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Kyrgyz Republic

Systematic Country Diagnostic Update

From Vulnerability to Resilience

May 4, 2023



Document of the World Bank

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GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of May 4, 2023)

Currency Unit = Kyrgyz Som (KGS)

US\$1 = KGZ 87.52

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYMS

ACLED	Armed Conflict Location Event Database
BEEPS	Business Environment and Enterprise Performance Survey
BTI	Bertelsmann Stiftung's Transformation Index
CE	Citizen engagement
CSP	Community Support Program
ECA	Europe and Central Asia
EPI	Environmental Performance Index
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GoKR	Government of the Kyrgyz Republic
GNI	Gross National Income
GRID	Green, Resilient, and Inclusive Development
LIC	Low-Income Country
LMIC	Lower Middle-Income Country
LSG	local self-governments
LFPR	Labor force participation rate
KIHS	Kyrgyz Integrated Households budgets and Labor force survey
MoF	Ministry of Finance
NDC	Nationally Defined Contributions
PPP	Purchasing Power Parity
PPP	Public Private Partnership
SCD	Systematic Country Diagnostics
UBK	Uibologo Komok, the social protection program targeted at poor children

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EXECUTIVE SUMMARY

The Kyrgyz Republic has recorded steady progress in poverty reduction and shared prosperity over the past twenty years. Between 2000 and 2019, the country maintained an average annual per capita GDP growth rate of 4.5 percent, which was shared amongst the bottom 40 percent of households and sufficient to reduce poverty from 62.6 to 20 percent (at the national poverty line). Initially, growth was facilitated by a shift in employment from agriculture to services and light industry, but latterly, by scaling up gold mining and worker remittances from abroad. However, the poverty reduction achieved was shallow, and many households stuck just above the poverty line were vulnerable to falling back down. And indeed, the onset of COVID-19, combined with intensified political turbulence in 2020, saw a sharp drop in GDP, a decline in remittances, a renewed rise in poverty, and an erosion of human capital. Responding to the pandemic's impact on lives and livelihoods required a substantial fiscal expansion, triggering an economic recovery and a sharp increase in public debt. The economy started recovering with an average growth rate of 6.6 percent in 2021-22. However, with macroeconomic buffers significantly eroded, there is little policy space left to respond to emerging challenges and increased uncertainty stemming from the expected global slowdown, spillovers from Russia's invasion of Ukraine, and sanctions against Russia.

The Government's National Development Program to 2040 sets a clear target for continued growth and improved living standards. The NDP sets out the ambition of achieving 5 percent average annual GDP growth, reaching upper-middle income country (UMIC) status by 2040; reducing the unemployment rate to 5 percent; ensuring annual FDI flows of at least 13 percent of GDP; maintaining public debt below 60 percent of GDP and reducing poverty to less than 20 percent of the population. Attaining these goals will require a shift from volatile sources of growth to productivity-enhancing structural change. To make good progress on these goals, strong reform actions will be required to strengthen policy and institutional frameworks, the initiation of which should start now. Remittances and gold will not suffice as drivers of future growth. Moreover, inequalities across several dimensions remain stark – with very poor service delivery in rural areas and women facing severe challenges.

The overarching theme of the SCD Update is the need to improve the economic environment to create jobs and efficiently provide public goods and services while ensuring the efficiency of natural resources to build climate resilience, reduce vulnerability, and support green growth. The central goals of rising prosperity and falling poverty face three threats in the current international context: (i) slowing global growth and higher vulnerability to external shocks – disruptions to trade and transit, food and energy price shocks that jeopardize the progress on fighting poverty, and climate shocks; (ii) a decline in competitiveness as relative productivity performance deteriorates because of poor opportunities for the private sector amidst dominant SOEs, large infrastructure gaps, and inadequate banking and capital markets; and (iii) institutional under-preparedness to address the new generation of complex development tasks and manage risks through long neglect, especially in public policy and governance, but also in capabilities to handle climate change risks.

In this context, this report finds that the transition of the Kyrgyz economy to productivity-driven growth is constrained by the following key issues:

Continued dependence on old drivers of growth. The private sector remains dominated by micro-enterprises and lacks medium-sized companies. Job creation is proceeding more slowly than working-age population growth. The failure of new engines of growth to emerge is contributed to by multiple policy failures, but the poor environment for private sector investment is a major barrier.

Progress on poverty reduction and inclusion stalls, and the potential for further gains remains uncertain. Social vulnerability, defined by the probability of falling into poverty, remains high. Meanwhile, large urban-rural and intraregional disparities and gaps in service delivery, infrastructure, and livelihood opportunities are sources of popular discontent. What's more, inactivity rates are increasing, particularly among women, who continue to face barriers to self-employment and entrepreneurship.

Little progress on institutional reforms and governance strengthening. Little progress was made in redefining the state's role to support efficient public service delivery and growth. The country scores poorly on governance and anti-corruption indicators.¹ Lack of transparency in government decisions and policy reversals (e.g., in public procurement laws) are barriers to attracting investment. On the other hand, the recent resolution of the dispute around the Kumtor gold mine between the authorities and a foreign investor² could strengthen the investment climate and facilitate gold exports.³

Increased environmental risks, natural resource degradation, and vulnerabilities. The Kyrgyz Republic is highly carbon intensive, despite the heavy reliance on hydropower. It has experienced water and land degradation, biodiversity loss, air pollution, and other detrimental impacts on health and labor productivity. Land degradation has deepened vulnerabilities for people, undermining the provision of critical ecosystem services.

Climate change will affect the country with projected increases in temperature significantly above the global average. The Kyrgyz Republic is the third most vulnerable country to climate change in the ECA region and is highly exposed to natural hazards and seismic risks. Droughts are common. Climate change will raise the frequency and intensity of disasters, greatly amplifying pressures on human lives, livelihoods, and ecosystems. Heat could combine with an increased incidence of drought to expand arid land cover; increased surface water evaporation leads to higher soil salinity and increased glacial water melts. Without effective adaptation, agricultural yields are likely to suffer by up to 30 percent by 2050.

This update to the 2018 Systematic Country Diagnostic (SCD) finds that the core constraints to growth and poverty reduction identified by the original SCD remain valid. Momentous shocks in recent years, such as COVID-19, have seriously impacted development outcomes,

¹ In 2022, the Kyrgyz Republic ranked 140 out of 180 countries in the Transparency International's Corruption Perception Index and in the World Bank's World Governance Indicators for 2021 it ranked in the bottom 20 per cent in rule of law and control of corruption indices and in the bottom 25 per cent for government effectiveness.

² In an out-of-court settlement in April 2022 the Kyrgyz Republic received full ownership of Kumtor Gold Company in exchange for its share in the investor company. The London Bullion Market Association (LMBA) restored Kyrgyz Republic's Good Delivery status in September 2022 which allows selling of Kyrgyz gold bullion in international markets.

³ IMF Staff Report on Article IV Consultations, approved by the IMF Board in January 2023

but this serves as evidence of the underlying vulnerability that was highlighted in the original SCD. The main message of this SCD Update is unchanged – namely that the current drivers of growth in the Kyrgyz Republic cannot be relied on for future development, and there is a need to intensify efforts to develop new sustainable sources of growth. Given the increasing threat of climate change, degradation of natural resources, and the centrality of adaptation to sustained growth, this SCD Update adds more emphasis on natural resource efficiency to build climate resilience, reduce vulnerability, and support green growth.⁴

Pathway 1: Catalyze private sector-led growth by ushering in greater macroeconomic stability, market contestability, connectivity, and trade integration, and improved access to finance.

The authorities should strengthen frameworks for predictable fiscal management and inflation control to provide the stability needed to support private investment and growth.

A prerequisite to private sector-led growth is a stable macroeconomic framework that enables private investors to plan and invest for the longer term. Over the years, fiscal management has been fitful and prone to deviations from its targets, although the government has maintained stronger fiscal discipline in recent years. This practice should be continued and perhaps embedded in a longer-term fiscal strategy to support improved stability and, thereby, the investment environment. Similarly, strengthening the tools available to the monetary authorities and coordinating fiscal and monetary policy will support a stable and low-inflation environment. Complementary reforms are needed to improve the governance of SOEs, create fiscal space, and prioritize essential spending, especially for high-return social and economic public investments. Additional reforms will be necessary to streamline the public sector wage bill, implement public administration reforms, and reduce budget subsidies to SOEs in line with the structural reforms of utility sectors. Enhancing the social protection system to safeguard the most vulnerable population segments and provide targeted social assistance is paramount. The governance of SOEs needs significant strengthening to improve ownership responsibilities, the transparency of budget transfers, procurement, performance management, and corporate governance.

The private sector faces several constraints stemming from excess bureaucracy, pervasive corruption, and weak regulatory frameworks. Firms overwhelmingly report corruption, informality, and political instability as major constraints. Access to finance and high barriers to international trade present additional burdens, especially in all aspects of trade facilitation and connectivity. The Kyrgyz Republic participates in global value chains (GVCs) primarily through exporting commodities, but the transition to more sophisticated participation in GVCs becomes increasingly more demanding in terms of skills, connectivity, and regulatory institutions.

Pathway 2: Promote inclusion by investing in human capital and improved public services with reforms in social protection

⁴ The existing three pillars of the SCD were: i) addressing poor governance and institutional quality; ii) removing obstacles to private sector growth and formalization; and iii) improving opportunities and protection for the poor, with cross-cutting priorities to improve social services, support sustainable resource use and address climate change.

Building human capital will be critical to inclusivity in growth. Despite gradual improvement in recent years, almost half of the children finishing primary school are yet to attain the basic proficiency in reading and comprehension.⁵ Pathways to improved educational outcomes lie in investment in the resilience, learning recovery, and quality enhancement of basic education through the digitization of teaching, enhanced remediation programs with continuous learning assessments, improved education content, teacher capacity, monitoring and assessment, and governance systems. It is also necessary to invest in expanding equitable access to quality ECE programs, boosting the quality and market relevance of skills development, and the capacity of research and innovation of higher education.

It is critical to ensure public access to essential health services, prioritizing higher quality, accessible, affordable primary health care provision. Service delivery is still highly focused on the maternal-child side and is not well prepared to address the increasing burden of noncommunicable diseases. Even in areas where service delivery is almost universal, such as prenatal care, the quality of care still has major gaps. The service delivery infrastructure is largely outdated, and the ratio of physicians per 1,000 people has steadily declined due to low wages and emigration. The government plans major infrastructure investments, including building 20-30 hospitals. This should ideally be accompanied by reforms to restructure the existing service delivery network, make the best use of existing resources, and be part of a consistent sector masterplan. On the financing side, the Kyrgyz Republic spends 2.6 percent of its GDP on public healthcare, well below the 4.6 percent average for the ECA region. The sector is highly dependent on out-of-pocket payments (especially for medicines), which limits access to adequate care for poor segments of the population. The Mandatory Health Insurance Fund consolidates funds from the contributory and subsidized health insurance schemes. However, its mandate, funding, and tools remain insufficient to be able to act as a strategic purchaser and provide the population with guaranteed access to a basic package of services. To be able to function as a strategic purchaser, its purchasing functions and tools need to be strengthened. The required actions include updating the state-guaranteed benefits package, provider payment methods based on outputs, data collection, and accountability mechanisms for results.

Transitioning to a more inclusive targeting approach for social protection programs will help protect the most vulnerable among the population. Scaling up the existing social protection programs and extended coverage could help mitigate the adverse effects of the loss of labor and remittance income.

Pathway 3: Build an effective state based on the rule of law, high governance standards, and strengthened risk-management capacities.

On these themes, despite bold plans, little progress has been made since the 2018 SCD. Despite the recent success in energy sector reforms, economic policy and reform implementation overall have suffered from political instability and weak government capacity. Governance and corruption remain key concerns for firms; weak contract

⁵ The National Sample-based Assessment of Learning Results (NSBA), 2017 reported that 59.8% of grade 4 students are below the basic proficiency level in reading and comprehension. The most recent results of NSBA, 2021 shows 49.2% of grade 4 students are below the basic proficiency level in reading and comprehension.

enforcement poses long-term risks, undermining potential returns for investors, and the country scores poorly on most governance indicators.

Of key importance is managing fragility and emerging sources of risk. At the regional level, contested border delimitation and management of transboundary resources provoke inter-community confrontations and frictions with neighboring countries. Opportunities to support conflict prevention include engaging with and supporting community-based institutions on both sides of the border to rebuild trust and investing in basic infrastructure and services and livelihood support in border communities.

There are serious deficiencies in local government services: The piped water supply service beyond the capital is largely intermittent and/or unsafe to drink, while solid waste collection coverage is inadequate with poor infrastructure. Investment planned in water, agriculture, forests, hydropower, and extractives requires environmental and social management systems for screening, scoping and analysis, risk mitigation and management, and monitoring and enforcement. To achieve this, capacity needs to be developed within environmental and social safeguard regulatory bodies, line ministry units responsible for project delivery, and the private sector.

Pathway 4: Strengthen natural resource efficiency to build climate resilience, reduce vulnerability, and support green growth

Facilitating the green transition will help to shift the Kyrgyz economy to a more resilient path, with positive spillovers on growth, welfare, and the environment. Inefficient management of the country's abundant resources undermines growth opportunities and raises risks for vulnerable households that are dependent on natural resources for their livelihoods. Climate change aggravates the risks stemming from resource degradation. Facilitating the green transition – by more efficient management of natural resources, tackling environmental externalities, and promoting a low-carbon, sustainable economy – offers opportunities to harness resources more sustainably in support of a more diversified growth path, more resilient livelihoods, and improved human and ecosystem health.

Strengthening the management of water resources is critical to driving opportunities for sustainable growth and improving the resilience of households. The main opportunities for diversified growth in the Kyrgyz economy – notably agriculture and energy exports, but also mining and, indirectly, tourism – are highly dependent on water. Water is also a crucial input for the multi-dimensional poverty reduction of farmers, particularly in the southern region. Integrated water resource management solutions and investments and policies that focus on harnessing water's productive potential are needed. Sustainable management of water resources will also require coordination and cooperation with other Central Asian countries on the water-energy nexus.

Sustainable and climate-smart agriculture can contribute to raising the productivity of smallholder agriculture. Rehabilitation and modernization of irrigation and drainage systems at off-farm and on-farm levels is needed and should be complemented with the promotion of climate-smart irrigation practices and resource utilization through improved on-farm water management practices.

Major infrastructure investments and service improvements lie in upgrading and modernization of water supply and sanitation (WSS), particularly in rural areas and small

towns, and improving irrigation services. Significant investments are needed to increase access to a safely managed drinking water supply, supported by strengthened policy and regulatory frameworks and institutional capacity at the national and local levels.

Exploiting huge and largely untapped hydropower and solar resources offers the Kyrgyz Republic a cost-effective pathway to meet growing energy demand, diversify the power mix, and expand green exports. To date, less than one-fifth of the country's hydropower potential has been exploited, while the country has an estimated 650 GW of unexploited solar power potential. At the same time, critical investments are needed in existing energy infrastructure to improve efficiency, reduce seasonal supply disruptions, and strengthen resilience to climate change. This will require tariff reforms and institutional strengthening to improve the sector's financial viability and pave the way to addressing the underinvestment in the maintenance and rehabilitation of energy infrastructure.

Landscape restoration and sustainable management of resources will boost the contribution of natural capital to economic growth through sustainable livelihoods and green jobs. Investments should be aimed at the restoration of degraded croplands, forestry, and pastures, improving the management of protected areas, strengthening glacier monitoring and risk assessment of the impact of climate change on infrastructure, and building protective measures against emergency risks.

Policy Priorities and High-Level Objectives

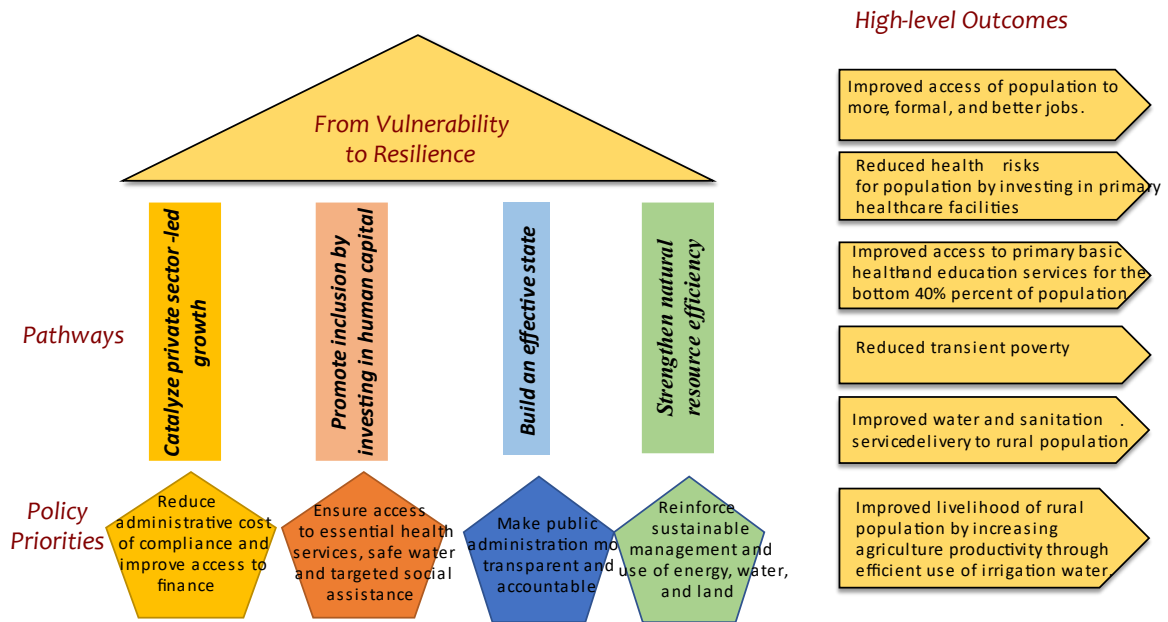
This SCD Update recommends 10 priority policies presented in Table 1 below for the 4 pathways briefly described above. It suggests that policies to reduce the cost of compliance with inspection and tax administration and to improve access to finance may have a bigger impact on growth and job creation. Policy priorities for promoting inclusion and human capital development relate to ensuring access to essential healthcare services and improving the protection of the most vulnerable among the population by transitioning towards a more effective targeting approach of the social protection programs. Policy priorities for building an effective state refer to addressing policy uncertainty, making the public administration more transparent and accountable, as well as clearly delineating functional responsibilities among different tiers and types of government, and separating different intergovernmental transfers. Policy priorities for ensuring green growth and climate change-focused strategies and practices refer to reinforcing the sustainable management and use of energy, water, and land resources to support improved livelihoods and economic outcomes and increase resilience to climate change. A more detailed list of policy recommendations and filters applied to derive the priority policies is presented in Table 3 of Section VI below.

