

Corruption in Kyrgyzstan

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Kırgızistan'da Yolsuzluk Olgusu

Abstract

This paper proceeding from the results of recent empirical studies and theoretical arguments on corruption in economic literature attempts to show the factors causing corruption and focuses on some facts of its consequences in Kyrgyzstan. Literature on corruption defines main causes of corruption as: 1) Excessive regulatory burden; 2) Weak juridical system; 3) Level of political competition and democracy; 4) Sociological factors; 5) Low wages in public sector Results of application of regression analysis on some causes of corruption in Kyrgyzstan correspond to these arguments. In particularly, relatively high levels of negative relations with corruption have proxies for regulatory burden and for the juridical system. Despite the secretive nature of corruption and difficulty in determining clearly the cost of corruption, some facts on the economic consequences of corruption prove the high cost of corruption in Kyrgyzstan economy.

Key Words : Corruption, Law Enforcement, Regulatory Burden.

JEL Classification Codes : E62, H1, H41, K4.

Özet

Bu çalışma iktisat literatüründe yolsuzluk üzerine yapılan teorik argümanlar ve deney dayalı çalışmalar sonuçlarından yola çıkarak Kırgızistan'da yolsuzluk nedenlerini göstermeyi amaçlamakta ve yolsuzluğun sonucu olarak ortaya çıkan bazı olguları açıklamaktadır. Yolsuzluk üzerine yapılan araştırmalar bunun nedenleri olarak şu önemli faktörleri belirlemektedirler: 1) Aşırı devlet düzenlemeleri; 2) Yasal sistem zayıflığı; 3) Siyasi rekabet ve demokrasi seviyesi; 4) Sosyolojik faktörler; 5) Kamu sektöründe düşük ücret düzeyi. Kırgızistan örneğinde bu nedenler üzerine yapılan regresyon analizi sonuçları söz konusu argümanlar ile uyusmaktadır. Özellikle yolsuzluğun devlet düzenleme yükü ve yasal sistem ile diğer faktörlere nazaran daha yüksek seviyede negatif bir ilişki gösterdiği ortaya çıkmaktadır. Yolsuzluk olgusunun gizli nitelikte olması ve bunun maliyetinin net olarak hesaplanması zor olmasına rağmen yolsuzluğun iktisadi sonuçları ile ilişkin bazı bilgiler Kırgızistan'da bu olgunun yüksek maliyetli olduğunu göstermektedir.

Anahtar Sözcükler : Yolsuzluk, Hukuk Dayatması, Kamusal Düzenleme Yükü.

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Beyan

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1. Introduction

The phenomenon of corruption is not new the history of human being has vast examples on this issue. However, starting from the beginning of 1990th, corruption phenomenon began to attract a great deal of attention. Several arguments can be advanced that suggest that corruption is attracting more attention now than in the past. The end of the Cold War and the increased opportunity for disseminating information due to the technological progress in last two decades made possible to attract attention to the corruption issue. In addition to these factors, with the globalization increased tendency towards the democratization, market economy and free trade in the world has caused more free and active media and nongovernmental organization activities that contributed to the active discussion of the corruption issue (Tanzi, 1998: 560-562).

The economic changes in the economies in transition are also one of the factors that have had an impact on rise of debates on corruption. At early stages of transition period the main focus of economists was in macroeconomic manner, emphasizing the importance of liberalization, privatization and stabilization. However, eventually, weak state and institutional base with malfunctioning juridical system and increased poverty and inequality were associated with rising issue of corruption.

This paper proceeding from the results of recent empirical studies and theoretical arguments on corruption in economic literature attempts to show the factors causing corruption and focuses on some facts of its consequences in one of the economies in transition, in Kyrgyzstan. The paper divided into five parts. The first part looks at the theoretical arguments and the results of econometrical analysis on causes and consequences of corruption. The second part focuses on the scope of corruption according to international indexes and on the causes of this issue in Kyrgyzstan. Preceding from this section the third part includes the regression analyze of the causes of corruption. Some facts on the economic consequences of corruption in Kyrgyzstan are given in the fourth part. Final part provides conclusions.

