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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR

A PROPOSED CREDIT

IN THE AMOUNT OF SDR 9.1 MILLION (US\$13.2 MILLION EQUIVALENT)

AND A PROPOSED GRANT

IN THE AMOUNT OF SDR 7.4 MILLION (US\$10.8 MILLION EQUIVALENT)

TO

THE KYRGYZ REPUBLIC

FOR AN

ENERGY SECTOR DEVELOPMENT POLICY OPERATION

December 31, 2014

Energy and Extractives Global Practice
Central Asia Country Unit
Europe and Central Asia Region

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THE KYRGYZ REPUBLIC -GOVERNMENT FISCAL YEAR

January 1-December 31

(Exchange rate effective as of November 30, 2014)

Currency Unit = Kyrgyz Som (KGS)

US\$1.00 = KGS54.1181

ABBREVIATIONS AND ACRONYMS

Act.	Actual	KIHS	Kyrgyzstan Integrated Household Survey
ADB	Asian Development Bank		
BKR CU	Belarus-Kazakhstan-Russia Customs Union	kWh	Kilowatt hour
		MBPF	Monthly Benefit for Poor Families
CAD	Current Account Deficit	MTTP	Medium-Term Tariff Policy for the power and heating sectors
CASA-1000	Central Asia-South Asia Electricity Transmission and Trade Project	NATO	North-Atlantic Treaty Organization
CHP	Combined Heat and Power	NBKR	National Bank of the Kyrgyz Republic
CoA	Chamber of Accounts		
CPS	Country Partnership Strategy	NPL	Non-performing Loan
DSA	Debt Sustainability Analysis	PEFA	Public Expenditure and Financial Accountability
ECA	Europe and Central Asia		
ECF	Extended Credit Facility	PER	Public Expenditure Review
ESARIP	Electricity Supply Accountability and Reliability Improvement Project	PFM	Public Financial Management
		PSIA	Poverty and Social Impact Analysis
FDI	Foreign Direct Investment	SDR	Special Drawing Rights
GCal	Gigacalorie	USA	United States of America
GDP	Gross Domestic Product	USAID	United State Agency for International Development
GNI	Gross National Income		
IDA	International Development Association	USD	United State Dollar
		VAT	Value Added Tax
IFC	International Finance Corporation	WBG	World Bank Group
IMF	International Monetary Fund	WEF	World Economic Forum
IPSAS	International Public Sector Accounting Standards	WTO	World Trade Organization
KfW	Kreditanstalt fuer Wiederaufbau	y-o-y	year-over-year
KGS	Kyrgyz Som		

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THE KYRGYZ REPUBLIC

ENERGY SECTOR DEVELOPMENT POLICY OPERATION

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SUMMARY OF PROPOSED CREDIT/GRANT AND PROGRAM

THE KYRGYZ REPUBLIC ENERGY SECTOR DEVELOPMENT POLICY OPERATION

Borrower	The Kyrgyz Republic
Implementation Agency	Ministry of Energy and Industry/Ministry of Finance
Financing Data	<p>IDA Credit Terms: 38 years of maturity including a 6-year grace period Amount: SDR 9.1 million (US\$13.2 million equivalent)</p> <p>IDA Grant Amount: SDR 7.4 million (US\$10.8 million equivalent)</p>
Operation Type	Single tranche, stand-alone operation
Pillars of the Operation And Program Development Objective(s)	<p>The Program Development Objectives are to improve the financial viability of the energy sector, enhance its governance and accountability while managing the impact of power shortages on poor regions. Accordingly, the proposed operation supports government efforts in the following three areas:</p> <ol style="list-style-type: none"> 1. Improving financial viability of the sector; 2. Enhancing sector governance, transparency and accountability; and 3. Managing the impact of power shortages on poor regions. <p>The program is at the core of the national Power Sector Development Strategy 2012-2017 and is fully aligned with the objectives of the Country Partnership Strategy for 2013-2017 and the World Bank's objective to reduce poverty and promote shared prosperity.</p>
Result Indicators	<ol style="list-style-type: none"> 1. Cash collected per kWh of power generated increased from 0.59 Som/kWh (2013) to 0.64 Som/kWh (2015) 2. Cash collected per Gcal of heat generated by Bishkek CHP increased from 460 Som/Gcal (2013/14) to 598 Som/Gcal (2014/15) 3. Power sector revenue allocated based on the tariffs for power sector companies set according to the approved methodology (2015) 4. State Regulatory Agency of the Fuel and Energy Complex is able to perform key economic regulatory functions (licensing, tariff setting and performance monitoring), as evidenced by the achievement of the target indicators on tariff setting methodology (#3) and service quality (#5) (2015) 5. Service quality indicators for the power sector are quarterly disclosed (2015) 6. Public awareness about the country's energy sector challenges and reforms increased from 17 percent (2014) to 27 percent (2015) and the State Regulatory Agency of the Fuel and Energy Complex holds at least two public hearings (2015) 7. Reduction in regional power consumption (2014/2015 consumption compared to regional average consumption of previous three years) does not differ by more than 5 percent across the regions
Overall risk rating	High
Operation ID	P152440

IDA PROGRAM DOCUMENT FOR A PROPOSED ENERGY SECTOR DEVELOPMENT POLICY OPERATION TO THE KYRGYZ REPUBLIC

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Energy Sector Development Policy Operation (ESDPO) will support the Kyrgyz Republic's reforms aimed at laying the foundations for long-term energy supply reliability.** To that end, the objectives of the operation are to improve the financial viability of the energy sector, enhance its governance and accountability while managing the impact of power shortages on poor regions. The program is at the core of the national Power Sector Development Strategy 2012-2017 and is fully aligned with the objectives of the Country Partnership Strategy¹ (CPS) for 2013-2017. The ESDPO will be a single tranche operation in the proposed amount of US\$24 million, of which 45 percent will be provided as a grant and 55 percent as a credit.

2. **Economic growth has been volatile in the last few years, with a more challenging outlook.** Growth averaged around five percent since 2010 with considerable fluctuations due to frequent shocks, including natural (land slide at the largest gold mine), external (food and energy price spikes) as well as political factors (2010 revolution). Most recently, economic growth has moderated in response to weaker growth in Russia, the closure of the Manas Transit Center and a poor harvest. Overall, economic management has been adequate, but continues to rely largely on ad-hoc measures rather than a systemic approach to structural reforms. Economic activity is concentrated in few, low productivity sectors (agriculture, trade) characterized by high informality. Continued sluggish growth in key trading partners and geopolitical factors are likely to limit growth prospects over the next few years.

3. **Volatile growth and frequent price shocks have kept poverty high.** A remarkable decline in poverty, from 62.6 percent down to 32 percent, was registered between 2000 and 2008 due to strong growth, additional job creation and surge in remittances. However, frequent shocks in recent years, including food price spikes and political instability, somewhat reversed this trend. In 2013, about 37 percent of the population lived in poverty, and an estimated 2.8 percent of the population lived in extreme poverty. The Kyrgyz Republic remains one of the poorest countries in Europe and Central Asia (ECA) with a GNI per capita of around US\$1,200 in 2013. Social safety nets have a limited role in supporting the most vulnerable; although public spending for social transfers account for more than two percent of GDP, only one of the programs is targeting the poor.

4. **The Kyrgyz Republic is a young democracy undergoing a significant transformation with nascent institutions and a challenging political situation.** Since the April 2010 events, significant progress has been made to improve democratic governance, rule of law, voice and accountability. The national index of confidence in the government also shows increasing public trust: in the second quarter of 2014, the confidence index reached 5.8 points compared to 3.5 points for the same period of the previous year and 4.0 points at the end of 2012. However, corruption and political instability remain important obstacles for doing business and gaining public trust.

¹ As discussed by the Board of Executive Directors on July 25, 2013.

5. **Despite its potential, the energy sector is a source of significant vulnerability.** The sector suffers from deeply rooted structural issues. The Kyrgyz Republic has the lowest electricity tariffs in the ECA region and one of the lowest worldwide, which contributes to the inefficient use of energy, severe under-spending on maintenance and new investments, and resulting poor supply reliability and quality. The patchwork regulatory framework, suboptimal contractual arrangements and overall poor transparency and accountability result in operational inefficiencies and undermine public trust. The sector is a source of significant quasi-fiscal deficit, which for the power sector alone exceeds two percent of GDP per year. These underlying weaknesses of the sector, when coupled with cycles of poor hydrology, lead to recurrent winter energy shortages with serious repercussions for the population and the economy. The situation for the 2014/2015 winter is particularly alarming due to the unfavorable hydrological situation and the interruption of gas imports in the south of the country. Expected power shortages equivalent to about 1.5 months of winter power consumption are estimated to translate into economic costs in excess of US\$300 million or 4.2 percent of GDP. Due to universal access to electricity, cold climate, large reliance on electric heating and lack of alternatives, power supply is an essential need for the Kyrgyz population. Based on the data from 2009-2010, when the Kyrgyz Republic experienced winter energy shortages of similar magnitude to those expected for the 2014-15 winter, the impact of power shortages are estimated to increase poverty in the range of 2-3 percentage points.

6. **Failure to improve energy supply reliability in a sustainable manner could impact political stability, both domestically and in the wider Central Asia region.** Dissatisfaction with energy sector policies and poor governance were fundamental causes of the political upheavals in 2010 leading to the loss of lives and extensive infrastructure damage. Given the delicate water-energy nexus in Central Asia, addressing the imminent winter power shortages in a sustainable manner is important to preserve the regional stability. In the past, the political relations in the region have significantly been affected by the water release patterns from Toktogul reservoir given its importance for irrigation in both the Kyrgyz Republic and the downstream countries (Kazakhstan, Uzbekistan and Turkmenistan). Should the reservoir be heavily discharged in winter in an attempt to avoid load shedding, the water release may reduce during the irrigation season.

7. **The proposed ESDPO will support the Government's energy sector reform program, which has gained momentum in the face of yet another winter energy crisis.** The weaknesses of the energy sector were apparent for some time; however, a challenging political environment undermined reform efforts. The Government has chosen to address the imminent energy crisis by implementing structural reforms, thus, creating an opportunity for sustainable impact. Specifically, the Government has established the legal basis for setting-up an economic regulator and an independent settlement center and has initiated tariff reforms. The proposed ESDPO will focus on three policy areas to support the Government's reform program: (i) improving energy sector financial viability to ensure essential investments, timely procurement of fuel, and incentives for energy efficiency, which will contribute to improved reliability of power and heat supply; (ii) enhancing sector governance, transparency and accountability to improve operational efficiency of the energy sector and ensure larger acceptance of energy reforms; and (iii) managing the impact of power shortages for the poor regions.

8. **While this ESDPO is designed as a stand-alone operation, it is part of the broader structural reform agenda supported by the World Bank.** The operation builds on the energy sector governance, transparency and accountability reform measures supported under the previous DPO series. In addition, medium-term reforms to continue enhancing the financial sustainability

of the energy sector, improving the social protection system for targeted support to the poor, and strengthening sector governance and regulation could be supported through the future DPO series. The proposed ESDPO is also closely linked to and complements the World Bank Group's other ongoing operations (see also section 4.3).

9. **The operation is closely aligned with the goals of reducing poverty and boosting shared prosperity.** Previous episodes of growth in the Kyrgyz Republic have been closely associated with poverty reduction and consumption growth of the bottom 40 percent. A financially viable energy sector will enable higher investments in modernizing and maintaining the sector, reduce the burden on public finances and improve the reliability of power supply. The latter is not only critical for improving the competitiveness of businesses, but will also help to improve the quality of life for people, especially the poor who have fewer alternatives of coping with power shortages. Accordingly, reforms supported by this operation are expected to contribute to both economic growth and poverty reduction.

10. **The operation faces high risks.** Energy sector reforms have been delayed in the past due to stakeholder resistance to tariff reforms. Major reasons behind the resistance were the lack of confidence in the ability of the Government and sector companies to use additional revenues for the benefit of the broader population and concerns that vulnerable groups will not be able to afford higher tariffs.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

11. **The Kyrgyz economy has shown some resilience in the face of numerous shocks in recent years but faces serious structural challenges.** Growth has averaged around five percent a year since 2010 with large fluctuations due to natural, external and political shocks. The excessive reliance of the economy on a few sectors or sources of finance (gold accounts for 40 percent of exports, transfers from abroad are 30 percent of GDP) and large informality (estimated at 40 percent of GDP) exacerbate volatility and vulnerability. While higher government spending supported demand, it also added to the fiscal deficit averaging 5.3 percent of GDP a year during 2010-2013. Key aspects of the business environment remain problematic, including functioning of institutions, business sophistication, and quality of infrastructure.² Access to a reliable power supply is especially challenging.³

12. **Economic activity moderated in 2014 as higher investment and increased gold exports were offset by a poor harvest and weak external demand.** GDP expanded by 3.7 percent year-on-year (y-o-y) in the first ten months of 2014, driven by a 15.3 percent growth in investment and a 2.4 percent increase in gold production. Construction increased by 23.8 percent in the first ten months of 2014. Greater availability of construction land, pent-up demand and stronger economic growth drove the recent construction boom, although the market may be showing signs of saturation. Investment in the mining sector was up 5.1 percent (y-o-y) and public capital spending remained high. On the other hand, higher inflation, stagnant remittances

² The 2014-2015 Global Competitiveness report ranked the Kyrgyz Republic at 108th place globally, noting weaknesses across the entire range of competitiveness pillars, including innovation (ranked 132nd), institutions (124th), business sophistication (119th), and infrastructure (115th).

³ 35 percent of businesses in Kyrgyz Republic identify electricity as a major constraint, compared to 18 percent in ECA region. Source: 2013 Enterprise Survey, <http://www.enterprisesurveys.org/data/exploreeconomies/2013/kyrgyz-republic#infrastructure>

due to lower growth in Russia and modest wage growth affected disposable income and consumer sentiments with consumption growth moderating to 2.2 percent (y-o-y) in the second quarter of 2014. Retail trade data suggest a mild improvement since. Also, weaker demand from main trading partners reduced non-gold exports. Furthermore, the Manas Transit Center, a US air base located at the Bishkek airport and contributing around 1 percent of GDP annually to economic activity, was closed in mid-2014.

13. Lower imports and robust gold exports narrowed the current account balance in 2014. Total exports were flat in the first ten months of 2014 compared to a year ago as the 11.9 percent increase in gold exports offset the 8.6 percent decline in non-gold exports, mostly due to declining re-exports suffering from weaker growth in main trading partners, the closure of the Manas Transit Center and thicker borders. Imports declined by 4.5 percent as slowing consumption added to the reduced demand for re-exports. Private transfers, including remittances from the large Kyrgyz diaspora but also unregistered exports of goods and services, increased slightly compared to a year earlier.

Table 1: Key Macroeconomic Indicators and Projections

(in percent of GDP unless otherwise noted)

	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.
<u>Real sector</u>							
GDP, in US\$ million	6,199	6,603	7,225	7,237	7,257	7,764	8,268
GDP per capita, in US\$	1,120	1,182	1,280	1,253	1,244	1,317	1,389
GDP growth, in percent	6.0	-0.1	10.5	3.0	3.5	4.5	5.0
Investment	24.0	26.2	25.6	26.5	28.1	28.4	28.6
<u>Fiscal accounts</u>							
Revenues and grants	31.8	33.7	33.9	34.9	33.5	32.9	32.3
Expenditures	36.3	39.4	37.7	40.7	41.3	38.4	36.3
Balance (“-” deficit)	-4.6	-5.7	-3.8	-5.7	-7.7	-5.5	-4.0
Public debt	49.4	49.0	47.7	56.4	60.7	62.4	62.9
<u>External accounts</u>							
Exports of goods and services	54.7	53.6	54.1	53.8	57.1	57.8	58.9
Imports of goods and services	82.3	97.7	95.8	95.2	101.1	100.8	101.1
Current account balance	-6.0	-15.0	-14.1	-12.5	-14.2	-13.3	-12.4
External debt	76.7	81.3	84.4	87.4	93.2	94.5	95.2
<u>Prices and exchange rates</u>							
Inflation, period average	16.6	2.8	6.6	7.6	9.3	7.0	6.5
Exchange rate, KGS/US\$	46.5	47.4	48.6	53.7			

Source: Bank staff calculations based on data from national authorities.

14. Borrowing, mostly by the public sector, compensated for reduced foreign direct investment (FDI) in 2014. Smaller reinvested earnings (mostly by Kumtor, the largest gold mine) as well as other inter-company transactions kept net FDI in the first three quarters of 2014 at US\$122 million compared to US\$535 million a year earlier. Still, debt-creating inflows increased, pushing external debt to 86.1 percent of GDP by September with an estimated increase to 87.4 percent of GDP by the end of 2014.

15. Higher non-tax revenues and a hike in excise tax rates helped offset the impact of slower growth over tax revenues, but a spike in capital expenditures increased the fiscal deficit. Slower growth affected Value Added Tax (VAT) and customs revenues, but stronger grant support, higher telecom dividend, a hike in excises and stepped-up tax collection ensured a robust revenue outturn in 2014. At the same time, more intensive works on foreign-financed

projects increased public capital expenditures while current expenditures fell slightly as percent of GDP because of lower purchases of goods and services. The deficit in the first ten months of 2014 was about three percent of GDP and was over-financed, increasing government deposits and debt. By October 2014, the government's net claims on the monetary sector were Kyrgyz som (KGS) 18.3 billion or 4.7 percent of GDP, strengthening its liquidity, while as of September 2014 public debt reached 53 percent of GDP, a 5.8 percentage points of GDP increase compared to a year ago. About half of the increase is due to the som depreciation (see paragraph below). The deficit is expected to reach around 5.7 percent of GDP for the full year bringing public debt to 56.4 percent of GDP.

16. Monetary policy has been tightened in response to rapid credit expansion, higher inflation and increased pressures over the som. The National Bank of the Kyrgyz Republic (NBKR) increased its main policy rate on four occasions since July 2014 by a total of 400 basis points, bringing it to 10 percent by November 2014 and stepped-up interventions on the foreign exchange market. Still, significant dollarization, low monetization and a predominantly cash-based economy limit the effectiveness of the interest rate transmission channel. At the same time, as currencies of key trading partners lost value, the som also came under pressure. From January until November 2014, the som depreciated by 17 percent against the US dollar, much less than the 35 percent depreciation of the Russian ruble, with the NBRK selling US\$390 million (or around 17 percent of the country's international reserves) to smooth the adjustment. Gross foreign exchange reserves stood at around US\$2 billion at the end of November 2014, exceeding three months of imports and covering almost fully broad money.

17. Financial sector indicators remain robust, although the sector remains shallow. With credit growth exceeding 40 percent (y-o-y), also driven by the som depreciation, the loan-deposit ratio reached around 108 by end-October 2014. Still, the capital adequacy ratio (21.5) remains above prescribed levels and profitability indicators (return on assets of 2.8 and on equity of 19.5) are sound. While non-performing loans (NPLs) are not high (4.1 percent), only 61.8 percent of NPLs are provisioned. In addition, liquidity in the system has declined because of NBKR's sales of foreign exchange.

