

# Theoretical and Practical Research in Economic Fields

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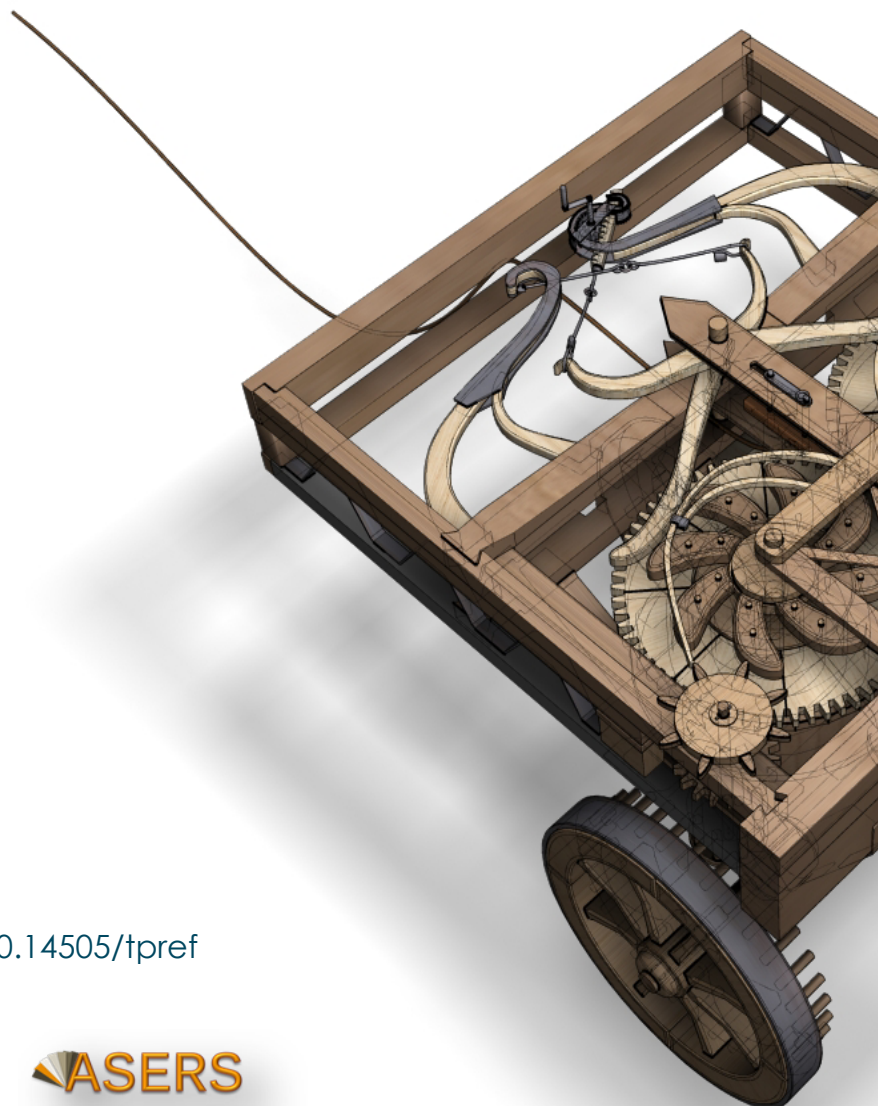
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## Kyrgyz Republic Tax Legislation Influence on the Local Automotive Industry Efficiency

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**Abstract:** The issue of tax regulation of the automotive industry is relevant, as in the context of a dynamically developing global economy and rapid changes in the automotive industry, the issues of tax regulation become key to the effective functioning of the industry in any country, including the Kyrgyz Republic. The study aims to identify the relationship between tax legislation and the efficiency of the automotive industry in Kyrgyzstan, considering the current challenges and trends in the industry. The study employed various methods, including analytical, statistical, functional, system analysis, deduction, synthesis and comparison. The study analysed the impact of tax legislation on the efficiency of the automotive industry in the Kyrgyz Republic. The focus was on identifying the key aspects of tax regulation that have a direct impact on various areas of industry, including the investment climate, innovation activity and overall competitiveness of enterprises. A systematic analysis of existing tax mechanisms was conducted, the current state of the automotive industry in the country was analysed, and the impact of external factors such as dependence on imports, economic stability and changes in global trends, especially in the context of the development of electric vehicles, was identified. Tax mechanisms in the automotive industry, including customs duties, excise duties, and value-added taxes (VAT) are studied. Particular attention is devoted to the changes in tax legislation introduced in 2023 aimed at exempting parts supplies from VAT. The results of the study indicate the positive impact of such measures on the efficiency of car production.

