

Czech University of Life Sciences Prague

Faculty of Economics and Management

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Diploma Thesis

Foreign trade impact on economy of Kyrgyz Republic

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BACHELOR THESIS ASSIGNMENT

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Economics Policy and Administration
Business Administration

Thesis title

Foreign Trade impact on economy of Kyrgyz Republic

Objectives of thesis

This bachelor thesis about foreign trade in Kyrgyz Republic. The aim of my thesis is to evaluate foreign trade impact on economy of Kyrgyz Republic. Firstly, in the thesis i would explain economical history of Kyrgyz Republic. Secondly, understand how foreign trade happens and what is main product. Show how and what does it depend on. Find troubles and try to eliminate them. Try to find ways to improve the economy in Kyrgyz Republic using foreign trade.

Methodology

This thesis employs two basic research methods: speculative and practical research methods. The speculative method allows to codify the basic foreign trade development theories for subsequent practical analysis. The speculative research method includes the review and analysis of the available literature, which contains the description of the existing foreign trade development theories. Also this thesis use induction method, generalization method, scenario method, practical research method.

The proposed extent of the thesis

35-40 pages

Keywords

Development, Foreign trade, improve, Economy of Kyrgyz Republic

Recommended information sources

Modern Principles: Microeconomics by Tyler Cowen and Alex Tabarrok. ISBN 9781319111670

Straight Talk on Trade: Ideas for a Sane Economy: Ideas for a Sane World Economy by Dani Rodrik. ISBN 9780691196084

2. GANDOLFO, G. International finance and open-economy macroeconomics. Berlin: Springer, 2002. ISBN 3-540-43459-3.

Expected date of thesis defence

2019/20 SS – FEM

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Declaration

I declare that I have worked on my diploma thesis titled "Foreign Trade impact on economy of Kyrgyz Republic" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the diploma thesis, I declare that the thesis does not break copyrights of any their person.

In Prague on _____

Acknowledgement

I would like to thank doc. Ing. Lubomír Cívín for his lectures which were given to us with a perfect explanation of Trade aspects and it was certainly the motivation for me.

Foreign trade impact on economy of Kyrgyz Republic

Abstract

This thesis features the specifics of the foreign economic processes impact on the development of the country's own economy.

The analysis findings of the foreign trade impact on the economy of the Kyrgyz Republic allow making the following conclusions:

- 1) The borders open for imports have adversely affected the country's own industry and agriculture. Local goods cannot compete with imports.
- 2) The requirements of the integration unions (EAEU, WTO) preclude from introducing preferences for the country's own producers and adequately protecting the country's own production.
- 3) The protracted development period of the domestic economy, which relies on re-export, adversely affects the development of the country's own industry.
- 4) The state fails to adequately employ the opportunities provided by the membership in such integration associations as the WTO, the EAEU, as well as the preferences under the GSP+ program to build its own economy.
- 5) Inadequate government efforts to combat smuggling and counterfeit imports undermine the foundations of its own economy and boosts corruption.

The thesis presents the following recommendations on leveraging foreign economic aspects for the development of the country's own economy:

- 1) Import substitution issues should be resolved as part of cooperation processes between the EAEU member states, rather than within Kyrgyzstan.
- 2) In order to enhance partners' trust, Kyrgyzstan should demonstrate its commitment to combat gray imports, thereby showing joint responsibility to protect the entire EAEU market.

- 3) The state should support the domestic businesses that already have experience in, and knowledge of, foreign markets.
- 4) Promote the development of high-performance production by reducing customs duties on the import of new technological equipment.
- 5) Enter the technological chains or value added chains of partner countries' successful businesses, which maintain stable sales in various foreign markets.
- 6) The services sphere, namely tourism, recreation, leisure, should be prioritized, among others, for export capacity development.

Keywords: development, foreign trade impact, import, export

Dopad zahraničního obchodu na ekonomiku Kyrgyzské republiky

Abstrakt

Představená diplomová práce ukazuje zvláštnosti vlivu zahraničně ekonomických procesů na vývoj vlastní ekonomiky země.

Na základě analýzy dopadu zahraničního obchodu na ekonomiku Kyrgyzské republiky byly předloženy následující závěry:

- 1) Otevřené hranice pro dovoz negativně ovlivnily jejich vlastní průmysl a zemědělství. Místní zboží nemůže konkurovat s dovozem.
- 2) Požadavky integračních odborů (EAEU, WTO) neumožňují zavést preference pro jejich vlastní výrobce a plně chránit jejich vlastní produkci.
- 3) Prodloužené období vývoje domácí ekonomiky založené na reexportu negativně ovlivňuje vývoj vlastního průmyslu.
- 4) Stát nevyužívá plně možnosti členství v takových integračních sdruženích, jako jsou WTO, EAEU, ani preference v rámci programu VSP + pro formování vlastní ekonomiky.
- 5) Nedostatečné vládní úsilí v boji proti pašování a dovozu padělaných výrobků podkopává základy vlastní ekonomiky a zvyšuje míru korupce.

Práce předkládá následující doporučení týkající se využití zahraničně ekonomických aspektů pro rozvoj vlastní ekonomiky:

- 1) Problémy se substitucí importu by neměly být řešeny nikoli v hranicích Kyrgyzstánu, ale v rámci spolupráce členských států EAEU.
- 2) Aby se zvýšila míra důvěry partnerů, musí Kyrgyzstán prokázat své odhodlání bojovat proti „šedým dovozům“, čímž prokáže míru společné odpovědnosti za ochranu celého trhu EAEU.
- 3) Stát by měl podporovat ty domácí podniky, které již mají zkušenosti a znalosti práce na zahraničních trzích.
- 4) Stimulovat rozvoj vysoce výkonné výroby snížením cel na dovoz nových technologických zařízení.
- 5) Zahrnout do technologických řetězců nebo řetězců s přidanou hodnotou úspěšných podniků partnerských zemí se stabilním prodejem na různých zahraničních trzích.
- 6) Jednou z priorit rozvoje exportního potenciálu je určit sféry služeb: cestovní ruch, rekreace a volný čas.

Klíčová slova: vývoj, dopadu zahraničního obchodu na ekonomiku Kyrgyzské republiky, dovoz, vývozní

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List of abbreviations

EU - European Union

GSP+ - Generalized System of Preferences

CIS - Commonwealth of Independent States

SCO - Shanghai Cooperation Organization

EAEU - Eurasian Economic Union

1 Introduction.

The historical evolution of the Kyrgyz Republic is distinguished by the fact that before it acceded to the Soviet Union there was no stable state formation on its present territory that would pursue an independent economic policy, including foreign trade. During the Soviet period, all economic activity was subordinated to the union-level state-planned economy, where the economic entities of the Kyrgyz Republic were assigned a role of dependent policy implementers. This circumstance dictates a significant difference between the situation in the Kyrgyz Republic and that in other countries of the former Socialist Bloc, which historically developed in a market economy, such as Hungary, Poland, Czech Republic, Russia, Latvia, Lithuania, Estonia etc.

Thus, starting with the independence of the Kyrgyz Republic in 1991, for the first time in its centuries-old history the country started modelling its own economic market-based liberal policy, including the establishment of foreign trade relations. This path was marked by both successes and by certain difficulties and failures, which account for the lack of experience and knowledge of the state structures responsible for economic development.

The reason not less important is the lack of knowledge and skills among the citizens of the Kyrgyz Republic, as well as among entire enterprises, pertaining to the independent organization of production of goods that could be competitive in foreign markets. For various objective and subjective reasons, the production facilities that ensured the export of products in the Soviet period ceased to operate in the country: agricultural and instrument-making machine building, computers manufacturing, automotive industry, defense production, light and textile industries etc. In fact, the beginnings of new export-oriented production were established from scratch: glass production, clothing industry, mining and food industries.

In the absence of its own production capacities, the initial period of the country's development was marked by flourishing imports, which flooded the markets of the Kyrgyz Republic further complicating the restoration of country's own production. A specific type of foreign economic activity - re-export of cheap, usually Chinese goods to the CIS countries, a significant part of which was actually smuggled goods - began to thrive.

At the first stage of the Kyrgyz Republic origination, all these and many other factors built new approaches to foreign economic activity.

It is necessary to mention that there are not so many analytical works in the country that consider the foreign trade influence on the country's economy as a whole. This also affects the state policy in foreign economic activity, which often lacks an analytical basis and sound recommendations.

Therefore, an important and exciting objective of this thesis is to identify certain critical aspects in the foreign trade activity of the Kyrgyz Republic and to formulate sound recommendations. The findings of the thesis will be helpful in terms of understanding the involvement of foreign trade in developing countries, including the countries in the post-Soviet period.

2 Objectives and Methodology

2.1 The aim and objectives of the thesis.

The aim of the thesis is to analyze the key aspects of foreign trade, including the regulatory function of the state, and their impact on the economic development of the Kyrgyz Republic.

In pursuing this aim, the thesis will focus on the following objectives:

- 1) Consider the basic theoretical foundations of foreign trade and the protectionist role of the government in foreign economic activity;
- 2) Review the key indicators of foreign trade development in the Kyrgyz Republic at the present stage;
- 3) Analyze the impact of the regulatory functions of the state on foreign trade.
- 4) Elaborate conclusions and recommendations for the improvement of certain aspects of the foreign trade development in the Kyrgyz Republic.

2.2 Methodology.

This thesis employs two basic research methods: **speculative** and **practical** research methods.

The **speculative method** allows to codify the basic foreign trade development theories for subsequent practical analysis.

The speculative research method includes the **review and analysis of the available literature**, which contains the description of the existing foreign trade development theories.

The literature review covers both printed and electronic materials, with the source address indicated for the latter.

The **induction method** allows to project the larger picture in a certain area to particular moments. At the same time, the flexibility of such projection is envisaged, since it is challenging to ensure an unambiguous result for certain characteristics.

The **generalization method** is used in the thesis, making it possible to draw a general conclusion about the objects or phenomena of the study based on individual characteristics. The **scenario method** is applied to forecast economic phenomena on the basis of generalization.

The **practical research method** is necessary to collect specific data on foreign economic activity, as well as other economic indicators.

The economic indicators are collected by the following methods:

- Review of publicly available sources of the National Statistical Committee of the Kyrgyz Republic,
- Published reports of state bodies and international organizations pertaining to certain aspects of foreign trade in the Kyrgyz Republic,
- Data presented in the development programme documents of the Kyrgyz Republic and individual sectors.

The obtained data is subjected to preliminary processing, which results in diagrams and tables used for further in-depth analysis.

For the purposes of thesis, the author used the method of **interviews** with individuals specializing in foreign trade, both from among government officials and from the business sector. This method allows to analyze the actual state of affairs in comparison with the expected situation, modeled based on the findings of theoretical studies.

3 Literature Review.

3.1 Theoretical aspects of foreign trade impact on the national economic growth.

Theoretical concepts scarcely ever provide ready-made solutions to the economic problems of a particular country. However, abstract theories serve to explain certain patterns of the country's economic development, as well as elaborate a framework for future economic policies.

The existing foreign trade theories describe the ways the countries benefit from foreign trade, as well as the principles of state engagement in the international system of labor division. They reveal the features inherent in exports and imports, the challenges faced by countries when opting for production specialization as well as other foreign trade issues.

The extent of foreign trade development is essential for any country's economic development, including the Kyrgyz Republic. Moreover, the role of foreign trade possesses two, sometimes opposite, characteristics for the country's economy. On the one hand, the large exports show the ability of the economy of a given country to compete with other countries. That is, the cost of high-quality products is lower than the same feature of the same products made in other countries. This demonstrates high labor productivity, the ability of the business sector to introduce and develop new technologies and innovations.

At the same time, it is generally accepted that large imports characterize the weakness of the country's economy. That is, the products coming from other countries are more attractive in terms of their cost and quality than domestic ones.

However, it is not that definite in practice. Let us consider the basic foundations of the impact that exports and imports have on the country's economic development.

A country is unable to develop without economic ties to other states. In the most simplified form, it is like this - export allows to accumulate business and state treasury incomes by selling domestic products to other countries, while import allows to meet the needs for those goods and services, which cannot be entirely satisfied by domestic production.

The above foreign trade provisions were described at an early stage of foreign trade development. Over the course of the long historical process, the influence of foreign trade on the countries' economies and on their development in general has changed and gained complexity. This was due to the fact that production technologies, trade promotion practices, and, most importantly, people's needs for goods and services were changing rapidly. The view of the "usefulness" or "non-usefulness" of exports and imports also changed.

There is a substantial body of theoretical works related to foreign trade impact on the development of countries and their economies. The variety of these scientific works cannot be covered in one thesis. Therefore, we are going to consider only the certain aspects of such impact, which will be helpful in the future while delving into the foreign trade issues of the Kyrgyz Republic.

One of the first classical works that examines foreign trade benefits is *An Inquiry into the Nature and Causes of the Wealth of Nations*¹ (1776) by Adam Smith. The author argued that countries were interested in the free development of international trade, since they could benefit from it regardless of whether they were exporters or importers. The work presented the absolute advantage theory, according to which a country benefits from foreign trade if it has absolute advantage in production, subject to a minimum use of similar resources.

Below is an example of absolute advantages theory application.

Example. Assume that France produces 1,000 liters of wine and 100 kg of cheese with certain inputs. While Portugal produces 1,200 liters of wine and 130 kg of cheese with the same resources.

