

DEPARTMENT FOR INTERNATIONAL DEVELOPMENT

The Department for International Development (DFID) is the British government department responsible for promoting development and the reduction of poverty. The government elected in May 1997 increased its commitment to development by strengthening the department and increasing its budget.

The policy of the government was set out in the White Paper on International Development, published in November 1997. The central focus of the policy is a commitment to the internationally agreed target to halve the proportion of people living in extreme poverty by 2015, together with the associated targets including basic health care provision and universal access to primary education by the same date.

DFID seeks to work in partnership with governments which are committed to the international targets, and seeks to work with business, civil society and the research community to encourage progress which will help reduce poverty. We also work with multilateral institutions including the World Bank, United Nations agencies and the European Commission. The bulk of our assistance is concentrated on the poorest countries in Asia and sub-Saharan Africa.

We are also contributing to poverty elimination and sustainable development in middle income countries, and helping the transition countries in Central and Eastern Europe to try to ensure that the widest number of people benefit from the process of change.

As well as its headquarters in London and East Kilbride, DFID has offices in New Delhi, Bangkok, Dhaka, Kathmandu, Nairobi, Dar-es-Salaam, Kampala, Harare, Pretoria, Suva and Bridgetown. In other parts of the world, DFID works through staff based in British embassies and high commissions.

COUNTRY STRATEGY PAPERS

Country Strategy Papers (CSPs) are prepared for all countries where we provide development assistance programmes, and are normally produced every three years. CSPs set out how we aim to contribute to achieving the international development targets in the country in question. Progress will be assessed against the strategic objectives set out in Section E of the paper. In preparing CSPs, we consult closely with governments, business, civil society, and others within both the partner country and the UK. In the case of Central Asia and the South Caucasus, we have produced a single strategy paper covering all UK bilateral assistance to the region.

Department for International Development
October 2000

CENTRAL ASIA AND THE SOUTH CAUCASUS: STRATEGY PAPER

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A. SUMMARY

A1. The countries of Central Asia (Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan) and the South Caucasus (Armenia, Azerbaijan and Georgia) were formerly part of the Soviet Union and face the challenge of becoming viable independent democratic states. The economic crisis in Russia had negative impacts on them all, but there is substantial and increasing diversity between them. They have very different resource endowments, and have made varying progress towards becoming market economies and pluralist democracies. Conflicts in both the South Caucasus and Central Asia threaten regional stability and economic growth.

A2. Many of these countries are poor, though there is significant variation between as well as within them. Living standards plummeted in most during the 1990s, and poverty is widespread. Sustainable poverty reduction depends on economic growth, structural reform, popular empowerment, and the reversal of current trends in environmental degradation.

A3. DFID's strategy for these countries aims to help them to meet these challenges, and reflects the United Kingdom Government's policy for co-operation with transition countries outlined in the 1997 White Paper on International Development. This commits us to continue to support the process of transition in the region, seeking to ensure that it brings sustainable benefits to all levels of society. In doing so we will support sustainable poverty reduction policies and initiatives. We will:

- focus our efforts on countries where the need is greatest and which, through their policies and actions, have demonstrated commitment to economic and democratic reform, and to addressing the needs of the poorest members of society. Based on these criteria, we will deepen our partnerships with three focal countries: Armenia, Georgia, and the Kyrgyz Republic, and will increase our programmes in these countries substantially. We will limit our efforts in Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan, while recognising that our approach in these countries may need to be revised if circumstances change significantly. We will keep our

strategy towards Tajikistan, the poorest country in the region, under close review in the light of the security situation there (see paragraphs E2-3).

- seek to maximise the impact of the international agencies on poverty elimination by working through, and with, the multilateral agencies to which we contribute, in particular the World Bank, the International Monetary Fund (IMF), the European Union (EU), and the European Bank for Reconstruction and Development (EBRD), as well as with other bilateral agencies, collaborating with them at both policy and sectoral level. We will explore opportunities for establishing a closer dialogue with the Asian Development Bank (ADB) in Central Asia.
- seek to ensure a joined-up approach across UK government departments on issues in which several departments have an interest, and which impact on poverty elimination, such as the implementation of the Partnership and Co-operation Agreements with the EU, broader trade issues, conflict prevention/resolution, and the environment.
- maintain links, in non-focal countries, with the multilateral agencies in the broader trade policy dialogue, and consider providing modest support for the latter, as well as for the development of civil society and for democratic reform. We will consider humanitarian and conflict issues on a regional basis.

A4. We shall continue to contribute to multilateral agencies operating in all these countries. The UK share of the EU Tacis¹ programme will continue to be around 15% each year; since 1992 this has amounted to some £80 million across the region. In addition we plan to expand our direct inputs in our focal countries from £5.75 million to £7.25 million by 2002/2003, and to reduce those in non-focal countries from £2 million to £0.5 million over the same time period. Our range of activities will, however, not expand. The purpose of our direct inputs is to seek to improve the impact of the much larger resources we provide through the EU and other multilateral agencies.

¹ Technical Assistance to the Commonwealth of Independent States.

B. THE CHALLENGE

B1. This paper covers the newly independent countries of the South Caucasus (Armenia, Azerbaijan and Georgia), and of Central Asia (Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan). They face many common challenges: to ensure that democracy and pluralism develop roots, to re-establish economic growth, and to reduce widespread poverty in the wake of economic decline, and the collapse of the Soviet era's comprehensive social welfare systems. They vary considerably in size, populations, culture, natural resources and economic potential, and are demonstrating increasing divergence in their attitudes to economic and democratic reform, as well as in the pace and extent of exploitation of their natural resources.

POLITICAL

B2. Conflict remains a central problem for the region, posing real threats to regional stability. The basis of many of these tensions lies in the legacy of the Soviet era. In the 1920s and 30s, borders were imposed which reflected neither the complex ethnic mix of populations, nor geographical boundaries. In the years that followed, whole populations and ethnic groupings were displaced, many as a matter of policy. Challenges to these borders underlie the ethnic conflicts which were repressed in Soviet times but which have since emerged. Other threats to stability result from the fact that relationships between the countries of the region and their neighbours are still evolving. The role of Russia, which maintains great influence in the region, is crucial. It is a widely held perception that elements of the political and military elite in Moscow are not reconciled to the dissolution of the Soviet Union, or to the diminution of Russian influence over these former Soviet republics.

B3. In the South Caucasus, the regions of Abkhazia and South Ossetia are seeking independence from Georgia, and Armenia and Azerbaijan have yet to agree a solution over the disputed territory of Nagorno Karabakh. These conflicts have resulted in large numbers of refugees, perhaps 1.3 million in all. In general, they live in poor circumstances and are marginalised from the economy. The recent conflict in Chechnya poses additional threats to security in the South Caucasus. The Fergana Valley in Central Asia is an area with

strong potential for conflict. It straddles Uzbekistan, Kyrgyzstan, and Tajikistan, and comprises 20% of Central Asia's population, but only 5% of its landmass. Social pressures and rising poverty have provided fertile recruiting grounds for political extremists seeking to exploit religious beliefs. In the past decade, there have been violent ethnic clashes, uprisings, assassinations and assassination attempts.

B4. There are other potential causes for conflict in Central Asia and the South Caucasus. Competition for jobs and resources is high and increasing, and often takes on an ethnic dimension. At other times, tension is inter-governmental (over water, for example). Narcotics trafficking and recent civil wars in Tajikistan and Afghanistan are additional destabilising factors.

B5. Internally, all these countries, which gained independence in the early 1990s, are still grappling with the challenges of defining a new set of relationships between central and local government, the private sector, civil society and the individual. They are establishing new institutions to meet these challenges. Many of these, both political and economic, have been borrowed from western parliamentary and market-based systems, and it is too early for them to have acquired a home-grown legitimacy.

