DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR THE KYRGYZ REPUBLIC

As approved by the Board of Directors at its Meeting on 1 September 2011

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EXECUTIVE SUMMARY

The Kyrgyz Republic is committed to the principles of Article 1 of the Agreement Establishing the Bank. The country is making good progress towards implementation of the principles of multi-party democracy and pluralism through introduction of a parliamentary system of government, election of a multi-party parliament and formation of a first-ever coalition government; however many challenges remain.

The political upheaval in 2010, which triggered a leadership transition but also a more fundamental change in the system of government, came at a significant human and social cost but has put Kyrgyz Republic more firmly on the path to democracy. A transparent constitutional referendum in June 2010, conducted under difficult circumstances, followed by generally free and fair parliamentary elections in October of the same year, are major milestones in democratic development. However, the new system is as yet untested, a presidential election is nearing and the root causes of the inter-ethnic violence in the south of the country – including poverty, unemployment and deeply rooted corruption – are yet to be addressed.

In the context of the global economic crisis, the domestic political shocks contributed to a short sharp contraction in GDP (seasonally adjusted GDP fell by more than 10 per cent during the second quarter in 2010 alone) which was ultimately contained. The economy started recovering in the second half of the year, driven by improved security and stability, higher gold prices, targeted fiscal stimulus and the timely and well-coordinated intervention of IFIs limiting the overall GDP decline in 2010 to 1.4 per cent. Inflation has accelerated since the middle of 2010, driven by increasing food and fuel prices, and exceeded 20 per cent in March 2011.

The socio-political crisis also affected the stability of the financial system, which experienced large non-resident deposit outflows from the largest banks, seven of which were placed under temporary administration although a general bank run was avoided. Serious governance issues were exposed, related to political intervention in the banking system, which further undermined confidence in the financial system. The loan quality in the banking sector worsened, non-performing loan ratios rose and credit to the private sector has not yet recovered.

As an “Early Transition Country” (ETC), Kyrgyz Republic shares many of the characteristics of the less advanced countries in the region, which include a high incidence of poverty, underdeveloped remote regions, limited debt capacity, a weak business environment and significant transition challenges across a wide range of economic sectors. Some reforms, albeit limited, in the business environment, utility tariffs and privatisation were starting to get under way before the political and socio-economic crises occurred, but since then they have slowed or gone into reverse. Deep rooted corruption is pervasive and a major obstacle to doing business.

Looking ahead, the main challenges are to solidify the economic recovery, maintain stability in the financial sector, address problems of public governance and restore business confidence. In the financial sector, the key challenges are to increase confidence in the system, strengthen and deepen the financial sector to finance the real economy, strengthen market discipline and provide a level playing field in the banking system so as to lower interest rates and increase access to finance, and to reduce excessive dollarisation and develop local currency capital markets to bring down systemic currency and counterparty risks.

A major cross-cutting transition challenge in the corporate sector is to improve the investment climate and restore investor confidence, which significantly deteriorated in the aftermath of the 2010 crisis. Fostering the private sector, especially small enterprises, will help to bolster economic diversification, expand external trade and generate employment, which is a key public policy challenge. Within the corporate sector, development of local agriculture and the full agribusiness value chain is particularly important for Kyrgyz Republic to address the problem of food security.

Basic infrastructure is in need of modernisation, but this is difficult to address before significant reforms are undertaken, especially in the power sector, and in light to the country's limited capacity for additional external borrowing. A key challenge is to re-establish access to basic public services, such as water supply, solid waste management and city transport. An additional challenge is to improve energy supply and energy efficiency.

Strategic directions

The new country strategy for Kyrgyz Republic is presented in a dramatically different political and economic setting. The political direction is positive, but there are major challenges ahead. The economic situation has stabilised, but there are critical weaknesses that need to be addressed. In response to these challenges, and to address the lessons of the crisis and its impact on the country, the Bank's activities in Kyrgyz Republic in the coming three-year strategy period will concentrate in the following areas:

- **Stabilising and developing the financial sector:** The Bank played a key role in stabilising the financial sector during the global economic crisis and will build on its strong presence and credibility in the market to promote further progress in stabilisation, intermediation and confidence building. It will do so by providing financial institutions with targeted loans, where possible in local currency so as to reduce dollarisation risk, possible equity investments, and through technical assistance and policy dialogue.
- **Supporting development of local private enterprises**: This is an area where the Bank can use ETC instruments and TC to great effect. Needs across a number of sectors are great, particularly rehabilitation needs of local and foreign enterprises in agribusiness, construction materials, consumer services, retail and tourism. The Bank will aim to target its support to projects in the corporate sector that will aim to increase productivity, production of higher value-added goods and products that can be competitive in foreign markets, raising business standards, and improving energy efficiency.
- **Strengthening critical infrastructure:** The Bank will seek opportunities for co-financing regional and municipal infrastructure, including water supply, solid waste management and urban transport. Where applicable, projects will put a particular emphasis on improving efficient use of energy. Due to debt sustainability concerns, any public infrastructure projects would be financed with co-financing grants or concessional loans from other IFIs or bilateral donors.

- **Policy Dialogue:** the Bank will conduct policy dialogue to address remaining issues in the investment climate, to further its efforts to strengthen the regulatory and legal basis for energy efficiency investment and to improve the macro-prudential environment for local currency finance. It will continue to support the Secretariat of the Council for Business Development and Investment through ongoing technical assistance.

Progress in implementing the Bank's strategy will depend on a building solid track record in implementing the reform agenda and preserving political and social stability. The Bank will work closely with other IFIs, as it did throughout the crisis period, to ensure coordination and effectiveness of its assistance to Kyrgyz businesses and institutions.

1. THE BANK'S EXPERIENCE AND PORTFOLIO

1.1. Overview over Bank activities to date

The Bank has been actively supporting the transition in Kyrgyz Republic since 1995. From 1995 to the end of May 2011, the Bank signed 75 projects accounting for a net cumulative business volume of €329 million at end May 2011. The last strategy period saw the highest increase in the net cumulative business volume (increase of €178m or 118 per cent) since the Bank started its operations in the Kyrgyz Republic.

During the 3 full years since the last strategy (2008-2010), the Kyrgyz portfolio increased by €112 million from €47 million at end 2007 to €159 million at end 2010. Operating assets increased by almost 20% to €44 million and comprise private sector operations in Financial Institutions (accounting for 48% of total operating assets), Industry, Commerce and Agriculture (41%), and Infrastructure accounting for 11%.

Over the past 3 years the Bank signed on average 9-10 projects per year with a total of 29 projects and €154 million in volume over the period with an average project size of €5.3 million. The Bank has continued to disburse commitments at approximately €15 million per year. Disbursement on two infrastructure sector projects signed in July 2009 – the Osh Isfana Road project and the Bishkek Water project – was delayed by the political turmoil in 2010.

The current private sector portfolio ratio (as a percentage of the total portfolio) is 84 per cent[1] which is well above the Bank's 60 per cent mandated ratio.

Table 1: Portfolio Development in the Kyrgyz Republic as at 31 May 2011

SECTOR	NET CUMULATIVE BUSINESS VOLUME				CURRENT PORTFOLIO STOCK				
Amount in EUR million	Number of projects	Total Project Costs	EBRD signed	*EBRD % of Total*	Number of projects	Portfolio	*% of Portfolio*	Operating Assets	*% of Op. Assets*
Energy	**6**	**430**	**146**	**44%**	**1**	**73**	**46%**	**-**	**-**
Natural Resources	3	387	103	31%	1	73	46%	-	-
Power and Energy	3	44	43	13%	-	-	-	-	-
Financial Institutions	**34**	**113**	**84**	**25%**	**18**	**29**	**18%**	**24**	**51%**
Bank Equity	4	17	6	2%	2	2	1%	2	4%
Bank Lending	5	35	43	13%	8	15	9%	10	21%
Small Business Finance	25	61	35	11%	8	12	8%	12	26%
Industry, Commerce & Agribusiness	**31**	**138**	**63**	**20%**	**11**	**19**	**12%**	**18**	**38%**
Agribusiness	9	30	16	5%	3	4	3%	4	9%
Equity Funds	4	2	2	1%	2	1.4	1%	0.3	0%
Manufacturing & Services	8	28	19	6%	3	11	6%	10	20%
Property & Tourism	9	38	20	6%	3	4	2%	4	9%
Telecom, Informatics, Media	1	39	7	2%	-	-	-	-	-
Infrastructure	**4**	**74**	**36**	**11%**	**4**	**36**	**24%**	**5**	**11%**
Municipal & Env, Infra	3	25	12	4%	3	12	9%	-	-
Transport	1	49	24	7%	1	24	15%	5	11%
TOTAL	**75**	**755**	**329**	**100%**	**34**	**158**	**100%**	**47**	**100%**

[1] Cumulative Business Volume: 5 year rolling basis

Table 2: Portfolio Development in the Kyrgyz Republic 2007 – 2010

Amount in EUR million	2007	2008	2009	2010*	Development over 2008-10 (3 years since last Strategy)
					(end 2007 vs end 2010)
Net Cumulative Business Volume	151	165	216	338	+ 124%
Cumulative Number of Operations	51	58	70	72	+ 41%
Current Portfolio Stock	47	44	86	159	+ 238%
Number of Operations	31	33	38	32	+ 3%
Operating Assets	37	37	40	44	+ 19%
% Undrawn	18%	12%	53%	73%	(effect of Centerra at €78m)
					(cumulative 2008-10)
Annual Business Volume	12	12	56	86	+ €154m
Number of Operations	10	9	12	8	+ 29 projects
Gross Disbursements	8	13	15	16	+ €44m
Annual Cancellations	4	7	0	2	+ €9m
Active Pipeline Stock	146	165	132	185	*at historically high levels*
Private Sector Share (% Portfolio)	88%	91%	65%	80%	
Non Sovereign (% Portfolio)	85%	91%	69%	87%	

NOTE: 2010 figures include two exceptional items: Centerra Natural Resource project at €78which affects all figures and €37m of TFPs (change in accounting: whilst in previous periods TFPs were accounted on annual basis, around €1m per year, in 2010 and beyond the amount is reported on a cumulative basis – this change only affects NCBV).*

1.2. Implementation of the previous country strategy

The previous strategy period coincided with two crises: the global economic and financial crisis of 2008-09 and the domestic socio-political crisis in 2010. Despite these major unforeseen events, the Bank was broadly successful in meeting its strategic priorities during the previous strategy period, including by broadening its support for private enterprises and resuming infrastructure lending for the first time since 1997. The significant increase in the Bank's activity during this difficult period was made possible by the Bank's swift response to the crises, as well as by close cooperation with donors and other IFIs, which culminated in co-financing two key infrastructure projects with investment grants.

The Bank's strategy approved in July 2007 set the following priorities:

- **Fostering the Private Sector:** Developing private businesses as the Bank's key operational objective. Direct financing targeted to agribusiness, textile, property and tourism, consumer services, as well as natural resources should there be opportunities with credible investors, thus contributing to diversifying the economy and expanding external trade.
- **Strengthening Financial Institutions:** Focusing on strengthening partner financial institutions in terms of capital, corporate governance and general competitiveness. Considering supporting the conversion of non-bank microfinance institutions (NBMFIs) into deposit-taking institutions.
- **Support for Critical Infrastructure:** Seeking non-sovereign infrastructure projects that could include financing for privatisations or concessions. Considering the level of the country's sovereign indebtedness, the Bank's ability to finance sovereign guaranteed projects will be limited, particularly if there is not access to a stable and predictable source of co-financing grants.
- **Policy Dialogue:** Supporting the Secretariat of the Investment Council, where business representatives can bring attention to key barriers to private sector development with the participation of both the President and the Prime Minister, to ensure follow-up of the Council's decisions and recommendations. Other key TC projects include ongoing training for judges and a legal reform programme to address obstacles to investment.

Fostering the Private Sector

The Bank's operations in support of local private enterprises took advantage of the ETC Initiative, which was instrumental in enabling the Bank to deliver a number of small projects with significant transition impact, particularly in the areas of corporate governance and business conduct. In all, the Bank supported eight local operations under the ETC Initiative. The impact of the global financial crisis and the domestic socio-political crisis impeded the Bank's ability to generate the volume of projects originally anticipated. In particular, a number of private sector projects under preparation when the crises hit – under DLF, DIF or MCFF – were cancelled or postponed as they became unbankable.

- Under the Direct Lending Facility (DLF), the Bank supported two property sector operations (a local hotel at the Issyk Kul Lake and a residential compound in Bishkek), a glass manufacturer, a construction materials producer, and a local food and beverages producer. As a result of the two crises, the Bank supported fewer DLF operations than expected: following the global financial crisis in 2008-9, the number of potential property projects decreased; following the socio-political turmoil in 2010, several DLF projects under preparation were cancelled and/or postponed. In the case of the EUR 10 million loan to the glass manufacturer in September 2009, the company faced a significant increase in project costs during implementation. Civil unrest in 2010 caused delays and cost overruns. A lesson learned is that delays and cost escalation could have been mitigated had the appointment of an Engineering and Project Implementation Agent been in place from the beginning.
- Under the Medium-sized Co-Financing Facility (MCFF), the Bank supported a leading food retailer with two MCFF loans. These were the Bank's first deals in the country's retail sector and the first sub-project with a new MCFF partner bank (Demir Kyrgyz International Bank). This was a modest achievement, with fewer deals under MCFF than expected coming to fruition. Following the 2010 crisis, it was particularly difficult to identify larger size investment projects that could be well supported by MCFF.
- Under the Direct Investment Facility (DIF), the Bank took a 34 per cent equity stake in a local dairy producer and provided technical assistance under the TAM programme to help it expand its processing plant. This operation complimented an initiative by the Swiss Government to revive the local economy in remote regions. DIF has proven to be a difficult instrument to deploy widely, as potential clients in the country are not yet ready to discuss the market value of their companies in accordance with international standards. Implementation of DIF operations in Kyrgyz Republic have also been quite labour intensive. A lesson learned from the case of the dairy producer, which was inexperienced in handling legal and strategic issues, is that the Bank can help fill such gaps and facilitate project implementation in DIF projects by appointing an experienced sector specialist as an EBRD Board nominee.
- Under the TAM/BAS program, the Bank facilitated the skill transfers to the local consultancy industry and improved the know-how and management of the MSME sector through the provision of management and advisory services to over 500 small local enterprises under the TAM/BAS grant-funded programme. This included a successful crisis response initiative in the South in 2010. Despite the

- The Bank supported a landmark large scale operation with a foreign strategic investor in 2010: a US$ 150 million three-year revolving credit facility with Centerra Gold Inc. in support of the company's ongoing operations and potential acquisitions of mining assets, signed in 2010. The company, 33 per cent owned by the Kyrgyz state, owns the Kumtor gold mine, which generates 30 per cent of country's foreign currency reserves and 10 per cent of its GDP. One of the major achievements of the project was to improve the reporting of taxes paid by the mining industry under the "Extractive Industries Transparency Initiative (EITI)" and on March 2011, the Kyrgyz Republic became "EITI Compliant". The EBRD supported this process through the active policy dialogue with the authorities and Centerra, the largest mining company in the country.

