PROBLEMS OF KYRGYZTAN'S REAL ECONOMY

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Abstract

This paper reviews a wide range of problems and potentials in the Kyrgyz economy in terms of the main sectors of the real economy. It provides some important observations on the struggle with the shadow economy and the development of realistic forecasts. Finally, it stresses the importance of certain cultural and personal qualities in the population necessary for Kyrgyzstan's development.

The growth and efficiency of the real sector are connected with targeted policy in the production and social spheres, taking into account economic-geographic features, resource potential, condition of enterprises, including their financial possibilities and many other factors. Infrastructure development for strengthening and expansion of the national economy have not yet become an effective means for accelerating growth in the real sector.

Stable macroeconomic conditions in the Kyrgyz Republic have not been achieved. In 2002, GDP fell by 0.5 per cent in comparison with 2001, and the volume of industrial production declined by 17.6 per cent. Among the CIS countries, Kyrgyzstan was the only Republic, having a decline in GDP and of industrial production. The macroeconomic indicators improved in 2003. For 6 months of 2003, GDP grew by 2.3 per cent, and industrial production by 2.5 per cent. However, the gross output of agricultural production declined by 3.4 per cent.

Kyrgyzstan's level of aggregate growth is lagging considerably behind many CIS countries. Low competitiveness and low quality of goods produced in the Republic limits the export possibilities of enterprises. The balance of trade in the period January to April of this year was in deficit by US$ 18.5 million.

Production capacities utilization in industry reached only 34 to 35 per cent. In specialized enterprises such as light industry, food processing, machine building (used in the production of consumer goods) capacity utilization was 5 to10 per cent. During May 2003, 29 per cent of all enterprises stood completely idle. Production declined and 45.6 per cent of the 268 most important industrial products were not produced at all.

Although the real sector has significant economic capacity, it is under utilized and unemployment continues to grow. On 1 June 2003, the registered unemployed reached 89.8 thousand persons, i.e. unemployment increased in comparison with the corresponding period of the previous year by 1.6 per cent. According to the available estimates, the total number of unemployed reached between 190 to 200 thousand persons.

The situation in industry continues to be problematic, especially after the restructuring of the fuel-energy complex, in particular the energy sector. The situation in enterprises producing consumer goods is also uncertain.

Despite the availability of significant potential energy resource in the Republic, more than 40 per cent of fuel-energy consumption is imported from Kazakhstan, Uzbekistan, Russia, etc. At the same time, the losses of electricity in transfer and distribution alone reached in 2002 about 50 per cent. As a result, the energy system during peak loads operates in critical regimes, consumer supplies are cut and simultaneously tariffs are rising. In 2002, the energy companies suffered significant losses. The situation is difficult in the provision of coal to heat plants, boilers, and households. Of the fuel-energy resources produced in the Republic, the share of electric energy in conventional values is 76 per cent, coal 10 per cent, petroleum products 8 per cent, natural gas about 1 per cent and oil 5 per cent.

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In the last decade (1991-2001) the production of coal declined 7.3 times, oil 2 times, gas almost 3 times. The production of electrical energy grew by 2 per cent, while the output of relatively cheap hydroelectric power stations increased almost 1.4 times, and for the heat power plants there was a decrease of 3.6 times. In spite of this, tariffs for 1 kWh of released electrical energy, grew sharply and are still rising (in 2002 the tariffs increased by more than 20 per cent). These factors increase the costs to the economy, reduce the competitive capacity of enterprises and decrease the consumer budgets of a significant proportion of the population.

The coal industry. Rising capacities and increase of coal production at the Kara-Keche deposit (up to 1.5 million tons per year) at a minimum cost of a ton of coal at about US$ 10 to 12 represents a considerable reserve for growth. In the next 3 to 4 years the net growth could be US$ 13 million, or approximately KGS 500-520 million. The development of this coal-mining enterprise will help to solve the problem of supplies to the Bishkek Heating Plant and to boilers and the population in the north of the Republic. It will also enable the development of a competitive environment for entrepreneurs to compete with suppliers of coal to the north of the Republic from Kazakhstan and to create additional jobs for approximately 800 people. Implementation of this project will require the solution of a number of complex problems: building the Kara-Keche - Rybachye railroad; refurbishing the technology of the Bishkek Heating Plant to use this coal; working out mechanisms for the delivery of high-quality coal to the population living in different regions.