2. Corruption in Economic Literature

The most popular definition of corruption is the abuse of public power for private benefits (for review of classification of corruption see: Amundsen, 2000). However, in theoretical discussions there are several critiques against this definition (for instance see: Svenson, 2005: 20-24; Tanzi, 1998: 564-565). Since proceeding from this definition one may conclude that corruption exists only in a public sector. While the practice of collusion between firms or misuses of corporate assets are also one kind of forms of corruption. In other words, this phenomenon appears in private sector as well. But public sector corruption is believed to be a more fundamental problem than private sector corruption. Because controlling public sector corruption is necessary for controlling the private sector corruption.

The main feature of corruption is its secrecy, which in turn makes difficult to determine definitely the extent of impact of corruption on economy. However, there are several commonly suggested theoretical arguments on causes and consequences of corruption that are supported by empirical studies. According to these surveys the causes of corruption can be summarized as follows:

- Excessive government regulative burden on different aspects of business is one of the sources of corruption. It includes regulative and authorization power of state bodies, such as taxation, licensing, certificates etc. Tanzi (1998: 566–567) argues that the existence of these regulations and authorizations gives a kind of monopoly power to the officials who must authorize or inspect the activity. These officials may refuse the authorizations or may simply sit on a decision for months or even years.
- Indeed in most developing countries despite the attempt to reduce the size of the state in the economy through low rate of tax burden and government expenditure, the rate of regulations remains at high level; consequently it contributes to excessive burden over the private sector, which in turn raises the level of corruption.
- Weak juridical and legislative institutions create different ways for arising corrupt activities. Malfunctioning penalty system reduces the cost of engaging into corruption. These conditions allow for relatively few people being punished for acts of corruption, in spite of the widespread extent of corruption. In most developing countries judges are not independent and they may be accessible to corruption. Often administrative impediments prevent the full implementation of penalties. Corresponding laws does not enough to penalize the discovered corruption acts adequately and just allow to fine. Rules are often confusing and documents specifying them are not publicly available, thus leave the grounds for different interpretations. Situation is worse when judges are not independent in making decisions on penalty. Therefore, the lack of transparency in rules and in processes increases corruption.
- Low wages in public sector. Van Rijchghem and Weber (1997) develop a model that suggests that there is strong relationship between public sector wages and corruption. Testing this hypothesis they find that countries with low wages have high level of bribery. Obviously low rate of wages leads public servants to seek for other additional sources of income by misusing their public power.
- High level of political competition and democratization allows for several options for monitoring corrupt activities. Since political competition and more democratic political system gives possibility for controlling corrupt activities through independent mass media, elections and through other

options of the societal control. Correspondingly, in countries where the democratic rights are not well protected the cost of engaging in corrupt activities is low.

- Sociological factors also contribute to the level of corruption. Countries where the allegiances to kinship practice of giving the gift or clan-based loyalties are widespread are more inclined to corruption.

Despite the fact that generally corruption is considered as negative phenomenon in economic literature there are some discussions about its possible positive effects. For instance, Leff (1964) and Huntington (1968) state that corruption by removing government-imposed rigidities that in turn impede investment and interfere with other economic decisions favorable to growth, can create the impact for efficiency. Lui (1985) argues that time has different values for different individuals depending on their level of income and the opportunity cost of their time. Those whom time is most valuable will offer bribes to public officials. Thus corruption may be efficient by saving the time for them. In a similar vein, some other researchers (Rose-Ackerman, 1996; Tanzi, 1998) argue that under some circumstances corruption may have positive results. That is that bribes give incentives to public officials to work better and bribe giving firms can avoid the overwhelmingly regulations of the state and tax burden. However, most empirical works refute these arguments and conclude that corruption has negative consequences for over all economy. These consequences are summarized below:

- The first negative impact of corruption on economic growth is the reduction of investment. P. Mauro (1995) found that corruption reduces investment, hence growth, due to higher costs and uncertainty that are consequences of corruption¹. Analogously, Shleifer and Vishny (1993) state that corruption negatively affects investment by raising the cost to potential investors.
- Corruption has influences both on revenue and expenditure side of government budget. It is obvious that its effect on tax administration and on custom reduces the revenue potential of the budget, hence, the ability of the government to carry out needed public expenditure. On the part of government expenditure the composition of government spending changes in favor of that type of spending which is more convenient for corrupt activities. Mauro (1998) argue that corruption decreases government expenditures on education and health, which do not have lucrative opportunities for corruptors. However, it does not imply that these sectors are excluded from any corrupt activities. In a similar vein, Tanzi and Davoodi (1997) found that corruption has negative impact on government

¹ *Concerning uncertainty, however, Campos et al. (1999) argue that the nature of corruption is also matters. In other words, corruption regimes that are more predictable have less negative impact on investment than those that are less predictable.*

expenditure by reducing expenditure on operation and maintenance. Thus public funds go away from high valuable projects to projects less favor to economic growth such as launching new unnecessary projects instead of maintenance of the existing infrastructure.

