

ASIAN DEVELOPMENT BANK

STS:KGZ 96029

KYRGYZ REPUBLIC

COUNTRY OPERATIONAL STRATEGY

**Programs Department (East)
Division III**

December 1996

CURRENCY EQUIVALENTS

(as of 15 July 1996)

| | | |
|---------------|---|----------|
| Currency Unit | - | Som |
| Som 1.00 | = | \$0.082 |
| \$1.00 | = | Som 12.2 |

The exchange rate for the Som is determined at regular auctions for foreign exchange conducted by the Central Bank.

ABBREVIATIONS

| | | |
|------------|---|---|
| EBRD | - | European Bank for Reconstruction and Development |
| ERRA | - | Enterprise Reform and Resolution Agency |
| ESAF | - | Enhanced Structural Adjustment Facility |
| EU | - | European Union |
| FSU | - | Former Soviet Union |
| GDP | - | Gross Domestic Product |
| GNP | - | Gross National Product |
| HDI | - | Human Development Index |
| IFAD | - | International Fund for Agricultural Development |
| IMF | - | International Monetary Fund |
| KHCAA | - | Kyrgyz Housing and Country Affairs Agency |
| KLSS | - | Kyrgyz Living Standard Survey |
| KNEHC | - | Kyrgyz National Energy Holding Company |
| MLSP | - | Ministry of Labor and Social Protection |
| NatStatCom | - | National Statistical Committee |
| NBK | - | National Bank of Kyrgyzstan |
| NGO | - | Non-Governmental Organization |
| OECF | - | Overseas Economic Cooperation Fund |
| PIP | - | Public Investment Program |
| PRC | - | People's Republic of China |
| SDP | - | Sector Development Program |
| TA | - | Technical Assistance |
| TACIS | - | Technical Assistance for Commonwealth of Independent States |
| UNDP | - | United Nations Development Program |
| UNFPA | - | United Nations Fund for Population Activities |
| UNICEF | - | United Nations International Children's Emergency Fund |
| USAID | - | United States Agency for International Development |
| VAT | - | Value-Added Tax |
| WHO | - | World Health Organization |
| WID | - | Women in Development |

NOTES

- (i) The fiscal year (FY) of the Government ends on 31 December.
- (ii) In this Report, "\$" refers to US dollars.

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COUNTRY PERFORMANCE INDICATORS

EXECUTIVE SUMMARY

The Kyrgyz Republic has experienced a severe depression since independence in 1991. From 1991 to 1995, gross domestic product (GDP) declined by more than one-half. The economic crisis, common to most of the Republics of the former Soviet Union (FSU) was the result of the breakdown in payments mechanisms and marketing arrangements, the loss of transfers from the central government of the FSU, and the hyperinflation in 1992 and 1993, that discouraged savings and investment. With the breakup of the FSU, lifetime employment for virtually all labor force participants in the Kyrgyz Republic has been replaced by widespread insecurity. Approximately 15 percent of the labor force was not fully employed at the end of 1995. The concurrent fiscal crisis has severely restricted the Government's ability to alleviate transition problems. Spending on social insurance, social assistance, and social services such as health and education has declined sharply in real terms. The deterioration in public support mechanisms comes at a time of great need and has had particularly severe impacts on the most vulnerable strata of the population, including children, the elderly, and families headed by women. The incidence of poverty has increased. In 1995, 55 percent of all households were living below the poverty line. Three appendices detail the impact of the transition: Appendix 1 discusses the social costs, including a poverty review; and appendixes 2 and 3 discuss the specific problems of women and children respectively.

The Government's strategy, in the face of these economic difficulties, has been to adopt policies for macroeconomic stabilization and to implement comprehensive structural reforms to develop a market-based economic system. In terms of macroeconomic stabilization, considerable success had been achieved by 1994 in moderating the debilitating inflation, but difficult problems remain in mobilizing domestic resources. In support of structural reform, the Government has moved in several broad directions to: (i) create the basic institutions necessary for free markets; (ii) ensure that competitive forces are encouraged to develop; (iii) develop safeguards against market failure and provide social protection in a fiscally sustainable manner; and (iv) protect the environmental resource base.

The main objectives of the Bank's assistance strategy for the Kyrgyz Republic are based on the developmental needs of the country:

- (i) Support the Government's reform activities and strengthen its development management through;
 - (a) encouraging institutional change,
 - (b) strengthening institutional capacity, and
 - (c) improving the provision of public services.
- (ii) Encourage the creation of a new structure for output and capacity by the private sector through investment and job creation.
- (iii) Arrest the rapidly deteriorating long-term potential of the country by investing in physical infrastructure and human resource development, but also by selective interventions to protect and rehabilitate the environment.

The implementation of the strategy through the country assistance program must be carefully designed to maximize the impact of the Bank's limited resources and to support the extensive assistance programs of other funding agencies. In view of these considerations and in

consultation with the Government, it is recommended that the Bank's activities concentrate on a small number of strategic areas including:

- (i) improvements in the provision of public services, particularly the provision of social services by local governments and development management;
- (ii) agriculture, including rural finance;
- (iii) human resource development, especially education; and
- (iv) infrastructure, especially rehabilitation projects to preserve the economic utility of the past investment in the energy and the roads sectors.

Cutting across these activities, the specific strategic concerns that need to be incorporated into project design are:

- (i) a geographical concentration in the economic zone along the Bishkek-Osh highway; and
- (ii) support for regional cooperation.

v

MAP

I. ECONOMIC PERFORMANCE

A. Output

1. The economy of the Kyrgyz Republic contracted continuously from 1990 through 1995. On a cumulative basis GDP declined by nearly 50 percent, accompanied by a sharp decline in per capita GDP.¹ The economic crisis, common to all the Republics of the FSU, resulted from (i) the breakdown in the payments mechanisms for cross-border transactions; (ii) the loss of traditional markets which caused a widespread decline in aggregate demand; (iii) the loss of transfers from the central government of the FSU, which had amounted to approximately 10 percent of GDP; (iv) a sharp deterioration in the Kyrgyz terms of trade, particularly because of higher prices for energy and natural resource imports; and (v) hyperinflation in excess of 1,000 percent annually in 1992 and 1993, which discouraged savings and investment.

2. The Government has achieved significant success in macroeconomic stabilization, especially in combating inflation. This success has set the stage for recovery and, in mid-1996, it seemed that the long contraction in output would end. Aggregate GDP in 1995 declined at the relatively mild rate of 6.1 percent and in 1996 could show a small net increase if current trends continue. The Kyrgyz Republic appears to be following a pattern similar to that found in Eastern Europe where positive growth appeared within one to two years after macroeconomic stabilization dampened inflation and tightened credit.

3. All the major sectors (agriculture, industry, and services) have suffered during the long depression. Industry, which accounted for 34 percent of GDP in 1990, has experienced the sharpest decline in output. On an aggregate basis, industrial production fell by 9.9 percent in 1995 after falling an average of 28.7 percent in each of the preceding three years. The most severe impacts are in the heavy industrial subsectors. These subsectors were developed under the system of central planning as integral parts of the economy of the Soviet Union. With the collapse of the Soviet economy, the demand for the products of Kyrgyz heavy industry fell because of the decline in investment throughout the FSU and the collapse of the Soviet defense industry. At the end of 1995, reflecting the first tangible results of the Government's reform programs and some pickup in external markets, there was evidence that production stabilized across a wide variety of industrial subsectors.

4. Agriculture also saw a net decline in output after independence. However, as a result of the differential decline in production relative to industry, agriculture has come to play a greater role in the economy and has increased its share of GDP from 33 percent in 1990 to nearly 47 percent in 1995. As with industry, the decline in agriculture production has been uneven across the subsectors and over time. Among crops, grain output held up comparatively well through 1993, but fell by 37 percent in 1994. The early stability in output partly reflected the Government efforts, immediately following the shock of the dissolution of the Soviet Union, to emphasize food security and to increase grain production either directly for food or indirectly for fodder. Livestock production is important both economically and culturally. Historically, raising livestock has been a focal point of the social organization in the country. Since independence, livestock production has fallen, with a sharp decline in the size of the herds. Between 1990 and

¹ A detailed discussion of the economy can be found in the *Economic Report on the Kyrgyz Republic*, 21 November 1994 (ECR KGZ 94022) and in the *Economic Report and Bank Operations, Kyrgyz Republic*, October 1995 (EBO KGZ 95013).

1995, the total number of animals in the country fell by 70 percent.¹ The decline reflects many factors: (i) feed and inputs for animal husbandry have become relatively expensive and supply uncertain; (ii) credit has become difficult to obtain; (iii) overgrazing has severely damaged rangelands and raised the cost of fodder; and (iv) the effective demand for meat and meat products has been weak because of the falling incomes.

5. In 1995, some improvement can be observed in agriculture. Crop production as a whole increased by 8.8 percent above the 1994 level with strong increases in the production of vegetables, potatoes, and cotton. The increase is partly in response to the reforms that have allowed farmers the freedom to change their crop mix in response to emerging urban markets.

6. The GDP and other production estimates in this Report are based on data collected by the National Statistical Committee. As is the case in most of the republics of the FSU, the data on GDP are a problem. Output data are unreliable because the reporting system covering enterprises has weakened with the breakdown in the former centralized planning system. There is little coverage of the newly emerging private sector, especially services, and there are incentives for the older firms to underreport production. In some cases, privatization exercises have removed assets and production activities from the coverage of the Government's statistical collection mechanisms.

B. External Sector

7. As noted earlier, one reason for the onset of the long economic depression was the disruption to the external sector after the dissolution of the Soviet Union. An early breakdown in the payments mechanism and considerable and inconsistent interference by the Government in all of the Republics of the FSU resulted in a near collapse in regional trade. Furthermore, the trade that continued was not necessarily sustainable. Enterprises in the newly independent countries maintained operations on the basis of the marketing structures established under central planning despite the changes in final demand patterns. This contributed to the development of sizable interrepublic debt supported only by unsold inventories of goods. The general improvement in the macroeconomic environment in the region in the last few years has contributed to a reduction in this debt and has increased the level of interrepublic trade. Moreover, there has been some modest diversification of the Kyrgyz external trade towards non-FSU markets. On balance, however, the Kyrgyz economy has been running a trade deficit, averaging about \$100 million between 1993 and 1995 (representing 8.9 percent of GDP in 1995).² Offsetting the trade deficit, official transfers or grants-in-aid, have provided balance-of-payments support for the economy, averaging about \$70 million in 1994 and 1995.

8. The country's experience in attracting direct foreign investment and entrepreneurship has so far been discouraging—until mid-1994, net inflows of foreign direct investment were less than \$12 million. Some increase in late 1994 and in 1995 was noticed, primarily connected with the investment in the Kumtor gold mining operation in the southeastern part of the country. This project is likely to require a total investment of approximately \$450

¹ The latest Census of Livestock, however, indicated that earlier data on the herd size may have seriously overestimated the number of animals in many regions of the country and that current estimates of the change in the herd size should be interpreted with caution.

² The discussion of developments in the external sector is complicated because of statistical problems. In particular, the lack of customs posts, inconsistent rules on customs procedures, and the large barter trade create unreliable data.

million, but before the end of the decade it is expected to be producing gold with a current market value in excess of \$100 million a year. The Government retains a majority ownership in the mine; however, development and management are vested in the foreign partners. There is only a small number of other potential mining projects that could result in foreign direct investment, and generate exports and Government revenue. Outside of mining, there has been some relatively small-scale investment in agroprocessing and small-scale service centers.

9. The foreign debt at the end of 1995 was \$535 million or approximately 35 percent of GDP. This debt is largely the result of official lending dominated by credits extended by the republics of the FSU, particularly the Russian Federation, to clear interrepublic and interenterprise arrears or accumulated trade debts. These loans were on a commercial basis and have resulted in a serious debt service burden, with the debt-service ratio (debt service as a fraction of the exports of goods and services) rising to nearly 25 percent during 1995, compared with 5 percent in 1994. The Government is concerned about the sharp growth of debt service. Based on advice from the International Monetary Fund (IMF), the Government is restricting its new borrowing largely to concessional funds. The World Bank and the IMF together have provided more than 55 percent of non-FSU assistance, on a disbursement basis.

10. Given the location of the Kyrgyz Republic, far from the markets of the industrialized world, regional trade will continue to be of primary importance. The three regional developing member countries of the Bank (Kazakstan, the Kyrgyz Republic, and Uzbekistan) have taken concrete steps to facilitate regional trade and cooperation. The initial agreements called for the creation of a customs union and for tariff harmonization within the broader framework of the Commonwealth of Independent States. The Kyrgyz Republic has also signed an agreement to join a customs union with Belarus, Kazakstan, and the Russian Federation. The consequences of this action are potentially serious. Under the agreement, the Kyrgyz Republic should harmonize its tariff structure, trade regulatory regime, and foreign exchange and currency systems with that of the Russian Federation. If this is actually accomplished, it would roll back many of the reform measures implemented recently.

C. Inflation and Monetary Developments

11. The Government is committed to maintaining low inflation as an integral part of its macroeconomic stabilization program.¹ As a result of concerted efforts by the authorities, inflation has moderated and the hyperinflation that characterized all the economies in the ruble zone after the dissolution of the Soviet Union has been broken. In 1992 and 1993, the Kyrgyz Republic inflation was in excess of 1,000 percent. With the establishment of the national currency, the som in mid-1993, the development of the tools of monetary control by the central bank, and the liberalization of prices for most goods and services, inflation began to moderate. By the end of 1995, inflation was a relatively moderate 32 percent.

12. The moderation in inflation has increased the willingness of the public to hold domestic currency. This is evident in the exchange rate. The som depreciated sharply immediately following its introduction in May 1993 from Som 4 = \$1 to Som 12.7 = \$1 by the end of May 1994. Subsequently the currency strengthened against the US dollar but by mid-1996 was trading at Som 12.5 = \$1. Currently the value of the som is set in auctions conducted by the

¹ The Government's stabilization program is currently supported by the IMF through an Enhanced Structural Adjustment Facility (ESAF), approved in July 1994. This program followed earlier support through a stand-by arrangement and the Systemic Transformation Facility.

National Bank of Kyrgyzstan (NBK). The som has generally appreciated relative to other currencies in the region.

13. To control the money supply, the NBK uses both credit and Treasury bill auctions. In both auctions, interest rates have declined consistently, if unevenly, since the beginning of 1994 as inflation abated. Real interest rates are quite difficult to analyze in the presence of the high and variable inflation that characterized the Kyrgyz economy through much of the period since independence. By the end of 1995, however, interest rates at the credit auctions and in the interbank market appeared, in real terms, to be positive and at levels that would not discourage long-term investment in the economy.

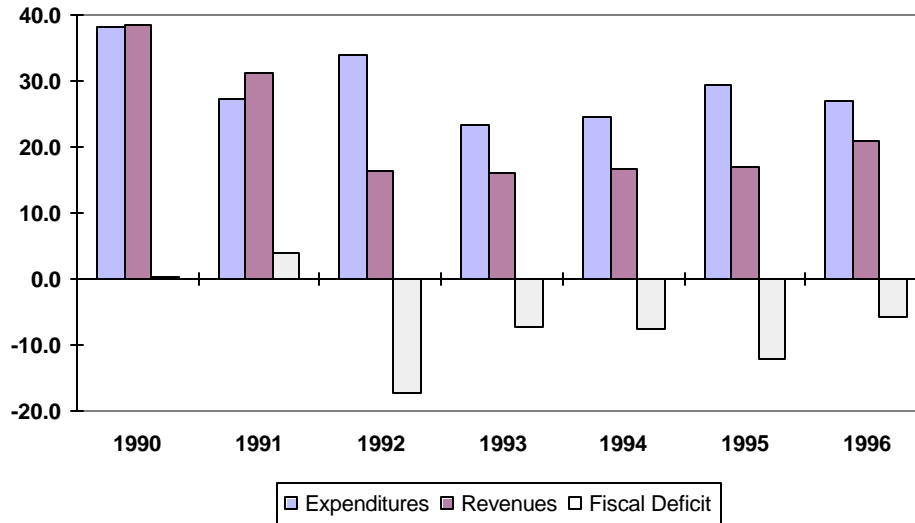
D. Public Sector Budget Developments

14. Prior to independence in 1991, the Government budget did not play a significant role in shaping the overall macroeconomic environment because the Government was able to rely on large transfers from the FSU to finance a substantial part of expenditures and to balance the overall budget. In the five years before independence, the transfers from the FSU averaged over 25 percent of total revenues. By 1991, the transfers had reached 35 percent of total revenues and were the largest single source of revenue, equivalent to over 11 percent of GDP. The other main source of revenue was the turnover tax, which accounted for almost 44 percent of tax revenues.

15. With independence, the Kyrgyz Republic experienced a severe fiscal shock from which it has not yet recovered. Transfers from the FSU were terminated and budgetary performance deteriorated sharply. The drop in economic activity, coupled with major problems in tax administration, sharply reduced revenues at precisely the time when the Government faced increased pressures to spend as a result of the need to assume defense-related costs, provide disaster relief, and increase social assistance. From a budgetary surplus in 1991, the budget plunged into a deficit equivalent to 17.4 percent of GDP in 1992 (see Figure 1).

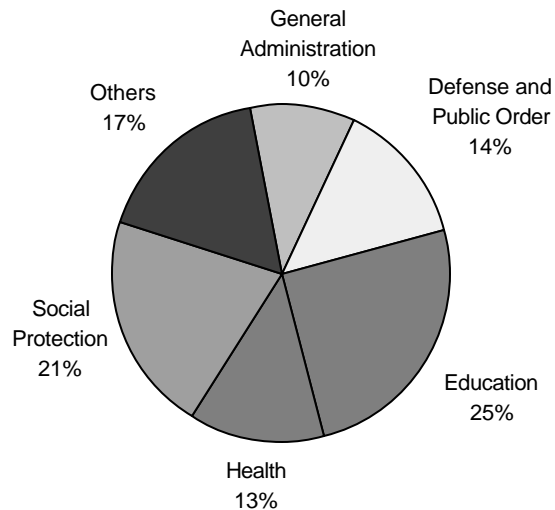
16. Despite these adverse circumstances since 1993, the Government has tackled its fiscal crisis by implementing measures to boost revenues, while restricting and restructuring expenditures. On the revenue side, these measures included the rationalization of the value-added tax (VAT), by reducing the tax rate, removing preferential rates, and broadening its base. Other important measures have been the imposition of new excise taxes on commodities such as petroleum, liquor, and cigarettes; strengthening customs administration; and a strengthening of the profits tax on enterprise. Efforts are also being made, with support from external aid agencies such as the International Monetary Fund (IMF) and the United States Agency for International Development (USAID), to improve tax administration. Tax revenues, which declined sharply in 1992 and 1993, because of the continued poor performance of most enterprises and weak tax administration, have recovered since then.

**Figure 1: Consolidated Government Budget
(percent of GDP)**



17. While there are some signs of progress, the fiscal situation remains extremely difficult. On the expenditure side, support for state enterprises has been severely curtailed, consumer subsidies nearly eliminated, wage increases in the public sector restricted, and the size of the civil service reduced. The Government has tried to minimize the impact of the fiscal crisis on social sector expenditure. During 1994 and 1995, social sector expenditure as a share of GDP increased. In the 1996 budget, social protection and social sector spending amounted to 58 percent of the total estimated expenditures (see Figure 2). However, given the contraction in GDP since 1991, a process that continued through 1995, the level of real resources committed by the Government for public spending is still less than the level before independence. Moreover, capital spending, which amounted to almost 6 percent of GDP in 1990, had declined to 2.6 percent by 1995. The lack of capital investment has resulted in the deterioration of the extensive infrastructure built up under the Soviet system.

18. The deficit widened in 1995 to 12.2 percent of GDP, despite the increase in tax revenues, as a result of a decline in nontax revenues and grants and an increase in expenditures. Thus, restoring the fiscal balance remains one of the keys to achieving macroeconomic stabilization and continues to be a key component of the Government's program supported by the Enhanced Structural Adjustment Facility (ESAF) of the IMF. For 1996, the budget deficit is targeted to fall to 6 percent. However, the Government has found it difficult to achieve its budget targets in recent years; indeed, the proposed budget deficit for 1996 is still above the original target for 1994. While there still remains some scope to rationalize expenditures further, most of the improvement in the fiscal balance will have to come from an increase in revenue collection and a further strengthening of tax administration.

Figure 2: 1996 Budget Expenditures

Consolidated Government Expenditures (excluding extrabudgetary funds) as Share of Total Expenditures.

19. In early 1996, a new tax code was passed by Parliament, which contained detailed provisions relating to major taxes, and also covered tax administration. The code is designed to provide the Kyrgyz Republic with a clear, consistent, and easily understandable tax system, with the aim of broadening the tax base and encouraging increased compliance. In particular, there is a need to try to bring activities in the informal sector within the tax net. The new tax code focuses on five main taxes: VAT, profits tax, income tax, excise taxes, and land tax. Since its introduction in 1991, the VAT has emerged as the Government's major source of revenue; in 1995, the VAT accounted for almost 27 percent of total revenues (30 percent of tax revenues).

E. Population and Labor Markets

20. The impact of the transition on population is clearly seen in declining birth rates, increasing death rates, and in emigration. The net result has been relative stability in the overall population. The population in 1995 at 4.5 million was little changed in total from the 1991 figure of 4.4 million. The net population growth rate between 1993 and 1995 was less than 0.2 percent per year, down from an average growth rate of 1.9 percent during 1970 to 1992. The factors affecting birth and death rates are discussed in other sections (see especially para. 89 and in Appendix 2 on the Impact of Transition on Women). With respect to emigration, more than 340,900 people have left the country since 1989, predominantly ethnic Russians and Germans. Since 1989, an estimated 71,700 Germans and 196,900 Russians have emigrated.

21. The economic depression has had a profound impact on working conditions. Before independence, the system of central planning provided for full employment—the right and obligation to work was strongly established. At the same time an extensive social security system allowed for a high percentage of economically inactive population (including relatively young pensioners). Consequently the employment ratio was relatively low. Women and men participated in the labor market in roughly equal measure. Women, however, were predominant in the social sectors and in public administration.

22. The ongoing economic transition to a market-based economy has resulted in a sharp decline in the active working force engaged in the formal (officially registered) economy, considerable hidden unemployment, a growing informal sector, and a change in the composition of jobs provided by the economy. At the end of 1995, 1.72 million people were registered as working, compared with 1.75 million at the end of 1991. By mid-1996, registered unemployment was 3.6 percent of the labor force, at the same time another 14.6 percent was unofficially unemployed or underemployed. Hidden unemployment results from the use of leave without pay and shortened working hours, reflecting the depressed level of output in most sectors. Open unemployment has emerged with the onset of serious stabilization operations in 1994 when credit flows to nonviable enterprises and farms were restricted. With the ongoing privatization of the state and collective farms and the continuing restructuring of enterprises, open unemployment is expected to increase.

23. Unemployment among the young and women is a particularly serious problem. Of the registered unemployed at the end of 1995, 44 percent are below 29 years old and 54 percent are women. Women are particularly vulnerable to early layoff because they form the majority of the staff providing social services such as kindergartens and medical clinics previously maintained by state enterprises. As discussed below, these social assets are being transferred to local governments or simply closed as a result of the restructuring by enterprises that are forced to compete in emerging markets.

24. Reflecting the deterioration in labor market conditions and the severe inflation, real wages and income have declined substantially since independence. By the end of 1995, the average monthly wage in the formal sector was Som 434, which was more than one-third below the minimum consumption basket. Moreover, the formal salary structure does not accurately represent the actual income. Often, salaries and related allowances are paid several months late. In mid-1995, outstanding wage payments amounted to Som 325 million, approximately one-half of the monthly wage bill for the whole economy. More than 73 percent of these debts to workers had been due for more than two months. Industry accounts for 38 percent of the unpaid wage bill; agriculture for 15 percent; and health, education, and social services for 28 percent. The very high rates of inflation experienced until recently seriously eroded the real value of wages that were paid even a few weeks in arrears.

25. A striking development in labor markets has been the growing inequality of compensation payments as market-oriented relations displace the older order established under central planning. Under the FSU system, wages were roughly equal across occupations. In contrast, by mid-1995, wages in agriculture represented only 41.2 percent of the average wage, and wages in health and social services 77.2 percent. The highest wages were in industry, communication, and banking and finance. Wages in the Bishkek region are considerably higher (148.2 percent of the 1995 average national wage) than in poorer regions such as Naryn (63.9 percent) and Jalal-Abad (83.1 percent). Reflecting the prevalence of women in occupations and sectors characterized by relatively low compensation, women's wages are generally lower than men's.

F. Socioeconomic Review

26. Prior to the disintegration of the FSU, the Kyrgyz Republic was able to achieve a comparatively high standard of human development. Indicators such as life expectancy and age-specific mortality rates were near the top of the range for countries with its per capita income. Universal literacy had nearly been achieved and enrollment ratios at all levels of education were high. However, because of the severe economic and fiscal crises, the social

performance of the Kyrgyz Republic has deteriorated considerably. Social services have been reduced in quality and quantity because of the lack of budget resources. Since 1991, the indicators of infant and maternal health, as well as of adult health, have deteriorated. The social safety net has been destroyed by the fiscal crises, hyperinflation, and restructuring of enterprises. This had a particularly severe impact in the poorer provinces (oblasts) and in the rural areas where pensions and allowances can account for 30 percent of household income. The impact of deteriorating health and social assistance support have had a particularly severe impact on women, especially the elderly.

27. Recent data show an increase in the incidence of poverty from 39.7 percent of all families in 1993 to 55 percent in 1995, and in rural areas from 48.1 to 70 percent over the same period. Overall, income inequality has worsened with the Gini coefficient rising from 0.3 in 1990 to 0.437 in late 1995. Reflecting the deteriorating economic and social conditions, the Human Development Index (HDI) prepared by the United Nations Development Programme (UNDP) fell from 0.908 in 1990 to 0.664 in 1993, and 0.618 in 1994. Using comparable international data, the per capita income in the country has fallen from \$1,020 in 1992 to \$610 in 1994.

