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Kyrgyz Republic: An Update on Country Developments

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1. This brief note provides an overview of the latest political and economic developments in Kyrgyz Republic. It supplements an assessment given in the Kyrgyz Republic: Country Strategy and Program Update (2006-2008) issued on 9 November 2005 (Sec. M101-05).

2. In March 2005, the regime of President Akaev fell in the wake of public upheaval after alleged fraudulent practices during the parliamentary elections. Two main opposition leaders Mr. Kurmanbek Bakiev and Mr. Felix Kulov became the country's President and the Prime Minister, respectively. The new Government formed in late September 2005, declared poverty reduction and fight against corruption as its main policy objectives. The constitutional reform¹, actively discussed after the March events and aimed at creating power balance between the Government branches (the President, executive bodies, legislatures, and judiciary), is now deferred, as claimed by the authorities not to create another source of political instability in the country.

3. The Government realizes it is important to break away from the 'business and politics as usual' approach. Several measures are underway to improve governance and fight corruption, including bringing about civil service reforms, removing administrative bottlenecks in the legal system, and improving fiscal management.

4. Realizing that the current momentum presents a unique opportunity to critically review the experience of the 15-year transition period and to develop a sound and feasible economic strategy and policies, the new Government launched preparation of National Poverty Reduction Strategy (NPRS) for 2006-2010. Key initial steps include: (i) performance review of the previous NPRS; (ii) extensive consultation on the 'ownership' of and the stakeholder participation in the NPRS process; (iii) deliberation on the role and functions of the Ministry of Economy and Finance in NPRS preparation and implementation; and (iv) issuance of the President's decree on establishment of the National Council for NPRS preparation under the chairmanship of the President. Other steps include taking stock of existing documents, assessments, fiscal activities, and capacity building initiatives, and preparing a draft outline of the new NPRS document. The Government and key donors including the ADB and the World Bank established a joint working group to guide and monitor the NPRS preparation and implementation.²

5. On the fiscal side, the situation remained healthy during the first half of 2005 and the Government was able to meet all IMF benchmarks. The Government is considering the possibility to receive Heavily Indebted Poor Countries (HIPC) debt relief. Despite receiving relief on concessional terms from the Paris Club creditors in March 2005, the debt parameters will remain above the HIPC threshold level until 2006 and the debt situation remains vulnerable to external shocks. The IMF's debt sustainability strategy for the Kyrgyz Republic emphasizes the need for fiscal control to reduce debt burden.³ The Government is continuing a program for

¹ In April 2005, Assembly on Constitutional Reforms, including representatives of Government, Parliament and Civil Society, was set up to recommend amendments to the current Constitution.

² The ADB and the World Bank are also providing technical assistance on several aspects of NPRS preparation. ADB approved on 29 November 2005 a TA for \$400,000. The World Bank approved a \$500,000 grant from its trust fund.

³ The debt situation is improving due to the restraint shown by the Government, strict adherence to the debt reduction strategy, and a favorable debt stock adjustment provided by the Paris Club creditors in March 2005. Considering these favorable developments, donors requested IMF that (i) a four-year moving average be used for PRGF ceiling disbursements to mitigate the potential risk of further project implementation delays caused by strict imposition of annual Public Investment Program (PIP) ceilings, and (ii) a modest increase in the lending levels from 2007 onwards be considered to enable the government protect the level of public investment.

implementing structural reforms in important sectors, including banking and financial sector. On several occasions, the Government stated its dedication to the announced policy of poverty reduction and fight against corruption, and the commitment to overcome the difficulties during the period.

6. The risks of political instability and the related adverse impact on the economy are high. This is despite the aforementioned actions on policy and governance reforms and the seemingly stable economic situation. During 2005, the Government was faced with several crisis situations, which included redistribution of property in a chaotic and at times violent manner as various interest groups including criminal, scrambled for the country's assets. There are other major incidences occurring in 2005 which also suggest similar political risks. They include: (i) disputes over ownership of large markets in the southern city of Osh that reportedly led to the death of two Members of Parliament (MPs); (ii) workers' uprising and taking over of the largest Karakeche coal mine in Naryn province; (iii) taking over the land by squatters in the capital city of Bishkek; (iv) inability to control the security situation by law enforcement agencies, and prison uprising which resulted in the murder of the third MP during the year; and (v) disputes over the ownership of the largest mobile phone operator and an independent TV channel which could further deteriorate the investors' confidence.

7. Faced with the deteriorating law-and-order situation, the general public seem to be most concerned with the way the Government handles various incidences and addresses underlying issues. In particular, they have expressed concerns over the following: (i) the process of redistribution of property mentioned above; (ii) the allegedly growing influence of criminal groups, and the perceived power vacuum; (iii) the remaining (and according to some views, increasing) corruption levels and governance issues in the public management structures; and (iv) the ousting of the former political allies by President Bakiev and the alleged differences between the offices of the President and the Prime Minister.⁴ As such, the Government's ability and capacity to deliver on promised policy changes are put to test. It is widely shared that the political stability and sustainability of the current Government will depend on urgent and visible improvement of economic and social conditions to meet expectations of the people.

8. The international community have also raised concerns over the law-and-order situation and overall political stability. At the same time, they share the view of continuing support for the Government in its efforts for strengthening democracy and economic development. The group of five multilateral and bilateral agencies including ADB, World Bank, DFID, SDC/SECO and UNDP are working together to develop the first joint results-based country support strategy and program. This joint work is being carried out in parallel to the Government's preparation of the new NPRS.

9. Thus, the risks of political instability remain due to slow progress on the constitutional reform and in terms of economic conditions and public governance. The coming anniversary of the March 2005 revolution is seen by many as a test for confidence and trust in the new regime, with a possibility of the political situation deteriorating in the spring of 2006. KYRM will monitor the situation, in collaboration with UN and the partner donor organizations.

⁴ The differences between the Parliament, the President, and the Prime Minister are evidenced by the late January 2006 TV address by the Prime Minister Kulov, the 3 February 2006 speech by President Bakiev in the Parliament, and the 7 February 2006 open letter by Prime Minister Kulov to the President.