NON-OFFICIAL TRANSLATION

Eurasian Fund for Stabilization and Development

Eurasian Fund for Stabilization and Development Strategy for the Kyrgyz Republic

2022–2026

This document is an abstract of the 2022–2026 Country Strategy of the Eurasian Fund for Stabilization and Development for the Kyrgyz Republic

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List of Abbreviations

ADB	Asian Development Bank
CA	current account
CAREC	Central Asia Regional Economic Cooperation Programme
CASA-1000	Central Asia – South Asia Energy Project
CIS	Commonwealth of Independent States
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
EFSD	Eurasian Fund for Stabilization and Development
EU	European Union
GDP	gross domestic product
GNI	gross national income
HPP	hydroelectric power plant
IFI	international financial institution
IMF	International Monetary Fund
NB KR	National Bank of the Kyrgyz Republic
NSC KR	National Statistical Committee of the Kyrgyz Republic
PIP	Public Investment Programme
REFCA	Regional Economic Framework for Central Asia
WB	World Bank
WTO	World Trade Organisation

Main Socio-Economic Indicators of the Kyrgyz Republic

Economic indicators	Latest available	Global ranking
GDP (2020, billion US $)	7.7	147
GNI per capita (2020, Atlas method, US $)	1,160.0	162
Logistics Performance Index (2018, 0 to 5)	2.6	108
Ease of Doing Business (2019, 0 to 100)	67.8	70
Social indicators		
Poverty rate (2020, national definition)	25.3	n/a
Human Development Index (2019, 0 to 1)	0.7	120
Inequality (2019, Gini coefficient)	29.7	25
Rural access to clean water (2020, % of total)	87.3	n/a
Population increase/decline (%, average over the past 5 years)	2.0	54
Share of population under 30 (2020, % of total population)	56.9	69
Share of rural population (2020, % of total population)	63.1	155
Child mortality rate (2019, per 1,000 births)	16.4	106
Total fertility rate (2019, births per woman)	3.3	54
Life expectancy (2019, years)	71.6	124

Introduction

The Country Strategy of the Eurasian Fund for Stabilization and Development (hereinafter referred to as the Fund, the EFSD) for the Kyrgyz Republic complements the Fund's 2022–2026 Strategy. It reflects the Fund's priority objectives within the framework of its core mandate aimed at supporting the macroeconomic and financial stability in its member countries. The Strategy also defines the priority areas of activity for 2022–2026 to assist the Kyrgyz Republic in implementing structural reforms in its economy and improving its key institutions, upgrading its basic (energy, agriculture, road, social) infrastructure, and developing its human capital to ensure sustainable economic growth and promote integration processes.

In order to determine the priority areas of the Fund's cooperation with the Kyrgyz Republic within the framework of its mandate of macroeconomic stabilisation, the EFSD ran diagnostics of the macroeconomic environment for the Strategy period, including debt sustainability analysis and stress tests. Taking into account the country's priorities enshrined in the national strategic and policy documents, as well as the results of its own diagnostics of structural and institutional constraints and working in close coordination with the key ministries and agencies of the Kyrgyz Republic, the Fund identified the main areas of reforms, the implementation of which will be supported through budget financing and/or technical assistance provided to the authorities in 2022–2026. Again in close coordination with the country's authorities, the Fund identified the priority areas for upgrading the basic and social infrastructure to be supported with targeted financing and grant programmes.

Since the EFSD resources are limited, the Fund determined the priority areas of its activity for 2022–2026 taking into account the priorities and objectives of the key development partners in the Kyrgyz Republic, with which bilateral consultations were held, as enshrined in their strategic documents. Such coordination facilitates maximum synergies and, thus, better use of the Fund's resources in assisting the Kyrgyz Republic in maintaining the macroeconomic stability and creating conditions for the country's sustainable development and improvement of the living standards of the population. The Kyrgyz Republic is also expected to achieve a number of Sustainable Development Goals approved at the UN Summit in September 2015:
Goal 1: no poverty.
Goal 2: zero Hunger.
Goal 3: good health and well-being.
Goal 7: affordable and clean energy.
Goal 8: decent work and economic growth.
Goal 9: industry, innovation and infrastructure.
Goal 10: reduce inequalities within and among countries.
Goal 13: climate action.
Goal 16: peace, justice and strong institutions.
Goal 17: partnership for sustainable development.

1. Socio-Economic Environment and Challenges to Sustainable and Inclusive Economic Growth in the Kyrgyz Republic

The Kyrgyz Republic is a mountainous country that does not have direct access to sea trade routes and borders Kazakhstan, China, Tajikistan, and Uzbekistan. The population of the country is over 6.5 million people, of which 57% are of working age (16–62 years) and more than 65.8% reside in rural areas. The Kyrgyz Republic remains a country with one of the lowest income levels among the EFSD borrowers. In 2019, the per capita gross national income (World Bank, Atlas method) was US $1,240. Despite a rapid poverty reduction over the past 20 years, about 20% of the population had incomes below the subsistence level in 2019 (national definition, Figure 1), and most of the poor live in rural areas. Lack of jobs drives the population to cities or results outward labour migration. About 1 million people migrate in search of work, mostly to Russia.

Over the past 20 years, Kyrgyzstan's economy has shown volatile growth rates (Figure 2) averaging at 4.5% in 2000–2019. The main economic growth drivers were remittances from labour migrants and production of gold mined at the Kumtor field. Accommodating macroeconomic policies led to mounting macroeconomic imbalances and significant deficits emerging in the state budget and the current account (CA). In 2001–2019, the annual CA deficit averaged 8.3% of GDP (Figure 3), and the state budget deficit was about 3% of GDP (Figure 4).

Figure 1. Poverty Rate, %

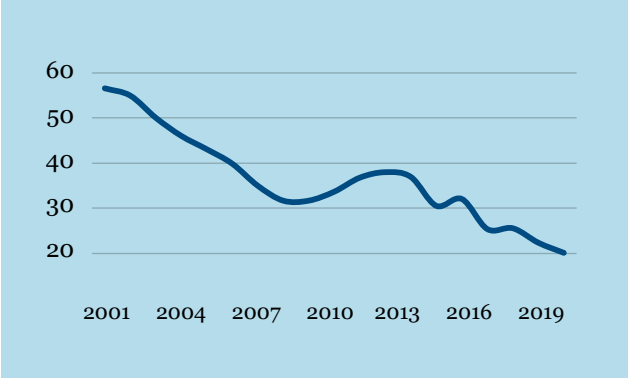


Figure 2. Real GDP Growth, y-o-y, %

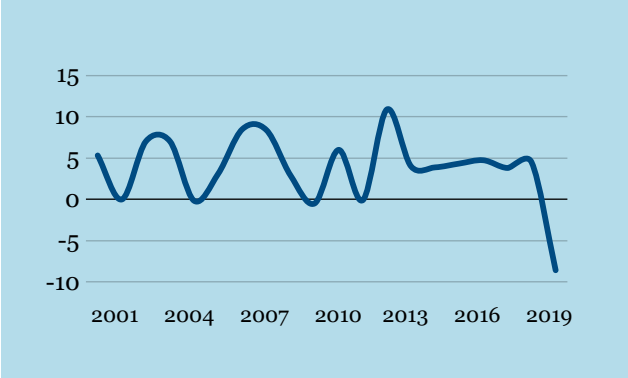


Figure 3. Current Account Balance, % of GDP

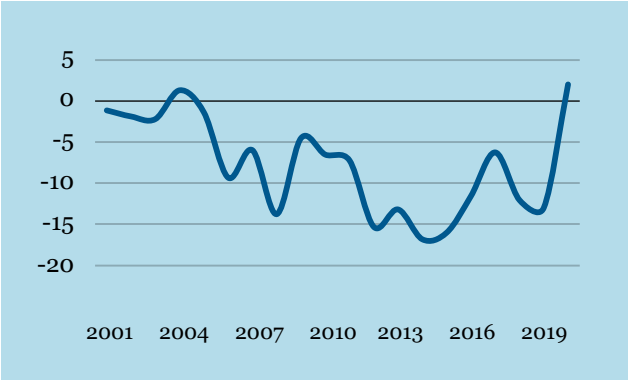


Figure 4. Fiscal Balance, % of GDP

Source: NSC KR, WB, calculations of the EFSD Project Unit.

On its way to long-term sustainable and inclusive growth, the country faces five major challenges: 1) diversification of economic activity (new sources of growth); 2) development and formalisation of activities of the private sector; 3) improvement of the efficiency of the public sector; 4) development of the basic infrastructure; and 5) human capital development and ensuring better quality of basic social services.

Challenge 1. Diversification of economic activity (new sources of growth)

The development of industries, in which the Kyrgyz Republic has natural competitive advantages, can become an additional source of growth.

Agriculture is a traditional sector of the economy, but the level of its productivity is very low, and the share of exports of agricultural products in total exports of goods does not exceed 1%. The agricultural sector, which employs most of the rural population, suffers from lack of machinery and logistics infrastructure, while small-scale production does not contribute to the competitiveness of agricultural products on foreign markets. However, agriculture, being a traditional sector, can become a driver of growth. This would be facilitated by the diversification of exports of agricultural products, among other things by enhancing the efficiency of production and developing the production of a number of “niche” agricultural products, and the promotion of the production of processed agricultural products. The “niche” areas include the cultivation and export of kidney beans, as well as the production and export of dairy products.

Hydroelectricity generation is another industry with potential scope for the Kyrgyz Republic to expand production. However, in 2000–2019, the share of the electric power industry in GDP and exports decreased from 6% and 9.8% to 2.2% and 0.01%, respectively. Upgrading the infrastructure of the sector, ensuring its financial transparency, and revising the principles of its management can play an important role in restoring the hydroelectricity generation potential.