B6. The process of establishing functioning democracies in these countries has a long way to go. Throughout the region, the practice of elections is becoming more established; all the countries of the region have elected Presidents. But the role and importance of constitutional checks and balances are not widely understood. Presidential power is not significantly constrained by parliaments, and the procedures for replacing Presidents are, in most cases, unclear. Local government is still in its infancy. There is a general lack of rule of law, particularly in the Central Asian states other than Kazakhstan and the Kyrgyz Republic. International corruption indices do not contain much specific data on these countries, but there is a widespread perception amongst donors and the business community that there are high levels of corruption. Commitment to tackling these issues varies, but is given some priority by the Kyrgyz Republic and Armenia, and, most recently, Georgia.

B. THE CHALLENGE

CONTINUED

B7. Throughout the region, traditionally marginalised groups have scant opportunity to enforce their economic or social rights. Political and civil rights are widely ignored, with arbitrary policing and little access to redress through the courts. Women experience domestic violence on a large scale, often with no redress or protection mechanisms except through a very small number of local non-governmental organisations (NGOs). Some governments and politicians find it difficult to accept active and diverse political opposition, whether it is reflected in strong parliamentary opposition or in an active and challenging civil society. Many people have only a rudimentary understanding of their rights, and only limited prospects of using or protecting them.

ECONOMIC

B8. From the early 1990s, the severe economic dislocation brought about by the break-up of the Soviet Union caused output and household incomes to collapse across all eight countries. But many now have a track-record of registering positive growth rates for some years, and 1999 was the first year since transition began that output in all eight grew. However, in none of the countries has GDP yet recovered to its 1990 level. And in three countries, Armenia, Georgia and Tajikistan, output in 1999 was still less than half the pre-transition level.

B9. There is great disparity in income and poverty rates. Statistical data must be treated with caution, but according to World Bank figures², at market exchange rates in 1998, only one, Kazakhstan (\$1,340), had GNP per capita above \$1,000. The countries with the lowest income levels were Tajikistan (\$370), the Kyrgyz Republic (\$380), Armenia (\$460) and Azerbaijan (\$480). These four countries, together with Turkmenistan, are classified by the World Bank as 'low income'. Assistance to all eight countries is classified as official development assistance (oda) by the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD).

B10. The World Bank estimates that, at the standard dollar-a-day absolute poverty line, three of these countries

have poverty rates of 10%. They are Tajikistan (18%), the Kyrgyz Republic (13%) and Armenia (10%). The \$2-a-day poverty line is more relevant for the region since it bears closer relation to national poverty lines. Again on this measure (based on surveys from 1996-98), poverty is highest in Tajikistan (68%), followed by the Kyrgyz Republic (49%), and Armenia (40%). The lowest level was in Kazakhstan, with 6% living on less than \$2-a-day.

B11. The Kyrgyz Republic, Georgia and Armenia continue to rely on agriculture as a key driver of growth and poverty reduction. Azerbaijan, Kazakhstan and Turkmenistan have large oil and/or gas reserves but their ability to exploit these natural resources successfully will take time, and depends heavily on the construction of new pipelines to western markets, reducing their dependency on Russia. In these countries, a key challenge is to manage natural resource wealth in a way that is supportive of broad-based economic growth.

B12. Commitment to reform varies across the countries. In general, the poorer countries have tended to be the most reformist. Six of the eight countries had IMF programmes on track in early 2000, although by the middle of the year, the Enhanced Structural Adjustment Facility (ESAF) programmes in Georgia and the Kyrgyz Republic were off track. Turkmenistan and Uzbekistan have opted to pursue their own 'national' strategies for development. The Kyrgyz Republic, Armenia, Georgia and Kazakhstan are the most advanced along the path of economic transition. The private sector accounts for more than 50% of GDP in all of them, and they have made relatively good progress on privatisation, corporate governance, and enterprise restructuring. They are also focusing attention on strengthening their banking systems and moving forward with public sector reform. Whilst Azerbaijan has managed to achieve macroeconomic stabilisation, progress on structural reform is slower. Turkmenistan and, to a lesser extent, Uzbekistan are doing little to tackle structural reform in any area. Tajikistan is a special case. It has made only limited progress, but is showing high commitment now as it struggles to emerge from internal conflict.

² The World Bank, in *World Development Indicators 2000*, classifies countries as 'low income' (1998 GNP per capita less than \$760) or 'lower middle income' (1998 GNP per capita between \$761 and \$3030).

B. THE CHALLENGE

CONTINUED

B13. The overwhelming majority of foreign direct investment into these countries has gone into the oil and gas sector. In each, the environment for foreign investment remains complex and lacks transparency. Nevertheless, since 1989, \$7 billion has flowed into Kazakhstan and \$3 billion into Azerbaijan. Both Turkmenistan and Uzbekistan have received \$800 million worth of investment. Rising commodity prices through 1999 allowed these resource-rich countries to recover relatively strongly from the 1997 Russian financial crisis.

B14. The countries with more limited natural resource endowments (Tajikistan, Georgia, Armenia and the Kyrgyz Republic) have attracted much less private investment. They have relied heavily on official lending for external finance, and all four countries have now been classified as IDA³ - only (concessional loans) borrowers by the World Bank. The depth and duration of the output collapse has left them with crushing debt burdens, which are damaging their prospects for growth and poverty reduction.

B15. The vulnerability of the region was highlighted by the impact of the financial crises in Asia and Russia. Subsequently, the low-income countries with limited natural resources have been further buffeted by sharp rises in oil prices. These external shocks have made economic management more difficult and weakened political support for reform.

B16. The challenge now for those who have made serious efforts at structural reforms is to consolidate and deepen them. Continued fiscal adjustment is required. Tax bases in all countries in the region remain narrow – the Georgian Government collects just 9% of GDP. There remains a huge agenda of public sector reform, including expenditure management, tax reform, improved tax and customs administration, energy subsidies, targeting of social protection and levels of public investment. The environment for private sector development also needs to be strengthened. This will require investment in critical

infrastructure like power, water, roads and telecommunications. The regulatory environment and legal and judicial systems also require strengthening and simplification. Financial sector development will also be crucial.

B17. Conflicts, and the risk of conflicts, in addition to their direct human costs, are also affecting economic prospects adversely across the region, damaging human, social and physical capital, and thereby reducing long-term growth prospects. Instability and violence also mean contracts are harder to enforce. In this environment, trade and investment – the key drivers of growth and rising incomes – are hampered. Conflicts are also preventing the development of regional initiatives and the integration of infrastructure that may encourage trade and the development of markets, as well as impacting on foreign investor confidence, and fledgling tourist industries.

SOCIAL

B18. Statistical information on poverty is emerging slowly from the countries in the region, as they upgrade their surveys of living standards and introduce new methodologies. It is clear from the data above, however, that the numbers who can be classified as very poor could range from 10% to 40% of the population, or even higher. More worryingly, there has been a sharp deterioration in virtually all measures of human welfare and health since 1990.

B19. Given the particular circumstances of these ‘transition’ countries, the International Development Targets⁴ do not fully capture the nature of the challenges they face. For example, in most countries the education targets are already virtually fully met (though there are signs that this situation is now deteriorating) and those on health do not cover adult mortality (see paragraph B23).

B20. The causes and consequences of poverty in this region will only become clearer with improved statistical and qualitative information. There is, therefore, limited

³ International Development Association.