28. A particularly serious set of issues has emerged with independence and the transition to the market. Especially in poor households, the condition of children has deteriorated with the growth in poverty and the closing of social service facilities such as schools, daycare centers, hospitals, and clinics (see Appendix 3, The Condition of Children). More than 50 percent of all rural pre-schools have closed since the breakup of the FSU. Among the 1.8 million children under the age of fifteen, there are increasing reports of illness and of growing malnutrition. School attendance is also down, particularly in rural areas where schools cannot be heated in winter and meals cannot be served to students. In 1994, kindergartens were serving only half of the attendance level in 1991 because of the fiscal constraints and the parents' inability to pay newly introduced fees. Many of the social facilities that have been closed were in rural areas where alternative services are not available.

G. Environmental Review

29. Upon independence, the Kyrgyz Republic inherited many environmental problems. These problems include (i) soil erosion from overgrazing, poor water management, and deforestation; (ii) air and groundwater pollution from industries and utilities near urban areas; (iii) a decaying and inadequate urban infrastructure such as heating plants, wastewater treatment facilities, water supply systems, and solid waste disposal facilities; and (iv) a lack of hazardous waste treatment and disposal facilities, including those for radioactive wastes. Untreated water pollution, in particular, is a serious concern; contributing to worsening health conditions. However, the country has generally been spared the environmental catastrophes found in neighboring countries such as those around the Aral Sea.¹ The problems that do exist developed despite the strict rules and regulations in the FSU, because environmental protection was accorded a relatively low priority under central planning which emphasized increasing output. Amid inefficient resource use in combination with incomplete ownership and responsibility for land and water, environmental degradation continues to the present. However, pollution levels have decreased in some localities as a result of the economic depression and the reduction in production.

¹ Although not directly affected by the Aral Sea tragedy, the watershed in the Kyrgyz Republic is an important upstream source of water for the Aral Sea and the country is participating in international efforts to reduce the environmental problems in the region.

II. DEVELOPMENT ISSUES; KEY POLICY CONCERNS

A. The Progress of Reform

30. The overall reform program will be a key element in determining the success or the failure of the transition period for the Kyrgyz Republic. New institutions must be created, old institutions restructured, and a new policy environment designed. The process is neither simple nor quick. Institutional change is necessarily an uncertain experiment in which all previous steps must be continually reviewed and judged as to their suitability under current conditions. An analysis of the policy environment should consider five basic conditions. First, macroeconomic stability; progress in this area has already been discussed. The four other conditions concern structural reform: (i) reforms to encourage the creation of free markets; (ii) reforms to encourage competitive forces to develop; (iii) programs to provide social protection; and (iv) policies to protect the environmental resource base. An additional consideration relates to the capability of government agencies to carry out their proper responsibilities. This overview on reform is supplemented by sector-specific discussion in sections II.B (industry, finance, and agriculture) and II.C (infrastructure and social sectors), covering both reforms and institutional problems and developments.

1. Encouraging Market Creation

31. A market system presumes the right or privilege to trade. Legal institutions are a prerequisite for the creation of a market system that can serve the broader national purposes of sustainable economic growth.¹ The legal system must ensure that: (i) property rights are upheld, (ii) voluntary transactions are the basis of trade, (iii) prices are free to adjust to changing market conditions, and (iv) entry into and exit from markets are relatively unrestricted.

32. The provision for property rights should ensure that: (i) ownership is defined and protected for both individual property and for common property; and (ii) the right to transfer property must be established and protected. In the Kyrgyz Republic, the development of functioning land markets is proving particularly difficult—there is no provision for the private ownership of land. However, land use rights that can be transferred are technically available. Land use rights are available for 49 years with the right to renew. In practice, land use titles have not been widely distributed and there is no secondary market for trading these titles.

33. In addition to property rights, basic to the operation of markets is that transactions should be free and without coercion. Under the FSU, the pre-transition economy was characterized by the Government maintaining control over important segments of the economy through the use of the state order system which obligated producers to sell to the state set quantities of products at set prices. In 1990, for example, the state purchased more than one-half of the output of such important products as wool and milk. This forced procurement has largely disappeared since the onset of reforms. In 1995, nearly all of the output of meat, milk, and wool from private farms was freely traded.

34. Price liberalization has also been basically accomplished, with most price controls lifted in 1994. Perhaps the most difficult step was the freeing of bread prices in 1995. Bread is a basic staple and price increases heavily affected the real disposable income of the

¹ See the Board paper on "Governance: Sound Development Management," R151-95, 17 August 1995, especially pp. 26-27.

urban poor. The prices for urban services such as electricity and district heating continue to be set by Government monopolies, and these are often set at levels that are too low to cover the long-term cost of providing the services (see para. 73).

35. In both domestic and international trading there seems to be general acceptance that freer trade provides benefits and that entry and exit should not be unduly regulated. In actual practice, however, there is usually some protection for domestic producers against international competition. In agriculture, this is often justified in the name of food security—to reduce a country's dependence on imports of food. In addition, in domestic markets there is continued protection of the monopoly position of some present and former state enterprises. Entry into domestic markets has been promoted through a reduction in administrative controls, particularly the replacement of most licensing requirements by a registration process. In 1994, exit procedures were similarly reformed through the introduction of laws governing bankruptcy; however, few registered firms have actually failed. The new systems will be increasingly tested as stabilization programs continue to restrict credit to loss-making firms.¹ The ability of the Government to allow large firms to move through bankruptcy proceedings and to restructure will be a major test of its commitment to shift towards a market system.

36. In international markets there too has been considerable liberalization; traders for most goods are free to sell or buy abroad. The breakdown of the interrepublic payments system within the FSU, however, has impeded the reestablishment of trade. Moreover, some trade, such as in energy, is still conducted on a government-to-government basis.

2. Promoting Competitive Forces

37. In the reform process, competitive forces must be encouraged. Monopolistic markets would reduce the efficacy of market institutions and restrict the distribution of the benefits. The development of competitive markets is, however, proving to be one of the most difficult areas of reforms in the transitional economies in Asia. The Kyrgyz economy is no exception. The importance of this problem should not be minimized. Kydd, et al, for example, suggest that failure to complete reforms in this area could contribute to the development of a "low-level equilibrium" growth trap where no sustainable significant growth appears.² Of the more important policy actions to encourage competition are the complete distribution of state assets and the creation of strong financial markets.

38. There has been significant progress in transferring public assets to private sector ownership. At the beginning of 1996, of more than 86,000 registered businesses, 75.6 percent were in the private sector. The privatization of small assets, trade outlets, and service establishments was largely completed by the end of 1994. These transfers were accomplished generally to employees and managers through negotiated sale or auction for cash or vouchers. At the same time many medium and large-scale enterprises were converted into joint-stock companies as a preparatory step to privatization. In some cases, actual privatization was accomplished by transferring substantial share ownership to workers collectives (including management); however, the state has often retained significant ownership. By the end of 1995,

¹ Under a World Bank-financed program, the Privatization and Enterprise Sector Adjustment Credit, approximately 30 large loss-making public enterprises have been cut off from budgetary support except for the minimal support required to assist the enterprises in restructuring and liquidation.

² Kydd, Jonathan, Allan Buckwell, and Jamie Morrison, 19 July 1994, "The Role of the Agriculture Sector in the Transition to a Market Economy in Central and Eastern Europe: An Analytical Framework," United Nations Commission for Europe, p. 9.

more than 50 percent of all medium and large enterprises were privately owned. The remaining state ownership shares are to be privatized through auctions, employing vouchers as well as cash.

39. The biggest problems concern the larger enterprises. Although they are generally reorganized as joint-stock companies, most of the largest state enterprises have not experienced any significant restructuring and are still under the control of a ministry or a Government-holding company. On balance, for the larger firms, the actions taken have not succeeded in laying the groundwork for competitive markets to develop. Moreover, there is some suggestion that corporatization has been pursued without adequate consideration of whether the functions should be undertaken by the public sector or the private sector. In the process of corporatization, some Government units have been included that should remain in the public sector; for example, those involved in the establishment of technical, safety, or environmental standards. The process of corporatization or incomplete privatization of these entities may weaken the institutional capacity of the public sector without properly setting the stage for appropriate privatization activities.

40. The transfer of assets to the private sector must involve the transfer of state and collective farms as well as the privatization of enterprises. In this area there has been considerable formal progress. At the beginning of 1995, there were over 22,000 private farms. However, these farms only accounted for 12 percent of the arable land of the country. The transfer of farms is complicated by the sheer size of the farms; the remaining state farms, for example, average over 2,000 hectares (ha). These farms were developed using highly specialized labor in a capital-intensive fashion. State and collective farms employ over 1,000 people—the simple division of the land is impractical and inefficient. The restructuring effort is very similar to that of large industrial enterprises; some sort of corporatization may be required in which the farm is reorganized on a share-holding basis. One difference that may be evolving between industry and agriculture in these corporatization exercises is that in some instances, the restructuring of the farms is proceeding along kinship lines in which extended families provide the basis for the organizational reform. In these cases, the extended families may be able to provide support and assistance for rationalization steps and new investment.

41. Beyond these activities, a robust financial sector is a necessity to support nascent activities in the private sector. In an institutional sense, there has been considerable progress in moving away from the command system in which financial flows simply were accounting exercises that had no independent function in the system. After independence, a two-tiered banking system was created with the central bank exercising supervisory control over private commercial banks. A large number of commercial banks were established; however, few of these have attempted to operate on a commercial basis. Instead, they have simply acted as conduits for credit to enterprises controlled by their owners. Gradual tightening of banking practices through expanded supervision and regulation by the NBK has eliminated the worst, but most commercial banks are technically insolvent with large portfolios of nonperforming assets.

42. The existing banks lack the technical skills to reorient their operations to support the emerging private sector by mobilizing resources and engaging in commercial lending. The former state-owned banks continue to dominate banking activity and account for about 85 percent of the total assets of the banking sector. However, these banks are hardly better equipped than their private counterparts to operate in a competitive market place. The continued dominance of the sector by such a small number of imperfectly privatized banks poses long-term problems: a more competitive market structure will not likely evolve without

active policies that, for example, redress the current concentration of bank branches. The entry of foreign banks would be one solution, but so far, no foreign bank has opened in the country, despite the absence of barriers to this entry.

43. Beyond the banking system, there has been only a beginning to the development of the legal support for such activities as insurance and securities exchange. In 1995, the nonbanking financial sector included several hundred currency exchange shops, more than 100 insurance companies, 24 investment funds, 18 pension funds, and a stock exchange. The legal framework for such activities is incomplete and largely untested. These institutions function in a formal sense, but they do not form competitive markets (except the foreign currency exchanges).

3. Providing Social Support

44. Reform is essentially a political process. If the transition period is perceived as failing to provide for social equity, then governments risk the loss of popular support for reform. Similarly, the lack of widespread participation in the benefits of transition or in the equitable sharing of the costs will ultimately limit economic performance and policy sustainability. In the Kyrgyz Republic, the ongoing economic transformation has been accompanied by a widespread increase in poverty. A long-term solution to poverty can only come with economic recovery and growth; however, social support is needed to reduce the impact of the transition on the most vulnerable. This is an essential element of good governance. Comprehensive social support requires (i) fiscally responsible social insurance programs, (ii) a fiscally sustainable level of social assistance to the truly needy, and (iii) adequate levels of public support for social services such as health and education.

45. As noted earlier, the Government has tried hard to minimize the impact of the fiscal crisis on social sector expenditure. Expenditures on education, health, and social insurance or social security have increased since 1994 both as a share of total expenditure, and as a share of GDP. In 1995, expenditures on education, health and social security (including social insurance) accounted for 53 percent and are targeted to rise to 58 percent of expenditures in 1996; as a share of GDP, social sector spending rose from 13.8 percent in 1994 to 16.6 percent in 1995. However, as noted earlier, given the fall in GDP since 1991, the level of real resources committed to these sectors is still extremely small compared with the level before independence, and resources will remain severely constrained in the foreseeable future.

46. Improving social protection and social assistance will require establishing priorities and ensuring that the available fiscal resources are used efficiently through well targeted efforts. The issue of targeting is particularly difficult. A legacy of the FSU system was overly generous pensions and social assistance entitlements. Before independence, roughly 40 percent of the population received some sort of social welfare payment such as a pension or family support payment. These entitlements were only maintained by large subsidies from the central government of the FSU. Better targeting would allow an increased level of real support for the more vulnerable groups including children and female-headed households.

47. Improving the social support systems is difficult, in part, because the responsibility for providing many of these services is increasingly borne by local governments. As a result of the FSU legacy and the ongoing process of devolution, local governments are increasingly responsible for financing and delivering social services such as health, education, and income supplements for the poor. Over the long term, the decentralization of the provision of public services should improve participation in the development process. In the meantime,

however, the provision of efficient and responsible services is hampered by limited management experience, overbuilt and inefficient institutional structures and physical infrastructure, limited local financial resources, and restrictive national policies that limit flexibility and encourage a continuation of the previous status quo that emphasized the quantity of the services.

48. Another problem in strengthening the delivery of social services is connected with the ongoing privatization program. Under the FSU system, medium and large firms had the responsibility for maintaining a diverse set of social infrastructure such as kindergartens, health clinics, day care centers, and local canteens. These social assets could only be provided by these enterprises, on the scale then found, through the complex system of subsidies that characterized central planning. As firms face increasingly competitive market tests under conditions of hard budgets, these social assets are being either closed or transferred to local governments. The latter are, at this juncture, ill-prepared to maintain an adequate system of social services.

49. One relatively successful aspect of the divestiture of social assets has been the privatization of the housing stock. Since 1992, housing, which had previously been maintained by local governments or enterprises, has increasingly been transferred to tenants. In Bishkek, for example, more than 70 percent of the Government's stock of housing has been transferred to private ownership.

4. Protecting the Environmental Resource Base

50. The Government has recognized the need to deal with environmental issues. In 1995, it adopted a National Environmental Action Plan that affirmed environmental protection and economic development are inseparable. The key areas of concern are to (i) provide for the sustainable and efficient use of natural resources, and (ii) reduce the impact of pollution on public health. The critical constraints to action are the limited national budgetary resources, and the weak institutional capability, including a shortage of qualified environmental technicians. Of high priority is the need to increase the capacity for research and monitoring. The country is unable to monitor effectively the changes and trends in the environment associated with pollution, biodiversity, wildlife, and the natural resource base. The environmental regulatory framework also needs to be enhanced, and staff trained in the application of modern cost-benefit and environmental impact analysis techniques. There is also a need to create the broad public awareness that the environment is a crucial element in personal health and safety. Initial efforts should focus on developing the appropriate legislative, regulatory, and administrative framework, and ensuring that new investments do not adversely affect the environment.

5. Institutional Capacity

51. The near-term prospects for successful reform of the economy will also depend on the institutional capability of the public sector to adapt to the changing world. The Government needs to be able to continue the reform process, to implement the existing reforms, and finally to accept new responsibilities consistent with the emerging market-based economy. Privatization, for example, is a two-way street: some government agencies must be transferred to the private sector; but at the same time, those units that are retained in the public sector must be strengthened and in some cases new units must be created. For example, the Government needs to develop the skills to adequately regulate a market-based economy. To provide a minimum of institutional support for the private sector in transition economies is a considerable challenge. In this respect, the management of reform is similar to the management of development: they are issues of governance. Although the challenges must be faced on a

sector by sector basis, some elements are present across sectors: (i) fiscal constraints imply relatively low public sector salaries and support; (ii) economic policy weaknesses reflecting incomplete reforms and incompletely implemented reforms; (iii) weak administrative structures illustrate that the functions and responsibilities of government agencies are not clearly defined; and (iv) a lack of experience with policies and procedures in market economies.

52. The situation with respect to local level governments (province, municipality, and district) is particularly serious. The historical inheritance from the FSU was that local governments functioned more as “branches of the central government than independently functioning governmental units.”¹ This perception is changing through an active program of devolution. In addition, local government units are assuming more responsibility for services and infrastructure that had previously been provided or maintained by state enterprises. The current tax and expenditure systems, however, limit the flexibility of local governments. Revenues, in particular, are determined by the central government and there is little relationship between particular expenditures and revenues. Restructuring intergovernmental fiscal relationships is an important task for the country; but it is only a first step, at the local level, institution-building must be considered a long-term endeavor.

B. The Development of the Private Sector

53. Beyond a need for continued progress on the wide range of unfinished reforms, there is a need to respond to the developing opportunities in the new economy. The private sector must develop a new structure for production to reverse the decline in aggregate output. New products and new production techniques need to be introduced and adopted.

1. Industry and Financial Sector Development

54. With increased macroeconomic stability, specific reforms in the industrial sector and in the financial sector become more important. The persistent poor performance by state-owned or controlled enterprises will impede, if not reverse, efforts to contain credit creation and to stabilize the money supply and public finances. In this regard, the most important program involving enterprise reform has been that coordinated by the Enterprise Reform and Resolution Agency (ERRA), supported by the World Bank. ERRA was created as a semiautonomous agency to manage the restructuring and liquidation of the largest, loss-making state-owned firms. These large firms were a considerable barrier to macrostabilization because the Government had to create money to support the credits extended to them by the banking system. The project was designed not so much to develop markets but rather to reduce the drag on the economy by these loss-making firms. With the start of the program, these firms were cut-off from any credit except that provided through ERRA through the state budget and then only for passive or relatively minor restructuring expenses or liquidation expenditures. This program, important as it is for macrostability, may not be suitable for developing a new structure for production, encouraging investment, and increasing output.

55. As noted earlier, there has been substantial progress to date in privatization, trade, and price liberalization. The unfinished agenda includes the need to continue privatization, restructure enterprises, and provide the basic legal structure supporting markets and the private sector. The transfer of ownership does not automatically bring about the conditions to encourage enterprises to restructure to survive under market conditions. Private

¹ Barents Group of KPMG Peat Marwick, 1996 “Intergovernmental Fiscal Relations in Kyrgyzstan: Approaches to Policy Reform,” p. 4.

ownership is only one aspect of the broader policy environment that determines incentives for the use of productive assets. In particular, majority private ownership has not necessarily brought control, because the Government retains significant ownership and the ministries and other government and semigovernment organizations influence decisions such as employment policies. The existing management often lacks the incentives, expertise, and the access to capital, which are necessary to undertake risky investments.¹ Moreover, newly privatized enterprises often retain much of their former monopoly position in markets. The net result is that the incentives for changing behavior are limited.

56. One important aspect of the problem is that mass privatization exercises used to help privatize the larger firms do not bring additional investment funds into an enterprise. Without additional investment, the ability to restructure an enterprise is often severely limited. Such activities as reducing the labor force are difficult without funds for severance payments or to pay arrears in wages. Moreover, new investment is required to allow firms to upgrade outdated technology—the technology installed under the central planning operations of the FSU is often completely inappropriate for firms attempting to compete in markets open to international competition. Additional problems impeding enterprise restructuring involve those noted earlier such as the necessity to divest the enterprises of their previous responsibility to maintain social service assets such as kindergartens and medical clinics.

57. As noted earlier, although there has been considerable restructuring of the financial sector during the past five years, the net result has been that most banks are technically insolvent and do not extend credit or mobilize domestic resources on a commercial basis. The problem is especially severe in the rural sector (see para. 65). Complementing the changes in the sector, nonbanking institutions have also emerged. The growth of investment funds has been particularly fast, stimulated by mass privatization exercises that provide citizens with vouchers that can be invested through these funds in particular enterprises. A stock exchange began operation in August 1995 with five companies listed. To date, however, the market has been very thin with little active trading. Across these sectors, there is a tremendous need to develop local expertise in accounting and financial management, especially in corporate and project finance.

2. The Rural Sector and Agricultural Development

58. Agriculture is, in many respects, the most important sector of the economy. Nearly two-thirds of the population lives in rural areas. Agricultural land accounts for more than half of the country's territory with intensively irrigated farms in the lowlands and the valleys, and large areas of extensive grazing in the mountains. Within the FSU, the country specialized in products such as yarn and woolen products, cotton, tobacco, fruits and vegetables, and red meat.

59. Under the FSU, agriculture production was highly capital-intensive with large farms requiring considerable capital investment in large-scale farm machinery and infrastructure including rural roads and irrigation facilities. The last was particularly important—nearly 80 percent of the crop production relies upon irrigation. Symptomatic of Soviet central planning, much of this capital was inefficiently invested or maintained. Inefficiency was also noted in the use of labor inputs. Agriculture was considered the residual employer. Overstaffing in state and

¹ Mass privatization, through voucher auctions, often provide investment funds with significant ownership; however, to date the shares owned by investment funds are too small, dispersed among too many enterprises, to allow these funds to play an active role in restructuring enterprises.

collective farms in the Kyrgyz Republic may have been as high as 50 percent during the Soviet regime.

60. As a result of the ongoing difficulties associated with independence and the transition to market-based institutions, agricultural producers have tended to retreat from commercial production to subsistence operations and barter exchange. Agroprocessing, storage, and distribution facilities operate significantly below capacity. Some regression in the sector was inevitable: the highly centralized system of the FSU was unsustainable with the collapse of central planning and independence for the different republics. But the decline also reflects the fundamental weaknesses in the sector's inherited structure of production and organization. The highly specialized and highly organized farm organizations face difficult restructuring and retrenchment in the same manner as needed for the industrial enterprises. The swift economic collapse precluded a gradualist approach to reform, but the inappropriate productive structure also offered scant potential for a rapid supply response to the initial reforms.¹

61. Development or rather redevelopment involving reform and restructuring of agriculture is key to the recovery and future growth of the economy and to the livelihood and reduced incidence of poverty among the rural population. The Government has been implementing a program of sectoral reforms focusing on: (i) land reform and privatization of state and collective farms; (ii) liberalization of commodity prices and trade; and (iii) demonopolization and privatization of input supply and output marketing and processing conglomerates. As discussed earlier, in each area there has been significant progress, but also an unfinished agenda. The Bank is providing assistance to the Government in this area through the Agriculture Sector Program approved in November 1995 and implemented in 1996-1997.² The Bank's policy-based lending program supplements and supports a similar lending operation by the World Bank, the Agriculture Privatization and Enterprise Adjustment Credit. Under these two programs, the Government is undertaking measures to:

- (i) support continuing land reform, in particular by limiting undue restrictions on the transfer of land or its use as collateral, to accelerate land titling and registration, and to establish transparent procedures for adjudicating land disputes;
- (ii) improve the use of irrigation, particularly by encouraging the formation of water users associations;
- (iii) increase the competitiveness of the input supply system through privatization of state-owned enterprises;
- (iv) provide for the restructuring and privatization of state-owned enterprises involved in marketing and processing including those involved in making and distributing bread;
- (v) reduce restrictions on the export of such products as cotton and wool;

1 In this, the experience under transition in the Kyrgyz Republic differs sharply from that found in the People's Republic of China and Southeast Asia. See David Jay Green and Richard W. Vokes, "Agriculture and the Transition to the Market in Asia," paper prepared for the Pacific Rim Allied Economic Organizations Conference on Economies in Transition', Hong Kong, 10-15 January 1996.

2 Loan No. 1407-KGZ: Agriculture Sector Program Loan for \$40 million.

- (vi) enhance social protection through support for social assistance funding;
- (vii) protect the environment by focusing on managed grazing of natural pastures and forested areas and reintroducing biological control measures for cotton pests; and
- (viii) enhance the capacity of selected Government agencies to implement the reform process and provide the required support for a market-based agriculture sector.

62. Overall, the program supports important steps in the transition towards a market-based economy. Even with the ongoing reforms, specific problem areas remain in input supply, marketing and agroprocessing, rural finance, infrastructure, and environmental protection. These areas are discussed in the following paragraphs.

a. Input Supply

63. The domestic supply of agricultural inputs is extremely limited, consequently the sector is heavily dependent on imported inputs such as fertilizer, pesticides, spare parts, and fuel. Imports of these goods have dramatically declined following the breakup of the FSU. There is a severe shortage of fertilizer, pesticides, and herbicides. Spare parts are difficult to obtain and the quality of inputs such as seeds has fallen. A complex system, created over decades of central planning, was, with independence, bereft of input supplies, markets, and technical support. Foreign trade links will have to be reestablished to ensure reliable supply of appropriate inputs. Farm machinery has to be adapted to small-scale farming and local support services have to be developed. The ongoing reforms have been achieving significant results in privatizing enterprises connected with input supplies, particularly distribution. The ongoing Agriculture Sector Program provides support to continue privatization measures for enterprises supplying agriculture equipment and spare parts, fertilizer and agrochemicals, and veterinary supplies. As markets develop, if there is adequate support for the private sector, some local input supply sources should develop to complement and compete with imports.

b. Marketing and Agro-Processing

64. Since the breakup of the FSU, agroprocessing concerns have experienced dramatic declines in output with many factories currently operating at less than 20 percent capacity. There are substantial constraints facing agroprocessing including: obsolete facilities; a limited and often poor product line; inefficient operations; a lack of management skills, including accounting and finance; and difficulties in marketing products and promoting exports. Although some downsizing or closing of firms is to be expected as the industry moves from operating under Soviet rules to operating in a free market, this is a sector in which the Kyrgyz have some long-term comparative advantages. There is an urgent need to address the constraints to new investment in the context of the ongoing industrial restructuring and privatization and more generally to reflect the changes that are taking place in other parts of the sector.

c. Rural Finance

65. The rural financial sector is simply not functioning. In early 1996, the Government made the decision to liquidate the increasingly insolvent successor bank to the former Soviet Agriculture Bank (Agroprombank) with the result that there is no significant formal institution serving much of the country's rural areas and the agriculture sector. In addition, most farms are heavily in debt as a result of past credit programs and present weak product markets. The

majority of farms would probably not qualify for commercially based loans even if institutions existed to provide them. With exception of some Government programs, a small number of NGOs, and some relatively small foreign-assisted programs, the sector is effectively bereft of credit inputs. There is a lack of working and long-term capital for financing agricultural production, marketing, processing, and distribution of commodities. This has contributed to the reduction in the use of inputs as noted earlier. It is difficult to see any large-scale improvement in the sector until institutions develop that can provide capital at market-related terms.

d. Appropriate Infrastructure

66. The irrigation system was constructed to deliver water to the previous system of state and collective farms. The farm distribution systems are generally poorly designed with transmission inefficiencies resulting in considerable water shortages. The Government's fiscal constraints have contributed to deficient maintenance and this is causing an overall degeneration of the system further resulting in water losses. As private farming becomes more common it will be necessary to (i) rehabilitate irrigation systems; (ii) introduce new institutional arrangements for the management and maintenance of the on-farm distribution system; (iii) introduce water charges to finance the operations and maintenance of the systems; and (iv) prevent further environmental degradation from the improper operation of the irrigation systems by improving drainage and reducing salinity and soil erosion. The ongoing Agriculture Sector Program addresses some of these problems by (i) clarifying water user rights and responsibilities and (ii) establishing collection systems for local water user associations. However, there will have to be a long process of institution building before local institutions have the capability for resource mobilization, cost recovery, and a sustainable maintenance and investment program.

