

CORRUPTION IN THE PRIVATE AND GOVERNMENT SECTORS: THE CHALLENGES OF REFORMS IN KYRGYZSTAN

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After one decade of efforts by the international community to build market economy and democracy, Kyrgyzstan is still economically backward and more authoritarian than it was at the outset of reforms. Scholars and practitioners have focused on political regimes, leadership, foreign direct investments, macroeconomic stability and all sets of other factors to understand economic failures and institutional weaknesses in Kyrgyzstan. Nonetheless, one of the crucial factors, which have been shaping the failure of political and economic development, has not drawn much attention. This factor is corruption.

The chapter argues that corruption has been one of the main obstacles to the formation and operation of the private sector and further institutional reforms toward democracy in Kyrgyzstan. Kyrgyzstan is an interesting case because it is still considered relatively more successful than other Central Asian countries in terms of initiation of radical economic reforms and building civil society. However, an examination of pervasive corruption in Kyrgyzstan demonstrates that it is far from being success.

The chapter is organized as follows. Firstly, I define corruption and link it to the level of economic development. Notably, corruption is much higher in Central Asia than in Eastern Europe. The former is also less economically advanced despite the endowments of natural resources. In Kyrgyzstan, corruption has been institutionalized and legitimized in all segments of the society. For example, the practice of giving and taking bribes is ubiquitous in high schools, universities, hospitals, police stations, municipal agencies and in other numerous places.

The second subchapter starts comparing briefly a command economy versus a market economy to show the efficiency and productiveness of the latter, and to stress the importance of the private sector for economic development. Then, it focuses on the privatization reforms undertaken to create the private sector. The privatization reforms

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aimed at transforming the state-owned enterprises into privately owned ones and introducing private property rights for the start up of new firms. Indeed, the privatization and land reforms facilitated the formation of small size enterprises and farms, as well as established a partial market environment for business conduct.

Yet, as I point out in the subchapter on corruption in the private sector, the process of privatization was largely venal because the government officials who had access to essential people, information and instrumentalities were the main beneficiaries from these reforms. This type of patronage privatization was the first step in legitimizing corrupt practices in business conduct. In addition, burdensome formal rules (onerous taxes, regulation fees, etc), informal interventions by bureaucrats, the lack of information by firms and deeply ingrained norms of informal dealings have shifted a substantial part of the Kyrgyz economy into the informal sector.

The fourth subchapter focuses on the corruption in the government sector, claiming that it is partially derived from the old Soviet system of *nomenklatura* and the institutional vacuum created during transition. Although the Kyrgyz government has declared its commitment to democratic principles and pluralism, the power is highly concentrated in the hands of the executive branch, and the public administration depends on the system of loyalties, appointments and corruption. Thus, the government is encouraging instead of combating corruption.

Finally, I discuss the major challenges that the private, government and third sectors are facing in terms of dealing with corruption. In the private sector, corruption poses a major challenge for firms without political connections and resources. Only do the firms, with informal networks of government officials and business partners, have a certain degree of predictability in doing business. However, as the private sector gets more complex, the necessity for firms to engage in impersonal exchange becomes inevitable, which can only be achieved through formal institutions (e.g., accountable courts, enforceable contracts, etc).

No doubt that the government has the most capacity to enforce formal institutions and eradicate corruption. But the dilemma is that political elites benefit from corruption and the challenge is to make these beneficiaries commit themselves credibly to put an end to the main source of their wealth and power. It is a very difficult task because the

incentives are structured to encourage corruption. Less capable but important actors to fight with corruption are international and local NGOs. They can be countervailing forces to the power of the state. However, they are facing their own challenges such as the lack of financial sustainability, incoherence between local conditions and prescribed programs, and “petty” corruption in their daily operations. Although international and local NGOs have been gaining more legitimacy and capacity over time to play watchdogs for government misdemeanors, the real efforts should be undertaken by the willingness and credible commitment of the government to change the status quo.

CORRUPTION

Corruption derives from the Latin word *corruptus*, meaning improper, illicit, immoral, vicious, bribable, venal, and so on. Corruption is defined as an “impairment of integrity” and “inducement to wrong by improper and unlawful means.”¹ The violation of integrity and laws is at the core of corruption. Nevertheless, not only is corruption a violation of integrity and laws but crime, misdeed, deception, trickery and others can violate integrity and laws. In social sciences, corruption is more associated with bribery and malfeasance in office. Bardham defines corruption as “the use of public office for private gains.”² Shleifer and Vishny define corruption as the “sale by government officials of government property for personal gain.”³ In all of these definitions, it is clear that corruption is abusive behavior by public officials to gain personal gains. The public sector is at the center of the phenomenon of corruption and; therefore, the word corruption is mainly associated with the abusive behavior by public officials.

However, not only do public officials engage in corruption, but also business representatives, non-profit organization employees and ordinary people engage in corruption on a daily basis. Hellman et al. divide corruption into two types – *grand and petty*. By grand corruption, the researchers imply, “private payments to public officials to influence the content of the basic rules of the game” and by petty corruption they imply corruption that individuals or firms face in their direct interaction with the state officials (19).⁴ Hence, we can define corruption more broadly as the abuse of the formal rules of the game by actors for their private gains. Although this definition applies to all types of

actors and organizations (public, private, non-government, etc), it cannot be applied to all forms of corrupt activities. Indeed, it is hard to define corruption in one sentence due to its complexity.

However it is defined, corruption has become a word of the day for politicians, scholars, practitioners and those who are interested in governance and development. It has recently been widely cited that widespread corruption in many underdeveloped countries accounts for their ineffective governance and economic backwardness. The World Bank stresses the significance of the problem of corruption: “corruption is of growing concern to donors, nongovernmental organizations, and governments and citizens in developing and industrial countries alike.”⁵ The president of the World Bank, James Wolfensohn, has called corruption the cancer with which international community must deal if it wants to achieve sustainable development.⁶ Mauro and Knack and Keefer provide empirical evidence that corruption lowers investment and economic growth.⁷ Gupta, Davoodi, and Alonso-Terme demonstrate that high corruption increases income inequality and poverty by reducing economic growth.⁸ In testing the effects of corruption on economic development, controlling for economic freedom, trade and geographic distance, economic backwardness is mainly the result of high levels of corruption and partially due to other factors.⁹ By and large, there is sufficient empirical evidence in economics and political science literature that corruption and development are inversely related.

