

**USAID/Kyrgyzstan**

**Annual Report**

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## Kyrgyzstan

### Performance:

BACKGROUND: Kyrgyzstan was the first Central Asian Republic to undertake meaningful economic and social reform. It inherited one of the least competitive economies of the former Soviet Union, with relatively few natural resources other than water. While it has good agricultural, tourism and hydropower potential, it is handicapped by protectionist measures and corruption, both internal and in neighboring countries, which impede exports. The most critical issue is the struggle between reformist elements within the government and those seeking to resist reform, maintain control of the economy by the ruling oligarchy, and avoid revelation of past corrupt practices in which external debt grew from zero in 1991 to over \$1.9 billion. Intense maneuvering continues in the lead up to the 2005 parliamentary and presidential elections. The President has stated that he will step down in 2005, perhaps signaling a chance for real democratic reform. Calls for him to remain, however, come from many sectors. The new elections code contains some improvements, but still falls short of international standards. Limited access to trade routes, deteriorating infrastructure, a heavy burden of external debt (\$1.9 billion), a weak (although improving) banking sector, as well as internal corruption at all levels, threaten economic and political reform and limit growth. Poverty and limited opportunities particularly jeopardize stability in the south, where isolation, difficult borders, drug trafficking, lack of investment, and ethnic differences are problems.

Freedom House ratings remained the same in electoral process (6); independent media (6); governance (6); civil society (4.5); and constitutional, legislative, and judicial framework (5.5). [Note: 7 is the worst score]. Civil society in Kyrgyzstan, while very donor-dependent, is far more developed and free than in other Central Asian countries. Non-governmental organizations (NGOs), civic organizations, and media are able, at times, to exert positive influences on government policy and legislation. Parliament sometimes provides a check on government authoritarianism. Local governments are increasingly transparent and responsive, although the process of fiscal decentralization is proceeding slowly due to a lack of high-level political will. Local elections held in 2001 were the first direct local elections in Central Asia and resulted in over 40% of the incumbents being ousted. In October 2004, elections for local councils proceeded largely free of administrative interference. The Constitutional Referendum held in February of 2003 greatly increased presidential control and limited both judicial and parliamentary independence as well as the activities of civil society.

Government data show that, in the first six months of 2004, GDP grew by 9.2%. GDP growth for the year was 6.8%, with the slight decrease explained by a second half decline in gold exports. The last two years have seen reasonable real GDP growth with per capita GDP reaching \$366.50 while the average monthly salary reported was approximately \$50. The inflation rate continued to be low at an annual rate of 4.5%, and the som was stable at 42/43 per dollar. The banking sector, though fragile, showed positive signs reflected in the moderation of excessively high interest rates (average bank lending rates fell by 5 percentage points to 25%) while bank deposits increased by 32% from 2003 to 2004. Growth has continued to be led by primary agriculture, services (mostly trade and catering), gold mining, and power, but the last two years also have seen the first signs of recovery in manufacturing (particularly in food processing, textiles, and construction material production) since the onset of the economic rebound. Export performance has been encouraging since 2003, with the volume of exports reaching \$523 million in 2004. Gold exports have responded to high world prices, and non-gold export performance has shown signs of diversification, with increased exports of food processing and manufacturing products. Tax collections increased by 20.3%, comprising 14.7% of GDP in 2004. Although total social expenditure allocations have marginally increased in GDP terms, this is largely driven by the increase in salaries, with public funds allocated to health, education, and social protection (other than pensions) remaining constrained. On the other hand, budget allocations for operation and maintenance of basic infrastructure

remained miniscule, continuing to affect such critical areas as irrigation networks, transportation, and education and health facilities.

Total public spending on health as a percentage of GDP has steadily declined from 4% in 1995 to less than 2% in 2001 and to 1.9% in 2003. Health as a percentage of total state budget expenditures has declined from almost 14% in 1996 to 9% in 2001 and to 7% in 2003. HIV/AIDS, tuberculosis, and sexually-transmitted infections are growing problems. HIV is spreading through risky behaviors such as intravenous drug use and unsafe sex, especially among youth. Women also account for an increasing share of newly-diagnosed HIV infections, 8.2% in 2001, compared to 12.4% by December 1, 2004. More than 74% of HIV infected people are under 34 years of age. Life expectancy is declining; working age adults are dying of chronic diseases 20 years sooner than their counterparts in the west. According to official Ministry of Health statistics, infant mortality has been gradually decreasing from 31.9 per thousand live births in 1993 to 19.8 in 2003.