The electric energy complex. The acute problem is to improve the functioning of the electric energy complex, which has entered into a phase of active market reforms. In 2002, the volume of electrical energy produced in the Republic was almost 12 billion kWh, 90 per cent of which was produced by hydroelectric power stations. The export of electrical energy was 1061 million kWh in comparison with 4 billion kWh in 1991. This influenced the operational effectiveness of the system. Consumers of electrical energy in the domestic market are: households (the largest) almost 50 per cent, industrial entities 18 per cent, agrarian consumers 6.2 per cent and government agencies 11.5 per cent. The losses of electrical energy in the National Electric Grids network were enormous in 2002. The grids losses amounted to 10.03 per cent of total output and in the distribution networks 37.9 per cent, involving about 5 billion kWh of electric power. These losses are valued at more than KGS 2.5 billion. During the autumn-winter period, the Republic experiences a deficit of the electric power. As a result, cut-offs from electricity occur more frequently which negatively affects the volumes of production in other sectors.

In this important sector of the economy, obsolete equipment and instruments as well as outdated technologies are used. The energy enterprises have relatively weak management and there is a shortage of working capital and investment for maintenance, modernization and building of power stations, power transmission lines and transformer substations. There is no coordinated program with Uzbekistan and Kazakhstan on the rational use of hydropower resources of Naryn River for irrigation and production of electricity. The capacity of Heating Plants and Hydroelectric Stations are not used effectively. The coefficient of capacity utilization in Heating Plants is about 20 per cent, in Hydroelectric Stations about 50 per cent. The utilization of generators in the Heat Plants is 1.7 thousand hours, and in Hydroelectric Stations 4.2 thousand hours[2].

[2] An increase in effectiveness of the energy sector requires: (a) reduction of losses of energy at the production transfer and distribution systems by 50 per cent, will bring additional revenues to the electric system of KGS 1.2-1.5 billion per annum; (b) to build capacities and increase coal mining at Kara-Keche deposit by 1.3 million ton per year, with possible ex-factory price of coal at US$ 10 to 12 for one ton, will increase production by KGS 550 to 600 million per annum; (c) sustainable provision of the Bishkek Heating Plant with relatively cheap coal (US$ 10 to 12 one ton) from the Kara-Keche deposit will increase electric energy generation 2 to 3 times in this plant, bringing the production level up to 3-3.5 billion kWh per year with additional profit of KGS 1.2-1.5 Som; (d) the rational use of the water resources of the Naryn river for irrigation and energy generation in Uzbekistan and Kazakhstan, while maintaining the optimal water level in Toktogul reservoir will, with the same water flows, increase electric energy generation at Toktogul hydro-station by approximately 10-15 per cent at a cost of KGS 350 to 450 million; (e) the accelerated completion of construction and phased equipment introduction in the Kambara hydroelectric station №2 in the next 2-3 years will increase production more than 1 billion kWh of electric energy annually, at a cost of about KGS 600-700 million; (f) reconstruction and

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Nonferrous Metals. Problems are developing in nonferrous metallurgical enterprises, especially the gold mine "Kumtor". The restructuring of the Kumtor Gold Company proposed by the Canadian side is directed towards removal of the Kyrgyz management. Moreover, by 2008 it is planned to complete works on the Kumtor large gold-ore layer. With total reserves of gold of approximately 700 tons, the company plans to develop more than 200 tons. The excavation of the remaining underground gold is not decided and remains a question. The curtailment of gold mining on the Kumtor layer after 2008 will lead to a sharp drop in GDP, unless there are measures in place for building gold-mining enterprises in Jeruy, left-bank of Taldy-Bulak and Salton -Sary. The Canadian forecast of a reduction in gold output by the Kumtor Gold Company from 21.5 tons in 2004 to 2.9 tons in 2008, will result in a significant decline in the rates of growth. The costs of this decline are valued almost at US$ 200 million. The assumed initiation of new gold-mining enterprises in 2004 on the layers of Jeruy, left bank of Taldy-Bulak, Salton-Sary would not cover even 50 per cent of this decline. It is, therefore, expedient that the following issues be solved: (a) to conduct additional exploration of the Kumtor layer and prepare technical and economic calculations for its development by underground mining; (b) to accelerate the design and building of gold-mine enterprises on the layers of Jeruy, Taldy-Bulak left-bank, Salton -Sary, which will produce 10 tons of gold per annum, which is more than US$ 100 million[3].

Semiconductors and Radio-Electronics. There are significant prospects for the development of a semiconductors and radio-electronic industry sector which currently has the necessary capacities but are not in use[4]. A number of factors are constraining the recovery of enterprises in this industrial sector. The most significant of them are: out-dated equipment of the important specialized enterprises, that restricts the output of products of high quality; the absence of a policy for protection of local producers in the domestic market reduces local production and increases the cases of bankruptcy; the significant debts of industrial enterprises, inaccessibility to credit resources because of high interest rates, the shortness of the credit period which deprives enterprises of investing in modernization, technical equipment and therefore their financial-economic recovery; the breaking of vertical business ties between agricultural producers and processing enterprises has resulted in food industry enterprises working at under capacity while raw materials are exported overseas without processing. The effective use of available capacities and resource potential and the improvement of product quality and competitive ability of enterprises could increase industrial production by 1,5 to 2 times by 2010.