67. The existing network of on-farm roads and tracks was developed to meet the needs of the large farms. As the farms are privatized, the road system may not be able to provide access to the new small private farms. More importantly, as the Government notes, "Arrangements for the management of rural infrastructure facilities following the break-up of the sovhozes [state farms] and kolhozes [collective farms] have yet to be clarified."¹ Most likely, the responsibility for maintaining access roads and rural roads in general will be shifted from farms and farm enterprises to local governments, which may lack the institutional capability and financial resources to maintain these systems.

e. Environmental Protection

68. Although spared the extreme environmental catastrophes found in neighboring FSU countries, agriculture practices have led to considerable damage to the environmental resource base. There has been considerable damage to the soil as a result of erosion, caused by poor cropping and grazing techniques, which has been aggravated on the many steeply sloped farms. Serious erosion problems are said to be present on more than 50 percent of the arable land. Improper water use is another problem leading to soil erosion but this has also resulted in poor drainage and excess water use in many areas. This situation has also increased soil salinity in some areas. The economic distress in agriculture has reduced the use of fertilizers and pesticides, but there is considerable evidence that normal operational practices involved very heavy use of these agricultural inputs—usage high enough to result in soil contamination. The Government must ensure that as production recovers the use of fertilizers

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Government of the Kyrgyz Republic, *Public Investment Programme 1996-1998*, p. 90.

and pesticides is adequately controlled and strike the right balance between enhancing productivity and protecting the environment.

C. The Decline in the Potential for Growth

69. In addition to the immediate necessity to continue the process of reform and encourage new systems of production, resources must be found to (i) maintain the physical infrastructure, (ii) restructure the systems for developing human resources, and (iii) protect and rehabilitate the environmental resource base. Environmental problems have been noted above in the review section (para. 29) and in the discussion on the state of reforms with respect to preserving the environment (para. 50).

1. Deteriorating Physical Infrastructure

70. It is vital to rehabilitate and modernize the physical infrastructure in the economy. Some parts of the existing infrastructure systems, built under Soviet planning, will not be required in the new emerging market economy. However, there is an urgent need to preserve the infrastructure critical to support the post-transition economy. Capital spending amounted to just 3 percent of total Government expenditure in 1995. This is the equivalent to \$15 million, which is small compared with the development needs. Equally important, the Government must provide the recurrent expenditure needed to meet operation and maintenance costs. Currently, much of the infrastructure is deteriorating because of a nearly complete lack of public funds for maintenance. In some instances, the choice is stark—a small amount of resources provided in a timely fashion will preserve significant economic assets; the lack of timely maintenance and rehabilitation will result in the loss of these assets. If these assets are not preserved the long-run growth potential for the economy will be lowered.

a. Energy

71. The energy sector in the Kyrgyz Republic is relatively large and plays an important role in the economy. The country has abundant hydropower resources that have been only partially developed. There is also a limited production of oil, gas, and coal; however, approximately two-thirds of the country's primary energy sources are imported. Most petroleum products imports come from Kazakstan and Russia, natural gas from Turkmenistan via Uzbekistan, and more than one-half of the country's total coal supply is imported from Russia and Kazakstan. While the country is a net importer of these products, it produces and exports to its neighboring countries hydroelectric power generated from the water of the Naryn River. Energy trade within Central Asia is largely through intergovernmental agreements with pricing and payments decisions often reflecting regional political considerations such as water rights or interrepublic debt management.

72. Domestic production of oil and gas is controlled by Kyrgyzneft, a state-owned enterprise. Most domestic production derives from mature oil and gas fields and incremental production will need to come from new reserves. Reasonable prospects for new discoveries exist but it will require foreign capital to explore and develop. There are no oil refineries in the country, but the Government is considering support for their construction. Taking the Central Asian region as a whole, additional refinery capacity is probably not needed, but from a national standpoint, the availability of refining capacity would enhance the country's choices and its bargaining position in regional energy trade discussions. The coal resources are largely low-grade, brown coal or lignite, and produced from relatively high-cost mines, that need new investment to reduce their operating costs. Domestic prices for petroleum products and coal

have been liberalized; however, markets are not competitive. Prices are determined by negotiation between Government-owned and controlled firms.

73. The electricity sector is also controlled by a wholly owned Government corporation, the Kyrgyz National Energy Holding Company (KNEHC). KNEHC is responsible for the generation, transmission, and distribution of electricity throughout the country and for the provision of hot water and steam for heating in the major cities. Electricity, utility gas, and district heating prices are administered. Currently, the prices of these services, particularly electricity, are inadequate for full cost recovery. However, as part of an ongoing program tariffs are being increased to financially strengthen KNEHC. Moreover, as part of a planned rehabilitation project supported by the Bank and other funding agencies, a tariff-setting mechanism will be established to determine tariff structures and marked improvements in revenue collection are expected.

74. The lack of adequate revenue in the power and urban service sectors has resulted in a deferral of nearly all maintenance activities. For example, the Bishkek Thermal Energy Station No. 1 plays a major role in supplying power to the northern region of the country and supplies heat to Bishkek. However, the majority of its boilers have accumulated over 100,000 hours of operation and urgently require refurbishment. Other problems include the deterioration of auxiliary plant systems such as coal handling, air pollution control, ash storage, and instrumentation and control systems, which affect the efficiency of the plant and the environment. Similar problems exist with the other thermal power plants in the country. The country's power distribution system also suffers from decreased maintenance but also as a result of increased residential consumption during the past few years. The latter was prompted by relatively low prices for electricity, and because payments for electricity can be delayed, unlike those for petroleum fuels or coal. In the winter of 1993-1994, approximately 13 percent of all distribution transformers were overloaded.

75. The failure to adequately maintain infrastructure systems is also evident in the Bishkek district heating system, which accounts for about 80 percent of the centralized heat supplied throughout the country. Over 400,000 people in Bishkek are provided with heat and hot water from this system. A number of industrial consumers also use the process steam and hot water. Currently, system losses in the district heating system in Bishkek are about 25 percent of heat generated. Normal losses in similar district heating systems with proper operation and maintenance practices range from 12 percent to 15 percent.

b. Transport and Communications Sector

76. The transport and communications infrastructure in the Central Asian Republics was developed as part of the large, inward-looking Soviet transport system. From the standpoint of Central Asia, the system was designed to facilitate relations and domestic trade with the northern and European part of the FSU. As a result, the infrastructure of the Kyrgyz Republic has close network linkages with its neighboring countries. The basic infrastructure developed in a regional pattern without consideration for what would become the political boundaries of the present-day Central Asian Republics. This presents a number of problems. First, infrastructure programs and planning should optimally continue to be undertaken on a regional or cross-border basis. Second, the technical standards of the FSU continue to be used in the Kyrgyz Republic and there is continued reliance on the Russian Federation and other countries of FSU for materials, spare parts, equipment, and maintenance services. The reliance upon FSU countries for assistance restricts the transfer of productivity-enhancing technology.

i. Transport

77. Since the breakup of the FSU in 1991, economic activities have declined and customary trading patterns have been disrupted, resulting in a dramatic fall in demand for transport. The volume of freight (in ton/kilometers) in 1995 was less than 20 percent of that in 1990, while passenger movements fell by more than 50 percent over the same period.

78. Road transport is the principal mode of transportation in the country. In 1995, road transport provided 82.1 percent of total freight traffic, while rail accounted for 17.2 percent. Less than 1 percent of the freight was moved by water or air. The share of road transport would be even larger if the informal and non-registered sector was included. There has been significant privatization in the sector. In 1995, the Ministry of Transport carried only 27.1 percent of the total freight (on a ton-km basis) with most goods transported by privatized joint-stock companies. However, most formally independent companies are majority state owned. There is a lack of real competition between these enterprises although the informal sector is increasingly offering competitive, if relatively small-scale service alternatives.

79. Rail transport is concentrated in the Bishkek region where the lines connect to the rail network in Kazakstan and in the Ferghana Valley where the lines connect with the rail system of Uzbekistan. The Kyrgyz transport network is rather more dependent upon the adjoining systems than the reverse. As a result, as the Government notes "... tariffs follow those set by the neighboring railway networks ..."¹ These tariffs are apparently adequate to cover operating expenses such as fuel and labor. However, as in other sectors, maintenance and rehabilitation are only minimal. Institutional change, to reflect the movement towards a market-based economy, is required. This should be implemented in the framework of regional agreements with respect to tariffs and service.

80. Air transport has also been affected by the breakup of the FSU. Passenger traffic at the main airport, Manas, near Bishkek, is down from over 1 million passenger trips in 1991 to 0.2 million in 1995. In what may be crucial for the future of this landlocked nation, with few exceptions, major international air carriers have bypassed the Kyrgyz Republic and traffic to that country must be routed through Kazakstan in the north and Uzbekistan in the south. A relatively small effective demand for air transport has discouraged air links, but there is also a need for rehabilitation work at the Manas Airport to meet international safety standards, particularly for air navigation. The national airline only operates aircraft and equipment inherited from the Aeroflot of the FSU, which often cannot be used for travel to countries that are not part of the FSU. Little progress has been made in transferring assets or service activities to the private sector.

81. The existing transport infrastructure would be adequate to support a moderate recovery in economic activity if maintenance and rehabilitation activities were undertaken. However, maintenance expenditures are not being undertaken. Public investment in the transport sector declined from about 4 percent of GDP during the 1980s to about 1 percent during 1994. The lack of funds for maintenance is responsible for a severe deterioration in the system to the point where major rehabilitation is required. More than 60 percent of the national roads are in poor condition, while the figure for a typical industrialized country would be about 5 percent. The rehabilitation and maintenance of key parts of the existing infrastructure is important to avoid major reconstruction costs in the future and to preserve the economic utility of past investments. The condition of the transport sector decreases the country's potential for growth and this needs to be reversed by resolving the funding constraints for rehabilitation and

¹ Government of the Kyrgyz Republic, *Public Investment Programme 1996-1998*, p. 74.

maintenance of existing assets, and by overcoming the operational, institutional, and policy constraints the sector is facing because of the sudden change from a centrally planned system to a market-oriented system.

ii. Communications

82. The situation in the communications sector is similar to that in the transport sector. The poorly maintained equipment is part of an infrastructure system that was designed to satisfy the needs of the FSU, not the Kyrgyz Republic. It is still generally easier, for example, to place a telephone call from Bishkek to Moscow than to any city outside of the FSU. The coverage of the telephone system is only 8.0 connections per 100 inhabitants, but it operates throughout the country. The principal system is supplemented by a limited number of new digital networks. International services are provided either through a limited satellite link through Turkey or through the older microwave channel through Moscow. The Government recognizes that it can take up to 10 hours to complete an international call and less than one-half of all calls are completed on the first try.¹

83. The sector is managed by Kyrgyz Telecom, a wholly state-owned enterprise. The enterprise is in need of restructuring, retrenchment of staff, and technical assistance. There have been some efforts to open the sector to private companies; at least one cellular telephone service has been started.

c. Water Supply and Sanitation

84. Groundwater supplies 85 percent of total water consumption in the country with the remaining 15 percent coming from surface water. Bishkek, with 20 percent of the population, consumes more than half the publicly supplied water in the country. Urban water supply is the responsibility of the Kyrgyz Housing and Country Affairs Agency (KHCAA); except for Bishkek, which receives its water from the Bishkek City Council. The water for Bishkek comes from two underground aquifers and is normally within internationally accepted health standards. Local contamination, however, occurs from the unsafe disposal of liquid and solid municipal and industrial wastes from sewers, livestock operations, laundries, and agro-industrial processing centers. Similar problems affect other urban areas. As a result of pollution problems, the KHCAA has attempted to depend entirely on groundwater; however, this is constrained by financial limitations. This problem is especially serious in the smaller towns that tend to rely mainly upon surface water. Approximately one-half of the rural population served by public water systems receive their water from open reservoirs and irrigation channels contaminated by sanitary wastes, livestock operations, and toxic industrial wastes. Water treatment has been restricted by the financial difficulties of KHCAA. About 70 percent of pumping, treating, and distribution equipment need repair or replacement and there are shortages of supplies such as chlorine.

85. The most serious problems of the water supply system lie in the institutional arrangements, not with the basic infrastructure. Over the medium term, a more efficient use of existing infrastructure is needed rather than an expansion of the system. The present system of financing for maintenance and expansion is insufficient. An increase in domestic and industrial tariffs and more efficient collections, are essential to improve operations. As with other utilities, there is nearly a complete lack of metering. Residences, either detached houses or apartments, have no metering system and only 5 percent of industrial users have meters.

¹ Government of the Kyrgyz Republic, *Public Investment Programme 1996-1998*, p. 79-80.

86. Wastewater treatment capacity in most cities is insufficient and the treatment is limited. The situation is most serious in the smaller cities. Despite being used beyond capacity, the facilities in Bishkek are basically satisfactory. In the smaller urban and industrial centers, such as Naryn or Kara Kol, both industrial and domestic waste is discharged into rivers without effective treatment. Public health problems directly related to poor sanitation include growing incidences of hepatitis A and diarrheal diseases. Sanitation is a major public concern in rural areas, with no public funds currently budgeted for the problem. The sewage charges are based on interconnection facilities, not actual use and collection problems appear even more serious than with other services. The Government recognizes that only a few enterprises pay their bills.

87. The uncontrolled dumping of solid and liquid waste is a problem throughout the country and is on the rise as collection equipment falls into disrepair and fiscal difficulties hinder operations. Over 90 percent of all solid waste disposal sites do not meet sanitary standards. The country has no treatment sites for toxic wastes, a serious problem in certain localities given the near total neglect of the environment during the Soviet era. Most industrial solid waste is stored on site or disposed of without monitoring or controls. The fines that are levied on illegal dumping are routinely ignored. There is no effective enforcement of the current laws and regulations.

2. Faltering Social Programs and Declining Human Development

a. Transition and Human Development

88. Equally important to maintaining the physical infrastructure of the country is maintaining the system for developing human resources, through support for education and health activities. The FSU provided broad access to social services. There was an extensive, if inefficient and costly medical system that eliminated many of the public health problems found in other low-income countries. Similarly the system of public education, while inefficient in the use of resources, achieved nearly universal literacy—nearly every child attended primary school and attendance in secondary school was very high. The fundamental strengths of both the education and health sectors still exist, but are steadily being eroded during the transition. The development of human resources is largely facing the same set of problems: limited Government funds; inefficiency in planning, management and resource use; and the need to integrate market forces and the private sector into the provision of services. The situation is more serious in the poorer rural areas and for particularly vulnerable groups such as elderly women and female-headed families. If this situation continues, as in the case with the deteriorating physical investment, the long-run growth potential of the economy will be reduced.

b. Deteriorating Health Indicators

89. Under the FSU, a comprehensive and well-established integrated health care system was developed. Extensive public programs resulted in health indicators such as life expectancy and age-specific mortality rates that were near the top of the range for countries with comparable per capita incomes. Life expectancy was about 68.5 years. The gains in health status came from effective programs of immunization, prenatal care, and health and nutritional monitoring. The country's free primary health care system provided comprehensive access, good coverage and frequent surveillance. The weaknesses in the health system included (i) an overspecialization and a lack of attention to preventive health measures, (ii) an overly rigid central planning and administration, (iii) a lack of cost recovery, (iv) an inefficient use of inputs, and (v) a weak education in public health.

90. Because of the severe economic and fiscal crises, the health sector has deteriorated considerably. Services have been reduced in quality and quantity because of the lack of budget resources by both the public sector and the enterprises that formally had the responsibility to provide these services. The Government has maintained total health expenditures at 34 percent of GDP, the same as prior to independence. However, with the decline in GDP, the resources are not sufficient to maintain the old standards of service. Health service utilization is declining because of the shortage of medicines and the loss of skilled health workers. Because of low pay and delays of two to five months in receiving salaries, many doctors and nurses are seeking alternative employment or migrating to other countries.

91. Since 1991, as a result of the decline in resources, health indicators for children as well as for adults have deteriorated. Infant mortality rates have increased from 29.7 per 1,000 live births in 1991 to 31.3 in 1993. The maternal mortality rate rose from 70.1 per 100,000 women of childbearing age in 1991 to 83.0 in 1995.¹ As in the other states of the FSU, the crude death rate has risen and life expectancy has fallen, from 68.8 to 68.0 years between 1991 and 1993. The declining public health resources and falling personal incomes are having a particularly severe impact on the health of children. Acute malnutrition is found among 7 percent of preschool-age children, and poor nutrition is becoming noticeable in all age groups, including adults. There is also concern about deficiencies in the diet of micronutrients such as iodine and iron. The high and rising incidence among children of respiratory infections in winter and of diarrhea in summer indicate the need for more effective primary health care, health education, and sanitation.

c. Problems in Education and Training

92. The economic transition has brought with it sharp reductions in real public spending for education, particularly for preschool and basic education. One disturbing development is the closing of preschools, which were formerly the responsibility of state enterprises. This affects not only the quality of input into basic education, but also the actual state of early child development in the country. There is an urgent need to mobilize resources from both the public and the private sectors to address this problem. Also, there is a need to review alternative methods of delivering distance education, nonformal education, and adult training. However, the resources must be mobilized carefully—already, the increase in the costs of participation in education and training poses a significant barrier to the poorer segments of the population. Education costs have risen absolutely as a result of the introduction of fees and the increase in the prices of such goods and services as transport. Costs have also risen relatively as many families have slipped into poverty. Limited fiscal resources have also contributed to the deterioration in the physical and institutional infrastructure in the school system. In addition, the quality of education is being compromised as attrition among teachers increases, largely because of low salaries. The teachers who remain have limited opportunities for the retraining necessitated by the economic transition and the need to provide students with marketable skills.

93. The limited public budgets come at the same time that there is an urgent need for structural change. The old system was part of the Soviet economy; the educational curriculum was suffused with the communist ideology and training was designed for lifetime employment in state enterprises. The training systems still reflect the former ties with large state enterprises

¹ Recent statistics in these areas sometimes show some improvements. This, however, appears to reflect problems in the statistical data and is not representative of the underlying health conditions (see Appendixes 2 and 3).

and are generally inappropriate for the needs of the newly emerging medium- and small-scale enterprises. Quality is further compromised by the inability to replace textbooks and learning materials that have been rendered obsolete both by the recent political changes as well as by simple physical deterioration.

D. Summary of Development Constraints

94. In summary, the more important development constraints facing the nation are:

- (i) the unfinished reform agenda, which must be implemented and which includes continuing the progress in the development of markets, enhancing competition in these markets, providing more effective social protection, improving environmental protection, and increasing the capacity for institutional reform;
- (ii) the failure of the industrial and financial sectors to support the development of new productive activities, new investment, and employment;
- (iii) a weak agriculture sector, which as the base of the economy, retards rural incomes and the development of light industry based on agroprocessing;
- (iv) the decline in the potential for long-term growth because of the deterioration in the physical infrastructure system, which requires rehabilitation, maintenance and institutional reform; and
- (v) the decline in the potential for long-term growth as a result of faltering investment in human development.

III. THE DEVELOPMENT STRATEGY OF THE GOVERNMENT

A. The Medium-Term Plan

95. After independence and in the midst of the severe depression, the Government summarized the economic difficulties of the nation in one of the first planning documents as follows:

- (i) Continued disruption of the economy because of the destruction of the structure of production in the FSU;
- (ii) Decline in effective demand;
- (iii) Obsolescence of the capital stock in most branches of industry;
- (iv) Low investment, partly caused by the high rates of inflation;
- (v) Insufficient and inefficient use of foreign investment and foreign assistance;
- (vi) Outmigration of skilled workers; and

- (vii) Insufficient privatization of state property and noncompetitive markets.¹

96. The analysis focused on the ongoing hyperinflation and emphasized the macroeconomic elements. A two-stage recovery was envisioned in which the first stage involved establishing targets for macroeconomic stabilization. As a result of the focus on the immediate macroeconomic crisis, the longer-term needs for the economy such as infrastructure were not emphasized. Although the document stressed the need to move towards a market-based economy, it still included some aspects of a centrally planned economy by including specific targets for a wide range of agricultural products.

97. The material prepared for the Consultative Group Meeting in 1995 indicates that there has been some change in thinking that reflect the improving economic conditions, especially the success of the stabilization program. At the Consultative Group Meeting, a formal public investment program (PIP) was presented in the context of a broad set of development objectives reproduced below:

- (i) Support the policy and institutional reforms necessary to facilitate the development of a market-oriented economy;
- (ii) Maintain the infrastructure that is necessary to support economic recovery and maintain essential services;
- (iii) Modernize the infrastructure that will be needed to support the introduction of the market economy;
- (iv) Promote the recovery in the enterprise sectors by providing support for enterprises already privatized and newly established small-scale enterprises; and
- (v) Ameliorate the adverse environmental legacies.²

98. At the time this report was discussed and cleared with the Government, a new development plan was being written. The following notes are culled from preliminary documents, especially the *Report on Indicative Social-Economic Plan for the Kyrgyz Republic for 1996-1998 and Economic Strategy through 2005* (the *Report*), and related discussions with Government officials.

99. There is a recognition of the successful elements of the Government's management of the transition, including the (i) beginning of the creation of the legal basis for a competitive market system and (ii) important elements providing for macrostabilization including lower inflation.

100. Conversely, there is a frank acknowledgment of the unfinished reform agenda and structural problems, including:

- (i) incomplete privatization, especially of larger firms—a privatization that did not result in behavioral changes in enterprises;

¹ Government of the Kyrgyz Republic, *Concept of Economic and Social Development of the Kyrgyz Republic till 2000*, 1994, p. 10-11.

² Government of the Kyrgyz Republic, *The Kyrgyz Republic, Public Investment Programme 1996-1998*, May 1995, pp. xi-xii.

- (ii) a financial sector that is unable to support a viable private sector, comprising non-viable banks lacking in public confidence, burdened by a portfolio of non-performing debt;
- (iii) in agriculture a need to complete land reform and develop means of supporting private farms;
- (iv) rationalizing social support mechanisms through separate restructuring of social assistance programs and social insurance institutions;
- (v) Government administration that still reflects earlier command economy and not the emerging market system, especially the need to develop regulatory institutions; and
- (vi) weak public revenues.

101. The preliminary *Report* identifies a strategic aim for Government policy as that of doubling real GDP through further development of legal institutions and growth of the private sector foundations of growth, followed by long-term activities (1999-2005) focusing on productivity increases.

102. Specific actions envisaged in the *Report* include:

- (i) Enterprise reforms comprising both the legal and regulatory institutions supporting private firms and the administration of state-owned enterprises, including the development of anti-monopoly and monopoly regulatory mechanisms.
- (ii) The identification of and elimination of continued illegal interference in the private sector by Government officials, especially at the local level.
- (iii) The use of public, budgetary funds for investment projects through debt relief, tax holidays, creation of export processing zones, directed sales of state-owned enterprises.
- (iv) In transport and communications there appears to be an emphasis on investment projects including (i) opening additional air transport routes served by new air craft, (ii) increasing bus and truck fleet and accelerating privatization of transport enterprises, and (iii) rehabilitating road network especially the Bishkek-Osh national highway.
- (v) Specific investment projects, to be either publicly or privately financed, are also noted for such subsectors as nonferrous metallurgy, electric energy, pharmaceuticals, communications, and social services (education and health).
- (vi) Further actions to increase regional cooperation and economic integration through more active participation in international organizations such as the World Trade Organization and regional initiatives such as customs unions with FSU countries.

B. The Public Investment Program

103. Further evidence of the Government's priorities are revealed in the indicative sectoral resource balance in the public investment program (PIP). The largest share of the PIP was allocated to infrastructure (41 percent), followed by industry and enterprise promotion, including lines of credit for privatized businesses (30 percent), natural resource management (15 percent), human resource development and social services support (12 percent), and public administration (2 percent).¹

104. The implementation of the PIP will depend on external support. The Government expects that foreign funding will finance approximately three-quarters of public investment spending. Given the Government's continuing budgetary difficulties, efforts have been made to minimize the recurrent cost implications of the PIP. Even so, the shortage of counterpart funding, whether for investment or recurrent cost purposes, is likely to limit financial absorptive capacity. Domestic funding for the PIP was expected to amount to \$23.2 million in 1995 and to \$45.3 million in 1998. Actually, the entire capital budget for 1995 was only \$15 million, while the budget for 1996 was only \$10 million.

C. External Assistance and Aid Coordination

105. Even though the country is only five years old and has a relatively limited exposure to the international community, the general view among that community is that aid coordination has proceeded well in the Kyrgyz Republic over the past three years. In large part, this is due to the effective management of the external assistance program by the State Commission on Foreign Investments and Economic Assistance, Goskominvest.² In addition, aid coordination takes place through regular local donors' meetings, the annual Consultative Group Meeting, and through discussions between Bank staff and their counterparts while on mission. Coordination between the Bank and the European Bank for Reconstruction and Development (EBRD) has been governed by a memorandum of understanding signed between the two institutions. The memorandum assigns the lead role in assistance to the public sector to the Bank, and to the private sector to the EBRD (see para. 164).

