

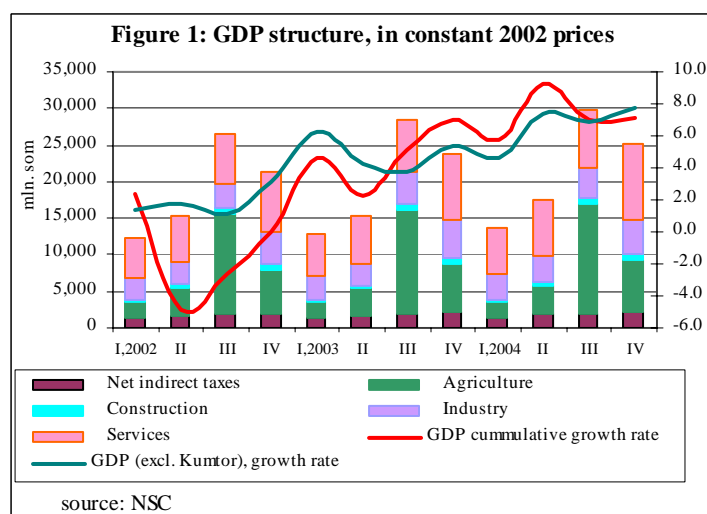
## The Kyrgyz Republic Recent Economic Developments: January-December 2004

### Summary

The Kyrgyz economy continued to grow strongly for the second year in a row, like many other CIS countries. The real GDP increased by 7.0 and 7.1 percent in 2003 and 2004<sup>1</sup>; GDP per capita increased from US\$381 to US\$431; and poverty declined by about 4-5 percentage points to 35 percent. Growth base continued to be broadened towards non-gold sectors, mainly non-gold industry and services, which have been developing strongly, contributing to GDP growth most substantially, while Kumtor related gold production entered into downward trend causing 0.7 percentage point decline in GDP. Agriculture grew by 4.1 percent, which is about 1 percentage point higher than its growth in the last two years, mainly due to favorable weather conditions. Fixed investments increased by 2.8 percent in real terms, which is lower than expected. The 12-month inflation declined to 2.8 percent after increasing to 5.6 percent in 2003. Low inflation and relatively stable nominal exchange rate led to depreciation of real effective exchange rate by 3.7 percent. Current account deficit increased from 4 percent of GDP in 2003 to 4.4 percent of GDP, reflecting increase in the trade deficit and reinvested income on gold related FDI<sup>2</sup>. Merchandise exports increased by 23 percent and imports increased by 31 percent. Inflow of private transfers continued to increase, which is explained both by better recording coverage and increase in inflow. General government fiscal deficit declined from 4.7 percent of GDP in 2003 to 3.9 percent of GDP in 2004, due to both increase in budget revenue and reduction in expenditure. One of the features of the government finance in 2004 was the increase in grant-financed capital expenditures. The real wage increased by 11 percent on average in all sectors of the economy, including wages of social sector public employees.

### 1. Growth

- **Real GDP** grew by 7.1 percent, based on contribution of services (4.3 percentage points), non-gold industry (1.3 percentage points), and agriculture (1.4 percentage points). Non-gold GDP grew by 7.8 percent, which is the highest growth attained during the last five years.
- **Non-gold industrial output** increased by 6.6 percent in real terms. Food industry, the main non-gold industrial sector, has been strongly developing over last three years. Construction material production has been recovering by remarkably high rates over the last two years (23-27 percent annually) stimulated by external demand and substantial growth of domestic construction. Overall growth of the economy, especially development of industry, led to increase in power



**Table 1: Growth rates of GDP and value added of sectors**

	2001	2002	2003	2004
GDP	5.3	0.0	7.0	7.1
GDP excl. Kumtor-gold	4.1	3.1	5.4	7.8
Agriculture	7.3	3.0	3.2	4.1
Construction	4.0	1.4	-2.2	3.5
Industry	4.8	-13.4	15.6	3.5
Services	3.3	4.4	7.3	11.7

Source: NSC

<sup>1</sup> The GDP growth rate for 2003 has been revised from 6.7 percent to 7.0 percent; all other data for 2004 are preliminary or estimates.