Strengthening Financial Institutions

The Bank provided crucial support to financial institutions during the previous strategy period at a time when the country was feeling the impact of the global financial crisis in 2008-09 and the domestic socio-political crisis in 2010. The global financial crisis affecting Russia and Kazakhstan had a knock-on effect on the Kyrgyz Republic, in terms of lower demand for Kyrgyz exports and a fall in inflows of remittances to fund private consumption. As the Kyrgyz banking system was dominated by banks with foreign capital, particularly from Kazakhstan, all banks and non-bank micro financial institutions reduced or stopped lending by the end of 2008. The Bank's crisis response included:

- In 2009, provision of local currency financing to banks. The Bank provided three local banks and three non-bank micro financial institutions (NBMFIs) with local currency credit lines totalling the equivalent of EUR 22.7 million at a time of scarce alternative commercial funding.
- In 2010, the Bank disbursed US$ 6.5 million equivalent (mainly in local currency) under four existing committed credit facilities in support of local enterprises. The Bank's continued support to the financial sector after the events of April and June 2010 was seen as a strong signal to the Bank's clients as well as other lenders to the sector.
- In the context of ongoing work to address local currency lending broadly across the region under the Bank's Local Currency and Local Capital Market Initiative, the Bank developed a proposal for local currency financing mechanisms, which was approved in February 2011. The Bank aimed to ensure more competitively priced and less volatile local currency operations and to decrease systemic dollarisation risk in the financial sector by introducing a risk-sharing scheme supported by donor funds.
- In response to the crisis in 2010, the Bank supported the National Bank with technical assistance, including through supporting its efforts to restructure Asia Universal Bank (AUB), the largest bank in terms of assets prior to the events in

During the past strategy period, the Bank continued moving its partners forward in area of corporate governance, through strengthening external and internal audit, improving shareholder transparency, and implementing better internal policies and procedures. The Bank also conducted training courses for its partner banks in the area of anti-money laundering (AML), which will continue to support better AML standards both at Government and bank levels, and may help to reduce crime and corruption. AML is important in helping local banks and NBMFIs with their transition to more transparent and commercially oriented operations.

Support for Critical Infrastructure

During the previous strategy period, the Bank financed two key infrastructure projects, the first projects to be financed by the Bank in this sector since 1997. However, intentions to finance infrastructure projects on the basis of PPPs turned out to be overly ambitious, given the very weak legal and regulatory framework and the early stage of transition.

- The Bank provided a US$ 35 million sovereign loan to finance the renovation of the highway linking the towns of Osh, Batken and Isfana. This road plays a crucial role as an international transit route in the region by linking Uzbekistan, Tajikistan and China. Through its financing and policy dialogue the Bank sought the following transition objectives: (i) introduction of tendering procedures for periodic road maintenance, (ii) refining road user charges and reform of the Road Fund, (iii) formulating the privatisation plan for maintenance units, and (iv) introducing service level agreements for routing maintenance.
- In the municipal infrastructure sector, the Swiss Government and the EBRD provided EUR 11.8 million to improve the water supply in Bishkek. The project is financed by a grant of EUR 5.7 million from the Swiss Government and a EUR 5.5 million sovereign loan from the EBRD. Projects in the water sector enabled the Bank to make progress with water tariff reforms, meeting IFRS accounting starndards, and promoting efficiency in the Bishkek water company.
- Despite the difficult domestic situation following the events in April and June 2010, the Bank continued the implementation of the municipal water project and the preparation of projects in urban transport and solid waste in Bishkek. In May 2011, the Bank signed new water/wastewater projects for Osh and Jalalabad.

Policy Dialogue

In line with the 2007 strategic priorities for policy dialogue described above, the Bank has been working to enhance its dialogue with the government to improve the investment climate and address bottlenecks affecting local and regional investors, co-ordinating with other international financial institutions, donors and the business community. With generous support from donors, the Bank has provided critical assistance to the secretariat for the Investment Council since its establishment in early 2007 and implemented legal TC for the training of judges.

- The Investment Council has been providing local and international business representatives (representing the mining, industry, agro-processing and tourism sectors) with a forum to discuss the main barriers to doing business with top officials of the government. Following the political events and subsequent changes in 2010, the new government acknowledged its commitment to improve the investment climate in the country and renamed the council as the Council for Business Development and Investment. The donor community expressed its readiness to continue its full support to the Council under the new government.
- The Bank actively participated in the IFIs Joint Economic Assessment (JEA), which set out a strategic framework for reconciliation, recovery and reconstruction after the April and June events of 2010. The JEA identified the need for external support in three major areas, including essential public expenditures, social needs, and critical investments. The JEA helped the government to achieve economic recovery more quickly than expected after months of political turmoil.
- The Bank continued to actively engage in policy dialogue with the government and local authorities to promote the further reform agenda in corporate and infrastructure sectors, although reform efforts were temporarily suspended due to the internal political crisis.
- The Bank strengthened its collaboration with the Kyrgyz Supreme Court with a view to increasing capacity in the judiciary dealing with commercial disputes. Since 2007, the Bank provided technical advice to the Judicial Training Centre, trained judicial trainers, delivered commercial law training seminars for up to 240 existing judges, created a law library at the Supreme Court, organised internships in the courts of Kazakhstan and Russia, and published a benchbook on commercial law. The Bank expanded its assistance in 2010 to help establish a training system for candidate judges, and implement a fair and transparent judicial selection process.

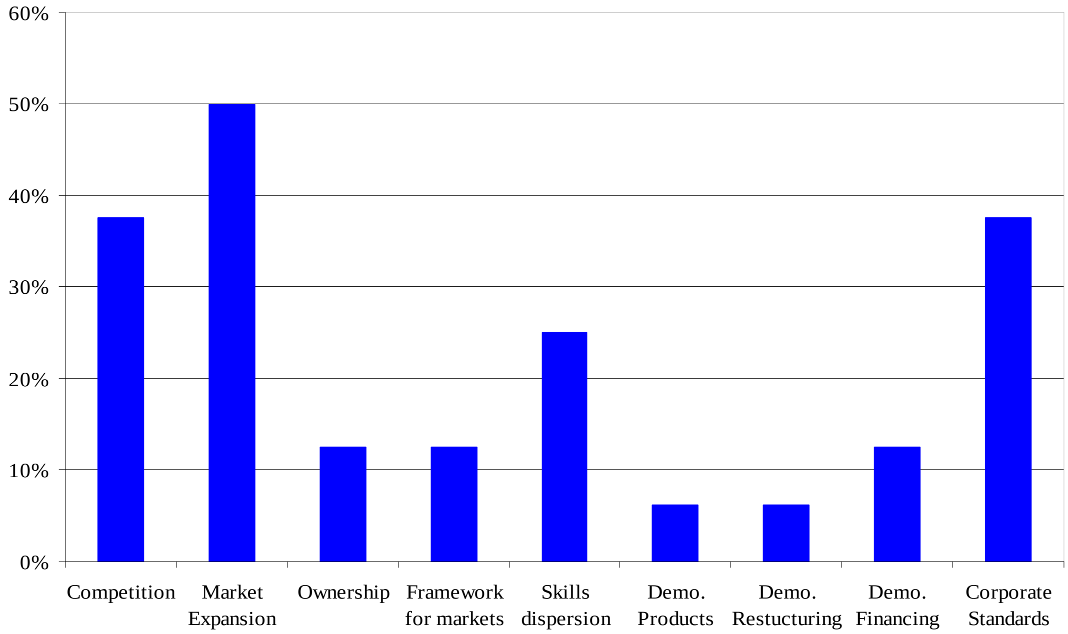
1.3. Transition impact of the Bank's portfolio

Since the previous strategy was adopted in June 2007, 100 percent of the Bank’s new projects in the Kyrgyz Republic have been ex-ante rated “Excellent” (25 percent) or “Good” (75 per cent). This is above the institution-wide target of 80 per cent of projects to be rated “Good” or “Excellent.” There were no projects rated “Satisfactory”. The projects signed during the crisis have had important additionality in terms of their transition impact potential, which improved during the crisis. In 2009, five new projects were signed, two of which had an ex-ante rating of “Excellent” while the other three had an ex-ante rating of “Good”.

At present there are 9 active projects operating in the country with strong transition impact potential. Around 20 per cent of these projects have transition impact rated as “Excellent”, while around 80 per cent are rated “Good”. However, due to the adverse impact of the socio-political crisis, the risk to the transition impact potential is rated as “High”, “High/Excessive” or “Excessive” for a large share of the operations. During the last strategy period there were 7 downgrades in the Bank’s project ratings: 3 downgrades in the transition impact potential and 4 increases in the risk to transition impact potential. The major factors that affect the high risk environment in the country relate to macroeconomic and political instability, political uncertainties and the commitment and capacity of the authorities to implement the reform agenda.

As Figure 1 indicates, key transition objectives across projects have been the building up of markets, improving corporate governance standards, increasing competition and skills dispersion. Around 12 per cent of projects aimed at ownership restructuring, improving frameworks for markets and demonstration of new financing methods.

Figure 1: Percentage of projects pursuing given transition objectives, 2005 - Present



2. OPERATIONAL ENVIRONMENT

2.1. Political Context

Kyrgyz Republic went through a period of political upheaval during the previous strategy period, but has emerged with a more democratically-oriented political system and a reform-minded government that seeks to adhere to the rule of law.

Large-scale demonstrations in April 2010, spurred by public anger over corruption, rising energy prices and the closure of several media outlets, forced President Kurmanbek Bakiev from power and from the country. Parliament was dissolved and an interim government stepped into the power vacuum. The new provisional authorities quickly declared their strong commitment to democracy and embarked on the task of changing the system of government from a presidential to a parliamentary model. The process of democratising the constitutional order included for the first time such elements as putting the draft constitution to a popular vote at a nationwide referendum and conducting free and fair elections.

The new Constitution was adopted in June 2010 and parliamentary elections were held in October. The election resulted in the formation of a first-ever three-party coalition government in December 2010. Almazbek Atambaev, the leader of the Social Democratic Party of Kyrgyzstan, was elected Prime Minister with the two other coalition partners getting the posts of the First Deputy PM and Speaker of Parliament. The three-party formation remains fragile as reflected in the April 2011 “temporary resignation” of the First Deputy PM, who stepped down to allow an independent parliamentary investigation into allegations of corruption.

In the coming strategy period the country will continue to face multiple challenges that are likely to affect the operating environment. The parliamentary model of government is untested and fragile; the upcoming presidential election will heighten political tensions in the second half of the year; and the root causes of the massive inter-ethnic violence in the south of the country in June 2010 – including poverty, unemployment and deeply rooted corruption – are yet to be addressed.

See Annex 1 for a more detailed political assessment of issues related to Article 1.

2.2. Macroeconomic context

The political turmoil in April 2010 and subsequent inter-ethnic violence in June 2010 in the south of the country caused GDP to contract by more than 10 per cent during Q2 2010 (adjusting for seasonal factors). Agriculture, construction, trade and other services were particularly adversely affected. The economy started recovering in the second half of the year, driven by improved security and stability, higher gold prices and fiscal stimulus, limiting the overall GDP decline in 2010 to 1.4 per cent. Inflation has accelerated since Q3 2010, driven by increasing food and fuel prices, and exceeded 20 per cent in March 2011. The exchange rate came under pressure at the time of the April/June 2010 events and depreciated by around 7 per cent over the year against the U.S. dollar.

The financial system was seriously affected as well by the socio-political crisis, which coincided with large non-resident deposit outflows at AUB. This bank accounted for about 50 percent of all deposits. AUB was placed under temporary administration together with six other banks, two of which were subsequently cleared. While a general bank run was avoided, loan quality in the banking sector worsened. In October 2010, the restructuring of AUB was completed and a new bank, “Zalkar,” was created in January 2011 out of the “good” assets of AUB.

On the fiscal front, the government has prioritised social and reconstruction needs, and international donors agreed to provide US$ 1.1 billion over 30 months to help meet financing needs. However, due to the slow implementation of reconstruction programmes, the fiscal deficit remained limited to around 6 per cent of GDP in 2010 (against a projected deficit of 12 per cent). The deficit is expected to increase to nearly 8 percent in 2011, in part because of large increases in public sector wages that are considered necessary for maintaining social stability. The new IMF programme approved in June, supported by a USD 100 million highly concessional loan, will help to close the fiscal and external financing gaps. This will likely pave the way for additional funding from other donors, provided that the government is committed to taking the necessary measures to maintain macroeconomic and public debt sustainability.