- Paolo Mauro (1997) advances the view that corruption causes talent misallocation by creating financial incentives which may lure the more talented people and better educated to engage in rent seeking rather than in productive work with adverse consequences for the country's growth rate.
- One of the important negative impact of corruption is the ineffective use of aid flows. This problem becomes extremely significant for developing countries which have the high rate of external debt. In most cases because of this problem donors have focused on issues of good governance and on addressed usage of credits.
- All of these negative impacts, naturally, result in rising poverty and inequality. Gupta, et al (1998) in their empirical analysis indicate that high and rising corruption increases poverty and income inequality by reducing economic growth, the progressivity of the tax system, the level and effectiveness of social spending, and the formation of human capital, and by perpetuating an unequal distribution of asset ownership and unequal access to education.

Thus, despite the some arguments that corruption under some conditions can be effective, in general it is considered as evil and poses a high cost for economic development. Conditions of the transition period give the fertile ground for engaging in corrupt activities. Reforms programs intended to transform previous structure into the new system have created opportunities for rising corrupt activities. Changes in regulations and policies with weak controlling institutions have contributed to the rise of corruption.

3. Corruption in Kyrgyzstan: Scope and Causes

In its way towards the market economy Kyrgyzstan is known for its most liberal reformist attempts in both political and economic spheres in Central Asian region. However, starting from the late of 1990s corruption became important problem, gradually taking a systematic form in government bodies.

Table:1
Corruption Level in CIS and Kyrgyzstan

| Countries | CPI* | NIT** |
|---------------------|------|-------|
| | | |
| Armenia | 2.9 | 5.75 |
| Azerbaijan | 2.4 | 6.25 |
| Belarus | 2.1 | 6.25 |
| Georgia | 2.8 | 5.5 |
| Kazakhstan | 2.6 | 6.5 |
| Kirghizstan | 2.2 | 6 |
| Moldavia | 3.2 | 6 |
| Russia | 2.5 | 6 |
| Tajikistan | 2.2 | 6.75 |
| Turkmenistan | 2.2 | 6.75 |
| Ukraine | 2.8 | 5.75 |
| Uzbekistan | 2.1 | 6.5 |
| Average | 2.5 | 6.17 |

* *Corruption Perception Index (CPI) of Transparency International ranks countries by scores ranging from 10 (low level of perceived corruption) to zero (high level of perceived corruption).*

** *Corruption rating of Freedom House International within its Nation in Transit Report is based on scale of 1 to 7, 1 representing the progressive level and 7 representing the most regressive level.*

Source: Freedom House, *Corruption Ratings 2006*, available from:

<<http://www.freedomhouse.org/template.cfm?page=261&year=2006>>, 25.09.2007; Transparency International, *Corruption Perception Index 2006*, available from:

<http://www.transparency.org/policy_research/surveys_indices/cpi/2006>, 18.09.2007.

Table 1 demonstrates the rate of corruption according to two international indexes: Corruption Perception Index (CPI) of Transparency International in 2006 and Corruption Ratings published within *Nation in Transit* Report of Freedom House International in 2006. Indexes are given for Commonwealth Independent States (CIS) countries and for Kyrgyzstan. Although in both of the indexes all CIS countries appeared with high corruption level, Kyrgyzstan even within these group is ranked as highly corrupted. The results of another survey *Business Environment and Enterprise Performance Survey* (BEEPS) conducted by European Bank of Reconstruction and Development (EBRD) and World Bank in 2005, show that in Kyrgyzstan almost 60% of interviewed firms indicated corruption as a main problem of doing business, while more than 50% of firms stated that bribe is frequent. The existence of high level of corruption in Kyrgyzstan is not only supported by the evidence from business environment, but also from general public opinion. In the survey done by International Republican Institute (IRI) and United States Agency for International Development (USAID) in April-May period in 2006, 61% of interviewed persons asserted that corruption in Kyrgyzstan is high. Thus various researches and facts of everyday life show that this issue has taken systematic character and became a part of functioning of different government bodies.