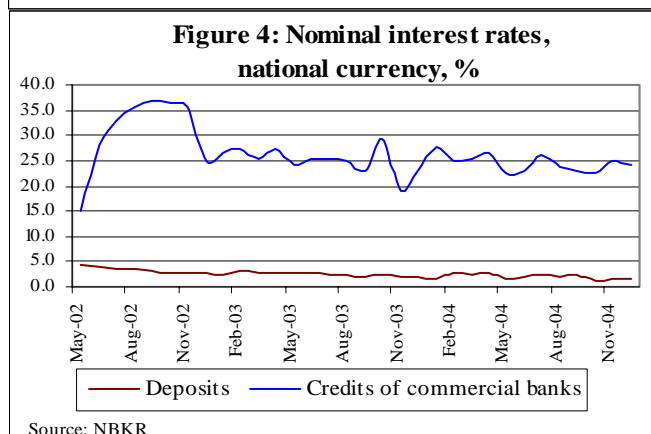
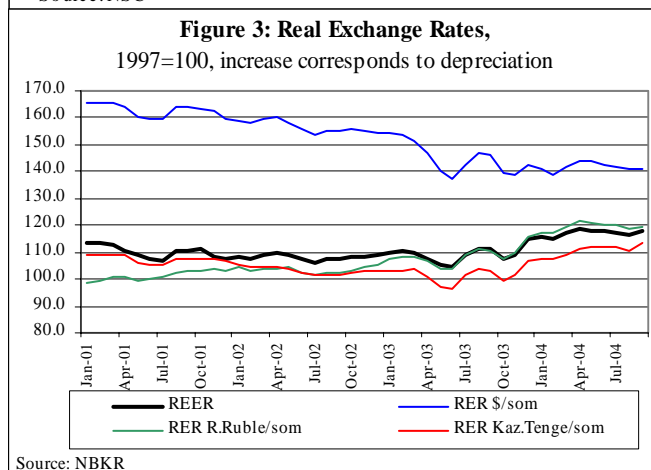
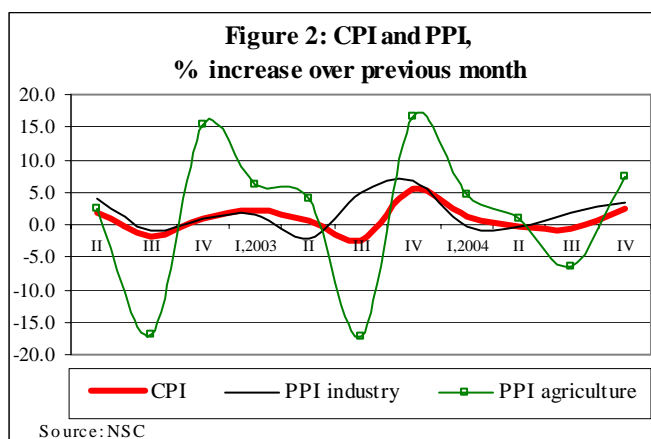
<sup>2</sup> The NBKR has substantially revised BOP statistics for 2003 and 2004 to reflect estimates of under recorded imports from China; and it caused an increase of current account deficit by about 2 percentage points of GDP in 2003 and 2004.

production and distribution by 6.5 percent.

- **Agricultural output** increased by 4.1 percent in real terms, based on growth of crop production by 8.1 percent. Favorable weather condition led to significant growth of vegetables and fruits production. Cotton production increased by 15 percent with exports increasing by 10 percent in real terms. However, there is a mismatch between statistical data on tobacco production, which doubled in real terms, and tobacco exports, which declined by 36 percent in real terms, given that domestic production of cigarettes increased only by 2 percent in real terms.
- **Construction sector output** increased by 3.5 percent in real terms, and its development continued to be dominated mainly by large constructions under Public Investment Program. In private sector, real estate construction has been growing substantially, stimulated by significant real estate price increase during the last two years. Official statistics indicates that investments in real estate construction doubled last year.
- **Services**, the most dynamically developing sector of the economy, grew by 11.7 percent in real terms. It has been growing at accelerated rates over the last three years, reflecting strong development of trade, food, hotel, and communication services. Official statistics suggests that transport services increased only by 1.4 percent, which most probably is underestimated, given strong growth of domestic and external trade.

