



Kyrgyz Republic

From a position as a constituent entity within a continent-wide economy, the breakup of the Soviet Union brought to the Kyrgyz Republic the immediate need to function as an independent state. Faced with severe economic difficulties, the Government chose to restructure the economy on the basis of market institutions. These difficulties included the breakup of the interrepublican payment mechanisms; the loss of traditional markets in the FSU; the cessation of large transfers from the Central Government; a deterioration in the terms of trade; and hyperinflation which discouraged saving and investment. The period since independence has been characterized by immense social costs and a massive decline in GDP. However, substantial progress has been made by the Government in macroeconomic stabilization and structural reform and the creation of a market economy.

Recent Trends and Prospects

The economic disruption encountered by all FSU republics has been particularly severe for the Kyrgyz Republic. Real GDP fell by nearly 50 percent from 1991 to 1994. Further contraction of 6.2 percent occurred in 1995, more in industry than in agriculture. The decline in agricultural output in 1995 was restricted to 2.0 percent, much less than its 1994 level of 17 percent. There appeared to be some stabilization in the output of some important products such as milk and meat along with a shift toward industrial crops such as sugar beets, cotton, and oil seed, and to vegetables and

cereals at the expense of wheat production. The latter is a generally positive development. Increased cultivation of wheat had come in the past few years as a result of government policies directed toward encouraging food security, irrespective of the underlying comparative advantage for the nation's farms. With the slow reestablishment of interrepublican trade and the spread of market-based incentives, farmers are moving toward a more efficient use of their resources. At the same time, the Government is withdrawing from administrative interference in the sector, most noticeably by the continued dismantling of the state order system.

Industrial output declined by 12.5 percent in 1995 as the Government continued to restrict credit to nonviable firms and to encourage industrial restructuring. Only about one fifth of all enterprises managed to increase production in 1995. The most severe impacts occurred in the heavy industry subsectors that had developed under the system of central planning as integral parts of the economy of the Soviet Union. With the collapse of that economy, the demand for the products of Kyrgyz heavy industry fell, both because of the decline in investment throughout the FSU and because of the collapse of the Soviet defense industry. In 1995, the output of the Kyrgyz machinery industry was less than one sixth of its 1990 level. The construction sector also suffered large declines in output, with the production of major building materials falling to between 25 percent and 50 percent of the already depressed 1994 levels.

The economic depression has had a profound impact on the country's labor markets.

The rigid Soviet economy was not only characterized by a lack of occupational choice, but also by security of job tenure. In 1991, nearly 80 percent of the working age population were employed and less than 200 people were officially registered as unemployed. By the end of 1995, registered unemployment was 100,000 or 6 percent of the economically active population.

As the unemployment and GDP figures suggest, the social and economic costs of the transition period have been immense. Average incomes have fallen between one third to one half. A comprehensive survey on poverty in late 1993 suggested that 40 percent of all households were living below the poverty line. In 1995, the Government began to address the problem of increased poverty through better targeting of social assistance payments.

Data on investment and saving are sparse and unreliable; however, for 1993, gross domestic investment was estimated at 30 percent of GDP and gross domestic saving at 22 percent, leaving a gap of 8 percent of GDP to be met from foreign saving.

Problems in the Government's macro-economic stabilization program are evident in the public sector (Figure 2.8). Most importantly, tax efforts lag behind program targets, resulting in a curtailment of needed public spending. As a result of the weak tax effort, total revenue, including grants, in 1995 was approximately 10 percent of GDP, nearly 15 percentage points below the budget target. Despite the lack of revenue, public spending grew to almost 22 percent of GDP in 1995, from 17 percent in 1994. Moreover, the overall budget deficit, including grants, rose to 11.4 percent of GDP in 1995, by over 3 percentage points from 1994. The Government is attempting to increase domestic revenue mobilization; however, given the current weak economy, there is unlikely to be any major increase in tax efforts in the next year.

The current level of public spending is too low to support economic development. As a result of the fiscal crisis, public sector infrastructure investment has been virtually nonexistent. Infrastructure facilities and equipment are going on without minimal operations and maintenance expenditures. Social spending, including social insurance, social assistance, and the provision of social services such as health and education, has also declined sharply in real terms.