The services sector can also expand its contribution to the economic growth of the Kyrgyz Republic. The country's nature and landscape give every opportunity for successful tourism development, while its location between major world powers opens up the potential for the development of logistics services and transit traffic.

Exports of digital services also have significant potential for growth. A national digital transformation strategy has already been developed and adopted. Its goal is to create conditions for the digital economy to develop through the use of digital technologies in public administration and opening of excellence and innovation centres.

Challenge 2. Development and formalisation of activities of the private sector

The private sector is the main source of prospects for enhancing the potential and sustainability of economic growth. 70–75% of the GDP of the Kyrgyz Republic is produced by private companies. 40–44% of the country's GDP is generated by small and medium-sized businesses, which are represented in retail and wholesale trade, hotel and restaurant services, agriculture and transport. In recent years, the pattern of the contribution of small and medium-sized businesses to exports of goods and services has shown some positive upward trends.

However, a large part of the private sector is involved in informal economic activities. There are gaps in public administration and corporate governance and difficulties in access to financial services and credit resources that hinder the growth of the private sector and encourage entrepreneurs to stay "in the shadow". According to the National Statistical Committee of the Kyrgyz Republic (NSC KR), the share of the informal economy increased from 12% of GDP in 2000 to 20.1% in 2017. According to 2018 data, 70.8% of the employed population is engaged in the informal sector.

Challenge 3. Improvement of the efficiency of the public sector

The public sector is represented by operations of the state budget and activities of about 100 state-owned enterprises. State budget expenditures make about 32% of GDP, of which about 10% of GDP is salaries and wages of budget sector employees. Budget sector employees account for about 60% of total formal employment. The salaries of employees in social sectors (healthcare, education) are low, at about 65% of average economy-wide wages, that indicates the need for an audit of the wage bill in the state budget and subsequent optimisation of employment in the budget sector.

In 2014–2019, public investment averaged at about 8.2% of GDP and was mainly supported with foreign loans and grants under the Public Investment Programme (PIP). At the same time, about 30% of the PIP funding is on-lent in the form of budget loans to state-owned enterprises, and mainly in the energy

sector. State-owned enterprises, a significant part of which belong to the electricity generation sector, are inefficient, insufficiently transparent, and financially insolvent. Against the background of continuing severe restrictions on raising electricity tariffs and risks associated with water shortages, budget loans, the stock of which amounted to 21.6% of GDP as at end-2020, pose significant quasi-fiscal risks.

The institutional environment data collected for the Worldwide Governance Indicators (WGI) over the past 20 years highlight the need for reforms in the areas of public finance management (PFM), regulatory functions of the government, and law enforcement. According to the Doing Business report, the Kyrgyz Republic ranks the 80th, with issues stressed in terms of protecting investors (128th), paying taxes (117th), enforcing contracts (134th), and getting electricity (143rd).

Challenge 4. Development of the basic infrastructure

Since the road transport services almost the entire domestic passenger and freight traffic and most of the foreign trade, roads have become a priority of the transport infrastructure development in the Kyrgyz Republic (see Section 3.2). Because of the high terrain and harsh climate in winter, road pavements require regular repair. Support for institutional reforms is needed to ensure effective road repair planning and allocation of funds.

The country still faces ambitious objectives of upgrading and developing the basic infrastructure in the energy sector. The energy sector, mainly represented by large hydroelectric power plants, is constrained due to enterprise insolvency and deteriorated infrastructure. The sector depends on substantial direct and indirect subsidies in an environment where the existing tariffs do not ensure its financial sustainability and the tariff policies have not changed over a long period. Given the high level of depreciation of fixed assets of most energy generating facilities in the Kyrgyz Republic, large-scale upgrading of key energy infrastructure facilities is required. Its goals are to ensure energy security, including the development of sufficient energy generation capacity to satisfy the needs of industrial growth, meet the rapidly growing demand for energy on the part of households (especially in winter), without creating additional risks in terms of water availability in high-mountain agricultural areas.

The challenge of outdated infrastructure is also relevant for agriculture and water management. Continuous renewal of the agricultural machinery and equipment fleet, and a stable inflow of investments are necessary for the development of the country's agricultural sector, which is of high social importance for the Kyrgyz Republic. In the field of water management, it is essential to develop drinking water supply, wastewater disposal, and sanitation systems, especially in rural areas and remote settlements.

Challenge 5. Human capital development and ensuring better quality of basic social services

Ensuring access to quality education, health, and other social services is another serious challenge for sustainable economic growth. The Kyrgyz Republic has been able to provide the population with access to basic health, education, and social protection services in large cities, but the quality of these services is not high. In rural areas, the poor quality of basic services is associated with the shortage or absence of infrastructure and workers with appropriate skills. The limited access to the social infrastructure

reduces the capacity of a significant share of households to benefit from education, health, and social protection services. It creates prerequisites for growing inequality and stimulates migration, including internal migration.

Lack of skilled labour in the education and healthcare systems was particularly pronounced in 2020, in the context of the COVID-19 pandemic. In order to achieve sustainable results in this area, measures should be taken to improve access to quality education, including vocational education, among other things by creating appropriate infrastructure and fully operational institutions.

2. Current Cooperation between the EFSD and the Kyrgyz Republic

2.1. Support to the Kyrgyz Republic in Ensuring Macroeconomic Stability and Implementing Structural and Institutional Reforms

The EFSD holds regular consultations with the Kyrgyz Republic on the macroeconomic situation and risks, the need for EFSD financing to support the macroeconomic stability, as well as the structural and institutional reform agenda.

- In 2019, the EFSD Project Unit worked with the Cabinet of Ministers of the Kyrgyz Republic on a three-year reform programme of the Government and the National Bank, which was to be supported with an EFSD-funded financial credit. Consultations were held with key ministries and agencies, as well as with development partners. The final draft of the programme identified important areas of institutional and structural reforms: measures to digitalise the economy; those to improve the public finance management system; reforms in the road sector; and steps to ensure transparency in the energy sector. However, due to the spread of the COVID-19 pandemic, the preparation of the financial credit was suspended.

- In 2020, as part of coordinated emergency support provided by key donors to the Kyrgyz Republic to counter the impact of the COVID-19 pandemic on the economy, its financial and social sectors, the Kyrgyz Republic prepared an application for an EFSD-funded financial credit in the amount of US $100 million. The main goal of the credit to the budget was to assist in financing measures aimed at mitigating the impact of the pandemic on the economy and prevent a fall in the living standards of the population The range of measures included support to the health sector, vulnerable groups of the population, and key sectors of the economy, as well as the implementation of prudent fiscal and monetary policies and ensuring stability of the banking sector. The EFSD Council approved the credit, and the agreement was signed and entered into force on 2 October 2020. However, due to the proclamation of an emergency situation against the background of political tensions in the Kyrgyz Republic, the access to the resources was suspended and the funds were not disbursed within the timeframe established by the agreement. Despite this, cooperation with the Cabinet of Ministers of the Kyrgyz Republic in the process of the programme preparation is a very valuable experience for both parties in terms of agreeing on the terms and conditions and emergency financing programmes, including communication and risk management during a crisis.

2.2. Support to the Kyrgyz Republic in Upgrading and Developing its Basic and Social Infrastructure

The Kyrgyz Republic was the first country to receive EFSD financing to support the basic infrastructure. At the moment, the EFSD supports the rehabilitation of the energy and transport infrastructure, and the agricultural sector in the Kyrgyz Republic, while preparing projects on housing finance, water supply, as well as grant projects to support the country's social infrastructure.

Assistance in improving the agricultural infrastructure

Agriculture is one of the vital sectors of the economy in the Kyrgyz Republic. About 66% of the country's population resides in rural areas, 20% of all workers are employed in agriculture. The development of the agricultural sector of the economy ensures the provision of the population with food and industrial enterprises with raw materials and generates a significant part of the added value in the GDP (its share in the GDP is about 13.5%). More than 440,000 economic entities of various forms of ownership, of which peasant farms (farmers) account for about 99%, are engaged in the production of the gross output of agriculture, forestry, and fisheries (Box 1).

Box 1. Overview of the Agricultural Sector in the Kyrgyz Republic

The growth rate of agriculture in the Kyrgyz Republic is lower than the average GDP growth rate and is accompanied by relatively high rates of population growth. During the period of 2000–2020, the economy grew by 105.7%, while the agricultural production increased by 54.2% (in real prices). However, the pace of the population growth in the country calls for accelerated growth of the production of basic food products and greater productivity of the agricultural sector.

As a result of national reforms, implemented since the country gained its independence in the 1990s, thousands of small household farms were created on the basis of large-scale collective farms. This required significant changes in the system of land tillage and management practices, cultivation and production of agricultural products. Some of the negative effects of that period still persist. In particular, weak competitiveness and low productivity of the agricultural sector due to its small-scale production and low incidence of effective forms of industrial integration of agricultural producers (cooperatives, clusters) are among the reasons for the insufficient output of basic products. As a result, a significant part of farmers' produce is consumed for their own needs, which leads to stagnation of the sector and lowers its positive contribution to the economic growth, as well as reduces its export potential. In 2019, the country imported 1.3 times more agricultural products than it exported – in value terms, it was US $262.5 million and US $192.7 million, respectively.

With a total gross output of KGS 247,298.2 million in 2020, the share of animal husbandry was 47.2%, while that of crop production made 50.2%. Fishing is a rapidly developing sector, but at present, its share is only 0.3%. The main sub-sectors of crop production are grain farming, fruit growing, vegetable growing, primarily potato growing, and cultivation of industrial crops, such

as cotton, tobacco, and sugar beets. The agricultural land is 10,658,200 ha, of which cultivated arable land accounts for 12%, and natural pastures are 9,165,600 ha or 86%, respectively.