Table 1: Pathways and 10 Policy Priorities Recommended by the SCD Update

<p>Pathway 1: <i>Catalyze private sector-led growth by ushering in greater macroeconomic stability, market contestability, connectivity, and trade integration, and improved access to finance</i></p>	<p>Pathway 2: <i>Promote inclusion by investing in human capital and improved public services with reforms in social protection</i></p>	<p>Pathway 3: <i>Build an effective state based on the rule of law, high governance standards, and strengthened risk-management capacities</i></p>	<p>Pathway 4: <i>Strengthen natural resource efficiency to build climate resilience, reduce vulnerability, and support green growth</i></p>
<p>Reduce the cost of compliance with inspections and tax administration by moving to risk-based inspections and audit practices</p>	<p>Ensure access to essential health services, prioritizing high quality, accessible, and affordable primary healthcare services</p>	<p>Address policy uncertainty and make public administration more transparent and accountable</p>	<p>Strengthen policy and regulatory frameworks and institutional capacity at the national and local levels to promote sustainable water and energy resource management</p>
<p>Improve access to finance</p>	<p>Expand access to safe water and sanitation services, underpinned by financial and institutional reforms in the WSS sector</p>	<p>Clearly delineate functional responsibilities of local governments and separate intergovernmental transfers supporting functions of local governments</p>	<p>Reinforce adequate small-scale infrastructure to promote on-farm service provision and market access</p>
	<p>Improve protection of the most vulnerable among the population by transitioning towards a more inclusive targeting approach of the social protection programs</p>		<p>Upgrade and modernize supply infrastructure and promote climate-smart irrigation practices</p>

The suggested development pathways and policies are expected to lead to high-level outcomes (HLOs), which are graphically illustrated in Chart 1 below. In improved access of the population to more and better-paid jobs facilitated by a reformed state: (ii) promoting inclusive well-being and improved access to essential healthcare and primary basic education services by the poorest and most vulnerable; and (iii) bolstering climate resilience through energy reforms, infrastructure linkages, and modernized natural resource management.

Chart 1: Pathways, Policy Priorities, and High-Level Outcomes



Source: Authors' graphic

I. INTRODUCTION

1. **This update to the Kyrgyz Republic Systematic Country Diagnostic 2018 (SCD) updates the World Bank Group assessment of the main constraints to poverty reduction and shared prosperity.** External developments and domestic instability since 2018 have increased risks that threaten to reverse the developmental gains achieved in the Kyrgyz Republic throughout the past two decades of the 2000s. Understanding how the economic and social context has changed because of these risks and identifying policies to help address them is essential in restoring poverty reduction and economic inclusion. This diagnostic identifies the reshaped principal constraints to inclusive growth and proposes the necessary policy changes for the authorities' consideration.

2. **Beyond updating the diagnostics, this report also reviews the pathways identified in the 2018 SCD and updates them in light of recent evidence and events.** The need for more inclusive sources of growth and better systems that reduce the widespread vulnerability of households to poverty is also addressed. The SCD Update highlights the critical threats to sustainability. It suggests four pathways to enhance the Kyrgyz economy's resilience to vulnerabilities through (i) catalyzing private sector-led growth by ushering in greater macroeconomic stability, greater market contestability, better connectivity, and trade integration and improved access to finance; (ii) promoting inclusion by investing in human capital and improved public services with reforms in social protection; (iii) building an effective state based on the rule of law, high governance standards, and strengthened risk-management capacities; and (iv) strengthening natural resource efficiency to build climate resilience, reduce vulnerability, and support green growth.

II. COUNTRY CONTEXT AND KEY RECENT ECONOMIC AND SOCIAL DEVELOPMENTS

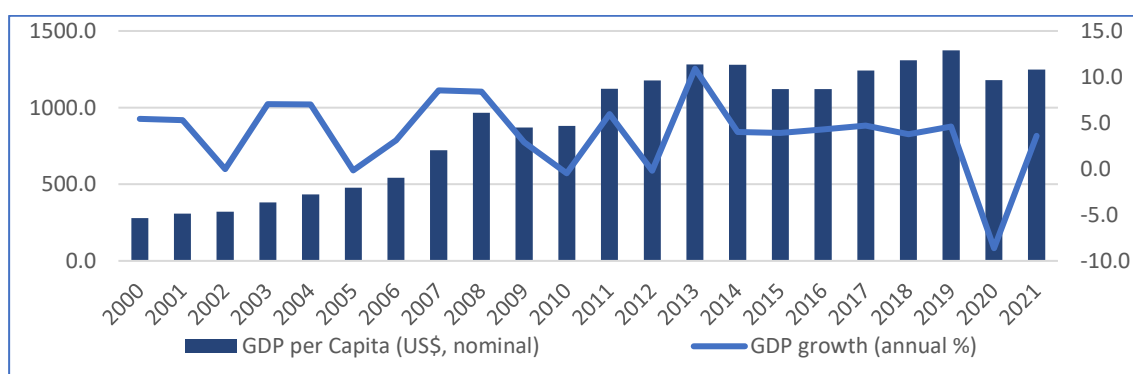
3. **The Kyrgyz Republic is a lower middle-income landlocked country close to the large markets of China, Russia, and South Asia.** The Kyrgyz Republic has been a lower middle-income country (LMIC) since 2013 and registered a per capita GDP of around US\$1,607 in 2022. Barely 7 percent of its land area is arable, with the rest consisting of glaciers, mountains, pastures, or steppe that support livestock grazing and forests. Over 90 percent of the Kyrgyz Republic’s territory of 198,500 km² area is at least 1,000 meters above sea level, and 30 percent is above 3,000 meters. Though small and landlocked, it is located within short reach of the huge markets of China, Russia, and South Asia.

4. **The country has a young and rapidly growing population, mostly rural.** The Kyrgyz Republic has a multi-ethnic, young, and fast-growing population. More than half (56 percent) of its population is below 30 years of age, and the average age is just over 25. The average annual growth rate of the population is 1.5 percent, similar across urban and rural areas. As of the end of 2021, the Kyrgyz Republic remained mostly rural, with only about a 35 percent urbanization ratio. Out of a population of 7 million, 1.2 million are migrant workers, mostly working in Russia, which hosts about 90 percent of migrants, and in Kazakhstan.

5. **The Kyrgyz Republic has significant hydroelectric potential and some sub-soil natural resources, such as gold, which it exploits.** The country’s natural resources include minerals - mainly gold- and abundant water for hydropower generation. The largest gold mine, Kumtor, currently accounts for 8 percent of the Kyrgyz Republic’s GDP, contributing 10 percent of fiscal revenues and about 30 percent of the country’s exports of goods.

6. **Over the past two decades, the Kyrgyz Republic has recorded solid growth, albeit volatile, but sufficient to elevate it out of low-income status (Figure 1).** Between 2000 and 2019, the Kyrgyz economy grew by about 4.5 percent on average per annum. Growth was driven mainly by gold, remittances, and a shift in labor from agriculture to low-productivity services. Growth dependence on metallic minerals and remittances led to growth sensitivity to exogenous factors and, thus, volatility. During this period, the Kyrgyz Republic experienced four contractions (in 2005, 2010, 2012, and 2020) and stagnation in 2002. Excepting the deep contraction of 2020, associated with the COVID-19 pandemic, all other episodes were associated either with the fall of remittances or gold extraction and exports.

Figure 1: GDP per Capita and Annual Rate of GDP Growth in the Kyrgyz Republic (2000-21)



Source: National Statistics Committee

7. **Growth has led to steady poverty reduction and shared prosperity.** From 2000 to 2020, the national poverty headcount ratio halved from 62.6 to 25 percent, and extreme poverty was almost eliminated (Figure 2).⁶ Poverty reduction was aided by economic growth, labor income, and remittance growth. Economic growth over this period- was inclusive and benefitted most of those at the bottom 40 percent of the income distribution. These outcomes were achieved against a backdrop of reallocation of labor from low-productivity agriculture to higher productivity services, which in turn resulted in a shrinkage in the share of agriculture employment from over 34 percent to nearly 18 percent of total employment and an expansion of gold production and exports, which have more than tripled their share in GDP over the past two decades.

8. **Remittances from outward migration, mainly to Russia, have been a driver of poverty reduction, especially among the poorest households.** Since the 2000s, international migration has provided job opportunities for many workers from the Kyrgyz Republic and their families in the context of a youth bulge and the limited absorptive capacity of the domestic economy. According to official sources, 1.2 million Kyrgyz people work abroad, which accounts for 31 percent of the country's working-age population and 17 percent of the total population who transferred remittances at about 33 percent of GDP in 2021.⁷ While real wages have increased rapidly over the past decade, wage differentials with countries such as Kazakhstan and the Russian Federation remain large, as migrants can earn about twice the wage they would earn in the Kyrgyz Republic by working in these destinations. Remittances have both lifted many households out of poverty and protected them from falling back into it during economic setbacks, especially in the rural South. During the first three quarters of 2022, migrants transferred US\$2,2 billion to the country- US\$188 million more than during the same period of 2021. Russia continues to account for over 97 percent of remittances. However, the outflow of remittances from the Kyrgyz Republic was also high at US\$780 mln during the nine months of the current year, much higher than the US\$563 mln for the full year of 2021. It is estimated that in net terms, remittances to the Kyrgyz Republic will see a decline in 2022.

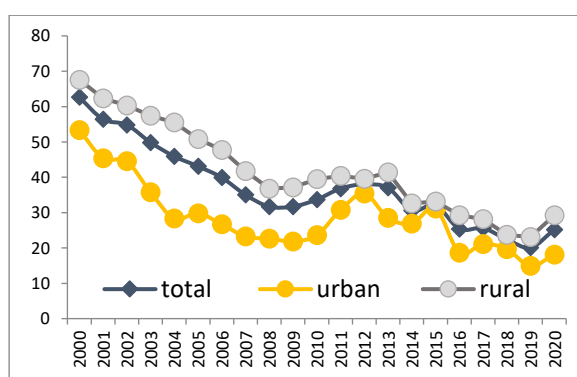
9. **But Kyrgyzstan's progress toward the twin goals has lagged behind its regional peers, and poverty remains pronounced.** In comparison to other countries in the ECA region at an internationally comparable US\$3.65 poverty line (at 2017 PPP), with poverty at an estimated 21.8 percent in 2021 (at US\$3.65 a day, 2017 PPP), the Kyrgyz Republic remains towards the

⁶ There are two series of poverty estimates available for the Kyrgyz Republic: (i) estimates based on the international poverty line for the lower-middle income countries expressed in terms of 2017 purchasing power parity (PPP), and (ii) estimates based on the national poverty line. The former is more easily adapted to cross-country comparisons, while the latter is calibrated by national authorities to the local context. Official poverty estimates in the Kyrgyz Republic are produced by the National Statistical Committee of the Kyrgyz Republic, based on the Kyrgyz Integrated Household Survey (KIHS). Absolute poverty estimates are based on the Cost of Basic Needs approach and use two poverty lines: an "extreme poverty" line corresponding to a minimum required level of 2,100 calories per capita per day, and an "overall poverty line" that is considered adequate to meet basic needs. In 2020, the annual absolute and extreme poverty lines were 35 268 soms and 19 774 soms per capita, respectively. The poverty line was calculated according to the Poverty line methodology approved by Government Decree #115 dated March 25, 2011. Since then, the national poverty lines have been updated using CPI, except in 2008, 2011 and 2019 when the cost of the food bundle and the food share in total poverty line were updated.

⁷ AQLpress and National Statistics Committee.

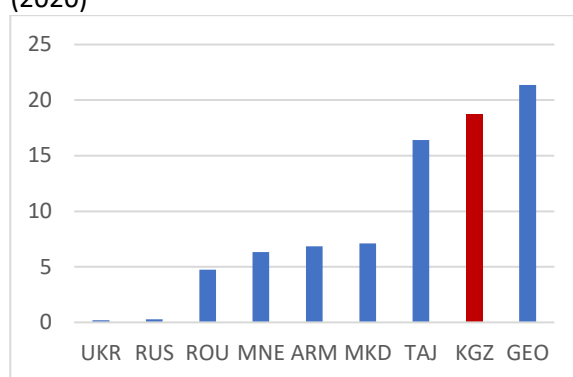
bottom of the poverty scale in the ECA – the second highest among ECA countries after Georgia (Figure 3).⁸

Figure 2: National Poverty Trends (2000-2020)



Source: National Statistics Committee, KIHS

Figure 3: Poverty Headcount Ratios in ECA (2020)⁹



Source: WDI

10. **Moreover, since 2015-16 the rate of economic growth has been slowing, leading to weaker poverty reduction and higher social vulnerability.** Growth has been slowing as the 10-year moving average growth rate weakened from 4.8 percent registered during the first decade of 2000 to 3.1 percent in the recent decade (Figure 4). Poverty changes in the Kyrgyz Republic closely followed the trajectory of economic growth. The growth elasticity of poverty has been increasing over the years. Between 2007 and 2015, the elasticity averaged -1.4, while during 2016-19, it increased to an average of -5.4¹⁰. Elasticities of high magnitude point to the pro-poor nature of economic growth observed over the past decade. However, the downside of the high elasticities is vulnerability to macro-economic volatilities, such as the COVID-19 outbreak and related economic fall-out. The pandemic reversed the declining trend of poverty in 2020 (Figure 5), with many citizens languishing just above the poverty line.

Figure 4: 10-year Moving Average Growth Rate

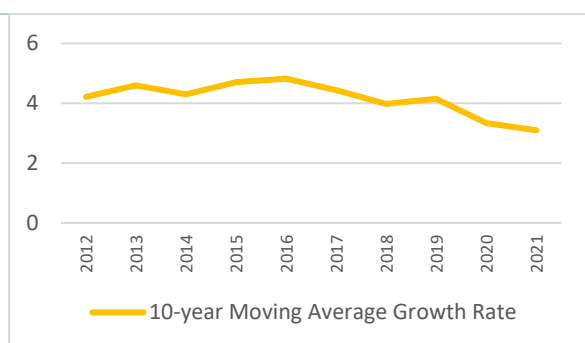
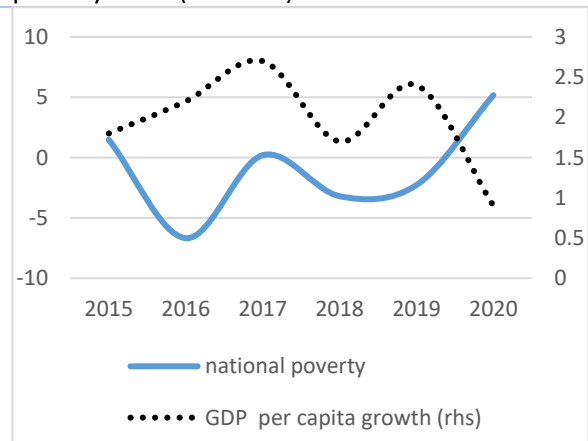


Figure 5: GDP per capita growth and change in poverty rates (2015-20)



Source: WDI and staff estimates based on KIHS 2015-2019

⁸ Data for Georgia is being verified.

⁹ Poverty Rate at US\$3.65 poverty line, 2017 PPP

¹⁰ The elasticities correspond to national poverty estimates.

11. **Also, several events that have affected Kyrgyzstan since the 2018 SCD have highlighted additional risk factors.** While the Kyrgyz Republic is distinguished in the region by its democratic achievements, a high degree of political volatility has undermined policy predictability and investor confidence, leading to economic volatility, and limiting the prospect of private sector-led growth. First, the COVID-19 pandemic, beginning in 2020, hit the Kyrgyz economy and people hard, leading to an 8.4 percent contraction in 2020 - the second worst economic outcome since the country gained independence from the Soviet Union in 1991. Second, the political system was shaken by major political volatility in the fall of 2020 following public demands to annul the results of the parliamentary elections, which led to the president's resignation and snap elections. The incoming president initiated constitutional amendments in the spring of 2021, which reversed the outcome of the 2010 Constitutional referendum, effecting a shift back from a parliamentary system to the centralized power structure of a presidential model. Snap parliamentary elections held in November 2021 led to a major government reshuffle. Third, the repercussions of Russia's invasion of Ukraine present new risks amid a slowdown in global growth, elevated price levels, disrupted regional trade and transit, and a difficult terrain of sanctions to navigate. The conflict has highlighted the vulnerability of Kyrgyzstan's economic growth model, which is focused on extractives exports and remittances from Russia.