## 2. Inflation, exchange rate, and interest rates.

- **Consumer prices** (December to December) increased only by 2.8 percent, compared to 5.6 percent increase in 2003. Food product prices increased by 2.2 percent; however, prices on some important food products such as meat, bread, eggs, and milk products increased at higher rates in the range of 9 to 20 percent, which were compensated by decline in prices on vegetables by 23 percent. Non-food product prices increased by 3.2 percent, reflecting mainly price increase on fuel. Prices on services increased by 2.5 percent, with tariffs on communication services increasing by 12 percent.
- **The real effective exchange rate** depreciated by 3.7 percent. The real exchange rate of Som against US dollar appreciated by 4.4 percent, reflecting worldwide weakening of US dollar; while it was stable against Euro. Lower inflation in the country, compared to that in main trade partners led to depreciation of the real exchange rates of Som by 6.7 percent against Russian Ruble and by 8 percent against Kazakh Tenge, keeping cost competitiveness of Kyrgyz exports.



- **Interest rate** on commercial bank loans has remained at 25 percent on average during the last two years, which is relatively high compared with the low level of inflation.

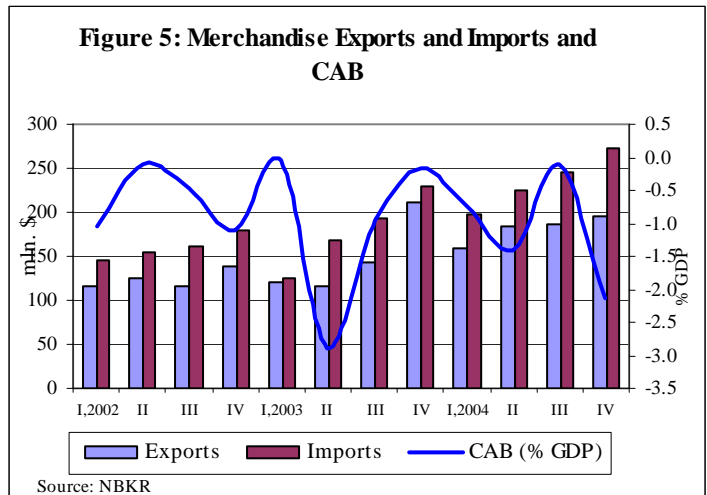
### 3. External Sector

- The NBKR has substantially revised the balance of payments statistics for 2003 and 2004 in order to reflect estimates of under recorded imports from China. According to revised preliminary data, **current account deficit** increased from 4.0 percent of GDP in 2003 to 4.4 of GDP in 2004.

**Table 2: Current Account Balance (million US\$)**

	2001	2002	2003	2004
CAB (% GDP)	-1.2	-2.8	-4.0	-4.4
CAB (million US\$)	-26.5	-44.3	-77.0	-97.1
Merchandise Exports	480.3	498.1	590.3	726.2
Gold exports	226.7	162.8	259.6	287.4
Merchandise Imports (fob)	449.9	572.1	723.8	901.5
Exports of services	80.3	142.0	154.7	208.6
Imports of services	124.7	147.3	149.5	215.8
Net income	-63.6	-53.4	-60.5	-101.1
interest payments (scheduled)	-39.3	-32.0	-26.8	-37.3
Current Transfers net	51.1	88.4	111.7	185.8

Source: NBKR



- **Merchandise exports** increased by 23 percent, reflecting the increase in exports of all functional categories of goods, due to both increase in domestic production and growth in demand from strongly growing economies of the main trade partners. The value of gold exports, which accounted 40 percent of the total exports, increased by 11 percent only due to price increase; however, in volume, its exports remained at previous year level and its production declined. Substantial increase in exports of consumer goods, such as sugar, electric bulbs, fruits, vegetables, and milk products, and continued recovery of exports of construction materials and cotton were a positive feature of export development in 2004. However, commodity and geographical concentration of exports remained relatively high. Exports increased mainly to Russia, Kazakhstan, and China.
- **Merchandise imports** (c.i.f., official statistics) increased by 31 percent, also reflecting the increase in imports of all functional categories of goods, with most significant increase in imports of energy products. Russia, Kazakhstan, Uzbekistan, China, and Germany remained to be the main trade partners on imports.

