



Kyrgyz Republic

Following severe economic dislocation, growth in the Kyrgyz Republic has recovered, supported by growth in both the agriculture and industrial sectors. However, the transition to market institutions required for long-term growth still has a long way to go.

RECENT TRENDS AND PROSPECTS

The breakup of the former Soviet Union brought political freedom to the Kyrgyz Republic, but also dislocated the production, trade, and financial networks on which its centrally planned economy rested. As a result, GDP declined by about 50 percent from 1990 through 1995, external trade was disrupted, inflation accelerated, and fiscal deficits increased sharply. In response to these difficulties, the government adopted a comprehensive program of macroeconomic stabilization and structural reforms. It is now committed to developing an economy that is based much more on market institutions and much less on state direction.

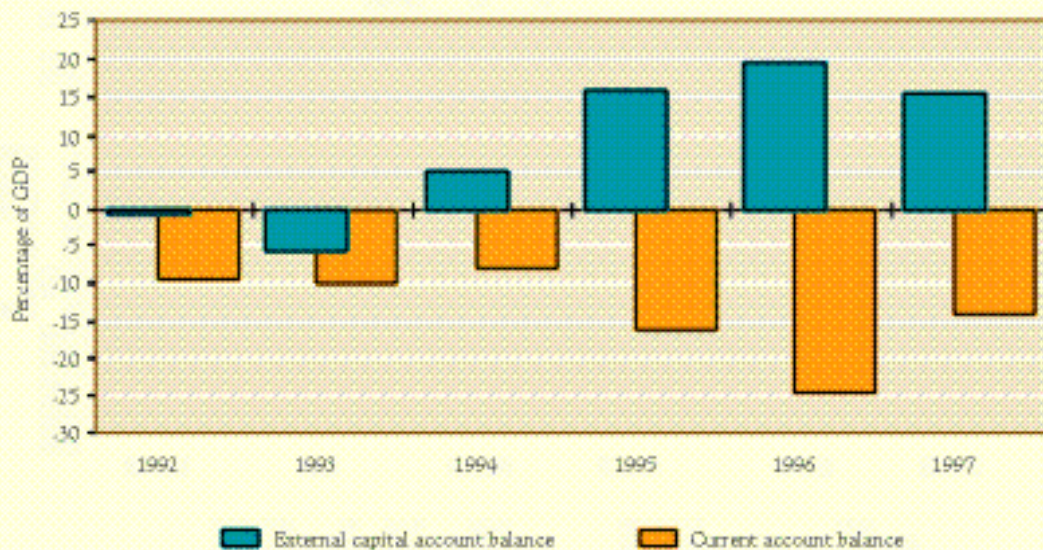
After six difficult years, some signs of economic recovery are now apparent. Real GDP has grown for two consecutive years: by 5.6 percent in 1996, and by an impressive 10.4 percent in 1997. Solid growth in the agriculture sector has helped this turnaround in economic performance. Agriculture is the largest sector in the Kyrgyz economy, accounting for around 50 percent of GDP. In the past two years, agricultural output has grown by an average of 10 percent, assisted not only by favorable weather conditions, but also by economic reforms. These reforms have allowed private sector farmers to respond to market incentives more easily, and despite a continuing lack of essential farm inputs, the output of key crops has increased in response to growing urban demands.

The spurt in GDP growth in 1997 was largely due to a leap in industrial production, which expanded by a massive 46.8 percent. Much of this is attributed to the commencement of production from the newly completed Kumtor gold mine. Stronger industrial growth has also been assisted by a recovery in food processing activity. Input supplies to food processing have expanded with the growth in agricultural production. Demand for industrial output has also increased as the economies of former Soviet Union partners have begun to stabilize.

Compared with agricultural and industrial production, activity in services seems to have been somewhat sluggish. Official statistics estimate the output growth in services to be about 1 percent in 1996. However, measuring the output of services is somewhat difficult, and some market activity probably goes unrecorded. In particular, the number of private businesses engaged in the urban retail trade and in other services has expanded rapidly in recent years, but is underreported in official statistics.