Table 1: Example of the absolute advantage theory.

Product	France	Portugal
Wine	1000 l.	1200 l.
Cheese	100 kg	130 kg.

Source: Author

It is obvious that Portugal production is much more efficient than the production of the same goods in France, since Portugal produces both products in greater quantities with equal inputs.

These are the goods that one should specialize in, selling their surplus in international trade. This work offers an important conclusion regarding the import of goods: "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage." In fact, we are talking about the use of "cheap" imported goods as a value added chain component to reduce the cost of the final product. This laid the

¹ An Inquiry into the Nature and Causes of the Wealth of Nations. Link <http://www.bibliomania.com/2/1/65/112/frameset.html>. Last visited on January 03, 2021.

beginnings of international division of labor. It is important to note that the work of Adam Smith is not about selling or buying goods, but rather about exchanging them. At the same time, the theory concerned a situation where countries enjoyed more or less equal economic development. Such an exchange of goods results in a win-win situation for the states, as they either get the goods they are unable to produce, or purchase foreign products at the prices significantly lower than those provided by domestic producers. In other words, international trade is turning into an activity that benefits all of its actors. By the way, this approach set the theory of Adam Smith significantly apart from the late mercantilism theory², which was popular in the 17th-18th centuries. In terms of country's competitiveness development in a market environment, the supporters of mercantilism preferred protectionist policies implemented by the state in order to gain advantages in pricing policy compared to other countries. It is important to emphasize that currently the approaches associated with the mercantilism theory are strong, especially among developing countries, with production costs reduction accounting to often unjustified patronage of these countries, rather than on the international integration principles. It is important to consider this aspect from the perspective of the subsequent analysis of foreign trade in the Kyrgyz Republic.

The absolute advantage theory was developed and at the same time criticized by David Ricardo, Adam Smith's follower and opponent. In his work *On the Principles of Political Economy and Taxation* (1817), where the seventh chapter was specifically devoted to the international trade theory, he presented the comparative advantage theory, which argued that foreign trade was beneficial to each of the two countries, even if neither of them had an absolute advantage in the specific goods production. His theory stemmed from the comparison of prices for individual goods produced by trading partner countries, while the absolute advantage principle turned out to be an individual case of the more general rule of comparative advantage in the production of a particular type of product.

D. Ricardo formulated the comparative advantage theory, introducing the opportunity cost concept. The **opportunity cost** is the relation of the amount of labor required to produce a unit of one product to the amount of labor required to produce a unit of another product.

Below is the example that illustrates the comparative advantage theory.

Example. Assume the production of 1,000 liters of wine in France requires the amount of labor of 100 workers a year. Portugal requires the amount of labor of 80 people for the same

² Wallerstein I. *The Modern World-System II. Mercantilism and the Consolidation of the European World-Economy*. New York — London, 1980

amount of wine. To make 100 kg of cheese, France requires the amount of labor of 40 people, while Portugal requires the labor of 20 people for the same amount of product.

Table 2: Labor costs associated with goods production (by the number of people).

Product	France	Portugal
Wine (1000 liters)	100 people	80 people
Cheese (100 kg)	40 people	20 people
Opportunity cost (wine in cheese units)	2.5	1.6
Opportunity cost (cheese in wine units)	0.4	0.5

Source: Author

In this example, one unit of wine in France costs 2.5 units of cheese. In Portugal, a unit of wine is worth less than the same unit in France - 1.6. However, it is different with cheese. The opportunity cost of cheese in France is less than that in Portugal (0.4 versus 0.5). Thus, if Portugal produces wine for France, and France produces cheese for Portugal, then both countries benefit from labor resources. For each unit of wine purchased, France saves $2.5 - 1.6 = 0.9$ of labor resources, while Portugal saves $0.5 - 0.4 = 0.1$ of labor resources by purchasing cheese.

Thus, if we take the absolute advantage theory, then Portugal should export products without maintaining mutual trade with France and receive all the benefits on its own. But at the same time, the risks are high that Portugal fails to increase its labor productivity and loses all of its advantages in the future.

According to the comparative advantage theory, both parties enjoy mutual benefits from foreign trade and use their labor resources rationally. The very process of mutual trade stimulates labor productivity growth, that is, the use of new technologies and innovations. It is important to note that this theory envisages the labor productivity factor a fundamental condition for entering the global market. That is, labor costs per unit of output determine the price advantage for goods similar to those produced in other countries.

In reality, the comparative advantage theory is not implemented to its full extent. Often the reason is that the overall efficiency gains depend on the actions of all partner countries,

which should specialize in their comparative advantage all at once. If one country refuses to produce ineffective products as part of the specialization division, and accordingly cuts jobs, this immediately causes social tension in the society. Therewith, the benefits of the comparative advantage theory manifest themselves in the long term only. For example, the Kyrgyz Republic continues to grow wheat at a low labor productivity rate compared to Kazakhstan, since this area employs a significant number of farmers. But the “invisible hand” of the market smooths such situations, with the evolutionary development most frequently proving the correctness of the comparative advantage theory.

The theoretical works on foreign trade have been improving with considerable experience gained in the countries’ actual foreign trade policy. The theory of two Swedish scientists E. Heckscher - B. Ohlin, which was published in B. Ohlin's book *Interregional and International Trade*,³ requires a special mention among these works. The theory is based on the factor model of foreign trade. These authors believe that the problem is that countries not only possess labor resources to a different extent and have different labor productivity, but also have inputs, such as land and capital. Ensuing is that a relatively different amount of certain factors is used in the production of different goods.

The following groups of goods are distinguished based on inputs classification:

- a) labor intensive;
- b) capital intensive;
- c) earth-intensive, or nature-intensive.

If this classification is applied to modern conditions, then India can be classified as a labor-abundant country; Japan, USA, Switzerland – as capital abundant countries; and the Russian Federation – as a land abundant country.

If certain countries face relative inequality in the distribution of different inputs, then these countries will also incur different input costs. For example, a country with a relatively greater endowment of such an input as labor, has relatively lower wages (the cost of this input). A country with a relatively larger capital resources has lower cost of financial resources, while a country that is rich in natural resources actually has lower cost of raw materials. For example, due to high birth rate and limited areas for living due to mountains, there is an

³ Ohlin B. *Interregional and International Trade*. Cambridge: Harvard University Press, 1933.

excess of labor resources in Kyrgyzstan and, accordingly, low wages in a number of industries, compared to other countries⁴. Lending offers on the financial market of the Kyrgyz Republic are insufficient, therefore, the rates offered on bank loans are high, ranging from 10% to 28% per annum⁵.

Countries are going to specialize in the production of goods that have more relatively cheap factors and relatively fewer expensive ones in their cost structure.

As B. Ohlin put it, “international exchange is an exchange of abundant factors for rare ones”⁶. A country exports the goods which require a greater number of abundant factors to produce, while imports those that require country's scarce resources.

There is another interesting conclusion from the Heckscher-Ohlin theory, namely that the foreign trade equalizes the costs of inputs. The essence of the equalization mechanism is as follows. Initially, the cost of inputs (wages, interest on loans, rent, etc.) is relatively low for the country's abundant inputs, while high for those that are lacking. At the same time, the country's specialization in the production of export goods leads to an intensive flow of capital into the exporting industry. In particular, the country's specialization in the production of agricultural products entails the transfer of resources to such industry, requiring additional mobilization of resources, and thus ultimately contributing to the increased prices for export products in the country. For instance, this was the case in the Kyrgyz Republic in 2019-2020, when an increased demand for meat in neighboring Kazakhstan led to increased feed production and livestock funding, resulting in the meat prices going up in the country.

Like any theory, the Heckscher-Ohlin model has been repeatedly subjected to practical analysis and examination. The most famous is the work of American economist W. Leontief, known as the Leontief paradox. Having studied the structure of US exports and imports in the late 1940s, Leontief came to a paradoxical conclusion: the United States exported relatively labor-intensive goods, and imported relatively capital-intensive goods. At the same time, it was traditionally believed that during this period it was capital rather than labor, which was a relatively abundant factor in the United States⁷.

⁴ Brief analysis of average employee wages by the types of economic activities in the Kyrgyz Republic. Link: <http://www.stat.kg/ru/news/kratkij-analiz-srednej-zarabotnoj-platy-rabotnikov-po-vidam-ekonomicheskoy-deyatelnosti-i-stranam-sng-v-yanvare-fevrale-2019g/>. Last visited on January 03, 2021

⁵ Loans in Bishkek, all loans in Kyrgyzstan. Link: <https://banks.kg/credits>. Last visited 03.01.2021.

⁶ Heckscher E.F. The Effect of Foreign Trade on the Distribution of Income. Readings in the Theory of International Trade/ In: Blakiston series of republished articles on economics. №4; Ohlin B. Interregional and International Trade. Cambridge (Mass.): Harvard University Press, 1933

⁷ Леонтьев В. Отечественное производство и внешняя торговля: переоценка позиций американского капитала [1953]/ Леонтьев В. Межотраслевая экономика. М., 1997. С. 44-45, 82 и др.

The author suggested that higher labor productivity in the US accounted for better skilled American workers. He proved that they exported goods that required more skilled labor than the amount of labor required for imported goods production. Thus, in the Leontief model an important place was given to workers' qualifications, which was directly related to labor productivity.

It should be noted that the concepts such as labor and capital need to be disaggregated. For instance, the concept of "labor" consists of such segments as management, innovation, qualifications, education, etc. Then we can say that exported are the science-intensive products, which include many varieties of the "labor" concept.

When analyzing foreign trade theories, it is important to identify the aspects that impact the distribution of income from trade operations both in relation to certain groups of the population and to entire industries. The above theoretical models state that trade benefits not only all the countries, but all their inhabitants, however the impact on domestic income distribution is not considered. At the same time, the analysis of the practical foreign trade benefits for citizens, as well as for the country's budget, is extremely important, since it actually constitutes the impact of foreign trade on the country's economy and life.

The general claim that external trade relations with other countries benefit all citizens is not fully justified for the following reasons:

- the movement of labor resources from one industry to another, due to a change in specialization, entails higher risks of further unemployment, or requires time to retrain personnel, which entails decreased income;

- a change in the product mix due to specialization may result in increased demand for some inputs with decreased demand for other inputs that are also associated with human life;

- attempts to upgrade production, enhance workers' qualifications, and, accordingly, increase labor productivity releases a certain number of workers, which results in the risk of increased unemployment if compensatory measures are not taken;

- availability of imported goods as products that replace the country's own inefficient production, in a free pricing environment can limit the range of domestic consumers with low solvency.

Therefore, the international trade is not as clearly beneficial for all citizens as described in the Ricardo model. Trade usually benefits the state as a whole, but it can adversely affect some population groups and industries.

The distribution of benefits from foreign trade between different groups of population and individual industries is considered in the model developed by Paul Samuelson and Ronald Jones⁸. We shall omit the detailed theoretical insights provided by this model, as they don't fall under the subject of this thesis, and shall consider the proposed conclusions.

International trade benefits the owners of abundant export-specific inputs. At the same time, the owners of the inputs specialized for the industries, where their products are imported into the country, lose. Part of the country's population benefits from participation in the international trade system, while some part loses. Those who are employed in export-oriented industries usually win. While those employed in the industries with products intensively imported into the country will lose after the borders reopen.

All of the above theories show the supply orientation of foreign trade for the countries that incur low production costs. However, international trade also needs to be viewed from the demand perspective. The major contribution to the understanding of how demand factors influence trade was made in 1961 by the Swedish economist Staffan Linder⁹.

Linder reasonably argued that inputs, as well as low costs play an important role in the commodities trade, while consumer tastes and preferences prevail in the trade in consumer goods and processed products.

The demand structure determines the nature of trade and primarily depends on country's per capita income. The higher the per capita income, the greater the demand for high quality and sophisticated consumer goods. And vice versa, demand in low-income countries prefers simple or low-quality goods.

At the initial stage of development, local manufacturers offer goods in the domestic market, where they are competitive and can cover the domestic market needs. When the local market is saturated, manufacturers look for new, foreign markets. This is where export begins. Immediately there is a concern as which markets are first to export to? The key consideration here is the similar structure of demand. Therewith a similar structure of demand exists in the countries with approximately the same per capita income. To illustrate this, Linder introduced the concept of overlapping demand. It is the general demand for products of a certain quality or complexity in the countries engaged in the trade.

⁸ Jones R.W. The Structure of Simple General Equilibrium Models. — *The Journal of Political Economy*, December 1965. — Vol. 57, № 6. — P. 557-572.

⁹ Linder S.B. *An Essay on Trade and Transformation*. New York: John Wiley and Sons, 1961.

The demand structure depends on per capita income, that is, the countries that have a similar per capita income will actively trade with each other. This is clearly illustrated by the foreign trade of the Kyrgyz Republic. The main trading partners of Kyrgyzstan are: China, Russia, Kazakhstan, Uzbekistan – i.e. the countries with relatively comparable income levels and the needs of citizens.

Another important aspect of Linder's hypothesis should be noted. The tastes and preferences of citizens are constantly changing, thus causing shifts in international trade. Moreover, in the globalization era it is no longer demand that determines supply, but rather on the contrary, imposed supply determines demand. These kinds of changes in demand follow the changes in production technology that affect product characteristics. Linder's theory also indicates other factors that can mold the trade structure. These include cultural, historical values and traditions. A striking example is the meat trade between Kyrgyzstan and Kazakhstan, where the common traditions of the national cuisine account for preferences for meat dishes.