18. Headline inflation picked up as prices adjusted to the weaker Kyrgyz som against the US dollar. Annual inflation surged to 10.2 percent in November 2014, up from 4 percent in December last year, due to high pass-through from the exchange rate.⁴ In addition, higher excise tax rates on fuels increased domestic fuel prices. Average inflation in the first eleven months of 2014 climbed to 7.3 percent and is expected to increase to 7.6 percent by the end of the year.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

19. The Kyrgyz economy is at an important juncture facing the need for significant structural transformation. Elections in 2015 may cool business sentiments while the external environment has become more challenging. The announced accession to the Belarus-Kazakhstan-Russia Customs Union (BKR CU) is adding another layer of uncertainty. Still, oil and food prices are projected to moderate while preferential access to the CU markets may provide some opportunity for Kyrgyz exporters to gain market share. Against this background, continued progress in advancing structural reforms, including actions supported by the proposed ESDPO,

⁴ The Kyrgyz Republic shares a number of the characteristics associated with high exchange rate pass-through to consumer prices, including small size, import dependence (close to 60 percent of food is imported) and limited domestic production.

will be important for sustainable and inclusive growth. Tackling key infrastructure bottlenecks, especially in energy and transport, is critical for growth in the Kyrgyz Republic, a land-locked country suffering from years of underinvestment (see Box 1). The availability of significant amounts of near concessional financing over the medium-term provides an important opportunity for the Kyrgyz Republic to address critical infrastructure needs. Still, making the most of this opportunity requires strengthened public investment and debt management.

20. The baseline scenario projects a modest pick-up in GDP growth to 4-5 percent a year as higher public sector investment, increased FDI, larger gold production and stronger credit to the private sector support demand. This scenario is based on World Bank's projections of economic developments in the region and the government's plans articulated in its 2015-2017 fiscal framework. More precisely, significant investment in energy and transport are ongoing or will be launched soon, including the construction of the line D of the Central Asia-China gas pipeline, the Kyrgyz section of the Central Asia-South Asia (CASA-1000) transmission line, the North-South road and gas pipeline, the rehabilitation of power plants and upgrade of road links, with financing secured from China, FDI, and multilateral and regional development banks. These projects are expected to address critical bottlenecks and considerably improve connectivity and energy security of the Kyrgyz Republic allowing the country to utilize its trade and transit potential. With a capital adequacy ratio of above 20 percent, the banking sector is well-placed to support businesses if opportunities emerge. Remittances are also expected to recover in 2016 and add to demand. Gold production and exports should benefit from stable gold prices and the commissioning of new mines. The accession to the BKR CU will affect non-gold exports by increasing input costs; however easier access to CU markets and preferential access to the Russian market may off-set some of the negative impact (Box 2).

Box 1: Public Investment Program

The Kyrgyz authorities have initiated a large Public Investment Program (PIP) to upgrade critical infrastructure in the country which will increase the fiscal deficit and public debt levels. The value of PIP projects to be implemented during 2015-2017 is above US\$2 billion, with most resources being allocated to transport (US\$900 million) and energy (US\$630 million). The largest projects involve improving road and energy connectivity between the North and South of the country, road connectivity on major regional trade corridors, as well as upgrades of critical energy generation infrastructure (rehabilitation of the Combined Heat and Power plant in Bishkek, and the Toktogul and Kambarata 2 hydro power plants). China has emerged as a major source of financing for PIP projects, financing around 40 percent of the PIP. Other important financiers include Asian Development Bank (ADB), Eurasian Development Bank, the World Bank and the Islamic Development Bank.

With the Kyrgyz Republic being a land-locked country and its quality of infrastructure ranked at 96th place globally (Global Competitiveness Report), there is a need to upgrade the infrastructure stock and the focus on roads and energy appears appropriate. The largest projects are part of the country's National Sustainable Development Strategy and sector strategies. Still, the recent Public Expenditure Review (PER) found that weaknesses in public investment management limit the gains from higher investments. Few domestically-financed projects are subject to rigorous appraisal and there are no systematic procedures to select projects and monitor implementation. Donor-financed projects, which comprise the bulk of public investment, are subject to more rigorous project cycle management; however, it appears that the quality of procedures varies considerably. Most projects have feasibility studies which indicate rates of return above generally accepted thresholds; however, not all of them are publicly available. Debt management capacity is only gradually developing in the Kyrgyz Republic and the development of a sound and comprehensive debt strategy that would cover the broader public sector is still at early stages. To improve debt management, the government is updating its public debt strategy and strengthening its ability to monitor developments in the 10 largest state-owned enterprises.

21. The government's medium-term fiscal framework envisages an investment-led expansion addressing critical investment needs in energy and transport. This will bring the

fiscal deficit up to 7.7 percent of GDP in 2015 before reducing it to four percent of GDP by 2017.⁵ China has become an important financing source, providing most of the financing needs with the World Bank, the ADB, the Eurasian Development Bank and other partners covering the remaining financing needs (Table 3). While supportive of growth, stronger public sector spending will significantly increase public debt which is projected to peak at around 63 percent of GDP by 2017, up from 48 percent of GDP at end-2013. The rapid increase in public debt will significantly limit the ability of the authorities to respond to potential shocks or undertake new larger projects without increasing the risk of debt distress in the future.

Table 2: Fiscal Accounts

(in percent of GDP)

	2012	2013	2014	2015	2016	2017
	Act.	Act.	Est.	Proj.	Proj.	Proj.
<u>Total revenue and grants</u>	33.7	33.9	34.9	33.5	32.9	32.3
Tax revenues	25.5	25.6	25.3	25.7	25.8	25.8
Non-tax revenues	5.7	5.8	7.3	5.4	5.2	5.2
Grants	2.5	2.5	2.4	2.5	1.9	1.4
<u>Total expenditures</u>	39.4	37.7	40.6	41.3	38.4	36.3
Current expenditure	31.8	30.5	30.7	29.7	28.7	28.1
Wages	8.7	8.0	8.2	7.6	7.5	7.4
Transfers and subsidies	3.5	3.5	3.6	3.1	2.8	2.6
Social Fund expenditures	9.5	9.4	9.6	9.7	9.4	9.3
Interest	0.9	0.9	0.9	1.0	1.0	1.0
Goods and services	9.1	8.8	8.4	8.2	8.0	7.8
Capital expenditure and net lending	7.6	7.1	9.9	11.5	9.7	8.2
o/w foreign financed	6.6	5.1	6.5	9.1	7.9	5.8
<u>Overall balance</u>	-5.7	-3.8	-5.7	-7.7	-5.5	-4.0

Source: Bank staff calculations based on data from national authorities

Note: Revenues and expenditure exclude social contributions for general government employees

22. **A strong consolidation effort is envisaged for the non-investment budget.** Excluding capital spending, the budget is projected to run a surplus of around 4.1 percent of GDP on average between 2015 and 2017 compared to only 1.1 percent of GDP during 2012-2013. The bulk of the adjustment is envisioned from wage freezes for most of the public sector (some increases are envisaged for limited sectors) as well as non-indexation of most of the social transfers. Ongoing early reforms in education (roll-out of per-capita financing) also have the potential to improve outcomes while generating savings. Savings are also expected from more transparent purchases of goods and services as the new public procurement framework, supported under the earlier DPO-series, is implemented. On the revenue side, the authorities plan to further increase excise tax rates (expected to add around 0.2-0.3 percent of GDP to revenues) while strengthening administration. A financially viable energy sector supported by this operation is expected to make an important contribution to improved fiscal outcomes, largely thanks to eliminating the need for budgetary transfers (around 0.5 percent of GDP in 2014), but also from increased tax revenues, both from VAT on energy consumption (though these gains may be limited as residential consumption is exempt from VAT) as well as eliminating the need for write-off of tax arrears of energy companies that has taken place in the past.

23. **Monetary policy will need to be responsive to price and exchange rate pressures while financial sector policies should support stability.** Inflation is expected to remain elevated during 2015-2017 as prices adjust to the exchange rate developments and the energy prices are

⁵ Excluding on-lending, the projected deficit is 3.3 percent of GDP in 2015 falling to 2.3 percent of GDP by 2017.

gradually increased. Still, the NBKR remains committed to price stability and keeping inflation in single digits and recent actions give credibility to this commitment. Maintaining the flexible exchange rate regime should preserve the economy's competitiveness, though interventions are likely to continue as the NBKR tries to smooth the volatility. Furthermore, improvements in the transmission mechanism for monetary policy should enable the NBKR to more effectively steer the economy. Better supervision and regulation of the financial sector, also supported by the Bank's Financial Sector Development Project, will help increase credit availability and keep risks manageable.

Table 3: Financing Needs and Sources

(in percent of GDP)

Fiscal Financing					External Financing				
	2014	2015	2016	2017		2014	2015	2016	2017
	Est.	Proj.	Proj.	Proj.		Est.	Proj.	Proj.	Proj.
<u>Requirements</u>	6.7	9.0	6.8	5.3	<u>Requirements</u>	12.6	19.1	17.4	16.1
Deficit	5.7	7.7	5.5	4.0	CAD	12.5	14.2	13.3	12.4
Amortization	1.0	1.2	1.3	1.3	Amortization*	2.9	2.8	2.5	2.1
					Reserves	-2.8	2.1	1.6	1.6
<u>Sources</u>	6.7	9.0	6.8	5.3	Sources	12.6	19.1	17.4	16.1
Loans	6.5	8.8	6.8	5.2	FDI	3.1	6.9	6.8	6.7
PIP	5.5	8.3	6.3	4.7	Disbursements	6.0	8.7	8.5	7.4
Budget sup.	1.0	0.5	0.5	0.5	Capital inflows	3.5	3.4	2.1	2.1
Privatization	0.0	0.0	0.0	0.0	Other flows*	0.0	0.0	0.0	0.0
Domestic*	0.2	0.1	0.0	0.1					

Source: Bank staff calculations based on data from Ministry of Finance, NSC and IMF.

*/ negative value refers to deposits increase.

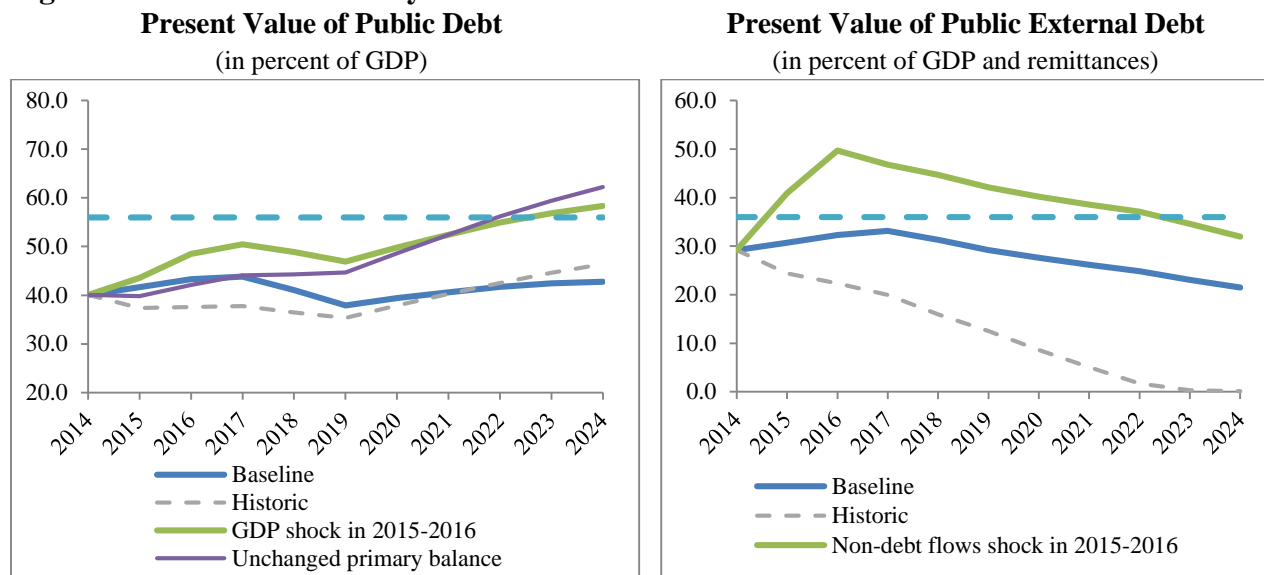
Source: Bank staff calculations based on data from Ministry of Finance, NSC and IMF.

*/ includes errors and omissions.

24. **The current account deficit (CAD) will remain high and will be fully financed with increased FDI and concessional borrowing.** Exports are expected to grow slightly as higher gold production and improved access to the CU markets off-set the declining re-exports and higher input costs. Transfers are expected to recover in 2016 as growth recovers in key migrant destinations (Russia and Kazakhstan). Investments to upgrade the capital stock, financed by FDI and public borrowing, will keep imports and the current account deficit high in the next few years. Under a reform scenario and given the proximity to China, access to markets in Russia and Kazakhstan, and low labor costs, the Kyrgyz Republic is well positioned to attract increasing investments. Trade credits and loans will cover the remaining financing gap (Table 3).

25. **According to the 2014 debt sustainability analysis (DSA), the country remains at a moderate risk of debt distress, but vulnerability has considerably increased.** Under the current fiscal framework and with growth rates over the medium-term reduced, debt will be increasing over the next couple of years and stabilize afterwards at slightly lower levels. Similarly, external debt levels are expected to increase over the medium-term. Despite the increase in debt levels, the country does not breach the sustainability threshold under the baseline and historic scenarios thanks to the concessional nature of debt. However, risks have increased with the country either coming close to or breaching the sustainability thresholds under several alternative scenarios, including further delays in consolidation of fiscal accounts, lower GDP growth or non-debt flows (FDI or transfers), stronger som depreciation or growing non-concessional borrowing. Given the uncertain external environment and the country's exposure to various shocks, the probability of these scenarios materializing has increased and could see the country move to high risk of debt distress.

Figure 1: 2014 DSA Summary Charts



Source: Bank-Fund 2014 DSA update.

26. **Despite elevated risks, the macroeconomic policy framework is considered adequate for the current operation.** The current set of macroeconomic policies strike a balance between the need to protect social spending, address critical infrastructure bottlenecks and maintain stability. The fiscal balance is largely in line with targets and government deposits provide a decent liquidity buffer. Monetary policy has, in general, responded adequately to the challenging environment as it tightened monetary conditions and allowed for depreciation of the som. The external imbalance has narrowed while the increase in inflation appears to be largely in response to exchange rate developments and supply factors.

27. **Downside risks to this outlook are significant, both external and domestic.** Remittances have so far been resilient to the slowdown in Russia (source of around 95 percent of private transfers), but a protracted slowdown, the current slide in oil prices and larger tensions with Ukraine could push consumption and investment in Russia into contraction, and therefore will lower remittances and exports and may result in return of jobless migrants. Next, terms-of-trade shocks also exist; a 10 percent reduction in the gold price will reduce exports by 1 percent of GDP; though some relief is expected from the lower food and oil prices. The geopolitical situation in the region remains fragile and could become more so after the pull-out of North-Atlantic Treaty Organization (NATO) troops from Afghanistan. Domestically, the still evolving political institutions may limit the ability of the government to implement reforms and test the commitment to prudent macroeconomic policies. The country has limited instruments to effectively respond to these risks in case they materialize which may expose it to a scenario of lower growth, higher inflation and increased social pressures.

Box 2: Implications of Accession to the BKR CU

On May 30, 2014, representatives of the Kyrgyz government and the leaders of the Eurasia Customs Union signed the roadmap on the Kyrgyz accession to the BKR CU. The Roadmap contains legislative amendments and infrastructure upgrades that would enable the Kyrgyz Republic to implement the regulations of the CU. The authorities are targeting January 1, 2015, as the date of accession; however, this may be too ambitious. To support the adjustments, the Kyrgyz and Russian governments reached an agreement on a US\$200 million grant facility to support the implementation of the Roadmap and a US\$1 billion concessional credit facility to finance development projects in the Kyrgyz Republic. The agreement on the facility was signed in November, 2014.

The accession of the Kyrgyz Republic to the CU is likely to significantly transform the Kyrgyz economy, generating risks and opportunities. Adoption of the BKR CU Common External Tariff will increase the Kyrgyz tariffs, in a number of cases above the Kyrgyz Republic's World Trade Organization (WTO) bound rates, which will have a one-off impact over domestic inflation. Also, the accession to the CU will reduce the scope for application of the simplified customs clearance. The simple and cheap method of clearing goods has been an important factor contributing to the growth of re-exports trade and the garments industry, the latter being a key employer and foreign exchange earner in the country. For the garments sector, this will lead to increased tariffs on imports and more formalization at the border, both of which can be expected to increase costs and hence reduce the industry's competitiveness. Recent simulations by the World Bank suggest that production costs may increase between 3.6 percent and 7.7 percent, or perhaps even more. Re-exports, already declining for some time due to more rigorous application of CU requirements by Kazakhstan, will also be affected.

The accession will also provide opportunities for Kyrgyz exporters, especially in food products and investment opportunities. Opening borders to Kazakhstan and Russia can improve trade facilitation and reduce trading costs. However, failure to meet CU standards and technical regulations may dent export opportunities. Similarly, businesses may be attracted by the somewhat more liberal business environment in the Kyrgyz economy compared to BKR CU members, although key aspects of the investment climate still remain difficult. It is also expected that CU accession will improve reliability of energy supplies, preserve preferential rates and improve the status of migrants.

28. **Fiscal policies will need to be adjusted in case risks to stability materialize.** While authorities have expressed commitment to macroeconomic stability, capacity to translate this into actual policies is still evolving and the authorities have largely relied on ad-hoc interventions to meet policy targets. Keeping the external public debt below 60 percent of GDP may require a delay in the execution of some PIP projects and a careful selection process of new projects.

29. **Without reforms in public service delivery, additional spending pressures may emerge from current spending.** While effective in the short-term, freezes on spending may undermine the sustainability of the consolidation, especially with Parliamentary elections scheduled for the second half of 2015. Higher spending may push the overall deficit up by around 1 percent of GDP and public debt to 65 percent of GDP by 2017. While strong government deposits at the moment would allow the authorities to finance higher spending in 2015; solvency could be put into question if the spending increases translate into permanent fixtures of the budget. Instead of unsustainable freezes, public expenditure reforms, including those identified in the recently completed PER, are needed to generate savings and improve outcomes of public spending. Wage freezes should be replaced with the commitment to implement the 2013 Civil Service reform package. Social protection and pensions policies need to be revamped, while education and health reforms extended to provide more authority and accountability to service providers. On the revenue side, bolder efforts in reforming the patent regimes and reducing VAT exemptions may be needed to ensure a robust revenue outturn, promote greater equity in taxation and reduce incentives for informality.

30. **While recent steps by NBKR demonstrate commitment, extended pressures on price and external stability will test NBKR's resolve.** The external environment is likely to remain volatile resulting in pressures on the som. Furthermore, inability to tightly control current fiscal

spending may also increase demand pressures. Preserving stability will require strict implementation of the monetary framework and adherence to the floating exchange regime with interventions limited to smooth volatility.

31. **Failure to rein in credit growth and strengthen NBKR's capacity to supervise the sector could increase risks to financial sector stability.** Despite some moderation recently, growth rates of credit to the private sector remain high and an abrupt disruption of economic activity may put some banks in difficulties and the NBKR in a protracted process of resolving problem banks. In the short-term, though the balance sheets of banks seem relatively sound and partly mitigate risks; NBKR may need to take additional measures (further tightening monetary conditions, macroprudential actions and closer surveillance) in case growth rates remain high. Over the medium-term, strengthened role of NBKR in regulating and supervising the financial sector and in resolving problem banks should also help in lowering risks to the sector.

