Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 22-Jun-2020 | Report No: PIDA29295

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kyrgyz Republic	P174028	Emergency Support for MSMEs Project	
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EUROPE AND CENTRAL ASIA	15-Jun-2020	30-Jul-2020	Finance, Competitiveness and Innovation
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Finance of Kyrgyz Republic	Project Implementation Unit at the Ministry of Finance (Kyrgyz Republic)	

Proposed Development Objective(s)

The Project Development Objective is to support MSMEs in response to and during the recovery from the COVID-19 crisis.

Components

Reimbursable Financial Assistance
Portfolio Risk Sharing Facility
Project Implementation, coordination and management

The processing of this project is applying the policy requirements exceptions for situations of urgent need of assistance or capacity constraints that are outlined in OP 10.00, paragraph 12.
Yes

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	100.00
Total Financing	100.00
of which IBRD/IDA	50.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	50.00
IDA Credit	25.00
IDA Grant	25.00
Non-World Bank Group Financing	
Other Sources	50.00
Asian Infrastructure Investment Bank	50.00

Environmental and Social Risk Classification

Moderate

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **The Kyrgyz Republic has experienced a consistent yet volatile economic expansion since the economy begun recovering in 1994 from the post-transition recession.**[1] Per-capita real GDP has grown by 3.1 percent a year on average since 1995 as a result of structural reforms, the emergence of remittances and commodity exports – largely gold – as powerful new drivers of growth, and improvements in the macroeconomic management. In 1998, the country became the first former Soviet Union nation to accede to the World Trade Organization, and it joined the Eurasian Economic Union in 2015. In 2014, the Kyrgyz Republic was reclassified from low income to a lower middle-income economy, as it was in 1990. Growth, however, has remained volatile due to fluctuations in commodity prices, uneven remittance flows, and political instability. For instance, firms have consistently ranked corruption and political instability as top constraints on growth.[2] Economic growth yielded significant welfare gains and poverty reduction, partially as a result of a significant relocation of labor from agriculture into the urban service sector yielding a boost to productivity. However, the progress in terms of poverty reduction has been uneven since 2009—effectively plateauing and even reversing among urban households. Despite a poverty rate of 15.3 percent in 2019, a large proportion of the population is clustered just above the poverty line, with a high risk of falling into poverty due to shocks and insufficient safety nets.

2. **Although the scope and duration of the COVID-19 pandemic are difficult to model, the economic impact—on a small open economy reliant on services, remittances and natural resources—is expected to be significant.** The necessary measures to mitigate the spread of the pandemic, including the closure of borders for nonresident entry and the suspension of non-essential businesses, have disrupted labor markets, international value chains, and the trade of intermediate inputs to production.[3] At the same time, the sharp contraction in

[1] In 1995, the GDP amounted to about half of its pre-independence level.
[2] Kyrgyz Business Enterprise Survey, 2019 and World Economic Forum's Global Competitiveness Index.
[3] A nationwide state of emergency was announced on March 22, 2020. It was followed, two days later, by additional measures in the three largest cities -

remittance flows and the demand shock are impacting the service sector with a particularly heavy impact on hospitality through the likely loss of the 2020 tourism season. While the strict quarantine is currently being relaxed, uncertainty remains as to whether further measures will be needed to respond to new waves of the pandemic. According to the most recent estimates,[4] GDP is expected to contract by 4–6 percent in 2020, and the poverty rate is projected to increase to 19.1 percent. A joint Bank-Fund Debt Sustainability Analysis published in March 24, 2020[5], indicates that the Kyrgyz Republic remains at moderate risk of debt distress, with some space, for both external debt and overall public debt, despite the expected spike of total public debt to 66 percent of GDP in 2020 in reaction to the outbreak of the COVID-19 pandemic and the depreciation of KGS vis-à-vis the US dollar.

