ASIAN DEVELOPMENT BANK

Kyrgyz Republic: Second Investment Climate Improvement Program (Subprogram 1)

Project Name	Second Investment Climate Improvement Program (Subprogram 1)
Project Number	41544-088
Country	Kyrgyz Republic
Project Status	Closed
Project Type / Modality of Assistance	
Source of Funding / Amount	**Grant 0432-KGZ: Second Investment Climate Improvement Program (Subprogram 1)** concessional ordinary capital resources lending / Asian Development Fund — US$ 20.00 million
Strategic Agendas	Inclusive economic growth Regional integration
Drivers of Change	Governance and capacity development Knowledge solutions Private sector development
Sector / Subsector	**Education** - Technical and vocational education and training **Finance** - Finance sector development - Inclusive finance - Small and medium enterprise finance and leasing **Industry and trade** - Industry and trade sector development **Public sector management** - Law and judiciary - Public expenditure and fiscal management
Gender Equity and Mainstreaming	Effective gender mainstreaming
Description	The proposed program aims to create a more attractive climate for private sector development in the Kyrgyz Republic. It will provide budget support to implement reforms to (i) increase and diversify financial products and services that better mobilize domestic savings; (ii) increase efficient private sector participation in physical and social infrastructure; (iii) diversify exports and export markets, and foreign direct investment; and (iv) increase the transparency and efficiency of public procurement, and reduce the costs of doing business. The programmatic approach will comprise three subprograms to be implemented during 2015_-2018. The impact of the Second ICIP will be increased private sector investment. The outcome will be an improved business and investment climate in the Kyrgyz Republic. The Second ICIP will deliver four outputs through various policy actions: (i) financial deepening and access to finance increased; (ii) comprehensive public_private partnership program fostered; (iii) trade and investment facilitated; and (iv) transparency and efficiency of doing business increased. Through the Second ICIP, ADB will continue to support the National Sustainable Development Strategy, 2013_-2017 in removing development constraints. Reforms listed in the policy matrix will facilitate the Kyrgyz Republic's transition to a sustainable economic development path. Budget support is necessary to finance part of the development financing needs, particularly covering the period between the introduction of reforms and the fiscal benefits resulting from the reforms. Although not used as a determinant of the program size, ADB's support can also help finance the direct and indirect fiscal costs to the government of implementing and monitoring the reforms. The government has the ability to implement the reforms effectively, demonstrated by its experience under the first ICIP and with the policy-based programs of other development partners. The Second ICIP is estimated to cost $63 million equivalent for 2015_2018, to help support a part of the development financing needs from the perspective of the overall projected budgetary financing requirements of the country (para. 14). The development financing needs are projected at approximately $600 million (2015), $517 million (2016), and $424 million (2017). The government has requested a grant not exceeding $20 million from ADB's Special Funds resources to help finance subprogram 1. Subprogram 2 (with an estimated loan amount of $23 million) and subprogram 3 (with an estimated loan amount of $20 million) are subject to further discussion between ADB and the government. The grant for subprogram 1 will be provided in a single tranche and funds may be withdrawn upon fulfillment of the policy actions. The subsequent subprograms will be submitted for ADB Board consideration upon completion of the policy actions. The proceeds of the grant will be disbursed in accordance with ADB's simplification of disbursement procedures and related requirements for policy-based loans Note: A country's eligibility for Asian Development Fund grants under the revised grant framework is determined by its risk of debt distress. The outlook for the Kyrgyz Republic has deteriorated markedly since 2014. ADB considers that the Kyrgyz Republic is at moderate risk of debt distress for 2014, and is therefore eligible to receive 100% Asian Development Fund grant allocation.

