

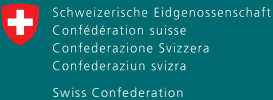


# Investment Climate in the Kyrgyz Republic as Seen by Small and Medium Enterprises

Investment Climate Advisory Services | World Bank Group



In partnership with:



The contents of this report are protected by copyright.

Neither this report nor its parts may be reproduced, copied or distributed in any form without reference to the IFC Report “Investment Climate as seen by Small and Medium Enterprises in the Kyrgyz Republic”.

IFC encourages dissemination of this publication and hereby grants permission to the user of this work to copy portions of it for the user’s personal, noncommercial use, without any right to resell, redistribute, or create works derived from the contents or information contained herein.

Any other copying or use of this work requires the express written permission of IFC. The materials contained in this report are presented as an overview of results from the Survey that was conducted between May and August 2009 among owners and/or managers of Kyrgyz small and medium companies, individual entrepreneurs, and farmers.

The information in this report is presented in good faith for general information purposes, and IFC, the World Bank Group, Government of Switzerland shall not be held liable for any of the information contained herein.

This report does not claim to serve as an exhaustive presentation of the issues discussed herein, and should not be used as a basis for making commercial decisions. Please approach independent legal counsel for expert advice on all legal issues.

All information and materials used in preparing this report are the property of and archived by IFC.

© 2010 International Finance Corporation

The report is available, in printed and electronic form, at the following address:

IFC Investment Climate Advisory Services Project  
4<sup>th</sup> floor, 6 Ryskulov Street  
Bishkek, Kyrgyz Republic 720001  
[www.ifc.org/beekg](http://www.ifc.org/beekg)

**Photographs:** Boris Kuptsov, Vlad Ushakov



# Investment Climate in the Kyrgyz Republic as Seen by Small and Medium Enterprises

Investment Climate Advisory Services | World Bank Group



**International  
Finance Corporation**  
World Bank Group



**World Bank Group**  
Multilateral Investment  
Guarantee Agency



**THE WORLD BANK**

In partnership with:



Schweizerische Eidgenossenschaft  
Confédération suisse  
Confederazione Svizzera  
Confederaziun svizra  
Swiss Confederation

Swiss Cooperation Office in the Kyrgyz Republic  
Кыргыз Республикасындагы Кызматташтык боюнча Швейцариялык Бюро  
Швейцарское Бюро по сотрудничеству в Кыргызской Республике

**2010**

## CONTENTS

Foreword and Acknowledgements .....	4
List of abbreviations .....	5
Name of Government Agencies .....	5
<b>1. EXECUTIVE SUMMARY .....</b>	<b>6</b>
Key recommendations .....	13
<b>2. BUSINESS ENVIRONMENT .....</b>	<b>18</b>
2.1. The impact of the global economic crisis in the Kyrgyz Republic remains relatively limited .....	18
2.2. The private sector has grown significantly in the past years, except for medium and large companies .....	20
2.3. High tax rates, corruption, macroeconomic instability and an unreliable electrical supply are the main problems faced by small and medium enterprises .....	22
2.4. Important legal reforms were made to improve the business environment, but the impact has been limited .....	26
Annex 2.1: Total cost of electricity outages for small and medium companies in 2008 .....	29
<b>3. REGISTRATION .....</b>	<b>30</b>
3.1. Key findings .....	30
3.2. Registration: the “one-stop shop” has improved the legal framework .....	30
3.3. Small and medium companies comprise the greatest proportion of respondents completing registration in 2008 .....	36
3.4. Registration procedure: small and medium companies bear a greater burden than individual entrepreneurs .....	37
3.5. Recommendations .....	40
Annex 3.1: Registration of all SMEs in 2008 – total costs .....	41
<b>4. PERMITS .....</b>	<b>42</b>
4.1. Key findings .....	42
4.2. The lack of a unified permit law and a comprehensive permit register are the main shortcomings of the permit legislation .....	42
4.3. Permit coverage and frequency: the number of enterprises obtaining permits is significant, with regional disparities .....	45
4.4. The Ministry of Health, the Fire Safety Department, the Ministry of Transport and local governments are the heaviest regulators on permits .....	47
4.5. Permit Administration: time-consuming and complex procedures promote informal solutions .....	48
4.6. Recommendations .....	51
Annex 4.1: Indicative list of permit issuing agencies and of the main types of permits (2009) .....	52
Annex 4.2: The implementation of the construction permits’ “one-stop shop” is weak, article published on February 2009 on the Investment Council website .....	53
Annex 4.3: Entrepreneurs believe they have a good knowledge of the permit legislation .....	53
Annex 4.4: Total cost of obtaining permits for all SMEs in 2008 .....	54
<b>5. LICENSING .....</b>	<b>56</b>
5.1. Key findings .....	56
5.2. Licensing: the legal framework includes a number of good practices .....	56
5.3. License coverage and frequency: the short validity of licenses is problematic .....	58
5.4. License administration: the Kyrgyz Republic outperforms most of its neighbors, yet SMEs still bear a big burden .....	61
5.5. Recommendations .....	63
Annex 5.1: Indicative list of license issuing agencies and of types of activities subject to licensing (2010) .....	64
Annex 5.2: Total cost of obtaining licenses for all SMEs in 2008 .....	66
<b>6. TECHNICAL REGULATIONS .....</b>	<b>68</b>
6.1. Key findings .....	68
6.2. Technical regulations: legislation has evolved positively following accession to the WTO membership, but implementation is slow .....	68

6.3. Mandatory certificates hinder the development of small and medium companies .....	73
6.4. The share of small and medium companies obtaining voluntary certificates of conformity remains very small.....	78
6.5. Recommendations.....	79
Annex 6.1: Certification schemes.....	80
Annex 6.2: Total cost of the certification procedure for all SMEs in 2008.....	81
Annex 6.3: List of ISO certified companies in the Kyrgyz Republic .....	82
<b>7. INSPECTIONS .....</b>	<b>84</b>
7.1. Key findings.....	84
7.2. Despite recent reform, the legislative framework is not based on contemporary practice in the conduct of inspections.....	85
7.3. Perceived risk is not a criterion in the selection of businesses for inspection .....	90
7.4. The frequency of inspections dropped during the moratorium, but this respite was not used to initiate reform .....	93
7.5. The majority of inspections are performed by the four most active inspectorates.....	94
7.6. Information on technical requirements is not always readily available to entrepreneurs .....	95
7.7. The sanctions used do not encourage compliance.....	96
7.8. The existing system is costly, for both businesses and inspectorates.....	97
7.9. Frequent inspections do not guarantee safety.....	98
7.10. Recommendations.....	99
Annex 7.1: State inspectorates and inspection agencies.....	100
Annex 7.2: Legislation governing inspections as of December 2009 .....	101
Annex 7.3: Incidence of inspections by state inspectorates and other agencies before, during, and after the moratorium .....	102
Annex 7.4: Small and medium enterprises' estimations of their knowledge of inspections legislation.....	103
Annex 7.5: The labor cost of inspections.....	104
<b>8. TAXATION .....</b>	<b>106</b>
8.1. Key findings.....	106
8.2. Legal framework: the new Tax Code is an important step in improving the tax system, but additional reforms are needed....	106
8.3. Context: tax revenues in the Kyrgyz Republic are growing .....	113
8.4. Survey results: tax accounting and compliance cost businesses an estimated KGS3.3 billion (\$88 million) in 2008.....	114
8.5. Small and medium companies bear the greatest burden in fulfilling mandatory reporting requirements.....	116
8.6. Businesses with a small turnover bear a comparatively heavier burden in terms of tax accounting and mandatory reporting ...	118
8.7. Inspections are a heavy burden and are not sufficiently risk-focused.....	119
8.8. The tax system discourages "graduation" from the patent regime to the simplified tax regime.....	122
8.9. Recommendations.....	128
Annex 8.1: Eligible activities under the voluntary tax patent regime .....	129
Annex 8.2: Taxes and rates applicable under each of the four tax regimes .....	134
Annex 8.3: Number of reports to be submitted to State Tax Service annually by small and medium companies under the old and the new Tax Code .....	135
Annex 8.4: Annual labor cost of tax compliance for SMEs.....	136
Annex 8.5: Annual labor costs of tax audits .....	139
<b>9. SURVEY METHODOLOGY .....</b>	<b>140</b>
<b>ANNEX 1. ACCESS TO FINANCE.....</b>	<b>146</b>
<b>ANNEX 2. FOREIGN TRADE.....</b>	<b>150</b>

## FOREWORD AND ACKNOWLEDGEMENTS

IFC, in partnership with the Swiss Government, presents the results of the first Survey of the investment climate in the Kyrgyz Republic. The Survey has been undertaken by IFC's Kyrgyz Republic Investment Climate Project. The objective of this Survey was to assess the existing conditions for doing business in the Kyrgyz Republic in 2008 and to develop recommendations for improving them.

This report is based on the results of a Survey of managers of about 2,000 small and medium enterprises (SMEs), conducted in May – August 2009, representing all regions of the country. Besides small and medium companies, the survey also included the sub-populations of individual entrepreneurs and farmers.

Detailed information on the realities of the investment climate that are faced by these three segments of the population is presented here; it is hoped that the empirical data from this Survey will be used by various stakeholders to stimulate the investment climate and make administrative procedures more efficient and transparent.

Since it began operating, the IFC Kyrgyz Republic Investment Climate Project has benefited from close interaction with many public and private institutions operating in the Kyrgyz Republic, as well as a number of international organizations. The project would like to thank the Ministry of Economic Regulation, the State Tax Service under the Government of the Kyrgyz Republic, and the State Department for Sanitary and Epidemiological Control under the Ministry of Health of the Kyrgyz Republic with whom the project signed a Memorandum of Understanding most in 2009. The project would also like to extend its gratitude to the Secretariat of the Investment Council under the President of the Kyrgyz Republic with which it developed a long-standing relationship, and to the State Statistic Committee of the Kyrgyz Republic, which has provided enormous support during the survey implementation and report writing process.

Numerous individuals and organizations contributed generously to the report, including the World Bank (Paulo Guilherme Correa, Ayse Boybeyi) and IFC (Christopher Miller, Wendy Jo Werner, Jacqueline Coolidge, Alberto Criscuolo, Sanjar Ibragimov, Jan Loeprick, Denis Torkhov, Alisher Isaev, Fakhriyar Jabbarov, Madina Nurmatova, Kateryna Onul, Serhiy Osavolyuk, Sanjukta Mukherjee, Olga Morozova and Ernst Mehrengs).

Bishkek, 2010

## LIST OF ABBREVIATIONS

<b>APEC</b>	– Asia-Pacific Economic Cooperation
<b>BEEPS</b>	– Business Environment and Enterprise Performance Survey
<b>EBRD</b>	– European Bank for Reconstruction and Development
<b>EU</b>	– European Union
<b>FIAS</b>	– Foreign Investment Advisory Service
<b>GDP</b>	– Gross Domestic Product
<b>GHP GMP</b>	– Good Hygiene Practice and Good Manufacturing Practices
<b>HACCP</b>	– Hazard Analysis and Critical Control Points
<b>IEC</b>	– International Electrotechnical Organization
<b>IEs</b>	– Individual Entrepreneurs
<b>IFC</b>	– International Finance Corporation
<b>ISO</b>	– International Organization for Standardization
<b>KGS</b>	– Kyrgyz Som
<b>LVL</b>	– Latvian lats
<b>METR</b>	– Marginal Effective Tax Rate
<b>NISM</b>	– National Institute for Standards and Metrology
<b>OECD</b>	– Organization for Economic Co-operation and Development
<b>SMEs</b>	– Small and Medium Enterprises
<b>SMCs</b>	– Small and Medium Companies
<b>UNDP</b>	– United Nations Development Programme
<b>USAID</b>	– United States Agency for International Development
<b>VAT</b>	– Value Added Tax
<b>WHO</b>	– World Health Organization
<b>WTO</b>	– World Trade Organization
<b>\$</b>	– U.S. dollar

## NAME OF GOVERNMENT AGENCIES

Pursuant to the *Presidential Decree No. 425 “On Measures to Ensure the Implementation of the Law of the Kyrgyz Republic on the Structure of the Government,”* adopted October 26, 2009:

- The State Committee on Taxes and Fees was reorganized into the State Tax Service
- The Ministry of Economic Development and Trade was reorganized into the Ministry of Economic Regulation

The old and new names of agencies are used throughout the report interchangeably, even when the report refers to events, which took place prior to the adoption of *Presidential Decree No. 425*.





# 1. Executive summary

## IFC Study of Investment Climate as seen by Small and Medium Enterprises in the Kyrgyz Republic

---

This report examines the key challenges faced by small and medium enterprises (SMEs) in the Kyrgyz Republic, in an attempt to identify the issues and areas in most urgent need of reform. The IFC *Study of Investment Climate as seen by Small and Medium Enterprises in the Kyrgyz Republic*<sup>1</sup> (the "Survey") is the first survey of the investment climate in the Kyrgyz Republic conducted by IFC (following the publication of similar surveys throughout the region since 2000, including in Azerbaijan, Georgia, Tajikistan, Ukraine, and Uzbekistan), and analyzes the views of 2,010 SMEs in three separate categories: individual entrepreneurs (667); small and medium companies (711); and farmers (632).

Respondents' views were sought on the key administrative procedures encountered in either establishing or running a business, during January–December 2008<sup>2</sup>. This report presents the key findings of the Survey, and incorporates background information on the policy, legal, and regulatory frameworks currently in force. Recommendations to policymakers are included at the end of each chapter, on the basis of analysis of both the regulatory framework and Survey results.

---

<sup>1</sup> IFC (2010) "Study of Investment Climate as seen by Small and Medium Enterprises in the Kyrgyz Republic".

<sup>2</sup> The reference period of the Survey was January–December 2008 for most regulatory procedures. All U.S.dollar (\$) / Kyrgyz Som (KGS) comparisons are therefore calculated on the basis of the average exchange rate in force during this period, i.e.: \$1 = KGS36.57. For inspections, the reference period of the survey was January 2008 – March 2009.



## THE BIG PICTURE: HIGH-LEVEL FINDINGS OF THE IFC SURVEY OF SMALL AND MEDIUM ENTERPRISES IN KYRGYZSTAN

- Small and medium enterprises cited high tax rates, macroeconomic instability, power outages, and corruption as the main obstacles to the development of their businesses.
- Individual entrepreneurship and the formation of small companies are both increasingly popular means of establishing a business, while the number of medium-sized companies formed between 2002 and 2008 has stagnated.
- Medium-sized companies face a significantly more difficult regulatory environment than other smaller business, in terms of the range and costs of the administrative and compliance obligations to which they are subject. Farmers, however, enjoy the lightest regulatory burden.
- Individual entrepreneurs bear the greatest regulatory burden, relative to turnover. For example, the cost of obtaining permits in 2008 represented one percent of the total turnover of individual entrepreneurs (including official and unofficial payments, but excluding labor costs), in comparison with the 0.16 percent of total turnover paid by SMEs.
- Between 24 and 44 percent of all small businesses (i.e., individual entrepreneurs, small and medium companies and farmers) admitted to having given unofficial payments, gifts, entertainment, or other services in an attempt to expedite the process of obtaining mandatory permits, licenses, and certificates, or to pass inspections. The incidence of such “unofficial payments” in the Kyrgyz Republic is among the highest of the post-Soviet countries.
- The incidence of regulatory procedures shows significant regional variation: businesses in Issyk-Kul are subject the most onerous procedures in obtaining permits and licenses, while businesses in Osh city face the most stringent inspection regime.
- The procurement of permits is the most burdensome regulatory procedure for SMEs, in terms of both compliance obligations and cost: the total cost to the private sector of complying with regulations governing the procurement of permits was KGS555.4 million (\$15.1 million) in 2008 (including official and unofficial payments and labor costs). This represents close to 0.37 percent of national gross domestic product (GDP).
- The average validity of licenses is short, at 22.7 months, on average, for small and medium companies and 13.1 months for individual entrepreneurs. Given that such licenses are often crucial to an enterprise’s core business, this makes for an insecure environment in terms of entrepreneurial activity.
- Compliance with certification requirements is the most lengthy and expensive procedure faced by small and medium companies, and the procedure most likely to hinder their development. The 17 percent of small and medium companies obliged to complete such procedures in 2008 spent, on average, KGS14,583 (\$399) in doing so (including official and unofficial payments, but excluding labor costs).
- Inspections place an onerous burden on all businesses, and are not risk focused. Seventy three percent of individual entrepreneurs, 69 percent of small and medium companies, and 29 percent of farmers were subject to investigation by at least one inspectorate in 2008, despite the government imposing a moratorium\* on inspections between April 25 and December 31, 2008.
- Tax administration is the most burdensome of all procedures for small and medium-sized businesses. Individual entrepreneurs, small and medium companies and farmers spent KGS11,740 (\$321), KGS79,054 (\$2,162) and KGS6,010 (\$164), respectively, in meeting their tax accounting and reporting obligations. This represents approximately 10 percent of individual entrepreneurs’ total profit, 13 percent of small and medium companies’, and 14 percent of farmers’. The total labor cost to SMEs in meeting their tax and reporting obligations (including tax accounting and mandatory reporting, but excluding tax audits) was in excess of KGS4 billion in 2008, representing 2.9 percent of national GDP, and exceeding the total costs of all other regulatory procedures together.

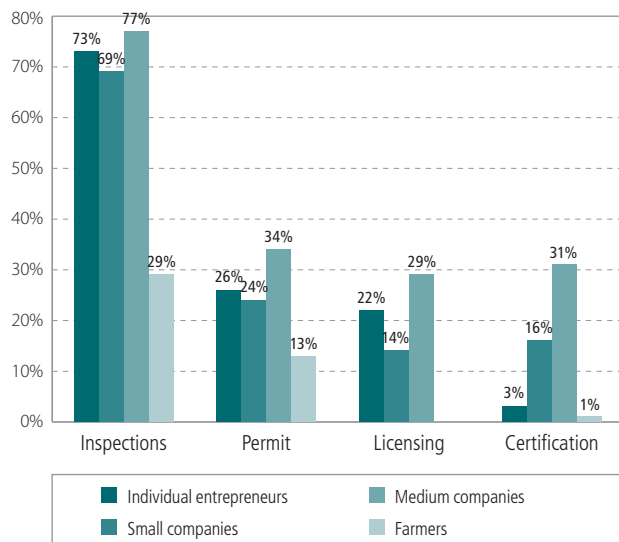
\* Presidential Decree No. 145 “On the Moratorium on Inspections by the Tax Authorities of the Kyrgyz Republic, and Reduction of Inspections of Business Entities Implemented by Other Authorized Inspectorates of the Kyrgyz Republic,” adopted April 22, 2008 and implemented between April 25 and December 31, 2008.

### Recent reforms have had a beneficial effect on the investment climate, but tangible improvements for most benefits are limited

A number of regulatory reforms have been implemented since 2007, particularly in respect of regulation governing the procurement of permits, as well as inspections, licenses, business registration procedures, and taxes. Further reform is currently in development. The benefits of such reform are clear, with the Kyrgyz Republic showing an improved ranking in the IFC–World Bank Doing Business 2010 report.<sup>3</sup> However, Survey results make clear that many of these reforms have yet to deliver tangible benefits or change for many businesses, in practice. The proportion of businesses subject to certain regulatory procedures remains high, particularly among individual entrepreneurs and small and medium companies, with medium-sized companies, in particular, bearing the greatest burden in terms of compliance (Chart 1.1).

**Chart 1.1: Medium-sized companies bear the greatest regulatory burden**

Percentage of businesses subject to various procedures in 2008



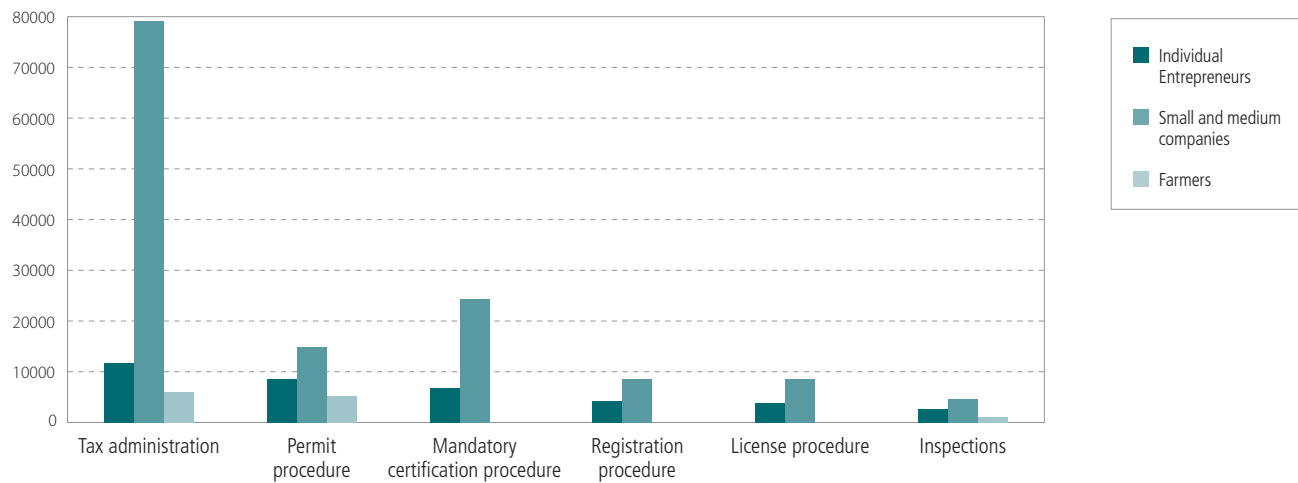
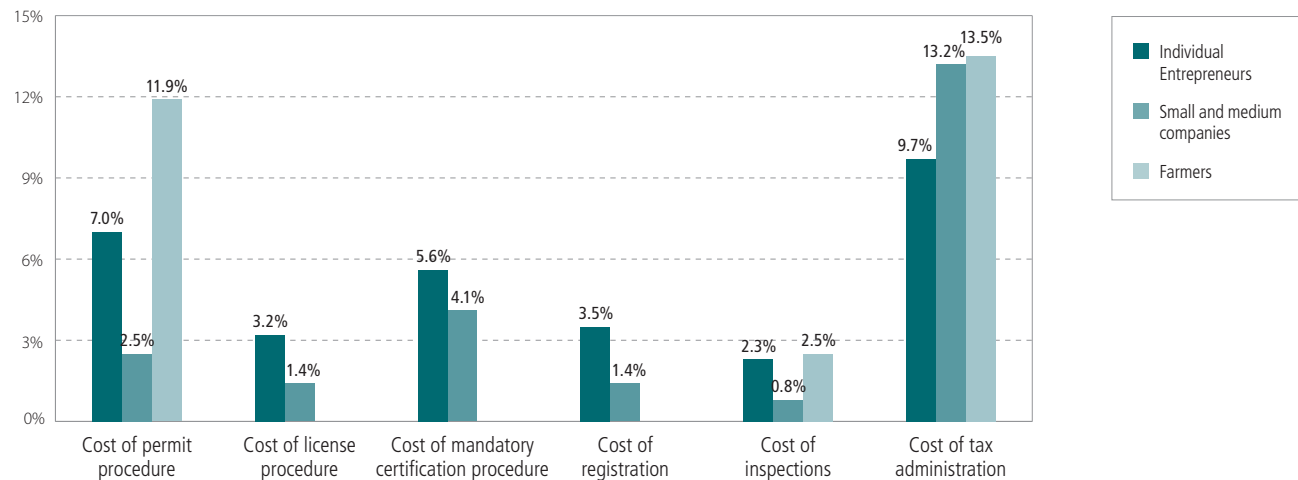
Medium-sized companies are also the category showing the greatest degree of stagnation since 2002, in comparison with the rapid growth recorded in the numbers of individual entrepreneurs, small companies, and farmers registering a business.

The dynamic growth witnessed in these categories, coupled with the low corresponding growth of medium-sized companies, points to an intrinsic problem in both the tax system and the regulatory regime. Neither is designed or managed in a way likely to encourage individual entrepreneurs and the smallest companies to “graduate” from the tax and regulatory procedures governing the operations of the smallest entities (i.e., individual entrepreneurs operating under the patent tax regime) to those governing medium-sized and larger enterprises. This is detrimental to the Kyrgyz Republic as a whole since medium-sized companies employ more staff, generate more tax revenue, and produce more exports than individual entrepreneurs and farmers.

All of these factors point to a clear need for (i) the introduction of further reform; and (ii) the effective on-the-ground implementation of reforms passed in recent years. Such improvements in the investment climate would increase the resilience of the national economy and individual businesses to external shocks (such as the current global economic downturn), as well as delivering direct benefits to business through reduced administration and compliance costs.

Although the absolute cost of regulatory procedures and tax administration is higher for small and medium companies (Chart 1.2), the proportional cost of regulatory procedures and tax compliance relative to profit is overall higher for farmers and individual entrepreneurs than for small and medium companies (Chart 1.3). In general, the costs of regulatory and tax compliance are regressive, with the result that businesses with low turnover and/or profit bear a proportionately heavier burden.

<sup>3</sup> The IFC–World Bank Doing Business 2010 report (which analyzes the regulatory conditions for starting, doing, and closing a business worldwide) ranked the Kyrgyz Republic in 14<sup>th</sup> place of 183 countries surveyed.

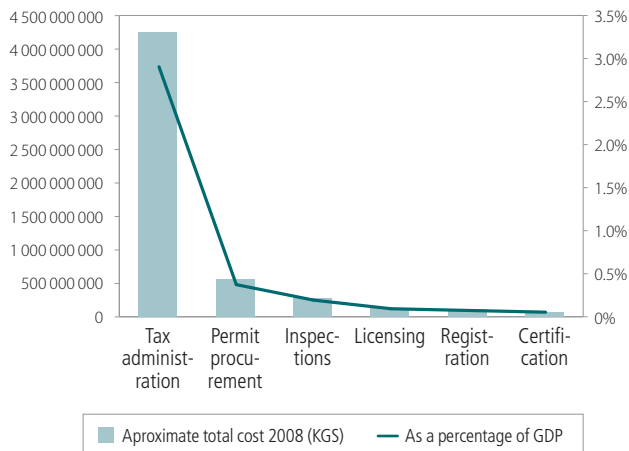
**Chart 1.2: Small and medium companies bear the highest absolute cost of regulatory procedures and tax administration****Average cost of the main regulatory procedures and tax administration (KGS)****Chart 1.3: The proportional cost of regulatory procedures relative to profit is overall higher for farmers and individual entrepreneurs than for small and medium companies****Average cost of main regulatory procedures and tax administration, relative to profit**

The total cost of tax and regulatory compliance for SMEs (including official and unofficial payments and the labor costs of staff working on these procedures) is a significant burden on businesses, and amounted to KGS5.4 billion (\$147.6 million) for all SMEs nationwide in 2008 – equal to 3.69 percent of nation-

al GDP. This total, moreover, does not include indirect costs, such as delayed market entry, reduced competitiveness, and revenue or profit lost due to the interruption or suspension of business operations. Of all procedures, tax administration represents the greatest compliance burden for SMEs (Chart 1.4).

**Chart 1.4: Tax administration represents the greatest compliance burden nationally, followed by permit procurement**

**Total national cost of key procedures (2008)**



Key Survey findings, together with analysis of relevant aspects of the regulatory framework, are summarized below.

### **All procedures are subject to the solicitation and payment of gifts, entertainment, and unofficial fees**

Thirty five percent of individual entrepreneurs and 27 percent of small and medium companies cited corruption as being one of the three most serious impediments to the development of their business. Survey results also indicate that between 24 and 44 percent of individual entrepreneurs, small and medium companies, and farmers admitted to having provided gifts, entertainment, services, or unofficial payments in an attempt to speed up the process of obtaining permits, licenses, or certificates, or to pass inspections. Individual entrepreneurs and small and medium companies estimated spending between nine and 10 percent of turnover on such unofficial payments to state agencies in order to get things done. If this is borne out in practice then it would appear that the rate of the “corruption tax” is even higher than the rate of the single tax on turnover, quite apart from the labor and other direct costs involved in finding “unofficial” solutions to regulatory and compliance issues.<sup>4</sup> Further reduction of the existing regulatory and compliance burden might help to alleviate this.

<sup>4</sup> The rate of the single tax on turnover is four percent for businesses engaged in manufacturing, trade, and agricultural processing, and six percent for all other activities.

### **Registration: additional reforms are needed, beyond the implementation of the “one-stop shop” principle**

The adoption of the *Law “On State Registration of Legal Entities and their Branches,”*<sup>5</sup> and *Government Resolution No. 182,*<sup>6</sup> together introduced the principle of the “one-stop shop” in the registration of legal entities in the Kyrgyz Republic, reducing the number of stages involved as well as the number of documents entrepreneurs were required to submit. While individual entrepreneurs are still required to register separately with the State Tax Service, this procedure does allow the simultaneous registration of individual entrepreneurs with both the State Statistics Committee and the Social Fund.

Since the reference period of the Survey was January–December 2008, Survey results do not fully capture the impact of these reforms. During 2008, small and medium companies still faced lengthy procedures in registering a business, spending, on average, 14 days on the preparation and submission of documents, and 15 days on obtaining registration. Such procedures regularly involved the payment of unofficial fees and/or gifts, with 22 percent of small and medium companies responding to the Survey admitting they had done so during the registration process. Research among focus groups also suggests that the registration of small and medium companies remained complex throughout 2009, with applications frequently refused on the grounds of minor errors (including, for example, minor discrepancies between Russian and Kyrgyz versions of documents). Moreover, the percentage of small and medium companies re-registering in 2008 was relatively high (at 9 percent of all small and medium companies registering that year), indicating a case for the reform of the current grounds for and legislation governing mandatory re-registration.

### **The procurement of permits is the most onerous regulatory procedure**

Some aspects of the permit procurement system have improved in recent years: the number of permits in force has been reduced, from 110 in 2004 to 67 in 2009<sup>7</sup>. Since 2004 these documents have all been recorded in a state “Permit

<sup>5</sup> *Law of the Kyrgyz Republic No. 57 “On State Registration of Legal Entities and their Branches,”* adopted February 20, 2009, implemented April 2009.

<sup>6</sup> *Government Resolution No. 182 “On the Procedure for Cooperation between State Authorities for the Registration of Legal Entities and their Branches under the Principle of the One-Stop Shop,”* adopted April 23, 2008, implemented May 2008.

<sup>7</sup> The “Register of Permits” issued by the executive bodies and their agencies, 2004 and 2009. This excludes permits issued by local self government.

Register<sup>8</sup>. Both the principles of the one-stop shop and the “silence is consent” were adopted in respect of construction permits in 2008. Nonetheless, there is no single source of legislation governing the issue and/or procurement of permits, and the list of permits included in the Permit Register is not comprehensive.

Recent reforms notwithstanding, almost 25 percent of individual entrepreneurs and small and medium companies were obliged to undergo procedures for the procurement of various permits in 2008 (Chart 1.1), as were 13 percent of farmers. Survey results also showed considerable regional disparities here, with enterprises in Jalalabat least likely to be subject to permit procedures, and businesses in Issyk-Kul the highest.

Survey respondents felt permit procurement procedures to be the most onerous regulatory procedure that they were forced to undergo (Chart 1.5), and it would also appear that these give rise the greatest cost (in terms of total costs nationally, Chart 1.4): both of which factors indicate a need for further reform. New legislation governing the procurement and dispensation of permits and licenses is currently being drafted as this report goes to press<sup>9</sup>.

### **The short validity of licenses, and the complexity of procedures relating to their procurement, are the main issues associated with current licensing regulation**

Some aspects of the licensing system have improved in recent years: the number of licenses in force was reduced to a total of 30 in 2010<sup>10</sup>, and a maximum lead time (of 30 days) introduced, together with limits on fees to be charged. Current legislation also stipulates that all licenses must be issued for a minimum duration of two years, unless provided for by law.

Despite recent reforms, the incidence of businesses having to undergo various licensing procedures remains high, with 22 percent of individual entrepreneurs and 15 percent of small and medium companies obliged to undergo various licensing procedures in 2008. As is the case for permit procurement, regional disparities are evident, with the incidence of licensing procedures highest in Issyk-Kul and lowest in Jalalabat.

Survey results found the validity of licenses issued to be shorter than provided for under current legislation: the validity of licenses for individual entrepreneurs and for small and medium companies is, de facto, 13 and 23 months, respectively. The brevity of license validity was cited by respondents as one of the key problems of the current licensing procedure, which they also feel to be complicated: over 50 percent of those businesses subject to licensing procedures indicated that they had found current procedures to be so (Chart 1.5).

### **Technical regulation: the slow pace of reform is hampering the development of small and medium companies**

The Kyrgyz Republic initiated the reform of its technical regulation system in 2004. This process is currently in transition, and it is anticipated that updated regulation will be adopted by December 2012. Current requirements not re-adopted at that point will either cease to be effective or will become voluntary according to the “guillotine” principle provided under the *Law of the Kyrgyz Republic “On the Fundamentals of Technical Regulation”*<sup>11</sup>. State standards relating to safety issues will remain mandatory during the transition period. Reform is proceeding at a slow pace, however, with only three technical regulations adopted by late 2009. Moreover, although the list of products subject to mandatory certification and conformity was reduced in number from 7,000 items in 2004 to 2,000 in 2009, this list, nonetheless, still includes a number of low-risk products (shoes, glass bottles, etc.), as well as foodstuffs, indicating scope for further reform.

As a result, mandatory certification remains a burdensome procedure, particularly for small and medium companies, with 17 percent of small and medium companies (mostly active in the industry/production and wholesale sectors) being subject to such procedures in 2008, each obtaining an average of seven certificates.

### **Further reform of inspections regulation is necessary, and implementation of the *Inspections Law* must be improved**

The adoption of the *Inspections Law* in May 2007<sup>12</sup> represented a clear improvement on the absence of regulation that had previously existed in this area. The *Inspections Law* defines the types of inspections that may be conducted, as

<sup>8</sup> Government Resolution No. 103 “On the Approval of the Register of Permits issued by the Executive Bodies and their Agencies,” adopted February 25, 2004.

<sup>9</sup> May 15, 2010.

<sup>10</sup> Presidential Decree No. 435 “On the Improvement of the State Regulation on Entrepreneurship,” adopted December 9, 2008.

<sup>11</sup> Law of the Kyrgyz Republic No. 67 “On the Fundamentals of Technical Regulation,” adopted May 22, 2004.

<sup>12</sup> Law of the Kyrgyz Republic No. 72 “On Procedures for Inspecting Business Entities,” adopted May 25, 2007, implemented May 1, 2008.

well as their frequency and duration, and obligatory aspects of the inspections process (including advance notification, the production of an inspections report, and so on). However, this law fails to introduce certain aspects of international best practice and contemporary principles, including (i) the risk-based selection of businesses to be inspected; and (ii) the introduction of checklists to determine a business's level of compliance. Survey results also indicate that many of the provisions of the *Inspections Law* (including, in particular, advance notification) are not observed in practice.

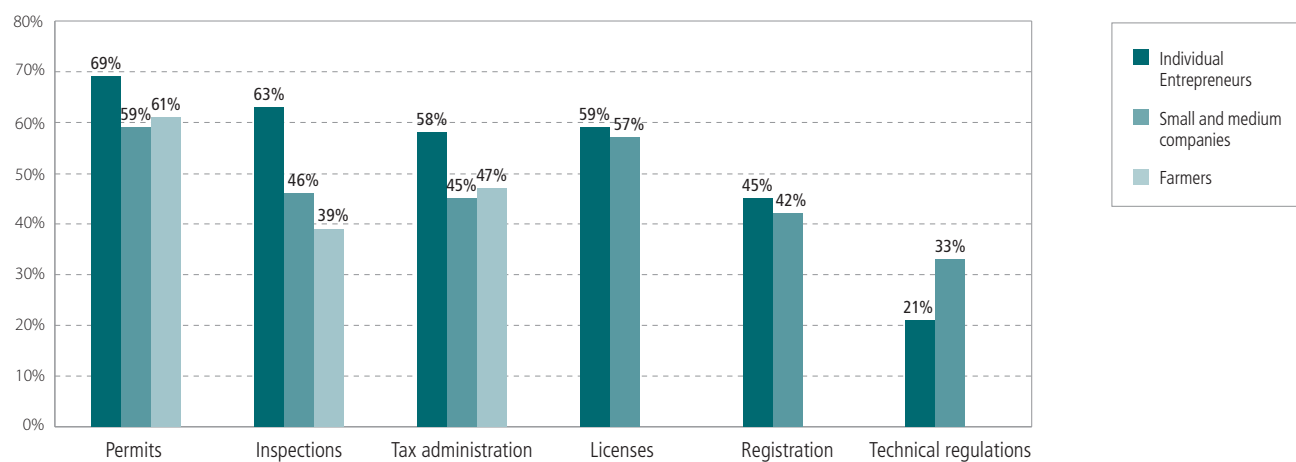
Survey results indicate a high incidence of inspections, suggesting that risk factors are not sufficiently considered in the selection of businesses for inspection, and indicating that resources are not being targeted at those businesses most likely to present the greatest risk to society, public health, and the environment, as well as indicating a waste of resources that is expensive for both government and business. Further reform is therefore urgently needed.

### The current tax system does not encourage business growth

Following the adoption of the new *Tax Code*, (implemented since January 1, 2009),<sup>13</sup> the total number of taxes paid and/or collected by businesses under the general tax regime was reduced. Many local taxes, in particular, were abolished, substantially simplifying the tax system for the majority of SMEs and drastically reducing administration costs for local tax authorities. The reduction in the rate of the single tax on turnover made the simplified regime more attractive to businesses, and the VAT rate was reduced from 20 to 12 percent. Further reform is needed, however. In particular, the combination of VAT and the new sales tax puts an excessive financial burden on businesses, and the patent tax regime and simplified tax regime need to be further reformed in order to encourage graduation from the former to the latter. Survey results indicate that the simplified tax regime did not, during 2008, play its intended role as an intermediate regime between the patent tax regime and the general tax regime, resulting in a constraint on both business growth and tax revenue collection. The simplified regime was, in fact, used by only 10 percent of small and medium companies and individual entrepreneurs eligible to do so. Survey results also indicate the labor costs involved in tax compliance to be very high (and higher than the labor costs associated with any other regulatory procedures covered by the Survey), indicating a clear case for the simplification of current tax administration and mandatory reporting procedures.

**Chart 1.5: Businesses believe the procurement of permits to be the most complex procedure to which they are subject**

Percentage of businesses rating procedures as "Rather difficult" or "Very difficult"



<sup>13</sup> The *Tax Code* of the Kyrgyz Republic, adopted October 17, 2008, implemented January 1, 2009.

## KEY RECOMMENDATIONS

One of the key objectives of the IFC *Study of Investment Climate as seen by Small and Medium Enterprises in the Kyrgyz Republic* is to identify precisely those areas in greatest need of reform, in order to reduce the regulatory burden and enable policy makers in the Kyrgyz Republic to establish priorities to encourage new business development and growth, resulting in higher employment and reducing poverty. Data contained in the Survey provide a basis on which the most viable potential reforms might be assessed. Table 1.1, below, summarizes the key recommendations arising from the Survey on that basis. More detailed coverage of each is available in relevant chapters.

**Table 1.1: IFC key recommendations call for the further simplification of procedures and the full implementation of the reforms passed in previous years**

REGISTRATION	
1.	Introduce the “silence is consent” principle into registration legislation, such that once an applicant has submitted all documents necessary for registration, the failure of the relevant registration agency to respond with a decision within a given timeframe shall be deemed to constitute approval.
2.	Amend simultaneous registration with the State Tax Service under the “one-stop shop” facility to include individual entrepreneurs.
3.	Cancel the requirement for re-registration in the event of a company increasing or decreasing its Charter Capital, and in the event of a business changing its name or address.
PERMITS	
1.	Develop a draft Permit Law, to include a comprehensive Permit Register.
2.	Reduce the burden of permit renewal by (i) extending the validity period of permits issued; and (ii) by simplifying the renewal procedure.
3.	Extend the “silence is consent” and the “one-stop shop” principles to other permits in addition to construction permits.
4.	Adopt self-certification as an alternative to the issue of permits for businesses and/or business activities that pose little risk.
LICENSING	
1.	Implement the provisions of current licensing legislation, particularly in respect of the terms of validity of licenses.
2.	Introduce a statutory five-year minimum validity for all licenses, and introduce additional permanent licenses, to be revoked only in the event of an infringement.
3.	Identify opportunities to further reduce the number of activities subject to licensing by excluding activities that present limited risk to public health and safety: potential examples might include real estate valuation and cargo transportation.
4.	Adopt the “silence is consent” principle.



## TECHNICAL REGULATIONS

1. Remove low-risk products and foodstuffs from the list of products subject to mandatory certification and declarations of conformity (e.g., shoes, glass bottles, etc).
2. Accelerate the process of the adoption and implementation of technical regulations in line with best international safety standards, norms, and rules, consistent with the provisions of the *Law on the Fundamentals of Technical Regulation*, 2004.
3. Provide legal requirements to allow the gradual transition from the ex ante control of food product samples (mandatory food product certification) to (i) the control of the food production process implemented under the “Hazard Analysis and Critical Control Points” (HACCP) and based on Good Hygiene Practice and Good Manufacturing Practices (GHP GMP); and (ii) to ensuring food traceability.

## INSPECTIONS

1. Introduce the principle of risk-based selection for the identification of businesses to be inspected.
2. Introduce in the legislation the obligation for all inspectorates to conduct inspections on the base of “checklists” and the obligation to develop inspection manuals outlining the inspection procedure.
3. Revise and update the compliance requirements of all inspectorates in order that these reflect directly the interests of public health, safety, and the environment, are consistent with the institutional context of the Kyrgyz Republic, and reflect international best practice.
4. Improve the practical, hands-on implementation of the *Inspections Law* of 2007.

## TAXATION

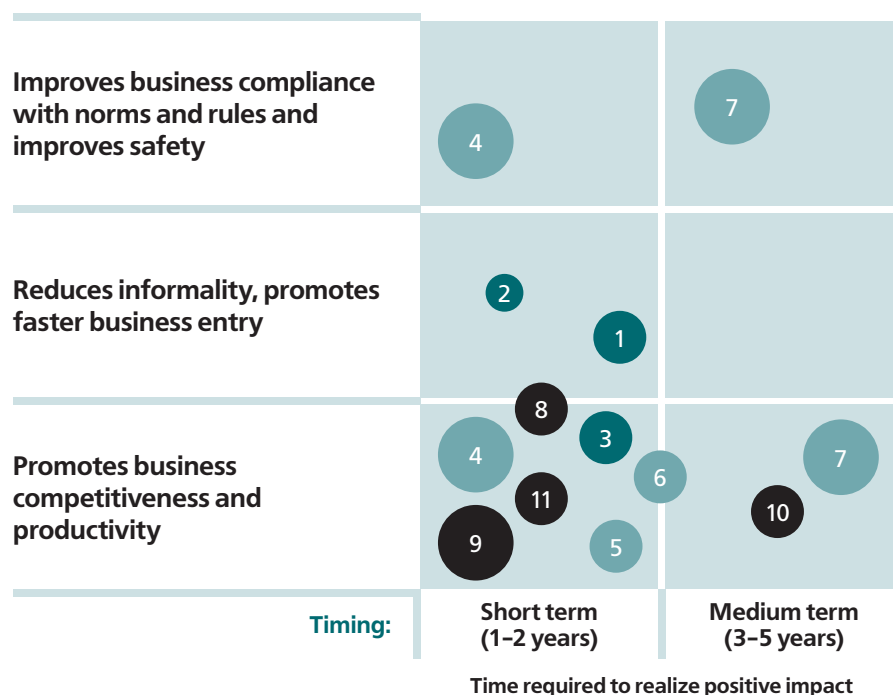
1. Building on the amendments introduced under the new *Tax Code*, undertake further reform of the simplified tax regime to make it more attractive in terms of its financial and administrative burden.
2. Once the simplified regime has been further reformed, reform the voluntary patent regime. A medium-term objective in this respect might be to revise the upper limit of the patent tax regime (based on turnover) in order to limit this facility to the smallest enterprises.
3. Implement a risk-based approach to the identification of businesses for tax audits, and to the planning and implementation of such tax audits.
4. Publicize the availability (and key principles of) the simplified regime. Materials for this purpose should include explicit information to help SMEs determine the tax regime most appropriate to their business.
5. Reduce the frequency of many filing requirements. It is recommended that businesses submit filings on a quarterly base for all taxes, with the exception of VAT.
6. Simplify reporting formats (by merging reports where appropriate, eliminating discretionary annexes etc.); eliminate the duplication of information requested by various agencies; and restrict to a minimum the amount of information requested by such agencies.
7. Encourage the voluntary filing of returns and reports online.

## Portfolio of recommendations to improve the investment climate in the Kyrgyz Republic

Size of bubble corresponds to expected impact



Status along the process:



### RECOMMENDATIONS

#### REGISTRATION

- 1 Introduce "silence is consent" principle into registration legislation
- 2 Amend simultaneous registration with State Tax Service under the "one-stop shop" facility to include individual entrepreneurs
- 3 Cancel requirement for re-registration in the event of a company increasing or decreasing its Charter Capital, and in the event of a business changing its name or address

#### PERMITS

- 4 Develop a draft Permit Law, to include comprehensive Permit Register
- 5 Reduce burden of permit renewal by (i) extending validity period of permits issued; and (ii) by simplifying renewal procedure
- 6 Extend "silence is consent" and "one-stop shop" principles to other permits in addition to construction permits
- 7 Adopt self-certification as alternative to issue of permits for businesses and/or business activities that pose little risk

#### LICENSING

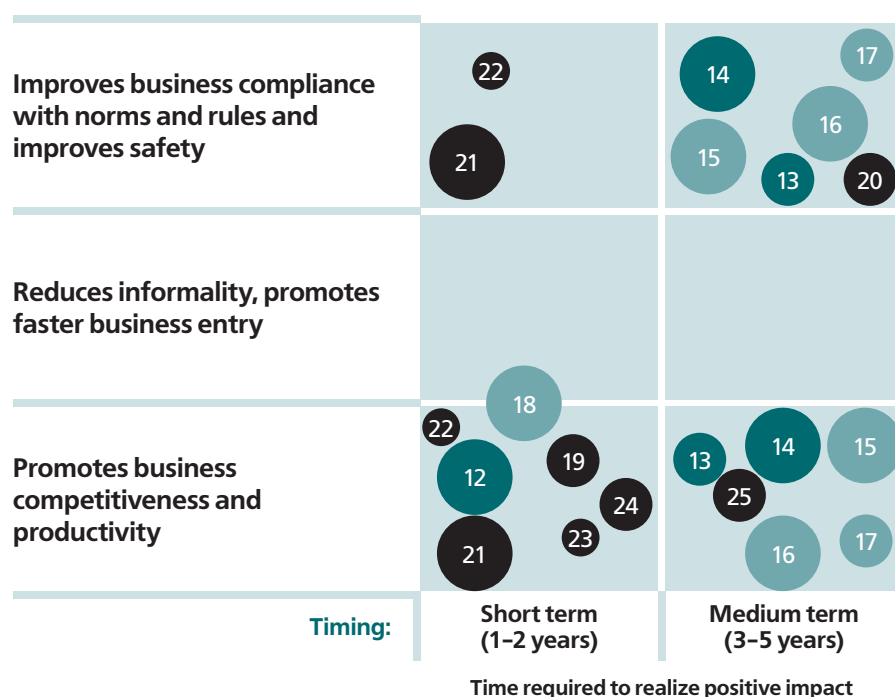
- 8 Implement provisions of current licensing legislation, particularly in respect of terms and validity of licenses
- 9 Introduce statutory five-year minimum validity for all licenses, and introduce additional permanent licenses, to be revoked only in event of infringement
- 10 Identify opportunities to further reduce number of activities subject to licensing (e.g., real estate valuation and cargo transportation)
- 11 Adopt the "silence is consent" principle

## Portfolio of recommendations to improve the investment climate in the Kyrgyz Republic

Size of bubble corresponds to expected impact



Status along the process:



## RECOMMENDATIONS

### TECHNICAL REGULATIONS

- 12 Remove low-risk products and foodstuffs from list of products subject to mandatory certification and declarations of conformity
- 13 Accelerate process of adoption and implementation of technical regulations in line with best international safety standards, norms, and rules
- 14 Provide legal requirements to allow gradual transition from the ex-ante control of food product samples (mandatory food product certification) to control of food production process

### INSPECTIONS

- 15 Implement principle of risk-based selection for identification of businesses to be inspected
- 16 Introduce in legislation the obligation for all inspectorates to conduct inspections on the base of "checklists" and the obligation to develop inspection manuals outlining the inspection procedure
- 17 Revise and update compliance requirements of all inspectorates
- 18 Improve practical, hands-on implementation of Inspections Law of 2007

### TAXATION

- 19 Undertake further reform of simplified tax regime to make it more attractive in terms of its financial and administrative burden
- 20 Once the simplified regime has been further reformed, reform voluntary patent regime. A medium-term objective in this respect might be to revise upper limit of the patent tax regime (based on turnover) in order to limit this facility to smallest enterprises
- 21 Implement risk-based approach to identification of businesses for tax audits
- 22 Publicize availability (and key principles) of simplified regime
- 23 Reduce the frequency of many filing requirements
- 24 Simplify reporting formats
- 25 Encourage voluntary filing of returns and reports online

**Investment Climate in the Kyrgyz Republic as seen by Small and Medium Enterprises report: organization and structure**

The introductory chapter to this report paints a general picture of the macro-economic situation in the Kyrgyz Republic, as well as providing a data-driven description of each of the three categories of enterprises covered in the Survey – individual entrepreneurs, small and medium companies, and farmers. Chapters 3 through 8 provide a detailed examination of Survey findings on a variety of key topics, and each chapter begins with an explanation of the legal and regulatory framework of that issue. Chapter 9 provides an overview of the survey methodology. Finally, the Data Annex presents additional findings on issues covered under “Access to Finance” and “Foreign Trade”.



## 2. Business Environment

Reforms improved the business environment but additional measures are needed to foster continued growth

### 2.1. THE IMPACT OF THE GLOBAL ECONOMIC CRISIS IN THE KYRGYZ REPUBLIC REMAINS RELATIVELY LIMITED

From 2000 to 2008, the Kyrgyz economy grew at an average annual rate of 4.8 percent – this despite zero growth in 2002 (the result of an accident at the Kumtor gold deposit) and economic contraction in 2005 (falling gold output and political instability). Growth peaked in 2007 and 2008, with rates of 8.5 percent and 7.6 percent, respectively (Chart 2.1). Yet the Kyrgyz Republic's economy has still not fully recovered from the collapse of the Soviet Union. GDP in 2008 was still only 96.4% of the 1990 level.

**Chart 2.1: The Kyrgyz economy has grown strongly between 2002 and 2008**

Real GDP Growth in percent (2000–2008)

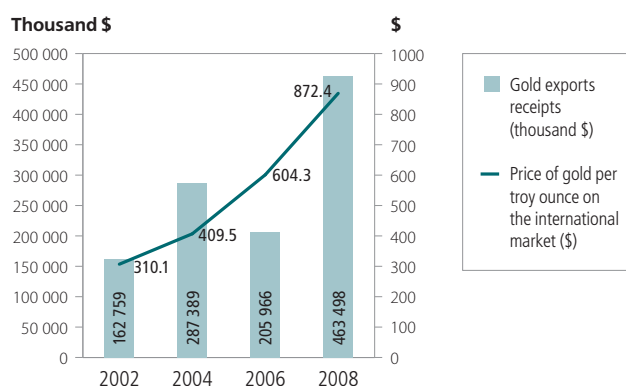


**Source:** IMF (2009) "Country Report No.09/209," July; IMF (2007) "Country Report No. 07/193," June; IMF (2006), "Country Report No. 06/235," June; IMF (2004) "Country Report No. 04/200," July.

Although the Kyrgyz Republic has since independence implemented reforms to improve the business environment, growth between 2000 and 2008 was mostly due to favorable external factors such as a steady increase in the price of gold (Chart 2.2), the main commodity of the Kyrgyz Republic, strong growth of Russia and other trading partners and a significant increase in remittances, which boosted consumption (Chart 2.3).

**Chart 2.2: Gold exports receipts have more than doubled between 2002 and 2008**

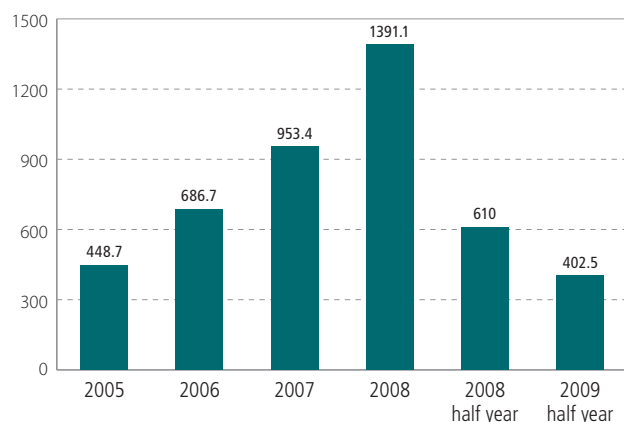
Evolution of gold exports receipts and price of gold per troy ounce, 2002–2008



**Source gold exports:** State Statistics Committee (2005) "Foreign Trade of the Kyrgyz Republic 2002–2004"; State Statistics Committee (2009) "Foreign Trade of the Kyrgyz Republic 2004–2008".  
**Source gold prices:** London Bullion Market Association, Gold Fixings, at <http://www.lbma.org.uk/?area=stats&page=gold/2008monthlygold>.

**Chart 2.3: Remittances have decreased by over 34 percent as a result of the global economic crises**

**Workers remittances 2005–2009** (Million \$)



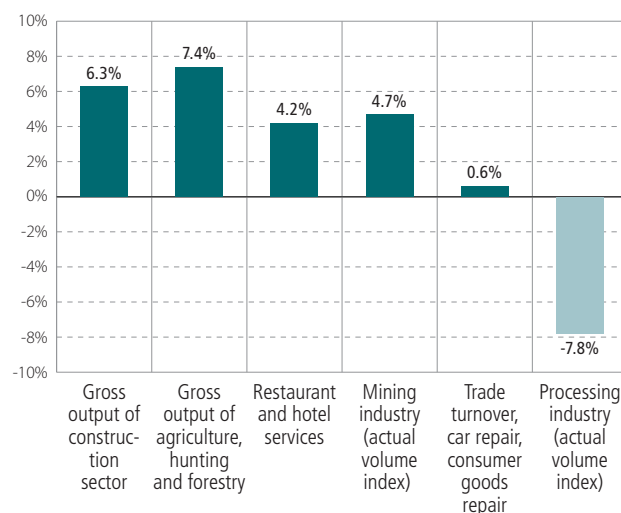
**Source:** National Bank of the Kyrgyz Republic (2009) "Balance of Payments of the Kyrgyz Republic, first half of 2009," October.

The impact of the global economic crisis on the Kyrgyz economy has thus far been relatively limited. The gold price rise from \$872<sup>14</sup> in 2008 to \$1,126 in November 2009<sup>15</sup> compensated for the decrease in exports receipts, which, in 2009, reached less than 80 percent of their 2008 level.<sup>16</sup>

Merchandise imports and remittances dropped 25 percent and 34 percent, respectively, in the first half of 2009. However, real GDP growth remained positive in 2009 (2.3 percent<sup>17</sup>), mostly thanks to growth in the agriculture, telecommunications and construction sectors. Meanwhile, the processing/industry sector declined 7.8 percent in 2009 (Chart 2.4) mostly due to the decline in export-oriented sectors such as textiles. This drop could be traced to an irregular supply of electricity and declining demand on the part of key trading partners Russia and Kazakhstan.

**Chart 2.4: The processing/industry sector is the only sector that contracted in 2009. Growth was highest in the agriculture sector**

**Growth rate of the main sectors of the economy**  
(January–December 2009)



**Source:** State Statistics Committee of the Kyrgyz Republic (2009) "Express Bulletin," December 9.

The global economic crisis has had no apparent impact on employment in the Kyrgyz Republic: unemployment fell by 8.6 percent in 2009.<sup>18</sup> However, a 34% decrease in remittances likely had an adverse effect on living standards in a country where more than a third of the population (35 percent) lives below the poverty line.

Survey results indicate that processing/industry is also one of the sectors for which the regulatory burden is the highest. The percentage of processing/industry companies that had to obtain government mandated "certificates of conformity" in 2008 was higher than that of any other sector. It is therefore important that the government continues to reduce the regulatory barriers that increase the costs of doing business in the Kyrgyz Republic. In addition, the Kyrgyz economy currently relies mostly on agriculture and trade (Chart 2.5) and needs to diversify. Alleviating the regulatory burden for SMEs would help expand the industry/production sector, boosting the diversification of the Kyrgyz economy.

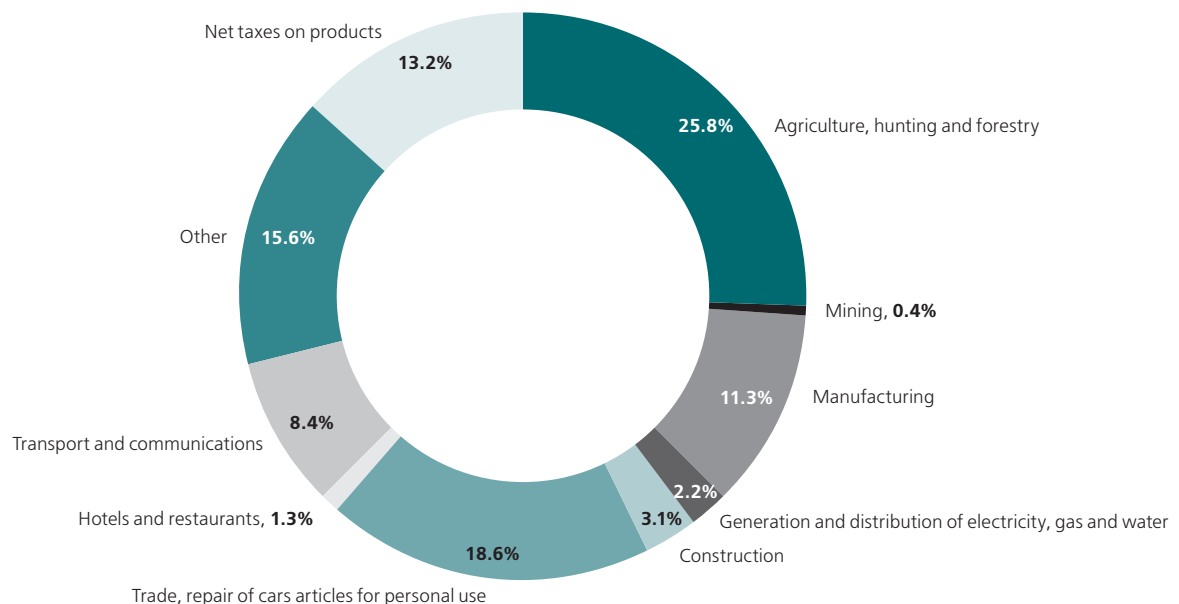
<sup>14</sup> Per troy ounce.

<sup>15</sup> London Bullion Market Association, Gold Fixings, at <http://www.lbma.org.uk/?area=stats&page=gold/2008monthlygold>.

<sup>16</sup> State Statistics Committee of the Kyrgyz Republic (2010) "Express information" (preliminary estimates), January 16.

<sup>17</sup> State Statistics Committee of the Kyrgyz Republic (2010) "Express information" (preliminary estimates), January 16.

<sup>18</sup> State Statistics Committee of the Kyrgyz Republic (2010) "Express information" (preliminary estimates), January 16.

**Chart 2.5: Agriculture and trade are the biggest sectors of the economy****Structure of GDP, 2008**

Source: National Bank of the Kyrgyz republic (2008) "Annual Report".

## 2.2. THE PRIVATE SECTOR HAS GROWN SIGNIFICANTLY IN THE PAST YEARS, EXCEPT FOR MEDIUM AND LARGE COMPANIES

For the purposes of this survey, the SME sector of the Kyrgyz Republic is dis-aggregated into three categories: individual entrepreneurs, small and medium companies and farmers (Table 2.1).

**Table 2.1: Definition of SME categories**

SME SUB-POPULATION	DEFINITION
Individual entrepreneur	A sole proprietor who owns an unincorporated business by himself/herself. A person who solely owns a legal entity is not a sole proprietor under this definition.
Small and medium company	A small and medium company in the production sphere is a legal entity having a maximum of 200 staff; in the non-production sphere it is a legal entity having a maximum of 50 staff.
Farmer	Owners of private agricultural farms, whether they are sole proprietors or legal entities.

Following the collapse of the Soviet Union, private sector enterprises sprung up and soon became a key part of the Kyrgyz economy, driving economic growth. The Kyrgyz SME sector now accounts for 13.8 percent of total employment and 42.8 percent of GDP.<sup>19</sup> In 2008, the private sector included 204,246 registered individual entrepreneurs, 11,988 small and medium companies and 1,631 large companies (Chart 2.6).

From 2002 to 2008 the number of registered farmers grew from 251,526 to 321,856, a 28 percent increase. Over the same period the number of registered private sector enterprises grew 60 percent, from 130,746 to 216,617. However, the business population grew unevenly. From 2002 to 2008, the number of:

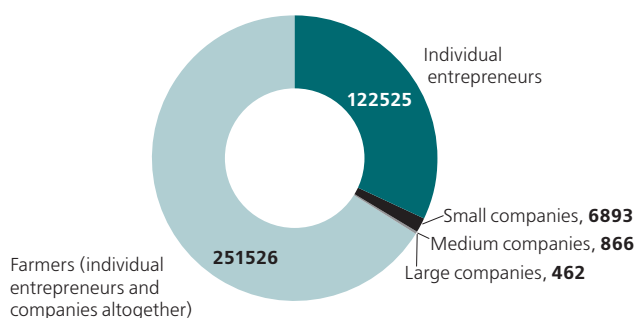
- individual entrepreneurs increased by 67 percent;
- small companies increased by 61 percent;
- medium enterprises increased by two percent (there were only 19 more medium enterprises in 2008 than in 2002);
- large companies decreased by 17 percent (there were 79 fewer large companies in 2008 compared to 2002).

<sup>19</sup> State Statistics Committee of the Kyrgyz Republic (2009) "Small and Medium Enterprises in the Kyrgyz Republic, 2004-2008".

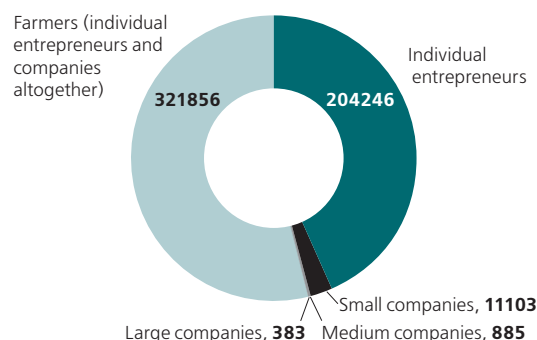


**Chart 2.6: The number of private enterprises increased sharply from 2002 to 2008, except for medium and large companies**

**Composition of the private sector, 2002**  
(number of businesses registered)



**Composition of the private sector, 2008**  
(number of registered businesses)



Source: State Statistics Committee.

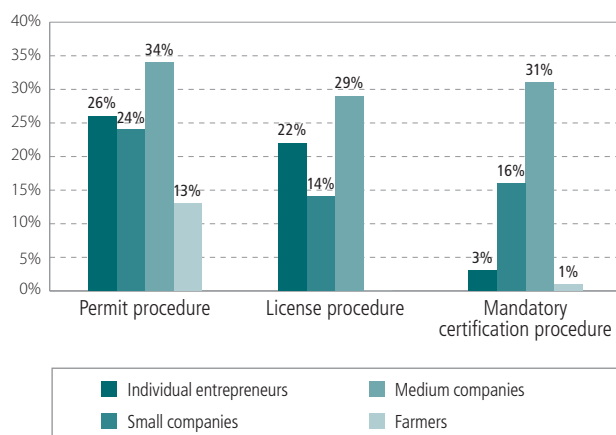
Note: Individual entrepreneurs and small and medium companies include businesses active in the agriculture and fishing sector.

The decrease in the share of medium and large companies in the overall private enterprise population between 2002 and 2008 can be partly explained by their more demanding business environment. IFC survey results indicate that, during this period, a greater percentage of medium-sized companies were subject to regulatory procedures than small companies, individual entrepreneurs and farmers (Chart 2.7).

Power shortages and political instability further explain the lack of growth. Medium and large companies are active in the processing/industry sector, and their profits thus depend heavily on uninterrupted access to electricity.

**Chart 2.7: In 2008, coverage of the main regulatory procedures was greatest for medium companies and lowest for farmers**

**Proportion of SMEs who went through selected regulatory procedures in 2008**



In spite of the increase in small companies between 2002 and 2008, the number of registered small and medium companies per 1,000 inhabitants, 2.3, remains comparatively low. Ukraine, for example, has 7.5 companies per 1,000 inhabitants, while Slovenia has 20 and Sweden more than 36. At about 53 percent of GDP<sup>20</sup>, the Kyrgyz informal sector is a much larger slice of the total economy than that of Europe, which partly accounts for the difference in the number of small and medium companies. A comparison with other countries in the Eastern Europe and Central Asia region, however, suggests there is room for growth. International experience has shown that a more favorable business environment would encourage informal businesses to register and join the formal economy.

Therefore, the need to implement additional regulatory reforms and to simplify the administration of regulatory procedures and ensure growth is urgent. Medium companies employ more staff and contribute more revenues to the national budget than do small companies, individual entrepreneurs and farmers. They are also more likely to export goods and services. Survey results indicate that medium companies employ on average 71 employees, against 16 employees for small companies, 4 employees for individual entrepreneurs and 5 employees and 5 relatives for farmers (Table 2). Survey results also indicate that 8.5 percent of medium companies exported in 2008, against 5.9 percent of small companies and 1.1 percent of individual entrepreneurs.

