



Report and Recommendation of the President to the Board of Directors

Project Number: 41544
May 2014

Proposed Policy-Based Grant for Subprogram 3 Kyrgyz Republic: Investment Climate Improvement Program

This document is being disclosed to the public prior to its consideration by ADB's Board of Directors in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 14 May 2014)

Currency unit	–	som (Som)
Som1.00	=	\$0.0191
\$1.00	=	Som52.249

ABBREVIATIONS

ADB	–	Asian Development Bank
GDP	–	gross domestic product
ICIP	–	Investment Climate Improvement Program
IT	–	information technology
NBKR	–	National Bank of the Kyrgyz Republic
PDSF	–	project development support facility
PFM	–	public financial management
PPP	–	public–private partnership
SMEs	–	small and medium-sized enterprises
SDR	–	special drawing rights
STS	–	State Tax Service

NOTE

In this report, “\$” refers to US dollars.

Vice-President	W. Zhang, Operations 1
Director General	K. Gerhaeusser, Central and West Asia Department (CWRD)
Director	B. Wilkinson, Public Management, Financial Sector, and Trade Division, CWRD
Team leader	R. Barreto, Financial Sector Specialist, CWRD
Team members	J. Colasito, Operations Assistant, CWRD
	M. Eshenaliev, Senior Project Officer, CWRD
	M. I. Martin, Associate Project Officer, CWRD
	I. Martinez, Private Sector Development Specialist, CWRD
	L. Nazarbekova, Principal Counsel, Office of the General Counsel
	M. Razaev, Project Officer, CWRD
	P. Sood, Financial Sector Specialist, CWRD
	J. Stickings, Senior Social Development Specialist (Gender and Development), CWRD
	G. Tentieva, Senior Economics Officer, CWRD
Peer reviewers	P. Marro, Principal Financial Sector Specialist, South Asia Department
	J. Procak, Regional Cooperation Specialist, East Asia Department

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
PROGRAM AT A GLANCE	
I. THE PROPOSAL	1
II. THE PROGRAM	1
A. Rationale	1
B. Impact and Outcome	3
C. Outputs	3
D. Development Financing Needs	6
E. Implementation Arrangements	6
III. DUE DILIGENCE	7
A. Economic and Financial	7
B. Governance	8
C. Poverty and Social	9
D. Safeguards	10
E. Risks and Mitigating Measures	10
IV. ASSURANCES	10
V. RECOMMENDATION	10
APPENDIXES	
1. Design and Monitoring Framework	11
2. List of Linked Documents	13
3. Development Policy Letter	14
4. Policy Matrix	19

PROGRAM AT A GLANCE

1. Basic Data		Project Number: 41544-084	
Project Name	Investment Climate Improvement Program - Subprogram 3	Department /Division	CWRD/CWPF
Country	Kyrgyz Republic	Executing Agency	Ministry of Economy
Borrower	Government of the Kyrgyz Republic		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Subsector(s) Economic affairs management		3.40
	Law and judiciary		1.00
	Public expenditure and fiscal management		4.10
Education	Technical and vocational education and training		2.80
Finance	Banking systems and nonbank financial institutions		0.40
	Central banking systems		1.38
	Finance sector development		1.40
	Inclusive finance		1.38
	Small and medium enterprise finance and leasing		1.38
Industry and trade	Small and medium enterprise development		3.46
	Trade and services		1.30
Total			22.00
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth	Subcomponents Pillar 1: Economic opportunities, including jobs, created and expanded Pillar 3: Extreme deprivation prevented and effects of shocks reduced (Social Protection)	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development	Components Anticorruption Public financial governance	Effective gender mainstreaming (EGM)	✓
Private sector development	Conducive policy and institutional environment		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		22.00	
Sovereign Program grant: Asian Development Fund		22.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		22.00	
9. Effective Development Cooperation			
Use of country procurement systems	Yes		
Use of country public financial management systems	Yes		

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based grant to the Kyrgyz Republic for subprogram 3 of the Investment Climate Improvement Program (ICIP).¹ Subprogram 3 is the last subprogram of a program cluster approved in 2008 that has helped the government improve conditions for sustainable economic growth and employment-generating investments.² The cluster program includes policy reforms in business regulation, access to finance, workers' skills development, and public-private partnerships (PPPs) that are expected to facilitate private investment in the country.

II. THE PROGRAM

A. Rationale

2. The Kyrgyz Republic is seen as the most democratic and open society in Central Asia. The country has undergone significant economic changes following the collapse of the Soviet Union, including an extensive economic liberalization program. Its transition from a centrally planned to a market economy has been among the fastest and most ambitious in the region. Liberal economic policies and market mechanisms have dramatically impacted society. Privatization of state-owned enterprises helped the private sector grow significantly and become the main economic driver.

3. However the reforms remain incomplete, with a limited modern legal and regulatory framework and weak market-based economic institutions and processes. Despite notable examples of entrepreneurship in some industries, such as garments and dairy, the private sector has limited productive capabilities. Only in 2011 did the country return to the level of economic activity achieved before the breakup of the Soviet Union.

4. Economic growth in the Kyrgyz Republic continues to be unstable, with annual gross domestic product (GDP) growth fluctuating from -0.5% to 10.5% during 2008-2013. Annual real GDP growth averaged 4.5% over this period. Internal and external shocks have caused wide growth fluctuations in the narrowly-based economy, while disruptive changes in government and political disputes have affected the socioeconomic situation. Absolute poverty declined from 39.9% to 31.7% during 2006-2009, a period of strong economic growth. During 2010-2012, poverty increased to 38.0% as a result of the domestic political unrest and the global economic crisis.³

5. The main factor contributing to poverty reduction in 2006-2009 was the growth in remittances, which fueled private consumption. A steady and growing flow of migrants has led to a significant increase in remittances, with transfers coming mainly from the Russian Federation and Kazakhstan. In 2013, net remittance inflows were equivalent to 24.8% of GDP, while total external debt was 80.1% of GDP. Trade deficits have been mainly financed by remittances, given the country's difficulty in securing foreign capital via loans and grants.

6. The Kyrgyz Republic's investment climate has improved since 2008, when the ICIP cluster implementation began. The country's ranking in the World Bank's Doing Business

¹ The design and monitoring framework is in Appendix 1. The Asian Development Bank (ADB) provided technical assistance to prepare subprogram 3. ADB. 2012. *Proposed Policy-Based Grant for Subprogram 2 and Technical Assistance Grant to the Kyrgyz Republic for the Investment Climate Improvement Program*. Manila.

² ADB. 2008. *Proposed Program Cluster, Grant for Subprogram 1, and Grant Assistance to the Kyrgyz Republic for the Investment Climate Improvement Program*. Manila. On 14 October 2011, the ADB operations manual D4 on policy-based lending was revised and the program cluster approach was renamed as programmatic approach.

³ National Statistics Committee. <http://www.stat.kg>

Report has improved from 94th in 2007 to 68th in 2013.⁴ Investment has increased in recent years and was estimated at 27% of GDP in 2013. Private investment has also increased from 17% of GDP in 2007 to an average of 19% of GDP during 2011–2013 (footnote 3); foreign investment accounted for 32% of total investment and about half of private investment over this period. Half of foreign investment has been directed to manufacturing, most of it to the Kumtor gold mine.⁵ The country has attracted more foreign direct investment as a percentage of GDP than Tajikistan and Uzbekistan, but performance is slow compared to Armenia and Georgia. In May 2013, the Kyrgyz Republic filed an application to join the Customs Union of Belarus, Kazakhstan and Russia. Accession is expected to change economic incentives in the country and present both opportunities and challenges.

7. Despite these positive results, further improvement of the private sector investment climate is needed, in particular to enable economic diversification and reduce dependence on external assistance. The three primary constraints preventing private sector from growing and producing higher-valued products and services are: (i) a challenging business environment that still discourages many entrepreneurs and investors from expanding, investing, or lending in the country; (ii) an increasing shortage of skilled workers that prevents firms from moving up the production ladder; and (iii) expensive, short-term finance that is concentrated in a few sectors.

