Kyrgyz Republic: Business Climate Improved, But Corruption Remains Key Problem ? New World Bank-EBRD Study

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According to the Kyrgyz Republics firms, the countrys business climate has significantly improved since 2008, but corruption remains one of the key obstacles in doing business, says the 2013 Business Environment and Enterprise Performance Survey (BEEPS), launched in Bishkek today.
A joint initiative of the European Bank for Reconstruction and Development and the World Bank Group, the 2012/2013 round of BEEPS surveyed 270 firms in all six oblasts of the Kyrgyz Republic to measure their perceptions and experiences on a broad range of issues concerning the business environment in the country: regulations and red tape, taxation, unofficial payments and corruption, labor and workforce development, access to financing, courts in legal system, infrastructure.
Comparing the findings of this years round to firms responses from 2008, the 2013 BEEPS identified the following remarkable trends:
Overview of changes in business environment
Overall, the 2013 BEEPS results suggest that firms perceptions of various aspects of the business climate in the Kyrgyz Republic have improved since 2008. For all but two of the 16 potential obstacles to doing business tracked by BEEPS (corruption and political instability), the share of Kyrgyz firms reporting that these issues are not a problem has increased. The areas showing the greatest improvement are "Electricity (from 11 percent of respondents reporting electricity not being a problem in 2008 to 35 percent in 2013), "Courts (from 40 percent reporting it was not a problem in 2008 to 87 percent in 2013), "Crime, theft, and disorder (from 24 to 51 percent), "Tax administration (from 22 to 48 percent), and "Practices of informal economy competitors (from 22 to 43 percent reporting this not being a problem in 2008 and 2013, respectively). The least improved areas in absolute terms were "Tax rates, "Skills and education of workers, "Transport, and "Customs and trade regulations.
Nevertheless, some old problems persist and new problems have emerged. Corruption remains the second worst obstacle and percentage of firms seeing it as an obstacle has increased between 2008 and 2013. Tax rates remained the third worst obstacle. Political instability now tops the ranking as the most severe obstacle in 2013 compared to 4th place in 2008 - in 2013 only 4 percent of the firms did not see it as an obstacle, compared to 22 percent in 2008 - reflecting the significant changes taking place from 2010. Skills and education of labor moved from the 10th to 4th worst obstacle.
Regulations and red tape
While perceptions of interactions with the Government have improved in general, experiences may show a more nuanced picture. For example, while the share of firms reporting that business licensing and permitting are not obstacles has increased from 51 to 80 percent, the percentage of firms reporting not spending any time on government regulations went down from 52 percent in 2008 to just 8 percent in 2013, although. while more firms spent time, the share of time remained almost unchanged (13 and 14 percent in 2008 and 2013), perhaps, more firms have started following the regulations.
The quality of services provided to businesses by the state is worsening. The waiting times for services such as electrical and water connections, construction permits and operating licenses increased, although not significantly. The poor score on electricity is corroborated by the Getting Electricity indicator from the World Bank Doing Business (DB) report where the Kyrgyz Republic is ranked 180th, reflecting more procedures, longer time and a much higher cost of getting a connection compared to other countries.
Taxation
Perceptions of the tax environment have improved, likely a consequence of tax policy reforms undertaken over the past five years. In 2008, 90 percent of firms reported that tax rates are a problem: by 2013 this number decreased to 77 percent. The percentage of firms reporting that tax rates are major/very severe problem went down from 49 percent in 2008 to 29 percent in 2013. Tax policy reforms have contributed to these trends. The corporate income tax rate was slashed from 20 to 10 percent in 2007 while social contributions were reduced from 19 to 17 percent. A new tax code was adopted in 2009 which, among other things, reduced the number of taxes from 16 to 8 and established a number of special simplified tax regimes.
Perceptions of tax administration have also improved again, probably as a result of tax administration reforms. The share of firms reporting tax administration as a problem decreased from 78 to 52 percent between 2008 and 2013. An important finding is that small firms appear to have been particular beneficiaries: only 37 percent of small firms perceived tax administration as a problem in 2013. The percentage of small and large firms perceiving tax administration as a major obstacle was reduced by half, while the percentage of medium firms perceiving tax administration as a major obstacle has not changed.
Unofficial payments and corruption
Corruption is a big and growing problem - it retains the second worst rank among 16 obstacles to business operation and growth measured in BEEPS. Although results show that in 2013 unofficial payments are less frequent than in 2008, the survey finds that more firms are subjected to bribe requests. Almost a half of firms (49%) reported that unofficial payments are needed in dealing with public officials, up from 37 percent in 2008.
Direct interactions between firms and government institutions are still a fertile ground for corruption. As it was mentioned earlier, bribe expectations reported by firms with first-hand experiences of direct interactions with government institutions show that bribe incidents are on the rise. When firms were asked about their own experiences with tax inspections in 2013, 53 percent of inspected firms indicated that an informal payment was expected or requested: a significant increase from 34 percent in 2008.