Table 2: Recent key macro-economic and social indicators

	2018	2019	2020	2021	2022f
Macroeconomic indicators					
GDP growth (percent)	3.8	4.6	-8.4	6.2	7
GDP per capita (US dollars)	1,364	1,430	1,231	1,359	1,607
Consumer Price Index (eop, percent)	0.5	3.1	9.7	11.2	14.7
Consumer Price Index (average, %)	1.5	1.1	6.3	11.9	13.9
Current account balance (% of GDP)	-12.1	-12.1	4.8	-8.6	-11.7
Fiscal balance (percent of GDP)	-1.6	-0.5	-4.2	-0.3	-3.2
Public debt (percent of GDP)	54.8	51.6	67.7	60.3	57.5
Social indicators					
Population (total, millions)	6.3	6.5	6.6	6.7	7
Unemployment rate (ILO definition)	6.9	6.9	8.7	9.1	6.7
Poverty rate (in %, national definition)	22.4	20.1	25.3

Source: National Statistics Committee and Authors' projections

12. **An economic recovery is underway in the post-pandemic period, with 5 percent growth in 2021-22, although the near-term outlook projects a weakening of the economy and a further worsening of poverty.** GDP growth is expected to weaken to below 4 percent in 2023 and middle to around 4 percent in 2024-25 because of the spillovers from Russia's invasion of Ukraine and the implications of the Russian sanctions. Inflation is expected to remain elevated in the short term, driven by imported inflation and demand push factors. The current account deficit is projected to remain high at above 10 percent of GDP, reflecting a continued rise in import cost and the increased demand for imports because of the expansionary fiscal policy of 2023, which is expected to improve over the medium-term if public spending is contained. This outlook reflects the implications of Russia's invasion of

Ukraine, which has resulted in a slowdown in global growth and domestic growth through different channels, including a rise in inflation, a deterioration in external balances (triggered largely by a deterioration in terms of trade), heightened concerns over food security and poverty, and a secular fall in migrants' remittances.

III. AN UPDATED DIAGNOSTIC OF THE MAIN DEVELOPMENTAL CHALLENGES

Recent Progress since the 2018 SCD

13. **The 2018 SCD highlighted the need to change the drivers of growth of the Kyrgyz economy.** The SCD highlighted that economic growth over the past decade had been driven by: (i) gold production and export; (ii) remittance-financed consumption, and (iii) by the structural shift and reallocation of labor from low-productivity agriculture to low-productivity services. Growth had relied upon a narrow export base, largely gold from a single mine, the export of labor (remittances), and reliance upon an informal economy, including informal bazaar trade. Moreover, it had benefitted from a commodity super cycle with a commodity price upswing.

14. **The SCD called for a new development model of private sector-led growth, supported by public policies to promote inclusion, and establish modern governance and regulatory institutions.** Implementing such a model, one sustainable and associated with lower risk, would require removing bottlenecks to greater private sector growth and formalization, addressing the causes of poor governance and institutions, increasing social protection of the poor and vulnerable, and creating an effective pathway for environmental sustainability. More specifically, the SCD called for a consistent strategy to spur private investment in productive economic activities while ensuring that the achievements already made in social equity and access to opportunities are preserved. The focus of such a strategy should be to address the obstacles that prevent firms' creation and growth within a competitive environment that promotes productivity.

15. **The SCD suggested not only addressing economy-wide constraints to private investment -- specifically targeting the most critical bottlenecks -- but also adopting deliberate strategies in those sectors** where (i) most of the population and the poor derive their livelihoods, (ii) the country has a clear comparative advantage, and (iii) new sources of growth and exports can materialize. In addition, the state was meant to play a supportive role, including by (i) refocusing its role of enabling and regulatory functions, (ii) ensuring macroeconomic and fiscal stability, and (iii) focusing squarely on efficiency and quality gains in the delivery of public services to individuals and firms. Meanwhile, over the longer run, key social and environmental sustainability elements should also have been addressed, including managing the transition from a predominantly rural to an increasingly urban society and economy and addressing the challenges arising from environmental and disaster risks.

16. **The 2018 SCD developed recommendations clustered around four pillars:** (i) improving the private investment enabling environment in policy, governance, and infrastructure, (ii) addressing sector-specific constraints preventing the private sector from investing in the competitive assets of the country; (iii) investing more efficiently in human capital, and (iv) protecting the sustainability of growth. It identified eight critical constraints to growth, poverty reduction, and shared prosperity.¹¹

17. **Constraints requiring priority and immediate attention referred to addressing sources of macroeconomic and fiscal stress,** increasing the value for money of public expenditures, improving the business climate, addressing external competitiveness

¹¹ Prioritization was achieved by applying the following six filters: impact on twin goals, reform potential, time horizon on impact, precondition, complementarities, and evidence base.

constraints, removing constraints for mining and hydropower development, improving agriculture productivity, improving targeting in social protection programs, and addressing policy uncertainty and weaknesses in the rule of law. According to the proposed filtering, other important constraints were not considered to present a strong case for attention in the short term. These constraints referred to making public administration more transparent and accountable, tackling infrastructure bottlenecks, particularly connective, addressing the quality deficit in social services provision, promoting sustainable use and management of natural resources, and mitigating climate and disaster risks.

18. **This SCD Update finds that little has changed over the past few years.** During the immediate post-SCD period, the government initiated certain reforms by approving a new Public Financial Management (PFM) Strategy for 2018-25, reviewing its public investment management (PIM) practices, and moving from an annual to a multi-year budgeting practice in 2020 to improve linkages between strategic planning and budgeting. However, the COVID-19 pandemic and domestic political instability in 2020 have significantly paralyzed the government's *modus operandi* and frozen the reform implementation process. Several important reforms, including the modernization of the pension system, introduction of fiscal rules, and conflict of interest legislation, were initiated by the government since 2018 but have failed to receive parliamentary support. Also, several policy and legislative reforms have been initiated yet subsequently reversed after parliamentary approval. An evident example of such cases is the Public Procurement Law (PPL) which was amended in 2019 to sharpen competition, yet where amendments in 2022 removed SOEs from the PPL framework in a major reversal with potential risks of corruption, and weak accountability, transparency, market contestability, and public control. The temporary procurement rules adopted in 2022 for SOEs create fragmentations in the procurement system and do not comply with WTO GPA. Finally, several critical reforms, including reforms of the energy sector and social protection system, have been frequently postponed but re-initiated recently. It is hoped that the Medium-Term Plan for Adjusting Energy Tariffs, which was approved but put on hold several times, will be implemented following the 2022 amendment.

19. **This SCD Update is informed by recent analytical and advisory works,** such as the 2021 Country Economic Memorandum, the 2021 Public Expenditure Review, the 2020 Country Private Sector Diagnostic report, and the 2022 Poverty, Vulnerability, and Mobility Assessment, amongst other products delivered since 2018.¹² Recent events have made it even clearer that the drivers of growth are insufficient to accelerate progress toward the twin goals, exposing the country to significant vulnerabilities. As discussed in the next section, productivity growth, investment, and human capital are at inadequate levels and unable to support the rapid economic growth required for poverty reduction.

Falling growth and increased volatility are further evidence of a failing growth model

20. **Growth performance has weakened before reversing amidst recent shocks.** During 2015-21 GDP growth averaged at just 2.7 percent, compared with the 4.5 average from 2000 to 2014. Growth started decelerating even before the sharp contraction of 2020 (Figure 6). A downtrend in growth is more pronounced in terms of GDP growth per capita, which weakened from 3.2 percent to 2.2 percent during 2015–19 over the same period (even before the COVID-19-related contraction in the most recent years). The Kyrgyz economy's growth

¹² A more comprehensive list of analytical and advisory products is presented in Table 3.

performance has weakened both relative to its outcomes of the early 2000s and, in comparison to its regional peers (Figure 7). The latter is explained partly by the high population growth¹³ rate but mostly by the higher rate of economic expansion registered by other countries in the region. Unlike many other countries, the Kyrgyz Republic exhibited only a slight recovery in 2021, inhibited by a weak fiscal response, political turbulence, and a private sector too weak to support recovery.

Figure 6: Long-Term Economic Growth and Trend (2000-21)

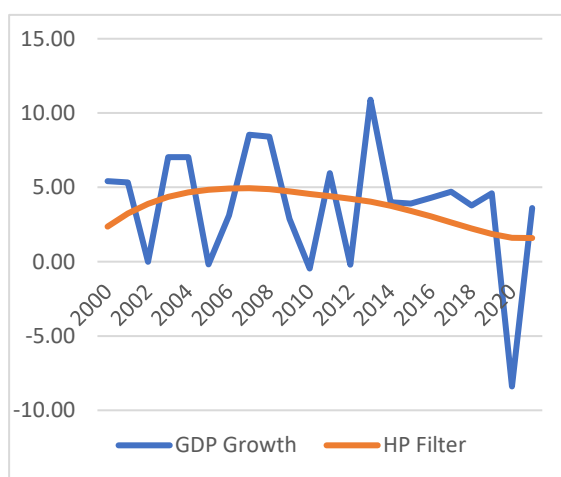
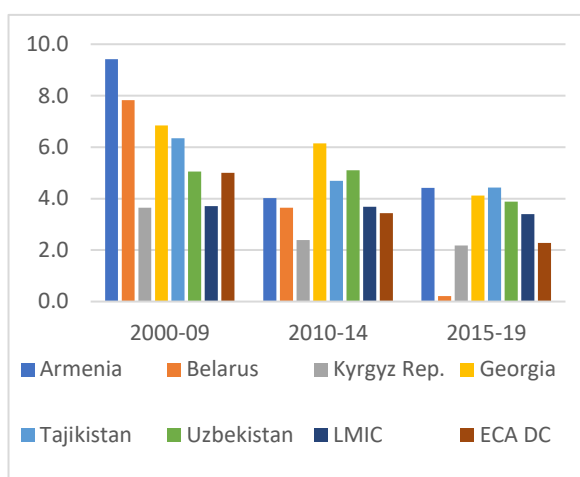


Figure 7: Average GDP per Capita Growth



Note: The trend line is calculated using the HP Filter.¹⁴

21. **Before COVID-19, growth was driven by investment, with little contribution from a growing labor force, human capital improvement, or productivity gains.** On the supply side, economic growth has been driven by increased physical capital accumulation, which accounted for 60 percent of growth from 2015 to 2019, significantly more than the previous period. The contributions of labor and skills have been low throughout, and the positive contribution of total factor productivity (TFP) has declined significantly in the latest period (Figure 8). TFP, the main driver of improving living standards over the longer term, is particularly important in supporting sustained income growth. Yet, over the past 20 years, the trend rates of productivity growth in the Kyrgyz Republic have been declining (Figure 9), and TFP contribution to growth is well below comparators.

¹³ The Kyrgyz Republic has the second highest (1.5 percent annual) population growth rate in the ECA region after Tajikistan.

¹⁴ The Hedrick-Prescott (HP) filter is a statistical technique used to produce a smoothed measure of real GDP. The HP filter is calculated until 2100 and smoothed at 100. Deviations from the smoothed curve would represent temporary deviations from the country's GDP growth potential.

Figure 8: Decomposition of GDP growth (2006-2019)

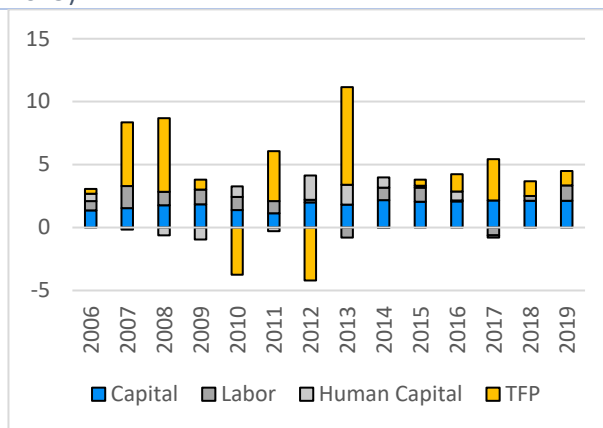
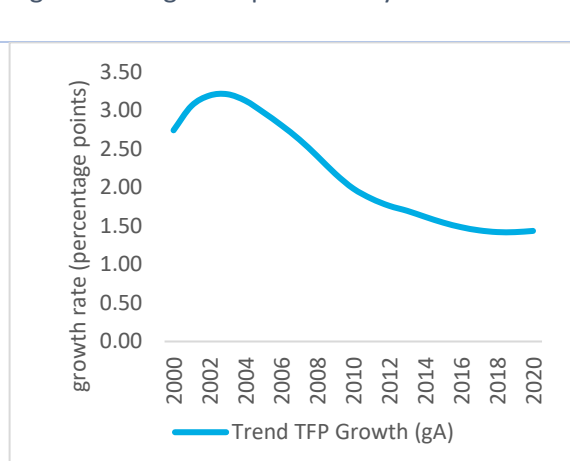


Figure 9: Long-term productivity trend



Source: Staff calculations based on National Statistics Committee’s (NSC) publications

22. **Investment and growth have been led by mining, but the sector’s outlook is uncertain.** Over previous years, services, construction, and mining supported relatively broad-based growth (Figure 10). However, from 2015 to 2021, the mining sector dominated, accounting for two-thirds of total growth over the period (Figure 11). Services and manufacturing growth over the period has been far lower. More than a quarter of investment is recorded in the mining sector and largely due to Kumtor, the main gold mine in the country. Yet the outlook for further investment in this mine is unclear as it reaches maturity, while concerns over the environmental impacts of mining have recently increased.^{15 16}

¹⁵ In early 2022, the government resolved a longstanding dispute with the parent company of Kumtor, the main local gold mining company, which has now become fully-government owned. As part of the agreement, the government relinquished its equity holding in the parent company and substantial associated dividends in exchange for full ownership of Kumtor. This financial transaction and the fact that Kumtor remains the country’s major export source (about 40 percent of the total) and a major taxpayer (about 25 percent of total tax revenue) means that the government is exposed to significant losses should the mine not continue to produce and export efficiently during its lifetime, estimated until 2031. The corporate governance of the mining company, the transparency of its operations, and the technical ability to operate the mine under exacting conditions are important factors that mitigate the risks of nationalization. Since nationalization, the data made available on operations has fallen short of expectations. Apparently, production has continued at a high level, although exports have been nil, and the lack of transparency raises questions as to the sustainability of public finances, as well as external balances. Moreover, the prolonged and acrimonious dispute with the country’s biggest foreign investor is likely to have damaged investor confidence. <https://s3.amazonaws.com/centerragold/news/February2021/Xwyzofy8ilmsYJ3vNEA.pdf>

¹⁶ Furstenberg, S. and Toktomushev, K. 2021. “Understanding Gold Mining and Social Conflicts in Kyrgyzstan”. University of Central Asia, Graduate School of Development, Institute of Public Policy and Administration. Working paper #63. <https://ucentralasia.org/media/ssmbkbyb/uca-ippa-wp63-understanding-gold-mining-and-social-conflicts-in-kyrgyzstan.pdf>

Figure 10: Investment by Sector

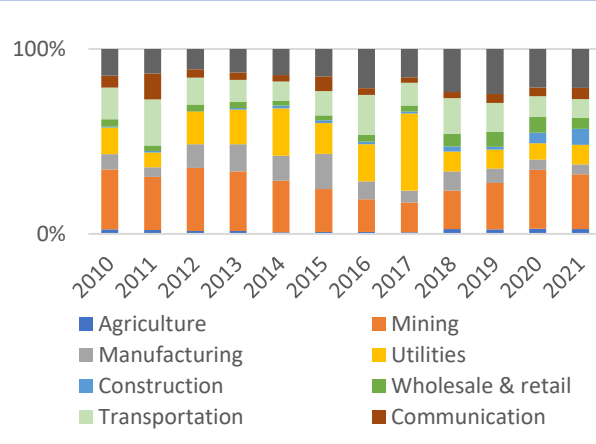
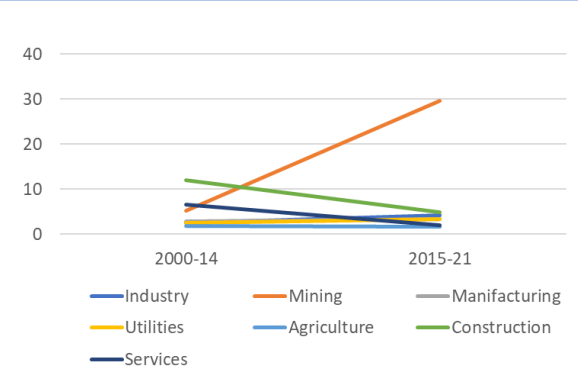


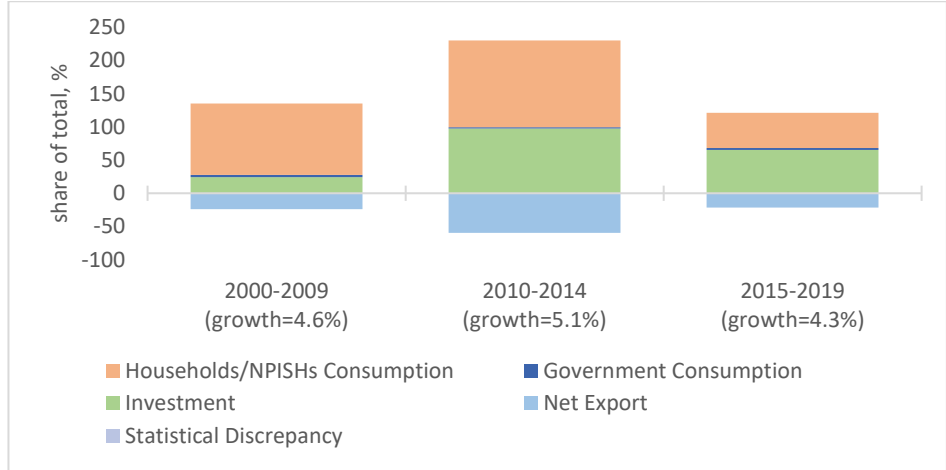
Figure 11: Value Added by Production Sector



Source: Staff calculations based on NSC publications

23. **Consumption growth was supported by remittances, which are near saturation.** Looking at the demand side of the economy, the importance of private consumption in driving economic growth through the Kyrgyz Republic’s recent economic history is clear (Figure 12), and a large part of this has been supported by growth in remittances (Figure 13). However, in the most recent period, private consumption growth has moderated, suggesting that this consumption-fueled growth period may end. Remittances as a share of GDP are now the second highest in the world after Tonga (Figure 14), and it is unlikely that they can continue to grow sufficiently beyond this elevated level in the future to support growth.