A significant part of agricultural land and pastures is subject to erosion to varying degrees. There were unstructured and, in some cases, unreasonable changes in the status of land, with its reclassification from agricultural to other categories, as well as widespread involuntary violation of agricultural technologies. The continuing downgrading of irrigation systems results in large losses and unsustainable use of water. The sector faces soil salinisation and water logging problems. No funds are allocated for the reclamation and maintenance of agricultural land fertility. Unacceptably large losses of water in the process of irrigation (about 30% annually) lead to water shortage despite the overall relatively high availability of water in the country.

The agricultural production in the Kyrgyz Republic remains inefficient, with low profits and many problems to be addressed. The main problems faced by agriculture in the Kyrgyz Republic are as follows:

- The agro-industrial complex in general does not ensure food security in terms of all basic food products, based on the targeted values of their estimated indicators, and does not generate added value commensurate with the share of the sector in the economy.

- Agricultural production in Kyrgyzstan develops mainly in an extensive way, has low productivity and yields in animal husbandry and crop production.

- There are low rates of introducing modern innovative technologies of soil cultivation, soil fertility improvement, water-saving irrigation, growing on protected ground, harvesting, and applying specialised machinery, intensive methods of animal breeding, etc. Farms, especially small ones, as well as private subsidiary farms, do not have access to modern technologies due to their high cost.

- The integration of agricultural producers is slow. In many cases, value chains do not develop properly and do not achieve high production results due to problems with harmonising the economic interests of the participants of these value chains, including producers of raw materials, intermediaries, processing enterprises, as well as due to structural imbalances in their productive capacities, logistics and marketing problems.

- The productivity of farm animals, as well as the yields of major crops have decreased significantly. The output of public and private breeding and seed farms does not satisfy the demand of agricultural producers and does not meet the value for money criterion. There are cases of importation of low-quality and uncertified pedigree and seed products, which do not enable higher productivity and, moreover, pose a threat to the environment.

- Research and breeding in the field of animal husbandry and seed production are not developing due to the weak physical capacity and lack of incentives.

- Kyrgyzstan is one of the countries that have limited areas of arable land for agricultural production and limited capacity to expand them. The above-mentioned trends of arable land reclassification and degradation, low rates of growth of the area of additional arable land, a large share of degraded pastures – all this may lead to problems in terms of sustainable supply of the population with food in the future.

The most important reasons for the poor performance and falling productivity in the sector also include poor technical facilities of farmers and agricultural enterprises and a high level of depreciation of agricultural machinery. The machine and tractor fleet mainly includes machinery of Russian, Belarusian, and Ukrainian production, supplied in the 1980s. More than 90% of the fleet is machinery whose useful life has been exceeded by 3–4 times, thus, it needs replacing. Due to the deterioration of their machinery, farmers and agricultural enterprises bear extremely high costs associated with its current maintenance and repair. The high costs of repairs and maintenance also arise as there is actually no adequate infrastructure.

Most of the lending to agricultural producers is provided by banks and non-bank financial institutions, as well as in the framework of the Financing of Agriculture Programme and the Public Investment Programme (PIP). In addition, agriculture is financed by various projects, foundations, and development partners. However, the total amount of lending is insufficient to meet the demand, commercial lending rates are too high for agricultural producers, while the terms and conditions of loans related to collateral security and loan formalisation are excessively stringent.

In view of the specifics of the functioning of the agricultural sector in the Kyrgyz Republic and the need to ensure food sustainability and security, state regulation and support should play an important role within the framework of the agricultural policy implemented.

In the context of assistance to agricultural machinery renewal programmes, in 2013, the EFSD Council approved the allocation of US $20 million to the Kyrgyz Republic to support the Agricultural Machinery Supplies Project. More than 1,000 units of agricultural machinery were purchased under the project and subsequently leased out to agricultural producers. On 30 June 2020, the disbursement of funds under the project was completed, however, the mechanism for creating a state leasing support fund, financed with repayments of the principal debt and payments of interest under a budget loan from Aiyl Bank, enables further financing of purchases of agricultural machinery, without borrowing additional resources.

Assistance in transport infrastructure rehabilitation

In 2012, when the Asian Development Bank (ADB) prepared a Concept Note on the rehabilitation of the Bishkek–Osh road and the search for sources to fund the programme began, the EFSD Project Unit launched consultations with the Ministry of Transport and Communications of the Kyrgyz Republic and the Ministry of Economy and Finance of the Kyrgyz Republic. The Bishkek–Osh road is the only one connecting the northern and southern regions of the Kyrgyz Republic, but its current technical condition does not meet the needs of the country's socio-economic development (Box 2).

Box 2. Overview of the Transport Sector of the Kyrgyz Republic

The development of the transport infrastructure, especially taking into account the geographical location and the mountainous terrain of the Kyrgyz Republic, is a prerequisite for sustainable economic growth and improvement of the living standards of the population, among other things by expanding the country's opportunities for participation in integration processes, including economic cooperation with the Fund member states. In 2016, the length of roads of international importance was 4,100 km, including 2,200 km of international transport corridors, while the total length of public and local roads was 14,600 km. Road transport is of paramount importance for the Kyrgyz Republic – it accounts for 92.7% of freight (excluding the pipeline transport) and 99.8% of passenger traffic. There are two major civil aviation airports in the country – one in Bishkek and one in Osh – with flights made to 23 international destinations in 9 countries of the world. The Kyrgyz railways have ceased to play a significant role in freight and passenger traffic, but there are ambitious plans to restore their importance. The contribution of transport to the country's GDP is 4.0%.

Despite the importance of the road infrastructure for the national economy, the tasks of maintaining existing roads and developing their network were not addressed in the 1990s and early 2000s. Due to significant underfinancing of the road sector since the Kyrgyz Republic gained its independence, there has been practically universal deterioration of the technical condition of public roads. Most roads have not been repaired since the late 1980s. No new roads, the need for which has arisen due to major structural changes in the economy, have been designed or built. The poor condition of roads and their low capacity resulted in greater accident risks and high costs for carriers, thus, creating logistical problems for small and medium-sized producers, hindering the realisation of the country's transit potential and, in general, negatively affecting the economic growth and the development prospects of the national economy. This negative trend was broken only in 2006–2010, when the budget for the construction, repair, and maintenance of public roads increased almost eight-fold. That was primarily facilitated by the cooperation of the Kyrgyz Republic with international donors and development partners.

Since 2006, the IFIs (WB, EBRD, ADB, IDB, and EFSD), as well as China and Japan in the framework of bilateral cooperation, have become the main sources of financing for projects in the area of road infrastructure in the Kyrgyz Republic. In 2019, the stock of their investments in the Kyrgyz Republic was about US $1.9 billion, which helped bring the existing roads into normative condition and build new roads of total length of about 1,500 km, primarily in the framework of international transport corridors.

In 2013, the EFSD Council adopted a decision to provide the Kyrgyz Republic with an investment credit to finance the Bishkek–Osh Road Rehabilitation. Phase IV Project in a total amount of US $60 million. The project covered the rehabilitation of the existing 67 km section of the road from Madaniyat to Jalal-Abad. The project is implemented within the framework of Phase IV of the Bishkek–Osh Road Rehabilitation Programme, with total financing of US $204 million provided in cooperation with the ADB. As a result of the project implementation, the capacity of this road section will increase, and the accident risks will decline. The project is also important as this section is the last one to be improved under

the programme of rehabilitation of the entire Bishkek–Osh road, and its completion is essential for the development of economic and social ties between northern and southern regions of the country, as well as for the realisation of the international transit potential of the Kyrgyz Republic within the framework of the CAREC Programme implementation. Disbursements to the beneficiary under the credit started in October 2018, and the project is currently at the active construction phase.

Assistance in energy sector modernisation

In 2012, the EFSD Project Unit began consultations with the authorities of the Kyrgyz Republic and development partners on the provision of investment financing for the modernisation of the energy sector of the Kyrgyz Republic. Taking into account the specifics of the energy sector development in Central Asia during the Soviet era, as well as the high level of depreciation of most power generating facilities at the moment, the Kyrgyz Republic needs investment resources for the upgrading of its key energy infrastructure facilities to ensure energy security, including the development of sufficient energy generation capacity to satisfy the needs of industrial growth, supply water to high-mountain agricultural areas, and meet the rapidly growing demand for energy on the part of households, especially in winter (Box 3).

Box 3. Overview of the Electric Power Sector in the Kyrgyz Republic

The Kyrgyz Republic has sufficient reserves of fuel and energy resources, including significant coal deposits and about 30% of the hydropower resources of Central Asia. However, the opportunities for the development of the fuel and energy complex are not sufficiently taken advantage of. The gross hydropower potential is estimated by the Institute of Water and Hydropower Problems of the Academy of Sciences of the Kyrgyz Republic at 245.2 billion kWh. Of those, the technically feasible potential for development is 142.5 billion kWh, and the economic or productive potential is 60 billion kWh. The level of development of the gross potential is 6%, that of the technologically feasible potential is 10%, and that of the economic or productive potential is 24%. The most developed is the Naryn River basin, which hosts the Lower Naryn cascade of hydroelectric power plants (HPPs) with reservoirs for long-term (Toktogul reservoir with a design capacity of 19 billion m^3) and seasonal regulation (Kurpsai, Tashkumyr, Shamaldysai, and Uch-Kurgan reservoirs). Electricity generation depends on the natural and climatic conditions and the water content of the basins of the Naryn River and its tributaries. Low-water and high-water cycles alternate every 3–4 years. Due to the dependence of electricity generation on the climatic conditions, there is shortage of electricity in winter, therefore it is necessary to import it from neighbouring countries.