Based on the review of certain basic foreign (international) trade theories, the following conclusions can be drawn for the purposes of further analyzing the situation in the Kyrgyz Republic:

- 1) Availability of country's own natural resources is an important factor for products export.
- 2) The export production should stimulate the development of specialized economic sectors.
- 3) It is necessary to be prepared for the fact that export growth can stimulate the growth in prices for such product in the country for domestic consumers.
- 4) Imported products should take the niches where the country misses or lacks natural or local resources in general.
- 5) Import, primarily that of technology and equipment, should stimulate the development of competitive, potentially profitable sectors of the country's economy.
- 6) When borders reopen, there is a risk of local production suppression, decreased differentiation of country's own economy, if imported goods prevail unreasonably.
- 7) Unbalanced foreign trade can adversely affect the income of certain groups of people, as well as the functioning of certain industries.

8) The first stage of foreign trade development requires the evolution of partnerships with the countries that exhibit similar income and demand structure. At the same time, the possibilities of entering other foreign markets with the products that may have competitive advantage should not be neglected.

9) Foreign trade should be based on the establishment of mutually beneficial, partnerships with other countries with a view of mutual stimulation of economic growth in such countries.

3.2 Theoretical aspects of the role the state plays in the development of foreign economic relations.

The international trade theory recognizes two types of state trade policy: protectionism and free trade.

Protectionism is aimed at protecting the domestic market from foreign competition through government interventions with a view to promote the national economy growth.

Free trade policy implies unrestricted implementation of foreign economic activity with minimal government regulation.

In the course of world economy evolution was marked by the prevalence of various types of foreign trade policy. The teaching of mercantilists (A. Montchrestien, W. Stafford, T. Mun, A. Serra, G. Scaruffi, etc.) was popular in the early period in the XVI-XVII centuries. The term "mercantilism" was introduced into scientific circles by French economist Antoine de Montchrestien¹⁰. He substantiated the necessity of active government intervention in economy, mainly in the form of protectionism: establishment of high import duties, extension of subsidies to national manufacturers, etc. Protectionism ensured advantages for individual developed countries, especially in the colonial period, when such advantages were actively used by the metropolises. They divided up the dominions and regulated the repartition of the world market. In the time of early colonialism this was true for Portugal, Spain, Holland, England.

However, the development of production technologies brought the growth in the economic strength of other, primarily European countries and the situation began to change. The protectionist policy created serious obstacles to the development of foreign trade exchange and capitalist relations. The mercantilist approach began to lose its position, giving way to free trade based theories. Following the industrial revolution, England that accumulated

¹⁰ Montchrestien, Antoine de, Traicté de l'oeconomie politique (1615)

sufficient resources in the colonial period, became the "industrial workshop of the world" and had no concerns regarding foreign competition¹¹. Due to the influx of cheap colonial raw materials and the growth of labor productivity, British industrialists felt cramped in their own market. This prompted them to abandon protectionism and opt for free trade. From the middle of the 19th century England was followed by other countries in its pivot from protectionism to free trade.

The key international trade theories that promoted the thesis of free trade benefits were formulated in the late 18th and early 19th centuries by eminent English economists Adam Smith, David Ricardo and John Stuart Mill, whose work was mentioned in the previous section.

The advocates of the free trade theory argued that economic resources such as natural resources, labor, etc. were distributed unevenly between countries. At the same time, the production of different goods requires different technologies or combinations of resources and the capacity of countries to produce such goods is different. In particular, D. Ricardo proved that the advantages, both absolute and comparative, enjoyed by countries were not given once and for ever, and that international exchange was possible and desirable for all countries¹². Subsequently, John Stuart Mill explained in his *Principles of Political Economy* (1848) that the cost of exchange was formed by the law of supply and demand so that the aggregate of each country's exports made it possible to pay for the aggregate of its imports¹³. Despite the importance of these theoretical propositions, these norms do not always work in the real economy due to the dynamic changes in the world economy.

Yet, the advocates of protectionism importance did not give up and put forward their arguments regarding the importance of foreign trade regulation by the state. In particular, F. List in his fundamental work *The National System of Political Economy* (1848) believed that the transition from a lower economic development status, for example, from agriculture to industry, requires customs duties to be imposed on industrial goods import in order to equalize competitive advantages between the domestic and external manufacturers¹⁴. At the same time F. List argued that state influence should be of a temporary nature, and when the competitive advantages become equal the protectionist indulgences should be cut.

¹¹ Robert C. Allen, *The British Industrial Revolution in Global Perspective*. University of Oxford (2009)

¹² D. Ricardo, *On The Principles of Political Economy and Taxation*. Batoche Books (2001)

¹³ See Mill, John Stuart (1848), *Principles of Political Economy with Some of their Applications to Social Philosophy*, London: John W. Parker, 2012.

¹⁴ Национальная система политической экономии. Л. Фридрих. Издательство «Социум», 2017.

In general, it should be noted that the period of the 19th - mid-20th centuries was marked by a fierce confrontation between the free trade principles and protectionism principles. During the dominance of broadly free-trade views, there was a revival and evolutionary development of protectionist doctrines in some periods. The underlying factors of protectionism revival in its extreme forms were the First World War, the 1929-1933 crisis, and the Second World War.

Nevertheless, after overcoming the challenges of crisis times, in the post-war period and up to the present time the free-trade avenue enshrined in the core of foreign economic relations, which manifested itself in the emergence of the open economy theory. At the same time, this theory does not relinquish the right of states to introduce certain regulatory measures for their national development. The necessity of protectionist measures first of all accounts to the unevenness of countries' development, and, as a consequence, insufficient competitiveness of domestic manufacturers in comparison with foreign suppliers.

It is worth mentioning that the free trade policy can be mainly afforded by developed countries, as well as by some of the developing countries that have fostered globally competitive industries. For other developing countries that are superior in number, the rejection of protectionism often adversely affects their economic development, since there is no enabling environment for the development of their own industry, low-tech goods predominate and resources with low added value are exported. All this is taking place against the background of the vigorous activity carried out by individual developed countries, which, while promoting active protection of the world trade liberalization, widely use protectionist tools in their foreign trade policy. This was especially clear in the US trade wars with China and the European Union countries.

Contemporary authors approach the interpretation of protectionism in different ways, defining it as “the foreign trade policy pursued by the state aimed at temporarily restricting the import of goods and supporting the production of similar domestic goods and services”¹⁵, or as “measures to protect the domestic economy by using tariffs, quotas and other restrictions”¹⁶. For all its many definitions, protectionism is understood per se as a policy aimed at protecting the national economy from foreign competition. This definition includes at least two aspects: restricting access to the domestic market for foreign competitors and

¹⁵ Цедилин Л.И. Протекционизм в российской экономической политике: институциональный исторический опыт. — М.: Институт экономики РАН, 2014. — С. 7.

¹⁶ Современный экономический словарь. Под редакцией ред. Райзберга Б.А. - М, 2003. - С. 314

providing assistance to domestic manufacturers, which shape the variety of protectionism reasons and tools.

As a rule, the arguments supporting the imposition of protectionist measures appeared during a free trade crisis, when certain economic threats and preconditions justified the abandoning of this model. The second half of the 20th century saw the emergence of new independent states, which trod their individual path to develop their own economy. These states included African countries after freeing from colonial rule, individual European countries that changed their political system after World War II, Asian countries that gained independence as a result of national liberation revolutions. At a certain period, these countries were forced to protect their nascent economies from aggressive imports from the countries that had low-cost goods and did not allow their own economies to develop. The developing countries of similar economy level formed their own economic blocs, such as the socialist bloc - the Council for Mutual Economic Assistance (CMEA). The following members acceded the CMEA: Bulgaria, Hungary, Vietnam, Cuba, Mongolia, Poland, Romania, USSR and Czechoslovakia. African countries also created their own economic association - the West African Economic Union, which included Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Ghana, Gambia, Guinea, Guinea-Bissau. After the collapse of the Soviet Union, former Soviet republics, including the Kyrgyz Republic, which had no background of independent economic activities, began to form different blocs, in one way or another, with an economic focus: the Commonwealth of Independent States (CIS), the Customs Union (CU), the Eurasian Economic Union (EAEU). The state regulation measures, such as, for instance, duties, constitute appropriate means for a state that is in the process of creating an analogue of foreign developed industry. The superiority of one country over another in a particular industry often arises only because it started such process earlier.

There is an extremely captivating division of protectionism into two categories, namely "protective" and "protectionist" policies, where "protective" are the protective measures taken to ensure security, but generally not conducive to economic growth, and "protectionist" are the measures taken on the basis of the interests of the national economy and national manufacturers. Back in 1909 this interpretation was proposed by Russian economist V. Vitchevsky in *Trade, Customs and Industrial Policy of Russia from Peter the Great to the present day*¹⁷. Unfortunately, the economic history of developing countries, especially that

¹⁷ В. Витчевский. Торговая, таможенная и промышленная политика России со времен Петра Великого до наших дней. Издательство: Социум. 2020.

of the former Soviet republics, has faced to a greater extent the protective measures of foreign economic relations regulation by the state.

In this regard, there is extreme relevance to the statements made by J. Stiglitz, who criticizes the extension of unreasonable tax and other benefits to large agricultural and energy companies, resulting in additional costs that ultimately fall on the entire society, while beneficiaries do not bear any extra burdens¹⁸.

In the modern economy, the importance of trade policy measures aimed at increasing the competitiveness of the national economy and pursuing the prospect of entering foreign markets, as well as the choice of priorities in relation to attracting imports, technologies, services, looms large.

In this regard, it is exciting to consider the relation of protectionism to freedom of trade described in the work of Russian economist T.M. Isachenko¹⁹.

First, will the global economic globalization and the global regulatory system formation lead to a weaker independence of national trade policies? In an economic interdependence environment, the efficiency of each country's trade policy largely accounts to the commitment to implement trade policy measures. One cannot solely rely on protectionist measures. At the same time, the diluted protectionist measures should be sustained by an adequate, alternative strategy to promote the interests of domestic producers.

Secondly, can close relations between states arising from liberal trade policies cause the growth of contradictions between these national economies? In other words, can one's own goals be realized at the cost of weakened economic positions and competitiveness of other countries?

This is especially true of the present period, associated not only with the general economic crisis, but also with global changes in the world economy arising due to the spread of COVID-19. These issues are relevant if we consider them through the perspective of the situation in the Kyrgyz Republic for this thesis.

For the purposes of future research, one can come to the following conclusions proceeding from this section:

¹⁸ Stiglitz, J. *The Price of Inequality: How Today's Divided Society Endangers Our Future*. W.W. Norton & Company. (2012). ISBN 0393345068

¹⁹ Исаченко Т.М. Свобода торговли или протекционизм: проблемы стратегического выбора. [Электронный ресурс] / Т.М. Исаченко // Российский совет по международным делам. - 2014. - 24 января. - Режим доступа: <http://mgimo.ru/upload/iblock/186/186938a21a730fd0e6dff24d11da8e83.pdf>

- 1) The foreign economic policy of a developing country, such as the Kyrgyz Republic, should focus on the underlying “open economy” principle with reasonable protectionist elements to ensure the development of its domestic economy and access to foreign markets in the future.
- 2) The economic sectors that are emerging in one country, but have already developed in others, can be extinguished without at least temporary protection amidst competition with foreign products and a low consumer base in their country before reaching the peak of development. At the same time, it is necessary to yield to the fact that domestic consumers will pay more for these products than for potential imports. Long-term government subsidies for this kind of products will not contribute to development, but, on the contrary, will cause manufacturer dependency.
- 3) There is a great temptation to introduce unreasonable customs duties, as well as export/import taxes as part of the state regulation for the fastest replenishment of the state budget. This produces adverse consequences for the entire economy of the country. Therefore, the customs and tax policy should be deliberate and balanced, in line with the interests of future development.
- 4) In the short term, protectionist policies can provide employment for the population. But the engagement in far-fetched protectionism for domestic industry will not result in an increase in jobs in the future. And conversely, cheap, unjustified imports will not provide any growth opportunity for domestic production, which will lead to the predominance of trade and service specialists, and depletion of professionals.
- 5) Import is not always a negative indicator in the foreign trade balance of the state. The import of new technologies and equipment guarantees future economic development.
- 6) Excessive restrictions on imports, the introduction of unreasonable import tariffs will lead to higher prices for certain goods necessary for the population, this is especially important in relation to food.