In addition to the effect of corruption on development, it has also been cited as one of the main obstacles to political and economic transition in the formerly Soviet countries.¹⁰ The level of corruption in the former Soviet countries is unprecedented. In particular, the countries of Central Asia and Caucasus are notable for ubiquitous corruption, weak democratic institutions and economic sluggishness. For example, according to Table 1, the countries of Central Asia and Caucasus lag behind the other formerly communist counterparts in terms of transparency and economic development. There is no Central Asian or Caucasian country that is included in the top 50 transparent countries of the world and no Central Asian or Caucasian country that has GDP per capita above US\$2000.

TABLE 1 Corruption Perceptions Index (CPI) 2003

World Ranking	Country	CPI Score	High-low range	GDP per capita
29	Slovenia	5.9	4.7-8.8	14000
33	Estonia	5.5	4.7-6.6	4863
40	Hungary	4.8	4.0-5.6	8378
41	Lithuania	4.7	3.0-7.7	5126
53	Belarus	4.2	2.0 -5.8	1829
54	Czech-Rep	3.9	2.6-5.6	8242
59	Croatia	3.7	2.6-4.7	5071
59	Slovakia	3.7	2.9-4.7	5752
64	Poland	3.6	2.4-5.6	5320
78	Armenia	3.0	2.2-4.1	661
83	Romania	2.8	1.6-5.0	2342
86	Russia	2.7	1.4-4.9	2992
100	Kazakhstan	2.4	1.6-3.8	1949
100	Moldova	2.4	1.6-3.6	411
100	Uzbekistan	2.4	2.0-3.3	350
106	Ukraine	2.3	1.6-3.8	962
118	Kyrgyz-Rep	2.1	1.6-2.7	346
124	Georgia	1.8	0.9-2.8	713
124	Azerbaijan	1.8	1.4-2.3	837

Note: CPI ranges between ten (highly transparent) and zero (highly corrupt). The full sample includes 133 countries worldwide.

Sources: CPI 2003 is available at the Transparency International Web site, <http://www.transparency.org/> (October 15, 2004).

GDP per capita for 2003 is from the World Economic Outlook Database (WEO), available at the IMF Web site, <http://www.imf.org/external/pubs/ft/weo/2003/02/data/index.htm> (October 15, 2004).

Kazakhstan has GDP per capita close to US\$2000 but mainly because of its huge reserves of hydrocarbon resources. The least corrupt country in Central Asia and Caucasus is Armenia, yet it is still ranked only 86th in the sample of 133 countries of the world. Georgia, Azerbaijan and Kyrgyzstan are the most corrupt former Soviet countries in this sample. Paradoxically, Kyrgyzstan, which followed most of the recommendations of international donors and undertook one of the most radical reforms among other Soviet

countries toward democracy and market economy, achieved neither the expected economic growth nor effective governance to guard the country from rampant corruption.

Although composite indices such as CPI do not show precisely the extent of corruption, they enhance our understanding of the general degree of corruption of one country in comparison to another. Moreover, since it incorporates professional polls and surveys that capture the perception of thousands of international business leaders, risk analysts, business journalists and others, it shows how corruption is perceived from abroad. Nonetheless, it is also important to examine how corruption is viewed within the country. In Kyrgyzstan, many scholars, politicians, business representatives and ordinary people agree that corruption has permeated into all sectors of society and institutionalized itself as a legitimate form of exchange.¹¹ Official surveys and studies confirm this observation as well. For example, the Center of Public Opinion Studies and Forecasts, which conducted the public opinion poll on corruption in 2001, confirms the pervasiveness of corruption in Kyrgyzstan.

When researchers asked a question regarding respondents' opinion on the place of Kyrgyzstan in terms of corruption scales: 40 percent of respondents replied that corruption in Kyrgyzstan like in other countries; 24 percent replied that it was one of the most corrupt countries; 14 percent replied that it was more corrupt than other countries. Thus, 78 percent of respondents thought that Kyrgyzstan had equal or higher levels of corruption than in other countries.¹² The survey results revealed that majority of respondents associated corruption with weakness of authorities and viewed this fact as one of the obstacles to economic reforms (29.2 percent). Respondents also interpreted corruption in various ways: 21 percent of respondents related it to bribery; 14 percent of respondents associated it with mafia, 12 percent with abuse of power, ten percent with stealing, ten percent with graft and ten percent with "pushing necessary people."¹³

Although the term corruption has various interpretations and perceptions, there is general agreement that corruption in Kyrgyzstan has become ever-present. According to Table 2 (see below), bribery has become a major form of exchange to get things done not only in the government but in everyday life as well. Both entrepreneurs and office employees gave bribes for most of the time. All of the respondents gave bribes to traffic inspectors and criminal investigators. More entrepreneurs than office employees bribed

military registration officials. It can be because of higher costs of bribes to avoid compulsory service in the army. The other situations, in which more than 75 percent of entrepreneurs and office employees on average bribed was when they went through customs procedures, entered universities, and went to hospitals.

TABLE 2 Instances of Giving and Taking Bribes in Kyrgyzstan in 2000

During last three years you bribed or were extorted, when you had:	Entrepreneurs	Office Employees
To get hired	63	40
To enroll your child in a school	58	50
To enter a university	85	73
To be in a hospital	82	75
To turn in a military registration office concerning conscription in army	100	70
To be asked or be under investigation	100	100
To obtain a flat (apartment)	58	59
To get residence registration or permission	67	53
To get permission to buy a land/build on it	77	73
To register a firm or prolong a permission	46	88
To obtain a contract for government projects	69	57
To obtain a contract for commercial projects	70	75
To pay taxes and submit tax declaration	44	70
To pass customs procedures	97	88
To obtain driving license and pass safety inspections	66	81
To break traffic rules and be arrested by police officers	100	100

Note: Numbers are in percents. The sample size for entrepreneurs is 1200 and the sample size for office employees is 300.

Source: Ilibezova et al., "The Public Opinion Poll on Corruption," at the UNDP Web site, <http://www.undp.kg/english/publications.phtml> (October 15, 2004).