⁴ The UK Government’s White Paper on International Development *Eliminating World Poverty: A challenge for the 21st Century* (November 1997) reaffirms its commitment to the International Development Targets. These are: a reduction by one-half of the proportion of people living in extreme poverty by 2015; universal primary education by 2015 and elimination of gender disparity in primary and secondary education by 2005; a reduction by one-half of the proportion of people living in extreme poverty by 2015; universal primary education by 2015 and elimination of gender disparity in primary and secondary education by 2005; a reduction by two thirds in mortality rates for infants and children under five, a reduction by three-quarters in maternal mortality, and access to reproductive health services for all of appropriate ages, all by 2015, to implementation of national strategies for sustainable development in all countries by 2005, to ensure that current trends in the loss of environmental resources are effectively reversed by 2015.

B. THE CHALLENGE

CONTINUED

knowledge of the impact of past policy initiatives on poverty, or of the policy changes needed to reduce poverty. It is fairly clear, though, that the major causes of increasing poverty have been general economic decline and the fragmentation of social welfare systems which, in Soviet times, provided some minimum standard of living for all. Across the region, countries' support services have collapsed, wages and pensions go unpaid or are severely delayed, unemployment has risen, and the real value of social support payments has fallen.

B21. Poverty, especially for women and children, appears to be more widespread amongst the rural population. Rural poverty has stimulated a high rate of economic migration to the towns and cities, increasing unemployment, and has strained urban support services. Many people have been forced to leave their homes and land because of conflict. The high level of migration has exacerbated inequality and worsened the living conditions of the migrants. Although family structures are stronger in Central Asia and the South Caucasus than in, for example, Russia, social cohesion is being undermined by rising inequality and the degree of migration. Stress indicators, such as high suicide rates and increasing acts of violence, are rising. Governments vary in the priority they give to addressing poverty. Armenia, Georgia, and the Kyrgyz Republic have made clear commitments to poverty reduction and to minimising the negative social impact of reform.

B22. A resumption of economic growth is a necessary, but not of itself sufficient, condition for the elimination of poverty in the region. Social exclusion and increasing inequality may prevent the poorest from benefiting from growth. Many households and individuals have become separated from the formal economy, and follow survival strategies by subsistence farming or eking out a living in the informal economy. There is a low level of involvement in civil society. Poor people have little access to information, or say in the determination of the policy of their government. More positively, the countries of this region have some advantages compared with others with a similar incidence of poverty because of their high levels of education and the existence (though poor functioning) of support services.

B23. The International Development Targets on health are relevant to this region, and are achievable. Infant, childhood and maternal mortality, while lower than, say, in Africa, are five times higher than in OECD countries, and three times higher than in European Russia – and the official rates may well understate the true extent of the problem due to the lack of accurate statistical data. The transition has taken a toll on people's health in other ways, not reflected in the International Development Targets. In the early years, for example, there were actual declines in life expectancy (which, despite some improvement recently, has not reached its pre-transition level). A key underlying factor has been a significant increase in deaths in adult males between 15 and 54, many of these from alcohol, suicide, crime and cardiovascular disease. There is also a wide differential in life expectancy between males and females – over eight years, for example, in Kyrgyzstan. Although there are many factors which impact on health status, one key challenge will be to rebuild health systems, which have virtually collapsed, and shift resources away from a crumbling, inefficient hospital sector to cost-effective primary care.

ENVIRONMENT

B24. The region suffers the environmental legacy of the worst excesses of Soviet central planning, low-level technology and ignorance or disregard of environmental legislation. The Aral Sea is a tragic example of environmental damage caused by centrally-planned agriculture. Areas in Azerbaijan are among the most polluted in the world, and populated areas are contaminated with highly toxic wastes. The Semipalatinsk area in Kazakhstan suffers the consequences of use as a nuclear testing site in the Soviet era.

B25. The countries are aware of their environmental problems and have signed up to the relevant international conventions. The World Bank has helped develop National Environmental Action Plans (NEAPs), and all but Tajikistan now have them. (The EU's Tacis programme is supporting their implementation). But the environmental institutions concerned generally have little political influence and few resources, and rely heavily upon external assistance.

B. THE CHALLENGE

CONTINUED

ROLE OF EXTERNAL ASSISTANCE

B26. External assistance will continue to be important for the economic development of those countries that lack significant natural resources and foreign investment. It will be important too for the future stability of Tajikistan. International financial institution (IFI) assistance has a crucial role to play in supporting reforms throughout the region, including in Azerbaijan and Kazakhstan before the oil wealth really flows.

INTERNATIONAL POLICIES

B27. The countries of the South Caucasus, in particular, look to the West. Georgia has already become a member of the Council of Europe; Armenia and Azerbaijan hope to follow shortly. Georgia and Armenia have expressed a long-term wish to join the EU, which has now signed and ratified Partnership and Co-operation Agreements (PCAs) with all three of the South Caucasus countries, as well as Kazakhstan, the Kyrgyz Republic and Uzbekistan in Central Asia.

B28. The Kyrgyz Republic and Georgia have joined the World Trade Organisation (WTO), and Armenia is expected to become a member in the near future.

For others the accession process will take much longer. The Russian financial crisis and the consequent decline in trade, particularly with Russia, has highlighted the risks of excessive dependence on single markets and single products – a legacy of Soviet central planning. It is clear that stability and growth will not be possible without a diversification of export structures and destinations, which is a long process. One requirement is integration into the global trading system – particularly important for those countries without readily exploitable natural resources. Accession to the WTO brings countries into the rules-based framework within which this integration can be achieved, and thus represents an irreversible commitment to reform and trade liberalisation.

B29. The relationships of these countries with Russia are close – though, in some cases, tense. There are large Russian minorities in a number of them. Russia maintains an active military co-operation with Armenia, and has a significant peace-keeping presence in Tajikistan. It has a peace-keeping presence in both Ossetia and Abkhazia in Georgia, and various military bases from which a programme of withdrawal began in 2000.

C. PARTNERSHIPS

C1. DFID currently provides technical assistance to a range of partners in the countries of Central Asia and the South Caucasus. These include civil society and private sector organisations as well as central and local government. We see further scope for working at the regional and community level where success can help to create impetus for reform at central level. We will seek also to increase our support to civil society, including NGOs, trade unions, professional associates and small-scale private sector organisations.

OTHER DONORS

C2. Total net World Bank/IDA lending to the region was \$503 million in 1997. Its programmes cover the spectrum of key sectors. The Asian Development Bank (AsDB) now has programmes in all Central Asian states except Turkmenistan, and loans averaging \$156 million a year have been approved since 1994. In 1997, the IMF lent a total of \$243 million (\$221 million of which was concessional), and exercises a considerable influence over the policy process of the six countries in the region which currently have IMF programmes.

C3. The EBRD net financial flow to the region in 1997 was €129 million. The EBRD's activities focus on providing investments and technical co-operation to strengthen financial institutions and legal systems, and to develop the infrastructure needed to support the private sector. The EU Tacis programme covers a wide range of sectors, and is increasingly active now in social areas. Commitments across the region between 1991 and 1997 totalled an average of €57 million per year, the UK share being €8.5 million. The EU also provides humanitarian assistance through ECHO (the EC Humanitarian Office), averaging €50 million per year over the last six years – the UK share being approximately €9 million.

C4. The main bilateral donors are the US, Germany, Japan and the Netherlands. There is significant US assistance to Armenia and Georgia (US\$135 million and \$120 million respectively in 1998). The Soros Foundation is the largest non-official donor in the region.