**Keywords:** investment climate; economic sustainability; fiscal reforms; innovation; vehicle production.

**JEL Classification:** D20; D22; E22; E62; O32.

### Introduction

The automobile industry is an essential factor driving economic development and innovation progress for many countries in the world today. It carries not only the function of producing vehicles but also provides the impetus for the creation of new technologies, stimulating the economy and shaping the innovation landscape. In this context, for the Kyrgyz Republic, where the automotive industry occupies a strategic position in the formation of the national economy, the issue of the impact of tax legislation on this industry becomes particularly important (Jomartova *et al.* 2021). Kyrgyz Republic, with its unique geopolitical position and potential for the development of the automotive sector, faces the challenges of global change and strives for sustainable, innovative growth. In this context, analysing the impact of tax regulation on the automotive industry goes beyond the usual financial aspect, becoming a strategic tool for shaping a competitive environment. It should be noted that tax regulation is a powerful means of influencing various aspects of the automotive industry, including attracting investment and supporting innovation (Akkucuk 2023). In the context of modern challenges, such as climate change and the transition to electric vehicles, the role of tax regulation in stimulating the sustainable development of the automotive industry becomes more relevant and important (Yaroshenko *et al.* 2018; Chochia *et al.* 2018; Spytyska 2023). The analysis and impact of tax mechanisms in this context become particularly important for ensuring sustainable and innovative development of the automotive industry in Kyrgyzstan.

Dzhailova *et al.* (2023) argue that high tax rates discourage investment in the automotive industry in Kyrgyzstan. The study provides data on how limited access to finance under conditions of high tax burden hinders the development of new technologies and modernisation of enterprises in the industry. Akanov and



Zhakypov (2022) emphasises that climate change and requirements for the environmental friendliness of cars are becoming determining factors in the modern automotive industry. They suggest reducing tax pressure for companies that actively implement technologies aimed at reducing the harmful impact on the environment. Das *et al.* (2023) conducted a study of the impact of tax incentives on the stimulation of innovation in industry. The results indicate the need to create favourable tax mechanisms for companies actively investing in research and development in various areas, including the automotive industry. Kondev *et al.* (2023) emphasise the sustainability of the domestic car market in Kyrgyzstan despite tax barriers. Their analysis suggests a revision of the tax incentive system to support domestic producers and improve their competitiveness. Generalov and Generalova-Kutuzova (2021) emphasise the social impact of tax policy on the country's industry. Their analysis shows that tax measures should be aimed at creating new jobs, improving working conditions and supporting the social responsibility of enterprises in various areas.

Based on previous studies of the impact of tax legislation on the automotive industry in Kyrgyzstan, problems associated with high tax rates that limit investment and innovation are identified. The importance of sustainability of the domestic market and social aspects of tax policy is also highlighted, emphasising the need for comprehensive analysis and reforms in this area. The impact of taxes on vehicle production, including automobiles, remains under-researched. The study aims to identify the relationship between changes in tax legislation and the automotive industry in Kyrgyzstan to formulate optimal tax mechanisms.

## 1. Literature Review

Taxes are a fundamental element in the economic system and fulfil several important functions. They provide the state budget with the funds necessary for the implementation of national programs and the provision of infrastructure. This means that taxes are a key source of revenue for the state. However, the role of taxes is not limited to the financial aspect. Gashi (2018) emphasizes that taxes fulfil the function of income distribution in society, as different categories of citizens and businesses bear different tax burdens depending on their income and asset structure. This function contributes to a more equitable social structure. In the industrial context, taxes play a crucial role in shaping the economic environment for enterprises. Tax policy determines the extent to which enterprises are incentivized to invest in new technologies, develop RandD projects, and renew production capacity.

The variety of tax types in the economic system has many impacts on industry, shaping its financial, competitive, and responsible aspects. Hakim (2020) argues that profit tax, being one of the main financial obligations of enterprises, directly affects their financial stability. High rates of this tax can significantly limit the ability of enterprises to invest in innovation and technological development, which can slow down the process of modernization of the industry. Another important tax affecting the industry is the value-added tax (VAT). Jensen (2022) points out that high rates of this tax can have a noticeable impact on the competitiveness of products, as they change the price structure in the production chain. This, in turn, can affect the demand for goods and services, determining the success of enterprises in a competitive market. Excises and special taxes play the role of an instrument influencing industries, considering social and environmental aspects. Adandohoin (2021) and Gunash *et al.* (2024) illustrate that the introduction of excise taxes on products harmful to health or taxes on emissions of harmful substances stimulates the formation of a more responsible approach to production. This not only contributes to the improvement of public health but also creates additional motivators for companies to introduce eco-friendlier technologies and processes.