2.3 IMF RELATIONS

32. **The authorities completed a three-year Extended Credit Facility (ECF) in mid-2014 and have initiated discussions on a new arrangement.** The IMF approved an ECF in June 2011 to support economic recovery in the short term and a stronger, sustained and inclusive growth in the medium-term by promoting gradual fiscal consolidation and strengthening of the financial sector. The final review of the ECF was successfully completed in June 2014. Discussions on a new arrangement were initiated in late October 2014 with the focus on the financial sector, tax policy and public finance management. The discussions are expected to continue in early 2015. World Bank and IMF staff collaborate closely resulting in largely shared views of the economic situation and development priorities, including in the energy sector, the need to strengthen public investment and debt management and safeguard sustainability. The IMF's assessment of the current situation is provided in Annex 2 to this document.

3. THE GOVERNMENT'S PROGRAM

3.1 ENERGY SECTOR CHALLENGES

33. **The energy sector of the Kyrgyz Republic, largely publicly owned, is relatively large and has significant growth potential.** The sector accounts for about four percent of GDP and 16 percent of the industrial production, and its performance is critical for the performance of the Kyrgyz economy. The power sector has significant potential for exports that is unrealized. Other advantages of the power sector are relatively low cost of power generation, reliance on clean sources of energy, and the near universal access to power supply.

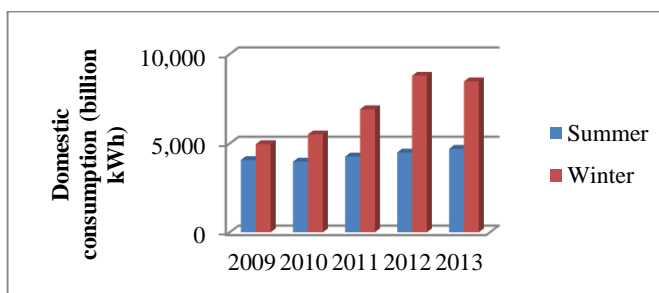
34. **Yet, the energy sector faces chronic crisis, which gets aggravated during years of poor hydrology.** Serious winter energy shortages are expected during the 2014/15 heating season due to a combination of factors, including: (i) significantly reduced water inflows in Toktogul reservoir caused by insufficient precipitation and glacier melting; (ii) low levels of coal and fuel oil reserves due to the dire financial condition of the energy sector; and (iii) significant growth of power demand in recent years, especially in winter months (Box 3).

Box 3: Factors behind the Anticipated 2014/15 Winter Energy Crisis

The Kyrgyz power sector is dominated by hydro generation and is therefore highly susceptible to variations in hydrology. The installed capacity of the power system is 3,786 MW, of which 3,070MW is hydro. Hydropower plants account for more than 90 percent of gross generation with the balance provided by two combined heat and power (CHP) plants. Winter power generation critically depends on the water level of Toktogul reservoir. During January-September 2014, the water inflows to the reservoir were 30 percent lower than the historical average (from 1979-2013); as of September 1, 2014, the water level of the reservoir was about 16 percent lower than the historical average.

Poor hydrology also impacts the sector's ability to procure coal and fuel oil reserves used by the CHP plants. Due to the low hydrology, the energy sector incurred significant financial losses in 2014, which are estimated to be around US\$90 million. This includes foregone power export revenues of about US\$60 million, costs of additional imports from Tajikistan in summer 2014 to preserve the water level in Toktogul reservoir, and the costs of additional generation of CHP plants that will be required to meet power and heat supply needs for the coming heating season. As a result, the dire financial condition of the sector has impacted the sector's ability to purchase sufficient coal and fuel oil reserves for the upcoming heating season. As of July 1, 2014, the coal reserves for Bishkek CHP were 59 percent lower compared to the reserves of the past three years, while fuel oil reserves for Bishkek and Osh CHPs were 47 percent lower. Coal, gas and fuel oil are the main fuel types used for district heating, accounting for about 76 percent, 12 percent and 8 percent respectively of the fuel consumed by the heating companies. In addition, about 40 percent of the urban households and around 75 percent of the rural households rely on furnaces primarily fueled by either coal or traditional wood-based biomass.

The significant growth in power demand has increased the sector's vulnerability to poor hydrology. From 2009 to 2013, power demand grew by 31 percent, with 84 percent of this growth occurring during winter months. With the increased demand, the sector is expected to incur power shortages equivalent to 1.5 to 2 months of winter consumption.



35. **Underlying the energy sector crisis are structural challenges that result in poor operational and financial performance of the sector.** The principal challenges of the sector include: (i) financial viability; (ii) power and heat supply reliability; (iii) affordability in future years; and (iv) governance of the sector. These challenges are interlinked. Financially weak energy sector companies are unable to properly maintain and invest in their assets, which leads to further deterioration of the aging energy infrastructure. The deterioration of assets eventually affects reliability and quality of energy supply. As a consequence, customers are unwilling to accept tariff increases necessary to improve energy companies' financial performance. Poorly targeted subsidy schemes also make it difficult to increase tariffs, as some customers are particularly vulnerable to tariff increases. In addition, weak sector governance exacerbates the poor operational and financial performance of the sector undermining public trust and acceptance of energy reforms.

36. **Low energy tariffs are the main source of the poor financial condition of the energy sector.** In the power sector, below cost recovery tariffs account for about 79 percent of the energy sector financial deficit, followed by losses (13 percent) and non-payment (8 percent). The power sector's actual costs incurred per kilowatt hour of domestic consumption were, on average, 35 percent higher than the average cash collected from domestic end-users. The gap between actual costs and cash collections are a result of low tariffs, which fail to reflect recurrent costs, let alone full costs of power and heat supply. Similarly, in the heating sector, residential end-user tariffs were more than six times below the short-term cost recovery contributing to the large financial deficit in the sector.

37. **Energy supply is unreliable because of aged and worn out energy assets and significant growth of power demand.** The four power distribution companies combined reported an average of 43 power outages per day between 2009 and 2012 with outages occurring predominantly in winter months. Service quality is also poor, as demonstrated by regular voltage and frequency fluctuations of power supply. Poor supply reliability and quality, as well as high technical losses are a result of the condition and age of assets. Power generation assets are on average 34 years old; fifty percent of the transmission substations are over 25 years old, and 18 percent of the transmission lines are over 40 years old. Likewise, the assets in the heating sector were commissioned some 20-40 years ago and are severely under-maintained with heat losses in excess of 25 percent and operational capacity of heat generation facilities constrained to only 20 to 50 percent of design capacity. Growth in power consumption has begun to strain the capacity of power sector assets, aggravating problems caused by the condition of assets. From 2009 to 2013, winter power consumption grew by 84 percent.

38. **Energy affordability could be a challenge in the future due to poor targeting of social safety nets.** Household expenditure on energy is lower in the Kyrgyz Republic than in most countries in the ECA region. Electricity spending accounts for 2.4 percent of household expenditure, while heating expenditure amount to about 2.3 percent of household expenditure. The social safety net in the Kyrgyz Republic is extensive, but not well targeted. The country spends a relatively high proportion of GDP on social assistance – 2.4 percent in 2013 – above the ECA regional average and significantly higher compared to peer countries. Only one of the social assistance programs – the Monthly Benefit for Poor Families (MBPF) with children – explicitly targets the poor, and its coverage is low. The MBPF covers less than one-third of the poorest 20 percent of the population and subsidizes only about 10 percent of their total consumption. Other social assistance programs are aimed at certain social categories, such as households with widows or disabled children. These other programs absorbed around 1.8 percent of GDP in 2013.

39. **Many of the financial and operational challenges in the energy sector can be attributed to problems with regulation and governance at both sectoral and company levels.** At the sectoral level, some of the key governance issues include: (i) overlapping roles and responsibilities in policy-making, ownership and regulation of the sector; (ii) sub-optimal contractual and settlement arrangements, which impede transparency and accountability of flow of funds and electricity, and undermine incentives for sector companies to improve operational and financial performance; (iii) unpredictable expenditure planning, which is done on a year-to-year basis, and largely in a reactive manner rather than by prioritizing investments based on transparent criteria and forward-looking sector planning; and (iv) an ambiguous regulatory environment, including absence of clearly defined and transparent mechanisms for setting tariffs. At the company level, manifestations of poor governance include deficient internal control systems, inadequate corporate resource management and customer information systems, which are largely based on manual entry and are not integrated, aggravating issues related to lack of accountability, transparency and data reliability.

3.2 GOVERNMENT PROGRAM

40. **Kyrgyz authorities are undertaking significant reforms to address the energy sector challenges.** These measures are anchored in the Power Sector Development Strategy for 2012-2017, the detailed Action Plan for Reforming the Energy Sector in 2013-14, which aims to operationalize implementation of the strategy and coordinate donor support, and the recently

amended sector laws. Key measures envisaged by the Strategy include: (i) strengthening the governance, transparency and accountability of the energy sector and companies; (ii) implementation of a medium-term tariff policy; and (iii) a number of important energy investments, including those aimed at expansion of regional trade and cooperation. The looming energy crisis provided significant impetus for structural reforms; the Government made a conscious decision and initiated several important steps to address winter energy shortages and broader energy supply reliability issues in a sustainable manner. With recent amendments in the key sector legislation, tariff reforms were depoliticized by removing the requirement for parliamentary approval of end-user tariff changes for the power sector. The amendments also created a legal basis for clearly delineating roles and responsibilities in the energy sector, concentrating economic regulatory functions in a single entity and establishing an independent settlement center. These are all bold actions given the stalled reform efforts in the past, particularly the inability of the Government to raise residential electricity and heating tariffs since 2008.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

41. **The proposed ESDPO is designed to support selected reforms of the Government's Energy Sector Action Plan.** The operation will focus on three policy areas: (i) improving financial viability of the energy sector through tariff reforms; (ii) strengthening sector governance, transparency and accountability through establishment of an economic regulator, adoption of a clearly defined tariff setting methodology, implementation of a performance reporting and monitoring framework, and public outreach and communication; and (iii) managing the impact of power shortages on the poor regions through preparation and implementation of power supply management plans for the regions based on the principles of transparency, equitability, predictability, and preservation of essential services.

42. **The policy areas of the proposed ESDPO are interlinked and essential for addressing energy supply reliability in a sustainable manner.** Improved financial viability of the energy sector through power and heating tariff reforms will allow investments in maintenance and system improvements, and procurement of fuel for the CHP plants. The reduction of the gap between the tariffs and the costs of power and heat supply will also improve price signals and create incentives for energy conservation, thus, managing the future demand growth. Strengthened governance, transparency and accountability of the sector will ensure that increased revenues are not mismanaged and lead to improvements of sector operational and financial performance. In addition, more rigorous reporting, monitoring and communication will ensure successful implementation of tariff reforms and broader stakeholder support. Finally, the management of power shortages will ensure that power rationing is equitable across the country and is not to the detriment of poor regions. The ESDPO supported reforms will lay foundations for improving reliability and quality of energy supply, which in turn is important for promoting economic growth, reducing poverty and promoting shared prosperity.

43. **The improvement of energy supply reliability will require medium- to long-term consistent reforms by the Government, some of which could be supported by the future DPOs.** These may include enactment of electricity and heat tariff increases in 2016 and 2017 based on the MTTP; adoption of a new multi-year tariff framework by 2017 to ensure that the phased tariff reforms are implemented in a consistent manner; establishment of a predictable tariff

setting methodology and performance reporting and monitoring framework for the heating sector; and enhancement of the institutional capacity and independence of the economic regulator. These reforms would need to be accompanied with improvement of the social protection system to ensure that a basic level of electricity and heat consumption remain affordable for the poor households.

44. **The design of the ESDPO draws on the experience of previous energy sector operations and the first series of DPOs in the Kyrgyz Republic.** The proposed operation incorporates the following key lessons: (i) support complex and politically difficult reforms through a dedicated sector DPO; (ii) concentrate on few policy areas that are fundamental for addressing sector key challenges and have full ownership of the Government; and (iii) complement the DPO with other instruments for Bank support, including investment project financing, technical assistance and economic and sector work.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Policy Area 1: Improving the Financial Viability of the Sector

Prior Action 1.1: The Recipient has approved the MTTP for electricity and heating for 2014-2017.

Prior Action 1.2: The Recipient through the State Regulatory Agency of the Fuel and Energy Complex has approved changes in electricity end-user tariffs for: (a) December 11, 2014-March 31, 2015, and (b) April 1, 2015.

Prior Action 1.3: The Recipient through the State Regulatory Agency of the Fuel and Energy Complex has approved changes in district heating and hot water end-user tariffs for: (a) December 11, 2014-March 31, 2015, and (b) April 1, 2015.

45. **Improving the financial condition of the energy sector will be a major stride for improving energy supply reliability.** Tariffs set well below the cost-recovery level are the main source of the financial deficit in the energy sector (see section 3.1). The sum of the fiscal and quasi-fiscal deficit attributed to the power sector alone accounted for about 3 percent of GDP in 2012. In September 2014, the outstanding balance of sovereign-guaranteed debt to the power sector was approximately US\$1.6 billion, representing 45 percent of total public external debt and 22 percent of the GDP in 2013. At the absence of tariff reforms, the financial and operational performance of the power sector will continue to deteriorate with the financial gap projected to reach 12 percent of GDP on a cumulative basis by 2020. The financial condition of the heating sector is similarly poor and largely dependent on extensive cross-subsidies from the power sector. For example, the company transmitting and distributing heat generated by the CHP plant in Bishkek purchases the heat at a price that covers less than a quarter of the heat generation costs. The energy sector financial deficit needs to be addressed to ensure that the sector is able to maintain its assets, make new investments to meet increasing demand and eventually ensure reliable energy supply conducive to economic growth.

46. **The Government has embarked on tariff reforms aimed at a phased increase of end-user energy tariffs.** The Government approved the MTTP for the power and heating sectors for 2014-17 (Resolution No.660, dated November 20, 2014). The MTTP envisages annual tariff increases (Table 4) for different consumer groups so as to achieve short-term cost recovery by

2017⁶. The MTTP envisages a 700kWh monthly threshold for residential electricity consumers beyond which the residential consumers will be charged the short-term cost recovery tariff (assessed for domestic power generation) plus the cost of imported power⁷ during the winter months. The 700kWh threshold is the level of power consumption that can be satisfied through domestic power generation. This threshold is therefore not a lifeline tariff; it is above the average monthly power consumption (667kWh) of households during the 2013/14 winter season. However, it will provide incentives for reducing power consumption. In line with the MTTP, the State Regulatory Agency of the Fuel and Energy Complex (Regulatory Agency) has issued orders (No.44, No.45, No.46 and No.47, dated December 11, 2014) enacting electricity, district heating and hot water tariff increases for 2014 and 2015.

Table 4: Electricity, District Heating and Hot Water Tariff Revisions Envisaged by MTTP

Consumer Categories	Electricity in Som/kWh (US\$/kWh)			District Heating in Som/GCal (US\$/GCal)			Hot Water in Som/GCal (US\$/GCal)		
	Before Increases	After Increases		Before Increases	After Increases		Before Increases	After Increases	
		2015*	2017*		2015*	2017*		2015*	2017*
Residential consumers (below 700kWh consumption for electricity)	0.70 (0.012)	0.84 (0.015)	1.21 (0.021)	n/a	n/a	n/a	n/a	n/a	n/a
Residential consumers (above 700kWh consumption for electricity)	0.70 (0.012)	Weighted average of 1.29 (0.022) + import price	Weighted average of 1.47 (0.026) + import price	715 (12.42)	1134.8 (19.71)	1615.4 (28.06)	518.3 (9.00)	981.8 (17.2)	1615.4 (28.06)
Industrial, Agricultural and Other consumers	1.33 (0.023)	Weighted average of 1.48 (0.026) + import price	Weighted average of 1.69 (0.029) + import price	929.2 (16.14)	1695.1 (29.45)	1981.3 (34.42)	929.2 (16.14)	1695.1 (29.45)	1981.3 (34.42)
Budgetary consumers	1.33 (0.023)	1.48 (0.026)	1.69 (0.029)	929.2 (16.14)	1695.1 (29.45)	1981.3 (34.42)	929.2 (16.14)	1695.1 (29.45)	1981.3 (34.42)
Pumping stations	0.70 (0.012)	0.78 (0.014)	0.89 (0.015)	n/a	n/a	n/a	n/a	n/a	n/a

* Tariff revisions scheduled on April 1 of each year.

47. The Government has committed to increase cash collected per kWh of power generation by 10 percent and cash collected per GCal of heat generated by the Bishkek CHP by 30 percent in 2015. In 2013, cash collected per unit of power and heat generated amounted to 0.59 Som/kWh (US\$0.010/kWh) and 460 Som/GCal (US\$7.99/kWh) respectively. The Government has committed to increase cash collected in the power sector to 0.64 Som/kWh (US\$0.011/kWh) and in the heating sector to 598 Som/Gcal (US\$10.39/GCal) by 2015. To achieve these indicators, tariffs for the power and heating sectors would need to increase as

⁶ The short term cost recovery tariff will allow the power and heating sector companies to recover recurrent expenses as well as the debt service (interest and principal payments) in 2017. It will thus eliminate the financial gap of the two sectors in the short-term. Further tariff increases would be needed to recover the sizable investment needs of the two sectors.

⁷ The Kyrgyz Government is currently negotiating the terms for importing power from Kazakhstan and possibly from Turkmenistan. Preliminary agreements are for import of 1 billion kWh of electricity at a tariff of 5.4 Som/kWh (US\$0.09).

envisaged by the MTTP without deterioration of other operating performance indicators (e.g. losses and collections) from 2013 levels.

***Prior Action 1.4:** The Recipient through: (a) the State Regulatory Department has approved a tariff setting methodology for power sector companies; and (b) the State Regulatory Agency of the Fuel and Energy Complex has established the 2015 tariffs for Electric Power Plants, National Electricity Grid, Severelectro, Vostokelectro, Oshelectro and Jalalabadelectro consistent with this methodology.*⁸

48. Tariff reforms need to be accompanied by a clear and consistently applied methodology. While the MTTP for 2014-17 determines the planned electricity tariff increase for end-users, there is no clearly defined methodology for setting tariffs for power sector companies. The Electricity Law defines tariff setting principles and procedural requirements for setting and revising power tariffs, which reflect good international practices. However, in practice, tariff setting procedures have not followed these principles and have been subject to conflicting methodologies due to overlapping responsibilities in economic regulation. At the absence of a clearly defined tariff setting methodology and given the exceptionally low end-user tariffs, the allocation of revenues between power sector companies has been determined based on frequent negotiations between the Government and the sector companies. This method of tariff setting and revenue distribution makes it difficult for the sector companies to realistically budget operating and maintenance expenses, and to plan capital expenditures. It also undermines incentives for companies to improve their operational performance.

49. The Regulatory Agency has committed to allocate revenues between power sector companies in 2015 based on the tariffs set according to the approved methodology. The Regulatory Agency has developed a methodology that allows setting tariffs for the power sector companies in a transparent and predictable manner. The Agency held public hearings with power sector companies and other stakeholders to discuss the draft methodology on October 26 and 27, 2014 and subsequently finalized and approved it (Order No.32, dated November 10, 2014). The Regulatory Agency issued Order No.50, dated December 15, 2014 approving power sector company tariffs based on this new methodology. The sector revenue in 2015 will be consistently allocated based on the approved tariffs.