There has been striking success in moderating inflation. Hyperinflation had characterized all the FSU economies in the ruble zone after the breakup of the Soviet Union. In the Kyrgyz Republic, in 1992 and 1993, inflation averaged about 1,000 percent. With the establishment of the national currency, the som, in mid-1993, the development of monetary control tools by the Central Bank, and substantial completion of price liberalization for most goods and services, inflation began to moderate. By the end of 1994, inflation had declined to under 100 percent and was estimated to be less than 50 percent in 1995.

Independence and the breakdown in the interrepublican payment mechanisms resulted in a virtual collapse in trade with other FSU economies. Improvements since 1992 have been reflected in rising levels of trade and in some diversification toward non-FSU markets. However, FSU markets still account for more than two thirds of Kyrgyz exports and imports. The Republic, located in the extreme corner of Central Asia, faces severe difficulties in developing new markets, especially in the industrial world. On balance, the Kyrgyz economy has been running a trade deficit, averaging close to \$100 million in 1994 and 1995, about 10 percent of GDP.

The current account deficit has been slightly smaller than the trade deficit, as private transfers out were offset by inflows of official transfers. The private outflows result from the substantial emigration of people from the Republic. Offsetting this, official transfers or grants-in-aid have provided considerable balance-of-payments support to the economy, averaging more than \$70 million in 1994 and 1995. The net current account deficit was financed substantially by medium- and long-term loans from multilateral financial institutions and bilateral assistance programs.

The country's foreign debt at the end of 1995 was \$535 million. A substantial portion of this resulted from the assumption of inter-enterprise arrears with other FSU states. The debt assumed was structured on commercial terms and scheduled for repayment between 1995 and 1999. The repayment of these obligations raised the debt-service ratio to nearly 25 percent during 1995, up from 5 percent in 1994. The sharp growth of debt service is worrisome. Under advice from the IMF, the Government is restricting its new borrowing largely to concessional funds;

the debt-service ratio should shrink as the commercial debt is repaid.

The Kyrgyz Republic has registered a continuous decline in GDP since independence. The formal sector of the economy is unlikely to show positive growth before 1997. Growth in the informal sector, however, could offset much of this continued decline. The Government estimates that the informal economy was 30 percent of GDP in 1994 and that it has been growing rapidly since 1990. If growth in the informal sector continues and the decline in the formal sector continues to moderate, then the economy as a whole could show positive growth by the end of 1996.

In 1996 and 1997, the Government is expected to work toward a reduction in the public sector budget deficit. Program targets call for a reduction from over 10 percent of GDP in 1995 to between 6 percent and 7 percent in 1996. This cannot be done without achieving at least modest increases in

revenue as expenditures cannot easily be further reduced. Revenue then would have to increase to about 20 percent of GDP. This will not be an easy task.

The projection, even of a slow recovery, is highly sensitive to developments in the other Central Asian Republics and in the Russian Federation. Similarly, any slackening of growth in China would result in a fall-off of demand for raw material inputs and have repercussions for the Kyrgyz Republic. Even with the projected slow recovery, the current account balance will likely require \$200 million in annual financing, the bulk of which will have to come from medium- and long-term lending by multilateral development institutions or from bilateral assistance programs.

Policy and Development Issues

The Government has continued its broad program involving structural reforms of the economy as well as its efforts toward macroeconomic stabilization. In 1995, considerable efforts were made to help create basic market institutions as well as to ensure that these markets develop in a workably competitive fashion. In agriculture, the state order system was restructured to eliminate the compulsory delivery and pricing aspects; future state orders will be conducted through market institutions. In international trade, measures were taken to support the development of international payment mechanisms. These included making the som a fully convertible currency in March 1995; phasing out most intergovernmental trade agreements, except for some energy trade; and eliminating most restrictions on international trade, such as export quotas.

The Government has made notable progress in enabling market institutions to allocate resources. There has, for example, been extensive privatization of state enterprises and nearly all price controls have been lifted. However, the unfinished areas of reform are still considerable. Among the more important areas requiring concerted government efforts are the completion of land reform and the distribution of land and farm assets; enterprise reform, including the full restructuring and privatization or the liquidation of the remaining large state enterprises; and a reduction in government direction of production and employment in semiprivatized enterprises.