Such a worse position of Kyrgyzstan in terms of the corruption can be explained by several factors. Preceding from the theoretical arguments and empirical results some factors can be referred as main causes of corruption in Kyrgyzstan case.

One of the sources of corruption in Kyrgyzstan is excessive regulatory burden. Due to adherence to liberal economic reforms of Kyrgyzstan there is effort to limit and downsize the share of the state in national economy. However, government regulation in the economy via bureaucratic instruments (licensing, certification etc) is high. According to World Bank Report “Doing Business in 2006” for dealing with licenses in Kyrgyzstan entrepreneurs have to complete 16 procedures, which can take 152 days, and its cost is 325.2% of income per capita. The data of the same survey shows that for importing number of required documents and signatures are correspondingly 18 and 27, the total time cost of these documents is 127 days.² By taking into account all of these facts it can be argued that the massive, non transparent and poorly applied regulatory system is fertile ground for corruption in Kyrgyzstan.

As it mentioned in the previous section low wages of civil servants promote corrupt activities among them. Generally, in developing countries this problem is the result of the general low income level in the country. The dramatic decline in output during the first decade of transition and the low economic performance decreased the level of income at substantial levels³. Under these circumstances the low wage rate in public sector is one another evident cause of the corruption.

Table 2 gives some evidences on the wage rate in Kyrgyzstan. In order to show the rate of wages in public sector compared to private sector wages, ratios of wages in government management, education and health sectors to wages in financial activity are given⁴.

² *In analyzing these features of doing business, this survey assumes a one standard firm (in terms of the size, location, production etc) and assumes that it will deal with each bureaucratic procedure legally.*

³ *During the first five years of independence Kyrgyzstan faced significant decline in output, that during the period between 1991-1995 decreased at 49.7%³, even in 2005 (according to EBRD data) produced GDP accounted only for 84% of GDP produced in 1989. In other words, after 16 years since independence pre-transition level of output is not still attained.*

⁴ *We are well aware of that fact that it may be misleading to take financial activity as a sole proxy for private sector wage rate. However, it can serve as a good indicator in showing the seriousness of low wages in public sector compared with private sector. Since financial sector according to data of NSC of Kyrgyzstan is activity that has highest wage rate, and education and health are among the sectors with the low wage rate.*

Table: 2
Average Nominal Wages in Kyrgyzstan (1996–2006)

| Sectors | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---------------------------------|------|------|------|------|------|------|------|------|------|------|------|
| Financial activity | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Government management | 0.74 | 0.47 | 0.43 | 0.41 | 0.39 | 0.48 | 0.47 | 0.51 | 0.42 | 0.36 | 0.35 |
| Education | 0.37 | 0.21 | 0.21 | 0.20 | 0.17 | 0.18 | 0.19 | 0.21 | 0.18 | 0.17 | 0.17 |
| Health care and social services | 0.35 | 0.20 | 0.19 | 0.17 | 0.14 | 0.15 | 0.16 | 0.17 | 0.15 | 0.14 | 0.16 |

Source: For the period 1996–1998 estimated on the basis of data given in *Statistical Yearbook “Kyrgyzstan v Tsifrah 2001”* (Kyrgyzstan in Numbers), Bishkek: National Statistical Committee of Kyrgyzstan (NSC), 2001. From 1999–2006 estimated according to data given on website of NSC of Kyrgyzstan, available from: <[http://www.stat.kg/Rus/Database/tab11\(a\).xls](http://www.stat.kg/Rus/Database/tab11(a).xls)>, 18.30.2007.

All of the shown public sector wages are considerably low with respect to the financial activity and decreased in all the given period. In particular, wage rate in government management sector reached the 35% of wages in financial activity, while both in education and health sector wage rates do not account even for 20%. Obviously, under these low wages corruption and bribe taking attempts of public officials are expected to be very often.