8. The National Sustainable Development Strategy, 2013–2017 is based on a vision of the Kyrgyz Republic as a nation with robust economic growth that is attractive to investors.⁶ The strategy foresees measures to effectively implement the rule of law and combat corruption to create an attractive environment for domestic and foreign investors. The country needs to attract private investment that increases productive capabilities and creates jobs, and this requires more certainty about business rules and their application in the economy.

9. Subprograms 1 and 2 of the ICIP were completed in 2008 and 2012. Subprogram 3 ends the program cluster by completing key reforms needed to improve growth prospects and employment opportunities, as described in the Development Policy Letter (Appendix 3). It includes changes that improve the business environment, enhance human capital, and increase access to finance, thereby addressing binding constraints to private sector development. These improvements will enable more predictability, which the private sector needs for investment. The support of the Asian Development Bank (ADB) is important because the political system is still new and sometimes divided, and vested interests resist economic policy changes. Subprogram 3 is included in ADB's country operations business plan, 2014–2016, for the Kyrgyz Republic and is in line with the country partnership strategy for 2013–2017.⁷ The subprogram reinforced and benefitted from other ADB and development partner interventions.⁸

⁴ World Bank. *Doing Business Report Series*. <http://www.doingbusiness.org/reports/>

⁵ The Kumtor mine produces the majority of the country's industrial output and exports. The concession has been renegotiated twice since its operations started in 1997. In February 2013, the Kyrgyz Parliament directed the government to renegotiate the agreement again amidst allegations that Kumtor operations have caused massive environmental destruction. Parliament has yet to ratify the non-binding Heads of Agreement on potential restructuring of the concession's ownership structure (signed by the government and the private partner in December 2013). ADB has shared its concerns with the government and other stakeholders regarding the implications of the renegotiation on investor confidence, particularly if the concession agreement is unilaterally terminated. ADB has also advocated dialogue between parties. See Sector Assessment (Summary) accessible from the list of linked documents in Appendix 2.

⁶ National Council for Sustainable Development of the Kyrgyz Republic. 2013. *National Sustainable Development Strategy for the Kyrgyz Republic for the period of 2013–2017*. Bishkek.

⁷ ADB. 2013. *Country Operations Business Plan: Kyrgyz Republic, 2014–2016*. Manila; ADB. 2013. *Kyrgyz Republic: Country Partnership Strategy, 2013–2017*. Manila.

⁸ ADB's interventions and other development partner activities are listed in Development Coordination (accessible from the list of linked documents in Appendix 2). The subprogram reinforced the project outcomes of development

B. Impact and Outcome

10. Subprogram 3 has maintained the expected impact and outcome of the ICIP cluster. Its expected impact will be sustainable economic growth and employment creation. Its outcome is an improved investment climate and business environment.

C. Outputs

11. Subprogram 3 continues to focus on achieving four outputs: (i) reduced cost of regulatory compliance, (ii) improved access to finance, (iii) enhanced workers' skills, and (iv) facilitation of PPPs. It is built on lessons from previous subprograms, particularly the need for improved monitoring and coordination; dialogue with stakeholders; and close attention to ensure that benefits are shared with all regions. Table 1 summarizes the achievements made under the cluster program.

Table 1: Summary of Achievements under the Investment Climate Improvement Program

Subprogram 1 Achievements (completed in 2008)	Subprogram 2 Achievements (completed in 2012)	Subprogram 3 Achievements (completed in 2014)
Output 1: Cost of regulatory compliance reduced		
Framework for one-stop shop for business registration established and capacity building initiated	Piloting of one-stop shop for business registration completed in all regions; registration requirements reduced	Options for electronic tax filing and payments and no-contact policy expanded to all regions
Legal and institutional framework for regulatory impact assessment (RIA) for businesses established	Licensing requirements reduced based on RIA results, and risk-based inspections institutionalized	Further reduction of licensing requirements and simplification of legal framework into a single law
Institutional framework for pre-customs single window adopted	Automated pre-customs single window system developed	Operations of pre-customs single window system initiated
Output 2: Access to finance improved		
Legal reforms to strengthen the secured lending framework initiated	Legal reforms on secured lending framework consolidated	Legal reforms on secured lending framework completed
Tax-related impediments to leasing removed	Availability of financial services further increased, particularly for women	Risk-based supervision of microfinance organizations strengthened
Legal framework for credit information sharing initiated	Institutional framework for credit information sharing improved	Legal framework for consumer protection strengthened
Output 3: Workers' skills enhanced		
	National Skills Development Council formed with women represented at near 50%	Sector councils on skills development established
	Qualification framework adopted for technical and vocational education for 18 occupations	Modern competency-based training introduced for more than 6,000 students in 18 occupations
Output 4: Public-private partnerships facilitated		
Legal reform for public-private partnerships (PPPs) initiated	Legal and risk management framework for PPP established	PPP standard tender documents developed
PPP risk management unit established	Units for risk management and PPP promotion operationalized	Project development support facility approved
	First steps taken to build PPP project pipelines through screening methods	Pilot PPP projects further prepared

Source: Asian Development Bank.

partners, particularly those from the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), International Finance Corporation, International Monetary Fund, Swiss State Secretariat for Economic Affairs, and the United States Agency for International Development. The International Monetary Fund program is supported by a 3-year SDR66.6 million (about \$100.8 million) extended credit facility arrangement approved in June 2011. Five reviews have been successfully completed with total disbursement of SDR 57.1 million (about \$90 million). The program remains broadly on track.

12. **Output 1: Cost of regulatory compliance reduced.** Subprogram 3 strengthens the reforms introduced in subprograms 1 and 2. It helps further reduce the regulatory costs of operating a business and makes regulatory acts more transparent and accountable, thereby narrowing opportunities for corruption.

13. A new licensing law—based on regulatory impact assessment and drafted with the support of the United States Agency for International Development—was approved in October 2013, reducing the number of licenses and permits from 347 to fewer than 200 and consolidating all types of licenses and permits into a single law. The risk-based audit system of the State Tax Service (STS) was improved and merged with the new integrated information technology (IT) system developed with ADB support. Beginning in June 2013, all tax offices are mandated to implement inspection plans generated in STS headquarters by the enhanced system. This is expected to improve targeting of tax audits and reduce the burden for businesses that have low risks of noncompliance.

14. A new legal and regulatory framework on electronic tax declarations using a “login-password” system was approved. This enables full operation of the new ADB-financed electronic system, which will increase the number of taxpayers filing electronically (4,665 taxpayers as of 30 June 2013) and reduce filing costs. The STS started pilots in Ortasai and Madina markets for electronic payment of tax patents through cash terminals and subsequently expanded this approach nationwide, allowing thousands of patent holders to pay their taxes without having to go to a bank branch.⁹ The STS started accepting payment of some taxes through electronic cards, with ATM receipts as proof of payment. The STS has also reduced tax compliance costs and scope for informal payments by introducing additional one-stop shops with no-contact windows for taxpayers in rural areas. The STS has conducted a campaign to raise the awareness of taxpayers in all regions regarding the use of new mechanisms (e.g., the electronic declaration and the call center) to comply with tax requirements.

15. Subprogram 3 continues to support implementation of a single window for foreign trade clearance, which was piloted under subprogram 2. The new system started operating in Bishkek in the fourth quarter of 2013 and has issued more than 200 clearance folders for foreign trade transactions. More than 60 companies so far have benefitted from the new system. The State Customs Service allowed all qualified importing and exporting businesses to access its new ADB-financed IT system for automated customs clearance procedures. The IT system was gradually implemented starting in December 2012 and has now reached all customs posts.