<sup>20</sup> UNDP (2006) "The Shadow Economy in the Kyrgyz Republic, Trends, Estimates and Policy Options".

Table 2.2: Typical Kyrgyz SMEs

	AVERAGE ANNUAL TURNOVER, IN KGS	AVERAGE ANNUAL PROFIT, IN KGS	INDICATOR VALUE	NUMBER OF RELATIVES
Individual entrepreneurs	361,708 (\$9,891)	120,566 (\$3,297)	4	
Small companies	5,052,320 (\$138,155)	559,021 (\$15,286)	16	
Medium companies	14,214,045 (\$388,681)	1,090,190 (\$29,811)	71	
Farmers	114,601 (\$3,134)	44,173 (\$1,208)	5	5

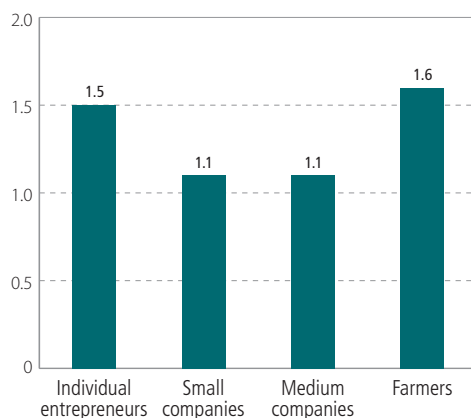
Source: Survey results.

### Medium companies are the least productive, farmers are the most productive

In more advanced market economies, small and medium companies are more productive than individual entrepreneurs. The larger turnover of small and medium companies usually allows them to capture economies of scale in the production process easier than farmers and individual entrepreneurs. However, in the Kyrgyz Republic, medium companies were in 2008 less productive than small companies, individual entrepreneurs and farmers. Farmers were actually the most productive segment of the SME population (Chart 2.8), although they had the lowest turnover (Table 2.2). One of the reasons why farmers were the most productive may be that the proportion of farmers subject to regulatory procedures is lower than for individual entrepreneurs and small and medium companies. The need to further alleviate the regulatory burden and increase SME productivity is therefore clear.

Chart 2.8: Small and medium companies are the least productive of the SME sector<sup>21</sup>

#### Productivity across the SME sector

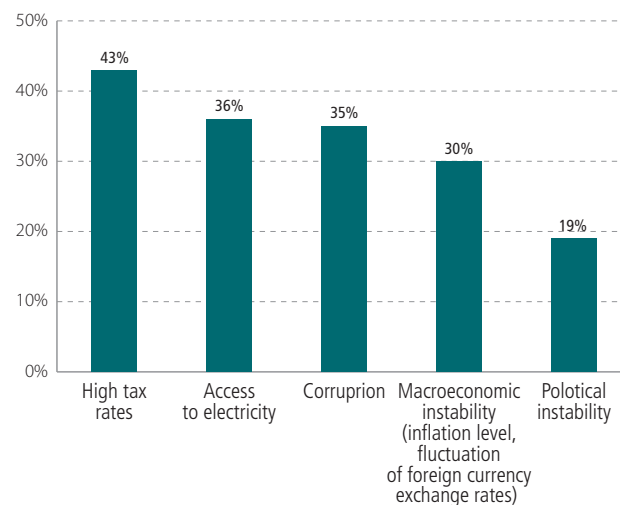


### 2.3. HIGH TAX RATES, CORRUPTION, MACRO-ECONOMIC INSTABILITY AND AN UNRELIABLE ELECTRICAL SUPPLY ARE THE MAIN PROBLEMS FACED BY SMALL AND MEDIUM ENTERPRISES

Survey data indicate that entrepreneurs view high tax rates, corruption, macroeconomic instability and the absence of a stable source of electricity as the main obstacles to growth. Reducing the regulatory burden for SMEs is an effective way to reduce corruption, as it decreases contacts between entrepreneurs and employees of regulatory agencies. A reduced regulatory burden also strengthens macroeconomic stability. For example, in the aftermath of the 1998 Asian crisis, South Korea instituted radical regulatory reform, reducing the number of permits, licenses, regulations and administrative procedures by 50 percent within two years. This led to more businesses and increased the overall strength and competitiveness of the South Korean economy.

Chart 2.9: Individual entrepreneurs consider high tax rates as the biggest obstacle to doing business

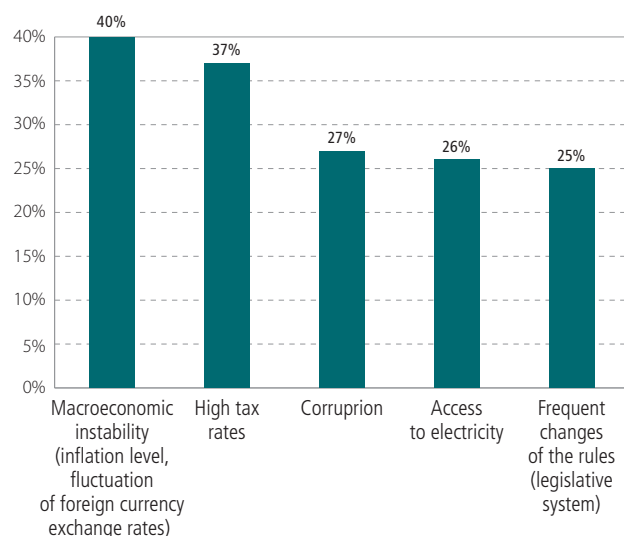
#### Main obstacles to business development as identified by individual entrepreneurs



<sup>21</sup> Productivity is calculated by IFC as a ratio of "Total annual turnover" to "Total annual turnover" – "Total annual profit".

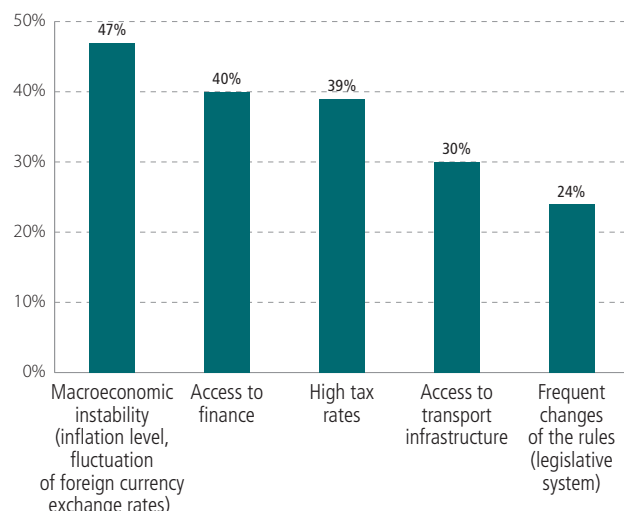
**Chart 2.10: Small and medium companies consider macroeconomic instability as the biggest obstacle to doing business**

Main obstacles to business development as identified by small and medium companies



**Chart 2.11: Farmers consider macroeconomic instability as the biggest obstacle to doing business**

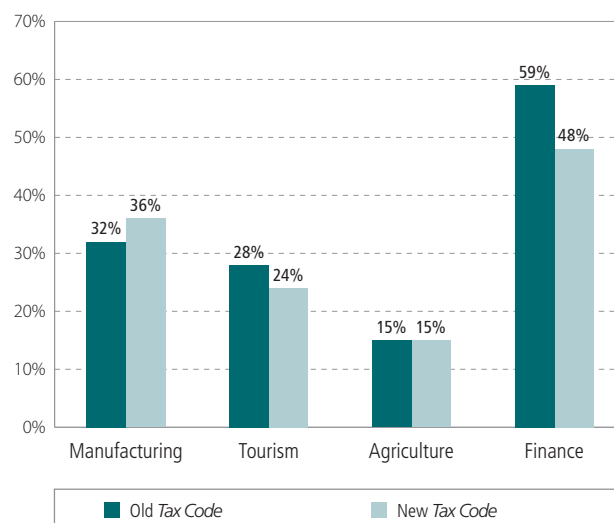
Main obstacles to business development as identified by farmers



For all SMEs, high tax rates are the number one obstacle to growth (Chart 2.9, 2.10 and 2.11): 43 percent of individual entrepreneurs, 37 percent of small and medium companies and 39 percent of farmers consider high taxes to be among the three main obstacles to the development of their businesses. An IFC survey done in September 2008 examined the Marginal Effective Tax Rate (METR),<sup>22</sup> which is the effective tax on an incremental investment by a business. The METR summarizes the effect of the entire tax code on an incremental investment; as a result it is a very useful parameter to assess the impact of the tax system on an investor's decision to infuse capital into his or her business.

**Chart 2.12: The tax burden on incremental investment is much higher than the 10 percent corporate tax**

Comparison of METRs under the old and the new *Tax Code*



Source: World Bank staff calculations, based on official data.

The METRs analysis for the Kyrgyz Republic reveals that, for all sectors, the overall burden of the tax system on investment is significantly greater than the statutory corporate rate of 10 percent (Chart 2.12). The METRs for the agriculture, tourism and finance sectors stayed the same or decreased under the new *Tax Code*, whereas the METR for the manufacturing sector rose. Because of the high number of transactions between the raw material stage and the retail sale, the cascading effect of the new sales tax poses a higher effective burden than the 20 percent VAT rate under the old *Tax*

<sup>22</sup> Foreign Investment Advisory Service (FIAS) (2008) "The Tax System and the Business Enabling Environment in the Kyrgyz Republic: Preliminary Results from the Initial Mission," September.

*Code.* The METR analysis indicates that enterprises face a high burden on investment, which limits their growth. In addition, survey respondents also find tax administration complex: 58 percent of individual entrepreneurs, 45 percent of small and medium companies and 47 percent of farmers found tax administration either “somewhat difficult” or “very difficult.”

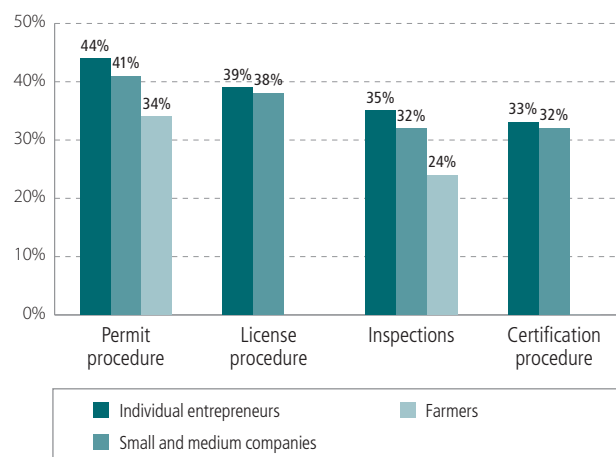
Macroeconomic instability was the second main obstacle identified by entrepreneurs (Chart 2.9, 2.10 and 2.11): 30 percent of individual entrepreneurs, 40 percent of small and medium companies and 47 percent of farmers considered macroeconomic instability to be among their three main obstacles. Entrepreneurs’ profits depend on macroeconomic stability. For example, farmers’ incomes depend on food prices, which are fixed internationally. The high share of entrepreneurs who identified macroeconomic instability as a major growth obstacle could be partially attributed to the fact that, at the time the survey was conducted (April-August 2009), fears remained that the global economic crisis would adversely impact the Kyrgyz economic. As stated above, the impact has been relatively limited.

Access to electricity is also an important obstacle identified by entrepreneurs, especially by individual entrepreneurs and small and medium companies (Chart 2.9 and 2.10): 36 percent of individual entrepreneurs and 26 percent of small and medium companies ranked the problem among their three primary obstacles. Business Environment and Enterprise Performance Survey (BEEPS) data confirm that lack of access to electricity is a major obstacle (Chart 2.14). Since 2008, the Kyrgyz Republic has faced serious electricity shortages due to low water levels in the Toktogul reservoir. Survey results indicate that 81 percent of small and medium companies faced scheduled power supply outages and 78 percent of small and medium companies faced unscheduled power supply outages in 2008. Average scheduled power outage losses totaled about KGS134,666 (\$3,682) per business – equal to 3.4 percent of small and medium companies’ annual turnover. Small and medium companies who suffered from unscheduled power supply outages in 2008 estimated the losses at KGS96,054 (\$2,627), or 1.7 percent of turnover. In total, Kyrgyz small and medium companies lost the equivalent of KGS2 billion (\$55 million), or 1.4 percent of 2008 GDP. Despite these significant losses, survey results indicate that only 31 percent of small and medium companies implemented energy efficiency measures in 2008. This calls for the scaling up of energy efficiency and saving policies such as efficient lighting, energy efficient equipment, thermal insulation of business premises, etc.

Some 35 percent of individual entrepreneurs and 27 percent of small and medium companies cited corruption as one of the three main obstacles to the development of their businesses. Survey data indicate that between 24 percent and 44 percent of businesses admitted to making unofficial payments to “speed up” the process of obtaining permits, licenses, certificates, or pass inspections (Chart 2.13). Individual entrepreneurs and small and medium companies estimate that they spent nine percent and 10 percent of their turnover, respectively, on unofficial payments and gifts to representatives of state agencies. This suggests the rate of the “corruption tax” is even higher than the rate of the single tax on turnover.<sup>23</sup> In addition to making unofficial payments, owners and managers spend staff time dealing with “unofficial ways” of solving problems.

**Chart 2.13: Between 24 percent and 44 percent of businesses said they made unofficial payments to speed up the process of obtaining permits, licenses, certificates, or pass inspections**

**Proportion of SMEs who practiced unofficial payments during procedures**



Other surveys confirm that corruption is a serious problem for businesses in the Kyrgyz Republic: the Kyrgyz Republic ranks 162 among 180 countries in Transparency International’s 2009 Corruption Perception index.<sup>24</sup> In addition, BEEPS data confirm that corruption is a major problem for businesses: 59

<sup>23</sup> The rate of the Single tax on turnover is four percent for manufacturing, trade and agricultural processing and six percent for other types of activities.

<sup>24</sup> Transparency International “Corruption Perceptions Index 2009”. Available at [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2009/cpi\\_2009\\_table](http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table)

percent of BEEPS respondents considered corruption a major obstacle to doing businesses (Chart 2.14). This share was among the highest of all post-Soviet countries (Chart 2.15). One effective way to reduce the “corruption tax” for small and medium enterprises is to alleviate the regulatory burden. An

ideal regulatory system is one that (i) ensures businesses do not threaten human health and safety or the environment, (ii) minimizes costs to businesses and (iii) optimizes outcomes to government. Despite recent reforms, the Kyrgyz regulatory system remains far from ideal.

### BOX 2.1: BEEPS DATA CONFIRM THAT UNRELIABLE ACCESS TO ELECTRICITY, CORRUPTION AND HIGH TAX RATES ARE MAJOR OBSTACLES TO DOING BUSINESS IN THE KYRGYZ REPUBLIC

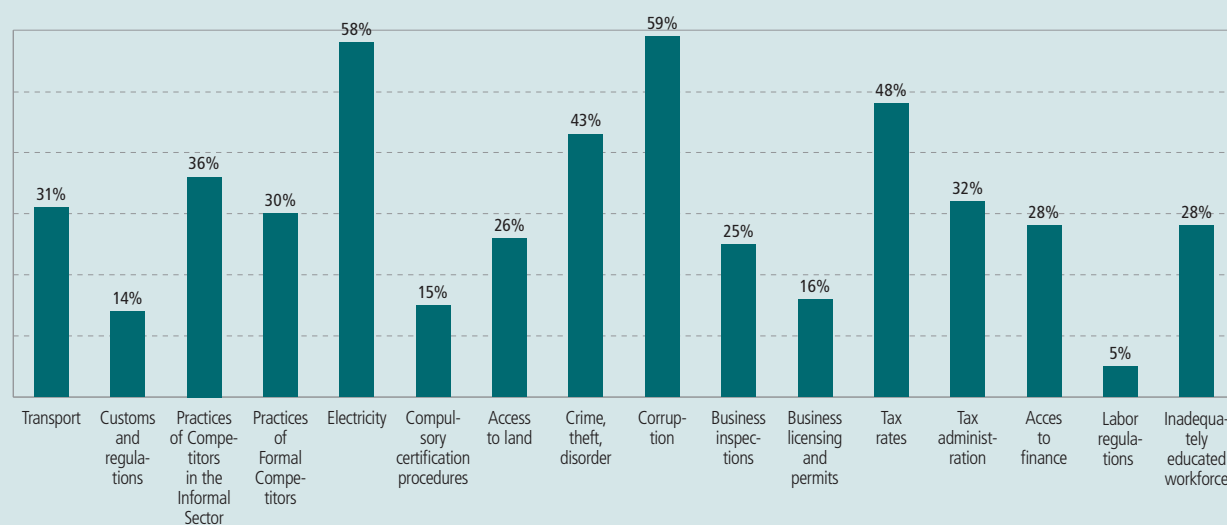
BEEPS are conducted by the World Bank and its partners across all geographic regions and cover small, medium and large companies. The surveys are applied to a representative sample of firms in the non-agricultural economy. The sample is consistently defined in all countries and includes the manufacturing sector, the services sector and the transportation and construction sectors. Public utilities, government services, health care and financial services sectors are not included in the sample.

Via face-to-face interviews with firm managers and owners, BEEPS collect a wide range of qualitative and quantitative information regarding the business environment and the productivity of their firms. Topics covered include the obstacles to doing business, infrastructure, finance, labor, corruption and regulation, law and order, innovation and technology, and trade.

BEEPS data indicate that the three main obstacles to doing business in the Kyrgyz Republic are corruption (59 percent of respondents), unreliable access to electricity (58 percent of respondents) and high tax rates (48 percent of respondents). These obstacles were also among the four main obstacles identified by the IFC SME survey respondents in 2008.

**Chart 2.14: Corruption was the main obstacle to doing business identified by BEEPS respondents in the Kyrgyz Republic, followed by unreliable access to electricity**

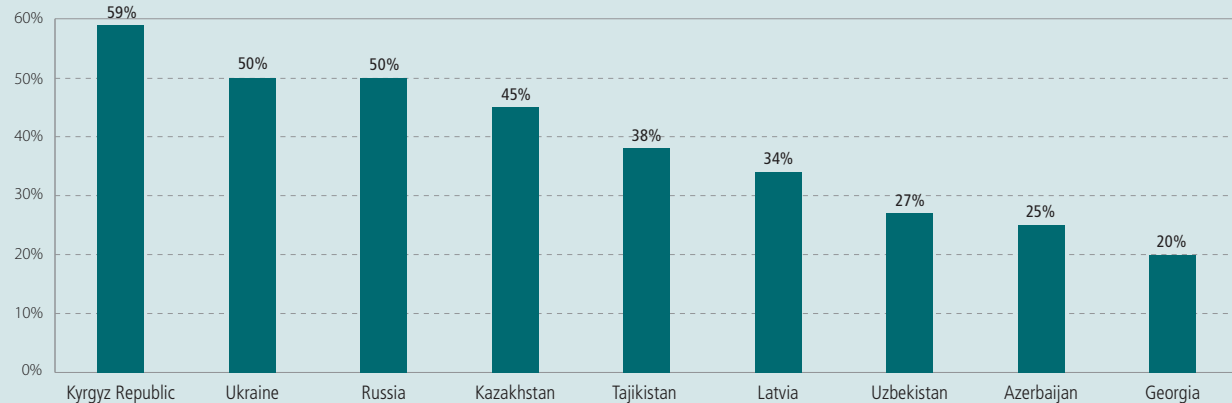
Proportion of respondents who cited the following as major obstacles to doing business



Source: EBRD-World Bank Business Environment and Enterprise Performance Survey data.

**Chart 2.15: The share of entrepreneurs who think corruption is a major obstacle to doing business in the Kyrgyz Republic is among the highest of post-Soviet countries**

Proportion of businesses who think corruption is a major obstacle to doing business in selected post-Soviet countries



Source: EBRD-World Bank Business Environment and Enterprise Performance Survey data

#### 2.4. IMPORTANT LEGAL REFORMS WERE MADE TO IMPROVE THE BUSINESS ENVIRONMENT, BUT THE IMPACT HAS BEEN LIMITED

The Kyrgyz Republic has since its independence been one of the leading economic reformers among post-Soviet nations, especially compared to other Central Asian countries. In 1998, these reforms led to its accession to the World Trade Organization (WTO); today it remains the only Central Asian member of the WTO. Since 2007, the pace of reforms has increased, especially in the area of permits/licensing, busi-

ness registration, taxes and inspections: a new *Tax Code* was adopted; three Laws and numerous Decrees and Resolutions covering the permit, licensing, registration, inspection and import/export procedures were passed (Table 2.3). More are under preparation. As a result, the Kyrgyz Republic was ranked third and second best reformer, respectively, in the IFC-World Bank Doing Business 2009 and 2010 reports. Survey results, however, indicate that legal reforms have made minimal impact and that additional reforms may be necessary.

**Table 2.3: Main Legislative acts that could positively impact the business environment introduced from 2007 to 2009**

DOCUMENT	DATE OF ADOPTION	CONTENT
<i>The Tax Code</i>	Adopted on October 17, 2008, in effect since January 1, 2009.	The legislation reduced the total number of different taxes paid and/or collected by businesses in the general regime from 15 <sup>25</sup> (8 national and 7 local taxes) to 8 (6 national taxes and 2 local taxes), cut the VAT rate from 20 to 12 percent, decreased the rate of the simplified tax on turnover and introduced the sales tax.
<i>Law of the Kyrgyz Republic No. 57 "On State Registration of Legal Entities and their Branches"</i>	February 20, 2009	Creates a "one-stop shop" for the registration of legal entities and cancelled some requirements for the registration of legal entities (e.g notarization of documents, the company seal is now voluntary, etc).

<sup>25</sup> The immovable property tax existed in the old tax code, but was not enforced. It was therefore not counted.

DOCUMENT	DATE OF ADOPTION	CONTENT
<i>Law of the Kyrgyz Republic No. 55 "On the Streamlining of the Legislative Framework for Entrepreneurship"</i>	April 5, 2008	Orders the use of the Regulatory Impact Analysis (RIA) methodology to streamline the legal framework for entrepreneurship. Forbids the issuance of permits and licenses which are not stipulated in the Laws and in the Resolutions of the Government of the Kyrgyz Republic.
<i>Law of the Kyrgyz Republic No. 72 "On Procedures for Inspecting Business Entities"</i>	May 25, 2007	Defines the different types of inspections, the principles and the general procedure of inspections, the rights and responsibilities of the state supervisory bodies and business entities.
<i>Presidential Decree No. 435 "On the Improvement of the State Regulation on Entrepreneurship"</i>	December 09, 2008	Orders the decrease in the number of licenses and permits by 30% and ordered to draft a Law on permits and licenses by the end of 2009.
<i>Presidential Decree No. 164 "On Streamlining of the Construction Permits System"</i>	May 14, 2008	Introduces the "one-stop shop" mechanism for construction permits.
<i>Presidential Decree No. 344 "On Arrangements to Streamline the Regulatory System"</i>	July 23, 2007	Orders the use of the Regulatory Impact Analysis (RIA) methodology to revise and streamline the legislation pertaining to business activity.
<i>Parliament Resolution No. 553-IV "On Approval of the List of Authorized Bodies Having the Right to Inspect Business Entities"</i>	June 20, 2008	Lists most of State Bodies who have the right to conduct inspections.
<i>Government Resolution No. 252 "On the Improvement of the Regulation on the Procedure of Issuance of Construction Permits"</i>	May 30, 2008	Defines the procedure to issue construction permits through the "one-stop shop" principle
<i>Government Resolution No. 509 "On the Streamlining of the Licenses and Permits Legislative Framework"</i>	September 11, 2008	Approves the Action plan for the implementation of the Law on "the streamlining of the Legislative framework for entrepreneurship".
<i>Government Resolution No. 603 "On the Methodology of Regulatory Impact Assessment of Normative Legal Acts Pertaining to the Operations of Businesses"</i>	December 20, 2007	Defines the methodology for the use of regulatory impact assessment to streamline the legislation linked with business activities.
<i>Government Resolution No. 533 "On the Procedures for Inspecting Business Entities".</i>	November 6, 2007	Prescribes the mandatory registration of planned and unplanned inspections in the Ministry of Economic Regulation prior to being conducted.
<i>Joint Order of the State Statistics Committee and the Social Fund, "On Cooperation Between the State Statistics Committee and the Social Fund in the Process of the State Registration, Re-registration and De-registration of Individual Entrepreneurs"</i>	April 23, 2008 and May 12, 2008	Introduces the "one-stop shop" registration for individual entrepreneurs (excluding the registration in the State Tax Committee)

The IFC-World Bank Doing Business 2010 report<sup>26</sup> reflected the advent of these reforms. It ranked the Kyrgyz Republic 41<sup>st</sup> in "Ease of Doing Business", up from 80<sup>th</sup> in 2009, and the second top reformer overall. The Kyrgyz Republic also performed well on "Protecting Investors", "Starting a Busi-

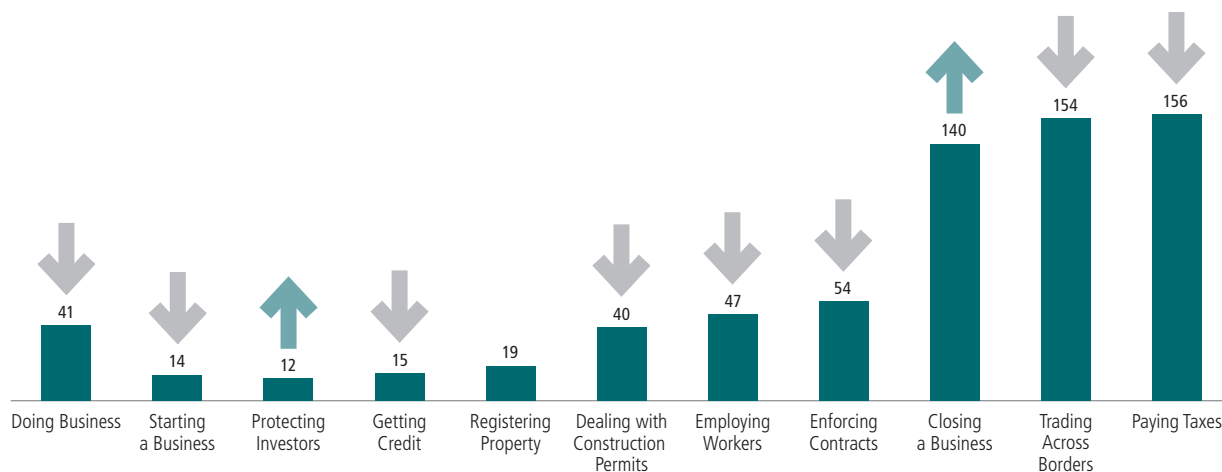
ness", "Getting Credit" and "Registering Property," ranking among the top 20 countries for these indicators. Meanwhile, between 2009 and 2010 the Kyrgyz Republic made the most progress on "Getting Credit," "Registering Property," "Trading across Borders" and "Employing Workers" (Chart 2.16).

<sup>26</sup> This report analyzes regulatory conditions for starting, doing and closing business worldwide according to 10 criteria.



**Chart 2.16: The IFC–World Bank Doing Business 2010 report ranked the Kyrgyz Republic in 14<sup>th</sup> place of 183 countries surveyed**

Detail of the 2010 Doing Business Ranking for the Kyrgyz Republic, out of 183 economies (arrows show evolution compared to 2009)

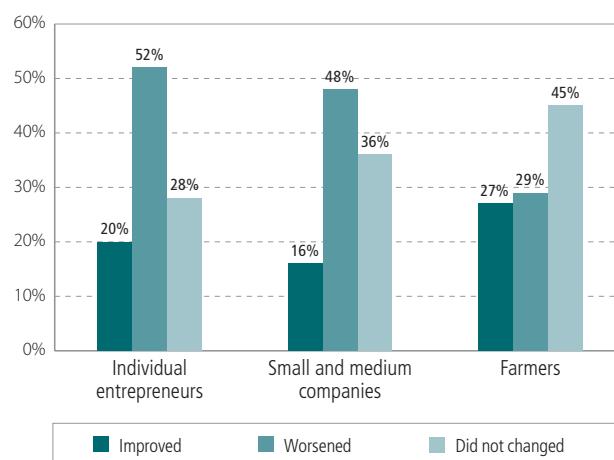


Source: IFC–World Bank “Doing Business 2010” report.

However, these business environment improvements were mostly driven by focused legal reforms and have made minimal impact in terms of day-to-day business operations. One of the major regulatory issues in the Kyrgyz Republic is the inconsistent implementation of laws and regulations. Survey results indicate that the provisions of the legislation are not always implemented. For example, State Inspectorates do not always respect the provisions of the *Inspections Law* regarding advance notification of inspections, presentation of identification and inspection order, registration of inspections in the logbook and mandatory writing of inspection reports. Licensing agencies, meanwhile, do not always respect the validity period of licenses indicated in the legislation. In addition, business administration remains plagued by corruption and illegitimate practices. Both the inconsistent implementation of laws and regulations and corruption add instability to the terms of entrepreneurial activity and are a major barrier to investment. Additional efforts are therefore needed to ensure that changes in the legislation are implemented consistently throughout government agencies and ministries and decrease the regulatory risk for businesses. Survey results indicate that 52 percent of individual entrepreneurs and 48 percent of small and medium companies estimated that in the first quarter of 2009 the business environment in their region had deteriorated compared to 2008 (Chart 2.17). This result is likely influenced by the economic crisis, but also suggests that the legal reforms implemented since 2007 have yet to deliver tangible benefits or change for many businesses, in practice.

**Chart 2.17: Close to 50 percent of individual entrepreneurs and small and medium companies estimated that the business environment had deteriorated in their regions in the first quarter of 2009 compared to 2008**

SMEs estimation of the evolution of the business environment in their region in the first quarter of 2009 versus 2008



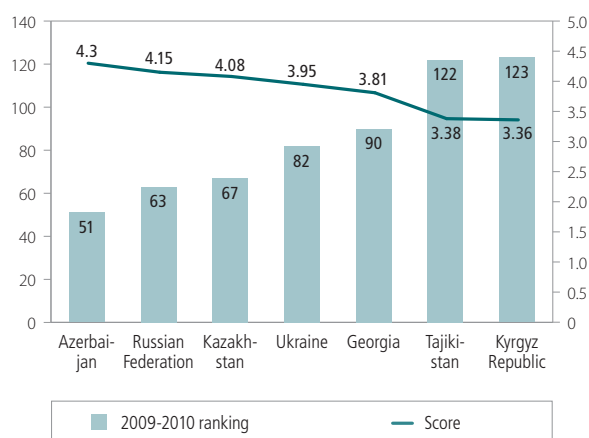
Other arguments call for a scaling up of reforms aimed at improving the business environment: (i) the Kyrgyz Republic’s overall competitiveness remains low, with the country ranking 123 out of 133 countries on the World Economic Forum’s Global Competitiveness Index<sup>27</sup> (Chart 2.18); (ii) in-

<sup>27</sup> World Economic Forum (2009) “The Global Competitiveness Report, 2009–2010”.

ternational experience has shown that it is more difficult to sustain growth than to ignite it, and required more extensive investment climate reforms. Thus, without implementing major regulatory reforms, it may be difficult for the Kyrgyz economy to maintain its 2000-2008 growth levels.

**Chart 2.18: The Kyrgyz Republic is the least competitive of all post-Soviet countries according to the Global Competitiveness Index 2009–2010**

**The Global Competitiveness Index 2009–2010 rankings and scores among selected post-Soviet countries**



Source: World Economic Forum (2009)  
"The Global Competitiveness Report, 2009–2010".

Previously passed reforms need to be fully implemented and additional reforms are needed to further improve the country's economic competitiveness and increase its resilience to external shocks. Reducing the regulatory barriers that increase the cost of doing business in the Kyrgyz Republic would reduce the price of Kyrgyz goods and services, making them more competitive in the domestic and international markets.

Additional reforms would also help the Kyrgyz Republic overcome the negative impacts of the global economic crisis and the subsequent slowdown in GDP growth. International best practices have shown that regulatory reform is an efficient way to promote growth and increase competitiveness and resilience to external shocks. In particular, additional reforms would help address the weaknesses of the Kyrgyz SME sector by helping to (i) ensure the growth of the industry/processing sector and (ii) the growth of medium companies. As indicated previously, these sectors are currently contracting (industry/processing) or stagnating (medium companies), and suffer from considerable regulatory burdens. This is problematic as these sectors are key for the diversification of the Kyrgyz economy, the development of exports and job creation.

## ANNEX 2.1: TOTAL COST OF ELECTRICITY OUTAGES FOR SMALL AND MEDIUM COMPANIES IN 2008

CODE		SCHEDULED OUTAGE	UNSCHEDULED OUTAGE	SOURCE
		81%	78%	Survey results
A	Number of small and medium companies	10,982	10,982	State Statistics Committee
B	Number of small and medium companies subject to outage	8,895	8,566	A * B
C	Average cost of outage	134,666	96,054	Survey results
D	Total cost of outage	1,197,910,630	822,794,722	B * C
E	<b>Grand total (KGS)</b>	<b>2,020,705,352</b>		
F	<b>Grand total (\$)</b>	<b>55,255,820</b> <b>Ex rate 36.57</b>		



# 3. Registration

The one-stop shop must be implemented with a vision for additional reforms

## 3.1. KEY FINDINGS:

- Seventeen percent of small and medium companies, 15 percent of individual entrepreneurs, and three percent of farmers completed corporate registration in 2008. Of these, nine percent of small and medium companies and 0.2 percent of farmers re-registered.<sup>28</sup>
- The registration procedure was lengthiest for small and medium companies, with these companies taking 14 days to prepare all necessary documents, in comparison with the six days typically taken by individual entrepreneurs. Moreover, small and medium companies were obliged to wait longer before their registration was confirmed, typically having to wait 15 days after submission of documents, in comparison with the seven days' wait experienced by individual entrepreneurs.
- Small and medium companies spent, on average, KGS 8,595 (\$235) on completing the registration procedure, including official and unofficial payments and labor costs, in comparison with the average KGS 4,238 (\$116) cost incurred by individual entrepreneurs. Of those entities registering in 2008, registration costs typically constituted 3.5 percent of individual entrepreneurs' profits, in comparison with the 1.4 percent of profits spent by small and medium companies.
- Total expenditure on registration costs nationwide (for both individual entrepreneurs and small and medium companies, and including labor costs and both official and unofficial payments) amounted to KGS106.5 million (\$2.9 million), representing 0.07 percent of gross domestic product (GDP).

## 3.2. REGISTRATION: THE "ONE-STOP SHOP" HAS IMPROVED THE LEGAL FRAMEWORK

As part of the government's efforts to improve the business environment in the Kyrgyz Republic, business registration procedures have been extensively reformed over recent years.

### **Both the processes and the number of documents needed to register a legal entity have been reduced**

Pursuant to Article 83 of the *Civil Code*, a legal entity is an organization which (i) holds exclusive ownership, management, or administration over its operations and property, and is liable for all obligations pertaining to such property; (ii) can independently acquire and exercise property and personal non-property rights; and (iii) can sue and be sued. Legal entities are required to maintain separate and exclusive financial accounts pertaining to their operations and activities.

### **BOX 3.1: THE CIVIL CODE PROVIDES FOR THE FOLLOWING LEGAL ENTITIES**

- Full partnership;
- limited liability partnership;
- limited liability company;
- joint-stock company;
- additional liability company;
- cooperatives; and
- state enterprises.

<sup>28</sup> Information is not available on the percentage of individual entrepreneurs re-registering in 2008.

**BOX 3.2: KEY LEGISLATION AND REGULATION GOVERNING THE REGISTRATION OF LEGAL ENTITIES**

- *The Civil Code of the Kyrgyz Republic, Part I*, adopted May 8, 1996;
- *Government Resolution No. 182, "On the Procedure for Cooperation between State Authorities for the Registration of Legal Entities and their Branches under the Principle of the One-Stop Shop"*, adopted April 23, 2008, implemented May 2008;
- Normative acts of the Ministry of Justice, the State Tax Service, the State Statistics Committee, and the Social Fund;
- *The Tax Code of the Kyrgyz Republic*, adopted October 17, 2008, implemented January 1, 2009;
- *Law of the Kyrgyz Republic No. 57 "On State Registration of Legal Entities and their Branches"*, adopted February 20, 2009, implemented April 2009;
- *Government Resolution No. 708 "On the State Registration Service Under the Government of the Kyrgyz Republic"*, adopted November 17, 2009. This resolution created a separate government agency, the State Registration Service, responsible for the simultaneous registration of legal entities at the State Statistics Committee, the State Tax Service and the Social Fund. This one-stop shop registration facility had previously (from its adoption on April 23, 2008 to November 16, 2009) been provided through the Ministry of Justice.

The earlier *Law of the Kyrgyz Republic "On State Registration of Legal Entities"* (adopted 1996)<sup>29</sup> required registration at the Ministry of Justice, the procurement of a unique classification number from the State Statistics Committee, and registration with the State Tax Service and the Social Fund. Registration of a new legal entity at the Ministry of Justice officially took 10 days, with registration at other government agencies taking one to two days at each. In practice, completing the full registration process could take longer than one month.

Legislative changes implemented in 2008 and 2009 (Box 3.2) have reduced these times considerably, particularly following the introduction of the one-stop shop principle in November 2009, which not only reduced the number of stages involved in registering a legal entity, but also the number of documents to be submitted (Table 3.2). The main legislative changes pertaining to the registration of legal entities are summarized in Table 3.1, and the key stages involved in registration following the introduction of the one-stop shop outlined in Figure 3.1.

**Table 3.1: Comparison of registration requirements pre- and post-reform**

PRIOR TO REFORM (AS OF JANUARY 1, 2008)	FOLLOWING REFORM (AS OF DECEMBER 31, 2009)	IMPLEMENTATION DATE <sup>30</sup>
Legal entities required to register at the Ministry of Justice, obtain a unique classification number recorded in the United Single State Register of Statistics, and register with the State Tax Service and the Social Fund	Registration at the State Registration Office ensures simultaneous registration with the State Statistics Committee, the State Tax Service and the Social Fund	June 2008 (one-stop shop) November 2009 (establishment of the State Registration Service)
Documents for submission subject to the form of entity to be registered, but requiring, as a minimum, a copy of the Company Charter	Submission of a Company Charter no longer required for registration of a legal entity	April 2009
Ministry of Justice no longer responsible for checking compliance of founding documents with current legislation	Consistent with the "declarative principle," responsibility for ensuring compliance of foundation documents now rests with company founders	April 2009
Notarization of documents necessary	Notarization of documents no longer required	April 2009
Permit required from Ministry of Internal Affairs to obtain a company seal	Permit from the Ministry of Internal affairs no longer required to obtain a company seal	April 2009
Procurement of a company seal mandatory	Procurement of a company seal now voluntary	April 2009
Official lead times for registration at Ministry of Justice—10 days; at State Statistics Committee—one to two days; with the State Tax Service—one to two days; at Social Fund—one day. Total official lead time: 13–15 days	It officially takes three working days in total to register a legal entity	April 2009

<sup>29</sup> *Law of the Kyrgyz Republic No. 39 "On Registration of Legal Entities"*, adopted June 26, 1996, implemented January 1, 1997.

<sup>30</sup> Survey conducted during 2008.

PRIOR TO REFORM (AS OF JANUARY 1, 2008)	FOLLOWING REFORM (AS OF DECEMBER 31, 2009)	IMPLEMENTATION DATE <sup>30</sup>
Entrepreneurs obliged to travel to regional centers to register legal entities	State notaries (based in district centers) may now receive applications for the registration of legal entities and forward these to the relevant office for one-stop shop registration under the Department of Justice; <sup>31</sup> an initiative intended to simplify registration in remote areas and obviate the need for travel to regional centers	April 2009
Registration of a legal entity at the Ministry of Justice previously free of charge; <sup>32</sup> registration with the State Tax Service cost KGS60 (equivalent to \$1.60)	Since October 2009 registration of a legal entity costs KGS224 (\$6.10) throughout the country <sup>33</sup>	April 2009

**Table 3.2: Documents required for registration of a limited liability company pre- and post-reform**

LIST OF DOCUMENTS TO BE SUBMITTED TO REGISTER A LIMITED LIABILITY COMPANY, BEFORE APRIL 2009	LIST OF DOCUMENTS TO BE SUBMITTED TO REGISTER A LIMITED LIABILITY COMPANY, AFTER APRIL 2009
Three copies of Company Charter	Application form
Three copies of Founders' Agreement	Founders' Resolution on the establishment of a new legal entity
Founders' Resolution on establishment of a new legal entity	Other documents pursuant to current legislation
If one of the founding entities is a state enterprise, approval of the appropriate authorized agency.	
If one of the founders is a legal entity, the approval of the appropriate authorized body on the establishment of such legal entity, together with copies of the Founders Agreement and certificates confirming state registration	
Other documents pursuant to current legislation	

<sup>31</sup> Resolution of the Ministry of Justice No. 155 "On the Approval of Instruction on Receipt of Documents from Commercial Organizations for State Registration at the Regional/City Level," adopted July 7, 2009. However, following the transfer of registration functions to the State Registration Service in November 2009 it is not clear whether this resolution will remain in force.

<sup>32</sup> Law of the Kyrgyz Republic "On State Registration of Legal Entities," adopted July 12, 2006.

<sup>33</sup> Normative Act adopted by the Ministry of Justice and by the director of the State Agency on Antimonopoly Policy and Competition, adopted October 15, 2009.

Figure 3.1: Stages involved in one-stop shop registration, as of December 31, 2009

	Step #/ location	List of documents to be submitted/activities	Official cost	Outcome	Duration
STEP 1:					
Pre-registration	<b>National Bank (for Banks only)</b>	<ul style="list-style-type: none"><li>At least 18 document to be submitted to National Bank (see <a href="http://www.nbkr.kg/contout.jsp?item=1468&amp;lang=RUS&amp;material=11747">www.nbkr.kg/contout.jsp?item=1468&amp;lang=RUS&amp;material=11747</a>)</li><li>At least 7 documents to be submitted to Antimonopoly Committee</li></ul>	No official fee	<ul style="list-style-type: none"><li>National Bank's approval</li><li>Antimonopoly Committee's approval</li><li>Legalized documents</li></ul>	<ul style="list-style-type: none"><li>Maximum 6 months in the National Bank (or one year for foreign entities)</li><li>Antimonopoly Committee 30 days</li></ul>
	<b>Antimonopoly Committee (when capital is above 15,000 KGS only)</b>				
STEP 2:					
State Registration	Single window of the State Registration Service (includes registration in Statistic Committee, Tax Authorities, Social Fund)	<ul style="list-style-type: none"><li>Application form</li><li>Shareholders' resolution on the registration of a new Legal Entity.</li><li>(iii) Additional documents to be submitted depend on the form of the legal entity and on specific cases (e.g registration of foreign legal entities).</li></ul>	224 KGS + 30 KGS for Social Fund application + 20 KGS for reference to bank (7.5 \$ in total)	<ul style="list-style-type: none"><li>Certificate of State Registration,</li><li>Tax payer identification number</li><li>General classifier for enterprises and organizations</li><li>Social identification number</li></ul>	<ul style="list-style-type: none"><li>Three working days</li></ul>
STEP 3:					
Not part of registration – optional	Private Company	<ul style="list-style-type: none"><li>N/A</li></ul>	The cost of the seal depends on the delivery time. The faster the delivery, the higher the cost.	<ul style="list-style-type: none"><li>Legal Seal</li></ul>	<ul style="list-style-type: none"><li>Between 1 hour and 2 days</li></ul>

Once completed, registration of a legal entity is valid indefinitely. Re-registration may be required in some cases,<sup>34</sup> however, including (i) on reorganization of the company; (ii) following an increase or decrease in charter capital; (iii) following changes to company name; and (iv) following a court resolution ordering the company's re-registration, etc.

The reforms of 2008 and 2009 undoubtedly contributed to the simplification of the registration procedure for legal entities – confirmed by the IFC-World Bank Doing Business 2010 report (Box 3.3).<sup>35</sup>

<sup>34</sup> Law "On State Registration of Legal Entities and their Branches," adopted February 20, 2009.

<sup>35</sup> IFC-World Bank "Doing Business 2010" report.

However, research among focus groups suggests that further reform needs to be undertaken – including the introduction of regulation governing the rejection of statutory documents and the introduction of a single, unified registration number to be used by the State Tax Service, the State Statistics Committee, and the Social Fund – an initiative which would further simplify the registration process and simplify the identification of businesses for administrative purposes (Box 3.4).

### BOX 3.3: KYRGYZ REPUBLIC RANKED IN 14<sup>TH</sup> OF 183 ECONOMIES FOR “STARTING A BUSINESS”

The progress made by the Kyrgyz Republic in simplifying the process of business registration is confirmed by the IFC–World Bank Doing Business 2010 report, which ranks the Kyrgyz Republic 14th among 183 countries surveyed in terms of the ease of “starting a business” in these locations. With performance improved by 20 points in comparison with 2009, the Kyrgyz Republic performs better than most Eastern European and Central Asian countries on this basis (Chart 3.1).

Limited liability companies are not subject to any minimum capital requirement and, according to the Doing Business 2010 report, registration in Bishkek can be completed in 11 days, including allowing time for the notarization of company documents and the purchase of a company seal.

This process has been made still simpler since these rankings were compiled, however, with the notarization of documents no longer required and the purchase of a company seal now voluntary. Furthermore, with effect from April 2009 it is envisaged that registration of a limited liability company should take no longer than three days.

### BOX 3.4: REFORMS IN OTHER COUNTRIES ARE REPLICABLE IN THE KYRGYZ REPUBLIC

#### Introduction of a single identification number for businesses

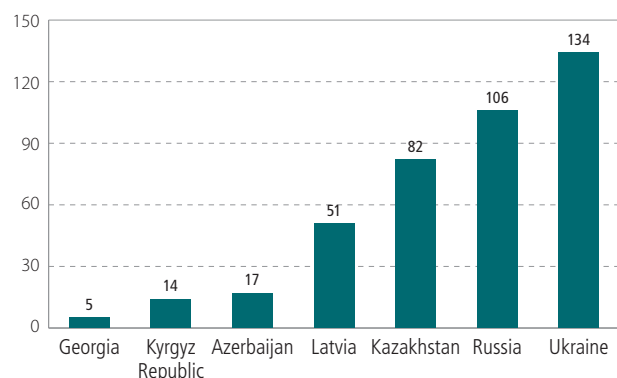
Centralized registration often goes hand-in-hand with the introduction of a single company identification number. Malaysia was the first country to introduce the use of a single company identification number for all interaction with government in 2001, recently followed by Singapore. India has recently introduced the use of a single identification number for tax purposes, following the success of the use of identification numbers for voters.

#### Making registration services electronic

The use of online registration facilities in business registration is developing rapidly, and the use of online facilities for business verification is now common not just in developed OECD economies but also increasingly throughout Central Asia, Eastern Europe, Latin America, and the Caribbean. Better service attracts more customers: in Bangladesh, the use of an online registration increased business verifications and registrations by 80 percent and 90 percent, respectively. Around 40 economies currently offer electronic registration services, although the level of implementation varies. In India, Norway, and Singapore registration is fully electronic. In Sweden applications for company, tax, and labor registration can be made online, but most forms must still be printed and signed by hand. In some countries (including Malaysia and Pakistan), as an incentive to encourage their wider usage, online systems are offered at a lower cost than traditional application methods, or are completely free of charge. In Croatia, online applications are subject to a 24-hour response time – a major improvement on the previous 14-day lead time for hard copy applications. Estonia requires no notarization for documents filed electronically. New Zealand has one of the most innovative systems to ensure the timely processing of online applications, with management automatically alerted if any process exceeds strict time limits.

IFC–World Bank “Doing Business 2010” report.

**Chart 3.1: Doing Business 2010 – Ease of Starting a Business indicator**



Source: IFC – World Bank “Doing Business 2010” report.

### Registration of individual entrepreneurs still offers scope for simplification

Registration by the State Statistics Committee is not mandatory for those individual entrepreneurs engaged in one of 124 activities eligible for inclusion under the voluntary tax patent regime. This facility offers individual entrepreneurs the opportunity to purchase a voluntary tax patent, which stands for both payment of taxes and registration. Individual entrepreneurs interviewed for the purpose of this Survey were all registered with the State Statistics Committee (this being one of the selection criteria for interviewees).



### BOX 3.5: KEY LEGISLATION AND REGULATION GOVERNING THE REGISTRATION OF INDIVIDUAL ENTREPRENEURS

- *The Civil Code of the Kyrgyz Republic, Part I*, adopted May 8, 1996;
- *Government Resolution No. 404 "On Adoption of Regulation on the Procedure of State Registration of Citizens Engaged in Entrepreneurial Activity Without Formation of a Legal Entity as an Individual Entrepreneur on the Territory of the Kyrgyz Republic,"* adopted July 2, 1998;
- *Law of the Kyrgyz Republic "On State Statistics,"* adopted March 26, 2007;
- *Joint Order of the State Statistics Committee and the Social Fund, "On Cooperation Between the State Statistics Committee and the Social Fund in the Process of the State Registration, Re-registration and De-registration of Individual Entrepreneurs,"* adopted April 23, 2008 and May 12, 2008, respectively, introducing the one-stop shop principle (with the exception of tax registration) for the registration of individual entrepreneurs;
- *The Tax Code of the Kyrgyz Republic*, adopted October 17, 2008, implemented January 1, 2009; and
- normative acts of the Ministry of Justice, the State Tax Service, the State Statistics Committee, and the Social Fund.

Citizens of the Kyrgyz Republic, as well as foreign citizens and/or stateless persons permanently or temporarily resident in the Kyrgyz Republic, can register as individual entrepreneurs.<sup>36</sup> Following the introduction in 2008 of the one-stop shop system for the registration of individual entrepreneurs (Box 3.5), registration at the State Statistics Committee and

the Social Fund were unified, thus decreasing the number of stages individual entrepreneurs were required to fulfill. The registration of individual entrepreneurs is now a two-stage procedure (Figure 3.2). The introduction of fully unified registration, to include registration with the State Tax Service, would further simplify this process, however.

**Figure 3.2: Registration of individual entrepreneurs**

	Step #/ location	List of documents to be submitted	Official cost	Outcome	Duration
<b>STEP 1:</b>					
Registration	Single Window of State Statistics Committee (includes registration in Statistic Committee and in Social Fund)	(i) Application form (ii) Passport (iii) Certificate of registration in the Ministry of Internal Affairs – for foreign citizens	230 KGS (\$6) in Bishkek for main activity. Plus 108 KGS (\$3) for secondary activity. The cost differs in each region.	<ul style="list-style-type: none"> <li>• Certificate of State Registration</li> <li>• General classifier for enterprises and organizations</li> <li>• Social identification number</li> </ul>	<ul style="list-style-type: none"> <li>• 2 working days</li> </ul>
<b>STEP 2:</b>					
Post Registration	State Tax Service (no later than 15 days after registration in Statistics Committee)	<ul style="list-style-type: none"> <li>• Application form</li> </ul>	Registration form, 5 KGS. (15 cent) Registration free of charge.	<ul style="list-style-type: none"> <li>• Tax payer identification number</li> </ul>	<ul style="list-style-type: none"> <li>• 5 working days</li> </ul>

Current legislation provides for the registration of an individual entrepreneur within a maximum period of two days. Registration as an individual entrepreneur is valid indefinitely, although re-registration is required in the event of a change in residence, business activity, or business name.

### Procedure for the registration of farmers

Farmers are required to complete registration as either an individual entrepreneur or other legal entity.

<sup>36</sup> *Government Resolution No. 404 "On Adoption of Regulation on the Procedure of State Registration of Citizens Engaged in Entrepreneurial Activity Without Formation of a Legal Entity as an Individual Entrepreneur on the Territory of the Kyrgyz Republic,"* adopted July 2, 1998.

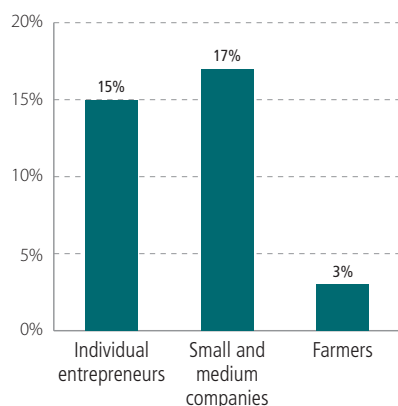
### 3.3. SMALL AND MEDIUM COMPANIES COMPRISE THE GREATEST PROPORTION OF RESPONDENTS COMPLETING REGISTRATION IN 2008

The Survey was conducted between April and August 2009, with the reference period for registration-related questions being January–December 2008. Survey results therefore only partially reflect the impact of the introduction of one-stop shop registration for legal entities (adopted April 23, 2008)<sup>37</sup> and the introduction of one-stop shop registration for individual entrepreneurs (adopted May 12, 2008).<sup>38</sup> The impact of the introduction of the *Law on State Registration of Legal Entities and their Branches*, adopted February 20, 2009 and introduced to ensure, inter alia, business registration within a time period of three days,<sup>39</sup> is not reflected in Survey results.

Seventeen percent of small and medium companies, 15 percent of individual entrepreneurs, and three percent of farmers completed registration in 2008 (Chart 3.2). Of these, nine percent of small and medium companies re-registered.<sup>40</sup> Since the percentage of farmers completing registration in 2008 was low, this category is not examined in this chapter.

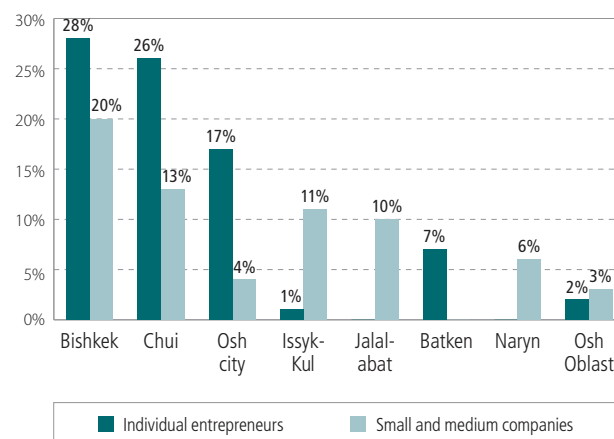
Although the number of individual entrepreneurs in the Kyrgyz Republic is much higher than the number of small and medium companies (at 204,246 and 11,988, respectively), and the greater complexity of registering a legal entity notwithstanding, the proportion of small and medium companies registering in 2008 as a proportion of all small and medium companies is higher than the corresponding proportion of individual entrepreneurs registering in the same year. This may be due to a higher proportion of small and medium companies re-registering in 2008.

**Chart 3.2: Small and medium companies comprise the greatest proportion of respondents completing registration in 2008**



The proportion of small and medium companies completing registration in 2008 was greatest in the capital city of Bishkek (where 28 percent of individual entrepreneurs and 20 of all small and medium companies nationally were registered), followed by Chui (registering 26 percent of all individual entrepreneurs and 13 percent of all small and medium companies) and the city of Osh (17 percent of individual entrepreneurs and four percent of small and medium companies), reflecting the position of Bishkek and Chui as the most affluent areas of the country (Chart 3.3). Gross regional product in Bishkek and Chui in 2007 was significantly higher than in other regions of the country at KGS50,486.9 million and KGS23,607.7 million, respectively.<sup>41</sup> Access to both start-up capital and markets is also easier in Bishkek, Chui, and Osh, which, as key urban centers, also provide a more amenable business infrastructure.

**Chart 3.3: Percentage of SMEs completing registration in 2008, by region**



<sup>37</sup> Government Resolution No. 182 "On the Procedure for Cooperation between State Authorities for the Registration of Legal Entities and their Branches under the Principle of the One-Stop Shop," adopted April 23, 2008, implemented May 2008.

<sup>38</sup> Joint Order of the State Statistics Committee and the Social Fund, "On Cooperation Between the State Statistics Committee and the Social Fund in the Process of the State Registration, Re-registration and De-registration of Individual Entrepreneurs," adopted April 23, 2008 and May 12, 2008, respectively.

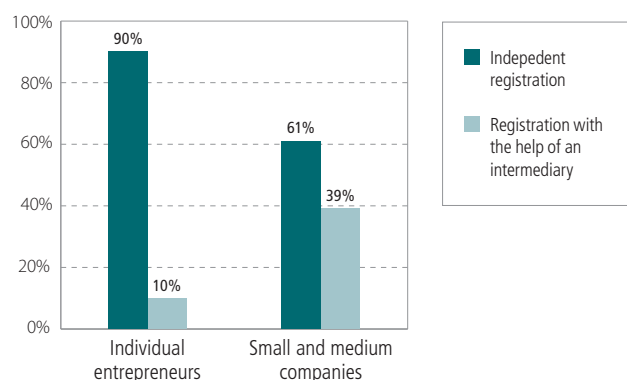
<sup>39</sup> Law of the Kyrgyz Republic No. 57 "On State Registration of Legal Entities and their Branches," adopted February 20, 2009.

<sup>40</sup> Data is not available on the number of individual entrepreneurs re-registering.

<sup>41</sup> Source: State Statistics Committee of the Kyrgyz Republic (2008), "National Accounts of the Kyrgyz Republic 2003–2007." Calculated at current prices.

Of those entities registering in 2008, 39 percent of small and medium companies and 10 percent of individual entrepreneurs engaged the services of external advisors (business consultants, lawyers, etc.) during registration (Chart 3.4). The higher proportion of small and medium companies using external advisors (in comparison with individual entrepreneurs) may be because (i) the documents necessary for the registration of a company are more complex than those needed to register an individual entrepreneur (and particularly so prior to the implementation of the *Law “On State Registration of Legal Entities and their Branches”* in 2009, when the compliance of all foundation documents had to be verified by the Ministry of Justice); (ii) the clear majority (88 percent) of small and medium companies being registered in Bishkek, where the availability of professional services is greatest; and (iii) the fact that more than half of those small and medium companies completing the registration process in 2008 had been registered previously, with the result that their awareness of available services was higher, as well as the likelihood of their being able to afford them.

**Chart 3.4: Almost 40 percent of small and medium companies used external advisors during registration**



### 3.4. REGISTRATION PROCEDURE: SMALL AND MEDIUM COMPANIES BEAR A GREATER BURDEN THAN INDIVIDUAL ENTREPRENEURS

Small and medium companies bear the greatest burden – in terms of both duration and cost – in registering as a legal entity. While the introduction of the one-stop shop principle in 2008, and the implementation of the *Law “On State Registration of Legal Entities and their Branches”* in 2009, were both intended to reduce the regulatory burden on legal entities, research among focus groups suggests that the procedure for business registration remains complex.

Small and medium companies registering in 2008 typically took 14 working days to prepare the documents necessary for registration (in comparison with the six working days taken by individual entrepreneurs). Again, this may be due to the fact that registration of a company requires the submission of more complex documents (and, again, particularly so in 2008 prior to the adoption of the *Law “On State Registration of Legal Entities and their Branches”* in 2009). Certain documents, including, in particular, the Founders’ Resolution and the Company Charter;<sup>42</sup> are quite complex documents to produce. Small and medium companies registering for the first time typically took 20 days to complete all procedures, in comparison with the 10 days taken by those companies re-registering.

Small and medium companies also faced a longer wait than the seven working days taken by individual entrepreneurs following submission of all necessary documents – facing, on average, a wait of 15 working days, with those companies registering for the first time obliged to wait 19 working days and those re-registering having to wait 12 (Chart 3.6). While the impact of *Government Resolution No. 182*,<sup>43</sup> implemented to facilitate the adoption of the one-stop shop system, might have been expected to be evident in Survey results, the typical lead times taken to complete the registration of a legal entity remained lengthy. Survey results also indicate that applicants were obliged to register at a number of separate government agencies (Chart 3.5), suggesting that the provisions of this reform had not been fully implemented even after May 2008. Research conducted among focus groups also suggests that registration remained complex even following the adoption of the one-stop shop principle.

<sup>42</sup> In 2008, registration of a legal entity required the submission of the Company Charter to the Ministry of Justice. Following the adoption of the *Law “On State Registration of Legal Entities and their Branches,”* this is no longer necessary.

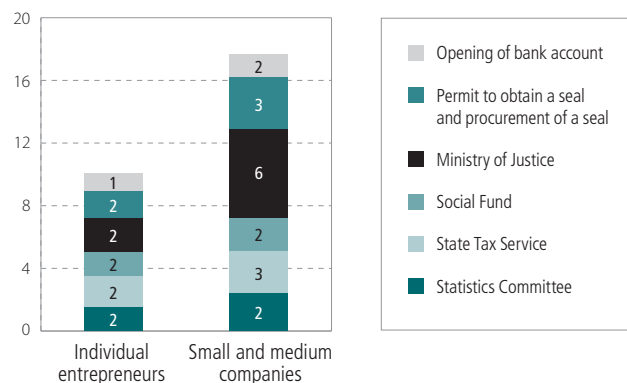
<sup>43</sup> *Government Resolution No. 182 “On the Procedure for Cooperation between State Authorities for the Registration of Legal Entities and their Branches under the Principle of the One-Stop Shop,”* adopted April 23, 2008, implemented May 2008.

“I am working for a consulting company which is helping small and medium companies to register. Well, I can tell you that the one-stop shop has not simplified anything. Things have got even worse, because in order to register companies in three days, registration bodies refuse any application if there is a slight inconsistency within the documents, for example between Russian and Kyrgyz versions of the documents. Each word is scrutinized in order to find reasons to refuse applications. Before, we were able to correct these inconsistencies in one or two hours, and re-submit the documents. Now the application is simply refused. This way, the procedure takes us one month or a month and a half.”

Entrepreneur, focus group participant

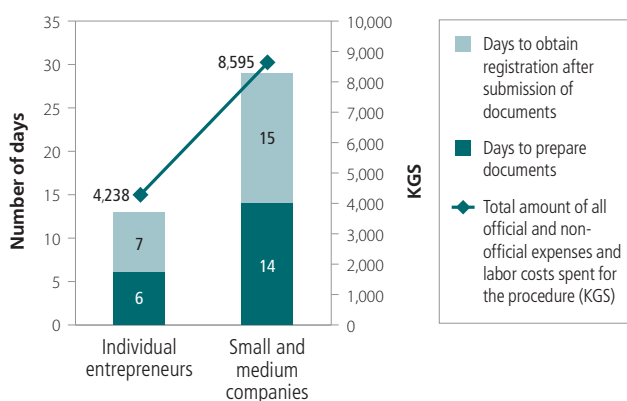
**Chart 3.5: Registration at the Ministry of Justice was the most lengthy stage of the registration procedure in 2008**

Number of working days taken at each stage of registration



**Chart 3.6: The registration burden is greater for small and medium companies than for individual entrepreneurs**

Duration and cost of registration procedures for individual entrepreneurs and small and medium companies (2008)



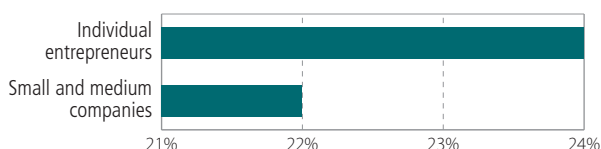
Not only was the registration procedure lengthiest for small and medium companies, but this category also faced the highest costs. Although the official cost of registering a limited liability company in 2008 was KGS60 (\$2), payable to the State Tax Service, small and medium companies spent, on average, KGS8,595 (\$235) throughout the complete registration process, including official and unofficial payments and labor costs. Individual entrepreneurs, however, spent, on average, KGS4,238 (\$116) on registration (Chart 3.6). Of those companies registering in 2008, registration expenses represented 3.5 percent of individual entrepreneurs' total profit, and 1.4 percent of small and medium companies'. The total cost of the registration procedure for all SMEs nationwide is estimated at KGS106.5 million (\$2.9 million), representing 0.07 percent of the country's GDP (Annex 3.1).

Expenses during the registration process include the following.

- (i) **Payments to external advisors.** The fact that small and medium companies made greater use of external professional services than other categories of respondents (Chart 3.4) is likely to be one of the main reasons for the higher costs incurred by this category. The costs of such external services in Bishkek are typically between KGS3,660–5,500 (\$100–150).
- (ii) **Notarization of documents.**<sup>44</sup> Typical costs for notarization are between KGS150 and KGS200 (\$4–5).
- (iii) **Official registration costs.** For example, while legal entities registering in 2008 were obliged to pay KGS60 (\$1.60) to the State Tax service, the cost for individual entrepreneurs registering with the State Statistics Service varied according to their locality.
- (iv) **Unofficial payments.** Twenty four percent of individual entrepreneurs, and 22 percent of small and medium companies indicated that they had made unofficial payments during the course of completing the registration process (Chart 3.7).

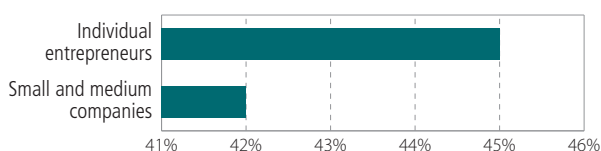
<sup>44</sup> Mandatory during 2008 but not following the adoption of the Law "On Registration of Legal Entities and their Branches" in 2009.

**Chart 3.7: Over 20 percent of respondents had made unofficial payments during registration**



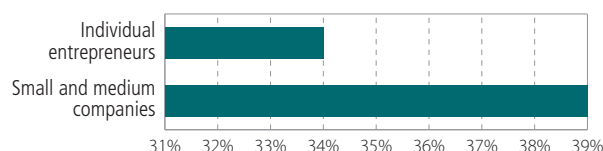
Survey results indicate that over 40 percent of all respondents found the registration procedure to be complicated (Chart 3.8), and those respondents who did not make unofficial payments found the registration procedure less complicated than the average (Chart 3.9).