Policy Area 2: Enhancing Sector Governance, Transparency and Accountability

***Prior Action 2.1:** The Recipient has established a framework pursuant to which the State Regulatory Agency of the Fuel and Energy Complex shall carry out its economic regulatory functions in the energy sector.*

50. Delineating the roles and responsibilities in the energy sector with respect to ownership, policy making and regulation is important to establish a clear framework for sector regulation and governance. Overlapping responsibilities for sector governance and regulation between Government entities caused confusion and inefficiency. Specifically, there

⁸ The State Regulatory Agency of the Fuel and Energy Complex is the successor of the State Regulatory Department of the Fuel and Energy Complex (which was under the Ministry of Energy and Industry). Depending on the date of the adoption of orders, the prior actions refer either to the State Regulatory Agency or the State Regulatory Department.

was significant overlap between the economic regulatory roles and responsibilities of the Regulatory Department of the Fuel and Energy Complex and the Antimonopoly Agency.

51. The Kyrgyz authorities are implementing reforms to delineate roles and responsibilities and to strengthen sector governance. The Parliament of the Kyrgyz Republic approved amendments to the Law on Energy, the Law on Electricity and the Law on Natural Monopolies on July 19, 2014. The amendments established the overall legal framework for delineating the roles and responsibilities with respect to ownership, policy-making, economic regulation, and technical inspection. The Government approved a resolution on the State Regulatory Agency of the Fuel and Energy Complex (Resolution No.650, dated November 14, 2014) establishing it as the single economic regulator in the energy sector. The resolution prescribes the economic regulatory functions, including licensing, tariff setting, and performance monitoring, entirely and exclusively to the Regulatory Agency. The resolution also specifies the organizational set-up, initial staffing and financing arrangements for the Regulatory Agency.

52. The Government has committed to ensure that the Regulatory Agency is able to perform key economic regulatory functions. The ability of the Regulatory Agency to perform economic regulatory functions will be assessed based on its satisfactory performance of tariff setting and performance reporting and monitoring functions (evidenced by the achievement of the target indicators for prior actions 1.4 and 2.2).

***Prior Action 2.2:** The Recipient through the State Regulatory Department of the Fuel and Energy Complex has approved a performance reporting and monitoring framework for the power sector.*

53. Establishing a performance reporting and monitoring framework can help build customer confidence and reduce opposition to tariff increases. The Qualitative Assessment of Poverty and Social Impacts of Energy Tariff Reforms (World Bank, 2014) indicates that one of the key reasons for public resistance to tariff reforms is the lack of confidence that increased revenues of the sector will translate into improved service quality and reliability. Under the past DPO series, a first step was made to increase the transparency of the power sector by mandating sector companies to publish extensive information on their operational and financial performance. However, the dispersed and changing responsibilities of economic regulation prevented establishment of a systematic monitoring and evaluation framework that would allow adequate tracking of the operational performance of power sector companies, in particular on power supply reliability and quality. Establishing and enforcing a performance monitoring framework will provide a clear path to better governance and accountability. The service quality indicators will need to be regularly published to build consumer confidence in the sector, which is a critical component of willingness to pay, especially in the Kyrgyz Republic.

54. The Regulatory Agency has committed to monitor and quarterly publish service quality indicators based on the approved performance reporting and monitoring framework. The Regulatory Agency developed performance reporting and monitoring regulation, specifying the service quality indicators that the power sector companies need to quarterly report together with their calculation methodology and monitoring arrangements. The Regulatory Agency held public hearings with power sector companies and other stakeholders on October 26 and 27, 2014 to discuss the draft regulation and subsequently finalized and approved it (Order No.33, dated November 10, 2014). The service quality indicators for 2015 will be published on the Regulatory Agency's website on a quarterly basis at the end of the month following the quarter end. After systematically monitoring and evaluating the service quality

indicators for two years, the Regulatory Agency plans to set a baseline for key indicators and define service quality standards against which the power sector companies will be held accountable for.

***Prior Action 2.3:** The Recipient through the State Regulatory Department of the Fuel and Energy Complex has established a working group to conduct public outreach campaigns and institutionalize public hearings on its main economic regulatory decisions in the energy sector.*

55. **Communications is critical in the success of major economic reforms, particularly energy tariff reforms.** As noted by the World Bank Group in its contribution to the G20 Energy Sector Working Group titled “Technical Report on Transitional Policies to Assist the Poor While Phasing Out Inefficient Fossil Fuel Subsidies That Encourage Wasteful Consumption,” regardless of how well planned the transitional measures for subsidy removal are, if an effective communication program is not implemented before, during, and after those measures go into effect, it is very difficult to earn the public’s trust and foster understanding for the political decisions. The experience of the Kyrgyz Republic also highlights this; as a young democracy with influential stakeholder groups (population, parliament, civil society, private sector) tariff reforms cannot be implemented in the country without consensus building. Reforms need to be well-defined and explained in order to generate sufficient public support and understanding of the rationale and longer term benefits associated with the proposed reforms. A well-designed communication is important to enhancing the effectiveness of tariff reforms.

56. **The authorities recognize the importance of increasing public awareness about energy sector challenges and reforms and the need to institutionalize the process of public hearings for important decisions.** As a first step, the Regulatory Agency set up a working group (Order No.31, dated November 10, 2014) that works with a professional firm to initiate and successfully implement a public outreach campaign for the planned reforms in 2014 and 2015. With the support of the professional firm, the working group will institutionalize public hearings for all decisions of the Regulatory Agency affecting economic interests of stakeholders. In 2015, at least two public hearings are planned prior to the enactment of the annual tariff increases for electricity and heating as envisaged by the MTTP. The expected outcomes of a successful public outreach campaign will be increased public awareness about the rationale for energy tariffs reforms. The baseline survey indicates that 17 percent of the respondents are aware about the Government’s energy reform program. A targeted survey will also be conducted after the campaign to measure the change in public awareness. Both the baseline and final survey will include the collection of disaggregated data on gender and income levels.

Policy Area 3: Managing the Impact of Power Shortages on Poor Regions

***Prior Action 3.1:** The Recipient through its Ministry of Energy and Industry has established monitoring and communication arrangements in the power supply management plans of the regions consistent with the Fall-Winter Preparedness Plan 2014-2015.*

57. **While the Government undertakes a set of important measures to address the winter energy shortages, power shortages are inevitable in the short-term and need to be adequately managed.** Based on the water level of Toktogul reservoir, the operational capacity of the existing CHP plants and the projected winter power demand, the power supply deficit is expected to be 2.4 billion kWh, equivalent to about 1.5 months of power consumption. The tariff reforms and accompanying governance and accountability reforms that the Government has

initiated will take time to translate to improved reliability of energy supply and elimination of winter power shortages. The Government therefore is also negotiating with neighboring countries to import power and undertaking measures to adequately manage the expected shortage.

58. **The Government has prepared a Fall-Winter Preparedness Plan that includes power system management plans for each region.** Government issued Decree No.250, dated May 8, 2014 approving the Fall-Winter 2014/15 Winter Preparedness Plan and Decree No.525, dated September 4, 2014 as an addendum to Decree No 250. The two decrees include a set of measures to address the imminent winter power shortages and to minimize the hardship for the population. Adopted measures include the allocation of budget for purchasing fuel for heating of public facilities, bringing the boilers running on coal and fuel oil into an operating condition, completing urgent repairs and maintenance of power and heating assets, etc. Decree No.525 also includes power supply management plans for each region prepared based on a systematic forecast of power supply and demand and resulting deficit. The plans aim to ensure that the distribution of load rationing among regions is equitable (26 percent reduction of peak load is imposed on each region) and that power restrictions are transparent and predictable for consumers. To ensure that power rationing is applied transparently, equitably and predictably across the regions, the Ministry of Energy and Industry has issued Order No.174, dated November 11, 2014 that defines how regional energy consumption will be monitored, how power rationing will be enforced, and how advance notification will be provided to consumers.

59. **The Ministry of Energy and Industry has committed to ensure that power rationing is equitable across the regions.** The equitability of power rationing will be assessed by comparing the regional power consumption in 2014/15 winter season against the regional average power consumption of the previous three winter seasons and ensuring that resulting reduction (in percentage terms) has less than 5 percent difference across the regions.

Table 5: Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Operation Policy Area 1: Improving Sector Financial Viability	
Prior action # 1.1 The Recipient has approved the MTTP for electricity and heating for 2014-2017	Power Sector Note, World Bank, 2014 Tariff Setting Methodology, World Bank, ongoing Urban Heating and Energy Efficiency Assessment, World Bank, 2014
Prior action # 1.2 The Recipient through the State Regulatory Agency of the Fuel and Energy Complex has approved changes in electricity end-user tariffs for: (a) December 11, 2014-March 31, 2015; and (b) April 1, 2015	Power Sector Note, World Bank, 2014 Energy Chapter of Public Expenditure Review, World Bank, 2013
Prior action # 1.3 The Recipient through the State Regulatory Agency of the Fuel and Energy Complex has approved changes in district heating and hot water end-user tariffs for: (a) December 11, 2014-March 31, 2015; and (b) April 1, 2015	Urban Heating and Energy Efficiency Assessment, World Bank, 2014 Tariff Setting Methodology, World Bank, ongoing
Prior action # 1.4 The Recipient through the (i) State Regulatory Agency of the Fuel and Energy Complex has approved a tariff setting methodology for the power sector companies; and (ii) State Regulatory	Tariff Setting Methodology, World Bank, ongoing

Prior actions	Analytical Underpinnings
Agency of the Fuel and Energy Complex has established the 2015 tariffs for Electric Power Plants, National Electricity Grid, Severelectro, Vostokelectro, Oshelectro and Jalalabadelectro consistent with this methodology	
<i>Policy Area 2: Enhancing Sector Governance, Transparency and Accountability</i>	
Prior action # 2.1 The Recipient has established a framework pursuant to which the State Regulatory Agency of the Fuel and Energy Complex shall carry out its economic regulatory functions in the energy sector	Technical assistance under USAID RESET Program (2014)
Prior action # 2.2 The Recipient through the State Regulatory Department of the Fuel and Energy Complex has approved a performance reporting and monitoring framework for the power sector	Tariff Setting Methodology, World Bank, ongoing Qualitative Assessment of Poverty and Social Impacts of Tariff Reforms, World Bank, 2014
Prior action # 2.3 The Recipient through the State Regulatory Department of the Fuel and Energy Complex has established a working group to conduct public outreach campaigns and institutionalize public hearings on its main economic regulatory decisions in the energy sector	Tariff Setting Methodology, World Bank, ongoing Public Information Program for Sector Reforms and Tariffs, ADB, ongoing
<i>Policy Area 3: Managing Impact of Power Shortages on Poor Regions</i>	
Prior action # 3.1 The Recipient through its Ministry of Energy and Industry has established monitoring and communication arrangements in the power supply management plans of the regions consistent with the Fall-Winter Preparedness Plan 2014-2015 .	

4.3 LINK TO CPS AND OTHER BANK OPERATIONS

60. **The ESDPO is aligned with and supports the CPS for 2013-2017.** The operation will directly contribute to the third pillar of the CPS, improvement of management of natural resources and infrastructure, by supporting policy measures that will strengthen governance and management in the energy sector. The operation will also contribute to the second pillar of the CPS, improvement of business environment and investment climate. According to the Business Environment and Enterprise Performance Survey (2014), poor quality of power supply is one of the biggest constraints to the business environment. The improved financial viability of the sector would lead to improved service quality and supply reliability over time, thus helping to improve the business environment.

61. **The operation builds on the energy sector engagement of the World Bank Group,** which is focused on helping the Kyrgyz authorities to strengthen governance and accountability in the sector, and enhance its financial viability (Box 4).

Box 4: The World Bank Group Engagement in the Energy Sector of the Kyrgyz Republic

The World Bank Group (WBG) is engaged in the sector through investment financing operations, analytical and advisory activities, and policy dialogue aimed at addressing the principal challenges in the energy sector. The ESDPO will build on the ongoing WBG engagement, as explained below.

Energy Chapter of the PER (P129309) and the Power Sector Note: The PER and the Sector Note analyzed the key challenges in the power sector of the Kyrgyz Republic and identified a comprehensive package of measures to overcome them. The Government's energy sector reform is guided by the analytical underpinnings of this work. The ESDPO will further support several of the priority measures identified in the PER and the Sector Note, including implementing tariff reforms, establishing a transparent and predictable tariff setting methodology, and setting up a performance reporting and monitoring framework.

Technical Assistance on Tariff Setting Methodology (P146333): The technical assistance supports the Regulatory Agency of the Fuel and Energy Complex in establishing a clear and predictable tariff setting methodology for the power and heating sectors, assessing the distributional impact of tariffs, designing mitigation measures and conducting a communication campaign to generate consensus for tariff reforms. The support provided through this technical assistance will support the Regulatory Agency to implement several of the policy measures of the ESDPO.

Heating and Energy Efficiency Assessment (P133058): The assessment identifies viable heating solutions and energy efficiency measures for the urban building sector of the Kyrgyz Republic that would help the country improve provision of heating services and address winter power shortages. The Government intends to use the findings of the assessment to mobilize investment support from development partners. The tariff reforms supported by the ESDPO will enhance the financial viability of heating and energy efficiency investments and facilitate mobilization of funding.

Electricity Supply Accountability and Reliability Improvement Project (ESARIP) (P133446): The recently approved ESARIP aims to strengthen the governance of the largest distribution company, Severelectro, and improve the reliability of power supply in the project area. To achieve this objective, the ESARIP envisages investments in metering, customer service and corporate management system improvement, distribution infrastructure strengthening, and institutional strengthening and project implementation support. By strengthening the governance and customer service of the largest distribution company, the ESARIP will support implementation of the reforms supported by the ESDPO.

Central Asia South Asia Electricity Transmission and Trade Project (CASA-1000) (P145054): The project aims to facilitate electricity trade between hydropower surplus countries in Central Asia and electricity deficient countries in South Asia by putting in place the commercial and institutional arrangements and the transmission infrastructure required for this trade. Additional export revenues generated through the CASA-1000 will help improve the financial viability of the energy sector while the governance reforms supported through the ESDPO will ensure that these revenues are used in an efficient and accountable

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

62. **The Government developed the Power Sector Development Strategy and the Energy Sector Reform Action Plan through extensive consultations.** The inclusiveness and consultations while still nascent are becoming institutional features of the Government. In line with the current practice in the country, all legal and regulatory changes are shared with the public for discussion via the Government's or the Ministry of Energy and Industry's website. The Energy Sector Reform Action Plan was prepared through extensive consultations with the donor working group, and with the Fuel and Energy Transparency Initiative, a partnership of civil society organizations and the Government aimed at increasing transparency, accountability and opportunities of civic engagement in the energy sector. The Energy Sector Reform Action Plan therefore has broad stakeholder support and the development partners support implementation of measures outlined in the Action Plan.

63. **The Bank closely collaborated with development partners on the design of the ESDPO.** The Bank has closely coordinated the design of the DPO with the energy sector donor working group represented by ADB, the World Bank, Japan International Cooperation Agency, Germany Development Bank (KfW), and the United States Agency for International

Development (USAID). ADB is supporting the Government with a public awareness campaign to increase the overall awareness of energy sector challenges and reforms that are implemented to address them. The USAID supported preparation of recent amendments to the energy sector laws, which were approved by the Parliament on July 19, 2014. The Eurasian Development Bank renewed its US\$30 million rolling credit line to the main generation company Electric Power Plants to finance preparations for the upcoming winter season.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

64. The analysis assesses the impact of higher electricity tariffs and the impact of increased district heating and hot water tariffs planned for 2015 for residential customers. The focus of the analysis⁹ is on estimating quantitative first round effect of the proposed tariff increases in the short run¹⁰, with the following scenarios being considered separately: (i) electricity price increase of 20 percent; and (ii) district heating tariff increase of 44 percent and hot water tariff increase of 59 percent.

Electricity

65. **Electricity tariff increases planned in 2015 are estimated to have a modest but slightly regressive impact on household expenditures.** In order to get the “worst case” scenario, the impact of tariff increases was estimated without a reduction in the power consumption (in volume terms). If this was to occur, the estimated reduction in real household income would be 0.5 percent for the bottom 40 percent. This presents an upper bound since generally consumption behavior changes when prices rise. Also in the case of the Kyrgyz Republic, given the large increase in electricity consumption over the last few years, there may be opportunities for households to roll back some of their increased usage of electricity. The impact of the tariff increases is likely to be moderately regressive with the lowest quintile experiencing a 0.6 percent reduction in income compared to 0.5 for the top quintile.

Table 6: Electricity spending after price increase, by income quintile, 2015 – in percent

	Quintile					Average
	Lowest	Second	Third	Fourth	Top	
Share of electricity spending in total expenditures AFTER price increase	3.5	2.9	2.8	2.9	2.8	3.0
Reduction in real household income	0.6	0.5	0.5	0.5	0.5	0.5

Source: World Bank calculations based on KIHS

66. **Poverty is estimated to increase on average by 0.7 percentage points due to the increase in electricity tariff, assuming no change in the residential electricity consumption behavior.** As indicated in the previous paragraph, the estimates of the poverty impact are based on the assumption that households continue to consume the same amount of electricity pre- and

⁹ The basis for the analysis is the Kyrgyzstan Integrated Household Survey (KIHS) data for 2012 administered by National Statistical Committee of the Kyrgyz Republic. This survey contains data on electricity and heat consumption by households, which is used in the current analysis, preserving the 2012 patterns of electricity spending and total consumption as a baseline. The simulations adopt forward looking approach i.e. the impact of energy price increases in 2015 is estimated, taking into account the effect of growing GDP and related increase in household’s total expenditure.

¹⁰ The impact of electricity and heat tariffs reform will also have significant economy wide impact, affecting relative prices, aggregate demand, labor market etc., creating second round effect, which is not focus of the current PSIA.

post-tariff increases. If this were indeed to happen, the incidence of poverty would increase with the biggest impact occurring in the two of the poorest oblasts (Jalal-Abad and Naryn) and in the capital and relatively affluent city of Bishkek. These three areas would see an increase in poverty rates of 1.1 to 1.5 percentage points.

Table 7: Change in Absolute Poverty Rates after Electricity Price Increase – in percent

Oblast	Absolute poverty rate, baseline 2012	Absolute poverty rate AFTER electricity price increase
Issyk-kul	28.1	28.4
Jalal-Abad	55.8	57.3
Naryn	39.9	41.0
Batken	34.2	34.5
Osh	51.4	51.6
Talas	39.6	40.2
Chui	16.6	16.6
Bishkek	21.4	22.9

Source: World Bank calculations based on KIHS

District Heating and Hot Water

67. **Only a small portion of the population has access to district heating and hot water.** The majority of the households connected to the district heating system are located in Bishkek - the city with the lowest poverty rate in the country (20 percent). An estimated 16 percent of the total population (or 14 percent of all households) and 8 percent of the poor live in Bishkek. Thus, the increase in district heating and hot water tariffs will affect a small portion of the overall poor since the majority of households use other forms of energy for heating.