3. **The COVID-19 pandemic has the potential to evolve from a temporary output and liquidity shock for firms into a solvency crisis with long term implications for growth and productivity.** A survey of businesses conducted in April, 2020[6] reflects the severity of the crisis in the private sector, with 80 percent of the respondents reporting a decrease in revenue of more than 75 percent and almost half of the respondents having put their staff on leave without pay. Despite these measures, 63 percent of the respondents do not have sufficient liquidity to cover their operational expenses for more than one month. These results were validated during project preparation through consultations with business associations that confirmed that the temporary liquidity crisis is making it increasingly difficult for micro, small, and medium enterprises (MSMEs) to meet operational expenses such as payroll, supplies, rent, and utilities. Importantly, enterprises create value through networks of relationships with their employees, customers, suppliers, creditors, and the government. These relationships are costly and time-consuming to build and maintain, particularly for MSMEs—in sectors such as tourism and other services, light manufacturing, and wholesale and retail trade—that lack the market power, scale, and access to finance to cushion the impact of a sustained economic shock. The longer the crisis extends, the greater the risk that otherwise healthy businesses may fail. Even when new firms enter the market, it may take years to rebuild value chains, retrain the workforce, find new suppliers and markets, and attract new investment.

4. **The financial sector may deleverage and amplify the COVID-19 shock, creating a negative feedback loop between the financial and real sectors.** With the private sector in crisis and expected losses on the rise, consultations with financial institutions point to growing risk aversion and a decreased willingness to extend new loans or renew existing credits. This might deprive firms of critical financing when it is needed most to cover operational expenses and survive the COVID-19 crisis. Indeed, newly issued credit dropped by 9 percent in March 2020 compared with the same period in 2019, reversing an increasing trend over the past decade.

Sectoral and Institutional Context

5. **As of 2019, the service sector dominates the economy, and informality is high.** Privatization efforts following independence have resulted in limited state ownership. The private sector accounts for 75 percent of GDP, a higher share than in any other Central Asian nation. Over the past two decades, the economy transitioned from agriculture into services, while the industry share of output remained relatively flat. Services accounted for

Bishkek, Osh, and Jalalabad. The measures included overnight curfews, a heavy reduction in public transportation, movement restrictions, mandatory use of face masks, and the closure of non-essential businesses.

[4] WB projection.

[5] https://www.imf.org/en/Publications/CR/Issues/2020/03/27/Kyrgyz-Republic-Request-for-Purchase-Under-the-Rapid-Financing-Instrument-and-Disbursement-49296

[6] "COVID19 impact on the business environment in Kyrgyz Republic", conducted by OSCE Programme Office in Bishkek, the JIA Business Association and the Entrepreneurs Support Center, covering 1,053 respondents.

54 percent of GDP at the end of 2019, followed by industry, agriculture, and construction at 21, 14 and 11 percent respectively. Within services, tourism, transport, and communications have grown rapidly (albeit from a low base), while retail and wholesale trade have benefitted from remittance-fueled domestic demand and intra-regional trade. Formal employment numbers largely mirror the sectoral distributions. While informality has declined over time, it is still estimated at approximately 24 percent of GDP[7] and roughly 37 percent of the labor force (concentrated among lower skilled jobs in trade and agriculture).

6. Job creation, productivity, and exports are positively correlated with firm size. Micro entrepreneurs are the largest private sector cohort by number. However, key indicators of firm performance—such as value addition per worker and export volume—increase by size. For example, among MSMEs, small and medium enterprises (SMEs) contribute a total of 61 percent of non-gold exports with an average export value per firm of approximately US$200,000 for small firms and US$1.5 million for medium-sized firms.