GDP growth is expected to pick up to 6.3 per cent in 2011, which in part reflects a one-off base effect associated with the economic recovery from the slump in 2010. On the external side, growth will be driven by stronger international demand, higher commodity prices, and increased gold production. On the domestic side, domestic demand will be higher due to increasing reconstruction and social expenditure by the government and growing inflows of remittances. These projections assume that internal security will be restored and political stability maintained. Annual average inflation is expected to remain high at around 20 per cent, but this is mostly due to higher international fuel and wheat prices the impact of which should wear off over time.

There are some risks to the medium-term growth outlook resulting from the creation of the Customs Union (CU) between Kazakhstan, Russia and Belarus in July 2010. These countries accounted for around 50 per cent of Kyrgyz exports in 2009 (if gold is excluded). Under the CU, Kazakhstan now has a more restrictive regime for its imports through non-standard channels, which are an important source of income for the Kyrgyz Republic. The CU also introduces higher tariff-preference margins for imports from CIS countries relative to non-CIS countries for imports through standard channels. In the near term, there is likely to be an adverse impact from the change in regime for imports through non-standard channels, especially given that Kyrgyz receipts from re-exports of Chinese and other goods through non-standard channels to Kazakhstan are a multiple of those through standard channels. While the total impact is very difficult to measure, the World Bank preliminary estimates that the losses associated with the reduction of such re-export business may amount to as much as 6 percent of GDP.

The CU is unlikely to lead to a fall in Kyrgyz exports to the CU countries, because CU import tariffs were increased for non-CIS countries. On the contrary, higher preferential margins in Kazakhstan create opportunities for CIS exporters in the medium term. However, whether this potential will be tapped depends, among other things, on the application the way rules of origin are applied to goods imported by the CU as well as on the application of sanitary and phyto-sanitary requirements and technical standards on products imported from abroad including other CIS economies. This also depends on the ability of firms to respond to new competitive conditions and on the ability of the Government to provide right incentives to those firms. The Kyrgyz authorities are meanwhile considering applying for CU membership. A thorough assessment of opportunities and the costs of joining CU would need to be conducted before any firm decision is made. As a member of the World Trade Organisation, joining the CU will require formal assurance that certain commitments made by the Kyrgyz government to the WTO will continue to be upheld.

From the point of view of EBRD operations these macroeconomic developments imply that (1) there is a need to support local private enterprises, particularly concerning rehabilitation and increasing export potential, although it will be more difficult to find profitable projects in sectors that use imported fuel and food products as inputs but have limited scope to raise their prices (such as energy intensive industry and restaurants); (2) there is a need to increase confidence and help stabilise the financial sector; (3) to ensure debt sustainability, all lending to the public sector should be concessional; while imported inflation remains high.

See table in Annex 7 for recent macroeconomic data.

2.3. Structural reform context

Progress with structural reforms has been mixed in the past few years, and several reforms were partially reversed. See Figure 2 below for an indication of reform progress to date.

Infrastructure reforms that had started under the previous regime were partially reversed after the political unrest in April 2010. In particular, the previous regime substantially increased utility tariffs in January 2010 with a view to stepping up the vital investments necessary to secure the supply of energy and to decrease technical and commercial losses. This included higher tariffs for electricity, hot water and district heating for both households and enterprises. These reforms were considered important, given the country had the lowest energy tariffs among CIS countries and that they brought tariffs closer to cost recovery levels. However, the tariff increases contributed to increased social tension amongst the population, and the interim government reversed the tariffs hikes after April 7. Tariffs were brought down to pre-crisis levels for households and were substantially lowered for the enterprise sector. The new government recognises the importance of increasing tariffs, and stated that such increases should be made gradually with full consultation and communication with the society.

Progress on the privatisation front has been mixed as well. On the positive side, the previous regime realised the long-awaited privatisation of two regional electricity distribution companies – Severelectro and Vostokelectro – in December 2009 and privatised KyrgyzTelecom (KT), the country's de facto monopolist over fixed line services, in February 2010. Subsequently, however, the interim government that came to power in April 2010 reversed these privatisations, blaming the ousted regime for a lack of transparency and irregularities during the privatisation process. The new Government is now planning to re-privatise KyrgyzTelecom by the end of this year, and the state budget envisages USD 100 mln in privatisation revenues in 2011. These plans have been heavily criticised by Parliament as being too optimistic in terms of timing and not sufficiently transparent regarding the tender process.

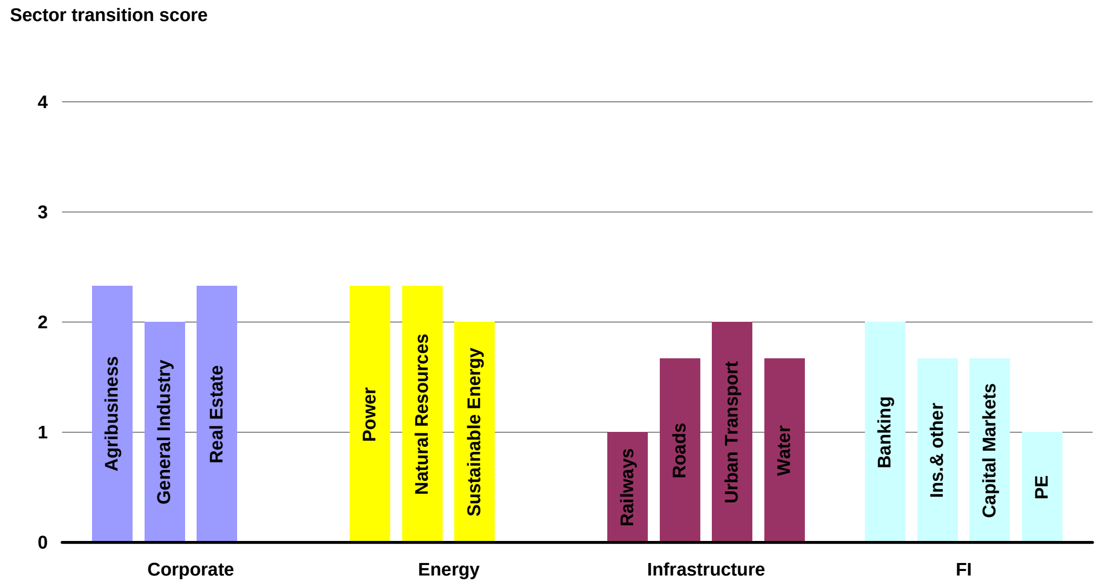
There has been no major progress with agricultural reform in recent years. Agriculture constitutes a large part of the country's economy with a share of 22 per cent in GDP and over 32 per cent in employment in 2009, although these shares are steadily decreasing. Agricultural output mainly consists of crops and livestock, which accounted for about 56 and 42 per cent, respectively. Most agricultural activity takes place in the south. The country has historically specialised in animal husbandry, and is believed to have a comparative advantage in this sector. This makes pastures an important economic asset for rural livelihoods. Some pastures are being intensively used and ill-managed, leading to negative consequences such as economic losses and ecological imbalances. There has been a need for reform in pasture use and management. The Law on Pastures adopted in January 2009 initiated a transfer of pasture management responsibility from local governments to unions of users of the grazing land with the purpose to involve citizens into active pasture management and to improve the quality of pasture land in the country. In July 2011 a number of changes were adopted to that Law including making the Kyrgyz Republic an exclusive owner of the pasture land. The Government, however, is more concerned with crops production, emphasising the importance of improving food security in view of the latest world food price increases.

There have been important steps forward to strengthen governance in the mining sector, which is based on substantial deposits of goal, coal, and uranium. Gold is the country's main export which is estimated to account for in excess of 40 per cent of total exports. The country formally launched the Extractive Industries Transparency Initiative (EITI) in June 2004 and has gradually strengthening governance by improving transparency and accountability, which culminated in the acceptance of the Kyrgyz Republic by the EITI Board as EITI Compliant on 1 March 2011.

The new government action plan for 2011 under the title "Economy and Security" envisages several measures to improve the efficiency of the public administration and state-owned enterprises as well as budget policy and debt management. The plan also considers measures to improve the business environment and stimulate investments. Moreover, it includes plans to examine tariff policy in the energy sector, and improve energy saving and efficiency.

See Annex 2 for a more detailed account of recent reforms and remaining transition challenges.

Figure 2: EBRD transition indictors for Kyrgyz Republic



2.4. Business environment

The last round of the Business Environment and Enterprise Performance Survey (BEEPS) conducted in 2008-09 concluded that the top obstacles to doing business in the country as perceived by enterprises were access to finance, the quality of electricity supply, and competition from the informal sector. Around 10 per cent of all enterprises and almost one quarter of medium-sized enterprises considered corruption to be the most significant impediment. In addition, the low level of business sophistication (management best practice, standards and innovation) is constraining business growth and export potential, particularly in strategic sectors such as agribusiness.

In 2008 and 2009, some progress was achieved in improving the business environment. Starting up a business was made easier in 2008 by the establishment of a one-stop shop, which significantly streamlined and simplified business registration processes. Further progress in this area was made in 2009 by eliminating the minimum capital requirement, reducing the registration time, an abolishing various post-registration fees. In addition, six previously required customs documents were eliminated and inspection procedures simplified in 2009.

In 2010, investor confidence deteriorated significantly, as the socio-economic crisis revealed the problems of deep rooted corruption and nepotism and undermined the credibility of the previous public administration and regulatory bodies. In Transparency International's 2010 Corruption Perception Index, the country scored 2 out of 10, where 10 is least corrupt. The World Economic Forum's Global Competitiveness Report 2010/2011 also placed the Kyrgyz Republic near the bottom (121 out of 139 rankings), primarily attributed to poor infrastructure, low innovation and lack of technological readiness. On the positive side, the country's ranking in the World Bank Group's "Doing Business" 2011 survey improved from 47th in 2010 to 44th out of 183 countries, but this largely reflected an improvement in the rating for "paying taxes" that was related to the introduction of tax privileges for businesses in the south affected by the June 2010 riots. The rating for "trading across borders" slightly deteriorated, reflecting the border closures after the above-mentioned events.

In order to ensure that the EBRD can still do business in this difficult environment, the authorities should continue their efforts to improve the business climate and restore investor confidence, particularly through fighting corruption, strengthening governance and protecting private property rights.

2.5. Social context

Strong economic growth experienced by the country during the 2003-08 period resulted in a substantial improvement in the living standards of the population and to a sharp fall in poverty. During this period, overall poverty fell from 64 to 32 per cent, and extreme poverty from 28 to 6 per cent. Strong growth in remittances and a rise in the real value of pensions also played a significant role. While poverty statistics for 2009 and beyond are not yet available, the pace of poverty reduction is likely to have slowed in 2009, when growth decelerated in light of the global economic and financial crisis.

The socio-political crisis in 2010 is also likely to have worsened poverty indicators, as the border closures and violent riots in the South resulted in considerable humanitarian and socio-economic damage. Unemployment rose and incomes fell as the country experienced significant disruptions to economic activity (particularly to construction, agriculture, trade and other services) as well as major physical damage to businesses, which in many cases resulted in business closures and a loss of jobs. The increase in utility tariffs in January 2010, while being a positive reform measure for the utility sector, had a negative impact on the poor, who had been suffering from the low quality of public utility services for several years, as it was not accompanied by targeted social assistance. It therefore contributed to social unrest that caused the new regime to reverse the tariff hikes after it came to power in April 2010. This has negatively affected the appetite for energy tariff reforms, implying that EBRD activities in this area will mostly focus on policy dialogue.

Poverty has negatively affected education outcomes in the Kyrgyz Republic. While the country used to have high literacy rates as a heritage of the Soviet era, the quality of education has steadily deteriorated, school enrolment rates have decreased, and rates of non-attendance and student-dropout have escalated. The country ranked last in the 2009 survey of the Program for International Student Assessment (PISA), which aims to predict and gradually improve nations' "economic and social well-being" through regular, comparative evaluations of teenagers' proficiency in reading, math and science. The country performed poorly in all three subjects, with a large performance gap between urban students and those in rural schools. Improvements in social conditions can only be expected with socio-political stability, effective social policies, and sustained economic growth. Sustained economic growth, in turn, will be difficult without improvements in human capital.

2.6. Legal context

The Bank's recent assessments of commercial and financial laws in the region show that the Kyrgyz Republic has made considerable efforts to upgrade its legislation over the last decade. In many legal areas (including pledge law, insolvency and corporate governance), the EBRD assessments reveal that the laws on the books have reached at least medium compliance with international standards of best practice, which by regional standards is a significant achievement. However, as is often the case in early transition countries, implementation of laws remains highly problematic and investor confidence in the judiciary to enforce laws on the books remains weak. To address this issue, the EBRD has spent considerable efforts during the last strategy period to assist the Kyrgyz authorities in their effort to increase judicial capacity in the commercial sector. Having recently completed a comprehensive training programme for sitting judges, the Bank has now turned its attention to the creation of a credible training programme for candidate judges, building on an improved and more transparent judicial selection process.

During recent years, the Kyrgyz government has launched initiatives to reform areas of regulation relating to infrastructure (e.g. telecommunications) or natural resources (e.g. the Extractive Industries Transparency Initiative (EITI)), however these reforms need to be pursued until completion and implemented in practice.

See Annex 3 for a more detailed assessment of the legal environment.

2.7. Energy efficiency and climate change

According to a recent market demand study assessing the market potential for energy efficiency and renewable energy investments in Kyrgyz Republic, experience in assessing and financing renewable energy projects is still limited. Although the existing legal framework satisfies the basic requirements of private investors, enforcement is still a challenge and some rules need to be more clearly and transparently defined. No specific investment and/or financing related to energy efficiency initiatives are currently in place in Kyrgyz commercial and residential sector, where energy consumption per square meter is still very high. In the industrial sector, equipment and machinery is characterised by obsolete and outdated technology, with energy losses in such equipment typically around 30-40 per cent. The assessment of potential energy savings for the whole economy is 1,800 ktoe, which would take 15 years to achieve.

Sectors such as water resources, hydropower and agriculture have been identified as vulnerable to the impacts of climate change. The power sector has also been identified as vulnerable to hydrology and reservoir management variability, with existing and future problem being energy supply during the winter season.