68. **The increase in tariffs for district heating and hot water tariffs by 44 and 59 percent respectively will have a marginal impact on the level of poverty.** Due to the lack of metering and temperature controls, households are unable to measure and adjust their consumption. Consequently, “norm-based” billing is applied that uses a formula based on the size of the unit and the number of registered persons. This means that there is no price elasticity of consumption. As can be seen in the table below, which depicts the result of simulations, the tariff increases result in the share of heating expenditures in total expenditures increasing from 2.4 percent to 3.2 percent for district heating and from 2.0 to 3.2 percent for hot water for those households connected to district heating – a relatively moderate impact. The decrease in real income is also limited with 0.9 percent for district heating and 1.3 percent for hot water on average for the poorest quintile of the population.

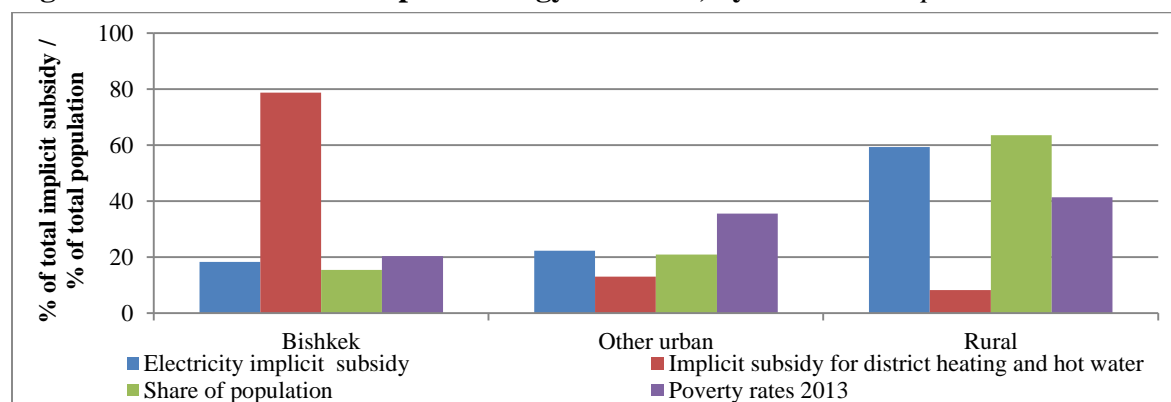
Table 8: Implication of District Heating and Hot Water Tariffs Increase on Household Spending and Incomes (only households connected to central heating and hot water), 2015 – in percent

	Quintile					Average
	Lowest	Second	Third	Fourth	Top	
Expenditures in total household expenditures						
w/ Old Tariff Prior to Medium-Term Tariff Policy						
For District Heating	2.4	2.1	2.2	2.2	2.5	2.4
For Hot Water	2.2	2.1	2.2	2.1	1.7	2.0
w/ New Tariff						
For District Heating	3.2	2.9	3.0	3.0	3.5	3.2
For Hot Water	3.5	3.4	3.6	3.3	2.7	3.2
Decrease in real income						
w/ New Tariff						
For District Heating	0.9	0.8	0.8	0.8	0.9	0.8
For Hot Water	1.3	1.3	1.4	1.3	1.0	1.2

Source: World Bank calculations based on KIHS

69. **The increase in tariffs implies a decrease in subsidies to households; some poor households will be affected, though the main impact will be mainly on the non-poor.** Most of the households connected to district heating are located in Bishkek and are non-poor. The higher tariffs will reduce the total amount of the implicit subsidies for district heating and hot water; the distributional impact of the implicit subsidy remains unchanged after the tariff increase as the absence of metering and norm-based billing means customers do not adjust their district heating and hot water consumption according to affordability.

Figure 2: Distribution of implicit energy subsidies, by location – in percent



Source: World Bank calculations based on KIHS

70. **At the absence of tariff and governance reforms and without adequate management of power shortages, however, the poverty implications will be more severe.** If the energy sector's fiscal sustainability is not addressed, there will be further power supply shortages. Tariff and governance reforms are critical to ensuring reliable supply of energy. In the Kyrgyz Republic, alternatives to power and district heating supply are limited, especially for the urban population, who cannot easily switch to other sources of energy. Shortages in power supply will also likely increase the price of alternative fuels such as coal, kerosene, and firewood - which are an important source for heating and cooking, especially in rural areas. In addition, energy shortages would also indirectly affect small businesses and thus, employment, as they may be unable to

afford back-up options for power and heat supply (e.g., diesel generators). While the exact quantitative poverty impact of electricity shortages is difficult to estimate, based on data from 2009-2010 (when the Kyrgyz Republic experienced a similar situation), the poverty rate increased by 2-3 percentage points, due to, among other factors, problems in energy supply.

Social Impacts

71. **While the social impact of the proposed operation in the short-term is limited, the ESDPO could contribute to generate a positive social impact in the longer term, especially for women.** Overall, the reforms supported by the operation, including tariff increases, will have similar impacts on men and women. At the same time, the Qualitative Assessment of Poverty and Social Impacts of Tariff Reforms (World Bank, 2014) indicated that women generally receive less information and are less aware of energy reforms. Women may thus have different and more acute needs in terms of receiving information on energy sector reform initiatives in the Kyrgyz Republic. The nationally representative surveys that will be conducted prior and subsequent to the public communication campaign will assess the change in awareness and acceptance of energy reforms and will provide disaggregated data by gender and income level. In the medium- to long-term, the improvement of energy supply reliability will have positive social impact, especially for women. Women spend significantly more time at home than men. Labor force survey data (2012) indicated that 23 percent of adult women report housekeeping as their main activity, this compares to only 1 percent for men. Within the household, it is almost exclusively women's responsibility to do housekeeping chores, such as cooking, cleaning, laundering, ironing, and repairing of clothing. Thus, women are the major users of household electricity, and frequent and prolonged power interruptions affect them more acutely and increase their time burden. The time and energy burden of household tasks reduces women's time for educational pursuits, income-generating activities, and family and community activities. Reliability of electricity supply (lighting) in public spaces, such as on streets and in bus stops, would also create a safer environment for women.

5.2 ENVIRONMENTAL ASPECTS

72. **The energy sector of the Kyrgyz Republic is highly sensitive to climate change.** According to the World Bank Report on Adapting to Climate Change in the ECA Region (2009), the Kyrgyz Republic ranks among the three most vulnerable countries to climate change in the ECA region and the upper 50 percent of countries in the region likely to experience a higher increase in climate extremes in the future, including changing hydrology and glacier melting. Given the strong dependency on hydropower, the energy sector in the Kyrgyz Republic is particularly sensitive to the impact of climate change through a potential increase in the variability of hydrology. As the report further highlights, under-investments in energy infrastructure, as is the case in the Kyrgyz Republic, further accentuate the vulnerability to the impact of climate change.

73. **The implementation of the policy actions supported by the proposed ESDPO is not likely to have significant impact on environment, forests, and natural resources.** By supporting energy tariff reforms, which will help to correct distorted price signals, the operation is likely to have positive environmental benefits. Energy intensity in terms of electricity consumption per capita and square meter in buildings is relatively high in the Kyrgyz Republic compared to countries with similar climates and/or income levels. Accordingly, gradually increasing energy tariffs will create more incentives for households and industries to improve the efficient use of energy and/or reduce consumption. Given that the current level of electricity and

district heating tariffs is exceptionally low and switching to alternative fuels generally requires upfront investments, the tariff increases are not likely to trigger households and business to switch to alternative fuel sources, including more polluting fuels.

5.3 PUBLIC FINANCIAL MANAGEMENT, DISBURSEMENT AND AUDITING ASPECTS

Accounting, Recording, and Reporting

74. **Improvements in the systems of accounting, recording and reporting are necessary.** Automation of treasury functions is limited to partial reconciliation of information between regional treasuries, local transit banks, the central treasury and the National Bank, there is no comprehensive automation of accounting, recording, and reporting. A fully integrated system is being developed. Quarterly reports are submitted to the president, the parliament and the prime minister. By mid-May of each year, the government submits annual report for the execution of the budget (cash-based) to the parliament. It includes extensive information on revenues and expenditures; however, it does not include accounting policies and is not supported by disclosures. The Republican government budget is published on the Ministry of Finance's web site (www.minfin.kg) and monthly execution tables are published on the web-site of the central treasury (www.kazna.kg) within a month.

75. **National accounting and reporting standards for the public sector are not developed yet.** The ongoing Public Financial Management (PFM) Trust Fund supports a few International Public Sector Accounting Standards related activities, including development of a concept for the methodological base and a limited number of introductory trainings to familiarize public accountants.

Public Sector Auditing

76. **Public sector auditing is performed by the Chamber of Accounts (CoA), the equivalent of supreme audit institution.** The CoA auditing activities are limited to the budget execution report and no audit opinion is given; instead a lengthy report of errors and violations is submitted to Parliament. The CoA audit of revenues and expenditure each year is not complete; the standards in relation to audit of financial statements are not transparent. The CoA ongoing technical assistance should enable the CoA to develop capacity to conduct financial audits in accordance with international standards.

77. **Internal audit is overall weak; however, recent measures should gradually strengthen this function.** The institutional capacity for effective internal audit practices is limited, including capacity for quality assurance by the central harmonization unit in the Ministry of Finance. The recently adopted legal and regulatory framework for Internal Audit needs to be rolled out and serve its proper function in the whole of public sector.

Foreign Exchange Control Environment

78. **The last safeguards assessment update concluded that the NBKR has established important safeguards in financial reporting, external and internal audits.** The IMF completed the update on October 28, 2011, and, in addition, highlighted some areas for improvement in the NBKR operations, including more effective reporting by the audit committee. The proposed new Banking Code is expected to strengthen the institutional autonomy and give the NBKR sole responsibility for the governance of official foreign exchange reserves.

79. **The NBKR has been audited regularly by internationally recognized audit firms.** The audit of the consolidated financial statements for 2013 was conducted by Grant Thornton, which issued unmodified audit opinion. Previous financial statements audited by LLC KPMG Bishkek have also been unmodified with no major issues raised in the management letter.

Public Procurement

80. **Recent changes to the legal and institutional framework for public procurement are bringing it in line with international good practices.** As part of the past DPOs 1 and 2 substantial progress was achieved in improving and modernizing public procurement in the country. The revised Public Procurement Law (PPL) is under discussion in the parliament. The Government issued a regulation to create a public procurement regulatory body and shared regulation to create an independent complaint review commission, which will be ratified after the new PPL is ratified. The Government successfully launched e-procurement and public procurement portal. The public procurement portal will contain procurement plans, bidding opportunities and contract awards. The Bank continues to support procurement capacity building (with ECA PFM TF) and institutional capacity building (regulatory body and complaint review commission) with an IDF Grant. With the above initiatives, the capacity and the legal framework will considerably improve. This should strengthen the adherence to procurement rules, a critical weakness in the existing system and reduce corruption in procurement.

Budget

81. **Enactment of the Budget Code, currently in Parliament approval procedure, will significantly strengthen budget processes in the future.** The draft submitted to the Parliament in October 2012 and approved in the first reading in June 2014 strengthens controls over non-allocated funds in the treasury, advances the introduction of internal audit and medium-term budgeting, and provides more clarity to the overall budget cycle.

Disbursement and Audit

82. **The credit and grant proceeds would be made available to the Kyrgyz Republic upon the effectiveness of the Financing Agreement and submission of withdrawal applications for the credit and grant.** IDA will disburse the amount into a foreign currency deposit account that forms part of the country's official foreign exchange reserves and is opened for that purpose in NBKR. This account is available for budget financing and will be managed by and subject to the control of the Ministry of Finance. The Recipient shall ensure that upon deposit of the proceeds of the credit and grant into the said account, and conversion into national currency, an equivalent amount will be credited in the Recipient's budget management system, in a manner acceptable to the IDA, that is: the current Treasury account will be credited with the Kyrgyz som equivalent at the official exchange rate. The foreign exchange proceeds of the proposed ESDPO will be sold by the NBKR or held in reserves, in accordance with the objectives of monetary policy. The authorities will report to the World Bank the amount deposited in the account and confirm its availability to finance budget expenditures within 30 days of receiving such funds. If, after depositing funds in this account, the proceeds of the credit and/or grant are used for ineligible purposes as defined in the Financing Agreement, the World Bank will require the authorities to refund the amount to the World Bank. Money refunded to IDA in respect of payments made for ineligible expenditures would be cancelled.

83. **The administration and accounting of the credit will be the responsibility of the Ministry of Finance.** The Ministry of Finance will be responsible for the credit and grant administration and for preparing the withdrawal application. The Ministry of Finance, with the

assistance of the NBKR, will maintain records of all transactions under the credit in accordance with sound accounting practices.

84. **Auditing.** Considering the Bank's knowledge of the PFM systems and the ongoing improvements of these systems, the positive assessment of the NBKR made by the IMF, previous unmodified audit reports issued by the NBKR's auditor on the recent years' financial statements, no additional fiduciary arrangements, including audit, will be required for the deposit account. Given that this is a high risk fiduciary operation, the Bank reserves the right to request an audit of the foreign currency deposit account.

Overall Assessment

85. **The overall fiduciary environment is weak.** Functioning foreign exchange control environment in the NBKR in which the ESDPO proceeds are deposited as well as current budget execution reporting requirements are sufficient for the purposes of the proposed ESDPO funds flow.

5.4 MONITORING AND EVALUATION

86. **The Ministry of Energy and Industry and the State Regulatory Agency of the Fuel and Energy Complex are jointly responsible for the monitoring and evaluation of the proposed operation.** Monitoring and evaluation will largely rely on the techno-economic indicators that the Regulatory Agency receives from the energy sector companies. The results indicator related to public communication will be collected by an independent professional firm that will support the Regulatory Agency with the public communication campaign. Although reliability of data is a serious issue for the energy sector due to the overall weak governance and lack of adequate information management systems, the results indicators for the proposed operation are based on data that is easy to monitor and verify.

6. SUMMARY OF RISKS AND MITIGATION

87. **The overall risk of the proposed operation is high.** The main risks to the proposed program's outcomes are political and governance risks, macroeconomic risks, operational sustainability risks and stakeholder risks.

88. **Political and governance risks.** The political environment in the Kyrgyz Republic has stabilized over the past year. However, the country still faces challenges as a young democracy and changes/reshuffling of the Government are likely to continue. The parliamentary elections in October 2015 may contribute to political instability and so may the winter energy shortages, if not managed adequately. Stability will also depend on the state's ability to fight corruption. The proposed DPO measures designed to strengthen energy sector governance, transparency and accountability should help to reduce political and governance risks. Nevertheless, the residual risk is high.

89. **Macroeconomic risks.** Macroeconomic risks have increased. Lower growth in Russia and Kazakhstan could weaken inflows of remittances, Kyrgyz exports and lead to further pressures on the exchange rate and prices. Another disruption in gold production or a significant deterioration in the terms-of-trade (decline in gold prices or spike in food and energy prices) will negatively impact the external balance. The medium-term fiscal policy for 2015-2017, while addressing bottlenecks in key infrastructure sector, will also increase fiscal risks, which if not managed

properly could jeopardize sustainability. The Bank’s planned continued engagement through budget support programs and the announced intentions of the authorities to enter into an arrangement with the IMF will partly mitigate these risks; however, the remaining risk is high.

90. **Sector strategies and policies.** The institutional arrangements in the energy sector are sub-optimal and there is significant overlap of roles and responsibilities, particularly with respect to economic regulation. The absence of clear responsibility for regulation has discouraged the development of a robust framework for economic regulation. The establishing of an economic regulator in November 2014 is a significant step to improve the institutional framework. Adoption of a transparent and predictable tariff setting methodology and establishment of an adequate performance monitoring framework supported by this ESDPO should further strengthen the regulatory framework. However, further progress in this area would be needed. The Government’s planned establishment of an independent settlement center and strengthening of the capacity of the Regulatory Agency should help reduce these risks.

91. **Institutional capacity for implementation and sustainability risks.** The policy measures supported by the ESDPO are largely focused on developing and implementing resolutions, regulations and plans in line with the revisions of primary legislation that has been already enacted. This should facilitate the implementation. However, tariff reforms are highly sensitive and have been reversed in the past. Therefore, sustainability risk is high. To mitigate this risk, the Government has launched an extensive public communication campaign related to the planned energy sector reforms, while the ESDPO supports the energy regulator in institutionalizing public hearings for main economic regulatory decisions in the future.

92. **Fiduciary risks.** Fiduciary environment is overall weak. The authorities have made important PFM reform steps under the past DPO series, including adoption of the Law on Internal Audit, enactment of Budget Code, and measures taken to enhance transparency and accountability of public procurement. However, these reforms take time to produce visible results. Fiduciary arrangements specific to the proposed ESDPO appear adequate.

93. **Stakeholder risks.** Tariff reforms have faced significant resistance in the past due to lack of consultation and communication and lack of confidence that the increased revenues of the energy sector will benefit the broader population. To mitigate these risks, the operation supports establishment of more rigorous reporting, communication and accountability measures. Still, the stakeholder risk remains high.