4 Practical Part.

4.1 Review of 2006-2019 international ratings of Kyrgyz Republic foreign trade.

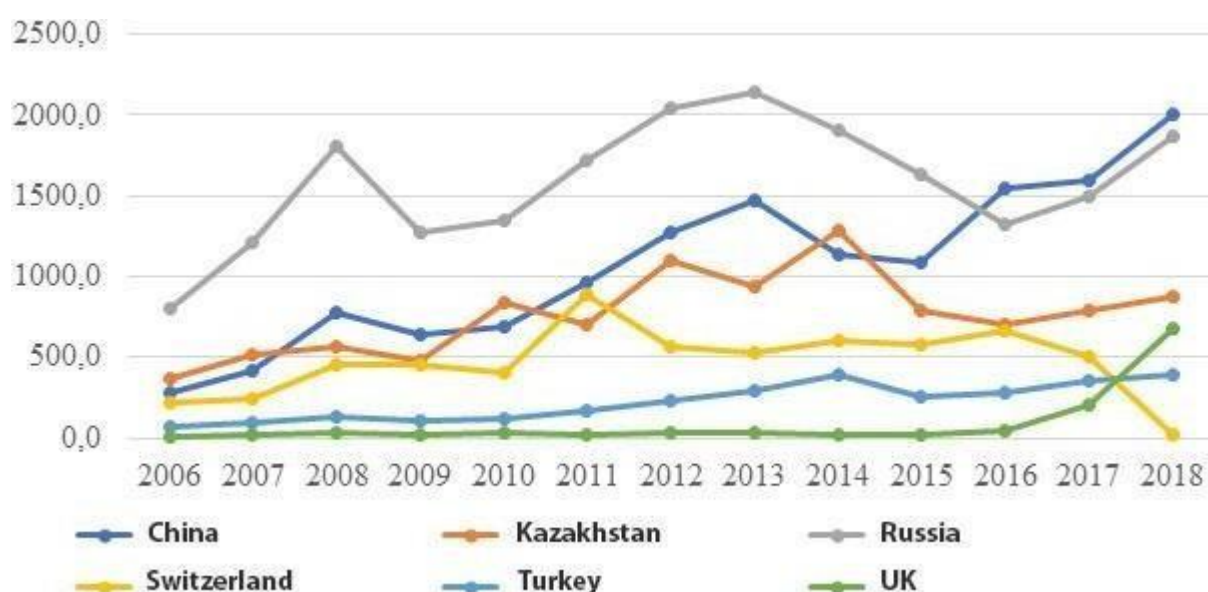
Nowadays the Kyrgyz Republic is a valid actor of the international foreign trade system. However, just like in the most Central Asian countries, its domestic market capacity is rather

small with a total GDP of \$ 8.45 billion²⁰ in 2019 and a small population size (6.38 million people).

The foreign economic activities in Kyrgyzstan are evolving in three key directions – the country cooperates with the Eurasian Economic Union (EAEU) states, the European Community (EU) and China.

Therewith, its key trading partners are Russia, Great Britain, China, Kazakhstan, Turkey and Switzerland (Figure 4.1.).

Figure 1: Key trade partners of the Kyrgyz Republic by 2006-2018 foreign trade turnovers, bln. USD²¹



Source: <http://www.stat.kg/ru/institut/>

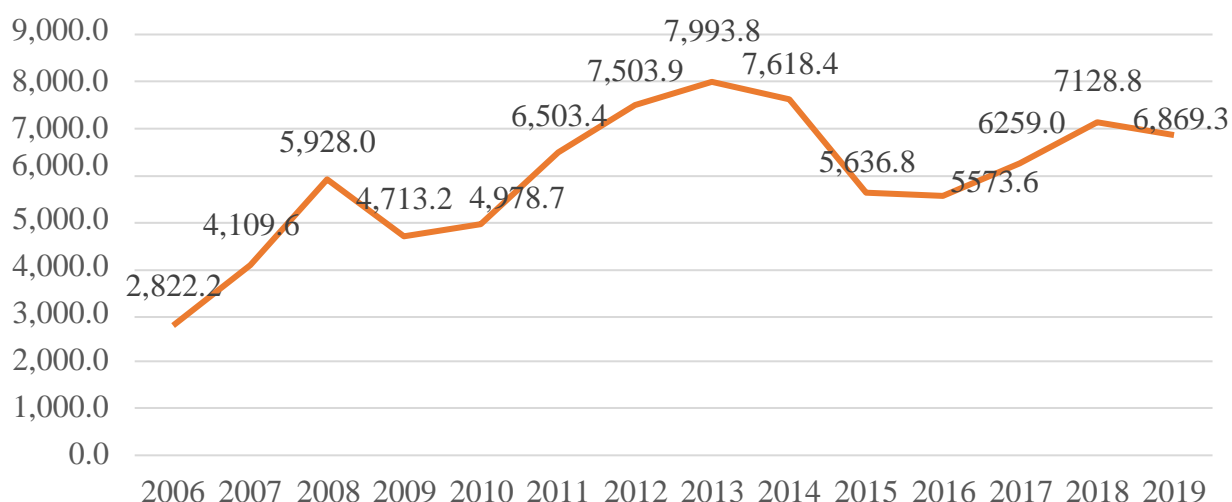
The foreign trade turnover of the Kyrgyz Republic was subject to sharp volume fluctuations. Thus, while the total trade turnover increased in the period from 2006 to 2008 from \$ 2.8 bln. to \$ 5.9 bln. or 2.1 times, in 2009 it tanked to \$ 4,7 bln. The largest increase in trade turnover took place in 2013, with its value reaching almost \$ 8.0 bln., but in 2016 its volumes decreased again, by almost one third and amounted to \$ 5.57 bln.²² (see Figure 4.2.).

²⁰ See: <http://stat.kg/ru/news/struktura-valovogo-vnutrennego-produkta-za-2019-god/>. Last visited: 14.02.2021.

²¹ Executive summary. Foreign trade assessment of the Kyrgyz Republic based on gravity model. National Statistics Committee. 2020. Link to website: <http://www.stat.kg/ru/institut/>

²² Executive summary. Foreign trade assessment of the Kyrgyz Republic based on gravity model. National Statistics Committee. 2020. Link to website: <http://www.stat.kg/ru/institut/>

Figure 2: Foreign trade turnover of the Kyrgyz Republic in 2006-2019, USD mln.



Source: <http://www.stat.kg/ru/institut/>

Such fluctuations primarily account for global prices volatility, changing purchasing power of population, domestic goods competitiveness, as well as other factors.

Despite the fact that Kyrgyzstan cooperates with 130 countries globally, the 2016 Global Enabling Trade Index ranks our republic only the 113th among 136 countries²³ (see Table 4.1.).

Table 3: The EAEU member states in the Global Enabling Trade Index 2014 - 2016 ranking

	2014	2016
Number of countries	134	136
Republic of Armenia	54	68
Republic of Kazakhstan	83	88
Kyrgyz Republic	98	113
Russian Federation	105	111

Source: <https://nonews.co/directory/lists/countries/global-enabling-trade>

The index measures the various institutions performance and international trade state policies, as well as the economic cooperation development. The index assesses the ability of economies to promote trade, and focuses on particular areas of improvement. As part of the study, the analytical team of the World Economic Forum compiles a countries rating based on four main indicators that address the exposure of their economies to international trade: access to domestic market, borders administration, business climate, as well as transport and

²³ Global Enabling Trade Index. See link: <https://nonews.co/directory/lists/countries/global-enabling-trade>.

communication infrastructure. It should be noted that the position of the Kyrgyz Republic is the poorest in comparison with the EAEU countries under nearly all indicators²⁴.

The small volumes of the national foreign trade turnover as compared with other EAEU states and emerging countries account for the underdeveloped real sector of the economy and low goods competitiveness (see Table 4.2.), which adversely affect the external demand.

Thus, according to the World Economic Forum official website, in 2018 Kyrgyzstan was ranked the 97th among 139 countries in the Global Competitiveness Report²⁵.

Table 4: The EAEU member states Global Competitiveness Report rating for 2010 – 2018

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Number of countries	139	142	144	148	144	140	138	137	139
Republic of Armenia	98	92	82	79	85	82	79	73	70
Republic of Belarus	-	-	-	-	-	-	-	-	-
Republic of Kazakhstan	72	72	51	50	50	42	53	57	59
Kyrgyz Republic	121	126	127	121	108	102	111	102	97
Russian Federation	63	66	67	64	53	45	43	38	43
EAEU	64	67	66	63	53	45	44	40	45

Source: <https://atameken.kz/uploads/content/files/>

It is noteworthy that the rating of the Kyrgyz Republic in the Global Competitiveness Report, as shown in Table 4.2., has always been lower than that of other EAEU countries over the entire period under review. The experts of the World Economic Forum note that the Kyrgyz Republic has relatively positive positions in terms of macroeconomic stability (64/140 place) and ICT introduction (73/140 place). Its weaknesses are commodity market efficiency (105/140 place), infrastructure (107/140 place), financial market development (118/140 place), market size (124/140 place) and innovations (125/140 place).

The generally negative trends in macroeconomic indicators exhibited by the Kyrgyz Republic affected the international ratings.

²⁴ Economic development of the Eurasian Economic Union and member states in 2018. <https://atameken.kz/uploads/content/files/>. Last visited: 14.02.2021

²⁵ Ibid.

Thus, in 2018 the Doing Business of the World Bank ranked the Kyrgyz Republic the 80th from 190 countries in terms of the business enabling conditions. The rating consists of several indicators such as "enterprise registration" (42nd place), "construction permits" (90th place), "connection to power supply" (143rd), "property registration" (7th), "borrowing" (15th), "minority investors protection" (128th), "taxation" (117th), "international trade" (89th), "contracts enforcement" (134th)²⁶.

4.2 Overview of the current foreign trade status of the Kyrgyz Republic²⁷.

In 2019 the volume of foreign goods trade²⁸ of the Kyrgyz Republic amounted to \$ 6,975.1 mln. The foreign goods trade turnover of the Kyrgyz Republic as compared with 2018 decreased by 2.2%, with imports decreasing by 5.7%, and exports, on the contrary, increasing by 8.1%.

A decrease in the volume of foreign trade turnover compared to 2018 occurred both in the CIS countries - by 0.5% (including imports - by 0.7%), and in non-CIS countries - by 3.5% (with imports decreasing by 9.8%, while exports, on the contrary, increasing by 15.2%).

Over the past five years, the share of exports in the total foreign goods trade increased from 26.3% to 28.5%, while the share of imports decreased from 73.7% to 71.5%.

The negative trade balance in 2019 amounted to \$ 3,002.8 mln. (in 2018 - \$ 3,455.2 mln).

The coverage between import and export in 2019 reached 39.8% (in 2018 - 34.7%).

Table 5: Foreign goods trade of the Kyrgyz Republic in 2019 (\$ mln.)

	2015	2016	2017	2018	2019
Foreign trade turnover	5,636.8	5,573.6	6,259.0	7,128.8	6,975.1
Export	1,482.9	1,573.2	1,764.3	1,836.8	1,986.1
Import	4,153.9	4,000.4	4,494.7	5,292.0	4,989.0
Balance	-2,671.0	-2,427.2	-2,730.4	-3,455.2	-3,002.9

Source: Author

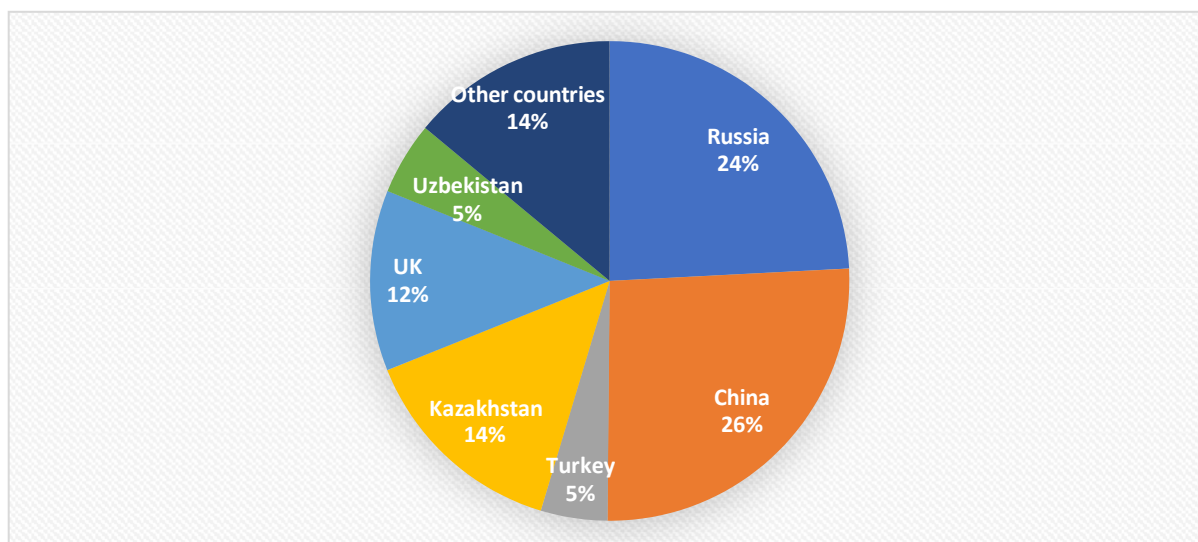
²⁶ Link to web-site: <https://russian.doingbusiness.org/ru/rankings>. Last visited 14.02.2021.

²⁷ Information derived from public sources of the National Statistics Committee of the Kyrgyz Republic. Link: stat.kg.

²⁸ 2020 data were not available from the National Statistics Committee of the Kyrgyz Republic as of the time of thesis development.

In 2019, the Kyrgyz Republic carried out its export and import operations with 130 countries globally. The key trading partners of the Kyrgyz Republic in 2019 were China (trade turnover of \$ 1,816.4 mln.), Russia (\$ 1,685.5 mln.), Kazakhstan (\$ 996.5 mln.), Great Britain (\$ 848.9 mln.), Uzbekistan (\$ 339.8 mln.) and Turkey (\$ 312.7 mln.) (see Chart 4.3).

