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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED

DEVELOPMENT POLICY CREDIT

IN THE AMOUNT OF SDR 9.4 MILLION (US\$13.2 MILLION EQUIVALENT)

AND GRANT

IN THE AMOUNT OF SDR 7.7 MILLION (US\$10.8 MILLION EQUIVALENT)

TO

THE KYRGYZ REPUBLIC

FOR THE

PROGRAMMATIC GOVERNANCE AND COMPETITIVENESS DEVELOPMENT POLICY
OPERATION (GCDPO-1)

June 8, 2016

Macroeconomics and Fiscal Management Global Practice
and Governance Global Practice
Central Asia Country Management Unit
Europe and Central Asia Region

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THE KYRGYZ REPUBLIC

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of April 30, 2016)

Currency Unit: Kyrgyzstani som (KGS)

US\$1.00 = KGS 68.42

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank	LDP	Letter of Development Policy
BEEPS	Business Environment and Enterprise Performance Survey	MBLIF	Monthly Benefit for Low-Income Families
CIS	Commonwealth of Independent States	MoE	Ministry of Economy
CoA	Chamber of Accounts	MoF	Ministry of Finance
CPI	Corruption Perception Index	MTEF	Medium-Term Expenditure Framework
CPS	Country Partnership Strategy	MTTP	Medium-Term Tariff Policy
DfID	UK Department for International Development	NBKR	National Bank of the Kyrgyz Republic
DPO	Development Policy Operation	NPL	Nonperforming Loan
DSA	Debt Sustainability Analysis	NSDS	National Sustainable Development Strategy
ECA	Europe and Central Asia	PEFA	Public Expenditure and Financial Accountability
ECF	Extended Credit Facility	PER	Public Expenditure Review
EEU	Eurasian Economic Union	PFM	Public Financial Management
EFO	Externally Funded Output	PIP	Public Investment Program
EU	European Union	PLR	Performance and Learning Review
FBO	Food-Business Operator	PPD	Public Procurement Department
FDI	Foreign Direct Investment	PPL	Public Procurement Law
FIAS	Foreign Investment Advisory Service	PSDP	Private Sector Development Program
GCI	Global Competitiveness Index	PSRR	Public Sector Reform Roadmap
GDP	Gross Domestic Product	SCA	State Communications Agency
GoKR	Government of the Kyrgyz Republic	SDR	Special Drawing Rights
GRS	Grievance Redress Service	SME	Small and Medium Enterprise
HACCP	Hazard Analysis Critical Control Point	SPS	State Personnel Service
ICT	Information and Communication Technologies	STS	State Tax Service
IDA	International Development Association	TA	Technical Assistance
IDF	Institutional Development Fund	TI CPI	Transparency International Corruption Perception Index
IFC	International Finance Corporation	US\$	United States Dollar
IMF	International Monetary Fund	VAT	Value-Added Tax
IPSAS	International Public Sector Accounting Standards	WBG	World Bank Group
KGS	Kyrgyzstani Som	WGI	World Governance Indicators

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KYRGYZ REPUBLIC
PROGRAMMATIC GOVERNANCE AND COMPETITIVENESS DEVELOPMENT POLICY
OPERATION

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SUMMARY OF PROPOSED CREDIT/GRANT AND PROGRAM

KYRGYZ REPUBLIC

PROGRAMMATIC GOVERNANCE AND COMPETITIVENESS DEVELOPMENT POLICY OPERATION

Borrower	The Kyrgyz Republic	
Implementation Agency	Ministry of Finance	
Financing Data	<p>IDA Credit Terms: 38-year maturity, including a 6-year grace period Amount: SDR9.4 million (US\$13.2 million equivalent)</p> <p>IDA Grant Amount: SDR7.7 million (US\$10.8 million equivalent)</p>	
Operation Type	The first in a series of two Programmatic Development Policy Operations	
Pillars of the Operation And Program Development Objective(s)	<p>The Program Development Objectives of the Programmatic Development Policy Operation are to support the Government of the Kyrgyz Republic in:</p> <p>1. Improving public sector governance through reforms aimed at improving public sector integrity, increasing the quality of public services, and enhancing energy sector governance; and</p> <p>2. Strengthening private sector competitiveness through measures to facilitate trade, improve the business environment, and promote greater connectivity.</p>	
Result Indicators	Pillar 1: Improving public sector governance	
	Percentage of declarations of personal interests of public officials verified by the Commissions on Ethics to identify potential conflicts of interest.	Baseline (2016): 0 Target (2018): 15% of all filed declarations (focusing on high-level officials and high-risk positions)
	Competition, value for money, and controls in public procurement PEFA (PI 19) score.	Baseline (2014): B Target (2018): B+
	Graft index (i.e., the number of reported bribes as a share of the number of reported transactions) in key public service areas.	Baseline (2016): 21% Target (2018): 10%
	Cash collected per kWh of power supplied to the domestic market.	Baseline (2015): 0.76 KGS/kWh Target (2017): 0.97 KGS/kWh
	Cash collected per Gcal of heat generated by the Bishkek Central Heating Plant.	Baseline (2015): 921.83 KGS/Gcal Target (2017): 1364.31 KGS/Gcal
	Disclosure of quarterly key performance indicators for the heating sector	Baseline (2015): no Target (2018): yes, as of 2017
	Pillar 2: Strengthening private sector competitiveness	
	Export sales tax rate	Baseline (2016): 2% on goods, 3% on services Target (2018): 0%
	Number of firms with certified HACCP.	Baseline (2016): 9 Target (2018): 20
	Number of firms included in the EEU register of FBOs and allowed to export to the EEU.	Baseline (2016): 9 Target (2018): 20
	Share of VAT refunds processed through the “green channel”.	Baseline (2016): 0% Target (2018): 25%

	Share of firms filling reports on social contributions to State Tax Service.	Baseline (2014): 0% Target (2018): 50%
	Share of firms inspected annually by the Sanitary Department.	Baseline (2016): 31% Target (2018): 20%
	Number of firms from which feedback on inspections has been received.	Baseline (2016): 0 Target (2018): 500
	International internet bandwidth indicator used by the International Telecommunications Union.	Baseline (2016): 5008 Mbps Target (2018): 6500 Mbps
Overall risk rating	High	
Climate and disaster risks	No short- or long-term climate and disaster risks are relevant to the proposed operation.	
Operation ID	P148099	

IDA PROGRAM DOCUMENT FOR A
PROPOSED GOVERNANCE AND COMPETITIVENESS DEVELOPMENT POLICY
OPERATION
TO THE KYRGYZ REPUBLIC

I. INTRODUCTION AND COUNTRY CONTEXT

1. **This Program Document presents a proposed Development Policy Operation (DPO), as part of a programmatic series to support the Kyrgyz Government's reforms to improve public sector governance and strengthen private sector competitiveness.** The first operation in the two-part series is in the amount of US\$24 million, split between credit and grant components. The DPO program supports the two main themes of the *National Sustainable Development Strategy* (NSDS) of the Kyrgyz Republic, namely sustainable governance and sustainable economic development. It builds on the previous programmatic DPO series, which also aimed to enhance public sector governance and improve the business environment, as well as on the recent Energy Sector DPO, which supported governance and financial viability reforms in the sector. The proposed operation is fully aligned with the FY14-17 *Country Partnership Strategy* (CPS) and 2016 *Performance and Learning Review* (PLR) of the CPS. The CPS focuses on reducing poverty and building shared prosperity by supporting public administration and service delivery reforms, improving the business and investment climate, and strengthening stewardship of natural resources and physical infrastructure.

2. **At US\$1,269 (in current US\$), the Kyrgyz Republic's GDP per capita remains one of the lowest in the Europe and Central Asia region.** In 2014, more than a third of the population was below the poverty line. Economic growth in recent years has been too volatile to significantly improve living conditions, while the largely informal private sector has failed to achieve productivity gains and create good jobs. The economy's excessive reliance on gold production, as well as on foreign aid and migrant remittances, further exacerbates poverty-related risks. Over the last five years, the poverty rate increased slowly up to 2012¹ and then gradually declined after 2013. Taking a longer-term perspective, the share of the population living below the poverty line has been largely stagnating at around 35 percent. The bottom 40 percent of population has generally benefited from episodes of economic growth, as reflected in the growth of mean real consumption expenditures in the lowest and second lowest consumption quintiles and in a decline in the Gini index from 0.257 to 0.224 between 2010 and 2014.

3. **The Kyrgyz authorities have embarked on a series of reforms to address structural impediments to growth.** Supported by successive International Monetary Fund (IMF) Three-Year Arrangements under the Extended Credit Facility (ECF), the government has been working to ensure prudent fiscal and macroeconomic policies to enhance stability and reduce volatility, while at the same time attempting to address the country's large infrastructure deficit.² The authorities

¹ This increase is partly attributable to the political upheaval in 2010.

² Underdeveloped infrastructure is consistently identified in business surveys as a major impediment to private sector investment and development.

have also launched an ambitious *Public Sector Reform Roadmap* (PSRR) program, focused on measures to improve the integrity of government decisions, increase the quality of services provided to citizens and businesses, and reduce revenue losses caused by corruption in key sectors such as energy. Taken together, these reforms have the potential to increase trust in government, and provide higher quality services to citizens and firms. Alongside more specific policy measures to boost competitiveness, which are outlined in the government's *Private Sector Development Program* (PSDP), these initiatives are critical to address the country's long-term private investment gap. Finally, efforts to ensure better connectivity through stronger information and communications technology (ICT) development have the potential to improve the business environment and support the delivery of public services.

4. **Building on the government's reform efforts and strategic priorities, the proposed DPO series has two pillars, covering reforms in public sector governance and the competitiveness environment.** Pillar 1 aims to enhance public sector governance through reforms to strengthen public integrity, increase the quality of public services, and improve energy sector governance. Pillar 2 aims to strengthen private sector competitiveness through measures to facilitate trade, improve the business environment, and promote greater connectivity. The dual—and complementary—focus of the proposed operation on governance and competitiveness is justified on three grounds: first, the proposed areas of engagement are aligned with the government's own priorities, strengthening ownership and enhancing the likelihood of positive results; second, preconditions for maintaining short- and medium-term macroeconomic stability are already extensively covered under the IMF-supported program; and third, weak governance and rule of law have been consistently identified as the most binding constraint to growth and investment in the Kyrgyz Republic.³

5. **This programmatic DPO series is part of a broader reform agenda supported by development partners.** This operation has been prepared in coordination with the International Monetary Fund (IMF), the Asian Development Bank (ADB), the UK's Department for International Development (DfID), the European Union (EU), and other development partners. The IMF is implementing a three-year arrangement under the Extended Credit Facility. Other partners are providing support in the areas of public sector strengthening, anti-corruption and accountability, energy sector reform, and the business environment. Reforms in these areas, a subset of which are supported under the proposed DPO, are focused on building more transparent institutions and the effective provision of public services, thus promoting the accumulation of assets and higher returns on assets for all population groups. Greater private investment will be supported by a better business environment and improvements in telecommunications infrastructure, as well as by more transparent and predictable government decisions stemming from the new public procurement and conflict-of-interest legislation. Improving public service quality, including the quality of the energy supply, will further accelerate economic activity and contribute to improvements in the fiscal position of the country.

³ Asian Development Bank (2014): "The Kyrgyz Republic: Strategic Assessment of the Economy," a growth diagnostic following the Hausmann-Rodrik-Velasco methodology.

II. MACROECONOMIC POLICY FRAMEWORK

A. RECENT ECONOMIC DEVELOPMENTS

6. **Regional and global headwinds have heightened the vulnerability of the Kyrgyz economy since 2014.** The sharp drop in global oil prices has impacted the Kyrgyz Republic's main economic partners, Russia and Kazakhstan, with adverse repercussions on the Kyrgyz economy through trade and remittance effects. Meanwhile, exchange-rate depreciation has affected the purchasing power of households. This “new normal” economic environment is expected to prevail over the medium term. When coupled with a softening of Chinese growth prospects, the external environment calls for significant adjustments, including not only fiscal and exchange rate adjustments but also a renewed emphasis on competitiveness. Against this background, recent economic developments in the Kyrgyz Republic have been encouraging, and the fiscal expansion envisaged by the authorities could play a positive countercyclical role, provided that it remains anchored by a sustainable overall fiscal framework.

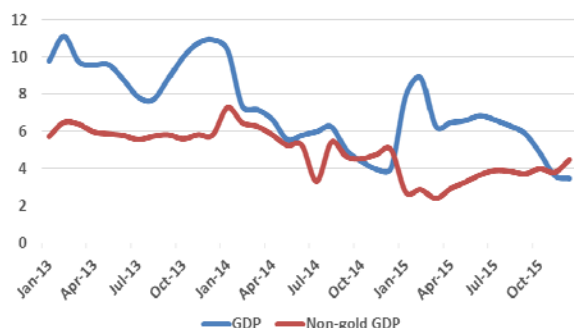
7. **Economic growth remained relatively robust in 2015 in spite of significant regional headwinds.** Real GDP growth is estimated to have reached 3.5 percent in 2015, down from 4 percent in 2014, driven by a good agricultural harvest on the production side and net exports on the expenditure side. While gold output declined by 8.3 percent, year-on-year, non-gold growth stood at 4.5 percent. A significant 6.2 percent expansion in agriculture⁴ compensated for a slowdown in services and construction, and a contraction in industry⁵. On the demand side, a sharp deceleration in private consumption growth caused the total consumption growth rate to fall from 3 percent in 2014 to 1.1 percent in 2015, despite an increase in public spending on wages, and goods and services. Investment growth also slowed to an estimated 2.3 percent, reflecting subdued household demand for new housing construction and the slow implementation of public infrastructure projects. In turn, growth was supported by net exports, with imports falling sharply.

8. **The Kyrgyz economy was adversely impacted by the contraction in Russia and slowdown in Kazakhstan.** The most significant shock to the Kyrgyz economy was the sharp depreciation of the Kyrgyzstani som against the US dollar, which reached about 20 percent in 2015, and its volatility against the Russian ruble and the Kazakhstani tenge. Exchange rate dynamics created uncertainty in the real sector of the economy, affecting the decisions of small and medium firms as well as households, while the stark depreciation of the ruble affected the real value of remittance inflows (in both som and dollar terms). Real-estate prices fell by about 20 percent in 2015, dampening private investment in construction. In addition, the volume of trade declined markedly.

⁴ Reflecting favorable weather conditions, a catch-up effect following a contraction in 2014, as well as continued support via budget-financed subsidized loans to farmers (KGS 3.8 billion in 2015 and KGS 5.3 billion in 2014).

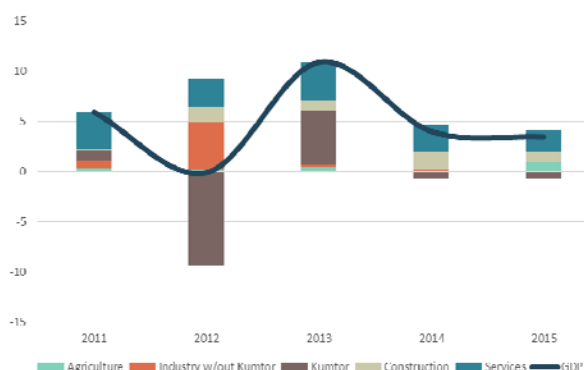
⁵ Services grew at 3.7 percent, down from 4.6 percent in 2014; construction growth decelerated to 13.9 percent from 27.1 percent, and industry contracted by 4.2 percent overall (or 0.5 percent, excluding gold).

Figure 1: Real GDP Growth (y-o-y, percent)



Source: Kyrgyz authorities.

Figure 2: Contribution to Growth (percentage points)



Source: Kyrgyz authorities.

9. **External trade contracted sharply due to declines in both exports and imports, while a steeper fall of imports led to reduced trade and current account deficits.** Exports are estimated to have fallen by nearly 17 percent in 2015 in dollar terms, reflecting the decline in gold production—due largely to geological factors—and, more importantly, diminished demand for Kyrgyz goods among major trading partners such as Russia and Kazakhstan. Likewise, remittance inflows also fell sharply, dropping by about 25 percent in dollar terms, entirely due to exchange rate dynamics⁶. This, however, was offset by a steep contraction in imports (-23 percent in dollar terms), which led to a reduction in external trade and current account deficits to 35.4 and 14.7 percent of GDP, respectively, in 2015⁷.

10. **The current account deficit was financed by foreign direct investment (FDI) inflows and external borrowing.** In 2015, FDI increased by about US\$350 million, reflecting larger reinvested earnings by Kumtor, the main gold mine, and an inflow of capital related to the newly established Russian-Kyrgyz Development Fund. At the same time, public borrowing declined, reflecting the slower-than-anticipated implementation of the Public Investment Program (PIP), though it remained the main source of financing of the current account deficit.

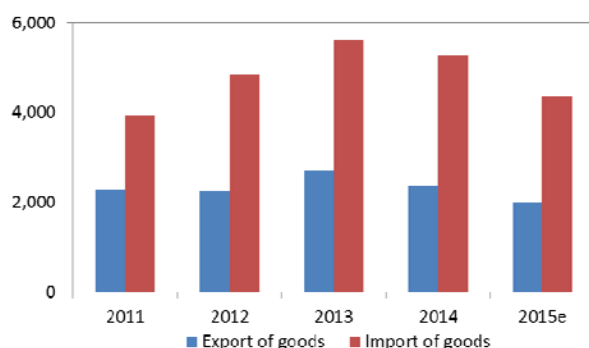
11. **Fiscal balances improved over 2015, but the public debt position deteriorated.** The fiscal deficit fell from 3.9 percent of GDP in 2014 to 3 percent in 2015, as weaker-than-expected tax proceeds and higher recurrent spending were more than offset by an increase in nontax revenues. The decline in tax revenues from 25.1 percent of GDP in 2014 to 24.6 percent in 2015 was mostly on account of weaker regional trade with the rest of the world, as the Kyrgyz Republic, under the Eurasian Economic Union (EEU), is entitled to receive a 1.9 percent share of total EEU external revenues. By contrast, nontax revenues increased markedly thanks to a large one-off mining license sale, the sale of radio frequencies, and large profit transfers from the central bank. As a result, total revenues including grants increased to 34.9 percent of GDP from 34.4 percent in 2014. At the same time, current spending increased to 30.6 percent of GDP from 29.3 percent in 2014, reflecting increased wages for teachers and higher spending on goods and services, while capital spending fell due to the slower-than-anticipated implementation of public investment projects financed by foreign loans. Despite this improvement in the fiscal balances, the public

⁶ As ruble inflows actually increased by around 20 percent.

⁷ From 39.7 percent and 16.7 percent, respectively, in 2014.

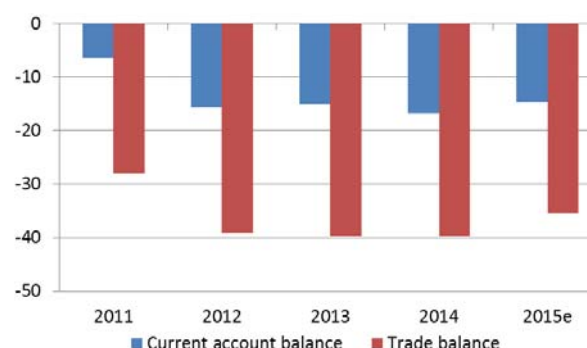
debt-to-GDP ratio deteriorated to 68.3 percent from 53.6 percent in 2014, mainly due to the depreciation of the exchange rate.