Tax incentives are a significant element contributing to the formation of a favourable investment climate in the economy. This instrument is particularly important in the context of industry, where innovation, capital attraction, and social development play key roles. Cnossen (2023) highlights that benefits directed at RandD activities have a significant impact on the innovation potential of the industry. Providing tax advantages for research projects incentivizes enterprises to adopt new technologies, conduct research, and develop innovative products. This, in turn, contributes to enriching the technological base and increasing the competitiveness of the entire industry. Investment incentives are an integral part of the strategy to stimulate industrial development. The provision of tax incentives to attract capital supports the growth of production, renewal of production facilities, and increase in the efficiency of enterprises. Geczy (2021) emphasizes that this, in turn, contributes to strengthening the competitiveness of the industry in the global market and promotes the creation of new jobs. Social benefits in the form of incentives for job creation and staff training also play an important role in tax policy. Jakubik *et al.* (2017) suggest that they promote sustainable social development, support employment, and, through staff training, improve the skills of the labour force. This comprehensive approach to social benefits creates favourable conditions for the formation of a healthy and diversified industrial sphere. As a result, incentive-oriented tax policy

plays an integral role in ensuring the efficiency and sustainability of industry. Creating conditions for investment, encouraging innovation, and improving the social aspects of labour relations form the basis for the sustainable development of the industrial sector.

The state of the automotive industry in Kyrgyzstan is a complex mix of factors that determine the dynamics of this industry. Musiralieva (2016) and Kerimkulov *et al.* (2015) observe that over the past few years, Kyrgyzstan has remained heavily dependent on imported cars, both new and used. The lack of domestic large-scale production defines the country as a car consumer, highlighting the importance of analysing external factors. Trends in car sales in the country are affected by economic factors such as income levels and stability in the economy. Fluctuations in economic activity and the availability of finance can have a significant impact on purchasing power and therefore on car sales. In the context of global trends, Kydykov (2021) notes that the focus on electric vehicles is becoming an important aspect of automotive industry development. Kyrgyzstan is also changing to promote electrification of the transport sector, which can influence infrastructure and stimulate the development of electric vehicles.

While previous studies have provided valuable insights into various aspects of taxation and its effects on different sectors, the specific impact of tax regulations on the efficiency and sustainability of Kyrgyzstan's automotive sector remains underexplored. This gap highlights the importance of the current study, which aims to provide a comprehensive analysis of how recent tax legislation changes, particularly the VAT exemption for domestically produced vehicle components, influence the production, innovation, and competitiveness of the local automotive industry. By addressing this gap, the study contributes to a deeper understanding of the strategic role of tax policies in fostering industrial development in Kyrgyzstan, offering actionable insights that could guide future legislative reforms and industrial strategies.

## 2. Materials and Methods

An extensive analysis of a variety of sources covering the impact of tax legislation on the automotive industry in Kyrgyzstan has been carried out. To obtain an objective estimation, official statistical reports on the website of the National Statistical Committee of the Kyrgyz Republic (2023) were used, which include information on the volume of production of vehicles, including cars, as well as parts and automotive accessories. These data served as a basis for quantitative analyses and identification of the main trends in the development of the automotive industry. The study also scrutinised tax laws, regulations and other official documents governing taxation in the automotive industry. Special attention was paid to the use of subparagraph 111 of Law of the Kyrgyz Republic No. 78 "On amendments to certain legislative acts of the Kyrgyz Republic in the field of taxation" (2023), according to which Article 296 of the Tax Code of the Kyrgyz Republic No. 3 (2022) was supplemented with paragraphs providing new opportunities for tax regulation in this area. These materials played a key role in understanding the current taxation system and highlighting the main aspects that affect the efficiency of enterprises in this sector. The analytical method was used to systematise the complex issue of the impact of tax legislation on the automotive industry in Kyrgyzstan and its components. This included analysing tax rates, examining their changes over time, identifying key laws and regulations, and highlighting the main factors affecting tax efficiency in this industry. The statistical method was used to examine quantitative data such as the volume of production of vehicles, parts and automotive accessories. This identified patterns and trends and provided an understanding of the relationship between tax parameters and production. The functional method was used to study the role of tax instruments in the industry. The study of the functions of tax incentives that stimulate innovation, attract investment, and support social and environmental initiatives identified their role in achieving the strategic development goals of the automotive industry.