**Chart 3.8: Between 42 and 45 percent of respondents felt registration to be "somewhat" complicated or complicated**



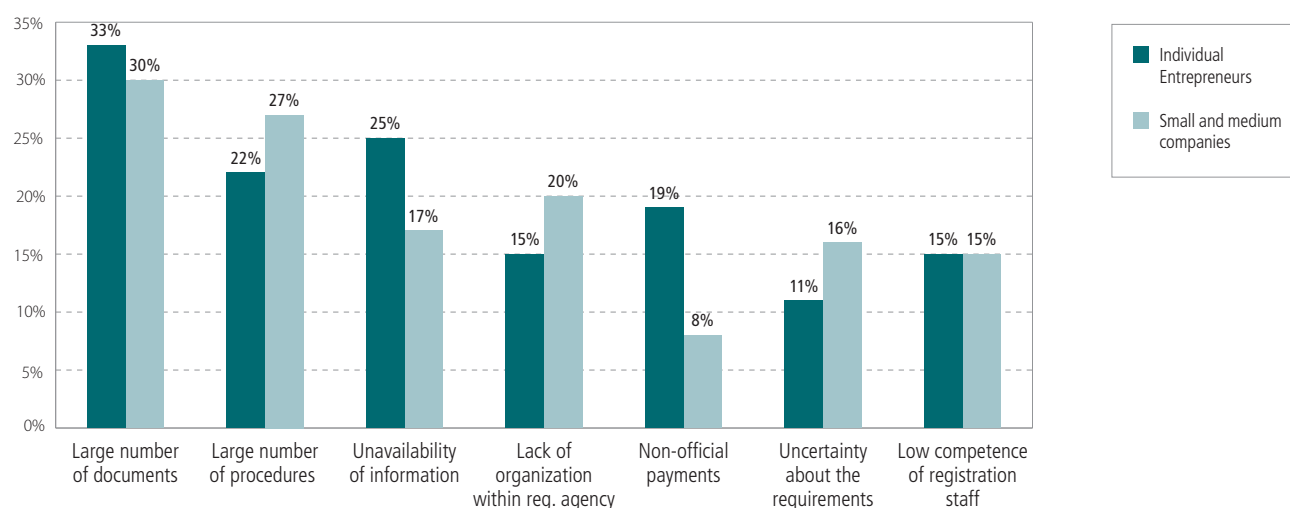
**Chart 3.9: Those respondents who did not make unofficial payments felt registration to be less complicated than the average**

**Found the procedure complicated or "somewhat" complicated (out of those who did not make unofficial payments)**



Of those respondents that indicated they had found the registration process difficult, the three greatest difficulties concerned (i) the large number of documents to be submitted; (ii) the number of agencies to be visited (and processes to be completed) during the registration procedure; and (iii) the lack of information available on the registration procedure itself (Chart 3.10). Although half of all small and medium companies had previously completed the registration procedure, 17 percent of all small and medium companies indicated the lack of information available on the registration procedure itself to be a major source of difficulty.

**Chart 3.10: The large number of documents for submission during registration was the difficulty most often cited by SMEs**



Those reforms implemented in 2008 and 2009 are likely to address some of these difficulties, since both the various stages of registration, and the number of documents required, have been reduced. The introduction of the one-stop shop principle is also likely to result in a reduction in the number (and value) of unofficial payments made, since direct contact between entrepreneurs and officials is also reduced.

However, research among focus groups indicated some delays in the implementation of recent reform, particularly with regard to the duration of the registration procedure, and its complexity. The fact that many respondents also felt insufficient information on the registration process per se as to be an issue might also indicate a need to raise public awareness in this respect.

### 3.5. RECOMMENDATIONS

ISSUE	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
<b>SHORT-TERM RECOMMENDATIONS</b>		
The one-stop shop for the registration of individual entrepreneurs includes registration at the State Statistics Committee and the Social Fund, but excludes registration at the State Tax Service	Include registration at the State Tax Service simultaneously with one-stop shop registration at the National Statistics Committee for all businesses including individual entrepreneurs	Further consolidating the various stages necessary to complete registration as an individual entrepreneur will reduce registration lead times and costs (particularly unofficial costs), resulting in faster and cheaper incorporation and subsequent benefits for profitability, employment levels, and tax revenue
The proportion of legal entities obliged to re-register (for various reasons) remains high	Cancel the requirement for re-registration in the event of an increase or decrease in Charter Capital, or a change in company name; replace this with a simple requirement for this information to be updated through the State Registration Service	Removing the requirement for re-registration would result in far fewer companies undertaking registration, with subsequent benefits in terms of time, costs, and profitability
Frequent rejection of completed documents (arising over translation queries and other errors) can result in significant delays	Stipulate in law the grounds on which registration documents may be rejected	Speedier registration procedures will result in the faster incorporation of legal entities
Inadequate information on the registration procedure per se is one of the main difficulties encountered by businesses	Raise awareness of the registration procedure (including the various stages, lead times, and costs) by making information available on the web sites of various government agencies; by conducting awareness campaigns in rural areas; by distributing information on new registration procedures to entrepreneurs; and by making procedural summaries ("route maps") available at registration offices. Such activity might also be supplemented by the broadcast of public service announcements on television and other media	Improving access to information will facilitate the faster registration of new businesses, encouraging business development and job creation
Officials do not always adhere to regulation on maximum processing times	Introduce the "silence is consent" principle in the regulation of the registration process—i.e., registration must be granted if an explicit refusal is not given on the expiry of certain periods following the submission of documents: this might be three days for small and medium companies, and two days for individual entrepreneurs	In addition to preventing delays, and allowing the faster incorporation of new businesses, such a system would also reduce the opportunity for unofficial payments
<b>MEDIUM-TERM RECOMMENDATIONS</b>		
The State Registration Service is now responsible for the simultaneous registration of legal entities with the State Statistics Committee, the Social Fund, and State Tax Service	Transfer responsibility for one-stop shop registration from the State Registration Service to the State Tax Service.	The number of state agencies involved in registration will be reduced from the current four <sup>45</sup> to three, <sup>46</sup> resulting in faster incorporation and encouraging the development of new businesses
Legal entities and individual entrepreneurs are not currently able to use a single, unified, identification number in their dealings with the State Statistics Committee, the Social Fund, and the State Tax Service	Introduce a single, unified identification number for individual entrepreneurs and legal entities, to be used in dealings with these agencies	Introducing a single, unified identification number will simplify both the registration process and other administrative issues, including the payment of tax and Social Fund liabilities
Over 20 percent of businesses report having made unofficial payments during the course of the registration procedure	Introduce online registration	As well as resulting in a faster registration process, online registration will also reduce opportunities for the soliciting and payment of unofficial fees

<sup>45</sup> The State Tax Service, the State Statistics Committee, and the Social Fund.

<sup>46</sup> The State Registration Service, the State Tax Service, the State Statistics Committee, and the Social Fund.

**ANNEX 3.1: REGISTRATION OF ALL SMEs IN 2008 – TOTAL COSTS**

		INDEPENDENT ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	SOURCE
A	Total number of enterprises	145,663	10,982	National Statistics Committee
B	Proportion of SMEs undergoing the registration procedure in 2008	15%	17%	Survey results
C	Number of registered enterprises	21,267	1,911	A * B
D	Average official and unofficial costs (KGS)	2,804	5,112	Survey results
E	Working days spent in preparing documents	5.6	13.6	Survey results
F	Average salary	5,378	5,378	National Statistics Committee
G	Total official and unofficial costs (KGS)	59,632,102	9,768,358	C * D
H	Total labor costs (KGS)	30,499,424	6,655,353	C * F * E/21
I	<b>Total costs (KGS)</b>	<b>90,131,526</b>	<b>16,423,710</b>	<b>G + H</b>
J	<b>Grand total (KGS)</b>	<b>106,555,236</b>		
K	<b>Grand total (\$)</b>	<b>2,913,733.50</b>		

**Note:** (i) the cost of various administration requirements were estimated based on reported official and unofficial payments as well as on time spent preparing to submit documents; (ii) the total cost of registering farmers was not calculated, as the number of respondents was not high enough to be meaningful; (iii) the estimated labor cost of registering individual entrepreneurs and small and medium companies was calculated although, since these SMEs are not yet officially registered, they have not yet incurred any official labor costs.





## 4. Permits

The permit procedure is the most burdensome regulatory procedure

### 4.1. KEY FINDINGS:

- Some 26 percent of individual entrepreneurs, 25 percent of small and medium companies and 13 percent of farmers obtained permits in 2008.
- Significant regional disparities exist regarding the coverage of the permit procedure: in Issyk-Kul, close to 80 percent of SMEs obtained a permit in 2008; while in Jalalabat, less than 10 percent of SMEs obtained a permit in 2008.
- The average permit validity is short: one year for individual entrepreneurs and small and medium companies and eight months for farmers. Problematically, the procedure for permit renewal is no easier than the initial application, as all documents must be re-submitted.
- While small and medium companies bear the biggest burden in absolute terms, farmers are the most burdened by the permit procedure in relative terms: the cost (including official and unofficial payments and labor costs) for small and medium companies to get all permits in 2008 (KGS14,869) was 3 times higher than for farmers (KGS5,259). The cost of obtaining permits represents, on average, 11.9 percent of farmers' profits and 2.5 percent of small and medium companies' profits (for those who went through the permit procedure).
- Including official and unofficial payments and labor costs, total permit costs for the private sector in 2008 were about \$15.1 million, which represents nearly 0.37 percent of GDP.

### 4.2. THE LACK OF A UNIFIED PERMIT LAW AND A COMPREHENSIVE PERMIT REGISTER ARE THE MAIN SHORTCOMINGS OF THE PERMIT LEGISLATION

Reform to permit regulation over the past six years has introduced a number of good practices, including a decrease in the number of permits, a permit register and the introduction of the "silence is consent" and "one-stop shop" principles for construction permits. However, the register does not include all permits issued by all permit issuing agencies. In addition, there is no unified single permit law. Additional reforms are therefore needed.

A unified legal definition of what constitutes a permit was issued in *Government Resolution No. 386 "On the Approval of the Regulation on Permits issued by State Bodies to Businesses,"* adopted July 30, 2001. According to this resolution:

***"A permit is a document that gives businesses the right to undertake specific activities. Permits are issued by authorized State Agencies and aim at ensuring the implementation of the legislation, as well as of certain standards, norms and regulations".***



#### BOX 4.1. WHAT IS THE DIFFERENCE BETWEEN A PERMIT AND A LICENSE?

In international practice, there is no difference between permits and licenses. Both words come from Latin and mean “something which is allowed.” However, in the former Soviet Union, licenses are understood as special permits that allow the implementation of an activity that is either potentially risky or involves any limited resources on a regular basis. In addition, licenses are often tied to a special knowledge on the part of the enterprise or entrepreneur (e.g. licenses to practice medicine) whereas permits rarely require special knowledge from the enterprise or entrepreneur, but are often tied to the particular location of an enterprise. In addition, permits are documents that allow the implementation of a risky activity for a specific period of time. These documents can be in the form of permit, approval, opinion, certificate, authorization, conformity assessment, payment of fees or any other document issued for the above-mentioned purposes.

#### BOX 4.2. KEY LEGISLATION AND REGULATION GOVERNING THE PERMIT PROCEDURE

- *The Civil Code of the Kyrgyz Republic*, Part I, adopted May 8, 1996;
- *Government Resolution No. 386 “On the Approval of the Regulation on Permits issued by State Bodies to Businesses,”* adopted July 30, 2001;
- *Government Resolution No. 103 “On the Approval of the Register of Permits issued by the Executive Bodies and their Agencies,”* adopted February 25, 2004. This register lists most of the permits issued in the Kyrgyz Republic, as well as the State Agencies issuing these permits, with the exception of the permits issued by local government;
- *Law No. 55 “On the Streamlining of the Legislative Framework for Entrepreneurship,”* adopted April 5, 2008. This Law forbids the issuance of permits and licenses which are not stipulated in the Laws and in the Resolutions of the Government of the Kyrgyz Republic. *Presidential Decree No. 164 “On Streamlining of the Construction Permits System,”* adopted May 14, 2008;
- *Government Resolution No. 252 “On the Improvement of the Regulation on the Procedure of Issuance of Construction Permits,”* adopted May 30, 2008;
- *Government Resolution No. 509 “On the Streamlining of the Licenses and Permits Legislative Framework,”* adopted September 11, 2008. This resolution approved the action plan for the implementation of the Law “On Streamlining of the Legislative Framework for Entrepreneurship.” Some amendments to this Government Resolution adopted July 17, 2009, introduced a moratorium on the creation of new permits and licenses;
- *Presidential Decree No. 435 “On the Improvement of the State Regulation on Entrepreneurship,”* adopted December 09, 2008, aimed at reducing the number of licenses and permits by 30 percent and ordering a draft law on permits and licenses by the end of 2009;
- Over 40 laws that regulate permits for specific activities.

The Kyrgyz Republic has no unified law regulating permit issuance. Rather, over 40 laws regulate permits for specific activities, in addition to the above-mentioned legal acts. The law on permits and licenses currently under preparation will therefore fill a legislative gap. It is important that the law includes a permit definition that covers “any kind of compulsory approval,” whatever its name.

As a result of the reforms undertaken since 2004 (Box 4.2), the number of permits listed in the permit register decreased from 110 in 2004 to 67 in 2009 (Annex 4.1, Indicative list of permits and permit issuing agencies). However, the list of permits listed in the permit register is not complete and excludes, for example, permits issued by local authorities. The creation of an exhaustive list of permits is required.

#### The permit legislation is more progressive than in most post-Soviet countries

The Kyrgyz Republic’s permit legislation compares favorably to those of other post-Soviet countries (Table 4.1). A unified legal definition of permit and the procedure for the creation of new permits were introduced in the legislation as early as 2001, whilst a permit register listing all national permits issued by State Agencies was developed in 2004. The “one-stop shop” and “silence is consent” principles for the construction sector were adopted in May 2008 (Box 4.3). In addition, the legislation on permits stipulates that:

- New permits can be introduced as a tool to protect national interests, the environment and consumer health and safety, including construction and building safety, and to ensure that businesses follow the norms and regulations of the Kyrgyz Republic.
- The introduction or abolishment of permits is stipulated by law, presidential act or government resolution.
- Permits are issued free of charge, or on a fee basis. The fees associated with issuing permits shall not exceed the actual cost incurred by the administration issuing the permit.
- Once the application for a permit has been submitted, permit issuing agencies must respond with a decision within 30 days.
- A state body can refuse to issue a permit (i) if the entrepreneur conducts an activity not allowed by the legislation and (ii) if the entrepreneur does not present all documents required to issue permits.

**Table 4.1: Comparison of best practices in permit legislation among selected post-Soviet countries**

	KYRGYZ REPUBLIC		TAJIKISTAN		UZBEKISTAN		UKRAINE
	YES	NO	YES	NO	YES	NO	YES
Definition and official list of permits	X			X		X	X (definition)
Clear procedure to create new permits	X			X	X (permits may be introduced by laws only)		X
Deadline for permit issuance or 'silence is consent' principle	Deadline, silence principle for construction			X	X (deadline for some permits, including construction)		
Self-certification		X		X		X	X (for fire safety)
One-stop shop	X (for construction)			X	X (for some permits, including construction)		X

#### **BOX 4.3. THE "ONE-STOP SHOP" AND "SILENCE IS CONSENT" MECHANISMS FOR CONSTRUCTION PERMITS WERE INTRODUCED IN THE LEGISLATION**

The "one-stop shop" and "silence is consent" mechanisms were introduced by *Government Resolution No. 252 "On the Improvement of the Regulation on the Procedure of Issuance of Construction Permits,"* adopted May 30, 2008, with the support of the USAID BEI project implemented by the Pragma corporation. These mechanisms apply to construction permits only. Construction permit applicants now go through two main phases to apply for permits.

Phase one: the applicant applies to the State Agency for Architecture and Construction to obtain approval for the construction plan (City Planning Regulation of Architectural Planning Conditions). The Agency for Architecture and Construction is then responsible for linking with the Fire Safety Department, the Sanitary and Epidemiological Service, the Agency for Environmental Protection and utility service providers (electricity, water, sewage, etc) to obtain their approval for the plan, as per the "one-stop shop" principle. An answer on the application should be issued within 20 working days after the application. If the State Agency for Architecture and Construction fails to answer within 20 working days, the decision is taken as an approval, as per the "silence is consent" principle.

Phase two: the applicant applies to the State Agency for Architecture and Construction to obtain approval and expertise of project documents and construction permit. The State Agency for Architecture is then responsible for linking with the Fire Safety Department, the Sanitary and Epidemiological Service, the Agency for Environmental Protection and utility services providers regarding permit approval. An answer on the application should be issued within a maximum of 40 working days after the application. The deadline of 40 days includes 7 to 20 working days to examine the project documents (depending on the complexity of the construction), 10 working days for approval of the project documents, and 10 working days for the issuance of the construction permit. If the State Agency for Architecture and Construction fails to answer within 40 days, the decision is considered as favorable to the applicant, as per the "silence is consent" principle.

Businesses going through the construction permit procedure now need visit only one government agency, as opposed to four agencies and several utility providers before the "one-stop shop" change was introduced. In addition, fewer documents are submitted. However, cost calculation for the procedure remains closed and indiscreet, despite reforms in disclosing the information on fee schedules. In addition, the implementation of the "one-stop shop" is uneven throughout the country, and needs to be improved, especially in rural districts (Annex 4.2, Article published on the website of the Investment Council).

Thanks to the reform, the Kyrgyz Republic improved its ranking on the "Dealing with Construction Permit" indicator in the IFC-World Bank "Doing Business 2010" report (Box 4.5).

Despite the fact that Kyrgyz legislation includes a number of good practices relative to the legislation of other post-Soviet countries, additional improvements are needed. It is recommended that the law on permits and licenses currently being drafted takes into account best international practices (Box

4.4). In particular, it is recommended that the new law introduces (i) "the silence is consent" and the "one-stop shop" principles for all permits, (ii) a comprehensive permit register that includes permits issued by local governments and (iii) a self-certification mechanism for businesses that poses little risk.

#### BOX 4.4: OTHER POST-SOVIET COUNTRIES HAVE IMPLEMENTED SOME REFORMS THAT ARE REPLICABLE IN THE KYRGYZ REPUBLIC

##### Georgia has adopted the “silence is consent” and the “one-stop shop” mechanism across permit issuing agencies

Rapid permit and licensing reform helped Georgia become one of the top 15 most business-friendly countries according to the IFC-World Bank Doing Business 2010 ranking. In addition to the sharp drop in the number of licenses and permits, from 909 to 137, the country has adopted the “silence is consent” and the “one-stop shop” mechanism across all permit issuing agencies, making procedures faster and more transparent. In addition, Georgia introduced a 30-day time limit to issue licenses and a 20-day time limit to issue permits.

##### Ukraine has adopted the self-certification mechanism

The self-certification procedure is one of the major innovations of the Ukrainian Permit Law. The majority of permit issuing bodies are eligible to adopt the self-certification procedure. However, only one agency is pioneering the reform: the State Fire Safety Department of the Ministry of Emergency Situation. According to self-certification, an entrepreneur may start doing business in the absence of a permit or an authorization. The business simply notifies the administrator or authorizing body that it is conforming with the Law's requirements. Self-certification does not require that a fire safety expert examine the applicant's premises. Instead, conformity with fire safety regulations is assessed during inspections. The self-certification procedure is becoming more popular every year because it costs less time and money than the permit procedure: it takes on average four days for small and medium companies to self-certify their enterprises, yet nearly five times that to obtain a permit (19 days). Self-certifications accounted for 22 percent of all permit documents issued by the Fire Safety department in 2008. The number of self-certifications has doubled every year, while the number of permits continues to fall.

### 4.3. PERMIT COVERAGE AND FREQUENCY: THE NUMBER OF ENTERPRISES OBTAINING PERMITS IS SIGNIFICANT, WITH REGIONAL DISPARITIES

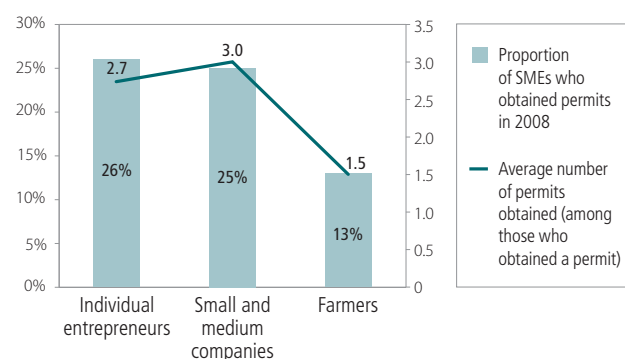
The number of Kyrgyz businesses who went through the permit procedure in 2008 is lower than in some neighboring countries, but remains significant: 26 percent of individual entrepreneurs, 25 percent of small and medium companies and 13 percent of farmers obtained at least one permit in 2008 (Chart 4.1). In Tajikistan, by comparison, 44 percent of individual entrepreneurs, 57 percent of small and medium companies and 7 percent of farmers went through the permit procedure in 2007.<sup>47</sup>

Although close to 15 percent of individual entrepreneurs and 9 percent of small and medium companies in Kyrgyz

began operations in 2008, 26 percent of individual entrepreneurs and 25 percent of small and medium companies went through the permit procedure that same year. This indicates that even businesses already operating need to go through the permit procedure. In countries where effective permit reforms have been implemented, the vast majority of businesses who go through the permit procedure are just beginning operations. In addition, individual entrepreneurs in the Kyrgyz Republic face higher permit coverage than small and medium companies even though individual entrepreneurs often pose little or no risk to society and the environment.

**Chart 4.1: Close to one-fourth of small and medium companies and individual entrepreneurs obtained one or more permits in 2008**

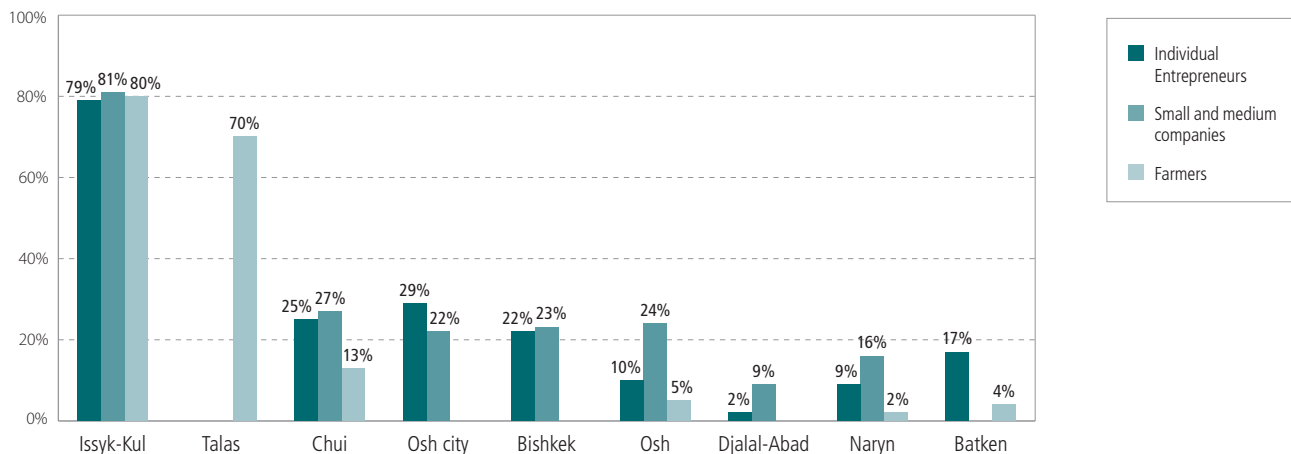
**Proportion of SMEs who obtained permits in 2008 and average number of permits obtained**



Survey results show regional disparities in the share of entrepreneurs who obtained permits in 2008. In Issyk-Kul, for example, the share of entrepreneurs who obtained permits was much higher for all categories of respondents (close to 80 percent of entrepreneurs) than in other regions. The share of entrepreneurs obtaining permits was lowest in Jalalabat (Chart 4.2).

In Issyk-Kul, the high share of individual entrepreneurs who obtained permits in 2008 could be partly due to the fact that the share of individual entrepreneurs engaged in permit-intensive sectors such as transport tends to be higher there than in other regions (27 percent of Issyk-Kul entrepreneurs work in the transport sector). However, this is less true for small and medium companies, as none of the top three small and medium companies permit intensive sectors is prevalent in the Issyk-Kul region. The same goes for farmers. This suggests that regional branches of permit issuing agencies interpret and/or implement the permit legislation differently, which underscores the need for a streamlining of permit issuance across the country.

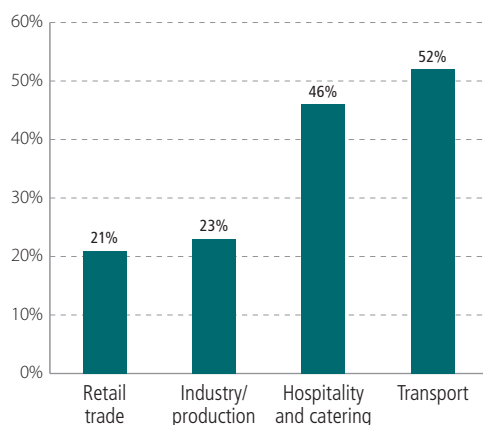
<sup>47</sup> IFC (2009) “Business Environment in Tajikistan as seen by SMEs”.

**Chart 4.2: There are regional disparities in the share of entrepreneurs who obtained permits in 2008****Regional distribution of SMEs who obtained permits in 2008**

“My husband and I operate a small flour selling business. We need to obtain each year a permit from the Fire Safety Department, from the Sanitary and Epidemiological Service, from the Agency for Architecture and Construction, from the city water supplier, from the energy supplier. These agencies inspect us regularly and fine us if we do not have permits.”

*Individual Entrepreneur operating in Issyk-Kul region*

Among the small and medium companies that obtained permits in 2008, the average number of permits obtained was three – the same amount as individual entrepreneurs whereas farmers obtained on average two permits. Permits issued to small and medium companies and individual entrepreneurs were valid for an average of one year, while farmer permits were valid for an average of eight months. The fact that entrepreneurs have to renew their permits annually, regardless of whether or not their businesses have undergone substantial changes, adds instability to the entrepreneurial environment and deters long-term investment. In addition, the permit renewal procedure is the same as the permit issuance process, which represents a significant administrative burden. A simpler procedure would ease the renewal process.

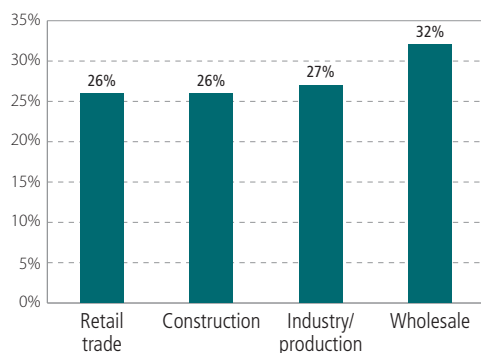
**Chart 4.3: The transport sector is the most permit-intensive for individual entrepreneurs****Proportion of individual entrepreneurs who obtained at least one permit per sector in 2008**

The transport sector is the most permit intensive for individual entrepreneurs: over 50 percent of individual entrepreneurs working in the transport sector had to obtain at least one permit in 2008 (Chart 4.3). Conversations with individual entrepreneurs indicated that they needed to obtain an “itinerary map” from the Ministry of Transport to operate. The majority of individual entrepreneurs active in the transport sector not only went through the permit procedure in 2008, but also went through the licenses procedure (69 percent obtained licenses in 2008), indicating that the regulatory burden for individual entrepreneurs active in the transport sector is very high. The regulatory burden for individual entrepreneurs active in the hospitality and catering sector is also quite high. Over 40 percent of these entrepreneurs had to obtain at least one permit in 2008 (Chart 4.3), while 25 percent of them went

through the license procedure. Additionally, over 30 percent of the small and medium companies engaged in wholesale had to get at least one permit in 2008 (Chart 4.4).

**Chart 4.4: The wholesale sector is the most permit-intensive for small and medium companies**

**Proportion of small and medium companies who obtained at least one permit per sector in 2008**

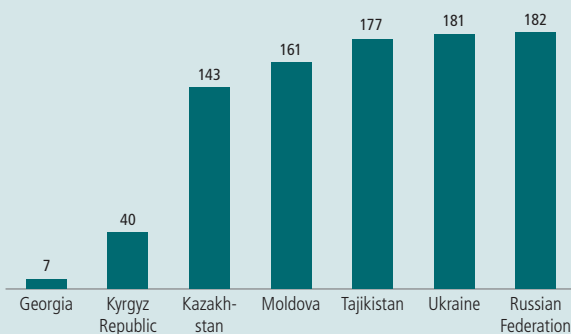


#### BOX 4.5: CONSTRUCTION PERMITS REGULATIONS: THE KYRGYZ REPUBLIC PERFORMS BETTER THAN MOST POST-SOVIET COUNTRIES

Improvements in the Kyrgyz permit procedure are confirmed by the IFC–World Bank Doing Business 2010 report, which ranks the Kyrgyz Republic 40 among 183 countries on the “Dealing with Construction Permits” indicator – 19 spots higher than in 2009. The Kyrgyz Republic performs better than most of the post-Soviet countries on this indicator, and according to the report it takes 12 procedures and 137 days to build a warehouse in the Kyrgyz Republic (including obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections), as opposed to 37 procedures and 211 days in Kazakhstan (Chart 4.5).

**Chart 4.5: The Kyrgyz Republic does well in regard to “Dealing with Construction Permits”**

**Ranking, Dealing with Construction Permits Indicator, Doing Business 2010**



Source: IFC–World Bank “Doing Business 2010” report.

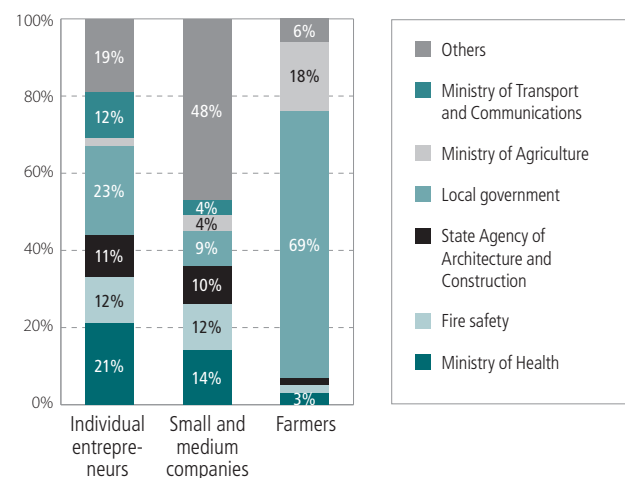
#### 4.4. THE MINISTRY OF HEALTH, THE FIRE SAFETY DEPARTMENT, THE MINISTRY OF TRANSPORT AND LOCAL GOVERNMENTS ARE THE HEAVIEST REGULATORS ON PERMITS

The most active permit issuing agencies are (Chart 4.6):

- Sixty-eight percent of the permits issued to individual entrepreneurs are issued by local governments (23 percent), the Ministry of Health (21 percent), the Fire Safety Department (12 percent), and the Ministry of Transport and Communications (12 percent).
- Twenty-six percent of the permits issued to small and medium companies are issued by the Ministry of Health (14 percent) and the Fire Safety Department (12 percent). The Fire Safety Department issues permits (i) when an enterprise starts its activities, (ii) when an enterprise builds or renovates its premises and (iii) as an intermediate step to obtain a construction permit. The percentage of permits issued by the Fire Safety Department to small and medium companies in 2008, 12 percent, aligns with the 9 percent of small and medium companies that started doing businesses during that year.
- Sixty-nine percent of all permits issued to farmers were issued by local governments. This is due to the fact that local governments issue land use permits, which are the permits most needed by farmers. The Ministry of Agriculture, Water and Processing Industry is also an important permit issuing agency for farmers (18 percent of all permits issued to farmers).

**Chart 4.6: Top permit issuing agencies: local governments, the Ministry of Health, the Fire Safety and the Ministry of Transport and Communication**

**Top permit issuing Agencies**

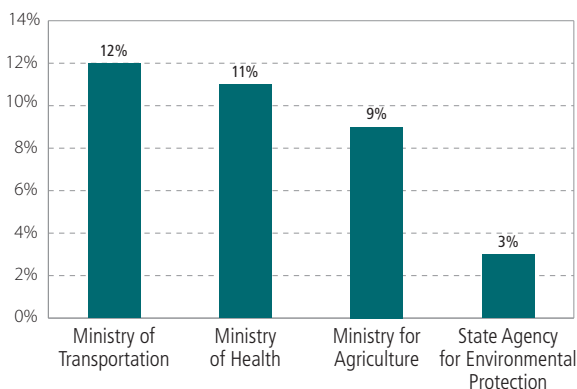


Some 12 percent of individual entrepreneurs obtained either a permit or a license from the Ministry of Transport and Communication and 11 percent of individual entrepreneurs and 10 percent of small and medium companies obtained either a permit or a license from the Ministry of Health (Chart 4.7, 4.8). These numbers are high compared to international best practices. For example, in Georgia in 2005, only six percent of business obtained license or permit from all issuing agencies<sup>48</sup>.

These numbers are all the more worrying in light of the fact that some entrepreneurs need to obtain both a license and a permit from the same issuing agency. For example, six percent of entrepreneurs obtained both a license and a permit from the Ministry of Transport and Communications.

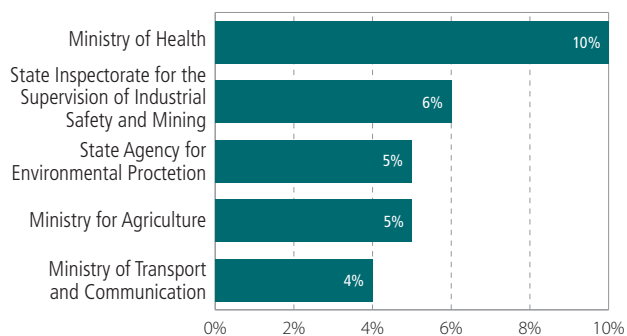
**Chart 4.7: Over 10 percent of all individual entrepreneurs obtained a permit or a license from the Ministry of Transport and from the Ministry of Health in 2008**

**Proportion of individual entrepreneurs who obtained a license or a permit from selected agencies in 2008**



**Chart 4.8: Over 10 percent of all small and medium companies obtained a permit or a license from the Ministry of Health in 2008**

**Proportion of small and medium companies who obtained a license or a permit from selected agencies in 2008**



#### 4.5. PERMIT ADMINISTRATION: TIME-CONSUMING AND COMPLEX PROCEDURES PROMOTE INFORMAL SOLUTIONS

The Survey data shows that individual entrepreneurs, small and medium companies and farmers need an average of seven days to prepare documents to obtain permits (Chart 4.10). Although the time needed for document preparation is nearly the same across all categories of respondents, the waiting time to obtain the permits, once the documents have been submitted, varies significantly. For individual entrepreneurs and farmers, the average wait time was eight calendar days, but it was 15 calendar days for small and medium companies.

The cost of getting permits is also higher for small and medium companies. Including official and unofficial payments but excluding labor costs, individual entrepreneurs and farmers spent an average of KGS3,674 (\$100) and KGS2,654 (\$73), respectively, on permits in 2008. Small and medium companies spent an average of KGS9,396 (\$257) (Chart 4.9). This represents one percent of individual entrepreneurs' turnover, 0.2 percent of small and medium companies' turnover and 0.1 percent of farmers' turnover. Relatively speaking, individual entrepreneurs' permit expenses are thus ten times greater than those of farmers.

The relative cost of permits as a percentage of turnover for individual entrepreneurs and small and medium companies is similar in Ukraine, a country where the permit burden is also sizable (Table 4.2). Although small and medium companies get, on average, only 15 percent more permits than individual entrepreneurs<sup>49</sup>, the cost for small and medium companies was on average 2.5 times higher than the cost for individual entrepreneurs – suggesting that small and medium companies made higher unofficial payments to get permits.

<sup>48</sup> IFC (2006) "Business Environment in Georgia".

<sup>49</sup> The Fire Safety Department has confirmed that permits were issued free of charge for both small and medium companies and individual entrepreneurs and the Ministry of Health has confirmed that permits were issued at the same fee for both small and medium companies and individual entrepreneurs. The list of documents to submit is also the same for both small and medium companies and individual entrepreneurs.



One reason why small and medium companies were subject to higher unofficial payments might be that they have higher revenues. Therefore, permit-issuing agencies target small and medium companies to force them to use unofficial ways to solve permit issues. Forty-one percent of small and medium companies reported that they had to make unofficial payments to obtain permits. The percentage of individual entrepreneurs that had to make unofficial payments was even higher at 44 percent of respondents, while the percentage of farmers was lower (34 percent), but still amounted to more than one-third (Chart 4.10).

**Chart 4.9: The burden of the permit procedure is higher for small and medium companies**

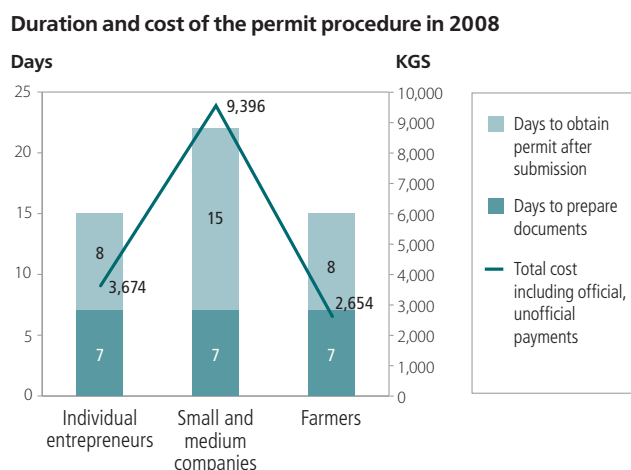
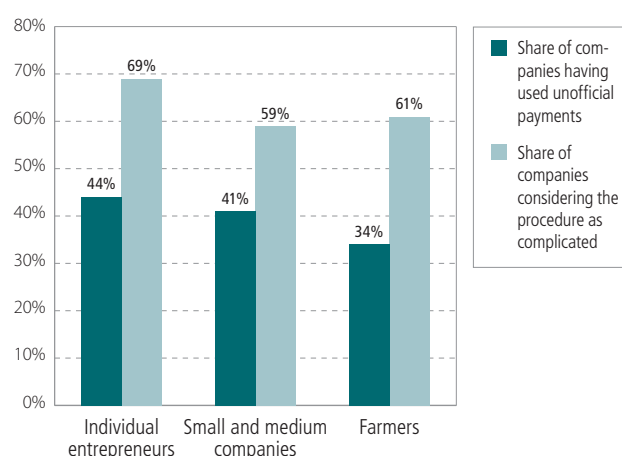


Figure one testifies to the complexity of the permit procedure. In order to obtain a permit on radiological safety for imported confectionary, it takes entrepreneurs four steps and up to seven working days. One entrepreneur said he paid KGS4,400 (\$120) to obtain this permit, although the official cost is KGS600 (\$16). Moreover, entrepreneurs have to re-apply for the permit on radiological safety for imported confectionary each time they receive a shipment from abroad.

**Chart 4.10: Nearly 40 percent of businesses reportedly made unofficial payments and close to 60 percent found the procedure complicated**

**Unofficial payments and level of difficulty of the permit procedure**



**Table 4.2: Comparative cost of obtaining permits in select post-Soviet countries (\$)<sup>50</sup>**

	KYRGYZ REPUBLIC (2008)		TAJIKISTAN (2007)		UKRAINE (2008)	
Individual entrepreneurs	\$100	1% of turnover	\$35	0.2% of turnover	\$475	1.3% of turnover
Small and medium companies	\$257	0.2% of turnover	\$458	0.7% of turnover	\$1300	0.2% of turnover
Farmers	\$73	2.3% of turnover	\$65	1% of turnover	N/A	N/A

<sup>50</sup> Source: (i) IFC (2009) "Business Environment in Tajikistan as seen by Small and Medium Enterprises," (ii) IFC (2009) "Investment Climate in Ukraine as seen by Private Businesses".

**Figure 4.1: Step-by-step instructions to obtain a sanitary and epidemiological permit on radiological safety from the Sanitary and Epidemiological Service under the Ministry of Health for imported confectionary**

STEP #/ LOCATION	LIST OF DOCUMENTS TO BE SUBMITTED/ACTIVITIES	OFFICIAL COST	OUTCOME	DURATION
<b>STEP 1:</b>				
Ministry of Health, SES, radiology division	<ul style="list-style-type: none"> <li>• Application form</li> <li>• Copy of certificate of origin</li> <li>• Copy of certificate of conformity</li> <li>• Copy of invoice</li> </ul>	N/A	Radiology Division examines the object	30 minutes
<b>STEP 2:</b>				
Ministry of Health, SES Laboratory	<ul style="list-style-type: none"> <li>• Measurement of ionizing radiations of (i) the products and (ii) the container in which the products were transported (this often implies an on site visit).</li> <li>• Analysis of the measurement's results.</li> </ul>	N/A	Test report	<ul style="list-style-type: none"> <li>• Unofficially 4-5 working days, possibility to have it in one day if unofficial payments</li> <li>• Officially 1-3 days</li> </ul>
<b>STEP 3:</b>				
Ministry of Health, SES	<ul style="list-style-type: none"> <li>• Payment of fees by business</li> </ul>	Officially 382 KGS for the analysis of the products, 600 KGS for the analysis of the container in which the product was transported (ca 1,000 KGS in total). Unofficially up to 4,400 KGS including analysis of product and container, and unofficial payments	Receipt confirming the payment of the fee	15-30 minutes
<b>STEP 4:</b>				
Ministry of Health, SES	<ul style="list-style-type: none"> <li>• Receipt confirming the payment of the fees</li> </ul>	N/A	Issuance of permit	1-2 days

Survey data shows that all three SME segments find the permit procedures to be complicated. This is reflected in their assessment (Chart 4.10), in which 59 percent of small and medium companies representatives found the permit procedure to be “somewhat complicated” or “very complicated.” This percentage is even higher for individual entrepreneurs (69 percent) and farmers (61 percent). Businesses consider the permit procedure the most complicated of all regulatory procedures, excepting the licensing procedure.

These data suggest that the procedure to obtain permits should be streamlined and simplified, which would lead to significant savings for entrepreneurs. The total average cost of the permit procedure in 2008 for the three categories of populations surveyed was approximately KGS555 million (\$15 million). This includes labor cost, official and unofficial payments, but excludes lost profit due to breaks or transactions delayed while awaiting government approval. This represents 0.37 percent of the country's 2008 GDP.



## 4.6. RECOMMENDATIONS

ISSUES	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
<b>SHORT-TERM RECOMMENDATIONS</b>		
The permit procedure is lengthy.	Reduce the permit issuing agency's response time from 30 to 15 days and extend the "silence is consent" principle to all permits: once an applicant for a permit submits the required documents, the failure of an issuing agency to respond within the given timeframe counts as an application approval.	The duration of the permit procedure will be reduced.
The percentage of businesses making unofficial payments during the procedure is high.	Reduce the timeframe during which a permit issuing agency considers an application and issues an answer from 30 to 15 days and introduce the "silence is consent" principle to all permits.	Unofficial payments made to "speed up the permit procedure" will be reduced.
The validity of permits is short and the permit renewal procedure is as complicated as the permit issuance procedure.	(i) Extend permit validity periods and (ii) simplify the renewal procedure: permit renewal should be automatic if there were no changes in the operations of the business.	This will reduce the cost of doing business and streamline the work of permit issuing agencies.
Permit coverage varies widely across different regions of the country.	Conduct permit legislation and issuance procedure trainings of all permit issuing agencies' staff across the country.	Permit coverage, frequency and procedures will be made uniform.
There is no single law on permits, the permit Register is not exhaustive as it does not include permits issued by local governments.	Develop a framework permit law <sup>51</sup> that includes an exhaustive permit register encompassing permits issued by local governments and detailing the rules, procedures and timeframe to obtain permits.	A single, unified legal basis for permits will foster greater understanding among permit issuing agencies and entrepreneurs, making for more efficient procedures and processes.
<b>MEDIUM-TERM RECOMMENDATIONS</b>		
The permit procedure is considered by businesses as the most complex regulatory procedure.	For businesses that pose little risk, permit-issuing agencies should adopt self-certification as an alternative to issuing permits. The "one-stop shop" principle should be extended to additional permits.	Self-certification will significantly simplify the permit process: businesses will spend less time and money than they did when following classical permit procedures. It will increase business responsibility and accountability for their operations, because a self-certifying business undertakes full responsibility for its operations.  The extension of the "one-stop shop" principle will simplify the permit procedure by reducing the number of agencies businesses have to visit to obtain permits.

<sup>51</sup> A license and permit Law is currently being drafted.

**ANNEX 4.1: INDICATIVE LIST OF PERMIT ISSUING AGENCIES AND OF THE MAIN TYPES OF PERMITS (2009)**

	STATE BODY	DEPARTMENT	TYPE OF PERMIT
1	Ministry of Health	Department of Sanitary and Epidemiological Control	Sanitary and epidemiological statement
		Department of Medicine and Medical Equipment Supply	Registration certificate
2	Local government (Akimiat, Village Council)		Various permits related to land use; Advertisement permit; Others
3	Ministry of Agriculture, Water Resources and Processing Industry		Seed import permit; Fishing permit
		State Inspection on seeds	Certificate of conformity
		Plant Protection Department	Registration certificate for pesticides; Phyto-sanitary certificate; Permit to import plants; Quarantine Certificate
		Veterinary Department	Veterinary certificate; Permit to produce veterinary medicines
		Transport Inspection	'Technical passport' for tractors, trailers
3	State Fire Department		Statement of compliance with fire safety requirements
4	State Agency for Architecture and Construction		Construction permit; Qualification certificate (for specialist)
5	National Statistics Committee		Registration certificate for individual entrepreneurs
6	State Agency for Environmental Protection and Forestry		Permit to use plant and animal by-products; Permit to import and export plant and animal by-products; Permit on waste disposal, air pollutants emissions; Forest use permit
7	State Inspection for Supervision of Industrial Safety and Mining Supervision of the Ministry of Emergency Situations Mining		Permit on blasting operations
8	State Committee on Taxes and Levies		Registration of legal entities, individual entrepreneurs; Patent
9	National Institute of Standards and Metrology (NISM)		Certificate for measuring equipment
10	Ministry of Interior	Department of Road Traffic	Permit to transport hazardous cargo; Permit to transport heavily-loaded cargo; Permit to modify transport vehicle
11	Ministry of Interior	Department of Public Safety	Permit to purchase, keep, convey, import and export arms
12	Ministry of Transport and Communications	Transport Inspection Department of Civil Aviation Department of International Carrier	Various permits and certificates depending on means of transport (automobile, aircraft, etc)
13	State Agency on Anti-monopoly Policy and Development of Competition		Certificate of consent
14	Ministry of Justice		Registration Certificate for Mass Media
15	Drug Control State Agency		Permit to import drugs and psychotropic agents
16	State Committee on Migration and Employment		Work permit
17	Ministry of Culture		Permit to export 'cultural value'
18	Ministry of Industry, Energy and Fuel Resources	State Inspection on Energy and Gas	Permit to run an energy production facility
19	Agency for the Control of the Financial Market		Certificate on state registration of stock securities; Auditor certificate; Permit to run a lottery facility

## ANNEX 4.2: THE IMPLEMENTATION OF THE CONSTRUCTION PERMITS' "ONE-STOP SHOP" IS WEAK, ARTICLE PUBLISHED ON FEBRUARY 2009 ON THE INVESTMENT COUNCIL WEBSITE

The State Agency for Architecture and Construction under the Government of the Kyrgyz Republic (Gosstroï) monitored the implementation of the "one-stop shop" in the regions of Talas, Chui, Issyk-Kul, Batken, Osh, and Jalalabat upon request of the Agency's manager, Kanybek Narbaev, according to Ainura Kanimetova, the Agency's press officer.

The Agency made a lot of efforts towards improving the issuance of permits in the construction sector as per the *Presidential Decree No. 164 "On Streamlining of the Construction Permits System,"* adopted May 14, 2008, indicated Mr Narbaev.

As Mr Narbaev puts it: "The Decree aims at improving the investment climate and at attracting investments in the construction sector. The "one-stop shop" is implemented across the Republic in order to reduce the duration and costs of services provided by the city and district departments of the State Agency for Architecture and Construction. It aims at reducing the contacts between a permit applicant and representatives of permit issuing agencies and at changing the existing system of approval of construction plans and of delivery of documents authorizing the construction and renovation of buildings. The system was radically changed based on best practices implemented in other countries."

The State Agency for Architecture and Construction carried out an analysis of the regulatory framework in the construction sector. As a result, the procedure for permit delivery

was streamlined, its duration and tariffs reduced. K. Narbaev pointed out that the tariffs had been sharply reduced, by between 20 and 44 percent compared to previous years. New rules were set up to issue construction permits within 10 working days.

The field monitoring visits were organized taking into account the importance of the implementation of the "one-stop shop". The results indicated that in Chui Region, the "one-stop shop" was well organized in Moscovski district, where transparent and timely procedures are guaranteed. However, some gaps were identified in the activity of the Agency for Architecture and Construction of Tokmok city: the information board is not properly designed.

In Issyk-Kul region, the implementation of the "one-stop shop" is satisfactory, but the results of the monitoring visits of the Southern regions showed that the district Architecture and Construction departments do not comply with all requirements. The implementation of the "one-stop shop" in Osh and Uzgen cities, as well as in Aravan and Kara-Suu districts is smooth. However, implementation in Batken district and in other districts is weak.

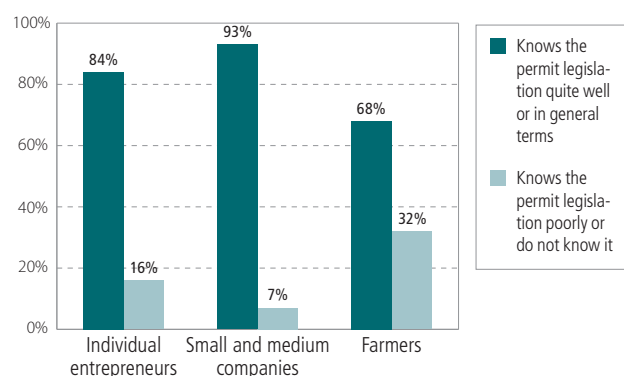
K. Narbaev encouraged the managers of cities and districts Architecture and Construction Departments to strengthen their efforts towards the implementation of the "one-stop shop" and improve the shortcomings as soon as possible.

## ANNEX 4.3: ENTREPRENEURS BELIEVE THEY HAVE A GOOD KNOWLEDGE OF THE PERMIT LEGISLATION

Overall, the respondents who obtained permits in 2008 assessed their knowledge of the legislation regulating the permit procedure confidently. Some 68 percent of farmers, 84 percent of individual entrepreneurs and 93 percent of small and medium companies estimated that they were either "quite well" aware, or aware in "general terms" of the legislation (Chart 4.11). Entrepreneurs who estimated the permit procedure as "somewhat simple" or "simple" were also those who tended to estimate their knowledge of the permit procedure as "good" or "rather good."

**Chart 4.11: An absolute majority of individual entrepreneurs and small and medium companies estimate that they know the permit legislation and procedures quite well**

### SMEs' assessment of their knowledge of the permit legislation



**ANNEX 4.4: TOTAL COST OF OBTAINING PERMITS FOR ALL SMEs IN 2008****Labor costs**

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of individual entrepreneurs companies subject to the permit procedure in 2008	26%	Survey results
B	Number of active individual entrepreneurs	145,663	State Statistics Committee
C	Average time spent by individual entrepreneurs in preparing documentation for one permit (working man-days)	7	Survey results
D	Average number of permits obtained	3	Survey results
E	Average number of working days	21	
F	Average monthly salary (gross pay) (KGS)	5,378	State Statistics Committee
G	<b>Total labor cost of permits, individual entrepreneurs (KGS)</b>	<b>184,159,132</b>	<b>A x B x C x D x (F:E)</b>
H	<b>Total labor cost of permits, individual entrepreneurs (\$)</b>	<b>5,035,798</b>	<b>Ex. Rate 36.57</b>

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of small and medium companies subject to the permit procedure in 2008	25%	Survey results
B	Number of active small and medium companies	10,982	State Statistics Committee
C	Average time spent by small and medium companies in preparing documentation for one permit (working man-days)	7	Survey results
D	Average number of permits obtained	3	Survey results
E	Average number of working days	21	
F	Average monthly salary (gross pay) (KGS)	5,378	State Statistics Committee
G	<b>Total labor costs of permits, small and medium companies (KGS)</b>	<b>14,846,608</b>	<b>A x B x C x D x (F:E)</b>
H	<b>Total labor costs of permits, small and medium companies (\$)</b>	<b>405,978</b>	<b>Ex. Rate 36.57</b>

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of farmers subject to the permit procedure in 2008	13%	Survey results
B	Number of active farmers	280,408	State Statistics Committee
C	Average time spent by farmers in preparing documentation for one permit(working man-days)	7	Survey results
D	Average number of permits obtained	1	Survey results
E	Average number of working days	21	
F	Average monthly salary (gross pay), KGS	5,378	State Statistics Committee
G	<b>Total labor costs of permits, farmers, KGS</b>	<b>94,242,030</b>	<b>A x B x C x D x (F:E)</b>
H	<b>Total labor costs of permits, farmers, \$</b>	<b>2,577,031</b>	<b>Ex. Rate 36.57</b>

## Official and unofficial payments

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of individual entrepreneurs companies subject to the permit procedure in 2008	26%	Survey results
B	Number of active individual entrepreneurs	145,663	State Statistics Committee
C	Average amount of official and unofficial payments spent by individual entrepreneurs to obtain permits	3,674	Survey results
D	<b>Total official and unofficial payments spent during the permit procedure by individual entrepreneurs (KGS)</b>	<b>140,748,622</b>	<b>A x B x C</b>
E	<b>Total official and unofficial payments spent during the permit procedure by individual entrepreneurs (\$)</b>	<b>3,848,745</b>	<b>Ex rate 36.57</b>

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of small and medium companies subject to the permit procedure in 2008	25%	Survey results
B	Number of active small and medium companies	10,982	State Statistics Committee
C	Average amount of official and unofficial payments spent by small and medium companies to obtain permits	9,396	Survey results
D	<b>Total official and unofficial payments spent during the permit procedure by small and medium companies (KGS)</b>	<b>25,487,157</b>	<b>A x B x C</b>
E	<b>Total official and unofficial payments spent during the permit procedure by small and medium companies (\$)</b>	<b>696,942</b>	<b>Ex rate 36.57</b>

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of farmers subject to the permit procedure in 2008	13%	Survey results
B	Number of active Farmers	280,408	State Statistics Committee
C	Average amount of official and unofficial payments spent by farmers to obtain permits	2,654	Survey results
D	<b>Total official and unofficial payments spent during the permit procedure by farmers (KGS)</b>	<b>96,002,165</b>	<b>A x B x C</b>
E	<b>Total official and unofficial payments spent during the permit procedure by farmers (\$)</b>	<b>2,625,162</b>	<b>Ex rate 36.57</b>

## Total cost of permits

	Individual entrepreneurs		Small and medium companies		Farmers	
	KGS	\$	KGS	\$	KGS	\$
Labor cost	184,159,132	5,035,798	14,846,608	405,978	94,242,030	2,577,031
Official and non official payment	140,748,622	3,848,745	25,487,157	696,942	96,002,165	2,625,162
Sub total	324,907,753	8,884,543	40,333,766	1,102,919	190,244,195	5,202,193
<b>Grand total (KGS)</b>	<b>555,485,714</b>					
<b>Grand total (\$)</b>	<b>15,189,656</b>					

**Note on cost calculations:** The cost of various administration requirements were estimated based on reported official and unofficial payments as well as on time spent preparing to submit documents.



## 5. Licensing

The short validity of licenses and the complexity of the procedures are the main problems with licensing

### 5.1. KEY FINDINGS:

- The share of small and medium companies (15 percent) and of individual entrepreneurs (22 percent) who obtained a license in 2008 is significant (since only 0.1 percent of farmers obtained licenses, they will be left out of the discussion for the majority of this chapter).
- There are some significant regional disparities in the coverage of the licensing procedure: the coverage of the procedure is highest in Issyk-Kul, where 44 percent of individual entrepreneurs and 21 percent of small and medium companies obtained a license in 2008, and lowest in Jalalabat, where no individual entrepreneurs and six percent of small and medium companies obtained a license in 2008.
- The validity of the licenses obtained in 2008 is relatively short: an average of 23 months for small and medium companies and 13 months for individual entrepreneurs.
- While small and medium companies bear the greatest expense in absolute terms (KGS8,654 against KGS3,802), individual entrepreneurs are the most burdened by licensing in relative terms: the cost of the license procedure (including official, unofficial payments and labor costs) for small and medium companies represents 1.4 percent of profit, but 3.2 percent of profit for individual entrepreneurs.
- In 2008, the total cost of the licensing procedure for individual entrepreneurs and small and medium companies<sup>52</sup> (including official, unofficial payments and labor costs, but excluding lost profit due to breaks or transactions delayed while awaiting licenses) was about KGS134 million (\$ 3.7 million), or nearly 0.09 percent of GDP.

### 5.2. LICENSING: THE LEGAL FRAMEWORK INCLUDES A NUMBER OF GOOD PRACTICES

Recent licensing reforms have reduced the number of activities subject to licensing from 32 in 2004 to 30 in 2010, and better explained the requirements to obtain licenses. However, additional reforms are needed. In particular, license validity periods could be extended, both de jure and de facto.

A unified legal definition of a license was issued on March 3, 1997 in the *Law "On Licensing"*: "A license is a permit issued by a competent State body that gives individuals or legal entities the permission to carry out certain types of activities."

#### BOX 5.1. WHAT IS THE DIFFERENCE BETWEEN A PERMIT AND A LICENSE?

In international practice, there is no difference between permits and licenses. Both words come from Latin and mean "something which is allowed". However, in the former Soviet Union, licenses are understood as special permits that allow the implementation of an activity that is either potentially risky or involves any limited resources on a regular base. In addition, licenses are often tied to a special knowledge on the part of the enterprise or entrepreneur (e.g. licenses to practice medicine) whereas permits rarely require special knowledge from the enterprise or entrepreneur, but are often tied to the particular location of an enterprise. In addition, permits are documents that allow the implementation of a risky activity for a specific period of time. These documents can be in the form of permit, approval, opinion, certificate, authorization, conformity assessment, payment of fees, or any other document issued for the above-mentioned purposes.

<sup>52</sup> Farmers were not included in the calculations as the coverage of licensing is low among farmers.

As a result of the reforms undertaken since 2008 (Box 5.2), licensing legislation in the Kyrgyz Republic includes a number of good practices. In particular, the legislation on licenses stipulates:

- New licenses may be introduced as a tool to protect the security of the State, to protect State monopolies, to enforce the law of the Kyrgyz Republic, to protect the environment, as well as to protect the property, health and life of the citizens of the Kyrgyz Republic. New licenses can only be introduced by law, not by subordinate legal acts.
- Licenses are required only for the types of activities listed in the legislation.
- Licenses can only be issued by Ministries, State agencies and other authorities identified by the legislation and the Government.
- Licenses are issued on a fee basis. The fees associated with issuing licenses shall not exceed the actual cost incurred by the agency issuing the license and shall not exceed three indicators of calculation<sup>53</sup> (in 2009,  $100 \times 3 = 300$  soms).
- Applications should be considered within 30 calendar days.
- When, in addition to a license, a permit is required to carry out a certain type of activity, such permit(s) shall be issued after the license has been obtained. A permit without the license shall be considered invalid.
- The grounds on which the issuance of a license can be denied or on which an issued license can be suspended.
- Licenses are permanent or temporary (issued for at least two years unless a shorter duration is stated in the legislation).
- Licenses are valid for activities that are conducted in part of the territory of the Kyrgyz Republic, in the whole territory of the Kyrgyz Republic and/or beyond the borders of the Kyrgyz Republic.

Recent amendments to the licensing legislation reduced the types of activities subject to licensing from 32 in 2004 to 30 in 2010 (Annex 5.1). The production and sale of alcohol are among the activities that were dropped from the list. However, some activities which are neither risky nor involve limited resources are still subject to licensing such as cargo transportation and real estate valuation.

### BOX 5.2. KEY LEGISLATION AND REGULATION GOVERNING THE LICENSING PROCEDURE

- *Law of the Kyrgyz Republic "On Licensing,"* adopted March 3, 1997;
- *Parliament Resolution No. 1101-1 "On the Adoption of the List of Goods whose Export and Import is Subject to Licensing,"* adopted June 8, 1998;
- *Government Resolution No. 260 approving the regulation "On the Licensing of some Specific Activities,"* adopted May 31, 2001. This resolution lists the requirements (list of documents, etc.) for the application to various licenses;
- *Law No. 55 "On the Streamlining of the Legislative Framework for Entrepreneurship,"* adopted April 5, 2008. This law forbids the issuance of permits and licenses which are not stipulated in the laws and resolutions of the Government of the Kyrgyz Republic;
- *Government Resolution No. 509 "On the Streamlining of the Licenses and Permits Legislative Framework,"* adopted September 11, 2008. This resolution approved the action plan for the implementation of the Law "On Streamlining the Legislative Framework for Entrepreneurship". Some amendments to this Government Resolution adopted July 17, 2009, introduced a moratorium on the creation of new permits and licenses;
- *Presidential Decree No. 435 "On the Improvement of the State Regulation on Entrepreneurship,"* adopted December 9, 2008. This decree aimed at reducing the number of licenses and permits by 30 percent and ordering a draft law by the end of 2009.

A new law on permits and licenses is currently being drafted. It is recommended that the law takes into account best international practices (Box 5.3). In particular, it is recommended that the new law introduces (i) the "silence is consent" principle, excepting sectors where the risks are too high to allow start-up prior to review of qualifications and (ii) increases the length of license validity, including the number of licenses valid permanently (Annex 5.1).

<sup>53</sup> The indicator of calculation was introduced by the *Law "On Indicator of Calculation"* adopted January 27, 2006. It replaces the minimum wage as a basis to calculate the cost of licenses. Decoupling the fees for licenses and other procedures from the minimum wage was a positive reform, since now increases in the minimum wage raise workers' salaries without also adding to the regulatory burden for entrepreneurs. In 2008, the indicator of calculation was 100 KGS. The amount of the indicator of calculation is approved by the Parliament.



### BOX 5.3. CHARACTERISTICS OF GOOD LICENSING LAWS

1. **Activities subject to licensing should be identified in a framework licensing law or other high-level instrument.** The instrument should not be vulnerable to capricious amendments that increase regulatory uncertainty. In some legal systems, lesser measures such as Cabinet resolutions may be used to implement administrative procedures called for in the framework law. In such circumstances, the framework law should clearly specify the purposes such measures will be used for, the parameters that shall apply to their contents (e.g. fees not exceeding administrative costs), time limits for promulgating them (e.g. six months after ratification of the law), legal guidance for the period prior to their prolongation and limitations on amendments (e.g. amendments not allowed more than once per year).
2. **Licenses should be valid in all sub-national jurisdictions.** A license attests to the operator's competency to carry out an activity in a manner that safeguards the public interest. To the degree possible, countries should make such licenses valid throughout the whole of their territories. For example, a business should not be required to acquire a separate license in each sub-national jurisdiction in which it operates.<sup>54</sup> That said, there may be sound reasons for creating license applications points close to businesses throughout the country.
3. **Licenses should be priced to cover administrative costs.** Licenses should serve as regulatory instruments rather than fiscal tools. (. . .). The cost of each license should not exceed the costs to ministries of collecting and reviewing applications.
4. **The law should clearly articulate the qualification criteria for each license.** The law should clearly state the requirements that applicants must meet to acquire a license, including the exact documents they must submit, credentials they must prove, etc. This information should be made available to the public via the Internet and/or printed publications.
5. **The law should contain "silence is consent" provisions. Such provisions mandate time limits for the processing of applications.** Applications not processed within those time frames receive automatic approval, or "consent." Silence is consent may not be practical for sectors where the risks are simply too great to allow start-up prior to review of qualifications — for example, sectors in which businesses process radioactive materials.
6. **The law should specify clear reasons why applications may be rejected or revoked as well as procedures for appeals.**
7. **Licenses should be valid for unlimited periods, except when periodic review of qualifications is necessary to fulfill regulatory objectives.** Businesses should not have to apply for periodic license renewals unless such renewals are necessary to safeguard the public interest or ensure proper management of scarce resources.

Source: World Bank Group (2006) "Business Licensing Reform: A Toolkit for Development Practitioners".

### 5.3. LICENSE COVERAGE AND FREQUENCY: THE SHORT VALIDITY OF LICENSES IS PROBLEMATIC

Thanks to the reforms implemented since 2007, license coverage in the Kyrgyz Republic tends to be lower than in neighboring countries, but it remains significant. The Survey results showed some regional disparities in license coverage, calling for a streamlining of license issuance throughout the country. In addition, actual license validity tends to be shorter than in neighboring countries such as Tajikistan.

The number of businesses who obtained at least one license in 2008 is relatively low compared to its neighbors, but it is however significant (excepting farmers, of whom only 0.1 percent obtained licenses). Due to the very small share of farmers who went through the license procedure in 2008, farmers will not be considered in this chapter. Over half of in-

dividual entrepreneurs and of small and medium companies (respectively 59 percent and 54 percent) said they needed a license to operate and 22 percent of individual entrepreneurs and 15 percent of small and medium companies obtained or renewed their licenses in 2008 (Chart 5.1). The share of businesses who obtained a license is much higher than in countries where extensive licensing reforms took place. For example, in Georgia, in 2005, 6 percent of small and medium enterprises obtained a license or a permit.<sup>55</sup> Although close to 15 percent of individual entrepreneurs and 9 percent of small and medium companies started their operations in 2008, 22 percent of individual entrepreneurs and 15 percent of small and medium companies went through the licensing procedure in 2008, indicating that even businesses which are already operating need to go through the licensing procedure. In countries where comprehensive licensing reforms were implemented, the vast majority of businesses obtaining licenses are start-ups.