Figure 3: Exports and Imports of Goods
(US\$, millions)



Source: Kyrgyz authorities.

Figure 4: External Trade and the Current Account Balance
(Percent of GDP)



Source: Kyrgyz authorities.

Table 1: General Government Budget
(Percent of GDP)

	2013	2014	2015	2016 Proj.
<u>Total revenues and grants</u>	33.4	34.4	34.9	32.8
Total revenues	31.0	31.9	32.7	30.3
Current revenues	30.8	31.8	32.7	30.2
Tax revenues	25.2	25.1	24.6	22.8
Non-tax revenues	5.6	6.7	8.1	7.4
Capital revenues	0.2	0.1	0.1	0.1
<u>Grants</u>	2.4	2.5	2.2	2.4
Program grants	1.6	1.9	1.7	0.5
PIP grants	0.8	0.6	0.5	1.9
<u>Total expenditure (incl. net lending)</u>	37.1	38.3	38.0	40.1
<u>Current expenditure</u>	30.1	29.3	30.6	30.1
Wage	7.8	7.8	8.3	8.7
Transfer and subsidies	3.5	3.4	3.5	3.5
Social Fund expenditures	9.3	9.2	9.1	8.9
Interest	0.8	0.9	1.0	1.1
Purchase of other goods and services	8.7	8.1	8.8	8.0
<u>Capital expenditure</u>	7.0	8.4	7.3	9.8
o/w foreign financed	4.9	6.1	4.6	6.7
<u>Net lending</u>	0.1	0.6	0.1	0.2
<u>Overall balance</u>	-3.7	-3.9	-3.0	-7.4
<u>Financing</u>	3.9	3.9	3.0	7.4
External	5.1	5.5	3.8	6.5
Domestic	-1.2	-1.6	-0.8	0.9

Source: Ministry of Finance.

12. Inflation moderated to 3.4 percent (end-of-period) in 2015. While the depreciation of the exchange rate was partly passed-through to domestic prices, the slowdown in private demand as well as lower food and fuel prices exerted a countervailing influence.

13. **Monetary and exchange rate policies were focused on adjusting to external shocks.** Monetary policy was kept broadly tight to ease pressures on the exchange rate, as well as to offset inflationary expectations. The National Bank of the Kyrgyz Republic (NBKR) initially cut its policy rate from 11 percent in January to 8 percent in July, then increased it to 10 percent in September in the face of rising exchange rate pressures following the liberalization of the tenge. This, along with stricter loan policies for commercial banks, significantly slowed the growth rate of credit to the economy, which declined from 43.6 percent in 2014 to 17.3 percent as of end-December 2015. However, the money-supply growth rate increased from 3 percent to 14.9 percent over the same period, reflecting to a large extent the impact of the exchange rate depreciation on the som-denominated value of foreign-currency deposits. Interventions by the central bank in the foreign-exchange market were limited to smoothing fluctuations in the exchange rate, though total sales were significant at US\$330 million in 2015, which also contributed to tightening liquidity in the economy. As of end-2015, gross international reserves stood at US\$1.8 billion, covering more than three-and-a-half months of imports.

B. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

14. **Growth is projected to decelerate marginally to 3.4 percent in 2016 and to 3.1 percent in 2017.** Weak growth prospects among major trading partners, especially Russia and Kazakhstan, will continue to negatively impact economic activity in the Kyrgyz Republic. At the same time, gradually improving access to the EEU common market, as Kyrgyz firms adapt to EEU standards and regulations, will have a countervailing influence. On the production side, output growth is expected to be dragged down by lower gold production in 2016 and 2017. On the demand side, stepped-up public investment should only partly mitigate subdued private demand, while the contribution from net exports is anticipated to be flat.

15. **Inflation is expected to pick up, albeit moderately, as the som remains weak and prices for domestically produced agricultural products increase.** The baseline scenario assumes no significant international food price increases, a stabilization of oil prices at their current low levels and a modest easing of exchange rate pressures. Under these circumstances, inflation is expected to rise to 7 percent in 2016 and to remain around that level in 2017.

16. **In turn, the main challenge for monetary policy will be to strike a balance between managing exchange rate and inflationary pressures while ensuring enough liquidity to support growth.** In the absence of sterilization options, interventions by the central bank have a tightening effect on liquidity, which in turn may require interest rate adjustments to support credit growth. Over time, it is expected that current de-dollarization strategies will gradually strengthen the interest rate transmission channel and improve the overall traction of monetary policy.

Table 2: Key Macroeconomic Indicators

Selected Indicators	2013	2014	2015	2016	2017	2018
				Prel.	Projections	
Income and Economic Growth						
GDP (current LCU, billions)	355.3	400.7	423.6	476.4	524.3	577.5
GDP Growth (% change, y-o-y)	10.9	4.0	3.5	3.4	3.1	4.1
Non-Kumtor GDP Growth (% change, y-o-y)	5.8	5.0	4.5	3.9	3.9	4.6
Gross Investment (% of GDP)	26.2	26.9	28.1	29.3	29.3	29.0
Prices and Exchange Rates						
Inflation, Consumer Prices (% change, y-o-y, end of year)	4.0	10.5	3.4	7.0	7.0	6.0
Inflation, Consumer Prices (% change, y-o-y, period average)	6.6	7.5	6.5	6.5	6.5	6.0
Nominal Exchange Rate (LCU/US\$, end of period)	48.44	53.7	75.9			
Real Effective Exchange Rate Index (2000=100)	113.1	128.8	116.1			
Fiscal (% of GDP, unless otherwise indicated)						
Revenues	33.4	34.4	34.9	32.8	32.6	33.2
Expenditures (incl. net lending)	37.1	38.3	37.8	40.1	37.2	35.2
Current	30.1	29.9	30.5	30.1	27.7	26.4
Capital	7.0	8.4	7.3	10.0	9.5	8.8
Overall Fiscal Balance	-3.7	-3.9	-3.0	-7.4	-4.6	-2.0
Primary Fiscal Balance	-2.9	-3.0	-2.0	-6.6	-3.6	-0.8
Total Public Debt	46.1	52.6	68.8	71.7	73.3	72.0
External Accounts (% of GDP, unless otherwise indicated)						
Export growth (nominal US\$, % yoy)	13.5	-13.5	-16.9	-7.1	8.5	12.1
Import growth (nominal US\$, % yoy)	16.1	-3.0	-23.1	-4.2	6.7	7.8
Current Account Balance	-15.0	-16.7	-14.7	-17.2	-12.9	-11.4
Foreign Direct Investment, net inflows	8.5	2.3	7.2	7.5	5.7	6.1
External debt, total	72.9	81.2	98.1	100.8	100.7	97.9

Source: Kyrgyz authorities and Bank staff estimates and projections.

17. The current account deficit is expected to remain elevated over the medium term. Proceeds from gold exports are expected to decline slightly due to volume and price dynamics, while continued economic difficulties among major trading partners should constrain non-gold export growth⁸. Meanwhile, the anticipated scale-up of the public investment program over the next two years is expected to drive import growth, given the high import content of large infrastructure projects. Remittance inflows are projected to decline further in 2016 in dollar terms, though at a slower pace reflecting a more stable ruble, and to rebound in 2017. As a result, the current account deficit is projected to widen to 17.2 percent of GDP in 2016 before narrowing to 12.9 percent in 2017.

18. The fiscal challenge over the medium term will be to support growth while remaining on a sustainable fiscal path. The fiscal deficit is expected to grow to 7.4 percent of GDP in 2016 due to higher public investment spending. The deficit will largely be financed by external concessional loans, primarily from China. However, the authorities have committed to fiscal

⁸ Although domestic companies that manage to comply with EEU standards and regulations will gain easier access to the broader customs union market.

consolidation measures, starting in 2017, to decrease the fiscal deficit to 4.6 percent in 2017 and 2 percent in 2018, in adherence to commitments under the IMF-supported program and joint World Bank and IMF engagement on the medium-term budget framework. The authorities intend to achieve this objective through measures to increase tax revenues and curtail current spending, while capital expenditures would remain high. Over 2017-20, tax revenues should increase by one percent of GDP, due to measures to: (i) expand the tax base by encouraging businesses to formalize, (ii) improve the administration of the value-added tax (VAT), (iii) reduce exemptions, through both non-renewal of existing exemptions and streamlining policies for granting new ones, and (iv) increase some tax rates, such as excise tax rates on alcohol and tobacco products. Meanwhile, over the same period, expenses are targeted to decline by over 1.5 percent of GDP as a result of efforts to (i) streamline non-priority purchases of goods and services, (ii) improve the targeting of social benefits, and (iii) reduce the wage bill as a share of GDP by implementing the recently adopted action plan for the reform of the public sector personnel and remuneration policy and by carrying out functional reviews of the civil service. More generally, gains are also expected from initiatives to strengthen public financial management by implementing the recently adopted *Public Procurement Law* and by developing a financial management information system to support the move to a Single Treasury Account. After increasing to 71.7 percent of GDP in 2016 and 73 percent in 2017, the public debt stock should begin to decline.

Table 3: External Financing

(Percent of GDP)	2014	2015	2016	2017	2018
Requirements	16.9	19.6	22.5	23.7	21.3
CAD	16.7	14.7	17.2	12.9	11.4
Amortization	5.2	6.2	8.1	8.1	8.5
Reserves	-5.0	-1.3	-2.8	2.7	1.5
Sources	16.9	19.6	22.5	23.7	21.3
FDI	2.3	7.2	7.5	5.7	6.1
Disbursements	11.5	12.8	16.7	15.4	14.5
Capital Inflows 1/	3.1	-0.4	-1.7	2.6	0.7

Source: Bank staff calculations.

1/ Includes errors and omissions

19. **According to the latest Debt Sustainability Analysis (DSA), the Kyrgyz Republic is at moderate risk of debt distress;⁹ however, risks have increased markedly, and large-scale planned investments combined with exchange rate volatility could tilt the assessment toward a high-risk scenario.** Going forward, the planned acceleration of the disbursement of PIP loans and the continued weakness of the som relative to the dollar are expected to result in a significant rise of external public debt ratios. Although PIP borrowing terms are highly concessional, stress tests suggest that the country is vulnerable to exogenous shocks. Fiscal consolidation and prudent use of concessional loans, in particular for large-scale public investment programs, remain crucial for keeping the debt outlook sustainable. Within the framework of the new IMF program, the authorities committed to: (i) fully disclosing public investment plans and commitments; (ii) refraining from non-concessional borrowing; (iii) grounding borrowing decisions in a medium-

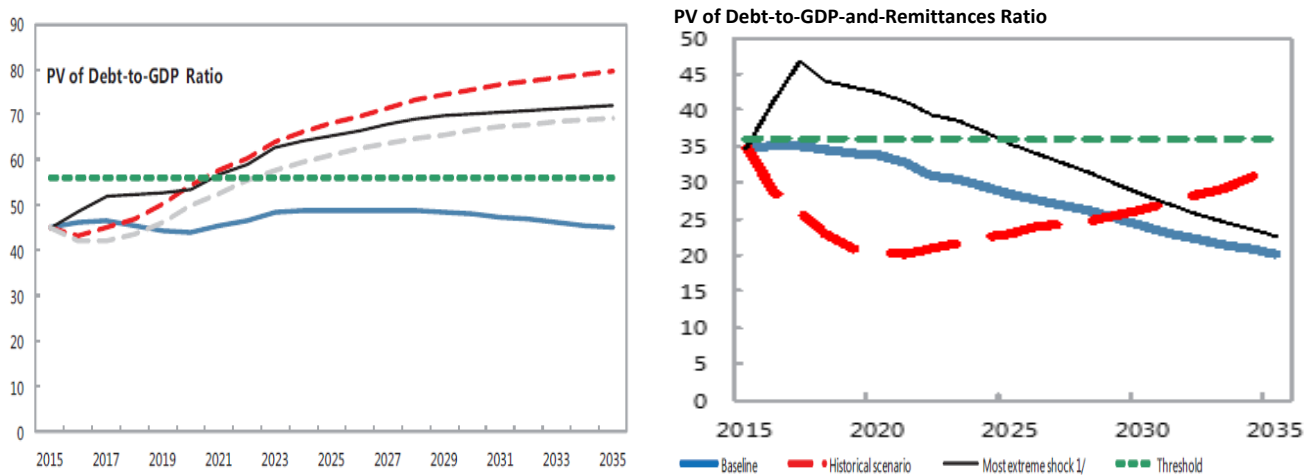
⁹ Joint IMF-WB Debt Sustainability Analysis, November 2015.

term debt strategy; and (iii) reviewing the public investment framework to identify gaps and define an action plan¹⁰.

20. **Under the DSA's baseline scenario, debt indicators do not exceed their indicative thresholds.** The present value of the public and publicly guaranteed debt-to-GDP ratio is expected to reach 46.2 percent in 2016 and 46.7 percent in 2017 before stabilizing at around 45 percent, remaining below the 57 percent indicative threshold due to fiscal consolidation over the medium term. The present value of the public and publicly guaranteed external debt-to-GDP-and-remittances ratio is expected to reach 35 percent in 2016, below its indicative threshold of 36 percent, before declining slowly.¹¹ The present value of the debt-to-exports-and-remittances ratio and the present value of the debt-to-revenue ratio, at 62 and 133, respectively, in 2016, are expected to remain well below their policy-based indicative thresholds.¹²

21. **However, stress tests show that external debt is vulnerable to large shocks or substantially less favorable assumptions.** The present value of the debt-to-GDP and remittances ratio rises above the relevant indicative threshold over the medium term under four of six stress tests: (i) when exports grow at one standard deviation below their historical average over 2016-2017; (ii) when net non-debt-creating inflows over 2016-17 are one standard deviation below their historical average; (iii) when the exchange rate depreciates by 30 percent in 2016 relative to the baseline; and (iv) under a shock over 2016-17 combining lower GDP and export growth, a decline in the dollar GDP deflator and lower net non-debt-creating inflows. The depreciation of the exchange rate in particular would lead to a significant and protracted breach of the indicative threshold over the medium term. However, none of the other debt indicators breach their indicative thresholds under similar stress tests.

Figure 5: Debt Sustainability Analysis Summary Charts



Source: Joint IMF-WB DSA Update, November 2015.

¹⁰ This was done with IMF Technical support in March 2015.

¹¹ The use of the remittance-adjusted thresholds is justified by the large size of remittances, which represented more than 30 percent of GDP and over 60 percent of goods and services exports, on average, during the past three years.

¹² The relevant thresholds are 120 percent for the present value of the debt-to-exports-and-remittances ratio and 250 percent for the present value of the debt-to-revenue ratio.

22. **A relatively strong pipeline of public investments and a well-capitalized banking sector may open up possibilities for growth, although the authorities will need to carefully monitor emerging signs of vulnerability in the financial sector.** Public sector investments in energy and communications are likely to remain strong over the next few years, including the start of construction of “line D” of the Central Asia–China gas pipeline, as well as heating and power plant rehabilitation, and upgrade of road links with financing secured from China or from multilateral development banks (e.g., the World Bank, the European Bank for Reconstruction and Development) and regional development banks (e.g., the Asian Development Bank, the Eurasian Development Bank). These projects are critical to address the Kyrgyz Republic’s large infrastructure gap, as poor quality and insufficient infrastructure is consistently identified by firms as one of the greatest obstacles to their operations. To date, and in spite of high levels of dollarization, the Kyrgyz financial sector has remained well capitalized, with a capital-adequacy ratio above 20 percent, and nonperforming loans (NPLs) have remained at modest and manageable levels below 6 percent. Consequently, the banking sector has the potential to support businesses if and when opportunities emerge. Nonetheless, vigilance will be required on behalf of the monetary authorities, as banks would come under duress in the event of a further large depreciation of the som or a real estate market crash, given currency mismatches and possible deteriorations in portfolio quality. Stress tests carried out by the central bank suggest that banks are vulnerable to risks stemming from exchange-rate dynamics as well as from sectoral concentration in trade and construction, making it critical to strengthen the regulatory, supervisory and resolution powers of the monetary authorities.

23. **Overall, the macroeconomic policy framework is assessed to be adequate for this operation, considering its consistency, credibility and sustainability.** With a significantly positive gross operating balance, the overall fiscal deficit is exclusively attributable to public investment. In turn, the government’s ambitious public investment program seeks to unlock binding constraints to growth by addressing the country’s significant infrastructure gap, while at the same time providing countercyclical stimulus to the economy in the face of significant external shocks. Large internal or external imbalances of a nature to endanger macroeconomic stability are unlikely to materialize, provided that: (i) the public investment program is scaled down gradually beginning in 2018; (ii) parallel measures to improve tax collection and contain recurrent spending growth are implemented; and (iii) the energy sector gradually moves toward cost recovery tariffs. Monetary and exchange rate policies, including a steadfast commitment to exchange rate flexibility, are aligned with the objectives of maintaining macroeconomic stability and external competitiveness. The authorities’ adherence to successive IMF programs provides reassurance that fiscal discipline will be upheld, including through actions to strengthen tax administration and streamline the public sector wage bill. Sources of financial sector vulnerability can be credibly addressed through strengthened oversight and supervision. Finally, although the debt sustainability outlook has deteriorated significantly due to exchange rate developments, the government’s commitment to strengthened public debt management under the IMF-supported program provides further ground for comfort. Yet the risks to the proposed operation are substantial, and the World Bank will continue to closely monitor macroeconomic developments and coordinate with the IMF to ensure that the environment remains adequate for the operation.

C. IMF RELATIONS

24. **The Kyrgyz Republic successfully concluded a Three-Year Arrangement under the Extended Credit Facility in June 2014, and a new Three-Year Arrangement under the ECF was approved by the IMF Board on April 8, 2015.** The 2011-14 program, in the amount of US\$106 million, was implemented without delays. The IMF stated in a press release on June 26, 2014 that, “During the program, strong adherence to the authorities’ Fund-supported program played a pivotal role in achieving economic recovery and macroeconomic stabilization following the 2010 domestic crisis.” Shortly after the completion of this program, the authorities reached an agreement with the IMF on a new program, which was approved by the IMF Board on April 8, 2015. Key policy areas under the new program include public debt and public investment management, tax administration, public expenditure and banking sector regulation and supervision. A First Review under the Arrangement was approved by the IMF’s Board on November 18, 2015, which concluded that the “program is broadly on track”. The World Bank team coordinates closely with the IMF team both on the macroeconomic framework and a wide range of structural issues.