D. CURRENT DFID ASSISTANCE

D1. The UK contributes to multilateral agencies: DFID's share of expenditure by the leading multilaterals is shown in the table below:

IMPUTED SHARE OF MULTILATERAL NET ODA

£ MILLION	1994	1995	1996	1997
EC	34.9	13.0	15.6	11.0
UN	0.8	2.0	2.0	2.5
Other	2.4	12.5	21.4	38.7
TOTAL	38.1	27.5	39.0	52.2

D2. We have played an active part in the World Bank-led Consultative Group – the formal donor co-ordination process in these countries – and in the design and implementation of Tacis strategies and programmes. We have commented on IMF and World Bank loan proposals, and have co-operated on the design and implementation of World Bank programmes in agriculture (particularly in Georgia and the Kyrgyz Republic) and in health (in Georgia, the Kyrgyz Republic, Kazakhstan and Uzbekistan), through providing supporting technical assistance. We have also worked closely with the World Health Organisation (WHO) and the United States Agency for International Development (USAID) across the region. We have briefed the UK Director at the EBRD on many proposals, and have collaborated with the EBRD through a trust fund⁵.

D3. DFID direct assistance has mainly been in the form of technical co-operation, totalling around £6-8 million per year across the region. Activities have been spread over various areas of public sector reform, mainly in agriculture, health, financial services, energy, media, small and medium-sized enterprises, good government and the environment, and, more recently, strengthening civil society and statistical capacity.

D4. We have also provided humanitarian relief (around £20 million since 1994). This has been disbursed through the multilateral humanitarian agencies and leading NGOs, in response to natural disasters, and for refugees and internally displaced persons.

D5. The region has also benefited from several region-wide schemes: Regional Academic Partnerships; British Executive Service Overseas; Charity Know How; Local Authority Technical Links Scheme; Joint Industrial and Commercial Attachment Programme; and the UK Chancellor of the Exchequer's Financial Sector Scheme. All countries in the region are now eligible to benefit from projects financed from DFID's Civil Society Challenge Fund.

D6. The broad geographical and sectoral spread of our direct assistance programmes has limited our ability to assess impact. We can, however, point to some successes, particularly in health and agriculture, and public administration. These have been based on the identification of key niches for DFID direct funding, and working closely with other (larger) donors. We have built valuable partnerships in such areas, and have also been influential in donor dialogues in the health sector despite our small financial input, mainly in countries which have regular round table donor discussions on a sector basis, such as Georgia, where we have collaborated effectively with the WHO and USAID in shaping much larger programmes.

D7. Elsewhere, our judgement is that the effectiveness of our direct activities has been variable. Not all countries have offered a wider, reform-friendly environment for our projects. We have often lacked the detailed knowledge of these countries to target our assistance optimally, and our embassies have not been resourced to provide such information. Our administrative and advisory resources have been overstretched to cover all these countries. We have drawn on these lessons in devising the following strategy for future assistance.

⁵ UK/EBRD Technical Co-operation Fund (Eastern Europe and Central Asia)

E. FUTURE STRATEGY

E1. Under our new strategy our goal will be to support the transition, seeking to ensure that it brings sustainable benefits, spread through all levels of society. Our purpose will be to support sustainable poverty reduction policies and initiatives.

COUNTRY FOCUS

E2. We will focus our efforts on three of the eight countries in the region: Armenia, Georgia, and the Kyrgyz Republic (see annexes 3-5 for details). They are among the poorer countries of the region, and have all demonstrated over the past few years a relatively high degree of commitment to economic and political reform, to the pursuit of policies which benefit poor people, and to the development of democratic institutions and respect for human rights. We therefore judge that the policy environment is most conducive to long-term poverty reduction in these three countries, and that our efforts to support this are likely to be most effective in them.

E3. Uzbekistan and Turkmenistan have made very limited progress on reform. Their Governments and those of Kazakhstan and Azerbaijan have not had clear strategies towards poverty in place (although in June 2000, the Kazakh parliament passed a resolution approving a National Programme to Fight Poverty and Unemployment); nor a strong record on democratic reform. Although Azerbaijan has managed to achieve macroeconomic stabilisation, it is making much slower progress in the area of structural reform. While there are many poor people in these countries, we believe that in the conditions that currently prevail our efforts towards poverty elimination would have a limited impact. Therefore, we will not seek to develop new activities through direct assistance in Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan, though we will maintain links with the multilateral agencies in the broader trade policy dialogue, and will consider providing support for trade-related capacity building (from our regional budget), as we will for civil society strengthening, and democratic reform. The security situation in Tajikistan, the poorest of the countries of the region, and just emerging from civil war, does not allow us to build programmes there. We will continue to monitor developments in all eight countries and will respond flexibly to changes in the policy environment

which may affect our ability to make a positive impact on poverty elimination.

DFID APPROACH

E4. In the light of what we know about the key determinants of poverty in the three focal countries, we will develop strategic approaches in a limited number of areas, taking account of our comparative advantage in relation to other partners.

E5. The UK is one of the few donors to the region with a clear focus on poverty reduction. Our experience of working in the region over the past five or six years has provided us with useful knowledge and insights. It has also given us expertise in certain areas (such as rural livelihoods, health, and public administration), and has enabled us to develop relationships on which to build. While our understanding of the region remains imperfect, we are well placed to make a useful contribution to the region's development. We will draw on experience in our dialogue with governments and multilateral agencies. Expanding our direct assistance programmes in the three focal countries will enable us to deepen our knowledge of these countries and to collaborate more effectively with our partners, including the multilateral organisations to which we contribute in order to benefit poor people. Our efforts in the three focal countries will be aimed at supporting them to implement reforms to achieve the following:

- good central and local public administration, with a focus on social protection systems, and the development of community-based solutions to reinforce social cohesion;
- an enhanced enabling framework for economic growth including measures to encourage sustainable rural livelihoods, while ensuring access to essential services for the poorest, and adequate environmental protection; and
- health systems which provide affordable quality health care to all levels of society, particularly the poorest.

Across the region we will support efforts to ensure:

E. FUTURE STRATEGY

CONTINUED

- democracy and respect for human rights, in particular through strengthened civil society, to help empower citizens in both rural and urban areas;
- the integration of the countries of the region into global economic frameworks; and
- improved regional stability through measures to prevent and reduce conflict.

E6. In the focal countries, we will work closely with the multilateral agencies to which we contribute, and co-operate with other donors. The World Bank, IMF, EBRD and EU have well established, substantial programmes in the South Caucasus and Central Asia, (and the ADB in the latter), which all to varying degrees share our goals of assisting a transition which benefits the whole of society. Where they are making a positive impact on the reform process, we will seek opportunities to reinforce this effort. Where we maintain a direct programme, it will be in the sectors in which our expertise can be used to inform others and/or to encourage a strong focus on poverty.

E7. We will continue the kinds of partnerships we have formed in the past. We will look for opportunities to provide supportive technical assistance, where this will help ensure local capacity to manage inward investment, ensure sustainability of activities, and reinforce the poverty focus of programmes. We will pilot approaches which then may be scaled up by the multilateral agencies, set up models of good practice to inform policy-making and its wider implementation. We will pay increased attention (including at the strategy and design stages) to the dissemination of results and lessons learned.

E8. We will continue our participation in the **World Bank**-led Consultative Group process, and to play an active role in the Comprehensive Development Framework in the Kyrgyz Republic, looking to ensure that the poorest sections of society are involved in its development. We will continue to be active in working with World Bank staff and in briefing the UK Executive Director of the **IMF** and World Bank to contribute to the shaping of policy both at the macro level and for certain sectoral loan portfolios, in particular for the

focal countries. We will increase our informal contacts with both Washington and in-country counterparts.

E9. We will continue to scrutinise **EU Tacis** Indicative and Action Programmes and play an active part in management committees. We will build informal contacts in the EU to ensure involvement at the early stages of future programmes, and encourage a strong focus on social and environmental issues. We will look for opportunities to co-ordinate programmes, such as in public sector reform in Armenia.