**Table 3: General government budget (% of GDP)**

	2002	2003	2004
<b>Total revenue</b>	<b>22.7</b>	<b>22.9</b>	<b>23.4</b>
Taxes	17.5	17.7	18.4
Income and profit tax	2.9	2.7	2.7
VAT	6.4	6.6	7.3
Excises	1.4	1.4	1.3
Customs	0.6	0.5	0.4
Payroll	3.6	3.5	3.5
Others	2.7	3.1	3.2
Non-tax and Capital	4.1	4.6	3.9
Grants	1.1	0.6	1.1
<b>Total expenditure</b>	<b>28.5</b>	<b>28.1</b>	<b>27.7</b>
Current	22.6	23.2	22.8
Wages	5.3	5.7	5.8
Transfers&subsidies	9.3	8.7	8.4
Interest	1.9	1.6	1.9
Goods and services	6.1	7.3	6.6
Capital	6.0	4.9	4.9
Foreign financed PIP	4.7	3.7	3.8
Net lending	-0.6	-0.5	-0.5
<b>Balance</b>	<b>-5.2</b>	<b>-4.7</b>	<b>-3.9</b>

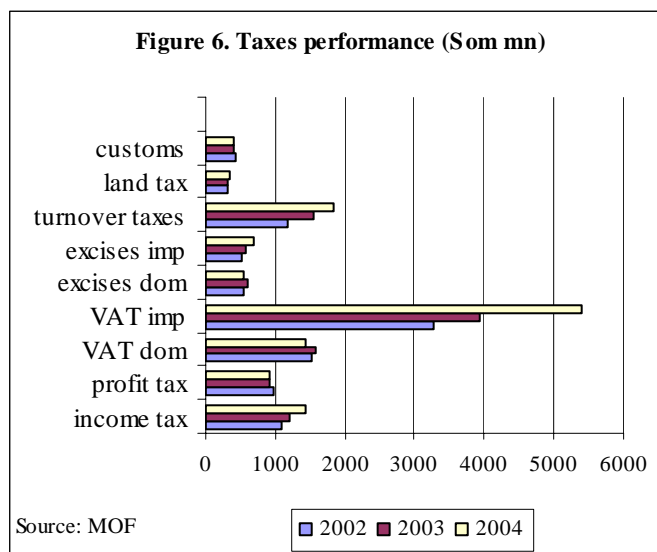
Source: the MOF and WB staff calculations

### 4. General Government budget

- **Fiscal deficit** (accrual) of the general government budget declined quite significantly from 4.7 percent of GDP in 2003 to 3.9 percent of GDP in 2004 due to both better performance in revenue collection and reduction in expenditure.
- **The general government revenue** increased to 23.4 percent of GDP, demonstrating the highest level for the last three years. Despite generally good economic performance, the main sources of revenue

growth were not domestically originated. Thus, revenues increased by 0.5 percent of GDP, bulk of which was provided by the increase in collections of VAT and excises on imports, and grants received from abroad (including capital grants). At the same time, domestically originated taxes showed very modest increase if at all (see Table 3 and Figure 6).

- **The general government expenditure** in nominal terms increased by Som 2,4 billion against its level in 2003, while as a percentage of GDP, it declined from 28.1 percent to 27.7 percent. The share of foreign financed PIP as a percentage of GDP remained roughly at the previous year level (3.8 percent), but its grant component increased significantly, from US\$ 1.6 million to US\$ 8.3 million or to 10 percent of the total PIP. In is important to note that the current state budget expenditures continued to be highly concentrated on financing of few economic items such as salaries and contribution to the Social Fund (36 percent of the total current



expenditures), interest payments (10 percent), purchase of other goods and services (9 percent), and utility payments (6 percent). Some key sectors suffered from concentration of expenditures on even fewer economic items. Thus, in education, expenditures on salaries and utilities increased to 86 percent of sectoral current expenditures, while only about 1 percent was spent on purchase of equipment and other goods; in health sector, salaries and utility payments took out 68 percent of its current budget, compared with 11 percent spent on drugs. Such expenditure structures, obviously, hamper efficiency of public service delivery. Although all PIP-related expenditures are considered as capital expenditures, part of them used for recurrent expenditures. However, the PIP data is not detailed enough to analyze structures of sectoral PIP expenditures.