Overall, in all of the instances, on average, 70 percent of business representatives and 68 percent of office employees replied that they bribed. When 70 percent of entrepreneurs bribed to get things done on everyday basis, the questions arise: Do entrepreneurs bribe to do their businesses as well? If they do, why do they do and how does it affect the entire economic performance? The next two subchapters will address these questions to certain

extent but to before this, we need to understand how the private sector has formed in Kyrgyzstan.

FORMATION OF THE PRIVATE SECTOR

In the light of experience with economic reform in the countries of Eastern Europe, we in Kyrgyzstan set a clear goal from the very beginning – to move from a planned to a market system, and not simply modernize the socialist economy. Our goal was to transform state-owned enterprises into joint stock companies through a wide-ranging process of privatization.¹⁴

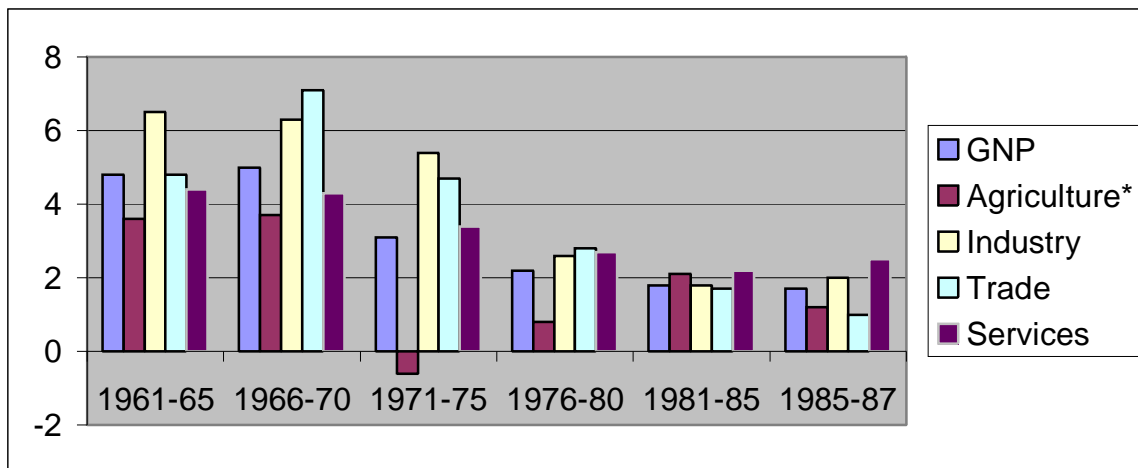
Kyrgyzstan had no substantial private sector and attributes of a market economy before the disruption of the Soviet Union (SU). The economy of Kyrgyzstan (the Kyrgyz Soviet Socialist Republic) was largely depended on the integrated Soviet economy, which functioned under the dirigisme regime of *piatilietskas* (five year plans) commanded by the *Gosplan* (state planning committee). The *Gosplan* controlled the entire economy and suppressed the private sector. The Soviet economy had inefficiency problems because of the centralized system of decision-making and the lack of market incentives. This type of system could have worked effectively if the bureaucrats in the *Gosplan* had perfect information on the state of the economy. In the absence of perfect information, bureaucrats often set redundant and extensive production goals, motivating managers of state enterprises to focus on the quantitative production more than on the qualitative production.

Furthermore, there were no private property rights except the rights of households to the private house and land lot in the SU. As a result, there were no incentives for competition, innovation, efficiency and growth. The state bureaucrats opposed direct competition and profit seeking and closed their eyes on loss-making enterprises. It is believed that the primacy of the decentralized market economy is rooted in market's ability to self-regulate and function efficiently in the absence of perfect information. The laws of supply and demand determine the prices on products and channel information to market participants and incentives are embedded in the self-interests of individuals and firms, exercising their property rights. These market mechanisms did not exist in the SU.

While the success of the Soviet economy at its early stages of development was due to the imported technology for further innovation and “scientific breakthroughs”, accomplished by mobilization of resources by the central government, its lack of attention

to the production of consumer goods, the absence of the private sector, inefficient decision-making process, and the lack of incentives for competition, innovation and entrepreneurship accounted for its continuous decline started in 1970s.¹⁵

FIGURE 1 Declining Soviet Aggregate Performance



Note: Numbers are at factor costs in 1982 prices

Sources: For the data, see *The Directorate of Central Intelligence Handbook of Economic Statistics* (Washington DC: Central Intelligence Agency, 1988), p. 60.

See also Carol Barner-Barry and Cythia A. Hody, *The Politics of Change: The Transformation of the Former Soviet Union* (New York: St. Martin's Press, 1995), p. 170.

Figure 1 shows that the Soviet economic performance declined in the industry, agriculture, services and trade sectors. For example, the annual industrial growth declined from 6.3 to 2 percent and Gross National Product by 3.3 percent from 1970 to 1987. The growth in trade sector decreased from 7.1 to one percent from 1966 to 1987. The growth in the service sector declined from 4.4 to 2.5 percent. The agricultural growth declined from 3.7 to minus 0.6 percent from 1966 to 1971 and increased again in 1981. However, the increase in agricultural sector was due to the decrease in the industrial sector.

When the Soviet Union disintegrated into the fifteen newly independent states (NIS), each country had to choose its own economic model. Askar Akaev, the first president in the history of Kyrgyz statehood, unlike other presidents of neighboring countries, was not the former communist first secretary. Moreover, because of the lack of financial and hydrocarbon resources, Akaev pushed for market-oriented model to seek

after international financial and technical assistance. By 1993, Kyrgyzstan received more than half a billion dollars from donor organizations. It received the largest International Monetary Fund (IMF) stabilization loan in Central Asia to alleviate the shock of leaving from the ruble zone.¹⁶ So far Kyrgyzstan has received more foreign assistance per capita than any of its neighboring countries in Central Asia.