16. **Output 2: Access to finance improved.** Subprogram 3 strengthens the reforms introduced in subprograms 1 and 2. It further promotes alternative financial products and strengthening of nonbank financing sources, including microfinance organizations. The subprogram helps increase access to finance for small and medium-sized enterprises (SMEs) and microenterprises—particularly for businesses owned by female entrepreneurs, who account for 75% of microfinance organization borrowers.

17. Protection of creditors’ rights and the dispute resolution framework were further improved with the enactment of legal amendments that enable accelerated court enforcement of arbitral awards. Under subprogram 3, the government has raised awareness of leasing as an option for female entrepreneurs, who are good credit risks but often cannot offer collateral.

⁹ The tax patent regime is targeted at individual entrepreneurs and applies to 132 types of business activities. Individual entrepreneurs pay a fixed amount (called a tax patent) for a predetermined period.

18. A law was enacted allowing microfinance organizations to offer additional financial services by acting on behalf of banks, and to conduct foreign exchange transactions. The government approved a program of required measures to provide deposit insurance for small depositors in the event a microfinance organization fails, including integration of these organizations into the payment system. These measures will increase trust in financial institutions, and help expand the saving products available to lower-income households. To support prudent microfinance development, the National Bank of the Kyrgyz Republic (NBKR) (i) strengthened its risk-based supervisory capacities by adopting new operational procedures for offsite and onsite supervision of microfinance organizations; (ii) strengthened consumer protection and fostered responsible lending practices for all financial institutions; and (iii) introduced legal, regulatory, and supervisory changes to prevent over-indebtedness, establish responsible product pricing, and increase transparency in communications between microfinance organizations and their clients.

19. **Output 3: Workers' skills enhanced.** The government continued to make its technical and vocational education and training system more responsive to market needs, and to address the lack of qualified workers. Subprogram 3 has further strengthened the institutional framework for workers' skills development that was introduced under subprogram 2, by establishing (i) appropriate rules on the composition and functioning of sector skills development councils, including the need for broad participation of private sector stakeholders and female entrepreneurs; and (ii) councils to expand dialogue between businesses and government in two additional sectors—energy and mining.

20. The Agency for Vocational Education, with ADB support, has established competency-based training for 18 occupations in more than 30 schools.¹⁰ The agency began implementing a marketing plan that aims to increase female enrollment in technology-based and nontraditional vocational education training programs. This is expected to bring more women into better-paid jobs and help reduce the salary gap between men and women.

21. **Output 4: Public-private partnerships facilitated.** The government has further developed the policy, legal, and institutional framework for PPPs that was established under subprograms 1 and 2. Under Subprogram 3, the government has amended relevant laws and regulations to align them with the PPP Law,¹¹ adopted standard development and tender procedures for PPP projects, established a Project Development Support Facility (PDSF) with adequate rules and funding, and built initial capacity in the ministries of Economy, Finance, Transport and Communications, and Health, as well as in the Bishkek City Development Authority, to prepare and implement PPP projects.

22. The PDSF will finance the development of potential PPP projects including costs of engaging consultants and transaction advisors to increase the quality and quantity of successful PPPs and government decision-making. The government has allocated \$2 million to the PDSF in the 2014 budget and has committed to additional allocations in 2015 and 2016.

¹⁰ Electric and gas welder; electrician (household equipment); electrician (electric equipment); electrician (power stations and networks); motor mechanic; plumber; plasterer, paver; master gypsum plasterboard construction; master finisher; joiner-carpenter; junior veterinary assistant; farmer; operator on agricultural products processing; hotel industry worker; cook; tailor; cutter; and hairdresser.

¹¹ Amendments were enacted to the Tax Code, the Customs Code, the Land Code, the Law on Basic Principle of Budget Law, the Law on Financial and Economic Conditions of Local Self-Government, the laws on the Status of the Capital City Bishkek and the Status of the City of Osh, the Law on Local State Administration, the Law on Local Self Government, and the Law on Municipal Ownership to harmonize them with the PPP law.

23. The pipeline of PPP projects has made good progress under subprogram 3, with 21 project proposals identified to date by three line ministries and the City of Bishkek. The Ministry of Economy has prepared position papers on six project proposals being considered for PPPs.¹² Three feasibility studies have been completed and two tender documents prepared for potential projects. Pre-feasibility studies have been completed for five of the seven initial project ideas in the health sector and two feasibility studies have been commissioned.

D. Development Financing Needs

24. The government requested a grant of \$22 million from ADB's Special Funds resources to finance its development program. The grant size is justified considering the government's development expenditures and financing needs (Table 2). The government is expected to close the remaining financing gap with recourse to short-term domestic debt securities. The 2014 budget allocates 50.3% of available resources (or 13.9% of GDP) to social expenditures (education, health, and social protection). The government has limited fiscal space—domestic and external public debt were 3.4% of GDP and 44.6% of GDP at the end of 2013.

Table 2: Kyrgyz Republic State Budget's Financing Gap for 2014

Item	Amount (\$ million)	% of GDP
1. Revenues and grants ^a	1,855.1	22.9
2. Expenditure	2,239.2	27.6
3. Overall fiscal balance (=1-2) ^a	(362.1)	(4.7)
4. Foreign financing ^b	349.9	4.3
5. Financing gap	34.2	0.4

GDP = gross domestic product.

Notes: The 2014 state budget projects a GDP for 2014 of \$8,101.6 million and an average exchange rate for the year of Som49.5 per \$1.

^a Excluding Asian Development Bank proposed grant.

^b Includes budget support loan proceeds from the European Union (€11 million), the International Monetary Fund (\$15 million), the World Bank (\$25 million), the Government of Turkey (\$31 million), and from development partners supporting the health sectorwide approach (\$9.2 million).

Sources: Ministry of Finance of the Kyrgyz Republic; International Monetary Fund.

E. Implementation Arrangements

25. The Ministry of Economy is the executing agency. The implementing agencies are the Ministry of Economy, the Ministry of Finance, the NBKR, the STS, the State Customs Service, the Agency on Vocational Education, the Single Window Center on Foreign Trade, and the Deposit Protection Agency. The Macroeconomic and Investment Policy Coordination Council—chaired by the Prime Minister—acts as a high-level steering committee overseeing program implementation. The council convened twice during the implementation period.

26. Grant proceeds will be disbursed in a single tranche to the Government of the Kyrgyz Republic as the recipient in accordance with ADB's Simplification of Disbursement Procedures and Related Requirements for Program Loans,¹³ upon compliance with all policy actions and with all conditions precedent to grant effectiveness. All 16 policy actions included in the policy matrix of subprogram 3 have been complied with (Appendix 4). The grant proceeds will be used to finance the cost (excluding local taxes and duties) of items produced and procured in ADB member countries, excluding ineligible items and imports financed by other bilateral and multilateral sources. The implementation period for subprogram 3 is from November 2012 to April 2014. Grant closing date is 31 December 2014.

¹² The position paper is an in-principle approval or rejection of project proposals, submitted by line ministries and implementing agencies, to proceed to the pre-feasibility stage. ADB has provided training to staff of the Ministry of Economy and prepared a template for position papers (footnote 1).

¹³ ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

III. DUE DILIGENCE

A. Economic and Financial

27. Subprogram 3 supports economic growth through investment and employment creation. The primary beneficiaries are current and future entrepreneurs and investors who will benefit from an improved legal and regulatory environment and have better investment opportunities. The reforms are expected to provide indirect benefits to the working population, both employed and unemployed, as investment opportunities translate into job creation and better wages. Women and rural entrepreneurs have been specifically targeted in subprogram 3.