The country also has a significant renewable energy potential. The main types of renewable energy sources include small rivers and watercourses, solar energy, wind power, geothermal energy, and biomass. The total gross hydropower potential of small rivers and watercourses exceeds 80 billion kWh per year, of which about 6 billion kWh is technically feasible for development. The total electricity generation by small HPPs is about 150 million kWh. Due to the lack of private investment and the low attractiveness of small-scale hydropower, and against the background of a number of projects in large-scale hydropower, this sector is still underdeveloped.

The main electric power capacities were created in the 1950s and 1970s. In 2019, the deterioration of equipment was about 70% for grid companies and 79.8% for Electric Power Plants OJSC, while the crisis level is 30%. The generation of electricity at HPPs depends on the water flow in rivers. In 2019, the total electric power generation amounted to 14.87 billion kWh, hydroelectric power plants produced 12.64 billion kWh (85%), and thermal power plants produced 2.2 billion kWh (15%). About 97% of electricity was sold on the domestic market.

In 2020, electricity generation amounted to 15.18 billion kWh, HPPs generated 13.36 billion kWh (88%), and thermal power plants generated 1.8 billion kWh (12%). During the period of 2015–2020, the average domestic electricity consumption was increasing year by year. As the economy develops and the demand by households grows, further increases in consumption will be expected. In 2020, the composition of electricity consumption by type of consumers was as follows: the population accounted for 73% of the total electricity consumption, industry – for 9.2%, state institutions – for 8.4%, and the agricultural sector – for 9.4%.

Due to its geographical features, the power system of the Kyrgyz Republic is divided into the northern and the southern parts, with 81% of power generating capacities located in the south, while more than 60% of the generated electricity is consumed by the country's northern regions. The challenge of ensuring energy independence was addressed through the construction and commissioning of the 500 kV Datka substation in the south, in Jalal-Abad oblast, and the Kemin substation in the north, in Chui oblast, as well as the construction and commissioning of 500 kV Datka–Kemin transmission lines, which contributed to improving the stability of power supply to the northern regions of the country, while reducing the cost of power transit.

Electric Power Plants OJSC, which generates about 98% of all electricity in the country, is the owner and operator of hydroelectric power plants (HPPs) and combined heat and power plants producing electricity and thermal energy (CHPs). Electric Power Plants OJSC has seven HPPs on the Naryn River with a total installed capacity of 3,030 MW and two CHPs (in the cities of Bishkek and Osh) with a total electric power capacity of 862 MW. The service life of these generating capacities exceeds 30–55 years, and most of them are currently implementing rehabilitation programmes, with financing mobilised from external sources, or are at the stage of preparation of such programmes. The commissioning of new capacities lags behind the growth rate of the load in the power system – in the past ten years, only one 120 MW unit was built and put into operation at the Kambaratinskaya HPP-2. The renewal of the fixed assets of power plants, whose depreciation has reached 70–93% (while the crisis threshold is 30%) and the standard service life (25—30 years) has been exceeded, is associated with the reconstruction and rehabilitation of HPPs.

National Electric Grid of Kyrgyzstan OJSC, which owns large substations and high-voltage power transmission lines, is engaged in the transportation of generated electricity. The total length of high-voltage power transmission lines is 7,548 km. About 5–6% of electricity is lost in transmission. But the technical losses increase with further distribution to end users. Significant technical and commercial losses of electricity persist due to a high wear rate of electric grids and the service life of substation transformers and electricity metering devices being exceeded, which causes accidents and power cuts, when the load increases, especially during the autumn and winter heating season. Although

electricity losses in distribution networks decreased from 16.5% in 2014 to 12.3% in 2019, they are still very high.

The state is almost the sole owner of companies in the energy sector – with the exception of a few distribution companies and small HPPs, the shares of energy sector enterprises are held by the state. Therefore, funds are periodically allocated from the state budget to cover the needs of companies in the energy sector in the form of budget loans, which are systematically accumulated and refinanced by the state. As at 1 January 2020, the stock of debt of energy companies to the state (loans and credits) amounted to KGS 154.6 billion (21.6% of GDP). Socially oriented electricity tariffs remain the lowest in the CIS and do not cover the costs of its production and sale, as well as those of the renovation and development of fixed assets. This aggravates the critical financial and economic situation of the energy sector companies, with their deficit (their expenses exceeding their incomes) growing annually and their debt to the state budget increasing, which poses significant quasi-fiscal risks to the state budget.

In 2021, the Cabinet of Ministers of the Kyrgyz Republic initiated a revision of the medium-term tariff policy, envisaging a gradual increase in tariffs, accompanied by provision of benefits to low-income groups of the population. The main goal is to ensure the financial sustainability of the energy sector.

Based on the assessment of the current situation in the country's electric power sector, in 2015, the EFSD Council decided to co-finance the Toktogul HPP Rehabilitation Project in cooperation with the ADB for a total amount of US $250 million. The EFSD financing is US $100 million. If implemented successfully, the project will contribute to an increase in the capacity of the Kyrgyz Republic's energy system (additional 240 MW), including opportunities for expanding its export potential. At present, the project is at its active implementation phase – the first (out of four) replaced hydropower unit is to be commissioned in November 2021.

The EFSD independently finances the project "Commissioning of the Second Hydroelectric Unit of the Kambaratinskaya HPP-2 in Kyrgyzstan" in the amount of US $110 million. The implementation of this project will help increase the capacity of the plant by 150 MW, reduce forced water discharges from the Toktogul reservoir in winter by 1.4 billion m^3, and increase the total electricity generation up to 1.140 GWh, of which up to 85% will be generated in the spring and summer period, and up to 15% – in the autumn and winter period. At present, an engineering consultant is preparing the tender documentation to select a contractor. The Fund also takes preparatory steps to finance the project "Construction of a Surface Spillway of the Kambaratinskaya HPP-2", which will create conditions for the safe operation of the HPP.

Assistance in equalising regional development through improved housing affordability for socially important workers

The Kyrgyz Republic is characterised by a high level of inequality in regional development. It is a significant barrier to the sustainable development of the country, reduction of poverty, and improvement of the inclusiveness of economic growth, which, in turn, creates significant social and fiscal risks. Reducing regional inequalities calls for an integrated approach to regional development, including the development of basic and social infrastructure. On 31 March 2017, the Government approved the Concept Document

on Regional Policy of Kyrgyzstan for the period of 2018–2022. The main goal of the Concept Document is "to ensure accelerated socio-economic development of the country's regions to improve the well-being and the quality of life of the population". The Concept Document also defines the approaches "aimed at creating a framework for the preparation of detailed medium- and long-term development programmes for certain regions and settlements".

One important area of the regional development policy is to improve the availability of quality education and health services. However, limited access to quality housing in the regions is a serious barrier to attracting qualified personnel in the social sectors. Therefore, an important area of the regional development policy is also the development of housing sector institutions (Box 4).

Box 4. Overview of the Housing Finance Sector in the Kyrgyz Republic

At present, the housing stock of the Kyrgyz Republic consists of about 1.3 million housing units, most of which need upgrading – about 85% of housing was built during the Soviet period. The level of depreciation of the housing stock is increasing and has exceeded 40% by now. At the same time, taking into account the fairly rapid growth of the population, housing per capita remains virtually unchanged. According to the NSC KR, housing per capita is 13.1 square meters, based on the total population of 6.38 million people. According to the Housing Code of the Kyrgyz Republic, the standard of living space per capita should be at least 12.0 square meters, while the Programme of the Government of the Kyrgyz Republic "My Home 2021–2026" aims at achieving the international standards for housing per capita of 18 square meters as defined by the UN.

In the context of small volumes of budget financing and insufficient supply of housing, the main source of funds to purchase housing is people's incomes. Kyrgyzstan is a low-income country, and the housing affordability ratio is more than 10 years – it is the time it takes for an average family of three to save money to buy housing, while, according to the UN-HABITAT methodology, housing is affordable, if funds can be saved to buy it in less than three years. For social workers (education, healthcare, social protection), whose salaries are slightly more than half of average economy-wide wages, buying housing is practically unaffordable.

The problem of low affordability of housing is gradually addressed as the housing financing sector has become one of the strategic priorities of the Government of the Kyrgyz Republic and mortgage financing instruments are being developed. Active development of the mortgage market in Kyrgyzstan began in 2015, with the adoption of the Government Programme "Affordable Housing 2015–2020" and the assignment of the role of the government housing programme operator to state-owned Mortgage Company OJSC. The implementation of the programme contributed to a decline in the weighted average mortgage rates from 20% to 14–13% per annum.

Based on the results of the implementation of the "Affordable Housing 2015–2020" Programme, the Cabinet of Ministers of the Kyrgyz Republic adopted the Programme "My Home 2021–2026". In the framework of its implementation, it is planned to apply an integrated approach, including the development of a mortgage lending system and a contractual housing savings scheme, expand

the housing construction, among other things through public-private partnership arrangements, and mobilise extra-budgetary sources to finance mortgage programmes. This approach will contribute to the growth of housing construction, reduce its cost, improve mortgage lending terms and conditions, and help a greater number of citizens to independently improve their living conditions.

The project is to be supported with an EFSD-funded investment credit of US $25.0 million at the first stage. With these funds, the Kyrgyz Republic plans to provide housing for at least 1,700 families, or 6,800 low-income citizens, employed in healthcare and education in regions of the Kyrgyz Republic, except for the cities of Bishkek and Osh. 122,400 square meters of living space will be provided to them (18 square meters per person).

The project can contribute to the achievement of regional development goals in terms of improving the quality of social services in regions (primarily school education and healthcare) and reducing the migration of the population from least developed regions. However, there are high institutional risks that can significantly weaken the effectiveness of the project. To mitigate these risks, additional reforms are needed to bring the following results:

- improved transparency of the public finance system and special-purpose construction;
- equalisation of salaries of qualified employees of the social infrastructure on average in the Kyrgyz Republic; and
- provision to social sector specialists, resettling from other regions, of allowances on appointment, linked to completion of their employment contracts at new locations, and land plots for special-purpose housing construction.