In exchange for assistance and in pursuit of his personal belief in free market, Akaev pursued a radical economic change from a planned to a market economy.¹⁷ He notes, “the only way out of the blind alley in which the socialist economy found itself was the way of radical reform and liberalization of the economy on the basis of market mechanisms.”¹⁸ The cornerstone of radical change was the formation of the private sector. Akaev formulated several principles in building the private sector: (1) Private enterprises must be developed comprehensively; (2) Agriculture must be transformed into individual farms and agribusinesses; (3) Privatization of enterprises must aim at radically transforming the structure of property rights, expanding the private sector and stimulating competition; and, finally, (4) Business must be given maximum economic freedom.¹⁹

The privatization process was divided into three stages though the transformation of enterprises was drastic. The first stage of privatization was implemented from 1991 to 1993. In early 1992, privatization began in “small-scale” enterprises in the fields of retail trade, services and consumer products. In early 1993, the government eliminated entry barriers into agriculture, marketing, transportation and external trade. Jienbekov, Chairman of the State Property Fund, notes that during 1991-1993 around 87 percent of overall establishments were privatized mainly in the consumption sector. As a result, the first stage of privatization broke down the state monopoly in trade and service sectors, liquidated commodity deficit and created the competition between newly transformed and created enterprises.²⁰ Indeed, the logic to privatize small-scale enterprises first was reasonable because few participants had the resources to privatize large construction, transportation and industrial enterprises.

The second stage of privatization (mass privatization) started in 1994. The focus was on the transformation of large and average industrial, transportation and construction enterprises (around 600 enterprises). The enterprises were mainly transformed into Joint-Stock Companies (JSC), in which five percent of the share was given free of charge to

employees, 25 percent was implemented through the exchange of coupons (vouchers) in bi-weekly auctions, and 70 percent was privatized through tenders, money auctions and individual privatization projects.²¹ Since state-owned enterprises never operated according to market mechanisms, restructuring and adjustment were necessary before the privatization. The Privatization of the Enterprises Special Adjustment Credit project (PESAC) under the World Bank carried out the structural adjustment of the 27 major machine building, technical and coal-mining enterprises from 1994 to 1996. However, only around nine out of 29 of the enterprises started to produce competitive goods and services.²²

The third stage of privatization, from 1996 to 1998, was a continuation and completion of the mass privatization program and incorporated the denationalization of strategic state monopolies, including JSC “Kyrgyz Energo” (energy), JSC “Kyrgyz Telecom” (telecommunications), printing duopoly of “Uchkun” and “Altyn” (newspaper, magazine and book publishing), “Kyrgyzaltyn” (gold company) and others in mining and tourism.²³ The third stage of privatization is still incomplete because there are no potential local investors in these capital-intensive sectors. The government has been actively attracting foreign investors, several of which have already invested in the gold, energy and tourism sectors.

After the Soviet economy disintegrated, the markets for industrial products also disappeared. The industrial output of Kyrgyzstan in 1993 became half of that in 1989 and the leading industrial sector became the second after agriculture.²⁴ Since Kyrgyzstan has become largely an agricultural society and more than 60 percent of the population currently lives in rural areas, it is important to examine the development of the private agricultural sector. It started in 1991 with the land reform of collective farms. The land was leased to former employees of collective farms and other rural residents for 99 years. The remaining property, including livestock, sheep, sheepfolds, tractors, combines and other agricultural equipments were distributed to individuals and cooperative farms.²⁵ As a result of land reforms, the number of private farms increased substantially. If the number of farms were only four and a half thousand in 1991, they became around 50 thousand by 1998, employing almost one million people and accounting for 12.4 percent of the GDP (see Table 3 below).

TABLE 3 Shift from State Owned Enterprises to Privately Owned Enterprises

Years	State-Owned Enterprises		Privately-Owned Enterprises		Farms	
	Number of Enterprises	Share of GDP	Number of Enterprises	Share of GDP	Number of Farms	Share of GDP
1991	6794	45.6	406	2.6	4567	-
1992	6756	45.4	500	3.9	8695	0.8
1993	4862	33.3	3443	9.1	15810	2.0
1994	3947	17.9	5165	14.1	21264	2.5
1995	2076	13.5	5853	21.6	23180	6.3
1996	1548	10.3	5605	21.7	31078	11.8
1997	1438	7.7	8004	27.8	38724	11.7
1998	1071	3.4	8484	28.3	49277	12.4

Source: Askar Akaev, *Kyrgyzstan: An Economy in Transition* (Australia: Asia Pacific Press, 2001). For the number of state and privately owned enterprises see, pp. 108-109, and for the number of farms, see, p. 121.

Overall, the privatization reforms denationalized the state owned enterprises into the privately owned enterprises and turned collective farms into privately and cooperatively owned farms and small agribusinesses. The number of state-owned enterprises decreased by six times from 1991 to 1998 and the number of privately owned enterprises increased by 20 times. If the state owned enterprises shared 45.6 per cent of the GDP in 1991, by 1998 they only shared 3.4 per cent of the GDP. In contrast, the privately owned enterprises gained the 28 per cent share of the GDP in 1998.

CORRUPTION IN THE PRIVATE SECTOR

Dealings between business and government are inherently unequal because one party (the government) is making and enforcing the rules that affect the interests of both. Hence, the lack of transparency in the regulation of entry and operation may invite opportunistic behavior by officials enforcing the law.²⁶

Although the Kyrgyz government and international donors claimed that privatization was successful, competitive enterprises were not the privatized firms but newly emerged ones. Only around 30 percent of medium and large privatized enterprises and half of privatized farms and small-scale enterprises survived. The success rate for small enterprises, farms,

and agribusinesses were more than for medium and large enterprises because they were less capital-intensive and more adaptable to the emerging market environment. The success rate for medium and large enterprises was not encouraging because “mass privatization” meant the destruction of the old enterprises at any costs. The government sold enterprises at the low average value because the number of denationalized entities mattered rather than the revenues that could have been generated and the further destiny of the privatized entities. Besides, the lack of entrepreneurial class, capital, and knowledge fostered new owners (mainly former government officials and “red directors”) to engage in rent seeking rather than profit seeking activities. One of the most paradoxical examples of rent seeking activities was privatization of plants with equipments made from aluminum, copper, steel and other metals to convert equipments into raw material to sell to China.

Furthermore, the privatization was far from being transparent and characterized by what was called “*nomenklatura privatization*,” in which government officials had advantage in terms of access to key people, information and instrumentalities. Akaev also admits that former managers of state enterprises (“red directors”) made every effort to maintain their existing privileges and authorities within the newly privatized enterprises and; therefore, they did not change the existing organization and management of new enterprises in spite of the changes in the structure of ownership.²⁷ However, not only did the former managers of state enterprises hinder transparent privatization but the government officials were also part of illegal practices.