106. Within the framework of the Consultative Group, the IMF and the World Bank are playing a lead role in mobilizing support in the international community for the transition of the Kyrgyz Republic to a market economy. These institutions are providing substantial support to the Government and policy advice related to macroeconomic stabilization and structural adjustment programs. In 1993, the IMF provided a Stand-By Arrangement and a Systemic Transformation Facility. The IMF's efforts have continued with the approval of an Enhanced Structural Adjustment Facility (ESAF) in July 1994. In mid-1996, some problems have developed in meeting specific targets, particularly those relating to Government revenues. However, in recognition of the generally good economic performance, the ESAF was increased from approximately \$105 million to \$131 million.

107. The World Bank has provided sectoral structural adjustment credits for enterprise reform and agriculture. As discussed in para. 54, the enterprise reform program provided minimal support for the largest loss-making state-owned enterprises prior to their restructuring

¹ Government of the Kyrgyz Republic, *Concept of Economic and Social Development of the Kyrgyz Republic till 2000*, 1994, p. xii-xiii.

² In April 1996, the Government has moved executive supervision of Goskominvest to the State Property Fund. It remains to be seen how this action will affect aid management in the country.

and privatization or liquidation. In agriculture, the World Bank has supported reforms in land titling and farm restructuring. These reforms were closely coordinated with the Bank's Agriculture Sector Program. The World Bank is processing policy support credit programs in social protection, labor market transformation, and public sector resource management. The Japanese Government has supported the World Bank's policy assistance through concessional lending, and has committed approximately \$100 million by mid-1995. In addition the World Bank has provided or is planning investment projects in agriculture, energy, environment, health, irrigation, and water supply. The energy project is cofinanced with the Bank. The International Finance Corporation has also been active in the country, supporting private sector initiatives in the financial sector through venture capital operations, in the mining sector, and in agroprocessing.

108. The EBRD has focused on technical assistance in such sectors as agriculture, hydropower, telecommunications, and tourism; and private sector investment projects in agriculture, energy, finance, industry, mining, and transport. A substantial amount of funds have been committed for these projects; however, disbursement has been quite low especially for the credit provided for onlending, because the private sector is still weak. While the EBRD is interested in expanding its loans, the Government is reluctant to accept nonconcessional EBRD loans unless they are utilized for revenue-generating activities or are cofinanced or blended with softer loans from other sources.

109. Other important multilateral assistance programs include the European Union (EU), International Fund for Agricultural Development (IFAD), and the United Nations. The EU has provided more than \$100 million in assistance between 1991 and 1994, largely to underwrite technical assistance under the Technical Assistance for Commonwealth of Independent States (TACIS) program, but also for commodity imports especially food and medical supplies. The technical assistance has been concentrated in agroprocessing, human resources development, and energy. IFAD has supported projects in agriculture, particularly with cofinancing from the World Bank. Financial and technical assistance has also been provided by agencies of the United Nations, especially the UNDP, which has provided assistance for the environment, health, and in institutional strengthening and capacity building.

110. The Government of Japan has provided the largest bilateral assistance program. In addition to the policy support lending noted earlier, the Government of Japan has provided technical assistance and is processing a loan for a project to upgrade the international airport at Bishkek. The United States has provided technical assistance programs in support of agriculture, energy, enterprise restructuring, privatization, and transport. In addition, it has also provided agricultural goods and humanitarian aid, particularly medical supplies and equipment. Support for the private sector in industry and finance is also provided through the operations of US-financed investment funds including the regional Central Asia Enterprise Fund. Other industrialized countries have also provided assistance, mostly import credits or technical assistance.

IV. THE ROLE FOR THE BANK

A. Developmental Needs

111. The principal developmental needs of the Kyrgyz Republic stem directly from the Government's objectives to guide the country through the transition to a market-based economy that can provide sustainable, significant growth and an appropriate degree of social protection

for the population. The main strategic objectives of the Bank's activities are based on the developmental needs of the country identified earlier:

- (i) In the near term, the priority needs reflect the requirements of an economy in transition:
 - (a) policy reforms to complete the task of developing a market-based economy;
 - (b) capacity building at all levels of the Government to provide, initiate, formulate, and implement reforms, and provide efficient public services;
 - (c) increased social support to minimize the human costs of the transition period; and
 - (d) economic recovery characterized by a broad-based increase in output and income accompanied by investment to create a new productive base for the economy.
- (ii) In the medium term, over the next three to five years, although some needs such as capacity building will remain, other concerns will become critical. In particular, a high priority must be given to the need to maintain the potential for growth:
 - (a) investment in infrastructure, especially rehabilitation projects, to preserve the economic utility of past investment;
 - (b) investments in human resources to preserve the gains under the previous system and to reorient service provision towards a market-based economy; and
 - (c) improvements in environmental protection.
- (iii) In addition, if and when the economy satisfies these concerns, the country will require:
 - (a) investments in new infrastructure to respond to emerging market needs;
 - (b) higher levels of investment in human resources such as improvements in urban services; and
 - (c) rehabilitation of the environmental resource base.

B. Operational Objectives

112. The developmental needs of the country listed earlier are vast, but the Bank's resources are limited. Priorities must be established. As a result of these considerations, it is recommended that the Bank assist the Government in filling the more immediate concerns of the country. Reorganizing slightly the developmental needs for the near and medium term noted above, it is suggested that the Bank concentrate on the following strategic or operational objectives:

- (i) Support the Government's reform activities and strengthen its development management through:
 - (a) encouraging institutional change,
 - (b) strengthening institutional capacity, and

- (c) improving public services.
- (ii) Encourage the creation of a new structure for output and new capacity through investment and job creation by the private sector.
- (iii) Arrest the rapid deterioration in the economic potential of the country, primarily by investing in physical infrastructure and human resources, but also by selective interventions to protect and rehabilitate the environment.

113. In determining the specific activities for support by the Bank, the priorities of the Government must be taken into account. Moreover, other agencies also provide extensive support and technical assistance and have undertaken substantial programs in several sectors. Consequently it is recommended that the Bank concentrate on four strategic areas in the following sectors and subsectors:

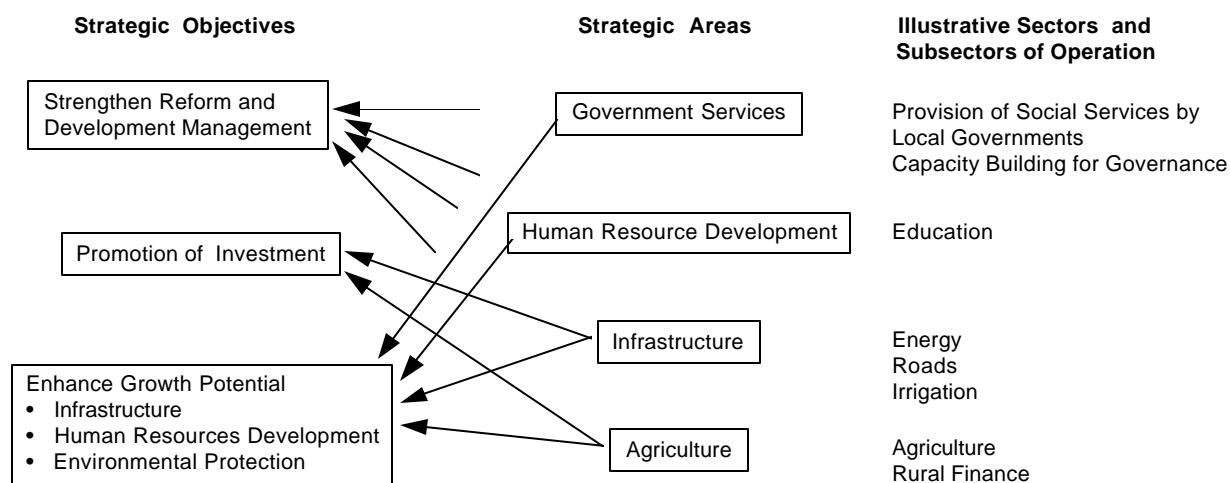
- (i) improvements in the provision of public services, particularly those related to development management and those social services provided by local governments;
- (ii) human resource development, by assistance to the education sector;
- (iii) infrastructure, especially investment in rehabilitation projects to preserve the economic utility of past investment in the energy and in the road sectors; and
- (iv) investment in agriculture, including rural finance.

114. An illustration of how the activities in these areas and sectors target the three operational goals is shown in Figure 3. The specific plans for Bank assistance are discussed later. The order in which the four strategic objectives are listed is solely for organizational purposes and is not meant to indicate priority.

115. This delineation of specific areas and sectors for Bank activities does not mean that other activities do not merit attention. However, these areas, from the standpoint of the use of Bank's resources, are either a lower priority or have alternative sources of external funding and assistance. A summary of the more important external assistance activities by operational sector and an indication of the Government's priorities for development investment is in Table 1.

116. The next three sections discuss sectoral activities organized by operational goal. Following these sections, several tactical considerations related to program design such as the location of projects and coordination issues are discussed. Finally, the relationship between the Bank's Strategic Framework and the country program is discussed.

Figure 3: Relationship Between Strategic Objectives and Strategic Areas for Bank Operations



The arrows show the more important impact of activities in a specific strategic area on the strategic objectives. All sectors will need to contribute to supporting policy reforms, but the arrows showing this are interrupted to simplify the diagram. In addition, not all subsectors receiving Bank assistance are noted.

117. The COSS does not attempt to provide detailed subsectoral projections. In particular, the study does not attempt to project trends in comparative advantage of the type that would be needed for industrial policy, except to identify the potential for export for resource-based industries such as hydroelectric power. The close determination of comparative advantage in transition economies must be approached with care because existing market relations neither reflect long-term trends nor directly translate into the financial incentives facing enterprises. That existing terms of trade do not reflect long-term trends is, in part, simply due to the lack of long-term stability for such important economic variables as the exchange rate or interest rates. Moreover, industry and agriculture have responded differently to the long contraction in output with respect to changes in prices and output—we would have to look over an entire business cycle to understand relative price changes. That the terms of trade do not translate directly into financial incentives facing enterprises, and thus affect behavior, stems partly from the lack of restructuring which leaves firms bearing large amounts of debt and social assets and responsibilities that dilute the impact on enterprise profitability of relative price changes. In summary, there is considerable structural reform to be accomplished before comparative advantages can be realized for the economy.

1. Supporting Reform Activities And Development Management

118. Many of the issues noted earlier relating to the importance of continuing reform activities and strengthening the Government's ability to manage reform are similar to those faced by other non-transition developing countries—issues of development management or governance. Where the transition and non-transition developing countries differ in these areas is sometimes simply a matter of costs. In transition economies, inaction, partial reform, or incorrect policy can quickly exacerbate the serious and inequitable social costs of the transition period. Minimizing these costs, improving governance, and managing reform is a primary concern of the Government and a primary focal point of the Bank's operations. This section (i) summarizes the discussion relating to issues of good governance, particularly the need for capacity building, (ii) elaborates the need to support reform through policy-based lending, and (iii) discusses a strategy to assist the Government in improving the delivery of public services to minimize the inequitable distribution of the costs of the transition.

a. Governance

119. The reform programs being implemented by the Government directly address many of the Bank's concerns regarding good governance, including (i) establishing appropriate legal institutions, (ii) increasing participation in decision making, (iii) building government capacity, and (iv) increasing the flow of information. As noted earlier, the Government has made considerable progress in establishing many of the formal elements of a legal system that can support the development of the private sector. Ultimately this legal system will protect property rights and encourage the use of markets and investment in risky ventures.

120. The privatization exercises that are a central feature of the reform program have transferred many public assets to private hands and have sharply redefined and reduced the role of the state in the economy and has widened the public's participation in economic decision making. As noted, there have been problems in establishing mechanisms to transfer assets, particularly for land, that provide for public accountability and are transparent in execution. It is also proving difficult to eliminate administrative interference because of the residual control of privatized firms by the Government and the restraints on rural enterprises by local governments. Given the scope of the program to privatize the major portion of a newly created nation's assets amid difficult economic circumstances, it is not surprising that problems are encountered. As the transfer of assets progresses and the role of the public sector becomes better defined, there will be the opportunity for long-term civil service reform that includes more public accountability and participation in decision making.

121. As markets develop, there will be a growing need for a flow of information concerning the economy to enable the private sector to operate properly. The Government has attempted to further this process by making public an increasing number of statistics and economic data. Considerable efforts, however, must be made to increase the reliability of these statistics by strengthening the capacity of public agencies to collect and analyze economic information.

Table 1: Summary of Sectoral Activities for External Funding Agencies

| Sector or Subsector | Government Priority as Determined by Staff | Existing External Support | Target for Bank Support |
|----------------------------|--|---|--------------------------------|
| Agriculture | High Economic Base of the Economy | World Bank policy, project support EU, USAID, technical assistance OECF policy support EBRD investment | ? |
| Communications | Medium | EBRD, WB investment WB, EU, USAID; technical assistance | |
| Education | High <i>Year of Education</i> | Small bilateral, NGO aid | ? |
| Energy | High Especially electricity | World Bank project EBRD investment EU, USAID; technical assistance | ? |
| Environment | Low | World Bank, technical assistance and project support through Water Supply and Agriculture | |
| Finance | High | World Bank, policy EU, USAID; technical assistance | |
| Government Services | Medium Capacity building crucial | World Bank, policy support for intergovernmental finance reform, social protection UNDP, USAID; technical assistance | ? |
| Health | High | World Bank project support; UN policy, project support | |
| Industry | High Especially enterprise reform, and export development | World Bank policy, project support; EU, USAID, technical assistance OECF policy support EBRD investment | |
| Social Protection | Medium | World Bank policy, project support UN, USAID, EU humanitarian assistance | |
| Transport | High Especially Roads | EBRD, EU, USAID; technical assistance | ? |
| Water Resources | Low | World Bank project planned | |

Source: Staff analysis.

122. An overriding concern for good governance and the management of reform and development is the need for long-term capacity building. Technical assistance directed towards capacity-building activities should focus primarily on the sectors in which the Bank is expected to conduct broad-based, long-term programs. In the following sections, the specific sectoral and subsectoral need for capacity building is discussed. Additional technical assistance should only be provided in support of central government operations such as aid management or policy analysis—areas that provide for an improvement in governance. Furthermore, this assistance should only be provided in situations where a significant impact can be made. As the Government notes, there are a considerable number of short-term training programs and uncoordinated technical assistance that have not materially advanced the transition process.¹

¹ Government of the Kyrgyz Republic, *Evaluation of the Technical Assistance Programme*, 29-30 November 1995, p. 9.

123. It also needs to be recognized that it may not be possible to mount successful programs of capacity-building in even the limited number of areas suggested. Successful capacity-building demands a responsive environment in the Government agencies targeted. Government personnel must be receptive to the process. The Bank must make an independent assessment of the potential for capacity building and only initiate technical assistance programs when the opportunity for successful interventions is present.

124. An additional consideration in the area of capacity building runs across those discussed in each individual sectoral area. The Government has informed Bank staff that, as a matter of policy, it is reluctant to accept technical assistance loans and has expressed its intention to limit the technical assistance component of any loans to less than 10 percent of the total amount of the loan. This policy partly reflects the Government's dissatisfaction with technical assistance programs conducted by other external assistance agencies in which the major part of the funds are used for foreign consultants who, in the view of the authorities, do not provide assistance commensurate with their expense.

125. To be responsive, it must be emphasized in the project design and in the implementation arrangement that Kyrgyz nationals be involved in consultant services and other project work. As noted, the level of human skills found in the country is high. Relatively small investments to help people reorient their skills to respond to the new demands engendered by the development of a market-based economy will probably yield high returns. The UNDP has made an effort to assist Kyrgyz nationals develop the relevant skills and to match skills with employment opportunities as they develop. The Bank should also support this process.

b. Support of Policy Reforms

126. As discussed earlier, the large unfinished reform agenda needs to be completed. This is a difficult task, made more difficult by the economic depression and the Government's fiscal difficulties. Policy-based program loans supported with technical assistance can enable the Government to continue its ongoing reforms. The Bank has already provided assistance to the Government through a policy-based program loan for agriculture, designed to support (i) land reform, (ii) the clarification and transfer of water rights to farmers, (iii) the privatization of Government enterprises supplying agriculture inputs, and (iv) the institutional strengthening of the Ministry of Agriculture and Food. Additional program loans may be useful, especially those to assist the Government in the management of transition such as through enterprise reform. Other program loans could come from among the strategic sectors noted, including agriculture, education, or rural finance.

127. The Bank's proposed Sector Development Program (SDP) could prove to be a very useful tool in assisting the Government in this area.¹ The SDP would permit simultaneous support for policy reform and investment in specific projects. In the context of the Kyrgyz economy the SDP could provide funding for infrastructure rehabilitation and for training needs in direct support of sectoral needs. The ability to assist the Government in both policy reform and investment would lower the risk of project failure associated with activities that only tackled one problem. Policy reform in education, for example, is much more likely to be successful, and encourage genuine participation by the beneficiaries, if conducted in the context of a program that reverses the severe deterioration of school buildings and supports training and teaching needs.

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R143-96: Review of the Bank's Program -Lending Policies, July 1996.

c. The Improved Provision of Local Government Services

128. Improving the provision of public services is an important element of the country's reform program and is also an essential part of any overall program for human development. This is particularly true for services providing for social support, including social insurance (for pensioners and the unemployed), social assistance (direct support for the poor), and social services (health, education, sanitation, and water supply). This concern reflects the nature of this period of transition when there are widespread and heavy economic and social costs—costs borne often by those least able to bear them. With support from the World Bank, the Government has begun to deal with some of the legacies of the Soviet system with respect to social insurance through reform of the pension system and a program of unemployment benefits and services that reflects emerging labor market needs. Technical assistance activities to strengthen social protection are becoming the largest single focus of the total technical assistance program in the country.¹ In addition, there has been some improvement in targeting assistance to the poor.

129. However, more needs to be done in this area. In particular, the local government units face unprecedented challenges in attempting to provide fiscally sustainable services that are responsive to the growing need for the services. Support to improve the delivery of government services at the local level would enable the country to improve the management of reform and ease the difficulties of transition. Several strategic elements are important in this area, including the necessity to:

- (i) improve the targeting of services and the transparency of the system to increase beneficiary participation;
- (ii) increase the efficiency of service provision including, where relevant through improved cost-recovery mechanisms;
- (iii) enhance the capacity of public agencies to redress problems and to initiate and implement reforms; and
- (iv) review and redress the role of the public sector vis-à-vis the private sector and non-government organizations (NGOs) and provide support for the active involvement of the private sector.

130. These elements follow generally from the overall country operational objectives as shown in Figure 4.

131. Care must be exercised in designing specific programs for this sector as the activities required are administratively costly. However, programs can be identified and formulated to incorporate three elements: (i) technical assistance to build institutional capacity, (ii) investment in equipment and small infrastructure needs, and (iii) financing for nonrecurrent restructuring expenses. Technical assistance is a priority, especially for the local governments that lack the ability to initiate or implement changes. Technical assistance can, however, proceed only after a needs assessment in agencies and with personnel that recognize the need for change and have the political support to undertake this change. In most areas there will be a need to upgrade equipment and to invest in relatively small, dispersed infrastructure such as

¹ Government of the Kyrgyz Republic, *Evaluation of the Technical Assistance Programme*, 29-30 November 1995, p. 7.

school buildings which need rehabilitation and social assets which need maintenance. Finally there are many nonrecurrent expenses, such as those related to retrenchment of employment. A failure to provide for the financing of these activities would inhibit any real reform. Several different methods could be used to allocate Bank resources to this sector. Program loans could be used to support policy reforms, with funds earmarked for specific interventions such as technical assistance or small infrastructure purchases. Sector loans or the Bank's new Sector Development Program may be, however, more applicable, by targeting a limited number of local government bodies for technical assistance and associated investment activities including infrastructure and restructuring expenses.

Figure 4: Country Operational Objectives and Improved Local Government Services

| <i>Country Operational Objectives</i> | <i>Improved Local Government Services</i> |
|--|---|
| <ul style="list-style-type: none"> • Strengthen reforms and development management; <ul style="list-style-type: none"> - institutional change, - institutional capacity, and - the provision of public services. | <ul style="list-style-type: none"> • Improve <ul style="list-style-type: none"> – service targeting; – service efficiency; – institutional capacity. |
| <ul style="list-style-type: none"> • Encourage the creation of a new structure of output and new production capacity. | <ul style="list-style-type: none"> • Support the involvement of the private sector. |
| <ul style="list-style-type: none"> • Arrest the rapid deterioration in the long-term potential of the country through: <ul style="list-style-type: none"> - infrastructure, - human resource development, and - environmental protection. | <ul style="list-style-type: none"> • Rationalize and rehabilitate equipment and small infrastructure. |

2. Encouraging the Creation of a New Structure for Output

a. An Active Program in Agriculture

132. Within the aim of facilitating the transition to a market-based agriculture system, the Bank's program in agriculture requires an integrated mix of policy reform, capacity building, and selective key investments. The immediate objectives would be: (i) to create a policy environment conducive to development of competitive market structure; (ii) capacity building to reorient and strengthen public sector agencies to support this market system; (iii) to build the basic institutions to provide financial services in the rural areas; (iv) to increase productivity and efficiency in key agriculture areas; (v) to develop systems for maintaining and rehabilitating agricultural infrastructure; and (vi) to arrest the degradation of the water and soil resources and improve the environmental resource base. The relationship between the country's operational program objectives and agriculture sector objectives is given in Figure 5.

133. **The Policy Environment.** As discussed earlier, many of the principal policy measures for land reform and farm restructuring are now largely in place or are being

implemented such as those supported by the Bank's Agriculture Sector Program. However, if the implementation of the reforms is to gain momentum, the Government has to consolidate the process within a clear legal and institutional framework. In particular, transparent procedures for effective implementation of the distribution of land and other assets are needed to provide farmers with clear titles and access to other factors of production.

Figure 5: Country Operational Objectives and Agriculture Sector Objectives

| <i>Country Operational Objectives</i> | <i>Agriculture Sector Objectives</i> |
|--|---|
| <ul style="list-style-type: none"> • Strengthen reforms and development management; <ul style="list-style-type: none"> - institutional change, - institutional capacity, and - the provision of public services. • Encourage the creation of a new structure of output and new production capacity. • Arrest the rapid deterioration in the long-term potential for the country through: <ul style="list-style-type: none"> - infrastructure, - human resource development, and - environmental protection. | <ul style="list-style-type: none"> • Establish a policy environment supporting competitive market structure; and • Build institutional capacity to reorient and strengthen public sector agencies. • Develop basic institutions to provide rural financial services; and • Increase productivity and efficiency. • Develop systems for maintaining and rehabilitating agricultural infrastructure; and • Arrest the degradation of the environment. |

134. The restructuring, demonopolization, and privatization of the state-owned enterprises that control the supply of inputs and output processing and the marketing system is also progressing. However, as noted, the pace of change is slow and formal changes in ownership have not necessarily resulted in an institutional or behavioral change. Consequently private initiative to enter the market for inputs and outputs is impeded. Some enterprises and holding companies exercise a considerable degree of monopolistic market power and retain public sector functions such as regulation and public procurement. Additional assistance to effectively implement the current reforms to encourage competitive markets will be necessary.

135. **Capacity Building.** A systematic capacity building effort is needed in the key Government agencies, both national and local, as well as with farmer and water user associations. The Bank has provided two advisory technical assistance (TA) projects¹ in conjunction with the Agriculture Sector Program Loan in support of capacity building, which will be implemented during 1996-1997. These activities follow the needs assessment produced in

¹ TA No. 2450-KGZ: Reorganization and Strengthening of the Ministry of Agriculture and Food, for \$1.324 million and TA No. 2451-KGZ: Building Capacity for the Formation and Management of Water Users Associations for \$861,000, approved on 23 November 1995.

earlier technical assistance activities sponsored by the Bank and by other funding agencies such as TACIS and the World Bank. The first advisory TA will strengthen the capacity of the Ministry of Agriculture and Food to (i) formulate strategies and policies; (ii) design, finance, and implement a program to complete the process of reform in the agriculture sector; and (iii) provide continuing support and strengthen the Ministerial units responsible for these tasks. The second advisory TA will reorient and strengthen the capacity of the Ministry of Water resources to facilitate the formation and the management of water user associations.

136. Beyond these first steps, a substantial reorientation and institutional strengthening of the public sector agencies supporting agriculture is essential to manage the design and implementation of the sector reform program and to provide the support services needed in a market-based agriculture sector. The reorientation of public agencies away from servicing the state and collective farms to supporting private farms and businesses is needed. In these activities, important areas include: advisory or extension services, market information, regulation, research, training, and education. In particular, the Ministry of Agriculture and Food must change its role and structure at the national, regional, and district levels. These issues require an integrated response to policy reform, enhanced institutional capability, and supportive investments.

137. **Rural Finance.** In this area, two critical issues face the Government: (i) the immediate need to ensure the availability of emergency seasonal credit in the absence of functioning commercial institutions; and (ii) the need to develop an efficiently functioning rural finance system to provide financial services in the rural areas in the medium to long term. The Bank is providing technical assistance to the Government to help in both areas—in designing policy mechanisms for Government-directed emergency credit and also in developing a pilot project of market-based lending in selected rural areas. The Bank's program will be supported by the World Bank's structural adjustment program for the financial sector. Considerable care will have to be taken in this subsector; there are, for example, currently no institutions that can provide market-oriented loan services in rural areas. In such a project, capacity building will need to extend to the rural finance institutions, but also to the borrowing farm and rural organizations or individuals. Few individuals or organizations have any experience in either lending or borrowing in a financial market.

138. **Improving Productivity.** The plan of action for agriculture and agro-industry that will support the transition to a market-based sector must include improvements in support services to private farms and farm-based enterprises. Positive encouragement is needed for the new private farms and agriculture enterprises from both expanded public sector support and private sector initiatives. Private sector investment activities such as contract farming programs or agroprocessing ventures to provide markets, technical support, credit and access to inputs are required. As discussed later, the Bank does not currently envisage undertaking investment operations in the private sector (para. 164); however, the Bank should increase its efforts to ensure that other funding agencies are aware of the new opportunities in this sector, particularly those that develop from Bank-initiated activities, and that these opportunities are acted upon. Particular attention should be paid to the need to improve distribution channels for agriculture products and agroprocessing industries.

