PROGRAM IMPACT ASESSMENT

1. The program size is determined based on the development financing needs of the country, the scope and nature of the package of policy reforms and the potential development impact of these reforms, with reference to specific elements of the government's development expenditure programs supported by counterpart funds of the grants and loan.

2. Economic growth in 2016 slowed marginally to 3.8% (from 3.9% in 2015). Recovery of the gold sector, and increase in private consumption fueled by increased remittances due to easier access to the Eurasian Economic Union (EEU) labor markets[1] and government spending helped offset a slowdown in manufacturing as well as spillovers from the recession in the Russian Federation and slower growth in Kazakhstan. Exports increased by 4.8% due to increase in exports by 4.3% to EEU member countries[2] and by 5.3% to other main markets. Imports declined by 5.7 % mainly driven by lower energy imports and weak domestic demand. The Som appreciated by about 9% relative to the US dollar.

3. The fiscal deficit is projected at 4.7% of GDP in 2017. Revenue and expenditure rationalization measures to meet the 2017 fiscal deficit target of 3% of GDP will continue, as required under the Three Year Extended Credit Facility of the International Monetary Fund.[3] Revenue enhancement and expenditure rationalization measures include elimination of the value-added tax exemption on flour, rationalizing the public sector wage bill, and streamlining spending on goods and services and better targeting of subsidies, as well gradually reducing, with IMF support, the overall government wage bill to 8% of GDP by 2018 from 9.6% in 2016. However, overall, downside risks remain—from possibly lower-than-projected commodity prices and/or slower-than-anticipated growth in key trading partners, particularly the Russian Federation and Kazakhstan. Lack of full compliance with EEU regulations and proactive measures to capitalize on the European Union's Generalized System of Preferences Plus (GSP +)[4] will also negatively impact the full realization of the benefits of the EEU accession and GSP Plus trade privilege. These downside risks could exacerbate financial and fiscal vulnerabilities.

4. The overall program is expected to provide financing of $70 million equivalent for 2015–2018. Subprograms 1 and 2 amount to $20 million and $25 million equivalent and have been fully disbursed. Subprogram 3 is estimated at $25 million. The government's development related financing gap is estimated at about $320.7 million for 2017, an increase of 1% from 2016. The fiscal deficit is projected at 4.7% of GDP in 2017. The gap is to be met mainly from long-term loans from foreign sources (projected at $109.9 million) and anticipated budget support from the ADB ($29 million), World Bank ($24 million), IMF ($26 million), and EU and other development partners ($37.9 million). Expected budget support from the Russian Federation is $32 million. The remaining gap is expected to be met from revenues from proposed privatization ($2 million) and issuance of government bonds. ADB's subprogram 3 will help narrow the financing gap by about 7.8% in 2017. Budget support is necessary to finance part of the development financing needs projected for the period covering subprogram 3 (2016–2017). The debt burden is projected to

[1] National Bank of Kyrgyz Republic. December 2016. Compared to 2015, remittances increased by 21.6% and amounted to about $1.6 billion but are still below pre-crisis levels.

[2] In 2016, the share of exports to EEU comprise about 26% of the country's total exports.

[3] The Extended Credit Facility was approved for SDR 66.6 million (then about US$92.4 million) on 8 April 2015.

[4] GSP+ is a trade privilege granted by the EU to a few countries to help diversify their economies. It provides zero or highly preferential tariffs for exports of more than 7,000 products from these countries. The countries are required to ratify and implement international conventions on human and labor rights, environment, and good governance. The Kyrgyz Republic received the GSP+ status in January 2016. The Kyrgyz Republic was granted the GSP+ in January 2016.

remain above 60% of GDP in the coming years but the Government has committed to a significant fiscal consolidation over 2017–18 with the deficit projected to be reduced to 4.2% of GDP in 2018. Budget support is necessary to finance part of the development financing needs.