Indeed, the government officials have set a precedent for illegal practices, legitimizing and institutionalizing corruption in the emerging private sector. The government was not able to enforce formal institutions that could have ensured transparency during privatization. In the absence of enforceable formal institutions, supporting the new market system, political and economic actors have constructed “networks of closed relationships”, and formed various informal economies. From 1999 to 2000, the size of informal economy in Kyrgyzstan constituted 39.9 percent of the entire GNP.²⁸ Akaev calls the shadow economy natural development process: “Under socialism, people often reverted to the shadow economy in order to compensate for shortcoming of the system, while, under transition, they go underground in order to avoid taxes and to win in competition with businesses that pay taxes fairly.”²⁹ According to Schneider’s data,

natural level of informal economy should be below 20 percent of GNP. For example, the average percent of informal economy in the OECD countries was 18 percent of GNP (N=16), Switzerland, with 8.8 percent, having the lowest share of the shadow economy.³⁰ Moreover, if we compare the GDP of US\$242 billion of Switzerland and the GDP of US\$1.3 billion of Kyrgyzstan (figures in 2000), for such a small GDP in Kyrgyzstan, US\$519 million (39.9 percent) of informal economy is alarming.³¹

There are several explanations for why firms do business in a shadow economy. There is a notion that firms can earn higher profits by minimizing formal payments (e.g., taxes, registration fees, inspection fees, etc). It is also argued that in the presence of burdensome formal rules of the game, entrepreneurs resort to informal arrangements and opportunistic economic activities.³² In advanced Western economies, the government provides market freedom and establishes a legal framework, in which private businesses can operate. The role of the market freedom is crucial: when entrepreneurs are unfettered by cumbersome regulations and taxes, they have incentives to work according to the fair rules of the game. In contrast, when the government imposes onerous taxes and regulations, firms have the incentive to move to the informal sector.

However, it is not just a matter of tax and regulatory burdens. The continued informal ways of doing business in the absence of burdensome regulations and other formal institutions in Kyrgyzstan shows that informal interventions by the government officials, the lack of information by firms and deeply ingrained norms of informal dealings shape the size and intensiveness of the informal economy. These informal arrangements are not cost-free. There are long-term costs, associated with uncertainty and externalities and short-term costs associated with constant government interventions, the cost of bribes, the opportunity cost of giving bribes and establishing informal arrangements, which could otherwise be aimed at productive activity.³³ Based on the results of the Regulatory Business Environment Survey to measure informal costs of starting up and maintaining small and medium size firms, firms paid on average around US\$60 despite the official cost of registration of US\$4.17 (numbers in 2000). Thus, the actual costs of commencing business activities exceeded the official costs by 14 times, indicating a high degree of bribing among the registration authorities. About 27 percent of respondents admitted that

the registration authorities forced them to make unofficial payments in the form of bribes, gifts and other services along with the official registration payments.³⁴

The situation was worse in the regulation of the private sector (e.g., licenses, permits, certificates and inspections) Unlike clearly identified official timelines and costs in the registration process, some regulatory agencies have fixed costs while others require applicants to receive the approval of on-site inspections on their own determination. Respondents found very disturbing the constant interventions by the government officials in their daily operations. Despite the law, limiting inspections on each business entity for once a year, inspectors, on average, visited firms once every three weeks. The inspectors from taxation agency and the Sanitary and Epidemiological Station were the most frequent visitors.³⁵ By and large, informal ways of doing business is ever-present in Kyrgyzstan, which is inimical to productive economic performance. The small and medium scale enterprises are especially prone to do business in the informal economy because they cannot bear the costs of constant government inspections.

Big firms, with considerable market share and customers, are unable to hide from the government and; therefore, have chosen to work in the official economy. These firms have established networks in the higher echelons of the government pyramid to protect their businesses from inspections by the bureaucrats in the lower ladders of the pyramid. Most firms are also increasingly willing to do business in the official realm if the government officials play by the formal rules of the game. The survey data by Hellman et al. confirms the desire of firms to eliminate corruption, crime and regulations in almost all of the transitional economies.³⁶ Thus, it seems that the government officials and predatory regulatory business environment have been imposing corruption upon firms rather than firms have chosen to do business informally on their own willingness. This leads us to the discussion of corruption in the main institution in Kyrgyzstan – the government.

CORRUPTION IN THE GOVERNMENT SECTOR

We can expect a greater degree of institutional continuity than change essentially because the elites designing institutions continue to view politics in much the same manner as they did in the previous institutional setting.³⁷

It is no doubt that the government should play a crucial role during transition from one type of political economic system to another. Polishchuk offers the “guided scenario,” where a proactive government creates the institutions of the new economy and maintains control over private economic activities until institutions that can supplant the state will emerge. The state in a guided economy corrects the market failures of transition reforms and provides adequate social protection.³⁸ Thus, the government should take care of the creation, development and efficient performance of market mechanisms during the transition period. For instance, the government can provide a solid macroeconomic climate and a predictable taxation policy, as well as protect property rights and the rule of law to decrease the transaction costs. The role of the government in enforcing formal rules to make them dominant modes of political, social and economic activity is essential. However, the government should be exempt from corruption and rent seeking itself before it enforces formal rules on others.

Unfortunately, the meaning of Latin phrase *corruptio optimi pessima* (the corruption of the best is the worst of all) has never been more evident than now in the Kyrgyz government. Corruption has permeated throughout all of the echelons of the government pyramid. It mainly derives from the old Soviet political system, and from the institutional vacuum created during radical reforms. Winiecki explores the origins of rent seeking in the Soviet political system in great detail, arguing that the principle of *nomenklatura* – the right of the communist party apparatus to “recommend” and “approve” appointments for all managerial positions on the basis of loyalty rather than meritocracy had adverse effects such as low competence and rent seeking of the managers.³⁹ Besides, because of the lack of information and high transaction costs, it is hard to coordinate the activities of all managers in the hierarchical system based on the principle of authority rather than the rule of law.