III. THE GOVERNMENT’S PROGRAM

25. **The government’s priorities and medium-term objectives are described in its *National Sustainable Development Strategy, 2013-17* (NSDS) adopted in 2013.** Strengthening governance and reducing corruption are the overarching themes of the NSDS, which recognizes that previous national development strategies in 2001, 2003 and 2009 largely failed due to “...bad governance, corruption, and the criminalization of certain state institutions.” In particular, it calls for creating a state governed by the rule of law, with a robust legal system, constitutional stability, a culture of legality, democratic elections, anticorruption efforts, strong local self-government, a reformed judiciary and reliable law-enforcement services.

26. **The second part of the NSDS identifies the country's economic development priorities.** These include continued macroeconomic stability, an improved business environment and investment climate, and a strengthened financial sector. Furthermore, the NSDS identifies strategic industries and sectors, including agro-processing, energy, mining, transport and telecommunications, and tourism, to promote inclusive growth.

27. **Building on the NSDS, the government has adopted a number of key policy documents directly relevant to the two proposed DPO pillars.** The *Public Sector Reform Roadmap* (PSRR) is a medium-term action plan identifying priority actions in seven areas of public sector reform: anticorruption, public financial management, public administration, the civil service, judicial reform, and governance in energy and extractive industries. The first version of the PSRR was prepared with World Bank Group support and adopted by Government Resolution No. 167 in May 2014. The PSRR was subsequently updated by Government Resolution No. 178-p, adopted on April 23, 2015. Energy sector reforms are anchored by the *Power Sector Development Strategy* for 2012-2017, accompanied by the detailed *Action Plan for Reforming the Energy Sector, 2013-14*. The national *Private Sector Development Program*, prepared with World Bank Group support, was adopted by the government on March 16, 2015. It describes the government’s reform agenda for private sector development and creates a unified platform for development partner support.

IV. THE PROPOSED OPERATION

A. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

28. **The overarching objective of the proposed programmatic DPO series is to support the Kyrgyz Government in promoting sustained economic growth through policies aimed at improving public sector governance and strengthening private sector competitiveness.** The design of the program reflects the priorities of the NSDS, as well as PSRR and PSDP. Drawing on the government's priorities in the PSRR, Pillar 1 supports key policy actions such as the introduction of conflict of interest legislation, implementation of the *Public Procurement Law*, and the adoption of public service standards, as well as a number of measures to increase the transparency and accountability of the energy sector. Taken together, these measures are expected to address key sources of both grand and petty corruption, and contribute to a more conducive environment for private sector investment and growth. Pillar 2, supporting competitiveness reforms, draws on the PSDP. It is built around the objectives of improving the business environment and enhancing connectivity in ways that would enable Kyrgyz businesses to grow and create jobs, while capitalizing on Kyrgyzstan's membership in the Eurasian Economic Union to boost exports.

29. **The proposed series has been prepared with a view to deepen reforms in areas supported under previous DPOs.** Specifically, the proposed operation extends reforms supported under the previous DPO series (P129597; P126274) in the areas of public personnel integrity, public procurement management, energy sector transparency and accountability, and business environment improvements. Likewise, this operation complements the policy program supported by the energy sector DPO (P152440) through effective implementation of the Medium-Term Tariff Policy (MTTP), extension of the tariff setting methodology to the heating sector, extension of the performance reporting framework to the heating sector, and further institutionalization of the sector regulator. In addition, a number of existing investment and analytical and advisory activities in the country have informed the design of the operation.

30. **The design of the proposed programmatic operation also benefited from lessons learned from the previous DPO series, as well as the recent energy sector DPO.** Key lessons from the energy sector DPO and the previous DPO series include the importance of (i) concentrating on a few policy areas that are fundamental to addressing key challenges and have the full ownership of the government; and (ii) complementing the DPO with other instruments for World Bank support, including investment project financing, technical assistance, and economic and sector work. The experience of the previous DPO series also provides a key lesson with respect to the sequencing of prior actions that include legislative actions; namely, that they should be followed by triggers that hinge on the effective adoption of these legal acts. In particular, if the first operation in the series includes a prior action formulated as a submission of legislation to the parliament, then it should be followed by an implementation measure, such as the enactment of key secondary legislation, in the second operation. This type of sequencing provides incentives for the timely enactment of legislation supported by DPO1, which is in turn a necessary condition for adopting secondary legislation under DPO2. Similar sequencing is also possible with consecutive DPO series. The proposed operation includes implementation measures for key legislation (i.e., the actions related to public procurement, energy, tax reform and telecommunications), thus

maintaining continuity in the reform areas of development policy programs in the Kyrgyz Republic, with a strong focus on implementation and results.

B. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

31. The Program Development Objective of the Programmatic Development Policy Operation is to support the Government of Kyrgyzstan in improving public sector governance and strengthening private sector competitiveness.

32. Improving governance and lowering the level of perceived corruption will alleviate one of the key constraints to unleashing the growth potential of the Kyrgyz economy. Both the 2013 *Business Environment and Enterprise Performance Survey* (BEEPS) and the World Economic Forum's 2015–2016 *Global Competitiveness Report* identified corruption as one of the most problematic factors for doing business in the Kyrgyz Republic. The country has recently made modest progress on key governance indicators, such as the World Governance Indicators (WGI) and Transparency International's Corruption Perception Index (TI CPI), albeit from low initial levels.¹³ Despite these modest gains, levels of public trust remain low. Negative perceptions of governance persist in the energy and mining sectors, as well as in the area of public financial management, particularly public procurement. The proposed DPO will support the government in tackling some of the key issues related to preventing corruption in the public sector (e.g. the *Law on Conflict of Interest*), and specifically with regards to public procurement (e.g. implementation of the *Public Procurement Law*). Moreover, the operation will support measures that are expected to improve governance and accountability in one of the most negatively perceived sectors: energy.

33. Improving the quality of public services will increase trust in government and enhance the attractiveness of investment, further spurring growth. According to the European Bank for Reconstruction and Development's 2010 *Life in Transition Survey*, only 36 percent of Kyrgyz citizens are satisfied with government services related to the issuance of official documents, while satisfaction with court services is dismal at 5 percent. Unofficial payments are “always” or “usually” necessary to obtain official documents according to 37 percent of respondents, more than twice the reported CIS average (15 percent). According to the 2013 *Global Corruption Barometer*, 45 percent of Kyrgyz respondents reported paying a bribe while accessing public services. The proposed DPO will support the government's efforts to address these issues by adopting, publicizing and adhering to public service delivery standards. This is expected to decrease processing times and improve government transparency and accountability, while also reducing the scope for petty corruption.

34. The poor bear a disproportionate share of the cost of corruption in public services. According to the World Bank's 2015 *Kyrgyz Republic Corruption and Poverty Survey*, the poor pay a higher bribe tax while obtaining services: the average amount in bribes for public services paid by the poorest quintile is 6.3 percent of annual consumption, compared to 5.8 percent for the richest quintile. Moreover, the average bribe per transaction paid by the poorest quintile (KGS 1,441) is higher in absolute terms than for the richest quintile (KGS 1,257). Therefore, reducing

¹³ The Kyrgyz Republic's TI CPI ranking in 2015 was 123rd out of 167 countries, compared to 164th out of 183 countries in 2011.

petty corruption in public services is directly related to the twin goals of reducing poverty and boosting shared prosperity.

35. Long-term growth and poverty reduction will depend on the Kyrgyz Republic's ability to stimulate private sector investment and development, as well as promote exports to the newly created EEU. Reform efforts in recent years have not yet translated into a business environment conducive for private investment, job creation and growth. Overall, the country ranked 67th out of 189 in the *Doing Business* report in 2016, reflecting no change from 2015. On another measure of the business environment—the World Economic Forum's Global Competitiveness Index (GCI)—the country's position was 102 out of 140 in 2015–16. The Kyrgyz Republic's weak performance on these measures, in spite of legislative and institutional reforms, reflects their poor implementation, as well as the persistence of a heavy regulatory burden, administrative complexity, and corruption. Specifically, complex tax administration hampers private sector growth, particularly among small and medium enterprises (SMEs). Moreover, weak ICT infrastructure and internet connectivity represent additional constraints on private sector activity, particularly in the services sector, which will be central to diversification efforts, increased value addition, and the creation of more productive jobs. According to the GCI, and as measured by the pillar on “Technological Readiness,” the Kyrgyz Republic ranks particularly low, has shown little improvement over time and is lagging behind many CIS countries. The country ranked 125th out of 144 countries on the “international internet bandwidth, kb/s per user” indicator—one of the country's lowest ranks among all GCI indicators. Pillar 2 of the proposed DPO is addressing the above bottlenecks to foster more vibrant private sector development.

Pillar 1: Improving Public Sector Governance

36. Reforms under the first pillar support three policy objectives: (i) improving the integrity of government decisions; (ii) increasing the quality of public services; and (iii) strengthening energy sector governance. These reforms were selected because they address the key drivers of poor governance in the Kyrgyz Republic, while leveraging longstanding government commitment for maximum impact. These reforms tackle both petty corruption in public services and high-level corruption (or “grand corruption”) in public procurement, energy sector revenue allocation, and across the public sector by public officials with conflicts of interest. Introducing conflict of interest primary legislation is groundbreaking in the Kyrgyz context. The new *Law on Conflict of Interest* will allow the sanctioning of one of the main sources of grand corruption in Kyrgyz Republic, defined as the misuse of public office for private gain. In addition, focusing on high-level corruption in critical areas such as public procurement and the energy sector has the potential to both curb the leakage of significant amounts of public funds and improve the public's perception of the most corrupt sectors. Finally, addressing petty corruption in public services will benefit the lowest-income citizens the most, thus contributing to the twin goals of eliminating poverty and boosting shared prosperity. Taken together, the measures supported by this pillar have the potential to alleviate key constraints to investment and growth.

Objective 1. Improving the Integrity of Government Decisions

➤ Regulating Conflicts of Interest

37. **Unregulated conflict of interest is an underlying source of corruption among public officials in Kyrgyzstan.** In October 2014, the Ministry of Economy (MoE) commissioned a study on the pervasiveness of conflicts of interest in the country based on focus groups of public officials and business representatives in the cities of Bishkek, Osh and Karakol. According to the results of this study, conflicts of interest in the Kyrgyz Republic occur most often in public procurement, when members of the tender committee have personal interests in the companies that bid on a contract. Other instances of conflicts of interest include public officials making regulatory decisions that affect businesses in which they have a private stake, as well as nepotism in the civil service. However, the Kyrgyz Republic's current primary legislation does not include a provision that would prevent or sanction this behavior, and it does not even define conflicts of interest.

38. **When public officials act to further their private interests while making official decisions, it negatively impacts the quality of those decisions and public services.** The results of the MoE focus group study suggest that conflicts of interest may contribute to infrastructure projects being of inferior quality or developed at an unnecessarily high cost; access to public sector contracts being reserved only for entities with connections to public officials; or public sector employees not being hired on a meritocratic basis. This not only decreases the public's trust in the government, but also affects private sector development, as entities with links to public officials receive preferential treatment. The quality of public policy decisions, such as regulation or contracting, also suffers. When conflicts of interest are present, decisions are no longer made based on the value for money for the public, but are instead guided by private interests.

39. **Regulating and preventing conflict of interest is a relatively new concept in the Kyrgyz Republic.** Legislative changes that address the existing lack of understanding, prevention, or sanctioning of conflict of interest can therefore have a significant impact on reducing corruption among public officials. On February 13, 2014 the government took an important step in this direction by adopting Government Resolution No. 90, "On the Approval of the Interim Guidelines on the Resolution of the Conflict of Interest at the Civil and Municipal Service of the Kyrgyz Republic." This resolution is the first public policy attempt to regulate conflict of interest among civil and municipal servants. However, primary legislation that would apply to all public officials is required to: (i) clarify the definition of conflict of interest; (ii) identify different types of conflict of interest; and (iii) develop robust and streamlined measures for identifying, managing and sanctioning conflicts of interest.

40. **Adopting the new *Law on Conflict of Interest* will increase transparency about the private interests of public officials and establish incentives to prevent conflict of interest.** The law will require that public officials submit declarations of personal interests together with their asset and income declarations. Commissions on Ethics will be created in various ministries, departments, and agencies. Their mandate will be to review and verify the declarations of personal interest and identify potential conflicts of interest. In cases when a public official is found to have acted in his/her public capacity for personal gain (i.e. a "consumed conflict of interest"), the law stipulates appropriate sanctions. Besides sanctions, the law also delineates advisory mechanisms to support public officials to help prevent conflicts of interest from arising.

41. **The following prior actions and indicative triggers are proposed:**

Prior Action #1. The Government of the Kyrgyz Republic submits the draft <i>Law on Conflict of Interest</i> to parliament.	(Indicative) Trigger #1. The Government of the Kyrgyz Republic issues key secondary legislation to implement the <i>Law on Conflict of Interest</i> .
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42. **Expected Results:** Increased transparency regarding the private interests of public officials and robust mechanisms for managing conflicts of interest, as measured by the percentage of declarations of personal interests of public officials reviewed and verified by the Commissions on Ethics to identify potential conflicts of interest.¹⁴ Additional indicators that could measure success include the number of cases of potential conflict of interest self-reported or identified by the Commissions on Ethics, with follow-up advice provided to officials by their superiors to regulate conflict of interest; and the number of cases of consumed conflict of interest identified and sanctioned.

➤ **Enhancing Public Procurement Practices**

43. **The landmark *Public Procurement Law (PPL)* was approved by parliament in January 2015 and signed by the President in April 2015.** The new PPL makes the following critical improvements to the Kyrgyz Republic’s public procurement system: (i) a more transparent procurement process in which information on every step of the process is made public on the Public Procurement Portal; (ii) improved oversight through a strengthened role for the Tender Commission, including mandatory review and declaration of no objection to bidding documents; (iii) process streamlining and simplification via the use of framework agreements; (iv) enhanced competition through limits on single-source procurement; and (v) improved redress mechanisms through the creation of an *Independent Complaint Review Commission*.

44. **The World Bank will continue to support the enhancement of public procurement practices in the proposed DPO series through implementation measures for the law.** DPO1 will focus on one key piece of secondary implementing legislation: the adoption of the *Regulation on the Independent Complaint Review Commission*. This is the most important area for improvement of the procurement system, according to the 2014 Public Expenditure and Financial Accountability (PEFA) assessment. The existence of an independent administrative procurement complaints review system (PI-19iv) is one of the four components of the PEFA’s “Competition, value for money, and controls in procurement” indicator (PI-19). While Kyrgyzstan’s composite score on PI-19 was a B, the country score was D on PI-19iv. Establishing an independent commission to review complaints, instead of the MoF’s Department of Public Procurement, will increase the accountability of government decision makers by giving voice to the firms competing for government contracts. Subsequently, DPO2 will further support the PPL’s implementation by requiring the adoption of “Guidance and Standard Procedures for the Application of the Public Procurement Law”. These documents will include step-by-step instructions on various

¹⁴ Although the law extends to all public officials, the results indicator will focus on high-level officials and other “politically exposed persons.” This approach uses risk-based selection for selecting a sample of conflict-of-interest declarations to verify initially as the institutional implementation capacity for verification is being developed.

procurement methods as well as a set of standard bidding documents consistent with the processes defined in the PPL.

45. **In addition, the World Bank and other development partners will support the development and implementation of procurement regulations and institutional capacity building.** This assistance will help operationalize the Public Procurement Department (PPD) as an effective regulatory body, as well as develop implementation guidelines and build institutional capacity for the Independent Complaint Review Commission. With World Bank support, the PPD and Training Institute in the Ministry of Finance (MoF) will roll out capacity building through online and face-to-face programs involving procuring entities, bidders and all other stakeholders. The program will include e-procurement.

46. **The following prior actions and indicative triggers are proposed:**

Prior Action #2. The Government of the Kyrgyz Republic, through the Ministry of Finance, issues a Regulation establishing an Independent Complaint Review Commission for public procurement.	(Indicative) Trigger #2. The Government of the Kyrgyz Republic, through the Ministry of Finance, issues the Guidance Notes delineating instructions on procurement methods and standard bidding documents to further operationalize the work of the Independent Complaint Review Commission.
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47. **Expected Results:** The implementation of the new PPL will: improve the complaints review system, as reflected by an increase in PEFA PI-19iv sub-score; and over time, create a more competitive, efficient and transparent public procurement environment, reflected in an increase in the overall score on PEFA PI-19.

Objective 2: Increasing the Quality of Public Services

➤ Adopting Public Service Standards

48. **Corruption is prevalent in key services used by the majority of Kyrgyz citizens.** According to the World Bank's 2015 *Kyrgyz Republic Corruption and Poverty Survey*, the most widely used services in the country have a high incidence of corruption. The "Graft Index," defined as the number of reported bribes divided by the number of reported transactions, is 24 percent in public education, 19 percent in employment and social security assistance, and 24 percent in identification, passport and registration services. Unpredictability and poor information about government services contribute to the ability of public officials to extort unofficial payments while delivering low-quality services.

49. **The introduction of public service standards increases the accountability of government officials for providing clearly defined services on time, thus reducing the scope for corruption.** The Kyrgyz authorities are fully committed to the development and adoption of service delivery standards. The *Law on Public and Municipal Services* requires the creation and approval of a Uniform Roster of Public Services encompassing services provided by executive agencies, their affiliates and subordinate institutions. At present, the Uniform Roster includes 373 public services, including education, health, social protection, administrative services and other

services, of which 224 are fee-based and 149 are free of charge.¹⁵ In order to streamline the provision of public services, the government has begun developing and approving relevant service standards and administrative procedures. Service delivery standards specify qualitative criteria for public service provision, such as the timeframe for service delivery, the locations where the service is delivered, standards of conduct of public officials, etc. The administrative procedures delineate the process of service provision and serve as guidelines for service providers. Templates for both service standards and administrative procedures have been adopted by two separate government resolutions.¹⁶ Government bodies are expected to develop standards and administrative procedures according to these templates and submit them to an interagency committee for review and approval, after which those standards and procedures are ready for formal adoption.

50. The following prior actions and indicative triggers are proposed:

<p>Prior Action #3. The Government of the Kyrgyz Republic adopts service delivery standards for at least 90 public services, including in the key areas of public education, social security and employment, and ID services.</p>	<p>(Indicative) Trigger #3. The Government of the Kyrgyz Republic: (i) adopts service delivery standards for an additional 120 services; (ii) adopts administrative procedures for at least 20 services; and (iii) establishes a monitoring mechanism for implementing the adopted standards and procedures.</p>
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51. Expected Results: More transparent service delivery standards, ultimately resulting in greater accountability of public officials and lower petty corruption, as reflected in a lower Graft Index in key public service areas such as education, health, social protection, and administrative services.

Objective 3: Strengthening Energy Sector Governance

52. Weak governance and poor financial viability are the root causes of the chronic crisis in the Kyrgyz Republic's energy sector. The supply of power and heat are unreliable due to antiquated and poorly maintained infrastructure, as well as weak governance and a lack of transparency and accountability. In turn, low electricity and heating tariffs compromise the financial viability of the sector, leading to severe underspending on maintenance and new investments, and distort pricing signals, which results in inefficient consumption. The Kyrgyz Republic has the lowest electricity tariffs in the Europe and Central Asia (ECA) region and one of the lowest worldwide; as a result, the sector constitutes a significant source of quasi-fiscal liabilities, as deficits of the power sector alone average two percent of GDP per year, covered by government loans. Weak governance and inadequate regulatory frameworks lead to executive discretion, arbitrary and non-transparent decision making about the allocation of funds in the sector, and lack of accountability for services delivered to consumers. As a result, Kyrgyz citizens perceive corruption in the energy sector as pervasive.