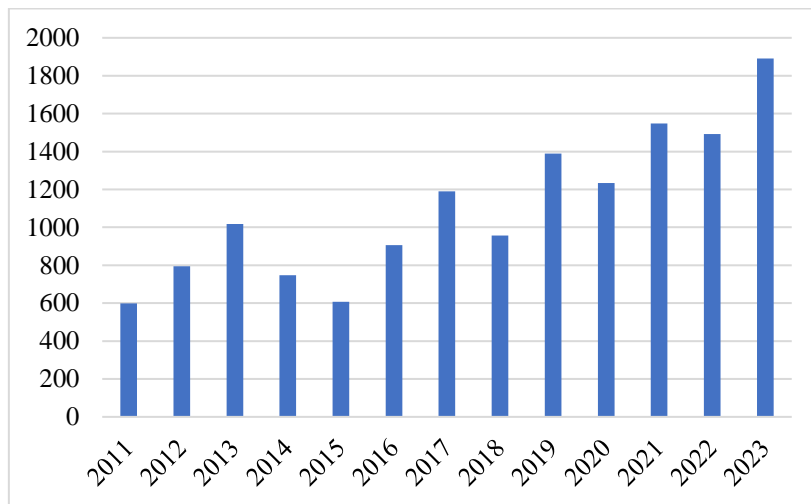
The method of system analysis was used to study the interrelationships and impact of various components of the system, in this case, the tax system on the automotive industry. This identified key factors and influences, as well as consequences of changes in the tax policy of the Kyrgyz Republic. The application of the deduction method allowed the study of general principles of taxation and their impact on the industry, going from general provisions to specific cases. This helped to identify the laws and trends underlying the tax impact. The synthesis method was used to bring together the various aspects of tax impact and form a comprehensive perception of the topic, thus creating a generalised picture of the impact of taxes on the automotive industry, considering multiple factors and variables. The comparison method was used to identify successful approaches that could be adapted or applied to optimise the tax impact in the context of the automotive industry in Kyrgyzstan. As a result, these actions were applied to consider the feasibility of improving tax legislation for the successful development of the automotive industry in the Kyrgyz Republic.

### 3. Results

#### 3.1 Production Trends in the Automotive Industry

With the increasing focus on environmental issues and social responsibility, automotive companies may face increased demands on the environmental performance of production and working conditions. Infrastructure such as road networks also has an impact on the automotive industry. The condition and development of infrastructure affect logistics, transport needs and therefore the efficiency of industry. Figure 1 shows the volume of vehicle production in Kyrgyzstan.

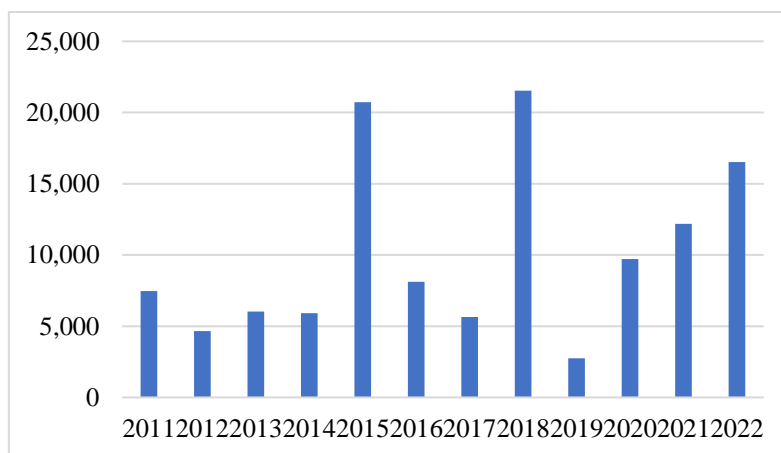
Figure 1. Vehicle production volume in Kyrgyzstan, million KGS



Source: compiled by the author based on (National Statistical Committee, 2023).