Risk Categories	Rating
1. Political and governance	High
2. Macroeconomic	High
3. Sector strategies and policies	Substantial
4. Technical design of program	Low
5. Institutional capacity for implementation and sustainability	High
6. Fiduciary	High
7. Environment and social	Moderate
8. Stakeholders	High
Overall	High

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions and Triggers	Results
<i>Policy Area 1: Improving Sector Financial Viability</i>	
Prior action # 1.1 The Recipient has approved the MTTP for Electricity and Heating for 2014-2017 pursuant to Resolution No.660, dated November 20, 2014, and effective on December 10, 2014.	Financial viability of the power and heating sectors improved Baseline: measured by the baseline indicators of prior actions #1.2 and #1.3 Target: measured by target indicators of prior actions #1.2 and #1.3
Prior action # 1.2 The Recipient, through the State Regulatory Agency of the Fuel and Energy Complex has approved changes in electricity end-user tariffs for: (a) December 11, 2014 - March 31, 2015, pursuant to Order No.45, dated December 11, 2014, and (b) April 1, 2015, pursuant to Order No.47, dated December 11, 2014.	Cash collected per kWh of power generated Baseline: 0.59 Som/kWh (2013) Target: 0.64 Som/kWh (2015)
Prior action # 1.3 The Recipient, through the State Regulatory Agency of the Fuel and Energy Complex has approved changes in district heating and hot water end-user tariffs for: (a) December 11, 2014 – March 31, 2015, pursuant to Order No.44, dated December 11, 2014 and (b) April 1, 2015, pursuant to Order No.46, dated December 11, 2014.	Cash collected per Gcal of heat generated by Bishkek CHP Baseline: 460 Som/GCal (2013/14) Target: 598 Som/Gcal (2014/15)
Prior action # 1.4 The Recipient, through the: (a) State Regulatory Department of the Fuel and Energy Complex has approved a tariff setting methodology for the power sector companies pursuant to Order No.32, dated November 10, 2014; and, (b) State Regulatory Agency of the Fuel and Energy Complex has established the 2015 tariffs for Electric Power Plants, National Electricity Grid of Kyrgyzstan, Sevelelectro, Vostokelectro, Oshelectro and Jalala-abatelectro, consistent with the methodology in said Order No.32 and pursuant to Order No.50, dated December 15, 2014.	Power sector revenues are allocated based on tariffs for power sector companies set according to the approved methodology Baseline: Lack of tariff setting methodology for company tariffs (2013) Target: power sector revenue is allocated based on the tariffs for power sector companies set according to the approved methodology (2015)
<i>Policy Area 2: Enhancing Sector Governance, Transparency and Accountability</i>	

Prior actions and Triggers	Results
<p>Prior action # 2.1 The Recipient has established a framework pursuant to which the State Regulatory Agency of the Fuel and Energy Complex Recipient shall carry out its economic regulatory functions in the energy sector, pursuant to Resolution No.650, dated November 14, 2014, and effective on November 25, 2014.</p>	<p>State Regulatory Agency of the Fuel and Energy Complex is able to perform key economic regulatory functions (licensing, tariff setting and performance monitoring) as evidenced by achievement of target indicators #1.4 and #2.2</p> <p>Baseline: Economic regulatory responsibilities are not consistently performed (2013) Target: Economic regulatory responsibilities are consistently performed as evidenced by the achievement of target indicators of prior actions #1.4 and #2.2 (2015).</p>
<p>Prior action # 2.2 The Recipient, through the State Regulatory Department of the Fuel and Energy Complex has approved a performance reporting and monitoring framework for the power sector pursuant to Order No.33, dated November 10, 2014.</p>	<p>Service quality indicators for the power sector are regularly monitored and disclosed</p> <p>Baseline: Service quality indicators for the power sector are not systematically collected and disclosed (2013) Target: Service quality indicators for the power sector are quarterly disclosed (2015)</p>
<p>Prior action # 2.3 The Recipient, through the State Regulatory Department of the Fuel and Energy Complex has established a working group to conduct public outreach campaigns and institutionalize public hearings on its main economic regulatory decisions in the energy sector pursuant to Order No.31, dated November 10, 2014.</p>	<p>(i) Public awareness about the country’s energy sector challenges and reforms increased; (ii) public hearings held by the State Regulatory Agency of the Fuel and Energy Complex</p> <p>Baseline: (i) 17.2 percent of respondents aware of energy sector challenges and reforms (2014); and (ii) no public hearings conducted (2013) Target: (i) 27 percent of respondents aware of energy sector challenges and reforms (2015); and (ii) State Regulatory Agency of the Fuel and Energy Complex holds at least two public hearings (2015)</p>
<p><i>Policy Area 3: Managing Impact of Power Shortages on Poor Regions</i></p>	
<p>Prior action # 3.1 The Recipient, through its Ministry of Energy and Industry has established monitoring and communication arrangements for the power supply management plans of the Recipient’s regions consistent with the Fall-Winter Preparedness Plan 2014-2015, pursuant to Order No.174, dated November 11, 2014.</p>	<p>The load rationing is equitable among the regions</p> <p>Baseline: Power supply management plans for the regions are not available (2013) Target: Reduction in regional power consumption (2014/2015 consumption compared to regional average consumption of previous three years) does not differ by more than 5% across the regions</p>

ANNEX 2: LETTER OF DEVELOPMENT POLICY

Official Translation

His Excellency Jim Yong Kim,
President of the World Bank Group
1818 H Street, N.W.
Washington DC, 20433

December 23, 2014

Your Excellency,

The Kyrgyz Republic would like to express its gratitude and appreciation to the World Bank for being a trusted partner and supporting the country in its efforts to foster sustainable socio-economic development. Our reform agenda is grounded on the National Strategy for Sustainable Development 2013-17, which sets the strategic direction of sustainable development, sovereignty and national security through appropriate economic policies, building up of human capital and strengthening of environment protection and crisis preparedness. The energy sector is central to the reform agenda since it has significant potential for growth and yet is a major bottleneck for the business environment and for sustainable economic development.

I am writing to request on behalf of the Government of the Kyrgyz Republic an Energy Sector Development Policy Operation (DPO) of US\$24 million to support our program of measures that aims to gradually improve the reliability of the energy supply by strengthening the financial viability of the sector and enhancing its governance, while managing the impact of power shortages on poor regions. In this letter we outline the energy sector reform program of the Government.

Recent Macroeconomic Developments

The external economic environment has become more challenging during 2014. Our main trading partners - Russia and Kazakhstan - saw significant slowdown in economic activity; they reduced their economic growth projections on three occasions and their currencies are depreciating. This affected the non-gold exports, the inflow of private transfers as well as consumer and investor sentiments and put pressure on the local currency (som), thus increasing inflation. Furthermore, the poor harvest affected agriculture output. In response, we undertook serious steps to support economic activity and safeguard macroeconomic stability, including significantly stepping up the implementation of infrastructure projects and increasing the Government's deposits.

The Kyrgyz Republic recorded positive economic growth in the first nine months of 2014; however, the growth has been slowing down notably since the beginning of the year. Based on the preliminary estimates of the Kyrgyz National Statistics Committee, the country's nominal GDP reached KGS 266.6 billion (US\$5.1 billion) and grew by 3.0 percent in real terms during the period from January to September 2014 compared to 8.9 percent a year earlier.

Our fiscal policy during 2014 was aimed at supporting economic activity, protecting the vulnerable and safeguarding fiscal solvency. We were able to off-set the negative impact of the slowdown over our revenues by increasing excise taxes on tobacco and alcohol products,

increasing grants and non-tax revenues (mostly from dividends from government shares in companies) as well as improving tax administration. We continued to implement prudent expenditure policies. We fully met our social obligations and were able to increase allocations for means-tested social transfers while wage increases were limited to critical parts of the public sector (law enforcement agencies) and the civil servants with the lowest earnings. At the same time, we implemented stronger controls over spending on goods and services. Finally, we were able to increase public capital spending by more than 50 percent trying to tackle key infrastructure gaps in transport and energy.

Pressures on the exchange rate of the som and higher imported fuel prices resulted in a pick-up in inflation. Annual inflation surged to 8.5 percent in June 2014, its highest level since late 2011 and up from 4 percent in December last year, but has since retreated to 7.4% in September. The National Bank of the Kyrgyz Republic (NBKR) remains committed to maintaining inflation in single-digit levels and is actively using its instruments to achieve this objective. The NBKR increased the discount rate in October 2014 bringing it to 9%. The NBKR also stepped up its interventions on the market and withdrew som liquidity to smooth large fluctuations of som.

Our macroeconomic policies over the medium-term are aimed at actively supporting economic activity while safeguarding macroeconomic stability. The medium-term outlook for the external environment remains uncertain. We are also aware that while our accession to the Belarus-Kazakhstan-Russia Customs Union would be beneficial in the long-run, there will be significant challenges in the short-run, especially for our vibrant re-export sector. In response, our 2015-2017 fiscal policy will provide an investment-led stimulus to the economy. We plan to increase our capital spending to around 10 percent of GDP to finance investments in key infrastructure sectors (energy sector and roads). At the same time, we are committed to tightly control the current spending. With financing already secured from affordable external sources and with the planned tax policy (higher excises, reduced VAT exemptions) and administration reforms, we are confident that we will maintain fiscal solvency and contribute to macroeconomic stability. At the same time, the NBKR remains committed to maintaining price and financial sector stability. In order to do so, the NBKR will continue to improve the recently introduced monetary policy framework and to enhance its regulatory and supervisory functions, including through gradual adoption of risk-based supervision.

With the support of development partners, we are also implementing reforms to improve the functioning of public institutions and enhance the business environment. We continue with the implementation of our anti-corruption agenda, including on prevention of conflict of interest and increasing transparency in the operations of the public administration and the assets of civil servants. For example, in the area of public financial management, the new Republican Budget Law for 2015 and Public Procurement Law are currently in parliamentary approval process and we remain committed to introducing good international practice in these areas. We also continue to make efforts to implement a fully integrated treasury management information system and strengthen internal and external audit arrangements in the public sector. We are also committed to improving the business environment by reducing, streamlining and automating procedures. As in the past, we hope that the implementation of these measures will be supported by the future development policy operations of the World Bank.

Energy Sector Challenges

The energy sector faces a serious crisis, which may undermine the economic growth and the

social wellbeing. Due to poor hydrology in 2014, the water inflow of Toktogul water reservoir was low this year amounting to less than 63 percent of the historical average in summer months. Our projections indicate that the water volume in Toktogul reservoir will be about 9.1 billion cubic meters by January 1, 2015, and 6.7 billion cubic meters by April 1, 2015. At the same time, in the past few years the power demand increased substantially, especially in winter. This means that the country will likely experience significant power shortages during the 2014-15 winter season, estimated at 2.4 billion kWh or about 1.5 months of power consumption.

The looming energy crisis, while intensified by the poor hydrology, is triggered by a number of structural weaknesses. These include:

- Financial losses of the energy sector due to low tariffs and resulting significant under-recovery of costs associated with power and heat supply. As a result, the maintenance, modernization, and construction of energy assets have been deferred;
- Aging assets (50 percent of energy sector assets have the end of their useful life) that are in poor condition;
- Low operational performance of the sector characterized by frequent power outages and high technical losses;
- Weak governance of the sector with low level of transparency and accountability in its operations;
- Lack of trust of the general public towards the energy sector and therefore lack of acceptance for reforms.

We intend to transform the crisis situation into an opportunity and carry out much needed reforms in the energy sector. The reform program will address the above weaknesses in a systematic and sustainable manner; and help tackle such crisis in the future (poor hydrology has been repeating every 5-6 years). Simultaneously, we plan to undertake measures to minimize the impact of the imminent crisis as discussed later in this letter.

Energy Sector Reform Program Goals

The overarching goal of the medium-term Power Sector Development Strategy (2012-2017) is to develop a reliable, efficient and transparent energy sector that meets the needs of Kyrgyz population and its economy in a sustainable manner. The Strategy also aims to transform the energy sector from a financial burden to a financial contributor to the state budget with sector companies able to competitively attract private capital based on the strength of their balance sheets. To translate these goals into attainable actions and to coordinate donor support to the sector, the Government adopted the Energy Sector Reform Action Plan for 2013-14, which defines policy actions that will create the foundation for achieving the medium term goals. The sections that follow outline the policy actions that the Government pursues, including those which are supported by the proposed Energy Sector Development Policy Operation.

Governance, Transparency and Accountability Reforms

Governance, transparency and accountability reforms aim to enhance the operational efficiency of the energy sector and rebuild consumer trust towards the sector. We have already undertaken a number of policy actions in this area. Thus, on July 19, 2014, several key laws were amended (the Law on Energy, the Law on Electricity and the Law on Natural Monopolies) to clearly delineate the policy-making, ownership and economic regulation functions in the energy sector. The amendments also removed the requirement for the Parliamentary approval of electricity end-user

tariff revisions and created the legal basis for the establishment of an energy sector regulator and an independent settlement center.

Based on the legal amendments, *the Government has issued Resolution No.650, dated November 14, 2014 approving the Regulation on the State Regulatory Agency of the Fuel and Energy Complex under the Government of the Kyrgyz Republic*. The Resolution assigns to the Regulatory Agency all key functions of economic regulation, including licensing, tariff setting and performance reporting and monitoring. The Resolution also specifies the number of staff, structure and sources of financing of the Regulatory Agency. Going forward, the newly created Regulatory Agency will play an important role in the energy sector. To that end, we prioritize the need to strengthen its institutional capacity (staffing and qualifications of staff), enhance its governance (internal decision making and consultations), and ensure adequate financial resources for its functioning. We count on the support of development partners, especially of the World Bank Group, to support the establishment and strengthening of the Regulatory Agency.

The Regulatory Department of the Fuel and Energy Complex has started developing key regulations for the energy sector. It has established a tariff setting methodology for the power sector (see next section) *has also issued an Order No.33, dated November 10, 2014 establishing a performance reporting and monitoring framework for the power companies*. The framework defines the service quality indicators the power sector companies will report on and which will be monitored, verified and published quarterly by the Regulatory Agency. The publication of 2014 service quality indicators is planned in February 2015 and thereafter on quarterly basis. We consider this an important accountability measure that should accompany tariff reforms. Based on the ongoing technical assistance of the World Bank, the Regulatory Agency will also establish a performance reporting and monitoring framework for the heating sector by March 2015. After monitoring the service quality indicators for two years, the Regulatory Agency will establish a baseline and set service quality standards against this baseline that the energy sector companies should meet over time. In addition, the Regulatory Agency will establish a multi-year investment planning framework that will link with service quality standards and improve the investment planning, prioritization and implementation by the energy sector companies.

Based on recent amendments in the legislation, we also plan to establish an independent settlement center in the power sector. The settlement center will allow for transparent accounting and monitoring of electricity and financial flows between the power sector companies.

While the independent settlement center will enhance the transparency at the wholesale level, we also undertake measures to strengthen the transparency and accountability at the company level. The Electricity Supply Accountability and Reliability Improvement Project funded by the World Bank supports strengthening of the governance of the largest distribution company, Severelectro, by incorporating Management Information Systems to provide real-time and reliable corporate and commercial information and therefore ensure that business operations are efficient, traceable, and transparent. We plan to replicate the same measures for the other large power sector companies with the support of development partners and increasingly through the private sector participation.

Going forward, we will strengthen the management of the energy sector companies and their internal controls. To that end, we intend to hire the senior managers of the companies competitively based on clearly specified Terms of References and qualification requirements for a

minimum tenure. We will also re-engineer business processes of the companies to strengthen the systems of checks and balances and to optimize the roles and responsibilities.

We recognize that the public communication is an essential part of our governance and transparency reforms so as to rebuild the customers' trust towards the energy sector. To that end, we have launched an extensive public communication campaign supported by the Asian Development Bank. In addition, *the Regulatory Department of the Fuel and Energy Complex has issued Order No.31, dated November 10, 2014 institutionalizing the process of public hearings and approving a working group for conducting public outreach campaign.* Through this Order, the Regulatory Department has committed that all decisions and reforms concerning the economic interests of energy sector stakeholders will be made following a due process of consultations. Through the support of a professional PR firm hired under the World Bank supported technical assistance, the Regulatory Department held two public hearings on October 27 and 28, 2014 to discuss the draft tariff setting methodology and the performance reporting and monitoring framework [<http://www.regulator tek.kg/node/251> and <http://www.regulator tek.kg/node/258>]. The working group established pursuant to the above Order is implementing a public communication campaign with the support of the World Bank to generate consensus around the policy measures that we currently pursue and that are supported by the proposed Energy Sector DPO.

Financial Sustainability Reforms

We recognize that the failure to increase electricity and heating tariffs for an extended period has resulted in inability of the companies to make required investments both in new assets and in modernization, upgrading and maintenance of existing assets. As a result, the energy sector assets are in poor condition leading to frequent equipment failures and system overloads. This in turn leads to poor quality and reliability of energy supply.

Understanding that this situation is not sustainable and aggravates over time, we have decided to increase the end-user electricity, heating and hot water tariffs in a consistent and phased manner. *The Government has issued Resolution No. 660, dated November 20, 2014 on Medium Term Tariff Policy (MTTP) for Power and Heating for 2014-2017 fiscal years ensuring annual end-user tariff revisions to attain short-term cost recovery by 2017.* The MTTP sets the multi-year end-user tariff revision framework based on which the Regulatory Agency of the Fuel and Energy Complex enacts annual tariff changes. To that end, *the Regulatory Agency has issued Orders No.45 and No.47, dated December 11, 2014, approving changes in electricity end-user tariffs for December 11, 2014 to March 31, 2015 and for April 1, 2015, respectively. The Regulatory Agency has also issued Orders No. 44 and 46, dated December 11, 2014, approving changes in district heating and hot-water end-user tariffs for December 11, 2014 to March 31, 2015 and for April 1, 2015, respectively, based on the MTTP.* The 2014-17 MTTP is the first step to ensure long-term cost recovery of electricity, district heating and hot water tariffs, which is important for attracting investments, increasingly through private sector participation. A number of initiatives will facilitate tariff setting for end-consumers and sector companies in future years, including the planned revaluation of energy sector assets, which will be conducted under a recently approved project financed by the Asian Development Bank, and improved reliability of energy sector data, which will be facilitated through the recently approved Electricity Supply Accountability and Reliability Improvement Project financed by the World Bank. We will prepare a new multi-year tariff policy in 2016 to continue revising tariffs towards long-term cost-recovery levels in a gradual and predictable manner.

In addition, *the Regulatory Department has issued Order No.32, dated November 10, 2014 approving a tariff setting methodology that details the approach for defining tariffs for power sector companies.* The methodology will allow allocating sector revenues between companies transparently and in a predictable manner. *The Regulatory Agency has also issued an Order No. 50, dated December 15, 2014 setting 2015 tariffs for Electric Power Plants, National Electricity Grid, Severelectro, Vostokelectro, Oshelectro and Jalalabadelectro in accordance with this methodology.* The World Bank technical assistance also supports the Regulatory Agency with the preparation of a tariff setting methodology for the heating sector; this methodology will be issued for consultations in December 2014 for its subsequent finalization and approval by February 2015.

To enhance the energy sector financial viability, we also prioritize investment and policy measures aimed at reducing technical and commercial losses in the energy sector. To that end, we implement a number of investment projects and reform initiatives aimed at improving the metering and the management information systems in the power sector and at strengthening the governance and internal controls in the energy companies.

Subsidy and Other Mitigation Reforms

We are committed to ensure that a basic level of energy consumption remains affordable for the low income households. To that end, *the Resolution No.660, dated November 20, 2014 approving the MTTP envisages a gradual increase of residential electricity, district heating and hot water tariffs.* In addition, we have a number of energy-related social assistance programs targeted at specific population categories (e.g. pensioners, public sector employees, recipients of compensations in lieu of privileges, people living in high-mountain and remote areas). Since these programs cover a large share of the population and are adjusted annually, we are confident that the existing programs will mitigate the impact of tariff reforms on the low income households in the short-run.

We, however, understand that the existing social assistance programs while being extensive are not sufficiently targeted given that the eligibility of beneficiaries in these programs is defined on the basis of specific population categories (categorical benefits). The monthly benefit for low-income families with children, targets poor families with children; however, this program is limited to families with children and reaches less than two thirds of the poorest 20 percent of the population. As we continue pursuing tariff reforms under current and future MTTPs, the existing social assistance system will need to be strengthened to properly channel assistance to the poorest members of the society and to mitigate the impact of rising energy prices. In the medium term, therefore, we plan to improve the social assistance system so that it can play a critical role in assuring energy affordability for the poorest members of the society. To that end, we will prepare and implement measures to strengthen the poverty alleviation program. The existing programs that target the poor will be strengthened in terms of their targeting efficiency and coverage capacity. We will also enhance the categorical programs. While this approach will not impose additional fiscal burden on the state budget, it will help mitigating the impact of future tariff increases on the poor in a targeted and cost-effective manner. The main objective is to have a program(s) in place by 2017 that can be rapidly scaled up to poor households with and without children.

In parallel to the reforms, we have initiated several measures to address the looming energy crisis. In summer we did not export power and, instead, imported power from Tajikistan to preserve

water level in Tokotgul reservoir for winter power generation. We carried out negotiations with the neighboring countries to import power during winter months and reduce the anticipated power deficit. We have also issued Decree No. 250 from May 8, 2014 and its addendum (Decree No 525 from September 4, 2014) approving the Fall Winter Preparedness Plan for the 2014/15. The Plan involves a comprehensive set of measures necessary for the energy sector's winter preparedness, such as allocation of funding for procurement of fuel for public facilities, maintenance and repair of important energy sector assets, ensuring that the boiler houses are in operational condition, etc. As part of these measures, we have prepared regional power supply management plans so as to ensure that the power rationing will be implemented transparently, predictably and equitably. *The Ministry of Energy and Industry has issued Order No.174, dated November 11, 2014, for the implementation of the Fall-Winter Preparedness Plan for the 2014-2015 heating season specifying monitoring and communication arrangements for the power supply management plans of the regions.*

Investment mobilization and regional cooperation

In the recent years, we have mobilized significant financing to rehabilitate and upgrade the existing assets and to invest in new assets. These investments are aimed at improving the reliability of energy supply, enhancing the energy security of the country and fostering regional cooperation.