Assistance in improving water supply and sanitation in rural areas

There are 1,905 settlements in the Kyrgyz Republic, including 31 cities and 1,874 rural settlements. More than 60% of the population lives in rural areas. There are no water supply systems in 346 villages, while in 476 settlements the systems were built in the period of 1950–1990 and need restoring. In rural areas, about 40% of the population do not have access to clean drinking water from centralised water sources, while more than sufficient and easily accessible fresh groundwater and surface water sources and reserves are universally available. The state of water treatment and centralised wastewater disposal facilities remains particularly problematic. All this leads to higher incidence of both diseases associated with poor water quality and induced treatment costs, comparable to the costs of building drinking water supply systems. There is practically no service for the operation of these systems, which would be sustainable and built on universal principles (Box 5).

Box 5. Overview of the Water Supply and Sanitation Sector in the Kyrgyz Republic

The population of Kyrgyzstan is in dire need of drinking water supply and wastewater disposal services. After the liquidation of collective farms and state farms, rural drinking water supply systems remained

abandoned, which subsequently led to a rapid deterioration of their technical condition and, thus, to a complete halt of their functioning in most villages of the country. In subsequent years, drinking water supply systems had to be restored. However, the service life of many of them exceeds 30 years: in 292 villages drinking water supply systems were built before 1970, in 597 villages – before 1990.

In the period of 2017–2019, water supply systems were built and rehabilitated in 107 villages out of 889. Nevertheless, the degradation of existing water supply and wastewater disposal systems continues, and the sanitary and epidemiological situation is getting more complex. There is no effective system for the operation of facilities, and even newly commissioned facilities do not have the necessary institutional and financial support.

In 2016, the Programme for Development of Drinking Water Supply and Wastewater Disposal Systems for Settlements of the Kyrgyz Republic until 2026 was adopted with the support of the country's development partners. It operates within the framework of the National Development Strategy of the Kyrgyz Republic for 2018–2040 and the Action Plan of the Government of the Kyrgyz Republic for 2018–2022 to Implement the National Sustainable Development Strategy of the Kyrgyz Republic for 2018–2040.

The Programme is aimed at improving the quality of water supply and wastewater disposal services, addressing the main problems, identifying promising areas, objectives, and functions of the ministries, administrative agencies, and local self-government bodies concerned.

The Cabinet of Ministers of the Kyrgyz Republic has identified 715 villages with water supply systems to be built and renovated as a matter of priority.

Authorised representatives of the Kyrgyz Republic in oblasts determine the rural settlements most in need of the construction and rehabilitation of water supply and wastewater disposal systems and send their lists of villages for approval to the supervising government body under the Government of the Kyrgyz Republic. The lists are then passed on to donors for project implementation.

The Preliminary Application of the Ministry of Economy and Finance of the Kyrgyz Republic, submitted to the EFSD, and the Project Concept Note, approved by the Government Council of the Kyrgyz Republic on Fiscal and Investment Policy (minutes No. 16-01 dated 28 August 2020), include rural settlements of Kara-Sui and Uzgen districts of Osh oblast identified for the construction and rehabilitation of water supply and wastewater disposal systems.

The Project "Improvement of Water Supply and Sanitation in Rural Settlements of Osh Oblast of the Kyrgyz Republic" is currently under internal review to complete approval procedures of the EFSD Project Unit and is to be implemented in 2022.

The implementation of the Project involves efforts to connect 18 villages of Kara-Sui district and 6 villages of Uzgen district of Osh oblast to the water supply and wastewater disposal system and build the capacity of municipal service enterprises in these districts. The goals are to be achieved through the rehabilitation of repair units, purchase of special machinery, laboratory, and IT equipment for the maintenance

and operation of water supply and wastewater disposal systems, enhancement of the institutional capacity of water supply and sanitation systems in these rural settlements.

Support of Government social sector programmes

Significant budgetary constraints in the Kyrgyz Republic have led to chronic lack of funding for key social sectors. It largely determines the unfavourable institutional environment and the low level of development of the healthcare infrastructure in the country that, in turn, poses significant risks to the human development and limits the social and economic mobility of the population. Therefore, one of the priorities of the Kyrgyz Republic's domestic policy is to meet the commitment of the Government to improve the access of the population to quality health services and, in general, the living standards of the population.

In order to support social sector development programmes in low-income countries, in 2015, the EFSD launched grant programmes in the social sphere. The Kyrgyz Republic took an active part in contests for grant programmes. At the moment, there are grant projects in the health sector under preparation.

Health sector

The main document that defines the goals and priorities in the area of healthcare for the period of 2019–2030 is the Programme of the Government of the Kyrgyz Republic for Public Health Protection and Healthcare System Development "A Healthy Person – a Prosperous Country". The goal of the Programme is to enhance people-centred health systems, provide life-long quality services aiming at maximum improvement of health indicators, reduce health inequalities, and ensure financial protection. The programme is aimed at achieving results in the following areas:

- public health;
- primary healthcare development;
- improvement and streamlining of the hospital system;
- development of emergency health care;
- laboratory services;
- medicines and medical devices;
- strategic healthcare system management;
- human resources in the healthcare system;
- e-health development; and financing of the system development.

The implementation of the Programme includes the adoption of measures to ensure effective use of the limited financial, human, and physical resources (Box 6).

Box 6. Overview of the Situation in the Health Sector of the Kyrgyz Republic

The health and social sectors are among those that require actions in terms of health infrastructure development and additional financing. In social terms, the issues of satisfying the basic vital needs of the population, eliminating the mounting tension due to the impoverishment of the population and the growth of unemployment have become extremely relevant.

Despite the difficult socio-economic situation, the Kyrgyz Republic has made some progress in a number of key aspects in the health sector. The achievements are explained by the implementation of ambitious structural reforms within the framework of three national programmes adopted since the country gained its independence: Manas (1996–2006), Manas Taalimi (2006–2011), and Den Sooluk (2012–2018). The reforms covered the areas of health service administration, financing, and provision.

In the current socio-economic environment, a significant increase in monthly funding for the social sector seems problematic. The lack of funds largely determines the unfavourable institutional environment and low level of development, including that of the healthcare infrastructure.

Primary health care is provided to the country's population by about 49 family medicine centres (FMCs) and 29 general practice centres (CPCs). Emergency medical care is provided to the population by two stations and 138 emergency health service (EHS) units in healthcare institutions.

Secondary healthcare institutions that provide specialised health services to inpatients are represented by 40 district hospitals, 29 general practice inpatient centres, 4 maternity hospitals, 3 city children's hospitals, 19 tuberculosis hospitals, 6 rehabilitation hospitals, 7 oblast hospitals, etc.

Tertiary healthcare institutions, providing specialised health services, are represented by 10 research institutes and national centres, 11 republican-level health institutions, etc. Inpatient care is provided to the population by 135 institutions, with the capacity of 24,965 beds, or 39.4 beds per 10,000 population.

However, the physical capacity is weak, there are no options for timely transportation of patients to health institutions. Outdated infrastructure and limited availability of new technologies make it difficult to provide comprehensive, high-quality health services to the population. EHS providers transport patients to the nearest healthcare institution and are not always able to provide qualified healthcare in case of the development of emergency and life-threatening conditions. In emergency cases, it creates obstacles to rapid and effective recovery of key emergency response systems and services and increases the vulnerability of institutions located in the emergency zone. EHS units in the Kyrgyz Republic do not meet modern standards in terms of the functions and tasks performed and do not satisfy the needs and demands of the population.

Within the framework of its grant programmes, the EFSD supports the Kyrgyz Republic in improving its healthcare system. The EFSD grant project "Caravan of Health (Kyrgyz Republic)" is under implementation.

The main goal of the project is to improve the prevention and detection of diseases among the rural population, including hard-to-reach areas. The project includes the purchase of two road trains, each of which consists of three mobile health clinics and a crew vehicle. In addition, the project covers the development of organisational and methodological documentation and outreach materials for the road trains to organise events related to preventive examinations, primary disease prevention, and health education of the population in rural and hard-to-reach areas of the country, as well as to train the health and technical staff of the beneficiaries involved in the implementation of the project.

On 9 March 2021, a contract was signed with a supplier of road trains. Efforts were made within the framework of the project activities to develop the legal and technical documentation. In July 2021, the road trains were delivered and handed over to the Kyrgyz Republic, and in June–July 2021, workshops and practical training exercises were arranged for technical and health specialists on the road train crew.

3. EFSD Strategic Objectives for 2022–2026

3.1. Defining EFSD Strategic Objectives for 2022–2026

Taking into account the main challenges for sustainable and inclusive long-term economic growth of the Kyrgyz Republic, as well as the country's strategic priorities for its development and improvement of the living standard of the population (Box 7), the EFSD, in its capacity of a regional financing and development arrangement, has identified the following long-term priorities for cooperation in the Kyrgyz Republic:

- to enhance the macroeconomic and financial stability;
- to improve the efficiency of the public sector;
- to improve the environment for private sector development;
- to upgrade the basic infrastructure in the energy, transport, and agricultural sectors;
- and to develop the human capital.

Box 7. Overview of Strategic Priorities of the Kyrgyz Republic

The main document regulating the strategic priorities of the Government is the National Development Strategy of the Kyrgyz Republic for 2018–2040. The country's long-term development policy is people-centred, the main objective is to create a comfortable environment for life and further comprehensive development. To achieve long-term sustainable development goals, there are also medium-term priorities identified, focusing on three main areas of reforms:

- social development, culture, and religion;
- economic well-being and quality of the environment for development; and public administration.