3. STRATEGIC ORIENTATIONS

3.1. Transition challenges

The Kyrgyz Republic is an early transition country (ETC) with significant reform and investment needs in the corporate sector, the financial sector, and infrastructure. The twin crises that hit the country during the past strategy period have revealed serious vulnerabilities in the financial sector and caused some reform reversals, which together make the transition challenges even more acute in the coming three-year strategy period.

Stabilising and developing the financial sector

The financial sector is small and undeveloped. Confidence and stability, which had always been weak, were further negatively affected by the 2008-09 global and 2010 domestic crises. In the years ahead, the main challenges are to increase confidence in the system, strengthen and deepen the sector so as to better intermediate between savings and investment, strengthen market discipline and provide a level playing field in the banking system so as improve financial services and increase access to finance, and reduce dollarisation and develop local currency capital markets so as to bring down systemic currency and counterparty risks in the financial sector.

Supporting the local private sector

A major cross-cutting challenge in the corporate sector is to improve the investment climate and restore investor confidence, which significantly deteriorated in the aftermath of the 2010 crisis. The crisis has also revealed the problems of deep-rooted corruption and nepotism and undermined the credibility of the public administration and regulatory bodies. Fostering the private sector, especially small enterprises, will help to bolster economic diversification, expand external trade and generate employment, which is a key public policy challenge.

Strengthening critical infrastructure

Basic infrastructure is in need of massive modernisation, but this is difficult to address before significant reforms are undertaken, especially in the power sector, and in light to the country’s limited capacity for additional external borrowing. A key challenge is to re-establish access to basic public services, such as water supply, solid waste management and city transport. An additional challenge is to improve energy supply and energy efficiency.

3.2. Bank's priorities for the strategy period

The overarching strategic directions of the Bank for the next strategy period are to assist the Kyrgyz Republic in addressing the impact of the two crises it suffered in 2010, especially to stabilise and diversify the financial sector, support local SMEs and other businesses in areas where the country has a clear comparative advantage and restore business confidence. These objectives correspond to the assessment of the remaining transition challenges, and are fully in line with the Government's reform programme. At this stage in Kyrgyz Republic's transition, where challenges remain significant across all sectors and the needs are still great, the Bank can have an impact in a number of areas, provided reforms continue and the political and social situation remains stable. As an ETC country, Kyrgyz Republic shares some of the main characteristics of the less advanced countries in the region, which include a high incidence of poverty, underdeveloped remote regions, limited debt capacity, a weak business environment and a client base that has had limited experience in working with IFIs or foreign investors.

The priorities reflect the lessons learned from the global financial crisis and the domestic socio-political crisis and their impact on Kyrgyz Republic. Although the scale of transition gaps and the main vulnerabilities (on the social side, in particular) remain as before, the strategy puts a greater emphasis on financial sector stabilisation given the reversals witnessed in this sector during the past strategy period and the importance of the financial sector to growing the real economy and addressing the job creation and other socioeconomic needs of the country at this stage of its development. The Bank's success in structuring projects that address the country's needs through extensive use of ETC instruments suggests a continuation and deepening of this aspect of the main strategic directions. The strategic priorities include:

- **Stabilising and developing the financial sector:** The Bank played a key role in stabilising the financial sector during the global economic crisis and will build on its strong presence and credibility in the market to promote further progress in stabilisation, intermediation and confidence building. It will do so by providing financial institutions with targeted loans, where possible in local currency so as to reduce dollarisation risk, possible equity investments, and through technical assistance and policy dialogue. It will focus in particular on MFIs, which account for around 30 per cent of all credit and are the main and often the only financial services provider in remote rural regions.
- **Supporting local private enterprises**: This remains the top priority for the Bank and the area where it can have the greatest impact using ETC instruments and TC. Needs across a number of sectors are great, particularly rehabilitation needs of local and foreign enterprises in tourism, construction materials, agribusiness, consumer services and retail. The Bank will aim to target its support to projects in the corporate sector that will aim to increase productivity, production of higher value-added goods and products that can be competitive in foreign markets, raising business standards, and improving energy efficiency.
- **Strengthening critical infrastructure:** The Bank will seek opportunities for co-financing municipal infrastructure, including water supply, solid waste management and urban transport, with particular focus in the south of the country. Where applicable, projects will put a particular emphasis on improving efficient use of energy. Due to debt sustainability concerns, any public infrastructure projects would be financed with co-financing grants or concessional loans from other IFIs or bilateral donors.

- **Policy Dialogue:** the Bank will conduct intensive policy dialogue to improve the investment climate and to further its efforts to strengthen the regulatory and legal basis for energy efficiency investment and to improve the macro-prudential environment for local currency finance. It will continue to support the Secretariat of the Council for Business Development and Investment through ongoing technical assistance. Efforts to strengthen judicial capacity to enforce commercial legislation will continue.

3.3. Sectoral Challenges and Bank Operational Response

3.3.1. Financial Institutions

Sectoral challenges

- **Increasing confidence in the financial system.** Confidence in the financial system has been weak since independence, given the history of financial crises and banking failures. The 2008-09 global and 2010 domestic crises further negatively affected confidence and stability.
- **Strengthening and deepening the financial sector**. The Kyrgyz economy remains largely cash based with a relatively low level of banking sector intermediation. The banking system remains small with an assets-to-GDP ratio of only 35 per cent.
- **Strengthening market discipline and level the playing field in the banking system.** Despite the fact that_there are 22 commercial banks, 10 of which are majority foreign-owned and account for three quarters of the banking system's assets, there is insufficient genuine competition amongst banks due to the heavy involvement of the state. More competition is expected to lead to better financial services and lower interest rates.
- **Reducing dollarisation and developing local currency capital markets.** Dollarisation remains very high, with foreign currency shares in deposits and loans amounting to 56 and 62 per cent, respectively. This reduces the effectiveness of monetary policy and increases indirect credit risk, particularly when unhedged borrowers are forced to borrow in foreign currency.

Bank's operational response

To increase confidence in the financial system, the Bank will provide the banking sector with targeted long-term equity and debt funding, together with technical assistance to help support activities that will help to limit the sector's future instability. It will also support the improvement of legal frameworks and the deposit insurance scheme and encourage the participation of foreign financial institutions in the Kyrgyz market.

To strengthen and deepen the financial sector, the Bank will support eligible local financial institutions through credit lines and, where needed, participation in capital increases. Where appropriate, the Bank will support consolidation, provided that this results in stronger and more efficient banks, and does not reduce competition. The Bank will also provide technical assistance to its partner banks and MFIs, in particular in the areas of problem loan management and operational risk management, as well as agricultural and sustainable energy financing, where appropriate. The Bank will help financial institutions to expand the range of financial sector products (particularly agricultural lending and supply chain products), and will support the authorities with improving and implementing the legal frameworks for these products (including leasing, insurance, and capital market instruments).

To increase market discipline and level the playing field in the banking system, the Bank will advise and assist the Government on divesting from state-owned banks, and will consider participating in their potential privatisations through equity investments, provided that such privatisations will be conducted in a fair and transparent way and will actually lead to increased competition. It will also encourage the Government to attract internationally recognised foreign banks that, through skills transfer and increased competition, can raise the standards in the Kyrgyz banking system.

To reduce dollarisation and develop local currency capital markets, the Bank will include the Kyrgyz Republic in the Local Currency Lending Programme for Early Transition Countries (ETC), which is supported by the EBRD and international donor countries. With the assistance of risk-sharing donor funds, the EBRD would be able to offer local currency lending products at interest rates that aim to catalyse local currency market development without crowding out other financial institutions. This programme will help to address the needs for longer term local currency funding by MFIs and commercial banks, and should contribute to the reduction of systemic currency and counterparty risks in the financial sector. This is particularly important for MFIs, which historically have received only FX funding, but are limited by law to lend in local currency only, and have very limited hedging opportunities. The Bank signed a Memorandum of Understanding with the authorities in May 2011 on encouraging local currency lending, supported by prudent macroeconomic policies that will aim to maintain exchange rate flexibility, lower inflation, and improve local capital market development.

3.3.2. Corporate Sector

Sectoral challenges

- **Increasing access to finance for agribusiness.** Developing the agricultural sector is crucial for fighting poverty and reducing dependence on imports, particularly given rising global food prices. Raising productivity and employment in agriculture is however constrained by an overall lack of access to finance and FDI.
- **Raising overall productivity and value added.** Low productivity and inefficiency remain significant challenges in agribusiness, manufacturing and services.
- **Improving corporate governance and business standards**. While the institutional framework has improved, the low level of business sophistication (management best practice, standards and innovation) continues to constrain business growth and export potential, particularly in strategic sectors such as agribusiness.
- **Improving frameworks for markets.** Market development in the corporate sector continues to be constrained by lack of protection of private property rights, monopolisation, administrative barriers, and non-transparent licensing procedures.

Bank's operational response

To increase access to finance for agribusiness, the Bank will offer agricultural financing through agricultural credit lines (where possible in local currency) via local financial institutions and it will finance agribusiness corporates along the value chain, combined as appropriate with technical assistance. The Bank will seek potential partners among domestic financial intermediaries in the Southern region. Policy dialogue will focus on securing better implementation of agricultural financing, which will include an improved legal framework for MFIs, agricultural sector reforms, the potential privatisation of Aiyl Bank, and the general improvement of the investment climate in the agricultural sector. Finally, the Bank will aim to encourage its partner banks and MFIs to increase their portfolio in the rural areas in the country.

To raise overall productivity and value added, the Bank will support projects that aim to address inefficiencies and low productivity, particularly where up-to-date techniques and machinery can be introduced, e.g., through upgrading inefficient processing plants. In particular, the Bank will support commercially viable local agribusiness and manufacturing enterprises that focus on higher value-added activities, such as food processing, textiles, construction materials, pharmaceuticals and retail. The Bank will also expand the use of ETCI and TAM/BAS products to support local companies with higher value added and higher growth and export potential in the regional market. (See Annex 5 for a full description of TAM/BAS activity). It will utilise the ETC Initiative to reach smaller Kyrgyz-owned companies via an expansion of MCFF, DLF and DIF products, and will provide financing in local currency whenever possible.

To improve corporate governance and business standards, the Bank will (1) support projects that will introduce best practices in areas such as technology, business planning, marketing, corporate management, and gender equality; (2) support the entry of new strategic investors with higher levels of business sophistication (including from countries such as Russia, Kazakhstan, Turkey and China), including through co-financing equity investments (especially when working with known clients and with those that have demonstrated strong corporate governance and high quality management); and (3) use TAM/BAS activities to provide technical advice and mentoring to small and medium sized enterprises (SMSEs) on improving transparency and business standards, particularly in agribusiness and in underserved regions, and develop a sustainable infrastructure of local business management and advisory services.

To improve frameworks for markets, the Bank will conduct active policy dialogue to improve the protection of private property rights, reduce monopolisation and corruption, support privatisation and new business development, and increase the transparency of licensing procedures (in particular in the mining sector, where it is important to attract more quality entrants into the sector, and convert exploration into development licenses). The Bank will also continue to support the Secretariat of the Council for Business Development and Investment through ongoing technical assistance. The Council's work will be maintained and re-focused, demonstrating the new Government's intention to continue pursuing effective mechanisms to facilitate the ongoing dialogue between the state and business. Finally, the Bank will improve judicial capacity building through a large technical assistance project.

3.3.3. Infrastructure and Energy

Sectoral challenges

- **Building the institutional framework for sustainable operations of municipal services.** Water and wastewater services are operated inefficiently, with problems involving water losses and shortages, as well as low water quality. Public transport services are limited due to a lack of long-term planning, lack of investment, low tariffs and insufficient regulation.
- **Improving energy supply and energy efficiency.** Energy consumption per square meter is very high and the power sector is beset with heavy quasi-fiscal deficits, outdated infrastructure, inadequate maintenance and investment, extremely low electricity tariffs and high distribution losses.
- **Improving regional infrastructure to facilitate regional trade and property and tourism development.** The road sector remains unreformed in most aspects (institutions, road user charges, private sector participation). Regional road maintenance units carry out maintenance works, but they have not been properly corporatised and there is no competition in place.

Bank's operational response

To re-establish access to basic public services, the Bank will focus on improving water supply, solid waste and public transport projects in Bishkek and the South. The Bank will establish a Framework Facility for water projects covering the Osh, Jalalabad, Karabalta and Bishkek (Bishkek Water II), as well as projects yet to be defined, e.g. Tokmok and Kant, with the aim to widen the geographical coverage of MEI operations in secondary cities throughout the country. The Bank will also develop solid waste and public transport projects in Bishkek, Osh and Jalal-abad. Where needed, it will establish Stakeholder Participation Programmes for new MEI operations aimed at improving collection rates and anchor acceptance of water tariff increases among the population. To bridge affordability and external debt constraints, any municipal infrastructure loans will be supported by co-financing grants or concessional loans from other IFIs or bilateral donors.

To improve energy supply and energy efficiency, the Bank intends to explore sustainable and energy efficiency opportunities across all sectors. It will seek to provide a credit line for energy efficiency and renewable energy (Kyrseff). However, it will be important to make progress with tariff reforms and raising collection rates in the context of these projects. Potentially viable power sector investments could include hydro power projects, high-voltage transmission line rehabilitation, as well as participation in the privatisation of distribution companies, if coordinated with other IFIs. EBRD also intends to actively pursue GEF and/or co-financing with other MDBs or donors, especially for adaptation to climate change or reducing GHG emissions through resource/energy efficiency and use of Best Available Technology (BAT) equipment. The Bank will also seek opportunities to improve the climate change resilience of investments in vulnerable sectors such as water infrastructure and hydropower. The Bank will seek to engage in policy dialogue to improve operational performance, transparency, and governance; improve energy efficiency legislation, especially in the built environment; and encourage the development of incentive schemes for energy efficiency and renewable energy. These operational and policy dialogue activities may be pursued in the framework of a sustainable energy action plan (SEAP).