Between 2011 and 2013, a significant increase in production volume took place, showing a significant increase of more than 60%. However, in 2014, there was a sharp decline in production volume, which can be attributed to various factors such as economic difficulties, changes in tax policy or other external influences. After declining in 2014 and 2015, vehicle production started to stabilise and show steady growth from 2016 onwards. Subsequent years (2016-2023) are marked by a gradual increase in production volume, peaking in 2023. In 2022 and 2023, vehicle production consisted of motor vehicles (1324 and 1728.4 million KGS) and other vehicles (145.1 and 162.5 million KGS, respectively). The growth of vehicle production can be attributed to the increase in market demand, the introduction of new technologies, and support from government and commercial structures. Figure 2 shows the dynamics of the volume of parts and motor vehicle accessories.

Figure 2. Production volume of parts and automotive accessories in Kyrgyzstan, thousand KGS



Source: compiled by the author based on (National Statistical Committee, 2023).



There are dynamic fluctuations in the volume of production of parts and accessories representing the automotive industry in Kyrgyzstan. The growth in recent years may indicate positive changes in the economy and the development of the automotive industry in the country.

### 3.2 Taxation Mechanisms and Their Impact on Production Efficiency

Taxation mechanisms in the automotive industry usually include various aspects. Customs duties and excise taxes are key instruments for government control and regulation of imports of automobiles into Kyrgyzstan. Customs duties are levied on imported cars and are a form of tax that is collected at border crossings. Excise duties may also be used to regulate the level of consumption of automotive goods, especially given their environmental impact. VAT (12%) applies to sales of motor vehicles and related services in Kyrgyzstan. This tax is levied at every stage of production and distribution of goods, including import, manufacturing, wholesale and retail sales. VAT creates an additional source of revenue for the government at each stage of the vehicle life cycle. The introduction of excise taxes on fuel (diesel fuel – 400 KGS per tonne, petrol – 5 thousand KGS per tonne) is a measure aimed at regulating fuel consumption and affecting the level of pollutant emissions. These excises can increase the cost of fuel, which in turn affects the costs of car owners and incentivises more efficient use of fuel resources.

Car companies, including dealers and service centres, are liable to pay income tax (10%). This tax is imposed on companies' profits after deducting various expenses. Payment of income tax is part of corporate responsibility and contributes to funding government programmes and services. The government can provide tax breaks and incentives to support the automotive industry. This may include lower tax rates for companies involved in car manufacturing, investment in innovation or clean technology. Such measures are aimed at stimulating the development and competitiveness of the industry. Companies that own production facilities and infrastructure in the automotive industry are subject to property tax. This tax is levied on their property, including buildings, equipment and other assets, and contributes to the financing of public needs. Given the growing attention to environmental issues, the state may introduce environmental tax mechanisms. These may include taxes on emissions, penalties for the use of harmful fuels, or incentives for those who use environmentally friendly technologies in cars.

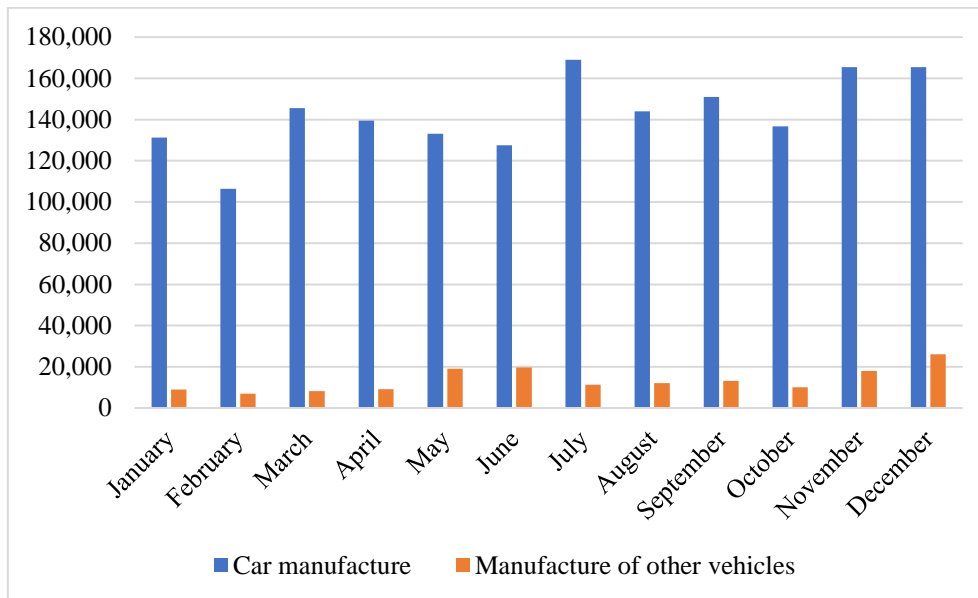
### 3.3 The Role of VAT Exemptions in Stimulating Local Production