E10. DFID's influence in the **EBRD** at policy level is primarily exercised through our Executive Director. We will also continue to contribute to the Trust Fund, given the EBRD's limited access to technical assistance funds, and will work to steer the use of this to dovetail better with the focus of our direct assistance programme.

E11. We will continue to work closely with the **WHO** in the health sector, including via co-financing, in order to help increase their effectiveness. If time and resources allow, we will explore the possibilities for closer collaboration with the **ADB** in Central Asia.

E12. We will take a more strategic approach in future to our provision of humanitarian assistance and conflict prevention support. In focal countries, we will integrate it with the management of our programmes, and seek to balance our support to refugees and internally displaced persons (IDPs) and our work designed to prevent or reduce the risk of conflict. On the former we will work with the EU, the Organisation for Security and Co-operation in Europe (OSCE), and agencies such as the United Nations High Commission for Refugees (UNHCR), International Organisation for Migration, and the International Red Cross (the International Federation of Red Cross and Red Crescent Societies, and the International Committee of the Red Cross).

A CO-ORDINATED UK APPROACH

E13. We will look for opportunities to assist our focal countries in the implementation of **Partnership and Co-**

E. FUTURE STRATEGY

CONTINUED

operation Agreements with the EU (PCAs). We will focus on the trade dimension, in close collaboration with the UK's Department of Trade and Industry (DTI). We will work alongside the UK's Foreign and Commonwealth Office (FCO) to help these countries address the political implications of the PCA.

Ei4. We will work with the DTI and FCO to intensify our policy dialogue in the area of **trade policy** with the countries of the region, by influencing the position the EU adopts on PCAs, in WTO accession working groups, and in the next round towards countries of the region. We aim to

establish a regional scheme to provide support for trade-related capacity building, including for WTO-related work (both pre and post-accession), and for country-based trade-related studies that can inform the dialogue on WTO accession.

Ei5. We will closely involve the UK's Department for the Environment Transport and the Regions (DETR) so as to ensure coherence of international policy in our work in the environment sector, and will continue to work closely with the FCO and the Ministry of Defence (MOD) on conflict and humanitarian affairs.

F. IMPLEMENTING THE NEW STRATEGY

Fi. The new strategy will demand a more proactive role with the multilateral agencies, and the rapid expansion of our work in our focal countries. In the medium (but not the short) term, there will be some opportunities to redeploy staff as our programmes in non-focal countries contract and we

reduce the spread of our activities. Staff complements have recently been augmented to help deliver this strategy, and local staff levels in Embassies in the focal countries will be kept under review. But we will need to be very selective in choosing issues to pursue.

G. PROGRAMME RESOURCES

Gi. Reflecting the proposed strategy, we plan a direct programme for our focal countries increasing from its current level of £5.75 million to £7.25 million by 2002/2003, and in

non-focal countries reducing from £2 million to £0.5 million over the same time period. (See annex 2 for further details).

SUMMARY OF PREPARATION PROCESS

Following publication of the 1997 White Paper, *Eliminating World Poverty: A Challenge for the 21st Century*, and the DFID policy document *Support for Transition Countries: A New Strategy*, we have undertaken a series of reviews and missions to determine how to take forward these policies in the countries of Central Asia and the South Caucasus.

As we have not yet had formal government-to-government agreements with the transition countries, consultation has so far been through informal channels, and in-country on a sectoral basis.

A series of meetings with DFID administrative staff and advisers led to a first outline draft, which formed the basis for consultations with British NGOs working in the region. Subsequently, an initial draft was circulated to DFID's Director-General (Programmes), Chief Advisers, Aid Policy Department, Environment Policy Department, Evaluation Department, Statistics Department, European Union

Department, Conflict and Humanitarian Assistance Department, and International Economic Policy Department, the British Embassies in Almaty, Tashkent, Ashkabat, Tblisi, Yerevan, and Baku, as well as the FCO's Eastern Department, the DETR, the DTI, and HM Treasury.

A consultation meeting was held with specialist conflict mitigation NGOs in May 1999, followed by consultation with local and international NGOs in the South Caucasus on conflict mitigation.

Further consultations were held in late 1999 and early 2000 with the FCO, DETR, DTI and HM Treasury, and with DFID Chief Advisers, Aid Policy Department, Environment Policy Department, Evaluation Department, Statistics Department, European Union Department, International Financial Institutions Department, Conflict and Humanitarian Assistance Department, and International Economic Policy Department.

ANNEX 2

EXPENDITURE PROFILE

£ MILLION	2000/ 01	2001/ 02	2002/ 03
BINDING COMMITMENTS			
Rural livelihoods	0.30	0.17	0.10
Environment	0.18	0.10	0.10
Humanitarian assistance and conflict prevention	2.35	1.81	0.65
Finance	0.24	0.25	0.15
Energy			
Economic development and reform	0.14	0.21	0.23
Civil society	0.47	0.40	0.87
Governance	0.60	0.69	0.52
Health	0.80	0.62	0.56
SUB-TOTAL	5.08	4.25	3.18
PIPELINE PROJECTS			
Rural livelihoods	0.37	0.52	0.52
Environment	0.20	0.50	0.50
Humanitarian assistance and conflict prevention	0.55	0.78	1.00
Finance	0.38	0.33	0.30
Energy			
Economic development and reform	0.40	0.40	0.54
Civil society	0.30	0.35	0.74
Governance	0.30	0.38	0.62
Health	0.17	0.24	0.35
SUB-TOTAL	2.67	3.50	4.57
TOTAL	7.75	7.75	7.75

NB: These figures are consistent with the agreed aid framework

ARMENIA

POPULATION: 3.8 MILLION

GNP PER CAPITA (1998): \$460

ECONOMIC

1. Following the severe economic dislocation brought about by the break-up of the Soviet Union, reform began in Armenia in 1994. Growth resumed rapidly and there was a reduction in the budget deficit to 8% GDP and of inflation to below double digits. However, the country's vulnerability was highlighted by the impact of the financial crises in Asia and Russia in 1997 – although growth in 1998 was still above 6%, by 1999 it had slowed to 3.3%. These external shocks have made economic management more difficult and weakened political support for reform. GDP has not yet recovered its 1990 level, and output in 1999 was still less than half the pre-transition level.

2. Statistical data must be treated with caution, but according to World Bank figures, at market exchange rates in 1998, Armenia had GNP per capita of just \$460. It is classified by the World Bank as 'low income', and as an IDA-only (concessional loans) borrower; assistance to Armenia is classified as official development assistance (oda) by the OECD Development Assistance Committee (DAC).

3. With limited natural resource endowments, Armenia continues to rely on agriculture as a key driver of growth and poverty reduction. And, with an enabling environment for foreign investment that, as in other countries in the region, remains complex and lacks transparency, Armenia has attracted relatively little private investment. It has relied heavily on official lending for external finance, and the depth and duration of the output collapse has left it with crushing debt burdens which are damaging prospects for growth and poverty reduction. Armenia also faces uncertainty linked to the Nagorno-Karabakh conflict, which has stifled trade (the borders with both Azerbaijan and Turkey are closed) and investment, and increased the vulnerability of the economy.

4. However, Armenia is one of the countries in the region most advanced along the path of economic transition. It has made relatively good progress on privatisation, (the

private sector accounts for about 75% of GDP), corporate governance, and enterprise restructuring. Armenia is also focusing attention on strengthening its banking systems and moving forward with public sector reform. It is in the third year of implementing an IMF Enhanced Structural Adjustment Facility, and is likely to join the WTO in 2000.