5. The program, including subprogram 3, will implicitly finance part of the development financing needs projected over the subprogram period i.e., 2016–2017. Key among these are expenditures needed to (i) develop new infrastructure and rehabilitate existing assets, along with overall sector reforms to crowd in private sector expertise and investments, and (ii) develop agriculture value chains, including product quality assurance infrastructure and related training and services, to capitalize on EEU market and the GSP+ trade privilege.

6. **Economic and financial benefits in the short and medium term.** The government sees the value of the Second ICIP reforms in realizing the commitments under the National Sustainable Development Strategy 2013–2017.[5] The strategy is aimed at creating the enabling environment for private sector development and an efficient and transparent public sector, to catalyze broad-based and sustainable economic growth.

7. Reforms to increase the share of electronic and mobile receipts and payments (noncash transactions) will help enhance the monetization of the financial system thereby making more funds available for credit to the economy. Technology can reduce the cost of financial intermediation enabling credit, financial services and even insurance facilities to be extended to the currently unbanked, particularly the poor and women, and create economic opportunities for them. Noncash transactions will allow tracking of transactions thereby reducing the informal economy and minimizing tax leakage and evasion.[6] Corruption will be reduced because of the increased traceability and accountability of financial transactions.

8. The State Guarantee Fund (GF) will help reduce the risks of lending by banks to SMEs thereby enabling SMEs to develop and expand and become part of global value chains and create higher value added jobs. Since start of operations in December 2017 the GF has issued 102 guarantees of $1.8 million catalyzing approximately $7.8 million in bank lending. Studies have shown that the that failure to promote empowerment of women, including through rights to access credit, could reduce per capita income growth rates by 0.1%–0.3%.[7] Women entrepreneurs constitute 39% of the GF's portfolio, and overall GF support to SMEs has helped create 344 new jobs and save about 1020 existing jobs.

9. The PPP program will support increased efficiency of public expenditures through better public investment planning and management, and crowding in of private sector investments and expertise. Sound PPP projects will also deliver nonfinancial benefits through higher levels of service quality and transparency in procurement. The first PPP contract—for hemodialysis services in Bishkek, Osh, and Jalalabad regions—was signed in August 2017. The project is expected to deliver high-quality services in accordance with the best industry standards, save the government money, and expand access of dialysis services to more patients.

10. Effective implementation of trade and investment policies will help diversify the economic base, create more and diversified job opportunities and hence, higher business and household incomes and government revenue. One such measure is the implementation of the technical

[5] Government of the Kyrgyz Republic. 2013. National Sustainable Development Strategy, 2013–2017.

[6] Mckinsey & Company. 2013*. Mckinsey on Payments*. The cost of cash to countries with a high rate of cash use can exceed 1% of gross domestic product, and the annual cost per household may total as much as 2% of income.

[7] International Finance Corporation. 2011. *Strengthening Access to Finance for Women-Owned SMEs in Developing Countries.* Washington, DC.

requirements of the GSP+ (footnote 4). Exports to the EU increased by 53.4% (from $20.1 million in 2015 to $66.7 million) in the first eleven months of 2016. Continued effective implementation is likely to benefit the Kyrgyz economy by several multiples of the size of subprogram 3 and the overall Second ICIP.[8]

11. Easing of registration and tax compliance burdens for businesses will incentivize formalization of the economy. Expanded use of e-procurement by the government will increase transparency and efficiency of public procurement. Combined with effective tax administration, the reforms will incrementally generate increased fiscal revenues and help narrow fiscal gaps.

[8] Armenia (also a member of the Eurasian Economic Union) and the Philippines are recent recipients of GSP+ status. Armenia's exports to the EU in 2014 (around Euro 60 million) surged in the first six months of 2015 alone to Euro 58 million. Exports to EU from the Philippines in 2014 (approximately Euro 584 million) increased in the first 6 months of 2015 alone to Euro 743 million after receiving the GSP+ status in late 2014.