Kyrgyz Republic: Investment Climate Improvement Program - Subprogram 2

**Project Name**: Investment Climate Improvement Program - Subprogram 2

**Project Number**: 41544-082

**Country**: Kyrgyz Republic

**Project Status**: Closed

**Project Type / Modality of Assistance**: Grant

**Source of Funding / Amount**:

- Grant 0319-KGZ: Investment Climate Improvement Program - Subprogram 2 (Preparing Subprogram 3)
  - Concessional ordinary capital resources lending / Asian Development Fund
  - US$ 20.00 million

- TA 8222-KGZ: Investment Climate Improvement Program - Subprogram 2 (Preparing Subprogram 3)
  - Technical Assistance Special Fund
  - US$ 550,000.00

  - Financial Sector Development Partnership Fund
  - US$ 150,000.00

**Strategic Agendas**

- Inclusive economic growth

**Drivers of Change**

- Governance and capacity development
- Private sector development

**Sector / Subsector**

- Education - Technical and vocational education and training
- Finance - Finance sector development - Inclusive finance - Small and medium enterprise finance and leasing
- Industry and trade - Industry and trade sector development
- Public sector management - Economic affairs management - Law and judiciary - Public expenditure and fiscal management

**Gender Equity and Mainstreaming**

- Effective gender mainstreaming

**Description**

The Investment Climate Improvement Program, approved by the Asian Development Bank (ADB) in 2008, follows a programmatic approach and envisages three subprograms to assist the government in creating conditions for sustainable economic growth and employment-generating investments. Subprogram 1, implemented in 2007-2008, included a policy-based grant, a project grant supporting the development of information technology systems for effective implementation of reforms, and a TA grant to help prepare subprogram 2. Preparation and implementation of subprogram 2 has also benefited from and reinforced other interventions. The reforms supported under subprogram 2 build on the achievements made under subprogram 1 despite difficult political and external conditions. They address binding constraints to private sector development and diversification in the areas of business regulation and taxation, access to finance, worker skills development, and public-private partnerships (PPPs).

The relevance of these constraints has been confirmed through recent studies and surveys, which explain some deviations from the constraints originally identified in 2008. Subprogram 2 is effectively gender mainstreamed to maximize benefits to women. The reform agenda that remains after subprogram 2 will be addressed under subprogram 3. Subprogram 2 complements the efforts of (i) ADB and other development partners to strengthen physical infrastructure and improve access to finance; and (ii) the International Monetary Fund (IMF) to rebuild fiscal buffers and safeguard monetary stability, which are important for a healthy business and investment climate.

Improving the investment climate for the private sector is critical for the government’s economic growth policies. Subprogram 2 contributes toward this end. The Government of the Kyrgyz Republic emphasizes improving the business climate. ADB’s country operations business plan for the Kyrgyz Republic identifies subprogram 2 as a means of broadening the Kyrgyz economy and its private sector.

**Project Rationale and Linkage to Country/Regional Strategy**

With almost a third of its 5.6 million people living in poverty, the Kyrgyz Republic’s economic growth and investment have been low and unstable. Growth of gross domestic product (GDP) averaged 4.1% since 2002, fluctuating from 1.4% to 8.5%. Gross fixed capital formation increased from 16.4% of GDP in 2005 to 25.3% in 2011, but its growth was volatile. The country has attracted foreign investment, but mainly in gold mining, which generates little employment. The official unemployment rate was 7.8% in 2011, but actual unemployment may be much higher. Low growth rates and economic instability were mainly caused by weaknesses in the business environment, combined with internal and external shocks. These included political turmoil in 2005 and 2010, and spillover from the global crisis in 2008-2009, mainly through Kazakhstan and the Russian Federation. Insufficient economic diversification makes the economy of the Kyrgyz Republic particularly vulnerable to shocks.