Agriculture. As shown by the experience of recent years, the reform of agriculture is a complex and long-term process requiring significant financial resources. For radical solutions to problems it is necessary that the sector introduces a set of organizational, economic and technical measures.

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modernization of Uchkurgon, At–Bashy hydroelectric stations and the Alamedin cascade of small hydroelectric stations will make it possible to produce an additional 1 billion kWh at a cost of KGS 700 to 750 million.

[3] In addition it is expedient to finalize the building of a mine and factories, and necessary infrastructure, to provide for the development of the layer of tin and tungsten in Sary- Jazz. The reserves of tin by category C_1+C_2 constitute 149 thousand tons, tungsten - 95 thousand tons, and forecasted reserves of tin are evaluated at 281 thousand tons, tungsten - 172 thousand tons. It is necessary to request JSC Kyrgyzaltyn to prepare a proposal of works on development of layers, with the use of existing infrastructure and also to ensure attraction of foreign investment.

[4] This industry sector includes: The production of polycrystalline silicon, quartz crucibles (State JSC Kristal in Tash-Kumyr). For completion of construction, investment of US$ 10-15 million is required. The cost of the product under the full use of the new capacities (600 tons of polycrystalline) will be approximately US$ 12 million or KGS 500 million per annum. The production of single-crystal silicon (State JSC KKHMZ), 100-110 tons per year, which will generate US$ 8-10 million or KGS 350-400; The production of goods made of semiconductors for the microelectronic industry (plate from single-crystal silicon for production of converters of solar energy into thermal or electrical (JSC Janar, etc.). The production of semiconductor materials, silicon plates, quartz crucibles, photoelectric converters is evaluated at KGS 1 - 1,5 billion per annum. These enterprises require significant investment. There is a demand on international markets for their products. Their potential role in the development of the economy of Kyrgyzstan is enormous.

As of 1 January 2002, arable land in the Republic constituted 12.5 per cent of the agricultural land, the rational use of which significantly influences the efficiency of agricultural production. The areas of arable land, hay mowing lands, long-standing cultivations are annually declining as a result of the allocation of land for civil construction without taking into account the economic value. Recently, approximately 200 thousand hectares of land dropped out of agricultural production (110 thousand hectares of used arable land; 45 thousand hectares – hay-mowing lands, 25 thousand hectares - long-standing cultivations). This has led to a deficiency in agricultural production.

The Republic originally specialized in livestock breeding, predominantly sheep breeding under the development of the distant-pasture regime. It has gradually developed into a more arable economy. Today stock raising in agricultural production is now in second place. Livestock of sheep, goats, pigs and birds have been reduced sharply. Thus, in 2002 compared to the level of 1990, the production of meat was only 76.9 per cent, milk 98.9 per cent, eggs 34 per cent, wool 29.7 per cent. For domestic consumption of livestock products the demand volumes are estimated to exceed output by 8 to 10 per cent per annum.

The stated objective of the government is an annual GDP growth of 10-per cent to 2010. The Center for Economic and Social Reforms used an econometric model and conducted calculations. The results showed that to achieve the necessary growth rates in the real sector it is necessary to achieve increased rates of production[5]. To achieve the indicated growth there is a need for annual investment in the real sector of not less than 20 per cent of GDP, which is unrealistic.

There are extremely difficult circumstances which constrain the implementation of measures to speed-up the GDP growth rate. First of all, there is no stability (especially in industry) or financial self-sufficiency of the economy. Secondly, the extreme shortage of domestic investment resources, dependence on foreign investment and tendency for the reduction inflow of foreign investment. Thirdly, there is a worsening of the physical and technological conditions in the economy and the increase in primitive production. Fourthly, there are no advanced industries and sectors which could provide rapid growth. Fifthly, the practice, methods and mechanisms of the government to manage and influence enterprises currently not in the state ownership, do not meet modern requirements. Sixthly, the real growth trend for the years 1996-2002 does not provide a firm basis for growth of 10 per cent.

On the basis of these arguments, we consider that proclaiming growth rates at 10 per cent, the Government could place itself in a position of 'doomed to frustration'. In international practice the annual growth rates of GDP of 10 per cent is rarely achieved even by countries with significant resources with scientific and technical advances and with effective reforms implemented. Kyrgyzstan, unfortunately, is not the same category as these countries.