Weakness of judiciary system is another factor contributing to high rate of corruption. With launching economic reforms towards the market economy, new legislative base was established. However, continuing amendments to major laws regulating business sphere, undeveloped system of advocacy and of securing property rights have caused the ambiguous and complicated legislative base and ineffective penalty system. Moreover, different government bodies issue various norms that should be implemented and themselves control the implementation of these norms. It results in conflicts of interests- government officials will develop instructions that will allow preserving their own controlling functions. As a consequence of this, several numbers of instructive norms have been adopted by different government bodies. While in the official list the total number of permissions that government bodies can give is only 136, in fact number of permissions, licenses and other documents are higher than that and most of them do not correspond to legislation (Omuraliev, 2007). This weakness of judiciary system is more complicated when the judiciary system itself is corrupted. According to the results of the questionnaire based survey made by IRI and USAID in 2006, custom, internal affairs and police, courts and tax offices are ranked as more corrupt institutions. Thus the worst thing of corruption, in this case, is that the officials that have to detect and sentence corrupt activities are themselves corrupted. In the same survey 37% of respondents answered that legislative base should be improved in order to combat with corruption, and 41% are sure that the items of Criminal Code should be really applied to detected corrupt activities. The weak law enforcement is the natural result of such judiciary system. These facts have the negative impact on contract enforcement by rising the cost and time of enforcement. According to the *Doing Business 2006* survey the cost of enforcing contracts in Kyrgyzstan is 47.9% of debt value, while 46 procedures have to be completed for that and necessary time to enforce contracts is 492 days.

Sociological features that embedded in social network of the nation are also one of the factors of corruption. Strong and tradition links among families and, more often, among groups with kinship relations creates the atmosphere for accepting the misuse of public power as a normal and, moreover, as obligated acts. On this point, study of Kuehnast and Dudwick (2004) is very interesting. This study surveys the social network and changes in it in Kyrgyzstan during the transition. They indicate that during the socialist period informal social networks were the most important mechanisms for getting things done, obtaining access to “deficit” goods and services, acquiring accurate information about events and opportunities etc., and status and power depended less on income than on the extent to which one’s formal networks included people with *blat* (pull or influence). At the same time, particularly in rural areas, Soviet collectivized agriculture often grouped extended families and clan groups together, thereby reinforcing kinship networks by ensuring that their members lived and worked in the same location. So this type of network reinforced the mutual support among kinship groups, friends, neighbors’, and colleagues. In post-socialist period together with drastic decline in living standards this network was intensified and people started more to rely on personal networks for support. In contrast to the situation in Soviet period, money has become a key means in networks. The importance of social networks for regulating access to public institutions and services has increased since the collapse of USSR. Respondents of the survey asserted that *blat*⁵ (pull or influence) had become essential for finding job, gaining admission to competitive university department, or resolving a traffic dispute (Kuehnast and Dudwick, 2004: 2-5).

Therefore, decreased living standards with strong social relations resulted in the rise of reliance to social network support, resulting in abuse of public power. However, it can be expected that along with increasing living standards these kinds of negative aspects of mutual support in society will decrease.

Finally, important factor affecting the level of corruption is political one - level of democratization, presence of independent and developed mass media, political stability in the country and balance of power in governing system etc. These elements give the possibility of controlling corrupt activities. The political aspect of the corruption in Kyrgyzstan is beyond the context of this paper. Therefore, we do not focus on this question. However, events occurred on in March 2005, and continuing debates on the balance of power between parliament, president and government prove that political factor of corruption in Kyrgyzstan has a distinct role.

⁵ *In this study it is noted that bribery and blat are different. Bribery “in local terms implies a conflict of interest where one is to be “compensated” for doing something one would not do otherwise. While blat is defined as a form of cooperation and mutual support with long-term perspective, implying trust rather than compensation for risk. However, from the point of view of corruption both of them are kind of corrupt activities and implies abuse of public power for personal interest.*

4. Regression Analyses

Proceeding from above mentioned arguments, for the more concrete exposition of causes of corruption in Kyrgyzstan the regression analyze is used. We employ ordinary least square (OLS) regression model to reveal to what the extent these factors affect the level of corruption in Kyrgyzstan case.

Data description and Model Specification

For analysis of causes of corruption in Kyrgyzstan we use the data given in Kaufman, et al. (2007). This survey measures governance in six dimensions: 1) Voice and accountability; 2) Political stability and absence of violence; 3) Government effectiveness; 4) Regulatory quality; 5) Rule of law; 6) Control of corruption. Of these *control of corruption* (COR) is taken as the dependent variable which indicates the level of corruption⁶. As explanatory variables we use remaining variables: *voice and accountability* (VA) and *political stability* (PS) dimensions, that can be interpreted as a proxies for political factor of corruption; *regulatory quality* (RQ) for regulatory burden of the state; *rule of law* (RL) for the influence of the judiciary system; finally we include the *government effectiveness* (GE) dimension, which assesses the general quality management in public sector and public services. These data includes years from 1996 to 2006. The survey's data are ranged between -2.5, indicating worse position and + 2.5 good position. Thus, modeling is based on the 5 variables that include the main three causes of corruption out of above explained possible causes: regulatory burden, judiciary system and the political factor. Unfortunately there is no appropriate measure for sociological factor that can be applied in the analysis. However, it does not imply that these factors are belittled.