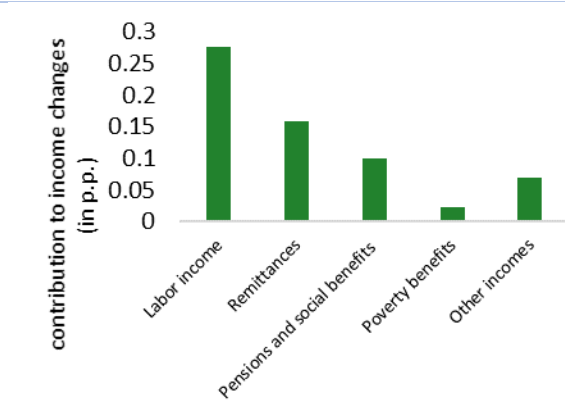
Figure 12: Contributions to Growth on the Demand Side



Source: Staff calculations based on NSC publications

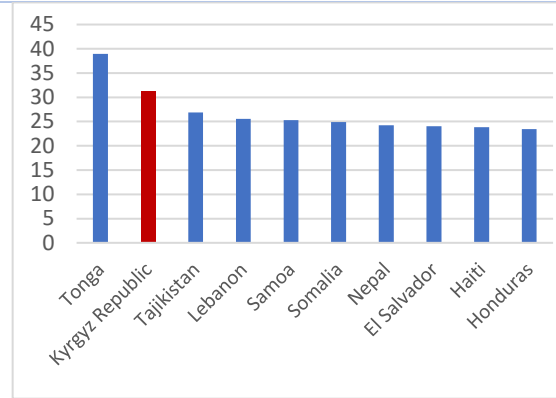
24. **Increasing gold exports have been more than offset by rising demand for imports.** The Kyrgyz Republic participates in global value chains (GVCs) primarily through exporting commodities, which have limited scope for job creation and knowledge spillovers. Exports are also concentrated, with gold accounting for more than half of total exports of goods in 2020. Minerals and agricultural products constituted 20 percent of total exports for that year. In 2019, the Kyrgyz Republic exported services mainly to Russia, China, and Kazakhstan (representing 23, 15, and 10 percent of all Kyrgyz exports of services).

Figure 13: Household Income Growth Decomposition (2013-2019)



Source: KIHS

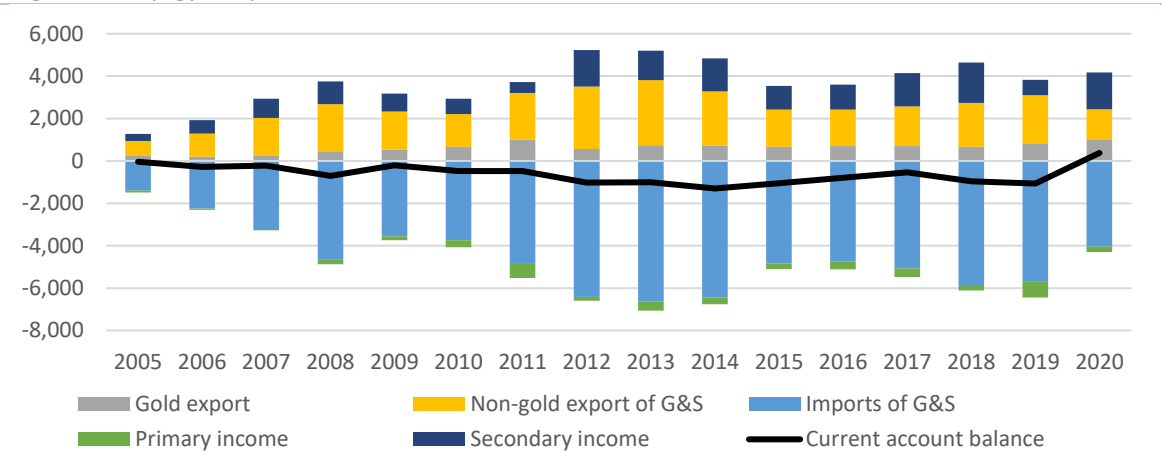
Figure 14: The 10 Most Remittance-Intensive Countries (as a percent of GDP in 2020)



Source: WDI

25. **Rising domestic demand and growing development needs have led to higher imports, keeping the current account deficit high before the pandemic.** The current account deficit (CAD) was above 10 percent on average during 2015-19, as imports far exceeded exports (Figure 15). Official aid and foreign direct investment attracted mostly by the gold sector were the main sources of current account financing. The current account improved sharply and turned a surplus of about 5 percent of GDP in 2020 due to a sharp (28 percent) contraction of imports before returning to a deficit in 2021. The current account has generally been financed by concessional lending and, in certain years, mining-related FDI. In recent years, gross international reserves have been maintained above six months of imports. With a flexible exchange rate policy, the KGZ/USD rate was stable for a prolonged period but depreciated by 20 percent in 2020 and has been under further depreciation pressure since Russia’s invasion of Ukraine.

Figure 15: Kyrgyz Republic: Current Account trends, US\$ million



Source: Staff Calculations based on NSC publications

The quality of growth has been diminishing with weaker job creation and increasing volatility leading to a slowing pace of poverty reduction

26. Job creation is proceeding slowly, increasing the risks of under- and unemployment.

The number of new jobs has been growing by less than one percent a year, while the number of working-age individuals has been expanding by an average of 1.5 percent over the past five years. Every year around 67 thousand individuals enter the working age category, and a vast majority will join the labor force in search of jobs. However, over the past seven years, the average number of new jobs added amounts to just 20 thousand. The rest are compelled to pursue self-employment opportunities or seek employment abroad. The deficit of jobs underscores the structural problems of the economy. An anemic rate of job creation is a symptom of weak productivity and low competitiveness of local firms. In the wake of macroeconomic and political volatility, the annual demand for labor is also volatile and varies across sectors. Notably, agriculture was massively shedding labor for a large part of 2015-2019, while services and trade were the main engines of job creation. This highlights the shifting pattern of labor demand, which follows the structural shifts in the economy, and the influence of growth via worker remittances fueling the non-tradable part of the domestic economy.

27. While job creation in the formal sector has proven insufficient to absorb excess labor, self-employment has increased significantly.

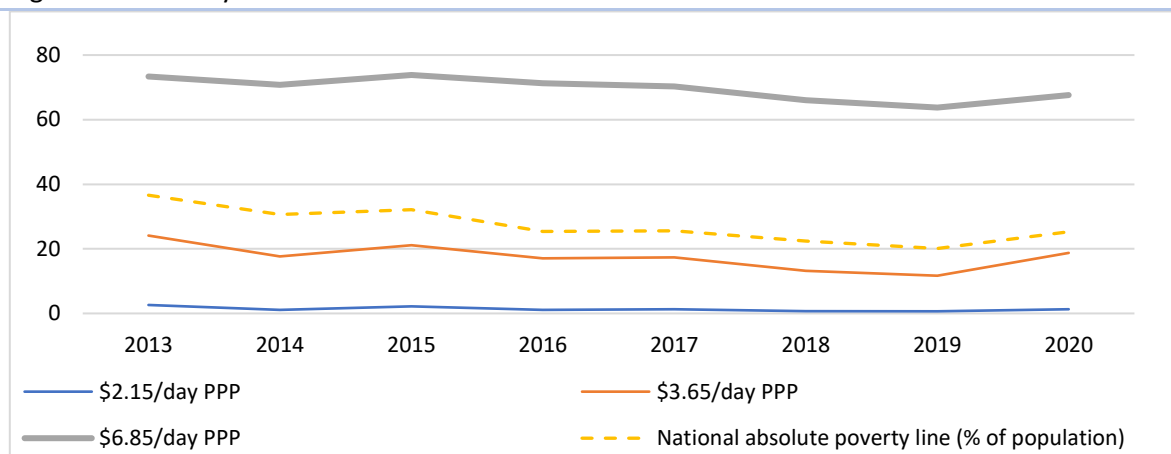
A third of employed individuals are engaged in wage employment in a (formal) firm or organization (registered as a legal entity). This share has remained relatively flat over the years. However, the share of working-age adults who engage in self-employed activities has significantly increased from 42 percent in 2013 to 52 percent by 2020. That increase was attributed to shrinking employment in (own) farming activities, which saw a reduction from 29 percent to 17 percent over the same time frame. This signifies two important findings: i) given the close correlation between self-employment and job formality, more individuals are now finding jobs in the informal sector, and ii) the firms and organizations of the formal sector are not creating a sufficient number of jobs to absorb labor re-locating from farming and rural areas.

28. Poverty has declined since the SCD, but the positive trend was reversed due to the pandemic and economic shocks.

Nationally defined poverty declined by seven percentage points to 25 percent from 2015 to 2019, with progress driven by income growth rather than re-distribution. The poverty gap in the Kyrgyz Republic mirrored the trend of the poverty headcount ratio, declining from 5.9 percent in 2015 to 3.3 percent by 2019.¹⁷ Following the economic downturn related to the spread of the COVID pandemic, the headline poverty rate increased by more than five percentage points in 2020, reversing the downward poverty trend (Figure 16). The rise in poverty rates was due to the combined effects of the pandemic and shocks to the economy and related lower earnings, as well as underemployment, that trapped many households in poverty, especially among the most vulnerable. COVID also disrupted the transition of households into and out of poverty: (i) the probability of escaping poverty dropped to 24 percent in 2020 from around 40 percent in 2018-2019, while (ii) the probability of non-poor individuals entering poverty increased to 9.8 percent between 2019 and 2020 from 6.2 percent between 2018 and 2019.

¹⁷ The poverty gap represents a deficit or shortfall of money and income for the poor to reach a threshold of poverty standards and thus escape poverty.

Figure 16: Poverty headcount ratios



Source: WDI and staff estimates based on KIHS 2015-20;
 Note: international poverty lines in 2017PPP terms

29. **In the post-SCD period, economic growth has become less inclusive.** Growth among households from the bottom 40 percent has lagged the growth rate of the median family since 2015 (Figure 17), raising inequality further. The Gini coefficient of household consumption as a welfare aggregate increased from 0.27 in 2014 to 0.30 in 2019 (Figure 18). Uneven resilience to shocks has set back inclusive growth and poverty reduction, as poorer households find it more difficult to bounce back when hit by an economic shock. As a result, the most vulnerable households are more likely to get caught in a poverty trap. Moreover, economic output, income per capita, and poverty rates remain uneven across the country, with most of the poor still clustered in the south.

Figure 17: Shared Prosperity Indicators *

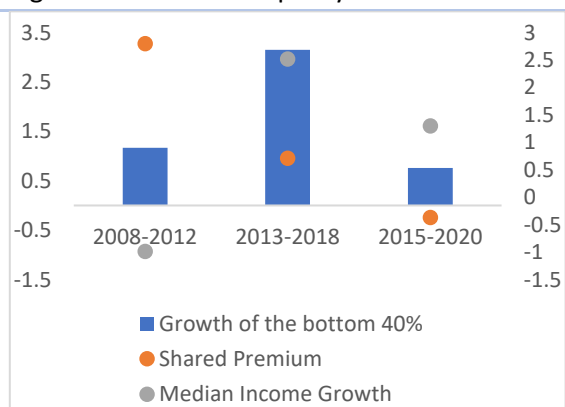
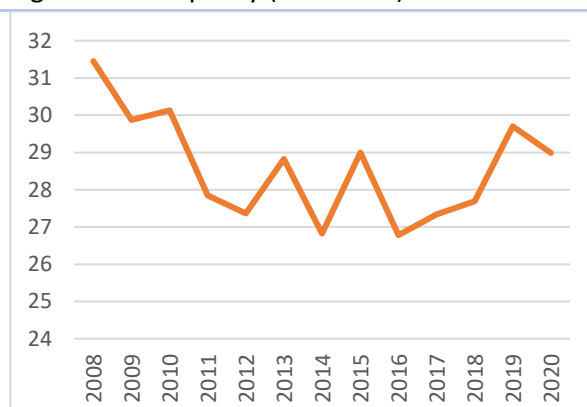


Figure 18: Inequality (Gini Index)



Source: WDI and staff estimates based on KIHS 2015-2020

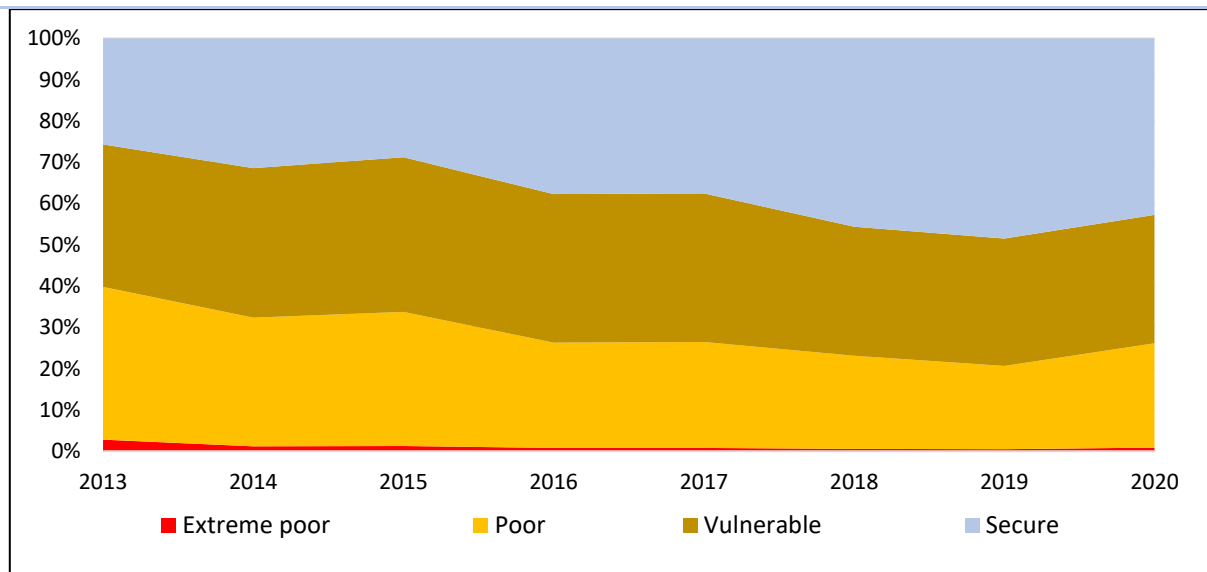
*Shared prosperity (bar), of the growth in real per capita income or consumption of the population in the bottom 40% of its distribution. The shared prosperity premium (orange) is the difference between the growth of the poorest 40 percent and the entire population.

30. **Many households remain vulnerable to falling back into poverty, and recent shocks have unfortunately driven such a reversal.** The share of the population vulnerable to poverty remained stubbornly above 30 percent up to 2019 (Figure 19 and Box 1).¹⁸ Analysis reveals that even as poverty was falling up to 2019, there were significant movements in and out of

¹⁸ National estimates, "Poverty and Vulnerability in the Kyrgyz Republic: Assessing Trends, Drivers, And Challenges" Report, World Bank, 2022.

poverty among the population and generally high probabilities of reversal in poverty status.¹⁹ Only households with no children below five years of age have shown a steady decrease in vulnerability. The vulnerability prevalence is higher in rural than urban areas, but since 2015, the vulnerability in rural areas has decreased, while urban areas have seen rising vulnerability since 2018. The onset of COVID-19 in 2020 saw an increase in poverty of more than five percentage points as compared to 2019 and a significant erosion of human capital. The pandemic's impact was borne by workers, particularly through under-employment. Average hours worked declined from 36.4 in 2019 to 33.2 hours per week in 2020.

Figure 19: Poor and vulnerable segment as a share of the total population



Source: staff estimates using KIHS and national lines

¹⁹ Vulnerability in this case is defined by the probability of a household falling into poverty, based on a logistic model covering important determinants of poverty status (López-Calva & Ortiz-Juarez, 2013).

Box 1. Poverty Profile in the Kyrgyz Republic.

Monetary poverty largely remains a rural phenomenon. Seven out of ten poor people live in rural areas (Table 3). The Kyrgyz Republic is mainly a rural society, with two thirds of the population living in the countryside. In 2020, 1,658 thousand people are estimated to be poor. Almost three quarters of them live in rural areas, and poverty is also deeper in those areas. In urban areas poverty is lower at 18 percent of urban citizens.

Household composition and more generally life-cycle effects, significantly impact the poverty status.