139. Public sector activities such as the provision of agricultural extension services and pest and disease control functions are also important. Some of these responsibilities are currently assumed by state-owned enterprises in the process of restructuring and privatization. These public sector-type responsibilities must be divested from these enterprises and assumed by properly constituted Government agencies. The Bank-financed Agriculture Sector Program

Loan supports some of these changes, but there is need for a long-term effort to support institution building.

140. **Infrastructure.** The agriculture sector is in the process of reestablishing itself in a private sector context. Among the other problems, when new production structures evolve, public infrastructure must adapt to service the new requirements. Private smaller-scale farms have different needs than the large state and cooperative farms. The priorities are to ensure adequate farm-to-market roads and irrigation systems servicing small farmer associations. Ironically, in the context of developing a private market-system, these infrastructure needs may well demand a stronger role for the public sector, particularly local governments. Activities that in the past had been provided by the state and cooperative farms must now be performed by local governments. Bank programs in this area should follow closely the considerations noted earlier for improving public service provision.

141. **Environmental Protection.** Within the overall context of assistance to the sector, it is important to move towards more sustainable agriculture practices. In particular, farming practices must be encouraged that will provide more protection for soil resources. Two principal concerns are present: (i) to improve water management practices; and (ii) to introduce sustainable soil conservation techniques. The first should be approached within the context of irrigation improvement projects, the second within the context of post-privatization support projects for farms.

b. Limited Activities in Industry and Finance

142. The strategy eschews active involvement in industry with the exception of program-based lending to further basic policy reform. In making this decision, the relatively limited resources of the Bank, the needs of the country, and the programs of other funding agencies have been taken into account. USAID and the World Bank have conducted active programs of technical assistance to further privatization and corporate governance. The activities in support of privatization were the largest single component of technical assistance received by the Government during 1993-1995. As discussed earlier, the World Bank has been supporting a large program to isolate and restructure or liquidate the largest and weakest enterprises. The EBRD and the United States, through the Central Asia Fund, have active programs involving lines of credit and technical assistance for commercially viable industries. The current memorandum of understanding between the EBRD and the Bank specifically calls for the EBRD to take the lead in private sector operations (see para. 164). As long as the Bank does not become directly involved in private sector support projects, the scope for long-term Bank operations in industry and finance, through loans to the public sector is limited.

143. The financial sector is currently incapable of supporting the development of the private sector in the country. The World Bank is taking the lead in supporting reforms with a Financial Sector Adjustment Loan which was approved in June 1996. In addition to activities to encourage reform, the scope for Bank activity is particularly in rural finance (see para. 137). The Bank's efforts in this field will provide support for other program activities in agriculture.

3. Arresting the Rapidly Deteriorating Economic Potential

a. Physical Infrastructure

i. Energy

144. In view of the discussion earlier about the problems in the energy sector, the strategic objectives for the sector include the need (i) to encourage fiscally responsible operations of state-owned enterprises; (ii) to rationalize, rehabilitate, and maintain the infrastructure supply system; (iii) to promote the active involvement of the private sector in production and in conservation; and (iv) to reduce pollution as a result of sector activities.¹ In particular, the first consideration would involve greater cost recovery including better revenue collection, cost-based pricing reflecting long-term supply costs, increased productivity, and reduced production costs. The linkages between the overall country operational objectives and these sector objectives can be seen in Figure 6.

Figure 6: Country Operational Objectives and Energy Sector Objectives

| <i>Country Operational Objectives</i> | <i>Energy Sector Objectives</i> |
|---|---|
| <ul style="list-style-type: none"> • Strengthen reforms and development management; <ul style="list-style-type: none"> - institutional change, - institutional capacity, and - the provision of public services. | <ul style="list-style-type: none"> • Encourage fiscally responsible operations of state-owned enterprises. |
| <ul style="list-style-type: none"> • Encourage the creation of a new structure of output and new production capacity. | <ul style="list-style-type: none"> • Promote the active involvement of the private sector, in production and conservation. |
| <ul style="list-style-type: none"> • Arrest the rapid deterioration in the long-term potential of the country through <ul style="list-style-type: none"> - infrastructure, - human resource development, and - environmental protection. | <ul style="list-style-type: none"> • Rationalize, rehabilitate, and maintain the infrastructure supply system. • Reduce pollution as a result of sector activities. |

145. The actions needed to achieve these objectives vary considerably across subsectors; however, the general needs include:

- (i) developing increased capacity to design and implement sector policy as well as establishing regulatory and administrative bodies;
- (ii) rationalizing and restructuring state-owned enterprises with the aim of providing for cost-recovery for operations including capital rehabilitation and maintenance;
- (iii) continuing privatization where applicable;
- (iv) reviewing the long-term infrastructure system needs within the context of the public investment program;

¹ These goals follow closely the Government's policy objectives for the sector in the Kyrgyz Republic, *Public Investment Programme 1996-1998*, May 1995, p. 69.

- (v) establishing social protection elements to mitigate the burden of tariff increases on the poor; and
- (vi) reviewing intercountry agreements and increasing regional cooperation.

146. **District Heating and Electric Power.** The most important subsector for the Bank is that of district heating and electric power. This is an area in which the public sector will be predominant and where the financing requirements exceed the ability of any single funding agency. Among the specific activities that will be required is new legislation to establish a more appropriate regulatory structure. This includes the necessity to establish nonpolitical procedures for tariff setting.¹ As a matter of policy, as soon as practical, tariffs for electricity and district heating should be set to cover long-term supply costs. To mitigate against the most severe impacts of such changes, lifeline tariff structures must be introduced and the system of social assistance strengthened to respond to large increases in utility charges. Tariff restructuring would provide an important first step in strengthening the state-owned enterprises, particularly KNEHC. Specifically for KNEHC, however, a long-term business plan needs to be prepared that provides for restructuring, cost recovery, and improved efficiency. As a related matter, a sector review is needed to determine if the possibility exists for privatizing some of the services. In terms of infrastructure investment, the rehabilitation of the Bishkek thermal plant was accorded a high priority. The Bank's proposed Power and District Heating Rehabilitation Project, supported by a parallel loan by the World Bank, will finance this rehabilitation. High-priority areas for future work include the rehabilitation of transmission and distribution systems.

147. This indicative plan for Bank operations specifies actions that fall within the power of the Kyrgyz Government to accomplish. Other problems, however, require assistance from other countries. For instance, Kyrgyz power generation is constrained by interrepublican water use agreements. These water use agreements can only be reviewed in a regional context, perhaps within a regional program for investment and policy coordination. Similarly, interrepublican electricity trade agreements need to be reviewed within a regional energy planning context. The Bank should make every effort to support regional efforts at policy coordination (see para. 169). One important possible regional initiative for the Bank would be to support the expansion of Kyrgyz power facilities to increase electricity exports to nearby countries such as the People's Republic of China (PRC), Kazakstan, and Pakistan. This would involve the negotiation of long-term purchase contracts as well as the construction of the additional generating facilities and transmission networks to establish a reliable power supply for the region.

148. Activities in this subsector should also be directed towards improving the environment. Increased efforts towards conservation are a primary concern. As a particular example, increases in retail prices to cover production costs, including infrastructure needs, would encourage conservation through demand-side management at the same time that the fiscal position of state-owned enterprises are strengthened. Equally important, infrastructure rehabilitation activities that preserve the economic utility of existing systems can, at the same time, move to improve the environment by directly reducing pollution and improving sanitation.

149. Other energy subsectors—coal, oil, and gas—receive considerable technical assistance from other funding agencies, including the EU, USAID, and Japan. Moreover, little public support of investment projects is envisioned, especially for the coal industry which faces

¹ This is to be accomplished under the Bank's proposed Power and District Heating Rehabilitation Project for the Bishkek thermal plant, supported by a parallel World Bank credit.

retrenchment. Investment in oil and gas should primarily be undertaken by the private sector. As an exception, the urban utility aspects of natural gas distribution require many of the same activities as noted in the discussion about electric power: tariff reform, strengthening state-owned enterprises, and infrastructure rehabilitation. In addition there may be a need for Bank assistance if oil and gas projects develop as regional initiatives—projects that develop in the course of considering regional needs. These type of projects may require the support of multilateral funding agencies including the Bank.

ii. Transport and Communications

150. As discussed earlier, the Kyrgyz Republic inherited its transport infrastructure from the FSU. The systems were planned without consideration for the needs of the now independent state. The Bank's operational goals, as translated into sectoral goals, are (i) to encourage fiscally responsible operations of state-owned enterprises; (ii) to introduce internationally compatible safety and technical standards; (iii) to accelerate privatization activities; and (iv) to rationalize, rehabilitate, and maintain the infrastructure supply system (see Figure 7).

151. Encouraging fiscally responsible operations in state-owned enterprises will involve a number of difficult steps, the most important one being the elimination of remaining subsidies for transport enterprises. The shift towards hard budgets (budgets unsupported by subsidies) and commercially oriented behavior would not only strengthen the sector but also have important carryover impacts on sectors supplying inputs to transport enterprises—energy and utility companies would benefit from increased revenues. Hard budgets for state-owned enterprises would, in turn, ease privatization activities in the sector and encourage an increased private sector presence. Towards this end, the Government has announced the goal of privatizing most transport activities except some rail, civil aviation, and bus services in the capital, Bishkek.¹ Private sector competition would be improved by the elimination of residual controls over road transport companies such as local licensing requirements. Internationally compatible safety and technical standards are important in and of themselves, but they would also enhance the transfer of productivity-enhancing technology.

152. The planned privatization activities must be accomplished within the context of a proper assignment of roles between the public and private sector. There is some evidence that actions such as corporatization or other pre-privatization activities have been carried out for units that properly should remain with the Government, for example, units responsible for setting technical standards. Consequently, there will be a continuing need to provide technical assistance to ensure that the Government sector has the capacity to (i) review and prepare new legislation affecting the sector, (ii) program and implement sector policies and investment projects, (iii) establish technical standards, and (iv) ensure compliance with environmental and safety standards.

153. Higher efficiency is important, but there is also a need for more public resources being devoted to infrastructure, particularly road maintenance. The planned establishment of a Road Fund to consolidate budgetary resources is only a first step towards this and there are clear problems in tax and fee collection to be resolved. The current tax base for supporting road activities should be shifted towards a reliance on fuel taxes and road use taxes and fees.

¹ Government of the Kyrgyz Republic, *Public Investment Programme 1996-1998*, May 1995, p. 76.

Figure 7: Country Operational Objectives and Transport Sector Objectives

| <i>Country Operational Objectives</i> | <i>Transport Sector Objectives</i> |
|--|--|
| <ul style="list-style-type: none"> • Strengthen reforms and development management; <ul style="list-style-type: none"> - institutional change, - institutional capacity, and - the provision of public services. • Encourage the creation of a new structure of output and new production capacity. • Arrest the rapid deterioration in the long-term potential of the country through <ul style="list-style-type: none"> - infrastructure, - human resource development, and - environmental protection. | <ul style="list-style-type: none"> • Improve the fiscal operations of state-owned enterprises. • Develop safety and environmental standards. • Accelerate privatization and private sector development. • Rationalize infrastructure, rehabilitation, and maintenance. |

154. The most important subsector is roads, and here, the Bank has been asked by the Government to play a major role in providing assistance. The Government has noted that, until recently, this subsector has not received significant technical assistance. An important task is to improve the policy and coordinating capability of the Ministry of Transport. This is a major capacity building activity requiring long-term technical assistance. A preliminary needs analysis was conducted in the course of processing the Bank's Road Rehabilitation Project for the Bishkek-Osh Highway. This work emphasized the importance of training staff, particularly in such areas as planning, accounting, project management, maintenance planning, and supervision. The Road Rehabilitation Project calls for an extensive capacity-building program to be designed and assistance to be provided for legislative review, for planning maintenance activities, and revenue planning.

155. The major investment activity needed for the sector is to assist in rehabilitating and maintaining the existing road system. Of particular importance is the upgrading of the Bishkek-Osh Highway to link the two major population centers of the country and to bring into contact with these urban markets the countryside between these two cities. This project is important from the standpoint of nation-building. In addition, this highway could further enhance regional travel by providing another route from countries such as Uzbekistan and Tajikistan to Kazakhstan and southern Russia. Future projects should target other similar arteries such as upgrading the road links between Bishkek and Djambal in Talas Province and between Bishkek and the PRC through Naryn Province at Torogart.

156. The regional perspective is important; there is a clear need to improve regional cooperation. The Bank's assistance in this area could be to help the Kyrgyz Republic to develop and improve complementary transport facilities within the context of a regional transport sector strategy.

157. The proposed strategy does not include active involvement in communications. While there exists a need for change, much of the efforts should come from the private sector. The experience in other countries has shown that new technology (cellular telecommunications, for example) can open opportunities for investment by the private sector, given an appropriate policy environment. Considerable technical assistance needs are present in the public sector, a new regulatory environment must be created for example. However, these needs are likely to be best served through assistance from an institution such as the EBRD or the IFC with their focus on private sector investments.

iii. Water Supply And Sanitation

158. Although serious problems exist in water supply and sanitation, especially in the smaller urban and rural areas, the Government assigns a relatively low priority to investment activities in this sector. Few activities by the Bank are called for over the planning horizon of three to five years, covered by this country operational strategy. It may be possible, however, to target some of the more important problems such as rural sanitation through agriculture development projects. For instance, low cost technologies are available for waste treatment in rural areas and could be introduced through farm restructuring projects. This activity would be effective in reducing health risks as well as in improving the environment and economic condition of the poor in small towns and villages. In addition, water supply and sanitation issues can be addressed in projects that more generally target the improvement of service provision by local government.

b. Human Resource Development

i. Education and Training

159. With its severe resource constraints, the Government has requested the Bank to play a major role in providing assistance in developing the education and training sector. Until recently, this subsector has not received significant technical assistance; in addition to the Bank, there have been only relatively small efforts by external funding agencies, particularly bilateral aid agencies. The Bank is playing a similar role in Kazakhstan and thus is developing experience and a comparative advantage, relative to other funding agencies, for activities in the sector. The sectoral objectives are: (i) to improve policy planning and efficiency to meet the demand of the new market-based economy; (ii) to reform education finance; (iii) to increase the involvement of the private sector; (iv) to increase investment in human resource development; and (v) to rationalize and rehabilitate the physical infrastructure of the education and training system. The relationship between the country operational objectives and education sector objectives are shown in Figure 8.

160. Specific policy needs are being addressed by the Bank's TA No. 2290-KGZ (Education and Training Master Plan). A comprehensive sector study was completed culminating in a draft master plan that was subsequently endorsed by a national consultative workshop held in December 1995. Among the more important tasks are to:

- (i) review existing legislation to allow for better integration of policy and implementation;
- (ii) restructure the Ministry of Education and Science and the Department of Vocational Training through a needs assessment to achieve more efficient planning and implementation;

- (iii) restructure existing higher education institutions to reduce duplication of effort, increase resource mobilization, and improve service delivery;
- (iv) enhance the role of local educational authorities;
- (v) provide for curriculum reform that reflects the emerging market economy.
- (vi) include early childhood development and gender issues into the reform package; and
- (vii) promote the role of the private sector in education and training.

161. In addition to policy reforms, education investment inputs identified as high priority include (i) the rehabilitation of schools, (ii) the provision of training materials and equipment for training centers, (iii) the establishment of an information system for the Ministry of Education, and (iv) the development of a distance training system for teacher training.

ii. Health

162. Recognizing the need for reform of the health sector, the Kyrgyz Government has developed a medium-term strategy, the Manas Health Plan, for addressing health sector needs. The objectives of the plan are to restructure the financing and delivery of health services to encourage more cost-effective health services delivery and to improve the delivery of government-financed primary health services to the populations most in need. Several aid agencies are developing projects to assist the Government in implementing the plan. There is no call for the Bank to adopt initiatives in the sector. Indeed in the Government's review of ongoing technical assistance activities it cites the need for better coordination rather than for increased support.¹ There are, however, health sector concerns that should be addressed within the context of improving the ability of local level governments to provide public services in general, if these efforts can be properly coordinated with ongoing activities in the health sector.

Figure 8: Country Operational Objectives and Education Sector Objectives

| <i>Country Operational Objectives</i> | <i>Education Sector Objectives</i> |
|---|---|
| <ul style="list-style-type: none"> • Strengthen reforms and development management; <ul style="list-style-type: none"> - institutional change, - institutional capacity, and - the provision of public services. • Encourage the creation of a new structure of output and new production capacity. | <ul style="list-style-type: none"> • Improve policy planning and efficiency. • Reform the state of education finance. • Improve the involvement of the private sector. |

¹ Government of the Kyrgyz Republic, *Evaluation of the Technical Assistance Programme*, 29-30 November 1995, p. 7.

- | | |
|---|--|
| <ul style="list-style-type: none"> • Arrest the rapid deterioration in the long-term potential of the country through <ul style="list-style-type: none"> - infrastructure, - human resource development, and - environmental protection. | <ul style="list-style-type: none"> • Increase investments in human resource development. • Rationalize and rehabilitate the physical infrastructure. |
|---|--|

C. Strategic Considerations

1. Coordination with EBRD and Support for the Private Sector

163. The importance of promoting private sector activity was highlighted in the discussion above. Specifically, the recovery of the economy will require more than the successful accomplishment of the Government's reform agenda and support for infrastructure and human resources development; the country requires the creation of a new structure of output, and the creation of new production capacity. Poverty and unemployment will be reduced on a sustainable basis only by the creation of new jobs. There is no substitute for new investment from the private sector, either foreign or domestic. The promotion of a private sector that can utilize specific public sector investment projects undertaken by the Bank is also important to ensure that these projects are successful in increasing economic growth and the quality of life. In a country with so little history of private sector activity, there may be no recognition by the small private sector of the expanded potential represented by Bank projects.

164. With respect to Bank activities in the Kyrgyz Republic, a memorandum of understanding signed with the EBRD delineates areas of responsibility for the two regional development banks. The Bank is responsible for investments in the public sector and the EBRD is responsible for activities in the private sector. At a minimum, forward-looking, active, close cooperation with EBRD will be a necessity to see that specific private sector projects are designed and implemented to support public sector investments including those sponsored by the Bank.

165. It should be noted that the memorandum was determined in the absence of any consultation with the Kyrgyz Government. The Government is not satisfied with the present delineation of responsibility and has specifically requested that the Bank undertake private sector operations. It should be noted that the memorandum referred to the agreed guidelines as "interim in nature" and called for a review after the completion of the first programming cycle of the Bank's operations which would be in 1996.

166. In the event of a reconsideration of the memorandum with the EBRD, one possible activity for the Bank would be to support a local development fund to provide technical assistance, investment support, and loan finance for private sector activities that would directly reflect the expanded opportunities resulting from the Bank's public sector investments. For example, the fund could focus on supporting activities in the agriculture sector, such as farm restructuring, rural credit, or agroprocessing activities, along the Bishkek-Osh road. This type of project would help bring out the complementarities in the Bank's program.

2. Geographical Cohesion: The Bishkek-Osh Artery

167. The Bank has only recently initiated investments in projects in the Kyrgyz Republic. Consequently, Bank staff lack experience in implementing projects in the country. Moreover, the Bank has not traditionally worked in Central Asia and lacks the reservoir of experience concerning the working conditions. Finally, conditions in the country, as a result of the swift moving transition, are constantly in flux. These factors, if not properly addressed, could raise the risk of program or project failure. One operational method of dealing with these problems is to provide a common geographical focus for the initial set of Bank support projects. A limited set of projects that touch on a common geographical region would help smooth the learning experience of Bank staff with the region. A common location for different projects would allow Bank staff to benefit from the immediate experiences of other staff—an important consideration in a country where Bank activities are just beginning.

168. One such geographical focus would be the economic zone identified by the Bishkek-Osh highway. This zone includes the two major urban centers, roughly one-half of the population, and traverses four of the six provinces. This zone has considerable potential for agriculture and considerable need for investment in infrastructure and human resource development. In as much as possible, project design in education, agriculture, and social services should be designed to be implemented in this common region.

3. The Potential for Subregional Cooperation

169. Several of the sectors in which the Bank will be active involve cross-border issues within Central Asia. Notable examples are transport, electric power, and water resources. Beyond ensuring that its activities in each country are consistent with what is being done in the others, the Bank should endeavor to undertake regional investment and policy coordination and promote efforts to ensure a rational pattern of resource use in the area as a whole.

170. All the economies of Central Asia were strongly integrated into the former Soviet economy, with little thought given to specialization and rational trade, or even integration across republican borders within the Central Asian region. These economies are all landlocked, with limited access to the outside world. The Bank should take care that in its investment activity and in its policy advice, it supports rather than interferes with regional cooperation. For example, the Kyrgyz Republic sees hydroelectric power as one of its undeveloped resources that could be developed to expand exports. At the same time Kazakhstan has set as one of its goals “energy independence” which may work against the import of power from the Kyrgyz Republic. Similar examples can be found in agriculture, water resources, and in transport. The Bank should, through regional technical assistance, actively pursue investments and other activities that would enhance regional cooperation.

4. Bankwide Concerns

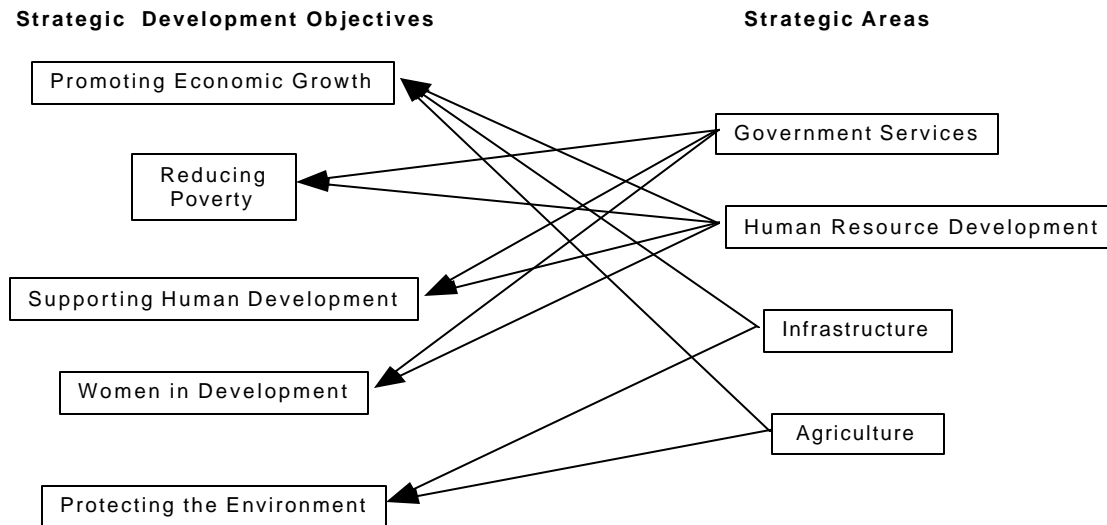
171. The proposed strategy is fully consistent with the Bank’s Medium-Term Strategic Framework 1995-1998 as shown in Figure 9. The strategy would promote efficient economic growth by supporting continued policy reform, through investment in infrastructure and human resource development, and specifically by investing in agriculture to set firm the base for future growth. Poverty reduction is a direct target of actions designed to increase social protection and investment in education and those allied projects that will more generally improve the condition of children. The strategy directly calls for investment in human development as a strategic direction. An improvement in the condition of women in development is targeted through actions

in education, social protection, and those activities that will directly improve the condition of children. The last is particularly important, those developments such as restrictions on the provision of social services for children have been among the most important factors contributing to the deterioration in the situation of women in the country.

172. The sound management of natural resources and protection of the environment is an important element in assuring sustainable growth when the economy recovers. The Government notes that the Kyrgyz Republic suffered less in terms of environmental degradation than did other republics and plans to allocate only limited public sector resources towards environmental improvement projects.¹ Moreover, many of the more serious environmental problems are those associated with industrial and mining activity and cannot be resolved without active involvement in these fields. Other problems, however, are found in agriculture and urban services and should be addressed in project design in these sectors, and in selective aspects of infrastructure investment projects, particularly those that contribute to the more efficient use of energy and water. Thus the Bank's involvement in environmental improvements should be sector-specific as indicated above in the discussions on agriculture and infrastructure.

¹ Government of the Kyrgyz Republic, *Public Investment Programme 1996-1998*, May 1995, p. 22

Figure 9: Relationship Between the Bank's Strategic Development Objectives and Strategic Areas for Activity in the Kyrgyz Republic



The arrows show the most important impact of activity in the strategic sectors on the different strategic development objectives of the Bank.

173. **Cooperation with Nongovernment Organizations (NGOs).** Bank activities in the Kyrgyz Republic offer considerable scope for encouraging cooperation with NGOs. Although NGOs do not have a history in the FSU Republics that they do in other Bank member countries, there are a growing number of such organizations. The NGOs are growing in response to the greater political freedom but also in response to the changing economic situation. As the private sector grows and the role of the public sector changes, there is an increased call for organizations to occupy some of the middle ground between public and private. There is particular need for the Bank to cooperate with NGOs in social service activities and in agriculture. In these sectors NGOs can supplement public information and advise the Bank on the design of projects to ensure that targeted beneficiaries are correctly identified and that activities reflect actual conditions in the country.

APPENDIXES

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THE SOCIAL COSTS OF TRANSITION

A. Social Investment in the Soviet Period

1. During the Soviet period, the people of the Kyrgyz Republic were among the poorest in the Soviet Union. However, major progress had been achieved in the social sphere and poverty was hidden behind a comprehensive social protection system. Literacy was widespread and a comprehensive health care system was maintained. A network of social support systems existed. State-owned and collective enterprises, trade unions and government agencies provided social assets and services such as kindergartens, canteens, child care, housing, health, and sports facilities. In addition, they provided utility services such as heating, transport, electricity, and water. There was also a comprehensive system of social transfers to a wide range of beneficiaries. More than one quarter of the public budget was devoted to the social sphere before independence. This high level of expenditure was made possible by large transfers from the Central Government of the former Soviet Union (FSU).