<sup>54</sup> The same principle does not necessarily hold true for permits. For example, it is reasonable to require businesses to gain permits for construction of buildings in each of the sub-national jurisdictions in which they intend to operate.

<sup>55</sup> IFC (2006) "Business Environment in Georgia".



The validity of licenses issued in the Kyrgyz Republic is short: licenses issued to small and medium companies in 2008 were valid for an average of 23 months, while licenses issued to individual entrepreneurs were valid for an average of 13 months. In Tajikistan, licenses issued to small and medium companies in 2007 were on average valid for 44 months, and licenses issued to individual entrepreneurs were valid for 24 months.<sup>56</sup> Although Kyrgyz legislation contends that temporary licenses are issued for a minimum of two years, unless a shorter duration is stated in the legislation, conversation with focus groups indicated that the validity of licenses, de facto, is different from the validity of licenses, de jure, which accounts for these Survey results. For example, the legislation indicates that licenses for passenger transportation by road are “temporary for at least two years or less if required by licensee”. Yet, conversation with focus groups indicated that these licenses are issued de facto for a maximum of one year, or less if required by the licensee.

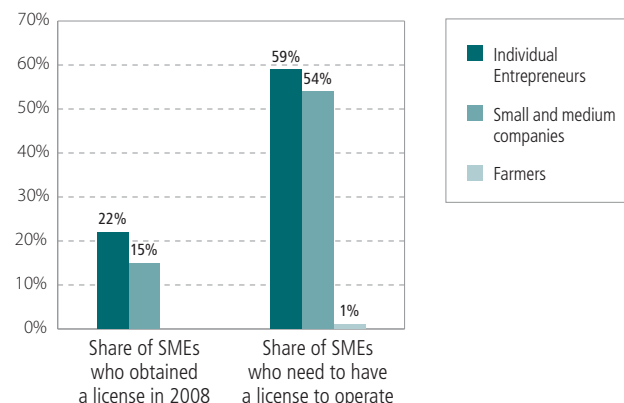
“*The maximum duration of licenses issued to drive a mini bus is one year. Each year, I have to obtain a new license again and gather the relevant documents such as the 40 hours training certificate. The training certificate is useful for those who just started driving, but I have been driving for 15 years, I do not need to study for 40 hours each year. I understand that licenses are necessary for security reasons, but it would be good if licenses were issued for a longer duration. It would save us time and money.*”

*Entrepreneur, focus group participant*

The short validity of licenses adds instability to the terms of entrepreneurial activity and deters long-term investments. It is one of the main problems associated with the licensing procedure in the Kyrgyz Republic. However, it must be noted that the license renewal procedure is simplified: documents that were initially submitted for the application need not be resubmitted. Unless there has been some change to the operations of the business, only the application is to be resubmitted.

**Chart 5.1: Over half of small and medium companies and individual entrepreneurs are required to have a license**

**Share of SMEs who obtained a license and required to have a license in 2008**



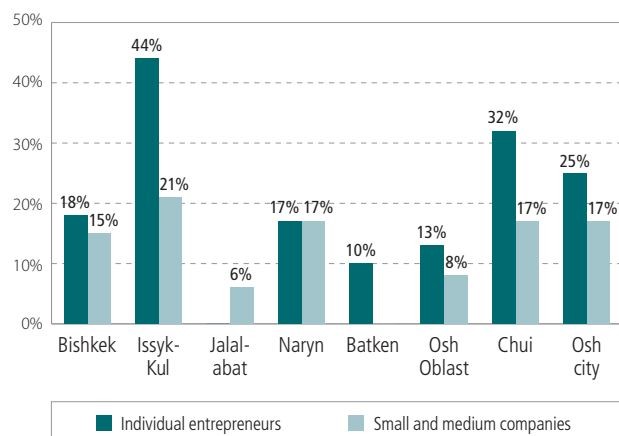
In the SME sector, there are less regional disparities in license coverage than in permit coverage. However, the region having the highest permit coverage (Issyk-Kul) also has the highest license coverage. Likewise, the region that had the lowest permit coverage, Jalalabat, also has the lowest license coverage. Indeed, Issyk-Kul region has the greatest permit and license coverage for individual entrepreneurs. This could be partly due to the fact that the share of individual entrepreneurs active in license-intensive sectors, such as transportation (Chart 5.2), is high in Issyk-Kul.

Some 19 percent of the transport sector entrepreneurs interviewed were based in Issyk-Kul. However, the share of individual entrepreneurs active in the transport sector is even higher in Chui, where 27 percent of all individual entrepreneurs active in the transport sector are located. Yet the share of individual entrepreneurs having obtained licenses in Chui is lower than the share of individual entrepreneurs having obtained licenses in Issyk-Kul. This suggests some regional disparities in the interpretation and/or implementation of the license legislation. As with permit legislation, implementation in Issyk-Kul seems to be more stringent than in other regions of the country, which suggests a less than uniform understanding of licensing procedures and policies.

<sup>56</sup> IFC, (2009) “Business Environment in Tajikistan as seen by SMEs”.

**Chart 5.2: Issyk-Kul is the region where the share of entrepreneurs who obtained licenses in 2009 is the highest**

Share of SMEs who obtained a license in 2008, per region

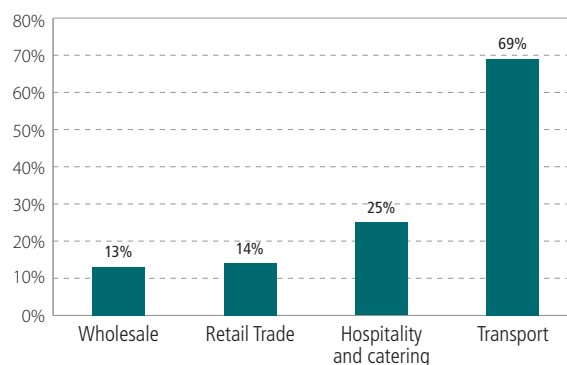


The transport sector is the most license-intensive for individual entrepreneurs: over 60 percent of individual entrepreneurs working in this sector had to obtain at least one license in 2008, while over 20 percent of individual entrepreneurs working in the hospitality and catering sector, and over 10 percent of the individual entrepreneurs working in retail and wholesale trade, had to obtain at least one license in 2008 (Chart 5.3). Due to the prevalence of transportation services and retail trade within individual entrepreneurs' activities, the biggest share of individual entrepreneurs having received at least one license in 2008 were engaged in transportation (52 percent), followed by retail trade (31 percent).

The transport and industry/production sectors are the most license-intensive for small and medium companies: 19 percent and 18 percent of small and medium companies active in these sectors, respectively, obtained a license in 2008 (Chart 5.4).

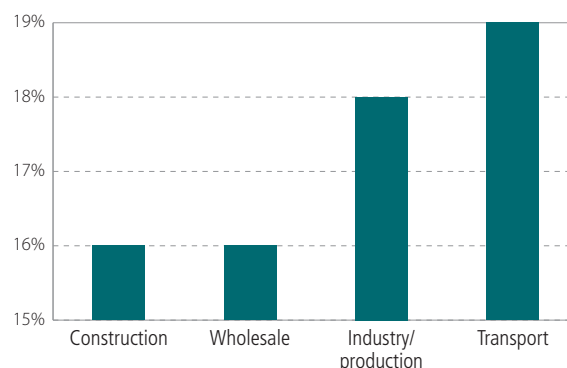
**Chart 5.3: Close to 70 percent of the individual entrepreneurs working in the transport sector obtained a license in 2008**

Proportion of individual entrepreneurs that obtained at least one license in 2008, per sector



**Chart 5.4: Close to 20 percent of small and medium companies working in the transport and industry/production sectors obtained a license in 2008**

Proportion of small and medium companies that obtained at least one license in 2008, per sector

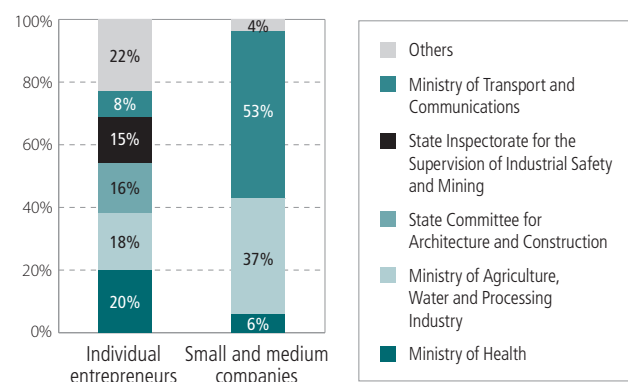


The agencies issuing the most licenses to small and medium companies are the Ministry of Health, the Ministry for Agriculture, Water and Processing Industry, the State Committee for Architecture and Construction and the State Inspectorate for the Supervision of Industrial Safety and Mining. These agencies process close to 70 percent of the licenses issued to small and medium companies.

The agencies issuing the most licenses to individual entrepreneurs are the Ministry of Transport and Communication and the Ministry for Agriculture, Water and Processing Industry. These agencies process over 95 percent of the licenses issued to individual entrepreneurs (Chart 5.5).

**Chart 5.5: Top license issuing agencies for individual entrepreneurs and small and medium companies are rather different**

#### Top license issuing Agencies



### 5.4. LICENSE ADMINISTRATION: THE KYRGYZ REPUBLIC OUTPERFORMS MOST OF ITS NEIGHBORS, YET SMES STILL BEAR A BIG BURDEN

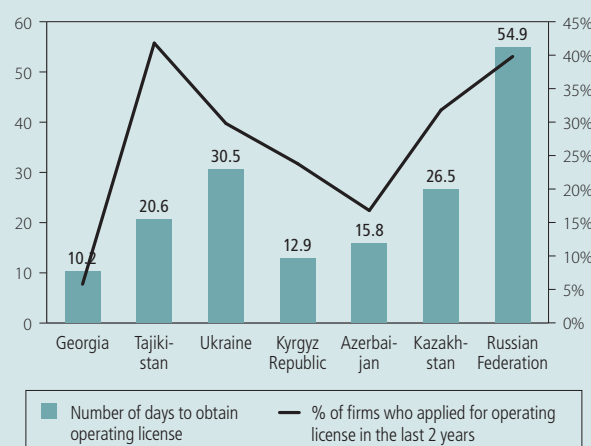
The procedure to obtain licenses for individual entrepreneurs in the Kyrgyz Republic has been streamlined somewhat in recent years. The time required to obtain an operating license is now among the lowest of post-Soviet countries (Box 5.4). Yet the procedure for small and medium companies remains relatively long, taking nearly a month to prepare the license application and wait for an answer. The cost of the procedure is also higher for small and medium companies. In addition, 40 percent of individual entrepreneurs and small and medium companies said they made unofficial payments during the procedure.

#### BOX 5.4: THE TIME REQUIRED TO OBTAIN AN OPERATING LICENSE AND THE OVERALL LICENSE COVERAGE IN THE KYRGYZ REPUBLIC ARE AMONG THE BEST OF THE POST-SOVIET COUNTRIES

Recent improvements in the Kyrgyz license procedure are confirmed by the EBRD–World Bank Business Environment and Enterprise Performance Survey (BEEPS) data. The Kyrgyz Republic is doing better than most of the post-Soviet countries on the “number of days to obtain operating license” indicator, as well as on the share of firms who applied for an operating license in the last two years. In the Kyrgyz Republic, it takes an average of 13 days to obtain an operating license – from submission of application to the day the license is granted. Meanwhile, the process takes 16 days in Azerbaijan and 27 days in Kazakhstan. In addition, 24 percent of firms applied for a license in the last two years in the Kyrgyz Republic, against 32 percent in Kazakhstan (Chart 5.6).

**Chart 5.6: The Kyrgyz Republic performs well on “the number of days to obtain operating license” indicator**

License coverage and number of days to obtain an operating license in selected post-Soviet countries



Source: EBRD–World Bank Business Environment and Enterprise Performance Survey data.

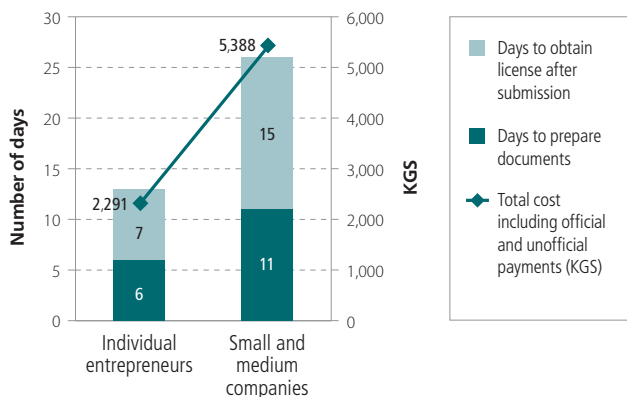
Small and medium companies spent about twice as much time as individual entrepreneurs to prepare the documents to apply for a license, respectively 11 working-man days to six working-man days. Small and medium companies also have to wait longer than individual entrepreneurs for the issuance/rejection of a license once the documents have been submitted to the relevant state agency, respectively 15 to seven calendar days. Further, small and medium companies who obtained licenses in 2008 spent an average of KGS5,388 to obtain one license, including official and unofficial payments, while individual entrepreneurs spent an average of KGS2,291. Although the total cost of licensing is higher for small and medium companies than for individual entrepreneurs, the total cost relative to profit is higher for the latter: the cost of one license (including official and unofficial payments, but excluding labor) represents 0.9 percent of small and medium companies' profit, but 1.9 percent of individual entrepreneurs' (Chart 5.7).

Thus, individual entrepreneurs pay eight times the maximum official fee of KGS300 per license, as per the legislation, while small and medium companies pay 16 times. Although entrepreneurs bear other costs in addition to the license fee to obtain a license (e.g. medical certificate, qualification card, 40 hours' training certificate, etc., for individual entrepreneurs involved in the transport sector), these do not account for the discrepancy between the maximum official fee and the cost actually borne by entrepreneurs, suggesting that the level of unofficial payments is high, especially for small and medium companies.

Some 40 percent of both small and medium companies and individual entrepreneurs said they made unofficial payments during the licensing procedure. Likewise, nearly 60 percent of small and medium companies and individual entrepreneurs find the procedure either “somewhat complicated” or “very complicated” (Chart 5.8). These data, and the step-by-step to obtain a transportation license (Figure one) suggest that there is still room for simplification and streamlining of the licensing procedure, which would likely represent significant savings. The total cost of the licensing procedure in 2008 for all small and medium companies and individual entrepreneurs, including labor cost and official and unofficial payments but excluding lost profit due to breaks or transactions delayed while awaiting licenses, is estimated at KGS134 million (\$3.7 million) (Annex 5.2). This represents 0.09 percent of the country’s 2008 GDP.

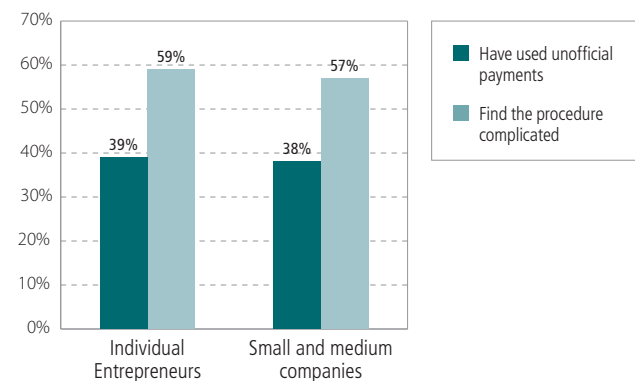
**Chart 5.7: The absolute burden of the licensing procedure is higher for small and medium companies; the relative burden is greater for individual entrepreneurs**

**Duration and cost to obtain licenses for individual entrepreneurs and small and medium companies in 2008**



**Chart 5.8: Close to 40 percent of entrepreneurs made unofficial payments and close to 60 percent found the procedure complicated**

**Unofficial payments and level of difficulty of the license procedure**



**Figure 5.1: Step-by-step licensing procedure for an individual entrepreneur driving a vehicle of over eight seats, de facto**

STEP #/ LOCATION	LIST OF DOCUMENTS TO BE SUBMITTED/ ACTIVITIES	COST (INCLUDING OFFICIAL AND UNOFFICIAL PAYMENTS)	OUTCOME	DURATION
<b>STEP 1:</b>				
Hospital/ medical facility	<ul style="list-style-type: none"> <li>Medical check up</li> </ul>	200-300 KGS	Medical certificate (validity 2 years)	From half a day to two days
<b>STEP 2:</b>				
Municipal transport inspection	<ul style="list-style-type: none"> <li>Category D driving license</li> <li>Driving license</li> <li>Itinerary sheet</li> <li>The entrepreneurs is trained on driving for 40 hours</li> </ul>	160 KGS	"40 hours certificate" (validity 1 year)	Five days (or less in case of "unofficial solution")
<b>STEP 3:</b>				
Road Police "Gai"	<ul style="list-style-type: none"> <li>Driving license</li> <li>Vehicle registration certificate</li> <li>Category D certificate</li> <li>40 hours training certificate</li> </ul>	350-400 KGS	Qualification card (validity one year)	One day

STEP #/ LOCATION	LIST OF DOCUMENTS TO BE SUBMITTED/ ACTIVITIES	COST (INCLUDING OFFICIAL AND UNOFFICIAL PAYMENTS)	OUTCOME	DURATION
---------------------	--	--	---------	----------

**STEP 4:**

Ministry of Transport	<ul style="list-style-type: none"> <li>• Application form</li> <li>• Copy of entrepreneur's registration</li> <li>• Copy of driver's license</li> <li>• Medical certificate</li> <li>• Qualification card</li> <li>• 40 hours certificate</li> <li>• Category D certificate</li> <li>• Patent</li> <li>• Vehicle registration certificate</li> <li>• Vehicle technical compliance</li> <li>• For long distance trips: proof of 3 years' work experience</li> <li>• The licensor examines the vehicle</li> </ul>	650-800 KGS	License	Between one hour and 3-4 days, depending on whether or not unofficial payments are made
-----------------------	---	-------------	---------	---

Source: Ministry of Transport, Municipal Transport Inspection, Road Police and individual entrepreneurs active in the transport sector.

**5.5. RECOMMENDATIONS**

ISSUE	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
<b>SHORT-TERM RECOMMENDATIONS</b>		
The licensing procedure is lengthy.	Reduce the timeframe during which a licensor considers an application and issues an answer from 30 to 15 days.	The duration of the licensing procedure would be reduced, saving businesses time and money.
The percentage of businesses making unofficial payments during the procedure is high.	Adopt the "silence is consent" principle: if an issuing agency fails to respond with a decision regarding a license application within the allotted timeframe, the license is automatically approved.	The duration of the licensing procedure, as well as unofficial payments made "to speed up the licensing procedure," would be reduced.
The validity of licenses is short in comparison to other post-Soviet countries.	Legislate a minimum five-year validity for all licenses and identify additional permanent licenses (revoked only in the event of infringements). Banking operations, notary and educational activities, as well as private detective and security activities, could be subject to permanent licenses.	Extending license duration would reduce the cost of doing business and encourage long-term investment while streamlining the work of licensors. Going by 2008 data, if the average validity of licenses was five years individual entrepreneurs who require licensing would save an average of KGS2,397 (\$66), whereas small and medium companies that require licensing would save an average of KGS2,823 (\$77) per year.
The de facto validity of licenses is shorter than the de jure validity, and license coverage varies depending on regions.	Train licensor staff on license legislation and procedures.	License coverage, frequency and procedures will be streamlined and made uniform across the country. De facto and de jure validity will concur.
<b>MEDIUM-TERM RECOMMENDATIONS</b>		
Some activities that are neither risky nor involve limited resources are subject to licenses.	Exclude cargo transportation and real estate activity from the list of activities subject to licensing: cargo transportation is for example not subject to licensing in Kazakhstan, only "hazardous cargo transportation" is. Real estate activity needs to be regulated to limit fraud, but alternative methods of regulation should be used.	Lower license coverage will reduce the cost of doing business and will reduce barriers to entry in relevant sectors.

### ANNEX 5.1: INDICATIVE LIST OF LICENSE ISSUING AGENCIES AND OF TYPES OF ACTIVITIES SUBJECT TO LICENSING (2010)

#	TYPES OF ACTIVITY SUBJECT TO MANDATORY LICENSING	STATE BODY ISSUING LICENSES	DURATION OF LICENSE	RECOMMENDATIONS
1	Design, construction and operation of hazardous production entities, except for operation of dangerous production entities using fixed and mobile lifting mechanisms, escalators and funiculars	<ul style="list-style-type: none"> <li>State Inspection for Supervision of Industrial Safety</li> <li>Mining Supervision of the Ministry of Emergency Situations</li> </ul>	Valid for two years, or less if requested by licensee.	Extend validity to five years
2	Construction of dams on rivers and reservoirs		Valid for period of construction, but no less than two years	Extend minimal validity to five years
3	Hunting and fowling according to the list approved by the Government of the Kyrgyz Republic	State Agency of Environmental Protection and Forestry	Permanent	
4	Production and sale of vaccines and serums, medicine, medical equipment and chemical substances, except when stated otherwise in the legislation	Ministry of Health	Valid for no less than five years	
5	Private medical practice	Ministry of Health	Valid for at least two years	Extend validity to five years
6	Private veterinary practice	<ul style="list-style-type: none"> <li>Veterinary Department</li> <li>Regional Veterinary Departments</li> <li>Bishkek Veterinary Department</li> </ul>	Permanent	
7	Establishment and maintenance of gambling houses, organization of gambling games	Ministry of Finance	Valid for 10 years	
8	All types of aviation works, certification of aircraft, technical maintenance of aircraft and their equipment carried out on the territory of the Kyrgyz Republic	Department of Civil Aviation under the Ministry of Transport and Communication	Valid for two years, or less if required by licensee	Extend validity to five years
9	City planning, design and survey of residential, public and production buildings and constructions	State Agency of Architecture and Construction	Permanent	
10	Construction and installation, excluding the construction of individual residential houses	State Agency of Architecture and Construction	Permanent	
11	Private detective and security activities	Ministry of Interior	Three years validity for first issuance; five years for all subsequent	Make license permanent
12	Banking operations, currency exchange transactions, activity related to electronic payments, activity of pawns. Activity of credit unions and attraction of funds from the population by legal entities on the conditions of fixed term, recovery and profitability	National Bank	One year validity	Make license permanent
13	Professional activity on securities	Financial Market Supervision and Regulation Service of the Kyrgyz Republic	Permanent	
14	Insurance activity	Financial Market Supervision and Regulation Service of the Kyrgyz Republic	Permanent	

#	TYPES OF ACTIVITY SUBJECT TO MANDATORY LICENSING	STATE BODY ISSUING LICENSES	DURATION OF LICENSE	RECOMMENDATIONS
15	Activities of non-government pension funds	Financial Market Supervision and Regulation Service of the Kyrgyz Republic	Permanent	
16	Activity in the field of posts and telecommunication, data transmission, television and radio broadcasting, use of radio frequency spectrum including design, production, construction, installation of relevant networks, lines, facilities, systems and devices (except for the organization of technological and internal production communication)	State Communications Agency	Permanent	
17	Production, transmission, distribution, sale of electricity and thermal energy, processing of oil and natural gas	State Energy Agency under the Ministry of Industry, Energy and Fuel Resources	Permanent	
18	Construction of power stations, substations and electric transmission lines	State Energy Agency under the Ministry of Industry, Energy and Fuel Resources	Permanent	
19	Auditing activities	Agency for the Control of Financial Market	Permanent	
20	Educational activity (except for state educational institutions implementing curricula of pre-school, primary, basic, and secondary education)	State Inspection on Licensing, Attestation and Accreditation of Education Institutions under the Ministry of Education	Valid for five years	Make license permanent
21	Import, development, production and sale of explosives and pyrotechnical substances and products	Ministry of Interior	Valid for at least two years	Extend validity to five years
22	Production, repair, trade in arms and ammunition	Ministry of Interior	Valid for at least two years	Extend validity to five years
23	Design, production and sale of military items and services	Ministry of Defense	Valid for at least two years	Extend validity to five years
24	Disposal, storage, elimination and burial of toxic wastes, including radioactive materials	State Agency of Environmental Protection and Forestry	Valid for at least two years	Extend validity to five years
25	Transportation (including cross-border transportation) of toxic waste	State Agency of Environmental Protection and Forestry	Valid for at least two years	Extend validity to five years
26	Activities of administrators of the bankruptcy procedure	Bankruptcy Department under the State Committee on the Management of State Property	Permanent	
27	Private notary and lawyer activities	Ministry of Justice	Notary: valid for five years Lawyers: permanent	Make notary license permanent
28	Passenger and cargo transportation by road, air, sea and railway except for special business and technological transport, bus stations, and armored transport	Ministry of Transport and communications	Valid for two years, or less if required by licensee	Cancel license requirement for cargo transport; extend other licenses' validity to five years
29	Activities in the area of customs-related services (owner of a temporary warehouse, owner of a custom warehouse, owner a duty-free store, customs broker)	State Customs Committee	Permanent	
30	Real estate activity	The legislation does not specify a licensor	Not defined in the legislation	Cancel license requirement



## ANNEX 5.2: TOTAL COST OF OBTAINING LICENSES FOR ALL SMES IN 2008

### Labor costs

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of individual entrepreneurs subject to the licensing procedure in 2008	22%	Survey results
B	Number of active individual entrepreneurs	145,663	State Statistics Committee
C	Time spent by individual entrepreneurs in preparing documentation (working-man days)	5.9	Survey results
D	Average number of licenses obtained	1	Survey results
E	Average number of days in a month	21	
F	Average monthly salary (gross pay) (KGS)	5,378	State Statistics Committee
<b>G</b>	<b>Total labor cost of licenses, individual entrepreneurs (KGS)</b>	<b>47,539,709</b>	<b>A x B x C x D x (F: E)</b>
<b>H</b>	<b>Total labor cost of licenses, individual entrepreneurs (\$)</b>	<b>1,299,965</b>	<b>Ex. Rate 36.57</b>

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of small and medium companies subject to the licensing procedure in 2008	15%	Survey results
B	Number of active small and medium companies	10,982	State Statistics Committee
C	Time spent by small and medium companies in preparing documentation (working-man days)	10.9	Survey results
D	Average number of licenses obtained	1.2	Survey results
E	Average number of days in a month	21	
F	Average monthly salary (gross pay) (KGS)	5,378	State Statistics Committee
<b>G</b>	<b>Total labor cost of licenses, small and medium companies (KGS)</b>	<b>5,523,521</b>	<b>A x B x C x D x (F: E)</b>
<b>H</b>	<b>Total labor cost of licenses, small and medium companies (\$)</b>	<b>151,040</b>	<b>Ex. Rate 36.57</b>

### Official and unofficial payments

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of individual entrepreneurs subject to the licensing procedure in 2008	22%	Survey results
B	Number of active individual entrepreneurs	145,663	State Statistics Committee
C	Average amount of official and unofficial payments to obtain licenses (KGS)	2,290	Survey results
<b>D</b>	<b>Total official and unofficial payments, licenses, individual entrepreneurs (KGS)</b>	<b>72,050,746</b>	<b>A x B x C</b>
<b>E</b>	<b>Total official and unofficial payments, licenses, individual entrepreneurs (\$)</b>	<b>1,970,215</b>	<b>Ex rate 36.57</b>

CODE	INPUT DATA	DATA	SOURCE
A	Proportion of small and medium companies subject to the licensing procedure in 2008	15%	Survey results
B	Number of active small and medium companies	10,982	State Statistics Committee
C	Average amount of official and unofficial payments to obtain licenses (KGS)	5,388	Survey results
D	<b>Total official and unofficial payments, licenses, small and medium companies, (KGS)</b>	<b>9,112,735</b>	<b>A x B x C</b>
E	<b>Total official and unofficial payments, licenses, small and medium companies (\$)</b>	<b>249,186</b>	<b>Ex rate 36.57</b>

### Total costs

	INDIVIDUAL ENTREPRENEURS		SMALL AND MEDIUM COMPANIES	
	KGS	\$	KGS	\$
Labor cost	47,539,709	1,299,965	5,523,521	151,040
Official and non official payment	72,050,746	1,970,215	9,112,735	249,186
<b>Sub total</b>	<b>119,590,455</b>	<b>3,270,179</b>	<b>14,636,256</b>	<b>400,226</b>
<b>Grand total (KGS)</b>	<b>134,226,711</b>			
<b>Grand total (\$)</b>	<b>3,670,405</b>			

**Note on cost calculations:** (i) the cost of various administration requirements were estimated based on reported official and unofficial payments as well as on time spent preparing to submit documents; (ii) the total cost of the licensing procedure for farmers was not calculated, as the number of respondents was not high enough to be meaningful.



# 6. Technical Regulations

Reform is being implemented at a slow pace

## 6.1. KEY FINDINGS:

- The mandatory certification procedure is most common among small and medium companies: 3 percent of individual entrepreneurs and 17 percent of small and medium companies went through the procedure in 2008, in contrast to only 1 percent of farmers.
- Over 40 percent of small and medium companies in the industry/production and wholesale sectors went through the certificate procedure in 2008.
- Small and medium companies who went through the procedure obtained an average of 7 certificates of conformity.
- The mandatory certification procedure is the most expensive regulatory procedure for small and medium companies: those small and medium companies who went through the procedure in 2008 spent an average of KGS24,340 (\$666), including official and unofficial payments and labor costs. This represents 4.1 percent of small and medium companies' profit.
- The total cost of the procedure for all SMEs<sup>57</sup> of the country in 2008 was approximately KGS73.8 million (\$2 million), or 0.045 percent of GDP.

## 6.2. TECHNICAL REGULATIONS: LEGISLATION HAS EVOLVED POSITIVELY FOLLOWING ACCESSION TO THE WTO MEMBERSHIP, BUT IMPLEMENTATION IS SLOW

The Kyrgyz Republic became a World Trade Organization member on December 20, 1998, the only Central Asian country to do so thus far. Before and after its accession, the Kyrgyz Republic brought its economic and trade legislation in conformity with WTO rules and obligations. The changes made included a decrease in custom tariffs, the elimination of non-tariffs barriers to trade, including import and export quotas, and a decrease in the number of commodities subject to import/export licensing. In addition, changes to the technical regulation legislation passed in 2004 and 2005 helped ensure conformity with the Sanitary and Phytosanitary Measures and Technical Barriers to Trade Agreements.

As a result of the reforms undertaken since 2004 (Box 6.3), the Kyrgyz Republic is currently in a transition phase: adoption of technical regulations establishing mandatory requirements related to products, processes of manufacture, storage, transportation, sale, operation and disposal of products should be completed by December 2012. Requirements that will not have been adopted by then will either stop being effective or will become voluntary, as per the "guillotine" principle embedded in the Technical Regulation Law. Meanwhile, during the transition period, state standards related to safety issues remain mandatory.

<sup>57</sup> Farmers were not included in the calculations as the coverage of the certification procedure is low among farmers.

### BOX 6.1: THE TECHNICAL BARRIERS TO TRADE AND THE SANITARY AND PHYTOSANITARY MEASURES AGREEMENTS

The Agreement on Technical Barriers to Trade (TBT) recognizes countries' rights to adopt the technical regulations and standards they consider appropriate, as long as they do not constitute unnecessary barriers to trade. It seeks to ensure that technical regulations and standards, as well as testing and certification procedures, do not create unnecessary obstacles to trade. However, it recognizes that countries have the right to establish protection at levels they consider appropriate (for human, animal or plant life or environmental health for example), and that they should not be prevented from taking steps to ensure those protection levels are met. The agreement therefore encourages countries to use international standards when appropriate.

The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) ensures that SPS measures (food safety and animal and plant health regulations) do not represent unnecessary, arbitrary, scientifically unjustifiable, or disguised restrictions on international trade. The agreement recognizes that governments have the right to take sanitary and phytosanitary measures but that they should be applied only to the extent necessary to protect human, animal or plant life or environmental health and should not arbitrarily or unjustifiably discriminate between members. In order to harmonize sanitary and phytosanitary measures on as wide a scale as possible, members are encouraged to base their measures on international standards, guidelines and recommendations whenever possible.<sup>58</sup>

## Technical Regulations establishing mandatory requirements related to products should be adopted by the end of 2012

### BOX 6.2: WHAT IS A TECHNICAL REGULATION?

A technical regulation is a document adopted by an authority that provides binding technical requirements, either directly or by referencing or incorporating the content of a standard, technical specification or code of practice. Technical regulations may specify the type of product that is not allowable, the type of product that is allowable, or the outcome that is required. By their very nature, technical regulations have an effect on the type of products that can be manufactured. Technical regulations are the most stringent form of governmental control and should ideally be used only in situations where none of the other options for the regulation of product, outlined above, will ensure the adequate protection of health, safety and the environment.<sup>59</sup>

### BOX 3: KEY LEGISLATION AND REGULATION GOVERNING TECHNICAL REGULATIONS AND THE CONFORMITY ASSESSMENT PROCEDURE

- Law "On the Fundamentals of Technical Regulation in the Kyrgyz Republic," adopted May 22, 2004;
- Presidential Decree No. 149 "On Institutional and Structural Changes in the Technical Regulation area," adopted April 30, 2005;
- Government Resolution No. 639 "On the Mandatory Certification of Products' Conformity," adopted December 30, 2005. This Resolution includes a list of products subject to mandatory certification and defines the procedure for mandatory certification;
- Government Resolution No. 512 approving the Regulation "On order of issuing declaration of conformity," adopted October 23, 2007.

The law limits the development of technical regulations only for products having a negative impact on health, safety and the environment and for which none of the other regulating options is applicable. Technical regulations should contain only minimal safety requirements. These provisions are in line with international best practices.

The Technical Regulation Law adopted the guillotine principle to reduce the number of requirements: technical regulations establishing mandatory requirements related to products' processes (methods) of manufacture, storage, transportation, sale, operation and disposal should be adopted within a transition period of eight years from the date the Technical Regulation Law came into effect (May 22, 2004). Requirements not adopted within that window will either stop being effective or will become voluntary. However, the adoption of technical regulations is moving forward slowly. As of the end of 2009, three technical regulations had been adopted<sup>60</sup> and two more were pending.<sup>61</sup>

The procedure to require technical regulations for certain products is transparent and requires the notification of the WTO and its members (as per WTO requirements). The reform has already allowed for a significant reduction of the number of products subject to mandatory certification from 7,000 in 2004 to 2,000 in 2009. As per the provisions of the *Law on*

<sup>58</sup> Summary of the WTO agreements.

<sup>59</sup> APEC (2000) "Information Notes on Good Practice for Technical Regulation".

<sup>60</sup> Law "Technical Regulation on Ecological Safety," adopted May 08, 2009"; Law "Technical Regulation on Safety of Transport," adopted May 29, 2009; Law "Technical regulation on Safe Exploitation and Utilization of Machinery and Equipment," adopted December 29, 2009.

<sup>61</sup> Draft Law "Technical regulation on Safety of Construction Materials, Items and Structures"; draft Law "Technical regulation on Safety of Buildings and Constructions".

*Technical Regulation*, the list may be revised on a yearly basis if needed. Despite the fact that the list of products subject to mandatory certification and declaration of conformity is revised regularly, some low risk products are still on the list (shoes, glass bottles, etc.). Additional revisions to the list should be made as soon as possible. In addition, all food items should be excluded from the list of products subject to mandatory certification. Indeed, the Kyrgyz Republic should harmonize its food standards with the Codex Alimentarius standards, which includes (i) the implementation of continuous quality control approaches such as the “Hazard analysis and critical control point” and the “Good hygiene practices, good manufacturing practices” approaches, as well as (ii) food traceability.

#### BOX 6.4: WHAT IS THE CODEX ALIMENTARIUS?

The Codex Alimentarius Commission (CAC) was established in 1963 by the Food and Agriculture Organization of the United Nations (FAO) and the World Health Organization (WHO) to protect the health of consumers and ensure fair practices in food trade. The Codex Alimentarius (“food code” in Latin) is the result of the work of the Commission and its technical committees: a collection of internationally adopted food standards, guidelines and codes of practice. Codex standards are voluntary and non-binding recommendations and their implementation is not controlled but many governments believe their adoption benefits their consumers and trade. Codex standards and guidelines are available, along with additional information, on the Codex web site: <http://www.codexalimentarius.net>

### Standards related to safety issues remain mandatory until the end of 2012

An important sub-set of technical regulations are standards. According to WTO and the Kyrgyz Law on Technical Regulation, standards should be voluntary. However, state standards related to safety issues including protection of life and health of humans, animals and plants and protection of the environment remain mandatory until the end of 2012. The list of standards that remain mandatory until 2012 is included in the list of products subject to mandatory certification. However, this list is not comprehensive.

#### BOX 6.5: WHAT ARE STANDARDIZATION AND STANDARDS?

Standardization is the activity of establishing, with regard to actual or potential problems, provisions for common and repeated use aimed at the achievement of the optimum degree of order in a given context. In particular, the activity consists of the processes of formulating, issuing and implementing standards. Important benefits of standardization are improvement of the suitability of products, processes and services for their intended purposes, prevention of barriers to trade and facilitation of technological cooperation.<sup>62</sup>

A standard is a document, established by consensus and approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for activities or their results, aimed at the achievement of the optimum degree of order in a given context. Standards should be based on the consolidated results of science, technology and experience, and aimed at the promotion of optimum community benefits.<sup>63</sup>

The Technical Regulation Law adopted May 22, 2004, draws a clear distinction between standards, where compliance is voluntary, and technical regulations, where compliance is mandatory and defines that:

- “Standardization is an activity to establish rules, general principles, characteristics designed for repeated use on a voluntary basis, directed to achieving orderliness, increasing competitiveness in the field of manufacturing and circulating products, performing works and rendering services.”
- “A standard is a document established by consensus in which are established rules, general principles, characteristics of products, processes (methods) of manufacture, storage, transportation, sale, operation and disposal, works or services for voluntary repeated use. A standard can also contain requirements to terminology, symbols, packages, marking and/or labeling.” As of the end of 2009, there were close to 22,000 standards in use in the Kyrgyz Republic (639 Kyrgyz national standards, 20,000 Inter State- governmental standards and 1,000 Russian standards adopted as national standards).

However, during the transition period (extended on November 16, 2009, until December 2012<sup>64</sup>) and pending the advent of appropriate technical regulations, the safety standards of products and their processes (methods) of manufacture,

<sup>62</sup> ISO/IEC “Guide 2 Standardization and related activities – General vocabulary, 1.1”

<sup>63</sup> ISO/IEC “Guide 2 Standardization and related activities – General vocabulary, 3.2”

<sup>64</sup> Amendments to the Technical Regulation Law, adopted November 16th 2009.

storage, transportation, sale, operation and disposal are subject to mandatory compliance. State standards (“GOST standards”) related to safety therefore remain mandatory for the time being.

During the transition period, the Kyrgyz Republic’s technical regulations should be harmonized with international standards (ISO, etc) and EU requirements. It is recommended that the Kyrgyz Republic, whenever possible, fully adopts these standards using the “cover letter” or translation methodologies. This would ensure that Kyrgyz companies who export their products to the EU and other advanced economies do not have to comply with both international and national standards that would decrease both production and compliance costs.

**Institutional structure: the standardization, accreditation and conformity assessment functions are now separated, in line with international best practices**

The National Institute for Standards and Metrology (NISM) is since 2005 the official standardization body for the Kyrgyz Republic, in charge of the development, coordination, promotion and dissemination of standards.<sup>65</sup> NISM replaced the State Inspectorate for Standardization and Metrology (Kyrgyzstandart), which exercised several conflicting functions, including: (i) development of mandatory standards and regulations, (ii) accreditation and monitoring of certification agencies, and (iii) provision of conformity assessment services through testing and certification. NISM, meanwhile, is a non-regulatory, non-enforcement and non-conformity assessment services provider. The separation of the functions pertaining to (i) the development of standards, (ii) accreditation of monitoring and certification agencies and (iii) conformity assessments is part of the country’s progress towards meeting the WTO requirements and international best practices and international best technical regulations practices as it prevents conflict of interest, even if in practice NISM still influences conformity assessment bodies. As a general principle, no single body should be responsible for developing standards, accrediting certification agencies and certifying conformity.

Whereas NISM used to be independent, it is since November 2009 under the Ministry of Economic Regulation.<sup>66</sup> This

enables NISM to fully support the Ministry of Economic Regulation to develop technical regulations. It is envisioned that NISM will become a Kyrgyz Center for Standards once its regulations, which are currently under development, are solidified.

**The list of products subject to compulsory certification of conformity is too long**

Either by undergoing a certification process or by declaring their compliance, businesses are required to demonstrate compliance with mandatory technical regulations and standards for 2,000 different products.<sup>67</sup> The process used should depend on the product and the business developing it, but in practice, however, all businesses use the more costly certification process.

The list of products subject to mandatory certification was last revised on February 18, 2009, which resulted in the shifting of some products from the mandatory certification list to the list of products subject to a “declaration of conformity.” For these products (plastic tubes, contact lenses, children clothes made of cotton, various types of shoes, glass bottles, ceramics, electrical pumps, etc), manufacturers no longer need to obtain a mandatory certificate from a third party certifying body, but can themselves declare conformity, certifying that the products they manufacture meet the requirements of the technical regulations, the provisions of standards or the conditions of contracts. Declaring conformity increases business responsibility and accountability for their products and decreases the costs linked to certification.

Certification is defined in the Technical Regulation Law as the process of “assuring conformity during which a certification body certifies that the product, processes (methods) of manufacture, storage, transportation, sale, operation and disposal, works or services meets the established requirements of technical regulations, the provisions of standards or conditions of contracts.”

Certification is carried out based on an application to a third party certification body whose accreditation scope includes the products which the applicant intends to certify. Certification bodies, which may be state or private enterprises, are accredited by an independent accreditation body. The Kyrgyz Republic currently has 18 certification bodies.

<sup>65</sup> Government Resolution No. 546 “On National Institute for Standards and Metrology,” adopted November 30, 2005.

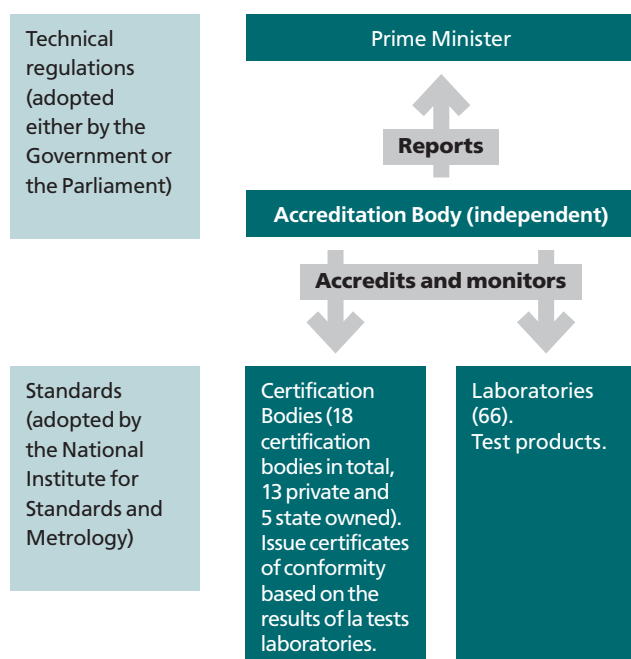
<sup>66</sup> Presidential Decree No. 425, “On Measures to Implement the Law On Approval of the Government Structure,” adopted October 26, 2009.

<sup>67</sup> The declaration of conformity is an option for some products only.

The certification process often involves the testing of the product to be certified in an accredited laboratory. If successful, a certification process results in the issuance, by the certification body, of a certificate of conformity. There are currently 67 accredited laboratories in the Kyrgyz republic (31 private laboratories and 36 State laboratories), 16 of which are accredited to test food. All laboratories were accredited by the national accreditation body. Some 24 laboratories comply with ISO/IEC 17025:2006 standard (updated version of ISO/IEC 17025) and 42 comply with ISO/IEC 17025:2000 standard. This structure is in accordance with international and WTO best practices.

Because the credibility of Kyrgyz laboratories is low, however, the majority are not recognized by foreign trading partners. As a result, Kyrgyz entrepreneurs looking to export have to test their products again in the importing country (which doubles the administrative burden of exporting). In addition, the number of laboratories in the Kyrgyz Republic is high compared to the population (66 laboratories for 5.24 million people). A decrease in quantity and improved quality of laboratories (through better equipment and staff training) is thus recommended. It is also recommended that the laboratories are accredited by international accreditation bodies.

**Figure 6.1: The technical regulation system in the Kyrgyz Republic**



Alternatively, for some products, manufacturers may issue a “declaration of conformity.” A declaration of conformity is a document by which the manufacturer certifies that the products they manufacture meet the requirements of the technical regulations. However, in practice, the declaration is more a “simplified permit” than a declaration, as it must be registered in the state agency responsible for the state surveillance of the type of product for which conformity is being declared. Best international practices indeed do not involve the registration of a declaration of conformity.

As of the end of 2009, no Kyrgyz business had declared conformity for any product. Businesses prefer to obtain certificates instead, although the procedure is more complex. Conversation with focus groups have indicated that businesses were reluctant to declare conformity as this would most likely not be accepted during inspections, although the procedure is de jure acceptable.

“Our inspectors are not used to declarations of conformity, and we would have trouble convincing them that this document is acceptable during inspections. Therefore, we prefer to continue using certificates rather than issue declarations of conformity. It would be much better if our products were not subject to any conformity assessment at all. In Europe, producers of glass bottles are not subject to any conformity assessment.”

*Entrepreneur, producer of glass bottles*

**Table 6.1: Step by step, declaration of conformity**

STEP 1
The entrepreneur verifies conformity on the basis of (i) his/her own verifications and (ii) on the basis of the verifications done by a third party (e.g., an accredited laboratory).
STEP 2
The entrepreneur fills the declaration.
STEP 3
The entrepreneur registers the declaration in the state agency responsible for the state surveillance of the type of product for which conformity is being declared.
The declaration should be registered within a day. Registration is free of charge.



### Recognition of conformity assessment results for exported products is inefficient

Rules and procedures for technical regulation and product certification apply both to domestic and imported products alike: imported products subject to mandatory certification must be certified before they enter the market of the Kyrgyz Republic. De jure, the Kyrgyz Republic accepts certificates and testing results issued in foreign countries including:<sup>68</sup>

- (i) bilaterally from Azerbaijan, Georgia, China, Armenia, Belarus, Kazakhstan, Moldova, Russia, Tajikistan, Turkmenistan and Ukraine.
- (ii) unilaterally from Iran, Slovakia, Turkey and EC countries.

In addition, conversations with focus groups indicate that certificates of conformity issued in the Kyrgyz Republic are often not recognized internationally, even by countries having signed bilateral recognition agreements (see list above). In such cases, Kyrgyz products have to go through re-assessment, increasing export costs and procedures. International accreditation of Kyrgyz laboratories would help Kyrgyz certificates of conformity gain international recognition.

“*I have to certify my products in the Kyrgyz Republic, before they are exported, and I often have to re-certify them in Russia. I do not understand the purpose of this double-certification. It is a loss of time and money. It would be much better if our certificates of conformity were always accepted in Russia.*”

*Entrepreneur producing dairy products*

### The post-market surveillance system must be strengthened

The conformity assessment system currently relies mostly on pre-market surveillance (testing, inspections, etc). However, it is also important to develop a post-market surveillance system to ensure that products which have been placed on the market comply or continue to comply with the relevant requirements.

It is therefore recommended to strengthen the post-market surveillance system by adding significant penalties for non-conformity and ensuring that non-compliant products are identified.

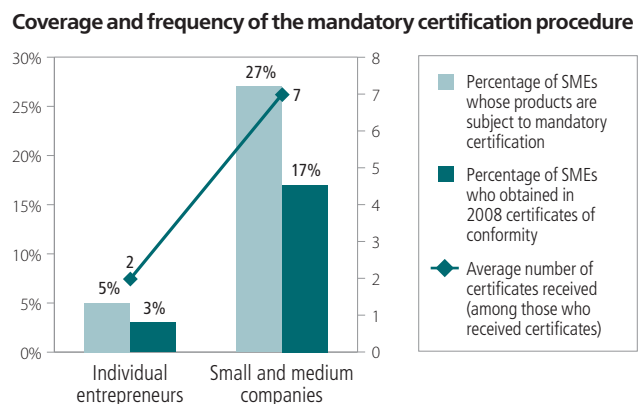
### 6.3. MANDATORY CERTIFICATES HINDER THE DEVELOPMENT OF SMALL AND MEDIUM COMPANIES

The current system of mandatory certification mostly hinders the development of small and medium companies because they are the category of respondents for whom the coverage of the certificate procedure is highest. Although the number of products subject to mandatory certificates decreased sharply from 2004 to 2008, some five percent of individual entrepreneurs and 27 percent of small and medium companies were still subject to mandatory certification in 2008 (Chart 6.1). As the percentage of farmers whose products are subject to mandatory certification is around one percent, they will not be discussed in this chapter.

In 2008, 17 percent of small and medium companies and three percent of individual entrepreneurs obtained mandatory certificates. Small and medium companies who obtained mandatory certificates obtained an average of seven certificates (indicating that those who received certificates of conformity certified an average of seven products – as certificates are issued per product), whereas individual entrepreneurs who obtained certificates obtained an average of two certificates.

The difference between the share of businesses whose products had to comply with mandatory certificates and the share of those who obtained mandatory certificates in 2008 (10 percent for small and medium companies and two percent for individual entrepreneurs) is likely due to the fact that some businesses obtained mandatory certificates earlier than 2008, and these certificates were still valid in 2008. Certificates may be valid for up to three years.

**Chart 6.1: The products of close to 30 percent of small and medium companies are subject to mandatory certification, and close to 20 percent of small and medium companies obtained a certificate of conformity in 2008**

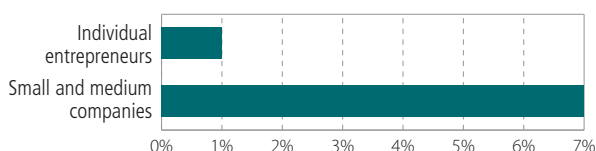


<sup>68</sup> Government resolution No. 8 “On Importation of Products Subject to Mandatory Certificates of Conformity and Recognition of Conformity Assessment Results Issued Outside the Kyrgyz Republic,” adopted January 11, 2006.

Businesses that either go through the certification procedure or want to improve the quality of their products may purchase documents related to the description of standards. In 2008, some seven percent of small and medium companies purchased documents related to the description of a given standard (Chart 6.2). Small and medium companies, who purchased these documents, purchased an average of 2.3 documents. These documents can be purchased from the office of the Bishkek based National Institute for Standards and Metrology and its branches. A Russian-language version of ISO 22000 standard, for example, costs KGS165 (\$4.5) while a Kyrgyz national standard costs approximately KGS180 (\$5).

**Chart 6.2: Close to seven percent of small and medium companies purchased at least one document describing standards in 2008**

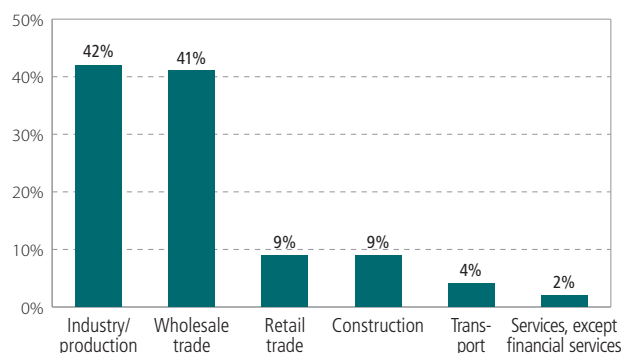
Share of SMEs who obtained a standardization document in 2008



The highest share of small and medium companies who obtained certificates of conformity in 2008 is to be found in the industry/production and wholesale sectors: respectively 42 percent and 41 percent of all small and medium companies active in these sectors obtained certificates of conformity in 2008 (Chart 6.3). The industry/production sector was also the sector where certificates were the most prevalent for individual entrepreneurs: 20 percent of individual entrepreneurs active in the industry/production sector received mandatory certificates of conformity in 2008.

**Chart 6.3: Over 40 percent of small and medium companies in the industry/production and wholesale sectors obtained certificates of conformity in 2008**

Proportion of small and medium companies whose products are subject to mandatory certification, per sector



Not only is the industry/production sector most affected by the mandatory certificates burden, but it is also the most affected by the economic crisis: in 2009, production in the sector dropped by 7.8 percent compared to the previous year.<sup>69</sup> The need to ease the regulatory burden is therefore urgent.

Frequent on-site inspections make the mandatory certification system all the more burdensome. Small and medium companies active in the industry/production sector had respectively the highest and second highest inspection coverage by the Sanitary and Epidemiological Service and the Fire Safety Department in 2008: 47 percent of the small and medium companies active in the industry/production sector were inspected by the Sanitary and Epidemiological Service in 2008, and 53 percent were inspected by the Fire Safety Department. Survey results indicate that inspectorates often do not use risk criteria for the planning of inspections (see chapter on inspections).

### **Mandatory certificates of conformity hamper the development of the food industry**

The food processing industry (part of the industry/production sector) is an important part of the Kyrgyz economy. In 2007, the agriculture, hunting and forestry sector amounted to 26.9 percent of GDP.<sup>70</sup> In 2009, nearly two-thirds (65 percent) of the Kyrgyz population lived in rural areas.<sup>71</sup>

Yet the food processing sector performs well below its potential. One of the reasons for this under-performance has to do with the failure of the Kyrgyz Republic to comply with international food quality and safety standards. Kyrgyz firms are only allowed to export most livestock products (meat, milk) to a very limited number of countries (mainly Russia and Kazakhstan), while safety issues prevent Kyrgyz companies from trading with the EU and other advanced economies (Box 6.6).

<sup>69</sup> Statistics Committee (2010) "Express Bulletin", January 16.

<sup>70</sup> National Bank of the Kyrgyz Republic (2008) "Yearly Report".

<sup>71</sup> State Statistic Committee of the Kyrgyz Republic Bishkek (2009) "Kyrgyzstan in Figures".

### BOX 6.6: OUTDATED STANDARDS HAMPER THE DEVELOPMENT OF THE LIVESTOCK SECTOR

A 2007 World Bank assessment identified outdated standards as a key obstacle in the development of the livestock sector.

“Although a member of the WTO, the Kyrgyz Republic has been slow to harmonize its standards with those of the Codex Alimentarius. It should be a priority for the government to expedite the harmonization of standards for those products that are exported or expected to be exported from the Kyrgyz Republic. Meeting the WHO health and safety provisions for food products is of critical importance for the development of any export-oriented business. Both Kazakhstan and Russia, traditional Kyrgyz export markets, are moving rapidly to harmonize their domestic standards for food products with the Codex Alimentarius. Once these countries have done so, Kyrgyz exporters will face the same high standards whether they are trying to export to Russia, to Kazakhstan, or to the EU.”

**Source:** World Bank (2007) “Kyrgyz Republic, Livestock sector review: embracing the new challenges,” January.

Kyrgyz legislation requires food products to conform to sanitary norms and rules (called “SAN PINS”) and/or mandatory standards (“GOST standards”). Best international practices also require food products to conform to sanitary norms and rules (e.g. threshold levels of contaminants, microbiological requirements, etc). However, best international food safety practices rarely rely on mandatory certification or rigid standards to ensure food safety (apart from labeling, packaging, and testing methods) – in part because the testing of one food product sample does not guarantee the safety of the rest of the production.

On the contrary, best food safety practices usually include:

- (i) a continuous safety management and control based on the Hazard Analysis and Critical Control Points (HACCP) system, which is grounded on the Good Hygiene Practice and Good Manufacturing Practices (GHP GMP). These mechanisms ensure that businesses have appropriate internal control and risk-based control systems for verification of compliance with safety requirements throughout the production process.
- (ii) assurances of food product traceability, according to the “from farm to fork” approach, so that unsafe products can be recalled promptly and non-compliant producers identified and sanctioned for any violations (Box 6.7).
- (iii) Producers are given the primary responsibility for safety, using tools such as traceability and HACCP. Governments take on advisory, oversight and rule-making roles.

### BOX 6.7: FOOD TRACEABILITY IN THE EU

#### Legal framework

Food traceability has been compulsory in the EU since the General Food Law entered into force in 2002.

#### What is traceability?

Under EU law, “traceability” means the ability to track any food, feed, food-producing animal or substance that will be used for consumption, through all stages of production, processing and distribution.

#### Why is traceability needed?

Traceability is a way of responding to potential risks that can arise in food and feed, to ensure that all food products in the EU are safe to eat. When a risk is identified, traceability allows tracing it back to its source in order to swiftly isolate the problem and prevent contaminated products from reaching consumers. As a result, traceability allows targeted withdrawals of affected products from the market and the provision of accurate information to the public, thereby minimizing disruption to trade. Past food crises, such as dioxin contamination and bovine spongiform encephalopathy (BSE, commonly known as mad-cow disease), have illustrated the importance of being able to swiftly identify and isolate unsafe foodstuffs in order to prevent them from reaching the consumer.

#### How is traceability implemented?

Food operators are required to document the names and addresses of the supplier and customer for each transaction (“one step forward and one step back”), as well as the nature of the product and date of delivery. Operators are also encouraged to keep information on the volume or quantity of a product, the batch number if there is one, and a more detailed description of the product, such as whether it is raw or processed. In the case of animals, producers must “tag” every animal with details of their origin and when animals are taken for slaughter, stamp each with the traceability stamp of the abattoir. The tools used (ear tags, passports, bar codes) may vary from one country to another, but must carry the same information.

**Source:** Health and Consumer Protection Directorate-General (2007) “Food Traceability Factsheet,” June

The step-by-step certification of cooked sausages (Figure 6.2) indicates the complexity of the procedure. The procedure is not only costly (minimum KGS3,000 for official payments only), but also involves at least two visits to a certification body and another to a laboratory, as well as a follow-up visit to the production facility by the certification body. In addition, international experience has shown that random sample testing does not guarantee overall food safety, as it does not guarantee the safety of the products that were not tested.

It is therefore recommended that the Kyrgyz Republic moves away from the requirements, for food products, to conform with sanitary norms, rules and standards and ensures instead (i) that all food business operators implement and adhere to HACCP, GMP and GHP and (ii) the traceability of all food products, starting with meat and milk. These approaches are in line with Codex Alimentarius food safety practices.

**Figure 6.2: Step by step for the certification of cooked sausages**

Step #/ location	List of documents to be submitted/ activities	Official cost	Outcome	Duration
<b>STEP 1:</b>				
Accredited certification body, chosen by the applicant among the 18 accredited certification bodies of the Kyrgyz Republic	<ul style="list-style-type: none"> <li>Application form</li> </ul>	None	The applicant chooses the certification scheme "3a" or "4a" (see annex 1, certification schemes) as instructed in the list of products subject to mandatory certificates of conformity	One day
<b>STEP 2:</b>				
Accredited laboratory, chosen among the 16 food laboratories accredited in the Kyrgyz Republic	<ul style="list-style-type: none"> <li>Sampling and testing of the sausage to be certified</li> </ul>	Between KGS 2,000 (\$55) and KGS 3,000 (\$82)	Result of testing	Up to seven working days
<b>STEP 3:</b>				
Accredited certification body chosen during step one	<ul style="list-style-type: none"> <li>Payment of the certificate fee</li> </ul>	KGS 500 (\$14)	Issuance of certificate	One hour
<b>STEP 4:</b>				
Production facility (this step may take place several months after the previous steps)	<ul style="list-style-type: none"> <li>The certification body verifies that the sausages are still complying with requirements</li> </ul>	KGS 500	Inspection control report	One day

Source: Sanitary and Epidemiological Service.

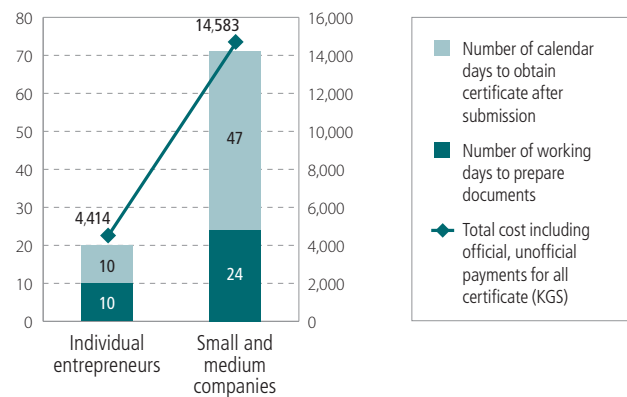
The mandatory certificate system poses substantial barriers to business development. In 2008, it took an average of 24 working days for small and medium companies to prepare their certification documents to obtain all certificates (seven certificates on average). After submitting the documents, small and medium companies waited an average of 47 cal-

endar days to obtain all their certificates. In 2008, small and medium companies that obtained mandatory certificates spent an average of KGS14,583 (\$399), including official and unofficial payments but excluding labor costs, to obtain those certificates (Chart 6.4). This cost represents 2.4 percent of small and medium companies' profit. Individual entre-

preneurs who obtained mandatory certificates needed an average of 10 working days to prepare the certification documents. After document submission, they waited an average of 10 calendar days to obtain all certificates. In 2008, individual entrepreneurs who obtained mandatory certificates spent an average of KGS4,414 (\$121) including official and unofficial payments but excluding labor costs to obtain all mandatory certificates, or 3.7 percent of average profit. In 2008, the total cost of the certification procedure for all Kyrgyz SMEs<sup>72</sup> was approximately KGS73.8 million (\$2 million) (Annex 6.2), or about 0.05 percent of GDP.

**Chart 6.4: Certification is the most costly procedure for small and medium companies**

**Duration and cost of the certificate procedure to obtain all certificates in 2008**



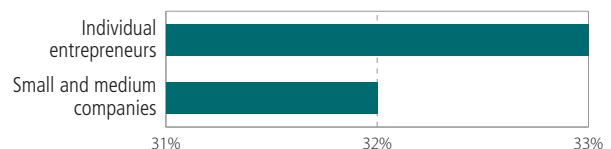
Furthermore, there are substantial indirect costs resulting from the technical regulation procedure, such as delayed market entry, reduced innovation, reduced competitiveness and hindered integration with international trade. In particular, the system restricts innovation and makes it difficult to launch new products. Some mandatory “GOST” standards are prescriptive rather than performance based, meaning that they specify the means for attaining the specified result rather than allow businesses to determine their own means for achieving the result. As a result, businesses are unable to find alternative means to achieve the necessary result, which hampers innovation. The level of innovation in the Kyrgyz Republic is low, and may be decreasing: 46 enterprises introduced innovations in 2008, as opposed to 50 in 2004.<sup>73</sup> It should be noted, however, that the creation of new products is easier than in some post-Soviet countries: it is possible to launch products that conform to Russian or international standards.

Because mandatory certificates are the most expensive regulatory procedure for small and medium companies (for those who went through this regulatory procedure in 2008), they represent a main hindrance to business development. It is therefore important to further reform technical regulations in order to promote the growth of small and medium companies. Small and medium companies should be the backbone of the economy, they create the highest number of jobs (employing an average of 20 employees, while individual entrepreneurs employed four<sup>74</sup>) and they contribute the biggest tax revenues to the state budget (per enterprise).

Survey data shows that about one-third of all individual entrepreneurs and small and medium companies (33 percent and 32 percent, respectively; Chart 6.5), reported making unofficial payments to obtain mandatory certificates. Meanwhile, some 21 percent of individual entrepreneurs and 33 percent of small and medium companies said the procedure to obtain mandatory certificates was either “somewhat” or “very” complicated (Chart 6.6).

**Chart 6.5: One third of those SMEs who went through the certification procedure made unofficial payments**

**Proportion of SMEs who made unofficial payments during the mandatory certification procedure**



**Chart 6.6: One third of small and medium companies found the procedure complicated**

**Proportion of SMEs who found the mandatory certification procedure rather complicated or very complicated**



<sup>72</sup> Farmers were not included as the coverage (one percent) is low enough to be negligible.

<sup>73</sup> Source: State Statistics Committee.

<sup>74</sup> Source: Survey results.

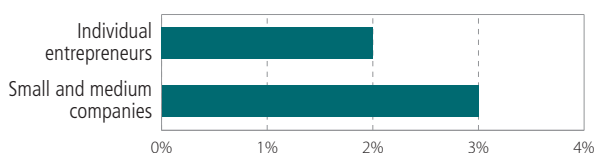
#### 6.4. THE SHARE OF SMALL AND MEDIUM COMPANIES OBTAINING VOLUNTARY CERTIFICATES OF CONFORMITY REMAINS VERY SMALL

A scant two percent of individual entrepreneurs and some three percent of small and medium companies obtained voluntarily certificates of conformity in 2008 (Chart 6.7), usually in an effort to boost sales and improve the quality of their products. This indicates that the market incentive for product certification in the Kyrgyz Republic is still low. Small and medium companies in the retail trade and industry/production sectors were the most likely to obtain a voluntary certificate: respectively eight percent and seven percent of small and medium companies active in these sectors obtained a voluntary certificate.

In more advanced market economies, it is usually in the interest of producers to comply with set standards, which enables them to do business with larger companies requiring minimum standard levels. Knowledgeable consumers then have the choice between certified and non-certified products, which then encourages producers to self-certify their products.

**Chart 6.7: Only three percent of small and medium companies certified their products on a voluntary basis**

**Proportion of SMEs who voluntarily obtained a certificate of conformity**



Likewise, the share of companies who conformed to international standards remains low. As of May 15, 2009, 20 companies in the Kyrgyz Republic had been ISO certified (Box 6.8). However, the number of ISO-certified companies is increasing: as of May 2007, only 12 Kyrgyz companies had been certified.

#### BOX 6.8: ISO CERTIFICATION IS DEVELOPING IN THE KYRGYZ REPUBLIC

The vast majority of ISO standards are highly specific to a particular product, material, or process. However, ISO 9001 (quality) and ISO 14001 (environment) are “generic management system standards.” These generic standards can be applied to any organization in any sector of activity, whether it is a business, a public administration, or a government department. ISO 9001 contains a generic set of requirements for implementing a quality management system and ISO 14001 for an environmental management system.