5. The challenge now is to consolidate and deepen the macroeconomic and structural reforms. Continued fiscal adjustment is required. The tax base remains narrow, and there remains a huge agenda of public sector reform including expenditure management, tax reform, improved tax and customs administration, energy subsidies, targeting of social protection and levels of public investment. The environment for private-sector development and investment also needs to be strengthened. This will require investment in critical infrastructure like power, water, roads and telecommunications. It also requires strengthening and simplification of the regulatory environment and legal and judicial systems.

POLITICAL

6. There has been some movement toward a functioning pluralist democracy. Parliament has begun to function as a check and balance on the executive, and the human rights record is good for the region. Armenia differs from other Former Soviet Union countries in its record on civil society development; NGOs have spread out from the capital throughout the country. The long-standing contacts maintained through the Diaspora alleviated some of the impacts of Soviet isolationism. Since independence, it has received large amounts of aid, primarily American, in response to natural disasters and to underpin economic activity. However, benefits to the general population are not obvious. Although there has been increased dialogue (during 1999 and early 2000) between Presidents Kocharian and Aliiev, the Nagorno-Karabakh dispute has yet to be resolved.

POVERTY ASSESSMENT

7. The transition has hit people in Armenia hard, and support to refugees and internally displaced persons from Nagorno-Karabakh and Azerbaijan has also been a strain on the social budget. Poverty has increased, particularly in urban areas, and although accurate data on national levels of poverty are only slowly emerging, the World Bank estimates that, at the standard dollar-a-day absolute poverty line, 10% of the population live in extreme poverty. Under the \$2 dollar-a-day line the figure is 40%.

8. As in the rest of the region, economic collapse, conflict, rising inequality, non-payment of wages and fragmenting social safety nets are all major contributing factors to deteriorating social indicators.

9. The Armenian Government has demonstrated commitment to reducing poverty and has taken some steps on social sector reform, including improved targeting of benefits, a new pension law in 1995, and steps to reallocate spending towards basic education. Health reforms have included the adoption of a strategy to improve the financing and provision of health care. Armenia has made good progress on producing a Poverty Reduction Strategy Paper, and aims to have the interim paper in place by October 2000.

EXISTING DFID PROGRAMME

10. Our direct assistance programme initially concentrated on the governance, finance and agriculture sectors. Our work with the Agrobank went well, but our project in agriculture was less successful, due to weaknesses in regulations over agricultural trading. More recent activities in Public Sector Reform, including assistance to the Ministry of State Revenues, and capacity-building in the Prime Minister's and President's office are progressing well. Our contribution to multilateral programmes averaged about £7 million per year between 1994 and 1997, and our direct assistance allocation in 2000-2001 is £1.75 million.

11. Armenia has benefited from the UNHCR regional programme for refugees and internally displaced persons to

which DFID contributed £1.2 million in 1997 and 1998, and from the EU ECHO programme; the UK's contribution between 1994 and 1998 has averaged £1.8 million per year. Direct assistance to Armenia in 1998/99 was around £100,000 in response to natural and man-made disasters, the latter related to Nagorno-Karabakh.

OTHER DONORS

12. Both the World Bank and IMF are important partners. The 1997 net financial flows to Armenia were \$77.4m (World Bank); and \$23.2m (IMF). A Structural Adjustment Credit was approved in 1997, with a strong focus on private sector development and social safety nets. World Bank support has also covered institution building, public sector reform, irrigation rehabilitation, power maintenance, social investment support, infrastructure, agriculture and enterprise development.

13. Tacis (average annual commitment, 1991-1997: €6.9 million) supports public sector development, human resources, energy and public investment. The EU is providing a loan/grant combination of exceptional financial assistance to Armenia to facilitate repayment of her share of an EC loan provided to the former Soviet Union. The EBRD Country Strategy highlights energy, banking and telecoms as priority sectors. The net financial flow to Armenia in 1997 was €14.4 million. The opening of a Yerevan office in mid-1999 gives the EBRD a presence in all its countries of operation. Armenia receives substantial amounts of US assistance (\$135 million in 1998). There is a risk of dependence on donors.

PROPOSED DFID PROGRAMME

14. Through our experience in working in Armenia, we have forged strong partnerships with the other major donors – in particular the World Bank, EU, and USAID. We will build on these links and design all future activities in close collaboration with them, as well as government and civil society. We shall continue to contribute financially to multilateral programmes in Armenia. For instance, our imputed share of the EU Tacis programme will be around 15% each year. Since 1992 this has amounted to some £17

ANNEX 3

CONTINUED

million. In addition, we plan to expand the direct assistance programmes increasing from £1.75 million to £2.25 million by 2002/2003. We will:

- build on recent success with support to high-level government policy-making. In the Prime Minister's and President's offices, we are working on a more wide-ranging project, in co-operation with the EU and World Bank, supporting the Government's Public Sector Reform Programme.
- continue, initially, effective work in public finance (tax and customs administration) in collaboration with USAID, and support on economic reform and the financial sector where we will first provide support to the Banking Advisory Centre to facilitate the disbursement of a World Bank credit line, and build capacity in participating banks.
- seek to increase the capacity of individuals and groups to help participate in and shape the transition, to promote democracy and human rights, and to ensure protection of vulnerable groups. Recent discussions with the Government, civil society groups and other donors have resulted in a commitment to support the World Bank Armenian Social Investment Fund II, and to work with the

Government and the World Bank on reform of the state benefits system.

15. DFID's Eastern Europe and Central Asia Department (EECAD) and Conflict and Humanitarian Affairs Department (CHAD) will work closely with the FCO, international agencies and NGOs in seeking to support conflict mitigation activities. In particular, we will support the efforts of the international community to assist reconstruction following a resolution of the Nagorno-Karabakh dispute. We will work closely with other UK government departments in our support of Armenia's accession to the WTO.

MANAGEMENT

16. A new structure for the local management of the DFID programme will be implemented following the recent Embassy inspection. On a trial basis, the Yerevan Embassy will have increased local staffing of an SAIC1⁶, underpinned by an SAIC2 and SAIC3. The Ambassador's commitment to DFID programmes will increase from 10% to 20%.

⁶ SAIC: DFID staff appointed in country.

GEORGIA

POPULATION: 5.4 MILLION

GNP PER CAPITA (1998): \$970

ECONOMIC

1. From 1994, Georgia made substantial progress on macroeconomic and structural reforms. Liberalisation, and fiscal and monetary stringency in the early 1990s, yielded positive results. Economic growth, based on agriculture, construction and general trade, resumed in 1995 and reached 11% in 1997. In 1998, internal and external problems resulted in growth of just 3%, and the worsening of most macroeconomic indicators. Whilst GNP per capita in 1998 was \$970, estimates for 1999 are up to 30% lower.

2. With limited natural resource endowments Georgia has found it harder than some in the region to attract private investment, relying heavily on official lending for external finance. The depth and duration of the output collapse has left the country with crushing debt burdens, which are damaging prospects for growth and poverty reduction. Georgia is classified as an IDA only (concessional loans) borrower by the World Bank.

3. The midterm review of the IMF Enhanced Structural Adjustment Facility (ESAF) was approved by the board in July 1999, and Georgia also received an augmentation to counter the effects of the Russian crisis. However, the programme went off track very quickly, and the IMF are unwilling to resume until measures have been taken on serious corruption and economic problems. In particular, the IMF does not believe the Georgian budget has realistic revenue estimates. Revenue remains less than 9% of GDP, and there have been considerable arrears in the payments of wages and social benefits, amounting to 2% of GDP. Corruption is endemic at all levels, and previous initiatives to address it have had little impact. President Shevardnadze has recently launched a new initiative, which will include a high-level anti-corruption working group.