However, improvements in the perceptions of corruption suggest that the Governments efforts to strengthen the institutional environment are having some positive impact. The largest decrease in the perceived frequency of unofficial payments is in dealing with taxes: while 37 percent of firms reported that unofficial payments were frequent in dealing with taxes in 2008, this share decreased by two thirds to 12 percent of respondents in 2013. Perceptions of corruption in public procurement show that more firms attempted to secure government contracts, while the amount of kick-backs went down.
Labor and workforce development
Skills are increasingly becoming an obstacle to doing business in the Kyrgyz Republic. Only 35 percent of firms do not see a problem with skills and education of their labor force making this the 4th most severe problem for doing business in 2013, compared to 10th in 2008.
While in 2008 finding qualified labor was a bigger problem for larger firms, in 2013 small firms also started to face difficulties in recruitment. In 2008 an inadequately educated workforce was cited as major obstacle by 18 percent of small firms, in 2013 this share more than doubled to 40%, while same percentages for larger firms changed significantly less: from 34 to 41% for medium firms and from 29% to 41% for large firms in 2008 and 2013, respectively.
Financing of firms
While credit is more easily available now than five years ago, progress in access to finance has been more limited relative to other areas. In 2013 access to finance became 7th most important obstacle compared to 9th in 2008 even though the perception of access to financing has improved. Given that there was strong growth in credit to the private sector over this period, these trends may reflect the inability of the financial sector adequately to support businesses.
On the positive side, commercial banks have reduced the complexity of the application process. In 2013 only 4 percent of firms reported the complexity of the application process as the main reason for not applying for a loan, compared to 12 percent in 2008. This may be a result of improved coverage of private credit bureaus, perhaps in combination with strengthened legal rights of firms.
A higher share of companies buying inputs on credit in 2013 could be indicative of increasing trust between economic agents, although it is not yet resulting in higher volumes of credit-based sales. Forty-four percent of firms purchased inputs on suppliers credit in 2013, up from 31 percent in 2008. At the same time, inputs purchased on suppliers credits as a share in total inputs purchased went down from 51 percent in 2008 to 28 percent in 2013. Consequently, economy-wide, sales on credit went down from 32 percent to 17 percent of sales in 2008 and 2013, respectively.
Courts and the legal system
Courts are perceived as one of the least problematic areas for doing business, second only to labor regulations; however, a deeper examination reveals significant efficiency issues. In 2013, only 13 percent of firms saw courts as a problem, and only 4 percentage points of respondents saw it as major or very severe problem. This is a significant improvement compared to 2008 when 60 percent of firms saw courts as a problem and 29 percent saw them as a major/severe problem. Around one fifth of firms reported using the court system in 2008 and 2013. Although courts are perceived as less corrupt than five years ago, they are seen as ineffective and slow and therefore firms are avoiding using the system to settle disputes.
Low use of courts and consequently a perception of the courts as an obstacle may be a result of low trust in the court system reported by respondents. All three indicators measuring court system performance derived from BEEPS show significant deterioration: only 9 percent of respondents think that courts are quick in 2013 (compared to 24 percent in 2008); only 21 percent believed that courts can enforce their decisions (47 percent in 2008), and only 9 percent felt that courts are fair and impartial and uncorrupt (24 percent in 2008).
Infrastructure
Perception of the quality of physical infrastructure is improving. Electricity is no longer the biggest obstacle to doing business but the 5th while telecommunications has moved from 5th to 11th place. Transport continues to be viewed relatively favorably, ranked as the 10th most severe obstacle among 16 measured in BEEPS, marginally worse compare to 2008 when it was 11th. While the percentage of firms experiencing power outages has increased from 47 percent to 73 percent between 2008 and 2013, losses from these outages have significantly reduced. Considering that available information does not show an increase in use of private generators, the latter results suggest that recent investments in the sector and efforts to improve governance may be paying off.
"The 2013 BEEPS report provides firm and welcome evidence that the Government's efforts really have transformed the investment climate, says Alexander Kremer, World Bank Country Manager in the Kyrgyz Republic. "However, despite these efforts, political instability and corruption remain important obstacles to business.
The BEEPS is a firm-level survey based on face-to-face confidential interviews with managers, examining the quality of the business environment. The BEEPS has been carried out in five rounds: in 1999, 2002, 2005, 2008, and 2012/13 and covers virtually all of the countries of Central and Eastern Europe and the former Soviet Union, as well as Turkey.
Since the start of its operations in the Kyrgyz Republic, the EBRD has invested approximately US$ 630 million in about 110 projects across different sectors of the Kyrgyz economy.
The World Banks overall mission in the Kyrgyz Republic is to reduce poverty, promote economic growth and shared prosperity. 45 percent of the World Banks assistance to the Kyrgyz Republic is in the form of grants. The other 55 percent is in highly concessional credits - no interest, and only a 0.75 percent service charge. Credits are repayable in 40 years, including a 10-year grace period, while grants require no repayment. The financial assistance to the Kyrgyz Republic since 1992 amounts to over US$1 billion.

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