What are the implications of the Soviet political system for the current Kyrgyz government? We can contend that although the Kyrgyz government has declared its commitment to democratic principles, the way it works and the way it is organized have not changed substantially from the Soviet times. Although it declared the separation of the branches of the government and free-elections, in reality, the power is concentrated in the

hands of the executive branch (Apparatus of the President) and the government operates on the Soviet system of loyalty, appointments and secret dealings.

The mere description of the state structure of Kyrgyzstan is evidence. It consists of the three branches of the government – executive, legislative and judiciary. The most influential branch of the government is executive, which includes the Apparatus of the President, ministries (e.g., the Ministry of Finance, Internal Affairs, Foreign Affairs, Defense, Justice, External Trade and Industry, Health, Education, Emergency Situation, Agriculture, Transport, Labor and Social Protection), state committees, commissions and agencies (e.g., committees on State Property and Tourism, commissions on Antimonopoly, Architecture, Drug Control, Religion, Material Reserves and Securities Market, agencies for Energy, Geological Survey, Real Estate Rights, Science and Intellectual Property, Communications, Standardization and Metrology), regional governments (*oblasts*) and district governments (*rayons*). The head of the executive branch and the state is the president who appoints the prime minister, all of the ministers, and the heads of the committees, commissions, agencies, regional governors and district governors.

The parliament (the *Jogorku Kenesh*) is the legislative body consisting of the Legislative Assembly (containing 60 deputies) and the People's Representative Assembly (containing 45 deputies). The parliament is the only formally independent body from the executive branch. The deputies of the Legislative Assembly and People's Representatives Assembly are elected for five years.⁴⁰ Although elections are considered democratic and independent, the executive branch often intervenes informally in the elections for the Parliament to put and support the people who serve the interests of the executive branch. The power of the parliament is in its capacity to introduce, approve and adopt laws and approve nominees by the president to the key government positions.

However, the laws introduced by the parliament are not significant in the country, in which people resort to the authority rather than the rule of law. The parliament always approves a candidate nominated by the president. Majority of deputies (enough to advance or block any laws) are representatives of the presidential administration rather than the people. There is a very small opposition group that has no sufficient political power. Moreover, the presidential administration often uses the judicial branch (in particular, the Prosecutor) to put pressure on the deputies to vote in the manner the president prefers.

Those who oppose are charged with tax evasion, corruption and other allegations. Several deputies admit that the presidential administration used “a variety of tactics to induce deputies to vote in a manner favorable to the president.”⁴¹

The judiciary branch of the government is formally independent but, in reality, it is a political tool used by the presidential administration. The International Crisis Group (ICG) reports that the president and the presidential circle have used the judicial branch to target political opponents by manipulating election results, constraining media, and issuing verdicts against opponents.⁴² For example, Spector confirms that Akaev used the criminal proceedings to appease his political opponents and manipulated the constitutional court to get reelected for the third presidential term in 2000.⁴³ He initiated laws that created barriers for new candidates to compete on fair grounds (e.g., Kyrgyz language clause) and manipulated courts to initiate criminal prosecutions of the three of the most popular candidates for the presidency at that time. Kulov, the former minister of internal affairs, and Turgunaliyev, the leader of the Erkindik Party, ended up in jail and criminal charges on Usenov, the leader of the People’s Party, were announced just before the elections.⁴⁴

Akaev has been manipulating the judicial system by appointing a popular and loyal judge, Cholpon Baiekova, as the head of the constitutional court. She closed her eyes on the Constitution of Kyrgyzstan, allowing Akaev to run for the third term. Thus, the legal system is controlled by force rather than the rule of law. A lawyer, Yuri Maksimov, complains, “Instead of administering justice, the courts always rule unreservedly in favor of affluent [powerful] people, whenever their interests are threatened.”⁴⁵ This is natural in the system, in which judges are unaccountable and highly dependent on the will of the presidential apparatus. This is because the judicial branch is the extension of the executive branch.

According to the Constitution of Kyrgyzstan, there are the Constitutional Court, the Supreme Court, the Higher Arbitration Court, and local courts. The Legislative Assembly and the Assembly of People's Representatives elect the judges of the Constitutional Court for a term of fifteen years upon nomination by the president. The Assembly of People's Representatives elects judges of the Supreme Court and of the Higher Arbitration Court for a term of ten years upon nomination by the president.⁴⁶ Unfortunately, the elections are declaratory and the role of the parliament in choosing the judges is nominal. In reality, the

president selects the judges and manipulates the members of the parliament to approve them. Oddly enough, the Parliament has never rejected a single nomination of judges by the president. Besides, the president without the approval of the parliament appoints the judges of the courts of the regions, the city of Bishkek (capital city), districts, and cities, and of the economic courts of the regions and the city of Bishkek, and also of the military tribunals.⁴⁷

Clearly, the political power is in the hands of the executive branch. It would not be a problem if the executive government were able to operate credibly, accountably and benevolently. Unfortunately, the veracity of the Russian proverb (i.e., a fish decays from the head) has never become more illustrative than now in the political hierarchy of Kyrgyzstan. Checks and balances on the power of the executive branch do not exist. As a result, various political and economic forms of corruption, manipulations and machinations have flourished in the higher echelons of the government. Corruption flows in both directions - from the top to down and from the down to top.

The government still operates on the deeply ingrained political culture of *nomenklatura*, neglecting the importance of competence and skills, and; therefore, limiting the pool of talent from which bureaucrats are drawn. A bureaucrat's success is not measured by performance and efficiency but by loyalty and "compliance with commands."⁴⁸ This type of political culture, emanating mainly from the Soviet legacy and, to some extent, from the Kyrgyz mentality of loyalty, dominates in administration of the state. Loyalty to the communist party was the driving value during the Soviet era and loyalty has also been an essential part of the hierarchical and clan based Kyrgyz culture. For instance, in Kyrgyz culture, the young is loyal to the elderly, women to men, children to parents, students to teachers, and most people are loyal to the clans and tribes they belong to. In the government hierarchy, loyalty to the ruling class is considered more important than possession of expertise and diplomas.

Because of this type of political culture, Akaev and his wife's friends, family members, clan and region receive the most representation in all of the branches of the government (especially in the executive branch). Many high-ranking officials graduated from universities in St. Petersburg (formerly Leningrad) where Akaev spent most of his academic years. Akaev and his wife's clans (*Sari-Bagish*, *Saru and Kutchu*) and regions

(*Kemin* and *Talas*) are disproportionately represented in the government and business. They occupy the pivotal positions in managing principal ministries and state enterprises (e.g., *Kyrgyzaltyn*, *Kyrgyz Telecom*, etc).