4. Georgia has the potential to become a major transit country for oil exports from the Caspian Basin and Central Asia. Georgia is westward-looking (it is, for example, a

member of the Council of Europe), has one of the most liberal trade and exchange regimes in the region, and has recently joined the WTO.

5. There is an urgent need to address the problem of low tax revenues through adoption of a coherent programme of fiscal reform. Structural reforms then need to be consolidated (banking reform, privatisation of urban land and large-scale enterprises). The problem of corruption and weak governance needs to be tackled through comprehensive public sector and civil service reform. There is also an acute need to improve the quality of economic data.

POLITICAL

6. Georgia has the potential to become the most democratic and pluralist of all the former Soviet Union countries. The emerging political system includes an acceptance of the importance of checks and balances, and Parliament may act as a brake on the powers of the President. The non-profit sector is the most sophisticated in the region. The major weakness is the lack of a functioning public service both at central and regional level.

7. Georgia faces serious domestic political problems. Ethnicity is a potent force, and secessionist groups in South Ossetia and Abkhazia still threaten the physical sovereignty of the country. These threats are regularly used by the Government as a reason for putting limits on democratic development.

POVERTY ASSESSMENT

8. A recent World Bank study indicates that poverty in Georgia is widespread and deep. There is wide regional variation – over half the long-term or chronic poor live in the poorest region, Imereti. One of the main determinants of poverty in Georgia is employment status, and there is, therefore, quite a strong link between macroeconomic performance and poverty. This link is weakening because of

the increasing level of income inequality, which is now comparable with Latin American countries. Another key determinant is access to land; most of the long-term poor live in urban areas. Although accurate data on national levels of poverty are only slowly emerging, what indications we have suggest that over 10% of people live in extreme poverty. This is backed up by the GNP per capita figure and by what we know of inequality.

9. Poverty reduction strategies need to address the issues discussed above. In the short term, social expenditures should be protected and efforts made to improve their effectiveness. Currently, the social safety net does not meet the needs of the poor. In the longer term, improved economic management and continued structural reforms will be required to sustain high rates of economic growth, leading to increased government revenues and a reduction in the pressure on the social services. Policies need to be developed which ensure that vulnerable groups are protected, and which address structural aspects of poverty.

10. Unlike many other governments in the region, the Georgian Government had explicitly adopted pro-poor expenditure policies including increased social spending, increases in the real value of public-sector wages and improved targeting of social safety net benefits. The Government, with the World Bank, is carrying out a major survey to improve data on poverty, including health, education and other social indicators. DFID is supporting this process. The Ministry of Health has just published its strategy developed with the WHO, which clearly targets priority health problems including maternal and child mortality. The financial crisis puts the ability of the Government to implement social policies under considerable strain. Georgia is in the early stages of developing a Poverty Reduction Strategy Paper with support from the World Bank and the United Nations Development Programme.

EXISTING DFID PROGRAMME

11. Our programme has so far comprised technical co-operation focused on the agriculture, energy, financial, and health sectors, plus humanitarian assistance. Our effectiveness has been poor in the financial sector, but good

in agriculture – where we have worked alongside the World Bank and Tacis. In energy, we have made effective inputs to oil and gas legislation. We have worked successfully with the World Bank in primary healthcare service development. Our contribution to multilateral programmes averaged around £9 million between 1994 and 1997, and our direct assistance allocation in 2000/2001 is £2 million.

12. Georgia has benefited from the UNHCR regional programme for refugees and internally displaced persons, to which DFID contributed £1.2 million in 1997 and 1998. Our average contribution to the EC Humanitarian Office programmes has been €2.5million, as well as some direct assistance (1997/98 £1 million in humanitarian assistance in response to natural and man-made disasters, and a further £130,000 in 1998/99).

OTHER DONORS

13. Georgia is eligible for support from the IDA and the International Bank for Reconstruction and Development (IBRD), and will remain dependent on international financial institution (IFI) concessional assistance for some time. The IFIs and bilateral donors have supported the reform process. The World Bank's net financial flow to Georgia for 1997 was \$64.3m; the IMF's \$76.4m. A second World Bank Structural Adjustment Credit is being implemented, and a third is under negotiation. The World Bank has a wide range of sectoral loans, and implementation has generally been good.

14. The EBRD net financial flow to Georgia in 1997 was €18 million. Priorities for 1999 included financial sector restructuring and development, agribusiness, and support for small and medium-sized enterprises (SMEs). EU Tacis (average annual commitment 1991-1997: €7.1 million) focuses on infrastructure, energy, private sector and human resources. The EU is providing a loan/grant combination of exceptional financial assistance to facilitate repayment of Georgia's share of an EC loan provided to the former Soviet Union. Georgia receives large amounts of US assistance (US\$120 million in 1998), particularly in the financial sector.

PROPOSED DFID PROGRAMME

15. In support of our collaboration with the multilateral agencies, our share of multilateral spend will continue at around 15%. We will also implement a tightly-focused direct programme, increasing to £2.5 million by 2002/2003. This reflects the positive record on both economic and democratic reform, the continuing social needs and the government's willingness to confront poverty. We will focus on:

- **Public Administration and Finance:** We have begun work in two pilot regions on a major regional and local government strengthening project, focusing on central government machinery for local government. We are starting work to support strengthening capacity within the Government to analyse and use statistical data in decision-making, and are exploring the possibility of assisting the Government to strengthen systems and capacity for budgetary allocation and management, working with the Finance Ministry and one pilot sectoral ministry. We will consider scope for helping address Georgia's serious public revenue and corruption problems, and support for civil society to help underpin democracy and respect for human rights.
- **Support for rural livelihoods:** We will build on our previous collaboration with the World Bank. We are designing a project to provide technical assistance to

enable local communities to access Bank loans and/or grants effectively, and we will build up our knowledge of rural poverty issues to develop further priority interventions with other donors.

- We are developing with the Georgian Government a project to pilot reforms to the primary health care system, which is designed to fit in with World Bank sectoral loans, through which (if successful) the project can be rolled out throughout Georgia.

16. We will provide humanitarian assistance to help improve the livelihoods of displaced peoples. We have begun discussions with local and UK NGOs on conflict mitigation and resolution issues, and are exploring options for assisting in relevant projects. We will work closely with other UK government departments on these issues, and in our support of Georgia's accession to the WTO.

MANAGEMENT

18. A new structure for the local management of the DFID programme will be implemented following the recent Embassy inspection. On a trial basis, the Tblisi Embassy will have increased local staffing of an SAIC1, underpinned by an SAIC2 and SAIC3. The Deputy Head of Mission will give up all development work once the SAICs are in place and trained, and the Ambassador's commitment to DFID programmes will increase from 10% to 20%.

THE KYRGYZ REPUBLIC

POPULATION: 4.6 MILLION

GNP PER CAPITA (1998): \$380

ECONOMIC TRANSITION

1. Reform in the Kyrgyz Republic has proceeded furthest of all the Central Asian countries. Prices and foreign trade have been liberalised, privatisation has advanced significantly, the financial system has been strengthened and public sector reform has progressed steadily. In this environment, and supported by an IMF Enhanced Structural Adjustment Facility (ESAF), GDP growth resumed strongly in 1996 and 1997. Agriculture and gold mining were the key drivers. In 1998, the Kyrgyz Republic also became the first country in the Commonwealth of Independent States (CIS) to join the WTO. A second ESAF was approved that year, but by the middle of 2000 was off track.

2. Coverage and quality of reforms have tended to be patchy, as policy changes have often been put in place under pressure from external lenders with limited ownership on the part of the Kyrgyz authorities and population. This lack of co-ordination and coherence in the transition process intensified the economy's vulnerability to external shocks.