The introduction of amendments to the Tax Code of the Kyrgyz Republic, exempting from VAT the supply of components and spare parts for vehicles, could have a significant positive impact on the efficiency of vehicle production in the country. VAT exemption for components produced domestically favours the development of local production. This can support car manufacturers in the country by reducing the cost of component procurement and increasing the competitiveness of domestic products. VAT exemption reduces the overall costs of car production, as components and spare parts imported from Kyrgyzstan become more affordable for manufacturers. This can lead to improved financial sustainability of enterprises and increase their efficiency. Reduced cost of components may increase the availability of inventories for vehicle production. Increased flexibility in inventory management can reduce time delays in production processes and improve production efficiency. Reducing the tax burden on the supply of components can also be an incentive for innovation in transport production. Increased investment in research and development of new technologies can lead to more modern and competitive vehicles. Improved conditions for local production can attract more investments and orders for vehicle production in the country. This also favours the growth of economic activity in the automotive industry.

Within the framework of the changes introduced by subparagraph 111 Law of the Kyrgyz Republic No. 78 "On amendments to certain legislative acts of the Kyrgyz Republic in the field of taxation" (2023), an article 296 Tax Code of the Kyrgyz Republic No. 3 (2022) was amended with paragraphs dealing with various aspects of taxation in the field of supply and maintenance. The amendments consist of 5 items. Supply of vehicles and components: VAT exemption for vehicles and components produced domestically. Such a measure aims to support local manufacturers and stimulate the domestic automotive industry. Supply and maintenance of cash register machines (CCMs): VAT exemption on supply and maintenance of cash registers entered in the Register of Cash Registers, as well as components for their repair. Such a measure may contribute to updating and maintaining the performance of cash register equipment. Supply of POS terminals: VAT exemption for the supply of POS terminals with the function of working with cash registers included in the Register of Cash registers. This may facilitate the introduction of modern technology in the retail sector and trade efficiency. Provision of excise duty stamps and identity documents: the item provides for VAT exemption on the supply of stamps subject to

excise duty, blank passports and identity cards of a citizen of the Kyrgyz Republic of the established standard. This may have an impact on administrative processes and state identification. Supply of electronic devices for software KKM, suggesting that the supply of electronic devices with a built-in receipt printer and operating system intended for installation of a software KKM is exempt from VAT. This may stimulate the introduction of modern technologies in the field of fiscal control. Figure 3 shows the volume of production of cars and other vehicles in the Kyrgyz Republic by month during 2023.

Figure 3. Production of cars and other vehicles in Kyrgyzstan for 2023, thousand KGS



Source: compiled by the authors based on (National Statistical Committee, 2023)

The VAT exemption for domestically produced components and spare parts reduces the overall cost of car production. This, in turn, leads to an increase in vehicle production volumes, as can be seen in the data for the period. The increase in production volumes starts in summer and continues until the end of the year. A similar trend is evident in the other vehicle production segment. There is an increase in volume from April to the end of the year. The impact of VAT exemption on the supply of components is evident in the growth of the production of various vehicles. Thus, the changes in the tax legislation have a positive impact on the automotive industry, contributing to an increase in production volumes and stimulating local entrepreneurship in this area.

#### 4. Discussion

This study highlights key aspects of the relationship between tax mechanisms and the automotive industry in Kyrgyzstan. The introduction of amendments to the tax code, exempting from VAT the supply of components and spare parts for vehicles manufactured in the country, provides significant incentives for the development of local production. This reduces financial barriers, improves the financial sustainability of enterprises and, consequently, increases their competitiveness. Changes in tax policy oriented to support domestic production have a positive response in the form of sustainable growth of vehicle production in the country. VAT exemption on locally produced components stimulates innovation and technological development, which in turn contributes to the creation of more modern and competitive vehicles.