**Table 4: Consolidated sectoral budgets (Som mn) 1/**

	2002			2003			2004		
	budget means	special means	external PIP	budget means	special means	external PIP	budget means	special means	external PIP
Gen.State Services	1887	370	9	2240	401	8	2637	461	13
Defense	1055	42		1207	76		1330	101	
Public Order	911	47		1066	55		1191	66	
Education	2534	816	145	2886	867	239	3320	1038	96
Health	1571	97	104	1725	102	385	2027	117	378
Social insurance	5008	3	171	5247	4	143	5645	6	153
Housing	1119	12		1176	18		1039	21	
Culture	366	28		456	29		542	36	
Fuel and energy	221	0	210	163	0	227	28	0	428
Agriculture	661	83	1397	676	107	1337	765	131	1293
Mining&construction	216	4		272	9		263	7	
Transport&Telecom	623	46	1198	512	54	699	564	89	871
Other	1212	1	330	3469	3	67	3845	1	310
<b>Total</b>	<b>17382</b>	<b>1549</b>	<b>3565</b>	<b>21096</b>	<b>1723</b>	<b>3105</b>	<b>23195</b>	<b>2075</b>	<b>3542</b>

1/ Cash basis, includes state budget, Social Fund budget and PIP

Source: the MOF, SF and WB staff calculations

## 5. The main legislative changes with economic impact in October-December 2004

1. **The Law # 188 “Amendments to the Law “On concessions and foreign concession enterprises in the Kyrgyz Republic”** provides additional requirements for concession of entities, aimed at protection of the state interests in concession agreements. According to experts’ opinion, the process of agreeing and changing concession contracts is complicated, thus having a negative impact on investors.
2. **The law # 189 “Amendments to the Law “On joint stock companies ”** allows application of the law “On concessions and foreign concession enterprises in the Kyrgyz Republic” to the joint stock companies with more the 2/3rds owned by the state, and specifically mentions the energy distribution companies in this category.
3. **The law #187 “Amendments to the law “On electric power industry”** widens obligations of both suppliers and consumers of the electricity, as well as sets up 1-month period for publishing an announcement on electricity tariff increases prior their introduction.
4. **The President’s decree #331** approves Investment Matrix #5, consisting of 4 sections: (1) implementation of the economic deregulation concept; (2) development of tax policy and tax administration, favorable for investments; (3) elaboration of the legal framework for investments stimulation; and (4) investment marketing of the Kyrgyz Republic.
5. **The President’s decree # 449** increases basic pension from 226 to 258 soms from January 1, 2005.
6. **The President’s decree # 349** increases salaries of education and health care employees by 13 percent, starting from October 1, 2004. Taking into account previous salary increase that took place in spring 2004, average salaries for these categories increased in 2004 by 30 percent.
7. **The government resolution # 803** reduces the rates of excises on imported and domestically produced gasoline from 1000 som/ton to 500 som/ton and diesel from 200 som/ton to 0 som/ton, starting from November 20, 2004. **The government resolution #857** increases excises on gasoline from 500 som/ton to 800 som/ton, on diesel – from 0 som/ton to 200 som/ton, starting from December 11, 2004. **The law “On basic rates of excise tax for 2005 year”** adopted by the parliament in December 2004, sets 0 rate on diesel and 800 som/ton on gasoline. Besides that, the law decreases excise rate for coffee and cacao by 5 percent.
8. **The government resolution # 763** adds tractors for agricultural works and forest farms to the list of goods, exempt from VAT.
9. **The government resolution # 798** sets up the new procedures for financing of regulatory agencies, except State Communication Agency and State Energy Agency. In particular, it states that all revenues from regulatory activities , earlier retaining with regulatory agencies and considered as their “special means”, are to be credited to the state budget revenues, while the agencies will get financing from the regular state budget.