Some of our sizable investments that are already completed include:

- Construction of the 500 kV Datka substation and 220 kV power lines to increase the power supply in the southern regions (US\$208 million);
- Modern metering and data acquisition system of the largest distribution company Sevelelectro (US\$45 million);
- 500 kV transmission line Datka - Kemin and 500 kV Kemin substation to supply electricity for the northern part of the country without depending on neighboring countries (US\$390 million);
- Rehabilitation of the largest Toktogul hydropower plant (US\$55 million);
- Renovation of substations in Bishkek and Osh, the two largest cities in the country (US\$23 million);
- Construction of Aigul Tash-Samat 110 kV transmission line and related substations for supplying power to Leilek district of Batken Region independently through the power system of Kyrgyz Republic (US \$11.99 million);
- Rehabilitation of At-Bashi HPP with a 10% increase in capacity (24.7 million Swiss Francs).

In addition, a number of projects have been launched recently to meet winter energy shortages and/or increase export potential, including:

- Construction of Upper Naryn Cascade of HPPs (US\$728 million);
- Construction of Kambarata-1 HPP;
- Modernization of Bishkek Combined Heat and Power Plant (US\$386 million);
- Improvement of electricity supply reliability for the largest distribution company Sevelelectro and strengthening its governance (US\$25 million);
- Central Asia South Asia (CASA- 1000) Transmission Project;
- Rehabilitation/construction of natural gas transmission and distribution network.

We recognize that the reforms aimed at enhancing the financial viability of the energy sector and strengthening its governance, transparency and accountability are essential for ensuring efficient and effective use of the investment financing and its sustainability. These reforms will also create enabling conditions for increasingly attracting private sector participation and financing in the energy sector.

In conclusion, we would like to reiterate our strong commitment to energy sector reform program and hope that the implementation of tariff and associated governance reforms will continue to be supported by the future development policy operations of the World Bank. We look forward to our future cooperation for improving energy supply reliability and quality for the benefit of Kyrgyz population and economy.

Sincerely yours,

D. Otorbaev

**Prime Minister
of the Kyrgyz Republic**



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Президенту Группы
Всемирного банка
г-ну Джиму Йонг Киму

Уважаемый господин Джим Йонг Ким,

Правительство Кыргызской Республики выражает свою благодарность и признательность Всемирному банку за надежное партнерство и оказанную поддержку стране, направленную на устойчивое социально-экономическое развитие. Наша программа реформ основана на Национальной стратегии устойчивого развития Кыргызской Республики на период 2013-2017 годы, в которой определены стратегически важные направления устойчивого развития, поддержание суверенитета и безопасности государства посредством реализации соответствующей экономической политики, формирования человеческого капитала, усиления охраны окружающей среды и готовности к кризисным ситуациям. Энергетический сектор является ключевым элементом программы реформирования, так как располагает существенным потенциалом роста и при этом представляет собой основное препятствие для бизнес-среды и устойчивого экономического развития.

Правительство Кыргызской Республики обращается к Вам с просьбой о выделении 24 млн долларов США в рамках Операции в поддержку политики развития (далее - ОППР) для энергетического сектора в поддержку нашей программы мер, направленной на постепенное повышение надежности электроснабжения через упрочнение финансовой устойчивости сектора и оптимизацию управления воздействием дефицита электроэнергии на бедные слои населения в регионах республики.

В настоящем письме приводится краткое описание программы Правительства Кыргызской Республики по реформированию энергетического сектора.

Сложившаяся макроэкономическая ситуация

На протяжении 2014 года внешняя экономическая ситуация стала более сложной. Существенное замедление экономического роста было отмечено у наших главных торговых партнеров – в Российской Федерации и Республике Казахстан. В этих странах были сокращены прогнозные

показатели экономического развития (что было вызвано тремя причинами), что привело к обесцениванию национальной валюты. Эти факторы затронули объемы экспорта товаров (кроме золота), частных денежных переводов, потребительские и инвестиционные настроения, оказали давление на местную валюту (киргызский сом), и тем самым привели к росту инфляции в Кыргызской Республике. Кроме того, низкий урожай сказался и на объемах производства сельскохозяйственной продукции. Наши ответные серьезные шаги заключались в поддержке экономической деятельности и сохранении макроэкономической стабильности, в том числе, значительном расширении реализации инфраструктурных проектов и увеличения правительственных депозитов.

В Кыргызской Республике отмечался положительный экономический рост за 9 месяцев 2014 года, однако этот рост существенно замедлился с начала года. По предварительным оценкам Национального статистического комитета Кыргызской Республики, номинальный ВВП страны достиг 266,6 млрд сомов (5,1 млрд долларов США) и увеличился на 3,0 процента в реальном выражении в период с января по сентябрь 2014 года по сравнению с 8,9 процента за прошлый год.

В 2014 году налогово-бюджетная политика Кыргызской Республики была направлена на поддержку экономической деятельности, защиту уязвимых слоев населения и обеспечение бюджетной платежеспособности. Мы смогли компенсировать отрицательное воздействие снижения темпов роста на наши доходы посредством повышения ставки акцизных налогов на табачные изделия и алкогольную продукцию, увеличения грантовых средств и неналоговых поступлений (в основном за счет дивидендов на государственную долю акций в компаниях), а также оптимизации налогового администрирования. Мы продолжили реализацию благоразумной налогово-бюджетной политики и в полной мере выполнили наши социальные обязательства и смогли увеличить размеры социальных выплат, предоставленных с учетом нуждаемости; при этом, повышение заработной платы коснулось только сотрудников основных компонентов государственного сектора (правоохранительные органы) и государственных служащих с низким уровнем заработной платы. В то же время мы ужесточили контроль над расходами на товары и услуги. Наконец, мы также смогли увеличить государственные капиталовложения более чем на 50 процентов, пытаясь восполнить основные инфраструктурные разрывы в транспортном и энергетическом секторах.

Рост инфляции был вызван давлением на обменный курс кыргызского сома и повышением цен на импортируемое топливо. Годовая инфляция резко увеличилась до 8,5 процента в июне 2014 года – самый высокий уровень с конца 2011 года – и увеличилась на 4 процента с декабря прошлого года, но после чего снизилась до 7,4 процента в сентябре текущего года. Национальный банк Кыргызской Республики (далее - НБКР) сохраняет приверженность удержанию уровня инфляции на уровне одного процентного пункта и активно использует свои

инструменты для достижения этой цели. В октябре 2014 года НБКР повысил учетную ставку до 9 процента. НБКР также расширил свои интервенции на рынке и изъяс избыточную ликвидность национальной валюты для спасения кыргызского сома от серьезных колебаний.

Макроэкономические политические меры Кыргызской Республики в среднесрочном периоде направлены на активную поддержку экономической деятельности и сохранение макроэкономической стабильности. Сохраняется неопределенность с нормализацией внешней ситуации в среднесрочном прогнозе. Нам также известно, что, несмотря на то, что вступление Кыргызской Республики в Таможенный Союз и Единому экономическому пространству Республики Беларусь, Республики Казахстан и Российской Федерации будет выгодным в долгосрочном периоде, в краткосрочном периоде ожидаются серьезные трудности. В особенности они, затронут наш чувствительный сектор реэкспорта. В качестве ответной меры в бюджетной политике на период 2015-2017 годов предусмотрено стимулирование экономики в целях привлечения инвестиций. Мы планируем повысить наши капиталовложения примерно до 10 процентов ВВП для финансирования инвестиций в основные инфраструктурные секторы (энергетический и транспортный секторы). При этом, мы сохраняем приверженность жесткому контролю над текущими расходами. В отношении социальных расходов мы увеличим выплаты, предоставленные с учетом нуждаемости, и в то же время сохраним категориальные пособия. Выражаем уверенность, что мы сохраним бюджетную платежеспособность и внесем вклад в макроэкономическую стабильность за счет обеспеченного финансирования из доступных внешних источников и реализации запланированной налоговой политики (повышение акцизных ставок, сокращение категорий налогоплательщиков, освобожденных от уплаты НДС) и реформ в области администрирования. Между тем НБКР сохранит приверженность поддержанию ценовой стабильности и стабильности финансового сектора. В этих целях НБКР продолжит совершенствование недавно принятой денежно-кредитной рамочной политики и оптимизирует свои функции регулирования и надзора, в том числе за счет постепенного внедрения надзора, основанного на оценке риска.

При поддержке наших партнеров в области развития в настоящее время также осуществляются реформы по улучшению работы государственных учреждений и совершенствованию бизнес-среды. Мы продолжим реализацию нашей антикоррупционной программы, в том числе в части предупреждения конфликта интересов и повышения прозрачности операций государственного управления и имущества государственных служащих. Например, что касается управления государственными финансами, в настоящее время на рассмотрении парламента находится новый Закон о республиканском бюджете на соответствующий год и Закон «О государственных закупках». Мы сохраняем приверженность внедрению принципов международной

передовой практики в этих областях. Мы также продолжим внедрение полностью интегрированной управленческой информационной системы в Казначействе и усилим внутренние и внешние аудиторские проверки в государственном секторе. Мы также сохраняем приверженность улучшению бизнес-среды за счет сокращения, упрощения и автоматизации процедур. Как и ранее, мы надеемся, что реализация данных мер получит поддержку в рамках планируемых Операций по поддержке политики развития Всемирного банка.

Вызовы энергетического сектора

Энергетический сектор находится в глубоком кризисе, который способен дестабилизировать экономический рост и социальное благосостояние. В связи с маловодным периодом приток воды в Токтогульское водохранилище в текущем году был незначительный и составил менее 63 процентов от среднего уровня в летние месяцы. Согласно нашим прогнозам, к 1 января 2015 года объем воды в Токтогульском водохранилище составит около 9,1 млрд м³ и к 1 апреля 2015 года - 6,7 млрд м³. С другой стороны, за последние несколько лет значительно возрос спрос на электроэнергию, особенно в зимнее время. Это значит, что, скорее всего, страна столкнется с серьезным дефицитом электроэнергии в зимний период 2014-2015 годов, который, по оценкам, составит 2,4 млрд киловатт-часов, или около 1,5 месяца потребления электроэнергии.

Угрожающий нам энергетический кризис, усугубленный маловодным периодом, спровоцирован рядом следующих структурных недостатков:

- финансовые убытки энергосектора по причине низких тарифов и сопутствующего значительного невозмещения затрат на электро- и теплоснабжение. Как следствие, откладываются работы по техническому обслуживанию, модернизация и строительство энергетических объектов;
- стареющие объекты (срок службы 50 процентов энергетических объектов подходит к концу) находятся в неисправном состоянии;
- низкие показатели операционной деятельности сектора, что выражается в частых аварийных отключениях электроснабжения и высоких технических потерях;
- неэффективное управление сектором при низком уровне прозрачности и подотчетности по операционной деятельности;
- недоверие широкой общественности к энергосектору и, как результат- сопротивление реформам.

Мы намерены преобразовать кризисную ситуацию в возможность и довести до конца столь необходимые реформы в энергетическом секторе. Благодаря реализации программы реформирования вышеуказанные недостатки будут планомерно и устойчиво устраняться, и потенциальный аналогичный кризис (маловодный период повторяется каждые 5-6 лет) будет преодолен. При этом, мы планируем реализацию мер по смягчению влияния грядущего кризиса, как описывается далее в настоящем письме.

Задачи Программы реформирования энергетического сектора

Ключевая задача Среднесрочной стратегии развития электроэнергетики (2012-2017 годы) – это развитие надежного, производительного и прозрачного энергетического сектора, отвечающего потребностям населения Кыргызской Республики и экономики страны на устойчивой основе. Стратегия также направлена на преобразование энергосектора из финансового бремени в источник поступления средств в государственный бюджет, при этом компании сектора смогут привлекать частный капитал на рыночных условиях благодаря прочному финансовому положению. Для превращения этих задач в выполнимые действия и в целях координации донорской поддержки для сектора, Правительство Кыргызской Республики приняло План действий по реформированию энергосектора на 2013-2014 годы, в котором определены политические меры, ведущие к заложению фундамента для достижения задач среднесрочного периода. В разделах ниже описываются политические меры Правительства, в том числе меры, согласующиеся с предлагаемыми Операциями по поддержке политики развития для энергетического сектора.

Реформы управления, прозрачности и подотчетности

Реформы управления, прозрачности и подотчетности направлены на повышение эффективности работы энергосектора и восстановление доверия потребителей к сектору. Мы уже предприняли ряд политических мер в этом направлении. 19 июня 2014 года были внесены поправки в некоторые ключевые законы в сфере энергетики (законы «Об энергетике», «Об электроэнергетике» и «О естественных и разрешенных монополиях») с целью четкого разделения функций формирования политики, ответственности и экономического регулирования в энергосекторе. Согласно поправкам также были отменены требования к получению одобрения парламентом изменений тарифов для конечных потребителей электроэнергии и была заложена законодательная база для создания регулятора в области энергетики и независимого расчетного центра.

В соответствии с внесенными изменениями Правительство приняло постановление от 14 ноября 2014 года № 650 «О вопросах Государственного агентства по регулированию топливно-энергетического комплекса при Правительстве Кыргызской Республики». В соответствии с указанным постановлением утверждено Положение, штатная численность, организационная структура и источники финансирования работы Государственного агентства по регулированию топливно-энергетического комплекса при Правительстве Кыргызской Республики (далее – Агентство по регулированию). Кроме того, в соответствии с постановлением Агентству по регулированию переданы все ключевые функции экономического регулирования, в том числе лицензирование, регулирование тарифных ставок, сбор отчетности по показателям деятельности и осуществление мониторинга. В дальнейшем созданное

Агентство по регулированию сыграет немаловажную роль в энергосекторе. В этой связи нашей приоритетной задачей является укрепление институционального потенциала (кадровый состав и квалификационные данные сотрудников), совершенствование модели управления (принятие решений на внутреннем уровне и консультации) и обеспечение адекватных финансовых средств для работы Агентства. Мы рассчитываем на поддержку со стороны наших партнеров в области развития (в частности, Группы Всемирного банка) в работе по учреждению и укреплению Агентства.

Государственный департамент по регулированию топливно-энергетического комплекса при Министерстве энергетики и промышленности Кыргызской Республики начал разработку основных нормативных положений для энергосектора. Государственный департамент разработал методологию установления тарифов для энергосектора (см. следующий раздел) и издал Приказ от 10 ноября 2014 года № 33 об установлении системы сбора отчетности и мониторинга показателей деятельности компаний энергосектора. В системе определены показатели качества обслуживания, по которым будут отчитываться компании энергосектора. Агентство по регулированию будет осуществлять ежеквартальный мониторинг и проверять показатели, после чего они будут опубликованы. В феврале 2015 года планируется опубликование показателей качества обслуживания за 2014 год, и в дальнейшем показатели будут публиковаться ежеквартально. Мы считаем эту работу важным элементом подотчетности, который должен дополнить ведущиеся тарифные реформы. Благодаря текущей технической помощи Всемирного банка, до марта 2015 года Агентство по регулированию также разработает систему сбора отчетности и мониторинга показателей деятельности для сектора теплотехники. После мониторинга показателей качества обслуживания в течение двух лет Агентство по регулированию определит базовые параметры и стандарты качества обслуживания на основе базовых параметров. Со временем компании энергосектора будут обязаны соблюдать указанные стандарты качества обслуживания. Кроме того, Агентство по регулированию также разработает структуру инвестиционного планирования на долгосрочный период, которая будет увязана со стандартами качества обслуживания и рационализирует процессы планирования капиталовложений, определения приоритетности инвестиций и освоения капитальных средств компаниями энергосектора.

Учитывая недавние поправки в законодательстве, мы также планируем создать независимый расчетный центр в энергетике. Расчетный центр позволит осуществлять прозрачный учет и мониторинг потоков электроэнергии и движения денежных средств между компаниями энергосектора.

В то время, как независимый расчетный центр повысит прозрачность на оптовом уровне, мы также предпримем меры по укреплению прозрачности и подотчетности на уровне компаний. В задачи Проекта по

повышению подотчетности и улучшению надежности электроснабжения, финансируемого Всемирным банком, входит совершенствование системы управления в крупнейшей распределительной компании ОАО «Северэлектро» посредством внедрения управленческих информационных систем для обеспечения надежной корпоративной и коммерческой информации в режиме онлайн, при этом обеспечивается результативность, прослеживаемость и прозрачность деловых операций. Мы планируем тиражировать данную работу в других крупных компаниях энергосектора при поддержке партнеров в области развития и при активном участии частного сектора.

В дальнейшем мы оптимизируем управленческую практику в компаниях энергосектора и системы внутреннего контроля, для чего мы намерены привлечь в компании руководителей высшего звена на минимальный срок. Данные лица будут отобраны на конкурсной основе согласно четко определенным сферам полномочий и квалификационным требованиям. Мы также перестроим бизнес-процессы компаний в целях укрепления системы сдержек и противовесов и оптимизации должностных обязанностей.

Мы признаем, что информирование общественности является важной составляющей наших реформ управления и повышения прозрачности, тем самым, восстанавливается доверие потребителей к энергосектору. С этой целью мы запустили широкую кампанию по информированию общественности при поддержке Азиатского банка развития. Кроме того, Государственным департаментом по регулированию топливно-энергетического комплекса при Министерстве энергетики и промышленности Кыргызской Республики издан Приказ от 10 ноября 2014 года № 31 об институционализации процесса общественных консультаций и одобрении состава рабочей группы для проведения кампаний по информированию общественности. Согласно данному Приказу Государственный департамент принял на себя обязательство в том, что все решения и реформы, затрагивающие экономические интересы заинтересованных сторон энергетического сектора, будут приняты и реализованы в рамках надлежащего процесса консультаций. При поддержке профессиональной компании, работающей в сфере связей с общественностью, нанятой в рамках технической помощи Всемирного банка, 27 и 28 октября 2014 года указанный Государственный департамент провел общественные консультации, где обсуждалась методология установления тарифов и системы отчетности и мониторинга показателей деятельности (<http://www.regulator.tek.kg/node/251> и <http://www.regulator.tek.kg/node/258>). В настоящее время Рабочая группа, созданная вышеупомянутым Приказом, проводит кампанию по информированию общественности при поддержке Всемирного банка для достижения согласия с политическими действиями, которые мы предпринимаем в настоящее время и которые согласуются с предлагаемой ОППР для энергетического сектора.

Реформа в области финансовой устойчивости

Мы признаем, что непопулярное решение о повышении тарифов на электрическую и тепловую энергию на длительный срок было вызвано неспособностью энергокомпаний вложить необходимые средства в новые активы, модернизацию, обновление и техническое обслуживание действующих основных фондов. В результате чего основные фонды энергетического сектора находятся в неисправном состоянии, что, в свою очередь, приводит к частым отказам оборудования и перегрузкам системы. Как следствие, качество электроснабжения потребителей низкое и ненадежное.