A study of the dynamics of motor vehicle production in Kyrgyzstan reveals the impact of various factors, including economic stability, income levels and government support measures. A positive trend in the increase of production volumes is noticeable, especially after changes in legislation. In the context of global trends towards the electrification of transport, it is important to note that the electric vehicle sector in Kyrgyzstan may also receive a new impetus for development. Strengthening environmental requirements and social responsibility of enterprises is becoming an increasingly important factor that can influence the future of the automotive industry in the country. In addition, the results emphasise the practical significance of the changes made to the tax legislation. The exemption from VAT on components and spare parts produced in the country not only supports local production but also creates conditions for increasing the efficiency of vehicle production, reducing overall costs and improving competitiveness. These measures promote innovation, investment attraction and sustainable social development in the Kyrgyz automotive industry.

This aligns with conclusions drawn by Llopis-Albert *et al.* (2021), who found that well-structured tax incentives foster innovation and attract investment within the automotive sector. Similarly, this study corroborates the notion that tax benefits not only stimulate technological advancements but also enhance the overall competitiveness of the industry. An earlier study conducted by Górecki and Letki (2021) highlighted the wider societal consequences of tax policy, specifically underscoring the significance of social advantages in advancing sustainable development. The results support this view, as the exemption of VAT on domestically manufactured components seems to have a beneficial impact on the social dimensions of the Kyrgyz automotive sector, such as the generation of employment opportunities and the enhancement of working conditions. Such a comprehensive tax policy strategy not only promotes industry expansion but also serves wider societal goals.

When analysing the influence of tax rates on the automobile industry, Trencher (2020) found a significant association between tax policies and the patterns of car manufacturing and sales. This paper expands upon the initial research by illustrating the direct impact of the decrease in VAT on components on the production volumes in Kyrgyzstan. This is supported by the observed rise in car production subsequent to the legislative reforms. This discovery emphasises the crucial significance of tax policy in influencing the economic architecture of the car industry. Furthermore, Fedeli and Giuriato (2023) conducted a comprehensive analysis of tax policies designed to encourage component supply, emphasising their efficacy in improving manufacturing efficiency. The present analysis supports their findings by demonstrating that the exemption of VAT has decreased manufacturing expenses, thereby enhancing the financial viability of automotive operations in Kyrgyzstan. The aforementioned result highlights the significance of implementing focused tax policies to promote a competitive and robust automobile sector.

The importance of environmental factors in the formulation of tax policies has been highlighted by Böckin and Tillman (2019), who emphasised the necessity of implementing tax systems that are environmentally appropriate. The results indicate that the tax incentives granted in Kyrgyzstan not only facilitate the expansion of the industrial sector but also promote the use of environmentally friendly technologies, so making a positive contribution to the sustainability of the automobile industry. These studies emphasise the key impact of tax mechanisms on the automotive industry. Tax incentives are an effective incentive for innovation, increasing the competitiveness of enterprises. Changes in tax legislation, such as VAT exemptions for component supplies, have a significant impact on the efficiency of domestic production. The role of tax solutions becomes important in the context of environmental responsibility and support for innovation in small enterprises. The competent use of tax mechanisms contributes to the financial sustainability, social development and overall competitiveness of the automotive industry, highlighting their central importance in the development of the sector.

## Conclusions

The present study offers a thorough examination of the influence of tax legislation on the operational effectiveness and long-term viability of the automobile sector in the Kyrgyz Republic. The primary results suggest that the recent exemption of VAT on components and spare parts manufactured within the country has greatly boosted local production, mitigated financial obstacles, and enhanced the competitiveness of domestic automotive firms. Furthermore, these tax incentives have played a role in fostering innovation and technological advancement in the sector, in line with worldwide movements towards sustainability and environmental accountability.

The implications of these findings go beyond the obvious advantages to the automotive industry. The implementation of tax measures has the capacity to attract additional investment, stimulate economic growth, and enhance the social conditions linked to the industry, including job creation and improved working conditions, by lowering production costs and promoting a favourable environment for local manufacturers. The aforementioned results indicate that tax policy has the potential to exert significant influence on both the economic and social and environmental aspects of the automobile sector in Kyrgyzstan.

Utilising these results, a number of suggestions for future investigation are put forward. First, additional research should investigate the enduring effects of tax incentives on the long-term viability of the automotive sector, notably with regard to environmental goals. Furthermore, studies should explore the possibility of extending comparable tax policies to other sectors of the economy in order to evaluate their wider relevance and efficacy. Ultimately, it is imperative to conduct thorough examination of consumer behaviour and market dynamics in reaction to these tax modifications. This analysis has the potential to offer significant insights for policymakers and industry participants. These recommendations emphasise the need of ongoing research and policy formulation to enhance tax policies that promote industrial innovation, competitiveness, and sustainability in the Kyrgyz Republic.