Figure 3: Individual countries in the total trade turnover of the Kyrgyz Republic in 2019 (percentage of the total trade volume).



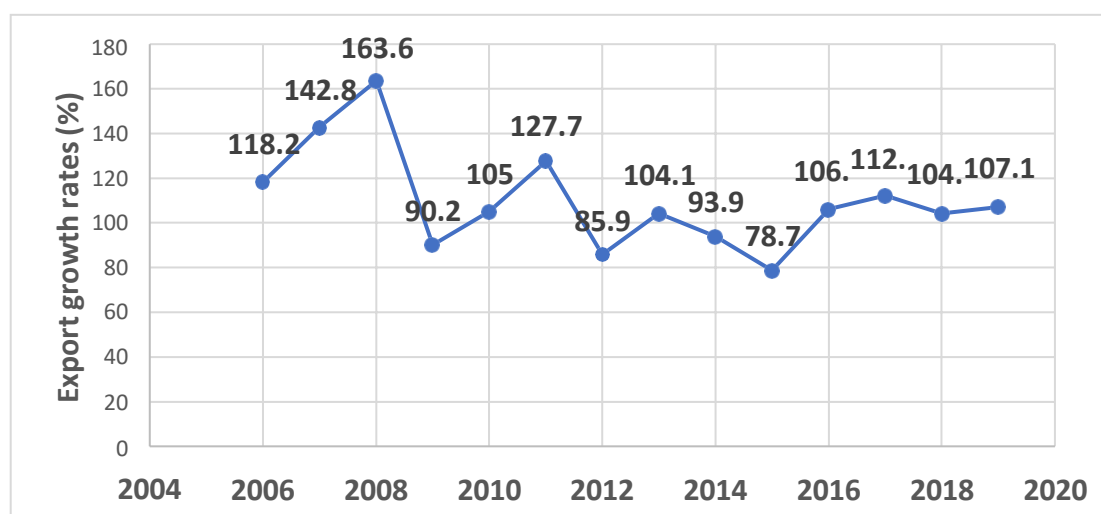
Source: Author

4.2.1 Trends in goods export of the Kyrgyz Republic in 2006-2019.

Let us consider the exports structure of the goods produced in the Kyrgyz Republic.

Over the past 10 years the export growth rates trends have been uneven (see Figure 4.4.). This is due to both internal and external factors. In particular, a sharp drop in export growth rates in the period of 2008-2009 accounts for an unstable political situation and economic crisis. In the wake of the 2010 revolutionary events that led to the change of government and the beginning of a new liberalization stage for the national economy, there was a certain increase in the export rates. However, the global financial crisis, which began in 2008, reached the Kyrgyz Republic by 2011. First of all, it manifested itself in the fact that the devalued currencies of Kazakhstan and Russia resulted in a serious reduction of our goods competitiveness in these markets.

Figure 4: Trends in the goods export of the Kyrgyz Republic in 2006-2019 (%)²⁹



Source: <http://stat.kg/>

The stagnation continued nearly until 2015, when the growth rates fell to the record values of 78.7%. One of the main reasons for this kind of decline was the failure of the Government of the Kyrgyz Republic to prepare for the accession to the Eurasian Economic Union (EAEU). The unwillingness to adopt the trade rules of the EAEU resulted in the decreased export of goods to such countries, which were the key foreign economic partners of Kyrgyzstan. The country failed to establish the required number of product certification laboratories. The domestic producers were not ready to focus on export in line with the EAEU rules.

The volume of export in 2019 amounted to \$ 1,986.1 mln. The largest export quantities in 2019 were delivered to the UK (42.0% of total exports). Other significant quantities of exported goods were delivered to Kazakhstan (17.5%), Russia (14.2%), Uzbekistan (7.0%), Turkey (4.5%), China (4.1%) and Tajikistan (2,9%).

It was mainly gold that was exported to the UK. Light industry products and agricultural products were primarily exported to Russia. Light industry products, agricultural products, as well as ores and precious metals concentrates were exported to Kazakhstan. Uzbekistan received ferrous metals, cement and Portland cement, copper waste and scrap, ferrous metal products, coal, fertilizers, glass and glass products, waste and scrap of ferrous metals, ceramics. Oil products (bunker fuel), crude oil, polished glass and plastic containers were

²⁹ According to the electronic resource of the National Statistics Committee of the Kyrgyz Republic: <https://stat.kg>

exported to Tajikistan. The products exported to Turkey mainly included vegetables (primarily legumes), oil products (bunker fuel), cotton fiber, ores and concentrates of precious metals, fruits (nuts). Ores and precious metals concentrates, tobacco products, petroleum products (bunker fuel), tanned cattle skins, brown coal, dried fruits, natural honey, unkempt wool were supplied to China.

Table 4.4. shows the largest export volumes by 4 sectors of the economy of the Kyrgyz Republic. It should be borne in mind that the total exports volume in 2019 amounted to \$ **1,986 mln.**

Table 6: Goods exporting areas of the economy of the Kyrgyz Republic (\$ mln) ³⁰.

No.	Name of production	Export volume (mln.\$)
1	Precious metals (gold)	853,5
2	Mineral products, chemicals (cement, stone, lime)	316,2
3	Agricultural produce	190,7
4	Light and textile industry	163,1

Source: <http://stat.kg/ru/publications/sbornik-vneshnyaya-torgovlya-kyrgyzskoj-respubliki/>

Gold accounts for the largest share in export volume (41.9%), it is produced by one of the world's major ore plants, the Kumtor Gold Company. There are also other standalone gold deposits in Kyrgyzstan, but they have a minor impact on the total volume as compared to Kumtor Gold.

Ensuing from the fact that a significant share of export is comprised of precious metals are the high risks of dependence of the Kyrgyz economy on one type of production. The situation is aggravated by the fact that pursuant to the agreement with the Kyrgyz Republic, the development of the Kumtor gold mine will be completed by 2025 and the prospects for extending the agreement are yet unclear.

Primarily two cement-producing plants generate minerals export: the Kyzyl-Kiya and Kant cement plants. Both of them were founded by foreign investors.

Thus, the largest export volume is concentrated in a country's relatively small territory and employs up to 8000 workers.

³⁰ Foreign and mutual trade of the Kyrgyz Republic in 2019. National Statistics Committee of the Kyrgyz Republic. Link to web-site: <http://stat.kg/ru/publications/sbornik-vneshnyaya-torgovlya-kyrgyzskoj-respubliki/>

In terms of the foreign trade impact on the overall economic development, the most illustrative is the light industry. Therefore, this thesis is going to review the impact of foreign economic factors on the development of the light industry sector as a case study.

4.2.2 Specifics of exports impact on the development of the light industry in the Kyrgyz Republic.

The Kyrgyz light industry combines textile, clothing (garment), leather, leather goods and footwear production and plays a critical role in the economy of the Kyrgyz Republic.

The garments sale volumes are shaped by domestic and foreign demand. According to the estimates of the Legprom Association, the ratio of domestic sales to exports is 5% to 95%.

The key markets for exported goods are primarily those of Russia and Kazakhstan. For example, clothes and apparel accessories were supplied to Russia for \$ 133.4 mln. (37.3% of the total export of the Kyrgyz Republic to Russia), and to Kazakhstan for \$ 15 mln.

According to the National Statistics Committee of the Kyrgyz Republic, by the end of 2019, 46 thousand people were employed in the light industry, save for individual entrepreneurs who operate on a patent (short-term license) basis. At the same time, according to an independent assessment, the industry, as well as related areas that supply fabrics, accessories, etc., employs over 160 thousand people, or about 7% of the country's working-age population. The majority of workers (about 150,000) are employed in the garment industry³¹. The average monthly salary of light industry workers is about KGS 16,700, which is comparable to the average monthly salary nationwide, i.e. KGS 17,445³². In 2019 the volume of exported light industry products amounted to \$ 163.1 mln., the share of the industry in the total exports structure reached to 8.3%. The positive indicators of the light industry are mainly generated by the garment industry, which is currently the driver of development in this area. The light industry is an illustrative example of the impact that external factors and foreign trade enabling conditions have on this sector development.

The enabling factors for the light industry development were ensured by the favorable conditions for Chinese goods re-export to the Russian Federation and Kazakhstan. Corruption flourished at border checkpoints, causing an inflow of uncontrolled smuggled products, including light industry goods: garments, knitwear, fabrics, accessories. This period lasted from the mid-90s of the last century to 2001-2002. It should be noted that cheap

³¹ Information provided by Legprom Association.

³² Data of the National Statistics Committee. Link to website: <http://stat.kg/ru/news/kratkij-analiz-srednej-zarabotnoj-platy-po-vidam-ekonomicheskoy-deyatelnosti-regionam-respubliki-i-stranam-sng-v-yanvare-iyune-2019-goda/>. Last visited: 15.02.2021.

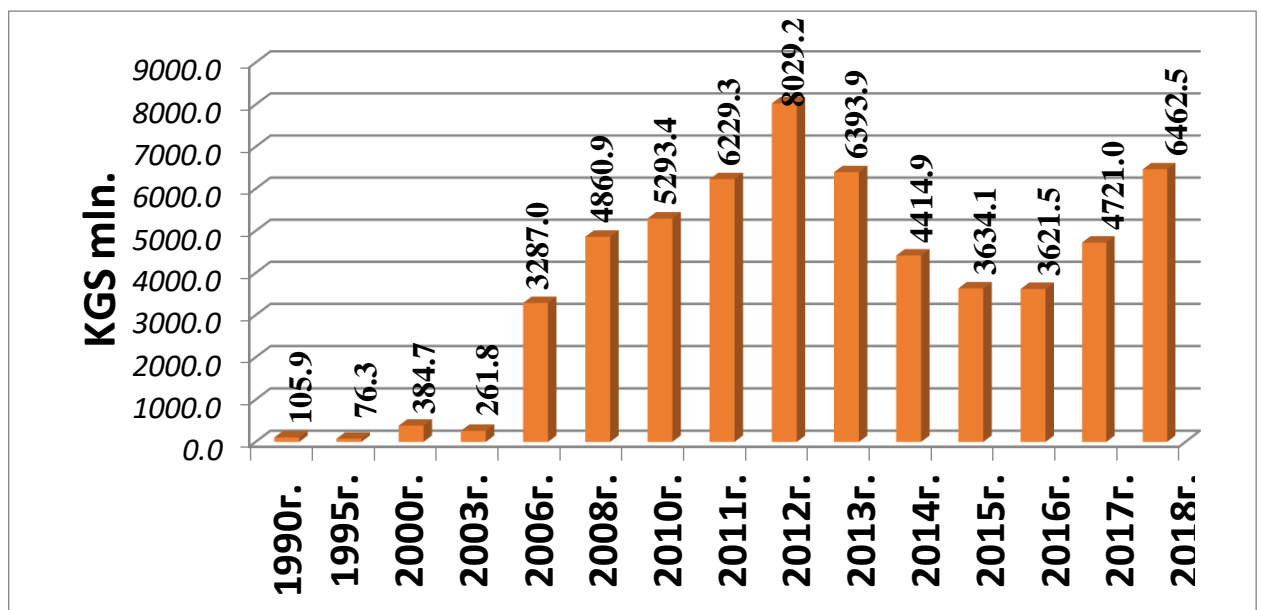
imports hindered the development of the country's own light industry, and moreover, by the beginning of the new 21st century, nearly all large enterprises significantly reduced their production volumes, or even completely ceased their operations.

Around 2001 customs duties and VAT were introduced in the Commonwealth of Independent States (CIS) resulting in restrictions on Chinese goods re-export. The background in sales allowed businessmen to launch garments production in Kyrgyzstan, or open their own sewing workshops. It was the beginning of garments production boom, which at that moment was largely of a “grey” nature and focused on sewing counterfeit products. But, nevertheless, it was at this stage that triggered the capacity building of the garment industry in the Kyrgyz Republic.

When they faced a threat of losing income from re-exporting counterfeit products, the former tourist traders realized that they needed to pivot and produce their own garments. This is how former teachers and engineers became garment manufacturers. The number of jobs rose sharply, women returned to jobs.

From an interview with S. Asanov, CEO of the Legprom Association.

Figure 5: Production volume trends of light industry goods³³.



Source: Information provided by Legprom Association of the Kyrgyz Republic

The free markets of the main partners, i.e. of Russia and Kazakhstan, as well as simplified goods delivery promoted further development of this economic sector. During this period, the Government of the Kyrgyz Republic supported the garment sector by significantly

³³ Information provided by Legprom Association of the Kyrgyz Republic

simplifying the taxation procedures specifically for garment production and provided major tax incentives. The legalization of the garment industry began in 2005 with the introduction of a patent (short license) system, which made it possible to freely manufacture products under the “Made in Kyrgyzstan” brand. In the short period of time, this brand conquered the spontaneous markets of Russia, Kazakhstan and other countries. The garment industry’s leading role was evidenced by its export share of 70% of the total light industry exports. A large number of people were involved in the garment industry. In addition, the related areas were also developing: trade in and repair of equipment, education system, manufacture and sale of accessories, shipping logistics. The products became competitive and were in demand in the CIS trade markets, which were ready to accept small batches of garments. At the same time, it is important to pay attention to the fact that the production of fabrics and accessories was to a lesser extent impacted by the garment production growth rates, since raw materials and fabric for garments were largely imported from China, Korea and Turkey. That is the illegal and somewhat facilitated import of raw materials, which contributed to garment production development, failed to create the similar conditions for the development of the raw material sources.