**Kyrgyz Republic: Key macroeconomic indicators**

	2000	2001	2002	2003	2004	2003	2003	2003	2003	2004	2004	2004	2004
					Prel.	I	II	III	IV	I	II	III	IV
<b>GDP and prices</b>	4.7	4.1	3.6	5.4	7.8								
GDP real growth (%)	5.4	5.3	0	7.0	7.1	4.6	0.8	7.8	12.0	5.7	12.2	4.8	7.2
GDP, som million	65,358	73,883	75,367	83,872	94,078	13,711	16,056	29,264	24,841	15,270	19,281	33,275	26,252
GDP, USD million	1,370	1,525	1,606	1,919	2,205	298	372	684	579	354	444	784	631
GDP per capita dollar (at avg x-rates)	279	308	322	381	431	...	...	...	...	...	...	...	...
Poverty headcount (% of population)	52	48	44	39	35	...	...	...	...	...	...	...	...
Extreme Poverty headcount (% of population)	18	14	14	9	...	...	...	...	...	...	...	...	...
GNI per capita dollar GDP (Atlas)	280	280	290	340	380	...	...	...	...	...	...	...	...
Inflation ( % beginning-to-end of period, CPI)	9.6	3.7	2.3	5.6	2.8	2.0	0.5	-2.5	5.6	1.3	-0.4	-0.7	2.6
Inflation ( % average, CPI)	18.7	6.9	2.1	3.1	4.1	3.0	...	...	...	5.3	...	...	...
Exchange rate (som/\$, avg of period)	48	48	47	44	43	46	43	43	43	43	43	42	42
REER (end of period, 1997=100, up=depreciation)	114	107	109	115	119	110	105	111	115	117	118	118	119
M2 (e.o.p as percent of GDP)	11.3	11.1	14.6	17.5	20.6	13.7	14.2	15.3	17.5	16.0	16.9	17.7	20.6
<b>External Sector</b>													
Current account balance (% GDP) <sup>3</sup>	-5.6	-1.2	-2.8	-4.0	-4.4	0.0	-2.9	-0.9	-0.2	-0.8	-1.4	-0.1	-2.1
Exports (mln US\$, f.o.b.)	511	480	498	588	726	121	115	142	212	159	184	187	196
- Power	80	47	22	19	14	2	2	10	6	2	6	0	6
- Gold	197	227	163	260	287	54	46	68	92	67	83	75	63
- Other	234	207	313	312	424	66	67	64	114	89	95	113	127
Exports GNFS (mln US\$)	573	561	640	745	935	148	150	189	258	201	233	253	247
Imports (mln US\$, c.i.f.)	559	472	640	716	941	126	168	193	230	197	226	245	274
- Food	61	44	64.0	78	113	16	19	20	23	21	29	31	31
- Other consumer goods	149	128	130	178	191	28	38	45	68	47	45	46	53
- Energy	129	121	152	180	256	31	40	46	63	60	54	56	86
- Other intermediate goods	113	121	125	152	217	25	38	42	47	42	58	62	56
- Capital goods	107	58	116	128	163	26	33	39	29	26	40	50	47
External Debt (mln US\$)	1712	1678	1785	1,943	2,108	1,804	1,840	1,912	1,943	1,965	1,981	2,020	2,108
Public External Debt (mln US\$)	1403	1436	1576	1,648	1,950	1,602	1,640	1,694	1,701	1,798	1,814	1,851	1,950
External Debt (% GDP)	125.0	110.0	111.1	101.2	96	94.0	95.9	99.6	101.2	89.1	89.9	91.6	95.6
Total debt service to exports of GS (%)	28.1	30.8	20.7	22.1	13.7	14.6	24.7	8.0	35.2	17.6	16.3	6.8	15.3
Public debt service to state revenues&grants (%)	37.4	27.7	23.3	14.6	13.9	19.0	17.8	10.8	17.6	9.0	18.9	10.3	16.0
Public external borrowing (excl. IMF, mln \$)	127	110	88	71	101	16	14	20	21	7	9	45	40
FDI (mln \$) <sup>1</sup>	-2	5	5	46	35	4	1	6	34	16	16	16	-13
<b>General Government Budget (percent of GDP)<sup>2</sup></b>													
<b>Revenues and grants</b>	18.5	20.4	22.7	22.9	23.4	4.3	5.9	6.1	6.7	4.9	5.6	5.8	7.1
Grants	0.9	0.8	1.1	0.6	0.9	0.0	0.1	0.4	0.1	0.3	0.0	0.0	0.6
Tax	12.3	12.4	13.9	14.2	14.9	2.7	3.4	3.8	4.2	3.1	3.7	3.9	4.3
Social fund contributions	3.7	4.0	4.2	3.5	3.5	0.8	0.8	0.9	0.9	0.9	0.8	0.9	0.9
Nontax and capital	1.5	3.2	3.5	4.6	3.9	0.7	1.5	0.9	1.4	0.7	1.0	1.0	1.1
<b>Expenditures</b>	28.1	26.2	27.9	27.6	27.2	5.5	7.2	7.0	7.9	5.8	7.0	6.4	8.0
Current (other than interest)	18.6	20.5	20.7	21.7	26.1	4.7	5.5	5.3	6.1	4.9	5.0	5.0	11.2
o.w. transfers & subsidies	7.5	8.2	9.4	8.7	8.4	1.7	2.2	2.1	2.8	1.7	2.0	2.1	2.6
wages & salaries	4.4	4.9	5.4	5.7	5.8	1.0	1.2	1.4	2.1	0.9	1.4	1.4	2.1
Interest payments	2.2	1.7	1.9	1.6	1.9	0.2	0.6	0.1	0.6	0.2	0.9	0.2	0.7
Capital	7.8	5.3	6.0	4.9	4.7	0.7	1.2	1.6	1.3	0.8	1.2	1.4	1.3
of/which foreign financed PIP	6.5	4.4	4.7	3.7	3.5	0.6	1.0	1.3	0.8	0.7	0.9	1.1	0.9
Net lending	-0.5	-1.1	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.2
<b>Fiscal Balance (accrual)</b>	-9.6	-5.8	-5.2	-4.7	-3.9	-1.2	-1.4	-0.9	-1.2	-0.9	-1.4	-0.7	-0.9
<b>Memo:</b>													
Primary Deficit (w/o interest and PIP)	-0.9	0.2	1.4	0.5	1.6	-0.4	0.2	0.5	0.2	0.0	0.4	0.6	0.6
Primary Deficit (w/o interest)	-7.4	-4.2	-3.3	-3.2	-2.0	-1.0	-0.8	-0.8	-0.6	-0.7	-0.5	-0.5	-0.2