Despite recent output growth, the employment situation shows few signs of improvement. The overall unemployment rate at the beginning of 1997 is estimated to have been about 22 percent. Difficult labor market conditions, exacerbated by the deteriorating quality and delivery of social services and the erosion of the social safety net, have increased the incidence of poverty. The proportion of households below the official poverty line rose from 40 percent in 1993 to 49 percent in 1996. Those in

Figure 2.3 External Capital and Current Account Balances:
Kyrgyz Republic, 1992-1997



Sources: Asian Development Bank (1997e) and staff estimates.

rural areas, pensioners, young people, and those in large families have been affected particularly badly.

Economic expansion has eased fiscal pressures, and fiscal consolidation is proceeding slowly, but steadily. Budgetary and civil service reforms have contributed to reduced government spending. The authorities have also taken measures to strengthen tax administration and increase tax revenues. As a consequence, in 1997 the budget deficit fell to 4.5 percent of GDP, down from 5.6 percent in 1996.

Inflation has improved markedly, declining to 25.5 percent in 1997 from nearly 300 percent in 1994. The successful containment of monetary growth helped to subdue domestic inflationary pressures, as did greater nominal exchange rate stability in 1997, which followed a sharp depreciation in 1996.

External balances remain fragile, although some improvement is detectable. The importation of capital goods needed to develop the Kumtor mine has, to some extent, exacerbated current account deficits, but structural weaknesses are also apparent. In 1997, despite a slowdown in capital goods imports, the current account deficit was still around 11 percent of GDP. To finance its current account deficits, the Kyrgyz Republic continues to rely largely on official transfers. Notwithstanding the Kumtor

project, foreign direct investment remains small. One reason for this is that the country faces a competitive disadvantage compared with its neighbors, as it lacks Kazakhstan's large energy and mineral resources and Uzbekistan's larger markets.

Since 1990, output and incomes have fallen precipitously. While the recent growth is welcome, the country still has a long way to go to restore previous standards of living. The potential for growth in the medium term is good. Output from the Kumtor mine project should again bolster growth in 1998 and 1999, and reforms in the agriculture sector should improve productivity. Overall economic growth of around 7 percent per year is expected. Improvement on other fronts is also likely, namely, a steady reduction in the fiscal deficit through 1999; more disciplined monetary control resulting in reduced inflation rates; and a decrease in the current account deficit, partly as a result of revenues from the Kumtor mine.

POLICY DEVELOPMENT AND ISSUES

Agriculture is the most important sector of the Kyrgyz economy and is likely to remain as such for the foreseeable future. Productivity gains in agriculture will, above all, determine the economy's

medium-term development prospects. Accordingly, the authorities must make determined efforts to address the pronounced policy and institutional inefficiencies that still exist in the structure of agricultural production and organization. While they have made some progress, a long agenda of unfinished reforms remains to be dealt with. In the medium term, agricultural policy and institutional reforms should focus on developing the legal framework for private farms and privatizing the remaining state and collective farms. Promoting the efficiency of the supply of inputs will also be necessary to alleviate input shortages. Other measures that would help agriculture include improving efficiency in the use of irrigation water and providing agricultural credit on a commercial basis.

The state has retained either full or partial ownership of the key medium and large industrial enterprises. These firms are, by and large, moribund. Inefficient enterprises survive only through subsidized loans and income transfers from the govern-

ment. The ability of these firms to compete in international markets is limited, and they show little institutional or technological dynamism. Enterprise reform is thus essential, both to stabilize macroeconomic balances and, more generally, to promote a healthy market economy. Where enterprises can be maintained as going concerns, they should be sold off in such a way that the state receives a fair price for its assets. Where enterprises are effectively insolvent and are beyond resuscitation, they should be closed with the recovery of whatever salvage value remains. To win the political and social consensus for these bold measures, some kind of social safety net is likely to be needed. However, safety net provisions must be well targeted; kept within the government's fiscal means; and, to the extent possible, support the development of human capabilities. Failure to take tough decisions on state enterprise reform will not only deprive the truly needy of resources, but will jeopardize everyone's future living standards.