Economic dystopia in Kyrgyzstan

Balihar Sanghera

Hailed as a success story for liberal market reforms, Kyrgyzstan in fact provides an example of how the rentier class have become an integral part of the economy, and how democracy has given way to plutocracy.

Despite being hailed as a success story for liberal market reforms, Kyrgyzstan actually provides an example of how the rentier class have become an integral part of the economy, and how democracy has given way to plutocracy. Sometimes with the assistance of the international donor and financial community, rentiers have shaped public policy in key industries, such as microfinance, real estate and utilities, allowing them to siphon off income from consumption and production. Their effects have been damaging: sharpening social divisions, corrupting public service, impoverishing rural communities, indebting working families, forcing ordinary people to live in squalid conditions, contributing towards an intensely individualistic and competitive economic life, and causing leakages to the national income flows.

A rentier lives off the income from investment, property, capital and other assets in the form of interests, rent and capital gains. Rentiers can write the rules of the game as to who gets what and when, as a result of owning and/or controlling assets and occupying positions of legal authority. In contrast, the rest of the population have to do other work, such as farming, cooking, nursing, building and teaching. Inequality is the inevitable result.

Microfinance

The microfinance sector has been growing since the 1990s in Kyrgyzstan, when international financial institutions and donor organisations (such as the United States Agency for International Development [USAID], the World Bank and the European Bank for Reconstruction and Development [EBRD]) advocated public access to finance as one of the effective ways to combat poverty and to stimulate entrepreneurial activity, following the model of the Grameen Bank in Bangladesh.

Currently in Kyrgyzstan, the assets of microfinance institutions (MFIs) account for 21% of the finance sector's assets, and MFIs' total loan portfolio is about 7.5% of GDP; and about 15% of the population is credited by MFIs. Since 2005, the microcredit coverage has increased from 1.4% to 7.6%, and the number of borrowers has increased from 35,000 to 436,000 people. MFI's credit portfolio has increased more than 26 times, from 722.9m to 19.1 billion soms ($16.06m to $424.44m). More than 80% of borrowers live in rural areas, and the MFI loan portfolio includes mainly medium and short-term loans up to three years. The main reasons for loans are for agricultural, trade and consumer purposes, borrowing on average $4,425.

The MFI loan portfolio is formed by attracting funds from international financial institutions and MFIs' own funds. In lending funds to MFIs, development banks and agencies expect a return on their equity, and in turn MFIs charge high interest rates on their loans to borrowers to recover their operating costs, and more. Although MFIs are ostensibly guided by social missions designed to tackle poverty, to foster social and economic development, and to provide opportunities to women, in fact their priority is always financial sustainability, which means making a profit on their operations. Typically, MFIs' effective interest rate for any credit is approximately 38%, sometimes going over 50%.

Typically, MFIs' effective interest rate for any credit is approximately 38%, sometimes going over 50%.

The practices of MFIs have come under some criticism. First, by charging exorbitant interest rates on vulnerable and needy members of society, MFIs enrich themselves by exploiting the needs of others, and profiting from debt. Shareholders, directors and staff members of MFIs have done very well in making money under the guise of social enterprise and development. For instance, Bai Tushum is one of the largest providers of microcredit in the country, obtaining loans from various agencies, including German development banks, USAID and EBRD. Within several years, its loan portfolio and coverage grew quickly, and having started as a non-governmental organisation in 2000, it is now a private bank.

Second, it is a myth that MFI loans enable poor families to escape poverty or to develop innovative micro-enterprises. Most of the agricultural loans are to subsistence farmers, who use them to eke out a living in what is a precarious economic sector. The exploitative and restrictive terms and conditions on which they borrow mean that there is little chance that farmers will use the loans for innovative enterprise.

Third, the level of indebtedness in the country has increased, with families having multiple loans. 31% of borrowers had more than one active loan. Poor families often have no option but to re-pay the loans using migrants' remittances. In one social survey, 20% of the respondents mentioned paying off loans as a reason for the expenditure of the remittances. In some of the poorest regions (Naryn, Talas and Issyk-Kul), several borrowers committed suicide because of the social shame, pressure and inability to re-pay the loans.

Market traders

Kyrgyzstan has become a country of small traders with a large share of the population working in the retail trade. In 1989, there were about 100 marketplaces in Kyrgyzstan, increasing to over 400 by 2005. About 10% of the population are involved in the wholesale and retail trade sector. The country has one of the largest bazaars in Central Asia, Dordoi Market in Bishkek. In 2009, the World Bank referred to Dordoi Market as a state within a state, calculating its annual turnover of over 3.9 billion

USD, mostly goods transiting from China for re-export to Kyrgyzstan's neighbours. Market rents at Dordoi vary from 2,000 soms to 175,000 soms ($44 to $3,888) depending upon the location in the market.

About 10% of the population are involved in the wholesale and retail trade sector.

Askar Salymbekov is one of the top ten richest people in the country. Salymbekov's family company, Dordoi Corporation, largely owns Dordoi Market. With huge profits from the marketplace, Dordoi Corporation developed other equally profitable businesses: shopping malls (including the luxury shopping centre Dordoi Plaza) and luxury hotel complexes (including Koitash Hotel in Bishkek). The company operates twenty different markets, including a highly profitable one for auto parts, Alamedin retail market and Dordoi Azia wholesale market specialising in household appliances, office supplies, rugs and everyday hygienic products. Dordoi Corporation is one of the shareholders of DosKredobank (a retail bank), and holds a controlling share of Kyrgyzmebel (one of the largest furniture manufacturers in Central Asia).

