particular need of new and better legislation are taxes, construction licensing, business liquidation, and the acquisition of real estate.

**Role of the Government in Improving the Business Environment**

It was noted that, because of the difficult environment in the Kyrgyz Republic (land-locked, small internal market), the country’s business environment must be much better than that of neighboring countries.

Minister Japarov noted that political will is essential if the government is to be effective in improving the business environment. The MEDT has recently taken a leading role in reforming the country's business environment. The **100 Days of Reform program**, which the Government has implemented with the support of the World Bank's Doing Business (DB) team, was only a first step in the government's ambitious reform agenda. Minister Japarov made clear that the goal of the government is not to improve the country's ranking on various indicators, but to make sure that legislation is being implemented.

Currently, the MEDT is finalizing its **4-year Development Strategy**, whose key purpose is the creation of a favorable investment climate and the attraction of foreign investors. In the medium and long-term, Mr. Japarov argued that the government therefore has to gradually reduce its control over the economy and make sure that it exercises authority according to the principle of minimal interference.

Representatives of the business community agreed with this and noted that the key role for the authorities was to:

- implement regulations effectively,
- guarantee a well functioning legal system (stable and predictable legal framework, independent judiciary), and;
- provide for a competitive business environment, including fair taxation and transparent regulation.

It was recognized that the Kyrgyz Government is still far from complying with the principle of minimal interference. On the contrary, the authorities impose **high administrative barriers and compliance costs** and obstruct private sector transactions. In the past there had been excessive focus on introducing legislative changes and improving rankings. The consequence is a gap between "paper" and reality, since de jure reforms do not automatically translate into de facto changes. One reason for the slow pace of *real* reforms is the existence of vested interests, which oppose reforms because they are expected to lose from their implementation.

It was agreed that, important preconditions for the effective implementation of economic reforms – political will and technical capacity – are present at the higher levels of government. However, **capacity constraints at the ministry and agency level** encroach upon reform success. It is important therefore for the government to take a more active role in supporting the agencies in implementing reforms. Officials noted that the lack of a critical mass of capable civil servants responsible for reform implementation (at least 20-25% of the total) is a serious obstacle to any reform effort. Examples were cited of other countries such as Georgia, where in some critical agencies the majority of staff were removed and replaced so as to form the critical mass and break with past practices.

### **Key Issues regarding Ongoing Reforms**

#### **Moratorium on Tax Inspections and Decrease in Number of Other Inspections**

Business representatives and officials pointed to the **ineffectiveness of the moratorium on tax inspections**, which was decreed by the Kyrgyz President on 22 April 2008. The decree forbids the tax authorities to inspect any business entity which during the effectiveness of the moratorium increases its tax contribution to the 2008 budget. The government was to develop implementing regulations with criteria to identify which businesses should not be inspected. However, as has been the case with many such decrees, these criteria have not been developed, with the consequence that the moratorium on tax inspections had not been effective. It was remarked that the presidential decree is not clear on how the mentioned criteria have to be defined in practical terms.

*Minister Japarov* indicated that **corruption** is a major obstacle to the implementation of the moratorium. Given that tax inspectors are not well paid, they are unwilling to forfeit the opportunity to collect informal payments from taxpayers. He suggested Kazakhstan as an example for efficient tax inspections

Nevertheless it was stated that the decree was effective with regard to other inspections. Since the adoption of the decree, non-tax inspections had been reduced by 70% according to a government official.

It was proposed that one solution to the problem of excessive inspections would be to introduce a **risk-based inspection system**. Thus, the relevant agencies should inspect only a small percentage of enterprises but make inspections 100% effective. At the same time, serious penalization should be imposed on negligent inspected entities. To support such an approach it was proposed that all inspecting bodies should establish an analytical group to determine risks and therefore needs of inspections. Such an approach would ensure that most enterprises have very few or possibly no inspections, but that the rules which inspections are designed to enforce, continue to be enforced.

#### Regulatory Impact Assessment (RIA)

While there was general support for the idea of assessing the impact of new laws and regulations on the business environment, it was generally agreed that it would be impractical to introduce RIA in all sectors/areas at the same time. Closely related to the introduction of RIA was the issue of implementing a **guillotine** on existing regulations for which no justification existed. It was proposed that only one or two agencies (concerned with service delivery) be chosen as pilots to implement a guillotine of regulations, through a detailed analysis of the need for existing regulations and the elimination of all those for which no justification exists.

#### Social Fund

Another issue raised was the high burden placed on entrepreneurs by contributions to the Social Fund, and it was proposed that there might be a **cap on the level of contributions**. However it was recognized that such measures would have to be combined with reforms to the financing of the Social Fund to ensure its financial sustainability.

### How to Go About Reform – Recommendations and Proposals

- **Focusing on specific reform areas and ensuring reform consistency**

It is important not to overburden the reform agenda, to be focused and consistent when planning and designing reforms, and to properly prioritize policy measures. It is not feasible to effectively implement an array of new laws in a number of ministries and agencies at the same time. Moreover, due to limited resources in the business community, representatives of business interests could only “process” three to four laws at a time.

In addition it was pointed out that the new draft Tax Code is not in line with the Law on Inspections, and this has far-reaching implications for the country’s legal system. It is clearly against good legal practice that a law is applied differently under different circumstances/in different areas (e.g. tax vs. sanitary inspections).

- **Improving the customer orientation of public organizations**

It was proposed that front offices should be established in government agencies to improve the government’s customer orientation. Presently, entrepreneurs and citizens receive little guidance if they have questions related to government services. Front offices should provide relevant documents, guidelines, a list of frequently asked questions etc. A government employee who can advise citizens on relevant legislation, processes, authorized persons etc. should also be present in these offices.

It was also suggested by government officials that the “silence is consent” principle should be introduced for all interactions between enterprises and the government, and that it should be institutionalized as a general principle.

- **Making government more transparent and communicating reforms**

Transparency was viewed as critical for improving the business environment in the short term: three particular aspects were emphasized:

1. The importance of carrying out transparent privatizations. This would have a significant public relations' effect, which could attract investors to the country.
2. Greater transparency and consultation in the decision making process on laws and regulations that affect the economy, and opportunities for feedback from the public and business community to monitor implementation.
3. Importance of raising public awareness and conducting explanatory work among entrepreneurs, and ensuring that all legislation is published and accessible to the public.

- **Monitoring reform implementation**

It was suggested that reform implementation could be assisted by giving authority to independent bodies, for instance the Investment Council, to monitor and supervise particular areas of reform and large reform projects. This would apply particularly to the 100 days reform program – to ensure that it is implemented in more than just the law.

To support this process a number of tools to monitor government performance were proposed:

- a telephone hotline for citizens' complaints,
  - enterprise surveys to get the feedback from the business community, and
  - performance indicators for public agencies.
- Longer term issues: Tackling underlying capacity and resource constraints

Several participants shared the view that tackling problems in the educational system is a precondition for improving the Kyrgyz Republic's investment climate in the long run. The same is true for the development of an efficient financial market.

*Notes were prepared by: Simone Giger*