Public expenditures on education are 4.5% of GDP. Teacher salaries are extremely low (\$15-20 per month), making it difficult to attract and retain qualified teachers. More than 70% of Kyrgyz schools are in rural areas and most suffer from aging infrastructure and poor access to information resources. Girls' primary education completion rate is 92.4%.

Overall, growth has not yet led to commensurate increases in the number of jobs (the ratio of newly-employed/total registered unemployed declined from 46.5% in 2001 to 45.3% in 2003). Wages in agriculture and trade remain very low, reflecting the presence of a large pool of jobless and discouraged workers. A good deal of activity continues to take place in the informal sector in services, street trading, and subsistence farming. Labor migration has a significant effect on the Kyrgyz economy. While accurate statistics are not available, estimates of Kyrgyz citizens working abroad range from 300,000 to 500,000. These labor migrants may send up to \$300-\$700 million in remittances back to Kyrgyzstan each year.

Significant progress was made in reducing overall poverty over the period 2001-2003 (from 47.6% to 40.8%), as measured by preliminary monetary indicators. Total poverty levels continue to fall in both rural and urban areas but poverty remains higher in rural areas (45.7% versus 31.5% in 2003). Extreme poverty fell rapidly from 13.5% to 9.4% during 2001-2003. It is difficult to assess the population's health status, especially as measured by infant and child mortality rates, maternal mortality, and child malnutrition due to unavailability of internationally-comparable data. Furthermore, little is known about the quality of water or consistency of its supply.

**U.S INTERESTS AND GOALS:** Kyrgyzstan's support of the coalition airbase near Bishkek and associated over-flight rights are essential to allied successes in Afghanistan, and Kyrgyzstan continues to be a strong strategic partner of the United States and others. Because regional stability is a key foreign policy goal, the potential for the messages from extremist groups (e.g., the Islamic Movement of Uzbekistan and Hizb-ut-Tahrir) to take hold among the country's vulnerable populations and those dissatisfied with government is also of concern. Our economic and financial programs benefit the poor, unemployed, and small/medium enterprises. Health, education, and democracy benefit all.

**DONOR RELATIONS:** Almost all major multilateral donors are active in Kyrgyzstan, together with many important bilateral donors such as the European Union, the British, the Germans, the Swiss, and Japanese. The largest donors are the Asian Development Bank (ADB), the International Monetary Fund (IMF), and the World Bank. Also important are the European Bank for Reconstruction and Development; the Organization for Security and Cooperation in Europe; World Health Organization; the Global Fund for AIDS, Tuberculosis, and Malaria (GFATM); the International Organization for Migration; the Islamic Development Bank; the Aga Kahn Foundation; the United Nations Development Program; and the Open Society Institute. USAID makes unique contributions in terms of financing university business education, investment climate improvement, land reform, and development of the agricultural supply market.

World Bank grants and loans support projects in rural water and sanitation, rural education, land and real estate registration, power, heating and irrigation system rehabilitation, banking system modernization, health reform, urban transport rehabilitation, public sector reform, decentralization, and poverty

alleviation. USAID helps to more effectively leverage World Bank assistance by providing technical assistance for the implementation of World Bank-funded commodities. Other significant donors to economic development include the IMF, ADB, and the European Union. The ADB's assistance focuses on agriculture and rural development, transport sector development, and support to the banking sector. It is also the largest donor in the education sector, followed by the World Bank. The ADB is involved in curriculum reform, textbook development, infrastructure repair, and development of distance education for teachers.

The British Department for International Development provides assistance in the areas of rural livelihoods, health, and governance. The Japanese International Cooperation Agency funds programs in economic development, infrastructure development, health and education, and environmental conservation. The European Union works primarily in the areas of social and economic development, governance, natural resource management, anti-drug trafficking, and border management. Swiss Development Cooperation projects are implemented in the areas of governance, security and conflict prevention; macroeconomic issues; private sector development; natural resource management; and health. The World Health Organization and the GFATM are also primary donors in the health sector.