Source: Ministry of Finance, National Statistical Committee, Social Fund, National Bank and World Bank staff calculations.

<sup>1</sup> Includes repayment of FDI related debt

<sup>2</sup> The state budget consolidates central and local budgets and includes the foreign-financed public investment program and the deficit of the social fund, which became an extrabudgetary Fund in 1991. The quarterly data are on cash basis and based on the Treasury reports

<sup>3</sup> Th NBKR has revised current account in order to include estimates of under recorded imports from China

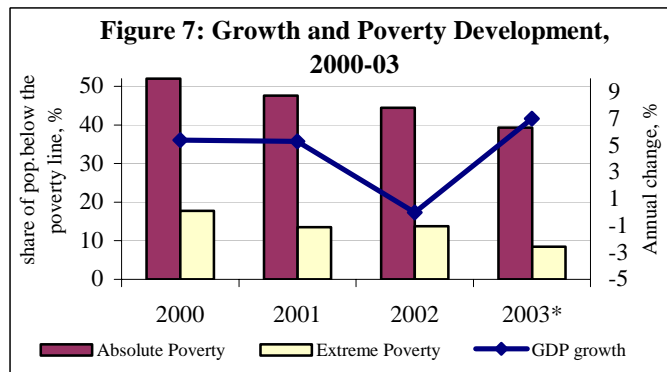
## 6. Poverty developments in 2003

The Kyrgyz Republic has made significant progress in the reduction of overall poverty over the period 2000-03 (from 52 percent to 39.3 percent, as measured by expenditure per capita approach). Economic growth is closely associated with poverty reduction as can be seen in Chart 1. Extreme poverty in particular appears to be sensitive to economic developments - it rose slightly when the economy contracted in 2002 but rebounded strongly with the 7% per annum growth in 2003.

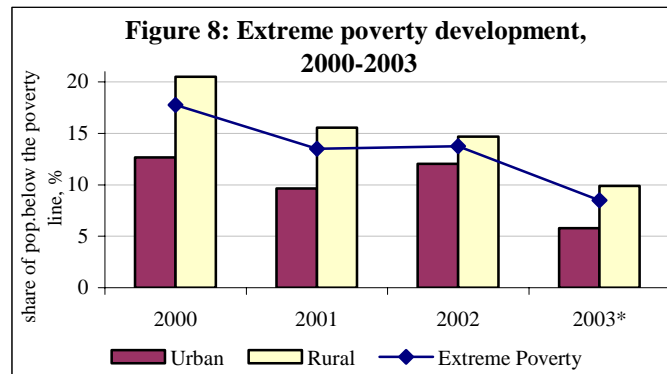
Two points could be highlighted from 2003 poverty data. First, total poverty level continue to fall in both rural and urban areas, but poverty remains higher in rural areas (46.2 percent versus 26.6 percent in 2003). Second, the reduction in extreme poverty was higher than the reduction in overall poverty, thus leading to a slight improvement in the Gini coefficient<sup>3</sup> (from 0.328 in 2002 to 0.325 in 2003). The data show extreme poverty falling sharply in urban areas in 2003 and a significant but relatively more moderate decline in rural areas.