7. The dominant banking sector appears resilient and liquid entering the COVID-19 crisis but is expected to be negatively impacted. The banking sector accounts for 77 percent of the financial sector assets. The banking sector's capital adequacy ratio stood over 25 percent in 2019, roughly twice the minimum regulatory requirement of 12 percent. The liquid asset to short-term liability ratio has remained within the range of 60–70 percent in the last two years, well above the minimum regulatory requirement of 45 percent. The amount of liquid assets to total assets is at 28 percent, suggesting a healthy liquidity situation. As part of the initial COVID-19 response measures deployed in March 2020, the National Bank forbade commercial banks to levy fines for the non-payment of loans and recommended that customers be granted a delay of at least three months. The COVID-19 crisis has already affected 90,000 borrowers with a total of KGS 58 billion (US$725 million) in restructured loans, or 33 percent of the total credit portfolio. Without additional support to the private sector, some of these restructured loans are expected to become non-performing. Overall, the COVID-19 crisis is expected to impact the financial sector indicators with a lag and amplify the negative effect on economic growth. Financial intermediaries can be expected to face reduced profitability, weaker asset quality, and lower deposit mobilization, negatively affecting liquidity and solvency indicators as well as their risk-appetite to extend further credit.

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

The Project Development Objective is to support MSMEs in response to and during the recovery from the COVID-19 crisis.

Key Results

8. Sixty-five percent of all MSMEs benefiting from the Reimbursable Financial Assistance (RFA) are expected to survive the COVID-19 crisis; and eighty-five percent of all MSMEs benefiting from the Portfolio Risk-Sharing Facility (PRSF) are expected to recover during the COVID-19 crisis.

[7] Based on government estimates, while other sources place the figure as high as 40 to 60 percent of GDP.

D. Project Description

9. Project description is summarized in the figure below.

Emergency Support for MSMEs Project
(US$100 million)

The project development objective is
to support MSMEs in response to and recovery from the COVID-19 crisis.

Component 1. Reimbursable Financial Assistance
(US$72 million)

Component 1 will finance Reimbursable Financial Assistance (RFA) to help businesses survive the economic slowdown and retain employees by supporting their short-term liquidity needs for operational expenses.

- ***Sub-component 1.1. RFA for Micro Entrepreneurs.*** This sub-component will provide assistance for micro businesses working primarily through a presumptive tax regime known as "patent". (US$30 million)
- ***Sub-component 1.2. RFA for SMEs.*** This sub-component will provide assistance for SMEs, both legal and physical entities, who keep accounting records, pay taxes, and hire employees. (US$42 million)

Component 2. Portfolio Risk Sharing Facility
(US$25.5 million)

Component 2 will finance the Portfolio Risk Sharing Facility (PRSF) to reduce the risk of deleveraging by the financial sector during the crisis and to foster credit provision to MSMEs during the recovery by sharing credit risk in MSMEs loans with financial institutions.

- ***Sub-component 2.1. Financing for PRSF.*** This sub-component will finance the PRSF under three windows: (i) short-term credits and overdrafts to MSMEs, (ii) restructured MSME loans, (iii) new MSME loans. (US$24 million)
- ***Sub-Component 2.2. Capacity Building.*** This sub-component will provide capacity building assistance to the State Guarantee Fund, the PFIs, and other stakeholders to operationalize the PRSF. (US$1.5 million)

Component 3. Project Implementation, Coordination and Management
(US$2.5 million)

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

10. The environmental risk is Moderate. The main environmental risks of the project are related to occupational health and safety, dust, water use, water-discharges, energy use and waste management at the sub-project, MSME level. These are expected to be site specific, temporary and can be readily addressed through standard mitigation measures and compliance with national laws. The overall portfolio risk is thus considered moderate. The implementing agency will ensure that FIs will be required to develop and implement an Environmental and Social Management System (ESMS) to classify and manage the E&S risks of their financing activities. Only those MSMEs whose business activities are screened to be of moderate or low environmental and social risks are eligible for project support. FIs will conduct screening of eligible MSME businesses they will finance and will require the MSMEs to develop and comply with corrective action plans to improve the E&S performance of the firms. At the MSME level, simple streamlined E&S due diligence procedures that includes screening against the prescribed eligibility criteria and compliance with national laws can serve as underlying framework for addressing E&S risks and impacts. Given the PIU's lack of prior experience in ESMS implementation under the World Bank ESF, the World Bank will maintain close oversight particularly in the early stages of implementation. In summary, Project activities are not expected to have large-scale, significant, and/or irreversible environmental and social impacts. The PIU will submit an evaluation report to the World Bank for no objection before the final selection of FIs. The implementing agency will also maintain a list of activities that cannot be financed by project funds that include major civil works or other activities that would increase the overall environmental risk of the project.