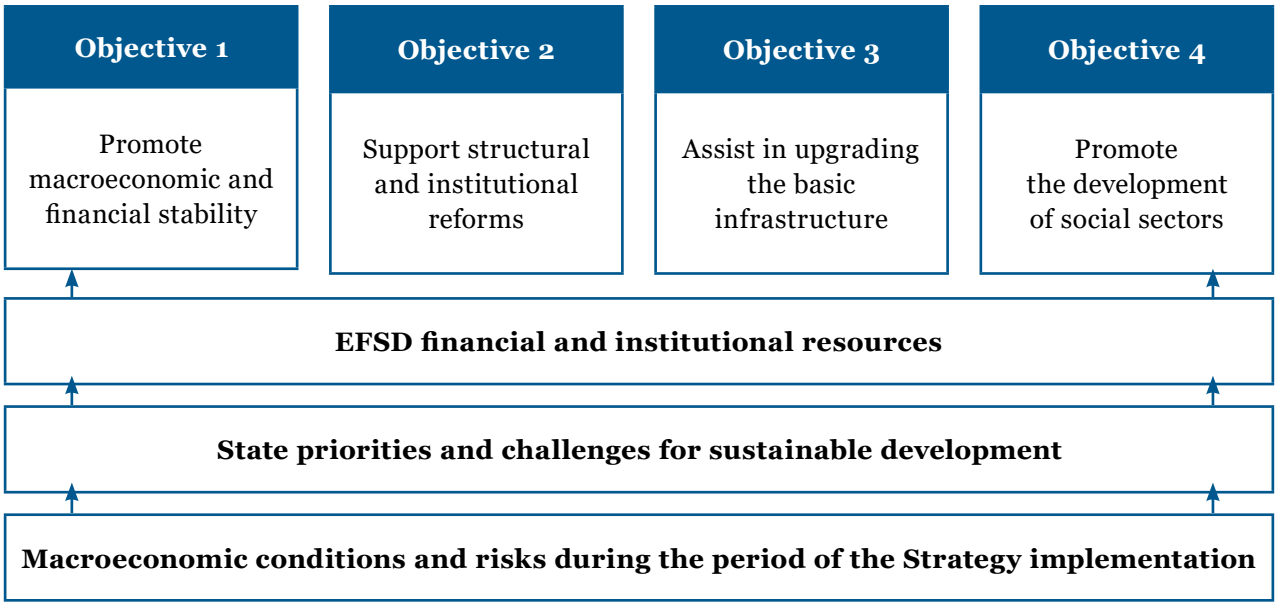
Social development involves improving the quality of life of the population, developing the potential, and providing equal labour opportunities and decent pension savings to every citizen. Within this area, it is planned to improve the quality of health services and the fight against infectious diseases; to raise the quality of education and ensure the alignment of the education system and the labour market; to build a system of equitable social protection and develop the system of social services; and to transform the pension system and achieve its sustainability. The areas related to culture and religion include measures to ensure harmony and stability in the society; to develop the official language; to form a multilingual learning environment; and to strengthen the principles of a secular and rule of law state.

These goals are to be achieved through reforms in three main areas. The first area covers the human development, labour market development, improvement of the investment climate, and promotion of exports. The main priorities of reforms in this area are to develop future marketable skills of the population, enhance foreign investments, develop and facilitate trade, upgrade the water and irrigation infrastructure, as well as encourage technological upgrades. The second area covers the creation of a sustainable environment for development. This involves the expansion of possibilities for small and medium-sized businesses; building of a competitive and fair tax system; development of financial institutions; expansion of energy generating capacities and financial recovery of the energy sector; enhancement of transport and logistics capacities; provision of the population with clean drinking water and rehabilitation of waste water disposal systems; and ensuring access to public services and the infrastructure connectivity of the country's regions. The third area defines priority objectives for the development of the export potential, including the development of the country's industrial potential and agro-industrial complex, support for the textile and garment production, and sustainable tourism development.

The improvement of public administration implies the development of effective and fair management based on the principles of meritocracy and mobility of the state apparatus; creation of a balanced system of state power by improving the inclusiveness of the electoral process; enhancement of the rule of law through a transparent and accountable judicial system; and ensuring the inviolability of private property. The security of the country will be ensured by eradicating corruption, preventing the spread of radicalism, and modernising the army. The pragmatic nature of the foreign policy will be supported through strengthened economic diplomacy, international positioning, and streamlining of the visa legislation and procedures. An important area of development is the digital transformation of the country that involves the creation of a modern information and communication infrastructure and the formation of an open digital society.

To clarify the goals of cooperation between the EFSD and the Kyrgyz Republic during the period of the Strategy implementation, four strategic objectives were identified for the EFSD to focus its efforts on in 2022–2026. Several key factors, including the macroeconomic environment and risks; long-term priorities of the Kyrgyz Republic and challenges for its sustainable growth; as well as the availability of the necessary competencies, expertise, and adequate resources of the Fund (Figure 5), were taken into account in determining the priorities of cooperation within the framework of the strategic objectives and the mandate of the Fund.

Figure 5. Defining EFSD Strategic Objectives in the Kyrgyz Republic for 2022–2026



Source: EFSD Project Unit.

3.1.1. Objective 1. Promote Macroeconomic and Financial Stability

Taking into account the continuing high vulnerability of the Kyrgyz Republic's economy to external shocks during the period of the Strategy implementation, one of the key objectives of the EFSD in the coming years will be to perform proper macroeconomic surveillance to ensure timely responses to crisis developments, including the provision of financing to support potential fiscal and/or balance of payments gaps. This includes the following areas of activity:

- regular macroeconomic monitoring, including updated forecasts of key macroeconomic indicators, fiscal and balance of payments gaps, debt sustainability analysis and stress tests;
- continued close dialogue with the national authorities on the need for financing to maintain the macroeconomic stability, including the sustainability of the budget and the balance of payments;
- continued close dialogue with key development partners (International Monetary Fund (IMF), World bank (WB), ADB, European Union (EU) agencies) on assessments of the macroeconomic and social environment, as well as on additional financing needs, in the event of a worsening fiscal and/or balance of payments crisis;
- provision of timely updates to the shareholders on the macroeconomic situation in the Kyrgyz Republic, as well as on emerging financing gaps and other risks; and
- provision of emergency financing in case the shocks that contribute to the formation of financing gaps materialise.

3.1.2. Objective 2. Support Structural and Institutional Reforms

Structural and institutional constraints in the economy of the Kyrgyz Republic have a negative impact on the potential and sustainability of its economic growth. Pro-cyclical macroeconomic policies, against the background of structural and institutional challenges, led to the accumulation of macroeconomic imbalances and risks to sustainable growth. The main challenges include: low diversification of exports and economic activity; a large informal sector; fiscal and quasi-fiscal risks; and insufficient access to financial services.

Structural and institutional reforms are needed to improve the potential and sustainability of economic growth in the Kyrgyz Republic. The following priority areas can be supported with EFSD-funded financial credits:

1) improvement of the public sector efficiency;

2) improvement of tax administration;

3) digitalisation of the economy;

4) enhancement of the transparency and accountability of the energy sector; and

5) improvement of the quality of road infrastructure management.

The efficiency of the public sector can be improved through transition to a new public administration strategy combined with mitigation of fiscal and quasi-fiscal risks. The automation of the budgeting process and the execution of the budget expenditure item of salaries and wages by integrating databases on the number of public sector employees with the budget execution system will result in more efficient allocation of resources under this item of state budget current expenditures. Effective management of quasi-fiscal risks will be facilitated by a qualitative assessment of these and other fiscal and quasi-fiscal risks in the preparation and forecasting of budget parameters and the elaboration of measures to mitigate them. Further promotion of transparency principles in programme-based budgeting at ministries and agencies, combined with evaluations of budget programme implementation would enable the creation of databases on performance indicators and enhance the capacity of ministries to improve the efficiency of the public sector.

Measures to improve the tax administration and fiscalisation, supplemented by improved efficiency of the system of granting tax and customs benefits, should give added impetus to the development of the private sector and reduce the share of the informal economy. The development of competition, the formalisation and growth of private enterprises, as well as the improvement of the business climate will be facilitated by measures of fiscalisation of tax procedures, streamlining of tax preferences and benefits on the basis of an assessment of their effectiveness, as well as improvement of the legislation in the area of tax administration.

Reforms in the area of digitalisation of the economy should be aimed at diversifying the economy, improving the access of the population to the basic infrastructure and financial services. The Cabinet of Ministers

of the Kyrgyz Republic has developed and adopted the national digital transformation strategy, which includes the digitalisation of government services, e-commerce development, and efforts aimed at testing and implementing innovative banking services. This will expand the access of the population to basic education, health, and other social and financial services. For a landlocked country, digital services are a potential source of export growth. If implemented successfully, the digital transformation strategy will contribute to the diversification of the Kyrgyz economy, as it will help open up new niches.

A whole package of measures with different timeframes will be needed to improve the performance of the energy sector. Short-term measures may include ensuring transparency and financial accountability of energy sector enterprises. Public availability of transparent financial statements of energy companies, as well as forecasts of electricity generation and consumption would contribute to financial rehabilitation of the sector. Medium-term tariff policy measures, combined with assistance to vulnerable groups of the population, will have a longer-term effect on building the financial sustainability of the sector.

Institutional reforms in the road sector to improve the quality of road maintenance and the efficiency of budget expenditures on current maintenance of roads would improve the transport and logistics connectivity of the country. Road transport services almost the entire domestic passenger and freight traffic and most of the foreign trade. However, because of the high terrain and harsh climate in winter, road pavements need regular maintenance. The introduction of a tool to control the road maintenance quality and the enhancement of the financial resource allocation framework would assist in ensuring sustainable operation of the road sector and improve the country's transit capacity in future.