To improve regional infrastructure, the Bank will consider financing additional key regional transport projects. This will be subject to the successful implementation of the existing high priority Osh-Isfana road project, as well as to further progress with sector reform. Moreover, just as for municipal infrastructure loans, any regional public infrastructure loans will need to be concessional given debt sustainability considerations.

3.4. Environmental and Social Implications of Bank Proposed Activities

The Bank's approach to environmental and social issues is complementary to that of other organisations, particularly in light of the Bank's emphasis on the private sector. All projects in the Kyrgyz Republic will continue to be subject to the EBRD's Environmental and Social Policy and Procedures and incorporate, where appropriate, Environmental and Social Action Plans (ESAPs) into the legal documentation in order to address issues raised during due diligence.

Many priorities that the Bank has set for the Kyrgyz Republic provide environmental and social benefits, such as water and wastewater treatment and energy efficiency. For projects in sensitive sectors, such as small hydropower projects, the Bank has developed eligibility criteria in the absence of any other national or international guidance on key issues for small scale hydro. The Bank will work closely with financial intermediaries on these projects, and it is likely they will need to employ third-party consultants to assess the proposed projects against these criteria.

The EBRD continues to monitor and provide environmental and social due diligence training to local banks to ensure that they are capable of implementing environmental due diligence procedures and thus support environmentally sound development within the SME sector. The Bank provides environmental due diligence training for the Bank's financial intermediaries, and where appropriate, additional capacity building may be considered to strengthen those intermediaries' environmental and social risk management capacities, particularly for clients in early transition countries.

As part of the implementation of the EBRD's Gender Action Plan, the Bank will continue to develop and implement gender-related components in MEI projects that promote equitable distribution of project benefits among men and women in the community. The Bank will also continue to support women's entrepreneurship through Financial Institutions projects that increase access to finance for women-owned and women-managed MSMEs and address barriers that impede access to credit, in particular in rural areas. Additionally, the Bank will look for opportunities to work with clients in other priority sectors to adopt gender balanced approaches in their human resources policies and practices (e.g. equal opportunities in recruitment and career development).

See Annex 8 for a profile on gender equality in Kyrgyz Republic.

4. ACCESS TO CAPITAL: PRIVATE AND PUBLIC SOURCES OF FINANCE

4.1. Access to capital

Access to financing remains constrained. Borrowers face short loan tenors that limit their ability to embark on long-term investment programmes and high real interest rates that often make loan financing only suitable for very profitable projects. Access to international capital markets is limited due to the small size (by international standards) of most firms and banks, the largely undeveloped government securities market, and the unfavourable risk profile of the economy. A commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds.

4.2. MDB finance and collaboration with other IFIs and multilateral donors

The Bank closely coordinates with other IFIs and multilateral donors to ensure that synergies are exploited. The main areas of co-operation include:

- **Policy dialogue:** The Bank is an active participant in the IFI co-ordination process under the Development Partners Co-ordination Council. Together with other IFIs, the Bank will focus on a coordinated dialogue with the Kyrgyz authorities on key issues related to the investment climate, transparency and corporate governance. The Bank will continue to support and listen to the concerns expressed by the re-established Council for the Business Development and Investment with an aim of improving the investment climate. The Bank, together with the IMF, the World Bank, and the ADB, played an active role in the Kyrgyz Joint Economic Assessment (JEA) that was carried out between May and July 2010. The JEA report, published on the websites of the various participating IFIs, outlined a strategy for recovery as well as priority actions and investments. Most recently, the Bank actively coordinated with the IMF to identify key areas of policy reforms to reduce dollarisation and develop local capital markets, in the context of the new ETC Local Currency Lending Programme.
- **Technical assistance:** The Bank is actively providing significant technical assistance financed by bilateral donors and special funds, such as the ETC Fund and the EBRD Shareholder Fund, mainly for project preparation and implementation. The Bank's technical assistance in the areas of the improvement of the business climate and training of judges are closely co-ordinated with other donors. (See Annex 6 for a breakdown of Bank-administered technical assistance by donor to Kyrgyz Republic over the past 3 years).
- **Project co-financing:** All infrastructure projects undertaken by the Bank during the past strategy period involved investment co-financing with other IFIs and donors (World Bank, European Union, the Switzerland). This cooperation is expected to continue during the strategy period under consideration. Affordability constraints require significant grant co-financing, particularly in the regions outside the capital.

World Bank Group

The July 2010 Joint Economic Assessment (JEA) led by three Development Partners (ADB, IMF and WB) with the participation of five other partners (EBRD, EDB, EC, IFC, UN) set out a strategic framework for reconciliation, recovery and reconstruction after the violence of 2010. Within this framework, the World Bank delivered the Emergency Recovery Operation (US$70 mln) in September 2010 in support of critical energy expenditures as well as NRRP Additional Financing for labour intensive public works in roads. Both are currently under implementation.

The World Bank is currently preparing a Budget Support Operation (US$30 mln), which aims to assist the economic recovery from 2010's negative growth by supporting the stabilisation of the fiscal balance and the financial sector, as well as improvements in the business environment. Additional financing for the Sector-Wide Approach (SWAP) to Health (US$24 mln) is being prepared, with a focus on improving access to health services for vulnerable households in conflict-affected areas. A second tranche of additional financing for a national road rehabilitation project (US$16 mln) is under preparation. In close consultation with the Government, the World Bank is preparing a FY2012-13 Interim Strategy for the Kyrgyz Republic. This interim strategy focuses on the country's recovery and stabilisation needs, but also envisages the resumption of support for long-term economic development. The total amount of financial assistance from IDA is expected to be about US$ 60 mln per year, consistent with the current IDA allocation. Simultaneously, the World Bank will assist the Government to prepare a medium term Country Development Strategy, which will serve as the basis for the next full Country Partnership Strategy.

In addition to its lending operations, the World Bank Group provides a range of analytical and advisory services, complemented by investments and guarantees through Bank Group institutions (IFC and MIGA) to strengthen and expand financial and private sector growth. In addition to IDA funds, the Kyrgyz programme includes a significant number of co-financing and stand-alone Trust Funds (TFs). The ongoing TF portfolio has a total value of more than US$ 100 million, out of which around US$ 80 million has been disbursed. In addition, IFC is envisioning supporting the Kyrgyz private sector in line with its strategy for Central Asia, which centres on the financial sector and services.

Asian Development Bank (ADB)

The Kyrgyz Republic joined the ADB in 1994. ADB assistance is provided on a 50 per cent grant, 50 per cent loan basis. The transport sector accounts for the largest share of ADB assistance. The ADB also supports policy reforms to facilitate the transition to a market economy.

In September 2010, ADB approved emergency assistance of $100 million equivalent to help the Kyrgyz Republic get back on its feet in the wake of the socio-economic crisis. A concessional ADF loan and grant will be used to help the government maintain key social services and rebuild homes damaged during the violence in June 2010. In addition to the Emergency Assistance for Recovery and Reconstruction, ADB also approved the Central Asian Regional Economic Cooperation (CAREC) Regional Road Corridor Improvement Project (Supplementary) and the Power Sector Improvement Project. In 2010, ADB provided a total of two ADF grants of $79.6 million and three ADF loans of $88.2 million for the three operations.

ADB’s ongoing portfolio comprises of 13 projects including 11 ADF grants in the amount of $229.1 million, 6 loans for $140.2 million, and one JFPR grant for $1 million.

International Monetary Fund (IMF)

The EBRD closely coordinates its activities with the local IMF office as well as with IMF consultation visits, with the emphasis on the coordination of support for reforms in the infrastructure sector as well as support for financial sector stability, local capital market development and financial intermediation deepening. The EBRD coordinated with the IMF on identifying policy reforms to reduce dollarisation and develop local capital markets, and used the IMF’s assessments for developing a Memorandum of Understanding between the EBRD and the authorities in the context of the ETC local currency lending programme, which was signed in May 2011.

The IMF, together with other IFIs, played a leading role in helping the country respond to the challenges it is facing in the aftermath of the April and June 2010 events. The 18-month, US$100 million arrangement under the Exogenous Shocks Facility (ESF) expired on June 9, 2010; only one out of three reviews was completed. A US$33 million disbursement under the Rapid Credit Facility (RCF) was approved by the IMF's Executive Board on September 15, 2010 in support of the authorities’ emergency economic program to meet the immediate challenges in the aftermath of the crisis.

In April 2011, IMF staff and the new Kyrgyz authorities started discussions in Bishkek on a new medium-term lending arrangement, in conjunction with the regular review of the country’s macroeconomic policies (Article IV consultation). In June 2011, the IMF Executive Board approved a new 3-year medium-term IMF arrangement supported by a US$ 100 million loan with a highly preferential interest rate (currently 0 percent) and a 10 year grace period. The new arrangement should help the authorities restore macroeconomic stability, address the protracted balance of payments needs, and mobilise critical donor assistance. Over the medium term, once economic recovery is underway, multi-year fiscal consolidation will be needed to maintain fiscal and external debt sustainability.

European Union (EU)

The Partnership and Cooperation Agreement between the EU and the Kyrgyz Republic entered into force in 1999. The development cooperation strategy under this partnership has been set out in the EU’s Regional Strategy Paper for the five countries of Central Asia. The current National Indicative Programme, covering the period from 2010-2013 under the 2007-2013 Country strategy, has the following priorities:

- Judicial Reform and the Rule of Law (including reforms in areas of justice, public administration and financial management).
- Social protection reform and income-generating activities – a Budget Support Programme, with technical assistance and a separate Call for Proposals for Income-generating activities, especially in the South of the country.
- Education: this is planned to develop into A Sector Policy Support Programme, including Professional and Vocation Education.

Some programmes covering several countries in central Asia also benefit the Kyrgyz Republic. In particular, the long-running BOMCA (Border Management) and CADAP (Anti-Drug) programmes are based in Bishkek.

ANNEX 1 - POLITICAL ASSESSMENT IN CONTEXT OF ARTICLE 1

Overview

The Kyrgyz Republic is committed to the principles of Article 1 of the Agreement Establishing the Bank. The country is making good progress towards implementation of the principles of multi-party democracy and pluralism but many challenges remain.

Replacing the highly centralised presidential system with a potentially more representative parliamentary system following the socio-political crisis of 2010 constituted genuine progress towards multiparty democracy and pluralism. However, there are many challenges remaining, including:

- The parliamentary model of government that has recently been put in place is untested and presents a challenge with regard to the smooth functioning of different branches of power and maintenance of political stability.
- The upcoming presidential election, expected in October 2011, is a complicating factor that will heighten tensions further in the second half of the year.
- The root causes of massive inter-ethnic violence in the south of the country in June 2010 – including poverty, unemployment and deeply rooted corruption – are yet to be addressed. The June violence had disastrous results for human rights and requires urgent remedial action.

Political Accountability

The period since the adoption of the last country strategy has been characterised by dramatic political events. The republic experienced two popular uprisings within the last ten years – in 2005 and 2010 – both resulting in change of power in the country.

Kurmanbek Bakiev was elected President in 2005 following a popular upheaval that ousted the country's first President Askar Akaev. Bakiev was re-elected in 2009 in an election which, according to OSCE/ODIHR, "failed to meet key OSCE commitments". His presidency was characterised by shockingly fast centralisation of power in the hands of the Bakiev family, particularly the President and his son Maxim Bakiev. In 2010 Bakiev followed Akaev's fate. After massive violent protests in April, President Bakiev fled the country, parliament was dissolved and an interim government stepped into the power vacuum.

The new provisional authorities declared their strong commitment to democracy and pluralism. They claimed that the main problem facing the country was a highly-centralised presidential system of government, which allowed one person to run the country without adequate checks and balances from either the legislature or judiciary. To avoid repetition of this scenario in the future, the provisional authorities embarked on a major task of changing the system of government from a presidential to a parliamentary model. The 'roadmap' of restoring legitimacy and democratising the constitutional order included several essential steps: putting the draft constitution to a popular vote at a nationwide referendum and conducting fresh parliamentary and presidential elections.

The constitutional referendum took place against the background of the inter-ethnic conflict in Osh and Jalal-Abad. A series of violent clashes there between Kyrgyz and Uzbek groups resulted in a high number of casualties and displaced persons. A state of emergency has been subsequently imposed in large parts of Osh and Jalal-Abad which expired prior to the referendum day. Some political parties and civil society activists called for the postponement of the referendum, arguing that it would be inappropriate to ask people to vote under such difficult circumstances.

Despite these extremely challenging circumstances, the provisional authorities succeeded in conducting a peaceful constitutional referendum, a milestone on the way towards restoring legitimacy. The formulation of the single referendum question which included three separate issues – 1) approve the draft constitution; 2) confirm Roza Otunbaeva as interim president until 31 December 2011, and 3) dismiss the Constitutional Court – made it difficult for voters to split their vote on the three distinct issues. Despite this drawback, the reported high turnout (albeit lower in the south) indicated citizens' resilience and desire to shape the future of the country. Security conditions prevented international bodies from observing the balloting in all parts of the country but there were no reports of serious shortcomings.

In October 2010 the country held parliamentary elections, characterised by a significantly increased role of political parties in the electoral process. The elections resulted in representatives from five parties entering the new parliament. According to international observers, the parliamentary elections were generally free and fair. The elections were conducted in a peaceful and pluralistic manner and brought the country closer to holding elections in line with international standards. Importantly, fundamental freedoms, including the freedom of expression, assembly and association, were generally respected in the process.

Following the parliamentary election a three-party coalition government was formed in December 2010. The voting spread required at least three political parties, out of five that won parliamentary representation, to come together to form a coalition to achieve a parliamentary majority. After a false start, the new coalition formed in December 2010 includes the Social Democratic Party of Kyrgyzstan (SDPK), Ata Jurt (Fatherland) and Respublika. The parliamentary majority controls 77 seats of a total 120. Almazbek Atambaev, the leader of the SDPK, was elected Prime Minister, while Omurbek Babanov of Respublika became his first deputy. Ata Jurt's Akhmatbek Keldibekov was elected Speaker of the new parliament.