2. The breakup of the FSU, with the attendant loss of subsidies and economic depression, rendered the existing systems unsustainable. At the same time, the sharp fall in income and the increase in poverty increased the need for social support and social protection. Limited fiscal resources have restricted social spending and the social infrastructure is deteriorating. Real public social spending has fallen by more than 50 percent within the last five years. Concurrently, real personal income has dropped by more than 60 percent. Unemployment is rapidly growing and an estimated 18 percent of the work force lacks full-time employment. The 1995 and 1996 Human Development Reports published by the UNDP, suggest the extent of social deprivation. The Human Development Index (HDI) of the Kyrgyz Republic has declined from 0.908 in 1990 to 0.664 in 1993 and 0.618 in 1994.

3. This Appendix brings together and supplements material discussed in the main text of the report, complementing the discussions in Appendix 2 on the Impact of Transition on Women and in Appendix 3 on the Condition of Children. The following sections deal with the (i) changes in the labor markets and the problems of unemployment, (ii) a profile of poverty in the country, (iii) the deterioration in the provision of social services, (iv) the weakening social safety net, and (v) strategies for the Bank to assist the Government in alleviating the high social costs of transition.

B. Labor Market Developments

1. Reduced Formal Employment

4. The contraction in output and the structural transformation of enterprises have had major impacts on the labor market. Labor market statistics show a trend of increasing open and hidden unemployment. An estimated 15.2 percent of the labor force lacked full-time employment at the end of 1995 compared with formal full employment in 1991 (see Table 1).

5. Open unemployment, at approximately 4 percent of the work force in mid-1996, is still relatively low. In 1995, 50,400 people were officially registered as unemployed, and the Ministry of Economy projects that this will increase to 112,000 by the end of 1996. Unemployment is visible in all sectors, but especially in the public sector including social services such as education and health. It is especially prevalent in the southern and poorer

oblasts (province) and in rural regions and has affected a wide range of people. At the end of 1995, about 33 percent of the registered unemployed were between 16 and 29 years old and 53.6 percent were women. Many professionals have left their jobs because salary levels are too low to support their families.

Table 1: The Labor Market in the Kyrgyz Republic

| Item | 1985 | 1991 | Dec 1993 | Dec 1994 | Dec 1995 | Apr 1996 |
|---|---------|---------|-------------|-------------|-------------|-------------|
| Population and Labor Force | | | | | | |
| population ('000) | 4,026.9 | 4,422.2 | 4,502.0 | 4,432.5 | 4,546.8 | 4,560.8 |
| rural population (%) | | 61.9 | 62.7 | 64.4 | 65.0 | 65.2 |
| female (%) | | 51.0 | 50.8 | 50.7 | 50.6 | 50.6 |
| labor force ('000) | 2,051.8 | 2,211.2 | 2,242.0 | 2,219.0 | 2,265.4 | 2,290.0 |
| economically active population (registered labor market) | 1,614.3 | 1,754.1 | 1,764.3 | 1,773.7 | 1,717.6 | 1,716.0 |
| Employment ('000) | | | | | | |
| industry | | 319.0 | 270.0 | 318.3 | 306.7 | |
| construction | | 147.0 | 89.0 | 88.0 | 84.7 | |
| transport and communication | 73.5 | 56.6 | 54.0 | 44.0 | | |
| agriculture | 529.1 | 572.0 | 651.0 | 692.2 | 676.2 | |
| health and social protection | | 107.0 | 125.0 | 105.0 | | |
| education | | 213.0 | 199.0 | 162.0 | | |
| Unemployment | | | | | | |
| % economically active population | | 0.0 | 0.2 | 7.4 | 15.2 | 18.2 |
| officially registered unemployed (numbers) | | 136 | 2,936 | 12,614 | 50,400 | 61,776 |
| % economically active population | | 0.0 | 0.2 | 0.7 | 2.9 | 3.6 |
| % women | | 81.9 | 73 | 67.7 | 53.6 | 52.1 |
| estimated hidden unemployment (numbers) | | 0 | | 118,500 | 210,000 | 250,000 |
| % economically active population | | | | 6.7 | 12.2 | 14.6 |

Sources: Ministry of Labor and Social Protection, NatStatCom, Ministry of Economy.

6. Open unemployment remains low, because many companies are reluctant to dismiss their employees. In response to depressed markets, they have resorted to introducing forced leave and shortening the work week. At the end of 1995, it is estimated that approximately 210,000 people (12.2 percent of the registered labor force) were, in this way, less than fully employed—are part of the hidden unemployment. Employees accept this circumstance, and do not apply for unemployment allowances, because (i) once registered as unemployed they lose their entitlement to enterprise run social services and benefits, (ii) unemployment compensation through the Employment Fund is extremely meager and uncertain, and (iii) there still remains the considerable social stigma that had been linked with unemployment during the Soviet period.

2. Declining Real Wages and Income

7. Weak labor markets and growing unemployment have been accompanied by a sharp decline in real wages. In 1995, real average wages were 35 percent of the 1991 levels (see Table 2). Real wages fell as the high inflation outpaced nominal wage increases. In 1995, the current average monthly wage was approximately Som 434 (\$34) with the banking and industrial sectors paying the highest wages. Agricultural and social sector wages tend to be very low, often one third of the average national wage. Only 10 percent of all registered employees have an average wage of Som 600 (\$48) or more and 37 percent receive less than Som 300 (\$24).

8. Exacerbating the real decline in income, wages are often not paid in a timely fashion, but rather paid many months in arrears. In high inflation periods, delayed wage payments can result in significant reductions in the real value of the payments.

9. Reflecting the difficult position of employers, wage payments are often made in kind and not in cash. This is especially common in rural areas, where up to 70 percent of the average wage of farm workers is paid in agricultural commodities. In many cases, commodity wages in-kind provide little real benefit to the worker and must be traded. Barter trade with such goods is often conducted at terms disadvantageous to the worker. For many families in rural areas, public support payments such as pensions and child allowances to poor families are the only source of cash income.

10. In the FSU, wages were relatively low, but were supported by a comprehensive system of transfers, social security and special allowances. With sharply reduced fiscal resources, social assistance and social insurance payments have fallen in real terms. Between 1990 and 1995 the real value of the minimum pension declined by more than 60 percent. In addition, these payments are often heavily in arrears. By mid-1996 arrears for pension and other transfers averaged six months of payments. Moreover the payments tend to be heavily biased towards urban areas, especially Bishkek.

11. In addition to cash transfers, non-cash compensation including the provision of such services as housing, kindergartens, and transport was commonly provided by employers under the Soviet system. These services were estimated to have corresponded to 30 percent of total labor compensation. With the economic difficulties since independence, the provision of many of these services has deteriorated dramatically. Housing services are an exception; the ownership of most houses and apartments has been transferred to their occupants.

12. As a result of growing poverty, households are increasingly spending a larger share of their income on food. The share of food in total cash expenditures for an average household increased from 37.6 percent in 1991 to 57.3 percent at the end of 1995. Apart from food, an increasing share of income is being spent on heating, education, and medical care. Before 1993, these expenditures were free of charge or provided by enterprises and the state for a nominal fee.

Table 2: Wages and Expenditures in the Kyrgyz Republic

| Item | 1985 | 1991 | 1993 | 1994 | 1995 |
|--|-------|-------|-------|-------|-------|
| Income | | | | | |
| average monthly wage (Som) | 0.8 | 1.8 | 83.8 | 231.8 | 434.1 |
| index of real average wage | | 100.0 | 37.3 | 27.3 | 35.4 |
| average labor pensions (Som) | | 2.0 | 57.2 | 90.0 | 196.4 |
| average monthly social allowance for children (Som) | | | | 34.1 | 32.3 |
| Composition of Average Household Money Income (%) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| wages | 72.4 | 71.0 | 49.5 | 55.4 | 54.4 |
| social transfers | 13.0 | 12.4 | 10.2 | 9.6 | 11.9 |
| other income (bazaar economy and informal sector) | 14.6 | 16.6 | 40.3 | 35.0 | 33.7 |
| Share of Food Expenditures in Total Household Spending | 40.8 | 37.6 | 58.0 | 55.4 | 57.3 |

Sources: NatStatCom, MLSP, Ministry of Economy, Social Fund, and staff estimates

C. Characteristics of Poverty

1. Rising Poverty

a. Defining the Poverty Line

13. Estimates of the incidence of poverty heavily depend on the methodology used to construct the poverty line and measures of household welfare. The National Statistical Committee (NatStatCom) publishes poverty data, for example, based on an assumed minimum per capita expenditure necessary for sustaining existence and providing for a daily energy intake of 2,240 calories. Alternatively the Ministry of Labor and Social Protection (MLSP) provides measures of the incidence of poverty relying on estimates of minimum income related to those used for the calculation of the minimum wage. The two procedures can yield very different estimates of the incidence of poverty. Using the NatStatCom standards, for example, in mid-1996, 80 percent of the population lives in poverty (see Table 3). Using the MLSP standard the incidence of poverty would be estimated at 26 percent. The MLSP standard is the official poverty line and is used by the Government, for example, to determine transfer payments to the poor.

Table 3: Incomes and the Incidence of Poverty in the Kyrgyz Republic

| Item | 1991 | Oct. 1993 | mid-1996 |
|--|--------------|-----------|------------|
| GNP per capita (US\$) | 1.020 (1992) | 830 | 610 (1994) |
| Poverty line estimates (Som [Rubles in 1991] per person per month) | | | |
| NatStatCom | 75 | 95.2 | 394 |
| MLSP (official poverty line of the Government) | | 32 | 68 |
| KLSS | | | |
| poverty | .. | 87 | .. |
| severe poverty | .. | 55 | .. |
| Incidence of poverty (percent) | .. | | |
| NatStatCom (population based) | 30 | | 80 |
| MLSP, official Government figures (population based) | .. | 20 | 26 |
| KLSS | .. | | |
| population below poverty line | .. | 45.0 | |
| below severe poverty line | .. | 25.0 | |
| households below poverty line | .. | 39.7 | 55 |
| rural | .. | 48.1 | 70 |
| urban | .. | 28.7 | 35 |
| regional distribution (households below poverty line) | .. | | .. |
| Naryn | .. | 53.9 | .. |
| Jalal-abad | .. | 51.1 | .. |
| Osh | .. | 47.3 | .. |
| Talas | .. | 39.7 | .. |
| Issyk-Kul | .. | 45.1 | .. |
| Chui | .. | 34.4 | .. |
| Bishkek | .. | 20.0 | .. |

Sources: MLSP, NatStatCom, KLSS, staff estimates

14. The World Bank also has estimated the incidence of poverty based on the results of the comprehensive Kyrgyz Living Standard Survey (KLSS). The first survey, undertaken at the end of 1993, was published in the 1995 World Bank, *Kyrgyz Poverty Assessment*. The World Bank estimates use consumption standards that are close to the NatStatCom standards.

b. The Incidence of Poverty

15. By whatever measure used, the problem of poverty has grown significantly since independence. The Kyrgyz Republic was, however, one of the poorest states of the FSU. In 1991, using the prevailing Soviet-standard, approximately one third of the population fell below the socially acceptable minimum level of living of Rubles 75 per head per month. Since independence, by 1995, using the NatStatCom measures, more than one million additional people have descended into poverty.

16. Rural households are far more likely to be poor than their urban counterparts: 48.1 percent of all rural households fell below the (KLSS) poverty line in late 1993 while 28.7 percent of all urban households lived in poverty. Poverty is especially severe in the southern regions of Osh and Jalal-abad and in the remote mountainous region of Naryn.

17. The growing poverty is accompanied by increasing inequality of income and wealth. In 1993, the top 20 percent of all families received about 25 percent of total national income. By November 1995, the top 20 percent had increased their share to 48.3 percent of total income and the poorest 20 percent received only 3.9 percent. Reflecting this growing inequality of income, the Gini coefficient has worsened from 0.3 in 1990 to 0.437 at the end of 1995.

2. Characteristics of the Poor

18. The KLSS found that the poor, in comparison with other households, were more likely to be headed by ethnic Kyrgyz, living in rural families with more than 4 children, and deriving a major part of their income from social assistance and informal sector activities. The severely poor are more likely to be either living in female-headed households with many children in rural areas or ethnic-Russian pensioners in the cities. These people often derive their income from home and subsistence production in the bazaar (informal) economy, live in families affected by alcoholism and high divorce rates, and are likely to be undernourished.

19. As discussed in Appendix 3. the growing problems associated with poverty have had a particularly severe impact on children. In the extreme, children have lost both family and societal support. UNICEF and the MLSP estimate that in mid-1996 about 800 street children were seeking income and survival for themselves in the streets of Bishkek. Before 1993 street children were not seen.

D. Deteriorating Social Service Provision

20. Under the FSU, a comprehensive and well-established, integrated health care system was maintained. Though the system was costly and inefficient in many respects, the pre-independence health conditions were good even compared with the standards of most middle-income countries (see Table 4). The situation has drastically changed for the worse since independence, impacting most severely on the poor. Hospitals no longer routinely provide medicine and medical supplies, doctors and nurses search for new employment due to low wages, medical equipment is not replaced because of funding problems, there is often a lack of heat in winter, and sanitary conditions are rapidly worsening. There has been a serious deterioration in the health condition of the populace at large and especially of women and children.

Table 4: Selected Social Sectors Indicators

| Indicator | 1985 | 1991 | 1993 | 1994 | 1995 | May 1996 |
|---|------------|-----------|-----------|---------|-----------|----------------------|
| Education | | | | | | |
| Adult literacy (%) | 90.5 | 95.2 | | 97.0 | 97.0 | |
| Number of children (aged 0-16, '000) | 1,697 | 1,827 | 1,870 | 1,860 | 1,863 | 1,882 |
| Number of children attending kindergarten ('000) | 176.6 | 190.1 | 92.2 | 58.9 | 46.1 | |
| Number of kindergartens | 1,398 | 1,604 | 998 | 639 | 448 | |
| Number of students ('000) | 1,647.2 | 1,492.5 | | | 1,680.0 | |
| general education (primary, secondary, and evening schools) | 936.6 | 962.5 | | | 968.0 | |
| special secondary education | 50.9 | 43.4 | 41.2 | | 32.7 | |
| university and higher education | 58.2 | 58.5 | | | 55.2 | |
| other schools (including adult education) | 601.5 | 433.3 | | | 629.2 | |
| School drop outs in grade 5-9 (number) | 4,602 | 6,852 | 6,645 | 5,829 | 6,094 | |
| Public education expenditure (% GDP) | 9.0 (1989) | 8.2 | | | 5.6 | |
| Health | | | | | | |
| Crude birth rate (per 1,000 inhabitants) | 32 | 29.1 | 26.1 | 24.3 | 25.9 | 27.5 |
| Crude death rate (per 1,000 inhabitants) | 8.1 | 6.9 | 7.7 | 8.3 | 8.1 | |
| Maternal mortality ^a (per 100,000 births) | 42.8 | 55.6 | 44.5 | 42.7 | | |
| Infant mortality ^a (per 1,000 live births) | 37.8 | 29.7 | 31.3 | 29.1 | 27.5 | 29.2 |
| Number of milk kitchens | | 160 | | 40 | 37 | 23 |
| Life expectancy at birth (years) | 68.5 | 68.8 | 68.0 | 66.0 | 71.0 | |
| women/men | 69.8/65.6 | 71.1/64.1 | 72.7/64.6 | | 73.8/66.6 | |
| Public Health Expenditure (% GDP) | | 3.9 | | | 3.4 | |
| Social Protection | | | | | | |
| Pension Fund | | | | | | |
| number of pensioners | | | | 631,000 | 579,000 | |
| revenue (Som '000) | | | | 597,481 | | |
| expenditures (Som '000) | | | | 622,521 | 1,273,256 | |
| Employment Fund | | | | | | |
| expenditures (Som '000) | | 2,780 | 1,959 | 15,572 | 84,700 | |
| unemployment allowances | | | 435 | 4,054 | 50,000 | |
| retraining | | | 143 | 1,415 | 15,500 | |
| public works and employment programs | | | 9 | 385 | 2,100 | |
| Social assistance beneficiaries (number) | | | | | 1,168,336 | 800,000 ^b |
| children | | | | | 1,101,135 | |
| disabled children | | | | | 14,563 | |

^a Health indicators for mother and child mortality rates for 1995 and 1996 are substantially underreported, in part because of the introduction of registration fees. A more realistic figure for the infant mortality rate for the end of 1995 was estimated by the Ministry of Health and the Kyrgyz Children Fund at 35 per 1,000 live births.

^b Projected for December 1996.

Source: Ministries of Finance, Health, and Education, and staff estimates.

21. The Soviet period also saw significant progress in meeting high standards for education as reflected in nearly universal literacy. An extensive school system provided coverage for all social groups, including the disabled. The costly system was maintained through the general budgetary subsidies from the FSU. Since independence, with the sharp fall in public resources, the number of schools, especially those previously maintained by state-owned enterprises and collective farms, has decreased significantly. Local authorities lack funds for heat, electricity, and transport. Capital expenditures for education have been frozen, and budget releases, including teacher's salaries, are delayed by several months. Whereas prior to

independence education expenditures amounted to 8-9 percent of the GDP, in 1996 this has slipped to less than 7 percent of a much smaller GDP. School attendance, especially in rural areas, has declined significantly.

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22. Before independence, many social assets such as housing, health care facilities, education facilities (especially kindergartens), cultural centers (libraries, sports and theaters), and utility services (heating, water, and transport) were provided by state farms and enterprises. In the process of privatizing and restructuring these farms and enterprise, these social assets have been divested, and some of them transferred to local governments. As a result, however, 30-70 percent of these divested social assets were simply closed due to the lack of local budgetary funds. Problems associated with deteriorating water and sanitation services have been noted in the main text. As noted above this has exacerbated the impact of growing poverty.

E. The Weakening Social Safety Net

23. Under the Soviet system a comprehensive social safety net provided coverage of both social insurance and social protection. Although the system was poorly targeted, social insurance was provided generally for the elderly, the unemployed, those unable to work, and people who fell ill. Social protection was designed for those who fell through the safety net provided for most people by enterprise employers, especially the rural poor, children and mothers. With growing fiscal problems the protection offered by these systems has weakened significantly exacerbating the problems caused by faltering provision of social services and social infrastructure.

1. The Underfunding of Social Insurance

24. The Kyrgyz social security system has four major windows: the Pension Fund (for old age insurance), the Employment Fund (unemployment benefits), social insurance endowments (disability benefits and sick payment), and, soon to be implemented, a Medical Insurance Fund (for medical treatments). The first three operations have been brought together under an umbrella Social Fund and it is expected that medical insurance will be initiated and attached to the Social Fund this year.

25. Throughout much of the period since independence, in the aggregate, the social insurance funds have been underfunded relative to their obligations. Weak economic conditions, resulting in massive, continuing losses for farmers and enterprises have resulted in poor revenue collections by the various funds.¹ The accumulated debts of the social insurance endowments, for example, rose from Som 170 million (\$13.6 million) in 1994 to an estimated Som 448 million (\$35.8 million) in 1995. Underfunding has resulted in lowered payments as benefit schedules have been kept from rising as fast as the general price level. Moreover, payments are often paid only months in arrears, which further reduces the value of the assistance to the beneficiaries.

26. The funding problems for social insurance are most critical in the rural sector. Farmers' pension entitlements, for example, in mid-1995 averaged Som 126 (\$10) per month but

¹ With a low level of open unemployment there has been relatively few funding problems associated with unemployment benefits. This is, however, a function of relatively small benefits and that the majority of the truly unemployed remain hidden and unregistered.

rural pension contributions averaged only Som 19 (\$1.5) per person per month. As a result, on a self-financing basis for the system, six to seven working farmers would be needed to pay for each pensioner. This is despite the fact that the average farmer's pension is only one

quarter of the income needed to buy the minimum consumption basket. The very poor economic conditions in the rural sector preclude any local self-sufficient financing for social insurance.

27. The newly restructured Social Fund is presently envisioned as an independent, self-financing, non-profit making public entity with a decentralized administration structure. The principal revenue source of the Social Fund is a tax on the wage bills of registered enterprises. Since January 1996, employers are obliged to contribute 34.5 percent and employees 2.5 percent of total wages. The total income of the Social Fund in 1996 is projected at Som 2,047 million (\$164 million), whereas expenditures are calculated at Som 2,139.6 million (\$171 million), leaving a deficit of Som 92.6 million (\$7.4 million) to be financed by the state budget. Given the expected activities, the newly reconstituted Social Fund would have revenues and expenditures larger than the consolidated state budget.

28. The Government is currently planning to introduce a Medical Insurance Fund as part of the overall health reform strategy—the Manas Plan. This Medical Insurance Fund will provide for individual contracts with doctors, hospitals, and clinics. The contracting would be on a compulsory basis and used to provide for financial coverage for all medical treatments. As a consequence the current medical system, in which nearly all workers are state employees under the Ministry of Health, will undergo major reforms. It is expected that these reforms will help rationalize the provision of health services with improved service provision and reduced government expenditures.

2. The Problems of Targeting

29. Social assistance transfers and allowances are provided as entitlements by MLSP. These transfers are the major source of income assistance to vulnerable groups. In mid-1995 social welfare benefits were given to approximately one-quarter of the population or 1.2 million persons. Approximately 95 percent of the payments were to children covering especially orphans and children living in special hospitals. As of the beginning of 1996, allowances were entitled to those families whose average monthly per capita income did not exceed Som 75 (\$6.5). The average monthly benefit was a scant Som 34 (less than \$3). Moreover, benefits were often not paid due to the lack of funds. In 1996, the (revised) consolidated public budget allocated Som 415 million (\$33.2 million) for transfer payments to the poor. However, by mid-1996 only Som 58 million (\$4.6 million) had been disbursed.

30. A major problem with the social assistance program is that payments were often not well targeted to the poor and inequitably distributed by region. The system, with World Bank support, underwent major reforms in the beginning of 1996. Most importantly the total number of people entitled to benefits is expected to be reduced by an estimated 35 percent to approximately 800,000 by the end of 1996. Over time, better targeting will improve the assistance to the truly needy.

F. Strategies for Poverty Reduction and Social Development

1. The Government's Program to Address Social Development

31. Generating viable employment, reducing poverty, and reforming social policy with a major focus on decentralization and rationalization are the key commitments of the Government in the social sphere. These commitments at the political level are supported by a

well functioning development administration. These are essential prerequisites for successfully containing the explosive increase in poverty in the presence of a weak economic environment.

32. A comprehensive program of structural reforms for a socially oriented market economy has been introduced since independence. Apart from industrial, agricultural and social protection reforms, investments in infrastructure and environmental protection, human resource development are the Government's priorities. Comprehensive programs for strengthening the social safety net, supporting the labor market and improving social services in health and education are envisaged, some are already under implementation.

33. The public social expenditure structures are a good indication of the Government's commitments towards alleviating poverty. At independence, public social spending on health, education and the social safety net was 15.6 percent of GDP. This declined to 9 percent in 1993 but recovered and rose to a projected 26.4 percent in 1996, even as GDP fell by approximately one half during the same period.

34. Local governments account for 74 percent of total public social expenditure for education and 84 percent for health. In total they spend about 80 percent of their resources in the social sphere. Local governments are often thought to be in a better position than the Central Government to provide social services that are responsive to local conditions. However, as noted in the main text, there are serious institutional and financial weaknesses.

2. Self-help and NGO Activities

35. The scope for private provision of social services is growing; however, the non-governmental sector ? social assistance through churches, foundations, or non-governmental organizations (NGOs) ? is still limited. However, structural reforms of the social transfer system, targeted interventions and sustainable insurance as well as the necessary divestiture of social assets from farms and industries are under way. This will provide for increasing opportunities for future private sector involvement especially for the private insurance industry.

36. As one indication of this response to the economic and political reforms of the transition, while in 1993 there were a total of 208 registered NGOs, the number increased to about 500 in mid-1996. Out of these about half of the organizations are considered functional. Many of these NGOs have a focus on issues concerning social problems, women, children, or the environment. In mid-1996 about 11 small-scale Grameen Bank type NGOs have been reported, working mainly in the rural areas. In common with NGOs worldwide, NGOs in the Kyrgyz Republic are characterized as having weak financial foundations, but there is considerable organizational potential and administrative capacity.

3. Scope for Bank Involvement

37. The Bank can target assistance to the Government's social program in three broad areas: (i) through a comprehensive program of assistance to the education sector; (ii) by strengthening the provision of public services at the local government level; (iii) and by incorporating appropriate elements in other Bank programs.

38. The Bank helped the Government in preparing a master plan for education, and is processing a sector development program. In this fashion, the Bank has reacted positively to the Government's and the donor community's request to play the lead role in the education sector.

39. In addition to supporting education, there is scope for strengthening local government, particularly in social service delivery, improving social infrastructure, and in financing viable insurance programs. These activities will allow the Bank to develop approaches to combine its strategic objectives of promoting viable growth with sustainable poverty reduction. In particular, there is the need to invest in the divestiture of social assets and a need to support the decentralization of social policy.

40. Since the social costs of transformation occur in all sectors, there is also an opportunity to incorporate the social dimensions in many Bank projects in the Kyrgyz Republic. Poverty alleviating measures can be especially envisaged in the Bank's agricultural and rural finance projects.

THE IMPACT OF TRANSITION ON WOMEN

A Introduction

1. One of the Bank's key strategic objectives is encouraging the participation of women in development and promoting gender sensitive policies, programs and projects. It reflects the concerns of the Bank that in the process of development, all costs and benefits of change should be equitably distributed and that in some countries active programs of intervention should be mounted to reduce gender-based inequities. This Appendix provides a summary of a study conducted by the Bank on women in development in the Kyrgyz Republic.

2. In general, the negative impacts of transition in the Kyrgyz Republic reflect the economic difficulties prevailing in the country, rather than gender-based social or political problems. The current period of transformation has been accompanied by high social and economic costs (see Appendix 1). Poverty has been increasing as national income has declined, unemployment has increased, and government budgets for social assistance have been reduced. The rural population (65 per cent of the total population) face particularly difficult conditions.