3.1.3. Objective 3. Assist in Upgrading the Basic Infrastructure

Agriculture

Pursuant to Decree of the President of the Kyrgyz Republic No. 25 dated 8 February 2021 "On Measures to Develop the Agro-Industrial Complex of the Kyrgyz Republic", the Ministry of Agriculture, Water Resources, and Regional Development of the Kyrgyz Republic prepared the Concept Document on Agrarian Development until 2025.

In terms of improving the productivity of the country's agricultural sector, the priority of the Government policy is to improve the regional infrastructure to further promote both foreign and domestic trade, enhance the competitiveness of the agribusiness sector, reduce the migration and improve the employment and incomes of the population, especially in agricultural regions, as well as address the issues of food security. As part of the preparation of concept documents and projects to support agriculture at both the regional and the national levels, the Cabinet of Ministers of the Kyrgyz Republic, with the support of the WB, raised the following range of issues:

1. Development of agro-technical services to agricultural entities and digitalisation of the agro-industrial complex;

2. Effective and sustainable development of seed production in the Kyrgyz Republic;

3. Development of livestock breeding, creation and development of a meat agro-cluster;

4. Development of intensive gardening, creation and development of a fruit-growing agro-cluster; and

5. Regional economic development, in particular in Batken oblast.

Other donors (primarily the ADB, the WB) will continue working with the sector during the period, covered by the Strategy, both supporting the rehabilitation of irrigation systems and implementing projects to enhance the resilience to natural hazards associated with high waters and floods. Donors (EU, IFAD, SDA, USAID, KOICA, JICA, and UN agencies, such as FAO, WFP) will also continue active implementation of technical assistance projects to develop organic agriculture, enhance the competitiveness, and unlock the potential of new markets and value chains.

The Kyrgyz Republic informed the EFSD about an initiative to apply for financing to implement a project in the amount of up to US $30 million, which is similar to the completed agricultural machinery leasing project, to continue financing the supply of agricultural machinery to agricultural producers in the Kyrgyz Republic. If the application is submitted, the project will be developed during the period of the Strategy implementation. Thus, the package of actions taken by donors will ensure comprehensive support to agriculture in accordance with the objectives of the National Strategy, ensuring its resilience to risks and product diversification.

Transport infrastructure

Continued large-scale reconstruction of the road infrastructure and development of the road network are seen by the Cabinet of Ministers of the Kyrgyz Republic as one of important preconditions for socio-economic development of the country. In the short term, it is planned to complete the Bishkek–Osh Road Rehabilitation Programme, co-financed by the EFSD, which will give a significant impetus to the socio-economic development of the country. In the medium term, the construction of the North–South road will be completed, and the road will become an alternative transport corridor connecting northern and southern regions of the country. It is planned to continue the implementation of projects on the rehabilitation of other important transport corridors, such as Taraz–Talas–Suusamyr, Osh–Batken–Isfana, and some others. The financing of projects related to road rehabilitation and construction of new roads will continue mainly at the expense of international donors and development partners, such as the WB, the ADB, the IDB, Exim Bank of China, etc.

The National Development Strategy of the Kyrgyz Republic for 2018–2040 emphasises the importance of developing the transport infrastructure and says that “the state will focus its efforts on the rehabilitation and preservation of roads, creation of liberal, safe international transport corridors, among other things using new technologies in the design and construction of roads”. It is also stressed that, in addition to developing its own transport network, the country will leverage the transport infrastructure in all the neighbouring countries to obtain positive economic effects, and in the medium term will adopt a decision on the construction of the China–Kyrgyzstan–Uzbekistan railway.

In addition, the Main Road Sector Development Guidelines for 2016–2025 (the Main Guidelines), approved on 1 July 2016, set out road sector development priorities and measures to improve its management framework and specify plans and measures to develop the road network in the medium term. The Main Guidelines also contain a plan for reforming the road sector, including proposals for changing the system of road monitoring and planning road repair and maintenance, and for using public-private partnership arrangements to determine the source of funding for such measures (the road fund, private investment, etc.). These measures are necessary to maintain international transport corridors and priority roads of state and local importance in a good technical condition, when the financing allocated from the state budget to repair and maintain the roads is insufficient.

However, the implemented and ongoing projects on road infrastructure development create significant additional needs for financing of the current road operation and repair. Since 2012, the trend of significant road work underfinancing has re-emerged. The lack of sufficient financing of such costs may lead to a lower standard service life of roads as a result of accelerated wear of the roadway, artificial structures, and engineering infrastructure. This negative trend poses risks to the sustainability of the results of large-scale investments in transport infrastructure supported by international financial institutions (IFIs) and, in general, does not serve the national sustainable development goals.

The National Development Strategy of the Kyrgyz Republic for 2018–2040 also stresses the need to develop the railway transport to expand its use for domestic freight and passenger traffic, as well as for the realisation of the significant transit potential – and this is the most promising area – along the routes China–Kyrgyzstan–Uzbekistan and China–Kyrgyzstan–Tajikistan–Afghanistan and further to Iran–Turkey and Pakistan–India.

In 2021, the implementation of the Bishkek–Osh Road Rehabilitation Project. Phase IV continued, with construction works to be completed in 2022. That will be followed by acceptance of the work performed, with all the measures to put the road into operation completed in Q3 2023. By 31 December 2020, the EFSD had disbursed US $17.2 million of the total approved investment credit of US $60 million to finance this project.

In 2021–2023, it is planned to continue consultations with the Ministry of Economy and Finance of the Kyrgyz Republic and the Ministry of Transport and Communications of the Kyrgyz Republic on financing programmes of technical assistance on institutional development to support the transport sector. In 2021, further consultations were held with the Ministry of Economy and Finance of the Kyrgyz Republic and the Ministry of Transport and Communications of the Kyrgyz Republic to advance the preparation of the investment project “Aral–Suusamyr Road Rehabilitation”. The Aral–Suusamyr road is a component, supplementing the ongoing North–South Transport Corridor Construction Project, which will link its middle part with the Bishkek–Osh road. Although the project is not mentioned in the Main Road Sector Development Guidelines for 2016–2025, amendments could be introduced to the document, given the high economic relevance and expedience of implementing the project.

In 2022, it is planned to launch consultations with the Ministry of Transport and Communications of the Kyrgyz Republic on financing a road maintenance and operation project using a Performance-Based Maintenance Contract. Therefore, it is also planned to hold consultations with the ADB on the results of the implementation of the ADB pilot project Bishkek–Kara-Balta, which was financed by the IFI

under a similar contract. In 2022, it is also planned to begin consultations with the Ministry of Transport and Communications of the Kyrgyz Republic on financing a road project using a public-private partnership arrangement (concessions for construction, capital grants in concession projects, projects related to toll collection from heavy commercial vehicles, etc.).

In 2023, it is planned to launch consultations with the Ministry of Transport and Communications of the Kyrgyz Republic on the prospects for cooperation in financing railway transport projects.

Energy sector

The Concept Document on the Fuel and Energy Complex Development in the Kyrgyz Republic for the period up to 2030 establishes the development of the energy sector as a priority strategic objective. The implementation of the Concept Document will contribute to improving the energy security of the Kyrgyz Republic, help increase the volume of electricity generated, reduce the likelihood of electricity shortage in winter, restore and increase the capacity of HPPs, and reduce their operation and repair costs. In addition, following the launch of the CASA-1000 Project (tentatively in 2023) and its connection to the Toktogul HPP (as well as the Kambaratinskaya HPP-1 (1,860 MW) and the Upper Naryn Cascade of HPPs (237 MW) in the future), the Kyrgyz Republic plans to expand the supply of surplus electricity generated in summer to Afghanistan and Pakistan via Tajikistan. In addition, the Concept Document defines the main measures: to increase the installed capacity of HPPs by 70% by 2030; to expand the generation of electricity by HPPs to 26.8 billion kWh in 2030; to ensure the reserve installed capacities of HPPs of 1.15 through phased commissioning of new generating capacities; to improve the fixed asset renewal ratio in the fuel and energy complex; to reduce the technological losses of electricity to 4–5% by 2030; to ensure efficient and optimal use of water and energy resources of the Naryn and Syr Darya river basins; to upgrade power transmission and distribution networks; to increase the share of renewable energy sources in total electricity generation from 1% to 5% by 2030; and to implement energy efficient technologies.

In support of the objectives outlined in the Concept Document, the EFSD will continue to actively implement the Toktogul HPP Rehabilitation Project, including the purchase and installation of hydroelectric units, and the commissioning of the second hydroelectric unit at Kambaratinskaya HPP-2, including its connection to Datka–Kemin transmission lines. At the same time, in the framework of supporting institutional reforms, there will be further consultations held on raising tariffs and ensuring efficient operation of the National Energy Holding. It is planned to launch negotiations with the authorities on an agreement to finance the construction of a surface spillway of the Kambaratinskaya HPP-2.

IFIs implement the following projects in the energy sector of the Kyrgyz Republic: the ADB – the Modernisation of the Uch-Kurgan HPP Project for a total amount of US $100 million; the Japan International Cooperation Agency (JICA) – the Construction of the Uchkun Substation Project for the amount of US $20 million; the Swiss Confederation – the Rehabilitation of the At-Bashinskaya HPP Project for the amount of US $19 million; and the WB – the Construction of Transmission Lines (CASA-100) Project for a total amount of US $125 million (together with the European Investment Bank (EIB)) and the Bishkek Heat Supply Improvement Project for a total amount of US $45 million.

It should be noted that the activities of the EFSD are systemic and complementary to those of other IFIs.

Housing finance

The main goal of the government programmes "Affordable Housing 2015–2020" and "My Home 2021–2026", reflected in the National Development Strategy of the Kyrgyz Republic for 2018–2040, is to provide affordable housing to citizens of the country through the development of a mortgage lending system and a contractual housing savings scheme (which would result in the accumulation of savings of the population), expanded housing construction, among other things using public-private partnership arrangements, and a focus on mobilising extra-budgetary sources of financing in the medium term.