Some of the requirements in the ISO 9001 quality management system include: a set of procedures that cover all key processes in the business; monitoring processes to ensure they are effective; keeping adequate records; checking output for defects, with appropriate and corrective action where necessary; regularly reviewing individual processes and the quality system itself for effectiveness; and facilitating continual improvement. As of May 15th 2009, 15 companies were ISO 9001 certified in the Kyrgyz Republic (Annex 6.3).

Some of the requirements of the ISO 14001 environmental management system include (i) the development of a business statement that includes commitments on prevention of pollution, continual improvement of the environmental management system and compliance with all applicable statutory and regulatory requirements, (ii) the setting of performance objectives to reach the commitments listed in the business statement and (iii) the implementation of activities aiming at reaching this objective (training of staff, establish work instructions and practices, etc.). As of May 15th 2009, three companies were ISO 14001 certified in the Kyrgyz Republic (Annex 6.3).

ISO 22000 is an international certification standard that defines the requirements for effective food safety management systems. It can be used by organizations throughout the supply chain – from farmers and ingredient suppliers, to food services, processors, transportation and storage companies, retailers and packaging companies. As of May 15<sup>th</sup> 2009, two companies were ISO 22000 certified in the Kyrgyz Republic (Annex 6.3).

Most companies were ISO certified by foreign certification bodies. However, one Kyrgyz certification body is accredited to certify companies applying for quality management systems.



## 6.5. RECOMMENDATIONS

ISSUES	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
<b>SHORT-TERM RECOMMENDATIONS</b>		
The list of products subject to mandatory certification includes some low risk products and food products.	Remove low risk products and food products from the list of products subject to mandatory certification and declaration of conformity (shoes, glass bottles, etc.).	This will reduce costs, make it easier to place new goods on the market and foster innovation. This in turn will lead to lower prices for goods and a wider choice for consumers.
<b>MEDIUM-TERM RECOMMENDATIONS</b>		
Food safety relies on “ex-ante” testing of food products.	Provide legal requirements to progressively move towards (i) better control of the food production process via the “Hazard Analysis and Critical Control Points” (HACCP), GMP, GHP and (ii) food traceability, so that the causes of potential problems can be tracked if necessary, starting with the most hazardous food products, milk and meat.	Food products’ safety practices will be in line with best international practices, which will improve consumer safety and facilitate international trade, including export of food products. In addition, food processing businesses will be relieved from unnecessary costs related to mandatory conformity assessment, leading again to lower product prices and wider consumer choice.
Only three technical regulations have been adopted.	Speed up the process of adoption and implementation of technical regulations in line with best international safety standards, norms and rules as per the provisions of the 2004 <i>Technical Regulations Law</i> .	This will make it easier to place new goods on the market, simplify innovation, reduce trade barriers and ease the export of Kyrgyz products.
Some standards are outdated.	Speed up the introduction of international standards and the review of national standards to ensure their harmonization with international standards using the “cover letter” and “translation” methods (original standards are adopted by simple attachment of a national cover letter to these standards; international standards are translated into the national language and then adopted).	Businesses will use voluntary standards to comply with the World Trade Organization’s Agreement on Technical Barriers to Trade. This will encourage innovation, reduce trade barriers and make the export of Kyrgyz products easier.
The post-market surveillance system is weak.	Strengthen the post-market surveillance system, including (i) significant penalties for non-conformity and (ii) an expectation by suppliers that non-compliant products will eventually be detected.	These steps will ensure that products comply or continue to comply with the relevant regulatory requirements. Businesses will take fewer risks in regard to product compliance.



## ANNEX 6.1: CERTIFICATION SCHEMES

*Government Resolution No. 639 "On the Mandatory Certification of Products' Conformity,"*  
adopted December 30, 2005.

### Mandatory Certification Schemes

(as) amended by *Government Resolution No. 512*, adopted October 23, 2007

SCHEME NO.	CONFORMITY ASSESSMENT CONDITIONS	OTHER STAGES OF CERTIFICATION	INSPECTION OF CERTIFIED GOODS
1	Testing type		
2	Testing type		Testing of samples taken from seller.
2a	Testing type	Facility performance analysis	Testing of samples taken from seller. Facility performance analysis.
3	Testing type		Testing of samples taken from manufacturer.
3a	Testing type	Facility performance analysis	Testing of samples taken from manufacturer. Facility performance analysis.
4	Testing type		Testing of samples taken from seller. Testing of samples taken from manufacturer.
4a	Testing type	Facility performance analysis	Testing of samples taken from seller. Testing of samples taken from manufacturer. Facility performance analysis.
5	Testing type	Quality certification system, availability of certified quality system	Testing of samples taken from manufacturer and/or from seller.
6	Testing type		
6a	Testing type		Testing of samples taken from lot.
7	Testing type		
8 Small lot	Review of documents provided		

**ANNEX 6.2: TOTAL COST OF THE CERTIFICATION PROCEDURE FOR ALL SMEs IN 2008**

		INDIVIDUAL ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	FARMERS	SOURCE
A	Number of active SMEs	145,663	10,982	280,408	State Statistics Committee
B	Proportion of SMEs obtained certificates in 2008	3%	17%	1%	Survey results
C	Time spent by SMEs in preparing documentation for ONE certificate (working man-days)*	5.0	5.7	n/a	Survey results
D	Average number of certificates obtained	1.8	6.7		Survey results
E	Average monthly salary (gross pay) (KGS)	5,378	5,378		State Statistics Committee
F	Total labor costs of certificates, SMEs (KGS)	9,719,900	18,216,605		$A * B * C * D * (E/21)$
G	Average amount of official and unofficial payments spent to obtain ALL certificates	4,414	14,583		Survey results
H	Total official and unofficial payments, certificates (KGS)	18,644,605	27,225,963		$A * B * G$
I	Total (KGS)	28,364,505	45,442,569		F + H
J	<b>Grand total (KGS)</b>	<b>73,807,074</b>			
K	<b>Grand total (\$)</b>	<b>2,018,241</b>			

**Note on cost calculations:** (i) the cost of various administration requirements were estimated based on reported official and unofficial payments as well as on time spent preparing to submit documents; (ii) the total cost of the certification procedure for farmers was not calculated, as the number of respondents was not high enough to be meaningful.

**ANNEX 6.3: LIST OF ISO CERTIFIED COMPANIES IN THE KYRGYZ REPUBLIC**

NO.	ORGANIZATION	PRODUCTS (SERVICES)	CERTIFYING AUTHORITY
1.	Avtomash-Radiator Ltd.	Design, development and manufacture of heat-transfer devices (radiators) for different purposes and manufacture (assembling) of tractors	Center for Certification of SMC and Personnel Ltd., Kyrgyz Republic.
2.	National Institute of Standards and Metrology of the Kyrgyz Republic "Kyrgyz Standard"	Standardization, metrology, testing of goods (services) and data support	Center for Certification of SMC and Personnel Ltd., Kyrgyz Republic.
3.	Center for Certification Ltd. (certificate No.1)	Certification of aircrafts	Center for Certification of SMC and Personnel Ltd., Kyrgyz Republic.
	Center for Certification Ltd. (certificate No.2)	Certification of aircrafts	Moody International Certification Ltd., Great Britain.
4.	Center for professional development and retraining, NISM KR	Additional professional education	Center for Certification of SMC and Personnel Ltd., Kyrgyz Republic.
5.	Ak Tel Ltd., "Fonex" Trade Mark	Mobile communication services	Center for Certification of SMC and Personnel Ltd., Kyrgyz Republic.
6.	CJSC Coca-Cola Bishkek Bottlers	Production of soft drinks	SGS International Certification Services EESV, Belgium.
7.	BeMoKom Ltd., "MegaCom" Trade Mark	Mobile communication services	Certification Authority for "Euro-Register" System, Russia.
8.	CJSC Kyrgyz Petroleum Company	Processing of oil-products	«TUV», Germany.
9.	OJSC Mailuu-Suu Electric Bulb Factory	Design, manufacture and sale of electric bulbs	«KEMA» Quality B.V., Netherlands
10.	Information and Financial Solutions Ltd.	Software development, implementation and maintenance, etc	Certification Authority for Management Systems «DQS GmbH», Germany.
11.	OJSC Kant Cement Plant	Cement production and sale	BM TRADA Certification, Great Britain.
12.	OJSC «Reemtsma-Kyrgyzstan»	Production of cigarettes	«BUREAU VERITAS Certification», Great Britain
13.	«Alex Stewart Assay and Environmental Laboratories Ltd»	Analytical and metallurgical research services	«BUREAU VERITAS Certification», Great Britain
14.	OJSC Bishkeksut	Milk and milk products: production and sale	Certification Authority for Quality Systems "ROSTEST – MOSCOW", Russia, No. POCC RU.0001.13ИСО4.
15.	TANSU Ltd.	Manufacture and sale of heating equipment	QP Projects AB, Sweden.

As of May 15, 2009, environmental management systems were implemented in compliance with the requirements of ISO 14001 in the following enterprises of the Kyrgyz Republic:

NO.	ORGANIZATION	PRODUCTS (SERVICES)	CERTIFYING AUTHORITY
1.	OAO «Reemtsma-Kyrgyzstan»	Production of cigarettes	«BUREAU VERITAS Certification», Great Britain.
2.	CJSC Coca-Cola Bishkek Bottlers	Production of soft drinks	SGS International Certification Services EESV, Belgium.
3.	TANSU Ltd.	Manufacture and sale of heating equipment	QP Projects AB, Sweden.

As of May 15, 2009, "Food Safety Management Systems: Requirements for Organizations Involved in Creation of the Food Chain" were implemented in compliance with the requirements of ISO 22000 in the following enterprises of the Kyrgyz Republic:

NO.	ORGANIZATION	PRODUCTS (SERVICES)	CERTIFYING AUTHORITY
1.	Osko Ltd.	Production of fruit and vegetables	Certification Authority Det Norske Veritas, Norway
2.	Ailana Ltd.	Production of fruit and vegetables	Certification Authority Det Norske Veritas, Norway



# 7. Inspections

Implementation of the *Inspections Law* must be improved: additional reforms are also needed

## 7.1. KEY FINDINGS:

- Seventy three percent of individual entrepreneurs, 69 percent of small and medium companies, and 29 percent of farmers were investigated by at least one inspectorate between January and December 2008.
- Of those organizations inspected, individual entrepreneurs were inspected, on average, six times, small and medium companies five times, and farmers twice, in the period from January to December 2008.
- The average labor costs incurred as a result of inspections were KGS2,743 (\$75) for every individual entrepreneur, KGS4,582 (\$125) for each small and medium company, and KGS1,106 (\$30) for every farmer. This represents 2.3 percent of individual entrepreneurs' total profit, 0.8 percent of small and medium companies', and 2.5 percent of farmers' annual profit.
- Despite a moratorium<sup>75</sup> on inspections being implemented between April 25 and December 31, 2008, the total equivalent labor cost of all inspections of SMEs conducted throughout the Kyrgyz Republic during that year nonetheless amounted to KGS281.2 million (\$7.7 million) or 0.19 percent of total gross domestic product (GDP).
- Those inspectorates most active in investigating individual entrepreneurs and small and medium companies (January 2008-March 2009) were:
  - the State Tax Service, visiting 71 percent of individual entrepreneurs and 65 percent of small and medium companies;
  - the Social Fund, visiting 38 percent of individual entrepreneurs and 45 percent of small and medium companies;
  - the Sanitary and Epidemiological Service, visiting 33 percent of individual entrepreneurs and 25 percent of small and medium companies; and
  - the Fire Safety Department, visiting 24 percent of individual entrepreneurs and 31 percent of small and medium companies.

<sup>75</sup> Presidential Decree No. 145 "On the Moratorium on Inspections by the Tax Authorities of the Kyrgyz Republic, and Reduction of Inspections of Business Entities Implemented by Other Authorized Inspectorates of the Kyrgyz Republic," adopted April 22, 2008 and implemented between April 25 and December 31, 2008.

## 7.2. DESPITE RECENT REFORM, THE LEGISLATIVE FRAMEWORK IS NOT BASED ON CONTEMPORARY PRACTICE IN THE CONDUCT OF INSPECTIONS

### The legislative framework has shown positive development in recent years

Inspections are essential components of any regulatory system, and are essential to ensuring that business activities are conducted in a way that protects human health and safety, and the environment. Inspections should be conducted in a way that (i) optimizes compliance with clear government regulation; (ii) incurs minimal costs to businesses; and (iii) achieves the optimum outcome for regulators.

The reform of legislation governing inspections was begun in the Kyrgyz Republic much later than in other countries of the region, commencing in 2005. Prior to the adoption of the *Law “On Procedures for Inspecting Business Entities”* (the “*Inspections Law*”) in 2007,<sup>76</sup> no single piece of legislation existed governing the conduct and regulation of inspections. Each state inspectorate maintained its own procedures, with businesses having only limited protection and recourse against such agencies’ potential abuse of authority. While the implementation of the *Inspections Law* was a marked improvement, it fell short of establishing contemporary, recognized principles in the conduct of inspections, including: (i) the risk-based selection of businesses for inspection; and (ii) the introduction of checklists to be used during inspections to determine a business’s level of compliance on a clear and transparent basis.

As well as other secondary regulation (shown in Box 7.1), inspections procedures are now predominantly regulated by the provisions of the *Inspections Law*, which defines the various types of inspections, the principles of and the general procedures for the conduct of inspections, and the rights and responsibilities of state inspections agencies and business entities (Box 7.2). The *Inspections Law* applies to those state inspectorates listed in *Parliamentary Resolution No.553-IV “On Approval of the List of Authorized Bodies Having the Right to Inspect Business Entities,”* adopted June 20, 2008 (Annex 7.1).

### BOX 7.1: KEY LEGISLATION AND REGULATION GOVERNING INSPECTIONS PROCEDURES

- *Law of the Kyrgyz Republic No. 72 “On Procedures for Inspecting Business Entities,”* adopted May 25, 2007, implemented May 1, 2008;
- *Government Resolution No. 533 “On the Procedures for Inspecting Business Entities,”* adopted November 6, 2007. This resolution prescribes the mandatory registration of planned and unplanned inspections by the Ministry of Economic Regulation, prior to their being conducted. Planned and unplanned inspections that have not been registered are illegal;
- *Parliamentary Resolution No. 553-IV “On Approval of the List of Authorized Bodies Having the Right to Inspect Business Entities,”* adopted June 20, 2008;
- *The Tax Code of the Kyrgyz Republic,* adopted October 17, 2008, implemented January 1, 2009;
- *Presidential Decree No. 237 “On Introduction of Registration of Inspections of Business,”* adopted May 14, 2009. This decree introduced the mandatory registration in the prosecutors’ offices of all inspections by all state inspectorates, tax authorities, and law enforcement agencies;
- The inspections process and the work of the state inspectorates is governed by more than 40 pieces of legislation (Annex 2).

### BOX 7.2: KEY FEATURES OF THE INSPECTIONS LAW OF 2007

#### Types of inspections

The *Inspections Law* identifies four types of inspections:

- planned inspections are performed by inspectorates in accordance with pre-approved plans; unplanned inspections are performed (i) at the request of individual businesses; or (ii) on an inspectorate receiving information of a violation by a business or legal entity;
- control inspections are held to verify that previous violations have been corrected; and
- re-inspections are performed in the event that a business or legal entity disputes the outcome of a previous inspection.

#### Frequency of inspections

Planned inspections are limited to no more than one inspection per year per inspectorate.<sup>77</sup> However, the frequency of other inspections (including unplanned, control and re-inspections) is not limited.

#### Duration of inspections

All inspections are limited to a duration of 30 days, and may be extended by no more than 10 days.

<sup>76</sup> *Law of the Kyrgyz Republic No. 72 “On Procedures for Inspecting Business Entities,”* adopted May 25, 2007, implemented May 1, 2008.

<sup>77</sup> With the exception of sanitary and veterinary inspections of high-risk objects.

**BOX 7.2: KEY FEATURES OF THE INSPECTIONS LAW OF 2007****Stages of the inspection process**

State inspectors are required to give at least 10 days' prior written notice of any planned inspection. Inspectors are required to show official identification and a "management" order authorizing an inspection prior to its being conducted.

All inspections must be registered in the logbook maintained for this purpose by all businesses. The outcomes of all inspections must be documented in a report made in two copies, one of which must be given to a representative of the business under inspection.

**Sanctions against abusive practices**

Penalties for the violation of current legislation have recently been strengthened, as follows: (i) any inspector or inspectors found to be guilty of a violation of the *Inspections Law* is subject to dismissal and barred from employment as a state employee or civil servant for a period of three years; and (ii) in the event that the outcome of an inspection is later invalidated by a court ruling, this may constitute grounds for the dismissal of the inspector or inspectors conducting such inspection.

**BOX 7.3: THE LEGAL BASIS FOR INSPECTIONS CONDUCTED BY LAW ENFORCEMENT AND LOCAL GOVERNMENT AGENCIES**

Pursuant to the *Law of the Kyrgyz Republic No. 131 "On Investigative Activities,"* adopted October 16, 1998 (the "*Law on Investigative Agencies*"), certain investigative agencies (including the police, the National Security Agency and the financial police) are authorized to:

- request verbal or written information from individuals and organizations;
- enter private and business premises;
- remove original private and business documents and copies thereof;
- access private and business electronic and postal correspondence, and conduct surveillance of telecommunications; and
- conduct other activities for the purpose of investigating alleged criminal activity or to collect information on persons and/or organizations believed to be involved in criminal activity.

However, the *Law on Investigative Agencies* offers little protection against abusive inspections by law enforcement agencies.

Inspections conducted by local government agencies are governed by the provisions of *Law of the Kyrgyz Republic No. 99 "On Local Self-governance and Local State Administration"* adopted May 29, 2008, under which local government agencies have authority to control compliance with environmental, construction, land, and sanitary regulations. Such "control", in practice, equates to the conduct of inspections. The *Law "On Status of Local Kenesh Deputies"*<sup>78</sup> also authorizes elected deputies to make "recommendations" to state inspectorates on the inspection of entities located within the jurisdiction of such local Kenesh (elected local legislative assembly or council).

**The mandatory registration of inspections by the Ministry of Economic Regulation and the Office of the General Prosecutor aims to reduce excessive and illegal inspections**

The purpose of inspections being regulated by the Ministry of Economic Regulation and the Office of the General Prosecutor is to reduce the occurrence of excessive and illegal inspections and to exert greater control over inspectorates. Registration by the Ministry of Economic Regulation applies only to authorized state inspection agencies,<sup>79</sup> and only to planned and unplanned inspections. Registration by the Office of the Prosecutor General applies to all types of inspections conducted by authorized inspections agencies as well as by the State Tax Service and law enforcement agencies, and thus provides greater protection to businesses (Table 7.1). However, inspections by local government agencies are not subject to any registration requirements, and are not subject to registration with either the Ministry of Economic Regulation or local offices under the Office of the Prosecutor General.

**Table 7.1: Types of inspections and corresponding registration requirements**

NO.	TYPE OF INSPECTION	REGISTRATION BY THE MINISTRY OF ECONOMIC REGULATION	REGISTRATION BY THE OFFICE OF THE PROSECUTOR GENERAL
State Inspections Agencies	Planned	Yes	Yes
	Unplanned	Yes	Yes
	Control inspection	No	Yes
	Re-inspections	No	Yes
State Tax Service		No	Yes
Law enforcement agencies		No	Yes
Local government		No	No

<sup>78</sup> The *Law of the Kyrgyz Republic No. 3 "On Status of Local Kenesh Deputies,"* adopted January 13, 2000.

<sup>79</sup> Pursuant to *Parliamentary Resolution No. 553-IV "On Approval of the List of Authorized Bodies Having the Right to Inspect Business Entities,"* adopted June 20, 2008.



## Some important legislative shortcomings remain

Despite recent reform, some legislative shortcomings remain.

- Since April 2009, the Sanitary and Epidemiological Service and the State Veterinary Department have had the right to inspect businesses perceived to be “high risk” up to four times per year. However, high-risk businesses have been only very broadly defined by the Sanitary and Epidemiological Service,<sup>80</sup> and the State Veterinary Department has no formal definitions in place.
- The *Law “On Introduction of the Tax Code”* was adopted on October 17, 2008,<sup>81</sup> with the result that tax inspections were henceforth excluded from regulation under the *Inspections Law*. Since January 1, 2009 tax inspections have been governed only by the provisions of the new *Tax Code*. However, although the new *Tax Code* introduced the progressive principle of the risk-based selection of businesses to be inspected, it regulates tax inspections in a manner that does not provide the same degree of protection for businesses as the *Inspections Law*: the *Tax Code* does not, for example, stipulate 10 days’ advance notice for any business to be inspected. Pursuant to the *Tax Code*, a list of those businesses selected for tax audits on a random basis must be published through the web site of the authorized tax body, and made available at the information desks of local tax offices prior to such audit being conducted. The *Tax Code* does not make reference to advance notice for those businesses selected for tax audits on the basis of risk criteria. Furthermore, sanctions against abusive inspectors are more strict under the *Inspections Law* than under the *Tax Code*.
- *Parliamentary Resolution No. 1037/IV “On Amending the List of State Inspections Agencies Approved by Parliamentary Resolution of March 12, 2009 No. 553”* excluded the State Tax Service, the Department of Civil Aviation, and the Chamber of Accounts from the list of authorized inspection agencies, with the result that these agencies are no longer subject to the provisions of the *Inspections Law*: an additional shortcoming of current legislation.
- In addition to those state inspectorates (“authorized inspection agencies”) listed in *Parliamentary Resolution No. 553*, other government agencies (including local government agencies, local offices under the Office of the Prosecutor General, the financial police, the police, and the National Security Agency) have the right to conduct “checks” on businesses on the basis of other legislation including: the *Law “On Investigative Activities”*,<sup>82</sup> the *Law “On Local Self-Governance and Local State Administration”*,<sup>83</sup> the *Law “On Prosecutors”*,<sup>84</sup> and others. Such “checks” are

not subject to the provisions of either the *Inspections Law*, nor *Parliamentary Resolution No. 533*, again representing a significant shortcoming in current legislation.

- Although the mandatory registration of inspections at local offices under the Office of the Prosecutor General represents an additional guarantee for businesses against abusive inspections, the double registration of planned and unplanned inspections by these agencies as well as by the Ministry of Economic Regulation would appear to represent an unnecessary duplication of activities, at unnecessary additional cost. Moreover, the need for inspectorates to secure registrations from both agencies can make it difficult for inspectorates to conduct urgent inspections when necessary. An effective inspections system should allow the selection of businesses for inspection on the basis of perceived risk while also allowing the conduct of genuinely urgent and necessary inspections where appropriate.

“*It is great that inspections now have to be registered by the prosecutor’s offices. It is an additional protection for us against illegal inspections. But the fact that they are also registered by the Ministry of Economic Regulation seems to be a duplication of activities.*”

*Entrepreneur, focus group participant*

## Implementation of the *Inspections Law* must be improved

Not only is current legislation not based on contemporary practice and principles (for example, in providing for the selection of businesses for inspection on the basis of perceived risk), but Survey results indicate that those inspectorates compelled to abide by the provisions of the *Inspections Law* were frequently in breach of this. The most common breaches in this respect involved inspectorates failing to send advance notification, to show inspection order or identification, to produce reports, and to complete log books (Charts 7.1-7.4).

<sup>80</sup> The list of such high-risk business categories was approved by Government on October 12, 2009.

<sup>81</sup> *Law of the Kyrgyz Republic No. 231 “On Introduction of the Tax Code,”* adopted October 17, 2008, implemented January 1, 2009.

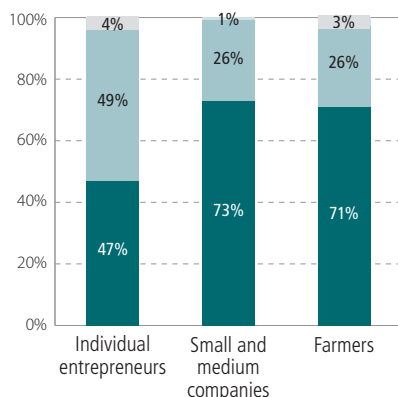
<sup>82</sup> *Law of the Kyrgyz Republic No. 131 “On Investigative Activities,”* adopted October 16, 1998.

<sup>83</sup> *Law of the Kyrgyz Republic No. 99 “On Local Self-Governance and Local State Administration,”* adopted May 29, 2008.

<sup>84</sup> *Law of the Kyrgyz Republic No. 224 “On Prosecutors,”* adopted July 17, 2009.

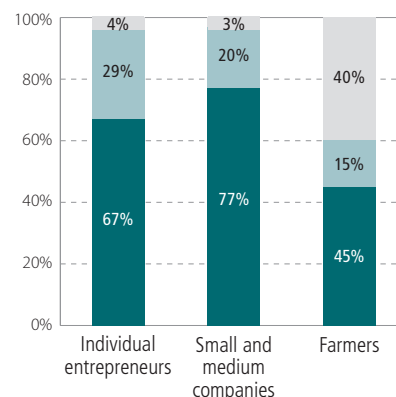
**Chart 7.1: Forty nine percent of individual entrepreneurs did not receive advance notification of planned inspections (January 2008 to March 2009)<sup>85</sup>**

Percentage of SMEs receiving advance notice of inspections



**Chart 7.4: Inspections were not recorded in logbooks for 29 percent of individual entrepreneurs (January 2008 to March 2009)<sup>88</sup>**

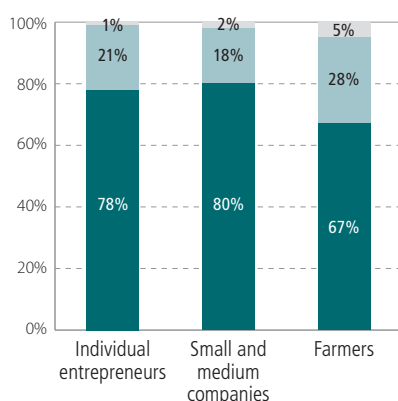
Percentage of SMEs for whom inspections were recorded in logbooks\*



\* Of those SMEs having a logbook

**Chart 7.2: Twenty eight percent of farmers were not shown any inspections order or identification (January 2008 to March 2009)<sup>86</sup>**

Percentage of SMEs shown and inspection order or identification



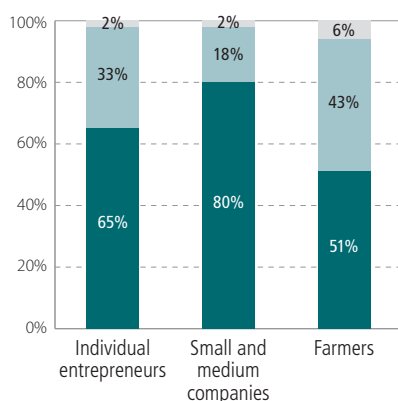
The failure of inspectors to complete the appropriate entries in logbooks is even more serious in light of the fact that close to 60 percent of individual entrepreneurs and 90 percent of farmers inspected in 2008 did not have a logbook (Chart 7.5). This indicates that businesses do not realize the value of the inspections logbook and do not use it effectively. Research conducted among focus groups suggests that businesses in rural areas prefer to maintain informal relations with inspectors.

“Asking inspectors to fill logbooks is the best way to spoil your relationship with inspectors. In rural areas, things are solved in a different way.”

Entrepreneur, focus group participant

**Chart 7.3: Inspectors did not produce reports for 43 percent of inspections conducted among farmers (January 2008 to March 2009)<sup>87</sup>**

Percentage of SMEs receiving inspection reports

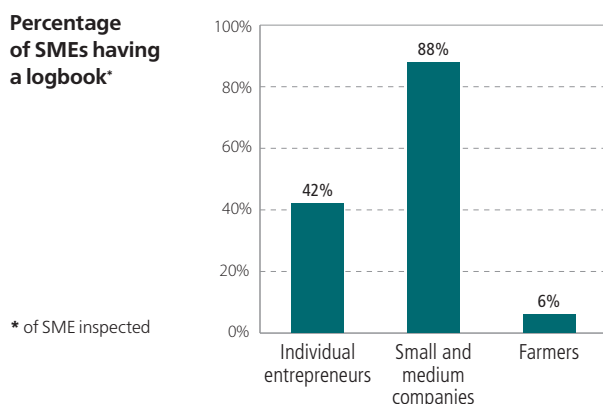


<sup>85</sup> The financial police, local offices under the Office of the Prosecutor General, and local government are not included in this chart since these are not required to give advance notification of inspections.

<sup>86</sup> All inspectorates are included in this chart since all are required to show orders for inspections as well as identification.

<sup>87</sup> Local government agencies are not included in this chart since these are not required to produce an inspections report detailing the results of an inspection.

**Chart 7.5: Almost 60 percent of individual entrepreneurs and over 90 percent of farmers did not have a logbook in 2008**



Breaches of the *Inspections Law* were found to be most common in inspections of farming businesses. This could be because: (i) farmers do not, in general, have a good knowledge of the provisions of the *Inspections Law* and are thus less able to defend their rights; and (ii) rural inspectors themselves do not have a good knowledge of the provisions of the *Inspections Law* and are thus more likely to infringe its provisions. Breaches of the *Inspections Law* were least frequent (although, nonetheless, significant) among small and medium companies. This may be due to the fact that small and medium companies have a better knowledge of the provisions of the *Inspections Law* – borne out by Survey results which indicate that 67 percent of farmers believe themselves to be “well aware of aware in general terms” of inspections legislation, in comparison with 92 percent of small and medium companies believing themselves to be so (Annex 7.4). Such frequent breaches of the requirements of the *Inspections Law* indicate a clear need for inspectors to be trained on the provisions of current inspections legislation, and the need for entrepreneurs to be better informed, particularly in rural areas.

Inspectors also reported that entrepreneurs in some cases avoid inspections by closing their businesses on those dates and times for which inspections are scheduled. This is clearly not only a waste of an inspector’s time, but may also have negative consequences for health, safety, and the environment in preventing appropriate action being taken against those businesses that are in breach of safety and other standards. It is, therefore, recommended that legislation be amended to ensure that businesses are penalized for intentionally avoiding inspections of which they have been notified in advance.

## Technical requirements and inspections procedures are not always registered by the Ministry of Justice

The legislation and regulation shown in Box 7.1 concerns only the regulation of general issues related to inspections. Other issues, particularly relating to procedures and businesses’ compliance with technical requirements, are often governed by specific specialist agencies. These requirements and procedures are often not registered by the Ministry of Justice – although this is a mandatory requirement under the *Law “On Regulatory Acts,”*<sup>89</sup> with the result that reference to these requirements and procedures by such agencies during the course of inspections may not be legal. This indicates a clear shortcoming in current legislation, and it is therefore necessary for all legislation which might be used or referred to during the course of an inspection to be registered by the Ministry of Justice – an approach adopted successfully in resolving a similar situation in the Republic of Tajikistan (Box 7.4).

### BOX 7.4: WORLD BANK AND IFC SUPPORT FOR THE REGISTRATION OF INSPECTIONS AGENCIES’ MANUALS AND CHECKLISTS BY THE MINISTRY OF JUSTICE, TAJIKISTAN

Pursuant to the *Law of the Republic of Tajikistan No. 54 “On Normative Acts,”* adopted December 8, 2003,<sup>90</sup> normative acts must be registered by the Ministry of Justice in order to be valid. However, until recently, inspectorates’ legal acts were often not registered by the Ministry of Justice, meaning that the legitimacy of the inspections conducted by these inspectorates was questionable.

In Tajikistan, the World Bank and IFC supported the registration by the Ministry of Justice of 23 inspection agencies’ manuals and checklists by including the registration of these documents as one of the prior actions necessary to receive a \$20 million World Bank Policy Development grant. This political support proved very valuable not only in ensuring the registration of manuals and checklists, but also in hastening their development.

In addition, IFC trained those Ministry of Justice officials responsible for the review and registration of legal acts on the key principles of such checklists, as well as on best practice in their development.

All inspection agencies in Tajikistan now have manuals and checklists registered by the Ministry of Justice, with the result that these documents can now be used in all legality during inspections.

<sup>88</sup> Local offices under the Office of the Prosecutor General, the financial police, and local government are not included in this chart since these are not required to record inspections in logbooks.

<sup>89</sup> *Law of the Kyrgyz Republic No. 34 “On Regulatory Acts,”* adopted July 1, 1996. This law was in force during the reference period of the Survey and was superseded by the *Law of the Kyrgyz Republic No. 241 “On Regulatory Acts,”* adopted July 20, 2009.

<sup>90</sup> This was later superseded by the *Law of the Republic of Tajikistan No. 506 “On Normative Acts,”* adopted March 26, 2009.

### 7.3. PERCEIVED RISK IS NOT A CRITERION IN THE SELECTION OF BUSINESSES FOR INSPECTION

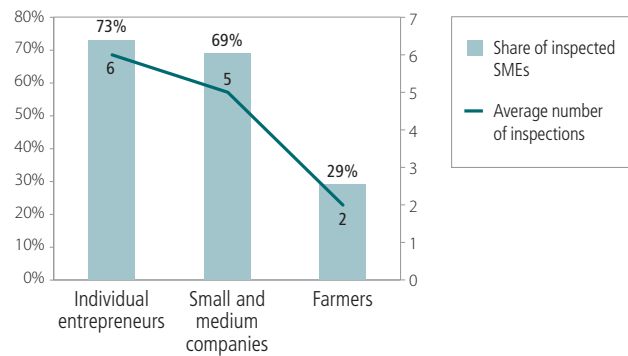
#### The incidence of inspections in the Kyrgyz Republic is high in comparison with international best practice

Survey results indicate that risk factors are not appropriately considered in selecting those businesses to be inspected, meaning that inspections are unlikely to target those businesses representing the greatest risk to society, health, and the environment. This not only results in an excessive burden being placed on low-risk businesses, but also in inspectorates being forced to stretch resources too far, and being unable to focus effectively on those businesses presenting the greatest risk. The inspections burden on low-risk businesses is thus excessive, while the inspections process, as a whole, delivers only limited benefit in protecting public health and the environment.

The percentage of businesses inspected between January and December 2008 was very high, and highest for individual entrepreneurs, with 73 percent being inspected during that period, as well as 69 percent of small and medium companies and 29 percent of farmers (Chart 7.6). The average number of inspections to which businesses were subjected during this period was also higher for individual entrepreneurs than for small and medium companies and farmers, at six, five, and two inspections, respectively. Individual entrepreneurs do not typically represent the greatest risk to society, health, and the environment. The fact that this category was subjected to the greatest number of inspections in 2008 is a clear indication that inspections are conducted “across the board” regardless of: (i) the risk a business may pose to society, health, and the environment; and (ii) the risk a business may pose in terms of tax evasion (in the case of tax inspections). Research conducted among focus groups indicates that one reason why individual entrepreneurs are inspected more frequently than small and medium companies may be because individual entrepreneurs are, in general, less knowledgeable than small and medium companies of applicable legislation and of their rights in this respect, and are thus more likely to make unofficial payments. Individual entrepreneurs were subject to the lowest proportion of planned inspections (at 40 percent of all inspections undertaken) between January 2008 and March 2009. Farmers and small and medium companies enjoyed a higher proportion of planned inspections, at 60 percent and 64 percent respectively, of all inspections undertaken. This data clearly indicates that individual entrepreneurs bear the greatest burden in terms of unplanned inspections.

**Chart 7.6: Individual entrepreneurs are proportionally more likely to be subject to inspection — indicating inspections are not conducted on the basis of perceived risk (January–December 2008 data)**

**Incidence of inspections across the SME sector, January–December 2008**

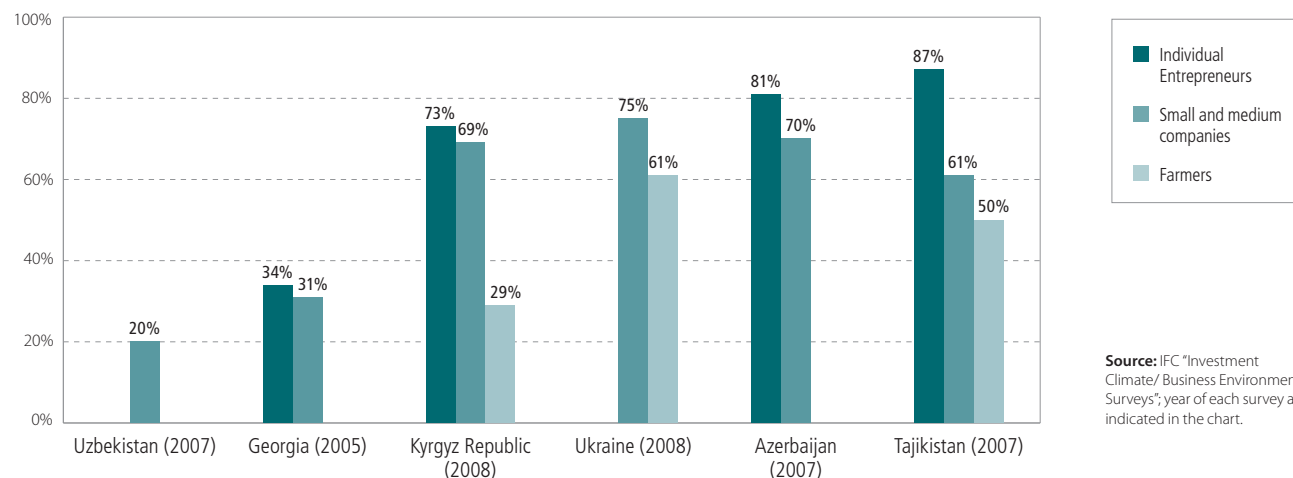


The percentage of businesses in the Kyrgyz Republic subject to inspections is high in comparison with levels in other countries. Data on OECD countries is not readily available, however, since, with no perceived problem associated with inspections, statistics are not recorded. However, in general, less than 10 percent of businesses are inspected each year in OECD countries – far fewer than in the Kyrgyz Republic. The percentage of businesses inspected in the Kyrgyz Republic is also much higher than in other post-Soviet countries that have reformed their business inspections systems.

*Investment Climate* surveys regularly conducted by the IFC in several post-Soviet countries allow comparisons to be made of the regulatory burden on businesses throughout the region. Despite including data sourced during the eight-month inspections moratorium announced in 2008, Survey results indicate inspections coverage in the Kyrgyz Republic to be among the highest of any post-Soviet country. Further reform is therefore necessary to reduce this to the levels of those countries that have done most to introduce international best practice – notably Uzbekistan and Georgia, which began reforms in 2004 and 2005, respectively (Chart 7.7).

**Chart 7.7: Additional reforms are needed to reduce inspections coverage in the Kyrgyz Republic to that of the most progressive post-Soviet countries**

Percentage of SMEs inspected at least once

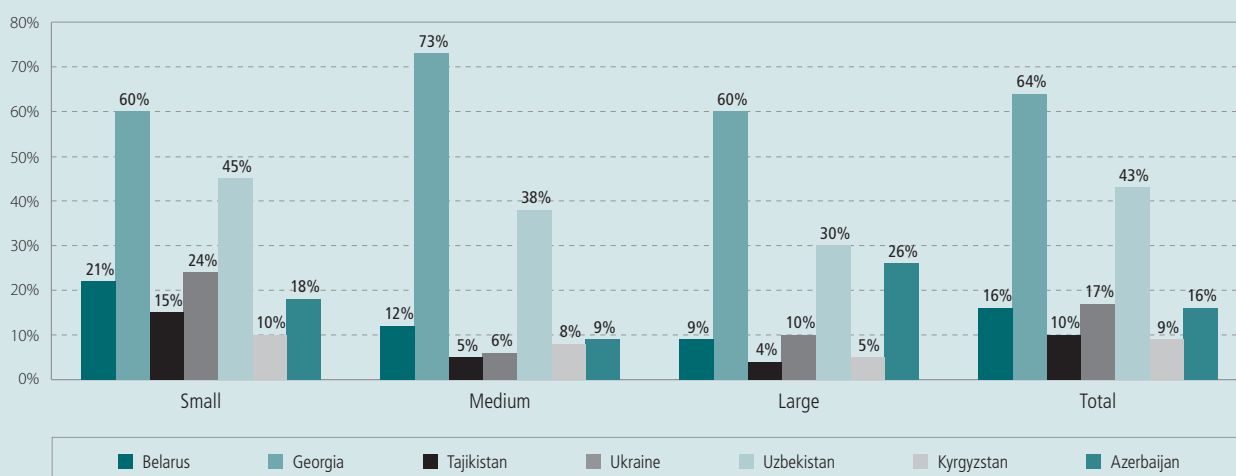


#### BOX 7.5: WORLD BANK BUSINESS ENVIRONMENT AND ENTERPRISE PERFORMANCE SURVEY (BEEPS) DATA CONFIRM INSPECTIONS COVERAGE IN THE KYRGYZ REPUBLIC TO BE HIGH

Other surveys confirm the disproportionate burden borne by businesses in the Kyrgyz Republic in comparison with other countries in the region. BEEPS data (Chart 7.8) demonstrates the proportion of companies throughout the region not subject to any form of inspection during the 2007 fiscal year. The proportion of companies in the Kyrgyz Republic that were not inspected, at nine percent, is the lowest in the region. This means that 91 percent of the firm population in the Kyrgyz Republic was subjected to at least one inspection in 2007. The difference between the results obtained by the 2008 *Investment Climate Survey* and BEEPS data may be linked to the 2008 inspections moratorium and to the different sample structure used in the latter.

**Chart 7.8: Inspections coverage is higher in the Kyrgyz Republic than in other post-Soviet countries**

Percentage of respondents reporting zero inspections in 2007



Source: EBRD-World Bank Business Environment and Enterprise Performance Survey data

### BOX 7.6: INTERNATIONAL BEST PRACTICE – FIRE SAFETY REFORM IN THE UNITED KINGDOM

The *Regulatory Reform (Fire Safety) Order* came into effect in October 1, 2006 and replaced over 70 pieces of pre-existing fire safety law. Reform had been prompted by (i) the recognition that much existing legislation was contradictory; and (ii) pressure from businesses complaining of excessive compliance costs under previous legislation.

Under this new legislation, the primary responsibility for ensuring the fire safety of business premises no longer rests with the Fire and Rescue Authority, but with such businesses themselves, whose owners are held accountable. Businesses are responsible for providing local Fire and Rescue Authorities with fire risk assessment reports, to be filed either by that businesses or an authorized third party. Premises are inspected on receipt of such risk assessment reports in order to assess their risk and compliance with fire safety regulations.

Fire inspections are carried out using checklists. These checklists allow fire inspectors, on completion of inspections, to calculate the level of compliance and the level of overall risk recorded at the inspected business premises. Factors such as a building's occupants, (e.g., in multiply occupancy residential buildings), fire warning system, access for rescue personnel, water supply, any history of previous fires, and any particular features which might cause a fire to spread, are taken into consideration in calculating the level of overall risk. On that basis, premises are then assessed against a risk matrix which prescribes the level of risk attributable to that building and, accordingly, the frequency of inspections to which they may be subject. Assessing the degree of compliance on a scale of one to five allows fire safety officers to determine impartially any action to be taken. Such actions may range from education on fire safety (level 1) to prohibiting the continued use of such premises (level 5).

As a result of these reforms, during 2008–09 Fire and Rescue Authorities in England inspected 26 percent of all care homes, and 22 percent of hotels, in comparison with only six percent of all retail premises.<sup>91</sup> The number of incidents to which Fire and Rescue Services were called to respond decreased from 336,100 in 2005–06 to 293,800 in 2007–08.<sup>92</sup>

The high coverage of inspections of both individual entrepreneurs and small and medium companies indicates a clear need for inspections to be based solely on perceived risk to health, safety and the environment. Some inspectorates, such as the Fire Safety Department, already apply some of the principles of such risk-based analysis in selecting premises to be inspected. Indeed, in keeping with an established Soviet-era practice, premises are categorized on the basis of their value and the potential risk (if any) to human life. Those buildings of highest value and presenting the greatest potential risk to human life are inspected most frequently. Such a system has limitations, however. With only three categories, criteria for classification can be approximate and out-of-date, and no system exists for the recording of historical compliance with directives arising from previous inspections. Also, despite the existence of such classifications, these can be inefficiently applied in selecting premises for inspection. Risk-based criteria were also previously used in determining health and sanitary inspections, but no longer apply. For example, the Sanitary and Epidemiological Service currently places excessive emphasis on checking nitrate levels in fruits and vegetables. This stems from previous practice to use a high level of fertilizers. As that practice is now far less prevalent, the need to check for nitrates (and strict observance of limits) is certainly not as acute, nevertheless there is no review of this targeting. It is thus suggested to move towards an inspections system based on risk analysis, as was successfully done in other countries (Box 7.6).

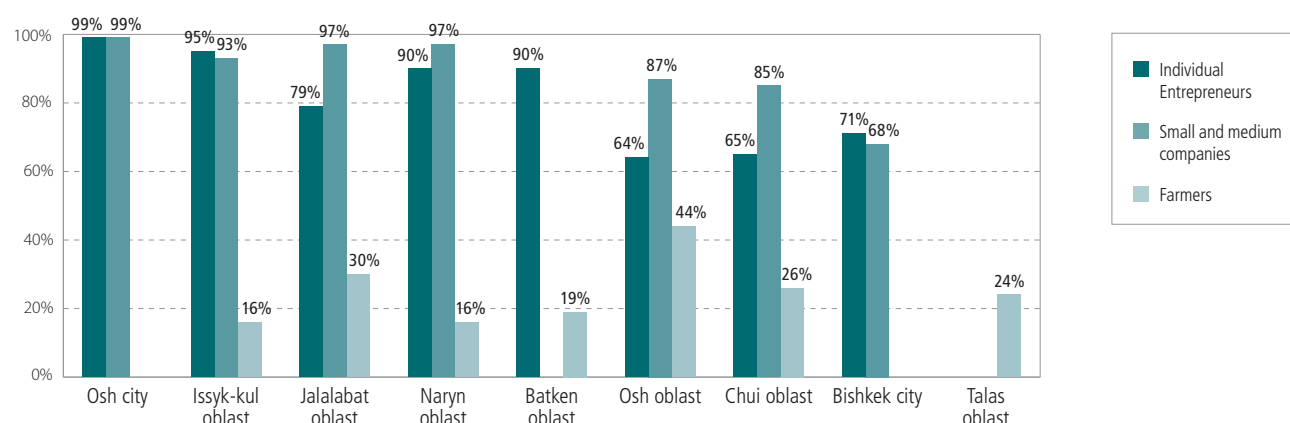
### Businesses operating in Osh city bear the greatest inspections burden

Analysis of inspections by region indicates a high incidence of inspections across all regions of the country, with an average of 60 percent of all small and medium companies and individual entrepreneurs reporting inspections during the period of the Survey. The incidence of inspections was particularly high, however, in Osh city, where almost 100 percent of all small and medium companies and individual entrepreneurs reported having undergone an inspection. The incidence of inspections is lowest in Bishkek city, but even there remains onerous, with 68 percent of all small and medium companies and 71 percent of all individual entrepreneurs reporting inspections (Chart 7.9). The result of the greater burden on businesses in Osh city may indicate greater opportunity for unofficial payments – with possible consequences for the quality of inspectors' work and business development in this region.

<sup>91</sup> Fire and Rescue Services (2009) "Operational Statistics Bulletin for England 2008/09".

<sup>92</sup> Fire and Rescue Services (2009) "Operational Statistics Bulletin for England 2008/09".



**Chart 7.9: The incidence of inspections is particularly high in Osh city****Percentage of businesses subject to inspections, by region**

#### 7.4. THE FREQUENCY OF INSPECTIONS DROPPED DURING THE MORATORIUM, BUT THIS RESPIRE WAS NOT USED TO INITIATE REFORM

Moratoriums have become popular tools in reducing the frequency of inspections in several post-Soviet countries. In the Kyrgyz Republic, *Presidential Decree No. 145*, adopted April 22, 2008 outlined the terms of the moratorium on inspections effective from April 25 to December 31, 2008. The purpose of this moratorium was to eliminate excessive interference in entrepreneurial activity, to create favorable conditions for investment, and to increase tax revenue through the anticipated boost in business growth.

During the moratorium, those state inspectorates listed in *Parliamentary Resolution No. 553-IV* were to reduce by 70 percent (in comparison with 2007 levels) the number of inspections undertaken. All inspections by the State Tax Service were covered by the moratorium with the exception of: (i) inspections of businesses operating under the voluntary tax patent regime; (ii) inspections requested at the initiative of businesses themselves; (iii) inspections requested by the tax authorities of other countries; (iv) inspections conducted as part of criminal proceedings; and (v) inspections conducted for the purpose of investigating alleged or actual tax evasion.

Survey results (Chart 7.11) indicate that the percentage of businesses inspected in any given month was reduced by more than half during the moratorium (i.e., during the period April

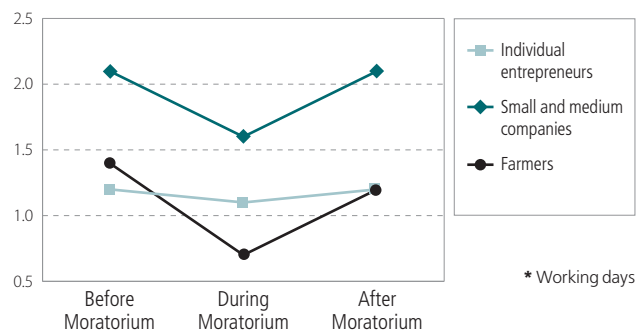
25 to December 31, 2008) in comparison with pre-moratorium levels (i.e., January–April 2008). Not only did those state inspectorates listed under *Parliamentary Resolution No. 553-IV* reduce the number and frequency of their inspections, but so did other agencies, including local government. For example, during the moratorium, local government agencies inspected two percent of farmers in any given month, as opposed to 13 percent before the moratorium (Annex 7.3). In addition, the duration of inspections during the moratorium was shorter during the moratorium than prior to it (Chart 7.10). The moratorium was therefore successful in decreasing the inspection burden on businesses.

However, although 2007 was not included in the reference period of the Survey, pre-moratorium 2008 data suggest that the moratorium did not quite reach its target of a 70 percent decrease on 2007 levels. Most importantly, inspectorates did not use the moratorium as a way to kick-start deeper reform such as the introduction of risk-based assessments in the selection of businesses to be inspected – on the contrary, inspections were simply deferred, and thus the activity of these inspectorates increased as soon as the moratorium was over (Chart 7.11). The incidence of inspections after the moratorium was indeed higher than had been the case prior to it, for both small and medium companies and individual entrepreneurs. For example, 15 percent of individual entrepreneurs were inspected in any given month prior to the moratorium, whereas 18 percent were subject to inspections after it had ended.



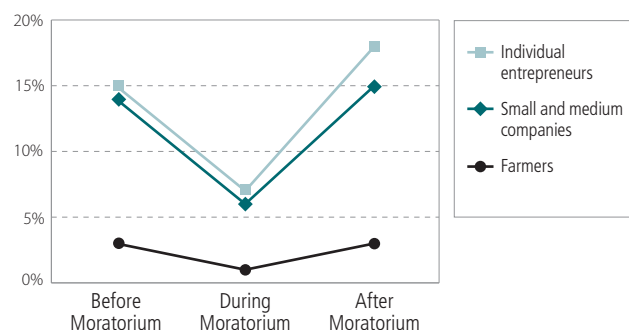
**Chart 7.10: The duration of inspections was shorter during the moratorium**

**Average duration of inspections before, during, and after the moratorium\***



**Chart 7.11: The incidence of inspections was higher after the moratorium than prior to it, for small and medium companies and individual entrepreneurs**

**Proportion of SMEs inspected each month before, during, and after the moratorium**



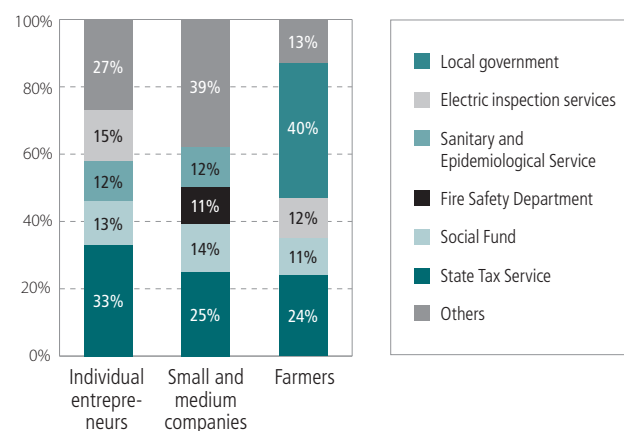
## 7.5. THE MAJORITY OF INSPECTIONS ARE PERFORMED BY THE FOUR MOST ACTIVE INSPECTORATES

The most active inspectorates (in terms of coverage and frequency of inspections) were found to be as follows.

- In terms of inspections of individual entrepreneurs and small and medium companies, the most active inspectorates are the State Tax Service, the Social Fund, the Sanitary and Epidemiological Service, and the Fire Safety Department. These agencies were responsible for 58 percent of all inspections of individual entrepreneurs, and 62 percent of all inspections of small and medium companies (Chart 7.12). The incidence of inspections by these agencies ranged between 24% and 71% for individual entrepreneurs and small and medium companies (Chart 7.13).
- Local government agencies, the State Tax Service, and the Social Fund are the most active inspectorates in respect of farmers, being responsible for 75 percent of all inspections in this sector (Chart 7.12).

**Chart 7.12: The State Tax Service is the most active inspectorate**

**Top inspecting agencies**

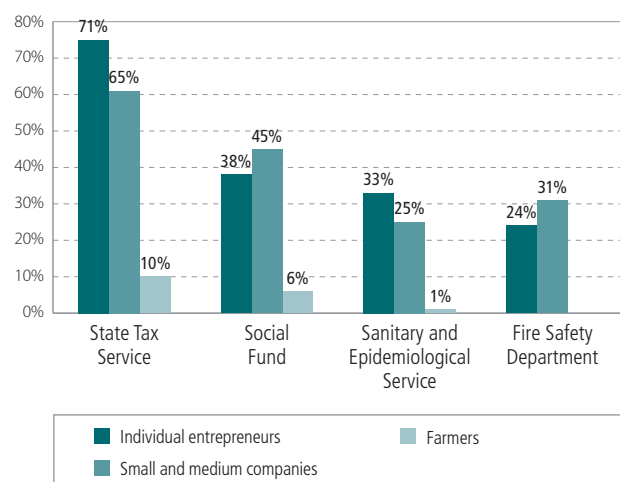


In addition, these inspectorates conducted, on average, more than one inspection per business during the reference period of the Survey. For example, the State Tax Service conducted inspections of individual entrepreneurs, on average, three times during the reference period of the Survey, while the Sanitary and Epidemiological Service inspected small and medium companies, on average, twice during the same period (Chart 7.14). Because the State Tax Service, the Social Fund, the Sanitary and Epidemiological Service, and the Fire Safety Department create the greatest inspections burden for businesses in the Kyrgyz Republic (as is the case in most post-

Soviet countries), these agencies should be priority targets for reform. In countries where inspections are conducted on the basis of perceived risk, the proportion of businesses subject to inspections is lower: for example, in France, less than two percent of businesses are inspected by tax authorities each year.<sup>93</sup> The targeting of a smaller proportion of businesses, but on the basis of stringent risk-assessment criteria, is an effective means of ensuring that resources are directed to those areas in which they are likely to have the greatest impact.

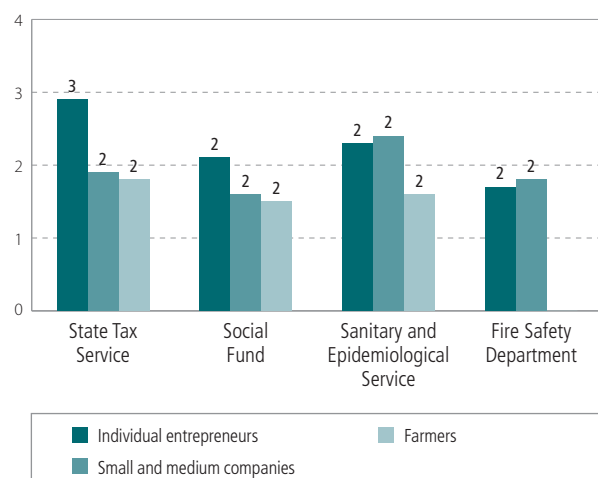
**Chart 7.13: The incidence of inspections by the most active agencies remains high despite the moratorium**

**Inspections of SMEs by the four most active inspectorates (January 2008 – March 2009)**



**Chart 7.14: The most active agencies also inspected certain businesses several times**

**Average number of SME inspections by the four most active inspectorates (January 2008 – March 2009)**



## 7.6. INFORMATION ON TECHNICAL REQUIREMENTS IS NOT ALWAYS READILY AVAILABLE TO ENTREPRENEURS

Information on the many technical requirements with which businesses must comply is not always made readily available publicly. For example, information on the 220 health and sanitary regulations with which businesses must comply is not available from the Ministry of Justice. Although these regulations are listed on the website of the Sanitary and Epidemiological Service,<sup>94</sup> their content is not displayed. In addition, not all health and sanitary legislation and regulation is available on “TOKTOM” or the “Adviser” database (electronic databases containing certain legislation and regulation): indeed, only 57 of the 220 pieces of legislation and regulation on health and sanitary issues are available on TOKTOM, while certain others are only available in hard copy – and even these are not always available for sale. Thus, businesses are not offered any facility through which to obtain (or, indeed, buy) information on the full range of legislation and regulation to which they are subject.

Such restricted access means that business (often inadvertently) fail to comply with regulation, and are more vulnerable to corrupt practices. Risk to human health and to the environment are also increased as a result of such low compliance. It is therefore recommended that inspection agencies work to improve businesses’ awareness of those requirements with which they need to comply. In countries that have implemented reform of their inspectorates and investigating agencies, such organizations are known not as “inspectorates” but “regulators,” and their core activity is understood to be the communication of technical compliance regulations and requirements in a simple, readily accessible way (through brochures, web sites and so on). It is recommended that such an approach be adopted in the Kyrgyz Republic. The use of checklists during inspections would also raise entrepreneurs’ awareness of the key rules and regulations to be observed (Box 7.7).

<sup>93</sup> General Directorate for Taxes, France (2007) “Rapport Annuel de Performance”. Available at [http://www2.impots.gouv.fr/documentation/rapports/activites/dgi/2007/dgi\\_rapport\\_performance\\_2007.pdf](http://www2.impots.gouv.fr/documentation/rapports/activites/dgi/2007/dgi_rapport_performance_2007.pdf) and [http://www.insee.fr/fr/themes/tableau.asp?reg\\_id=0&id=219](http://www.insee.fr/fr/themes/tableau.asp?reg_id=0&id=219)

<sup>94</sup> Further information on this organization is available at: <http://www.dgsen.kg/>

### BOX 7.7: WHAT IS AN INSPECTIONS CHECKLIST AND HOW IS IT HELPFUL?

An “inspections checklist” is a legal document developed by an inspecting agency for use in all inspections. Such checklists typically contain all those questions an inspector is likely to cover to determine an organization’s compliance with regulation in force. Such checklists are used routinely in countries as diverse as France, Germany, Great Britain, Latvia, Mexico, and Uzbekistan.

Checklists benefit both the government and the private sector, by:

- reducing the time required to carry out an inspection;
- making it easier for an inspectorate to train staff in investigating various types of businesses;
- reducing the degree of variability between individual inspectors and the investigations they conduct;
- increasing the transparency of the inspections process;
- raising entrepreneurs’ awareness about the key regulation that must be observed; and
- resulting in a clear record of infringements found during an inspection.

## 7.7. THE SANCTIONS USED DO NOT ENCOURAGE COMPLIANCE

Survey results indicate that the majority of inspections undertaken do not result in any sanctions being imposed (Chart 7.15). This data does not necessarily reflect a high level of compliance with regulation, however, but rather indicates the absence of any risk-based analysis in the selection of businesses to be inspected. Article 11 of the *Inspections Law* stipulates that, during planned inspections, a fine may not be imposed on a business in the event of non-compliance, and that any business found to be in breach of regulation must be given a period of between three days (in the event of non-compliance presenting a risk to safety, health, or human life) to 30 days to correct such breach. However, Survey results (across planned, unplanned, control and re-inspections) indicate that, where sanctions are imposed these involve, in the majority of cases, the payment of fines. As shown in Chart 7.17, 100 percent of sanctions imposed on farmers involved the payment of fines. Subsequent inspections undertaken to verify measures taken to rectify non-compliance occur less frequently than the imposition of fines – for example, 32 percent of farmers indicated that they had undergone subsequent inspections as a result of an earlier sanction. This would appear to suggest that the provisions of Article 11 of the *Inspections Law* are not always observed, and that the current

system encourages the imposition of sanctions rather than preventing the violation of regulation and ensuring compliance. In countries where the inspections system has been subject to reform, sanctions typically result in subsequent inspections rather than the imposition of a fine. Efficient enforcement systems should, therefore, reward the fast correction of problems and use coercion only on a gradual basis and as a last resort.

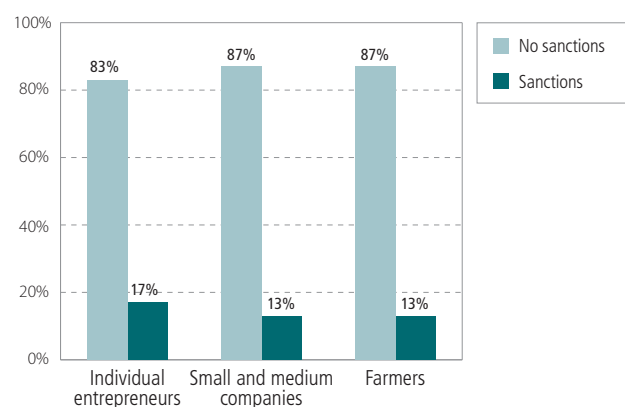
Despite the frequency of fines imposed (and the subsequent overall burden on many small and low-risk businesses as a result), the low value of individual fines is not sufficient to act as a deterrent. On average, fines range in value from KGS300 (\$8) to KGS10,000 (\$273). Accordingly, in some cases businesses prefer to pay a fine rather than incur the costs and inconvenience of compliance.

The incidence of unofficial payments made during the course of an inspection is also high. Between 24 and 35 percent of Survey respondents indicated that they had engaged in this practice, indicating that non-compliance is dealt with on an informal basis in this number of cases (Chart 7.16).

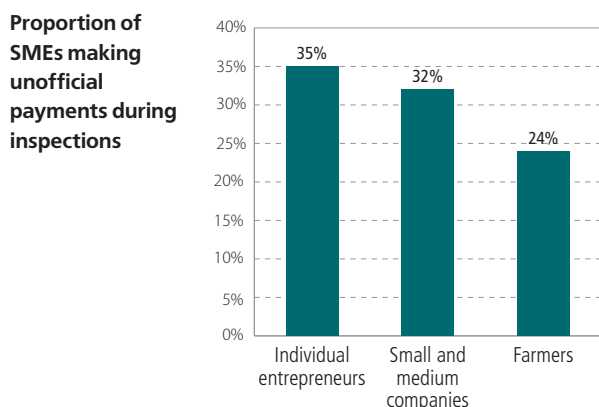
Small and medium companies constitute the only category of respondents for whom inspections occasionally result in the suspension of their operations: six percent of those small and medium companies that were imposed sanctions indicated that they had been subject to such suspension of operations, although the threat of suspension may be more widespread.

**Chart 7.15: The majority of inspections do not result in official sanctions**

### Proportional imposition of sanctions

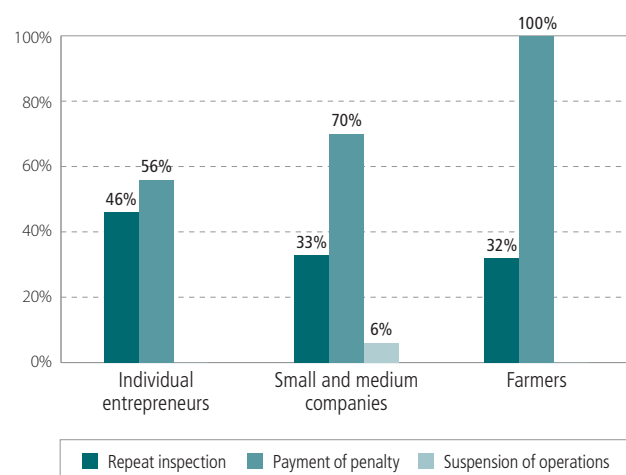


**Chart 7.16: The proportion of respondents reporting unofficial payments, gifts, or entertainment suggests some violations are resolved informally**



**Chart 7.17: Non-compliance generally leads to the imposition of sanctions rather than subsequent inspections<sup>95</sup>**

**Types of sanctions imposed as a result of violations**



### Appeals procedures are biased in favor of inspection agencies

The proportion of businesses appealing against the result of an inspection is low: only five percent of both individual entrepreneurs and small and medium companies receiving a penalty or sanction appealed that decision.

Current legislation provides for appeals to be filed as follows.

- (i) At a higher authority within the inspectorate that conducted the inspection (although it should be borne in mind that inspectorates may be biased in favor of their inspectors).
- (ii) In court (although it should be borne in mind that this procedure is costly, time consuming, and complex; nor are courts perceived as being entirely impartial).
- (iii) At a branch of the Office of the Prosecutor General (again, however, since these offices do not have a reputation of traditionally protecting the interests of businesses, commercial entities are reluctant to approach them).

In addition, regulation governing appeal procedures is complicated and difficult for businesses to understand without legal support. As a result, the percentage of businesses appealing against the result of an inspection is low.

### 7.8. THE EXISTING SYSTEM IS COSTLY, FOR BOTH BUSINESSES AND INSPECTORATES

Between January 2008 and March 2009, small and medium companies were subject to inspections lasting, on average, a total of 11 working days. Individual entrepreneurs were subject to inspections lasting, on average, a total of nine working days, and farmers three (Chart 7.18).