28. Reducing regulatory costs will attract more businesses to the formal sector, thus increasing the number of formal jobs. More than 250 licenses and permits were eliminated in 2013, bringing the total reduction under the program cluster (–372) to more than 75% of the initial number of licenses and permits in 2008 (470). This reduces the regulatory burden for firms and scope for corruption. Mandatory use by all tax offices of centralized, computer-generated audit plans will reduce unjustified costs for firms that are in compliance.¹⁴ Labor costs incurred as a result of inspections is estimated to reduce total profits by 2.3% for individual entrepreneurs, 0.8% for SMEs, and 2.5% for farmers. The STS conducts the highest number of inspections on businesses, visiting 71% of individual entrepreneurs and 65% of SMEs.¹⁵ Electronic tax collection will improve transparency and increase the financial system's depth. Documentation for customs clearance requires an average of 23 days and \$210 for exports, and 25 days and \$280 for imports. This adds up to a total of 63 days and \$4,360 for a typical export transaction, and 75 days and \$5,150 for a typical import transaction.¹⁶ The two new IT systems implemented by the Customs Service and the Single Window Center will reduce these costs.

29. Long periods before full enforcement of arbitral awards have constrained this alternative dispute resolution mechanism. The enactment of amendments to the Civil Procedures Code to enable accelerated court enforcement of arbitral awards by the state courts is expected to reduce the average enforcement period from 8 to 6 months. Given that 75% of arbitration cases involve loan transactions, the change is expected to reduce lending costs. The leasing market is starting to benefit from the tax code revision supported by previous subprograms. The average volume of leasing transactions increased from \$2.3 million per year during 2008–2011 to \$10.0 million per year during 2012–2013. The government's awareness campaign for female entrepreneurs is expected to bring leasing benefits to female borrowers. The loan portfolios of microfinance organizations grew strongly in 2011 and 2012 to over 500,000 borrowers, but there were increasing cases of multiple borrowing and possible over-indebtedness. NBKR supervision initiated in 2012 resulted in closure of more than 180 noncompliant microfinance organizations, which led to a reduction of the average annual interest rates for microfinance organization loans, from 38.3% in 2011 to 31.0% in 2013. Improved supervision of and expanded financial services (particularly deposits) offered by microfinance organizations and strengthened consumer protection will ensure consumers benefit from financial transactions. One of the largest microfinance organizations was transformed into a bank in November 2012, taking advantage from the reforms implemented since subprogram 2.

¹⁴ In 2011–2012, with the support of the International Finance Corporation, STS introduced a concept of risk-based auditing and new software that creates audit plans based on pre-determined risk criteria. However, at the beginning of subprogram 3, in about 50% of the offices, tax inspections were still conducted grounded on paper-based plans proposed by the offices themselves.

¹⁵ World Bank. 2011. *Running a Business in the Kyrgyz Republic*. Washington, DC.

¹⁶ The World Bank Group. 2013. *Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises*. Washington, DC: World Bank.

30. About two-thirds of firms say graduates from vocational colleges currently do not meet company requirements. Workers receive premium wages in sectors that have fewer available workers, particularly in manufacturing, electricity, gas and water, financial services, transport, and communications. For example, in 2012 monthly manufacturing worker salaries were 43% above the national average. Improved standards in vocational schools, and more graduates in key areas, will help firms to recruit qualified workers. Students will also benefit from increased economic opportunities.

31. Subprogram 3 achieved significant milestones in the long-term process of developing an enabling environment for PPPs. The pipeline of potential PPP projects has been evolving, with improved outcomes expected from investment projects in infrastructure and social services.

32. All policy actions from previous subprograms remain intact. Subprogram 3 did not pursue some previously envisaged actions, because due diligence indicated that other actions can have a more immediate impact on the program's outcome, or that other development partners are implementing such actions. International Organization for Standardization (ISO) certification of the new business registration system was not pursued because benefits will more likely come from this certification after a few years of experience operating the system. The government and female entrepreneurs have discussed the constraints to their businesses and further actions will be taken under the ADB Japan Fund for Poverty Reduction Women's Entrepreneurship Development Project.¹⁷ The number of inspection agencies was reduced from 21 to 12 in 2012. As a consequence, the number of business inspections excluding tax inspections declined from 21,000 in 2011 to 13,500 in 2013. The roll-out of the pre-customs single window in regions other than Bishkek and Chui requires more time and expertise, to be provided by ADB's Central Asia Regional Economic Cooperation Regional Improvement of Border Services Project.¹⁸ Online filing of pledges and payment of fees to enhance the secured lending framework is supported by the World Bank. No actions were deemed necessary to improve credit information sharing, given the significant progress thus far.¹⁹ The subprogram does not include a data-sharing mechanism between government agencies on access to finance by women, because NBKR now collects sex-disaggregated data from microfinance organizations. Tendering of PPP projects to the private sector has been delayed pending development by the government of adequate guidelines on the use of budgetary funds to finance project preparation. PPP sector policies will be developed in 2014 after the PPP policy is approved.

B. Governance

33. The legal basis for public financial management (PFM) has improved, but implementation challenges remain. The operational efficiency of PFM systems has improved in recent years, including through automation of tax and customs operations, replacement of manual reporting in some key PFM areas, introduction of management information systems, and modernization of treasury operations. The ongoing public expenditure review however

¹⁷ ADB. 2013. *Proposed Grant Assistance to the Kyrgyz Republic for the Women's Entrepreneurship Development Project*. Manila.

¹⁸ ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grants to the Kyrgyz Republic and the Republic of Tajikistan for the Central Asia Regional Economic Cooperation Regional Improvement of Border Services Project*. Manila.

¹⁹ Almost 1.2 million credit reports have been shared between credit institutions (banks and microfinance organizations) through the credit bureau in 2012 against an annual average of 371,000 between 2008 and 2011. Almost 100 institutions are now sharing information through the credit bureau, against 48 in 2012.

continues to reveal weaknesses: (i) inconsistent budget policy outcomes with a significant variation in the quality of public service provision; (ii) frequent reallocation of resources within the originally approved budget, resulting in low predictability of funds; (iii) weak links between sector strategies and the budget; (iv) low public access to key budget information; and (v) inadequate internal checks and balances.²⁰ The internal audit system is nascent and does not yet provide assurance of the legality, effectiveness, and efficiency of public funds use. Development partners continue to assist the government in addressing these weaknesses.

34. In 2012, the government decided to shift from manual to electronic procurement to limit the scope for corruption. The Public Procurement Development Strategy 2012–2014 is being implemented and reaffirms the government's commitment to improved public procurement.²¹ The Ministry of Finance, with ADB support, is establishing a centralized electronic procurement platform. Five government entities are involved in pilot testing of electronic tendering.

35. The Kyrgyz Republic scores poorly in Transparency International's Corruption Perception Index (150th out of 177 countries), although there has been some improvement following the political events of 2010. Rent-seeking and corrupt practices are perceived to be concentrated in government agencies that collect public revenues (e.g., taxes, customs, electricity fees, and social contributions), or that have regulatory or administrative powers (e.g., inspections, licensing, and the judicial system). Frequent and arbitrary renegotiations of concession agreements undermine investor confidence. Legal amendments were passed in August 2012 to further increase the liability for corruption or economic crimes. Amendments were made to the Constitutional Law in 2012 to lift the immunity of judges and members of the parliament. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

C. Poverty and Social

36. Policy reforms are expected to have an indirect medium- and long-term impact on poverty, mainly through increased employment opportunities and improved livelihoods. Reduction of regulatory costs and increased access to finance will increase business investments and help economic activities. Enhancement of workers' skills is expected to have more direct benefits on poverty if the poor continue to enroll in vocational schools. Subprogram 3 includes measures targeted at the population outside Bishkek, where poverty is more common. These measures include expansion of microfinance, establishment of one-stop no contact windows in tax offices outside main cities, and a public information campaign in all regions on tax requirements. This is expected to increase the number of low-income households who benefit directly from an improved business climate and better access to financial services.