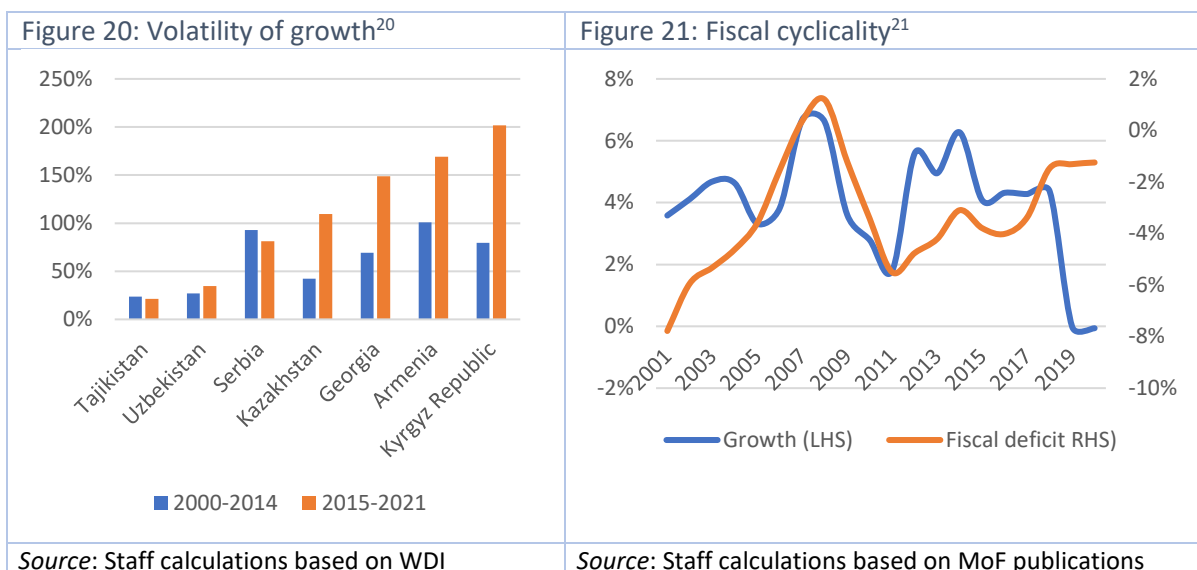
- *Larger households*, especially those *with children under 14*, are very vulnerable to falling into poverty. The risk of becoming poor for a family with children is 2.5 times higher than for a family without children but with other similar characteristics. Households headed by a female are not significantly distinguishable from male-headed households in terms of risk.
- *The larger the share of employed adults in the family, the lower the risk of falling into poverty*, while having an informal job increases by 20 percent the probability of falling into poverty compared to having a formal job.
- *High educational attainment reduces by half the risk of falling into poverty* relative to having only general education. Professional education of the household head reduces the risk of slipping into poverty by 20 percent.
- *Increasing public and private transfers help prevent falling into poverty*. Increments of pensions, in particular, reduce the risk of becoming poor by around 30 percent. The risk of reduction due to pension benefits shared within households is higher than the reduction due to remittances and social benefits. This may be due to the greater certainty of long-lasting eligibility of the transfer, and therefore of a more certain expectation of financial stability, lowering the probability of experiencing a decline in households' standard of living.

Table 3: Sociodemographic characteristics of the Kyrgyz Republic population by area of residence and poverty status, 2020.

	National	Area		Poverty		
		Urban	Rural	Nonpoor	Poor	Urban poor
Household size	4.06	3.49	4.47	3.70	5.66	5.19
Households with no children	31.1	39.7	24.7	36.6	5.9	8.2
Households with 1 child	21.4	21.7	21.2	23.8	10.4	10.0
Households with 2 children	35.8	32.4	38.3	31.9	53.7	62.8
Households with more than 2	11.7	6.1	15.8	7.7	29.9	19.0
HH without children under 5	51.3	57.0	48.1	58.2	31.0	32.7
HH with children under 5	48.7	43.0	51.9	41.8	69.0	67.3
HH without children under 14	21.3	27.2	18.0	26.9	4.8	6.3
HH with children under 14	78.7	72.8	82.0	73.1	95.2	93.7
Dependency ratio	0.97	0.90	1.04	0.88	1.23	1.12
Gender of HH head: Male	67.7	62.8	70.5	66.6	71.0	66.3
Gender of HH head: Female	32.3	37.2	29.5	33.4	29.0	33.7
Highest level of education attained by HH head:						
Higher education	16.7	29.0	9.9	18.9	10.2	19.4
Professional education	20.4	23.2	18.9	21.0	18.7	23.6
General secondary education	53.4	41.5	60.0	51.0	60.3	47.8
Less than secondary education	9.5	6.3	11.3	9.1	10.7	9.2

Source: Staff estimates using KIHS and national line.

31. **Already identified as a problem in the SCD, economic volatility has increased further.** Many countries have experienced increased economic volatility in recent years, particularly due to COVID-19, over the recent period. And yet the Kyrgyz Republic today stands out for volatility over the past six years, far higher than in previous years and the highest amongst the peer group (Figure 20). Moreover, the government's role in counteracting macroeconomic volatility seems insufficient. Figure 21 shows that the fiscal deficit has been less sensitive to growth trends in recent years, especially in 2020. For the past three years, the Kyrgyz economy has registered the highest (about 15 percent) level of inflation in the CIS region, and the authorities have faced ongoing challenges in curbing it.



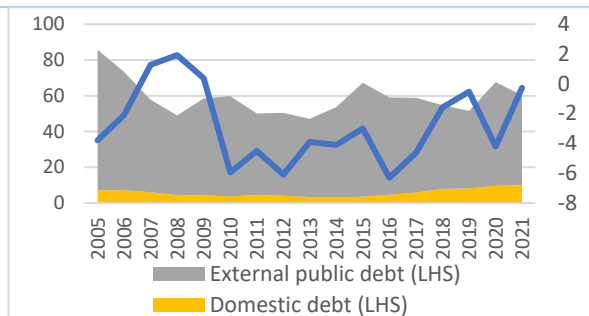
32. **The Kyrgyz Republic’s tax effort remains robust, but the tax policy design can be improved to improve horizontal equity and formalization incentives for businesses.** Except for the 2020 pandemic year, the government has maintained the tax-to-GDP ratio at 24-5 percent of GDP since 2015, which is a higher revenue mobilization effort compared with Kyrgyzstan’s regional and global/LMIC peers (18 percent of GDP). This comfortable level of tax collection combined with other sources of revenues has ensured high (about 31-32 percent of GDP) total revenues, facilitating a sharp fiscal consolidation and helping to reduce the fiscal deficit to below 1 percent of GDP in 2019 and in 2021 from 5-6 percent in 2011-13 (Figure 21). However, even after the 2021 tax reform, the tax system continues to suffer from several weaknesses, including tax exemptions estimated at 3 percent of GDP and disincentives to formalization embedded in the design of the simplified tax regime.

33. **A high level of recurrent public spending presents fiscal sustainability challenges and is crowding out important public investment.** Following the Paris Club debt restructuring in the early 2000s, the Kyrgyz Republic has effectively improved its aggregate fiscal indicators and put public finances on a more sustainable footing (Figure 22). Yet, a high and rising level of public spending, with an exceptionally high wage bill - expected to amount to 16 percent of GDP following a recent large public pay rise in 2022 - means that fiscal sustainability remains a constant challenge. The Kyrgyz Republic had spent around 8 percent of its GDP on public investments until 2017. However, this level sharply declined to an average of 4 percent of GDP during 2018-20, below the 5.4 percent average for the ECA region (Figure 23). In addition to the public sector wage bill, spending growth in recent years has also been driven by significant increases in other recurrent spending, namely spending on goods and services, interest payments on public debt, and utility subsidies. This high level of recurrent spending poses challenges both for aggregate fiscal sustainability and capital expenditure. Notwithstanding certain important projects, such as the redevelopment of the national electricity network, the public expenditure program is low given the country’s high level of need, to be elaborated on in detail in later sections.

²⁰ Volatility is measured as the “Coefficient of Variation” of real GDP growth in local currency units over the period.

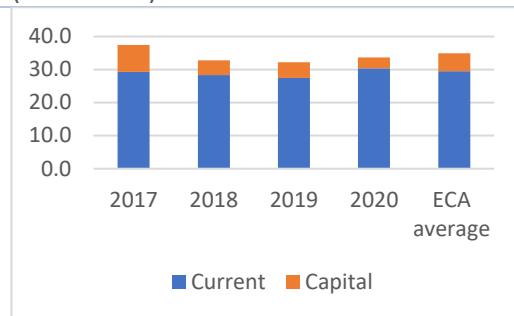
²¹ Series are three-year centered averages to account for short term volatility.

Figure 22: Fiscal balance and public debt, % of GDP



Source: Staff Calculations based on MoF data

Figure 23: Composition of Public Expenditures in the Kyrgyz Republic and the ECA region (202017-20)

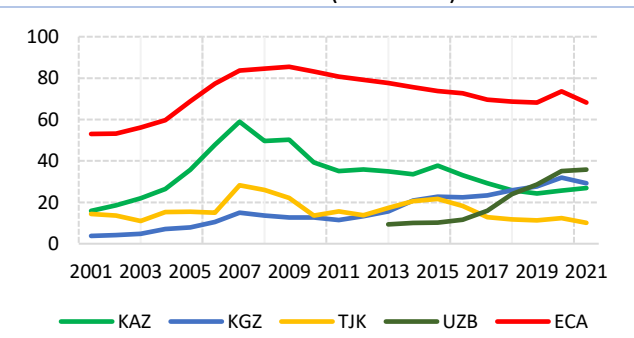


Source: World Development Indicators

34. **The energy sector, in particular, is heavily indebted, with a cumulative debt of KGS 133 billion (US\$1.5 billion or around 20 percent of 2021 GDP), posing the largest risk to fiscal sustainability.** Most of the current loan balance is from the on-lending of the external debt taken by the government, followed by budgetary loans from the Ministry of Finance (MoF). The energy sector operates with a quasi-fiscal deficit from the sale of electricity in the domestic market, emerging from below-cost recovery tariffs, under-collection of revenues, and excessive technical losses. There had been almost no adjustments in tariffs since 2015 until very recently, which led to declining tariffs in real terms over the period, adding to sector financial challenges and payment arrears, shrinking funds available for operations and maintenance (O&M) purposes and capital expenditures, and thus the decreasing quality of service.

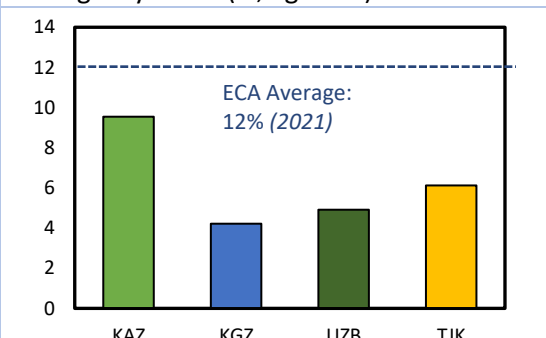
35. **An underdeveloped financial sector is also a potential source of vulnerability and inhibits growth.** As the economy and the banking sector remain dollarized,²² vulnerability to risks associated with exchange rate volatility and regional economic conditions multiply. In this respect, steady efforts are needed to strengthen the banking sector, which represents over 70 percent of the financial sector. The operations of non-bank credit institutions remain weak, and efforts to develop them have stalled due to the pandemic.

Figure 24: Private credit by deposit-taking banks and other financial institutions (% of GDP)²³



Source: Global Financial Development [Database](#)

Figure 25: Savings as the main source of emergency funds (% of savings, age 15+)



Source: Global Findex database for financial inclusion indicators

²² The share of USD-denominated deposits accounts for 48.6 percent of total deposits, and the share of USD-denominated loans for 23 percent of total loans as of September 2022.

²³ In both Panels A and B, the average value for ECA countries excludes Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan.

36. **The banking sector development in the Kyrgyz Republic is slow and lagging behind its regional peers.** Despite some improvements in the pre-pandemic years, the credit-to-GDP ratio, at 29 percent in 2021, is low and far below the 68 percent average of the ECA region (Figure 24). Financial deepening and intermediation are most hindered by the inadequate deposit mobilization rate (Figure 25) and weak confidence in the banking sector. The sector is facing the highest non-performing loans since 2010, reaching 14 percent in July 2022.

Public sector effectiveness in delivering public goods and services is weak

37. **Improving public sector performance remains an enduring challenge for the Kyrgyz Republic, and despite bold plans, little progress has been achieved on reforms since the last SCD.** Weak institutions and low state capacity have had a detrimental effect on social and economic development. Insufficient policy prioritization and ineffective coordination mechanisms hinder the implementation of policies; this reflects in the high turnover in senior government positions.

38. **Consistency in economic policy and follow-through on reform implementation has been largely undermined by persistent political instability.** Since 2011, there have been 11 changes in government; the average tenure of the cabinet of ministers is less than a year. Political instability and civil unrest have been inextricably linked to perceptions of corruption and misgovernance; the 2020 revolution was also driven by public dissatisfaction with the ability of the government and the legislature to create a long-term sustainable political environment. A volatile political environment undermines the institutional capacity of the government to deliver public services, with the Kyrgyz Republic trailing both ECA countries and LMIC countries globally on most governance metrics.

39. **The role of the state remains poorly defined.** The reorientation of this role from a producer to an enabler, facilitator, and prudent regulator tasked with ensuring transparent rules and a level playing field for all market participants has not taken place. The state would need to be a more effective guarantor of the rule of law. Guaranteeing the rule of law and minimizing expropriation risk are prerequisites for building private sector confidence.

40. **The dominance of SOEs in the economy remains significant.** The public sector in the Kyrgyz Republic still owns 136 SOEs at the national and over 600 SOEs at the municipal level, accounting for 10 percent of the GDP.²⁴ SOEs continue to operate in key economic sectors such as energy, mining, transport, and banking. In 2018, the SOEs generated revenues equivalent to 22.6 percent of GDP.²⁵ Around half of total SOE assets (48.5 percent of total and 62 percent of non-financial SOE assets) are in the energy sector. The same sector also accounts for 90 percent of non-financial SOEs' liabilities, equivalent to 20 percent of the country's GDP. Many SOEs are not operating efficiently, run losses and receive government subsidies and loans. At the same time, their service delivery to citizens remains sub-optimal, and the contributed taxes and dividends are insufficient.²⁶

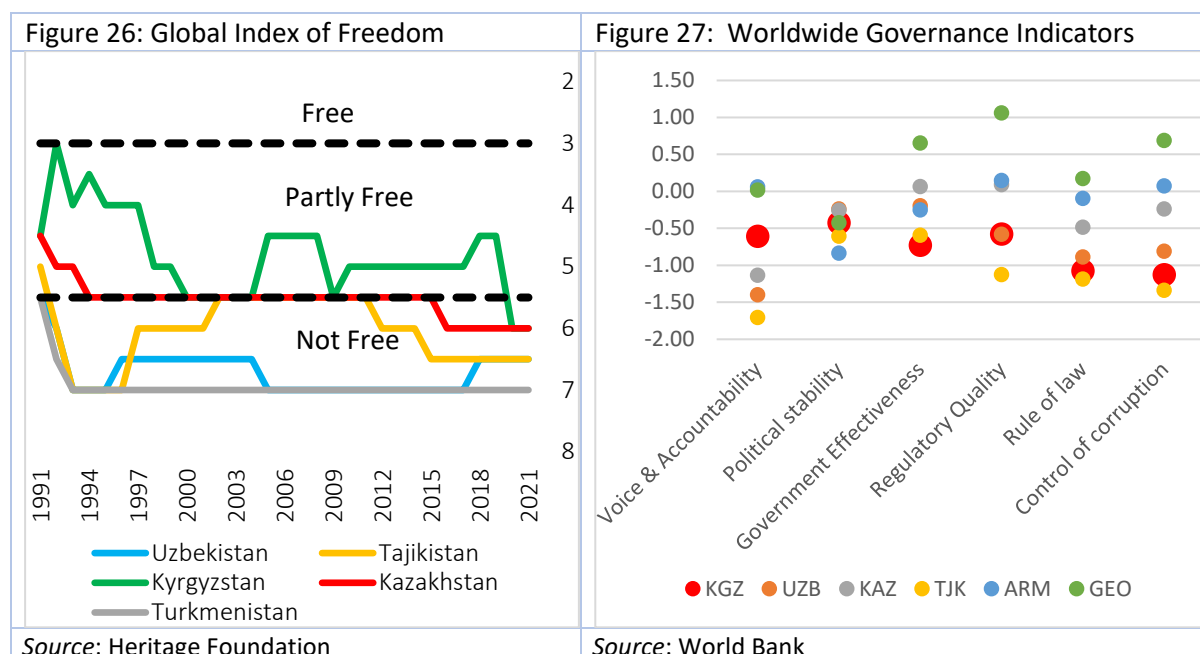
41. **Efficiency in managing public funds remains a challenge.** While the overall fiscal deficit was kept under control in recent years, except for the 2020 pandemic year, the recent

²⁴ Kyrgyz Republic Diagnostic, Hans Holzhacker and Dana Skakova, EBRD, 2019

²⁵ Kyrgyz Republic: Integrated State-Owned Enterprise Framework Assessment (ISOEF), World Bank, 2020

²⁶ According to the 2020 ISOEF report of the world Bank the entire SOE sector contributed KGS 5.7 billion (USD 83 million, or 1 percent of GDP) through taxes and dividends to the central government budget in 2018 and received government subsidies in a similar amount; this accounts for 0.8 percent of GDP.

2021 Public Expenditure and Financial Accountability (PEFA) assessment documented several weaknesses, including poor alignment of budgeting and strategic planning, and policies; weak commitment controls with no monitoring of expenditure arrears, and weak fiscal risk management. Budget reliability has also seen a slight deterioration compared with the previous assessment.²⁷ The recent Public Expenditure Review (PER) for the Kyrgyz Republic concluded that achieving inclusive growth and providing access to quality services, especially to the poor, remains a challenge despite high public spending.²⁸



42. **Revenue mobilization efforts rely on a narrow tax base, which limits the government’s ability to raise additional revenues when needed, as well as resulting in a tax system devoid of incentives to exit the informal sector and increasing the tax burden on the few who fall under the tax system.** Weak tax administration and complex tax policy resting upon a narrow base due to multiple exemptions lead to tax system inefficiency. While the number of taxes is not excessive, exemptions and a plethora of simplified regimes are adding to the tax system's complexity.