This represents a significant burden on businesses in terms of the labor costs incurred by such inspections. Survey results indicate the total average labor cost associated with inspections (for those businesses subject to inspections in 2008) to be KGS2,743 (\$75) for individual entrepreneurs, KGS4,582 (\$125) for small and medium companies, and KGS1,106 (\$30) for farmers. This represents a total of KGS281.20 million (\$7.70 million) for all SMEs nationwide, despite the moratorium of April–December 2008.

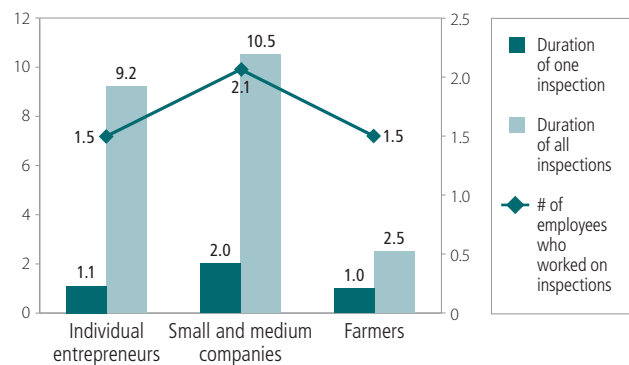
In addition to the labor costs of inspections, businesses also bear other costs – such as the official payments and fines imposed on them as a result of inspections, as well as unofficial payments.

The current system requires an inspectorate to allocate valuable human and financial resources, and efficiency is low. International best practice has demonstrated that the use of a risk-based approach to the selection of businesses for inspection is the most appropriate means of ensuring that resources are directed to those areas in which they are likely to have the greatest impact.

<sup>95</sup> The total is higher than 100 percent due to the opportunity for multiple answers.

**Chart 7.18: Small and medium companies were subject to inspections totaling 11 working days, and individual entrepreneurs nine, between January 2008 and March 2009**

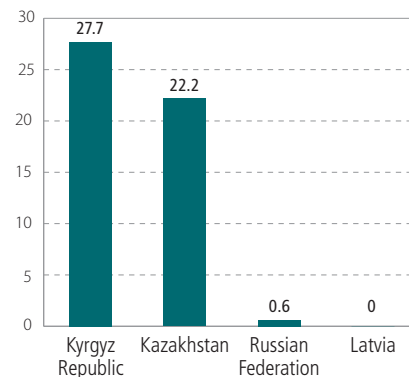
**Average duration of inspections and number of employees involved**



**Chart 7.19: The Kyrgyz Republic has a higher mortality rate from diarrheal diseases than most countries in the region**

**Mortality rate, diarrheal diseases per 100,000\***

\* 2004 data



**Source:** World Health Organization (2009) Department of Measurement and Health Information, February.

## 7.9. FREQUENT INSPECTIONS DO NOT GUARANTEE SAFETY

In 2009, the Sanitary and Epidemiological Service was exempted from some of the provisions of the *Inspections Law* due to the high incidence of infectious diseases in the Kyrgyz Republic. However, while it is certainly the case that greater use needs to be made of risk-based systems in determining those venues to be visited, and while certain higher-risk venues probably warrant more frequent supervision than once a year, a high incidence of inspections per se has never been proved to be an effective tool in promoting public health. Rather, data on mortality rates from infectious diseases tend to show no correlation between a higher incidence of inspections and a lower incidence of infectious disease: in anything, those countries subject to more frequent inspections appear to suffer from a higher incidence of infection.

Survey results indicate that the Sanitary and Epidemiological Service inspected 33 percent of individual entrepreneurs and 25 percent of small and medium companies between January 2008 and March 2009. However, mortality rates from diarrheal diseases in the Kyrgyz Republic are much higher than in other countries with a far lower incidence of inspections: for example, in Latvia, the risk of dying from diarrheal diseases is 27.7 times lower than in the Kyrgyz Republic (Chart 7.19).

## 7.10. RECOMMENDATIONS

ISSUE	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
<b>SHORT-TERM RECOMMENDATIONS</b>		
The provisions of the <i>Inspections Law</i> are frequently ignored	<p>Submit inspectors to regular training programs and professional tests on the provisions of inspections legislation and inspections procedures, as well as communication skills, and so on</p> <p>Ensure the widest possible dissemination of the provisions of the <i>Inspections Law</i> throughout the business community</p>	<p>Inspectors' professional skills and the efficiency of the inspections process will be enhanced. Compliance with the <i>Inspections Law</i> will improve</p> <p>Greater awareness of the provisions of the <i>Inspections Law</i> will allow businesses to engage more effectively with inspectors, will reduce opportunities for the soliciting of unofficial payments, and will reduce the cost of inspections to businesses</p>
Businesses are often denied access to full information on regulation and compliance	<p>Ensure that full information on all current regulation, and the means of ensuring full compliance with it, is made readily available to the business community</p> <p>Develop checklists containing all potential questions that might be used during an inspection and/or in investigating the degree of regulatory compliance within a business</p>	<p>Greater awareness of the provisions of current regulation, and the means of ensuring full compliance with it, will allow businesses to engage more effectively with inspectors, will reduce opportunities for the soliciting of unofficial payments, and will reduce the cost of inspections to businesses</p>
Some businesses intentionally avoid inspections of which they have received advance notification	Amend legislation to ensure that businesses are penalized for intentionally avoiding inspections	The incidence of businesses intentionally avoiding inspections will decrease. As a result, the level of compliance will increase and the resources of inspectorates will be used more effectively
Planned and unplanned inspections conducted by state inspection agencies must be registered both with branches of the Office of the Prosecutor General and the Ministry of Economic Regulation	Abolish duplication by maintaining a single, unified registration system	Avoiding duplication of activities will allow the more effective use of public resources
Businesses currently face a substantial burden in terms of the extent, frequency, and duration of inspections	<p>Limit the total number of inspections to which a business may be subject in a single year (with due exceptions for higher-risk businesses); limit the number of inspections that may be conducted simultaneously by different inspectorates</p> <p>Businesses which have only recently received a permit or license should not be checked on the requirements pertaining to such permit or license for a period of at least six months after the date of issue — except in the case of high-risk businesses and pending a review of permits and licenses currently in force: an initiative likely to reduce their scope and number and result in their being issued only in respect of high-risk businesses</p>	Limiting the number of inspections to which a business may be subject will reduce the overall burden on SMEs
<b>MEDIUM-TERM RECOMMENDATIONS</b>		
The basis on which businesses are selected for inspection is not sufficiently based on an assessment of perceived risk	<p>Develop risk-based selection mechanisms for the selection of businesses to be inspected: such criteria will, of course, vary according to the specific risk parameters applicable to each business and/or each market sector, as well as the regulation in force</p> <p>Once risk-based assessment practices have been established cancel the current requirement for inspections to be registered by the Ministry of Economic Regulation and branches of the Office of the Prosecutor General</p>	<p>(i) The protection of human health and safety, and the environment, will be enhanced; (ii) inspection coverage among low- and medium-risk businesses will be greatly reduced and the overall burden of inspections for businesses will decrease; and (iii) public resources will be directed to those areas in which they are likely to have the greatest impact</p>

ISSUE	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
Businesses are often not aware of inspections procedures	All inspectorates should develop manuals outlining the procedures applicable to each inspectorate. Such inspections manuals should include: (i) the criteria used in determining risk categories or the selection of those business to be inspected; (ii) the checklists to be used by that inspectorate in identifying the criteria against which businesses are to be inspected; and (iii) any forms and/or data collection mechanisms to be used during the inspection process. All manuals and checklists should be made available to businesses online	The development of checklists and manuals will increase entrepreneurs' awareness of compliance requirements and inspections procedures, as well as increasing the transparency and fairness of the inspections process
Some technical requirements and inspections procedures developed by individual agencies are not registered by the Ministry of Justice, meaning that the use of these documents during inspections may not be legal	Ensure all technical requirements and inspections procedures (including checklists and manuals, once these are developed) are registered by the Ministry of Justice	Inspections will be conducted on an entirely legal basis
Inspectors' salaries are low and are not based on performance	Inspectorates should review incentives for inspectors, so that they are rewarded on the basis of knowledge, adherence to good practice, and overall performance	Inspectors' professional skills and the efficiency of the inspections process will be enhanced. Compliance with the <i>Inspections Law</i> will improve

## ANNEX 7.1: STATE INSPECTORATES AND INSPECTION AGENCIES<sup>96</sup>

1. State Customs Committee;
2. State Agency for Architecture and Construction, under the Government of the Kyrgyz Republic;
3. State Agency for Antimonopoly Policy and the Development of Competition;
4. State Agency for Environmental Protection and Forestry, under the Government of the Kyrgyz Republic;
5. State Agency for the Production, Storage, and Sale of Alcohol and Beverages, under the Ministry for Agriculture, Water, and Processing Industry;
6. State Inspectorate for the Quarantine of Plants, under the Ministry for Agriculture, Water, and Processing Industry;
7. Department for Precious Metals, under the Ministry of Finance;
8. State Inspectorate for the Supervision of Industrial Safety and Mining, under the Ministry of Emergencies;
9. State Labor Inspectorate of the Kyrgyz Republic, under the Ministry of Labor and Social Development;
10. Kyrgyz Transport Inspectorate, under the Ministry of Transport and Communications;
11. State Inspectorate for Energy and Gas, under the Ministry for Industry, Energy, and Fuel Resources;
12. State Inspectorate for Mineral Resources Management of the State Agency for Geology and Mineral Resources, under the Government of the Kyrgyz Republic;
13. State Department for the Regulation of the Fuel and Energy Complex, under the Ministry for Industry, Energy, and Fuel Resources;
14. Department for the Supply of Medicines and Medical Equipment, under the Ministry of Health;
15. State Veterinary Department, under the Ministry for Agriculture, Water, and Processing Industry;
16. Department for Sanitary and Epidemiological Supervision, under the Ministry of Health;
17. State Fire Service, under the Ministry for Emergencies;
18. National Communications Agency;
19. Financial Market Supervision and Regulation Service; and
20. Social Fund.

<sup>96</sup> On March 12, 2009 the State Committee for Taxes and Duties, the Department of Civil Aviation of the Ministry of Transport and Communications was excluded from the list of state inspectorates. At the time of Survey was conducted, however, this agency was included in the list of inspectorates.



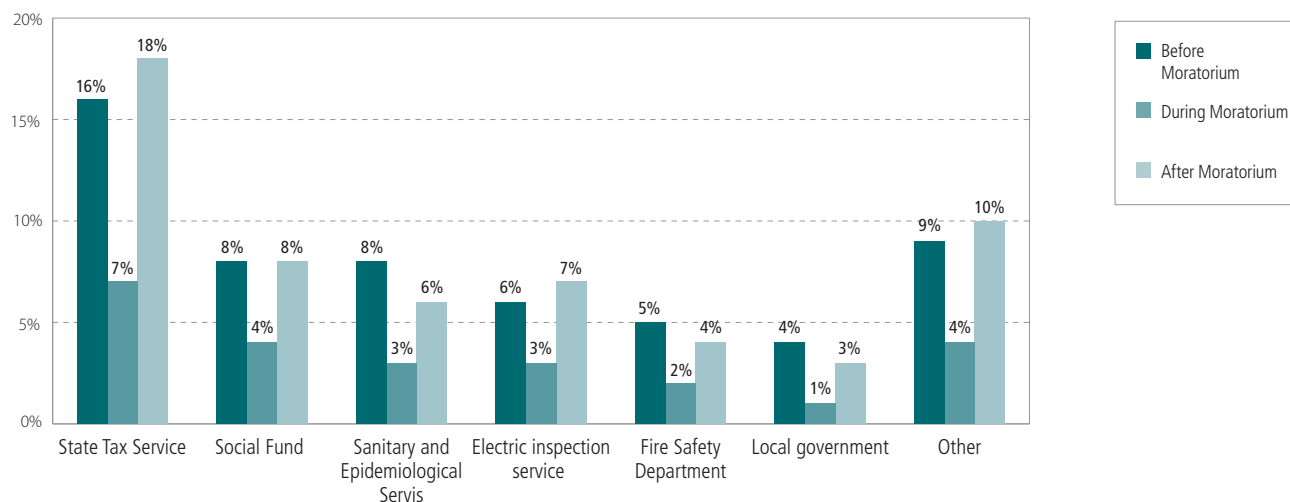
## ANNEX 7.2: LEGISLATION GOVERNING INSPECTIONS AS OF DECEMBER 2009

1. Law of the Kyrgyz Republic No. 1360-XII "On Internal Affairs Authorities in the Kyrgyz Republic," adopted January 11, 1994
2. Law of the Kyrgyz Republic No. 1362-XII "On National Security Authorities in the Kyrgyz Republic," adopted January 11, 1994
3. Law of the Kyrgyz Republic No. 1372-XII "On Urban Construction and Architecture in the Kyrgyz Republic," adopted January 11, 1994
4. Law of the Kyrgyz Republic No. 1480-XII "On Non-Tax Payments," adopted April 14, 1994
5. Law of the Kyrgyz Republic No. 26 "On Plant Quarantine," adopted June 27, 1996
6. Law of the Kyrgyz Republic No. 56 "On Electric Power Industry," adopted October 30, 1996
7. Law of the Kyrgyz Republic No. 12 "On Licensing," adopted March 3, 1997
8. Law of the Kyrgyz Republic No. 105 "On State Protection Service in the Kyrgyz Republic," adopted December 29, 1997
9. Law of the Kyrgyz Republic No. 27 "On Commercial Secrets," adopted March 30, 1998
10. Law of the Kyrgyz Republic No. 31 "On Electronic and Mail Communication," adopted April 2, 1998
11. Law of the Kyrgyz Republic No. 131 "On Investigative Activities," adopted October 16, 1998
12. Law of the Kyrgyz Republic No. 139 "On Antidumping," adopted October 31, 1998
13. Law of the Kyrgyz Republic No. 155 "On Advertising," adopted December 24, 1998
14. Law of the Kyrgyz Republic No. 51 "On Atmospheric Air Protection," adopted June 12, 1999
15. Law of the Kyrgyz Republic No. 53 "On Environmental Protection," adopted June 16, 1999
16. Law of the Kyrgyz Republic No. 54 "On Environmental Impact Assessment," adopted June 16, 1999
17. Law of the Kyrgyz Republic No. 58 "On the Radiological Safety of the Population of the Kyrgyz Republic," adopted June 17, 1999
18. Law of the Kyrgyz Republic No. 3 "On Status of Members in Local Keneshes," adopted January 13, 2000
19. Law of the Kyrgyz Republic No. 35 "On Rescue Services and Status of Rescuers," adopted January 21, 2000
20. Law of the Kyrgyz Republic No. 15 "On the Protection of Entrepreneurs' Rights," adopted February 1, 2001
21. Law of the Kyrgyz Republic No. 53 "On Flora Protection and Use," adopted June 20, 2001
22. Law of the Kyrgyz Republic No. 93 "On Industrial Safety of Hazardous Industrial Objects," adopted November 19, 2001
23. Law of the Kyrgyz Republic No. 30 "On Export Control," adopted January 23, 2003
24. Law of the Kyrgyz Republic No. 51 "On Anticorruption Activities" adopted March 6, 2003
25. Law of the Kyrgyz Republic No. 91 "On Pharmaceuticals," adopted April 30, 2003
26. Law of the Kyrgyz Republic No. 16 "On Administrative Procedures," adopted March 1, 2004
27. Law of the Kyrgyz Republic No. 67 "On Technical Regulation Principles in the Kyrgyz Republic," adopted May 22, 2004
28. Law of the Kyrgyz Republic No. 70 "On Cooperatives," adopted June 11, 2004
29. Law of the Kyrgyz Republic No. 103 "On the Social Fund of the Kyrgyz Republic," adopted August 2, 2004
30. Law of the Kyrgyz Republic No. 116 "On Health-care Organizations in the Kyrgyz Republic," adopted August 13, 2004
31. Law of the Kyrgyz Republic No. 117 "On the Chamber of Accounts of the Kyrgyz Republic," adopted August 13, 2004
32. Law of the Kyrgyz Republic No. 121 "On the Procedure for the Jogorku Kenesh of the Kyrgyz Republic to Exercise its Control Functions" of August 13, 2004
33. Law of the Kyrgyz Republic No. 6 "On Health-care for the Citizens of the Kyrgyz Republic," adopted January 9, 2005
34. Law of the Kyrgyz Republic No. 61 "On Veterinary Medicine," adopted April 12, 2005
35. Law of the Kyrgyz Republic No. 82 "On the Prevention of Delinquency in the Kyrgyz Republic," adopted June 25, 2005
36. Law of the Kyrgyz Republic No. 67 "On Procedure for the Consideration of Appeals from Citizens," adopted May 4, 2007
37. Law of the Kyrgyz Republic No. 14 "On Ensuring Uniformity of Measurements," adopted August 10, 2007
38. Law of the Kyrgyz Republic No. 99 "On Local Self-government and Local State Administration," adopted May 29, 2008
39. Law of the Kyrgyz Republic No. 24 "On the State Tax Service of the Kyrgyz Republic," adopted January 23, 2009
40. Law of the Kyrgyz Republic No. 151 "On General Technical Regulation to Ensure Environmental Safety in the Law of the Kyrgyz Republic," adopted May 8, 2009
41. Law of the Kyrgyz Republic No. 166 "On the Development of Agriculture in the Kyrgyz Republic," adopted May 26, 2009
42. Law of the Kyrgyz Republic No. 178 "On General Technical Regulations of the Kyrgyz Republic on Land-based Vehicle Safety," adopted May 29, 2009
43. Law of the Kyrgyz Republic No. 248 "On Public Healthcare," adopted July 24, 2009
44. Law of the Kyrgyz Republic No. 251 "On the Securities Market," adopted July 24, 2009
45. Law of the Kyrgyz Republic No. 269 "On State Regulation of the Production and Sale of Ethyl Alcohol and Alcohol Products," adopted October 13, 2009

### ANNEX 7.3: INCIDENCE OF INSPECTIONS BY STATE INSPECTORATES AND OTHER AGENCIES BEFORE, DURING, AND AFTER THE MORATORIUM

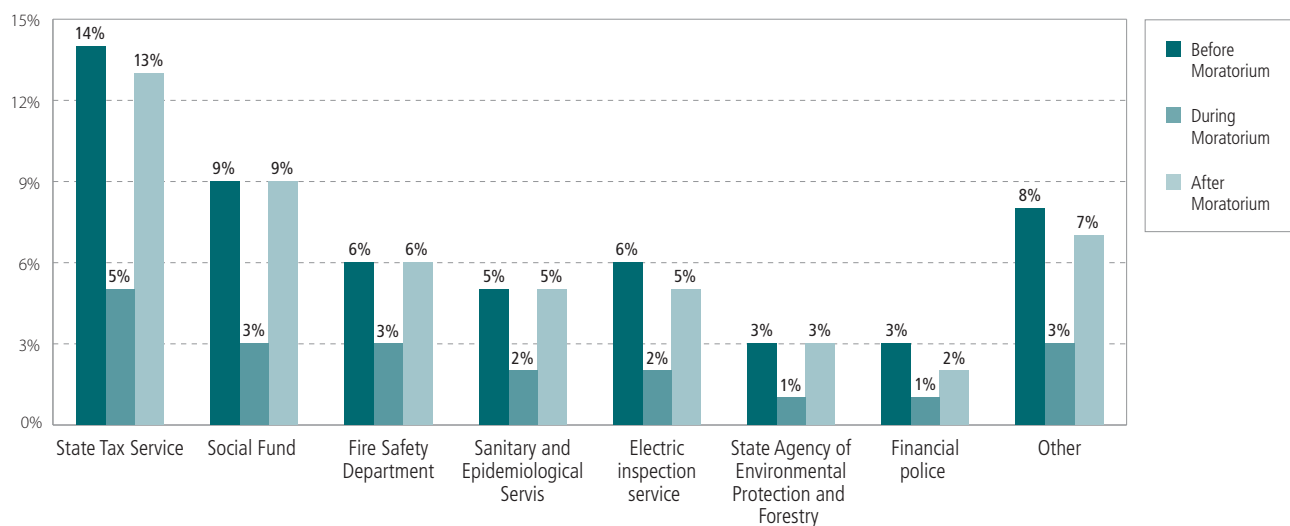
**Chart 7.20: Inspections coverage of individual entrepreneurs was higher after the moratorium than prior to it, indicating that the moratorium simply delayed inspections**

Monthly percentage of individual entrepreneurs inspected each each month by the main inspection agencies before, during, and after the moratorium



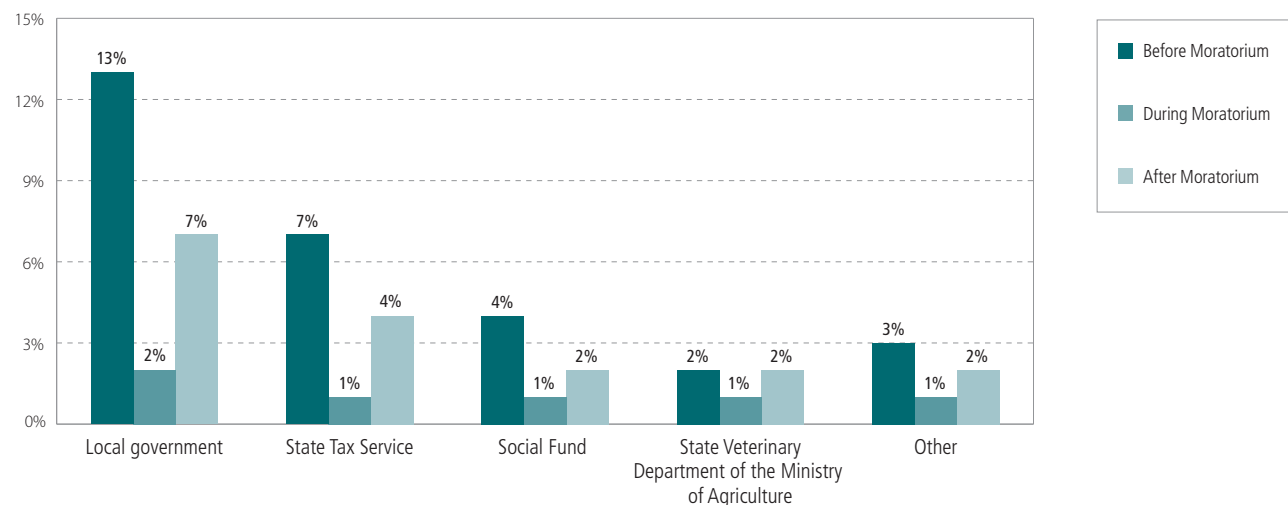
**Chart 7.21: The incidence of inspections of small and medium companies was similar both before and after the moratorium**

Monthly percentage of small and medium companies inspected each month by the main inspection agencies before, during, and after the moratorium



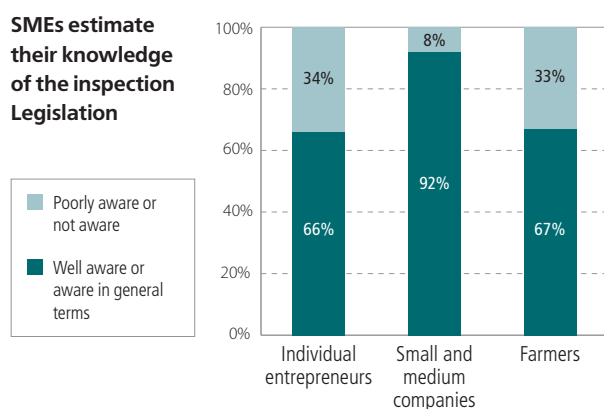
**Chart 7.22: Farmers were the only category for which the incidence of inspections was lower after the moratorium than prior to it**

Monthly percentage of farmers inspected by the main inspections agencies before, during, and after the moratorium



#### ANNEX 7.4: SMALL AND MEDIUM ENTERPRISES' ESTIMATIONS OF THEIR KNOWLEDGE OF INSPECTIONS LEGISLATION

**Chart 7.23: Small and medium companies were the category most confident of their knowledge of inspections legislation**



## ANNEX 7.5: THE LABOR COST OF INSPECTIONS

### Labor costs of State Tax Service inspections

		INDIVIDUAL ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	FARMERS	SOURCE
A	Total number of enterprises	145,663	10,982	280,408	State Statistics Committee
B	Proportion of SMEs subjects to tax inspections in 2008	66%	59%	10%	Survey Results
C	No. of enterprises inspected by the State Tax Service	96,720	6,446	27,200	A * B
D	Duration of all Tax inspections in 2008 per business	2.98	4.68	2.25	Survey Results
E	50% of time	1.49	2.34	1.13	Hypothesis: SMEs staff spend 50% of their time with inspectors during tax inspections
F	Average number of staff involved	1.5	2.2	1.5	Survey Results
G	Average salary	5,378	5,378	5,378	State Statistics Committee
H	<b>Total, KGS</b>	<b>55,412,699</b>	<b>8,497,319</b>	<b>11,754,588</b>	<b>C * G * F * (E/21)</b>
I	<b>Grand total, KGS</b>	<b>75,664,607</b>			
J	<b>Grand total, \$</b>	<b>2,069,035</b>			

### Labor costs of Social Fund inspections

		INDIVIDUAL ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	FARMERS	SOURCE
A	Total number of enterprises	145,663	10,982	280,408	State Statistics Committee
B	Proportion of SMEs subjects to Social Fund inspections in 2008	34%	41%	5%	Survey Results
C	No. of enterprises inspected by Social Fund	49,817	4,448	14,301	A * B
D	Duration of all Social Fund inspections in 2008 per business	2.02	1.67	1.40	Survey Results
E	50% of time	1.01	0.8	0.70	Hypothesis: SMEs staff spend 50% of their time with inspectors during Social Fund inspections
F	Average number of staff involved	1.50	2.20	1.40	Survey Results
G	Average salary	5,378	5,378	5,378	State Statistics Committee
H	<b>Total, KGS</b>	<b>19,298,184</b>	<b>2,097,179</b>	<b>3,589,121</b>	<b>C * G * F * (E/21)</b>
I	<b>Grand total, KGS</b>	<b>24,984,484</b>			
J	<b>Grand total, \$</b>	<b>683,196</b>			

**Labor costs of other inspections**

		INDIVIDUAL ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	FARMERS	SOURCE
A	Total number of enterprises	145,663	10,982	280,408	State Statistics Committee
B	Proportion of SMEs subject to inspections in 2008	54%	48%	22%	Survey Results
C	Number of inspected enterprises by other authorities	78,221	5,293	62,251	A * B
D	Duration of all other inspections in 2008 per business	4.64	4.83	1.18	Survey Results
E	Average number of staff involved	1.50	2.26	1.40	Survey Results
F	Average salary	5,378	5,378	5,378	State Statistics Committee
G	<b>Total, KGS</b>	<b>139,454,759</b>	<b>14,782,480</b>	<b>26,336,310</b>	<b>C * F * E * (D/21)</b>
H	<b>Grand total, KGS</b>	<b>180,573,549</b>			
	<b>Grand total, \$</b>	<b>4,937,751</b>			

**Total labor cost of inspections**

	INDIVIDUAL ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	FARMERS
State Tax Service	55,412,699	8,497,319	11,754,588
Social Fund	19,298,184	2,097,179	3,589,122
Others	139,454,759	14,782,480	26,336,310
Total	214,165,643	25,376,978	41,680,019
<b>Grand total (KGS)</b>	<b>281,222,639</b>		
<b>Grand total (\$)</b>	<b>7,689,982</b>		



# 8. Taxation

## Tax legislation and compliance requirements hinder business growth

### 8.1. KEY FINDINGS:

- Survey results (collected in 2008 and reflecting the impact of the old *Tax Code*,<sup>97</sup> together with a preliminary analysis of the new *Tax Code*,<sup>98</sup> indicate that the tax system does not encourage the graduation from the patent regime to the simplified tax regime. This has serious consequences for both business growth and tax revenue collection. Additional reforms to both the patent and the simplified tax regime are therefore needed.
- The total average labor cost associated with tax accounting and mandatory reporting in 2008 was KGS11,740 (\$321) per individual entrepreneur, KGS79,054 (\$2,162) per small and medium company and KGS6,010 per farmer (\$164). This represents approximately 10 percent of individual entrepreneurs' total profit, 13 percent of small and medium companies', and 14 percent of farmers'.
- The labor cost to SMEs in fulfilling their tax compliance and reporting obligations in 2008 (including tax accounting and mandatory reporting, but excluding tax audits) amounted to over KGS4 billion (\$116 million), representing 2.9 percent of the country's gross domestic product (GDP). This is higher than the cost of other main regulatory procedures altogether (registration, permits, licensing, technical regulations and inspections).
- Inspections are a heavy burden and are not risk-focused: 66 percent of individual entrepreneurs, 59 percent of small and medium companies and 10 percent of farmers were inspected by the State Tax Service in 2008, despite an inspection moratorium being in place between April and December 2008. The cost of tax audits to SMEs in 2008 was close to KGS48 million (\$1.3 million), representing 0.03 percent of the country's GDP.

### 8.2. LEGAL FRAMEWORK: THE NEW TAX CODE IS AN IMPORTANT STEP IN IMPROVING THE TAX SYSTEM, BUT ADDITIONAL REFORMS ARE NEEDED

#### **Positive reforms under the new *Tax Code* include a decrease in the number of taxes and a decrease in the rate of the single tax on turnover**

The new *Tax Code* was adopted on October 17, 2008 and became effective on January 1, 2009. It replaces the *Tax Code* that had previously been in force since 1996. Some of the main changes that were gradually introduced during the period of 1996–2008 included the creation of the simplified taxation regime, the decrease of the profit tax rate from 20 to 10 percent, and the switch from a progressive to a flat income tax.

#### **BOX 8.1: KEY LEGISLATION REGULATING TAXATION**

- *Law of the Kyrgyz Republic No. 76 "On Accounting,"* adopted April 29, 2002;
- *The Customs Code of the Kyrgyz Republic,* adopted July 12, 2004;
- *The Tax Code of the Kyrgyz Republic,* adopted October 17, 2008, in effect since January 1, 2009;
- *Government Resolution No. 736 "On the Registration and Sealing of Cash Register Machines,"* adopted December 30, 2008;
- *Government Resolution No. 733 "On Approving Amount of Voluntary Patent Tax by Type of Entrepreneurial Activity,"* adopted December 30, 2008;
- *Government Resolution No. 58 "On Mandatory Patent Rates,"* adopted January 28, 2009.

<sup>97</sup> *The Tax Code of the Kyrgyz Republic,* adopted June 26, 1996, implemented July 1, 1996.

<sup>98</sup> *The Tax Code of the Kyrgyz Republic,* adopted October 18, 2008, implemented January 1, 2009.

The new *Tax Code* was developed between 2005 and 2008 by a working commission (the “Commission”) that included representatives of the government and the business community, as well as independent tax experts. Members of the public were also given the opportunity to contribute, and more than 5,000 comments and suggestions were received by the Commission between 2004 and 2008.

The new *Tax Code* was designed to streamline the existing tax system (for example, in reducing the total number of taxes in force), and to introduce modern taxation principles (risk-based tax management, the principle of good faith, and so on) as well as modern tax administration management with a view to reducing the tax burden on businesses while optimizing efficiency. The principle of risk-based audit was introduced into the *Tax Code*, including a provision stating that taxpayers be rated according to their estimated “risk,” and tax audits planned accordingly.

With the enactment of the new *Tax Code*, the total number of taxes paid and/or collected by businesses under the general

tax regime decreased from 15 (comprising eight national and seven local taxes) to eight (six national and two local taxes).<sup>99</sup> Most previously existing local taxes, in particular, were cancelled, which considerably simplified the tax system for the majority of SMEs and drastically reduced administrative costs for tax authorities. In addition, the decrease of between one and four percent in the rate of the single tax on turnover made the simplified tax regime more attractive for businesses. The rate of VAT was also decreased, from 20 to 12 percent (Table 8.1).

However, additional reforms of the tax system are needed as:

- the combination of VAT and of the new sales tax imposes both an excessive financial burden on businesses, as well as a greater burden in terms of tax compliance; and
- the tax patent regime and the simplified tax regime should be further reformed in order to encourage graduation from the former to the latter, thus encouraging business growth, with positive impacts on the economy and employment; and
- tax administration remains complex and time consuming.

**Table 8.1: SMEs are subject to fewer taxes, but additional reforms are needed**

CHANGES LIKELY TO HAVE A POSITIVE IMPACT	CHANGES LIKELY TO HAVE A NEGATIVE IMPACT
<p>The new <i>Tax Code</i> introduced fundamental principles of:</p> <ul style="list-style-type: none"> <li>– fairness (all taxpayers are treated equally);</li> <li>– transparency (all legal acts regulating taxation must be made public);</li> <li>– the presumption of good faith; and</li> <li>– certain elements of risk-based tax audit</li> </ul>	
<p>New tax regimes were introduced, including:</p> <ul style="list-style-type: none"> <li>– the “contract-based tax payment” regime (Box 2); and</li> <li>– taxation in free economic zones</li> </ul>	
<p>The following national taxes were eliminated:</p> <ul style="list-style-type: none"> <li>– road use tax; and</li> <li>– contribution to Emergency Situations Fund</li> </ul> <p>The following local taxes were eliminated:</p> <ul style="list-style-type: none"> <li>– health resort tax;</li> <li>– tax on advertising;</li> <li>– hotel tax; and</li> <li>– tax on retail sales and consumer services</li> </ul>	<p>Higher rates of land tax (variable, depending on the region in which such land is held)</p>
<p>The VAT rate was reduced from 20 to 12 percent</p>	<p>A sales tax (of 1.5–3.5 percent) was introduced: the simultaneous use of two indirect tax instruments (i.e., the VAT and the cascading sales tax), poses a higher effective tax rate and tax compliance burden than the original 20 percent VAT rate<sup>100</sup></p> <p>The price of the tax patent was increased</p>

<sup>99</sup> The tax on immovable property existed under the old *Tax Code*, but was not enforced and is not included in this calculation.

<sup>100</sup> This is particularly true for the manufacturing sector, due to the high number of transactions involved between the purchase of raw materials and retail sale.



CHANGES LIKELY TO HAVE A POSITIVE IMPACT	CHANGES LIKELY TO HAVE A NEGATIVE IMPACT
<p>The rate of the simplified tax on turnover ("single tax") was reduced from its previous levels of:</p> <ul style="list-style-type: none"> <li>– five percent of turnover for businesses in agricultural processing, manufacturing, and public catering;</li> <li>– six percent of turnover for business in trade and transportation services; and</li> <li>– 10 percent of turnover for businesses in other sectors</li> </ul> <p>Rates are now:</p> <ul style="list-style-type: none"> <li>– four percent of turnover for businesses in manufacturing, trade, and processing; and</li> <li>– six percent of turnover for businesses engaged in other activities</li> </ul>	
Taxes previously levied on owners of vehicles and immovable property (although this latter tax was not enforced under the old <i>Tax Code</i> ) were combined into the "property tax"	
Short-term patents were introduced (of one, two, and 15 days' duration)	
An additional facility for tax returns to be filed online was introduced (not yet implemented)	

### Following the implementation of the new *Tax Code*, businesses in the Kyrgyz Republic now have a choice of five tax regimes

In addition to the reforms outlined above regarding changes in the number of taxes and applicable tax rates, the new *Tax Code* saw the introduction of two new tax regimes. As of late 2009, the tax regime for free economic zones was used by 580 businesses in four free economic zones throughout the Kyrgyz Republic.<sup>101</sup> In addition, a new regime, the "contract-based tax payment" regime, was introduced (Box 8.2). Tables 2 and 3 outline entrepreneurs' eligibility for each of these tax regimes, the operational limitations associated with them, and the taxes applicable under each regime. More information on applicable taxes under each regime is given in Annex 8.2. Due to the geographical limitations of the tax regime for free economic zones, this regime is not included in Tables 8.2 and 8.3, nor in Annex 8.2.

In addition to the tax regime for free economic zones, the Kyrgyz Republic currently has four other tax regimes in force.

- The *voluntary* tax patent regime is targeted at individual entrepreneurs, and applies to 124 types of business activity. Under the patent regime individual entrepreneurs pay a fixed amount for a pre-determined period (Annex 8.1). The administration of the voluntary tax patent regime is very simple and requires a maximum of one report to be submitted to the tax authorities. The *mandatory* tax patent regime applies to all businesses (not just individual

entrepreneurs) engaged in any of seven prescribed types of activity.<sup>102</sup>

- The simplified tax regime targets both individual entrepreneurs and small and medium companies and is intended to be an intermediary regime between the patent tax regime (a very simple mechanism, suitable for the smallest businesses) and the general tax regime (which is more onerous in terms of administration and compliance (as well as cost), and is targeted at larger businesses). Businesses operating under the simplified tax regime pay up to four taxes, as well as making payments to the Social Fund.
- The general taxation regime targets both individual entrepreneurs and small and medium companies and is intended to apply to larger businesses. Businesses operating under the general tax regime pay up to eight taxes, as well as making payments to the Social Fund.
- The newly introduced "contact-based tax payment" regime involves the payment of an amount fixed in advance in lieu of payment of VAT, the sales tax, and profit tax.

<sup>101</sup> The free economic zones of "Naryn," "Karakol," "Bishkek," and "Maimak" were created in 1991, 1994, 1995, and 1997, respectively. However, the old *Tax Code* contained no provisions governing free economic zones, and tax exemptions for businesses operating in free economic zones were regulated by the *Law of the Kyrgyz Republic No. 1076-XII "On Free Economic Zones,"* adopted December 16, 2002.

<sup>102</sup> Mandatory patents are necessary for the operation of saunas and public baths, billiard halls, casinos and slot halls, money exchange offices, and 24-hour parking facilities.

Table 8.2: Eligibility and operational limitations of enterprises under various tax regimes

	GENERAL TAX REGIME	SIMPLIFIED TAX REGIME (SINGLE TAX)	PATENT		CONTRACT- BASED TAX PAYMENT REGIME
			MANDATORY	VOLUNTARY	
ELIGIBILITY					
Small and medium companies	Yes	Yes	Yes	N/a	Yes
Individual entrepreneurs	Yes	Yes	Yes	Yes	Yes
Farmers	Yes	N/a	N/a	Yes	Yes
OPERATIONAL LIMITATIONS					
	No operational limitations	Up to KGS4 million annual turnover  Applicable to all activities except: – financial and insurance services; – investment fund activity; – professional activity on securities  Businesses liable for excise tax cannot register under the simplified tax regime  Businesses with more than 30 employees cannot register under the simplified tax regime	Applies to seven types of activities	Up to KGS4 million annual turnover  Applicable to 124 types of business activity <sup>103</sup>  Valid only in the region in which it was issued  Import–export operations are ineligible  Business with more than 30 employees are ineligible	Available to businesses that have been operational for at least three years

Table 8.3: Taxes payable under the four tax regimes

	GENERAL TAX REGIME	SIMPLIFIED TAX REGIME	TAX PATENT	CONTRACT-BASED TAX PAYMENT REGIME
<b>Necessary to submit tax reports to the State Tax Service?</b>	Yes	Yes	No	Yes
<b>Documents to be maintained by businesses</b>	Accounting records	Accounting records	Patent and patent receipt	No requirement to keep tax accounting records for taxes pertaining to the tax contract (profit tax, VAT, and sales tax)
Personal income tax	Yes	Yes	Yes	Yes
Profit tax	10%	N/a	N/a	Included in the amount covered by the contract
Sales tax	Yes	N/a	N/a	Included in the amount covered by the contract
VAT	Yes	N/a	N/a	Included in the amount covered by the contract
Land taxes (on agricultural and non-agricultural land)	Yes	Yes	Yes	Yes
Excise tax	Yes	N/a	N/a	N/a
Property tax	Yes	Yes	Yes	Yes
Tax on the use of mineral resources	Yes	Yes	N/a	Yes
Single tax on turnover	N/a	Yes	N/a	N/a
Contributions to Social Fund	Yes	Yes	Yes	Yes

**Note:** Farmers are exempt from the profit tax, sales tax, and VAT. VAT registration is obligatory for companies and individual entrepreneurs with turnover in excess of KGS4 million.

<sup>103</sup> Government Resolution No. 733 "On Approving Amount of Voluntary Patent Tax by Type of Entrepreneurial Activity," adopted December 30, 2008. See Annex 8.1 for the list of activities.

### BOX 8.2: THE NEW “CONTRACT-BASED TAX PAYMENT” REGIME IS ASSOCIATED WITH HIGH TAX PAYMENTS

A new tax regime, the “contract-based tax payment” regime, was introduced under the new *Tax Code*.

#### Eligibility

All businesses operational for at least three years are eligible to be taxed under this regime, except for those that have a mandatory patent, that pay the excise tax, or that pay the tax on the use of mineral resources. In addition, taxpayers engaged in credit, financial, and insurance activities, or in activities linked to investment, pension funds, and securities, are also ineligible.

#### Guidelines

The tax contract replaces three taxes — the profit tax, VAT, and the sales tax. Taxpayers operating under the contract regime must pay all other taxes as defined in the *Tax Code*. The amount of tax due under the tax contract shall be at least 25 percent higher than the highest annual tax payment made by the business during the past three years. Businesses operating under this regime are exempt from business inspections, which is one of the main advantages of the regime. The main disadvantage of the regime is the sharp increase in tax payments, regardless of a business's results.

The tax contract regime had been introduced for a few months at the time the Survey was conducted.<sup>104</sup> On that basis, respondents were asked to identify what they perceived to be the main advantages and disadvantages of the contract-based tax payment regime. Survey results show that over 60 percent of small and medium companies and individual entrepreneurs were not aware of all aspects of this regime at the time of the Survey. As at the end of November 2009, 1,344 entrepreneurs had subscribed to the contract-based tax payment regime.

### The simplified tax regime is more advantageous under the new *Tax Code* than under the old *Tax Code*

Whether or not the general tax regime is more beneficial for businesses than the simplified tax regime depends on the profit margin of the business concerned: the lower the profit margin, the more financially advantageous the general tax regime; and, conversely, the higher the profit margin, the more financially advantageous the simplified tax regime. This is due to the fact that the single tax applicable under the simplified tax regime is based on turnover, whereas the profit tax applicable under the general tax regime is, as its name indicates, on profit. Box 3 indicates that, due to a decrease

in the rate of the single tax on turnover under the new *Tax Code*, and due to the introduction of the sales tax, to be paid only by businesses operating under the general tax regime, the simplified tax regime is now more advantageous for businesses than it was under the old *Tax Code*. Since the new *Tax Code* came into force, the profit margin thresholds above which the simplified tax regime is more profitable for businesses than the general tax regime have decreased.

### BOX 3: COMPARATIVE LIABILITIES DUE UNDER THE NEW AND UNDER THE OLD *TAX CODE*, FOR TWO HYPOTHETICAL COMPANIES

The case studies below, based on (i) a small and medium company in the retail trade located in Osh; and (ii) a small and medium company in the service sector based in Tokmok, the turnover, profit and number of employees of which are hypothetical in both cases (Table 8.4), compares how far the general tax regime was/is more financially advantageous than the simplified tax regime, under the old and the new *Tax Code*. These two case studies consider only those taxes applying differing amounts under the old and the new *Tax Code*. For example, the case studies do not consider the land tax, since the amounts due under this tax are the same under both regimes. In addition, the case studies do not take into account differences in tax administration (mostly the labor costs of complying with tax accounting requirements), although these do, of course, affect the overall compliance burden. The costs of complying with tax administration are higher for companies operating under the general tax regime than for companies operating under the simplified tax regime.

For the two hypothetical companies examined in these case studies, the general tax regime was considerably more advantageous than the simplified tax regime, in 2008. The hypothetical company in Case Study 1 would have had to pay KGS14,438 more in taxes under the simplified than under the general tax regime;<sup>105</sup> and the company in Case Study 2 would have had to pay KGS36,715 more in taxes under the simplified tax regime than under the general tax regime. In 2009, under the new *Tax Code*, the amount of taxes to be paid by the hypothetical companies chosen for the purpose of this study is the same under both regimes (Table 8.5). Tables 8.6 and 8.7 show the profit margin thresholds above which the simplified tax regime is more profitable for businesses than the general tax regime, under the new *Tax Code*.

This reflects the fact that the simplified tax regime is now more advantageous than it was under the old *Tax Code*, since the rate of the single tax on turnover was reduced under the new *Tax Code* from six to four percent for companies in the retail trade sector, and from 10 to six percent for companies in the service sector (other than public catering).

<sup>104</sup> The new *Tax Code* became effective from January 1, 2009. The Survey was conducted between May and August 2009.

<sup>105</sup> Only the profit tax, the personal income tax, the sales tax, and the simplified tax regime tax are considered here.

**Table 8.4: Main characteristics of the hypothetical small and medium company used in Case Study 1 and Case Study 2**

	CASE STUDY 1	CASE STUDY 2	SOURCE
Region	Osh	Tokmok	Hypothesis
Minimal income set by tax authorities	3,500	4,100	Tax authorities
Sector of activity	Retail trade	Services	Hypothesis
Annual turnover (KGS)	1,000,000	1,000,000	Hypothesis
Net profit (KGS)	33,343	141,595	Hypothesis
Profit margin	3.33%	14.16 %	Net profit/ annual turnover *100
Average number of employees	5	5	Hypothesis
Average salary (KGS/month)	5,378	5,378	State Statistics Committee

**Table 8.5: Comparative taxes paid under the general and simplified tax regimes, under the old and the new Tax Codes – Case Study 1 (a retail trade business in Osh)**

	2008 (OLD TAX CODE)			2009 (NEW TAX CODE)		
	RATE	GENERAL REGIME (KGS)	SIMPLIFIED REGIME (KGS)	RATE	GENERAL REGIME (KGS)	SIMPLIFIED REGIME (KGS)
Profit tax	10%	3,705	–	10%	3,705	–
Simplified regime tax rate	6%	N/a	56,604	4%	N/a	38,462
Personal income tax	10%	25,787	25,787	10%	25,787	15,420
Retail sales tax	4%	38,462	N/a	–	–	–
Sales tax	–	–	–	2.5%	24,390	N/a
<b>Total Amount of taxes paid (KGS)</b>		<b>67,952.83</b>	<b>82,390.33</b>		<b>53,881.54</b>	<b>53,881.54</b>
<b>Difference: general tax regime – simplified tax regime</b>			<b>–14,437.50</b>			<b>0</b>

**Table 8.6: Comparative amount of taxes paid by the hypothetical company under the general and simplified tax regimes, under the old and the new Tax Code – Case Study 2 (a service business in Tokmok)**

	2008 (OLD TAX CODE)			2009 (NEW TAX CODE)		
	RATE	GENERAL REGIME	SIMPLIFIED REGIME	RATE	GENERAL REGIME	SIMPLIFIED REGIME
Profit tax	10%	15,733	–	10%	15,733	–
Simplified regime tax rate	10%	N/a	90,909	6%	N/a	56,604
Personal income tax	10%	25,787	25,787	10%	25,787	18,732
VAT	20%	N/a	N/a	12%	N/a	N/a
Excise tax	N/a	N/a	N/a	N/a	N/a	N/a
Land tax						
Tax on the use of mineral resources	N/a	N/a	N/a	N/a	N/a	N/a
Property tax	N/a	N/a	N/a	N/a	N/a	N/a
Retail sales tax	4%	38,462	N/a	–	–	–
Sales tax		–	–	3.5%	33,816	N/a
<b>Total taxes paid (KGS)</b>		<b>79,980.88</b>	<b>116,695.65</b>		<b>75,335.76</b>	<b>75,335.77</b>
<b>Difference general regime – simplified tax regime</b>			<b>–36,715</b>			<b>0</b>

Tables 8.7 and 8.8 indicate the profit margin thresholds above which the simplified tax regime is more beneficial for businesses than the general tax regime, under the new *Tax Code*, insofar as this applies to the two hypothetical companies in the case studies – an Osh-based small and medium company active in the retail trade sector (Table 8.7) and a Tokmok-based small and medium company active in the service sector (Table 8.8).

Below these profit margin thresholds, the general tax regime is more profitable; above these thresholds, the simplified tax regime is more profitable.

**Table 8.7: Profit margin thresholds above which the simplified tax regime is more profitable than the general tax regime, for a (hypothetical) business active in the retail trade in Osh**

ANNUAL TURNOVER (KGS)	1,000,000	2,000,000	3,000,000	4,000,000
Profit margin	3.33%	8%	9.55%	10.33%

**Table 8.8: Profit margin thresholds above which the simplified tax regime is more profitable than under the general tax regime, for a (hypothetical) business active in the service sector in Tokmok**

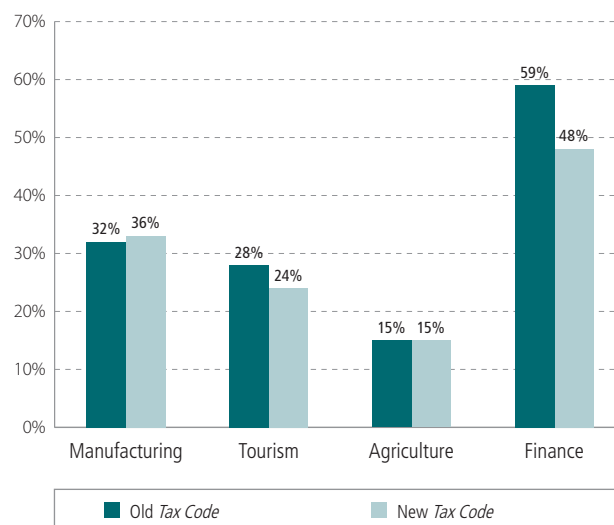
ANNUAL TURNOVER (KGS)	1,000,000	2,000,000	3,000,000	4,000,000
Profit margin	14.16%	17.33%	18.39%	18.92%

### Marginal Effective Tax Rate (METR) analysis confirms that the tax burden remains high under the new *Tax Code*

An IFC study undertaken in September 2008<sup>106</sup> considered the Marginal Effective Tax Rate (METR), which focuses on the impact of business taxes on marginal investment decisions, and thus provides a measure of how a business tax regime may affect investment trends in the country, its competitiveness vis-à-vis alternative investment locations, or the relative tax penalty (or subsidy) on different sectors of the economy and different types of assets.

**Chart 8.1: The tax burden on incremental investment is much higher than the 10 percent corporate tax**

Comparison of METRs under the old and the new *Tax Code*



Source: World Bank staff calculations, based on official data.

The METR analysis for the Kyrgyz Republic reveals that the overall burden of the tax system on investment is quite different from the statutory corporate rate of 10 percent, being higher for all sectors, including agriculture (which, overall, enjoys a lower rate than other sectors). The METRs for the agriculture, tourism, and finance sectors are the same or lower under the new *Tax Code*, whereas the METR for the manufacturing sector is higher under the new *Tax Code*, due to the cascading effect of the new sales tax. The METR analysis indicates that enterprises face a high burden on investment, and that this limits their growth.

### Treatment of leasing is unclear in the new *Tax Code*

The law on leasing was passed in the Kyrgyz Republic in 2002, creating a framework for the growth of the leasing industry, which, by some estimates<sup>107</sup>, has generated \$1.7 million in new leasing transactions in 2008 alone. However, with the introduction of sales tax in the new *Tax Code*, treatment of leasing is unclear. As a result, private lessors suspended almost all leasing transactions, effectively shutting down the private leasing market. Losing the option of leasing will increase operational costs for businesses that depend on leasing for financing their physical assets.

<sup>106</sup> Foreign Investment Advisory Service (FIAS) (2008) "The Tax System and the Business Enabling Environment in the Kyrgyz Republic: Preliminary Results from the Initial Mission," September.

<sup>107</sup> IFC Azerbaijan-Central Asia Leasing Facility advisory services project.

“Since the new tax code came into effect on January 1, 2009, I have suspended all leasing activity because we cannot be certain of how we will be taxed on these transactions. It is not very clear how these operations will be charged with various taxes. As a result, in 2008 we did 44 leasing transactions with a total value of 300000 USD while in 2009 we did zero.” Losing the option of leasing will increase operational costs for businesses that in depend on leasing for financing their physical assets.

*The general manager of a leading financial institution in the Kyrgyz Republic*

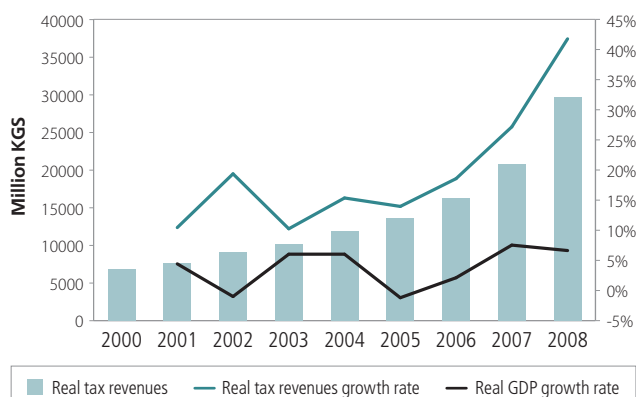
To address this issue, the World Bank and IFC work jointly on recommendation of comments and introduction of changes to the tax code that will bring leasing operations back to life, and back to benefiting Kyrgyz businesses.

### 8.3. CONTEXT: TAX REVENUES IN THE KYRGYZ REPUBLIC ARE GROWING

Tax revenues in the Kyrgyz Republic have grown strongly since 2001. Growth was especially strong in 2007 and 2008, at 28.1 percent and 42.7 percent, respectively, in real terms (Chart 8.2). Growth in tax revenues has largely outpaced GDP growth over the 2000–2008 period: GDP has increased by 37.8 percent (in real terms), while tax revenues have increased by 164.5 percent. Although GDP declined in 2005, tax revenues increased even during that year. Tax collection has improved in recent years as the result of “improved customs administration and streamlined tax procedures, including better arrears management.”<sup>108</sup>

**Chart 8.2: Tax revenues have increased by far more than GDP over the 2000–2008 period**

#### Evolution of tax revenues and GDP (2000–2008)

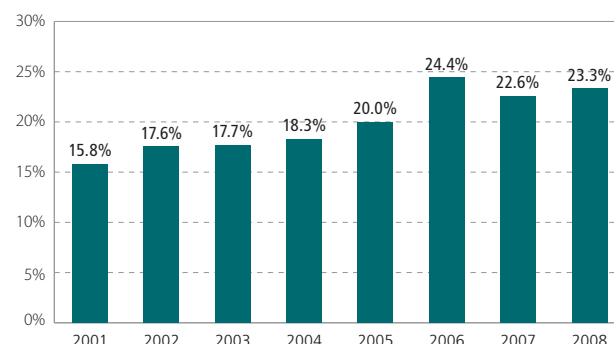


Source: Real GDP sourced from IMF country reports; information on tax revenues sourced from the State Statistics Committee and calculated in real terms on the basis of World Bank World Development Indicators data.

The ratio of tax revenue to GDP in the Kyrgyz Republic has increased from 15.8 percent in 2001 to 23.3 percent in 2008 (Chart 8.3). This ratio is average in comparison with other post-Soviet countries (Chart 8.4).

**Chart 8.3: The ratio of tax revenue to GDP has grown continuously since 2000**

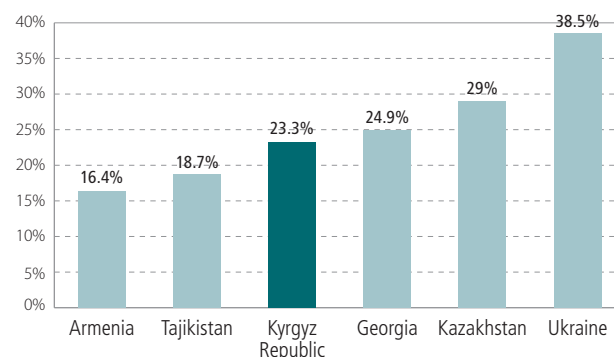
#### Ratio of tax revenue to GDP



Source: IMF reports.

**Chart 8.4: The ratio of tax revenue to GDP is average in comparison with other post-Soviet countries**

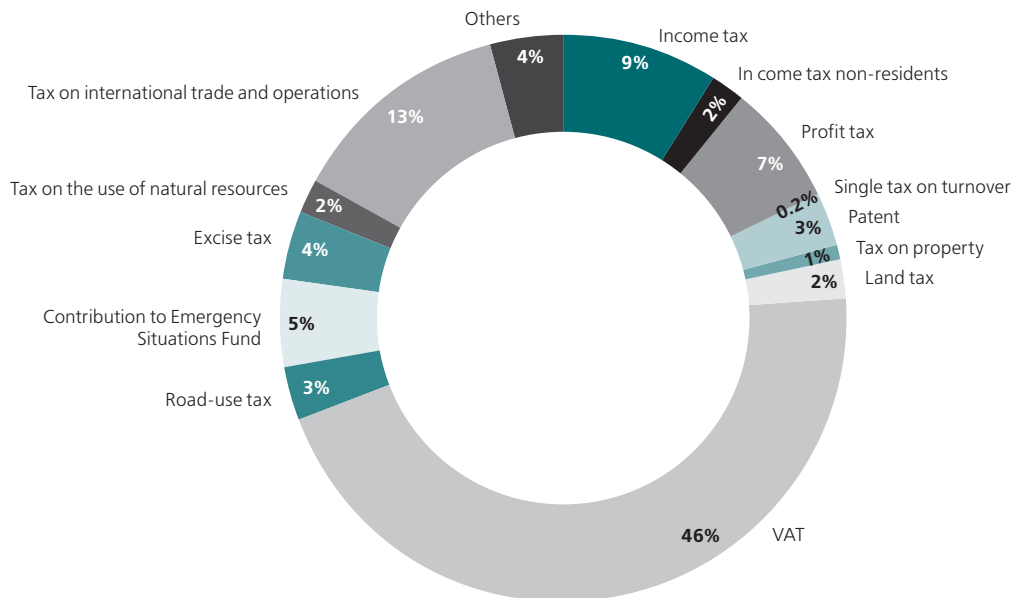
#### Ratio of tax revenues to GDP in post-Soviet countries



Source: IMF (2009) “Country Reports”.

Taxes on consumption, as well as income tax, are the main sources of revenue. VAT collection accounted for 46 percent of total taxes in 2008, while income tax and profit tax accounted for 17 percent of total taxes in 2008. The single tax on turnover accounted for only 0.2 percent of total tax revenues in 2008.

<sup>108</sup> IMF (2009) “Kyrgyz Republic Country Report,” 09/209.

**Chart 8.5: VAT contributed nearly 46 percent of total tax revenues in 2008 (under the old Tax Code)****Contribution of each tax to overall tax revenue, 2008 (%)**

Source: State Statistics Committee (2008). Available at <http://www.stat.kg/rus/part/fin.htm>

#### 8.4. SURVEY RESULTS: TAX ACCOUNTING AND COMPLIANCE COST BUSINESSES AN ESTIMATED KGS3.3 BILLION (\$88 MILLION) IN 2008

The labor cost born by SMEs in maintaining the accounting procedures necessary for tax compliance is high, amounting to KGS3.3 billion (\$88 million) in 2008 – approximately two percent of the country's GDP. Such significant costs call for a simplification of the tax accounting obligations on businesses, under both the general and the simplified tax regimes.

The majority of small and medium companies (75 percent) hire part- or full-time accountants for this purpose, while 11 percent of the owners or managers of such small and medium companies fulfill these requirements themselves. Small and medium companies are more likely than individual entrepreneurs to hire part-time or full-time accountants for the purposes of tax accounting because (i) turnover in these businesses tends to be higher than for individual entrepreneurs, necessitating the maintenance of more extensive records; and (ii) such small and medium companies operate under both the general and the simplified tax regimes, both of which are associated with high compliance requirements. The turnover-based simplified tax regime reduces compliance costs by lowering the complexity and frequency of accounting and reporting requirements. However, the single

tax under this regime replaces corporate income tax and the sales tax only, with the result that enterprises operating under the simplified tax regime are, nonetheless, required to maintain full bookkeeping and reporting for all other taxes for which they are liable.<sup>109</sup> As a result, tax accounting and compliance remains complex, and small and medium companies operating under the simplified tax regime are often obliged to rely on the assistance of accountants.

The vast majority of individual entrepreneurs (83 percent) fulfill all tax accounting requirements themselves (Chart 8.6). This is due to the fact that the majority of individual entrepreneurs operate under the patent regime, which does not require any bookkeeping. Ten percent of individual entrepreneurs engage either a full-time or a part-time accountant to meet their tax accounting and compliance obligations. These individual entrepreneurs, for the most part, operate under the general or simplified tax regimes: 81 percent of those individual entrepreneurs that engage accountants full-time

<sup>109</sup> In 2008 such other taxes included: personal income tax; land tax; contributions to the Social Fund; and, where applicable: the tax on the use of mineral resources; hotel tax; resort tax; advertisement tax; and vehicle taxation. In 2009 such other taxes included: personal income tax; land tax; property tax; contributions to the Social Fund; and, where applicable, the tax on the use of mineral resources.



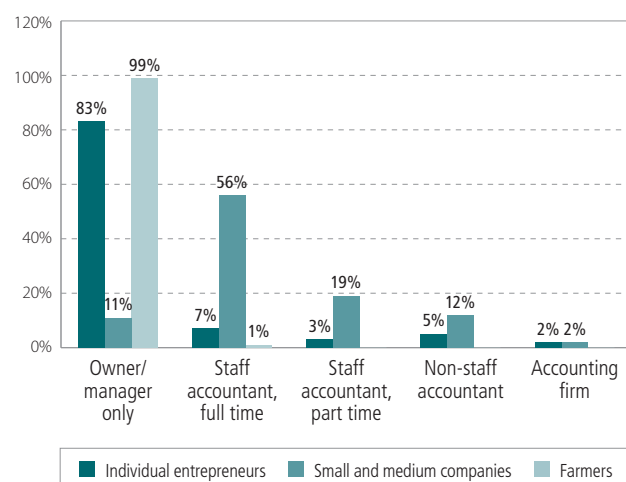
are working under the general tax regime, while 53 percent of those individual entrepreneurs that engage part-time accountants operate under the simplified tax regime.

The vast majority of farmers (99 percent) fulfill all tax accounting requirements themselves, while one percent engage a full-time accountant for this purpose. This low percentage is due to the fact that farmers are exempt from most taxes and thus have limited compliance obligations.

In general, it is rare for tax accounting and reporting to be sub-contracted to a firm of accountants; only two percent of small and medium companies and individual entrepreneurs do so. This may be the result of under-developed business and consulting services in the Kyrgyz Republic, or due to the complexity of current tax accounting and compliance requirements.

**Chart 8.6: Most small and medium companies engage accountants for bookkeeping, while individual entrepreneurs and farmers generally do this themselves**

#### Persons responsible for tax compliance within SMEs



The average labor costs involved in meeting tax accounting and compliance obligations in 2008 were KGS8,500 (\$232), KGS48,300 (\$1,321), and KGS5,300 (\$145), respectively, for individual entrepreneurs, small and medium companies and farmers.

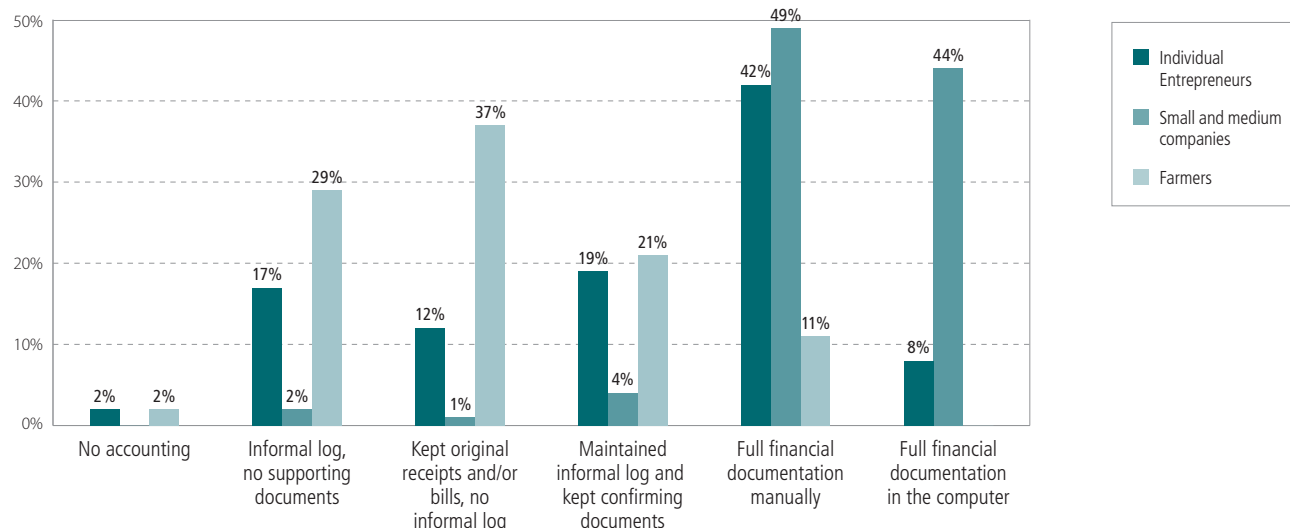
### Bookkeeping skills do not constrain “graduation” to the simplified tax regime

Respondents indicated that the bookkeeping systems they maintained were more sophisticated than necessary to meet the reporting requirements of the *Tax Code*, particularly for those businesses operating under the patent regime: this would suggest that bookkeeping skills are not, necessarily, a deterrent in “graduating” to the simplified tax regime.

Legislation under both the old and the new *Tax Code* requires patent holders to maintain minimal financial documentation (in those cases where businesses do not maintain a cash registers, they are required to maintain ledgers recording all cash receipts), while individual entrepreneurs and small and medium companies operating under the simplified and general tax regimes are required to maintain full financial documentation in respect of all taxes for which they are liable. Bookkeeping requirements are greatest for small and medium companies operating under the general tax regime.

Half of all individual entrepreneurs (50 percent) maintain full financial documentation, either through a computer system, or manually (Chart 8.7). Over 57 percent of those individual entrepreneurs operating under the patent regime maintain either full or partial financial documentation. These data may indicate that larger and/or more complex entities arrange their corporate structure in such a way as to be eligible to operate under the patent system. The lack of a suitable intermediate regime between the patent and general tax regime incentivizes entrepreneurs to over-utilize the patent system, compromising business growth and revenue collection.