37. Subprogram 3 includes policy actions designed to address obstacles faced by female entrepreneurs, and to promote a level playing field between male and female entrepreneurs. Patents (rather than other taxes) have been chosen for piloting electronic payments as they specifically benefit women (70% of female entrepreneurs use the patent system). The number of terminals at which patents can be paid greatly exceeds the original target. Electronic filing of taxes and no-contact windows in tax offices will deter corrupt practices and rent-seeking behavior, which especially affects female entrepreneurs, given the existing stereotypes about the role of women.²² Microfinance organizations will be able to offer additional services (e.g.,

²⁰ World Bank. Kyrgyz Republic: Public Expenditure Review Policy Notes (draft). Unpublished.

²¹ Resolution of the Government of the Kyrgyz Republic no. 661, of 27 September 2012.

²² Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

payments, savings, and demand deposits) tailored to women's needs. The expansion of leasing will also benefit women, who are frequently unable to offer collateral to obtain bank credit. Workshops were held to raise awareness among female entrepreneurs on the availability and benefits of leasing products for business development. Increased participation by women in decision making on skills development councils will promote consideration of their views in technical and vocational education, and improve outreach to girls. Implementation of a marketing plan to increase women's enrollment in technology-based, nontraditional vocational education training programs started under subprogram 3. The government will track and report the number of (i) female entrepreneurs, (ii) electronically filed tax declarations by women, (iii) leasing transactions by women, and (iv) women who enroll in modern competency-based training for promising occupations.

D. Safeguards

38. Subprogram 3 has no impact on environment or on indigenous peoples, and does not entail any involuntary resettlement. It is classified as category C.

E. Risks and Mitigating Measures

39. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan.²³ Economic slowdown in neighboring countries—particularly in the Russian Federation—may reduce inflow of remittances. Perception of weak government, high expropriation risk, and domestic political instability may deter private investment. The government has been implementing reforms to change the incidence and perception of corruption and expropriation risk. ADB supported a government working group that drafted amendments to the investment legislation to ensure a more stable legal and taxation regime for investors. The overall risk assessment of the program is medium and the government has in place necessary mitigating measures. The subprogram's integrated benefits and impacts are expected to outweigh the costs.

IV. ASSURANCES

40. The government and the Ministry of Economy have assured ADB that implementation of the subprogram shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the grant documents.

V. RECOMMENDATION

41. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$22,000,000 to the Kyrgyz Republic from ADB's Special Funds resources for subprogram 3 of the Investment Climate Improvement Program, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Takehiko Nakao
President

28 May 2014

²³ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines ^a	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impact Sustainable economic growth and employment creation</p>	<p>GDP growth higher than 5% per annum on average in 2014–2018 (2008–2012 baseline: average of 3.2%)</p> <p>Unemployment rate reduced to below 7% (both female and male) in 2018 (2012 baseline: 9.5% female, 7.7% male)</p>	<p>NSC annual statistical yearbook (www.stat.kg)</p> <p>NSC annual report on employment and unemployment. (www.stat.kg)</p>	<p>Assumption Sustained regional cooperation on trade and labor migration</p> <p>Risks Economic slowdown in neighboring countries may reduce inflow of remittances</p> <p>Domestic political instability may affect business environment, reducing economic growth and employment opportunities</p>
<p>Outcome Improved investment climate and business environment</p>	<p>Gross fixed capital formation, private sector increased to 23% of GDP in 2015 (2007–2011 baseline: average of 21.1% of GDP)</p> <p>Lending to the private sector increased to 15% of GDP in 2015 (2008–2011 baseline: average of 12.5% of GDP)</p> <p>Number of female entrepreneurs increased to 75,000 in 2015 (2011 baseline: 64,290)</p> <p>Female enrolment in technology-based, nontraditional vocational education training programs increased by 20% by 2015 (2013 baseline: 124)^b</p>	<p>World Bank, World Development Indicators</p> <p>International Monetary Fund, International Financial Statistics Online</p> <p>NSC: Women and Men in the Kyrgyz Republic (www.stat.kg)</p> <p>Agency for Vocational Education's progress reports under the Second Vocational Education and Skills Development Project^c</p>	<p>Assumption Continuous stakeholder support for reforms</p> <p>Risk Perception of weak government and high expropriation risk resulting from insufficient government efforts to fight corruption</p>
<p>Outputs 1. Cost of regulatory compliance reduced</p>	<p>Number of licenses and permits reduced from 347 to fewer than 200 by 2014</p> <p>At least 5,000 taxpayers (including at least 50% women) use electronic</p>	<p>Consolidated list of licenses and permits provided by the government</p> <p>State Tax Service, reports (www.sti.gov.kg)</p>	<p>Assumptions Increasing acceptance by the business community of the newly implemented government services</p>

Design Summary	Performance Targets and Indicators with Baselines ^a	Data Sources and Reporting Mechanisms	Assumptions and Risks				
	filing by December 2014 (baseline: zero usage before 2010) Pre-customs clearance time for imports reduced from 25 days in 2009 to 10 days by 2014; and for exports, from 23 days in 2009 to 10 days by 2014	World Bank Doing Business report					
2. Access to finance improved	Enforcement period for arbitral awards shortened to 6 months in 2014 (2010 baseline: 8 months) Number of financial leasing transactions increased to more than 400 in 2014 (2008–2012 baseline: average of 172 per year), of which 50% are for women At least two financial institutions providing microfinance are able to collect deposits that are tailored to women's needs (by December 2014)	World Bank Doing Business report Union of Kyrgyz Banks http://www.ub.kg/ru/liz/ National Bank of the Kyrgyz Republic, Bulletin (www.nbkr.kg)					
3. Workers' skills enhanced	At least 5,000 students (of whom at least 50% are women) enroll in modern competency-based training for 18 key occupations by December 2014	Agency for Vocational Education progress reports under the Second Vocational Education and Skills Development Project ^c					
4. Public–private partnerships facilitated	PDSF approved by the government by December 2014	Ministry of Justice, depository of laws and government resolutions	PDSF receives continuous allocations from the state budget				
Activities with Milestones Program activities Government complies with all policy actions as specified in the policy matrix by April 2014		Inputs ADB: \$22 million <table border="1" data-bbox="1040 1497 1432 1602"> <thead> <tr> <th data-bbox="1040 1497 1274 1535">Item</th> <th data-bbox="1274 1497 1432 1535">Amount</th> </tr> </thead> <tbody> <tr> <td data-bbox="1040 1535 1274 1602">Policy-based grant (ADF)</td> <td data-bbox="1274 1535 1432 1602">\$22 million</td> </tr> </tbody> </table>		Item	Amount	Policy-based grant (ADF)	\$22 million
Item	Amount						
Policy-based grant (ADF)	\$22 million						

ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, NSC = National Statistics Committee, PDSF = Project Development Support Facility.

^a The targets included in previous subprograms have been updated based on recent performance.

^b The Agency for Vocational Education has identified the following technology-based, nontraditional vocational education training programs for women: welder, electrician, forester, junior veterinarian, master of dry construction, driver, and cattle-rancher.

^c ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Kyrgyz Republic for the Second Vocational Education and Skills Development Project*. Manila.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=41544-084-2>

1. Grant Agreement
2. Sector Assessment (Summary): Multisector for Private Sector Development
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

DEVELOPMENT POLICY LETTER

**КЫРГЫЗ
РЕСПУБЛИКАСЫНЫН
ВИЦЕ-ПРЕМЬЕР-
МИНИСТРИ**



**ВИЦЕ-ПРЕМЬЕР-
МИНИСТР
КЫРГЫЗСКОЙ
РЕСПУБЛИКИ**

720003, Бишкек ш., Абдумомунов көч., 207

720003, г. Бишкек, ул. Абдумомунова, 207

201 4 -ж.г. « 30 » 04

№ 16-15009

DEVELOPMENT POLICY LETTER

**Mr. Takehiko Nakao
President
Asian Development Bank
Manila, Philippines**

Subject: Subprogram 3 of the Investment Climate Improvement Program

Dear Mr. President,

On behalf of the Government of the Kyrgyz Republic I would like to thank the Asian Development Bank (ADB) for its continued support of the Kyrgyz Republic's development process across major economic sectors.