¹⁵ The Uniform Roster was approved by the Government Resolution No. 85 on February 10, 2012.

¹⁶ The template for standards was approved in 2012 (Decree No. 603), while the template for administrative procedures was approved in 2014 (Decree No. 287-p).

53. **The proposed DPO series supports governance and tariff reforms in the energy sector as part of a medium-term reform agenda.** The operation focuses on two reform areas that were launched under the recently approved Energy Sector DPO: (i) improving the financial viability of the energy sector through transparent tariff reforms, and (ii) strengthening transparency and accountability in the sector. These reforms will help address both the perceptions of grand corruption in the distribution of funds in the sector, as well as petty corruption in the provision of energy services. They will also help improve the quality of services delivered by reinforcing the financial position of operators and promoting public accountability measures, and they will reduce fiscal pressure on the state budget by promoting cost-recovery pricing objectives.

➤ **Improving Economic Governance of the Energy Sector: Transparent Tariff Reform**

54. **The government has taken important steps toward transparent tariff reforms.** On November 20, 2014 the government approved the Medium-Term Tariff Policy (MTTP) for the power and heating sectors for 2014-17 (Resolution No.660), which calls for tariff increases for different consumer groups designed to gradually achieve cost recovery. On December 11, 2014 the Regulatory Agency of the Fuel and Energy Complex enacted tariff increases for 2015 (Order No.45). However, additional policy actions will be necessary to complete these reforms.

55. **The proposed DPO series will support the government in implementing phased tariff reforms to ensure the sector's financial viability.** DPO 1 will support the approval of a tariff-setting methodology for heating companies as the first step toward transparent heating pricing. DPO 2 will build on this reform by supporting an update and extension of the MTTP through 2018. This will enable the government to continue revising electricity and heating tariffs towards long-term cost recovery levels in a gradual and predictable manner, while taking into account the significant decline in world oil and gas prices.

56. **The following prior actions and indicative triggers are proposed:**

Prior Action #4. The Government of the Kyrgyz Republic, through the State Regulatory Agency of the Fuel and Energy Complex, adopts a tariff-setting methodology for heating sector companies.	(Indicative) Trigger #4. The Government of the Kyrgyz Republic adopts a revised Medium-Term Tariff Policy for 2014-17, consistent with the medium-term objective of improving the financial viability of the sector.
	(Indicative) Trigger #5. The Government of the Kyrgyz Republic extends the revised Medium-Term Tariff Policy by one year (through 2018) in accordance with the objective of increasing sector revenues.

➤ **Promoting Transparency, Accountability, and Rules-Based Governance in the Energy Sector**

57. **Regulatory reforms must accompany tariff reforms in order to ensure increased accountability by power and heating companies, build consumer confidence and encourage the acceptance of reforms.** On November 14, 2014 the government designated a single entity,

the State Regulatory Agency of the Fuel and Energy Complex, for economic regulatory functions in the energy sector (Resolution No.650).

58. **The State Regulatory Agency of the Fuel and Energy Complex has been made responsible for the allocation of funds collected from end-users across electricity generation, transmission and distribution companies.** This is an important change. Previously, payments collected from energy consumers were allocated across companies based on a monthly ministerial order and did not systematically correspond to the actual volumes of power made available to distribution companies. DPO1 will support the adoption of a Government Resolution delineating rules-based governance of the allocation of funds to electricity sector companies based on tariffs and volumes, rather than executive discretion. Not only will this result in increased transparency, but the reform is also expected to create incentives for distribution companies to improve their operational and financial performance, including collection.

59. **The agency will also take steps to increase the government's accountability for heating services delivered to the population.** DPO1 will support transparency, accountability and performance management by establishing a performance reporting and monitoring framework for the heating sector. Key performance indicators for the sector will include the number of breakdowns, the amount of heat generated in the districts, as well as the number of complaints. The previous DPO series supported a similar reform for the power sector, Regulation No.33, which was issued by the State Regulatory Agency of the Fuel and Energy Complex on November 10, 2014.

60. **Going forward, it will be important to ensure the functionality, independence, and funding of the State Regulatory Agency of the Fuel and Energy Complex, so it can continue to act as an impartial regulator of the energy sector.** DPO 2 will focus on strengthening decision making within the agency, as well as adopting a sustainable funding mechanism to ensure adequate financial resources for the Agency.

61. **The following prior actions and indicative triggers are proposed:**

<p>Prior Action #5. The Government of the Kyrgyz Republic adopts a Resolution that institutes a new cash settlement mechanism between electricity generation, transmission and distribution companies, which ensures that cash allocations are automatic and consistent with the tariffs approved by the State Regulatory Agency of the Fuel and Energy Complex.</p>	
<p>Prior Action #6. The State Regulatory Agency of the Fuel and Energy Complex adopts a Performance Reporting and Monitoring Framework for the heating sector.</p>	<p>(Indicative) Trigger #6. The Government of the Kyrgyz Republic adopts a Resolution establishing the governance structure and funding mechanism for the State Regulatory Agency of the Fuel and Energy Complex to increase its autonomy and ensure that it has adequate financial resources.</p>

62. **Expected Results:** (i) Increased financial viability of the energy sector, measured by a rise in cash collected per kWh of power generated and per Gcal of heat generated by the Bishkek Central Heating Plant; (ii) Improved accountability for heating service provision, with disclosed quarterly key performance indicators for the heating sector.

Pillar II: Strengthening Private Sector Competitiveness

63. **Reforms under the second pillar support three policy objectives:** (i) promoting trade, in the context of the Kyrgyz Republic's recent accession to the EEU; (ii) enhancing the business environment to stimulate private-sector-led growth; and (iii) improving internet connectivity as an important catalyst for private sector development. Accomplishing these goals will allow Kyrgyz businesses to access the larger markets of EEU member countries and improve private sector competitiveness more broadly. In addition, expanding the coverage of internet connectivity to rural areas and improving its quality is an important driver of shared prosperity.

64. **The reforms supported under this pillar build a foundation for the Kyrgyz Republic to reap the long-term benefits of economic integration.** Joining the EEU's customs union gives Kyrgyz producers an opportunity to reach a much larger market, while creating demand to reform the investment climate in directions that will be necessary to compete on a regional or global scale. This will facilitate a long-term transition from a gold- and remittance-dependent economy toward a competitive economy integrated into regional and global trade networks. This transition will take time, and it will require the Kyrgyz Republic to increase the quality of its infrastructure and testing services, as well as the knowledge and capacity of domestic producers. This operation builds on existing strengths, capacities, and ongoing World Bank Group support in order to strengthen the foundation for this transition, while using other complementary instruments and partnerships to achieve long-term results. It targets specific binding constraints to the private sector, within a broader policy agenda supported by development partners. It is complementary to the Asian Development Bank's parallel budget support engagement, which seeks to, *inter alia*, improve access to finance for the private sector, encourage private sector participation in physical and social infrastructure and facilitate FDI in the Kyrgyz economy.

Objective 1. Promoting Trade

65. **At present, export and import procedures are particularly complex in the Kyrgyz Republic.** According to the 2016 *Doing Business* report, the Kyrgyz Republic ranks 83rd out of 189 countries on the *Trading Across Borders* indicator. The time to export, at 51 hours, compares favorably to the ECA average of 59 hours, but the total cost to export, at US\$675 per container, is considerably higher than the ECA average of US\$363. The comparable import figures for the Kyrgyz Republic are 73 hours and US\$712 compared to an ECA average of 50 hours and US\$310. Beyond time and cost, border compliance is still done almost exclusively through physical inspection, and the limited use of ICT and risk-based control creates extensive opportunities for corruption. In the most recent Enterprise Survey, the single greatest response on corruption was related to importing goods, with 65.5 percent of firms expected to pay bribes, compared to an ECA average of just 10.5 percent. In order to reduce the time and cost of trade, the MoE prioritizes a number of activities to be achieved in the short and medium term, including the abolition of the sales tax for exports to promote exports to EEU member and non-member countries, as well as a significant overhaul of the institutional and legal/regulatory framework governing food safety.

66. **DPO1 will support reform measures to abolish the sales tax for exporters.** This reform will contribute to the optimization of indirect taxes, particularly VAT and sales tax. Currently, sales tax on exports is still applied, rendering export procedures cumbersome and expensive and putting Kyrgyz producers at a significant cost disadvantage in foreign markets. Besides the burden involved in complying with the sales tax, exporters are taxed twice—first in Kyrgyzstan and then in the destination country—as the sales tax, unlike the VAT, is not refunded. According to the current Tax Code, all exports of goods and services are subject to a sales tax of 2 percent on goods exports and 3 percent on services. While abolishing the sales tax for exporters is likely to result in a loss of public revenue, this can be more efficiently compensated through a gradual increase in the VAT rate.

67. **DPO2 will support the adoption of a new *Law on Food Safety* to, *inter alia*, provide a sound legal basis for an integrated system of risk-based food-safety inspections and to define clear requirements for Food-Business Operators (FBOs).** Food product exports amounted to US\$120 million in 2013, of which more than 25 percent were sold to EEU member countries. While the Kyrgyz Republic is relatively well prepared to meet EEU requirements, with its internationally accredited laboratories, it must resolve several institutional and legislative challenges in order to achieve compliance with new requirements under the EEU. Additional efforts are also required to increase export readiness, particularly in food industries. The new *Law on Food Safety* will introduce more efficient and reliable controls and supervisory systems for food safety, improve coordination among supervisory bodies, and establish a single state inspection for food safety control and supervision. It will also establish clear requirements for FBOs, including the introduction of Hazard Analysis Critical Control Point (HACCP) certification, traceability, and FBO liability. The *Law on Food Safety* is being drafted in consultation with stakeholders under the World Bank Group's Investment Climate TA, and it will ensure more efficient state control of the food industry, which will make Kyrgyz food producers more competitive in international markets.

68. **The following prior actions and indicative triggers are proposed:**

Prior Action #7. The Government of the Kyrgyz Republic submits to parliament amendments to the Tax Code abolishing sales taxes for exporters.	(Indicative) Trigger #7. The Government of the Kyrgyz Republic submits to parliament a new <i>Law on Food Safety</i> .
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69. **Expected Results:** More manageable and cheaper export procedures due to the abolition of export sales taxes for both goods and services for all export destinations. Greater export readiness among Kyrgyz firms, as measured by an increasing number of firms: (i) with certified HACCP; and (ii) included in the EEU register of FBOs and allowed to export to the EEU.

Objective 2. Enhancing the Business Environment

70. **Businesses in the Kyrgyz Republic face high administrative costs of paying taxes.** The number of tax payments per year per business (52) is far above the regional average (20.5); the number of hours required to complete tax declarations is comparatively high (210); and 52.5 percent of businesses identify complicated tax administration as one of the key challenges for

business development according to the 2015 *Doing Business* report. VAT refunds are particularly problematic and a major issue raised by investors as an obstacle to their operations in the Kyrgyz Republic. In addition, social security contributions, fees, and other mandatory charges must be paid to the Social Fund of the Kyrgyz Republic rather than the tax committee. Furthermore, entrepreneurs do not have the option to pay social contribution and taxes at the same time, and have to make payments to specific banks separately for social contributions and other tax payments. As a result, enterprises in the Kyrgyz Republic spend an average of 5.6 days per year making separate payments to the Social Fund.

71. DPO1 will support amendments to the Tax Code to streamline the administration of the VAT. These amendments will introduce new practices whereby a range of VAT invoice numbers will be assigned to taxpayers, thus replacing the need for paper-based invoices that are currently purchased from tax services. The law will also have provisions for expediting VAT refund procedures, through a so-called “green channel”, for trustworthy businesses, with taxpayer trustworthiness identified based on risk analysis. These changes would significantly reduce compliance costs related to administration of VAT invoices and improve the cash-flow of firms - particularly exporters - able to avail themselves of the streamlined refund procedures.

72. DPO2 will support legislative changes that begin to transfer the administration of social insurance payments from the Social Fund to the State Tax Service (STS), thus reducing the time required for businesses to administer social insurance contributions. This requires amendments to a package of laws, including amendments to the Tax Code and the legislation governing social insurance payments. The government plans to begin by transferring the administration of social insurance payments for the self-employed, while launching pilots for businesses. The World Bank Group is currently providing TA to STS to ensure that it has adequate institutional capacity to administer social insurance payments.

73. The following prior actions and indicative triggers are proposed:

<p>Prior Action #8. The Government of the Kyrgyz Republic submits to parliament amendments to the Tax Code to streamline VAT administration by eliminating paper-based VAT invoicing and assigning a range of numbers for invoicing, and introduce simplified procedures for VAT refund for trustworthy taxpayers.</p>	<p>(Indicative) Trigger #8. The Government of the Kyrgyz Republic (i) transfers administration of social insurance payments from the Social Fund to the State Tax Service for the self-employed; and (ii) carries-out pilots for businesses.</p>
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74. Expected Results: Lower administrative cost of paying taxes and social contributions as measured by a growing share of: (i) VAT refunds processed through the ‘green channel’; and (ii) firms filling reports on social contributions with the State Tax Service.

75. Sanitary and radiology inspections constitute an additional burden on firms. Enterprise surveys indicate that the inspection process is unsystematic and opaque, resulting in needless additional transactions between firms and government officials and creating room for rent-seeking. While progress has been made, including through measures supported by the

previous DPO series—such as amendments to the legislative framework that reduced the number of inspections and allowed for the introduction of risk-based inspections; and the launch of a risk-based inspections coordination module—much remains to be done to improve the efficiency and targeting of the inspections framework.

76. **DPO1 will support further improvements to the risk criteria for inspections.** The government plans to amend its current resolution *On Setting Risk Criteria for Inspections* to allow for less-frequent inspections for entities with lower levels of risk. This offers the double benefit of: (i) allowing inspection services to better target their efforts to high-risk firms, while limiting the scope for rent-seeking in the inspections process; and (ii) reducing the burden inspections impose on firms while safeguarding the public interest. Specifically, the new criteria will reduce the number of possible inspections by the Sanitary Department by half and introduce criteria for radiology inspections, which did not exist previously.

77. **DPO2 will further support increasing the efficiency of inspections.** This will be achieved through developing clear guidelines for inspections, including checklists setting out the requirements for businesses during inspections, thus streamlining the process and making it more transparent. In addition, systems will be developed to give firms opportunities to provide feedback on inspections so as to measure, track and ultimately improve their quality.

78. **The following prior actions and indicative triggers are proposed:**

Prior Action #9. The Government of the Kyrgyz Republic amends its Resolution <i>On Improving Risk Criteria for Inspections</i> to allow for less-frequent inspections for entities with lower levels of risk.	(Indicative) Trigger #9. The Government of the Kyrgyz Republic adopts guidelines for inspections' checklists and institutes feedback mechanisms to measure, track and improve the quality of inspections.
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79. **Expected Results:** A lower administrative burden on firms due to overuse of inspections, as reflected in reduced inspection coverage by the Sanitary Department, measured as the share of firms inspected annually. Improved systems to provide feedback on inspections and thus improve their quality, as measured by the number of firms' feedback on inspections received.

Objective 3. Improving Connectivity

80. **The proposed DPO program supports two of the government's key priorities for expanding internet access across the Kyrgyz Republic.** The first priority is to expand wireless network coverage and effectiveness. The ongoing migration from analog to digital television will free up radio spectrum frequencies previously used for television services. Using these frequencies will help telecommunication companies reduce the cost of deploying wireless networks, making them more effective for use in rural telecommunications. Another priority is to increase international connectivity. The availability of bandwidth at the moment is both relatively constrained and excessively reliant on Kazakhstan. The amendments to the *Law on Telecommunications*, approved by parliament and signed by the President on December 23, 2014, and the subsequently adopted secondary legislation define a standardized set of guidelines

regarding how telecommunications networks can deploy high-capacity fiber optic cables for international connectivity.

81. **The authorities aim to ensure competitiveness of the connectivity market and provide a level playing field for all market players.** The sector’s regulator, the State Communications Agency (SCA), plans to undertake a market analysis of the wholesale internet connectivity market to ensure that it is competitive. If a dominant firm or firms exist, SCA will define specific competition safeguards, such as tariff regulation or open access rules, to ensure a level playing field in the market. In order to ensure that all players, including internet service providers and other electronic communications service providers, can protect their legitimate interests and address their disputes efficiently, the authorities plan to establish a dispute-resolution mechanism based on international good practices at a competent public body. Due to its proximity to the market, the SCA is well placed to perform this role. Formal dispute-resolution procedures would serve as a market self-regulation mechanism and alleviate the burden on the national court system.

82. **The proposed prior action and indicative trigger support the government’s existing programs for broadband connectivity, reflecting the findings of the 2016 World Development Report.**¹⁷ The report underscores the importance of competition and legal certainty as essential determinants of private investment in ICT. Moreover, the supported reforms would also lay the groundwork for implementing the regional Digital Central Asia-South Asia (CASA) Project under preparation. The series of projects under the Digital CASA aims to implement a regional, cross-border approach to improve broadband internet connectivity in the landlocked countries of Central Asia and parts of South Asia by catalyzing private sector investment in infrastructure and modernizing relevant policies and regulatory frameworks.¹⁸

83. **The following prior actions and indicative triggers are proposed:**

<p>Prior Action #10. The Government of the Kyrgyz Republic, through the Ministry of Transport and Communication and the State Border Service Agency, adopts regulations setting-out the rules and procedures by which authorized telecommunications companies can deploy cross-border telecommunications cables, in order to ensure competition in the international connectivity market and create time-bound and transparent procedures.</p>	<p>(Indicative) Trigger #10. The Government of the Kyrgyz Republic, through the State Communications Agency: (i) submits to parliament amendments to the <i>Law on Electronic Communications</i> to promote competition in the issuance of the radio spectrum resource for providing data transmission; and (ii) adopts a procedure for dispute resolution between electronic communications service providers.</p>
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84. **Expected Results:** Greater competition in the sector, leading to a measurable increase in the international internet bandwidth (Mbit/s) during the life of the operation, and increased access

¹⁷ World Bank: “World Development Report 2016: Digital Dividends”, 2016

¹⁸ The Digital Central Asia-South Asia Program aims to improve telecommunications and Internet connectivity throughout the region, focusing initially on connecting the relatively underserved markets of Afghanistan, Kyrgyz Republic, and Tajikistan. The Kyrgyz Republic has sent a request to the World Bank to join this program. The PCN for Kyrgyz Republic (P160230) is tentatively scheduled for September 2016, with a presentation to the Board tentatively projected for FY18.

to broadband internet in the country over the long run; enhanced international connectivity through the deployment of new cross-border connections; increased private investment in national wireless broadband infrastructure, leading to more wireless broadband internet users and higher demand for the international internet bandwidth (existing and deployed cross-border telecommunication cables); improved competitiveness in the market; and consistent grievance redress in the sector.