A clear majority of small and medium companies (93 percent) maintained full financial documentation, which is a requirement for companies working under the simplified and the general tax regimes. Farmers have the lowest bookkeeping standards of the three categories of respondents: 37 percent maintained original receipts and/or bills but did not maintain logs to record these; 29 percent maintained informal records or logs without retaining any confirmatory documents (such as payment receipts or bills); and 21 percent of farmers maintained informal records or logs and also retained confirmatory documents. Farmers were, in 2008, exempt from both profit tax and VAT, and were thus not subject to any mandatory obligation to maintain full financial documentation. Lower levels of accounting skills in rural areas may also account for farmers’ lower standards in bookkeeping.

**Chart 8.7: The bookkeeping standards of individual entrepreneurs exceed those required by law****Bookkeeping standards by category of respondent**

### 8.5. SMALL AND MEDIUM COMPANIES BEAR THE GREATEST BURDEN IN FULFILLING MANDATORY REPORTING REQUIREMENTS

In addition to tax accounting, businesses are required to submit mandatory reports to (i) the State Tax Service; (ii) the Social Fund; and (iii) the State Statistics Committee. The production of these reports is time-consuming and represents an additional burden on small and medium companies, to the point that they are sometimes referred to as an “information tax” with which businesses must comply. Total labor costs associated with mandatory reporting amounted to KGS 1 billion (\$28 million) across the SME sector in 2008, close to 0.7 percent of national GDP. The average labor cost of fulfilling mandatory reporting requirements in 2008 was KGS3,240 (\$89), KGS30,754 (\$841), and KGS710 (\$19), respectively, for those individual entrepreneurs, small and medium companies and farmers responding to the Survey.

Mandatory reports for submission to the State Tax Service consist mostly of tax returns; reports to the Social Fund consist mostly of information on a business’s number of employees, and payments to the Social Fund, etc.; and reports to the State Statistics Committee consist mostly of information about the specific activities in which that SME is engaged.

The number of mandatory reports that SMEs are required to submit to the State Tax Service, the Social Fund, and the Statistics Committee, as well as the frequency on which they must be returned, depend on several factors including:

- (i) the tax regime under which the business operates. Small and medium enterprises operating under the patent regime have the lowest burden in terms of the number of reports to be submitted, and SMEs operating under the general tax regime the highest;
- (ii) the taxes for which a business is liable (Table 8.1). The more taxes an SME is obliged to pay, the more reports it must submit to the State Tax Service; and
- (iii) the type of activity in which a business is engaged. Small and medium enterprises are required to submit reports to the State Statistics Committee depending on the activities in which they are engaged, while individual entrepreneurs engaged in certain activities are exempt from submitting reports.

The number of reports that a SMEs is, under the new *Tax Code*, required to submit each year varies from one (for individual entrepreneurs employing fewer than two employees and operating under the patent regime in a sector for which statistical reporting is not required) to 139 (for an SME operating under the general tax regime and engaged in the production of beer).<sup>110</sup> The reporting burden for SMEs under the simplified tax regime is lower than under the general tax regime, under both the old and the new *Tax Code*. In addition, the frequency of reports to be submitted by businesses

<sup>110</sup> This comprises: 12 income tax returns; one corporate income tax return; 12 VAT returns; 12 sales tax returns; 12 excise tax returns; one property tax return; one land tax return; 12 Social Fund contribution returns; and 76 statistical reports.

working under the simplified tax regime has decreased since the new *Tax Code* came into force: the number of reports to be submitted in respect of the single tax on turnover was reduced from 12 (monthly filings) to four (quarterly filings), resulting in a significant contribution to the alleviation of the reporting burden for businesses operating under the simplified tax regime (Annex 8.3).

Survey results indicate that the degree of compliance with reporting requirements varies significantly across the three categories of respondents.

- Small and medium companies are subject to the greatest burden in terms of reporting compliance. Close to 100 percent of small and medium companies have submitted mandatory reports to the State Tax Service and the Social Fund, and close to 97 percent have submitted reports to the State Statistics Committee (Chart 8.8). On average, those small and medium companies that had submitted mandatory reports in 2008 had submitted 17 reports to the State Tax Service, 16 reports to the Social Fund, and 10 reports to the State Statistics Committee (Chart 8.9). That is, a total of over 43 reports, on average, for those businesses that had submitted reports to these three agencies in 2008. The majority of these reports consisted of tax returns. Some of the reports that businesses are obliged to file are somewhat complicated and lengthy. For example, the VAT return consists of a one-page form that also includes five attachments comprising 11 pages in total (Box 8.4); the property tax return consists of five forms comprising 14 pages in total; and the return for the single tax on turnover is unclear and too detailed for the purpose it serves.
- Compliance among individual entrepreneurs is lower. Although all individual entrepreneurs are required to submit reports to the State Tax Service and to the Social Fund, in practice only 65 percent of individual entrepreneurs responding to the Survey indicated that they had submitted reports to the State Tax Service; 45 percent had submitted reports to the Social Fund; and 28 percent had submitted reports to the State Statistics Committee (Chart 8.8). The average number of reports submitted by individual entrepreneurs was also lower than the number returned by small and medium companies, with respondents returning an average of 10 reports to the State Tax Service, 11 reports to the Social Fund, and seven reports to the State Statistics Committee (Chart 8.9).

Compliance among farmers is the lowest of all three categories of respondents. Although all farmers are required to submit reports to the State Tax Service and to the Social Fund, only 26 percent of farmers indicated that they had submitted mandatory reports to the State Tax Service, 21 percent had submitted reports to the Social Fund, and 15 percent had submitted reports to the State Statistics Committee (Chart 8.8).

#### BOX 8.4. THE SUBMISSION OF VAT RETURNS IS TIME CONSUMING

Since January 1, 2009, businesses in the Kyrgyz Republic have been required to submit a VAT return consisting of one form and five attachments amounting to 12 pages in total. The VAT return must be submitted in three copies. The form contains the information necessary to calculate the amount of VAT due (i.e., volume of sales, volume of sales exempted from VAT, amount of VAT to be reimbursed, etc.) and taxpayers are required to provide more detailed information in the attachments.

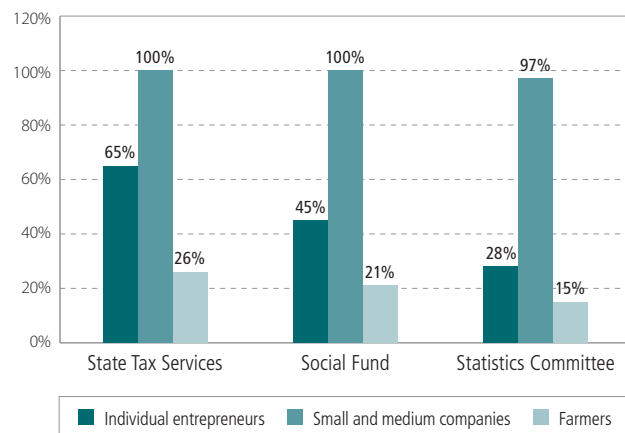
Although these attachments may help taxpayers calculate the VAT due by providing a framework for the calculation of their liabilities, and although a 17-page instruction booklet is available giving advice on the completion of the VAT return, completing these attachments is a time-consuming process and the volume of information required can lead to mistakes and, subsequently, sanctions or penalties. In addition, taxpayers are requested to submit a monthly report listing all VAT invoices received and issued. Both the VAT return and the monthly invoice report place a heavy VAT compliance burden on businesses, quite apart from the burden of the 12 percent VAT rate.

It is therefore recommended that the filing of attachments to the VAT return be made voluntary, and that VAT submissions be made in one copy instead of three, as is the case currently. It is further recommended that, in the short term, the returns for the sales tax and VAT be merged, since the tax base is the same in both cases and that, thereafter, the sales tax be abolished in favor of a higher rate of VAT — an initiative which would result in a reduction of taxpayers' compliance costs.

These recommendations are based on international best practice: in European Union countries, for example, VAT returns are quite simple. In the Netherlands, the VAT return consists of a two-page form, and only one copy of the VAT return is required by the tax authorities. In addition, VAT is the only tax levied on the supply of goods and services, and no additional sales tax is levied.

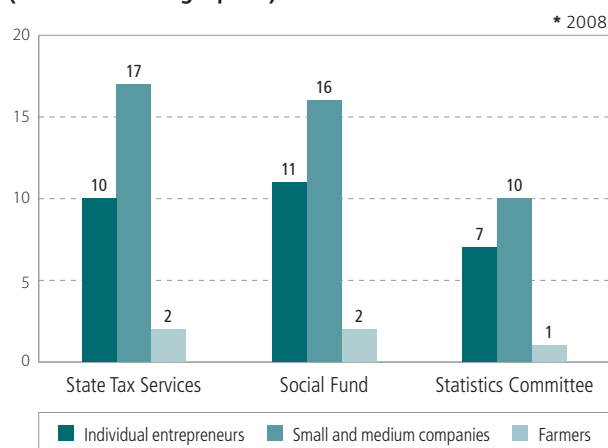
**Chart 8.8: The reporting burden is greatest for small and medium companies**

**Proportion of businesses having submitted reports to the three main agencies**



**Chart 8.9: A clear majority of small and medium companies submitted an average of 43 reports in 2008**

**Average number of reports submitted by SMEs (of those returning reports)\***



The low level of compliance by individual entrepreneurs and farmers in the submission of reports is not correlated to low tax compliance: indeed, 99 percent of farmers stated that they had paid land tax liabilities in 2008, and 94 percent had paid due contributions to the Social Fund. Rather, it is due to (i) an ignorance of reporting requirements on the part of farmers and individual entrepreneurs; and (ii) the fact that these two sectors are not treated as priority groups by the authorities to whom reports are due. The relevant authorities appear, rather, to prioritize the submission of reports by small and medium companies, possibly because these businesses tend to (i)

have greater tax liabilities; (ii) employ more personnel; and (iii) tend to be bigger producers and have thus more information to report to various agencies. Small and medium companies also have greater capacity than individual entrepreneurs and farmers (at least in terms of human resources) to prepare and submit mandatory reports, which may also account for their better compliance.

The high costs incurred by small and medium companies in meeting their reporting obligations, and the low level of compliance by individual entrepreneurs and farmers, suggests that current mandatory reports represent both a significant burden (at least on small and medium companies) while failing to be properly effective – as witnessed by the low level of compliance by independent entrepreneurs and farmers. On that basis, reform of the system is clearly necessary.

## 8.6. BUSINESSES WITH A SMALL TURNOVER BEAR A COMPARATIVELY HEAVIER BURDEN IN TERMS OF TAX ACCOUNTING AND MANDATORY REPORTING

In general, the greater the turnover of a business, the greater its tax accounting and reporting costs. However, tax accounting and reporting costs are strongly regressive, with the result that these do not increase in proportion to company turnover (Charts 8.10 and 8.11).

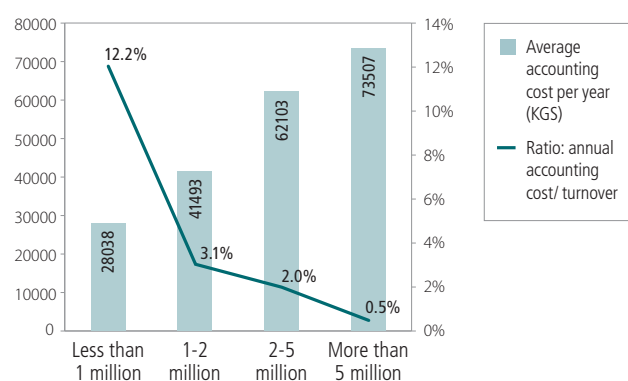
The labor cost of tax accounting for small and medium companies with turnover below KGS1 million (\$27,344) per year equates to an additional tax burden of 12 percent on turnover, whereas the equivalent cost for companies with annual turnover in excess of KGS5 million (\$136,724) amounts to an additional tax of only 0.5 percent on turnover. This may be due to the fact that companies with higher turnover realize some economies of scale in their tax accounting and book-keeping – a company with a higher turnover is more likely to be able to maintain computerized accounting systems, for example. The mandatory reporting burden is also proportionately higher for smaller companies: small and medium companies with turnover below KGS1 million incur costs in the order of 10 percent of annual turnover, while for those small and medium companies with turnover in excess of KGS5 million the proportional cost is only 0.3 percent.

The high relative cost of tax accounting and mandatory reporting for small and medium companies with turnover below KGS1 million per year suggests that, after deduction of tax liabilities and associated administration costs, only those companies that generate a very high return on investment

can survive. Those businesses that do not generate such high rates of return either do not survive or else operate on an informal basis. Even those businesses that are able to generate a sufficiently high rate of return to be viable face strong competition from imports and the products and services of larger businesses for which the cost of tax accounting and compliance is proportionately lower.

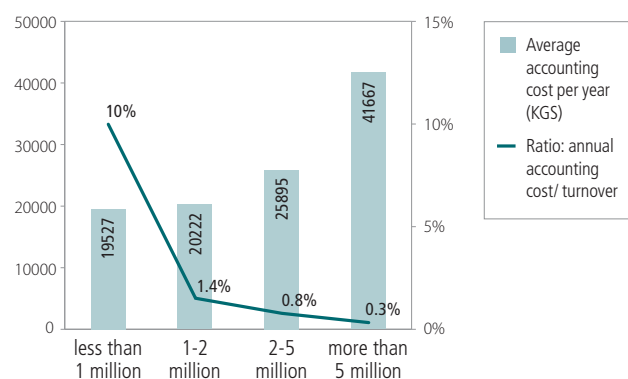
**Chart 8.10: The labor costs of tax accounting are strongly regressive**

Relative labor costs of tax accounting (in proportion to turnover) for small and medium companies



**Chart 8.11: The labor costs of tax reporting are also strongly regressive**

Relative labor costs of mandatory reporting (in proportion to turnover) for small and medium companies

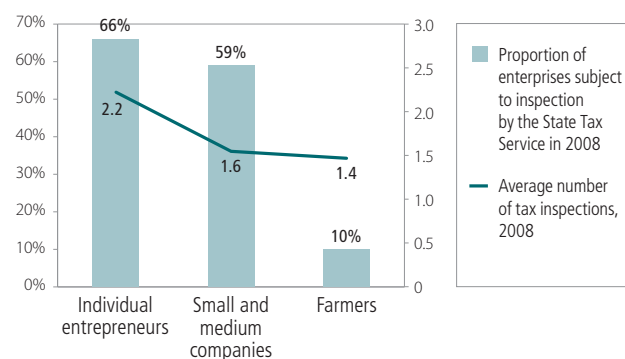


## 8.7. INSPECTIONS ARE A HEAVY BURDEN AND ARE NOT SUFFICIENTLY RISK-FOCUSED

The proportion of SMEs subject to various types of tax inspections in 2008 is very high: 66 percent of all individual entrepreneurs, 59 percent of all small and medium companies, and 10 percent of all farmers completing the Survey were subject to inspections during that year (Chart 8.12). Tax inspections include not only full tax audits, but also the verification of patents, cash registers, and permits.

**Chart 8.12: Tax inspections are a heavy burden on individual entrepreneurs and small and medium companies**

Proportion of enterprises subject to tax inspections in 2008, and average number of inspections per business



This percentage is even higher if the proportion of businesses inspected by the Social Fund (which checks similar information) is also taken into consideration: 72 percent of individual entrepreneurs, 70 percent of small and medium companies and 12 percent of farmers were inspected by either the State Tax Service or the Social Fund in 2008, whereas 37 percent of individual entrepreneurs, 41 percent of small and medium companies and four percent of farmers were inspected by both organizations. Inspections of the same businesses by both the State Tax Service and the Social Fund would appear to suggest a waste of resources on the part of both inspecting agencies and enterprises, since the same documents are checked in each case.

The high incidence of tax inspections, and the fact that individual entrepreneurs are subject to more inspections than small and medium companies, would suggest that risk-management principles are not, in general, used in the selection of businesses for inspection. Survey results indicate, rather, an excessive number of inspections regardless of the anticipated benefit in terms of additional tax revenues. In France, by comparison, less than two percent of all businesses are inspected

by the tax authorities every year.<sup>111</sup> In Germany, medium-sized businesses are inspected, on average, once every 11.1 years (Table 8.9). In South Africa, less than five percent of SMEs are subject to any kind of tax inspection or audit in any given year.<sup>112</sup>

**Table 8.9: Tax audits in Germany (2000)**

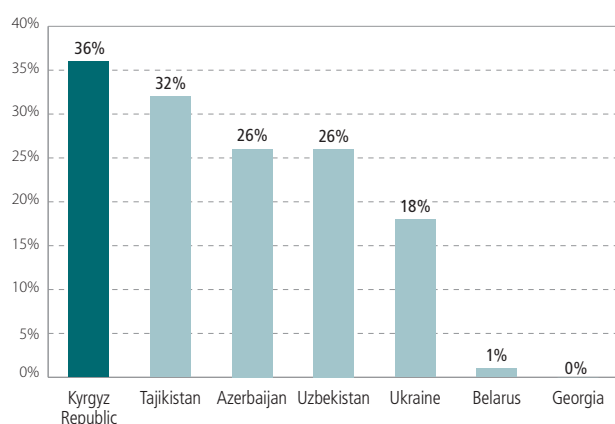
SIZE OF BUSINESS	NUMBER OF REGISTERED BUSINESSES	NUMBER OF TAX AUDITS CONDUCTED	AVERAGE FREQUENCY OF AUDITS
Large	167,164	38,115	Every 4.3 years
Medium	755,061	67,457	Every 11.1 years
Small	1,169,364	119,111	Risk-based selection of a small number of small and micro businesses for audits
Micro	4,394,539		

Source: World Bank Group (2007) "Designing a Tax System for Micro and Small Businesses: Guide for Practitioners."

In addition, the high number of inspections in the Kyrgyz Republic increases contacts between taxpayers and tax officials and results in the soliciting and payment of unofficial fees and gifts. This, in turn, may have a negative impact on the volume of tax revenue collected. World Bank Business Environment and Enterprise Performance Survey (BEEPS) data indicate the soliciting and payment of gifts and unofficial fees during tax inspections to be among the highest of all post-Soviet countries (Chart 8.13).

**Chart 8.13: BEEPS data indicate the practice of informal payments during tax inspections in the Kyrgyz Republic to be among the highest of all post-Soviet countries**

**Percentage of firms indicating gifts/informal payments had been requested during a tax inspection**



Source: EBRD-World Bank Business Environment and Enterprise Performance Survey data.

The new *Tax Code* foresees the implementation of a risk-based approach to the planning and conduct of tax inspections. The focus of such risk-based audits should be on those taxpayers that are most likely to be non-compliant, and those most likely to generate the highest tax revenue in terms of each audit conducted.

Risk-based audits both improve the efficiency of tax administration and decrease the burden on businesses. In particular, risk-based audits increase the tax yield per audit and decrease the compliance burden borne by honest tax payers, since these are audited less frequently.

In addition, pursuant to *Presidential Decree No. 425 "On Measures to Ensure the Implementation of the Law of the Kyrgyz Republic on the Structure of the Government,"*<sup>113</sup> and pursuant to *Government Resolution No. 735 "On the State Tax Service under the Government of the Kyrgyz Republic,"*<sup>114</sup> the State Tax Service is now responsible for the administration and collection of contributions to the Social Fund. Once this measure becomes effective it is expected to have a positive impact on the incidence of inspections to which businesses are subject, since de facto inspections by the State Tax Service and the Social Fund will be merged. It will also result in the more efficient use of the resources of these two organizations.

<sup>111</sup> General Directorate for Taxes, France (2007) "Rapport Annuel de Performance". Available at [http://www2.impots.gouv.fr/documentation/rapports/activites/dgi/2007/dgi\\_rapport\\_performance\\_2007.pdf](http://www2.impots.gouv.fr/documentation/rapports/activites/dgi/2007/dgi_rapport_performance_2007.pdf) and [http://www.insee.fr/fr/themes/tableau.asp?reg\\_id=0&id=219](http://www.insee.fr/fr/themes/tableau.asp?reg_id=0&id=219).

<sup>112</sup> World Bank Group (2009) "Tax Compliance Cost Survey".

<sup>113</sup> *Presidential Decree No. 425 "On Measures to Ensure the Implementation of the Law of the Kyrgyz Republic on the Structure of the Government,"* adopted October 26, 2009.

<sup>114</sup> *Government Resolution No. 735 "On State Tax Service under the Government of the Kyrgyz Republic,"* adopted December 4, 2009.



The official number of tax audits performed by the State Tax Service in 2008 differs from the total number of tax inspections indicated in Survey results. Survey results indicate that around 260,000 tax inspections were performed in 2008,<sup>115</sup> whereas the State Tax Service reports that 10,157 audits were conducted in that year.<sup>116</sup> This discrepancy is due to the fact that (i) Survey results include all tax inspections, not tax audits alone – i.e., Survey results also include verification of patents, cash registers, etc.; and (ii) some audits may have been conducted “unofficially” and are thus not registered by the State Tax Service.

The number of audits (as well as subsequent tax yields) recorded between 2005 and 2008 suggests that in 2008 the State Tax Service began to use risk-based criteria for the planning of audits and the selection of businesses for investigation (Table 8.10). The number of audits conducted decreased

by 40 percent between 2007 and 2008, while total tax yields increased by 14 percent. The criteria used by the State Tax Service for the selection of businesses to be audited include (i) discrepancies in the information submitted to various government agencies; (ii) failure to justify inconsistencies in tax returns; (iii) the regular declaration of losses by a business; and (iv) tax liabilities lower than other businesses engaged in similar activities. However, risk-related data on taxpayers are not available electronically, and data collected are currently held by various agencies, with the result that the efficiency of the risk-based selection of taxpayers to be audited remains limited.

As this report went to press (spring 2010), the IFC was engaged in assisting the State Tax Service in evaluating the challenges associated with the implementation of the risk-based audit system in the Kyrgyz Republic consistent with international best practice (Box 8.5).

**Table 8.10: Number of tax audits conducted in the Kyrgyz Republic 2005–2008 and subsequent tax yields**

YEAR	2005	2006	2007	2008
Number of audits	15,598	15,898	16,791	10,157
Tax yields (KGS)	863,318,600	524,232,800	921,823,200	1,053,170,100
Tax yield/audit (KGS)	53,964	32,975	54,900	103,689

**Note:** Includes planned, unplanned, control and re-audits. Source: State Tax Service.

#### **BOX 8.5: INTERNATIONAL BEST PRACTICE – LATVIA HAS SUCCESSFULLY ADOPTED A RISK-BASED APPROACH TO TAX CONTROLS**

The modernization of Latvia’s State Revenue Service tax control system was supported by international organizations such as the World Bank and the European Union.

Prior to the introduction of risk criteria for the selection of taxpayers to be audited, regional offices of the State Revenue Service would select taxpayers to be audited autonomously, on the basis of subjective criteria. The number of tax audits was high, and the average tax yield of a single audit relatively low. A system for the risk-based selection of taxpayers to be audited was gradually established between 2001 and 2004.

Prior to the “Eskort” system being put in place in 2004 (i.e., between 2001 and 2003), local offices of the State Revenue Service would conduct credibility checks of VAT returns manually, on the basis of defined risk criteria. For this purpose taxpayers were divided into various risk categories. The VAT returns of high-risk taxpayers were analyzed individually using certain risk criteria contained in a specific checklist, and “points” awarded. The total sum of points calculated after completion of the checklist allowed inspectors to define further actions to be taken against the taxpayer (e.g., a systematic check, VAT audit, deregistration of company from the VAT register, etc.). The manual credibility check of VAT returns was then replaced by a fully computerized system.

During 2002 and 2003 the central administration of the State Revenue Service also helped regional offices to select high-risk taxpayers through a simple semi-computerized risk filtering approach. Tax inspectors were to divide all taxpayers into risk categories and focus on those taxpayers whose fiscal risk (compliance level) and fiscal importance (measured, for example, in terms of turnover) was the highest.

<sup>115</sup> Estimate based on Survey results.

<sup>116</sup> Including planned, unplanned, control and re-audits.



Fiscal risk was measured using simple filtering techniques such as (i) the selection of those taxpayers submitting information that appeared to differ on customs and VAT returns; and (ii) the selection of those taxpayers recording a high VAT turnover but a small number of employees (indicating a potential risk that the company was using illegal labour), and so on.

Since 2004 the State Revenue Service has used the “Eskort” risk analysis system in the planning of various tax control initiatives. “Eskort” is a fully computerized system that evaluates a taxpayer’s risk and helps identify those deemed to present the greatest potential risk. Three types of risk factors are used in identifying higher-risk tax payers.

- (i) “Common risks” include information such as a taxpayer’s sector of activity, compliance and business history, number of employees, level of salaries paid, etc.
- (ii) “Comparative risks” compare taxpayers’ data from various sources in order to identify discrepancies (for example, if an export volume or amount in a customs declaration does not tally with an export amount declared in a VAT return).
- (iii) “Analytical risks” compare a taxpayers’ data with that of other taxpayers engaged in similar activities.

Each risk factor is allocated a risk score on the basis of the probability that such risk factor may involve non-compliance. Based on this, the “Eskort” system is able to identify those taxpayers that represent the greatest risk, and which should, therefore, be subject to investigation or control. Those taxpayers representing the greatest risk are those that demonstrate several risk factors. For example, a taxpayer that has declared losses for several years, and that has tax liabilities lower than those of similar taxpayers, or that demonstrates discrepancies between, for example, VAT and customs returns, clearly demonstrates a number of risk factors and is likely to appear at the top of any list of taxpayers to be investigated.

As a result of the risk-based approach to tax controls implemented in Latvia since 2001, the number of tax audits undertaken has decreased rapidly, while the average tax yield of a single audit has increased significantly, from LVL 15,903 in 2000 to LVL 77,164 in 2005 (Table 8.11).

**Table 8.11. Number of audits and average tax yields prior to and after reform**

YEAR	NUMBER OF AUDITS	TAX YIELD (LVL MILLION)	AVERAGE TAX YIELD PER SINGLE AUDIT (LVL)
2000	4,144	65.9	15,903
2003	2,768	133.1	48,085
2004	1,887	98.3	52,093
2005	1,918	148	77,164

Source: IFC (2009) “Case Study on Tax Control Reform and Implementation of a Risk Analysis System in the State Revenue Service of Latvia”.

## 8.8. THE TAX SYSTEM DISCOURAGES “GRADUATION”<sup>117</sup> FROM THE PATENT REGIME TO THE SIMPLIFIED TAX REGIME

The Survey was conducted between April and August 2009, with the reference period for tax-related questions being January–December 2008. It does not, therefore, reflect the impact of the new *Tax Code*, which came into effect on January 1, 2009. However, the Survey does highlight the key challenges and problems experienced under the tax administration system, which can, accordingly, be examined in light of the changes introduced under the new *Tax Code*.

Survey results indicate that the majority of small and medium companies chose to operate under the general tax regime, despite its generally complex and labor-intensive demands in terms of compliance. There appear to be four main reasons for this: (i) the simplified tax regime was unattractive financially for most small and medium companies, (ii) over 40 percent of those small and medium companies that were eligible to operate under the simplified tax regime were unaware of that regime; (iii) the general tax regime provides for the refund of VAT; and (iv) operating under the general tax regime may boost sales by enlarging a company’s customer base.

<sup>117</sup> Graduation is understood here to refer to a business switching from one tax regime to another, more complex one – for example, from the patent regime to the simplified tax regime, or from the simplified tax regime to the general tax regime.

The majority of individual entrepreneurs (51 percent) operate under the patent regime. Apart from the fact that a great number of activities (124) can be conducted under the patent regime, the turnover ceiling under the patent regime is quite high (at KGS4 million). Compliance with the regime and with tax audits conducted in accordance with it are simple, and tax liabilities are known in advance – and, in most cases, are lower than they would be under other regimes, particularly for individual entrepreneurs at the upper end of the patent ceiling.

Individual entrepreneurs are discouraged from joining the simplified tax regime by high tax payments, by the fact that the turnover ceiling is the same as under the patent regime, and by the complexity of compliance. As a result, entrepreneurs at the upper end of the patent regime have a strong disincentive to graduate from this and thus keep their operations artificially small in order to continue to benefit from it. The patent regime therefore encourages evasion and creates unfair competition.

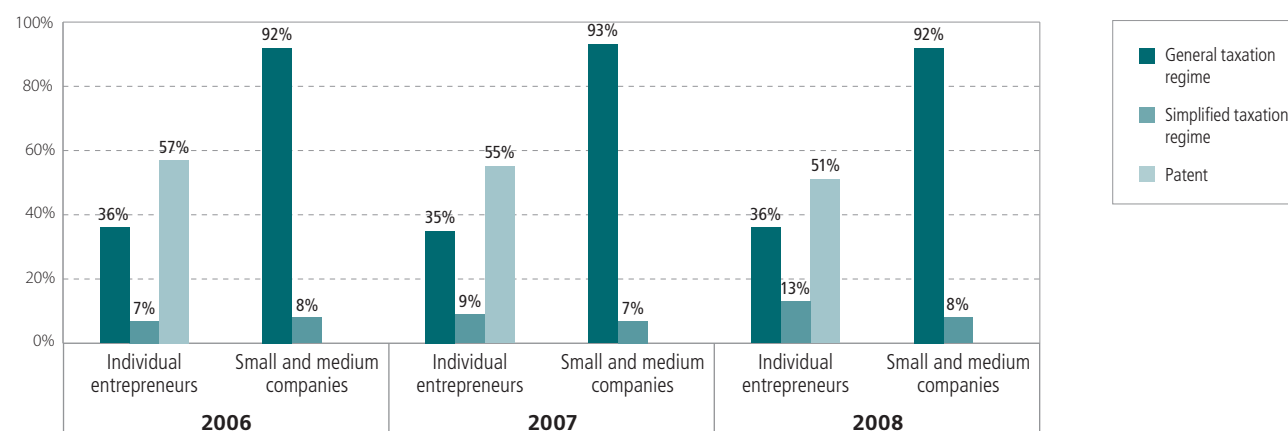
#### BOX 8.6: WHY WOULD TAX REGIME GRADUATION APPEAL TO A BUSINESS?

Business graduation – from the patent regime to the simplified tax regime, and ultimately to the general tax regime – may support business growth for the following reasons.

- (i) Businesses operating under the simplified and the general tax regime have easier access to credit since they are viewed as more sustainable businesses. In contrast to those businesses operating under the patent regime, businesses under the simplified and the general tax regime are required to maintain accounting records for tax purposes. These tax accounting reports, stamped by the State Tax Service, may be used to support credit applications in demonstrating a business's ability to repay a loan or other credit facility.
- (ii) Taxation regime graduation helps businesses gradually improve their accounting capacities and skills, which in turn supports their growth.
- (iii) Businesses operating under the general tax regime have the opportunity to register for VAT. VAT registration allows businesses to (i) obtain appropriate VAT refunds; and (ii) to issue VAT invoices, allowing their customers to obtain VAT refunds. As a result, VAT registration can enable a company to increase its client base. VAT registration can also have a positive impact on the reputation of a business, further supporting its expansion and growth.

**Chart 8.14: The simplified tax regime is rarely used**

Use of various tax regimes by SMEs and individual entrepreneurs



#### The attractiveness of the patent regime means it is used by almost half of all individual entrepreneurs

The patent regime is very attractive but, as a result, is believed to discourage tax regime graduation, with negative consequences for business growth and revenue collection (Box 8.6). Close to half of all individual entrepreneurs choose to operate under the patent regime (Charts 8.14 and 8.17). The proportion of individual entrepreneurs operating under the patent regime has, however, decreased from 57 percent to 51 percent between 2006 and 2008, while the proportion of individual entrepreneurs using the simplified tax regime has increased (Chart 8.14).

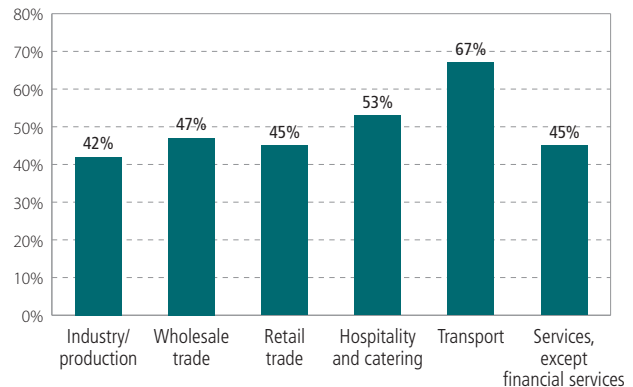
The proportion of individual entrepreneurs with annual turnover below KGS4 million using the patent regime is greatest in the hospitality and catering and transport sectors, at 53 and 67 percent, respectively (Chart 8.15). The proportion of individual entrepreneurs with annual turnover below KGS4 million operating under the patent regime is greatest in the rural districts of the country, with 97 percent of individual entrepreneurs in Batken and 93 percent in Naryn choosing to operate under this regime (Chart 8.16).

The reason why the patent regime is used most extensively by individual entrepreneurs is due to the fact that (i) it encompasses a significant number of activities (124, see Annex 8.1); (ii) compliance is easy, requiring only minimal tax accounting records to be maintained (including, for those businesses that do not maintain cash registers, the use of specific ledgers for all cash receipts) and requiring only one annual report to be submitted; (iii) tax inspections are easier since minimal accounting is subject to review by inspectors; (iii) the extent of tax liabilities under the patent regime is known in advance and is relatively proportional to turnover, particularly for those individual entrepreneurs whose turnover is close to the patent regime ceiling; and (iv) the turnover ceiling for patent users is quite high in comparison with other post-Soviet countries (at KGS4 million or \$109,379) and is similar to that applicable to an entrepreneur operating under the simplified tax regime.<sup>118</sup> These reasons are valid under both the old and the new *Tax Code*.

Because the patent regime is very attractive, individual entrepreneurs have no incentive to graduate from the patent to the simplified or the general tax regimes. As a result, some individual entrepreneurs manage their operations in such a way as to remain under the patent regime. This is borne out by research among focus groups, which indicates that some opportunities arise for tax minimization or evasion, for example where (i) those individual entrepreneurs whose turnover is close to the KGS4 million turnover threshold hide part of their turnover in order to remain under the patent regime; and (ii) some individual entrepreneurs divide their operations into two and purchase a patent for each in order to remain under the patent regime.

**Chart 8.15: The proportion of individual entrepreneurs using the patent regime is greatest in the transport sector**

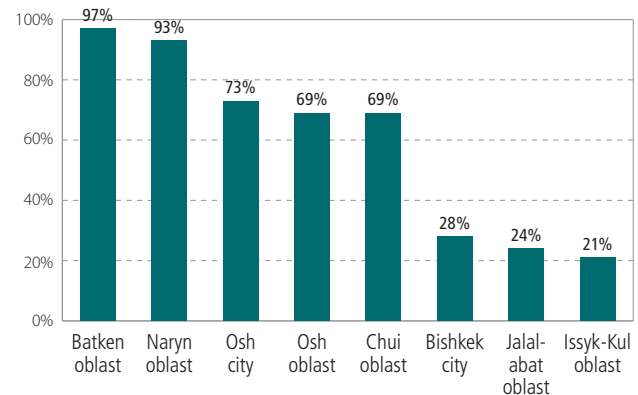
**Proportion of individual entrepreneurs operating under the patent regime, by sector\***



\* Of those eligible to operate under the patent tax regime.

**Chart 8.16: The patent regime is the preferred regime among individual entrepreneurs, particularly in rural areas of the country**

**Proportion of individual entrepreneurs operating under the patent regime, by region\***



\* Of those eligible to operate under the patent tax regime.

### **The simplified tax regime lacks attractiveness and is therefore rarely used**

Survey results show that the simplified tax regime was rarely used in 2008 because (i) it is unattractive to enterprises; and (ii) many businesses are unaware of it. As a result, the simplified tax regime did not, under the old *Tax Code*, play its intended role as an intermediary regime between the patent regime and the general tax regime, and one which would enable small businesses to gradually grow and formalize their operations. Survey results indicate that only 10 percent of those small and medium companies eligible to operate

<sup>118</sup> In Tajikistan, the annual turnover ceiling for individual entrepreneurs operating under the patent regime is TJS200,000 (approximately \$63,000). Uzbekistan imposes no turnover ceiling for individual entrepreneurs paying the fixed tax. Rather, the ceiling is set according to the number of employees, and individual entrepreneurs paying the fixed tax cannot engage employees. In Ukraine, the ceiling for individual entrepreneurs operating under the patent regime is set on the basis of both the number of employees (a maximum of five) and annual turnover (a maximum of UAH119,000 (approximately \$14,875).

under the simplified tax regime (i.e., those with a turnover below KGS4 million) chose to do so, while 90 percent of small and medium companies eligible to operate under the simplified tax regime chose instead to operate under the general tax regime. Likewise, only 10 percent of those individual entrepreneurs eligible to operate under the simplified tax regime chose to do so, whereas 41 percent of the same group chose to operate under the general tax regime (Chart 8.17). These data indicate that the simplified tax regime, as at 2008, was unattractive to these businesses. As a result, some individual entrepreneurs structured their activities in a way which would allow them to remain under the patent regime, with negative consequences for:

- (i) the growth of these businesses – operating under the simplified or the general tax regime (a) improves access to credit; and (b) helps businesses improve their accounting skills and capacities, which in turn supports the growth of their turnover and profit;
- (ii) employment, since business growth results in job creation;
- (iii) the development of the private sector in the country; and
- (iv) tax revenue collection, since the higher the turnover and profit of a business, the more tax revenue it generates.

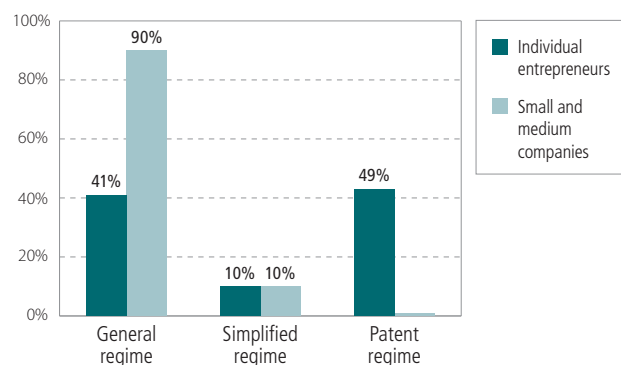
This situation has, to a certain extent, changed under the new *Tax Code* as the reduction in the rate of the single tax on turnover has made the simplified tax regime more advantageous for businesses – although it is, as yet, not clear whether this has resulted in any change in behavior.

“*If I joined the simplified tax regime I would have to pay much more tax than under the patent regime. So, each time my turnover approaches the KGS4 million threshold, I buy a patent under the name of one of my employees, and continue doing business under my employee’s name. It is possible to get by with this practice with the State Tax Service.*”

*An entrepreneur in the retail trade*

**Chart 8.17: Most businesses that have a choice between the simplified and the general tax regime choose the general tax regime**

**Use of different tax regimes among businesses with turnover below KGS4 million**

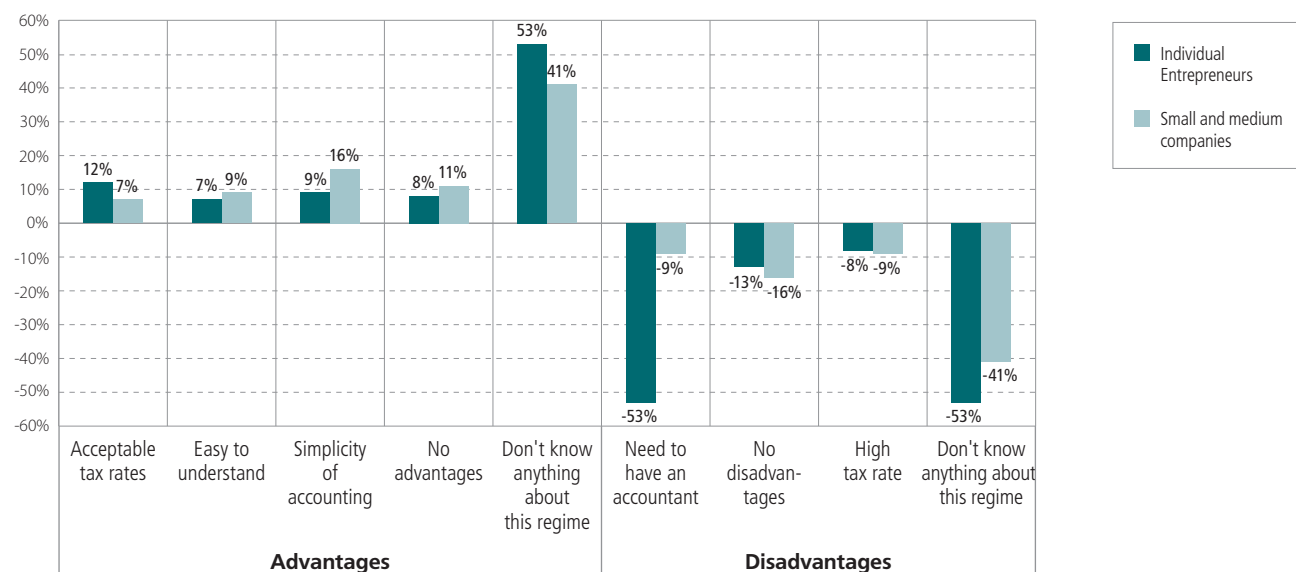


When questioned on the advantages and disadvantages of the simplified tax regime, 41 percent of those small and medium companies and 53 percent of those individual entrepreneurs eligible to operate under this regime indicated that they were not aware of it (Chart 8.18). This low level of awareness is, in part, due to the fact that most small and medium companies operate under the general tax regime and most individual entrepreneurs operate under the patent or general tax regimes – indicating, perhaps, a need for awareness campaigns on the eligibility criteria and benefits of the simplified tax regime. Research among focus groups would appear to suggest that businesses remain unaware of the improvements that have been made to the simplified tax regime under the new *Tax Code* – including, for example, the reduction in the rate of the single tax on turnover, reduced frequency of reporting requirements, and so on.

Approximately 10 percent of individual entrepreneurs and of small and medium companies with turnover below KGS4 million were operating under the simplified tax regime in 2008. Usage of the simplified tax regime was lowest in the Naryn and Batken regions, as well as Osh city, and highest in Bishkek city, followed by Issyk-Kul, and Chui (Chart 8.19). This may be due to the fact that those enterprises based in Bishkek, Issyk-Kul, and Chui are more likely to be active in sectors that have a higher profit margin (e.g., financial services, consumer services, and so on), and are thus more likely to choose the simplified tax regime. For example, 93 percent of small and medium companies operating in the financial sector, and 89 percent of all small and medium companies active in the service sector (excluding financial services) were based in Bishkek.

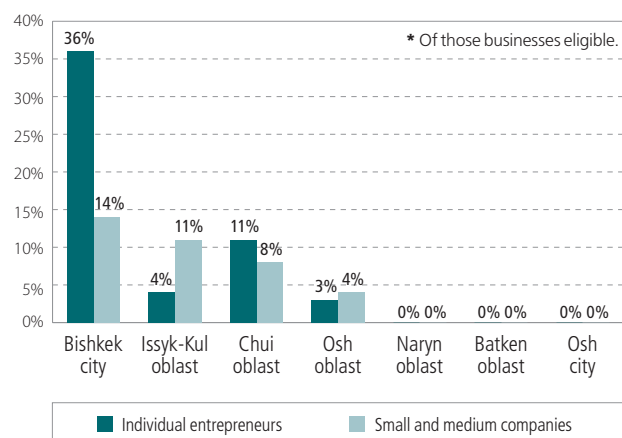
**Chart 8.18: Over half of those individual entrepreneurs and over 40 percent of small and medium companies eligible to operate under the simplified tax regime were unaware of it<sup>119</sup>**

**Simplified regime: main advantages and disadvantages**



**Chart 8.19: The simplified tax regime is not utilized at all in more than half of the regions of the country**

**Proportion of individual entrepreneurs and small and medium companies using the simplified regime\***



**The general tax regime is chosen by the majority of small and medium companies even though compliance is complex**

All survey respondents were eligible to operate under the general taxation regime, and all were asked to identify what they perceived to be the main advantages and disadvantages of it. Thirty two percent of all small and medium companies (the single largest group) indicated that they perceived there

to be “no advantages” to operating under the general tax regime, while 28 percent of respondents perceived the main advantage to be the opportunity for reimbursement of VAT. Twenty six percent of respondents felt the main advantage to be the opportunity to buy from and sell to a large number of companies, insofar as many suppliers and distributors prefer to trade with VAT-registered companies in order to benefit from the refund of VAT, and being VAT registered is believed to enhance a company’s reputation.

Small and medium companies cited the main disadvantages of working under the general tax regime as the cost of labor-intensive accounting procedures (28 percent) and the complexity of accounting and compliance (20 percent). Although the greatest proportion (30 percent) of small and medium companies believe there to be “no advantages” to the general taxation regime, the vast majority (92 percent in 2008) nonetheless chose to operate under the general taxation regime between 2006 and 2008. This may be due to the fact that the general tax regime was, for many businesses, at least prior to the introduction of the new *Tax Code*, more advantageous financially than the simplified tax regime. This situation has changed to some extent since the new *Tax Code* was adopted. For example, the percentage of small and medium companies operating under the general taxation regime (98 percent) was particularly high in

<sup>119</sup> Positive numbers indicate advantages and negative numbers disadvantages.

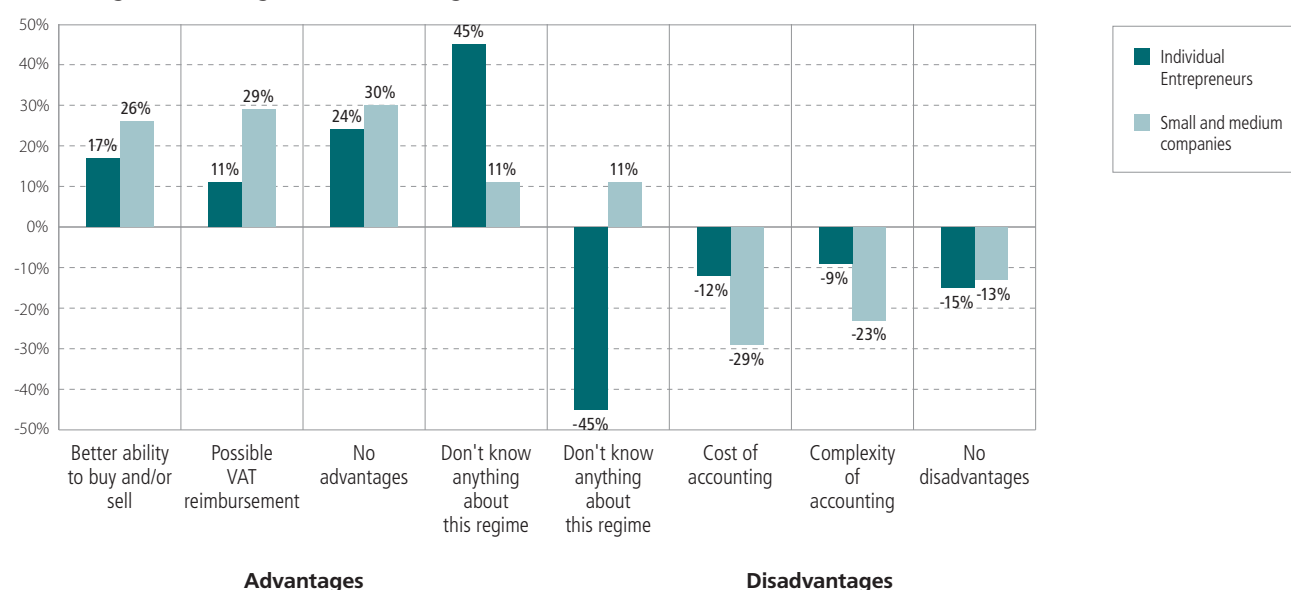
the wholesale sector. In general, small and medium companies active in sectors in which profit margins tend to be low and in which turnover is generally high (e.g., companies engaged in trading operations) prefer, as a rule, to operate under the general tax regime, regardless of their size, since this regime operates on the basis of a tax on profit, whereas the simplified tax regime operates on the basis of a tax on turnover. Because the general tax regime was, in 2008, more advantageous financially, overall, than the simplified tax regime, 74 percent of those small and medium companies operating under the general tax regime were found to have recorded annual turnover below KGS4 million – the threshold at which a business becomes eligible to operate under the simplified tax regime. Many of these small and medium companies, however, had no incentive to do so.

Small and medium companies' awareness of the general tax regime was relatively high, with only 10 percent claiming no knowledge of it – due to the fact that the majority operate under this regime (90 percent in 2008), partly because they are ineligible for the patent tax regime. Individual entrepreneurs' awareness of the general tax regime is low, with 45 percent of respondents in this category indicating that they had no knowledge of it: this low awareness, however, is due to the fact that most individual entrepreneurs operate under the patent tax regime.

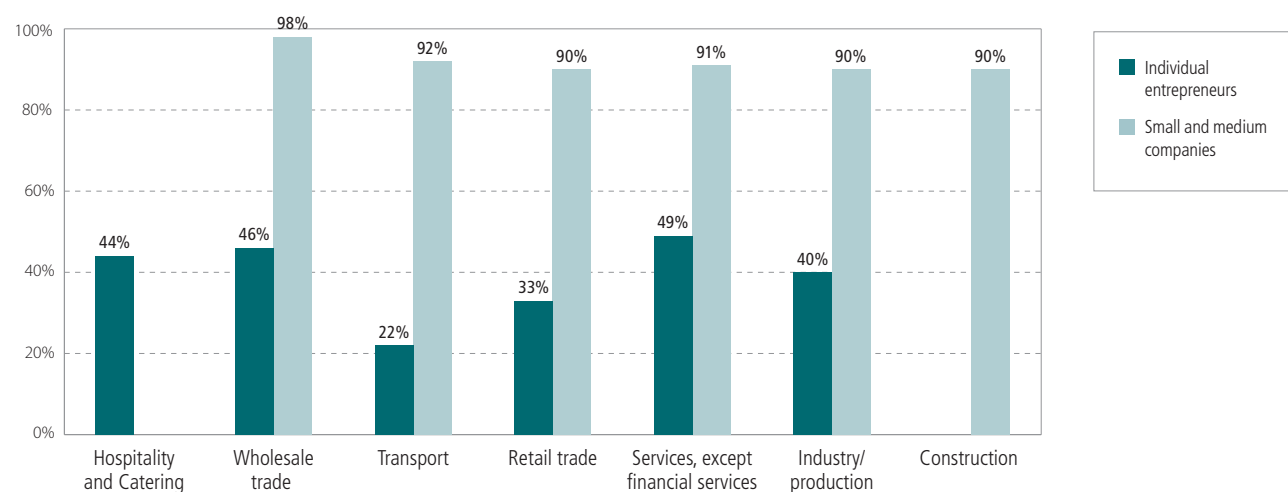
When asked what they perceived to be the main advantages and disadvantages of the general tax regime, 24 percent of those individual entrepreneurs that demonstrated an awareness of the general tax regime indicated that they felt the general tax regime to have no advantages, with 17 percent citing its only advantage as the opportunity to buy from and sell to a wider range of companies (Chart 8.20). The proportion of individual entrepreneurs operating under the general tax regime (36 percent) remained stable between 2006 and 2008. Individual entrepreneurs may choose to join the general tax regime (i) in order to benefit from the advantages of the general tax regime (specifically the opportunity for the refund of input VAT); (ii) if the activity or activities in which they are engaged cannot be conducted under the patent regime; or (iii) if their annual turnover exceeds KGS4 million. The sector showing the greatest proportion of individual entrepreneurs operating under the general tax regime is the service sector, at 49 percent, with the transport sector the lowest, at 22 percent (Chart 8.21). Individual entrepreneurs operating in the transport sector rarely record annual turnover in excess of KGS4 million (indeed, the turnover of individual entrepreneurs in this sector is lower than in any other), and are thus likely to be eligible to operate under the patent tax regime.

**Chart 8.20: Close to one third of small and medium companies surveyed indicated that operating under the general tax regime has no advantages<sup>120</sup>**

#### General regime: Advantages and Disadvantages



<sup>120</sup> Positive numbers indicate advantages and negative numbers disadvantages.

**Chart 8.21: The general tax regime is the system most widely used by small and medium companies across all sectors****Proportion of entrepreneurs operating under the general tax regime, by sector****Farmers have the least burdensome tax regime of all categories of SMEs**

The tax regime is considerably less onerous for farmers than for individual entrepreneurs and small and medium companies since farmers are exempt from profit tax and VAT and, from 2009, from the sales tax. The liabilities of the majority of farmers are limited to the land tax (paid by 99 percent) and contributions to the Social Fund (paid by 94 percent). Although farmers engaged in land cultivation, harvesting, slaughtering, and the sale of meat products are eligible to operate under the patent tax regime (under both the old and the new *Tax Code*) none of the respondents to the Survey had chosen to do so.

**8.9. RECOMMENDATIONS**

ISSUE	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
<b>SHORT-TERM RECOMMENDATIONS</b>		
Although implemented with effect from January 1, 2009, awareness of the various provisions of the new <i>Tax Code</i> (including the filing of tax returns) is low	Develop a guide or manual supplementary to the <i>Tax Code</i> in order to increase taxpayers' knowledge of their potential liabilities and compliance obligations. Ensure the wide dissemination of this information through the web site of the State Tax Service and other sources	Better knowledge of their tax liabilities and compliance obligations will (i) reduce compliance costs for businesses; (ii) reduce opportunities for the unofficial payments; and (iii) increase tax revenue through the avoidance of error
The costs involved in tax accounting and compliance are high. The simplified tax regime is rarely used, with the result that few businesses benefit from its less onerous accounting requirements	The advantages of the simplified tax regime should be widely publicized, with detailed information allowing SMEs to choose the regime most appropriate to their business (e.g., highlighting the benefits of the simplified tax regime for businesses with higher profit margins etc.)	A better knowledge of the various tax regimes would enable taxpayers to make an informed decision on the regime most appropriate to their businesses. Businesses will be aware of the lower accounting and compliance costs incurred under the simplified tax regime
The cost involved in tax compliance are significant	The reduction in the number of applicable taxes, following the implementation of the new <i>Tax Code</i> , have already resulted in a reduction in businesses' compliance costs. However, abolishing the sales tax (and raising the VAT rate to compensate for this) would further reduce the compliance burden with no corresponding reduction in revenue, since both are imposed on the same tax base	Compliance costs will be reduced in line with a further reduction in the number of applicable taxes



ISSUE	RECOMMENDATIONS	ANTICIPATED IMPACT(S)
The cost of complying with mandatory reporting requirements (including the preparation and submission of reports) is high	Simplify reporting forms (such as the single tax on turnover return); merge some reports (e.g., reports on social insurance payments and PIT); eliminate some annexes to the VAT return; eliminate duplication of information arising from submissions to different agencies	Simplifying reporting formats would reduce the administrative burden on both taxpayers and officials and would encourage the avoidance of error
Inspections represent a significant burden on taxpayers, and are not sufficiently risk-based	Implement a risk-based approach to the selection of businesses for inspection, and in the planning and implementation of inspections	Fewer inspections will reduce compliance costs for businesses, will allow the better and more cost-effective targeting of the resources of the State Tax Service, and will result in the higher generation of net tax revenue
The simplified tax regime is rarely used	Building on amendments introduced under the new <i>Tax Code</i> , introduce further reform to the simplified tax regime (e.g., simplifying the return for the single tax on turnover) to make it more attractive in terms of its financial and administrative burden	Businesses will have a stronger incentive to graduate to the simplified tax regime, and tax revenue will increase
<b>MEDIUM-TERM RECOMMENDATIONS</b>		
The cost of complying with mandatory reporting requirements, including filing, is high	Encourage voluntary e-filing	The time spent on report submission will be cut, and interactions between tax officials and taxpayers reduced. Wider use of electronic systems will help to develop a comprehensive information database, which will ultimately allow the easier implementation of risk-based audits
The voluntary patent regime is very attractive and, as a result, does not encourage graduation to the simplified tax regime	Once the simplified tax regime has been further reformed, reform the voluntary patent regime. A medium-term objective might be the introduction of a new upper limit on turnover under the patent regime, with the result that this facility would be limited to the smallest businesses only. Such a ceiling should be significantly lower than the current ceiling for VAT	Limiting the patent regime to the smallest businesses only, and encouraging larger businesses to graduate to the simplified tax regime, will encourage businesses to grow and tax revenues to increase

## ANNEX 8.1: ELIGIBLE ACTIVITIES UNDER THE VOLUNTARY TAX PATENT REGIME

Bishkek city, Government House

December 30<sup>th</sup>, 2008, *Government Resolution No. 733*

*"On Approving Amount of Voluntary Patent Tax by Type of Entrepreneurial Activity,"*

NO.	ACTIVITY/ACTIVITIES	COST FOR 30 DAYS (KGS)
1.	Cultivation of land and harvesting	2,000
2.	Slaughtering	2,000
3.	Production of bread and bakery products	10,000
4.	Manufacturing of turning items	3,000
5.	Repair of television and radio electronic devices	4,000
6.	General construction work <sup>121</sup>	5,000
7.	Electric installation work	5,000
8.	Sanitary and technical work	6,000
9.	Carpentry work	2,500

<sup>121</sup> Operating under the patent regime is possible only for businesses involved in minor construction work such as painting, plastering, etc. Businesses involved in the construction of a new building or buildings, or the capital repair of old buildings may not operate under the patent regime.

NO.	ACTIVITY/ACTIVITIES	COST FOR 30 DAYS (KGS)
10.	Maintenance and repair of vehicles	
	a) Maintenance of cars (per vehicle place)	3,000
	b) Car body shop services	10,000
	c) Repair of tires, wheels	3,000
	d) Repair of cars, including repair of doors, windows, locks, etc.	2,000
	e) Car washing services (per washing place)	4,000
11.	Trade in agricultural non-processed products, livestock, raw textiles and semi-finished goods	3,000
12.	Sale of garment, knitted goods, and footwear	2,000
13.	Sale of fur, leather, and fake leather	10,000
14.	Sale of cloth and fabric	2,000
15.	Sale of carpets	5,000
16.	Sale of detergents and cosmetics	2,000
17.	Sale of jewellery	2,000
18.	Sale of toys and souvenirs	2,000
19.	Sale of national artistic goods	1,500
20.	Sale of tin goods	3,000
21.	Sale of video, audio-cassettes and CDs	2,000
22.	Sale of spare parts and equipment for cars	4,000
23.	Sale of radio and television devices, spare parts, and components	3,000
24.	Sale of stationery	3,000
25.	Sale of household goods and equipment	3,000
26.	Sale of flowers and floral compositions	2,000
27.	Sale of newspapers, books and magazines	500
28.	Sale of tobacco goods	2,000
29.	Sale of bread and bakery	1,000
30.	Sale of confectionery	1,500
31.	Sale of meat of livestock, poultry, and other animals, live, raw, or processed	1,800
32.	Sale of milk and dairy products	500
33.	Sale of vegetables, fruits, berries, natural or processed	1,300
34.	Sale of apiculture products	2,000
35.	Sale of soft and national drinks	2,000
36.	Sale of baking and dairy products	1,000
37.	Sale of food products in stationary outlets and in kiosks, pavilions, containers, trailers, concessions, shop counters, stalls, yurts, manual movable carriages, tents, etc.	7,000
38.	Sale of non-foods items, except for pyrotechnical goods, in stationary outlets and in kiosks, pavilions, containers, trailers, concessions, shop counters, stalls, yurts, manual movable carriages, tents, etc.	15,000
39.	Sale of construction materials (except for cement, roof slates)	10,000
40.	Sale of lubricating oil and coolant materials at private residences and at the road side	2,000
41.	Sale of electric appliances, tools, and devices	2,500
42.	Sale of fish (dried, salted, fresh, etc.) and fish products	2,000
43.	Sale of turning items	1,000
44.	Sale of spare parts for agricultural machinery	1,000
45.	Breeding and sale of goldfish and pet birds, and related foodstuffs and accessories	1,000
46.	Sale of goods and equipment for hunting, fishing, and sport	1,000

NO.	ACTIVITY/ACTIVITIES	COST FOR 30 DAYS (KGS)
47.	Sale of paintings and portraits	2,000
48.	Sale of animal foodstuffs	1,000
49.	Sale of grains: wheat, barley, corn, etc.	1,500
50.	Shoe repair	1,000
51.	Watch repair	1,000
52.	Repair of household goods and personal items	1,000
53.	Production and sale of hotdogs, cheeseburgers, and hamburgers	3,500
54.	Passenger and cargo carriage:	
	a) Transport of passengers in minivans of 12 seats	2,000
	b) Transport of passengers in a bus of 12–33 seats	3,000
	c) Transport of passengers in a bus of over 33 seats	4,000
	d) Transport of passengers in cars (taxi services)	1,000
	e) Transport of cargo by vehicles with a capacity of up to one ton	2,000
	f) Transport of cargo by vehicles with a capacity of one to eight tons	4,000
	g) Transport of cargo by vehicles with a capacity of over eight tons	6,000
55.	Storage room services	6,000
56.	The rent of:	
	a) own real estate as a hotel (per bed)	4,000
	b) living space (per room)	1,500
	c) non-residential premises (depending on area)	10,000
57.	Photographic activity	3,000
58.	Services on packaging of goods (cargo)	2,000
59.	Repair and restoration of furniture	3,000
60.	Design decoration services	15,000
61.	Cleaning of pits and removal of household waste	2,000
62.	Artistic activities	1,000
63.	Amusement ride (per ride):	
	a) in Bishkek city	5,000
	b) in resort zones	50,000
	c) in the rest of the country	4,000
64.	Renting of bikes, skis, parachutes, catamarans, horses (per piece)	25,000
65.	Hairdressers and manicure, up to three seats (per seat)	2,000
66.	Paid public toilets (per cubicle)	200
67.	Massage therapy	5,000
68.	Repair and sharpening of cutting instruments, glass cutting	2,000
69.	Transportation of cargo by handcarts	150
70.	Glass recycling	500
71.	Breeding and sale of dogs	500
72.	Stocking of skin and wool of livestock	5,000
73.	Herding services	1,500
74.	Cooking and sale of shish kebab of meat of livestock and poultry	1,500
75.	Services of private flour mills, oil and rice mills	2,500

NO.	ACTIVITY/ACTIVITIES	COST FOR 30 DAYS (KGS)
76.	Production of ready-made textile goods, including tailoring of jackets and floor covers for cars	Up to 10 units of equipment (sewing machines, knitting machines, etc.): 2000. For the next 10 pieces of equipment, an additional 1000
77.	Manufacture of hosiery and knitted goods	
78.	Manufacture of leather and fur garments, as well as leather substitutes	
79.	Manufacture of work garments	
80.	Manufacture of clothes	
81.	Manufacture of underwear	
82.	Manufacture of hats and related garments	
83.	Manufacture of fur	
84.	Manufacture of saddle goods	1,000
85.	Timber sawing services	1,500
86.	Paper recycling	1,000
87.	Manufacture of ceramic and decorative products	1,500
88.	Fabrication and repair of keys and locks	500
89.	Repair of agricultural machines	1,500
90.	Repair of special medical equipment	1,000
91.	Production of national musical instruments	1,000
92.	Repair and tuning of musical instruments	600
93.	Home production of natural and artistic goods	800
94.	Manufacture of artificial flowers and funeral wreaths	1,000
95.	Sale of gas tanks	1,500
96.	Sale of saddle goods	800
97.	Sale of national musical instruments	100
98.	Sale of artificial flowers and wreaths	800
99.	Sale of ceramic and decorative products	1,500
100.	Sale of gravestones, bases and supporting elements	200
101.	Purchase, repair, and sale of precious metals and stones in outlet of up to 10 square meters	2,000
102.	Repair of clothes, hats, furs, garments, knitted goods, accessories, etc.	1,500
103.	Public catering:	
	a) in temporary facilities (pavilions, yurts, tents, etc.), per table with four seats	1,000
	b) located in educational establishment buildings (depending on number of students)	4,000
	c) in stationary facilities, located in resort zones and operating during the holiday season, per table with four seats	2,000
104.	Advertising by radio in markets and other public places	1,000
105.	Operation of:	
	a) computer games centers (per computer)	500
	b) game console centers (per console)	300
106.	Maintenance of computer hardware and software and copiers	2,000
107.	Training of dogs	500
108.	Translation and consulting services for international projects and programs	2,000

NO.	ACTIVITY/ACTIVITIES	COST FOR 30 DAYS (KGS)
109.	Local staff of international projects and programs:	
	a) managers and advisers	3,000
	b) coordinators	2,000
	c) specialists and experts	1,500
	d) administrative and financial assistants	1,000
	e) secretaries, drivers	700
	f) support staff (security guards, doormen, cleaners, etc.)	500
110.	Services:	
	a) processing of documents with computers and copying	1,000
	b) typing	500
	c) crediting of cell phones	500
111.	Services:	
	a) teaching of foreign languages, computer use, accounting, driving, tailoring, sewing, knitting, and other skills	2,000
	b) tutoring	600
112.	Audio and video shooting and recording, karaoke	1,500
113.	Musical arrangements during celebrations and ceremonies	2,500
114.	Organization of:	
	a) paid games (tennis, chess, etc.)	1,000
	b) games "Russian lotto" and Bingo-lotto"	2,000
115.	Boat, motorboat, and yacht riding services	50,000
116.	Laundry services at home	500
117.	Make-up designer services	1,000
118.	Manufacture of gravestones, bases, and supporting elements	1,200
119.	Astrological forecasts	500
120.	Housekeeping and baby sitting	500
121.	Installation of television antennae	800
122.	Carpentry services	900
123.	Welding services	1,000

## ANNEX 8.2: TAXES AND RATES APPLICABLE UNDER EACH OF THE FOUR TAX REGIMES

	GENERAL TAX REGIME	SIMPLIFIED TAX REGIME	TAX PATENT REGIME	TAX CONTRACT REGIME
Required to submit tax reports to State Tax Service?	Yes	Yes	No	Yes
Documents to be retained	Accounting records	Accounting records	Patent and patent receipt	No requirement to keep tax accounting records for the taxes covered by the tax contract (profit tax, VAT, and the sales tax)
Personal income tax <sup>122</sup>	10%	10%	10%	10%
Profit tax <sup>123</sup>	10%	N/a	N/a	Included in the amount of the contract
Sales tax	<b>Sale of products, works and services bearing or exempt from VAT:</b> Trading activity: 1.5% Other activities: 2.5% <b>In other cases not provided for under the above:</b> Trading activity 2.5% Other activities: 3.5%	N/a	N/a	Included in the amount of contract
VAT	12%	N/a	N/a	Included in the amount of the contract
Land taxes (on agricultural and non-agricultural land)	Varies according to the type of land and/or business, and its regional location	Varies according to the type of land and/or business, and its regional location	Varies according to the type of land and/or business, and its regional location	Varies according to the type of land and/or business, and its regional location
Excise tax	Varies depending on the goods in question	N/a	N/a	N/a
Property tax	Varies according to the size of the property	Varies according to the size of the property	Varies according to the size of the property	Varies according to the size of the property
Tax on the use of mineral resources	Bonus levels determined by the government according to a specific classification table (based on the type of mineral resource and extent of extraction activities) Royalty amount based on the type of mineral resource and volume sold	Bonus levels determined by the government according to a specific classification table (based on the type of mineral resource and extent of extraction activities) Royalty amount based on the type of mineral resource and volume sold	N/a	Bonus levels determined by the government according to a specific classification table (based on the type of mineral resource and extent of extraction activities) Royalty amount based on the type of mineral resource and volume sold
Single tax on turnover	N/a	Manufacturing, trade, agricultural processing: 4% Other activities: 6%	N/a	N/a
Social Fund contributions	17.25% of salary	17.25% of salary for small and medium companies Individual entrepreneurs : 9.25% of own salary	25% of tax patent cost	17.25% of salary for small and medium companies Individual entrepreneurs: 9.25% of own salary

<sup>122</sup> Under the simplified tax and the patent tax regimes, the tax base is not the wage but the minimal income defined annually by the tax authorities.