### Credit Authorship Contribution Statement

**Kanash Abilpeissov:** Conceptualization, Investigation, Project administration, Methodology, Formal analysis, Software, Writing – original draft, Supervision, Data curation, Validation, Writing – review and editing, Visualization.

### Declaration of Competing Interest

The author declares that he has no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

### Declaration of Use of Generative AI and AI-assisted Technologies

The author declares that he has not used generative AI and AI-assisted technologies during the preparation of this work.

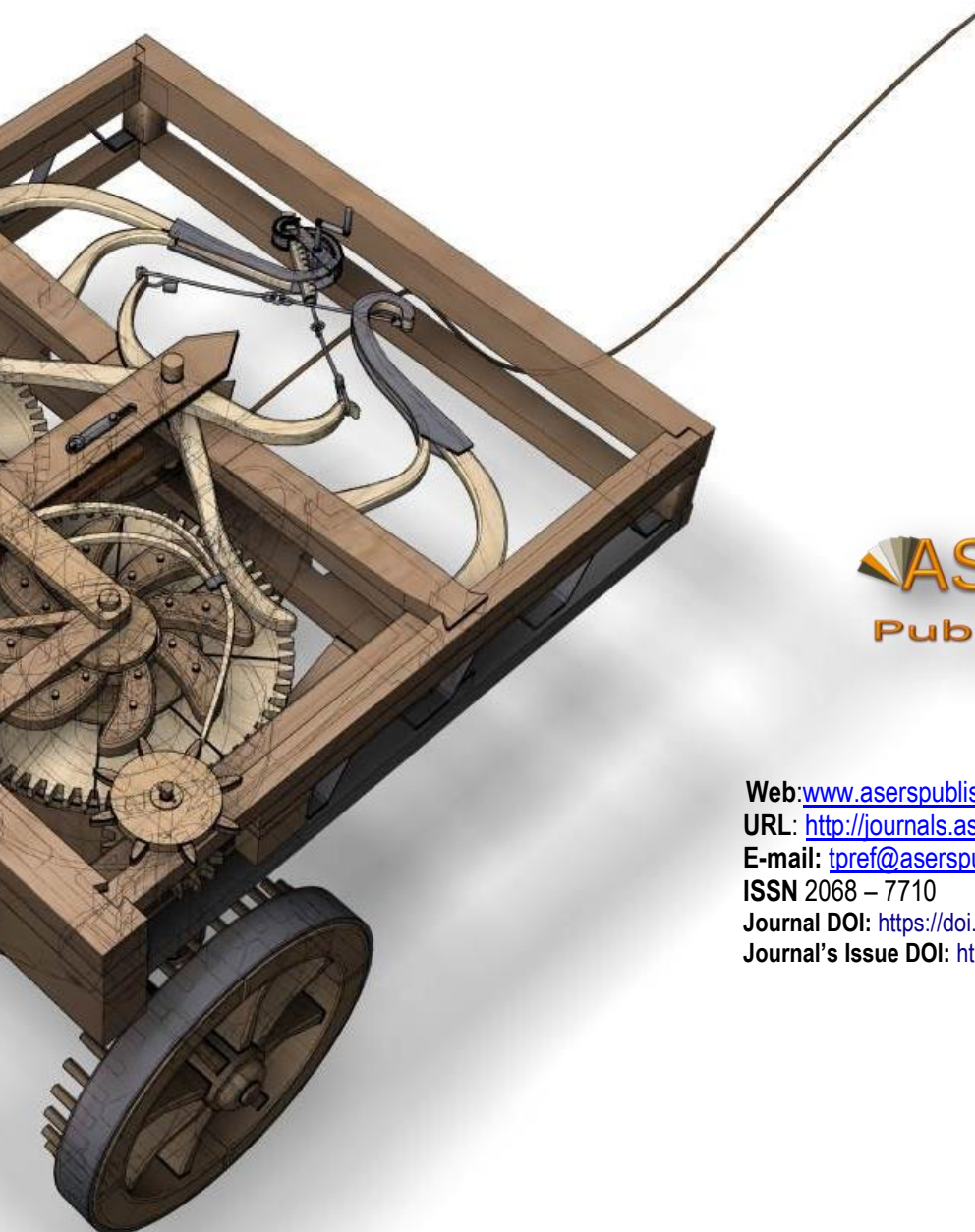
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