During the two decades following the breakdown of the Soviet Union, the Government of the Kyrgyz Republic has been working on improvement of economic and social situation, not without support from donor countries and international organizations. Due to weak governance, corruption and criminalization of certain state institutions under the rule of the first two presidents of the country, these undertakings have not provided sufficient impetus to national development. Persistent poverty and economic disparities are the most significant challenges the Government is facing. The poverty rate declined rapidly from 56.4% in 2001 to 31.7% in 2008. A harsh winter of 2008, the global economic crisis and the events of 2010, stalled progress and as a result, poverty rate rose to 38.0% in 2012.

The Kyrgyz Republic's economy continues to experience unstable economic growth, with external and internal shocks causing sudden and sharp slowdowns in the narrowly based economy. It remains dependent on external financial and energy resources. The Government's lack of financing capacity is limiting investment in public goods. Private investment has been accounting for about 75% of total investment.

The Government's development expenditures and financing needs over the next years are substantial. The 2014 budget allocates 50.3% of the available resources (or 13.9% of GDP) to social expenditures in education, health and social protection. The Government has a limited fiscal space, with external public debt at 44.6% of GDP in 2013.

Adoption of the new Constitution and the first in the history of the independent Kyrgyz Republic free democratic elections in 2010 and 2011 have revived the hopes of the people for justice and prosperity. National Sustainable Development Strategy for the Kyrgyz Republic for the period of 2013-2017 outlines the Government's vision for resolving the most urgent social, political, economic, ideological, regional and ethnic issues. The strategy envisions the Kyrgyz Republic as a country with robust economic growth and high attractiveness for investors. The strategy foresees measures required to enforce the rule of law and combating corruption. In the economic sphere, our major focus is to create an attractive environment for domestic and foreign investors. Of particular importance is the need for private investments that will increase productive capabilities and create jobs.

Mr. President, let me stress that the Government is committed to economic structural reforms to achieve those goals. Development of the private sector's productive capabilities is a cornerstone of our economic strategy. This is crucial for diversification into higher-value-added products and opening up new markets. The partnership with the ADB Investment Climate Improvement Program has been key for improvement of the business environment and enabling investors and entrepreneurs to expand, perform better, and innovate. Our program continues to focus on key weaknesses of our investment climate, namely, high cost of regulatory compliance, limited access to finance, and lack of skilled workers. We also continue to develop the framework for public-private partnership as a key solution to improving investment outcomes.

Cost of Regulatory Compliance Reduced

To reduce the costs of regulatory compliance, we have further reduced the number of necessary licenses and permits and have consolidated all 98 activities subject to licenses and permits in a single law. The State Tax Service (STS)'s risk-based audit system was enhanced and merged with the new integrated IT system developed with the ADB support. Since June 2013, all tax offices have been obliged to implement inspection plans generated in STS headquarters by the enhanced system. This is expected to improve targeting of tax audits and reduce the burden of businesses with low non-compliance risk.

A new law on electronic tax declarations using a 'login-password' system was approved to enable the new ADB-financed project. It should increase the number of taxpayers filing declarations online to over 5,000 and reduce costs. The STS started pilots of accepting payments for tax patents through cash terminals in major trade and market areas like "Ortosai" and "Madina", and subsequently expanded the pilot to the whole country allowing thousands of patent holders to pay their taxes without having to go to a bank branch. The STS has taken steps for accepting payment through the national card payment system (Elcard) by accepting ATM receipts as proof of payment and signing agreements with the Interbank Processing Center and three commercial banks. The STS has also reduced tax compliance costs and scope for informal payments by introducing additional one-stop shops with no contact windows for taxpayers in rural areas and by conducting a campaign to raise taxpayers' awareness on how to make use of new mechanisms to comply with tax requirements (e.g. electronic declaration and call center) in rural areas.

We have continued the implementation of the single window for foreign trade clearance which was piloted under subprogram 2. The new system started operating in Bishkek in 2013 and has issued more than 150 customs clearance folders for foreign trade transactions. More than 40 companies have so far benefitted from the new system. Moreover, the Customs Service allowed all qualified importing and exporting businesses to access its new ADB-financed IT system. The new system has reached all customs posts in the country.

Access to Finance Improved

The government has continued to address structural impediments to lending by promoting alternative financial products and strengthening nonbank financing sources, including microfinance organizations (MFOs). The focus has been on increasing access to finance for SMEs and microenterprises - particularly women entrepreneurs, who account for 75% of MFO borrowers.

Protection of creditors' rights and dispute resolution framework were further improved with enactment of legal amendments that enable accelerated court enforcement of arbitral awards. Leasing market is growing as a result of amendments to the Tax Code supported by previous subprograms. It reached \$7.1 million of transactions in 2012 against an average of \$2.3 million per year in 2008-2011. Under subprogram 3, the government has raised awareness of this alternative financial product among women entrepreneurs, who are in need of loans but often cannot offer collateral.

A law was enacted to allow MFOs to offer additional financial services acting on behalf of banks and to conduct foreign exchange transactions. The Deposit Protection Agency has also designed a program of required measures to provide deposit insurance for small depositors in case of MFO failure. These measures will help develop saving products for lower income households by increasing trust in a wider range of financial institutions. To support prudent microfinance development, National Bank of the Kyrgyz Republic (NBKR) strengthened its risk-based supervisory capacities by adopting new operational procedures for off-site and on-site supervision of MFOs. It has also strengthened consumer protection and fostered responsible lending practices for all financial institutions, introducing legal, regulatory and supervisory changes to prevent over-indebtedness, set responsible pricing for products, and increase the transparency of communication with clients.

Workers' Skills Enhanced

The Government continued its efforts to make its technical and vocational education and training system more responsive to market needs and to address the lack of qualified workers. We have further strengthened the institutional framework for workers' skills development by establishing appropriate rules on the composition and functioning of sector skills development councils, including the need for broad participation of private sector stakeholders and women entrepreneurs. We have also established additional councils for the energy and mining sectors to expand dialogue between businesses and government in these priority sectors.

The Agency for Vocational Education (AVE) has been rolling out competency-based training for 18 key occupations in more than 30 schools and more than 6,000 students have already benefitted from this initiative. ADB support for this effort has been crucial. The AVE introduced a marketing plan that aims to increase female enrollment in technology-based and nontraditional vocational education training programs. With this measure we aim to bring more women into better paid jobs and thus help to reduce the salary gap between men and women.

Public-Private Partnerships Facilitated

The Government has further developed the policy, legal and institutional framework for PPPs which requires further improvements. We have amended the following laws to align them with the PPP Law: the Tax Code, the Customs Code, the Land Code, the Law on Basic Principles of Budget Law, the Law on Financial and Economic Conditions of Local Self-Government, the laws on the Status of the

Capital City Bishkek and the Status of the City of Osh, the Law on Local State Administration, the Law on Local Self Government, and the Law on Municipal Ownership. We have also adopted standard development and tender procedures for PPP projects.

To provide financing for PPP project development and implementation, we have approved the Scheme and Guidelines for a Project Development Support Facility (PDSF). To increase the quality and quantity of successful PPPs and the Government decision-making, the PDSF will finance development expenses of potential PPP projects including costs of engaging consultants and transaction advisors. The Government has allocated \$2 million to the PDSF in the 2014 budget and we pledge additional allocations of at least \$1 million in both 2015 and 2016 budgets.

The Government has been developing a pipeline of credible PPP projects and building capacity in different ministries to prepare and implement PPP projects. The pipeline of PPP projects has made good progress under subprogram 3: 21 project proposals have so far been identified by 3 line ministries and the City of Bishkek. The Ministry of Economy has prepared position papers on 6 project proposals that have been shared with respective line ministries. Opportunities for PPPs in the health sector have been identified: pre-feasibility studies have been completed for 3 out of 7 initial project ideas and 2 feasibility studies have been commissioned (proposals for a central laboratory and for hemodialysis units have so far demonstrated potential for PPPs). Feasibility study has been completed and tender documents prepared for 1 potential PPP project (Karakul Hydropower plant).