The World Bank leads the donor coordination efforts in the country and maintains an active database of projects and programs. USAID collaborates in all areas, but most significant are the joint efforts in health reform and HIV/AIDS and policy discussions on governance issues. In all sectors, USAID seeks to complement and achieve synergies with other donor programs. In the energy sector, the World Bank and Swiss Government are both funding electricity loss reduction projects developed from the USAID-sponsored model.

**CHALLENGES:** USAID faces an increasing challenge to maintain the direction of democratic reforms, at least at the national level. The flawed constitutional referendum in 2003 was a setback for democratic institutions, and the political space remains limited for pro-reform political parties, parliamentarians, and NGOs. Independent media struggles to achieve sustainability and avoid takeover by powerful political interests. Encouraging closer adherence to international elections standards and a peaceful, democratic transfer of power in 2005 is still the primary challenge. Corruption and a lack of political will are key factors that impede meaningful reform in numerous areas. A high turnover in government positions also disrupted the momentum of some reforms.

The economy is holding its ground, but still faces serious difficulties. Even with donor funding, the budget is not adequate to address all critical problems, and the electrical infrastructure in particular is very vulnerable. The banking sector, while weak, has shown some improvement. In other areas, there is often a lack of commitment to follow through with reform recommendations. Reform of the energy sector has yet to occur, which means continued sizeable losses to the state budget through unsustainable subsidies. The infrastructure is very old and vulnerable to failure. Trade barriers, such as the border closure with Uzbekistan, and corruption, continue to be formidable. Many lucrative businesses and investment projects have been monopolized by a small group of politically well-connected entrepreneurs. A maze of uncodified "fees" continues to constrain free enterprise.

Despite our success, in the health sector, reliable statistics are badly outdated, with the last full-scale demographic health survey conducted in 1997. Anecdotal evidence is that the situation has deteriorated. Tuberculosis and HIV/AIDS are growing problems. The biggest challenges in health are now low budget allocations and allowing the health sector to keep savings generated through reforms, instead of losing a corresponding amount from the normal (insufficient) budget allocations from the Ministry of Finance.

With the demise of the Soviet Union, Kyrgyzstan suffered a substantial deterioration of the once-strong education sector. Schools lack resources to maintain their buildings and pay staff salaries. Extremely low salaries of teachers provide a disincentive for the younger generation to pursue careers in education, as well as for qualified teachers to remain in the profession, resulting in a lack of teachers, particularly in rural areas. A high percentage of teachers will retire in the next few years; finding replacements will be a major problem. In spring 2005, USAID will conduct an assessment of the education program to determine next steps in the face of declining budgets.

## KEY ACHIEVEMENTS:

**IMPROVED ENVIRONMENT FOR SMALL AND MEDIUM ENTERPRISES:** USAID assisted the Customs Service in the transparent development of a new Customs Code, allowing businesses to participate in the drafting process and ensuring that the draft is compliant with World Trade Organization (WTO) and World Customs Organization (WCO) requirements. The new code and its supporting legislation reduce the costs of trade and greatly simplify customs clearance and customs control procedures, as well as reduce costs and corruption by reducing regulatory ambiguity and increasing transparency. USAID also provided assistance with drafting a new tax code and supported an open drafting process through roundtables, a public awareness campaign, and support to business-oriented NGOs. The current draft is a significant improvement over the current legislation. The draft code is principles-based and unifies the disparate elements of tax legislation, creating a single, consistent set of rules. This is an improvement for both tax administration and the taxpayer. A USAID-funded commercial law reform project reinforces efforts to increase citizens' knowledge about their legal rights and to train judges on commercial law and other issues, thereby achieving synergy with other legal and judicial reform efforts.

**STRENGTHENED DEMOCRATIC CULTURE AND INSTITUTIONS:** Despite the serious challenges noted above, USAID's efforts to promote democracy have made significant achievements in certain areas. USAID-funded NGOs participated actively in conducting voter education and monitoring of local elections in October 2004. NGOs conducted advocacy campaigns on issues such as a draft law on community-based organizations and freedom of assembly. The USAID-funded parliamentary program worked with parliamentarians to hold public hearings on the national budget, the elections law, and energy sector reform. Efforts to promote legislative transparency and public input also support the reform process in all other sectors in which USAID is active. In July 2004, a new law on the principles of budgeting at both central and local government levels, drafted with significant input from USAID, was adopted. When effective in January, it will substantially change the centralized system of public finance in Kyrgyzstan and give local self-governments far more authority to determine their own expenditure plans. The USAID local governance program collaborates closely with the USAID-funded fiscal reform program to implement decentralization reforms. A USAID-funded civic education textbook, which empowers students with knowledge of their rights, began to be used in all secondary schools nationwide.