The devaluation of neighboring countries’ currencies - Russian ruble and the Kazakh tenge, lower incomes of population, as well as a stricter product quality policy led to a decline in export and production starting from 2012.

The crisis period winnowed small counterfeit producing enterprises from the sector, as the requirements in Russian and Kazakh markets became more stringent.

The businesses took the crisis time to upgrade their equipment, introduce new technologies, thus reaching the accession of the Kyrgyz Republic to the EAEU economic bloc more prepared compared to other industries.

The lifting of customs barriers, introduction of a unified tax policy made it possible to increase the volume of produced and exported light industry goods. In the period from 2017 to 2018, the garment export exhibited positive trends, generating \$ 118.3 mln. and \$ 145.1 mln respectively. The reason for that were the advantages of the Kyrgyz Republic’s accession to the EAEU, preferential taxation regimes, preferences for imported sewing equipment that came then into effect. At the same time, the purchasing power of people in Kazakhstan and Russia was recovering after the tanking of ruble and tenge exchange rates.

When Kyrgyzstan acceded to the EAEU, there were concerns about the potential challenges of supplying raw materials from China, that there would be difficulties with customs and agreements with Russia. But the work turned out to be more profitable, it is for sure that it didn’t get any worse.

From an interview with Zarlyk Imankulov. Aziar Fashion LLC.

Some export disruption occurred in 2019 (\$ 99 mln.), when the export figures decreased by 32% as compared to 2018. The reason was that Russia, the main consumer of light industry goods, imposed remittance restrictions as part of its monetary policy. In addition, the barriers on the Kyrgyz-Kazakh border, caused by political disagreements between our countries, also had a negative effect. Despite these temporary difficulties, by the end of 2019 these problems began to be addressed, and the garment industry started regaining its positions. In this an important role was played by the first B2B meeting of Kyrgyz light industry enterprises with the representatives of Russian chain stores, which took place on December 4-5, 2019. Such networking activities made it possible to bring our garments trade to a higher level.

The government continues supporting the export capacity of the light industry sector. The patent-based taxation system still persists. In addition, the insurance premium rates for legal entities in clothing and textile production have been reduced for 4 years. A fixed income tax has been established for each employee or individual entrepreneur based on the minimum estimated revenue. The corresponding changes were made on December 23, 2019 to the Law of the Kyrgyz Republic "On insurance premiums rates under the state social insurance" and the Tax Code. Insurance premium rates for garment sector workers were reduced from 27% to 12%. These amendments will remain in effect until January 1, 2024.

As a result of all these measures taken to support the light industry export capacity the role played by this sector became social rather than economic. The light industry taxes collected in 2019 amounted to KGS 127.6 mln. only (about \$ 20 million), which is even less than 1% of the country's total tax revenues. The key indicators now are employment and income of workers. Another important indicator is the share of female employees in this sector, which reached 90% and greatly influenced the smoothing of the gender imbalance in the economy as a whole. At the same time, small enterprises continue to manufacture products. Cooperation or new businesses consolidation come to no good. A limited production scale precludes them from implementing optimal production processes and mechanisms to achieve the productivity required to compete internationally. The proclaimed advantages of Kyrgyzstan in terms of the workers' readiness to receive lower wages, as well as low energy costs, are outweighed by low labor productivity. As there are no large companies that would have high product quality standards, scale efficiency and higher productivity, it is not quite feasible to meet the foreign market demand for large orders. It appears from the economic trends in the neighboring EAEU countries, as well as in China and Uzbekistan, that the risks

of not being able to withstand competition and lose those current advantages are going to increase drastically, if Kyrgyzstan continues to operate the existing scheme for garment industry development.

It is expected that Russia and Kazakhstan, the main consumers of light industry goods, will transfer a significant part of the trade in clothing and textiles to shopping malls after 2020, thus causing decline in trade carried out in the clothing markets. The customers, i.e. retail chains, are going to place large orders for branded products at affordable prices with good quality, while the domestic industry is not ready for this. Moreover, the Russian Federation is enhancing protection of its own market, and makes efforts to reduce capital export. It means that the actions of the main consumers of our light industry goods are aimed at legalizing the production and trade processes. It is back in 2019 that the exports of light industry goods to the Russian Federation have already exhibited a decrease by 28.8% or \$ 53.6 mln.

The EAEU countries and our neighboring partners create favorable conditions for light industry development along with the protective measures, thus increasing their competitive advantages.

Uzbekistan introduced the loan repayments compensation rules and provided tax incentives for the light industry sector. It is likely that in the coming years, the textile and clothing industry of Uzbekistan will seriously compete with the similar areas of Kyrgyzstan.

The Republic of Belarus and in some segments the Russian Federation are also tough competitors in the garment production development. Traditionally strong positions have China, Vietnam, Laos, India and other countries in the Asian region.

Currently, the Kyrgyz Republic has enabling conditions for bringing the textile and clothing industry to a level, where it can ensure sustainable development and compete in the international markets.

One of the main factors enabling further light industry development is the accession of the Kyrgyz Republic to the Eurasian Economic Union (EAEU) in 2015, which provided access to the EAEU markets and will contribute to export growth in the future. For Kyrgyzstan, access to the EAEU market is critical due to its size, geographic proximity, and cross-border infrastructure. Removing barriers to trade reduces the cost of imports that are important for light industry development in Kyrgyzstan. Despite the conditions created, the share of Kyrgyzstan among the EAEU garment products manufacturers, subject to imports from third

countries, does not exceed 0.36%³⁴. This figure places Kyrgyzstan together with Armenia in the last places of share ranking. The analysis shows that even if Kyrgyzstan “reconquers” only 1% of this market volume, it is going to increase its garment production growth opportunities twice.

The future development of the textile and clothing industry to the great extent depends on Kyrgyzstan’s accession to One Belt and One Road (OBOR) initiative of the People's Republic of China. As Kyrgyzstan is one of the countries along this route, the OBOR initiative can play an important role in securing the necessary investment. The Silk Road Investment Fund was established in December 2014 and its funds can be mobilized for textile and clothing production development in partnership with Chinese businesses, which are among the leaders of this industry.

In January 2016, the Kyrgyz Republic was made a part to the Generalized System of Preferences for developing countries (GSP+), which exempts our country from customs tariffs for a period of 7 years applicable to more than 6 thousand commodity items, including textiles, felt goods, and clothing. Until now, the domestic businesses failed to use the GSP+ opportunities to full extent due to the high level of goods protection in the EU countries through non-tariff barriers, as well as the weak infrastructure in Kyrgyzstan and its remoteness from European markets.

In order to maximize the use of existing opportunities, domestic businesses need to ensure compliance with the foreign production and trade rules, while the state should provide an enabling environment.

The following conclusions can be drawn based on the above overview:

- 1) The small capacity of country's own market causes dependence of domestic producers on the production export capacity, in particular that of the light industry
- 2) Changes in the foreign trade rules in the markets of Kyrgyzstan's trading partners significantly affect the development of its own production. At the initial development stage, the Kyrgyz industry has to “adjust” to the conditions imposed by external partners and cannot promote its own rules.
- 3) The competitiveness of Kyrgyz goods to date is ensured by tax preferences and social contribution benefits. However, the same preferences restrain real growth in labor

³⁴ Foreign and mutual trade in goods of the Kyrgyz Republic in 2018. National Statistics Committee. 2018. Link to web-site: <http://stat.kg/ru/publications/sbornik-vneshnyaya-torgovlya-kyrgyzskoj-respubliki/>
Last visited: 15.02.2021

productivity, which is one of the key factors to ensure competitiveness in foreign markets.

- 4) The Kyrgyz Republic fails to adequately use the integration opportunities between partner countries and the possibilities to participate in international economic unions. Lagging behind these processes reduces the country's export opportunities and adversely affects its own production.

Based on the findings, the following recommendations can be made:

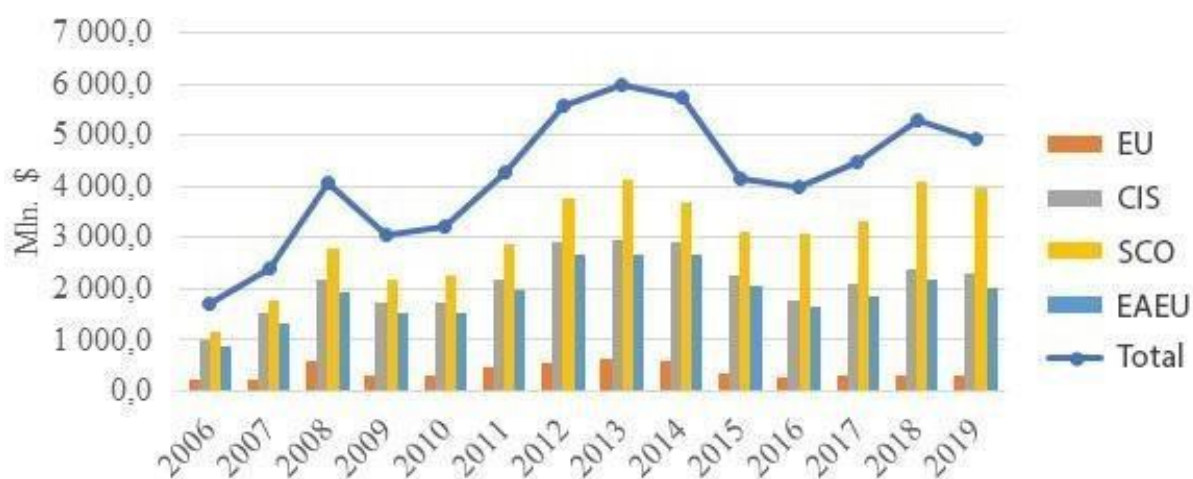
- 1) Stimulate the operations of industrial enterprises that increase labor productivity. In particular, introduce a preferential regime for organizations importing new equipment and technologies. Provide soft loans for innovation.
- 2) Mobilize an international investor possessing a well-known brand to locate their production on the territory of the Kyrgyz Republic, thus allowing to shape the country's own culture of light industry production in the future based on advanced technologies with the development of their own "Kyrgyz brand". Mobilization of such an investor should rely on the establishment of separate industrial zones with developed infrastructure, preferential taxation regime, and the availability of qualified workers.
- 3) Create stimulating conditions to build large manufacturing enterprises that will ensure high productivity, a wide range of products and volumes that are in demand by the trading networks in the EAEU countries.

4.2.3 Trends in goods import in the Kyrgyz Republic.

The trends of goods import to the Kyrgyz Republic for the period from 2006 to 2019 are varying, with its rates going upward. Imports in 2019 almost tripled compared to 2006 (see Chart 4.6).

Figure 6: Trends in geographical distribution of goods import to the Kyrgyz Republic in 2006-2019 (USD mln.)³⁵

³⁵ Foreign and mutual trade of the Kyrgyz Republic in 2019. National Statistics Committee of the Kyrgyz Republic. Link: <http://stat.kg/ru/publications/sbornik-vneshnyaya-torgovlya-kyrgyzskoj-respubliki/>



Source: <http://stat.kg/ru/publications/sbornik-vneshnyaya-torgovlya-kyrgyzskoj-respubliki/>

Imports inflow in the period under review peaked in 2013, when the volume reached its maximum, that is, almost \$ 6 bln.

Later in 2014, imports to the republic tanked (from \$ 5.7 bln. to \$ 4.0 bln., or more than by a third), which situation preserved until 2016. This decline accounts for the reduction of deliveries to Kyrgyzstan from such countries as Japan (by 92.8%), the Netherlands (by 79.8%), the Republic of Korea (by 76.8%), Germany (by 73.3%)³⁶ etc. in this period due to the accession of the Kyrgyz Republic to the EAEU, and, accordingly, the assumption of certain discriminatory obligations against third countries. These measures include the Uniform Customs Tariff with the weighted average rate higher than the tariff used in the Kyrgyz Republic prior to the accession (weighted average tariffs of the Kyrgyz Republic in 2015 - 5.04%, UCT - 5.71%³⁷), as well as non-tariff regulation measures - technical regulations, sanitary and phytosanitary requirements.

Moreover, after Kyrgyzstan acceded to the EAEU the customs re-export duties became levied on goods value, rather than on goods weight, which also played its part in the decrease of import figures. However, over time business operations adapted to the EAEU conditions, applicable to our country, and from 2016 to 2018 imports started going up. Then, in 2019 imports decreased by 7.3% compared to 2018 and amounted to \$ 4.9 bln., with the decreased supplies primarily pertaining to the EAEU countries - by 6.7%, the CIS - 4.3% and SCO countries - 3.4%. The key reason was the sharp decline in the exchange rate of the ruble and

³⁶ Based on the web-site data of National Statistics Committee of the Kyrgyz Republic [Electronic resource]. Link: <http://www.stat.kg/>

³⁷ See: <http://www.eurasiancommission.org/ru/nae/news/Pages/11-08-2015-2.aspx>

the Kazakhstani tenge, which immediately caused a rise in prices for the products imported from these countries.