The coalition remains fragile. Following allegations of corruption made in parliament by the former Prosecutor General, first Deputy PM Babanov announced his temporary resignation to allow an independent parliamentary investigation into the allegations.

Irrespective of the immediate prospects of the current government coalition, the overall democratic progress made so far is clear. The adoption of the new Constitution in June 2010, parliamentary elections in October (which led to a multi-party parliament and the establishment of the first-ever coalition government) are important democratic milestones. The strong multi-party legislature is a major shift away from the more authoritarian systems of the past. The upcoming presidential election is another important step on the road to forming a new democratic constitutional order in the country.

The Rule of Law and Human Rights

The legal framework to ensure effective governance and the impartial rule of law is established in the new Constitution and in the laws that provide for an independent judiciary and protection of human rights. The authorities have confirmed their strong commitment to initiate a new phase in the development of the country by strictly adhering to the rule of law and respect for human rights.

In practice, however, the rule of law and protection of human rights in the Kyrgyz Republic remains weak, as consistent and impartial implementation of the adopted recommendations, laws and regulations is a serious problem. Pervasive corruption is a challenge, as acknowledged by the authorities. Corruption remains a serious problem at all levels of society. According to Transparency International's Corruption Perceptions Index, in 2010 the Kyrgyz Republic ranked 164 out of 178 countries surveyed, with better scores than Uzbekistan and Turkmenistan but worse than all other countries of the region.

A positive recent development was recognition of the Kyrgyz Republic's compliant member status under the Extractive Industries Transparency Initiative (EITI). In March 2011 President Roza Otunbaeva participated in an EITI global conference in Paris after the EITI Board's decision on 1 March to designate the Kyrgyz Republic EITI Compliant.

The overthrow of the Bakiev regime in April 2010 resulted in an improvement in the government's commitment to human rights but many problems remain and violations are frequent, as reported by specialised human rights organisations, including cases of abuse by law enforcement officials, lack of judicial independence, and the government's failure to adequately protect refugees. Massive violations of human rights took place during the June 2010 events in Osh, Jalal-Abad and neighbouring cities in the south. It is absolutely essential to establish the truth about these tragic events and the work of the International Independent Commission of Inquiry could be instrumental in achieving this objective.

National minorities, which make up 35 percent of the population, are generally underrepresented in government, particularly Russians and Uzbeks, the two largest ethnic minority groups.

ANNEX 2 - ASSESSMENT OF TRANSITION CHALLENGES

The table and the supporting text below provide an overall assessment of Transition Challenges by sector, based on Transition Report 2010. There are two separate scores for each sector, rating market structures and market-supporting institutions. Scores range from negligible, small, medium and large. “Negligible” means that the remaining challenges are minor and that the sector is well advanced in moving towards the standards of a well-functioning market economy. “Large” means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform.

Sectors	Market structure	Market-supporting institutions
Corporate sectors		
Agribusiness	Medium	Medium
Manufacturing and Services	Large	Medium
Real estate	Large	Medium
Telecommunications	Large	Medium
Energy		
Natural resources	Large	Medium
Power	Medium	Large
Sustainable energy	Large	Large
Infrastructure		
Urban transport	Medium	Large
Water and wastewater	Large	Large
Roads	Large	Large
Railways	Large	Large
Financial institutions		
Banking	Large	Large
MSME	Large	Large
Insurance and financial services	Large	Large
Private equity	Large	Large
Capital markets	Large	Large

CORPORATE SECTOR

Agribusiness
Market structure: Medium
Institutions/policies: Medium

While trade and price liberalisation has progressed further than in other Central Asian countries, low productivity in particular in cereal production leads to significant price differentials to world market levels and substantial dependence on imports from neighbouring Kazakhstan. With a history of mainly bulky, unprocessed commodity exports the major challenge remains to upgrade inefficient processing plants and shift to higher-value specialised products that conform to international quality standards. This is constrained by insufficient infrastructure and an overall lack of FDI into the sector. Progress has been made in privatisation of agro-processors but post-privatised companies remain inefficient partly as a result of lack of private credit. This could be partially addressed by developing leasing services in the agricultural sector which are in high demand but have not developed due to lack of incentives. Further regional integration could play a significant role in reducing transport costs along the food value-chain.

Manufacturing and Services
Market structure: Large
Institutions/policies: Medium

The institutional framework for new business entry and corporate governance has improved and the market faces limited distortions from government subsidies and formal trade barriers. However, these improvements have had only a limited impact on new business entry in Manufacturing and Services sectors and FDI, due primarily to the small size of the economy and high transport costs for exports. The global economic downturn followed by social and political turmoil in 2010 negatively impacted the sector with investment scale-backs. Significant challenges remain not only in improving corporate governance and business standards, but also in improving the overall productivity and efficiency of Manufacturing and Services sectors. Ensuring a fair and competitive market environment is also a major challenge.

Real estate
Market structure: Large
Institutions/policies: Medium

The property market is at early stages of development, including the introduction of new products and financing methods. There is significant unfulfilled demand for modern commercial property in all sub-segments. The mortgage market for residential housing remains underdeveloped, and property titles can be subject to legal challenge, which is hindering the development of the sector. Dealing with construction permits became easier, thanks to a one-stop shop making it possible to obtain a design permit, construction license, and occupancy permit at a single place. There is little state interference (subsidies etc.) in the sector but gaps remain with regard to the legal enforcement and practical implementation of the legislative framework. Public awareness of energy efficiency is low with little incentive due to low electricity tariffs combined with an ineffective bill collection system.

Telecommunication
Market structure: Large
Institutions/policies: Medium

The regulator is partially independent. The latest attempt to privatise the fixed-line incumbent, Kyrgyztelecom in February 2010 was cancelled following the political and social turmoil, and the state still holds a majority stake. The market, including fixed-line, has been fully liberalised since 2007, and although three fixed-line companies have been licensed to compete with Kyrgyztelecom, the latter continues to capture close to 100 per cent of the fixed-line market. Private operators are active in the mobile and Internet markets, heavily investing in the relevant infrastructure. There are four mobile network operators. Kyrgyz Republic has one of the largest numbers of Internet users per capita in Central Asia, but Internet access is concentrated in urban areas and broadband Internet availability is extremely limited in the rural areas.

Immediately after the April events, the mobile operator Alfa Telecom (with a brand name of Megacom) was fully nationalised.

ENERGY AND INFRASTRUCTURE

Natural Resources

Market structure: Large
Institutions/policies: Medium

The Kyrgyz Republic has substantial deposits of coal, gold, and uranium. Gold is the country's main export, estimated to account for around 40 per cent of total exports and 50 per cent of industrial production in 2010. Kyrgyzaltyn (a gold mining and refining company), Kyrgyzneftegaz (oil and gas production) and KyrgyzGaz (the gas distribution company) remain state-owned. The largest gold mine (Kumtor) was privatised in 2004 through an IPO of Centerra (a joint venture between Kyrgyzaltyn and Cameco of Canada). Following Cameco's disposal of its entire 48.5 per cent stake in Centerra at the end of 2009, the Kyrgyz state mining company Kyrgyzaltyn is the single largest shareholder, although the majority of shares (66 per cent) remain in free float. Further large-scale investments in the extractive sector are limited by the weak regulatory regime and non-transparent licensing procedures. The State Department of Fuel and Energy Regulation at the Ministry of Industry, Energy and Fuel Resources of the Kyrgyz Republic is responsible for setting gas energy tariffs and for licensing decisions. Its administrative capacity is weak and lacks independence. Several gold mining licenses have been annulled on the two major gold deposits – Jerooy and Taldybulak Levoberezhny – and given to different investors. Revenue streams from Centerra have been clarified as the company complies with the EITI principles that the government endorsed in 2004. The Kyrgyz Republic was granted EITI compliant status in March 2011.

Power

Market structure: Medium
Institutions/policies: Large

The power sector is unbundled but remains state-owned. Only a few small hydro power plants are private and a handful of private suppliers with a small market shares. There is no independent regulator. Some progress towards commercialisation has been achieved since 2006, as electricity tariffs have increased for all classes of consumers and a schedule for further medium-term tariff increases until 2012 has been announced. However, further increases in 2010 were partially reversed following the social and political unrest in April 2010. Cross-subsidisation, high losses and low collection rates, along with non-transparency and corruption continue to mar the sector, in part due to the lack of management experience and massive underinvestment in distribution assets for the last 20 years. Winter electricity rationing still takes place due to excessive dependence on hydro resources, the use of which is driven by the regional water sharing arrangements in place, exacerbated by significant transmission bottlenecks to meet winter peaks. The country has been trying to attract FDI for large-scale power generation and distribution companies, but still lacks an adequate framework to attract private investors and exploit its medium and small hydro potential.

Sustainable Energy
Market structure: Large
Institutions/policies: Large

Low energy tariffs as well as a weak legal and institutional framework for sustainable energy create an unfavourable investment climate for energy efficiency and renewables. Tariffs are still not costs reflective and do not include environmental costs. Therefore price signals do not provide incentives to use energy efficiently and to invest in RES projects. Several important legal steps have been recently taken: the Law on Energy Efficiency was adopted in 2007, the Law on State Policy and Regulations in the Area of Emissions of GHGs was approved in 2007 and the Law 'On Renewable Energy' passed parliament in 2008, followed by the introduction of 'Rules for connecting small hydropower stations to the transmission network'. A small, NGO-run, revolving credit facility for small renewable energy projects has been established. This resulted in some small scale pilot project activities being implemented. The Kyrgyz Republic has signed and ratified the Kyoto protocol. Remaining challenges are to increase energy tariffs to provide incentives for efficient use of energy, develop and implement secondary regulations and strengthen institutions, introduce economic incentives to support market penetration of renewable projects, and strengthen capacity for carbon finance projects.

Urban Transport
Market structure: Medium
Institutions/policies: Large

Private mini-buses play a dominant role. Mini-buses are largely deregulated and operate profitably without subsidies. Competition is intense among them but the regulation is essentially non-existent, with small-capacity units operating in a taxi-like fashion, with little respect for formal bus routes, timetables and stops. This causes related concerns over safety standards, over-loading and vehicle standards (e.g. pollution and CO_2 emissions). Municipally owned urban transport companies benefit from capital and operational subsidies, but due to loose contractual arrangements and regulation, these remain inefficient to permit long-term financing to occur. These companies remain largly loss-making as regulated tariffs are low (political considerations are sigificant) and annual transfers are not enough to reach break even. There are no or limited transparent contractual arrangements between the companies and municipalities. Long-term master planning or urban transport planning are lacking. Revenue collection is a problem and the city authorities are considering introduction of the unified e-ticketing system.

Water and wastewater
Market structure: Large
Institutions/policies: Large

Water/wastewater services are separated from the central administration and remain under municipal control but are operated inefficiently (with some exceptions). Financial and operational performance is generally poor particularly in the smaller cities, but the Bishkek Water Company is providing a regular service to the capital city and operate profitably with relatively good performance (high collection rate, high meter coverage, relatively low water loss, etc.). Transition challenges remain significant and are identified in the following areas: (i) improvements in regulation (e.g. tariff methodology); (ii) development of contractual arrangements between the owner/policy maker and the company; (iii) further tariff increases and collection rates; (iv) corporate restructuring and further commercialisation (including restoration of physical supply, reduced water losses and increased water quality); and (iv) introduction of meters and meter-based billing.

Roads
Market structure: Large
Institutions/policies: Large

The road sector remains unreformed in most aspects (institutions, road user charges, private sector participation). Both state and local roads are under jurisdiction of the Ministry of Transport and Communications. Regional road maintenance units carry out maintenance works, but they have not been properly corporatised and there is no competition in place. Road construction is largely conducted by the private sector. The level of fuel levy is low, even by regional standards. Nonetheless, road maintenance expenditures (i.e. allocations from the central budget) increased significantly in recent years. A comprehensive road sector strategy has been prepared but very little progress has been made in its implementation. The sector development strategy for 2007-2010 was adopted in 2006, with the intention to apply wider market mechanisms, introduction of new methods of public-private interaction, legislation on toll roads, but so far has not been implemented. Therefore, the implementation of the strategy is a challenge for the medium term. Remaining challenges are to: (i) ensure adequate resources are allocated to the sector with prioritisation on road maintenance; (ii) introduce of tendering procedures for periodic road maintenance; (iii) refine road user charges and reform of the Road Fund; (iv) formulate a privatisation plan for maintenance units; and (v) introduce service level agreements for routing maintenance.

Railways
Market structure: Large
Institutions/policies: Large

The railway system is fairly simple as there are very few networks (mainly for industrial use). Operating and policy setting functions are not separated and core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. Sector reform is still at a very early stage of development. There are significant transition challenges remaining in almost all areas, but the priority should be given to the following areas: (i) full corporatisation and establishment of arms-length relationship between the government and management; (ii) increase financial transparency and sustainability; and (iii) improvements in governance and procurement practices.

FINANCIAL INSTITUTIONS

Banking

Market structure: Large
Institutions/policies: Large

The Kyrgyz economy remains largely cash based with a relatively low level of banking sector intermediation. The banking system remains small with the assets-to-GDP ratio at 35 per cent. There are 22 commercial banks, 10 of which are majority foreign-owned. These account for three quarters of the banking system's assets. The state-owned banks hold an 8 per cent market share in terms of assets. The deposits-to-GDP ratio remains low at 17 per cent at end 2009. Foreign currency shares in deposits and loans were 56 and 62 per cent, respectively. Private sector credit to GDP amounts to 20.5 per cent. Although the sector withstood the global financial sector crisis, it has been negatively affected by the internal socio-political crisis following the April events. Seven commercial banks including the country's largest bank – AsiaUniversalBank (AUB) – were placed under temporary administration. AUB has gone through bankruptcy procedures and its assets were restructured for further re-privatisation. The main challenges relate to increasing confidence in the banking system; strengthening and deepening the financial sector; increasing competition; and stimulating local currency finance.