As a matter of fact, the forecast of rates becomes, to a certain degree, an end in itself. When monthly growth targets are traced and forecast in the Comprehensive Development Framework (CDF) and are then corrected in an *ad hoc* or unsystematic way professional. If a lag has occurred, forecast rates are corrected for an increase. But it is necessary to analyze why the lag happened and to estimate what can and has to be done, not to forecast by pulling it out of the sky! In the end, at this stage of development, the rates themselves are not important. What is important is to create reliable base for economic development. We should do it steadily, consecutively in a well thought-out manner effectively covering the entire potential of the economy.

According to the forecasts, the year 2003 will be more successful than 2002. GDP will increase and industrial production will increase. In the services sector, there is steady growth. Agriculture and construction could exceed the level of 2002. An increase of the average monthly wage is expected. The index of consumer prices is at acceptable levels. The value of the minimum consumption basket will increase. The number of officially registered unemployed will be less than in 2002. The exchange rate of KGS has strengthened against US dollar thus confirming the growth of the economy.

[5] The following rates are required: in industry – from 15.3 per cent in 2004 to 13.5 per cent in 2010; in agriculture - from 12.3 per cent to 10.5 per cent, in services sector - from 15.5 per cent to 17.4 per cent.

At the same time, there are unsolved problems indicating expected variability in the pace of economic development. An efficient new structure of the economy has yet to be developed, especially in industry.

Industry as a whole has taken no leading raw materials direction of development. Light industry, which has the supplies of raw materials and could have created jobs in all regions of the country, revives slowly and in general its overall production volumes do not grow. The number of enterprises, which have the capacity for the expansion of production, is not increasing. The State has limited possibilities for social infrastructure construction and a major part of the population has no funds for housing construction. Although small in number, the rich "new Kyrgyz" build glaringly expensive, luxury houses. Among them are high government officials including ministers, deputies, governors, Akims (local governors), officers of defence ministries and so forth.

The volume of services provision does grow, but there is a "discrepancy" when comparing the growth rates of the services sector with the growth rates (or decrease) of physical production and imports of consumer goods. The question arises: what causes this growth volume in the services sector? Maybe services provided are paid from the shadow economy? Does the shadow economy use services? Do products of the shadow economy go into the market? Or does the services sector itself include shadow activity?

There is a question whether all production is reflected in the official statistics? There is a question whether all small and medium enterprises are transparent in showing their volumes of production? What is the per centage of the production of the shadow economy in terms of its contribution to the official GDP in the country? Is it 30 or 50 per cent or 100 per cent or is it more than the official GDP? There is no precise answer to these questions, because a thorough analysis of the shadow economy has not been conducted. Therefore, the struggle with it is ineffective.

The real volume of GDP, if it includes the production of the shadow economy, may possibly be twice the level currently indicated. Even in this case, the country will remain, according to the classification of the World Bank, in the group of under-developed countries. If current GDP per capita is approximately 300 dollars, then with the assumption cited above, GDP per capita would be 600 dollars. That still places the country in the category of under-developed countries.

Reasons for the problematic development of the economy, as a rule, include: the inefficiencies of Soviet economic heritage; the economic crises; the political collapse of the USSR and the break of economic ties in the structure of the former Union; weaknesses in governing the economy; imperfection of economic mechanisms and legislative base; the poor economic education; lack of knowledge of economics and economic psychology of population; the high levels of taxes and customs tariffs, prices, etc. All that is correct. They are both objective and subjective reasons and they cannot be removed instantaneously.

The reference to these as problems of unstable development of the economy is on the one hand correct and on the other incorrect. It is correct because these conditions existed and they still exist, although measures to remove them are in place. It is incorrect, because we should not refer to these problems and wait for their elimination. Some problems can be completely removed, and others will be constantly present, but each time, under new conditions and with new approaches and means, we should remove or neutralize them.

Nevertheless, it is necessary to live and create our own fate and to make it better. What, in the end, does the success depend upon? It depends on our own will, the desire and aspiration for strengthening ourselves and achieving objectives. It also depends on self-discipline, self-respect, objective focusing. The patriotism should be organically inherent in society as a whole and to its individuals (employees, entrepreneurs, officials, those who have political power). It is necessary to drop the feelings of economic inferiority, to be more energetic and with joint efforts go for real economic growth.

Economic patriotism assumes the unity of personal and general national objectives; the strengthening of civil cooperation; the aim of authorities for peace and prosperity in society, but not to preservation of their positions; the will of entrepreneurs not only to increase their profits but also to work on raising living standards of the population; the aspiration of society for new knowledge, education and advanced international experience, discipline and a high work ethic for the sake of great economic successes.