Akaev fills these pivotal positions by friends and family members because the system is based on loyalty rather than on meritocracy. Of course, there are also cases, in which Akaev appoints qualified persons outside his circle (e.g., Tanaev, Premier, Otorbaev, Vice-Premier,). However, it is also the case that those government officials who become popular within Kyrgyzstan are likely to be reappointed to diplomatic posts. For instance, Sadyrkulov, a former head of the Presidential Administration, was reappointed as the Ambassador to Iran, Otunbaeva, former Vice-Premier and Minister of Foreign Affairs, was reappointed as the Ambassador to the UK, Isaev, the current Ambassador to the UK, was the head of the crucial State Committee on Foreign Investments and so on. Askar Akaev has also tried to involve a younger generation of specialists (e.g., Bekbolotov, Press Secretary, Sarbanov, head of the National Bank, etc). He has recently appointed Turdukulov, a talented Chief Executive Officer of the BITEL cellular company, as the deputy minister of telecommunications but there are also rumors that it is a part of the deal to acquire the shares in the lucrative cellular company.⁴⁹

It is believed that Akaev and his family are beneficiaries of corruption. Otherwise, Akaev could have put an end to it. It is suspected that corruption is one of the ways to accumulate wealth, promote family businesses and hold compromising records on political opponents. Appointments on the basis of loyalty and exchanges are not peculiar to the presidential circle. Other high-ranking bureaucrats and politicians also appoint on the basis of relationships and loyalty in spite of the lack of qualifications their appointees possess. The system based on appointments encourages rent seeking and corruption.

Besides, the low administrative salaries and high pay offs from engaging in bribery cultivate the current economic incentives for government corruption. For example, when the Public Opinion Poll on Corruption, asked what respondents considered as the main reason for corruption among government officials: 14 percent of respondents believed it was low salaries, 12 percent believed it was economic crises, ten percent believed that corruption itself within the government was the reason, nine percent pointed the weakness of the government, eight percent thought imperfect legislation, and so on.⁵⁰ Of course, a

low salary encourages corruption but a high salary is not a panacea to corruption when it penetrates deeply into the political culture and becomes the essential part of society. Yet, performance based salaries and other psychological incentives are essential for an accountable and professional administration of the state. The merit-based system and higher salaries would recruit a more market-oriented and accountable generation of managers to the state service, who are employed currently in the private sector and international development projects.

Those who go to the public sector for patriotic and personal considerations struggle with the old mentality of the existing political elites. Most of the time, corrupt public officials ruin their perception of the public service. They impede newcomers from making the difference and want them to be like themselves. It is also easier for newcomers to be like their predecessors rather than change the deeply ingrained political culture. Many newcomers become a part of the old guard and engage in corruption because of the need for survival in the existing political culture and the lack of material and other incentives to work by the law. It is obvious that the government encourages rather than combats corruption. The challenge is to reform this most influential institution of Kyrgyz society to make it transparent, responsive and professional.

CONCLUSION: THE CHALLENGES OF REFORMS

For the growth of the private sector, the predictability of business environment and long-term investments are vital. Currently, firms, with limited resources and without government connections, do their business in the informal economy. Under the current system of corruption, only do those firms, which are protected from the higher echelons of the government pyramid and have informal networks of business partners, can have a certain degree of predictability in the short-term. This system is limited because it is based on personal exchange and insiders. As the private sector gets more complex, firms will need to involve in impersonal exchange with partners from the outside of the trusted group. Impersonal exchange in complex economy can only be achieved through formal institutions, such as courts, legal system of contracts, property rights and the rule of law. Therefore, it is unclear how far the private sector will grow under a very corrupt and

informal economy and whether the growth in the private sector will push the government to stick to and enforce the formal rules of the game. This poses a great challenge for the existing and emerging private sector.

It is also unclear whether the government is likely to make credible commitment to change the status quo. It seems highly unlikely because the incentives are structured to encourage noncompliance and corruption. Even if the leadership changes, it is very hard to imagine that a new leader commits to improve the situation. This is mainly because a new leader is likely to come from the old guard because of the lack of transparent election system. Besides, corruption is deeply seated in the government that it can be too risky for a newcomer to upset the existing elites and to make changes without costs and sacrifices. Of course, the government is the most powerful institution in Kyrgyzstan and if corruption needs be eliminated, those people and institutions that hold the power are the most capable of eliminating it. At the present, it does not seem that the current elites are committing themselves sincerely to combat corruption despite recent declarations by the president that corruption is the main obstacle to reforms and needs be addressed.

Less capable but important actors to fight with corruption are the public and NGOs. The public is realizing that chronic corruption is one of the main reasons for the increasing poverty, inequality and government ineffectiveness. Kyrgyz citizens believe that the government must eradicate corruption but they are reluctant to challenge the abusive behavior by the government officials because of the weakness of legal system to protect their civil rights. To put it simply, they are reluctant to voice their accusations publicly. People also view the state as the main provider of goods and services. They are incapable of reducing their cultural dependency and mental model that the state must provide and guide.

People also are getting used to corruption and they often say that corruption is the way things have always been done to achieve wealth and power. However, the gap between poor and rich is widening fast. It is also noticeable that the rising unequal standards of living and inequitable opportunities are mainly between public officials and ordinary people. The extreme level of inequity is a recipe for social unrest and conflict (especially in the south), if measures to combat corruption and revitalize social programs are not undertaken. This is a very serious challenge for Kyrgyzstan.