Micro, Small and Medium-sized enterprises

Market structure: Large
Institutions/policies: Large

Commercial banks and other institutions have increased their MSME lending in recent years, in particular to small traders in the main cities with a large portion coming from a large number of non-bank financial institutions (including micro finance institutions). Total loans by micro finance institutions reached 8 per cent of GDP at end 2010. Nonetheless, very few enterprises apply for a loan and around 70 per cent of applications are being rejected, according to the BEEPS survey in 2009. In addition, less than a quarter of firms have access to a bank loan or overdraft facility according to the same survey. The most commonly cited reasons for not applying for an MSME loan are burdensome application procedures. A credit information bureau was established in 1998 under the National Bank and became independent in 2003. Although improved in the recent past, the coverage of credit information services needs to be further extended. Commercial banks tend to concentrate their lending activities in the capital city as it has the highest concentration of MSMEs. Financial needs of enterprises outside the capital are mainly being catered by non-bank financial institutions. The financial crisis and political developments have affected growth of lending to MSMEs as international MFI lenders have refrained from providing finance, which is now recovering.

Insurance and other financial services

Market structure: Large
Institutions/policies: Large

Insurance legislation and regulation fall short of the IAIS standards. Insurance penetration remains very low at less than 0.01 per cent of GDP. The sector is still dominated by state-owned insurance companies. The availability of insurance products is very limited. There is a shortage of required skills. The development of the leasing market has been constrained by the shortcomings in legislation, including inadequacy of the pledge law. The pension framework provides for private pension funds, however, significant challenges remain. Development of a compulsory private pension pillar is in process. The sector remains highly underdeveloped.

Private equity
Market structure: Large
Institutions/policies: Large

A commercial private equity sector is yet to develop and to date the country has attracted almost no interest from international private equity funds. There are no country dedicated fund managers. Only one regional fund manager has been identified to include the Kyrgyz Republic in its target region. Available capital and active capital are estimated to amount to 0.1 per cent of GDP. Currently the main focus of these funds is on small cap strategy, with other strategies virtually non-existent. Local institutional and private clients are not present in the market. Kyrgyz Republic's conformity with OECD's Principles of Corporate Governance is relatively good. However, a difficult business environment including the security of property rights due to the weakness of the judiciary, limited investment opportunities and poor exit prospects all negatively affect the development of the sector.

Capital markets
Market structure: Large
Institutions/policies: Large

Securities legislation is relatively advanced, although some areas (e.g. the rules on collective investments) require improvement. The effectiveness of implementation of rules and regulations is poor. The public equity market capitalisation at 0.04 per cent of GDP is extremely low. There are only around 35 companies that are listed on the Kyrgyz Stock Exchange. The government bond market is well developed and regular and frequent auctions are taking place. However, liquidity in the secondary market remains very low. Money markets in the country are underdeveloped.

ANNEX 3 - LEGAL TRANSITION

Overall assessment

The Bank's recent assessments of commercial and financial laws in the region show that the Kyrgyz Republic has made considerable efforts to upgrade its legislation over the last decade. In many legal areas, the EBRD assessments reveal that the laws on the books have reached at least medium compliance with international standards of best practice, which by regional standards is a significant achievement.[2] However, as is often the case in early transition countries, implementation of laws remains highly problematic and is hampered by the lack of investor confidence in the judiciary.

Through its Legal Transition Programme, the EBRD helps create an investor-friendly, transparent and predictable legal environment in transition countries. Programme activities may include policy dialogue, legal assessment, and technical cooperation with the country's authorities. Below is a review of legal developments in sectors crucial to the Bank's investment strategy for the Kyrgyz Republic, together, where applicable, with a summary of current or planned EBRD technical cooperation activities.

Investment climate / private sector

EBRD programme to increase judicial capacity in commercial sector

Improving the quality and efficiency of judiciaries in the commercial sector is a huge challenge in all CIS countries. Investors need to be re-assured that their contractual rights will be upheld by local courts should the need arise. The EBRD has been collaborating with the Kyrgyz authorities[3] since 2006 to increase capacity in the local commercial courts, with a focus on training judges already in place. Technical cooperation has included assistance to the local Judicial Training Centre (JTC) with financial, personnel and technical matters. The programme also included classroom training on the main topics of commercial and financial law for up to 270 judges. A new commercial law library for judges was created in the Supreme Court building. A number of junior judges with leadership potential were sent on internships to Kazakhstan and Russia. Finally, a bench book was prepared for commercial judges in Kyrgyz and Russian languages. An independent evaluation of this project noted in 2009 that some improvements have been noticed in the perception of judicial performance by local court users.

In 2011, the Bank launched a new phase of this project to create a training programme for *candidate* judges and help establish a fair and transparent selection process for new judges. This new phase will last until early 2012 and will train the first batch of 30 candidate judges on key judicial skills and competencies, and on judicial ethics.

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[2] For specific data on the quality of Kyrgyz commercial legislation, see http://www.ebrd.com/pages/sector/legal/what/interact

[3] This project was developed by the Bank in collaboration with the International Development Law Organization (IDLO).

Going forward, it will be crucial that the Kyrgyz government ensures sustainability of the newly established training structures by granting appropriate budget resources to the JTC. Thanks to the knowledge acquired during the EBRD project implementation, the JTC should thus be able to continue training activities and further improve the quality of commercial judiciaries in the Kyrgyz Republic.

Further improvements required to private sector-supporting legislation

The **pledge law,** [4] which applies to security over movables and immovables, seems to be working to the satisfaction of market participants, although some technical issues remain. Recent amendments to legislation have improved the situation, including making out-of-court enforcement possible.

In order to support the development of the residential mortgage market, the Kyrgyz authorities should consider the following: developing a system allowing for simultaneous registration of a title transfer and mortgage on the same property; improving property appraisal to meet international standards; establishing legal techniques for financing buildings in construction and condominiums, and providing for flexibility in loans that will allow for more sophisticated modes of financing.

In order to support development of a secondary mortgage market, the authorities should simplify the process for transferring mortgages and reconsider the functioning of the Specialised State Mortgage Agency which is reported to have created market disincentives. Support to SME and micro-finance (including in the agribusiness sector) will require improvements to the pledge registration system, by making the centralised, electronic pledge register searchable for users, reducing the number of documents that need to be produced at registration, connecting the different asset registries, and clarifying how creditor priority ranking is determined when an asset may be registered in multiple registers but the pledge is only registered in one.

Developing a sound credit reporting system should be encouraged to help boost SME and micro-lending. A draft law is currently under development.

Insolvency legislation[5] is of relatively good quality when compared with internationally recognised standards. However changes to the relevant legislation are desirable to make insolvency proceedings more efficient, in particular with a view to introducing a comprehensive stay on creditor action in case of bankruptcy, allowing fresh financing in a reorganisation, increasing scope of anti-avoidance provisions, establishing formal professional standards for insolvency practitioners, and strengthening their investigatory powers.

Kyrgyz legislation on **corporate governance** and **capital markets** has been recently upgraded with the adoption of two new laws.[6] Despite this improvement, the main issues relate to practical implementation of legal provisions (especially minority shareholder protection) and monitoring of market participants. In the corporate

[4] Law on Pledge of 12 March 2005 (as amended).

[5] Law on bankruptcy of [date] 1997, as amended.

[6] Law on Securities Markets of 24 July 2009 and Law on State Service for Regulation and Supervision of the Financial Markets of 24 July 2009.

governance sector,[7] a lot of practical shortcomings appear to be in the areas of publication of financial reports, notice and agenda for shareholder meetings, pre-emptive rights for new share issues, and valuation of in-kind contributions by shareholders. The EBRD started a technical cooperation project in 2006 with a view to strengthening investor protection on Kyrgyz capital markets. However, the project has been on hold for the last 3 years due mainly to political instability and lack of commitment by the local regulators. The Bank will re-assess the future of this project in the context of its recent initiative on Local Currency and Local Capital Markets Development.[8]

Infrastructure and natural resources

Attracting private capital to finance public infrastructure in the country will require an overhaul of the **concession legislation.**[9] The current law is not comprehensive enough and the selection procedures are yet to be defined by the government, together with a list of infrastructure objects that may be financed by way of concessions. Although the Bank is not currently contemplating financing public infrastructure projects on the basis of PPPs, this type of financing structures could become relevant in the future, in particular in the power and transport sectors.

Similarly, the laws on **public procurement**[10] are deficient on many accounts. They provide for a number of domestic preferences and in many ways are too bureaucratic and cumbersome. The timing of public procurement procedures is insufficiently addressed by the law. There are also reports of corrupt practices leading to unfair selection of bidders. The EBRD is launching in 2011 a joint initiative with the UNCITRAL to promote better public procurement frameworks in CIS countries. The Kyrgyz Republic will be targeted by this initiative including policy workshops in the region, detailed diagnostic studies and policy dialogue, and potentially technical cooperation with the country's authorities if they make a request to that effect. One of the main tools to promote this initiative will be the recently adopted UNCITRAL Model Law on Public Procurement.

One important initiative to attract more foreign investment to the **natural resources sector** in the Kyrgyz Republic is the country's participation in the Extractive Industries Transparency Initiative (EITI). During the coming strategy period, the Bank will look for opportunities to support EITI Kyrgyzstan Secretariat (EITIKS) and the government in the implementation of a comprehensive framework for award and regulation of extractive industries, and the transparent revenue management and allocation of the proceeds of the extractive industries in the interests of the overall development of Kyrgyzstan, based on EITI principles.

[7] See in particular Law on Joint Stock Companies of 27 March 2003, as amended; and Civil Code of 8 May 1996, as amended.
[8] [insert link to LC2 initiative]
[9] Law on Concessions and Foreign Concessionary Entities, of [date] 1992 (as amended).
[10] Law on Public Procurement of 24 May 2004 (as amended).

ANNEX 4 - TAM/BAS ACTIVITY

TAM/BAS supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises (MSMEs) and contributing to the development of sustainable infrastructures of local business advisory services.

Previous TAM / BAS experience

Since inception in 1998, TAM has received a total of €2.6 million in donor funding for projects in Kyrgyz Republic. The largest donors to TAM have been the EBRD Shareholder Special Fund, the ETC Fund, Japan and Switzerland. Additional funding came from Belgium, Canada, Italy, Luxembourg, Netherlands, Taiwan and the UK. TAM has carried out 36 projects throughout the Kyrgyz Republic of which 8 are still in progress. Enterprises assisted operate mainly in Agribusiness, Tourism, Furniture, Information Services and Data Processing.

Since inception in 2004, BAS has received a total of €5 million in donor funding. Switzerland is the primary donor with co-financing from the EBRD Shareholder Special Fund which has been matched by €1.1m in enterprise contributions to projects. To date, BAS had completed 375 projects with a further 89 ongoing, engaging 147 local consultants. Since 2007, 60 per cent of projects were located in rural areas outside the main cities such as Bishkek. Despite the difficult business climate, in the year following project completion, turnover increased in 48 per cent of clients and 16 per cent secured external investments of over €500k on average. BAS has mainly focused on facilitating rural development, with offices established in Karakol and Osh. BAS has also undertaken more than 120 Market Development Activities (MDAs) with the objective of establishing a sustainable infrastructure of local advisory services. This has included capacity building and support for the Central Asian Institute of Certified Management Consultants (CAI CMC), the newly established association of management consultants in the Kyrgyz Republic.

MSME and Consulting sector in Kyrgyz Republic

The MSME sector

The MSME sector (excluding farmers) accounted for around 30 per cent of total GDP in 2010 and contributed almost 14 per cent to total employment in the Kyrgyz Republic. Most MSMEs are involved in the trade and services sector, more than three quarters are located in the capital city of Bishkek and Chui oblast, while 11 per cent operate in Osh and Osh region. To support business development, there are several non-governmental business representation organisations advocating the needs of MSMEs, such as the Chamber of Commerce of the Kyrgyz Republic, the Union of Entrepreneurs, the International Business Council and the Bishkek Business Club.

The consultancy market

The local infrastructure of business advisory services is seriously underdeveloped. The results of the BAS Annual Consultant Review 2010 – for which 58 consultancy firms were interviewed – highlight the main challenges on the supply side.

Consultancy companies in the Kyrgyz Republic are rather small, with more than 70 per cent employing less than 5 consultants, whilst none employed more than 25. MSMEs are either unaware of the services offered by consultants or not trusting of consultants. The consultancy market remains dependent on subsidies (average subsidies ranging from 25 to 46 per cent) and his heavily concentrated in the capital, Bishkek. Enhancing the provision of services to improve business planning and financial transparency is required to assist companies to secure financing in order to grow. In the longer term, developing advisory services in environmental management and energy efficiency is also a future growth area.

Trainings delivered to date by BAS, such as the core consulting skills course and more specific technical courses, have been well received although their impact has not been assessed systematically. With BAS support, the local association CAI CMC can play a pivotal role, for instance by running the CMC accreditation process, as well as providing other trainings to improve the quality and professionalism of the local advisory services market.

Institutional framework: government and donor support to the MSME sector

In October 2009, the Kyrgyz government has been restructured, and the responsibility for SME policy and development was delegated to the Ministry of Economic Regulations (MER). Following the political turmoil in 2010, which adversely affected MSMEs, the MER is in the process of restructuring. MSMEs rely on comprehensive support from international donor programmes mostly targeted at the business environment and micro finance. The World Bank has been playing a crucial role in SME financing whereas USAID has been investing in the MSME sector, notably through the Business Environment Improvement (BEI) project. Other important donors include the Asian Development Bank, GTZ, the Swiss Secretariat for Economic Affairs (SECO) and the Aga Khan Development Network. The European Union has committed itself to support SME performance in the Kyrgyz Republic under the Development and Cooperation Instrument (DCI).