43. **Despite a track record as a liberal democracy in Central Asia, the institutional environment in the Kyrgyz Republic is weak and punctuated by political and social instability.** Despite a reputation for being the most democratic country in Central Asia, democratic freedoms have slowly eroded in the Kyrgyz Republic (Figure 26), and the environment has been punctuated by political turbulence. In 2005, 2010, and 2020, popular protests led to major political change beyond the regular electoral cycle.²⁹ Government

²⁷ PEFA 2021

²⁸ PER, 2020

²⁹ In 2005, after nearly 15 years in power, Kyrgyzstan’s first president was forcibly removed from his position following his disputed re-election; in 2010, his successor was overthrown after widespread public demonstrations against corruption, nepotism, and the misuse of public assets. A constitution, approved by referendum in 2010, legislated a shift from the presidential to a parliamentary system, yet the system for checks and balances remained largely undeveloped. The political system was shaken in the fall of 2020 after public demands to annul the results of the parliamentary elections which led to the president’s resignation and snap

effectiveness is very weak (Figure 27) as even aside from these political upheavals, there has been substantial turnover in government positions and policy. The general rule of law is also weak, as is regulatory quality. Implementation capacity is constrained, leading to significant gaps between *de jure* design of regulation and *de facto* implementation. These gaps create additional risk and delay for firms, as well as opportunities for rent-seeking and corruption. They also undermine the efficiency of public investments and the quality of service delivery by the public sector, where weak management tools and capacity are prevalent.

44. **The Kyrgyz Republic continues to suffer from severe weaknesses in the judicial system's performance in terms of efficiency of services, quality of services delivered, and access to services, undermining legal certainty and predictability.** This impacts private sector development and investor disputes in particular.³⁰ Stakeholders anticipate predictable and rule-based court outcomes in countries with effective justice institutions and carry out their business “in the shadow of the law.” If they do not, they risk suffering legal consequences. The lack of legal certainty, weak property rights, and underperforming justice institutions in the Kyrgyz Republic contributes to an implementation gap of legal and regulatory frameworks across sectors and maintains an uneven playing field where economically stronger and politically better-connected actors enjoy limited contestability. At the same time, this leads to a lack of access to justice for micro, small, and medium-sized enterprises, and vulnerable groups of citizens. Under the Enforcing Contracts chapter of the now discontinued Doing Business Report, Kyrgyzstan performed poorly and ranked 134th out of 190 economies in 2020. The weak performance was due mainly to high costs and weak performance under the Quality of Judicial Processes Index, especially in terms of case management and court automation. Moreover, the World Justice Project’s Rule of Law Index has further identified the weak performance of the civil justice system in terms of integrity (score of 0.34 compared to a regional average of 0.45 and a global average of 0.56) and effectiveness of enforcement (score of 0.38 compared to a regional average of 0.50 and a global average of 0.52).

45. **Citizen confidence in government is low, and transparency and accountability of public institutions could be improved.** Citizen engagement is greater than in other Central Asian countries. Yet, patterns of social exclusion persist, citizens face difficulty in providing feedback on public service delivery, and mechanisms for inviting public input into policymaking are largely ineffective. Moreover, the voice and accountability (as measured by the Worldwide Governance Indicators), which increased during 2008-2018, dropped back to 2017 levels, declining from 34.8 (2018) to 31.9 (2020) in percentile ranking. Social cohesion is distributed unevenly, with a stronger social capital within communities. The Integrated Households budgets and Labor force survey for the Kyrgyz Republic reveals significant levels of citizen mistrust concerning various local government actors.

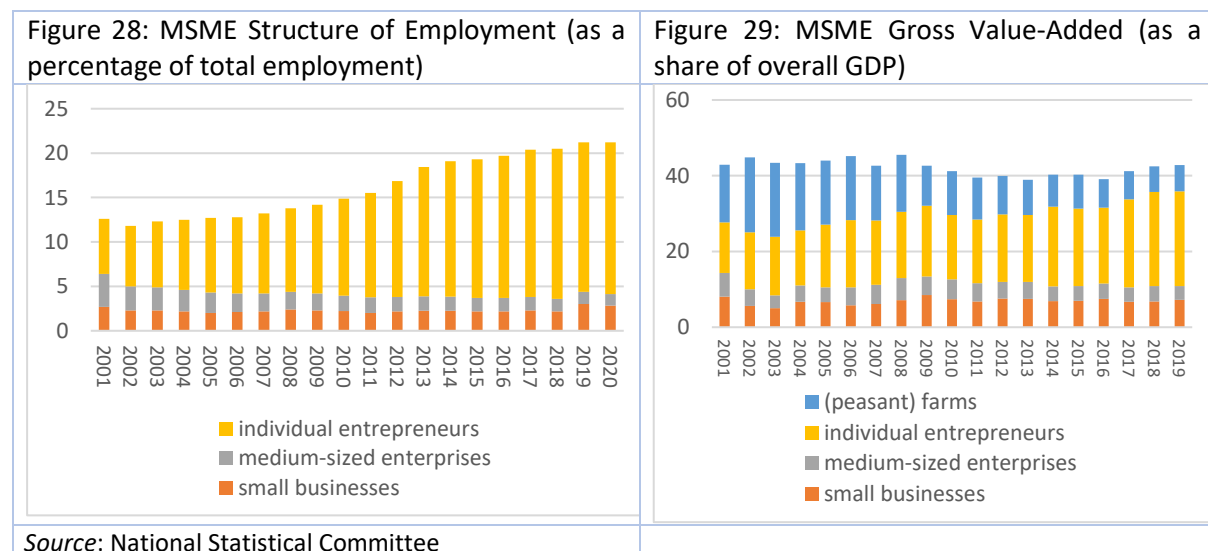
elections. The new president initiated constitutional amendments in spring 2021 which restored a centralized power structure within a presidential model. Snap parliamentary elections held in November 2021 led to a major reshuffle in government and a high turnover in technical and senior official positions. About 30 percent of the Cabinet of Ministers was renewed during the first year of the current government’s term.

³⁰ The Kyrgyz Republic has one of the highest numbers of international investment disputes in the Central Asia region. Past cases have been overwhelmingly decided in favor of investors, suggesting state violations, and costing the state US\$10.4 million in damages awarded in arbitration per case on average, and US\$3 million per case in legal and administrative costs. The majority of the cases involve state breaches of investment agreements. The Kyrgyz Republic does not have a mechanism in place to prevent the escalation of investor grievances into international investment disputes.

Policy and institutional frameworks are insufficient for a stable and conducive environment for private sector-led growth

46. **Over the past few years, there has been little progress in structural reforms to improve the business environment, stymying efforts to support private sector growth and job creation.** Policy uncertainty, corruption, and informality remain pervasive constraints to business, while high trade costs and relatively high labor costs are barriers to international competitiveness. Regulatory burdens, including the tax and licensing regimes, are high and deter businesses from formalizing, growing, or starting up in the first place.

47. **Micro, small, and large enterprises dominate the private sector, and there is a ‘missing middle’ of medium-sized firms.** The number of individual entrepreneurs has doubled over the past decade, today accounting for a substantial share of MSME employment (Figure 28) and value-added (Figure 29). Meanwhile, medium-sized enterprises account for an insignificant share of both employment and value-added, and their share has fallen since 2001. Micro and small enterprises prefer remaining small and operating informally to avoid regulatory burdens, the distortive tax regime, and ineffective and burdensome government oversight. But in the broader landscape of enterprises, the largest contribution to both value-added and employment comes from large firms, at 66.4 percent of GDP and 78.8 percent of employment.³¹



48. **Higher rates of informality and weak firm creation point to significant private sector impediments.** More than half of firms in the Kyrgyz Republic reported competing against informal or unregistered firms, compared to less than a third across the ECA region. Around 40 percent of firms also report that the practices of informal firms are a major constraint to their business, double the rate across ECA.³² Further, the rate of new business creation is around half that of the ECA region average (Figure 30).

³¹ Country Private Sector Diagnostics, IFC 2020

³² World Bank Group, 2019 Kyrgyz Republic Enterprise Survey and other enterprise surveys.

Figure 30: Business entry density
(New registrations per 1,000 people)

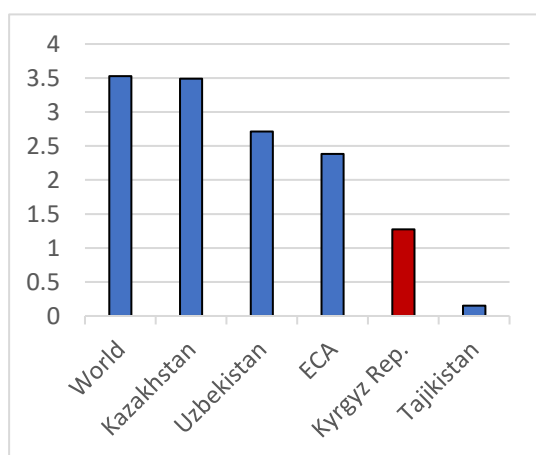
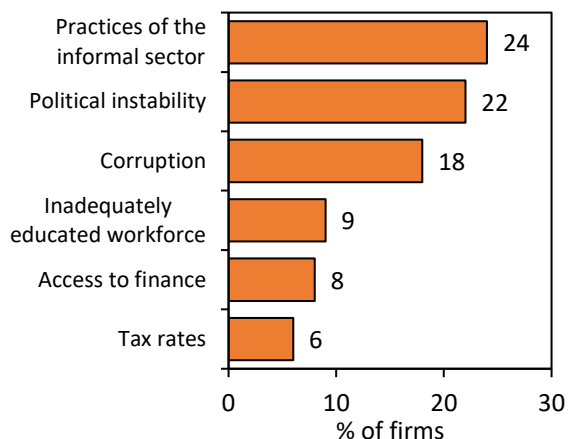


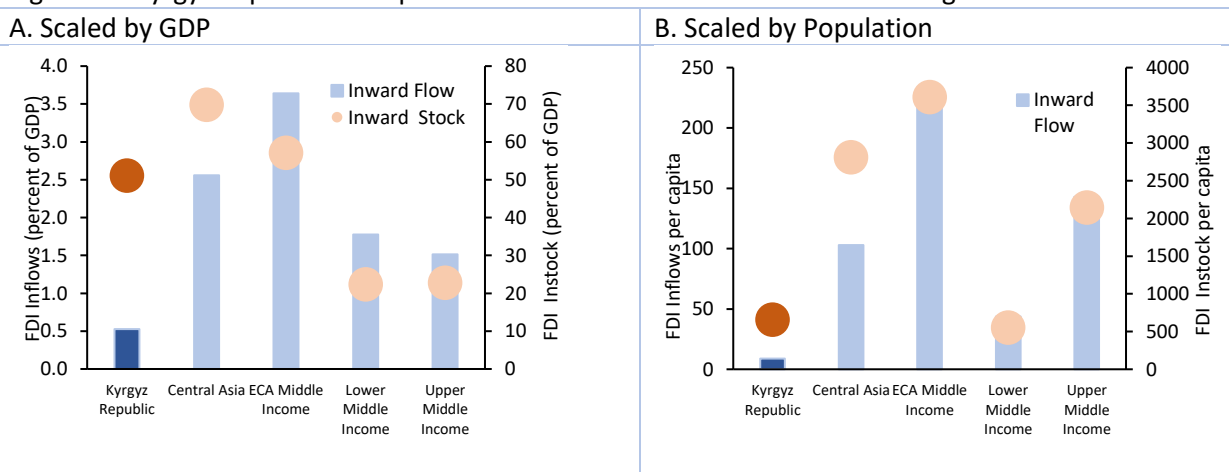
Figure 31: Greatest obstacles for firms



Source: WBG Enterprise Survey 2019

49. **Firms overwhelmingly report corruption, informality, and political instability as major constraints.** Far exceeding the averages of other countries, these three factors combine to make for a very adverse business environment (Figure 31). Corruption perceptions have deteriorated compared to 2020, as reflected in Transparency International’s downgrade of the country’s ranking to 144 out of 180 countries in 2021. Business procedures are complex and burdensome (for instance, taking up to 800 steps according to a recent survey by OSCE) for land & construction permits and energy supply. Tax compliance costs are also high. According to the World Bank’s 2019 Enterprise Survey, 82 percent of firms had to meet tax officials, compared to the 49 percent global average, and 29 percent of firms had to give “gifts” to tax officials compared to 12 percent globally. These distortions encourage firms to stay small and informal. Political instability and a lack of regulatory transparency and consistency also deter firms from starting up, investing, and growing.

Figure 32: Kyrgyz Republic underperforms on inward FDI flows and stock during 2017-2021



Note: Data from UNCTAD. Averaged between 2017-2021.

50. **Foreign investors also cited policy uncertainty as the major factor deterring them from investing in the Kyrgyz Republic.** Foreign Direct Investment (FDI), a critical source of both private investment and productivity gains, remains at low levels: Average FDI inflows per

capita were just US\$8 per capita in 2017-21, significantly below the lower middle-income countries' (US\$44) and Central Asia average (US\$103), and the FDI stock was at US\$653 per capita (Figure 32). A World Bank survey of foreign investors in the Kyrgyz Republic found that “unpredictable, arbitrary, and inconsistent government decisions” and “a lack of regulatory transparency” were the most common complaints. Another reflection of poor governance is the relatively high incidence of investor-state disputes taken to arbitration. Not only does the Kyrgyz Republic have a very high number of such cases for an economy of its size, but it also has a track record of losing these cases, reflecting a very real risk for firms.

51. **The high cost of administrative compliance is a serious constraint to business formalization and growth.** This refers to ineffective and burdensome inspections and compliance with tax and customs procedures. While inspection reforms were initiated in 2006, they have not sufficiently reduced the administrative burden on businesses.³³ The number of controlling agencies and inspections (25) remains excessive, with limited coordination among these agencies and the inspection regime proving cumbersome for businesses. Meanwhile, the lack of a risk-based approach leads to unnecessary inspections despite many businesses' low or moderate risk levels, creating a significant burden on both the agencies and the businesses. An assessment by the IFC suggests that even the 2016 reform failed to improve key performance indicators for inspections substantially and that substantial capacity gaps among inspectors remain, despite intensive training.³⁴ There is also a need to increase transparency in inspections. The tax compliance burden in the Kyrgyz Republic remains high, with 82.4 percent of firms reporting that they experienced visits by tax officials or were required to meet with tax officials. The average for ECA was 39.8 percent.

52. **Other shortcomings of the business environment are weak investor protections, weak contract enforcement, and high labor costs.** According to transition indicators of the European Bank for Reconstruction and Development, the Kyrgyz Republic is the lowest-ranked country in Central Asia for investor protection, with particularly low scores on resolving insolvency and enforcing contracts. Unit labor costs³⁵ in the Kyrgyz Republic have increased substantially since 2000 (Figure 33) due to the exchange rate, wage increases, and high remittance inflows.³⁶ These trends, along with other constraints to business, such as the high cost of capital, lend a degree of urgency to reforms that would improve national competitiveness.

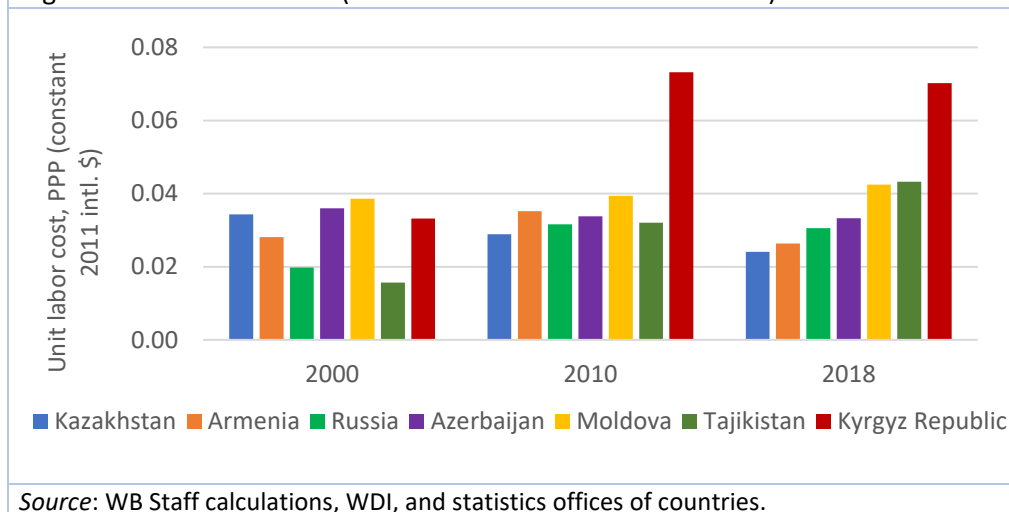
³³ IFC (2021). Kyrgyz Republic Inspection Reform Case Study—The Reform Process (2006–19): What Can We Learn? Washington DC. https://www.ifc.org/wps/wcm/connect/145985d8-d571-4661-b51b-75ac94f17e53/Inspection+Reform+Case+Study_KR.pdf?MOD=AJPERES&CVID=ntEi3ad.

³⁴ Ibid.

³⁵ The unit labor cost is derived by multiplying the employment data with an average wage in the economy (in PPP constant 2011 international \$) and dividing by GDP (in PPP constant 2011 international \$).