On the contrary, the supplies from the EU countries slightly increased (by 1.3%). Thus, among the European Union countries, the largest imports increase was provided by Malta (1.7 times), Sweden (1.6 times), France (1.5 times), the Czech Republic (1.2 times) and Poland (1.1 times).

The structure of imports is dominated by industrial goods (23.2%), cars and equipment (21.8%) (see Table 4.5)

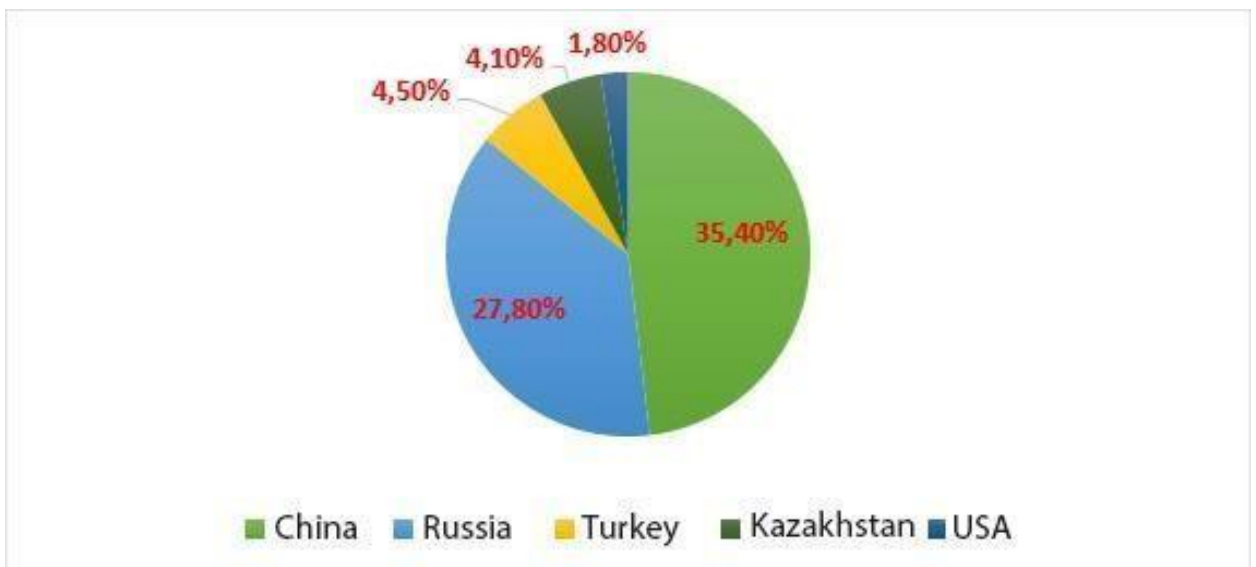
Table 7: Import structure in the Kyrgyz Republic in 2019.

No.	Types of imported goods	Share (%)
1	Industrial goods	23.2
2	Cars and transportation equipment	21.8
3	Finished goods	15.0
4	Mineral fuels, lubricating oils and similar materials	14.0
5	Chemicals and similar products n.e.c.	11.5
6	Food and live animals	9.5

Source: Author

The main importers are China (35.4%), Russia (27.8%), Kazakhstan (12.4%), Turkey (4.5%), Uzbekistan (4.1%) and the USA (1.8%) (see Chart 4.7.).

Figure 7: Key importers to the Kyrgyz Republic (at the end of 2019).



Source: Author

According to official data, China is leading in imports to the Kyrgyz Republic. It is important to note that back in those days Chinese imports, consisting mainly of textiles, footwear, clothing, technology, electronics, even satisfied the certain social needs of the population. At the same time, a bulk of imports from China fails to meet safety requirements, thus jeopardizing the national public health, and also escalates competition in the domestic market for domestic manufacturers. One of the reasons why consumer goods are imported in such significant quantities is, first of all, much lower prices than the local prices for similar domestic goods.

The following types of goods prevail in the imports structure: technological equipment for industrial purposes, and as is customary, vehicles (used cars, tractors, buses, etc.), food products, light and textile industries goods. The imported technological equipment is demanded by the launch and operation of a number of large mining enterprises. Due to low customs duties, a large number of used vehicles are imported into Kyrgyzstan. As there are no strict environmental safety rules for exhaust gas emissions the purchase of such cars is attractive to consumers. Moreover, the used car markets have become popular with buyers from Kazakhstan. In some years, for example in 2014, 110,000 used cars were imported into the Kyrgyz Republic. Over time, cars import is expected to decline as customs clearance rules come into force as a result of the Kyrgyz Republic's EAEU membership.

A large share of imported consumer goods accounts for insufficient supply from domestic manufacturers, which stems from the crucial problem of the Kyrgyz economy - de-industrialization, which occurred with the collapse of the Soviet Union. Moreover, labor productivity in these economic sectors is extremely low, and therefore domestic goods are non-competitive in foreign markets and unable to resist imports.

The economy of Kyrgyzstan is service-based, since 46.9% (as of 2019) of GDP is formed by services, trade and tourism. The share of agriculture, forestry and fishing is 12.1%, that of construction - 9.7%, of industry - 17.9%³⁸.

In order to showcase the influence of foreign economic activity, namely imports, with a certain economic area, let us review the light industry sector just as in the previous sections.

³⁸ According to the National Statistics Committee of the Kyrgyz Republic. See link: <http://stat.kg/ru/news/struktura-valovogo-vnutrennego-produkta-za-2019-god/>

4.2.4 Specifics of the imports impact on the development of light industry in the Kyrgyz Republic.

The light industry sector evokes interest as a large share of consumer goods imported from China, the country's key importer, consists of the products related to the light industry: clothing, footwear, fabrics, accessories, leather, etc. At the same time, as noted previously, the light industry sector also plays an important role in exports. Thus, the light industry is an illustrative area to trace the positive and negative impact of foreign trade operations on its development.

Kyrgyzstan's imports of garments are 7 times higher than its own production. This indicates the higher demand of country population for imported clothing, large re-export volumes, as well as weaknesses in statistical accounting of light industry production³⁹. There has been an ironic situation with Kyrgyzstan contributing to gray imports, which dumps prices and prevents the EAEU goods, including those from Kyrgyzstan, from getting into trade networks at a reasonable and adequate prices, although it was itself interested in entering the EAEU market with its own sewn products. The reasons for this situation are rooted deeply, one can only highlight certain points:

- 1) Gray import of raw materials, or smuggling, is beneficial for garment manufacturers, as they can produce goods cheaper than their competitors from Belarus and Russia.
- 2) Public decision-makers are not interested in strengthening customs administration and suppressing smuggling, since the customs duties split ratio of 1.9% covered by other countries allows Kyrgyzstan to have a rather comfortable life.
- 3) There are influential groups that have divided up this corruption area, and do not allow changing the existing situation.

However, the EAEU membership will demand combating gray imports in the near future. This process will be triggered by the introduction of electronic goods labeling.

The garments made in Russia and Belarus are not competitive for the Kyrgyz domestic market in comparison with domestic products. Therefore, in the future it is important to engage in cooperation with the partner states in order to increase our presence in the EAEU

³⁹ Foreign and mutual trade in goods of the Kyrgyz Republic in 2018. National Statistics Committee of the Kyrgyz Republic. 2018. Link: <http://stat.kg/ru/publications/sbornik-vneshnyaya-torgovlya-kyrgyzskoj-respubliki/>
Last visited: 18 February 2021

markets rather than ensure protection from garment imports from these countries. The first step that has been already envisaged is contract manufacturing development⁴⁰.

Cooperative deliveries are evolving. In 2019, cooperative deliveries to the EAEU increased as compared to 2015⁴¹ (+15.9% growth). Unfortunately, cooperative deliveries impacted the industry of the Kyrgyz Republic, including the garment industry, to a lesser extent. However, these processes have already been initiated under the direct liaisons between Kyrgyz sewing enterprises, as well as businesses and trade networks in Belarus and Russia. The specifics of foreign economic activity as part of integration processes, are the alteration of the traditional attitude towards imports. They are being replaced by the cooperation processes with partners from the EAEU member states aimed at the replenishment of this economic union's common market. According to expert estimates, “for the first time in the last four years, the reduction (in US dollars) of the EAEU Member States Common Market capacity has almost stopped. This trend indicates the transition of the EAEU market from depression to recovery growth. This can only be prevented by large-scale external events that can dramatically worsen the situation in the Russian market”⁴². Unfortunately, large-scale external events did take place in the form of the COVID-19 epidemic and certainly affected the capacity of the EAEU market. Nevertheless, there were no economic conditions that would demand the reduction of the industrial products share among the EAEU countries by the beginning of 2019. This suggests that the soonest medical solution to the COVID-19 problem will allow the EAEU industry to recover faster.

One of the objectives pursued by all Union countries is to increase their share in the EAEU Common Market and strive for a gradual production localization. Obliquely, the solution to this problem implies a decrease in the share of imports from third countries to the Common Market. At present, the share of textiles and garments imported from third countries to the EAEU market is 59.1%, which evidences great perspectives for import substitution by domestic producers in the EAEU countries. The share of Kyrgyzstan in this segment is only 0.36%. For reference, the share of Belarus, which has a developed light industry sector is

⁴⁰ Contract manufacturing is the release of products on a by-order basis using standalone manufacturing facilities, which ensures full compliance with the technological cycle and quality control of finished products in accordance with the customer's requirements.

⁴¹ Cooperative deliveries are intermediate goods intended for production of goods and provision of services, which bring their entire cost to the finished product within one production cycle.

⁴² On import substitution in Kyrgyzstan. J. Imanturova, NISR KR. Link: <http://www.nisi.kg/112-stati/460-k-voprosu-importozameshcheniya-v-kyrgyzstane.html>
Last visited: 23 February 2021.

6.4%⁴³. At the same time, competition with imports is only possible with joint capacity of all EAEU member countries. Moreover, in the next couple of years, the demanded mix of garment products is expected to pivot in response to the lower income of the middle class. Therefore, a favorable situation is going to spring in this period for businesses to launch joint operations in textile, clothing industry and retail chains and produce the goods that are able to compete with certain import segments. Certainly, this kind of activity should be accompanied by a campaign promoting the EAEU products not only on the basis of price and quality, but also with a view to protect the interests of domestic manufacturers. It is important to accelerate the integration process of the Kyrgyz garment industry into the value chain of products made for the EAEU market with a capacity of 182.7 million people.

In 2016, the National Institute for Strategic Research (NISR) surveyed the existing barriers for industrial cooperation with the EAEU countries⁴⁴. It resulted in the following list of problems:

- lack of working capital for the development of cooperative relations with businesses (68.4% of responses);
- long distance and transportation costs, leading to higher product prices (58% of responses);
- lack of information about potential partners (57.9% of responses);
- lack of information about companies in the EAEU member states (50% of responses).

The above problems are not critical and can be efficiently addressed under the integration cooperation. Moreover, the current conditions request that cooperation is also understood as the joint development of new technologies, new equipment, advanced training of workers in the garment industry, new brands creation and promotion.

One of the key conditions promoting cooperation and mutually beneficial trade ties is the elimination of gray imports, primarily that of garments from China. The situation will dramatically change after the electronic labeling of light industry goods is introduced in the EAEU territory. The idea behind electronic labeling is to trace the entire way of product based on each label - from production to its sale to end consumer. Electronic labels will contain all possible information about the product - date of manufacture, manufacturer, place of manufacture, when and to whom it is sold or transferred, image of the product, its

⁴³ On import substitution in Kyrgyzstan. J. Imanturova, NISR KR. Link: <http://www.nisi.kg/112-stati/460-k-voprosu-importozameshcheniya-v-kyrgyzstane.html>
Last visited: 23 February 2021.

⁴⁴ Ibid.

composition. The main purpose of labeling is to reduce the number of gray and counterfeit goods in the EAEU territory.

The main threat for the Kyrgyz Republic is that if the labelling is accepted by other countries, and Kyrgyzstan lacks time to introduce it, then the entry of goods to the EAEU markets will be closed, which means that the country's entire garment industry is going to be scaled back. The elimination of gray imports first of all implies the legalization of fabrics and accessories supply. Payment of fees and customs duties will also require the payment of VAT on imported goods. In this case, the state needs to arrange a transparent and clear VAT refund procedure for businesses. Otherwise, it will be unprofitable to legally supply fabrics. At the same time, the business is ready to work under lawful schemes, if they are the same for all market actors.

According to our preliminary calculations, the payment of the duty based on customs value is not going to significantly affect the cost of garments. It is important that the mechanism for processing the necessary documents in a consolidated cargo and the VAT refund mechanism work clearly. Today we are satisfied with the logistics for fabrics delivery and customs clearance, it is important to maintain this mechanism in the future.
From an interview. Zarlyk Imankulov. Aziar Fashion LLC.

Conclusions:

- 1) Import substitution matters should be addressed as part of cooperation between the EAEU member states rather than within the borders of Kyrgyzstan.
- 2) To enhance the trust among the partners, Kyrgyzstan should demonstrate its commitment to combat gray imports, thereby showing the joint responsibility to protect the entire EAEU market.
- 3) The benefits from the introduction of electronic labeling for garments are more important than the expected drop in production volumes at the initial stage.

4.2.5 Realization of the benefits ensured by the membership of the Kyrgyz Republic in integration associations.

EAEU membership.