3. There are circumstances however, where the economic difficulties have had more severe impact on women than on men. In particular, the deterioration of the education and health care delivery systems has reduced employment possibilities for women in sectors in which they previously predominated. The weakening social safety net has severely reduced social assistance to the elderly and children exacerbating the situation for many women by increasing their traditional domestic responsibilities in this difficult economic period. On the other hand, the transition has also offered women new opportunities to improve their status in society, both in specialized labor markets as well as in the socio-political setting.

4. The following sections provide a discussion of: (i) the demographic profile of women in the Kyrgyz Republic; (ii) the shifting parameters in the economy relating to unemployment, the incidence of poverty among women, and the changing social scenario; (iii) the new opportunities made available to women during this period of transition; (iv) government programs and support for gender issues; and (v) specific recommendations for Bank activities. As adequate gender disaggregated statistical data are not available, the discussion relies in places upon anecdotal evidence developed through field research. In some instances, for example, with respect to maternal mortality, there is evidence to believe that the statistics do not accurately reflect the situation and qualifications are noted.

B. A Profile of Women in the Kyrgyz Republic

5. Women constitute 51 percent of the Kyrgyz Republic's population of 4.5 million (see Table 1). This slightly higher demographic percentage of women reflects normal male versus female birth and mortality-rate differentials. A woman's life expectancy is 74 years while that for a man is 67 years.

6. Since World War II, women have figured prominently in the work force of the Kyrgyz Republic. This was an economic necessity, prompted by the large loss of life among men, but was also consistent with Marxist ideals of gender-equality in the work place. The result was a system wherein women were encouraged to work outside the home. Before transition, some 83 percent of all working age women in the Kyrgyz Republic participated in

the official labor force and about 49 percent of the total labor force was composed of women. Occupations with a large employment of women included education, public health, textile manufacturing, food industry, clerical work, banking and engineering. Government sponsored social support such as child care centers, medicine, and extended maternity leave allowed women to enter the labor force and work outside of the home. The economic transition forced women to leave the formal industry sector in favor of agriculture, the informal sector and household activities. Today about 70 percent of the women of working age and 51 percent of all women are formally involved in the labor force. They comprise --with a decreasing trend-- 46 percent of the employed in the formal sector.

Table 1: Socio-demographic Male-Female Gaps

| | 1991 | 1993 | 1995 |
|--|-----------|-----------|-----------|
| Demographic data | | | |
| Population (women as percent of total) | 51.0 | 50.8 | 50.6 |
| Population ('000) | | | |
| number of girls (0-14 years) | 815.8 | 841.2 | 826.4 |
| number of women in the reproductive age (15-49) | 1,030.5 | 1,053.7 | 1,055.2 |
| number of women older than 60 | 227.9 | 232.1 | 219.7 |
| Life expectancy at birth (ages, women/men) | 71.1/64.1 | 72.7/64.6 | 73.8/66.6 |
| Average age at first marriage (ages, women/men) | | 21/24 | 22/25 |
| Poverty | | | |
| Incidence of household poverty (percent) | | 40 | 55 |
| female headed households (percent of all poor households) | | 45.1 | |
| Female poverty in rural areas (percent of all rural women) | | 55-79 | 70-80 |

Sources: NatStatCom, AYALZAT (President's program on Women, 1996), UNDP 1996

7. The legacies of the Soviet period included an extensive, state-financed education system for women as well as for men. Many educational institutions specifically designed for women were founded in the 1950s. As a result, the literacy rate among women in 1989 was 97 percent, about the same as for men. During transition, female enrollment in higher education has continued to rise from 55 to 66 percent. In the same period, the proportion of women students in vocational training programs has risen from 30 to 35 percent. It should be noted, however, that girls comprise 70 percent of the children who are not attending primary school.

8. The modern Kyrgyz woman is influenced not only by the Soviet experience, but also by prior traditional values. However, the nomadic, patriarchal norms, have generally encouraged a degree of independence for women. Throughout the country, women continue to have ample opportunity to study and work outside the home.

C. The Shifting Parameters for Women

1. Women in the Transforming Labor Market

a. Increasing Unemployment among Women

9. The economic crisis since independence has resulted in growing open unemployment. During the first quarter of 1996, of the total number of 71,737 people

registered as unemployed, women constituted 56 percent. This follows more serious imbalances in previous years: in 1995, 54 percent of all unemployed people were women, in 1994 it was 68 percent, and 82 percent in 1991 (see Table 2). The small number of officially unemployed in the early 1990s included a disproportionate number of social service personnel, generally women, as a result of the closure of social facilities by enterprises. As the depression deepened, firms were forced to dismiss production and management staff, including larger numbers of men. Therefore, although the gap between female and male unemployment has decreased since 1993, this is the result of the larger number of men being unemployed rather than an improvement in the employment rate of women. Also, women have more difficulties in finding new jobs in the formal labor market. Only about 49 percent of job placements by employment services are women, although they make up more than 53 percent of the applicants.

10. The closure of over two thirds of the country's kindergartens, and the reduction in child care, nursing, health and old age centers have reduced employment for women, but have also increased the difficulties in carrying out their traditional domestic responsibilities and reduced their flexibility in the work place. Even in cases where child care is available, many cannot afford the rising cost of such services.

11. Data are very unreliable on hidden unemployment, but MLSP staff suggest that women account for more than one half of the unofficially unemployed. Such hidden unemployment is often in the form of long-term leave given by the employer. Women, for example, are sometimes given lengthy maternity leave as a way to temporarily reduce the number of employees. Unofficial unemployment is debilitating, since these people cannot register for unemployment benefits, although they may continue to receive some benefits from their employer including access to social services.

b. Changing Employment Patterns

12. The economic depression and weak labor markets have changed the composition of the employment market. Of all employed women in 1985, 26 percent were in industry, while agriculture accounted for 17 percent. This distribution in sectoral employment reversed by 1994, as only 18 percent of all women were employed in industry and 28 percent in agriculture. In part, this represents the ability of agriculture to act as the residual employer, absorbing unemployed industrial workers. Some agricultural jobs offer more flexible work arrangements than formal industrial jobs. These jobs are attractive to women, as they allow them to fulfill their often considerable domestic, child and elderly care responsibilities. However, the standard of living in rural areas tends to be lower than for women in urban areas. Problems such as lack of running water, heat in winter, and reasonable transportation compound the already difficult lives of rural women.

c. Gender-Based Work Inequalities

13. Transition has created large wage differentials in those sectors where the employment of women is prevalent, i.e. agriculture, education, health, and social protection. In 1995 the wages in these sectors was 30-60 percent lower than the national wage. For the nation as a whole, the average wage of women is 23 percent lower than that of men reflecting

the prevalence of women in relatively low paid occupants.¹

Table 2: Gender Issues in the Labor Market

| | 1985 | 1991 | 1993 | 1994 | 1995 |
|---|------|------|------|------|------|
| Employment | | | | | |
| Women as percent of registered employed | 48.3 | 48.9 | 44.9 | 46.5 | |
| Distribution of total women employed across sectors | | | | | |
| industry | 25.5 | 24.5 | 18.1 | 17.6 | |
| agriculture | 17.0 | 13.9 | 14.1 | 28.0 | |
| health and social protection | 10.3 | 13.1 | 15.5 | 13.4 | |
| education | 53.5 | 53.3 | 41.0 | 41.8 | |
| Women as percent of registered unemployed | | 81.9 | 73.0 | 67.7 | 53.6 |
| Management positions (women as percent of total) | | | 35.2 | 36.1 | |
| industry | | | 33.0 | 34.2 | |
| agriculture | | | 20.2 | 14.2 | |
| health and social protection | | | 55.3 | 47.6 | |
| education | | | 45.1 | 50.5 | |
| parliament seats occupied by women | | | 8 | 4.1 | |

Sources: NatStatCom, Ministry of Labor and Social Protection, AYALZAT (Presidential program on Women, 1996), UNDP.

14. Within sectors, women often occupy the lower paid positions. In 1993, women accounted for only 20 percent of higher-paying jobs in agricultural enterprises, and a year later they accounted for only 14 percent.² In 1995, women occupied only about 9 percent of the management positions in the 18,000 joint stock companies and small enterprises.³ On the other hand, women occupy a substantial portion of middle management and technical support positions both in business and public administration. Women are more likely than men to be multilingual, speaking English or German in addition to Russian and Kyrgyz. Women thus often act as interpreters, office managers and trainers. They are more likely to receive training from international organizations in computer skills, communication technologies and in service-oriented industries. This may in the future give women the edge needed for promotion and allow them to move into upper management.

2. Gender Aspects of Growing Poverty

15. Prior to 1991, the Soviet system provided substantial interrepublic transfer payments and a comprehensive social insurance and social assistance system. The rapid introduction of a market economy and the sudden loss of massive subsidies from the Central Government of the FSU hastened the deterioration of labor markets, and the education and health care systems of the command economy. It should be emphasized that, in many respects, the weakening social safety net has affected both men and women equally. The deteriorating economic conditions have affected nearly everyone through increased unemployment, the growing incidence of poverty, and falling income. The exceptions are noted below in discussing

¹ The AYALZAT (Presidential program on Women), March 1996, Bishkek

² National Statistical Committee, Statistics on Women in the Kyrgyz Republic, 1995, Bishkek.

³ The AYALZAT (Presidential program on Women).

those groups of women who are particularly vulnerable to the current

developments. These are female teenagers, mothers with many children, and urban women pensioners.

a. Young Women

16. Rising unemployment and changes in the labor market have particularly affected young women. Under the Soviet system young women not entering vocational training programs or universities were provided employment. Now, more and more young women are becoming economically dependent on their relatives especially in rural areas.

17. The lack of economic and social direction has been costly. There has been a 34 percent increase in births by unmarried teenagers (13 and 17 years of age) since 1989. According to the Ministry of Health, the increase in teenage pregnancies is directly related to the lack of contraceptives for this group of women, lack of family health education in the schools, and the societal shift in sexual morals. Women under 19 account for 10 percent of all maternal deaths.

b. Single Mothers with Many Children

18. There are 150,000 single mothers with more than four children in the country. Most of them are ethnic Kyrgyz. Significant negative impacts on women headed households with many children are caused by (i) the budgetary cuts and delayed payments in public family and maternity allowances, (ii) the deteriorating and self-financed and expensive provision of social services such as kindergartens and health care, and (iii) the rising living costs with declining family income and high unemployment. In addition, problems resulting from the severe economic crisis have encouraged alcoholism among men, increasing family stress.

19. Many women in the urban bazaar economy are also single mothers with many children, often migrated from the rural areas. Women are particularly vulnerable in cities, where the traditional family safety nets are weak, and where they do not have access to food production from home gardens.

c. Urban Pensioners

20. In mid-1996, of the 600,000 pensioners, more than two third were women. It was estimated by the Social Fund responsible for social insurance payments that 80 percent of these women are essentially destitute. The Government has been unable to provide an adequate level of support. Funding limitations stem partly from the inability to collect wage taxes. The Social Fund has resorted to collecting tax obligations from enterprises in kind and paying beneficiaries with the goods collected. This is, however, not likely to provide important relief.

21. The ethnic Kyrgyz female pensioners in rural areas are less exposed to destitution, because they can rely on their informal family safety net and can provide for most of their food needs. Many of the urban and ethnic Russian or German pensioners however have lost their family support due to migration.

22. Examining Government social assistance programs, support for youths, invalids, and young mothers seems to take precedence over the aging female population. Recognition that such social triage can severely undermine political support for the reform process has led to pension reforms to raise the pension age and enlarge the resource base of the Pension

Fund. The system of social assistance is also undergoing major changes including means testing, to allow more resources to be devoted to assisting those truly in need.

3. Social Deprivation

a. Health and Reproduction

i. Declining Health Conditions

23. The Soviet period brought great improvement to the life expectancy of the people of the region. The introduction of vitamin-rich garden vegetables to the nomadic diet decreased the frequency of the many vitamin-deficiency related diseases common among early 20th century Kyrgyz. Soviet maternal health care and child birth practices dramatically decreased the rate of infant and maternal death. Unfortunately, with the change in economic conditions these advances have been curtailed by the breakdown of the socialist health care system. Many indicators of health are worsening both related to health infrastructure as well as reflecting diseases, malnutrition and reproduction issues. These changes appear to affect women and children much more than men.

24. With a faltering public health program, many formerly eradicated diseases such as tuberculosis have reappeared and there is a widespread and seriously increasing problem of female anemia, especially in remote rural areas and places of ecological destruction such as near the Aral Sea.

25. The weakness in the delivery of health care services and the worsening sanitary and social conditions for women can also be seen in the increase in sexually transmitted diseases. The number of reported female cases of syphilis has increased, from 47 in 1991 to 503 in 1994. Reported cases of female gonorrhea have grown from 1,029 to 1,244 during the same period. The increasing incidence of sexually transmitted diseases results from the restricted availability and relatively high price of condoms, but Kyrgyz sociologists suggest that there is also a general relaxation of societal restrictions on premarital sexual activity due in part to the influence of imported and uncensored mass media.

26. The economic difficulties have resulted in a particularly difficult situation for pregnant women. With inadequate nutrition, there is a prevalence of protein and vitamin deficiency. Work done by the World Health Organization (WHO) suggested that approximately 35 percent of all pregnant women suffered from anemia in 1994, up from 17.1 percent in 1988 and 29.4 in 1991 (UNICEF 1993). In 1996, estimates of the Ministry of Health suggest a dramatic increase of up to 70 percent in rural areas. The single most limiting factor for healthy pregnancies and safe deliveries, however, is the lack of timely transportation. A deteriorating public transportation system and increased transport costs have meant particularly hard problems for rural health care systems. In addition, at the rural health posts, two thirds have no telephones for emergencies.

ii. Decreases in Birth and Fertility Rates

27. Birth and fertility rates have decreased in the last several years. Between 1985 and 1994 the birth rate per 1,000 has steadily declined from 32 to 24.3, a 24 percent drop. The fertility rate (the average number of children per women of childbearing age) has likewise declined, nearly 23 percent from 4.0 in 1985 to 3.1 in 1994.

28. According to the Ministry of Health's 1996 data, approximately three-quarters of women practice some form of family planning. The data may overestimate the actual extent of contraceptive use, however, there has been an increase from the 1993 World Bank figures of only 25.4 percent. Among birth control acceptors surveyed, 40 percent report using intrauterine devices and 30 percent using contraceptive pills.

Table 3: Health and Reproduction

| Item | 1985 | 1991 | 1993 | 1994 | 1995 |
|---|-------------|------------|-------|-------|-----------------|
| Health Infrastructure (numbers) | | | | | |
| specialized women doctors | 402 | 562 (1990) | 513 | 378 | |
| nurses for women | 4074 | 3763 | 3649 | 3414 | |
| midwives | 921 | 939 (1990) | 860 | 848 | 865 |
| hospital beds for pregnant women | 4,699 | 5,507 | 4,801 | 4,473 | 4,211 |
| polyclinics for women | 402 | 584 | 511 | 378 | |
| Diseases | | | | | |
| TB [respiratory] (per 100,000 women) | | 39.6 | 39.6 | 39.7 | |
| sexually transmitted diseases | | | | | |
| syphilis: female (number of registered cases) | | 1,029 | | 1,244 | |
| gonorrhea: female (number of registered cases) | | 47 | | 503 | |
| anemia among pregnant women (percent) | 17.1 (1988) | 29.4 | 30.9 | 35 | 70 ^b |
| Reproduction | | | | | |
| crude mortality rate | 8.1 | 6.9 | 7.7 | 8.3 | 8.1 |
| maternal mortality (per 100,000 live births) ^a | 42.8 | 55.6 | 44.5 | 42.7 | |
| (per 100,000 women in the age of 15-40) ^a | 81.4 (1989) | 70.1 | 75.8 | 80.1 | 83.0 |
| infant mortality (per 1,000 live births) ^a | 37.8 | 29.7 | 31.3 | 29.1 | 27.5 |
| abortions per 100 births | 55 | 38 | 31 | 27 | 25.1 |
| Use of contraceptives among pregnant women (percent) | | | 25.4 | | |

^a Estimates from Ministry of Health. Substantial underreporting presumed for data after 1993.

^b Estimates for mid-1996, rural areas only.

Sources: NatStatCom, Ministry of Health, AYALZAT (Presidential program on Women, 1996), UNDP, UNICEF, UNFPA, World Bank.

29. The relative prevalence of abortion is a legacy of Soviet practices. Abortion has been legal in the Kyrgyz Republic since the early 1950s. In 1989, the Kyrgyz Republic had one of the highest rates of abortion in the Soviet Union, after Russia and the Ukraine. For every 100 live births in 1985, approximately 55 pregnancies were terminated. In 1995, the abortion rate fell to 25.1 for every 100 live births. However, field interviews of women in the Osh region suggest that unregistered abortions are becoming more frequent, in the wake of stronger Islamic sentiments condemning the practice of abortion.¹

b. Family and Society

i. Marriage and Divorce

30. The popular perception is that marriage and divorce rates have changed dramatically as a result of the economic distress. Data from NatStatCom suggest that in the last

¹ Kuehnast, K. 1993: *Women and Economic Change in Kyrgyzstan*, World Bank, Washington, D.C.

ten years, marriage rates have fallen by about 42 percent and divorce rates increased 29 percent. Registered marriages fell from 40,341 in 1985 to 26,807 in 1995, though the

population is getting younger. Economic incentives such as brideprice, given in traditional marriages by the husband's family, are seen as a deterrent to early marriages under present economic circumstances. In 1985, 17 percent of all marriages ended in divorce, while in 1995 this figure rose to 22 percent. The popular perception of even more dramatic changes may also reflect "unofficial divorces" in which one partner has emigrated or lives separately in search of work and there is great uncertainty about the continuation of the marriage.

ii. Increasing Crime against Women

31. Women express as much concern about the deterioration of the social fabric of their society as about the practical matter of finding jobs and worsening social assistance. The rapid increase in crime and violence against women in both urban and rural areas have influenced women's previous sense of safety, especially regarding travel outside the home in the evening. Statistics provided by the Ministry of Internal Affairs do suggest increasing numbers of crimes where the victims are women.¹ In addition, women are increasingly subjected to physical abuse and psychological humiliation as poverty, unemployment and alcoholism among men increases. As poverty and unemployment has increased, larger numbers of women have been forced to turn to prostitution.

Table 4: Women in Family and Society

| Item | 1985 | 1990 | 1993 | 1994 | 1995 |
|--|-----------------|-----------------|-------|-------|-------|
| Family | | | | | |
| marriages (per 1000 inhabitants) | 10.1 | 9.9 | 8.2 | 5.8 | 5.9 |
| divorces (percent of marriages) | 17 | 18 | 16 | | 22 |
| births outside marriage (percent of all births) | | | 14 | 17 | |
| Social Fabric | | | | | |
| reported rapes (numbers) | 397 | | 421 | | 500 |
| crimes committed by unemployed (percent) | | | | 50.2 | 60.2 |
| reported crimes committed by the youth | | | | 1,439 | 1,605 |
| reported crimes committed by women (number) | 1,038 (1980) | 1,937 (1991) | 2,187 | | |
| Functioning NGOs (number of registered and informal) | | | | | 300 |
| covering gender issues | | | | | 50 |
| special women organizations and NGOs | | | | | 18 |

Sources: NatStatCom, AYALZAT (Presidential program for Women), UNDP, UNICEF, Women in Development Bureau.

D. New Opportunities for Women

1. An Expanding Role for Women in the Economy

32. The unemployment developments discussed above reflect largely the nature of the formal sector. These mask some important changes in women's role in the informal sector of the economy. Although data on the informal sectors are limited, estimates of the Ministries of Economy and of Labor and Social Protection suggest that women make up 70 percent of all

¹ AYALZAT (Presidential program on Women), March 1996, Bishkek.

workers. One important trend is that women are becoming more important in the rapidly

expanding bazaar economy. This is one indication that women are actively participating in the economy as entrepreneurs. Moreover, women are developing and participating in credit programs that can provide support to new entrepreneurial activities.

a. The Bazaar Economy

33. With the ongoing reforms providing for a liberalization of the economy, commercial opportunities are expanding. In particular, some urban-based women are traveling to nearby countries such as the Russian Federation and Uzbekistan, and farther afield to such countries such as India, Iran, Italy, Pakistan, the People's Republic of China, and Turkey. *Shop tur* excursions in which women buy goods in foreign countries and sell them for higher prices in the Kyrgyz Republic yield profits commonly reported on the order of \$500-3,000 per trip. This is a substantial sum in a country where the average annual income is less than \$1,000. Women with commercial and foreign language skills have apparently responded to the market-opening opportunities to a much greater degree than men. It must be emphasized however that these opportunities have so far been limited to a small proportion of the population.

b. The New Entrepreneurs

34. Even with sharply depressed economic conditions many women are responding to the new opportunities by developing their own businesses. It was estimated by MLSP that about 30 percent of rural and 50 percent of urban women are engaged in informal income generating activities. They are mostly working in trade, food processing, and handicrafts.

35. As an example of new job opportunities, 11 women in the Osh Oblast bought sewing machines with a grant from a UNDP-sponsored program and began to produce Uzbek wedding crafts and garments to be sold across the border in the region. Initial success in this venture has been followed by the start of a credit union to finance future business ventures. In Chui Oblast, a Kyrgyz refugee group from Tadjikistan received a similar grant to set up two agricultural cooperatives producing watermelons and wheat. With their profits they have purchased a mill employing seven people, and have opened two bakeries employing 10 women.

c. Credit for Women

36. The weakness in the financial sector has been an important constraint on the development of new production structures. Small-scale credit provision is particularly lacking. In response, a number of NGOs, many of them dominated by women, have been started to provide small loans and support for small entrepreneurs. The Government and the international funding community have supported such activities. With the help of the World Bank, MLSP has a small-scale pilot program in Issyk-Kul and Osh oblasts providing up to Som 400 (\$32) of credit to individuals and groups attempting to start their own businesses. According to MLSP estimates, 90 percent of the participating groups consist of women. Among the 50 or more NGOs that focus on issues important to women, at least 30 percent are engaged in credit schemes.

2. New Government Policy Directives Towards Women and the Family

37. In response to the challenges posed to women in this transition, in March 1996 President Akayev officially proclaimed this year as the "Year of Women and the Family". He appointed a special Committee on Women and the Family under the Deputy Prime Minister for

Social Policy to oversee the integration of women and family concerns throughout all the ministries of the Government, and to develop implementation plans for the years 1996-2000 (program AYALZAT). Stated goals for women of the AYALZAT committee include improved health care, increased involvement in the economy, elimination of violence, promotion of education and retraining, an increased role in governmental and legislative activities, and support of women's organizations.

E. Recommendations for the Bank

38. This section provides some recommendations for gender-oriented Bank assistance, specifically to address the needs of women in the current period of transition. The recommendations focus on both policy reforms and project investments. Actions must (i) encourage women's abilities to participate in the emerging market economy, (ii) improve social support mechanisms and social service delivery systems, and (iii) develop capacity building exercise.

1. Encouraging Participation in the Market

39. Given the demanding domestic responsibilities assumed by many women, labor force participation will be enhanced by increasing access to employment providing flexible working conditions. There is a particularly important need to assist the many women in the rural sector who previously worked in social service activities. Actions should include:

- (i) support to women for technical training in the development of grass-roots credit schemes and savings clubs to support small-scale entrepreneurs;
- (ii) training programs for women in order to gain access to skills needed in the new market economy and to promote women to management positions;
- (iii) support for light industries with the potential for employment of women such as food-processing, indigenous crafts, and clothing manufacturing;
- (iv) encouragement of locally developed non-governmental organizations by streamlining the registration process; and
- (v) legal protection for women entrepreneurs.

2. Promotion of Social Protection and Social Services Delivery

40. Some women depend critically upon public support, particularly the elderly and women who are heads of households with many children. There is a need to improve beneficiary targeting, devise more efficient government operations, and increase budgetary support for social assistance programs. Programs of technical assistance should be directed towards local governments that have the responsibility of actually delivering social support payments.

41. The improved delivery of social services, including health services, education, sanitation, and water supply, are also critical to arrest the deteriorating condition of women. Important actions should be directed to:

- (i) improving the transportation infrastructure, particularly in rural areas, to reduce

such health problems as infant-maternal mortality and to increase school attendance;

- (ii) improve the capacity of social service delivery systems to obtain basic utility services, especially during the winter months and in rural areas;
- (iii) maintain child-care facilities at the local level; and
- (iv) introduce low cost health care information and distance education services in rural regions.

3. Capacity Building for Gender Issues

42. Capacity building for dealing with gender issues includes close cooperation between the various stakeholders involved. Gender issues are present to some degree in most of the Bank's projects. In particular, capacity building exercises should be incorporated into the Bank's technical assistance projects to encourage consideration of gender-based issues. The Bank should see to it that its projects are, at a minimum, not detrimental to women's concerns, and where ever possible should include pro-active components designed to increase the welfare of women.

THE CONDITION OF CHILDREN

A Introduction

1. It is a policy requirement of the Asian Development Bank that specific consideration be given to human resources development and cross-cutting social issues in program and project activities. In the Kyrgyz Republic, the Bank's work is being conducted under difficult socioeconomic circumstances, including precipitous declines in national income, increases in the incidence of poverty, growing unemployment, decreasing social service provision, and a weakening social safety net (see Appendix 1). The net result has been a serious deterioration in the overall condition of children and women. The changes in the economy and society affecting most directly women are discussed in Appendix 2.

2. The deteriorating situation of children in the Kyrgyz Republic is of great concern to the Government and to the international aid community. Independence and the difficult transition to a market-based economy have led to complex problems that were not visible as part of society five years ago. The problems involving children developed, in particular, as a result of increased numbers of families living below the poverty line, the emergence of widespread unemployment, a reduction in social assistance, and a deterioration in the institutions providing for the delivery of social services. As a result of the rapid worsening of the conditions for children, the development potential of the nation has been seriously reduced.