The Salymbekov businesses do not contribute anything to the market traders' income generation, but as a landlord he is able to collect substantial rent from them, profiting from their risk-taking and hard work. Like the microfinance debtors, the small traders and retailers have to produce enough surplus for their own basic needs and for the Salymbekov family's consumption wants.

Banking

The banking sector in Kyrgyzstan underwent a rapid growth, with total banking assets increasing from 7.9 billion soms in 2002 to 44 billion soms in 2008 ($175.56m to $977.76m). 60% of total assets belonged to international financial institutions, of which 35% came from Kazakhstan. International financial institutions lent capital to Kazakhstani banks, which in turn lent to their domestic customers and invested in Kyrgyzstani banks, aiming to expand their loan portfolio. The Central Asian banks betted on a constant supply of cheap credit overseas to fund domestic borrowing and to develop the mortgage market.

The business model of the banking system was based on the ability of national banks to generate profits by borrowing cheaply abroad and lending domestically at 20-25% interest rates. In Kyrgyzstan, mortgage loans were only given out by banks with foreign capital endowments: EnergoBank, Halyk Bank, Kyrgyz Investment and Credit Bank (owned jointly by the EBRD, Aga-Khan Foundation, German Investment and Development Corporation, and International Financial Corporation), FinanceCreditBank, and KyrgyzCredit Bank (supported by an Italian investor). In 2008, mortgage loans were approximately 3.4 billion soms (75.56 million USD, 2.3% of GDP, and 15% of the total bank loans). Despite the 2008-09 global credit crunch, mortgages account for 9.6% of total bank loans.

The financialisation of the housing market has had two detrimental effects.

Housing

The financialisation of the housing market has had two detrimental effects. First, the global credit-induced construction boom has sharpened social divisions, and has not been an engine for the country's development, rather failing to improve ordinary people's living and housing standards. Most construction companies target the high end of the property market, specialising in luxury, up-scale apartment blocks, 5-12 stories high, mainly concentrated in the three largest cities (Bishkek, Osh and Jalalabad). In 2006, up to half of all completed luxury apartments were unclaimed. Investors do not necessarily build or buy luxury apartments to sell them immediately to families, but rather they hold on to them, aiming to profit from rising prices. In addition, wealthy criminals buy luxury apartments, not only to clean their money obtained illegally from drug trafficking and tax evasion, but also to receive unearned capital appreciation. As apartment prices are beyond the reach of most families' budget, ordinary people have little option but to either rent or build their own home. Most build adobe houses as the easiest and most affordable way for them to improve their housing situation. Bishkek has 53 such informal settlements (with an estimated population of between 200,000 and 300,000), and most of the houses are self-built adobe units, of which many lack adequate sanitation, running water, electricity and gas.

Second, in the process of acquiring land in prime locations, financiers and property developers bargain with corrupt city authorities to relax planning permissions. Rich developers with government connections have often bypassed regulations and ignored building codes. In 2014, an inquiry into planning applications in Bishkek found that there were 235 illegal building projects underway, and nothing could be done to stop them. The connection between finance, property and politics is also evident in Parliament, where many of the deputies have links to construction.

In 2014, an inquiry into planning applications in Bishkek found that there were 235 illegal building projects underway.

Political influence

The Kyrgyzstani first two presidential families of Akayev (1991-2005) and Bakiyev (2005-10) were notorious for privatising and controlling the country's prime rent-yielding assets, such as the gold mines and utility companies. Maksim Bakiyev, the eldest son of President Bakiyev, exercised a blatant form of political rent-seeking entrepreneurship, resulting in the fall of the regime on 7 April 2010, partly because newly privatised quasi-monopoly companies hiked their prices, thereby increasing the economic rents for the new owners, who were closely linked to Maxim Bakiyev. The international donor community expressed doubts about the way some companies had been privatised, and how they were managed through a fraudulent and elaborate accounting system, designed to conceal Maxim Bakiyev's involvement and to siphon off wealth into secret bank accounts in the UK, Belize and New Zealand.

Politicians can be entrepreneurial in developing, privatising, taking-over or negotiating with rent-extracting enterprises, many of which are natural and artificial quasi-monopolies, such as utilities, mining, mobile communication, transport, supermarkets and hotel resorts. Because of their economic and geographical dominance in the market, these companies can charge what are known as economic rents, which are a margin over actual production costs. Economic rents create prices empty of cost-value, siphoning off for rights-holders, income that otherwise would be spent on goods and services in the real economy.

Economic rents are leakages from the national income flow in three ways. Some economic rents leave the country as capital flight into foreign accounts and offshore tax havens, occasionally using 'shell' companies to disguise the real owners. Economic rents are also ploughed into rent-yielding assets (such as luxury apartments and financial securities) to accumulate further unearned income, rather than to buy goods and services. When real purchases are made, they are more likely to be expensive luxury imports.

Public policy discussion

To counter the anti-progressive economic system in Kyrgyzstan, public policy discussion requires a re-familiarisation with terms such as 'rentier', 'unearned income' and 'economic rent', which disappeared from public discourse. In addition, a public policy response to rent extraction must include a progressive taxation of wealth, the nationalisation of quasi-monopolies, anti-monopoly regulation to ensure fair competition and pricing, and participatory democracy to break the current property-politics nexus in the country.

Standfirst Image: New EurasiaNet/Demotix (c)