Theoretically all included explanatory variables have to have negative relation with corruption, since, any improvements in these variables result in decrease of corruption. Estimation is based on the following model:

$$COR_i = C + \beta_1 VA_i + \beta_2 PS_i + \beta_3 GE_i + \beta_4 RQ_i + \beta_5 RL_i + e_i \quad (1)$$

⁶ In aggregating these dimensions Kaufman, et al. (2007) uses the both representative and non-representative sources, and presents the broad view on these dimensions.

Table: 3
Summary Statistics on Explanatory Variables

| Variable | Mean | Standard Deviation | Skewness | Kurtosis | Jarque-Bera Statistic |
|---|--------|--------------------|-----------|----------|-----------------------|
| Voice and accountability | 0.2875 | 0.187521 | -0.273842 | 1.569546 | 0.782053 |
| Political stability and absence of violence | 0.9937 | 0.778532 | 0.638884 | 2.270433 | 0.721653 |
| Government effectiveness | 0.2662 | 0.203606 | 0.225231 | 2.168814 | 0.297929 |
| Regulatory quality | 0.2712 | 0.183726 | -0.113698 | 1.619806 | 0.652215 |
| Rule of law | 0.8625 | 0.179742 | 0.686204 | 2.339877 | 0.773089 |

Results of Regression

The selection and adding of variables are hypothesized using t-statistic and F-statistic. Table 4 shows the parameter estimations of regression model used in this study. According to results generated from regression model the variables government effectiveness (GE) and political stability and absence of violence (PS) are statistically significant at 5% and 10% levels, other variables are not significant. But F-statistic is significant at 5% level. That means individually GE and PS are effective in influencing corruption. However, totally all the variables have effect on the corruption.

Table: 4
Model Specification and Parameter Estimations

| Variable | Coefficient | Std. Error | t-statistic |
|-----------------|----------------------|----------------------|--------------|
| C | 0.519653 | 0.186478 | 2.786667 |
| VA | -0.004667 | 0.086688 | -0.053832 |
| PS | -0.092503 | 0.026212 | -3.528985*** |
| GE | 0.597983 | 0.097519 | 6.131952** |
| RQ | -0.241271 | 0.132901 | -1.815418 |
| RL | -0.392933 | 0.138382 | -2.839471 |
| R-squared 0.987 | Adj. R-squared 0.957 | F-statistic 32.246** | |

** Significant at level 5%.

*** Significant at level 10%.

The results of the regression show that the sign of coefficients, excluding (GE), are negative that consistent with the theoretical arguments. The government effectiveness shows unexpected positive relation with corruption. The possible explanations for that is the data issue. Since the time period included in the analysis is short and, hence, the data used may be insufficient for presenting the more efficient results. However, the other coefficients in particularly regulatory quality and rule of law, presents the high negative relation with corruption. Therefore, these factors can be referred as the main causes of the corruption in Kyrgyzstan among included variables. But, we would like to note again,

these results are conditional since other variables that could have important effect were not included, such as wage rate, or sociological factors.

5. Some Facts on Consequences of Corruption in Kyrgyzstan

The main difficulty in explaining the importance of the effect of corruption on economic performance is its secretive nature. This problem of such “invisibility” does not allow us to determine definitely the extent to which the corruption affects economic variables. However, as it is mentioned above, empirical studies on the economic impact of corruption shows the positive correlation between corruption and low economic performances, in particularly, with low investment (both total investment and foreign direct investment), deterioration of public finance balance by reducing revenue potential and decreasing effectiveness of public expenses, and with the reduction of expenditures on education and health, consequently these facts result in poor social indicators: increasing poverty and inequality. The same facts can be evidenced in Kyrgyzstan.