Poverty remains mainly rural phenomena in the Kyrgyz Republic, with 70% of poor living in rural area. Though the number of urban poor is much lower than of the rural poor, there appears to be a high concentration of poverty in urban centers in oblasts. Over 60% of the urban populations in Batken, Talas, and Naryn oblasts live below the poverty line. One possible explanation for this could be the problem of 'one-company' towns, where the largest employer is not working and the population has limited options for employment.

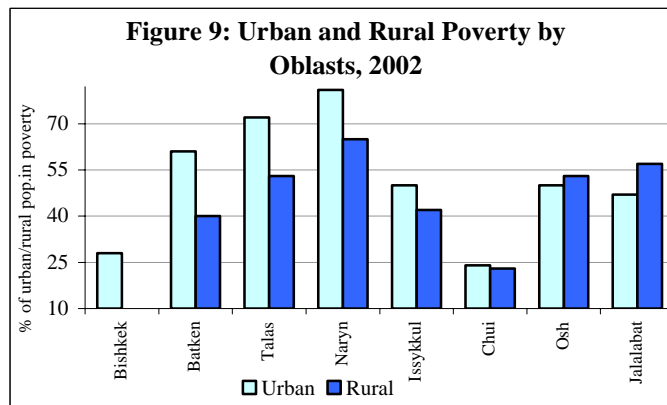
The relatively strong improvement in the overall levels of poverty provides optimism for the likelihood of achieving CDF poverty reduction targets (38.9 percent in 2005 and 26.5 percent in 2010) earlier than it was expected. Medium-Term Budget Framework (MTBF) for 2005-2007 has corrected CDF poverty reduction objectives by targeting to reach 30 percent by end of the period.



Source: NSC \*/ 2003 data are based on KIHHS and not strictly comparable with 2000-02 HBS data



Source: NSC \*/ 2003 data are based on KIHHS and not strictly comparable with 2000-02 HBS data



Source: NSC

<sup>3</sup> Measured by expenditure approach

## *New household survey*

In 2003 the National Statistics Committee of the Kyrgyz Republic has conducted two household surveys for the analysis of poverty. First survey was a regular household budget survey (HBS), which covered 1100 households and used to be undertaken in previous years. The second pilot survey – Kyrgyz Integrated Household Survey (KIHS) – was introduced to improve the quality of poverty indicators. The survey sample covers 5016 households chosen by improved methodology and represent 208 settlements (114 settlements in HBS). KIHS collects data on a quarterly basis, thus imposing less burden to participating households. It has modified questionnaires that include household characteristics, expenses on food and non-food items, housing conditions, and a section for estimation of unemployment data. The survey presents not only quantitative indicators, but also qualitative ones (such as access to drinking water, services of health care)<sup>4</sup>. Starting from 2004 only KIHS data will be collected.

Comparability of 2003 poverty indicators built on both surveys is a subject for a further analysis. Because of a larger sample size and improved sample design, KIHS results for 2003 are considered to better reflect the poverty situation in the Kyrgyz Republic. Nevertheless, main trends in rural and urban poverty development for 2003 remained the same in both surveys.

**Table 5: Poverty indicators by KIHS and HBS, 2003**

<i>% of population in poverty</i>	HBS	KIHS	Discrepancy
Absolute poverty	<b>40.8</b>	<b>39.3</b>	<b>-1.5</b>
Rural	45.7	46.2	0.5
Urban	31.5	26.6	-4.9
Extreme poverty	<b>9.4</b>	<b>8.5</b>	<b>-0.9</b>
Rural	11.7	9.9	-1.8
Urban	5.0	5.8	0.8

Source: NSC

<sup>4</sup> the new indicators included in KIHS will be available later on upon publication of KIHS results by the NSC