³⁶ The high inflow of remittances has been pushing reservation wages up.

Figure 33: Unit labor costs (constant 2011 international dollars)



53. **Trade facilitation remains weak with a high cost of connectivity and logistics.** As a landlocked country, the Kyrgyz Republic faces challenges in trade and connectivity. Indeed, the impediments to conducting trade are severe, worse even than its double-landlocked neighbor Uzbekistan. Over the past decade, the Kyrgyz Republic has ranked 132nd on the World Bank’s Logistics Performance Index, in the bottom quartile of countries. Distance from the Kyrgyz Republic to Russia is shorter compared with its neighbors. However, according to recent survey results, it is more expensive and slower to get to Russia from the Kyrgyz Republic than from Tajikistan or Uzbekistan.³⁷ In addition, trade facilitation is hindered by cumbersome and costly border procedures; the recent time release study shows that there are some improvements in 2021 compared to 2018, but it still takes 4 hours on average to complete border import procedures. The quality infrastructure for testing and certification, as well as for sanitary and phytosanitary standards, also needs to be upgraded.

54. **Kyrgyz firms face severe constraints in accessing finance.** As high as 97 percent of firms in the Kyrgyz Republic have an account at a financial institution, slightly higher than the regional ECA average of 95 percent.³⁸ However, as mentioned above, private sector credit to GDP is still significantly lower at 28.3 percent in 2020, compared to 57.5 percent in ECA (excluding high-income countries)³⁹ and the lower middle-income peer average of 45.9 percent. Bank intermediation is constrained by the limited deposit mobilization whereby the domestic bank deposit to GDP ratio is 28.4 percent in 2021. This further limit overall financial sector development and needs to be addressed by building credibility and trust in the financial system and by domestic economic management. The proportion of loans requiring collateral is high at 93.6 percent, compared to 71.2 percent in ECA, and the value of collateral needed for a loan is high at 244 percent, compared to 175 percent in ECA. This indicates a significant challenge in accessing a bank loan, and most firms rely on their internal financing for working capital and investments. Unlike SMEs, most micro-entrepreneurs operate without bank accounts. While the access to finance in terms of account ownership of adults at a financial institution or mobile money providers has dramatically improved from just 3.8 percent in

³⁷ Trade Facilitation Survey done by GIZ, 2021.

³⁸ The World Bank Enterprise Survey 2019.

³⁹ International Monetary Fund, International Financial Statistics and data files, and World Bank and OECD GDP estimates.

2011 to 45.1 percent in 2021, it remains among the lowest in the ECA region (77.8 percent) or its lower-middle-income peers (62.4 percent)⁴⁰. The availability of an accessible banking infrastructure is an important entry point to access financial services.

55. **Digital financial services are a growing opportunity to strengthen financial inclusion.** Digital channels have improved the convenience and accessibility of financial services, reaching 1.8 million mobile wallets and 4.6 million banking card holders in 2022. Still, the Kyrgyz Republic needs to catch up with global developments in digital financial services, especially the emergence of FinTech. It is important to strengthen financial infrastructure, such as credit bureaus, a collateral registry, and payments, to reduce finance costs and enhance competition by broadening the availability of financial products and services.

56. **The Kyrgyz Republic is under-exploiting the potential of ICTs due to low penetration rates.** Kyrgyzstan ranked 91 out of 121 in the 2021 Network Readiness Index Ranking,⁴¹ behind Kazakhstan (61) and Russia (43). This is due to substantial gaps in internet access, mobile applications development, the use of virtual social networks, internet shopping, ICT use, and e-government. However, the Kyrgyz Republic's digital innovation sector has grown steadily over the past eight years – its Global Innovation Index (GII) rank improved from 117 out of 173 in 2013 to 105 in 2021.⁴²

Limited progress in basic public services and persistent spatial and gender disparities

57. **The government's fiscal interventions did not meet the needs of certain vulnerable groups, as the country saw a worrying reversal of poverty reduction, which continued into 2021.** The per capita sum of direct transfers to the poor did not change in 2020 relative to 2019. Growth in direct transfers was detected only for the extremely poor, who obtained 15 percent of their disposable income from transfers compared to 6.7 percent in 2019. On the other hand, children, especially families with one or two children and single-parent families, faced reductions in direct transfers in 2020. This uneven performance and lack of adjustment of the fiscal redistribution to the COVID-19 challenges means that many in need during the COVID-induced crisis did not receive adequate support.

58. **Many more individuals, mostly females, remained excluded from the labor force and engaged in home duties.** Inactivity rates are increasing, particularly among women. The share of young NEET women and men aged 15-24 is at about 30 and 12 percent, respectively. This could be linked to a growing share of children in the households and low access and prevalence of child-care facilities, constraining female labor market agency. Women spend nearly twice as much time on unpaid domestic and care work than men. They face barriers to self-employment and entrepreneurship, including insufficient start-up capital, male dominance in the financial sector, limited access to technology, inadequate digital literacy, a lack of access to digital equipment, and social norms that encourage women to remain at home.⁴³ Inactivity is traditionally dominated by individuals engaged in schooling and academia, but recently the student share among the inactive has declined for females. While women enroll in tertiary education at higher rates than men, higher education does not translate into better opportunities, with working women dominating lower-paying

⁴⁰ Findex 2021

⁴¹ Portulans Institute (2021). Network Readiness Index. <https://networkreadinessindex.org/countries/>.

⁴² https://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2021.pdf.

⁴³ World Bank. Forthcoming, Kyrgyz Republic Country Gender Analysis.

sectors such as health and education. Moreover, the wage gap remains stubbornly high: women earn just 75 percent of what men do. COVID disproportionately hit women⁴⁴ and women-headed households due to quarantined kindergartens and the closing of small businesses, sewing industries, and bazaars where they have traditionally been engaged.⁴⁵

59. **Job availability, rising food prices, and children's education remain the most significant concerns for the population.** In 2022 the share of the population concerned by those factors has been steadily increasing. Increased food prices and a lack of domestic jobs create risks of deepening poverty and its increasing prevalence. Employment difficulties were concentrated among youth and women, with both groups over-represented among the 53 percent stating in August that it was not a good time to find a job. Job security has remained a challenge, with 64 percent in August 2022 confirming they were worried about losing a job or not finding one, thus more than ten percentage points above the level of December 2021.⁴⁶

60. **Presently, women remain heavily underrepresented in public service and more senior roles.** The Kyrgyz Republic has gender equality in political rights stipulated by the Constitutional Law on the Election of the President of the Kyrgyz Republic and Deputies of the Jogorku Kenesh⁴⁷ of the Kyrgyz Republic. This law requires a minimum 30 percent gender quota. It directs a certain rank order of candidates, thus preventing female candidates from being placed on the bottom of the party lists with little chance of being elected. (Article 60). Implementing these measures has secured 19 seats for women in the legislature, or 35 percent of the 54 members elected from political parties and 21 percent of the total number of 90 deputies. A similar mechanism – a gender quota of 30 percent – was introduced in the law “On Elections of Deputies of Local Keneshes” (local councils) in August 2019 to ensure greater female representation. However, despite a strong legislative base guaranteeing gender equality, the country still suffers from high inequalities and faces major regional disparities.⁴⁸ Women generally occupy administrative posts with fewer responsibilities, while men hold more political and senior positions. Women are also better represented in offices and ministries that deal with the social sector. Out of 21 members of the Cabinet of Ministers, there are only two women – The Minister of Health and the Minister of Natural Resources, Environment, and Technical Supervision.

61. **Further, persons with disabilities continue to face exclusion** in terms of prejudice, segregated residential settings and special school systems for children of various disabilities, inaccessible public infrastructure, transportation and information communication technologies, and barriers to accessing employment opportunities. Women with disabilities may face greater exclusion and enhanced vulnerability with increased exposure to sexual exploitation, abuse, sexual harassment, and a lack of access to resources and jobs. The Labor Code requires all public and private entities with 20 or more employees to hire a 5 percent

⁴⁴ Three-quarters of women shifted to home-based work, 43 percent reduced their working hours, 69 percent increased time spent on care work and 80 percent spent more time on unpaid domestic work, significantly higher than men.

⁴⁵ UN Women (2020) The impact of COVID-19 on women’s and men’s livelihoods in Europe and Central Asia: Preliminary results of a Rapid Gender Assessment, United Nations (2021) COVID-19 Socioeconomic Response Framework for the Kyrgyz Republic.

⁴⁶ Source: Listening to the Kyrgyz Republic, August 2022.

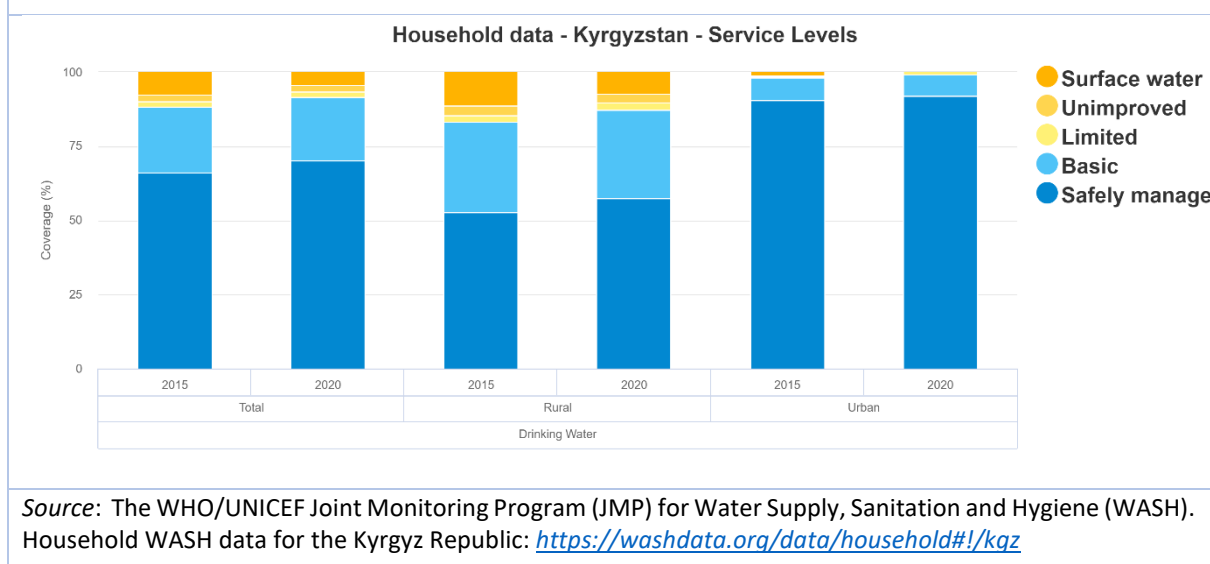
⁴⁷ Jogorku Kenesh (translated as "Supreme Council") is the legislative body, the unicameral parliament of the Kyrgyz Republic.

⁴⁸ UN Women Europe and Central Asia <https://eca.unwomen.org/en/where-we-are/kyrgyzstan>

ratio of people with disabilities as the minimum quota set in the Labor Code.⁴⁹ However, 71 percent of employers openly exhibit discriminatory attitudes toward job applicants with disabilities.⁵⁰ Most infrastructure is not accessible for persons with disabilities, and only 8 percent of schools have the necessary infrastructure for children with disabilities.⁵¹

62. Gender-based violence (GBV) remains prevalent, and services for survivors are very limited. Violence against women is widespread and takes many forms, including domestic violence, bride kidnapping, trafficking, early marriages, and physical abuse. According to the 2012 Demographic and Health Survey (DHS), about one in four women and girls aged 15-49 who are, or have ever been married, reported having experienced domestic violence. The pandemic also increased gender-based violence: From January to March 2020, law enforcement agencies registered a 65 percent rise from March 2019. The evidence clearly shows that the pandemic has significantly affected patterns of gender-based violence in the Kyrgyz Republic: from January to March 2020, law enforcement agencies registered 2,319 reports of domestic violence, which is 65 percent more than in the same period of 2019. Ninety-five percent of victims are women aged 21 to 50. And while bride-kidnapping is illegal, the law is not well enforced, prosecutions are very rare, and bride abductions are prevalent.⁵² GBV services are run almost entirely by NGOs, with very limited government support. Women face limited access to justice, especially in rural areas. Only a small number of complaints registered by the police reach the courts, with these cases being considered administrative offenses and not crimes. An even smaller number results in a conviction. There is high victim shaming and blaming levels in the justice system, where survivors often face discrimination and gender stereotypes when seeking justice.⁵³

Figure 34: Rural and urban drinking water service levels, 2015 and 2020



⁴⁹ The Labor Code of the Kyrgyz Republic, Ministry of Justice of the Kyrgyz Republic, <http://cbd.minjust.gov.kg/act/view/ru-ru/1505>

⁵⁰ “Promoting the rights of persons with disabilities in Central Asia: Institutional Experiences and the way forward”, UNDP Regional Centre for Europe and the CIS, 2013

⁵¹ “Global Education Monitoring Report 2021: Inclusion and education: All means All – Central and Eastern Europe, Caucasus and Central Asia”, 2021, UNESCO

⁵² ADB (2019) Kyrgyz Republic Country Gender Assessment

⁵³ American Bar Association Center for Human Rights (2020) Kyrgyzstan: Violence against women: Barriers to accessing justice, fair trial rights and the right of peaceful assembly.

63. **Over the past five years, there have been some positive developments, and access to certain basic public services has improved, although large gaps in the provision of basic services persist.** This improvement from 2019 to 2000 was broad-based: expected years of schooling rose from 11.8 to 13.0 years, and average years of schooling had increased from 9.8 to 11.1 years by 2019.

64. **Despite significant gaps, water supply and sanitation service delivery have also improved.** Access to safely managed drinking water increased from 66 to 70 percent⁵⁴ (Figure 34). In 2020, in urban areas, access to safely managed drinking water supplies⁵⁵ reached around 92, while in rural access - around 57 percent.⁵⁶ However, based on the most recent data from the Kyrgyz Republic's rural water and sanitation information system (SIASAR)⁵⁷, access to safely managed water in rural areas is as low as 18.79 percent.⁵⁸ In most schools and health care facilities in rural areas, the WASH situation is poor: around 38 percent of rural schools and 58 percent of rural health centers do not have access to improved water sources and lack adequate hygiene⁵⁹. Access to at least basic sanitation is reported to be 34 percent in rural areas⁶⁰. Most people (about 66 percent) have access to unimproved or shared facilities, and some (0.7 percent) still practice open defecation.⁶¹ ⁶² Overall, poor WSS is estimated to cost the country about US\$120 million per year, or more than 1.6% of GDP (2017).⁶³

65. **The energy sector reports poor reliability and high losses due to insufficient investments in the rehabilitation and upgrading of aging infrastructure.** Reported total losses were about 20 percent of net generation in 2020, and actual losses are likely higher considering the lack of metering and poor management information systems. This is more than twice as high as commercial and technical losses in high- and some middle-income countries. About half of the generation capacity and 60 percent to 70 percent of distribution assets are beyond their useful lives. The main inefficiency is in the distribution segment, which

⁵⁴ World Health Organization (WHO)/United Nations Children's Fund (UNICEF) Joint Monitoring Program (JMP),

⁵⁵ Safely managed drinking water includes three dimensions: (a) available on premises, (b) reliably available when needed, and (c) free of key pollutants (chemical and bacteriological).

⁵⁶ JMP data from <https://washdata.org/data>. Data is based on trend extrapolation of national surveys where definitions may be differently defined. For example, all private piped connections from individual wells may be interpreted as safely managed without being provided as a public service. As such it is difficult to compare this data with SIASAR data that provides more accurate and detailed information on service levels.

⁵⁷ SIASAR, introduced in the country in 2018 under the World Bank-financed SRWSSDP, provides data collected in rural areas across the country over 2019-2021.

⁵⁸ SIASAR data (January 2022). <http://data.globalsiasar.org/sdgs>.

⁵⁹ SIASAR data (January 2022). <http://data.globalsiasar.org/schools> and <http://data.globalsiasar.org/health-centers>. Only 10% of rural schools and 16% of rural health centers were reported to have soap at the time of the surveys.

⁶⁰ JMP data states 99% basic sanitation in rural areas; however, estimates assume that all pit latrines are improved, which in reality is not the case.

⁶¹ Basic sanitation refers to an improved facility that is not shared with other households. Safely managed sanitation means three dimensions are fulfilled i) improved facility that separates excreta from human contact, ii) is not shared with other households, and iii) excreta produced to be treated and disposed in situ, stored, emptied and transported to treatment off-site, or collected by sewer and then treated and used/disposed.

⁶² Basic sanitation refers to an improved facility that is not shared with other households. Safely managed sanitation means three dimensions are fulfilled i) improved facility that separates excreta from human contact, ii) is not shared with other households, and iii) excreta produced to be treated and disposed in situ, stored, emptied and transported to treatment off-site, or collected by sewer and then treated and used/disposed.

⁶³ The World Bank (2019). Central Asia: Regional Water Security (internal report). Washington, DC: World Bank.

accounts for up to 80 percent of reported losses. Old and obsolete distribution lines and equipment have led to frequent supply disruptions due to equipment failures and overloading across the country. In addition to load shedding, distribution companies have recently introduced additional bottlenecks to limit consumption for individual customers up to a certain threshold. Applications for new connections, for instance, are being processed very slowly—and even rejected during the winter season—because of generation and distribution capacity constraints. Distribution companies have been experiencing a significant increase in energy demand due to urban development. The aging distribution networks cannot keep up with demand growth, leading to more frequent and longer outages and forcing distribution companies to reject new applications for connections. The need to upgrade aging assets and expand distribution capacity through targeted investments is evident in the network.