High level of corruption in the tax administration causes the avoidance of private sector from tax and other regulatory burden of government, which in turn give rise to increase the unofficial economy and reduces tax revenue. According to the survey of UNDP the share of unofficial economy in Kyrgyzstan is about 53 % of GDP. In the same survey, analysis show that in 2004 the size of tax base avoided taxing was approximately 32 %. The same facts can be observed in the custom services. For instance, according to the data of Chinese custom services annually to Kyrgyzstan from China imported goods for about 200 million US dollars, while in official Kyrgyzstan statistics it is shown only at half (Omarov, 2007).

Another impact of corruption in Kyrgyzstan is on the human capital formation, which is the one of the prerequisites for economic development. Bribery taking practices in education and healthcare system results in low quality of these services. According to Omarov (2007) the most tragedy of corruption in education system in Kyrgyzstan is not only the low quality of these services, but that since the mid of 1990s it has been preparing the corruptor youth ready to apply their dishonest skills, that became their part of life, in their future carrier.

Another negative impact of corruption on the economy of Kyrgyzstan can be mentioned as the misuse of external debt and aid flows. The first private investments in the Kyrgyz economy were not only misconceived, they were guaranteed by the state, creating a national debt which now totals around \$2 billion and accounts for about 70 % of GDP. In turn, high ratio of external debt causes the problems in increasing the social expenditures. Only 20 per cent of the one billion soms of credit guaranteed by the Kyrgyz government has been returned to state coffers. The remainder is unlikely ever to be recovered, as loans to agriculture were written off against bad harvests and many firms went bankrupt before

paying off their debts (Kenenbaev, 2000). Most of these practices show that most part of external debt received under the government guarantee has been used for private gains.

All of these negative appearances resulted from corruption ultimately contribute, to some extent, to the high rate of poverty and increasing income inequality. According to the data of National Statistical Committee of Kyrgyzstan in 2005 43.1 % of population was living below the poverty line. Moreover, the situation worsens when the increased inequality and poverty causes the mass of population unsatisfied with corrupt activities of public officials, since it threatens the political and social stability of the country by discrediting the state policy.

6. Conclusion

Theoretical discussion and empirical studies on impacts of corruption on economy state that the main characteristics of highly corrupt economies are low income level, massive state intervention, weak democratic institutions, poorly operating legal system and cultural background which provoke corruption. All of these features can be observed in Kyrgyzstan as well.

Causes of corruption are complex and can not be explained by a single cause. Therefore, the same complexity emerges in solving this issue. Because of that the fight against corruption should be launched in many aspects. Secretive nature of corruption does not give possibility to determine clearly the scope, causes and consequences of corruption. However, facts mentioned in this paper indicate that in Kyrgyzstan this issue has a wide scope and really threatens the future prospects of the economy. We do not focus on the details of possible cures for this problem. However, the following directions for reforms can be advised:

- Reform of the state: This reform can be implemented in two main directions. The first one is the administrative reform that has to result in reducing the government officials and optimization of government bodies with clearly defined responsibilities of each of them. The second direction is the informative modernization of the state activity. Since closed information does not allow for controlling corruption. Widespread use of e- government practices would be effective in getting the free information.
- Optimization of the regulatory system of the state is one another direction for reforms. Some facts mentioned above show that in Kyrgyzstan the regulatory system presents the fertile ground for the corruption. In this aspect it is important again to define clearly the responsibilities of each government bodies that have regulative power. Additionally, the complexity and uncertainty of laws caused by continuous amendments and changes should be reduced. In particularly it concerns The Tax Code, the new

redaction of which is not still adopted.

- Juridical reforms: This issue is important one since without effectively enforced law, detection and sentencing of corrupt activities is impossible. This reform should result in creating the independent, but at the same time responsible judgment system. Since in most cases judgment system itself appears as corrupted.
- Increases in civil servants' wages. As it is mentioned in previous part wage rate in public sector is very low compared to private sector. Therefore, as one of the primary step in reduction of corruption wage rate should be increased. In particularly it concerns the education and health sectors.

Several other recommendations can be added to this list. However, it is important to note again that fight against corruption should be based on the multi-sided strategy. It would be misleading to focus on the actions only in one of the area, for instance, just in increasing wage rates, or in penalties, or creating the special anticorruption agency. Anticorruption strategy should be based as on economic and on juridical tools, as well as on improvements in other institutional aspects. Since liberalization and decentralization of the economy is not enough for removing the opportunities for corruption. In particularly development of independent mass media, NGOs and human rights protection are the preconditions for successful anticorruption strategy.

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