TAM/BAS continuation in Kyrgyz Republic

Although TAM has been present in the country since 1998 and BAS since 2004, there is a considerable need for the Programme in the Kyrgyz Republic to continue over the coming three year period. Unrest in the first half of 2010 has given way to a period of uncertainty. The economic damage caused by looting and the general economic downturn has been felt particularly in the South but it has affected virtually every enterprise in the country. As enterprises endure a fragile post-conflict period, support provided by TAM/BAS is essential for sustainable growth, both at the enterprise level and the market development level. Key industry sectors to be supported include agribusiness (particularly food processing), manufacturing (especially textiles), wholesale and trade, and tourism. Where possible, TAM/BAS will seek to supplement the delivery of management and advisory services with increased access to finance through linkages with EBRD banking teams, credit lines and partner financial institutions. TAM/BAS will continue to address cross-cutting issues that are pertinent to MSME sector development in the Kyrgyz Republic. BAS will build on its previous record over the past five years of addressing cross-cutting issues in particular gender (32 per cent of all projects), and rural development (30 per cent).

TAM will continue to focus on medium sized businesses that require international expertise in strategic planning, corporate governance and other vital business development areas on a cost sharing basis as per the new TAM/BAS Strategic Plan 2011-2015. TAM will continue to target companies outside the capital and in key growth industries. The ICT Business Incubator in Bishkek will continue to provide trainings and support to the growing IT sector. Where appropriate, TAM will assist enterprises that have links with EBRD banking operations, to either support and strengthen the management during the pre or post investment stage. TAM will also stress the importance of strong financial reporting with each enterprise it assists, by including financial specialists on projects. Where practical, TAM will twin with local consultants to ensure that the application of international knowledge and skills, particularly in energy efficiency and environmental services, is delivered in a sustainable manner.

Continued BAS intervention is needed to support MSME development and the sustainability of the local advisory services market. BAS will seek to develop the local market for business advisory services and the infrastructure of MSME support,across the following dimensions: (i) *Stimulate demand for business advisory services*, particularly among micro and small enterprises in the South and rural areas to deliver tangible benefits to companies and generate a demonstration effect to improve competitiveness; (ii) *Strengthen supply of business advisory services*, particularly for enterprises outside the capital, to improve access to business best practice and technology, particularly to improve market performance and strategic planning; (iii) *Improve quality of local business advisory services*, especially in more sophisticated areas in need such as corporate governance and quality management; (iv) *Continue formalisation of the consultancy industry and MSME institutional framework*, through continued support for the local association of consultants plus new public and/or private initiatives to develop the business enabling environment.

BAS will continue to prioritise interventions that generate maximum benefit and transition impact with a view to building a sustainable infrastructure of business advisory services. BAS will seek to exit from areas where supply and demand for the service are at a level at which the intervention is no longer additional and focus increasingly on underserved areas, such as the South through the existing office in Osh as well as Naryn in the South-East and Talas in the West. The BAS grant will remain a key instrument of BAS assistance with the grant percentage reviewed annually to ensure the continued additionality of BAS interventions. Higher grants will be given to enterprises outside the capital city in the southern part of the country, most affected by the events of 2010. In addition, higher grants will be given to support projects to improve market performance, introduce quality management and certification, energy efficiency and to improve environmental management.

BAS assistance at the enterprise level will be complemented with the following market development activities:

- *Visibility and dissemination:* To promote the use of business advisory services, BAS will disseminate case studies of successful projects to entrepreneurs where consultancy is low in demand. BAS will organise publications in local

- *MSME and consultancy training*: BAS will collaborate with CAI CMC and other stakeholders to build the capacity of the local advisory services industry and MSMEs. Key products to be delivered include Core Consulting Skills, Start-your-consulting-business as well as more specialised topics in areas such as financial management with a view to ultimately establishing a system of continuous professional development (CPD).
- *Support to and development of existing local institutions*: BAS will continue supporting the Central Asian Institute of Certified Management Consultants in particular to become a full member of the International Council of Management Consultancy Institutes (ICMCI). In addition, BAS will build partnerships with NGOs to implement MDAs and support enterprises in geographical areas with limited BAS representation to date (Naryn and Talas). In the long term, transferring business support functions to these local institutions will support the long term sustainability of the intervention.

Contribution to EBRD policy dialogue

TAM/BAS will continue to contribute to policy dialogue initiatives in the Kyrgyz Republic at the national and regional levels. At the national level, one of the main mechanisms for policy dialogue is the BAS Steering Committee (SC) bringing together stakeholders from the business community and government representatives to discuss MSME issues and set the priorities for the programme. The SC meets on a six monthly basis. In the regions, TAM/BAS cooperates with appropriate Government representatives in order to promote the MSME development mission and deliver TAM/BAS information to a broader audience of entrepreneurs.

ANNEX 5 - TECHNICAL ASSISTANCE

TC COMMITMENTS BY DONOR THROUGH EBRD, 2008-2010

Donor	TC Commitments (€)
Belgium	50,000
Early Transition Countries Fund	3,133,880
EBRD Shareholder Special Fund	6,634,319
EBRD Water Fund	300,000
Japan	148,880
Korea	280,000
Luxembourg	85,269
Sweden	97,680
Switzerland	2,622,624
Total	**13,352,652**

TC COMMITMENTS BY SECTOR THROUGH EBRD, 2008-2010

Sector	TC Commitments (€)
Energy Efficiency and Climate Change	124,960
Environment	53,500
Financial Institutions	1,420,000
Legal Transition	1,531,920
Municipal Environmental Infrastructure	2,421,785
Other (including Investment Council)	629,318
Power and Energy	800,000
TAM/BAS	3,795,325
Transport	2,575,844
Total	**13,352,652**

ANNEX 6 - SELECTED ECONOMIC INDICATORS

	2005	2006	2007	2008	2009	2010 *Estimate*	2011 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	-0.2	3.1	8.5	7.6	2.9	-1.4	6.3
Private consumption	13.8	23.1	11.9	17.9	-20.9	11.0	na
Public consumption	-2.9	8.1	21.0	6.8	16.2	7.8	na
Gross fixed capital formation	6.0	10.0	12.0	6.0	15.0	-6.0	na
Exports of goods and services	-3.9	20.9	41.2	17.4	1.5	-22.2	na
Imports of goods and services	12.9	44.6	34.5	23.2	-13.2	-10.8	na
Industrial gross output	-12.1	-10.2	7.3	14.9	-6.4	na	na
Agricultural gross output	-4.2	1.7	1.5	0.8	7.4	na	na
Employment			*(Percentage change)*				
Labour force (end-year)[1]	-0.4	0.9	0.8	0.8	0.8	0.5	na
Employment (end-year)	1.6	1.7	1.4	1.4	0.1	0.7	na
			(In per cent of labour force)				
Unemployment (end-year)	7.2	6.5	5.9	5.4	6.0	5.8	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	4.3	5.6	10.2	24.5	6.8	7.8	19.9
Consumer prices (end-year)	4.9	5.1	20.1	20.1	0.0	18.9	12.5
Producer prices (annual average)	2.8	15.3	11.8	26.4	12.0	22.9	na
Producer prices (end-year)	6.3	10.4	20.6	17.4	20.4	0.2	na
Gross average monthly earnings in economy (annual average)	16.6	25.2	21.4	35.5	14.6	15.8	na
Government sector[2]			*(In per cent of GDP)*				
General government balance	-3.8	-2.7	-0.6	0.0	-3.5	-6.5	-7.6
General government expenditure	28.5	29.1	31.0	29.2	36.1	38.1	42.3
General government debt	85.9	72.5	56.8	48.5	58.0	62.6	56.5
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	17.8	51.0	44.2	6.5	17.5	23.6	na
Domestic credit (end-year)	19.6	39.8	49.8	18.5	-15.0	17.1	na
			(In per cent of GDP)				
Broad money (M2, end-year)	15.8	21.2	24.5	19.7	21.6	25.3	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Official rate	6.2	4.7	13.2	18.3	1.9	6.6	na
Money market rate[3]	4.4	4.8	4.9	13.2	10.6	4.6	na
Deposit rate[4]	5.8	5.6	5.4	4.0	3.9	4.1	na
Lending rate[4]	26.6	23.2	25.3	19.9	23.0	31.5	na
			(Soms per US dollar)				
Exchange rate (end-year)	41.3	38.1	35.5	39.4	44.1	47.1	na
Exchange rate (annual average)	41.0	40.2	37.3	36.6	42.9	46.0	na
External sector			*(In millions of US dollars)*				
Current account	68.8	-87.2	-5.8	-413.2	30.0	-98.0	-453.0
Trade balance	-311.5	-686.5	-1,076.0	-1,612.2	-978.6	-1,144.0	-1,640.0
Merchandise exports	794.0	1,106.0	1,559.5	2,141.4	1,835.0	1,837.0	2,271.0
Merchandise imports	1,105.5	1,792.4	2,635.5	3,753.5	2,813.6	2,981.0	3,911.0
Foreign direct investment, net	42.6	182.0	208.1	265.2	190.0	234.0	219.0
Gross reserves, excluding gold (end-year)	569.7	764.4	1,107.2	1,152.9	1,494.0	1,603.6	na
External debt stock	2,103.9	2,205.1	2,291.1	2,113.0	2,472.0	2,644.0	2,647.0
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.9	4.1	4.1	2.9	4.9	4.9	na
			(In per cent of exports of goods and services)				
Debt service	7.1	5.7	4.4	3.6	3.2	3.6	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	5.1	5.2	5.2	5.3	5.3	5.3	5.4
GDP (in millions of soms)	100,899.2	113,800.1	141,897.7	187,991.9	201,222.9	212,177.4	245,685.4
GDP per capita (in US dollars)	478.7	545.8	726.9	974.6	882.8	863.8	1,055.5
Share of industry in GDP (in per cent)	17.3	14.9	13.1	15.2	16.9	19.4	na
Share of agriculture in GDP (in per cent)	28.5	28.7	26.9	23.5	18.8	18.5	na
Current account/GDP (in per cent)	2.8	-3.1	-0.2	-8.1	0.7	-2.1	-8.7
External debt - reserves (in US$ million)	1,534.2	1,440.8	1,183.8	960.1	978.0	1,040.4	na
External debt/GDP (in per cent)	85.5	77.7	60.2	41.2	52.8	57.3	51.0
External debt/exports of goods and services (in per cent)	199.7	148.5	102.1	69.6	91.7	104.5	84.5

1 Based on labour force data from IMF World Economic Outlook, May 2011

2 General government includes the state, municipalities and extra-budgetary funds. It also includes expenditure under the foreign-financed public investment programme and net lending.

3 Weighted average rate on interbank loans in soms with 1-90 day maturities, from International Financial Statistics.

4 Weighted average over all maturities from International Financial Statistics.

ANNEX 7 – GENDER EQUALITY

In contrast to statistics on poverty and human development, on which Kyrgyz Republic scores relatively low on a global scale, the country's score on the Gender Inequality Index is more positive. The Gender Equality Index was designed to indicate how national human development achievements are eroded by gender inequality. When reproductive health, education, political and labour dimensions of gender equality are factored in, Kyrgyz Republic scores amongst the richer countries of the Human Development Index (HDI).

	Index/% (1.0 max)	**Ranking (out of 169)**	**Year**
Human Development Index	0.598	109	2010
Gender Inequality Index	0.560	63	2008

Source: UNDP Human Development Index 2010

However, a number of areas of concern remain. In the years following transition, according to the ILO figures, gender differences have broadened in terms of labour force participation. The level of women in employment has decreased from 65 per cent in 1990 to 59.3 per cent in 2009. The overall level of male employment exceeds those of women by around 20 per cent. This trend is more significant in women aged 25-34 and appears to be related to women's reproductive years, particularly in the private sector where an employee's maternity rights are usually enforced only in large enterprises or organisations with a strong union presence. Also, rural women face additional barriers in terms of accessing employment opportunities.

	Female	Male	Year
Labour force participation	59.3%	82.9%	2009
Informal employment	22.4%	25.4%	2003
Unemployment rates	9.4%	7.3%	2009

Source: ILO Key Indicators of the Labour Market 2009

According to the UN, in the post-transition period gender disparities have become more pronounced in terms of job status and increased segregation in the labour market. Most women are clustered in traditionally feminised low pay, low status professions mainly in the public sector, including education, healthcare and social services. In addition, men have moved into previously feminised sectors, such as banking, and dominate at management level. Discrimination against women, including sexual harassment, has become common in the workplace, according to local NGOs.

The wage gap between men and women is close to the world average but it increases for certain female dominated professions where salaries are approximately 2.5 times lower than salaries in traditionally ‘male’ sectors, such as mining, construction and transport.

Estimated ratio of female to male income	0.55	2007

Source: UNDP Human Development Index 2007 (latest available data)

Many obstacles faced by Kyrgyz entrepreneurs are universal; however, women entrepreneurs tend to encounter greater difficulties, especially regarding access to finance for business start-ups. As a result, women are generally not well represented among entrepreneurs and are concentrated in low profit micro and small business, trade and informal sector. Also, just over 20 per cent of executive managers of registered business entities are women.

According to the 2009 ILO study on assessing the business environment for women’s entrepreneurship development in the Kyrgyz Republic, much of the micro-credit (around 80 per cent) provided to women entrepreneurs was supplied by non-bank financial institutions while commercial banks preferred to extend loans to men. It should be noted, however, that the Country Gender Assessment carried out in 2008 did not reveal any regulatory discrimination against women in access to finance and credit. Out of 36 per cent of women who applied for credit to commercial banks, 83 per cent of applications were successful. According to the EBRD/World Bank BEEPS 2008-2009, out of all Kyrgyz companies in the sample which applied for a loan in fiscal year 2007, 46 firms (65 per cent of those firms who applied) had a female among owners and out of them only 11 (24 per cent) applications were rejected.

This implies that along with other obstacles that may be preventing women from applying and receiving credit on the same footing as their male counterparts, women find it difficult to provide collateral that commercial banks usually require, and also, certain gender stereotypes still continue to disadvantage women on the credit market.