**IMPROVED MANAGEMENT OF NATURAL RESOURCES:** The USAID Transboundary Water and Energy Project identified that much of the electrical losses in the Kyrgyz electrical system are due to poor management practices and corruption. The Bishkek distribution company has gone beyond the metering improvements provided by the USAID project and is using the area as a model for meter reading, billing, and collection. Other international donors such as the Swiss State Secretariat for Economic Affairs (SECO) and World Bank are replicating USAID's loss reduction project on a larger scale. Several Kyrgyz Government officials and managers of energy facilities have requested USAID assistance in updating the 1998 Framework Agreement to provide for improved transboundary coordination of water and energy resources and maintain safe operations of the regional grid. USAID efforts in this sector are helping to reduce corruption and improve accountability of government institutions. In late FY 2004, USAID established a DCA with a \$1 million cost-share to enable investors to undertake rural water infrastructure rehabilitation. Activities in this sector support the Presidential Initiatives Water for the Poor and Clean Energy.

**INCREASED UTILIZATION OF QUALITY PRIMARY HEALTH CARE:** In 2004, the Kyrgyz Parliament discussed and approved several laws critical to the sustainability of Kyrgyz health reforms, including the Health Protection Law. USAID worked closely with key policymakers in drafting these laws and discussing them with parliamentarians. Kyrgyzstanis increasingly sought outpatient care from primary health care (PHC) clinics rather than from specialty polyclinics. After 18 months of USAID assistance in the design of a comprehensive and integrated quality improvement policy, the Kyrgyz Ministry of Health approved a national quality strategy that will provide a framework for coordination. Very few countries have such a policy developed through broad consultation and national consensus. This type of policy making process is simultaneously promoted through the USAID parliamentary assistance and civic advocacy programs. In 2004, the Ministry of Health assessed USAID-supported pilot programs on

integration of sexually-transmitted infectious services into primary health care and authorized a national roll-out of the program. USAID-supported reforms in the health sector have reduced corruption by making payments more transparent.

**EDUCATION:** The USAID basic education program focuses on teacher training, community involvement, and sector management. Despite efforts to increase public spending for education, funding for schools is lacking and inefficiently distributed. USAID has assisted the Ministries of Education and Finance to introduce a new financing mechanism based on a per capita formula, which is expected to bring equity in resource allocations in future budgets. Pilot teacher training programs based on interactive teaching methodologies are being developed and are slated for country-wide rollout. USAID has assisted the creation of 13 school-community groups, which are becoming effective in combating non-attendance and tackling school problems through joint effort. The National Scholarship Testing Initiative, supported by USAID, allowed for transparent and fair distribution of state grants for undergraduate study. Since its introduction in 2003, more than 70,000 applicants took the test to compete for government-provided scholarships at colleges and universities. In 2004, the test began to be used by universities not just for scholarship students, but for general admission purposes, and a local NGO was established to take over administration of future tests. In its second year. By introducing merit-based principles, the scholarship test has lessened the incentive for corruption in the education sector.

**CONFLICT VULNERABILITY/MITIGATION:** Kyrgyzstan does not appear to be sliding into open conflict, and conflict has not impeded program implementation. The border closure with Uzbekistan, and extremist elements that prey on the unemployed, are the primary sources of conflict. By the close of FY 2004, USAID was implementing conflict mitigation activities in 38 sites, primarily Ferghana Valley border communities, which have identified sources of local tension. Infrastructure projects benefited more than 750,000 people and local communities contributed an average of 31% of project costs. The results included refurbished schools, health clinics, and new roads. Social projects helped to bring citizens of different ethnic groups together.

**GENDER:** USAID's program addresses gender disparities in a variety of ways. Gender sensitive USAID funding is enabling women's shelters to provide counseling, job training, and accommodation to victims of domestic abuse and sex trafficking. In 2004, a new grant program provided small grants to NGOs for anti-trafficking prevention and victim protection programs. Additionally, through the Participant Training Program, of more than 3,400 Kyrgyz citizens trained in FY 2004, approximately 52% were women.