Mr. President, the Government of the Kyrgyz Republic continues to face significant development financing needs. The Investment Climate Improvement Program is a vital mechanism for addressing this issue, not only for the direct support to the state budget but mostly because it helps bringing more private investment to finance our development strategy. I hope our cooperation will result in poverty reduction and growth of prosperity in the country. I appreciate your continued support in this endeavor.

Best Regards,



Valery Dill
Vice Prime Minister,
Kyrgyz Republic

POLICY MATRIX

Principal Objective	Subprogram 3	
	Detailed Actions	Results
Output 1: Cost of Regulatory Compliance Reduced		
Simplified business licensing and inspection procedures	1.1 To further simplify licensing of businesses, (i) reduce the number of licenses and permits from 347 to fewer than 200, based on a regulatory impact assessment, and (ii) consolidate all types of licenses and permits into one single law.	Complied with. Law no. 195, enacted on 19 October 2013, reduces the number of licenses and permits to 98 types of activities and consolidates them in a single law. The law was prepared with USAID support.
	1.2 The STS to take further steps towards risk-based auditing of businesses by mandating all tax offices to implement inspection plans generated at the central level by computer software.	<p>Complied with. In 2011–2012 the STS introduced with IFC support the concept of risk-based auditing and a new audit software that generates audit plans based on pre-determined risk criteria. However, at the beginning of ICIP subprogram 3, in about 50% of the tax offices, tax inspections were still conducted grounded on paper-based plans proposed by tax offices and approved at the regional or central level. This practice lacked adequate transparency and was not sufficiently risk-based, imposing unjustified costs to businesses that are in compliance.</p> <p>In 2013, the risk-based audit system was enhanced and merged with the new STS integrated IT system developed with ADB support. The enhanced system was extended to all tax offices.</p> <p>An STS Order was approved in May 2013 which mandates all tax offices to implement inspection plans generated in STS headquarters by the enhanced system starting from third quarter of 2013. This will improve targeting of tax audits and reduce the burden for businesses that have low risk of non-compliance.</p>

Principal Objective	Subprogram 3	
	Detailed Actions	Results
Reduced tax compliance costs	<p>1.3 Expand options for electronic tax filing and payments, with particular benefits for women entrepreneurs, by:</p> <ul style="list-style-type: none"> (i) allowing electronic submission of tax returns using login-password system, (ii) starting a pilot for electronic payment of patents which is the tax regime for the majority of women entrepreneurs, and (iii) accepting payment of taxes using the national electronic card payment system (Elkart). 	<p>Complied with. The Law no. 57 on electronic submission of tax returns using login-password system was enacted on 24 April 2013. Government resolution no. 453, of 6 August 2013, details the implementation procedures. The new system is now available to taxpayers in Bishkek. It will significantly reduce costs of electronic submission of tax returns and help increase the number of taxpayers filing electronically (4,665 taxpayers, as of 30 June 2013).</p> <p>In 2013, STS started pilots in Ortasai and Madina markets for electronic payment of patents through cash terminals that can be used by thousands of patent holders. STS went beyond the initial plan and has already expanded this approach: currently there are 174 terminals across the country where patent holders can pay their taxes without having to go to a bank branch. Patent tax (rather than other taxes) was chosen for piloting electronic payment as it specifically benefits women (70% of women entrepreneurs work under the patent system).</p> <p>STS has signed an agreement with the Interbank Processing Center accepting payment of taxes through the Elkart payment system. Agreements have also been signed with 3 banks accepting payments with cards in ATMs. Government resolution no. 642/44/12, of 27 November 2013, authorizes the use of ATM receipts as proof of payment of taxes. This is in line with the State Program on Increase of Non-cash Payments.</p>

Principal Objective	Subprogram 3	
	Detailed Actions	Results
	1.4 Expand initiatives to reduce informal payments to tax officials in rural areas by establishing one-stop shops with no-contact windows in at least 10 tax offices outside main cities.	<p>Complied with. STS has completed the construction of 10 new one-stop shops with no-contact windows in the following tax offices: Issyk-Ata, Kemin, Tyup, Jety-Oguz, Ak-Suu, Batken, Kadamjay, Leilek, Batken city and Sulyukta city.</p> <p>The new layout in the tax offices requires taxpayers and tax officials to discuss tax matters in an open space where they are separated by a desk with a window. This will dissuade rent-seeking behavior that often occurs in closed rooms, which especially affects women entrepreneurs (given the existing traditional and religious stereotypes about the role of women).</p>
	1.5 Conduct a public information campaign to raise taxpayers' awareness in rural areas on how to comply with tax requirements.	<p>Complied with. STS conducted a public communications campaign in the second half of 2013 to inform taxpayers about the new call center, the new website, the new system of electronic tax declarations, and the new one-stop shops with no-contact windows. Billboards, seminars, and media clips were used in the campaign.</p>
Improved cross-border trade	<p>1.6 Simplify foreign trade clearance by</p> <ul style="list-style-type: none"> (i) making the pre-customs single window (PCSW) operational with 150 customs clearance folders issued by the PCSW, for at least 20 companies, that are electronically submitted to the Unified Automated Information System (UAIS) of the State Customs Service, and (ii) implement and allow access of qualified importing and exporting businesses to the new UAIS. 	<p>Complied with. The PCSW initiated its operations in Bishkek in the last quarter of 2013. The system has been rolled out and nine government agencies are fully connected. An agreement on electronic interchange of information between PCSW and Customs UAIS was signed on 23 September 2013. As of 21 February 2014 the PCSW had issued 208 customs clearance folders for foreign trade transactions that have been electronically received by Customs. The target for 2014 is 5,000 electronic clearance documents. More than 40 traders and brokers have so far used the new system.</p> <p>The State Customs Service has implemented the ADB-financed UAIS from October 2012 to December 2013. All 40 customs posts and offices are now connected to</p>

Principal Objective	Subprogram 3	
	Detailed Actions	Results
		the UAIS. More than 190,000 electronic customs declarations have been processed in 2013 (73.6% of total declarations issued in 2013). In 2014, all customs declarations have been issued on electronic format through the UAIS. The UAIS has an online interface that can be accessed by more than 400 users.
Output 2: Access to Finance Improved		
Improved creditor rights and dispute resolution framework	2.1 Enact the amendments to the Civil Procedures Code to enable accelerated court enforcement of arbitral awards.	Complied with. Under subprogram 2, the government drafted amendments to the Civil Procedures Code to (i) reduce the period of review by the state courts of the request for writ of execution to enforce arbitral awards and (ii) introduce the institute of provisional measures imposed by the state courts in arbitration cases. These amendments were submitted to Parliament and subsequently approved by the President (Law no. 217, of 11 December 2013).
Development of financial leasing facilitated	2.2 Ministry of Economy (i) approves and initiates implementation of a time-bound action plan of targeted workshops to raise awareness among women entrepreneurs on availability and benefits of leasing products for their business development, and (ii) allocates necessary resources for its implementation.	Complied with. The Ministry of Economy approved on 30 December 2013 an action plan for 2014 to raise awareness among women entrepreneurs on the availability and benefits of leasing products. The action plan includes workshops in all regions of the country. The Ministry of Economy has allocated staff and venues where workshops will be held. The Ministry also allocated resources under the ADB-JFPR's Women Entrepreneurship Development Project to help implement the action plan. Two pilot workshops were conducted in February 2014, one in Bishkek and one in Osh.