Another powerful source to initiate reforms comes from NGOs and international donors. Though the Kyrgyz government has exercised a strict control over the media, political parties, political opponents and legal process since 1995, it has allowed NGOs to develop freely. NGOs have been advocating democracy, human rights and providing collective goods and services to the needed since the country's independence. Civil society in Kyrgyzstan has been ranked steadily 4.5 from 1995 to 2003.⁵¹

TABLE 5 Ratings and Scores of Democracy for Central Asia, 2003

Country	EP	CS	IM	GOV	CLGF	CO	DEM
Kyrgyzstan	6.00	4.50	6.00	6.00	5.5	6.0	5.67
Tajikistan	5.75	5.00	5.75	5.75	5.75	6.25	5.71
Kazakhstan	6.50	5.50	6.5	6.25	6.25	6.5	6.25
Uzbekistan	6.75	6.50	6.75	6.25	6.50	6.00	6.46
Turkmenistan	7.00	7.00	7.00	7.00	7.00	6.25	6.88

Note: The ratings are from one to seven, one being the highest and seven being the lowest level of democracy. The democracy score (DEM) is an average of electoral process (EP), civil society (CS), independent media (IM), governance (GOV), constitutional, legislative and judicial framework (CLJF), and corruption (CO).

Source: Data available at Freedom House Web site, <http://www.freedomhouse.org/>

According to Table 5, Kyrgyzstan is relatively more democratic than others in Central Asia. Kyrgyzstan is leading in terms of democratic civil society among all other Central Asian countries. By 2001, 3019 public associations, 1608 social protection unions, 195 religious organizations, 289 professional unions, 121 political unions, 335 scientific and cultural unions, 1608 social protection unions, 71 youth and students' associations, 94 women associations and 388 printed media were registered.⁵²

Fiona Adamson notes that civil society in Central Asia has been built from the outside with the financial and technical assistance of international donors and advanced democratic countries. For example, by the end of 1993, international donors pledged around half a billion dollars to Kyrgyzstan. Adamson notes that these democracy assistance programs have achieved a number of results. For example, the government and the people are recognizing the importance and role of the third sector.⁵³ Kyrgyzstan has become a home to 3000 registered local and international NGOs. The largest NGO in Kyrgyzstan is called "Coalition NGO," which is an umbrella coalition, uniting more than

100 local organizations and representing all regions of Kyrgyzstan. Some NGO representatives argue that NGOs are real force in Kyrgyzstan because they nurture future leaders and put checks and balances on the government's abusive behavior (e.g., "Coalition NGO").⁵⁴ However, formal registration and presence of NGOs do not reflect their effectiveness. The number of active and effective NGOs is considerably less than 3000. Many NGOs are registered to receive financial aid from international donors and do not serve their real purposes.

Though some NGOs were successful in terms of providing public goods and enhancing public's awareness of democratic values, they were less successful in changing the existing structure of the government and in fostering grassroots democracy. The failures are due to several reasons. Firstly, most NGOs are not financially sustainable and artificially created from the outside. These NGOs are not comparable to the self-sustained advocacy groups we know in Western societies that have fund-raising capacities and originate from non-state societal interests. The primary goal of this type of NGOs is to receive money from international donors. Hence, they tend to write positive reports and success stories. Secondly, many international donors apply the same universal programs to all countries without accounting for regional and local variations. Adamson rightly claims that NGOs in Central Asia must adapt to local environments and indigenous political institutions. It is hard to adapt in the existence of incoherence between the assigned program and local conditions.⁵⁵

Finally, rampant corruption is one of the main obstacles to the operation of NGOs. International NGOs should work in a corrupt environment on an everyday basis. Most representatives of international NGOs cannot involve in corruption while such things as installing phone lines, paying bribes to police inspectors, and registering NGOs requires payments to the government officials. The problem of corruption is even more challenging when it gets to local NGOs financed by international donors. The grant money is often used for personal purposes, equipments can be bought on a black market and receipts can be falsified.⁵⁶

In spite of these challenges, there is a hope that the third sector will gain more power and capacity over time and thus will put checks and balances on the government corruption. It is possible for NGOs to play a role in fostering democracy and combating

corruption, making people aware of their rights, counterbalancing the power of the government and protesting corruption. International NGOs such as the Soros Foundation, IREX, TACIS/Tempus programs and others have been playing a huge role in educating new generation of younger elites and exposing them to Western ideas. The National Democratic Institute, ARD/Chechi and American Bar Association under the USAID have helped to draft formal institutions such as corporate and legislative laws. Many regional NGOs have existing communication infrastructure to disseminate newsletters, newspapers and other type of publications. Overall, NGOs can be effective because they are trustworthy, neutral, and work with communities on the ground.

More powerful institutions such as the World Bank, Asian Development Bank, International Monetary Fund, and others can influence the government to initiate more comprehensive reforms in the state governance. Indeed, under the pressure of such international donors, the Kyrgyz government has undertaken certain reforms to improve governance and combat corruption. It has piloted the comprehensive development framework program (CDF). The participants of the CDF have agreed that institutional and legal reforms should be conducted at all levels of state administration including the parliament, bureaucracy, judicial system and local government. The CDF has identified four main areas of creating effective and transparent state governance: (1) democratic and open system of state governance; (2) independent, fair and competent judicial power; (3) professional, efficient and accountable civil service; and (4) democratic institutions. By democratic state governance, the CDF document has identified the independence of the executive, legislative and judiciary branches of government. No doubt that these branches of the state can play a part in creating and enforcing formal rules and laws that protect the market economy and promote the rule of law.⁵⁷

The CDF document recognizes that the public administration in the government bureaucracies of Kyrgyzstan neither meets modern requirements nor does it satisfy the requirements of the society. A high concentration of power in the central bodies and the lack of coordination in their activities have left public officials uncontrollable and unresponsive. The bureaucratic agencies are still characterized by huge expenditures for their support, non-transparency to the society, the lack of clear authorities between public bodies and civil control bodies, absence of clear separation of functions and authorities

between politically elected and appointed officials and public servants.⁵⁸ The existing government bodies, with its current structure of ministries, which are duplicating and incompetent, have become an obstacle to development. Apparently, transparency is a precondition for the transition to modern type of public administration. In many respects, it is rightly defined in the CDF document that reforms in public administration should be launched in the first place. However, realizing that reforms in public administration are needed is one story and trying to change the existing status quo is a completely different story. Suffice it to say that the government is the hardest institution to reform. It is especially hard to reform the higher echelons of the government because they set the rules of the game and the current rules of the game sustain corruption.

NOTES

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⁴⁵ *Ibid.*, p. 13.

⁴⁶ *Constitution of Kyrgyzstan*, chapter 6: article 80.

⁴⁷ *Ibid.*, section 2: article 46.

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