Project Rationale and Linkage to Country/Regional Strategy	The Asian Development Bank (ADB) has supported the government to address development constraints on business regulation, access to finance, workers' skills development, and public_private partnerships (PPPs). From 2008 to 2014, the first ICIP and attached technical assistance helped reduce the costs of doing business by eliminating 75% of business licenses required at the start of the first ICIP, implementing a one-stop shop business registration system, and creating a single window for pre-customs clearance. Access to finance, particularly through leasing, was improved through legislation requiring sharing of information among credit finance organizations. The average volume of transactions increased from $2.3 million per year during 2008_2011 to $10.0 million during 2012_2013. Strengthening the enabling environment for PPPs has resulted in a pipeline of 14 projects at various stages of preparation. Improvements include the PPP law (largely in line with international benchmarks); clearly defined coordination, risk management, and development roles among the Ministry of Economy (MOE), the Ministry of Finance, and line ministries; and project preparation support through the Project Development Support Facility (PDSF).Overall, progress has been made in enabling the private sector to contribute more effectively to growth.Despite the progress made under ADB's past assistance there are still policy distortions and market failures in five areas, constraining the private sector from contributing more effectively to stable and sustainable economic growth. Limited access to finance and financial services: The financial sector has grown steadily since 2004, with assets, loans, and deposits all increasing faster than gross domestic product (GDP) since 2011. However, a low level of financial intermediation persists, and savings mobilization is particularly small (financial sector assets were 38% of GDP in 2013). Financial product diversification is limited. Financial services and access to finance, including long-term finance for small and medium-sized enterprises (SMEs), are still restricted. High interest rates and collateral requirements also make it difficult for SMEs to borrow. Small agricultural producers and SMEs owned and operated by women are particularly disadvantaged due to a lack of (i) supply chain finance instruments (e.g., warehouse receipts), (ii) an effective commodities exchange, and (iii) mechanisms to reduce the perceived risk of lending under low collateral conditions. Microfinance organizations with assets over 6% of GDP provide one-third of the economy's total credit, but are constrained in their ability to grow due to laws that do not allow deposit-taking and related prudential regulation. Regulations and laws expanding access to Islamic banking services were approved in 2013, but a prudential regulatory framework for Islamic finance does not yet exist. The economy remains heavily cash-based, imposing large costs on the day-to-day transactions of government, businesses, and consumers. New technologies that promote mobile financial services have the potential to lower the costs of providing financial services, reach new customers, increase transparency, and expand lending capacity by increasing the volume of money in the formal financial system. A robust regulatory framework is required to enable these technologies to be deployed in a structured manner and to enable the industry to make the necessary investments. Nascent private sector participation in infrastructure development.:The legal, regulatory, and institutional framework has been created for private sector participation in infrastructure development, including through PPPs. A credible PPP program selects the most viable projects that are anchored in robust public investment programming and are properly structured, starting with pilot projects to develop experience. However, key government ministries and agencies responsible for developing, coordinating, and promoting PPPs have weak operational knowledge and capacity, which has resulted in an ad hoc selection of projects. In addition, an absence of standardized PPP documentation (e.g., concession agreements) makes transaction costs high. The banking sector and capital markets are not yet able to provide long-term finance for infrastructure. Government financial support mechanisms (e.g. guarantees, viability gap funds, and mechanisms facilitating long-term debt), especially needed in the early stages of PPP market development, are in early stages of development. Undiversified trade and investment. Trade and investment remain undiversified despite generally open policies. International trade has become an increasingly important part of the economy, with the Kyrgyz Republic's trade-to-GDP ratio rising from 95% in 2005 to over 143% in 2013. However, exports remain concentrated on a low number of value-added products sent to a few destinations. This puts exporters at risk when any export markets experience an economic downturn, as is currently happening in the region. The country is open to foreign direct investment (FDI), but FDI is forthcoming mostly for capital-intensive, extractive industries like mining and energy, and from a limited number of investors Therefore, FDI has minimal linkages with the local economy and generates modest employment. Investment-related disputes are inevitable in any country, but repeated renegotiation of contractual obligations has occurred on one major mining operation. This carries serious reputational risks, undermining other efforts to promote investment. Industry_labor market skills mismatch: The curricula and training being provided under the general education and technical and vocational education systems are not compatible with the current and future needs of the labor market. There is an oversupply of unskilled workers and professionals with law, economics, and management degrees, and there is a shortage of graduates in scientific, technical, and engineering fields, and of workers qualified for mid-level positions requiring technical and other industry-specific skills. Weak governance: Lack of transparency and real and perceived corruption continue to adversely affect the investment climate. The country's corruption perception index is ranked 136 out of 175 countries, improved from 154 in 2013. Progress is being made, but challenges remain. A reduction from 370 to 98 in the number of activities requiring licenses, tax payment automation, and risk-based business inspections (all introduced under the first ICIP) has helped reduce corruption. E-procurement, which accounted for about 5% of GDP and about 20% of the budget in 2014, can increase transparency and reduce corruption. The government's efforts to remove constraints to growth are supported by various development partners. The International Monetary Fund's Extended Credit Facility (2011_2014) supported efforts to consolidate the country's fiscal position and develop the financial sector. The credit facility approved in April 2015 will support fiscal sustainability and reforms to boost the economy's potential. The World Bank's Development Policy Operations 1 and 2 concentrated on public finance management, corruption, and increasing competitiveness. The International Finance Corporation is working on risk-based inspections, agricultural export potential, and the investment policy framework. The United States Agency for International Development, Japan International Cooperation Agency, European Bank for Reconstruction and Development, German development cooperation through KfW and GIZ, and the Swiss State Secretariat for Economic Affairs also support various aspects of private sector development. ADB's long-term partnership with the Government during the first ICIP enabled ADB to motivate the government to undertake reforms that might not have been addressed otherwise.
Impact	Increased private sector investment