Table 4: DPO Prior Actions, Analytical Underpinnings and Technical Assistance

Prior Actions	Analytical Underpinnings
Operation Pillar 1: Improving public sector governance	
Prior Action #1. The Government of the Kyrgyz Republic submits the draft <i>Law on Conflict of Interest</i> to parliament	TA on conflict of interest under the Capacity Building for Economic Management Project (2014); TA on conflict of interest under the implementation of the PSRR (2013-2016).
Prior Action #2. The Government of the Kyrgyz Republic, through the Ministry of Finance, issues a Regulation establishing an Independent Complaint Review Commission for public procurement.	<i>Country Fiduciary System Review Report</i> (2012); <i>Public Expenditure and Financial Accountability Assessment</i> (2014); World Bank TA engagement.
Prior Action #3. The Government of the Kyrgyz Republic adopts service-delivery standards for at least 90 public services, including in the key areas of public education, social security and employment, and ID services	TA under the implementation of the PSRR (2013-2016); World Bank <i>Kyrgyz Republic Corruption and Poverty Survey</i> (2015); European Bank for Reconstruction and Development <i>Life in Transition Survey</i> (2010).
Prior Action #4. The Government of the Kyrgyz Republic, through the State Regulatory Agency of the Fuel and Energy Complex, adopts a tariff-setting methodology for heating sector companies.	Energy Sector DPO; Electricity Supply Accountability and Reliability Improvement Project; Tariff-Setting Methodology TA (ongoing).
Prior Action #5. The Government of the Kyrgyz Republic adopts a Resolution that institutes a new cash settlement mechanism between electricity generation, transmission and distribution companies, which ensures that cash allocations are automatic and consistent with the tariffs approved by the Regulatory Agency of the Fuel and Energy Complex.	
Prior Action #6. The State Regulatory Agency of the Fuel and Energy Complex adopts a Performance Reporting and Monitoring Framework for the heating sector.	
Operation Pillar 2: Strengthening private sector competitiveness	
Prior Action #7. The Government of the Kyrgyz Republic submits to parliament amendments to the Tax Code abolishing sales taxes for exporters.	World Bank-executed Trade and Competitiveness Advisory Program (2009-17).
Prior Action #8. The Government of the Kyrgyz Republic submits to parliament amendments to the Tax Code to streamline VAT administration by eliminating paper-based VAT invoicing and assigning a range of numbers for invoicing, and introduce simplified procedures for VAT refund for trustworthy taxpayers.	<i>Business Environment and Enterprise Performance Survey</i> (BEEPS) 2013

Prior Actions	Analytical Underpinnings
Prior Action #9. The Government of the Kyrgyz Republic amends its Resolution <i>On Improving Risk Criteria for Inspections</i> to allow for less frequent inspections for entities with lower levels of risk.	
Prior Action #10. The Government of the Kyrgyz Republic, through the Ministry of Transport and Communication and the State Border Service Agency, adopts regulations setting-out rules and procedures by which authorized telecommunications companies can deploy cross-border telecommunications cables, in order to ensure competition in the international connectivity market and create time-bound and transparent procedures.	Advisory Services and Analytics undertaken in FY13 and FY14 to identify opportunities and challenges in regional and cross-border telecommunications connectivity in Central Asia.

C. LINK TO CPS AND OTHER BANK OPERATIONS

85. **The proposed programmatic operation is fully aligned with the FY2014-2017 CPS and the CPS PLR (February 2016).** The CPS, approved in June 2013, focuses on supporting the government in tackling the country's overriding development challenge of improving governance. This is reflected in the government's *National Sustainable Development Strategy 2013-17*, which adopts improved governance and reduced corruption as unifying themes and as the basis for the country's economic and social development. The CPS's strategic goal is to help reduce extreme poverty and promote shared prosperity through support for improved governance. Correspondingly, the CPS proposes three broad areas of engagement: public administration and public service delivery, the business environment and investment climate, and the management of natural resources and physical infrastructure. The CPS envisions a balance of investment and development policy lending in the context of a satisfactory macroeconomic framework and reform implementation record. The two pillars of the proposed programmatic operation are aligned both with the objective of improving governance and with two of the three areas of engagement: public administration and public service delivery and the business environment and investment climate. The CPS PLR concluded that the overarching focus on governance and the CPS areas of engagement remain valid, while noting that the deteriorated external environment called for additional focus on job creation through exploiting new opportunities for private sector development in the context of EEU membership.

86. **Several World Bank capacity-building operations and analytical and advisory activities have been supporting the implementation of the identified reform agenda.** These include: TA support for the implementation of the PSRR; public procurement TA using Trust Fund and Institutional Development Fund (IDF) resources; a public financial management (PFM) capacity-building project supported by several development partners; joint donor coordination efforts to support the implementation of the PSDP, funded by IDF resources; Investment and Competitiveness TA; and consultation of the World Bank's *Doing Business* team. Energy reforms have been supported by the Energy Sector DPO, the Electricity Supply Accountability and Reliability Improvement Project, and an ongoing TA on tariff-setting methodology.

D. CONSULTATIONS AND COLLABORATION WITH OTHER DEVELOPMENT PARTNERS

87. **The World Bank has collaborated closely with the IMF and other development partners on the proposed programmatic operation.** The World Bank team has discussed the macro-economic framework with the IMF country team extensively. In addition, DfID supported

the World Bank's TA activities in public sector governance, including implementation support to the Prime Minister's Office on the PSRR through a recently completed Externally-Funded Output (EFO). The World Bank has closely coordinated the energy sector reforms supported by the proposed operation with the energy sector donor working group represented by the Asian Development Bank, the World Bank, Japan International Cooperation Agency, Germany Development Bank and the United States Agency for International Development. The private sector competitiveness agenda has been strongly supported by IFC advisory services on tax administration, inspection and permits reform.

88. The government has held extensive public hearings on a number of prior actions and related reforms, including on conflict of interest, energy, food safety and the budget code. Several of these consultations have been supported by the World Bank's ongoing technical assistance projects and involved multiple stakeholders, including all branches of government and civil society. In some cases, this led the team to reconsider prior actions that were initially included in the program's concept stage.¹⁹ In other instances, most notably with regard to the Budget Code, these consultations led to multiple revisions of draft legislation so as to achieve maximum consensus. Finally, the World Bank team conducted public consultations on the proposed program with civil society organizations, which created a platform for civil society to engage in the monitoring of the reforms and their results, as well as in the design of triggers for DPO2. Specific suggestions adopted by the team and reflected in indicative triggers include: (i) the need to ensure that the Independent Complaints Review Commission for public procurement receives implementation support to carry out its functions; (ii) the importance of strengthening the capacity and governance of the energy sector regulator; and (iii) the need to complement the adoption of service standards with dissemination and accountability measures.

V. OTHER DESIGN AND APPRAISAL ISSUES

A. POVERTY AND SOCIAL IMPACT

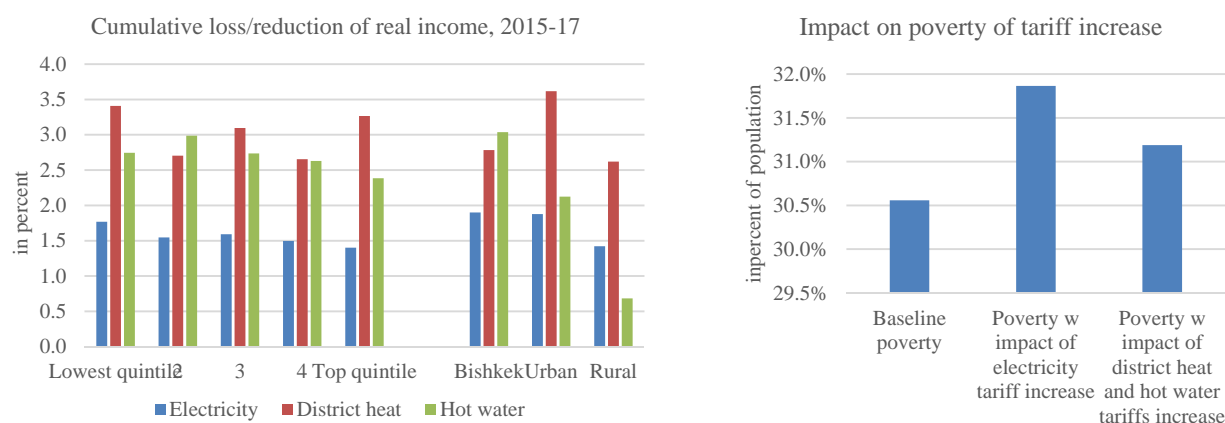
89. Poverty analysis shows that changes in poverty are closely linked to economic growth, while corruption also significantly affects the poor. A majority of households view corruption as a major problem in the Kyrgyz Republic. According to a recent household survey, which specifically included questions related to the incidence and practice of petty corruption, more than 90 percent of respondents perceived corruption as a major issue. Households reported that one out of six interactions involving public services entails some type of bribe. The national level graft index, according to survey information, has been estimated at 16 percent. Survey data further suggests that all groups of households are vulnerable to corruption. While respondents from all income quintiles report being "asked" for bribes, the richest and poorest seem to be most exposed to corruption, though likely in relation to different public services. The poorest quintile and top quintile experienced corruption 20 percent and 22 percent of the time, respectively, while accessing public services. The cost of corruption for households is high, reaching 6.3 percent of the household budget for the poorest population, which is twice as high as the share of electricity expenditures.

¹⁹ For instance, this includes the initially proposed prior action concerning the elimination of the mandatory certificate of origin, which businesses feared could have led to abuse.

90. **Thus, policy reforms and measures that positively impact growth and anti-corruption will have positive long-term distributional impacts.** Successful implementation of policy actions under the current DPO should also improve the institutional capacity of the government to provide quality public services to its population, particularly those in the bottom income quintiles. While direct quantification of the impact of anti-corruption efforts is difficult, fair and transparent government procedures and institutions will result in better, client-oriented public services and fewer opportunities for rent-seeking. Combined with improvements in the business and regulatory climate, this should facilitate much-needed growth in the private sector, where the bottom 40 percent of the population engages in labor activities. In short, the proposed operation will have a positive impact on sustainable economic growth over the medium to long run, and as such will contribute to the objectives of shared prosperity and inclusive growth.

91. **Detailed analysis based on 2014 household survey data suggests that the cumulative effects of rising energy tariffs on poverty is marginal to moderate, but slightly regressive.** The graphs below show how the MTTP, which stipulates gradual tariff increases for electricity, district heat and hot water, is estimated to impact the population by quintiles of consumption. The simulation assumes no changes in the quantities consumed, which reflects the worst case scenario (i.e. zero price substitution). Under those assumptions, price increases for electricity and district heat and hot water lead to reductions in real income of around 1.7 percent and 3 percent, respectively, for the bottom 40 percent of households and to a roughly 1 percentage point increase in the overall poverty rate. It has to be noted that while access to electricity is universal, only about 10 percent of the population—predominantly in Bishkek—have access to district heat and hot water. This mitigates the impact of thermo-power tariffs on poor populations. The loss of real income due to electricity tariff hikes will be felt equally across the country, but the impact will be more pronounced in relative terms for households in the bottom income quintiles, and thus slightly regressive. The impact of the increase in tariffs for hot water is the largest and is felt more in Bishkek, the region with the lowest poverty rate.

Figure 6: Estimated impact of the Medium Term Tariff Policy



Source: Staff estimates based on KIHS 2014.

92. **Moreover, a large part of the population is covered by some type of social and/or energy benefit.** According to household survey data, half of the population was covered by some type of social transfer in 2014, including 58 percent in the poorest quintile and 51 percent in the

second-poorest quintile. Pensions are the most common transfer, covering 46 percent of the poorest quintile and 42 percent of the second poorest, and they have the most significant impact on poverty. In the absence of pensions it is estimated that the poverty rate would double. Around 95 percent of pensioners receive electricity compensation. In addition, all benefits were topped-up following the 2009 doubling of the electricity tariff. The tariff was rolled back in early 2010, but the increases in benefits were not reversed. As per the current medium-term tariff policy, electricity tariffs are expected to increase gradually, rising by 20 percent per year from a very low rate, which has not changed since 2008. This is in contrast to the 2009 increase, which doubled the tariff overnight.

93. **The World Bank is discussing with the government how best to improve the targeting of energy-related subsidies over time.** The World Bank has recommended that the government restructure and phase out energy-related benefits, which are not well targeted. The World Bank's advice is to restructure energy-related benefits by moving to a proxy means test under the current Monthly Benefit for Low-Income Families with children (MBLIF) program, which is the only poverty-targeted program in the country. This could be achieved primarily through setting coverage targets and introducing energy-related top-ups to the MBLIF, and beneficiaries could include households in the bottom 40 percent of the income distribution that are above the MBLIF eligibility threshold. While the authorities are considering increasing the MBLIF budget and benefit value, recalibrating targeting may take additional time.

94. **Qualitative research suggests that energy sector reforms may involve a gender dimension.** According to qualitative research carried out in a number of ECA countries,²⁰ this is due to (i) the higher vulnerability of female-headed households; (ii) intra-household roles related to energy use; (iii) the differentiated impact of coping strategies; and (iv) behavioral differences in how men and women interact with relevant institutions, such as energy providers and social assistance offices. Specific insights from focus groups in the Kyrgyz Republic suggest that:

- a. Women perform most of the household tasks that require energy, while spending a greater amount of time in the dwelling, and are thus more likely to be affected by pressures to reduce energy/heating use;
- b. Women would be more affected by coping strategies due to (i) a greater propensity to prioritize energy payments over their own needs; (ii) the time and effort involved in securing alternative means of energy/heating supply; and (iii) cultural norms making it unacceptable for men to borrow money.

95. **However, the relatively low share of energy-related expenditures in total household expenditures, which average less than 7 percent, suggests that these impacts are likely to be modest.** Nonetheless, the World Bank will endeavor to take into account gender dimensions while monitoring the results of the DPO, including for instance through the *Corruption and Poverty Survey* and in the context of the tariff-setting methodology TA.

²⁰ The World Bank: "Toward Gender-Informed Energy Subsidy Reform: Findings from Qualitative Studies in Europe and Central Asia" (2015)

Box 1: Planned electricity tariff increases and protecting the poor**There are five different energy-related social assistance schemes in the Kyrgyz Republic**

Social Assistance Program	Implementing Agency	Number of direct beneficiaries (individuals or households)	Spending (in mln KGS)
<i>Electricity compensations to pensioners</i>	Social Fund	553,900	1,747.7
<i>Compensations in lieu of privileges</i>	Ministry of Social Development	54,245	1,530.1
<i>Life-line tariff for high-altitude areas</i>	Ministry of Finance, local govt.	178,568 households	118
<i>Compensations to public servants</i>	Ministry of Finance	52,215	10.44
<i>Utility subsidy (only Bishkek)</i>	Bishkek City Administration	3,909 households	25.1

Source: World Bank, Social Assistance Public Expenditure Review (2013)

The 2013 Public Expenditure Review (PER) recommended adopting a plan to restructure energy benefits that largely leak to the non-poor and reallocate spending to poverty-targeted programs. The situation is changing in the right direction, albeit slowly and not consistently. Key energy benefits, including compensation to pensioners, compensation to public sector employees and compensations in lieu of privileges, have been kept constant since 2010. This led to a decrease in spending on these benefits from 1.8 percent of GDP in 2010 to less than 1 percent in 2013. The Social Fund plans to phase out the electricity compensation for pensioners by merging it with the basic pension. In February, the government approved the Social Protection Program for 2015-2017, which envisages (i) an annual minimum 10-percent increase in the Guaranteed Minimum Income used to determine eligibility for the MBLIF; and (ii) a relative increase in the MBLIF budget from 33.4 percent of all Ministry of Social Development benefit spending in 2014 to 45 percent in 2017.

The PER also recommended strengthening the MBLIF through better targeting and increased spending. The program currently covers 310,000 children, or about 10 percent of the population when all household members are included, but it reaches less than one-third of households in the poorest quintile. Spending on the MBLIF was equal to KGS 2,061 million, or about 0.5 percent of GDP, in 2014. Improving the MBLIF's targeting will involve a shift from direct means testing to a proxy means test. The World Bank social protection team is trying to facilitate this transition; however, this has proven to be difficult and has taken longer than expected. Potential reforms include introducing an energy-related top-up to the MBLIF benefit and establishing a second income threshold to cover a larger part of the bottom 40 percent of the income distribution with incomes above the MBLIF threshold. In light of the planned gradual increase in electricity tariffs, the MBLIF could become a platform for additional targeted energy benefits. The World Bank will continue to work with the government to strengthen the MBLIF and to design and adopt a time-bound plan to phase out existing energy benefits.

Source: World Bank staff.

B. ENVIRONMENTAL ASPECTS

96. **The specific policies supported by the DPO program are not expected to have adverse effects on the environment and natural resources.** Implementation of the energy sector policy actions supported by the proposed DPO1 is not likely to have a significant impact on the environment, forests and natural resources. By supporting energy tariff reforms, which will help to correct distorted price signals, the operation is likely to have positive environmental benefits. Energy intensity in terms of electricity consumption per capita and square meter in buildings is relatively high in the Kyrgyz Republic compared to countries with similar climates and income levels. Gradually increasing energy tariffs will therefore create incentives for households and

industries to more efficiently use energy and/or reduce consumption. Given that current levels of electricity and district heating tariffs are exceptionally low and that switching to alternative fuels generally requires up-front investments, the tariff increases are not likely to trigger households and business to switch to alternative fuel sources, including more polluting fuels. Other policy actions supported by the operation have been found to be environmentally neutral.

C. PFM, DISBURSEMENT AND AUDITING ASPECTS

Accounting, Recording, and Reporting

97. **Improvements in accounting, recording and reporting systems are necessary.** While the limited computerisation of treasury functions now enables partial reconciliation of information between regional treasuries, local transit banks, the central treasury and the National Bank, there is no comprehensive automation of accounting, recording, and reporting. Monthly and quarterly reconciliations between the records of budgetary organisations and those of the central treasury take place, though the arrangements are cumbersome and likely do not resolve all data errors. A fully integrated system is being developed; though progress is very slow. Quarterly reports are submitted to the President, the parliament and the Prime Minister. By mid-May of each year, the government submits a report for the execution of the budget (cash-based) for the previous year to the parliament. The report includes extensive information on revenues and expenditures; however, it does not include accounting policies and is not supported by commentary that would assist in its interpretation. The government's budget is published on the MoF's website (www.minfin.kg) and monthly execution tables are published on the website of the central treasury (www.kazna.kg) within a month.

98. **National accounting and reporting standards for the public sector have not yet been developed.** The 2012 amendments to the Law on Accounting mandated the adoption of International Public Sector Accounting Standards (IPSAS) by all budget organizations. However, the legal and methodological framework, as well as the institutional mechanisms, required to transition to international standards are insufficient. A recent IPSAS gap assessment revealed significant differences between the country's legislative framework for regulating public sector accounting and IPSAS, as well as a substantially larger gap between actual accounting practices and the prevailing legislative framework. The assessment proposes a practical and achievable roadmap for accounting reforms, which is tailored to fit the country's accounting environment and needs. The MoF and high-level officials in the Kyrgyz Republic have demonstrated a strong commitment to strengthening public sector accounting, which is a key factor for successful reforms.