Принимая во внимание неустойчивый характер текущей ситуации и ее постепенное обострение, мы приняли решение о последовательном и поэтапном повышении тарифов для конечных потребителей электроэнергии, тепловой энергии и горячей воды. Правительство приняло постановление от 20 ноября 2014 года № 660 «О Среднесрочной тарифной политике на электрическую и тепловую энергию на 2014-2017 годы», предусматривающей ежегодную корректировку тарифов для конечных потребителей для доведения тарифов до уровня покрытия затрат в краткосрочном периоде к 2017 году. Среднесрочная тарифная политика (далее - ССТП) предусматривает схему ежегодного пересмотра тарифов для конечных потребителей, согласно которой Агентство по регулированию ежегодно корректирует тарифные ставки. В связи с этим, в целях реализации ССТП Агентством по регулированию изданы приказы (от 11 декабря 2014 года № 45 и 47), утверждающие тарифы на электроэнергию для конечных потребителей с 11 декабря 2014 года по 31 марта 2015 года и с 1 апреля 2015 года соответственно. Агентство по регулированию также издало приказы (от 11 декабря 2014 года № 44 и 46) об изменениях тарифов для конечных потребителей тепловой энергии и горячей воды с 11 декабря 2014 года по 31 марта 2015 года и с 1 апреля 2015 года соответственно. ССТП на 2014-2017 годы – это первый шаг к обеспечению возмещения затрат на электроэнергию, центральное отопление и горячее водоснабжение за счет тарифов в долгосрочном периоде, что важно для привлечения инвестиций, и все в большей мере - для участия частного сектора. Ряд инициатив будет направлен на установление тарифов для конечных потребителей и отраслевых компаний в дальнейшем периоде, в том числе планируемая переоценка основных фондов энергетического сектора (в рамках недавно одобренного проекта Азиатского банка развития), а также повышенная достоверность данных по энергосектору, что будет обеспечено в рамках недавно одобренного Всемирным банком Проекта по повышению подотчетности и надежности электроснабжения. В 2016 году мы подготовим новую тарифную политику на долгосрочный период для последующей корректировки тарифов до уровня возмещения себестоимости в долгосрочном периоде на постепенной и предсказуемой основе.

Кроме того, Государственный департамент по регулированию топливно-энергетического комплекса при Министерстве энергетики и промышленности Кыргызской Республики издал Приказ от 10 ноября 2014 года № 32 об одобрении методологии установления тарифов, в которой описан детальный подход к определению тарифов для компаний энергосектора. Методология устанавливает принцип распределения доходов сектора между компаниями на основе прозрачности и предсказуемости. Агентство по регулированию также одобрил Приказ (от 15 декабря 2014 года № 50) об установлении тарифов на 2015 год для ОАО «Электрические станции», ОАО «Национальная электрическая сеть Кыргызстана», ОАО «Северэлектро», ОАО «Востокелектро», ОАО «Ошэлектро», и ОАО «Жалалабатэлектро» в соответствии с данной методологией. В рамках технической помощи Всемирного банка Агентству по регулированию также оказывается поддержка в подготовке методологии тарифообразования для теплоэнергетического сектора. Данная методология будет передана Агентству по регулированию для консультаций в декабре 2014 года в целях дальнейшего окончательного согласования и утверждения в феврале 2015 года.

Для повышения финансовой устойчивости энергосектора мы также разрабатываем приоритетные инвестиционные и политические меры, направленные на снижение технических и коммерческих потерь в энергосекторе. С этой целью мы реализуем ряд инвестиционных проектов и инициатив реформирования, направленных на улучшение учета потребления и управленческих информационных систем в энергосекторе и усиление управления и систем внутреннего контроля в энергокомпаниях.

Субсидии и прочие реформы по смягчению последствий

Мы сохраняем приверженность доступности базового уровня потребления электроэнергии для малообеспеченных слоев населения. С этой целью постановлением Правительства от 20 ноября 2014 года № 660 об одобрении ССТП предусматривается постепенное повышение тарифа на электроэнергию для бытовых потребителей, тарифа на тепловую энергию и горячую воду. Кроме того, действует ряд программ социальной помощи, связанных с энергоносителями. Программы предназначены для специфических групп населения (например, пенсионеры, государственные служащие, получатели компенсационных выплат взамен льгот, лица, проживающие в высокогорных и отдаленных районах). Так как эти программы охватывают большую часть населения и корректируются ежегодно, мы уверены, что текущие программы, вкупе с тарифом по норме потребления тепловой энергии, смягчат последствия тарифной реформы на малообеспеченное население в краткосрочном периоде.

Однако, несмотря на масштабность действующих программ социальной помощи, мы отмечаем недостаточный уровень адресности, так как право на получение помощи в рамках данных программ определяется согласно принадлежности к специфическим группам населения

(категориальные пособия). Ежемесячное пособие для малообеспеченных семей с детьми – направлена на малоимущие семьи с детьми. Однако действие этой программы ограничивается семьями с детьми и охватывает менее 2/3 от 20 % беднейших слоев населения. В процессе реализации тарифной реформы, в соответствии с текущими и будущими ССТП, действующая система социальной защиты должна быть подкреплена в целях надлежащей ориентированности помощи на бедные слои населения и смягчения последствий роста цен на энергоносители. В среднесрочном периоде мы планируем усовершенствовать систему социальной защиты с тем, чтобы она играла важную роль в обеспечении доступности энергоносителей для бедных слоев населения. С этой целью мы подготовим и реализуем меры по оптимизации программ смягчения бедности. Действующие программы, ориентированные на малоимущее население, будут усовершенствованы, в части их потенциальной результативности и охвата. Также будет проводиться работа по оптимизации категориальных программ. Этот подход не налагает дополнительное финансовое бремя на государственный бюджет, а, напротив, поможет смягчить последствия дальнейшего повышения тарифов на малоимущие слои населения на адресной и малозатратной основе. Основная цель заключается во внедрении программы к 2017 году, которая может быть развернута и охватит малоимущие семьи с детьми или без детей.

Параллельно с данными реформами мы инициировали несколько мер по решению предстоящего энергетического кризиса. Летом текущего года экспорт электроэнергии не осуществлялся. Напротив, электроэнергия импортировалась из Таджикистана, чтобы сохранить объемы воды в Токтогульском водохранилище для выработки электроэнергии в зимнее время. Мы провели переговоры с соседними странами по импорту электроэнергии в зимние месяцы и снижению ожидаемого энергодефицита. Правительство приняло постановление от 8 мая 2014 года № 250 и соответствующие поправки к нему (постановление от 4 сентября 2014 года № 525) об одобрении Плана готовности к прохождению осенне-зимнего периода 2014-2015 годов. План содержит комплекс необходимых мер для подготовки энергосектора к зимнему периоду, например, выделение финансовых средств на закупку топлива для государственных учреждений, техническое обслуживание и ремонтные работы на важных энергетических объектах, обеспечение исправного состояния котельных, и т.д. В рамках указанных мер мы подготовили региональные планы по управлению потреблением электроэнергии, с тем, чтобы обеспечить прозрачное, предсказуемое и справедливое нормирование электропотребления. Министерство энергетики и промышленности Кыргызской Республики приказом от 11 ноября 2014 года № 174 одобрило реализацию Плана подготовки к прохождению отопительного сезона осенне-зимнего периода 2014-2015 годов, с указанием мероприятий по

мониторингу и информированию о планах по регулированию электроснабжения регионов.

Привлечение инвестиций и региональное сотрудничество

За последние годы мы привлекли существенные объемы финансовых средств для реконструкции и обновления текущих активов и капиталовложений в новые объекты. Данные инвестиции направлены на повышение надежности электроснабжения, укрепление энергетической безопасности страны и расширение регионального сотрудничества.

В числе наших крупных капиталовложений:

- строительство подстанции «Датка» 500 кВ и ЛЭП 220 кВ для повышения электроснабжения в южных областях (208 млн долларов США);
- современная система учета потребления и сбора данных в крупнейшей распределительной компании ОАО «Северэлектро» (45 млн долларов США);
- ЛЭП «Датка-Кемин» 500 кВ и подстанция «Кемин» 500 кВ для передачи электроэнергии в северные области страны, что устраняет зависимость от поставок через соседние страны (390 млн долларов США);
- реконструкция крупнейшей Токтогульской ГЭС (55 млн долларов США);
- обновление подстанций в городах Бишкек и Ош – в двух крупнейших городах страны (23 млн долларов США).
- строительство ЛЭП 110 кВ «Айгуль-Таш – Самат» и сопутствующих подстанций для автономных поставок электроэнергии в Лейлекский район Баткенской области по энергосистеме Кыргызской Республики (11,99 млн долларов США).
- реконструкция Ат-Башинской ГЭС, с повышением мощности на 10 % (24,7 млн швейцарских франков).

Кроме того, в недавнем времени был запущен ряд проектов для покрытия энергодефицита в зимнее время и (или) повышения экспортного потенциала, в том числе:

- строительство Верхне-Нарынского Каскада ГЭС (728 млн долларов США);
- строительство Камбаратинской ГЭС-1;
- модернизация ТЭЦ города Бишкек (386 млн долларов США);
- повышение надежности электроснабжения для крупнейшей распределительной компании ОАО «Северэлектро» и модернизация управления (25 млн долларов США);
- проект по передаче электроэнергии Центральная Азия – Южная Азия (CASA- 1000);
- реконструкция/строительство сети транспортировки и распределения газа.

Мы понимаем, что для эффективного и результативного использования капиталовложений и устойчивости принципиальное

значение имеют реформы, направленные на укрепление финансовой устойчивости энергосектора, модернизацию управления, повышение прозрачности и подотчетности. Данные реформы также создадут благоприятные условия для привлечения частного сектора и финансовых средств в энергосектор.

В заключение мы хотели бы вновь заявить о нашей твердой приверженности программе реформирования энергосектора. Мы надеемся, что выполнение тарифной реформы и сопутствующей реформы управления и далее будет получать поддержку в рамках перспективных Операций по поддержке политики развития Всемирного банка.

Выражаем уверенность, что сотрудничество в области повышения надежности и улучшения качества электроснабжения в целом послужит на благо населения Кыргызской Республики и экономическому развитию страны.

С уважением,

Премьер-министр



Дж.К.Оторбаев

ANNEX 3: FUND RELATIONS ANNEX

KYRGYZ REPUBLIC—ASSESSMENT LETTER TO THE WORLD BANK ¹ (Board discussion of Energy Sector Development Policy Operation) December 9, 2014

This assessment letter provides an update on the Kyrgyz Republic's economic developments and performance. It reflects discussions with the authorities during the November 2014 mission.

- 1. Under the ECF-supported program completed in July 2014, the Kyrgyz Republic made good progress towards macro-economic stability by pursuing fiscal consolidation and embarking on key structural reforms.**² To move to the next stage in economic development, more needs to be done to stabilize growth, fight poverty, and reduce dependency on gold, remittances, and aid. These challenges are amplified by a deteriorating regional outlook, driven by the Russia-Ukraine conflict and uncertainty surrounding accession to the Eurasian Economic Union (EEU).
- 2. The authorities are developing an economic reform program that aims at strengthening and diversifying the economy, enhancing macro-economic stability, and sustaining the development of the financial sector.** It also includes structural reforms to build strong institutions and sustain inclusive growth.
- 3. The November mission held productive discussions with the authorities on a possible IMF successor program that would support these reforms.** We plan to remain in close contact with the authorities as they finalize the planned measures in the reform program to achieve their goals. In this context, measures to safeguard financial sector soundness and to enhance transparency regarding public investment plans and new borrowing will be critical to avoid deterioration in the risk of debt distress and to safeguard macroeconomic and financial stability. A follow up mission is expected to return to Bishkek in the coming period to continue discussions.
- 4. Adverse weather and regional developments have led to a slowdown in growth and an uptick in inflation.** Real GDP growth is expected to fall to 2.7 percent this year reflecting slowing economies in the region, exacerbated by the Russia/Ukraine crisis, weaker than expected agricultural season and downward revisions to growth in the services and construction sectors. Inflation is expected to reach around 10 percent by end-2014, fueled by the weakening of the som. The som has depreciated by about 17 percent against the U.S. dollar since the beginning of 2014, mainly as a result of the fall of the ruble and the tenge.
- 5. The faster than expected execution of the government's public investment program (PIP) has led to a widening of the fiscal deficit.** The fiscal stance in 2014 was expansionary with deficit including on-lending widening to 6.4 percent of GDP due to higher than expected foreign-financed investment projects. However, the operating surplus is projected to improve to 4.4 percent of GDP. The authorities are also expected to tighten current expenditures,

¹ The views expressed in this letter are those of the IMF staff not its Executive Board.

² The IMF Board concluded the last Article IV consultation with the Kyrgyz Republic in March 2013.

especially on goods and services. The current account is expected to narrow to 15.6 percent of GDP in 2014 due to a drop in imports.

6. As a result of the ramping up of the investment program, external public and publicly guaranteed debt is expected to rise to 55.6 percent of GDP in 2014 and up to 63.5 percent of GDP by 2017. The PIP anchored in the National Development Strategy is aimed at addressing critical infrastructure and energy needs. The program is financed through FDI and foreign concessional borrowing from China and other bilateral and multilateral partners. Nevertheless, based on preliminary DSA results, public debt is still expected to remain, albeit barely, at a moderate risk of distress.

7. Monetary and financial sector conditions are mixed. The NBKR recently raised the policy rate for the seventh time this year to 10 percent and continues to intervene in the foreign exchange market in a bid to curb inflation and exchange rate volatility. Dollarization, which exceeded 50 percent on both deposits and credits, is undermining the efficiency of monetary policy. Credit grew by 40 percent (September year-on-year). Strong credit growth reflects a low base effect, and NBKR's efforts to improve access to credit for businesses in the areas of trade, agriculture, construction, and manufacturing. At 16.3 percent of GDP, credit to the private sector is however far below the CIS average of 40 percent. Foreign exchange reserves, at 3.6 months of imports are adequate.

8. The medium-term outlook is for moderate growth, with risks tilted to the downside. Growth is expected to average about 4 percent, well below potential (5 percent), whereas inflation is expected to gradually moderate to single digits. Risks, however, remain significant. A further slowdown among trading partners, especially Russia, could hurt growth and the balance of payments. The recovery of currently stalling remittances is expected for 2016 but could be further delayed in this case. The depreciation of the som in the wake of the falling ruble could exacerbate inflationary pressures. Renewed problems with the Kumtor gold mine could impact growth, revenues and the current account. Political tensions could rise in the run-up to next year's parliamentary elections, with populist rhetoric undermining reforms awaiting parliamentary ratification. Finally, accession to the EEU could have moderate adverse effects on economic growth and government revenues in the near term. There is also upside potential as Russia is expected to contribute over time up to \$1 billion toward a development fund.

Table 1. Kyrgyz Republic: Selected Social and Economic Indicators, 2012–19

I. Social and Demographic Indicators								
Population (In millions, 2012)	5.6							33.4
Unemployment rate (official, 2011)	8.5							69.6
Poverty rate (2012)	38.0							99.0
GNI per capita (2013, Atlas method, U.S. dollars)	1200							23.6
II. Economic Indicators								
	2012	2013	2014	2015	2016	2017	2018	2019
	Act.	Act.			Projections			
Nominal GDP (in billions of soms)	310.5	350.0	387.3	438.4	490.9	546.1	604.5	665.7
Nominal GDP (in millions of U.S. dollars)	6,603	7,225	7,158	7,318	7,954	8,592	9,280	10,018
Real GDP (growth in percent)	-0.9	10.5	2.7	3.4	4.2	4.9	5.0	5.1
Nongold real GDP (growth in percent)	5.0	5.8	2.7	3.4	4.1	4.7	5.1	5.1
GDP per capita (in U.S. dollars)	1,182	1,280	1,256	1,271	1,368	1,463	1,564	1,672
Consumer prices (12-month percent change, eop)	7.5	4.0	10.3	9.6	6.5	5.5	5.5	5.5
Consumer prices (12-month percent change, average)	2.8	6.6	7.5	10.1	8.1	6.1	5.4	5.5
General government finances (in percent of GDP) 1/								
Revenue	34.9	35.0	36.2	35.9	34.7	34.5	35.0	35.1
Of which: Tax revenue	20.6	20.8	21.0	21.0	21.3	21.6	21.8	22.0
Expense	33.0	31.6	31.9	31.5	29.8	29.3	29.1	28.7
Gross operating balance	1.9	3.4	4.4	4.5	4.9	5.2	5.9	6.3
Net acquisition of nonfinancial assets	7.6	7.1	6.8	10.6	8.9	9.5	8.4	7.6
Overall balance (net lending/borrowing)	...	...	-2.5	-6.1	-4.0	-4.3	-2.4	-1.3
Overall balance including onlending	-5.7	-3.8	-6.4	-9.9	-6.2	-4.9	-2.5	-1.3
Primary net lending/borrowing	...	...	-1.6	-5.2	-2.8	-3.1	-1.3	-0.5
Primary balance excluding foreign financed PIP loans	...	...	2.5	3.0	4.2	3.9	1.7	1.0
Primary balance excluding grants	...	...	-5.5	-10.0	-5.7	-5.8	-3.6	-2.6
Total public debt 2/	49.0	46.8	57.7	60.4	63.7	64.9	60.8	55.7
Banking sector								
Reserve money (percent change, eop)	17.7	13.4	11.7	16.7	9.0	13.0	12.1	11.0
Broad money (percent change, eop)	23.8	22.8	18.2	22.7	13.8	17.7	16.6	12.0
Credit to private sector (percent change, eop)	26.2	36.1	31.6	24.4	18.0	17.3	16.4	14.1
Credit to private sector (in percent of GDP)	13.5	16.3	19.4	21.4	22.5	23.7	25.0	25.9
Velocity of broad money 3/	3.2	2.9	2.7	2.5	2.5	2.3	2.2	2.2
Interest rate 4/	5.2	4.5	...	...	...	...	...	...
External sector								
Current account balance (in percent of GDP)	-15.9	-16.6	-15.6	-16.6	-15.2	-14.2	-14.0	-13.6
Export of goods and services (in millions of U.S. dollars)	3,235	3,653	3,471	3,792	4,068	4,345	4,532	5,090
Export growth (percent change)	3.4	13.0	-5.0	9.2	7.3	6.8	4.3	12.3
Import of goods and services (in millions of U.S. dollars)	6,174	6,845	6,680	6,944	7,281	7,676	7,993	8,455
Import growth (percent change)	26.0	10.9	-2.4	4.0	4.8	5.4	4.1	5.8
Gross International reserves (in millions of U.S. dollars)	2,061	2,031	2,100	2,274	2,414	2,416	2,255	2,085
Gross reserves (months of next year imports, eop)	3.6	3.6	3.6	3.7	3.8	3.6	3.2	2.8
External public debt outstanding (in percent of GDP)	46.3	44.4	55.6	58.6	62.0	63.5	59.5	54.5
External public debt service-to-export ratio (in percent)	3.0	2.8	3.3	3.6	3.8	4.1	4.3	3.8
Memorandum items:								
Exchange rate (soms per U.S. dollar, average)	47.0	48.4	...	...	...	...	...	...
Real effective exchange rate (2010=100) (average)	108.8	107.6	...	...	...	...	...	...
Gold related tax receipts of the general government (percent of GDP)	1.5	1.0	...	...	...	...	...	...

Sources: Kyrgyz authorities and IMF staff estimates and projections.

1/ General government comprises State Government and Social Fund finances. State government comprises central and local governments.

2/ Calculated at end-period exchange rates.

3/ Twelve-month GDP over end-period broad money.

4/ Interest rate on three-month treasury bills.