Project Outcome

Description of Outcome	Improved investment and business climate
Progress Toward Outcome	
Implementation Progress	
Description of Project Outputs	Financial deepening and access to finance increased Comprehensive PPP program fostered Trade and investment facilitated Transparency and efficiency of doing business increased.
Status of Implementation Progress (Outputs, Activities, and Issues)	All policy reforms, targeted for completion under subprogram1 for each of the four outputs, have been completed. $20million disbursed.
Geographical Location	Nationwide

Safeguard Categories

Environment	C
Involuntary Resettlement	C
Indigenous Peoples	C

Summary of Environmental and Social Aspects

Environmental Aspects	The project is a program grant with policy conditions for reforms and does not entail any environmental impact.
Involuntary Resettlement	The project is a program grant with policy conditions for reforms and has no adverse impact on indigenous peoples.
Indigenous Peoples	The project is a program grant with policy conditions for reforms and does not entail any involuntary resettlement of people.
Stakeholder Communication, Participation, and Consultation	
During Project Design	Stakeholders including relevant government departments, private sector, financial institutions, consumer and business associations and development partners are being consulted.
During Project Implementation	The same set of stakeholders will be consulted during implementation.

Responsible Staff

Responsible ADB Officer	Sood, Priyanka
Responsible ADB Department	Central and West Asia Department
Responsible ADB Division	Public Management, Financial Sector and Trade Division, CWRD
Executing Agencies	*Ministry of Economy* *106, Chui Prospect, Bishkek, Kyrgyz Republic*

Timetable

Concept Clearance	23 Sep 2014
Fact Finding	04 Feb 2015 to 17 Feb 2015
MRM	15 Apr 2015
Approval	17 Jun 2015
Last Review Mission	-
Last PDS Update	09 Sep 2015

Grant 0432-KGZ

Milestones					
Approval	Signing Date	Effectivity Date	Closing		
			Original	Revised	Actual
17 Jun 2015	17 Jun 2015	30 Jul 2015	31 Dec 2015	-	06 Oct 2015

Financing Plan		Grant Utilization			
	Total (Amount in US$ million)	Date	ADB	Others	Net Percentage
Project Cost	20.00	Cumulative Contract Awards			
ADB	20.00	17 Jun 2015	20.00	0.00	100%
Counterpart	0.00	Cumulative Disbursements			
Cofinancing	0.00	17 Jun 2015	20.00	0.00	100%

Project Page	https://www.adb.org/projects/41544-088/main
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