

Factors Affecting Foreign Direct Investment Inflows Into Kyrgyzstan



Economics

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ABSTRACT

To conclude, Kyrgyzstan possesses a great opportunity for multinational companies to invest in the country. The country's geographical location makes Kyrgyzstan a strategic point for multinational companies trying to penetrate or expand businesses in Central Asia and China. Nevertheless, Kyrgyzstan needs to eliminate government corruption as its utmost priority in order to develop the country's economy and provide a decent living condition for its citizens. Also, Kyrgyzstan will need to revamp its educational system as it reduces the illegal production and trafficking of heroin.

Introduction

Kyrgyzstan is a small Central Asian country with a population of a little over 5 million people. "After coping with economic difficulties stemming from the collapse of the Soviet Union and its subsequent independence in 1991, as well as the financial crisis in the late 1990s, the Kyrgyz government has maintained a macroeconomic discipline:" as it relates to the Poverty Reduction and Growth Facility program (Economic Outlook for Kyrgyzstan, 2012).

Kyrgyzstan became a part of the World Trade Organization in 1998 and has gained an advantage in terms of trade. Some of the borders of Kyrgyzstan are China and Uzbekistan which permit Kyrgyz traders to bring goods from these countries to Kazakhstan, Russia and other former Soviet countries (Zuzulinsky, 2007). However, according to the most recent reports in Economic Outlook for Kyrgyzstan as featured in *Russia and CIS*, the real Gross Domestic Product (GDP) growth forecast for 2012 has been downgraded to 4.9% from 5.6% as stated previously. This downgrade is the result of a slowdown in global economic activity and the instability surrounding the Eurozone sovereign debt crisis. All of these events have caused cyclical effects in the economy of Kyrgyzstan and they have also continued to translate into lower 2012 export receipts for the country as well (pg.9). Some other economic forecasts have further concluded that as a result the debt crisis, there will continue to be lower demand for Russian exports and investment activity in Russia in general.

Giving the looming effects of an overall dismal country and regional economic outlook, how does Kyrgyzstan grow its economy? On whole, "remittance flows are extremely important to the Kyrgyz economy. According to data from the World Bank, 2009 remittance flow for this county equated to 15.4% of the Gross Domestic Product" (pg. 9). Given these constant downward revisions and forecasts of a weaker economy, how does Kyrgyzstan continue to attract foreign direct investments at a rate that does not slow its economy but instead grows the economy? Let's explore answering this question through the lens of identifying key issues and offering thoughtful insight and suggestions to help resolve dwindling foreign direct investments in Kyrgyzstan.

During any ailing economic downturn, even healthy economic countries face trouble rebounding and recovering losses in market share. To set the stage, Kyrgyzstan still remains one of the poorest nations in the world (Kyrgyzstan Review 2012, pg. 87). Its main exports are gold, mercury, natural gas, and electricity. Although this country produces cotton, tobacco, wool, and meat, only tobacco and cotton are exported in any significant amounts. (Kyrgyzstan Country Review, 2012). On whole, the government's attitude toward foreign investment has been perceived as favorable. Some of the key citings or missteps are that the government of Kyrgyzstan does not enforce or sanctify con-

tracts. In the past, individual investors have become involved in contract licensing issues, contract registration, and enforcement. Moreover, corruption is a serious problem and thus, a hindrance to doing business in Kyrgyzstan. (Kyrgyzstan Country Review, 2012).

Education Affecting Foreign Direct Investment

By occupation, Kyrgyzstan consists of 55% agriculture, 15% industry, and 30% services. Although the literacy rate is 98.7 % , the formal years of education are on average is nine years (Background Notes on Countries of the World: Kyrgyzstan, 2011). Given agriculture is the main industry, employers and the labor market have not demanded nor required a highly skilled labor pool.