The goals of government affordable housing programmes are aligned with the goals of the Housing Finance Project, aimed at providing citizens of the Kyrgyz Republic, employed in the field of education and health, with housing and improving access of the population in regions to quality education and health services, improving the overall living standard, and reducing the internal migration of the population in the Kyrgyz Republic. Since November 2019, the German Development Bank (KfW) has been engaged in the implementation of these programmes. The target audience of the programme is low- and middle-income families residing and engaged in activities in regions of the Kyrgyz Republic, with the exception of the cities of Bishkek and Osh.

Drinking water supply and wastewater disposal sector

Providing the population with water supply and wastewater disposal services is an important area of socio-economic policy, contributing to the achievement of the Sustainable Development Goals (SDG 6 "Clean Water and Sanitation"), implementation of the National Sustainable Development Strategy of the Kyrgyz Republic for 2018–2040, the Strategy for the Development of Drinking Water Supply and Wastewater Disposal Systems for Settlements of the Kyrgyz Republic until 2026, as well as the fulfilment of international obligations of the Kyrgyz Republic on adaptation to climate change in the sector of drinking water supply and wastewater disposal.

The implementation of the Project "Improvement of Water Supply and Sanitation in Rural Settlements of Osh Oblast of the Kyrgyz Republic" will contribute to the creation of a sustainable and reliable mechanism for drinking water supply and wastewater disposal in settlements of Kara-Sui and Uzgen districts of Osh oblast, building the capacity of institutional development of the population and municipal water supply enterprises of these districts.

The Cabinet of Ministers of the Kyrgyz Republic has performed extensive work to mobilise IFIs and donors to implement its water supply and wastewater disposal programmes and allocates significant amounts of own funds for that. Most of the country's local infrastructure facilities are financed from external sources at the expense of international donors – the WB, the ADB, the EBRD, and the EIB, as well as other sources. At present, the total amount of resources mobilised by the sector is US $277.1 million and EUR 180,475.

3.1.4. Objective 4. Promote the Development of Social Sectors

In 2022, the Fund will extensively assist the Ministry of Health and Social Protection of the Kyrgyz Republic in completing the second (final) phase "Organisation and Implementation of Preventive Examinations, Monitoring, and Evaluation" of the Caravan of Health (Kyrgyz Republic) Project. It is planned to complete procurement procedures under the project in the second half of 2022.

In 2022–2023, the EFSD project "Emergency Response to the Consequences of COVID-19" is expected to be implemented, with procurement under the project to be completed in the second half of 2022. The project will be a good addition to the Caravan of Health (Kyrgyz Republic) Project. The goal of the project is to purchase medical vehicles and ambulances (about 70 units in total) to equip public health institutions of the Kyrgyz Republic. It would help improve the infrastructure and upgrade emergency and intensive care units in hospitals, among other things for the treatment of patients with the coronavirus infection (the situation in this respect remains difficult in the country); improve the provision of qualified health services and the transportation of patients in well-equipped ambulances to hospitals; and strengthen the public health service and primary healthcare system to implement epidemic control measures and provide primary healthcare services. The implementation of the two projects would strengthen the medical potential of the healthcare systems of the Kyrgyz Republic, both in terms of expanding the overall capacity and in terms of combatting COVID-19.

Along with the projects already under implementation and preparation for implementation, it is planned to expand the grant portfolio to support social sectors of the economy and public administration in the Kyrgyz Republic. This will be done through contests for EFSD grants to finance social projects in the EFSD member countries, as well as by investigating potential joint projects with other international donors operating in the country (and/or their complementarity with EFSD projects) in the area under consideration. The WB is one of the largest donors, with the total amount of grant financing of about US $9.5 million within the framework of two projects, aimed at combating the coronavirus infection, to be implemented in 2020–2024. Under the WB project "Enhancing Resilience in Kyrgyzstan", 13 ambulances worth US $764,000 were purchased in 2020.

In 2020, the ADB allocated US $20 million to the Kyrgyz Republic, of which US $10 million is a grant, to implement a project aimed at mitigating the impact of COVID-19 on the country. In addition, the ADB is financing a project (with a grant component) as part of the fight against COVID-19 – a programme of active response and support to cover the country's expenses in the amount of US $50 million. Additional US $200,000 were provided in the form of technical assistance for the purchase of personal protective gear. In late 2021, it was planned to prepare and finance a project to support vaccination against COVID-19 in the amount of US $25 million.

In 2020, the EU also disbursed US $525,000 to the Kyrgyz Republic in the framework of the implementation of a project (until 2022) under the Central Asia COVID-19 Crisis Response Programme.

In 2020, the Turkish Cooperation and Coordination Agency (TIKA) allocated funds in the amount of US $92,000 to purchase a mobile mammography complex, US $44,000 to equip a temporary quarantine hospital, and US $24,000 to purchase personal protective gear to combat the COVID-19 infection.

Assistance is also provided to support the healthcare system of the Kyrgyz Republic through USAID programmes. Some of them have been implemented since 2017 and are to be completed in 2024. The total amount of funds disbursed and in the pipeline is about US $32 million.

Since 2018, UNICEF has implemented a project in the Kyrgyz Republic (scheduled for completion in 2022) aimed at strengthening the healthcare system. The total amount of financing will be about US $5.5 million.

Since 2020, the World Health Organisation has implemented a project in the Kyrgyz Republic (scheduled for completion in 2021) aimed at improving the quality of healthcare in the country. The amount of financing will be about US $3.5 million.

4. Coordination of Support with Development Partners

Taking into account that the resources of development partners and the EFSD are limited, while the structural and institutional reforms to be implemented are complex and the financing needs for basic and social infrastructure modernisation and development are great, such close coordination will enhance the effectiveness of support in certain areas of cooperation and achieve maximum synergies in helping the Kyrgyz Republic create the conditions for its sustainable, inclusive, and catch-up development.

In the Kyrgyz Republic, it is the Development Partners' Coordination Council that officially coordinates activities between development partners. There is a number of working groups, including those on macroeconomic and fiscal policies, transport, energy, financial institutions, and agriculture. The Fund plays an active role in the donor community and raises issues related to the financing of economic sectors, as well as moderates the dialogue on the formulation of government policies and implementation of joint initiatives.

The ADB Country Operations Business Plan for 2021–2023 includes seven main areas of support: transport infrastructure; energy sector; public administration sector; healthcare; education; agriculture and rural development; and water supply to urban areas. Three of the seven areas overlap with the EFSD priorities under financial credits. Moreover, coordination of support through investment projects is planned within the framework of transport infrastructure, agriculture, water supply, and energy sector development.

The World Bank Country Partnership Framework for the Kyrgyz Republic for 2019–2022 covers six main areas of reforms: closing infrastructure gaps; creating a more attractive business environment; improving public assets management; deepening the financial sector; developing the human capital; and supporting regional development. Three of those are priority areas for the EFSD within the framework of investment credits and grants: the regional CASA-1000 project, supported by the WB, will facilitate the development of the electric power infrastructure, transport connectivity of Central Asian countries and will offer export development opportunities for them; projects in agriculture, water supply, and irrigation will enhance productivity in regions of the country; and investments in healthcare will help address the challenges associated with the impact of the COVID-19 pandemic. In addition to investment projects, the EFSD coordinates activities with the WB in the framework of public finance management reforms and improvement of transparency, accountability, and financial sustainability of the energy sector.

Regular consultations between the EFSD Project Unit and the IMF team, together with IMF press releases following missions to the country, provide an opportunity to outline the key recommendations of the IMF on improving the quality of macroeconomic policy, reforming the tax legislation, and reducing quasi-fiscal risks.

During the period of the Strategy implementation, the EFSD will continue to work in coordination with the IMF, the WB, the ADB, and the EU to build a dialogue with government agencies on macroeconomic and institutional reforms. Box 8 presents the main priority areas of reforms, where the EFSD plans to coordinate its activities in the Kyrgyz Republic with the key development partners to provide budget support.

Box 8. Coordination of the EFSD Budget Support with Key Development Partners in the Kyrgyz Republic

The EFSD plays an active role in the donor community, raising issues for the agenda of the Coordination Group on Macroeconomic and Fiscal Policies related to the dialogue on the formulation of government policy and implementation of joint initiatives. During the period of the Strategy implementation, the EFSD will continue to reconcile macroeconomic and institutional reforms with the IMF, the EU, the WB, and the ADB.

In 2021–2023, the EU and the ADB are planning to provide support to the budget. The EU is engaged in the area of the digitalisation of the economy, in particular supporting the development of digital skills among young people, the digitalisation of public services and local governments, as well as the enhancement of cybersecurity. Until 2022, the budget support provided by the ADB will continue to be focused on improving the investment climate and the business environment through assistance in implementing an export development strategy, improving the Doing Business indicators, and developing public-private partnership arrangements. Starting in 2023, the ADB plans to focus on strengthening the capacity of government institutions in promoting digitalisation.

During the period of the Strategy implementation, the EFSD Project Unit will cooperate with the EU and the ADB on reforms in the field of digitalisation. Reforms in the road sector are also under development in cooperation with the ADB, in particular regarding the transition to the principles of a sustainable and performance-based mechanism for road infrastructure quality assurance. The EFSD Project Unit actively cooperates with both the ADB and the WB on reforms aimed at improving the transparency and accountability of energy sector enterprises. Both of these institutions have significant experience and expertise in this sector. In its capacity of a trust fund manager, the WB also has significant experience in supporting the public administration sector. The engagement of donors in the area of macroeconomic regulation reforms is traditionally coordinated by the IMF, which conducts regular macroeconomic surveillance of the country.

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