Public Sector Auditing

99. **Public sector auditing is performed by the Chamber of Accounts (CoA), the equivalent of a supreme audit institution.** The CoA is still in the initial phases of its development, and auditing functions are limited to the budget execution report prepared by the Ministry of Finance. The CoA reports its findings to the parliament. No audit opinion is given; instead, a report of errors and violations is submitted. The CoA's audit of revenues and expenditures each year is incomplete and the standards for auditing financial statements are not transparent. In addition, the CoA audits budget organizations; however, it does not separate reporting on financial statements from compliance and performance audits. Ongoing technical

assistance to the CoA by the World Bank and EU should enable the CoA to develop its capacity to conduct financial audits in accordance with international standards.

100. **Internal audit capacity is weak overall; however, recent reforms should gradually strengthen this function.** Institutional capacity for effective internal audit practices, including quality assurance by the central harmonization unit of the Ministry of Finance, is limited but developing. In addition, awareness of the internal audit function within the public sector is low. In line with the 2009 Law on Internal Audits, internal audit units are currently established in 20 agencies. Important steps have been taken recently in this area by the government. National internal audit standards based on international standards (i.e. the International Professional Practices Framework) were approved by the government in June 2014 and were successfully piloted in several ministries. There is a common audit methodology framework now in place as a result of approved internal audit standards and an internal audit handbook. The legal and regulatory framework, along with the recently adopted Code of Ethics, needs to be rolled out in order to serve its proper function across the public sector.

Foreign Exchange Control Environment

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

102. **The NBKR has been audited regularly by internationally recognized audit firms.** A 2015 audit of its consolidated financial statements was conducted by the Deloitte & Touche, LLC Kyrgyz Republic, which issued an unmodified opinion on the NBKR's financial statements. Previous audited financial statements have also been unmodified, with no major issues raised in the management letter.

Disbursement and Audit

103. **Credit and grant proceeds would be made available to the Kyrgyz Republic upon the effectiveness of the Financing Agreement and the submission of withdrawal applications for the credit and grant.** The IDA will disburse the amount into a foreign currency deposit account that forms part of the country's official foreign exchange reserves held by the NBKR. The Government of the Kyrgyz Republic can use the proceeds to: (i) make budgeted foreign currency payments directly from this account; (ii) transfer amounts from the foreign currency account to a local currency bank account of the GoKR, which the GoKR uses to make payments for budget expenditures; or (iii) support a combination of these two approaches. The authorities will report the amount deposited in the account to the World Bank and confirm its availability to finance budget expenditures within 30 days of receiving the funds. If after depositing funds in this account, the proceeds of the credit and/or grant are used for ineligible purposes as defined in the Financing Agreement, the World Bank will require the authorities to refund the amounts to the World Bank. Amounts refunded to the World Bank in respect of ineligible expenditures will be cancelled from the credit.

104. **Auditing.** Considering the World Bank's knowledge of the country's public finance management systems and ongoing improvements to these systems, the positive assessment of the NBKR made by the IMF, and previous unmodified audit reports issued by the NBKR's auditor on recent financial statements, no additional fiduciary arrangements will be required for the deposit account. However, taking into account substantial fiduciary risk, the World Bank reserves the right to request an audit of the deposit account. This provision will be reflected in the Financing Agreement.

D. MONITORING, EVALUATION, AND ACCOUNTABILITY

105. **The Ministry of Finance is responsible for overall monitoring and evaluation of the proposed operation and for coordinating actions among other ministries and agencies.** In addition, with World Bank support the Prime Minister's office is monitoring implementation of the PSRR, which underpins Pillar 1 actions. The World Bank has an extensive program in a number of reform areas, and monitoring the results of the DPO actions will be undertaken through ongoing World Bank engagement. The recent World Bank Kyrgyz Republic Corruption and Poverty Survey (2015) will be repeated using the same instrument, though possibly focusing on a narrower set of indicators. The Energy Tariff Setting TA will also produce baselines and targets for indicators on the improved financial viability of the energy sector. Similarly, ongoing TA activities related to conflict of interest, public procurement and private sector dialogue will assist the government in tracking progress. Moreover, to the extent possible, data collection in the context of the Corruption and Poverty Survey, as well as TA activities, will provide gender-differentiated findings.

106. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service, please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org

VI. SUMMARY OF RISKS AND MITIGATION

107. **Overall risk is assessed as high for this operation.** Given the inherent complexity of this operation, the main risks relate to the political and governance environment, followed by implementation and sustainability, stakeholder, macroeconomic, and technical design risks.

- (a) **Political and governance risks.** While the political environment has stabilized since 2010 and democratic principles have become firmly established, the vibrancy of the

political process also entails challenges to policy continuity. In particular, the short lifespan of governments and frequent cabinet dismissals (29 in the past 21 years) continue to pose a risk to achieving the program's development outcomes. However, the Kyrgyz authorities have broadly maintained their commitment to key policy initiatives, even if implementation has often been delayed. The proposed DPO series mitigates these risks by strengthening the state's ability to fight corruption, improve public services and reduce poverty through inclusive growth, which are prerequisites for greater political stability. This risk rating is aligned with the assessment included in the 2016 *Performance and Learning Review* of the CPS.

- (b) **Macroeconomic risks.** Macroeconomic risks are rated as substantial, although they are mostly exogenous. They stem largely from adverse regional developments, which have put pressure on remittances, exports, exchange rates and prices. Further exchange rate depreciation could result in heightened financial sector vulnerability while undermining the debt sustainability outlook, which would also deteriorate in the event of substantial additional borrowing. Continued economic hardship in neighboring countries would affect external balances, through decreased exports, and fiscal balances, through lower external tariff revenues. However, these risks are significantly mitigated by the joint IMF and World Bank engagements (the ECF and DPO series). Together, they provide a solid anchor for fiscal policy planning and incentives for implementing key reforms in fiscal management, public sector governance and financial sector supervision.
- (c) **Sector strategies and policies risks.** Frequent changes in government and key personnel have in the past affected the ownership of sector reform programs and/or resulted in implementation delays. However, all prior actions and triggers in this operation have a strong basis in existing sector strategies adopted through official government documents, which mitigates the risk to some extent.
- (d) **Technical design risks.** This operation supports several legislative actions formulated as "submissions to parliament," which entail the risk of delayed enactment and reform implementation. However, this risk is mitigated in the context of a programmatic DPO series by including triggers that focus on the implementation measures for the same legislative actions, such as adoption of secondary legislation. This reflects positive lessons learned from previous operations, where the sequencing of legislative prior actions and implementation triggers created incentives for timely action.
- (e) **Implementation and sustainability risks.** Given the complexity and political sensitivity of the supported reform agenda, policy reversals are possible, especially in energy and public procurement. In energy, planned tariff increases were reversed or delayed in the past. In public procurement, draft amendments to the landmark PPL, which would reverse key gains, have been under consideration. The DPO-based policy dialogue provides the World Bank with leverage and a platform for communicating with the government at the highest levels to safeguard these reforms. This risk rating is aligned with the assessment included in the 2016 *Performance and Learning Review*.
- (f) **Fiduciary risks.** Reforms in public financial management require the government's continued attention in order to improve the country's fiduciary environment. The

enactment of the Budget Code, supported by the previous DPO series, lays the foundation for a strong public financial management framework. The implementation of the Budget Code will help mitigate fiduciary risks over time.

- (g) **Stakeholders risks.** There are numerous stakeholders within the government involved in the design and implementation of policies under both pillars of this operation. However, policy coordination and interagency cooperation remain weak. There are often multiple actors involved, without a clear delineation of responsibilities and accountabilities. With respect to external stakeholders, the government can be commended for increasing its use of consultative processes in developing strategy documents and draft legislation. However, fostering broad-based support for specific reform efforts remains a key challenge, in part reflecting the vibrancy and openness of the political process. To mitigate this risk, the World Bank has supported a communications campaign for the PSRR that includes broad-based public consultations and information campaigns.

Table 5: Systematic Operations Risk Rating (SORT)

Category	Risk	Rating (High, Substantial, Moderate, Low)
1	Political and governance risk	High
2	Macroeconomic risk	Substantial
3	Sector strategies and policies	Substantial
4	Technical design of project or program	Substantial
5	Institutional capacity for implementation and sustainability	High
6	Fiduciary risk	Substantial
7	Environment and social risk	Moderate
8	Stakeholders	High
9	Others:	
	Overall	High

Source: World Bank staff.

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions Under DPO1	Indicative Triggers for DPO2	Results Indicators (by end 2018)
<i>Pillar 1: Improve public sector governance through reforms aimed at improving public sector integrity, increasing the quality of public services, and strengthening energy sector governance.</i>		
Prior Action #1. The Government of the Kyrgyz Republic submits the draft <i>Law on Conflict of Interest</i> to parliament.	(Indicative) Trigger #1. The Government of the Kyrgyz Republic issues key secondary legislation to implement the <i>Law on Conflict of Interest</i> .	Percentage of declarations of personal interests of public officials verified by the Commissions on Ethics to identify potential conflicts of interest. Baseline (2016): 0 Target (2018): 15% of all filed declarations (focusing on high-level officials and high-risk positions)
Prior Action #2. The Government of the Kyrgyz Republic, through the Ministry of Finance, issues a Regulation establishing an Independent Complaint Review Commission for public procurement.	(Indicative) Trigger #2. The Government of the Kyrgyz Republic, through the Ministry of Finance, issues the Guidance Notes delineating instructions on procurement methods and standard bidding documents to further operationalize the work of the Independent Complaint Review Commission.	Competition, value-for-money, and controls in public procurement PEFA (PI 19) score. Baseline (2014): B Target (2018): B+
Prior Action #3. The Government of the Kyrgyz Republic adopts service-delivery standards for at least 90 public services, including in the key areas of public education, social security and employment, and ID services.	(Indicative) Trigger #3. The Government of the Kyrgyz Republic: (i) adopts service-delivery standards for an additional 120 services; (ii) adopts administrative procedures for at least 20 services; and (iii) establishes a monitoring mechanism for implementing the adopted standards and procedures.	Graft index (i.e. the number of reported bribes as a share of the number of reported transactions) in key public service areas. Baseline (2015): 21% Target (2018): 10%
Prior Action #4. The Government of the Kyrgyz Republic, through the State Regulatory Agency of the Fuel and Energy Complex, adopts a tariff-setting methodology for heating sector companies.	(Indicative) Trigger #4. The Government of the Kyrgyz Republic adopts a revised Medium-Term Tariff Policy for 2014-17 consistent with the medium-term objective of improving the financial viability of the sector. (Indicative) Trigger #5. The Government of the Kyrgyz Republic extends the revised Medium-Term Tariff Policy by one year (through 2018) in	Cash collected per Gcal of heat generated by Bishkek Central Heating Plant. Baseline (2015): 921.83 KGS/Gcal Target (2017): 1364.31 KGS/Gcal Cash collected per kWh of power supplied to the domestic market.

Prior Actions Under DPO1	Indicative Triggers for DPO2	Results Indicators (by end 2018)
	accordance with the objective of increasing sector revenues.	Baseline (2015): 0.76 KGS/kWh Target (2017): 0.97 KGS/kWh
Prior Action #5. The Government of the Kyrgyz Republic adopts a Resolution that institutes a new cash settlement mechanism between electricity generation, transmission and distribution companies, which ensures that cash allocations are automatic and consistent with the tariffs approved by the Regulatory Agency of the Fuel and Energy Complex.		
Prior Action #6. The State Regulatory Agency of the Fuel and Energy Complex adopts a Performance Reporting and Monitoring Framework for the heating sector.	(Indicative) Trigger #6. The Government of the Kyrgyz Republic adopts a Resolution establishing the governance structure and funding mechanism for the State Regulatory Agency of the Fuel and Energy Complex to increase its autonomy and ensure that it has adequate financial resources.	Disclosure of quarterly key performance indicators for the heating sector Baseline (2015): no Target (2018): yes, as of 2017
<i>Pillar 2: Strengthen private sector competitiveness through measures to facilitate trade, improve the business environment, and promote greater connectivity.</i>		
Prior action #7. The Government of the Kyrgyz Republic submits to parliament amendments to the Tax Code abolishing sales taxes for exporters.	(Indicative) Trigger #7. The Government of the Kyrgyz Republic submits to parliament a new <i>Law on Food Safety</i> .	Export sales tax rate: Baseline (2016): 2% on goods; 3% on services. Target (2018): 0% Number of firms with certified HACCP. Baseline (2016): 9 Target (2018): 20 Number of firms included in the EEU register of FBOs and allowed to export to the EEU. Baseline (2016): 9 Target (2018): 20
Prior Action #8. The Government of the Kyrgyz Republic submits to parliament amendments to the Tax Code to streamline VAT administration by	(Indicative) Trigger #8. The Government of the Kyrgyz Republic (i) transfers administration of social insurance payments from the Social Fund to	Share of VAT refunds processed through the “green channel.”

Prior Actions Under DPO1	Indicative Triggers for DPO2	Results Indicators (by end 2018)
eliminating paper-based VAT invoicing and assigning a range of numbers for invoicing, and introduce simplified procedures for VAT refund for trustworthy taxpayers.	the State Tax Service for the self-employed; and (ii) carries out pilots for businesses.	<p>Baseline (2016): 0</p> <p>Target (2018): 25%</p> <p>Share of firms filing reports on social contributions to State Tax Service.</p> <p>Baseline (2014): 0%</p> <p>Target (2018): 50%</p>
Prior Action #9. The Government of the Kyrgyz Republic amends its Resolution <i>On Improving Risk Criteria for Inspections</i> to allow for less frequent inspections for entities with lower levels of risk.	(Indicative) Trigger #9. The Government of the Kyrgyz Republic adopts guidelines for inspections' checklists and institutes feedback mechanisms to measure, track and improve the quality of inspections.	<p>Share of firms inspected annually by the Sanitary Department.</p> <p>Baseline (2016): 31%</p> <p>Target (2018): 20%</p> <p>Number of firms from which feedback on inspections has been received.</p> <p>Baseline (2016): 0</p> <p>Target (2018): 500</p>
Prior action #10. The Government of the Kyrgyz Republic, through the Ministry of Transport and Communication and the State Border Service Agency, adopts regulations setting-out rules and procedures by which authorized telecommunications companies can deploy cross-border telecommunications cables, in order to ensure competition in the international connectivity market and create time-bound and transparent procedures.	(Indicative) Trigger #10. The Government of the Kyrgyz Republic, through the State Communications Agency: (i) submits to parliament amendments to the <i>Law on Electronic Communications</i> to promote competition in the issuance of the radio spectrum resource for providing data transmission; and (ii) adopts a procedure for dispute resolution between electronic communications service providers.	<p>The international internet bandwidth indicator used by the International Telecommunications Union.</p> <p>Baseline (2013): 5008 Mbit/s</p> <p>Target (2018): 6500 Mbit/s</p>

ANNEX 2: LETTER OF DEVELOPMENT POLICY

**КЫРГЫЗ
РЕСПУБЛИКАСЫНЫН
ӨКМӨТҮ**



**ПРАВИТЕЛЬСТВО
КЫРГЫЗСКОЙ
РЕСПУБЛИКИ**

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**Президенту
Группы Всемирного банка
г-ну Джим Йонг Киму**

Уважаемый господин Ким,

Правительство Кыргызской Республики свидетельствует свое почтение и высокое уважение Всемирному банку и выражает благодарность за постоянное содействие в социальном и экономическом развитии Кыргызской Республики.

Настоящее письмо описывает экономическую программу и стратегический курс Правительства Кыргызской Республики, направленные на улучшение управления в государственном секторе и повышение конкурентоспособности частного сектора. Правительство Кыргызской Республики обращается к Всемирному банку с просьбой оказать помощь для реализации программы «Первой операции в поддержку политики развития в области государственного управления и конкурентоспособности» в размере 24,0 миллионов долларов США.

Цели и индикаторы развития страны

Более широкие приоритеты и задачи в области развития установлены в соответствии с Национальной стратегией устойчивого развития Кыргызской Республики на период 2013-2017 годы, утвержденной Указом Президента Кыргызской Республики от 21 января 2013 года № 11 и отражает стратегические направления устойчивого развития страны, основные приоритеты и главные инвестиционные проекты за этот период. В соответствии с этой стратегией развития основная задача на следующие пять лет заключается в создании государства с сильными демократическими принципами и построении фундамента для успешного развития Кыргызской Республики. Это станет возможно, если государство и общество будут фокусировать внимание на следующих трех предпосылках для реализации Национальной стратегии:

- использование собственных возможностей;

- усиление верховенства закона;
- достижение единства.

Основная цель Национальной стратегии устойчивого развития на период 2013-2017 годы заключается в построении стабильного общества, повышении уровня жизни, снижении уровня бедности через ускорение экономического роста, улучшении деловой среды и укреплении верховенства закона, создании эффективной системы управления. Достижение данных целей потребует построения функционирующей социальной рыночной экономики, движимым динамичным частным сектором, при этом задача государства должна главным образом быть сконцентрирована на создании благоприятной среды для деятельности частного сектора. Правительство Кыргызской Республики также привержено реформам судебной системы, в целях усиления верховенства права, поддерживая конституционные положения о независимости судебной власти с помощью Всемирного банка и других партнеров по развитию.

Макроэкономическая стабильность является основной задачей. Основа экономической стабильности в среднесрочной перспективе включает фискальную и монетарную политику, нацеленную на достижение устойчивого экономического роста, хорошо сбалансированного бюджета, предсказуемой инфляции и жизни по средствам, а не за счет «будущих поколений».

Программа государственных инвестиций нацелена на развитие таких секторов, рост которых больше всего обеспечит экономическое развитие отдаленных регионов, и которые имеют значительный мультипликативный эффект на развитие смежных отраслей. Правительство Кыргызской Республики уверено, что реализация реформ, заложенных в стратегии, позволит достичь амбициозные цели.

Последние экономические события

Внешние условия ухудшились за последние несколько месяцев, что сказалось на перспективах экономического роста. Экономика выдержала сильные неблагоприятные шоки в 2015 году, но ожидается, что рост дополнительно замедлится в этом году. Свою роль в этом сыграют снижение спроса на нашу экспортную продукцию в основных странах - торговых партнерах, влияние сокращения денежных переводов на внутренний спрос и трудности адаптации к условиям, связанным с членством в Евразийском экономическом союзе (далее - ЕАЭС). Ожидается, что рост замедлится в этом году и затем ускорится начиная со следующего года.

Согласно данным Национального статистического комитета Кыргызской Республики, за 2015 год реальный рост ВВП сложился на уровне 3,5 %, что ниже уровня соответствующего периода 2014 года на 0,5 процентных пункта, а номинальный объем ВВП сложился на уровне 423,6 млрд сомов.