11. Social Risk is rated Moderate. The key social issues relate to: (i) exclusion/ inclusion – providing an opportunity to all eligible FIs to participate and derive benefits from the projects which would in turn ensure that most needed MSMEs do receive assistance and at the same time avoid covering the other non-deserving MSMEs; (ii) sensitizing the participating FIs to adopt and adhere to the ESS stipulations; and (iii) Information, Education and Communication (IEC) campaign to accomplish effective outreach so that all potential beneficiaries are fully aware of the project benefits and how to access them, and that all the stakeholders share a common understanding about the project. The drivers of exclusion is likely to be based on: (i) size/ scale of operations -- smaller and poorer MSMEs (relative to larger and rich entities) may find it difficult to fulfil all the formalities which the project would demand; (ii) geographical location - MSMEs in rural and mountainous areas may have difficulty in accessing the 'project' relative to those in urban areas; (iii) young and new (vs established ones) entrepreneurs who have set up the business recently and are struggling to break-even; and (iv) gender- women entrepreneurs may find it difficult to combat the COVID-19 situation and may stay away from entrepreneurial activities. Exclusion/ Inclusion errors can be contained by drafting carefully the rules of the participation viz., drafting the eligibility criteria for participation by: one, FIs; and other, MSMEs. Capacity support and capacity building will help sensitizing the FIs. Finally, an appropriate Stakeholder Engagement Plan (SEP) will help in accomplishing effective outreach.

E. Implementation

Institutional and Implementation Arrangements

12. To leverage implementation capacity within the government, the existing MoF PIU will act as the project's PIU. The MoF PIU has been successfully implementing World Bank projects in the Kyrgyz Republic since 2002, either as a single PIU or by performing fiduciary/safeguards/monitoring and evaluation (M&E) functions only. The MoF PIU has accumulated significant experience in procurement, financial management, environmental and social development safeguards and M&E, in accordance with the World Bank policies and procedures. To remain cost-efficient, avoid duplicating roles in different agencies, and use existing capacity, the MoF PIU will implement the project as it relates to the management of RFA under Component 1, procurement, FM, E&S safeguards and M&E monitoring. The MOF PIU will prepare a Project Operations Manual (POM) and RFA Procedural Manual (RFA PM).

13. The MoF PIU will disburse and manage the RFA. The MoF PIU will, inter alia: (i) assess compliance with eligibility criteria and sign agreements with SDAs who will act as financial assistance disbursement agents for the RFA; (ii) prepare the RFA Procedural Manual, detailing implementation arrangements, terms and conditions; (iii) support the outreach campaign for the RFA in collaboration with the SDAs; and, (iv) ensure reimbursement of the RFA. The SDAs will receive funds directly from the MoF PIU to disburse financial assistance to MSMEs, and disbursement will be report-based. The SDAs will have a variable ceiling, based on a six-month forecast to cover project implementation needs.

14. **The SGF will manage the PRSF.** The SGF is the only guarantee fund operating at a national scale and it will manage the PRSF operations. Notably, the SGF is familiar with development partner projects and is currently working with the World Bank (under the Integrated Dairy Productivity Improvement in the Kyrgyz Republic project). The SGF will, *inter alia*: (i) select eligible PFIs and facilitate the signing of agreements with them; (ii) prepare the PRSF Procedural Manual, detailing implementation arrangements, terms and conditions; (iii) conduct information sessions to introduce PRSF to financial institutions; and, (iii) manage the day to day operation of the PRSF.

15. **A steering committee will supervise overall project implementation.** The Government of the Kyrgyz Republic will establish a national-level steering committee to oversee the project and serve as the highest-level consultative and decision-making body, responsible for strategic guidance, coordination, and implementation support.

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