With the investment climate and despite past reforms, private enterprises still suffer from excessive regulatory and licensing requirements, pervasive inspections by various enforcement agencies, complex and arbitrary taxation, and cross-border trade barriers such as complex pre-customs clearance. These, with the room for corruption and fraud they create, constrain most private enterprises, especially women entrepreneurs’ smaller businesses. Remaining policy, legal, and regulatory issues restrict access to finance, particularly for micro, small, and medium-sized enterprises and women entrepreneurs, who frequently have little collateral to offer for credit. Inadequate worker skills are an increasingly pressing issue, as the education system responds poorly to changing market needs and many qualified workers seek employment abroad. Labor migrants’ remittances reached 25% of GDP in 2010, but they fuel consumption rather than investment and increase imports, as the weak business environment prevents many enterprises from positively responding to demand by increasing production and employment. Finally, weaknesses in the education and health systems and inadequate infrastructure in other sectors frequently result from underinvestment. A weak enabling environment has been preventing private investment in these areas. Due to fiscal weakness, the Kyrgyz Republic is in particular need of such investment.

There is broad consensus that the long-term development prospects of the Kyrgyz Republic depend on its ability to improve its investment climate to develop a vibrant private sector, diversify the economy, and expand markets. This would make the economy more resilient, promote long-term growth, create additional employment, and help reduce poverty.

**Impact**

Sustainable economic growth and employment creation

**Project Outcome**

**Description of Outcome**: Improved investment climate and business environment

**Progress Toward Outcome**: Policy reforms under subprogram 2 have been completed.

**Implementation Progress**
Description of Project Outputs
1. Cost of regulatory compliance reduced
2. Access to finance improved
3. Workers’ skills enhanced
4. Private public partnerships in infrastructure and social services facilitated

Status of Implementation Progress (Outputs, Activities, and Issues)
All policy actions under subprogram 2 have been implemented. The attached technical assistance that supports implementation of subprogram 3 was extended to 15 October 2014.

Geographical Location

Safeguard Categories

| Environment | C |
| Involuntary Resettlement | C |
| Indigenous Peoples | C |

Summary of Environmental and Social Aspects

Environmental Aspects | C
Involuntary Resettlement | C
Indigenous Peoples | C

Stakeholder Communication, Participation, and Consultation

During Project Design
The project design rests on the design of the ICIP cluster, which was developed in 2007-2008 based on comprehensive stakeholder consultations, leading to the approval of the cluster and subprogram 1 in 2008.

During Project Implementation
Consultations were continued from 2009 onwards through a TA approved together with subprogram 1 to prepare subprogram 2 and a sequence of reconnaissance and consultation mission. An official fact-finding mission was held in November-December 2011. A final consultation mission was held in September 2012.

Business Opportunities
Consulting Services
The TA will require 13 person-months of international and 52.0 person-months of national consultants’ services. The consultants will be a national business-regulation expert for 10.0 person-months, an international microfinance regulation expert for 3 person-months, an international financial market expert for 2.0 person-months, an international PPP specialist for 8.0 person-months, two national PPP specialists for 24.0 person-months, and a national legal expert for 18.0 person-months. The consultants will not likely be fielded at the same time and focus on three not directly related outputs. All international and national consultants will, therefore, be engaged on an individual basis in accordance with ADB’s Guideline on the Use of Consultants (2007, as amended from time to time), and ADB’s procedures for recruiting individual consultants. ADB staff will oversee the consultants’ work and act as team leader.

Update as of 26 March 2014
Four international consultants (Microfinance, PPP, Legal and Deposit Insurance experts) and six national consultants (Legal, Business regulation, foreign trade clearance, Finance, and PPP experts) have been engaged since January 2013. The TA has been extended to 30 September 2014. It is proposed to engage one international microfinance regulation expert for 2 person-months from April to end Sep 2014 on intermittent basis.

Procurement
No procurement of goods/services is envisaged.

Responsible ADB Officer
Ruben Barreto

Responsible ADB Department
Central and West Asia Department

Responsible ADB Division
Public Management, Financial Sector and Trade Division, CWRD

Executing Agencies
Ministry of Economy
106, Chui Prospect, Bishkek, Kyrgyz Republic

Timetable

| Concept Clearance | - |
| Fact Finding | 22 Nov 2011 to 02 Dec 2011 |
| MRM | - |
| Approval | 26 Nov 2012 |
| Last Review Mission | - |
| Last PDS Update | 16 Sep 2014 |

Grant 0319-KGZ

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### TA 8222-KGZ

#### Milestones

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#### Financing Plan/TA Utilization

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#### Cumulative Disbursements

- Gov
- Beneficiaries
- Project Sponsor
- Others

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**Project Page**
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