The educational system of the Kyrgyz Republic does not have a lengthy history similar to other nations. The structured education system used in the Kyrgyz Republic has only been in existence since the start of the 20th century. In the 1920s Kyrgyzstan came under the influence of the Soviet Union and it was at this time that the educational system in that country started developing (Encyclopedia.com n.d). Kyrgyzstan has a three tier educational structure that includes primary, secondary and higher institutions for learning. Since its inception, the Kyrgyz education system continues to follow the model established by the Russian Government. However, since gaining independence from the Soviet Union in 1991, the Kyrgyz government has looked into the feasibility of changing the curriculum (Encyclopedia.com n.d).

The Kyrgyz Republic places great deal of emphasis on education for the purposes of improving this developing nation. The Kyrgyz Republic believes that education is the impetus into the global economy. Since the collapse of the Soviet Union and the Republic gaining its independence in 1991, Kyrgyzstan has continued to experience a decline in the quality of its educational system. The inadequacies of the Kyrgyz education system begin with the lack of necessary funding required to sustain and to make improvements to the educational infrastructure. According to a report published by UNICEF, education spending is a priority issue of Kyrgyzstan in which the Republic spends 4.6 percent of the gross domestic product on education. (Unicef.org n.d) While the percentage spent on education by the Republic is the highest in the region, reports suggest this level of funding does not support the needs of the educational system. The lack of Kyrgyz educational funding has also brought forth a decline in the amount of teachers within the system. According to data reported on Encyclopedia.com, "In 1998, the number of teachers in the primary section had dropped from 24,086, to 19,122" (Encyclopedia.com n.d). The data reported also suggests this decline was a result of unpaid teachers leaving the profession. (Encyclopedia.com n.d)

The unfavorable conditions of the Kyrgyz educational system has direct link to the overwhelming amount of individuals that live at or below the poverty line. In a report published by the Childhood Poverty Research and Policy Centre, Falkingham and Ibragimova report that “Children living in households where the head had only primary education or less were nearly eight times more likely to be chronically poor than children living in households where the head had a higher education” (The Dynamics of Child Poverty in the Kyrgyz Republic, 2005). Education provides the citizens of the country with skills necessary to compete for jobs, along with applying those skills to employment tasks that assist companies in becoming competitive within the market place. In Kyrgyzstan, rural areas face challenges in accessing quality education. According to a data reported in a country profile completed by UNICEF, “Rural children are the most difficult to reach in Kyrgyzstan because they are largely inhabit remote mountainous villages that are difficult to access” (UNICEF, org.n.d).

Kyrgyzstan Drug Trafficking and its Impact on Foreign Direct Investments

Kyrgyzstan is in close proximity of what is known as the Golden Crescent. The Golden Crescent consists of the countries Afghanistan, Iran, and Pakistan. This area is known for producing approximately 92% of the world's heroin (Aguilar-Mila, 2008). The drug problems in Kyrgyzstan have been ongoing for many years. The end of the Soviet reign in 1991 enhanced these issues drastically. Partial to the economic status in this country, drug use has risen steadily since the early 90's. There are many issues that stem from the increasing use of drugs in the Kyrgyz Republic. Economic growth will continue to suffer as the presence of drugs continues to be prominent. Health issues within the population will begin to surface and hinder further economic and social development within the country. Also, due to the level of poverty and corruption that remain in place, there is an unlawful profit to be made for looking away from the drug trafficking.

There has been a decrease in police and military influence in this region since the Kyrgyz Republic's independence. Patrol of the countries' borders and corruption of border patrol members make the trafficking appealing in Kyrgyzstan. In the late 1990s, drugs began to fund Islamic militants in the region. Insurgent groups such as the Islamic Movement of Uzbekistan (IMU) held territory in northern Tajikistan and conducted raids into southern Kyrgyzstan and Uzbekistan. Although they claimed to be engaged in a jihad against the Uzbek government, there was a more pragmatic aim—the control of a lucrative drug route from Afghanistan to the southern Kyrgyz town of Osh (Lewis, 2010).