One of the key factors in the economic development is the accession of the Kyrgyz Republic to the Eurasian Economic Union (EAEU) in 2015, which made it possible to provide access to the EAEU markets and will contribute to the export growth in the future. The EAEU

proclaimed freedom of goods, services, capital and labor movement, which are the most important conditions for ensuring economic growth in all EAEU member countries. For Kyrgyzstan, engagement in this integration association is important, as its key trading partners are the EAEU countries, which account for 35% of the total trade, including exports - 32.6%, imports - almost 36%. The largest share of trade between the Kyrgyz Republic and the EAEU countries belongs to the Russian Federation - 66% and Kazakhstan - 32.3%.

For Kyrgyzstan, access to the EAEU market is critical due to its size, geographic proximity, and cross-border infrastructure capabilities. Removing barriers to trade reduces the cost of imports, which is important for the development of industry in the Kyrgyz Republic.

At the same time, many issues that preclude the full realization of the benefits ensured by the Kyrgyz Republic's membership in the EAEU for the development of its own economy are pending solution:

- 1) Some EAEU member states continue to pursue targeted policies to protect their internal markets, based on the national economic interests. This approach of the partners in the Union significantly reduces the opportunities for the Kyrgyz Republic to increase the export of products to the EAEU market.
- 2) There are not enough funds to fulfill all the EAEU conditions for the launch of laboratories, providing customs checkpoints with the necessary equipment, and coordination of information systems of the EAEU member states.
- 3) Domestic manufacturers have not yet learned how to produce goods that would meet the EAEU requirements and rules. False phytosanitary documents are often used. Such examples inflict economic and image losses on the Kyrgyz Republic, which becomes an additional argument of some Union partners to criticize the Kyrgyz Republic.
- 4) The Russian Federation plans to introduce a mandatory monitoring system for the movement of goods across the country using the GLONAS and PLATON systems. This circumstance may create additional procedural difficulties for cargo carriers.

GSP + system of preferences.

In January 2016, the Kyrgyz Republic was included in the Generalized System of Preferences for developing countries (GSP+), which exempts our country from customs tariffs for more than 6 thousand commodity items for a period of 7 years.

Today ten countries enjoy the GSP+ status, namely Armenia, Bolivia, Cape Verde, Georgia, Kyrgyzstan, Mongolia, Pakistan, Paraguay, Philippines, Sri Lanka. The main condition for status assignment is country's recognition as particularly vulnerable and less protected. The European Union believes that by providing preferences to such countries they help them

develop and gain attractiveness for investors. At first glance, it would seem that the Kyrgyz Republic is using the GSP+ status to its advantage. According to EU statistics, the total trade between the EU and Kyrgyzstan in 2018 amounted to EUR 917 million, including the goods imported from the Kyrgyz Republic to the EU for EUR 632 million. Compared to the last year, the figure has almost tripled. One shouldn't though rejoice at such high amounts. The bulk of goods exports go to the UK - EUR 556.2 million. This is due to gold exports, which are not linked to GSP+ preferences. At the same time, agricultural products were exported to Europe for only EUR 16 million. The bulk of Kyrgyz goods imports into the EU under the GSP+ system are fresh fruits and nuts. Where the export of agricultural products is concerned, then it is necessary to obtain an "Organic" certificate. The Kyrgyz Republic has been using GSP+ since 2016 only. This period is too short to appreciate all the pros and cons of the system.

The problem with Kyrgyzstan is that trade is not diversified. This is probably the main obstacle to strengthening and building our trade relations with the EU. There is some room for maneuver, there is room for improvement. If Kyrgyzstan manages to diversify its economy, then there will be a higher potential to increase trade with the European Union. From an interview with the Deputy Minister of Economy of the Kyrgyz Republic D. Imanaliev.

In addition, domestic businesses fail to use the capabilities of GSP+ adequately due to the high protection of goods in the EU countries through non-tariff barriers, as well as the weak Kyrgyz infrastructure and remoteness from European markets.

According to some estimates, the cost of certification and the establishment of the necessary ties with European businesses can reach up to EUR 500 thousand. Despite all the difficulties, Kyrgyz business is gradually discovering Europe. While in 2016 the goods exported to the EU through the GSP+ system amounted to EUR 3.2 million only, by 2018 this figure increased by EUR 2.8 million⁴⁵.

WTO membership.

In December 1998, Kyrgyzstan was one of the first among the post-Soviet countries to join the World Trade Organization. Over 20 years of WTO membership, the trade turnover of Kyrgyzstan has grown fivefold - from \$ 1.4 billion in 1998 to \$ 7.1 billion in 2018.

The main benefits of joining the WTO:

- export of Kyrgyz goods and services received the most favored nation treatment

⁴⁵ GSP+. Why Kyrgyzstan loses an opportunity to export to Europe. See: <https://rus.azattyk.org/a/kyrgyzstan-gsp-europe-export/29775993.html>

- domestic trade and tax legislation is harmonized with international rules and regulations, leading to country's improved competitiveness and investment image
- predictable regime has been created for domestic producers and investors in both trade and services
- geographical distribution of the republic's trade expanded from 98 countries in 1998 to 131 countries
- Kyrgyzstan now has access to the WTO trade dispute settlement mechanism

However, accession to the WTO also caused certain difficulties for the economy of the Kyrgyz Republic:

- 1) The rapid accession of Kyrgyzstan to the WTO caused a sharp deterioration in relations with traditional trading partners that are not members of the WTO. The terms of accession were not fully worked out, and our country made significant concessions, especially with regard to protecting the interests of the national market.
- 2) The opening of the domestic market led to an increase in imports of cheaper and better quality raw materials for industrial production, which reduced the need for local raw materials.
- 3) Certain important requirements for the WTO and EAEU members contradict each other and currently create difficulties in adapting the rules. This negatively affects the formation of country's own economic policy, and has a threat of imposing risks for relations with partners in the future.

5 Results and Discussion.

In more than 30-year history of its independence, the Kyrgyz Republic has generally established the rules for conducting foreign economic activities with other partner countries. The foreign trade development and its impact on the country's economy took place in the difficult conditions of the country's transition from a state-planned to a market economy. In addition, due to historical circumstances the state and the population had no experience of running businesses in a market economy. Moreover, they had no experience of carrying out foreign economic activities and compete with other countries.

Therefore, in the beginning of transition to new economic conditions, there were both successes and mistakes. Recommendations of international financial institutions to maximize the free market environment, as well as the country's accession to the WTO, in the initial period contributed to the domestic market saturation with imported goods. The absence of a state system that would control goods quality, established simplified customs

regime led to the situation when low-cost imported goods ruined the pre-existing sectors of the economy, which failed to compete with importers in such conditions.

Reforms in agriculture, privatization of agricultural land led to the dissolution of large farms and the country's transition to small-scale production. This type of agricultural operation is unsuitable for export, where large volumes of supplies are required. Moreover, small-scale production led to the cost of agricultural products that could not compete with imported goods due to low labor productivity and the country's markets were filled with cheaper products from China and even European countries.

At the initial transformation stage the focus of the Kyrgyz Republic on re-export, primarily of everyday goods, as well as used cars, during its establishment was a rescue. That is, the state has maximized the benefits from the facilitated goods import procedures, and also took advantage of their export to the CIS countries, where initially there have been also problems with quality control and customs procedures.

But these processes were not focused on promoting the development of the country's own economy, and everyone understood that one day the re-export economy would cease to benefit both the country and the population.

It should be noted that it was external factors that played an important role in the pivot of the activities carried out by state and the domestic private sector from trade to production. As a result of stricter goods quality control measures, transition to mandatory products certification and labeling, the state faced the need to speed up the establishment of a competitive industry.

Currently, the following main challenges stand out, which hinder the building of export capacity for the country's economy:

- 1) Inability of domestic producers to provide the required volume of high-quality, competitive products to enter foreign markets. First of all, this is due to low labor productivity, lack of local cheap raw materials.
- 2) Export is primarily focused on Kazakhstan and Russia. Trade turnover with other countries remains small and unstable (save for gold supplies). Changes in the political and economic situation in these two countries immediately negatively affect the entire state of Kyrgyz economy.
- 3) Imports, primarily that of raw materials, are also dependent on a limited number of importers, primarily China and Russia. This also makes our country vulnerable to the situation in these countries.

- 4) Insufficient institutional support from the state to businesses in entering and settling in new sales markets.
- 5) Inadequate use of various mechanisms to access financial resources, including export loans and insurance.

Based on the situation analysis, the following recommendations are elaborated for using the advantages in foreign economic activity to develop the country's own economy:

- 1) Promote the development of high-performance production by reducing import customs duties for new technological equipment. For Public-Private Partnership Projects, envisage state aid to cover the cost of such technologies introduction.
- 2) Create preferences for future investors in the form of tax incentives, enhance industrial infrastructure, set conditions for the investor, so that it would not only organize competitive production, but also form a whole new culture of production. This should be ensured through the mandatory recruitment of local personnel at all levels of production, including the management. The development of dual education should also become a condition for the investor⁴⁶.
- 3) For the accelerated development of a competitive industry, it is important to be included in technological chains, or value added chains of successful enterprises of partner countries that have stable sales in various foreign markets, possess advanced technologies, and the ability to scale production, rather than create own autonomous enterprises.
- 4) For certain sectors of the economy, for example, light industry, it is important to attract a globally recognized investor that has its own brands in the world market. The conditions created by the state should attract such an investor by a promise of lower costs compared to other countries. This can be achieved by the development of industrial infrastructure, cheap energy resources, the availability of qualified personnel, tax preferences, government subsidies for certain investor expenses.
- 5) The state should support the domestic enterprises that already have experience and knowledge of working in foreign markets. This supported should consist of targeted programs aimed at each of such enterprises, when challenges of a particular enterprise are promptly addressed on a case by case basis.

⁴⁶ Dual education— a type of education, where theoretical part of training is delivered in an education facility, while practical part— on the job.

- 6) One of the priorities in the development of export capacity is to establish the sphere of services: tourism, recreation, leisure. Even now the Kyrgyz Republic is distinguished by its attractive mountain, adventure and winter tourism. The catering sector, hospitality business, and recreation areas are developing successfully. But so far these areas have not received proper support in terms of these services promotion in the EAEU, CIS and non-CIS markets.

These proposals are based on the current situation analysis of the foreign economic activities of the Kyrgyz state. Their implementation requires political will to commit to economic transformation. It takes courage to identify priority areas for development, perhaps even to the detriment of country's other economic spheres and social life.

6 Conclusion.

Based on the analysis findings, the following recommendations can be presented on leveraging external economic factors for the country's economic development:

- 1) For the most efficient use of the benefits provided under the GSP + program, strengthen the role of technical assistance made available by international organizations to train local entrepreneurs in the requirements of European markets.
- 2) With a view to combat smuggling and gray imports, develop customs automated systems and minimize the contacts between officials and entrepreneurs.
- 3) For the purposes of developing exports, switch to direct contracts of local producers with the trade networks of the main partners - Russia and Kazakhstan.
- 4) Promote the development of high-performance production by reducing import customs duties for new technological equipment. For Public-Private Partnership Projects, envisage state aid to cover the cost of such technologies introduction.
- 5) Create preferences for future investors in the form of tax incentives, enhance industrial infrastructure, set conditions for the investor, so that it would not only organize competitive production, but also form a whole new culture of production. This should be ensured through the mandatory recruitment of local personnel at all levels of production, including the management. The development of dual education should also become a condition for the investor⁴⁷.
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partner countries that have stable sales in various foreign markets, possess advanced technologies, and the ability to scale production, rather than create own autonomous enterprises.

- 7) For certain sectors of the economy, for example, light industry, it is important to attract a globally recognized investor that has its own brands in the world market. The conditions created by the state should attract such an investor by a promise of lower costs compared to other countries. This can be achieved by the development of industrial infrastructure, cheap energy resources, the availability of qualified personnel, tax preferences, government subsidies for certain investor expenses.
- 8) The state should support the domestic enterprises that already have experience and knowledge of working in foreign markets. This supported should consist of targeted programs aimed at each of such enterprises, when challenges of a particular enterprise are promptly addressed on a case by case basis.
- 9) The services sphere, namely tourism, recreation, leisure, should be prioritized, among others, for export capacity development. Even now the Kyrgyz Republic is distinguished by its attractive mountain, adventure and winter tourism. The catering sector, hospitality business, and recreation areas are developing successfully. But so far these areas have not received proper support in terms of these services promotion in the EAEU, CIS and non-CIS markets.

These proposals are based on the current situation analysis of the foreign economic activities of the Kyrgyz state. Their implementation requires political will to commit to economic transformation. It takes courage to identify priority areas for development, perhaps even to the detriment of country's other economic spheres and social life.

This thesis shows only one of the dimensions in the foreign trade impact and, in general, the foreign economic policy of the Kyrgyz Republic aimed at the development of its own economy. Additionally, it is important to consider the financial and tax regulation of foreign economic activity and their impact on economic entities. Moreover, the movement of labor also constitutes an essential foreign economic activity factor that impacts the situation in Kyrgyzstan.

Nevertheless, this paper presents a general framework and fundamental conclusions regarding the influence of external factors on the development of country's own economy.

This thesis will be helpful for novice economists who will be involved in economy and foreign trade regulation within public service. The materials of this work can also be used by economic researchers who are interested in country development during transition from one social system to another.

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