<sup>123</sup> Individual entrepreneurs operating under the general tax regime pay the profit tax in respect of their own income, and the personal income tax in respect of their employees.

### ANNEX 8.3: NUMBER OF REPORTS TO BE SUBMITTED TO STATE TAX SERVICE ANNUALLY BY SMALL AND MEDIUM COMPANIES UNDER THE OLD AND THE NEW TAX CODE

	OLD TAX CODE			NEW TAX CODE		
	GENERAL TAX REGIME	SIMPLIFIED TAX REGIME		GENERAL TAX REGIME	SIMPLIFIED TAX REGIME	
		LEGAL ENTITIES	INDIVIDUALS		LEGAL ENTITIES	INDIVIDUALS
Income tax	12	12	Imputed	12	12	Imputed
Corporate profit tax	1	Imputed	N/a	1	Imputed	N/a
VAT	12	N/a	N/a	12	N/a	N/a
Excise tax	12	N/a	N/a	12	N/a	N/a
Land tax	1	1	1	1	1	1
Property tax	N/a	N/a	N/a	1	1	1
Mineral re-sources use tax	12	12	N/a	12	12	12
Sales tax	N/a	N/a	N/a	12	Imputed	Imputed
Single tax on turnover	N/a	12	12	N/a	4	4
Social Fund	12	12	12	12	12	12
Emergency Fund	12	N/a	N/a	Abolished	Abolished	Abolished
Hotel tax	12	12	12	Abolished	Abolished	Abolished
Resort tax	12	12	12	Abolished	Abolished	Abolished
Advert tax	12	12	12	Abolished	Abolished	Abolished
Retail Sales tax	12	Imputed	Imputed	Abolished	Abolished	Abolished
Real property tax	N/a	N/a	N/a	Abolished	Abolished	Abolished
Vehicle owners' tax	1	1	1	Abolished	Abolished	Abolished
Road use tax	1	Imputed	N/a	Abolished	Abolished	Abolished



## ANNEX 8.4: ANNUAL LABOR COST OF TAX COMPLIANCE FOR SMEs

### Annual labor costs of accountancy and tax filings for individual entrepreneurs

		OWNER/ MANAGER	STAFF ACCOUNTANT, FULL TIME	STAFF ACCOUNTANT, PART TIME	NON-STAFF ACCOUNTANT	ACCOUNTING FIRM	OTHER	TOTAL (KGS)	SOURCE	COMMENTS
A	Proportion of individual entrepreneurs using the following human resources for their accounting	88%	7%	3%	5%	2%	1%		Survey results	Total higher than 100 because respondents were allowed to give multiple answers
B	Proportion of this time spent on accounting	77%	68%	68%	63%	32%	0%		Survey results	
C	Proportion of this time spent on preparation and submission of reports	23%	32%	32%	37%	68%	100%		Survey results	
D	Total monthly expenses in 2008 (KGS)	635	3 789	2 974	1 806	500	0		Survey results and State Statistics Committee (for owners)	
E	Number of employees	1							Survey results	
F	Number of working days	2,5							Survey results	
G	Number of active individual entrepreneurs except agricultural sector	145,663							State Statistics Committee	
H	Total number of individual entrepreneurs using the following human resources for their accounting	128,475	9,704	4,703	7,722	2,768	728		G*A	
I	Total yearly cost (KGS)	978,795,065	441,208,041	167,833,229	167,334,213	16,605,582	0	1,771,776,130	H*D*12	
J	Total yearly cost tax accounting (KGS)	750,735,815	301,345,092	114,407,360	104,979,769	5,349,112	0	1,276,817,148	I*B	
K	Total yearly cost, preparation and submission of reports (KGS)	228,059,250	139,862,949	53,425,869	62,354,445	11,256,470	0	494,958,982	I*C	

## Annual labor costs of accountancy and tax filings for small and medium companies

		OWNER/ MANAGER	STAFF ACCOUNTANT, FULL TIME	STAFF ACCOUNTANT, PART TIME	NON-STAFF ACCOUNTANT	ACCOUNTING FIRM	OTHER	TOTAL (KGS)	SOURCE	COMMENTS
A	Proportion of small and medium companies using the following human resources for their accounting	46%	57%	19%	12%	2%	0%		Survey results	Total higher than 100 because respondents were allowed to give multiple answers
B	Proportion of this time spent on accounting	31%	66%	58%	50%	62%	45%		Survey results	
C	Proportion of this time spent on preparation and submission of reports	69%	34%	42%	50%	38%	55%		Survey results	
D	Total monthly expenses in 2008 (KGS)	663	7,497	4,349	3,008	6,497	8,834		Survey results and State Statistics Committee (for owners)	
E	Number of employees	1							Survey results	
F	Number of working days	2,6							Survey results	
G	Number of active small and medium companies except agricultural sector	10 982							State Statistics Committee	
H	Total number of small and medium companies using the following human resources for their accounting	5,014	6,242	2,073	1,346	186	46		(G*A)	
I	Total yearly cost (KGS)	39,874,453	561,581,994	108,198,429	48,586,821	14,529,702	4,869,990	777,641,390	(D*H*12)	
J	Total yearly cost tax accounting (KGS)	12,231,498	368,128,045	63,163,068	24,507,017	8,957,365	2,173,340	479,160,332	(I*B)	
K	Total yearly cost, preparation and submission of reports (KGS)	27,642,955	193,453,949	45,035,362	24,079,805	5,572,337	2,696,650	298,481,057	(I*C)	

## Annual labor costs of accountancy and tax filings for farmers

		OWNER/ MANAGER	STAFF ACCOUNTANT, FULL TIME	STAFF ACCOUNTANT, PART TIME	NON-STAFF ACCOUNTANT	ACCOUNTING FIRM	OTHER	TOTAL (KGS)	SOURCE
A	Proportion of farmers using the following human re-sources for their accounting	98%	1%	0,5%	0,1%	0%	0%		Survey results
B	Proportion of this time spent on accounting	90%	69%	62%	60%	62%	45%		Survey results
C	Proportion of this time spent on preparation and submission of reports	10%	31%	38%	40%	38%	55%		Survey results
D	Total monthly expenses in 2008 (KGS)	486	2 335	3 169	3 150	6 497	8 834		Survey results and State Statistics Committee (for owners)
E	Number of employees	1							Survey results
F	Number of working days	1,9							Survey results
G	Number of active farmers	280,408							State Statistics Committee
H	Total number of farmers using the following human resources for their accounting	274,800	2,804	1,402	280	0	0		G*A
I	Total yearly cost (KGS)	1,601,543,853	78,563,463	53,309,085	10,599,422	0	0	1,744,015,824	H*D*12
J	Total yearly cost tax accounting (KGS)	1,433,440,693	54,005,360	32,908,590	6,343,042	0	0	1,526,697,684	I*B
K	Total yearly cost, preparation and submission of reports (KGS)	168,103,160	24,558,104	20,400,496	4,256,381	0	0	217,318,140	I*C

## Annual labor costs of accountancy and tax filings for SMEs

	INDIVIDUAL ENTREPRENEURS		SMALL AND MEDIUM COMPANIES		FARMERS		TOTAL (KGS)
	KGS	\$	KGS	\$	KGS	\$	
Labor cost on tax accounting	1,276,817,148	34,914,333	479,160,332	13,102,552	1,526,697,684	41,747,271	3,282,675,164
Labor cost on reporting	494,958,982	13,534,563	298,481,057	8,161,910	217,318,140	5,942,525	1,010,758,179
Total	1,771,776,130	48,448,896	777,641,390	21,264,462	1,744,015,824	47,689,796	
<b>Grand total (KGS)</b>	<b>4,293,433,344</b>						
<b>Grand total (\$)</b>	<b>117,403,154</b>						

## ANNEX 8.5: ANNUAL LABOR COSTS OF TAX AUDITS

		INDIVIDUAL ENTREPRENEURS	SMALL AND MEDIUM COMPANIES	FARMERS	SOURCE
A	Total number of enterprises	145,663	10,982	280,408	State Statistics Committee
B	Proportion of SMEs subject to tax inspections in 2008	66%	59%	10%	Survey results
C	No. of enterprises inspected by State Tax Service	96,720	6,446	27,200	A * B
D	Proportion of SMEs having staff accountant	7%	57%	1%	Survey results
E	Proportion of SMEs where the owner/manager was in charge of tax accounting	93%	43%	99%	Survey results
F	No. of SMEs having staff accountant	6,443	3,664	217	C * D
G	No. of SMEs where the owner/manager was in charge of tax accounting	90,277	2,782	26,983	C * E
H	Total monthly expenses on staff accountants in 2008 in KGS	3,789	7,497	2,335	Survey results
I	Average No. of accountants	1,06	1,34	1,04	Survey results
J	Average salary of one accountant	3,585	5,596	2,245	Survey results
K	Average salary of owner/manager	5,378	5,378	5,378	State Statistics Committee
L	Duration of all tax inspections in 2008, working days	2,98	4,68	2,25	Survey results
M	Time spent by SMEs on inspections	1,49	2,34	1,12	Assumption: staff spend half of the duration of the inspection working with inspectors
N	Labor costs of accountants working on tax inspections (KGS)	1,640,640	2,284,187	26,001	(J*M/21)*F
O	Labor costs of owner/manager working on tax inspections (KGS)	34,480,751	1,667,034	7,761,541	(K*M/21)* G
P	<b>Total labor cost of tax inspections for each category (KGS)</b>	<b>36,121,391</b>	<b>3,951,221</b>	<b>7,787,542</b>	
Q	<b>Total labor costs of tax inspections for SMEs (KGS)</b>	<b>47,860,154</b>			
R	<b>Total labor costs of tax inspections for SMEs (\$)</b>	<b>1,308,727</b>			



# 9. Survey Methodology

**Objective:** The main objective of the SME survey was to measure regulatory and administrative barriers adversely affecting the activities, growth and development of small and medium enterprises in the Kyrgyz Republic. The empirical survey data and subsequent recommendations to Kyrgyz state authorities are expected to stimulate the debate for reform of the regulatory and administrative environment facing small and medium enterprises. This national level survey is the first of its kind to be implemented in the Kyrgyz Republic.

**Reference period:** The reference period of the survey is 2008, except for the inspections procedure. For the inspections procedure, the first quarter of 2009 was also included in the reference period of the survey in order to allow assessment of inspections after the Moratorium. (The Moratorium on Inspections was effective from April, 25 2008 until December, 31 2008).

## Coverage of the Survey and definitions

Three categories of populations were covered in the nationwide survey:

1. Small and medium companies (SMCs). This was an important sub-population to be surveyed as small and medium companies account for approximately 10% of the nation's GDP. Large companies were excluded from the survey both because the focus of the Project is on SMCs, and because large companies often have separate practices when complying with regulatory and administrative procedures. For the same reasons only privately owned companies were covered.
2. Individual entrepreneurs (IEs). This was an important sub-population to be surveyed as individual entrepreneurs

account for approximately 17.8% of the nation's GDP. The survey makes no distinction between individual entrepreneurs with and without labor force. In practice there is no difference between the two types of individual entrepreneurs both can hire workers or not. Moreover, there is a very common practice, when individual entrepreneurs hire other workers, but workers pay taxes for themselves by purchasing patents from the tax authorities. As a result, reporting or tax burden for individual entrepreneurs who hire a worker (with a patent) is the same as for individual entrepreneurs who do not hire any labor. For purposes of monitoring employment level, the Government in statistical reporting distinguishes individual entrepreneurs with hired workers and individual entrepreneurs without workers. Since there is no difference in practice between the two sub-populations of individual entrepreneurs the survey makes no distinction between the two sub-populations of individual entrepreneurs

3. Farmers: This was an important sub-population and sector of economy to be surveyed as farmers' account for approx. 17.6% of the nation's GDP. Legal entities and individual entrepreneurs involved in agricultural activities will be categorized in the agricultural/farmers population. Traditionally, legal enterprises and individual entrepreneurs involved in agricultural activities appear as a sub-sector in SME surveys, but in the Kyrgyz survey they will be classified as farmers. The rationale for this is that, although the Kyrgyz legislation does not provide for separate registration for farmers, farming activities are regulated differently from other types of production or service, so for the purpose of the survey they are distinguished from small and medium companies and individual entrepreneurs NOT engaged in agricultural production.

### Sampling methodology

The sampling was stratified by region, firm size/type and sector of the economy thus ensuring a nationally representative sample. Data from the Kyrgyz National Statistics Committee showing registered small and medium companies, individual entrepreneurs, and farmers and their location and principle business activity was used as a basis for populating the samples. The sample structure was shifted to secure sufficient representation of small strata's to enable disaggregated comparison. Within each stratification cell, probability-based sampling methodology was used, where the businesses for interview were selected according to a known non-zero probability equal for every respondents. The major advantage of this method was that it allowed statistical inferences to be made about a larger population (at national, regional levels), which in turn can be used to evaluate the impact of regulatory reforms. It is expected that the estimates from the survey will provide benchmarks against which change can be measured. To this end, the survey data is expected to facilitate: (a) Monitoring & Evaluation exercises during and at the end of the project cycle and (b) economic impact assessment, including ex-post assessment of legislation passed.

### Classification of firm type and sector of economic activity

According to the Kyrgyz legislation, classification of firm type/size is based on headcount or turnover and it is further refined by activities in the production and non-production sphere.

The definition of establishment size was adopted by Decree of the Government of the Kyrgyz Republic #78 of February 17, 1998 and Decree of the Government of the Kyrgyz Republic #500 of August 29, 2002. According to its definition, establishments are classified as follows:

#### (a) Small and medium companies by number of employees

Size of enterprise by average number of paid employees	Threshold and interval of average number of paid employees	
	Group I (In the production sphere)	Group II (In the non-production sphere)
Small companies, including very small (micro)	Up to 50 inclusively Up to 15 inclusively	Up to 15 inclusively Up to 7 inclusively
Medium companies	From 51 to 200 inclusively	From 16 to 50 inclusively

#### (b) Small and medium companies by turnover

Size of enterprise by total turnover (production, work and services)	Threshold and interval of total turnover (production, work and services), thousand Soms	
	Group I	Group II
Small companies, including very small (micro)	Up to 500 Up to 150	Up to 500 Up to 230
Medium companies	From 500 to 2,000	From 500 to 2,000

For the purpose of the BEE/IC Survey, Kyrgyz classification of firms by headcount criteria was followed: *in the production sphere*, firms with head count less than 50 are considered to be small enterprises whereas firms with headcount between 51-200 are classified as medium enterprises. *In the non-production sphere*: firms with head count less than 15 are considered to be small enterprises; firms with headcount between 16-50 are classified as medium enterprises.

### Sectors of economic activity

For the purpose of this survey, the sample was stratified by sectors of economic activities. Sectors of the economy are defined on the basis of the national system of economic sectors classification which is different from internationally recognized classifications.

For small and medium companies sectors are: manufacturing industry, construction, trade and repair, transport and communications, real estate and other services, and other. The criterion for selection of these 5 sectors was as follows: total number of enterprises in each of these sectors more than 5% of the total number of enterprises in the country. All remaining industries were included in "Other" sector to allow for statistically valid analysis: mining, electricity, gas and water supply, hotels and restaurants, finance, education, health service, Housing and communal services.

For individual entrepreneurs sectors are: manufacturing industry, trade and repair, hotels and restaurants, transport and communications and other. The criteria for sectors selection was the same as for small and medium companies. The following industries were included in "other" sector to allow for statistically valid analysis: mining, electricity, gas and water supply, construction, real estate and other services, finance, education, health service, housing and communal services.

### Regions of the Kyrgyz Republic

The regional breakdown of the Kyrgyz Republic is: Issyk-kul oblast, Jalalabat oblast, Naryn oblast, Batken oblast, Osh

oblast, Talas oblast, Chui oblast, Bishkek city and Osh city. For the purpose of the survey, sampling was done on the basis of the regional breakdown of the number of enterprises. The rationale for this grouping was to have more detailed reflection of the businesses' distribution in the sample.

### Determination of sample size

Since we have no data of previous surveys, it's difficult to calculate sample size for means. To determine minimum sample size for each sub-population we use estimates of population proportion with levels of precision at a minimum 4% precision for 95% confidence intervals<sup>124</sup>:

$$n = \left[ \frac{1}{N} + \frac{N-1}{N} \frac{1}{PQ} \left( \frac{k}{z_{1-\alpha/2}} \right)^2 \right]^{-1}$$

where: n-final sample size, N = population size, P = population proportion, Q = 1-P, k = desired level of precision,  $z_{1-\alpha/2}$  is the value of the normal standard coordinate for a desired level of confidence, 1- $\alpha$ .

### Non-response rate

In order to derive the final sample size for each population, it is necessary to take into account the possible non-response rate based on experience of previous surveys. Since there is no precedent in the Kyrgyz Republic to estimate the possible non-response rate for farmers, individual entrepreneurs and small and medium companies, the non-response rate was estimated to be of respectively 5%, 10% and 20%. To calculate final sample size it is necessary to use following formula:

$$n_f = n / (1 - R_n)$$

where:  $n_f$  = final sample size, n = sample size without non-response rate,  $R_n$  = non-response rate.

### Sampling distribution for small and medium companies

In order to establish the sampling universe for small and medium companies, the incidence and regional distribution as of 01.01.2009 of existing small and medium companies were obtained from the Kyrgyz National Statistical Committee. Legal entities involved in agriculture, hunting and fishery were categorized into the farmer's sub-population and is not reflected here. Based on the above formula and taking into account the non-response rate, the national incidence of 10,982 small and medium companies therefore, was regionally distributed as follows:

**Table 9.1. Sample size of small and medium companies by region**

	Total number of SMCs, N	Sample size without non-response rate, n	Sample size with non-response rate (20%)
Issyk-kul oblast	331	34	43
Jalalabat oblast	415	45	58
Naryn oblast	217	22	27
Batken oblast	138	15	17
Osh oblast	361	38	48
Talas oblast	119	13	16
Chui oblast	1,056	111	137
Bishkek city	7,666	211	263
Osh city	679	80	102
Total	10,982	569	711

As can be seen from the table, the state distribution of small and medium companies is uneven and largely skewed towards Bishkek city. In order to mitigate this and allow for statistically valid analysis across regions, the sample size for Bishkek city was reduced by half and the sample sizes for other regions were proportionately increased. For data analysis initial shape of distribution will be restored by weight coefficients. The sample was further stratified by size of firms based on national incidence of small and medium enterprises for 2008 provided by the National Statistics Committee of the Kyrgyz Republic.

**Table 9.2. Sample size by region and size of firms**

	Number of small companies	Number of medium companies	Sample size n, small companies	Sample size n, medium companies	Total sample size
Issyk-kul oblast	277	54	39	4	43
Jalalabat oblast	350	65	52	6	58
Naryn oblast	193	24	26	1	27
Batken oblast	120	18	17	0	17
Osh oblast	323	38	46	2	48
Talas oblast	104	15	16	0	16
Chui oblast	943	113	130	7	137
Bishkek city	7,189	477	233	30	263
Osh city	635	44	98	4	102
Total	10,134	848	657	54	711

<sup>124</sup> A 4% precision of an estimate in a 95% confidence interval means that we can guarantee that the population parameter is within the 4% range of the observed sample parameter, except in 5% of the cases.



The table below shows the sample distribution of the small and medium company population by sector of economic activity.

**Table 9.3. Sample size by sector and size of firms**

SIZE OF FIRMS	TOTAL	SMALL	MEDIUM
Manufacturing industry	113	103	10
Construction	79	74	5
Trade and repair	216	205	11
Transport and Communications	61	54	7
Real estate and other services	152	138	14
Other	90	83	7
Total	711	657	54

The final sample size of 711 small and medium companies is representative of the national population such that statistically valid inferences at 4% significance level for this sub-population within 95% confidence interval are possible for small and medium companies in each region and sector of activity.

#### Sample distribution for individual entrepreneurs

The data on national incidence and distribution of individual entrepreneurs as of 01.01.2009 was obtained from the Kyrgyz State Statistics Committee. The national incidence of 145,663 individual entrepreneurs in all sectors with the exception of the agricultural sector was distributed by regions and sectors as follows:

**Table 9.4. National incidence of individual entrepreneurs as of 01.01.2009 by region and sector**

	TOTAL	MANUFACTURING INDUSTRY	TRADE AND REPAIR	HOTELS AND RESTAURANTS	TRANSPORT AND COMMUNICATIONS	OTHER
Batken oblast	8,264	749	5,292	431	1,179	613
Jalalabat oblast	10,636	1,126	7,265	535	1,060	650
Issyk-kul oblast	17,178	822	9,796	601	4,551	1,408
Naryn oblast	6,346	876	4,265	207	566	432
Osh oblast	20,375	2,809	11,904	797	3,863	1,002
Talas oblast	3,070	342	2,002	105	345	276
Chui oblast	29,444	2,671	16,393	1,172	6,283	2,925
Bishkek city	35,298	3,594	21,181	2,530	2,834	5,159
Osh city	15,052	834	8,713	789	3,246	1,470
Total	145,663	13,823	86,811	7,167	23,927	13,935

The corresponding sample size was calculated. As can be seen from the table, the national distribution of individual entrepreneurs is larger in the trade and repair sector. In order to mitigate this and allow for statistically valid analysis across sectors, the sample size for the trade and repair sector was reduced by half and the sample sizes for other sectors were proportionately increased. For data analysis initial shape of distribution will be restored by weight coefficients.

**Table 9.5. Sample size of individual entrepreneurs by region with non-response rate (10%)**

	TOTAL NUMBER OF IEs, N	SAMPLE SIZE, N
Batken oblast	8,264	35
Jalalabat oblast	10,636	43
Issyk-kul oblast	17,178	81
Naryn oblast	6,346	27
Osh oblast	20,375	94
Talas oblast	3,070	14
Chui oblast	29,444	141
Bishkek city	35,298	161
Osh city	15,052	71
Total	145,663	667

**Table 9.6. Sample size of individual entrepreneurs by sector with non-response rate (10%)**

	TOTAL NUMBER OF IES, N	SAMPLE SIZE, N
Manufacturing industry	13,823	111
Trade and repair	86,811	199
Hotels and restaurants	7,167	56
Transport and communications	23,927	191
Other	13,935	110
Total	145,663	667

The final sample size of 667 individual entrepreneurs is representative of the national population such that statistically valid inferences at 4% precision level for this sub-population within 95% confidence interval are possible for individual entrepreneurs in every region.

#### **Sample distribution for Agricultural enterprises/ farmers**

In the first stage of sampling of the population of agricultural enterprises, the regional distribution from official sources was obtained. The information was provided by the Kyrgyz National Statistics Committee as of 01.01.2009. At the second stage of sampling different types of agricultural enterprises were aggregated into two sub-populations:

1. Agricultural legal entities included:
  - a. Farmer cooperatives
  - b. Peasant farms registered as legal entities
  - c. Small and medium companies in the Agriculture and Fishery sectors
2. Agricultural Individual enterprises included:
  - a. Peasant farms registered as Individual enterprises
  - b. Individual entrepreneurs in the Agriculture and fishery sectors.

The national incidence of both agricultural sub-populations was regionally distributed as follows:

**Table 9.7. National incidence of agricultural enterprises**

	TOTAL	LEGAL ENTITIES	INDIVIDUAL ENTREPRENEURS
Batken oblast	14,244	244	14,000
Jalalabat oblast	80,327	1,593	78,734
Issyk-kul oblast	16,403	510	15,893
Naryn oblast	34,518	470	34,048
Osh oblast	66,907	641	66,266
Talas oblast	18,110	334	17,776
Chui oblast	46,418	668	45,750
Bishkek city	737	66	671
Osh city	2,618	22	2,596
Total	280,282	4,548	275,734

At the third stage the corresponding sample size was calculated:

**Table 9.8. Sample size of agricultural enterprises by region with non-response rate (5%)**

	TOTAL	LEGAL ENTITIES	INDIVIDUAL ENTREPRENEURS
Batken oblast	33	6	27
Jalalabat oblast	187	36	151
Issyk-kul oblast	42	11	31
Naryn oblast	76	11	65
Osh oblast	142	15	127
Talas oblast	42	8	34
Chui oblast	103	15	88
Bishkek city	2	1	1
Osh city	5	0	5
Total	632	102	529

The final sample size of 632 agricultural enterprises was representative of the national population such that statistically valid inferences at 4% precision level within 95% confidence interval.

**The aggregate sample size for all 3 populations amounted to 2010 i.e. small and medium companies = 711, individual entrepreneurs = 667 and farmers = 632, which matched the initial plans.**

### Fieldwork

For the purposes of the survey, questionnaires for each target population were developed. Given the emphasis on the quantitative survey, the questionnaires were pre-coded and closed-ended. The selected Survey Company (SIAR) was responsible for translation of survey instruments into Kyrgyz.

For the purpose of respondents recruitment, a call-center was organized by the survey company. Such approach allowed providing fieldwork in the needed timeframe and reach relevant respondents for interviewing.

IFC survey specialists conducted comprehensive operational trainings to enumerators and supervisors prior to starting the survey field work. Enumerators and their supervisors were trained on data collection procedures, rapport building and on their responsibility in collecting reliable information from respondents. Supervisors were also trained on were trained on the utilization of random sampling. In addition, a data collection manual was developed for enumerators and supervisors. In the manual, definitions and concepts of various terms used in the questionnaire were provided to all enumerators and supervisors.

Before the main fieldwork, piloting of all questionnaires was carried out on a sample size of 70 followed by minor modifications to the survey tool and final approval of the full survey. IFC survey specialists participated in the pilot interviews to ensure the interviewers understood the terminology and interviewing methodology.

The survey use method of face-to-face interviewing of the most knowledgeable person in the businesses (owner or manager). Face-to-face interviews allow for longer interviews and usually have a higher response rate. Respondents also feel more comfortable providing sensitive information during face-to-face interviews than over the phone. The average duration of interviews was 45-50 minutes.

### Qualitative Methods of Data Collection

Key informant interviews and focus groups were organized at the beginning and at the end of the survey process to interpret and complement quantitative survey data. During the conceptualization of the survey process, focus groups and key informant interviews with industry practitioners and experts were also organized to identify problems and procedures for the survey.

### Quality control

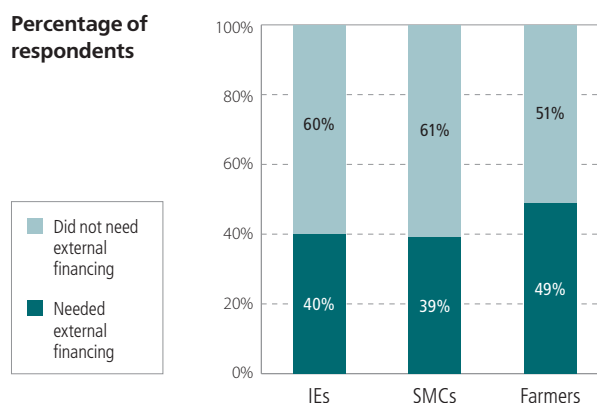
Survey control was performed both by the research company and by IFC at all stages of the survey. The control of the screening and field work processes was conducted through weekly submission of progress reports to IFC. The quality control of the enumerators' work was performed by IFC through random attendance of the interviews in the field. Prior to start of the data entry, IFC conducted a visual review of 20% of randomly selected questionnaires of each interviewer to check for quality of completion. In addition, statistical methods to check the consistency, accuracy and quality of work of each interviewer were used. Logical control of all questionnaires was performed at the stage of data entry. The research company used special programs to perform logical control of the data. The double-entry approach was applied to ensure quality of the data entry.

# Annex 1.

## Access to Finance

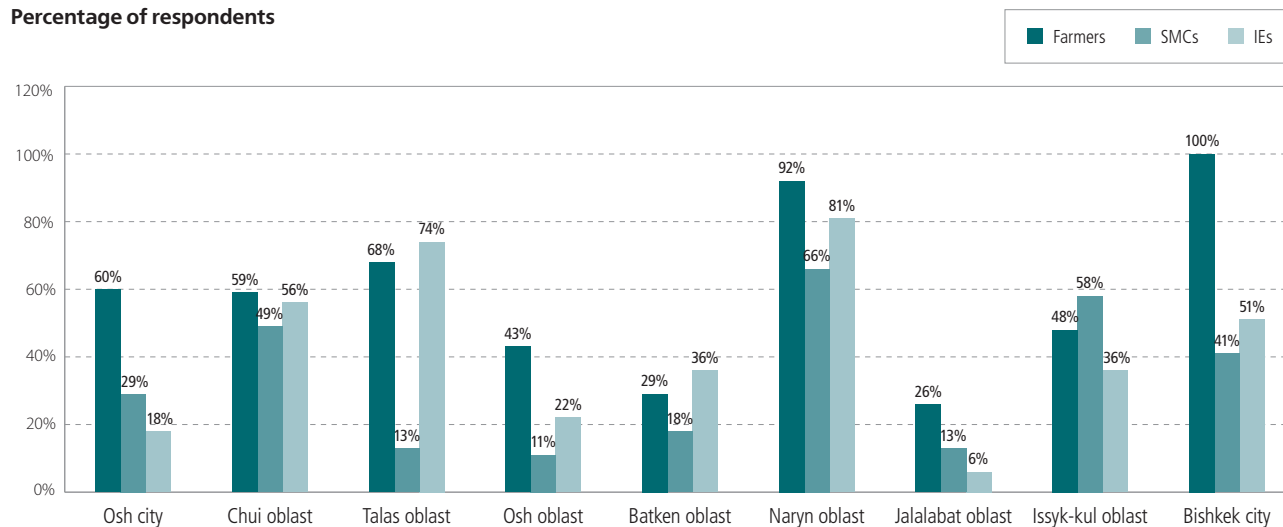
### Respondents need for external financing in 2008

Percentage of respondents



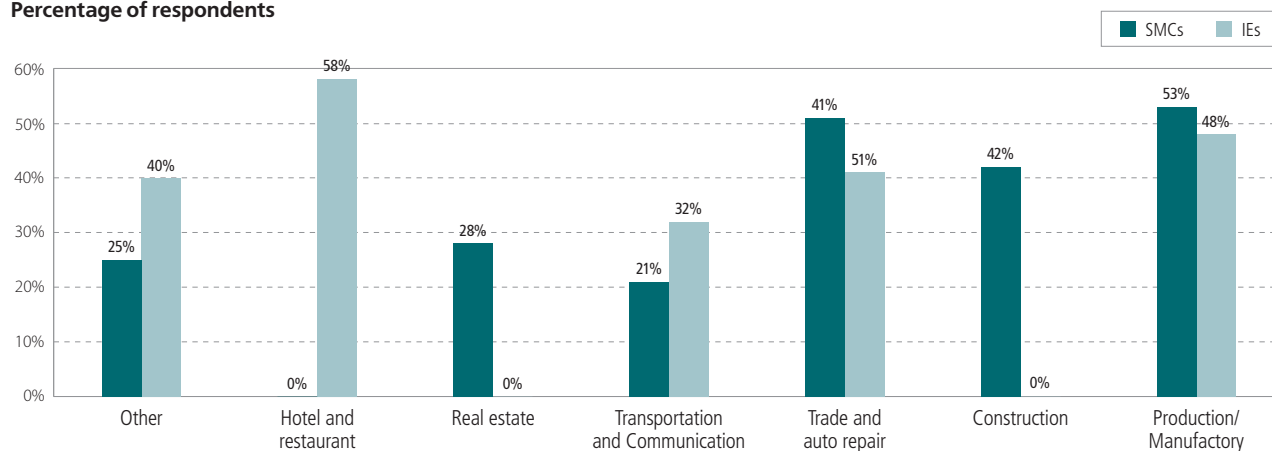
### Respondents need for external financing (by region)

Percentage of respondents



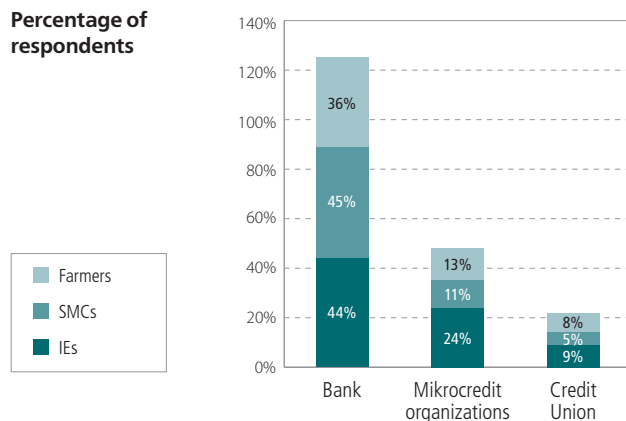
### Respondents need for external financing (by sector)

Percentage of respondents



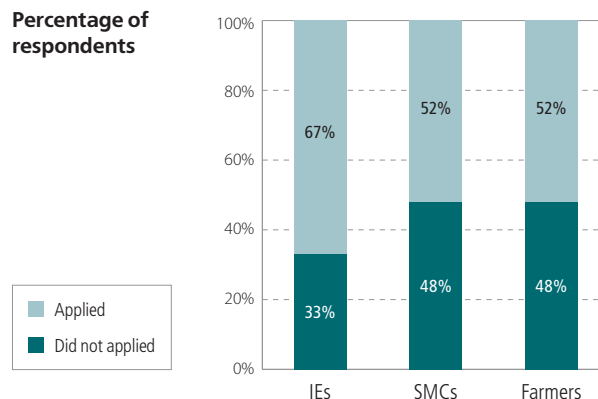
### Respondents who needed external financing and applied for a loan (by financial institutions)

Percentage of respondents



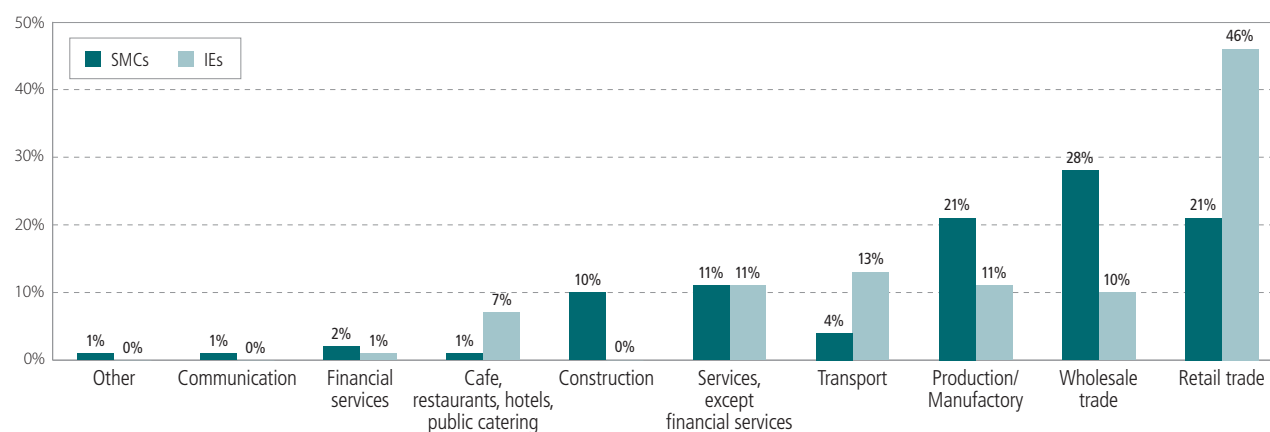
### Respondents who needed external financing and applied for a loan

Percentage of respondents



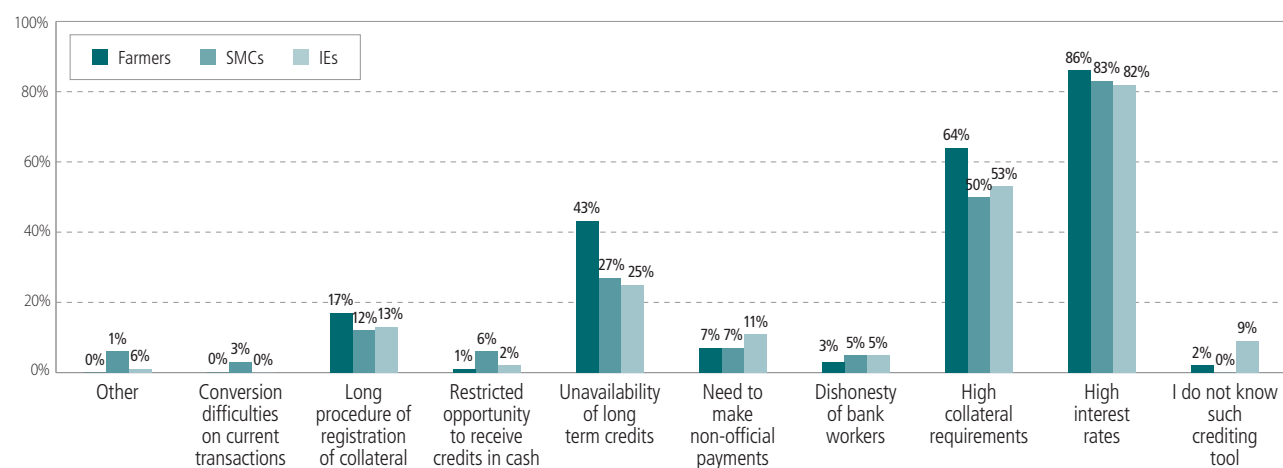
### Respondents who needed external financing and applied for a loan (by sector)

Percentage of respondents



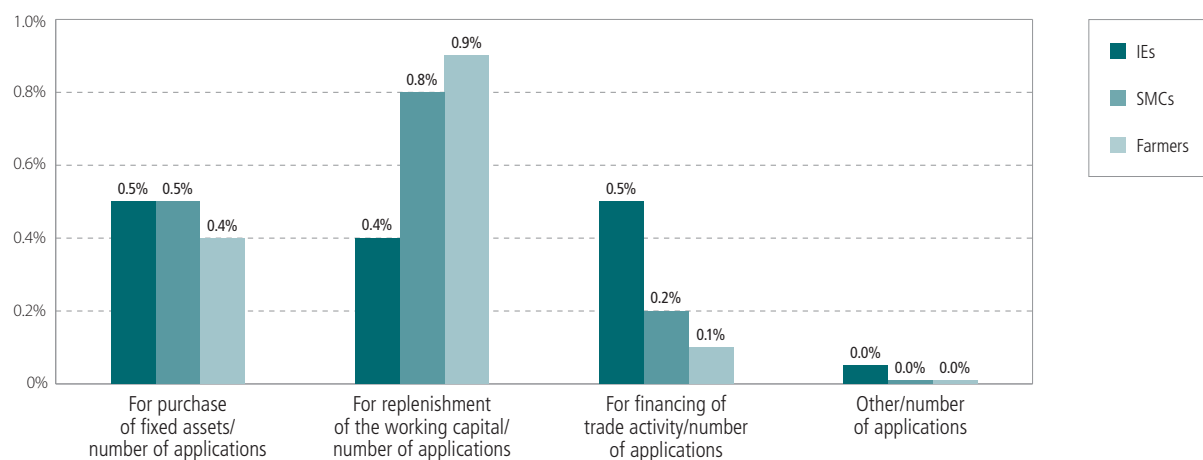
### Respondents stated the main three reasons for not applying for a loan

Percentage of respondents



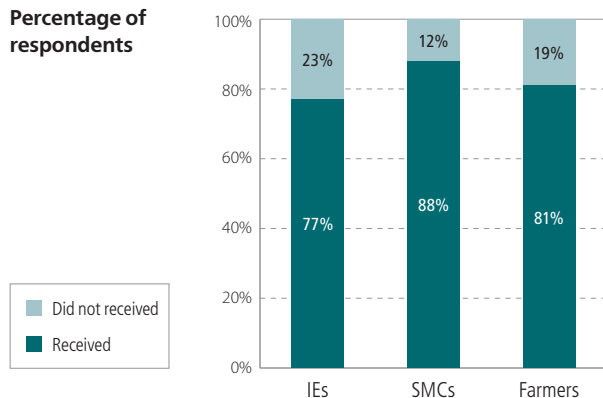
### Respondents received loans (by purposes)

Percentage of respondents



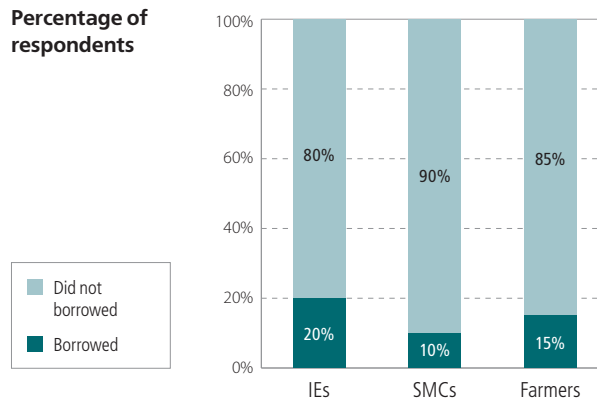
### Respondents who applied and received loans

Percentage of respondents

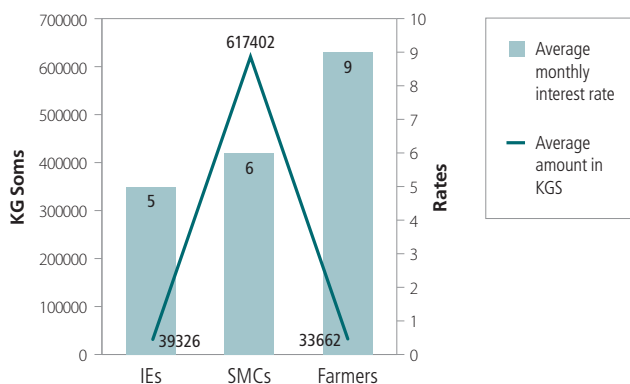


### Respondents who borrowed money unofficially at interest for their enterprises' activity in 2008

Percentage of respondents

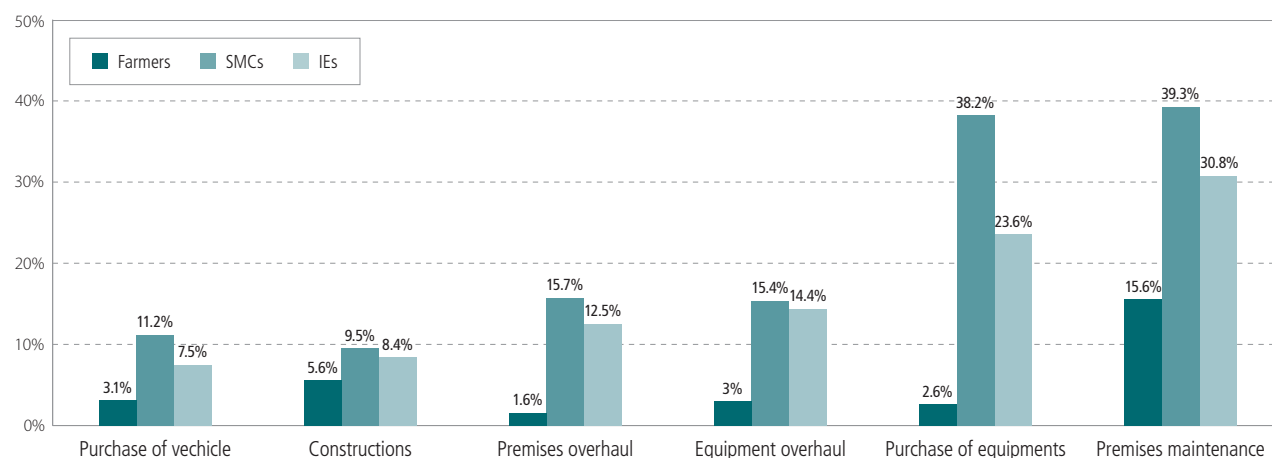


### Unofficial loans' description



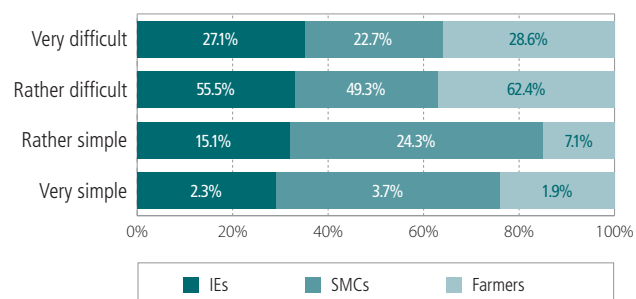
### Respondents invested in enterprise assists

#### Percentage of respondents



### Respondents estimated the access to finance

#### Percentage of respondents



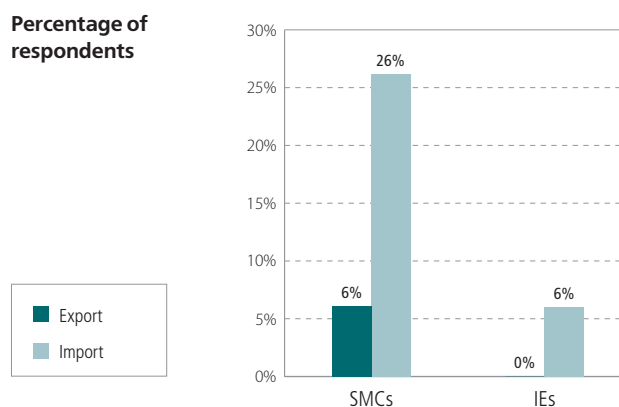
**Note:** Some tables in Annex 1 do not contain information on farmers because the response rate was insignificant (less than 15)



## Annex 2. Foreign Trade

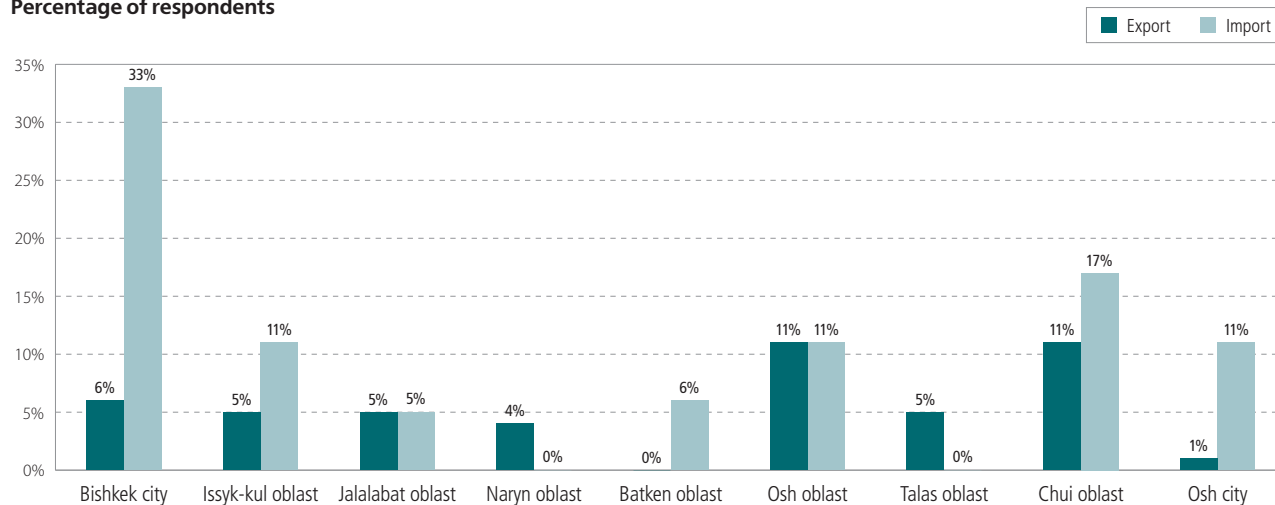
### Share of businesses dealing with export/import in 2008

Percentage of respondents



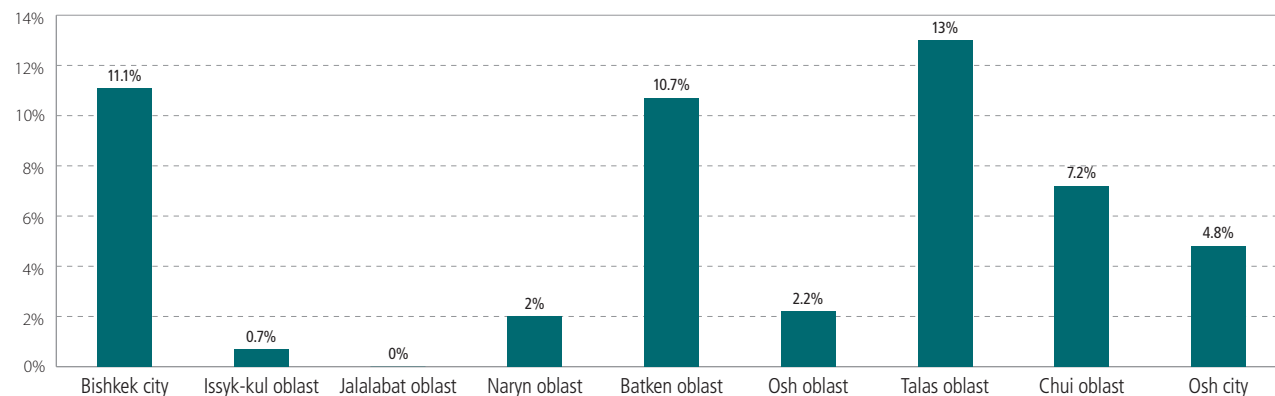
### Share of SMCs dealing with export/import (by region)

Percentage of respondents



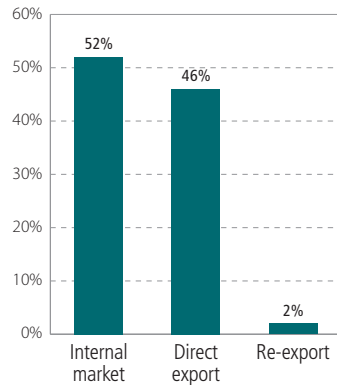
### Share of IEs dealing with import (by region)

Percentage of respondents

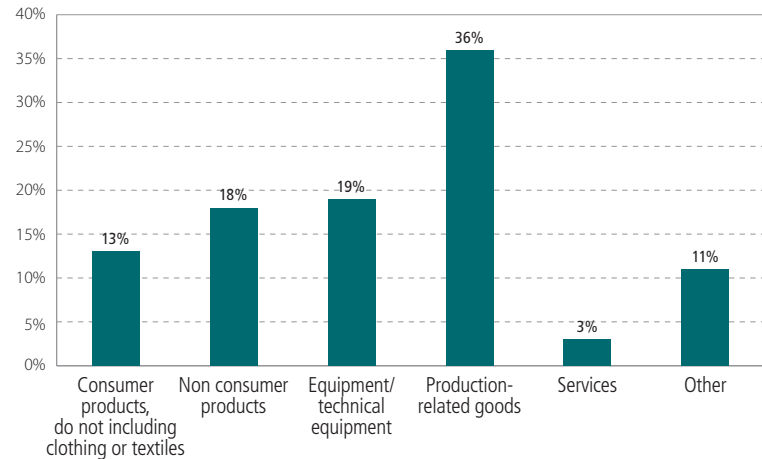


### Market distribution of exported goods by SMCs

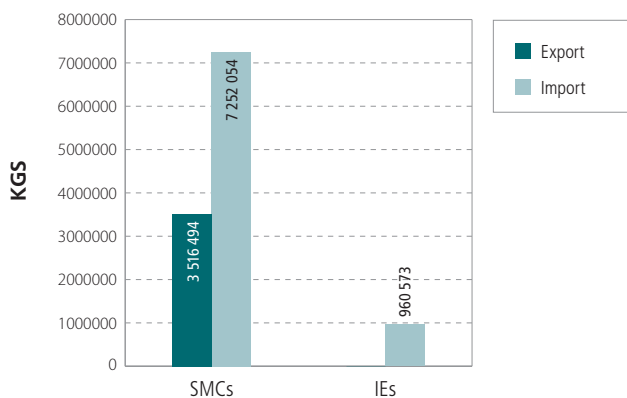
Percentage of respondents



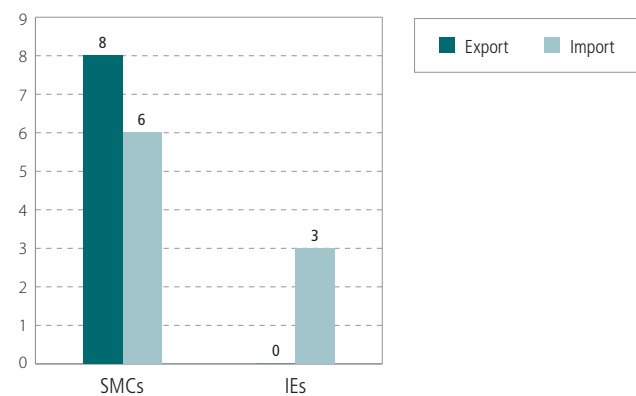
### The main type of product imported by SMCs in 2008, in %



### Average total volume of exported/imported products in 2008, KGS

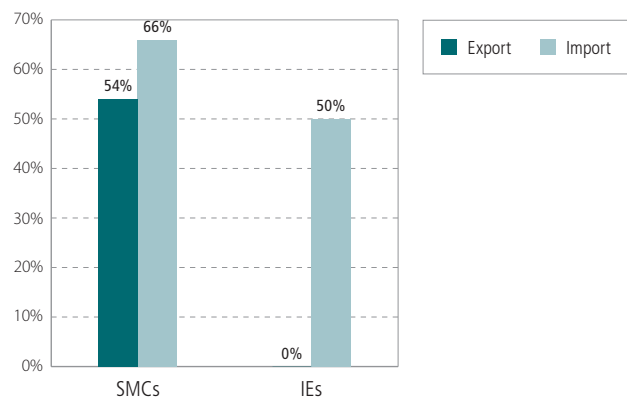


### Average number of export/import transactions

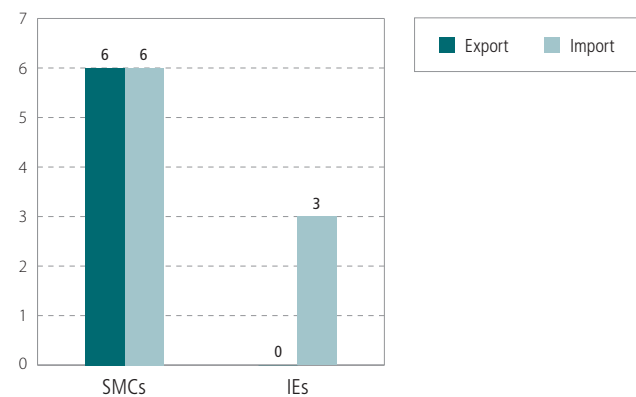


### Share of companies requested to provide a certificate of compliance for export/import

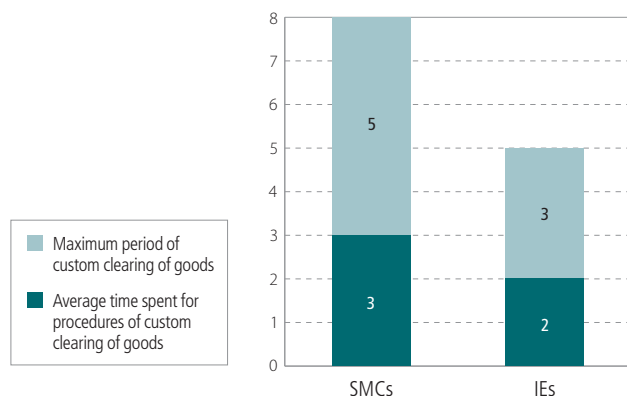
Percentage of respondents



### Average time spent for procedures related to registration of ONE export/import transaction in 2008, in working days (man-days)

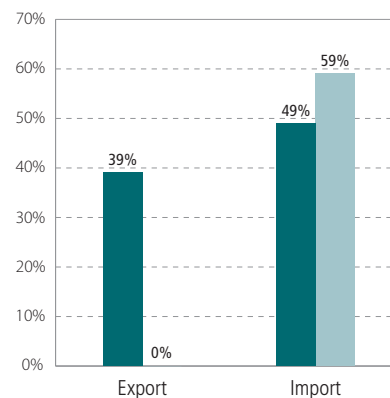


### SMCs spent more time for import procedures



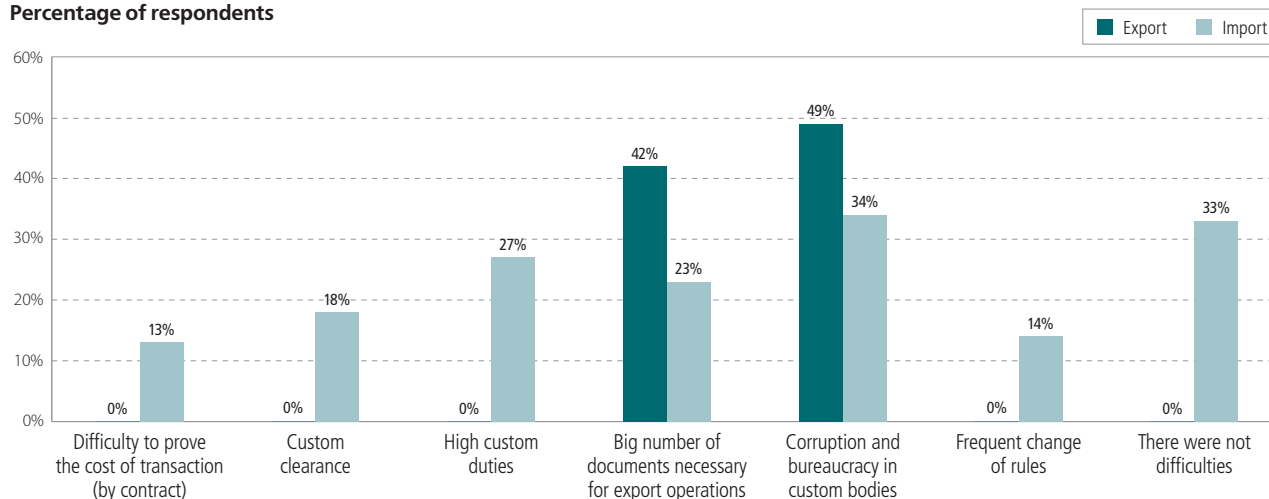
### Share of companies experienced informal methods of export/import procedures

Percentage of respondents



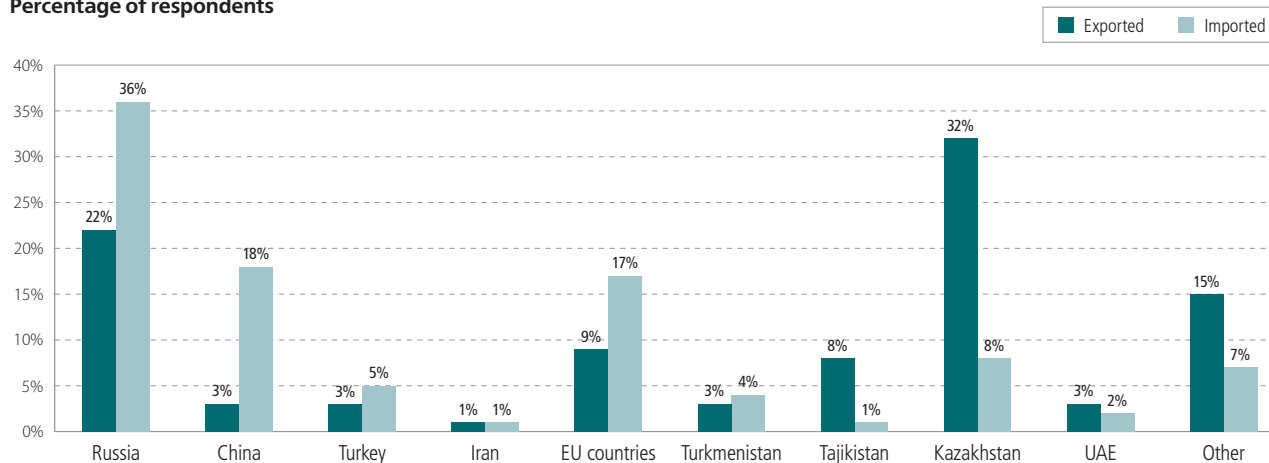
### SMCs identified main challenges of export/import procedures

Percentage of respondents



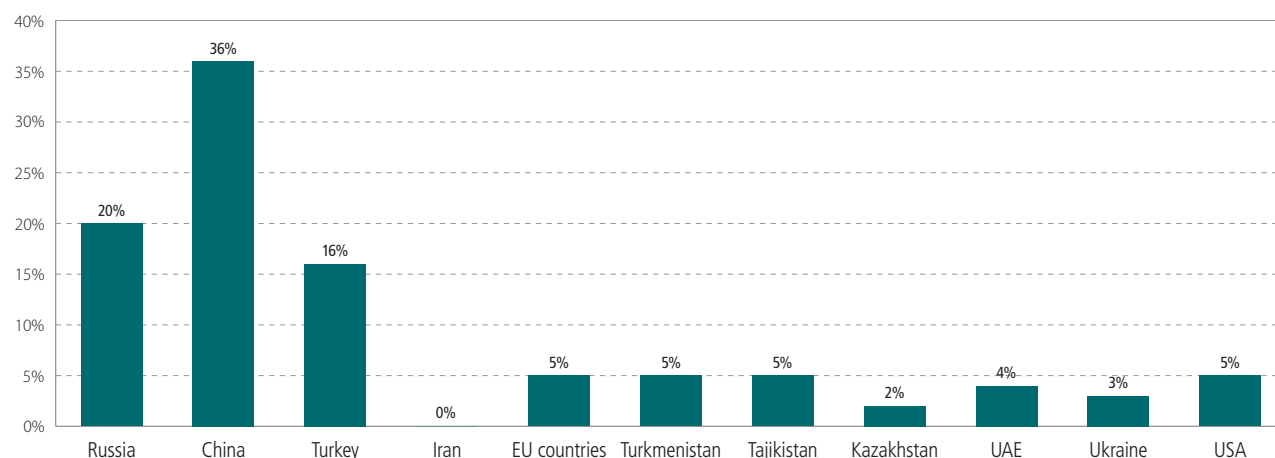
### SMCs exporting/importing countries

Percentage of respondents



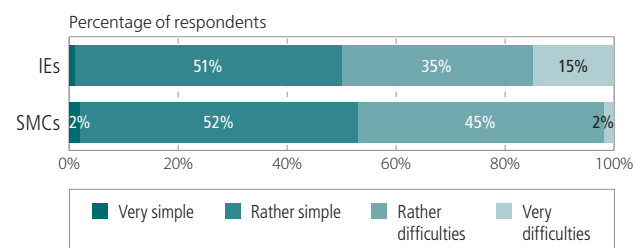
## IEs importing countries

### Percentage of respondents



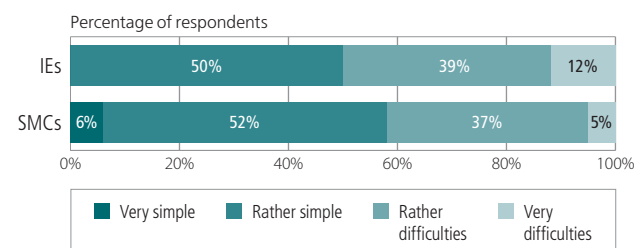
## Respondents estimated export procedures

### More than 50 percent businesses state that passing export procedures as rather simple



## Respondents estimated import procedures

### Almost every second businesses said that passing import procedures was rather simple



**Note:** Tables in Annex 2 do not contain information on farmers because the response rate was insignificant (less than 15). Tables on IEs in Annex 2 do not contain information on export because the response rate was insignificant (less than 15), except the table "Level of difficulties"





**IFC Investment Climate Advisory Services Project**

4<sup>th</sup> floor, 6 Ryskulov Street  
Bishkek, Kyrgyz Republic 720001  
Tel.: +996 312 626162  
[www.ifc.org/beekg](http://www.ifc.org/beekg)