3. In order to monitor the impact of transition on children and to better assist the Government, the Bank, in mid-1996, conducted a study on the condition of children to obtain operational recommendations for its country strategy and future programs and projects. The study was done in a participatory manner involving both international and local experts as well as stakeholders from government at the central and local level, NGOs, and other funding agencies. This Appendix provides a summary of that study covering children and young people. In the sections below the most immediate concerns relating to the socioeconomic costs of transition for children are discussed, including (i) the deteriorating education system, (ii) health and nutrition problems, (iii) homelessness and youth crime, and (iv) the eroding social infrastructure. In the final sections of the report, specific interventions are discussed in (i) education, (ii) other social sectors, (iii) the rural sector, and (iv) within the Bank's planned infrastructure activities. As disaggregated statistical data are not always available, the discussion relies in places on anecdotal evidence collected in field studies. In some instances there are problems with the reliability of data, for example, with respect to child mortality, and qualifications are noted.

B. The Socioeconomic Costs of Transition on Children

4. In the FSU, children were well protected under a comprehensive social safety net and family support system. Child care facilities were good and education, health, culture and sports were strongly promoted. In spite of this consideration given to children by the state and society, the status of child development was weakened by a social services delivery system which emphasized quantity over quality. On balance, however, health and education indicators for child development were very high compared with even moderate income countries.

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5. The economic and fiscal crises emerging after independence have resulted in tremendous strains on the family at the same time that public support has diminished. During

transition, children were among the first to suffer the consequences of the breakdown of the socioeconomic system. The economic and social developments in the country have resulted in severe problems for children manifested in the extreme in children without families or homes.

6. The deteriorating social service delivery system is characterized in the education sphere by a massive closure of kindergartens and child care centers. Limited fiscal resources result in pervasive problems. For example, children are deprived of meals at school, a significant problem when hunger is present among the country's poor. Children drop out of schools because of a lack of appropriate clothing, lack of heating of the facilities and poor transportation. The increased difficulties, discouraging school attendance, exacerbate the growing tendency for children and young people to prematurely enter the labor force. Driven by increasing poverty in addition to a faltering education system, these young job market entrants are ill-prepared to compete in the emerging marketplace.

7. The increasing incidence of poverty and deteriorating social infrastructure has also had a clear impact on deteriorating health conditions. Serious problems are apparent in the rising incidence of infant mortality and childhood diseases. A widespread and growing lack of basic nutrition lie behind many of the problems.

8. The sections below detail the general deterioration in the condition of children including discussions on (i) the faltering education system, (ii) the developing problems of child labor and unemployment, (iii) the worsening health situation, and (iv) increasing social problems involving children.

1. A Faltering Education System

a. Shrinking Access to Education

9. The rapid eradication of illiteracy through investments in primary and secondary education was one of the more remarkable achievements of the former Soviet system. The Kyrgyz Republic's literacy rate was approaching 98 percent before 1991. Small class sizes, schools in nearly every community, and free books, meals, and summer enrichment programs reflected the high priority given to children's education in the socialist system and supported by transfers from the Central Government of the FSU. With independence, public resources available for social spending have declined precipitously, and the education system has weakened. Human development has clearly suffered with negative consequences for society and future labor resources.

i. Closures of Kindergartens and Pre-schools

10. The deterioration is most evident in the pre-schools or kindergartens. During Soviet times, kindergartens were an integral part of the education system. Most of the kindergartens were run by state enterprises and collective farms. With privatization, kindergartens were among the first social assets to be divested. Formally, the responsibility of maintaining the facilities was transferred to local governments. The local governments, however, did not have sufficient funds to maintain the buildings, staff, and provide for materials and supplies. As a consequence, since 1991 the number of children attending kindergartens has declined rapidly from 190,100 to 46,114 in 1995 (see Table 1). In the rural areas, in 1994 only 22,000 children had access to kindergartens. The Ministry of Education is concerned that

those children who cannot attend kindergarten will become disadvantaged in participating in the emerging market society.

11. The closure of kindergartens has had major negative impacts on rural children's health situation, as those facilities had previously provided medical care and nutrition supplements such as milk. To illustrate the problem, out of the 160 milk kitchens that were open in 1991, 123 have had to be closed due to a lack of funds (see para. 34.). An additional problem resulting from the closure of kindergartens is the reduced employment and income possibilities for women in rural areas. The activities connected with the divestiture of social assets resulted in considerable unemployment for women, especially during the first few years after independence (see Appendix 2).

Table 1: Indexes of the Changing Education System

| Item | 1985 | 1991 | 1993 | 1994 | 1995 | 1996 |
|--|-------|-------|-------|-------|-------|-------|
| Pre-school/Kindergarten education | | | | | | |
| number of institutions | 1,398 | 1,604 | 998 | 639 | 448 | |
| rural | 811 | 994 | 566 | 314 | | |
| number of children ('000) | 176.6 | 190.1 | 92.2 | 58.9 | 46.1 | |
| rural | 71 | 88 | 41 | 22 | | |
| School enrollment ('000) | | | | | | |
| general education | 936.6 | 962.5 | 954.7 | 952.0 | 968.0 | |
| primary education (grade 1-4) | | | | 385.9 | 391.8 | 395.2 |
| basic education (grade 5-9) | | | | 460.5 | 479.5 | 499.5 |
| secondary education (grade 9-11) | | | | 97.5 | 91.3 | 88.8 |
| evening schools and distance education | | | | 8.1 | 5.4 | |
| training | | | | | | |
| specialized secondary training | 50.9 | 43.4 | 41.2 | | 32.7 | |
| vocational training | | 44.3 | 40.8 | | 35.1 | |
| university and higher education | 58.2 | 58.5 | | | 55.2 | |
| Estimate of school dropouts (numbers) | 4,601 | 6,852 | 6,645 | 5,829 | 6,094 | |
| grade 1-4 | 2,418 | 3,252 | 2,992 | 2,134 | 2,345 | |
| grade 5-9 | 1,940 | 3,304 | 3,363 | 3,495 | 3,561 | |
| grade 10-11 | 243 | 296 | 290 | 200 | 188 | |
| School workers ('000) | | 344.9 | 334.5 | 295.4 | | |
| teachers | | 75.8 | 73.2 | 69.0 | | |

Sources: NatStatCom, UNDP, UNICEF, Ministry of Education, Ministry of Labor, and staff estimates.

ii. Deteriorating Provision of Public Education

12. Declining public sector funds have led to an overall deterioration of the school system. It is estimated that half of all schools need serious renovations or require complete reconstruction. Rehabilitation work is particularly needed in the approximately 200 primary and secondary schools that suffered heavily from the 1992 earthquake in the south of the country. The Bank is processing support for the Government at the central and local levels in the rehabilitation of school infrastructure through the proposed Education Sector Program Loan (as well as through a possible project to improve the delivery of social services by local governments).

13. Shortages of teaching materials are particularly serious. In rural regions of Naryn, for example, it is common for three to four children to share one worn-out textbook. The textbook, printed in the early 1960s, typically emphasizes the importance of communist values in the context of a command economy. Such materials lend little insight into the emerging reality, and children are disinterested in reading such textbooks, since they are quite aware that they are outdated. Some international organizations, such as the Soros Foundation and the American Peace Corps, have provided new materials, but they have reached less than 100 schools.

14. The impact on the provision of educational services of deteriorating facilities and outmoded equipment is exacerbated by a lack of funds to provide for heat in winter and meals for the students. The lack of heat, especially in rural areas, is a major reason for decreased attendance and school closures. The failure to provide meals has contributed to the increased problems of malnutrition (see para. 31.).

b. Rising Access Costs

15. With growing poverty, it is very difficult for people to pay for school-related expenses. Before independence, education was free and such items as school books, transport, and school meals were provided by the State. The schools were maintained through state and enterprise budgetary support. With declining local budgets, the privatization of farms and enterprises, and increasing poverty, the school infrastructure has been eroded, and the costs of attending schools and kindergartens have increased.

16. Although, officially, access to education is free in the Kyrgyz Republic, school fees have been introduced as an economic necessity in the transition period. Estimates provided by parents interviewed and the information from the press suggest that school fees total at least Som 100 per child. In some regions, where teachers' salaries have not been paid by the government for more than five months, families are also required to provide cash or in kind contributions in order to help the teacher. In addition to attendance fees, a widely-used, unofficial practice fines students up to Som 5 for a missed day of school. They are only allowed back in class after payment of the fine for their absence.

17. The impact of fees and other charges is particularly serious at pre-schools. Those kindergarten and pre-school facilities which are open are sometimes imposing fees of between Som 300 and Som 700 per child. These are substantial sums and have greatly restricted the access of children of poorer families to pre-school facilities.

18. Other school-related costs are becoming barriers to participation in the education system especially for the poor. The issue of adequate winter clothing and shoes for children offers an illustrative set of problems. For example, in 1994 in Bel-Aldei Rayon, in Jalal-abad Oblast, it was reported that children from 18 of 28 households did not attend school due to the lack of winter clothing and shoes.¹ In oblasts such as Naryn, where the winter is six to seven months long, clothing for most low-income families is thread-bare and inadequate. The Government is considering reintroducing the mandatory use of school uniforms in an attempt to minimize the social differences between poor and better-off households. However, it is not clear how the poor could obtain such uniforms or shoes for their children. A program

¹ Howell, Jude (1994): *Coping with the Transition: Household Coping Strategies in Kyrgyzstan*. Bishkek/London: Save the Children Fund.

mandating school uniforms, if not properly constituted, could further restrict the access of the poor to the education system.

c. Declining School Enrollment

19. School enrollment in the Kyrgyz Republic was very high before independence. The transition to a market economy, however, has forced many children to drop out of schools prematurely. In the first half of the 1990s, the number of grade 5-9 school dropouts has, for instance, increased by more than three quarters over the mid-1980s level (see Table 1). A rapidly growing percentage of younger children drop out in order to find work in the informal sector. Field studies and interviews with teachers and the staff of the Ministry of Education suggest that the actual number of children dropping out of the schools is much higher than what the official figures indicate, especially in the rural areas.

20. Students from rural areas are most affected by the changes in the provision of education. In Naryn for example, the most remote oblast of the country, the number of school drop-outs increased by 35 percent between 1991 and 1994. Under the conditions of rising poverty, rural children's responsibilities for contributing to family income are often bigger than for urban children. More schools in the rural areas are closed for lack of heating or transport. The lack of adequate winter clothing is another factor as to why pupils in the rural areas do not attend their schools during the long winter months.

2. Increasing Child Labor and Youth Unemployment

21. Many households are becoming increasingly dependent on the labor of children both in and out of the household. Although the traditional economic activity of animal herding has always involved children, the present occurrence of child labor is much more common than in the pre-independence years. Families are depending on children for income as well as for performing many of the household duties formerly done by one or the other parent. This is particularly apparent in rural areas where children help in farming and husbandry activities. In the rural areas, with the breakdown of family units, the migration of fathers in search of work, and with mothers working at two or more jobs, children are playing a larger role in the household.

22. There is also an increase of child labor in urban areas, often associated with rural to urban migration of poor families. Typical activities of children in urban areas include working at the bazaar or in kiosks, selling newspapers, working in small-scale industries, and begging. In any case, these children have considerably less ability to attend school and to study than they should, a situation detrimental to the long-term development of the country.

23. With privatization and economic restructuring, formal and informal unemployment is rapidly increasing. Every year more than 100,000 students leave school, most of them facing grave difficulties in finding formal employment. Data from the Ministry of Labor suggest that nearly half of the officially registered unemployed are between 18 and 30 years old. The country will experience increasing youth unemployment problems in the next five to ten years, when many of the 40 percent of the population which is now made up of children under 18, will begin seeking jobs.

3. Health and Nutrition

24. The health and family assistance systems are rapidly eroding (see Appendix 1). As a consequence, the health status of children is worsening. A very diverse set of problems must be considered in this area. The sections below discuss issues concerning (i) infant mortality, (ii) childhood diseases, (iii) disabled children, (iv) nutritional problems, and (v) teenage pregnancy.

a. Infant Mortality

25. An accurate picture of the health situation concerning children is difficult to draw due to problems in the most basic statistics. Infant mortality figures, for example, appear to misrepresent the underlying health situation. Registered infant mortality in 1995 was 27.5 deaths per 1,000 live births, down from the 31.3 deaths reported in 1993 (see Table 2). However, the Ministry of Health and experts estimate that, contrary to their own statistical collection, there has been a serious increase in the infant mortality rate of perhaps up to 35 per 1,000 live births by the end of 1995. The 1994 introduction of registration fees has apparently resulted in underreporting which compounds the problems of underutilization of the health delivery system. The Ministry of Health suggests that the situation has worsened in 1996 and that rural areas are exhibiting much more serious problems than in Bishkek.

Table 2: Worsening Children's Health

| Item | 1985 | 1991 | 1993 | 1994 | 1995 |
|--|----------------|---------|----------------|-------------------|-------------------|
| Children's Health | | | | | |
| nutrition | | | | | |
| milk kitchen (number) | | 160 | | 40 | 37 |
| malnutrition (percent of all children) | | | 9.8 | | |
| anemia in pregnant women (percent) | 17.1 (1988) | 29.4 | 30.9 (1992) | 35.0 | |
| incidence of rickets among children | | 12.4 | | 16.7 | |
| diseases in children | | | | | |
| tuberculosis (per 100,000) | | 22.9 | | 24.7 | 28.7 |
| respiratory diseases (number of cases) | | 425,910 | 400,609 | 305,936 | 281,538 |
| infant mortality (per 1,000 live births) | 37.8 | 29.7 | 31.3 | 29.1 ^a | 27.5 ^a |
| Disadvantaged children (number) | | | | | |
| children in orphanages and orphans boarding schools | 4,950 | | 829 | 857 | 947 |
| physically and mentally disadvantaged children | 4,950 | | 2,970 | 2,410 | 2,190 |
| centers for handicapped people (children and adults) | | | 318 | 414 | |

^a Ministry of Health suggests underreporting due to the introduction of registration fees; the actual figure for 1995 is estimated at 35 per 1,000 live births.

Source: NatStatCom, Ministry of Health, UNDP, UNICEF, WHO, and Kyrgyz Children Fund.

26. Among the causes cited for infant mortality in 1995, 43 percent were related to respiratory diseases, 24 percent resulted from prenatal conditions, 16 percent from infections, 9 percent resulted from congenital anomalies, and 6 percent due to other causes. The prevalence of many of these problems is quite recent. In some cases, they are directly related to the worsening of heating and sanitation systems in formerly public, communal housing. Very often children's deaths could have been prevented with proper care, if the facilities in hospitals and clinics functioned as they previously did.

27. Deaths also occur because of a lack of transport facilities to hospitals and doctors. The Ministry of Health suggest that almost half of the child deaths in rural areas occur

at home or on the way to the hospital. In the remote areas of Talas and Jalal-abad the figures are thought to be even higher. A vicious pattern is developing, in which poor facilities and higher costs limit access to health care until problems become obviously critical, at which time there may be little or nothing that can be done.

b. Childhood Diseases

28. Similar to the situation with reported infant mortality, in the face of overwhelming anecdotal evidence to the contrary, the Ministry of Health statistics suggest that, between 1991 and 1995, the incidence of childhood diseases has generally decreased from 880,500 cases in 1991 to 697,353 in 1995. The official data appears to reflect the diminished use of the medical system, fewer consultations with doctors, and fewer visits to clinics, rather than an improvement in the condition of children. Less interaction with health delivery systems results from a diminished capacity of the system, poorly equipped or closed clinics as well as increased user costs.

c. Disabled children

29. Alongside the general deterioration in the quality of life, disabled children find themselves in a more vulnerable position than they were prior to independence. Irregular payments of state benefits mean that many families cannot afford to buy necessary medicine in the treatment of chronic disabilities such as diabetes and mental disorders. Those with mental or physical disabilities face other difficulties since the restricted fiscal resources have meant sharp cutbacks in maintenance activities and restricted operations for public health and physical therapy facilities. The number of pedagogical staff for physical and disadvantaged children, for example, declined by 40 percent in just one year to 437 doctors from 1993 to 1994. Underlying this contraction, the number of special boarding schools fell from 29 in 1985 to 19 in 1994.

30. With fewer treatment centers, teachers and doctors, the number of disabled children who received special treatment and care decreased from 93 percent of eligible children to 60 percent between 1991 and 1994. Field evidence suggests that increasing numbers of disabled children, especially in the rural areas, are falling outside the formal care system.

d. Nutritional problems

31. With the increased incidence of household poverty since independence, the prevalence of poor nutrition among children has risen. In 1993, 7 percent of pre-school children suffered acute malnutrition or wasting.¹ Estimates from UNICEF and field studies reveal an increase in malnutrition of children in rural areas of up to 15 percent. For example, in Naryn Oblast, the Deputy Akim estimated that less than adequate nutrition affects as many as 30-40 percent of all children and acute malnutrition affects more than 7 percent. There are specific problems regarding the lack of nutritional supplements for lactating mothers and for infants less than one year of age. The high incidence of anemia among pregnant women (35 percent in 1994) is suggestive of a further rise to come in the number of malnourished children.

¹ Popkin, B.M., Martinchik, A.N., (1993): *Nutritional Conditions of the Kyrgyz Population*. Paper presented at the National Seminar on Poverty and Social Protection, Bishkek: Ministry of Labor and Social Protection/World Bank.

32. The specific incidence of poverty is the basic reason for growing malnutrition, especially the lack of budgetary resources for relief assistance and the limited availability of cash income in rural areas. Poor women surveyed in mid-1996 in the remote Naryn Oblast reported that they had not received any cash benefits from the Government since December 1995. Thus, state benefits were more than five months in arrears. Some had received in-kind assistance, a bag of flour that could support a family of six for two weeks. Mid-1996 field studies with five low-income families in Naryn indicated that all of the 22 children were undernourished and 10 percent of the children showed early signs of malnutrition including headaches, dizziness, and lethargy. When asked about what they had eaten that day, one mother with a monthly income of Som 300 (\$25) said that she had fed her seven children tea and bread for breakfast, tea for lunch, and she did not know what they would eat for supper. By all observations, this was an accurate account of the family's situation since no other food could be found in their two-room house. About half of the women waiting in front of the social assistance office in Naryn during one field visit said that they could only feed their children water and black bread.

33. The most clear-cut problems involving nutrition include (i) the simple lack of an adequate amount of food, and (ii) specific micronutritional deficiencies. One aspect of both of these problems is the declining consumption of milk. Precise statistics on milk consumption are not available; however, there is considerable evidence that serious problems exist. Lack of milk for children results in protein deficiency and is directly linked, for example, to an increase in the incidence of rickets among children, from 12.4 percent of all children in 1990 to 16.7 percent in 1994.

34. The closing of many state-supported milk kitchens especially in the rural villages has been one of the reasons for decreased milk consumption by young children. Out of the 160 milk kitchens in 1991, only 37 remained open by the end of 1995. The seriousness of these closures can be seen in their impact on children in the Batkin district. Before independence 80 percent of the children in Batkin received food from the milk kitchens. By 1994, the figure had fallen to 20 percent. Whereas the central milk kitchen in Batkin had previously prepared 4,000 portions of milk products daily, by 1994 it was only making 40-50 portions each day.¹ In addition to supply problems related to the distress in the agricultural sector, many families simply cannot afford to buy the dairy products (milk, cheese, sour cream, and yogurt) that were once staples of the Soviet diet.

35. One positive development from this crisis is a general trend towards increased breast-feeding of infants. The Ministry of Health reports that, in 1995, 50 percent of all mothers reported that they were breast-feeding their children; up from 30 percent in 1991.

36. As a natural consequence of the general problem of poor nutrition, there are major issues facing children concerning micronutrient deficiency, especially with regard to iron, folic acid, and iodine. A program has been initiated by UNICEF to provide enrichment equipment for three flour mills in the country. However, the benefits will not be widespread because of the small scale of the project. The issue of iodizing salt is also of great concern. The Center for Disease Control in Atlanta reported the results from a study of 800 children in the Kyrgyz Republic that tested for various nutritional deficiencies. Of the children tested, 44 percent exhibited iodine deficiency. This is a serious childhood problem that can cause an

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irreversible lowering of intelligence. The Government of India is supplying iodine to the Kyrgyz Republic in an attempt to remedy this problem.

e. Teenage pregnancies

37. The lack of an effective health care system has exacerbated the growing problem of teenage pregnancies especially in urban areas. By the mid-1990s, births to unmarried young women between 13 and 17 years of age had increased by more than one third over the levels seen in the 1980s. Weak contact with the health care system for these young women compounds the lack of sex education in the school system and the mounting social and family stress resulting from the economic crisis. The negative impact on the development of the young women is discussed in Appendix 2.

4. Children in Society

38. This section provides a discussion of two additional aspects of the impact of transition on the condition of children: (i) the emergence of homeless children; and (ii) the increasing incidence of criminal activities by youth.

a. Homelessness

39. There was always a high number of orphaned children in the former Soviet Union, especially after the World War II, when many children were placed in children's homes. Since independence, however, the country has witnessed the phenomenon of parents abandoning their children because of their impoverished conditions. In some orphanages the numbers of children have doubled, whereas local government funds for the support of these children has all but disappeared.

40. Most notably, for the first time, ethnic Kyrgyz children are also being found in orphanages, in the company of equally unfortunate children of Slavic or other ethnic backgrounds. Prior to independence, Kyrgyz family values ensured that an abandoned child would be adopted by relatives. Since independence, the enormous economic stress on many families has discouraged this ancient nomadic custom.

Table 3: Indexes of a Weakening Social Fabric

| Item | 1991 | 1993 | 1994 | 1995 | May 1996 |
|--|-------|-------|-------|-------|----------|
| Total Population ('000) | 4,422 | 4,502 | 4,432 | 4,547 | |
| Juvenile crime (cases) | | | 1,439 | 1,605 | |
| Children in detention centers (no.) | | | 900 | 1,214 | |
| homeless people in Bishkek (estimated no.) | | | | | 5,000 |
| women and children | | | | | 2,500 |
| street children | | | | | 800 |
| orphans (not in orphanages) | | | | | 400-500 |

Source: NatStatCom, AYALZAT (Presidential program from women), UNDP, UNICEF, Women in Development Bureau, Kyrgyz Children Fund, Ministry of Labor and Social Protection, Ministry of Health, and staff estimates.

41. As a result of the weakening social protection and social assistance systems and of the increasing pressure on families, some children are completely without homes. In 1995, in the city of Bishkek alone, 1,200 children were being kept in detention centers. This is three times more than in 1992. In addition to these children there are a growing number of street children without any family or public support. Unofficial estimates of these homeless

children in mid-1996 put the number in Bishkek at 800. Family problems that have resulted in children making their homes in the streets include alcoholism in parents, violence, the death of parents, poverty, and hunger. Most of these children do not attend school, are illiterate and face uncertain health conditions in unsafe and insecure living environments. In Bishkek, the Kyrgyz Children's Fund is opening a resource center where children can come to rest, eat, and shower.

b. Increasing Youth Crime

42. With rising poverty and social problems such as alcoholism, increasing stress on families, and increased numbers of street children, crimes committed by youth and children are growing in numbers. In 1995, 1,605 cases of juvenile crime were reported. Many of the crimes are committed by children organized in gangs and living in the streets of the larger cities like Bishkek and Osh.

C. Public Assistance For Children

43. The Government provides considerable direct support to children within the broad institutions for social assistance (see Appendix 1). During Soviet times, the Government granted substantive support to poor families and other individuals. Support was provided to a large number of people on an entitlement basis. These social assistance grants were given to about 30 percent of the population in the Republic but were not well targeted from the standpoint of assisting the truly needy. After independence, reforms have increasingly provided for improved targeting and, since 1993, more than 90 percent of social assistance payments have been granted to children. However, due to heavy budget constraints, actual government support to poor children has been small. Through May 1996, only 1.3 percent of the Som 415 million allocated for child and social allowances in the 1996 budget were actually released. The average monthly payment was Som 32 (\$3); this compares with a minimum subsistence level for children of Som 292. Although this is insufficient to sustain a child, these meager monthly assistance payments are important for poor families and sometimes provide for the only cash income to the families.

D. Programs for Action

1. Strengthening Education and Early Childhood Development

44. Human development will depend upon a strengthened education system. The Bank's Agriculture Program Loan brought to the Government's attention the need to maintain the pre-school programs. The Bank is taking the lead among international funding agencies within the overall education sector. An education master plan has been developed with the Bank's technical assistance. The Bank's sector strategy is discussed in the main body of the text. A project involving policy reforms and specific investment activities is being prepared for 1997.

2. Other Social Services and Social Protection

45. Improved access for children to a wide range of social services is needed. In particular, local health services must be improved through service delivery improvements and a higher level of local funding. Similarly, social assistance needs to be rationalized through better targeting and more efficient operations. Payment arrears must be eliminated.

46. The Bank is processing a project to improve the provision of social and communal services at the local level in pilot regions. The project will integrate self-help initiatives by the private sector and by NGOs to provide for essential social services for children, linking these to government activities. This project is considered as a pilot in providing valuable experience to develop further investment opportunities for the Bank for poverty alleviation and human resource development, especially for children.

3. A Focus on the Rural Sector

47. The problems affecting children are heightened in the rural areas as a result of the higher incidence of poverty and lower levels of public support. Completing the unfinished reform agenda in agriculture and rural development, including rural credit, will be an essential element in eventually reducing poverty and youth unemployment. Strengthening local governments will also be an important activity.

48. The Bank's strategy for the agriculture sector was discussed in the main text of this document. The proposed project providing for rural credit is particularly significant. Small-scale credit can support small farm and business activities that can facilitate immediate income generation activities that can flexibly co-exist with domestic responsibilities. Some credit lines may support local artisans and self-help groups in their endeavors to rehabilitate essential social infrastructure, such as schools, kindergarten and health care centers. This will have a positive impact especially on the children in the rural areas.

4. Infrastructure Policies

49. The Bank has committed itself to providing significant assistance to the Government in rehabilitating infrastructure and completing necessary policy reforms in the energy and transport sectors. The Bank will be particularly sensitive to the need to establish policies that provide for economic restructuring without unduly increasing the present difficulties of the poor and the children. Tariff reforms to raise overall revenue, for example, will be designed to provide life-line services. This means to provide for low-cost services that ensure the access of the poor and the children to minimum-level services, particularly for heating, electricity, and water. An improved policy environment for private sector rural transport services could play a particularly important part in improving the situation for children by improving access to health facilities and to schooling.