3. The 1998 Russian financial crisis exposed this vulnerability. The currency depreciated sharply and inflation increased. Falling demand in CIS markets saw the current account deficit widen dramatically. Despite the authorities' robust response, they could not prevent sizeable budgetary arrears emerging. There is a need to tackle fiscal adjustment, to press on with structural reforms and to improve financial discipline in public and private sector enterprises, as well as debt management. The climate for inward investment needs to be improved and the efficiency of social spending raised.

4. With limited natural resource endowments, the Kyrgyz Republic has attracted relatively little private investment, and has relied heavily on official lending for external finance. The depth and duration of the output collapse has left the country with crushing debt burdens which are damaging its prospects for growth and poverty reduction. The Kyrgyz Republic has been classified as an IDA-only (concessional loans) borrower by the World Bank.

POLITICAL TRANSITION

5. After violent, inter-ethnic clashes in the mid-1990s, the Kyrgyz Republic is now the most liberal and reform-minded of the Central Asian states. But political opposition remains weak, and there is no credible successor to President Akaev. The Kyrgyz record on human rights is generally good and compares favourably with its Central Asian neighbours, but there is concern, more recently, that the President is becoming increasingly intolerant of domestic criticism.

6. In July 1999, there was an armed incursion from Tajikistan into Osh Oblast in the South, believed to be mainly of Uzbek Moslems, Tajik opposition fighters, and some from the conflict in Afghanistan. The fighting led to 5,000 or more displaced persons, and there are ongoing concerns that the problem could escalate in the Fergana Valley where there are existing ethnic tensions and poverty.

POVERTY ASSESSMENT

7. Poverty is a serious problem in the Kyrgyz Republic, which has levels of per capita income roughly equivalent to Senegal or Pakistan. Consumption levels are hard to capture in a predominantly rural society, but it is clear that poverty is exacerbated by worsening job opportunities in the non-rural economy. As in the rest of the region, economic collapse, conflict, rising inequality, non-payment of wages and fragmenting social safety nets are all major contributing factors to deteriorating social indicators. The Republic has suffered more than most of the transition countries from rising income inequalities. Although accurate data on national levels of poverty are only slowly emerging, the World Bank estimates that, at the standard dollar-a-day absolute poverty line, 13% of the population are in poverty. At the \$2 dollar-a-day level, this rate increases to 49%.

8. There is a strong, explicit government commitment to eliminating poverty and reversing the deterioration of key social indicators. The Kyrgyz Government volunteered as a pilot for the Comprehensive Development Framework

(CDF) and, through this initiative and the process of establishing a Poverty Reduction Strategy Paper, has reaffirmed this commitment. Through improved targeting, efficiency and reliability of social assistance, the Government aims to ensure that the most vulnerable groups receive a high proportion of benefits. Spending on health services and education will be maintained and reforms implemented to improve effectiveness. The Government is also developing labour market programmes, and aims to improve the effectiveness of the benefit system.

EXISTING DFID PROGRAMME

8. The DFID programme has comprised technical co-operation and humanitarian assistance. We have collaborated with other agencies, in particular the World Bank and the EU. Direct support has focused on agriculture and health. In agriculture, we have helped progress land reform and have established the first agricultural market information system. Both of these initiatives have been expanded on by the World Bank. In health, we have collaborated successfully with the World Bank, the WHO and other donors to help the Government develop and implement policies to improve the delivery of health services within the resources available. Our contribution to multilateral programmes averaged £7 million per year between 1994 and 1997. The direct assistance allocation for 2000/2001 is £2 million.

9. The Kyrgyz Republic has benefited from the UNHCR regional programme for refugees and internally displaced persons, to which DFID contributed \$1 million in 1997. Our contribution to ECHO (EC Humanitarian Office) has averaged €2.5 million over the last few years and we have provided some direct assistance (for example, £30,500 of humanitarian assistance in 1998 to help flood victims).

OTHER DONORS

10. The Kyrgyz Republic is eligible for IDA and IBRD support, and is likely to be dependent on concessional assistance for some time. The World Bank 1997 net financial flow to the country was \$66.5 million, and the IMF \$76.2 million. The Bank has provided substantial support in the

form of structural adjustment loans. A public sector resource management adjustment credit was approved in 1997. A social sector adjustment loan is under negotiation, and a further adjustment operation is planned this year. The ADB has approved loans and grants averaging US\$64.5 million since the Republic became a member in 1994, and will this year focus on public (particularly social) services, agriculture (including rural finance), education and infrastructure.

11. The EBRD net financial flow to the Kyrgyz Republic in 1997 was €14.3 million. Priorities for 1999 include the financial sector, privatisation, agribusiness and energy sector projects. The EU (average annual commitment 1991 - 1997: €5.8m) has been working in governance, agriculture and infrastructure. It plans to expand its portfolio to include the social, SME and investment sectors. There is a limited amount of international NGO activity.

FUTURE STRATEGY

12. In support of our collaboration with the multilateral agencies and a coherent UK approach to the Kyrgyz Republic, we will implement a tightly focused direct programme, increasing to £2.5 million by 2002/2003. This reflects the high levels of poverty, the government's commitment to poverty reduction and generally positive progress on economic and political reform.

13. The DFID programme will support the CDF process by helping the Kyrgyz Republic to build capacity to lead this process, consult with civil society and co-ordinate international donors. The Kyrgyz CDF process is currently prioritising the development of a national strategy for poverty reduction. It is also providing an important forum for the institutional debate around the appropriate roles for the state and civil society. Within this debate, arrangements for provision and delivery of services to the poor are a key element. DFID assistance will underpin this national discussion, as well as supporting implementation of policy, in the following areas:

- Utility reform: We will work with the World Bank and others to support the Government's objective of achieving financial and economic sustainability in the

utility sectors, while ensuring that an acceptable level of access and standard of service is preserved for the poorest, and adequate environmental protection is achieved through appropriate regulation and sound operational practices.

- Rural livelihoods: We will build on recent success in working alongside the World Bank in support of the Government's reform programme. We will build up our knowledge of rural poverty issues to develop further priority interventions with other donors.
- Health care reform: We will continue to work alongside the World Bank and the WHO in health, in particular assisting the Government to build up rural support services, to provide access to basic health care, and clean water, for all levels of society, including the most vulnerable.

14. As local capacity to own the reform process and co-ordinate donors develops in line with the vision for the CDF outlined above, DFID will, as a small donor, seek to tighten the focus of its programme still further in line with national priorities and its own expertise. This will not only support the efforts of the authorities to co-ordinate donors more effectively. It will also enable DFID to deepen its sectoral knowledge and thus take a more proactive, and influential, stance in the policy debate.

15. DFID will contribute to this goal through assistance to strengthen national capacity to address poverty. This

includes support for the development of the reliable social statistics required to develop policy and track outcomes. We will also continue our recent support, through international NGOs, to strengthen civil society groups and encourage their effective links with government. In addition, DFID will remain actively engaged, through the local office, in the CDF process. We will also examine the need for further support to build the national authorities' capacity to manage and develop the CDF process.

16. We will work closely with DFID's Conflict and Humanitarian Affairs Department, the FCO, relevant humanitarian agencies, and NGOs, in seeking to support the conflict mitigation activities and provide necessary humanitarian assistance. We will work alongside the FCO and other UK government departments to assist in the implementation of the Partnership and Co-operation Agreement, and on environmental matters. We will work closely with other UK government departments in supporting the Kyrgyz Republic in implementation of the WTO requirements.

MANAGEMENT

17. Our programme is covered by our Embassy in Almaty, Kazakhstan (70% of a DS9) and a DFID office in Bishkek (100% of a SAIC 11; plus 100% of a SAIC111). We will strengthen the UK-based and local staff in line with the increased programme and the more diverse channels of support.