Экономика продолжает подвергаться неблагоприятным внешним шокам, поскольку условия в регионе оказались хуже, чем ожидалось в конце 2015 года. Экономика пережила сокращение в начале 2016 года, и более низкие, чем ожидалось, темпы роста и курсы валют в регионе (особенно в России и Казахстане) будут сдерживать рост в течение всего года.

Общий бюджетный дефицит в 2015 году составил 1,5 процента ВВП, существенно ниже целевого показателя по программе (3,5 процента ВВП). Доходы были выше, чем ожидалось, благодаря разовым неналоговым поступлениям от продажи лицензии на разработку месторождения Джеруй и части радиочастотного диапазона, а также за счет перечисления прибыли Национального банка Кыргызской Республики. С другой стороны, налоговые доходы оказались ниже прогноза вследствие более слабой экономической конъюнктуры, особенно в секторах, обеспечивающих наибольшие налоговые поступления (торговле и строительстве).

Государственный внешний долг продолжал расти, повысившись на 14 процентных пунктов ВВП в течение 2015 года вследствие дополнительного заимствования и влияния снижения обменного курса.

Всё более сложные задачи возникают в области налогового администрирования, особенно в процессе перехода к работе в рамках ЕАЭС. Передача функции сбора НДС и акцизов после вступления в ЕАЭС от Государственной налоговой службе при Правительстве Кыргызской Республики (далее - ГНС), с уплатой налогов на основе самоисчисления после ввоза товаров в страну, привела к недовыполнению прогноза по сбору этих налогов. Возможности по сбору этих налогов дополнительно ограничиваются зависимостью от еще окончательно не сформировавшейся системы налогового администрирования в отношениях между странами-членами ЕАЭС. Мы осознаем, что хотя предпочтительно иметь единый механизм для сбора налогов, передачу дополнительных функций сбора ГНС следует производить постепенно, с тем, чтобы добиться максимальной эффективности.

Настоящее письмо о политике развития устанавливает ключевые меры, которые предпринимаются Правительством Кыргызской Республики для поддержания макрофискальной стабильности и укрепления управления государственным сектором, а также среды для развития частного сектора. Программа реформ соответствует задачам Национальной стратегии устойчивого развития страны и является продолжением программы, которая была поддержана в рамках предыдущей программы «Операции в поддержку политики развития». Данная программа предполагает позицию в фискальной политике, которая поддерживает макроэкономическую стабильность, обеспечивающую расходы на защищенные социальные статьи, а также реформы, направленные на повышение прозрачности и подотчетности

государственного сектора, сокращение бремени проверок на бизнес и снижение рисков для финансового сектора.

Совершенствование управления в государственном секторе

Управление государственными финансами

В целях совершенствования бюджетного законодательства и приведения его в соответствие с международными стандартами, а также внедрения прогрессивных инновационных решений в бюджетный процесс, принят Бюджетный кодекс Кыргызской Республики. Министерством финансов Кыргызской Республики получены комментарии от Всемирного банка, которые будут проработаны министерством в ходе дальнейшего совершенствования правовой основы и продолжающейся работы по введению Единого Счета Казначейства (далее - ЕКС).

Также продолжается работа по обеспечению повышения уровня прозрачности бюджетного процесса. Информация о бюджете публикуется на веб-сайте Министерства финансов Кыргызской Республики на регулярной основе, включая среднесрочный прогноз бюджета, проекты бюджетов и принятые годовые бюджеты, гражданский бюджет, детальный ежемесячный отчет об исполнении бюджета и другая информация по бюджету. Общественные слушания по бюджету продолжают оставаться одним из каналов обеспечения прозрачности и вовлечения граждан к процессу разработки бюджета.

Продолжает отмечаться прогресс в постепенном переходе к программному, ориентированному на результат бюджетированию. Проведен расширенный тренинг для бюджетных специалистов в профильных министерствах и в бюджете на 2015 год представлен проект программного бюджета для 28 пилотных ведомств в дополнение к их бюджету, составленному в традиционном формате. Более того, Кыргызская Республика успешно провела пилотное финансирование, ориентированное на результат, услуг здравоохранения; Правительство Кыргызской Республики остается приверженным продолжению этой практики в рамках новой законодательной базы Бюджетного кодекса. Также, завершается внедрение стандартов по Руководству финансовой статистики 2001 в подготовке бюджета и отчетности по нему.

Кроме того, недавно заключили соглашение по новому многостороннему трастовому фонду в целях поддержки реформы управления государственными финансами. Применение новой информационной системы управления финансами (далее - ИСУФ) для всех операций ускорит внедрение ЕКС. С этой целью в последнем квартале 2015 года был подписан Меморандум о сотрудничестве с Турецким агентством по сотрудничеству и развитию по

финансированию новой ИСУФ.

Регулирование конфликта интересов

В соответствии с Указом Президента Кыргызской Республики «О мерах по устранению причин политической и системной коррупции в органах государственной власти» от 12 ноября 2013 года № 215 разработан нормативный правовой инструментарий по выявлению и урегулированию конфликта интересов на государственной и муниципальной службе и предоставлен на рассмотрение Жогорку Кенеша Кыргызской Республики. Данный документ направлен на совершенствование института урегулирования конфликта интересов, сокращение числа ситуаций, при которых должностные лица оказываются в ситуации, которая ведет к коррупции, а также является продолжением начатых в Кыргызской Республике административных реформ и мер предупреждения политической и системной коррупции.

Совершенствование и унификация законодательства о конфликте интересов путем внедрения механизмов своевременного выявления, предотвращения и урегулирования конфликта интересов направлены на оказание практической помощи государственным органам и их служащим в поддержании эффективной системы государственного управления.

Правительство Кыргызской Республики остается приверженным скорейшему исполнению закона и приложат усилия, чтобы уполномоченные органы пользовались достаточной мерой независимости и необходимой ресурсной базой для выполнения своих задач.

Повышение эффективности государственных закупок

Закон Кыргызской Республики «О государственных закупках» в первую очередь направлен на исключение коррупционных проявлений, обеспечение прозрачности и открытости, а также эффективному и экономичному использованию государственных средств, обеспечение равных и справедливых условий для поставщиков (подрядчиков) при осуществлении государственных закупок. В то же время, активно продолжается работа по совершенствованию правовой основы государственных закупок и приведению в соответствие с международными стандартами. Данная работа будет продолжаться совместно с партнерами по развитию, с тем, чтобы сохранить ключевые достижения и положения Закона Кыргызской Республики «О государственных закупках».

Вместе с этим сообщаем, что решением Правительства Кыргызской Республики создана Комиссия, куда входят специалисты по закупкам министерств и ведомств Кыргызской Республики и представители общественности, для повышения статуса рассмотрения жалоб и включения в Базу данных ненадежных и недобросовестных поставщиков.

На сегодняшний день действует двухуровневый порядок рассмотрения

жалоб:

- первый уровень - межведомственная комиссия;
- второй уровень - суд.

Улучшение стандартов государственных услуг

В рамках первого этапа реформ в секторе государственного управления в течение 2011-2012 годов была проведена инвентаризация и сортировка услуг на основе списка имеющихся государственных услуг. Целью данного этапа являлось формирование нормативно-правовой базы, регулирующей процесс предоставления государственных услуг, упорядочение критериев определения государственных услуг, их платности и бесплатности, создание единого реестра государственных услуг.

Для проведения системной работы по оптимизации государственных услуг, с учетом общественного мнения, Правительством Кыргызской Республики была образована Межведомственная комиссия по оптимизации системы предоставления государственных и муниципальных услуг. Всего проведено 38 заседаний Межведомственной комиссии, в том числе 22 заседания - по рассмотрению проектов стандартов государственных услуг, на которых рекомендовано для утверждения 338 проектов стандартов государственных услуг, что составляет 91 % от общего количества государственных услуг.

Постановлением Правительства Кыргызской Республики от 3 июня 2014 года № 303 «Об утверждении стандартов государственных услуг, оказываемых органами исполнительной власти, их структурными подразделениями и подведомственными учреждениями физическим и юридическим лицам», в том числе путем внесения в него дополнений, утверждено 270 стандартов государственных услуг, из них только по 14 государственным органам 100 % утверждены все стандарты государственных услуг.

Правительство Кыргызской Республики уже обеспечивает соблюдение принятых стандартов государственных услуг и осуществляет мониторинг в сотрудничестве с гражданскими организациями. Правительство Кыргызской Республики намерено продолжать совершенствовать правовую основу для соблюдения принятых стандартов государственных услуг, включая через непосредственную подотчетность соответствующих государственных служащих.

Улучшение управления энергетическим сектором

На сегодняшний день фактические затраты теплоснабжающих организаций значительно ниже реально необходимых затрат для обслуживания и эксплуатации оборудования и теплоснабжающих сетей. Назрела острая необходимость срочного вложения средств на замену и

реконструкцию значительной части основных средств теплоснабжающих организаций, что необходимо для обеспечения приемлемого уровня обслуживания в настоящее время и развития системы теплоснабжения в будущем. При этом до сегодняшнего дня в Кыргызской Республике не была разработана отраслевая методика формирования тарифов, которая учитывала бы специфику сектора теплоэнергетики, а также сложное положение, приближающееся к критическому уровню, сложившееся с изношенностью основных фондов теплоснабжающих организаций.

В этой связи, благодаря технической помощи, оказываемой Всемирным банком регулятору в энергетике Кыргызской Республики - Государственному агентству по регулированию топливно-энергетического комплекса при Правительстве Кыргызской Республики, совместно с экспертами Всемирного банка разработана и введена в действие тарифная методика для сектора теплоснабжения. Новая методика определяет подход к формированию тарифов на теплоэнергию, позволяющий обеспечить полный учет всех расходов на производство и передачу теплоэнергии до потребителя. Таким образом, с помощью новой Методики удастся определить полную стоимость тепловой энергии с учетом расходов на необходимые инвестиционные вложения и дефицит денежных средств по каждому теплоснабжающему предприятию.

Мы провели пересмотр действующих тарифов на электрическую и тепловую энергию и намерены пересмотреть среднесрочную тарифную политику Кыргызской Республики (далее - ССТП) на электрическую и тепловую энергию на 2014-2017 годы. Это позволит сектору достичь улучшения своей финансовой устойчивости. Пересмотренная ССТП, основанная на принципе повышения доходов энергосектора с целью обеспечения ее самоокупаемости, будет одобрена Правительством Кыргызской Республики в июле 2016 года. С этой целью, до марта 2017 года будет продлен срок действия ССТП на один год (на 2018 г.).

На протяжении нескольких лет распределением денежных средств между энергетическими компаниями занималось Министерство энергетики и промышленности Кыргызской Республики. Однако это распределение не было регламентировано каким-либо нормативным актом, и его порядок не был определен. Как следствие, рост дебиторской и кредиторской задолженности энергокомпаний.

Так, по итогам 2015 года дебиторская задолженность потребителей перед распределительными электроэнергетическими компаниями возросла на 286 млн сомов, а кредиторская задолженность перед поставщиками электроэнергии возросла на 385,0 млн сомов. Данный рост создает спираль неплатежей, затрагивая передающие и генерирующие предприятия. В результате все предприятия электроэнергетического сектора испытывают проблемы с выполнением своих обязательств. Также наблюдались случаи,

когда участникам оптового рынка, с учетом их наиболее сложного финансового положения, сложившегося в результате недобора платежей, предоставлялись определенные преференции при долевом распределении денежных средств, что также негативно отражалось на выполнении компаниями своих обязательств.

В целях стимулирования к увеличению сборов платежей за потребленную электроэнергию и обеспечения снижения кредиторской задолженности регулирующим органом в энергетике Кыргызской Республики разработан и утвержден постановлением Правительства Кыргызской Республики от 17 мая 2016 года № 262 механизм долевого распределения денежных средств между энергетическими компаниями.

С принятием механизма ожидается упорядочение деятельности участников энергетического рынка, снижение кредиторской задолженности, увеличение сборов платежей и своевременное выполнение запланированных мероприятий в энергокомпаниях. Новый порядок долевого распределения денежных средств между энергокомпаниями сделает предсказуемым поступление доходов и выполнение обязательств энергокомпаний.

Государственное агентство по регулированию топливно-энергетического комплекса обеспечит отчетность о производительности и структуру мониторинга сектора теплоснабжения.

Отдельно необходимо отметить, что благодаря технической помощи, оказываемой Всемирным банком регулирующему органу в энергетике Кыргызской Республики, проведена работа по внедрению показателей деятельности теплоснабжающих предприятий. Целью внедрения является определение ответственности за обеспечение прозрачности предоставления общественности и регулирующему органу информации о качестве услуг, предоставляемых теплоснабжающими организациями.

В 2015 году регулирующим органом разработано и утверждено Положение по введению и мониторингу показателей деятельности сектора теплоснабжения, которое определяет принципы формирования ключевых показателей эффективности для отслеживания качества предоставления услуг теплоснабжения.

Разработанное Положение является основным документом для проведения мониторинга деятельности сектора теплоснабжения, и по итогам отчетного периода 2016 года будут сделаны первые выводы относительно эффективности деятельности теплоснабжающих предприятий.

Укрепление конкурентоспособности частного сектора

Улучшение условий предпринимательской деятельности

Правительством Кыргызской Республики продолжается работа по улучшению системы налогообложения по созданию условий для развития

частного сектора. В этом направлении принят Закон Кыргызской Республики «О внесении изменений и дополнений в некоторые законодательные акты Кыргызской Республики» от 31 декабря 2015 года № 235 предусматривающий отмену налога с продаж с облагаемых поставок, за исключением сотовой связи, с экспортных поставок и поставок вне территории Кыргызской Республики без повышения ставки НДС, а также повышение действующего регистрационного порога НДС.

Государство создает условия для налогоплательщиков по уплате налогов, постоянно совершенствуя налоговое законодательство и работу налоговой службы в соответствии с меняющимися условиями и потребностями времени.

Эти изменения направлены на формирование эффективной системы налогообложения, удобной для уплаты налогов и представления отчетности налогоплательщиками, а также создание благоприятных условий для отечественных предпринимателей.

В частности, в целях совершенствования налогового администрирования принято постановление Правительства Кыргызской Республики «Об утверждении форм отчетностей и порядка их заполнения и представления» от 9 октября 2015 года № 699 предусматривающее представление налоговой отчетности по подоходному налогу, налогу с продаж и роялти субъектами малого, среднего предпринимательства и некоммерческими организациями на ежеквартальной основе.

Проект Закона Кыргызской Республики «О внесении изменений и дополнений в некоторые законодательные акты Кыргызской Республики» (Налоговый кодекс Кыргызской Республики, Закон Кыргызской Республики «О введении в действие Налогового кодекса Кыргызской Республики») одобрен постановлением Правительства Кыргызской Республики от 25 мая 2015 года № 318 и в настоящее время прошел первое чтение в Жогорку Кенеше Кыргызской Республики.

Предлагаемый законопроект позволит установить барьер для регистрации по НДС субъектов-лжепредпринимателей, а также практически свободное получение возмещения или/возврат суммы превышения НДС, значительно упростит процедуру получения электронных номеров счетов-фактур, а также регламентирует процедуру получения электронных номеров счетов-фактур.

В целях совершенствования правового регулирования проведения плановых проверок на основе оценки рисков, с учетом результатов правоприменительной практики исключения существующих правовых коллизий, а также во исполнение Программы Правительства Кыргызской Республики по внедрению международной системы классификации опасности и маркировки химических веществ в Кыргызской Республике, внесены

изменения и дополнения в критерии оценки степени риска при осуществлении предпринимательской деятельности.

Изменения включают критерии оценки степени риска всех субъектов, подлежащих проверкам, обеспечивают единообразный концептуальный и технологический подход.

Кроме того, за время применения подхода на основе оценки рисков сложилась определенная практика, которая выявила недостатки существующей системы оценки рисков. Новая редакция является результатом обобщения и анализа правоприменительной практики за прошедшие два года. В частности, для создания более прозрачной и понятной системы определения степени риска в главу включена таблица, закрепляющая порядок применения проверочного листа при проведении плановой проверки.

Улучшение доступа к коммуникационным сетям

Министерство транспорта и коммуникаций Кыргызской Республики издало приказ от 22 апреля 2016 года № 108, определяющий правила и процедуры, с помощью которых уполномоченные телекоммуникационные компании могут разворачивать и использовать трансграничные телекоммуникационные кабели, обеспечивающие конкуренцию на международном рынке соединений и устанавливает срочные и прозрачные процедуры. В этом направлении, будет продолжена работа по обеспечению высококонкурентной среды в данном секторе, включая сохранение существующих законодательных положений, обеспечивающих конкуренцию на международных рынках соединений. Правительство Кыргызской Республики также продолжит работу по обеспечению устойчивого, прозрачного и адекватного финансирования регулирующего органа.

В заключение Правительство Кыргызской Республики выражает уверенность в том, что реализация приоритетов Национальной стратегии устойчивого развития Кыргызской Республики является делом первостепенной важности для обеспечения устойчивого и успешного будущего нашей страны и в том, что реформы, обозначенные в ней, представляют собой последовательную программу, предусматривающую устойчивый экономический рост и снижение уровня бедности в среднесрочной перспективе. Надеемся, что настоящая просьба в адрес Всемирного банка о поддержке программы реформ в размере 24,0 млн долл. США будет одобрена.

С уважением,

Премьер-министр



С.Ш.Жээнбеков

LETTER OF DEVELOPMENT POLICY (*Unofficial translation*)

To: **President of the World Bank Group, Jim Yong Kim**

Outgoing No: 17-20461 dated 26 May 2016

Dear Mr. Kim,

The Government of the Kyrgyz Republic presents its compliments and renews the assurances of its highest consideration to the World Bank, being grateful for the continued support it provides to the social and economic development of the Kyrgyz Republic.

The purpose of this letter is to describe the economic program and strategic direction of the Government of the Kyrgyz Republic, whose aim is to improve governance in the public sector and enhance the competitiveness of the private sector. In that context, the Government of the Kyrgyz Republic would like to request the World Bank to provide assistance for the implementation of the Development Policy Operation – 1 focused on governance and competitiveness in the amount of USD24.0 million.

Development Goals and Indicators

Broad development priorities and objectives have been set-out in the *National Sustainable Development Strategy* of the Kyrgyz Republic for 2013-2017, approved by Presidential Decree No 11, dated 21 January 2013. The document defines strategic directions for sustainable development of the country, key priorities and main investment projects for the period. According to this strategy, the main goal for the five years period is to create a state with strong democratic principles and build a foundation for the successful development of the Kyrgyz Republic. This, in turn, will only be possible, if the state and society focus on the following three prerequisites for implementing the National Strategy:

- Utilizing domestic resources and solutions;
- Strengthening the rule of law;
- Achieving unity.

The main goal of the *National Sustainable Development Strategy* for 2013-2017 is to build a stable society, increase living standards, reduce poverty through accelerated economic growth, improve the business environment and strengthen the rule of law, and establish an effective system of governance. In order to achieve these goals, we need to build an adequately functioning social-market economy, driven by a dynamic private sector, while the state primarily focuses on establishing a conducive environment for the private sector. The Government of the Kyrgyz Republic is also committed to reforming the judicial system in order to strengthen the rule of law, including through upholding the constitutional provisions for judiciary independence, with the assistance from the World Bank and other development partners.