The amount of drugs that are being transported through the Kyrgyz Republic has slightly declined in last few years. The volume of narcotics flowing out of Afghanistan to Central Asia and Russia appears to have decreased slightly over the past year. But the stockpile of opiates that traffickers already have on hand is sufficient to supply users in Central Asia and Russia for 15 years (Weitz, 2011).

The presence of drugs in this country is beginning to have a direct affect on the health of the population. Many of the heroin users are converting from smoking heroin to injecting it. This practice has sparked a significant rise of HIV among heroin users. Most users are hooked on heroin, stoking ancillary public-health problems, in particular a rise in HIV infections. “Sixty-five percent of new cases of HIV patients result from the harmful sharing needle practice among drug users.

With the amount of revenue generated by cultivation and transportation of opiates being so substantial, corruption will always play a role in the realm of drug trafficking in this region. Many members of military, government officials, and local police of-

ficers take bribes from trafficking groups to allow drugs to cross borders of the countries along the transport routes.

Figures such as Bayaman Erkinbaev, who was alleged to control a key drug trafficking route in the south through the city of Osh, were elected to parliament, and could be seen happily dining in the capital's hotels with senior political figures. Erkinbaev was a colorful leader from the south of the country, who combined political ambition with dubious business interests. He won his parliamentary seat with 95 percent of the vote (Davis, 2010).

Government Corruption Affecting Foreign Direct Investment

Foreign direct investment (FDI) plays a critical role in the development of any country. Lack of FDI could impede any country to have a stable economy. The Republic of Kyrgyzstan has been an emerging country since its independence from former Soviet Union. Kyrgyzstan and has a very small FDI compared to its surrounding neighbors such as Azerbaijan, Turkmenistan, Kazakhstan and Uzbekistan (Dikkaya & Keles, 2006). One major reason foreign direct investment is truncated in Kyrgyzstan is the result of government corruption. This creates difficulties and raises the cost of conducting businesses in the country. According to US government, corruption is a serious a problem in all levels of Kyrgyzstan society. Kyrgyzstan level of corruption occupies number 164 out of 182 in the Perception Index from Transparency International for 2011 (US Department of State, 2012). Corruption deteriorates international investment and halts economic growth if high level of it persists in a country. Government corruption has been a critical issue since Kyrgyzstan separation from former Soviet Union. Looking at Kyrgyzstan history back in 1995, President Akayev tightened control with corrupt patronage networks that looted public assets. He also ransacked assets into his own network (Collins, 2011). Tired of corruption, Kyrgyz people movement called “The Tulip Revolution” started to come strong against President Akayev and his corrupted government. They mobilize kinships, clans and villages to stand against corruption and finally in 2005 President Akayev has ousted out (Collins, 2011). Thereafter, a new president arose. President Bakiyev took leadership in Kyrgyzstan with hopes of change from its predecessor. However, corruption did not last to appear under this new government. Bakiyev used intimidation against political opponents including he placed his brother and son in charge of Presidential Guard and National Security (Collins, 2011). Also, the corruption under his era involves his seven brothers and two sons who got shares of the state's wealth through political appointments. Bakiyev allies demanded excessive kickback and extortion from state ventures in the gold industry. His family connections appropriated annual profits from the Toktogul hydroelectric power plan. They also pocketed multimillion dollar in contracts from fuel suppliers to U.S. military base Manas (Collins, 2011). One more time in year 2010, Kyrgyz people arose against demanding an end to corruption, nepotism and clan conflict. Finally, Bakiyev was ousted during the so called “April 2010 Revolution” (Collins, 2011). Recently, government corruption is one more time in the headlines around the world. A new accusation of corruption against Kyrgyzstan Prime Minister Omurbek Babanow. He is accused of receiving a bribe of over one million dollars in the shape of an English bred horse. It is believed that Kyrgyzstan's current president, Almazbek Atambayev is working behind the scenes to deprecate the government and hoping to have a prime minister who will favor the president's ideals (The Economist (US), 2012).