**TRADE CAPACITY BUILDING:** USAID supports trade capacity building in Kyrgyzstan through accounting reform and regional trade promotion. USAID experts helped draft resolutions, accepted by government, that provide more detail than previous resolutions to ensure greater WTO compliance and improved trade policies. USAID support was instrumental in the drafting and adoption of the law, "On the Fundamentals of Technical Regulation," in May 2004, establishing a WTO-compliant system for the regulation of goods to protect health and safety.

## Results Framework

### **116-0110 Privatization**

### **116-0120 Increased Soundness of Tax and Budget Policies and Administration**

### **116-0130 Increased Soundness of Tax and Budget Policies and Administration**

### **116-0131 Improved Environment for the Growth of Small and Medium Enterprises**

#### **SO Level Indicator(s):**

Business Environment Index

**IR 1.3.1** Increased Opportunities to Acquire Business Information, Knowledge, and Skills

**IR 1.3.2** More Responsive Financial Institutions, Instruments, and Markets

**IR 1.3.3** Increased Implementation of Laws and Regulations

### **116-014 A More Competitive and Market Responsive Private Financial Sector**

### **116-0150 Energy**

### **116-0160 Environmental Management**

### **116-0161 Improved Management of Critical Natural Resources, Including Energy**

#### **SO Level Indicator(s):**

Number of Demonstration Models Replicated in the Central Asia Region

**IR 1.6.1** Increased Management Capacity in Natural Resource Sector

**IR 1.6.2** Improved Policy and Regulatory Framework

**IR 1.6.3** Sustainable Models Developed for Integrated Natural Resources Management

**IR 1.6.4** Public Commitment Established for Natural Resources Management Policies

### **116-0210 Citizen Participation**

### **116-0211 Strengthened Democratic Culture Among Citizens and Target Institutions**

#### **SO Level Indicator(s):**

Percent of Targeted Population Exhibiting Civic Consciousness and Activism

**IR 2.1.1** Stronger and More Sustainable Civic Organizations

**IR 2.1.2** Increased Availability of Information on Civic Rights and Domestic Public Issues

**IR 2.1.3** Enhanced Opportunities for Citizen Participation in Governance

**IR 2.1.4** More Effective, Responsive, and Accountable Local Governance

### **116-0220 Rule of Law**

### **116-0230 More Effective, Responsible, and Accountable Local Governance**

### **116-0240 Conflict Mitigation**

#### **SO Level Indicator(s):**

Communities Contribute Growing Costs Toward Projects

Number of Projects Implemented Without Donor Support

Percent of Communities Reporting Lessened Tension or Resolved Conflicts

**IR 2.4.1** Strengthened Community Participation

**IR 2.4.2** Improved Local Services Through Community Decisions

### **116-0310 Humanitarian**

### **116-0320 Increased Utilization of Quality Primary Health Care for Select Populations**

#### **SO Level Indicator(s):**

Percent of New Smear Positive Pulmonary TB Cases Registered in a Specified Period that were Successfully Treated through the Directly Observed Treatment Short-Course (DOTS)

Percent of Total Outpatient Visits that Occurred in Primary Health Care Clinics in Pilot Sites

**IR 3.2.1** Select Populations are Better Informed about Personal Health Care Rights and Responsibilities

**IR 3.2.2** Improved Quality of Health Care including Infectious Diseases and Maternal and Child Health

**IR 3.2.3** Improved Use of Health Care Resources for Primary Health Care

**IR 3.2.4** Improved Legislative, Regulatory, and Policy framework

**116-0330 Environmental Health**

**116-0340 Improved Quality and Access to Basic Education in Target Areas**

**SO Level Indicator(s):**

Number of Children Benefitting from USAID Basic Education programs

Percent of Parents Satisfied with Quality of Education in Target Areas

**IR 3.4.1** Improved Quality and Access to In-Service Teacher Education in Target Areas

**IR 3.4.2** Increased Parent and Community Involvement in Target Areas

**IR 3.4.3** Strengthened Institutional, Management, and Technical Capacity in the Education System

**116-041 Special Initiatives**

**116-0420 Cross-Cutting Programs**