Maintaining macroeconomic stability is another key objective. The foundation of economic stability in the medium term includes: fiscal and monetary policies supportive of sustainable economic growth, well-balanced budgets, predictable inflation, and living within our means and not at the expense of future generations.

The Public Investment Program targets the development of those sectors whose growth can contribute the most to the economic development of remote regions, and which have significant multiplier effects and linkages with related industries.

The Government of the Kyrgyz Republic is confident that implementing the reforms embedded in this strategy will help to achieve its ambitious goals.

Recent Economic Developments

External conditions have worsened over the last months, affecting the perspectives for economic growth. The economy withstood strong adverse shocks in 2015. However, growth is expected to slow down this year, in particular due to dampened demand for our export products in main trade partner countries, reduced remittance inflows affecting domestic demand, and challenges in transitioning to the rules, regulations and norms of the *Eurasian Economic Union* (thereafter, EEU). Growth is expected to slow down this year, before accelerating again as of next year.

According to the National Statistics Committee of the Kyrgyz Republic, real GDP growth reached 3.5 percent in 2015, which is lower than in 2014 by 0.5 percentage points, while nominal GDP stood at KGS 423.6 billion.

The economy continues to be exposed to adverse external shocks, with continued hardship in the region and slower recovery than initially anticipated at the end of 2015. The economy shrank in early 2016, with low growth and weak currencies in the region (especially, in Russia and Kazakhstan) hampering growth prospects for the full year.

The total fiscal deficit reached 1.5 percent of GDP in 2015, which was considerably lower than the target of 3.5 percent of GDP. The revenue outturn was higher than expected, thanks to one-off non-tax receipts from the sale of a mining license for Jerooy deposit and of a part of the radio-frequency band, as well as to high transferred profits from the National Bank of the Kyrgyz Republic. However, tax revenues proved lower than the forecast as a result of the weak economic conjuncture, especially in those sectors that generate the largest tax returns (trade and construction).

The public external debt continued to grow, by 14 percentage points of GDP during 2015, under the combined effects of additional borrowing and exchange rate depreciation.

Additional challenges emerged in the area of tax administration, especially in the process of transitioning to new EEU procedures. The function of VAT and excise collection was delegated to the State Tax Service (thereafter, STS) after accession to the EEU, with tax payment on imports based on self-enumeration; these changes have resulted in underperforming collection for these taxes relative to the forecast. The capacity to collect these types of taxes is further constrained by the still-developing system of tax administration in relations between the EEU member countries.

Although we recognize that a unified mechanism for tax collection is preferable, further delegation of tax functions to the STS should be implemented gradually for maximum effectiveness.

This *Letter of Development Policy* establishes key measures taken by the Government of the Kyrgyz Republic to support macroeconomic and fiscal stability, strengthen governance in the public sector and the environment for the private sector. This reform program complies with the country's *National Sustainable Development Strategy* and constitutes the continuation of the program supported by the previous Development Policy Operations. It implies that fiscal policy will continue to be geared to supporting macroeconomic stability, expenses on social items will be protected, reforms aimed at improving the transparency and accountability of the public sector will be carried out, and efforts made to reduce the burden of inspections on businesses and safeguard risks in the financial sector.

Improving Governance in the Public Sector

Public Financial Management

In order to improve budgetary legislation and harmonize it with international standards, as well as to introduce advanced innovative solutions to the budgeting process, a new Budget Code of the Kyrgyz Republic has been approved. The Ministry of Finance of the Kyrgyz Republic received the World Bank's comments on the Law and will take them into account, when making further improvements to the legal framework; it will also continue to work to introduce the Treasury Single Account (thereafter, TSA).

Further efforts were made to ensure increased transparency of the budgeting process. Information on the budget is published on the website of the Ministry of Finance of the Kyrgyz Republic on a regular basis, including the mid-term budgetary framework, draft budgets and adopted annual budgets, citizens' budget, detailed monthly reports on budget execution and other budgetary information. Public hearings on the budget are one of the channels to ensure the transparency of and citizens' involvement in the budget formulation.

Further progress was made in the gradual transition to programmatic, result-oriented budgeting. An extended training took place for budget specialists in key ministries, and the budget for 2015 contains a draft program-based budget for 28 pilot agencies in addition to their budgets drafted in a traditional format. Moreover, the Kyrgyz Republic successfully pioneered output-based financing of health services, and the Government remains committed to the continuation of this practice, within the new legislative framework of the Budget Code. Also, we are finalizing the introduction of standards under the Government Finance Statistics Manual 2001 on budget preparation and reporting.

Moreover, recently, we have agreed on a new Multilateral Trust Fund to support public financial management reform. Using the new Finance Management Information System (thereafter, FMIS) for all transactions will speed up the introduction of TSA. To that end, in the last quarter of 2015, a Memorandum of Cooperation was signed with the Turkish International Cooperation and Development Agency to finance the new FMIS.

Conflict of Interest Regulation

In compliance with the Decree of the President of the Kyrgyz Republic ‘On the Measures to Eradicate Political and Systemic Corruption in Public Bodies’ dated 12 November 2013 No 215, a new regulatory toolkit was developed to identify and address conflict of interests in civil and municipal service. The toolkit was submitted to the Jogorku Kenesh (Parliament) of the Kyrgyz Republic. Its objective is to improve the way in which conflict of interest is regulated, reduce the number of situations where public officials are faced with opportunities for corruption. This is an additional step to further administrative reforms and measures to prevent political and systemic corruption.

The improvement and harmonization of legislation on conflicts of interests, through introducing mechanisms for early identification, prevention and regulation of conflicts of interests seek to provide practical assistance to the relevant public bodies and officials in maintaining an efficient system of governance.

The Government of the Kyrgyz Republic is committed to the soonest implementation of the law and will ensure that authorized implementing bodies have the required independence and resources to fulfil their mandate.

Improving Public Procurement Efficiency

The Law of the Kyrgyz Republic ‘On Public Procurement’ is aimed, first of all, at precluding corruption, ensuring transparency and openness, making efficient and economic use of public funds, and establishing equal and fair conditions for suppliers (contractors) in the implementation of public procurement. While additional efforts will be made to improve the legislative framework for public procurement and bring it in compliance with international standards, this will be done jointly with development partners so as to preserve the main achievements and provisions of the Law of the Kyrgyz Republic ‘On Public Procurement’.

Meanwhile, we would like highlight that, by decision of the Government of the Kyrgyz Republic, an Independent Complaints Review Commission was established, including procurement specialists from ministries and agencies of the Kyrgyz Republic and civil society representatives, to improve procedures on complaints consideration and inclusion of unreliable and dishonest suppliers into the relevant database.

Currently, there exists a two-level procedure for complaints consideration:

- First level: by the interagency committee;
- Second level: by the court.

Improving Standards of Public Services

During the first phase of reforms of the public administration sector (2011-2012), we carried-out an inventory and classification of public services actually provided. The objective was to establish a baseline to guide the process of public services provision, streamline the criteria for identifying which public services should be provided on a fee basis and which should be free), and establish a single roster of public services.

In order to systematically streamline public services' provision, with due regard for public opinion, the Government of the Kyrgyz Republic formed an Interagency Committee to improve the system of civil and municipal services provision. In total, the Interagency Committee held 38 meetings, including 22 meetings to discuss draft standards of public services. This process resulted in recommendation to approve 338 draft standards of public services, which covers 91percent of the total number of public services.

The Resolution of the Government of the Kyrgyz Republic dated 3 June 2014 No 303 'On the Approved Standards of Public Services Provided by the Executive Bodies, their Structural Divisions and Subordinate Institutions to Individuals and Legal Entities', approved 270 standards of public service provision. This includes all services provided by 14 public bodies.

The Government has already begun implementing the adopted standards of public services and monitoring adherence in cooperation with civil society organizations. The Government plans to continue improving the legal framework for ensuring compliance with the approved standards of public services, including through making the relevant public officials directly accountable.

Improving Governance in the Energy Sector

As of today, the actual revenues of heat-supplying entities are considerably lower than the needs for maintaining and operating heat-supply equipment and networks. Thus there is an acute need for urgent investments into the replacement and rehabilitation of a significant part of the fixed assets of heat-supply organizations to ensure continued acceptable levels of services and develop the heat-supply system in the future. Meanwhile, to date, the Kyrgyz Republic did not have a sectorial methodology of pricing, taking into account thermal power sector specifics as well as the difficult, nearly critical situation of the heat-suppliers' worn-out fixed assets.

In this regard, owing to technical assistance provided by the World Bank to the energy sector regulator of the Kyrgyz Republic (the State Agency on the Regulation of the Fuel and Energy Complex under the Government of the Kyrgyz Republic), a tariff setting methodology for the heating sector has been developed and operationalized. The new methodology identifies an approach to pricing thermal power that takes into account all expenses for the production and transmission of thermal power to consumers. Thus, with the new Methodology, it will be possible to identify the full cost of thermal power supply with due regard for necessary investments, and the shortage of monetary funds for each heating enterprise.

We have revised the existing electricity and heating tariffs and intend to revise the Mid-Term Tariff Policy of the Kyrgyz Republic (thereafter, MTTP) for electricity and heating for the period of 2014-2017. This will allow the sector to achieve improvements in its financial stability. The revised MTTP based on the principle of increased revenues of the energy sector and the objective of cost-recovery will be approved by the Government of the Kyrgyz Republic in July 2016. Moreover, prior to March 2017, the timeframe of MTTP will be extended by one year (through to 2018).

For several years, the distribution of cash between energy companies was a function of the Ministry of Energy and Industry of the Kyrgyz Republic. However, such distribution was not regulated, and its procedure inadequately identified. As a result, the energy companies were faced with growing receivables and payables.

Thus, as of 2015, the consumers' receivables to energy distribution companies grew by KGS 286 million, while payables to the electricity suppliers reached KGS 385 million. This created a spiral of non-payments, affecting transmission and generation companies. As a result, all enterprises of the electricity sector faced difficulties in performing their obligations. Also, there were cases whereby wholesale market participants, given their difficult financial position due to underpayment, had to be granted exceptional preference in the shared distribution of cash, further adversely affecting the ability of companies to operate.

In order to incentivize and improve the collection of payments for the consumed electricity and ensure a reduction in payables, the energy sector regulator of the Kyrgyz Republic developed a mechanism for the shared distribution of cash funds between energy companies, which was approved by the Resolution of the Government of the Kyrgyz Republic dated 17 May 2016 No 262.

The approved mechanism, will help streamline operations of the energy market participants, reduce payables, increase the collection of payments and ensure the timely implementation of planned activities by energy companies. The new procedure for distributing cash funds between energy companies will ensure greater predictability of their revenues and thus help them fulfill their obligations.

In addition, the State Agency on the Regulation of the Fuel and Energy Complex will provide regular reporting on the efficiency and the process of monitoring performance of the heating sector.

In that respect, it should be mentioned that with technical assistance from the World Bank to the energy sector regulator, work was carried-out to develop and introduce performance indicators for heat-suppliers. The objective is to foster greater transparency and information to the public and the regulator on the quality of services provided by heat-supply organizations.

In 2015, the regulator developed and approved the Regulation on the Introduction and Monitoring of the Heating Sector Performance Indicators that identified the principles to formulate key performance indicators for monitoring the quality of heat-supply services.

The developed Regulation constitutes the main document to monitor heating sector operations, and, based on the reporting period of 2016, first conclusions will be drawn on the performance of heating enterprises.

Strengthening Private Sector Competitiveness

Improving the Business Environment

The Government of the Kyrgyz Republic continues the work to improve the taxation system and establish conducive conditions for private sector development. To that effect the Law of the Kyrgyz Republic 'On Modifications and Amendments to a Number of Legislative Acts of the Kyrgyz Republic' dated 31 December 2015 No 235, was adopted, which abrogates sales tax, except for cellular communications, including from exports and from sales outside the territory of the Kyrgyz Republic without any increase in VAT rate. At the same time, the VAT registration threshold has been increased.

A further objective is to create the conditions for tax payers to comply with their obligations, through ongoing improvement of the tax legislation and the tax service's work in accordance with changing conditions and modern needs.

These changes aim to establish an effective taxation system, facilitate tax payment and reporting for tax-payers, and establishing enabling conditions for domestic entrepreneurs.

Specifically, in order to improve tax administration, the Resolution of the Government of the Kyrgyz Republic 'On the Approved Forms of Reporting and Procedure for Their Filling in and Submission' dated 9 October 2015 No 699, was approved which envisages the submission of tax reports on the income tax, sales tax and royalty by small- and medium-size enterprises and non-commercial organizations on a quarterly basis.

The draft Law of the Kyrgyz Republic 'On the Introduced Modifications and Amendments to a Number of Legislative Acts of the Kyrgyz Republic' (Tax Code of the Kyrgyz Republic, the Law of the Kyrgyz Republic 'On the Effectiveness of the Tax Code of the Kyrgyz Republic') was approved by the Resolution of the Government of the Kyrgyz Republic dated 25 May 2015 No 318 and passed the 1st reading in the Jogorku Kenesh of the Kyrgyz Republic.

The proposed draft law introduces provisions that deter fraudulent VAT registrations of phantom entrepreneurial entities. Further, the draft law simplifies procedures for obtaining VAT refund; considerably simplify the procedure of getting electronic numbers for invoices; and regulate the procedure of getting the electronic number for invoices.

In order to improve the regulation of scheduled inspections based on risk assessments, while taking into account existing legal requirements and in order to implement the Program of the Government of the Kyrgyz Republic on the introduction of the system of hazard classification and labeling of chemical substances in the Kyrgyz Republic, modifications and amendments were introduced to the evaluation criteria for assessing the degree of risk involved in various entrepreneurial activities.

The modifications include the criteria for evaluating the degree of risk for all entities subject to inspections, and ensure a uniform conceptual and technical approach to such assessments.

They reflect the lessons learned, during the past two years, while implementing risk-based approaches and address identified shortcomings of the existing system of risk assessment. In particular, in order to establish a transparent and clear system of risk identification, the relevant section includes a table which establishes a check-list of procedures to be carried out during a scheduled inspection.

Improving access to communication networks

The Ministry of Transport and Communication issued a Decree dated 22 April 2016 No 108 identifying rules and procedures to allow authorized telecommunication companies to deploy and use transboundary telecommunication cables, ensuring competition in the international market of communications, and setting time-bound and transparent procedures. In this area, there will be continued the work to ensure a highly competitive environment in the sector, including the preservation of the existing legislative provisions ensuring competition in the international markets

of communications. The Government of the Kyrgyz Republic will also continue to work to ensure sustainable, transparent and adequate financing of the regulatory body.

In conclusion, the Government of the Kyrgyz Republic would like to express its assurance that implementing the priorities of the National Sustainable Development Strategy of the Kyrgyz Republic constitutes a matter of the highest importance to ensure the sustainable and successful future of this country, and that the reforms outlined in the strategy amount to a consistent program for sustainable economic growth and poverty reduction in the medium term. We hope that this request to the World Bank Board of Directors to support to our reform program, in the amount of US\$24.0 million, will be approved.

Sincerely,

Prime Minister
S. Sh. Jeenbekov

ANNEX 3: FUND RELATIONS

IMF Statement at the End of a Review Mission to the Kyrgyz Republic

Press Release No. 16/197

May 5, 2016

An IMF mission, led by Edward Gemayel, visited Bishkek from April 21 to May 5, 2016 to conduct the second review under the Extended Credit Facility (ECF).

At the conclusion of the visit, Mr. Gemayel issued the following statement:

“The Kyrgyz economy has been facing severe external shocks, including lower commodity prices, weak growth and depreciating currencies in the region. As a result, growth fell to 3.5 percent in 2015, with remittances being hit especially hard. On the positive side, the floating exchange rate regime under the National Bank of Kyrgyz Republic’s (NBKR) stewardship acted as a shock absorber, mitigating the impact of external shocks on the real economy.

“The weak external environment is expected to persist in 2016, further slowing growth to about 3 percent, widening external and fiscal deficits and slowing credit to the economy. Recovery in the medium term will hinge on steadfast commitment to reforms, in addition to improvements in the economies of main trading partners.

“A combination of slowing revenues and rising spending have exhausted the fiscal space available to the government. Debt is approaching a critical level, making it increasingly difficult to raise necessary financing while at the same time meeting essential social and development needs. Against this backdrop, it is imperative to keep the budget deficit within the target of 4.5 percent of GDP approved in 2016 budget. Achieving this target will require major additional efforts—identifying permanent revenue measures, containing non-priority spending, and exercising diligence in the choice of investments and associated borrowing.

“The financial sector has shown resilience in the face of adverse economic conditions. Banks remain well capitalized. The NBKR is keeping a close eye on emerging vulnerabilities stemming from the weak economic environment, high dollarization, and currency rate fluctuations. The central bank is deploying prudential and other tools at its disposal to bolster the sectors’ defense.

“A key missing instrument in the NBKR’s toolbox is an efficient bank resolution mechanism. The existing framework is contradictory and inefficient. By allowing shareholders to delay the resolution process indefinitely, it opens the door for insolvent banks to resurrect and provides impunity to bank owners at the expense of depositors who are made to wait for years to be compensated. The banking legislation lingering in Parliament since 2013 aims to address these issues by establishing a robust banking resolution framework in line with international best practice. The proposed framework allows for swift resolution of distressed banks to prevent problems in one bank from destabilizing the entire sector. It also allows depositors to be paid out quickly, and protects their rights. The challenging economic environment strengthens the case for the passage of the banking legislation in the nearest future.

“The situation with DEBRA and the banks under its administration is another manifestation of the shortcomings of the existing bank resolution framework. Delays in the liquidation of these banks, some of which have been under DEBRA since the mid-1990s, undermine the credibility of banking regulations and trust in the system as a whole. We look forward to the completion of the audit of DEBRA and the banks under its management in the coming weeks and the commencement of liquidation procedures for a number of bankrupt banks in the coming months.

“Institutional and structural reforms are essential for the Kyrgyz economy to realize the benefits from Eurasian Economic Union (EEU) membership, and more generally to raise growth in the medium term. The latest Doing Business Report highlights a number of persistent challenges, such as the difficulty of establishing and closing a business, accessing electricity and other utilities, and enforcing contracts. Measures to improve the business climate and reduce corruption are therefore particularly important.

“The mission and the authorities have made good progress toward reaching a staff-level agreement on the second review under the ECF. Discussions with the authorities will continue in the coming weeks. If these discussions are successful, the second review can be completed in June.

“During its visit, the mission met with Prime Minister Jeenbekov, Deputy Prime Minister Pankratov, Minister of Finance Kasymaliev, Chairman of the National Bank Abdygulov, Head of the President’s Administration Niazov, Members of Parliament and other senior officials, and representatives of the private sector, civil society, and the diplomatic community. The team thanks the authorities and other counterparts for their warm welcome, excellent cooperation, and candid and constructive discussions during the visit, and reaffirms the IMF’s support to the government’s efforts to implement their economic reform program.”