Principal Objective	Subprogram 3	
	Detailed Actions	Results
Increased availability of financial services and strengthened consumer protection	<p>2.3 Broaden the scope of services provided by MFOs, including deposit services provided by qualified MFOs, to respond to the needs of women entrepreneurs in particular, by:</p> <ul style="list-style-type: none"> (i) allowing MFOs to act as bank agents and to conduct foreign exchange transactions, and (ii) developing a program of required measures for deposits in qualified MFOs to be covered by an insurance scheme, including integration of qualified MFOs into the national payment system. 	<p>Complied with. Under subprogram 2, the government submitted to the Parliament draft amendments to the laws on microfinance, on credit unions, and on foreign exchange transactions. Under subprogram 3, the amendments were enacted through Law no. 60 of 26 April 2013, allowing qualified MFOs to act as bank agents and to conduct foreign exchange transactions.</p> <p>The government approved its resolution no. 198, of 2 April 2014, on a program of required measures for deposits in qualified MFOs to be covered by an insurance scheme. The resolution was prepared by an interagency committee headed by the Deposit Protection Agency, with ADB technical assistance.</p>
	<p>2.4 The NBKR to strengthen risk-based supervision of MFOs by adopting an integrated framework for off-site supervision and onsite inspections.</p>	<p>Complied with. NBKR has adopted a new integrated framework with (i) new manual for off-site supervisory procedures, including criteria, indicators and thresholds to determine program of annual targeted onsite inspections, and (ii) new manual for onsite inspection procedures. The new framework was prepared with ADB technical assistance.</p>
	<p>2.5 To improve consumer protection, particularly women borrowers, NBKR will</p> <ul style="list-style-type: none"> (i) define minimum standards for affordability assessments of MFOs' clients and identify and monitor early warning indicators of debt stress to prevent borrowers' over-indebtedness, (ii) require MFOs to increase the transparency of interest rate calculation by providing information to borrowers about effective interest rates, and (iii) set standards for responsible and transparent pricing of loans. 	<p>Complied with. Article 35.2 of the Law No. 60 from 26 April 2013, on amendments to the Law on MFOs (and others), describes minimum standards for lending. NBKR approved resolution No. 41/10 that introduces (i) strengthened requirements for financial institutions' loan screening and for information to be collected from borrowers, and (ii) increased customers' rights and transparency measures. Revised inspection procedures adopted in 2013 include inspection of (i) loan appraisal and cash flow analysis, (ii) completeness of borrower records, (iii) appropriateness of MFO staff's incentive payments, (iv) sample loan agreements, (v) average</p>

Principal Objective	Subprogram 3	
	Detailed Actions	Results
		<p>loan size, (vi) loan rescheduling, and (vii) portfolio-at-risk.</p> <p>NBKR Resolution no. 51/3 of 27 December 2012 mandates financial institutions to (i) reflect effective interest rates, all other related costs, and monthly repayment schedule in the loan agreement; and (ii) publicly advertise and disseminate information of both nominal and effective rates.</p> <p>Article 35.2 of the Law No. 60 from 26 April 2013, on amendments to the Law on MFOs (and others) restricts penalty rates to 20% of the credit amount. NBKR approved Resolution no. 35/14 of 25 September 2013 on minimum credit risk requirements for non-deposit-taking microfinance organizations, including recommendations for pricing policy.</p>
Output 3: Workers' Skills Enhanced		
Improved worker skills through demand driven vocational education	<p>3.1 National Skills Development Council (NSDC) to recommend and Agency on Vocational Education (AVE) to approve (i) regulations on the composition and functioning of sector skills development councils and (ii) establishment of such councils in two additional priority sectors. The sector councils will allow broad participation of private sector stakeholders and women entrepreneurs.</p>	<p>Complied with. AVE Order no. 1/235, of 4 November 2013, approved the regulations on the composition and functioning of sector councils. The regulations require sufficient involvement of private sector participants and women in the composition of sector councils.</p> <p>In May 2012, the NSDC approved the establishment of sector councils for 5 priority sectors (agriculture/agro-processing, construction, textiles and garment, restaurants and hotels, and tourism). In September 2013, 2 additional councils (for the mining and energy sectors) were established. The 7 sector councils comprise a total of 54 members, of which 25 are women. The ADB-financed Second Vocational Education and Skills Development Project will provide assistance to the skills development councils over the next few years.</p>

Principal Objective	Subprogram 3	
	Detailed Actions	Results
	<p>3.2 Further improve technical and vocational education training by (i) introducing modern competency-based training for 18 occupations to at least 5,000 students; and (ii) starting implementation of a marketing plan to increase female enrollment in technology-based and nontraditional vocational education training programs.</p>	<p>Complied with. AVE has been rolling out competency-based training. As of 30 November 2013, 6,270 students in 34 primary vocational schools have received competency-based training, of which 46% are women.</p> <p>A marketing plan was approved in September 2013 to increase female enrollment in technology-based and non-traditional occupations. Implementation of the campaign started in March 2014 with ADB support.</p>
Output 4: Public-Private Partnerships Facilitated		
Improved enabling environment for PPP	<p>4.1 The government to:</p> <p>(i) adopt standard development and tender procedures for PPP projects, and</p> <p>(ii) enact amendments to the Tax Code, the Customs Code, the Land Code, the Law on Basic Principle of Budget Law, Law on Financial and Economic Conditions of Local Self-Government, the laws on the Status of the Capital City Bishkek and the Status of the City of Osh, the Law on Local State Administration, the Law on Local Self Government, and the Law on Municipal Ownership, to harmonize them with the PPP law.</p>	<p>Complied with. The government approved through Resolution no. 39 of 28 January 2013, (i) the Provisions on the Tender Committee on Selection of Private Partners for PPP Projects and (ii) the Procedure on Preparation of Tender Rules and Tender Documentation for PPP projects.</p> <p>Law no. 201, enacted on 15 November 2013, amends 10 laws to harmonize them with the PPP law.</p>
	<p>4.2 To provide financial support for PPP project development and implementation the government will:</p> <p>(i) approve a PPP project development support facility (PDSF); and,</p> <p>(ii) ensure, through annual allocations from the state budget, minimum financial resources in the PDSF (\$2 million in 2014, \$1 million in 2015, and \$1 million in 2016).</p>	<p>Complied with. Government resolution no. 147, of 17 March 2014, approved the establishment, governance, funding and operational guidelines for a PPP project development support facility. The resolution was drafted by the Ministry of Economy with ADB support. The PDSF is designed as a revolving fund, recovering costs from winning bidders into the PDSF.</p> <p>The government resolution approves an allocation of \$2 million from the state budget to the PDSF in 2014—which is also reflected in the 2014 budget law—\$1</p>

Principal Objective	Subprogram 3	
	Detailed Actions	Results
		<p>million in 2015 and \$1 million in 2016.</p> <p>The seed funding for the PDSF is based on international experience which shows that development costs are usually about 5% of project cost for mid-sized projects (e.g., \$100-300 million).</p>
PPP project pipeline developed	<p>4.3 To further develop a pipeline of PPP projects:</p> <p>(i) the Ministry of Economy will complete position papers on 6 PPP project proposals,</p> <p>(ii) the government will complete feasibility studies for at least 1 project.</p>	<p>Complied with. The pipeline of PPP projects has made good progress under subprogram 3, with 21 project proposals so far identified by 3 line ministries and the City of Bishkek. The Ministry of Economy has prepared position papers on 6 project proposals that have been shared with the respective line ministries. ADB technical assistance prepared a template for position papers (i.e., in-principle approval or rejections for PPP proposals submitted by line ministries and implementing agencies) and guided the Ministry of Economy's staff in this process.</p> <p>Three feasibility studies have been completed (Karakul hydropower plant, performance based maintenance for the Bishkek- Kara Balta road section, and small hydro power plants) and two tender documents prepared for potential projects. Pre-feasibility studies have been completed for five of the seven initial project ideas in the health sector and two feasibility studies have been commissioned.</p> <p>Opportunities for PPPs in the health sector have been identified: pre-feasibility studies have been completed for 5 of the 7 initial project ideas and 2 feasibility studies have been commissioned (the proposals for a central laboratory and for hemodialysis units have so far demonstrated potential for PPPs).</p>