Government corruption does not seem to end in the history of Kyrgyzstan. Consequently, government corruption deteriorates foreign direct investment in Kyrgyzstan. Government corruption affects foreign direct investment in so many reasons. One major reason is it tarnishes the perception of government stability. When investors see a high level of government corruption, they see this as a disadvantage for businesses because bribes

and kickbacks will provide an extra cost to the business causing a decrease in profits and affecting their investment (King, 2003). Furthermore, government corruption does not allow business to have a fair competitiveness for any businesses. Hence, investors are afraid of investing in a country where businesses will not have a fair chance in competing for businesses. Government officials receiving bribes and kickbacks will give preferential treatment to those companies that are willing to engage in government corruption over those companies with strong ethical commitments (King, 2003). In addition, government corruption in regards to infrastructure discourages foreign investors. Infrastructure is very important in the development of any businesses such as highways in good condition are vital to transport products from one place to another. Government officials pocketing sources that are directed to infrastructure dampen the desire of any venture capitalist to be part of the country's investment because there would not be adequate infrastructure to fulfill demands of any enterprise (King, 2003). Finally, another reason government corruption affects foreign direct investment is the rule of law. Business contracts are seriously affected by lack of rule of law. Investors are afraid that as of result of government corruption, there is a lack of rule or law is not enforceable due to government officials receiving high bribes to apply the law to benefit only certain companies (King, 2003).

Recommendations

The road to improving the declining educational system in Kyrgyzstan is to invest in its infrastructure. The government needs to build new schools and make repairs to existing schools in urban and rural areas of the country. This will help in fostering positive learning environments for students. Once the country as whole becomes economically stronger, appropriate measures can be taken to make significant improvements to the educational system. Research done through Encyclopedia.com provided the following summary, "It is apparent the most significant changes required for Kyrgyzstan's educational system to stabilize would be for the country to enjoy economic stability and prosperity, from which education could take its place as a significant contributor to the country's viability" (Encyclopedia.com n.d)

Possible solutions to halt government corruption in Kyrgyzstan are necessary to improve the foreign direct investment in the country. In Kyrgyzstan, the different government branches do not have equal powers to create a check and balance system. One of those solutions is to create strict norms and procedures to create accountability among all public servants in the different branches of government as well as reinforce equality of pow-

ers among the different government branches. Second of all, a new democratic electoral system needs to be created. Currently, there is a weak government in Kyrgyzstan. Government officials are ill-qualified and cabinet posts are often about expropriating resources (The Economist (US), 2012). Hence, a new electoral system will create a strong government. Kyrgyz people should be able to elect candidates for parliament, president and prime minister that seek the best practices and benefits for their constituents. Lastly, informal groups of politicians remain and do as they please in the political system of Kyrgyzstan. Laws should be created and enforced to prevent political groups from taking government powers in their own hands. Political groups involve in any actions outside the law should be severely penalized to stop volatility in Kyrgyzstan government.

The issues caused by the continuous increase of drug trafficking and drug abuse in Kyrgyzstan will directly affect the possibilities of foreign direct investments. The Kyrgyzstan government needs to apply a strong focus on corruption issues involved with drug trafficking. The trafficking problems will linger as long as enforcement agencies are not held accountable for their corruptive actions. Proper training and up-to-date drug detection equipment is key in the crack down on drugs. Once the training begins and better detection equipment is put in place, the patrol at main gateway areas of the borders will need to be increased. Kyrgyzstan should accept support and collaborate with bordering countries in the attempt to reduce trafficking in this region. This effort will eventually deter the drug activity and attract possibilities of foreign direct investments.

Conclusion

To conclude, Kyrgyzstan possesses a great opportunity for multinational companies to invest in the country. The country's geographical location makes Kyrgyzstan a strategic point for multinational companies trying to penetrate or expand businesses in Central Asia and China. Nevertheless, Kyrgyzstan needs to eliminate government corruption as its utmost priority in order to develop the country's economy and provide a decent living condition for its citizens. Also, Kyrgyzstan will need to revamp its educational system as it reduces the illegal production and trafficking of heroin.

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