66. In terms of social services, the quality of education has remained a considerable challenge. The education and training system has been slow to improve its service delivery quality and adjust to the country’s changing economic needs, resulting in persistent skills mismatches. Learning-adjusted years of schooling are only equal to 8.4 years of schooling. Around 64 percent of children finishing primary school are not proficient in reading and comprehension.⁶⁴ Enrollment in Early Childhood Development (ECD) has increased over the past years from 22.7 percent in 2014 to 39 percent in 2018. The pandemic has led to learning losses for students. The mandatory closure of schools and remote teaching is estimated to have resulted in substantial learning losses and pushed more students into functional illiteracy. Learning outcomes are estimated to have dropped by the equivalent of 8 PISA points, or by 20 percent per year in 2020 and 2021. Estimates suggest that the percentage of students performing below the level of functional literacy will increase by four percentage points (from 91 to 95 percent). An adult skills survey conducted in 2019, adapted from the OECD’s Program for the International Assessment of Adult Competencies, showed that about 90 percent of adults surveyed performed below the minimum proficiency level in basic foundational skills - literacy, numeracy, and problem-solving.⁶⁵

67. Tertiary education and skills development are crucial for sustainable economic growth, but at present, it is poorly aligned with the economy’s demand. The higher education system has accomplished tremendous improvement in access since the Kyrgyz Republic’s independence in 1991, when only nine public universities existed, enrolling around 55,000 students. As of 2021, there are 60 higher education institutions (HEIs), enrolling around 230,000 students.⁶⁶ This rapid growth has created challenges in the quality and relevance of higher education. For instance, the tertiary education gross graduation rate was only 29 percent in 2019. Over the years, most curricula are not updated systematically to match economic transformations. Collaboration with industries is largely absent, and research outputs are lagging. Skills deficiency is a major concern for the economy. About 90 percent of adults performed below the minimum proficiency level in foundational skills:⁶⁷ even among the most educated, a large share had low basic skills, according to the 2019

⁶⁴ Global Learning Poverty Update 2022

⁶⁵ Hou, Dingyong; Acevedo Gonzalez, Karina Margarita; De Laat, Joost; Larrison, Jennica.2021. Building the Right Skills for Human Capital: Education, Skills, and Productivity in the Kyrgyz Republic. Washington, D.C.: World Bank Group.

⁶⁶ National Statistical Committee of the Kyrgyz Republic, <http://stat.kg/en/>

⁶⁷ Hou, Dingyong; Acevedo Gonzalez, Karina Margarita; De Laat, Joost; Larrison, Jennica.2021. Building the Right Skills for Human Capital: Education, Skills, and Productivity in the Kyrgyz Republic. Washington, D.C.: World Bank Group. <https://imagebank2.worldbank.org/search/32431024>

Adults Skills Survey. According to the latest Enterprise Survey, an inadequately educated workforce is the 4th biggest constraint for businesses, as 9 percent of firms and 16 percent of large firms stated that this was their largest constraint (the ECA average is 7 percent).⁶⁸

Table 4: Key Health Indicators for the Kyrgyz Republic (2016-20)

	Kyrgyz Republic		Lower Middle-Income Countries	
	2016	2020	2016	2020
Life expectancy at birth	71.0	71.8	68.4	69.3
Under-5 Mortality rate (per 1,000 live births)	21.2	17.5	51.2	44.9
Infant mortality rate (per 1,000 live births)	18.9	15.7	38.3	33.9
Total Fertility Rate (number of children per woman)	3.1	3.0	2.8	2.7
Prevalence of moderate and severe stunting*	12.9	11.8	32.4~	29.1~
The proportion of women receiving at least 4 antenatal care consultations *	94.6	94.3	59.1 (2017)	not applicable (NA)
The proportion of births attended by skilled health personnel (%)*	98.4	99.8	75.2 (2018)	NA
Contraceptive prevalence rate (% of married women aged 15-49)*	41.9	39.4	50.9 (2018)	
The proportion of 1-year-old children fully immunized against diphtheria (%)	96.0	87.0	NA	NA
The proportion of 1-year-old children immunized against measles (%)	97.0	92.0	NA	NA
<i>Source:</i> World Bank, 2022, Databank, Health, Nutrition, and Population Statistics, https://databank.worldbank.org/source/health-nutrition-and-population-statistics , accessed June 9, 2022. *Data is from 2014 and 2018. ~Modeled estimate.				

68. **The Kyrgyz health sector has progressed regarding maternal and child health outcomes but has been negatively impacted by the COVID pandemic.** Life expectancy at birth has increased by more than a year since 2014, to 71.8, above the LMIC average but still below ECA and UMIC averages (Table 4). Maternal mortality fell by 15 percent from 2014 until the latest data point (2017), and infant mortality has fallen even further. However, here too, COVID has had a disruptive effect. Childhood immunization rates dropped significantly in 2020, and preliminary data for 2021 suggests they have yet to recover. Maternal mortality increased from 24.8 in 2019 to 36.1 per 100,000 live births a year later, reversing four years of progress on that indicator. The mortality impacts of the pandemic are much more severe than what is suggested by the official COVID-19 death toll. While the COVID-related state of emergency was lifted in May 2022, the country remains vulnerable to possible future waves of the pandemic due to low vaccination rates.

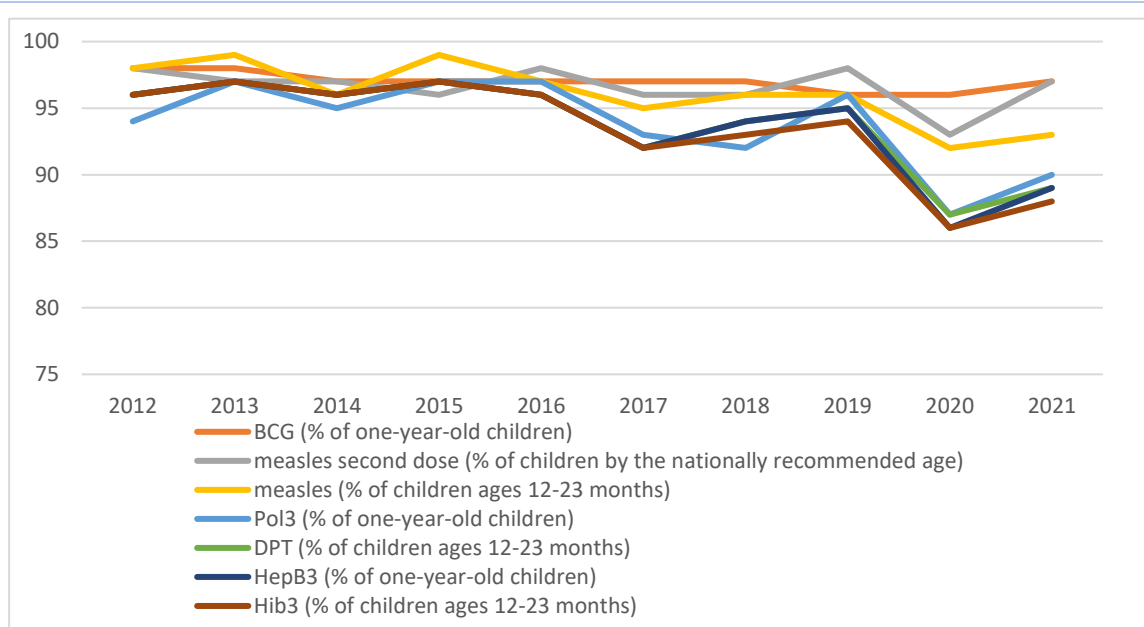
69. **Health has traditionally been a priority in the Kyrgyz Republic, and the country has achieved better health outcomes than other countries with similar income levels** (Table 4). The population enjoys a longer life expectancy of 71.8 years in 2020, partly due to the significant progress in reducing under-5 mortality from 65.8 deaths per 1,000 live births in 1990 to 17.5 in 2020. Improvements in undernourishment have been dramatic over the past decade, and the prevalence of tuberculosis halved between 2000 and 2012. In 2015, the

⁶⁸ Enterprise Surveys: Kyrgyz Republic 2019.

country officially achieved Millennium Development Goal No. 4 on reducing mortality among children under five.

70. **The COVID-19 pandemic negatively impacted the delivery of routine health services and the population's health.** Childhood immunization rates against Diphtheria-Polio-Tetanus, Hib69, and HepB70 dropped by 8 to 9 percentage points in 2020 (Figure 35), and preliminary data suggests that they did not rebound in 2021, especially for the youngest age groups (children aged 1). Maternal mortality increased from 24.8 per 100,000 live births in 2019 to 36.1 per 100,000 live births in 2020, reversing four years of progress on that indicator.⁷¹ The reported incidence of acute intestinal infections dropped by almost two-thirds between 2019 and 2020, likely partly reflecting a reduction in health services and not only a decrease in morbidity. Other indicators show similar reductions in service availability, though the decline started before the pandemic. For example, access to contraceptives decreased by 1.7 times between 2016 and 2020, with even sharper decreases in some geographical areas such as Osh (5.6 times decrease) and Talas Province (2.4 times).⁷²

Figure 35: Childhood Immunization Rates, Kyrgyz Republic, 2013-2020



Source: World Bank, Databank, Accessed June 10, 2022.

71. **Despite the progress in health indicators, the trends in primary health care (PHC) in the Kyrgyz Republic are concerning.** First, utilization of primary care is low and declining. Even before the COVID-19 pandemic, the number of outpatient contacts per person per year was trending downward from an already low level: from above 4 in the early 2000s to 2.5 in 2019, while high-income countries and other countries from the Community of Independent States (CIS) register an average of 7. This decline points to issues of availability and quality of care and low trust in the system. Second, service availability suffers from high vacancy rates,

⁶⁹ Haemophiles Influenzae type b

⁷⁰ Hepatitis B

⁷¹ National Statistical Committee, 2022, <http://www.stat.kg/en/opendata/category/5/>, accessed June 10, 2022.

⁷² UNFPA, 2021, Report on Situation Analysis of Reproductive Health, kyrgyzstan.unfpa.org.

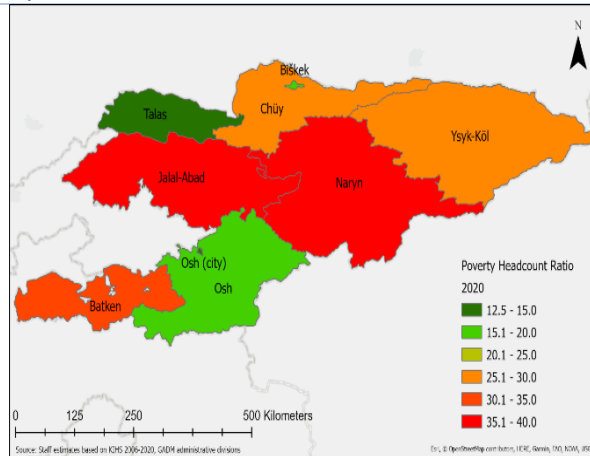
particularly at the PHC level. The ratio of physicians per 1,000 people has steadily declined due to low wages and emigration. In 2018, outside of Bishkek, almost 15 percent of Primary Health Care physician positions were vacant, reaching almost 20 percent in four regions (Talass, Issyk-Kul, Osh, and Chuy). For hospitals, vacancy rates were more uniform throughout the country and lower (around 4 percent). The low vaccination rates against COVID-19 are emblematic of primary care problems. Although a large share (79.4 percent) of health care workers is vaccinated with two doses, vaccine hesitancy remained high throughout the vaccination campaign, and primary care providers could not convince the eligible population to vaccinate. The quality of care in PHC also remains insufficient. Although most women do receive some form of prenatal care, such care often does not include essential services such as screening tests; when it does, most of the screening services are provided in the private sector against payment, even when they are covered under the State Guaranteed Benefits Package (SGBP).

72. **The Kyrgyz Republic spends 2.6 percent of its GDP on public healthcare, well below the 4.6 percent average for the ECA region.** Out-of-pocket expenditures continue to represent almost half of the country's total health expenditures (especially for medicines), exposing the population to the risk of impoverishment and catastrophic health costs. Service delivery infrastructure is largely outdated, and health care workers' official remuneration remains low. The ratio of physicians per 1,000 people has steadily declined due to low wages and emigration, and there is an acute shortage of physicians in primary health care. Beyond Bishkek, almost 15 percent of PHC positions are vacant.

73. **Spatial differences in poverty and access to basic services have deteriorated.** The gap between urban and rural poverty remained significant as only minor economic development changes occurred in the rural and most impoverished areas (Figure 36). Poverty incidence has been converging across regions over recent decades (Figure 37): those regions that had lower average per capita consumption expenditures experienced higher and more accelerated growth in mean expenditures over the years. Moreover, regions (oblasts) with initial high poverty rates also had a higher pace of reduction in poverty headcount ratios (Osh, Jalal-Abad). The regional trends of poverty changes were driven by changes within the oblasts, as opposed to shifts in the population across the regions.⁷³ There are significant spatial differences in skilled labor, a low level of economic opportunities, low market accessibility, and a low level of development of relevant economic institutions, infrastructure, and services. Most of the rural poor work in the informal sector and are beyond the reach of formal social safety nets. Regional and socioeconomic inequality in access to ECD between urban and rural areas is significant, as enrollment in urban areas is roughly twice that of rural areas. The wealthiest quintile of households has a 50 percent enrollment rate compared to 12 percent for the poorest quintile.

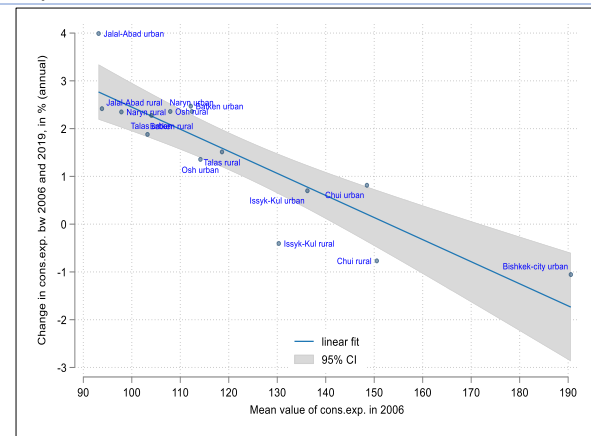
⁷³ Poverty and Vulnerability in the Kyrgyz Republic: assessing trends, drivers and challenges, Poverty and Equity Assessment, World Bank 2022.

Figure 36: Poverty Rates in the Kyrgyz Republic by oblast, 2020



Source: Based on KHS 2020

Figure 37: Regional Convergence in Mean Expenditures



Source: Based on KHS 2016-2020

74. **Geographic and socio-economic disparities in access to basic public services constrain the accumulation of assets and the equalization of opportunities across the population.** Owing partly to the country’s topography, which makes access to many services, including education, health, infrastructure, and markets, difficult, large socio-economic disparities exist between rural and urban areas. For instance, while 70 percent of the urban population has access to improved sanitation, in rural areas, the share is only 8 percent. Regional and socioeconomic inequality in access to early childhood development (ECD) between urban and rural areas is significant, as enrollment in urban areas is roughly twice that of rural areas. The wealthiest quintile of households has a 50 percent ECD enrollment rate compared to 12 percent for the poorest quintile. Indeed, almost all human development indicators show a huge divide between rural and urban areas. These economic and social differences, exacerbated by ethnic and other divisions between the rural south and urban north, have generated communal tensions. The unbalanced regional development and gaps in service delivery, infrastructure, and livelihood opportunities are sources of popular discontent. At the same time, communities have high social cohesion, which the GoKR can leverage to foster local economic development and service provision. Nearly 50 percent of citizens in the southern regions believe at least eight out of ten random people in their community would turn out to help with a community-level infrastructure project. Ethnic minority groups agree with the statement that “people of all faiths and ethnicities are treated equally and fairly in the country by the government.”⁷⁴

Increased vulnerability to climate change and high reliance on natural resources

75. **The Kyrgyz Republic is the third most vulnerable country to climate change in the ECA region.** Warming over the 1986–2005 baseline period may reach 5.3°C by the 2090s under the highest emissions pathway, thereby greatly amplifying pressure on human lives, livelihoods, and ecosystems. The country is highly exposed to natural hazards (e.g., mudflows, landslides, avalanches, floods, loss of glaciers, wildfires, and earthquakes). Simulations indicate that a large earthquake could impact about 2.4 million people and lead to losses and damages equivalent to half of the country’s GDP. On average, 80,000 people are exposed to flood risks annually, costing the economy US\$70 million. Droughts are common, and the

⁷⁴ World Bank. Forthcoming. *Fostering Resilient and Cohesive Communities in the Kyrgyz Republic*. Washington D.C.: World Bank.

annual probability of severe drought is estimated to more than double from 14 percent in 2020–2039 to 31 percent in 2040–2059. Heat stress may represent a serious risk to human life during peak summer temperatures. Moreover, heat could combine with the increased incidence of drought to expand arid land cover; increased surface water evaporation leads to higher soil salinity and increased glacial water melts.

76. **The loss of mountain glaciers may reduce the regularity of flows and result in the drying of some watersheds.** Flooding and associated hazards such as landslides are expected to intensify, damaging lives and livelihoods. Frequent and often local hydrometeorological disasters and extreme temperatures undermine development and economic growth, particularly for vulnerable groups, and pose a risk to vital infrastructure. While well-endowed with water resources, the country faces high spatiotemporal variability in water availability that will be exacerbated by climate change. Rainfall is generally inadequate for agriculture beyond subsistence levels. Climate change is estimated to have a major impact on erosion as flows become more variable, mainly due to the reduced regulating role of snow and glaciers in the Naryn river basin, exacerbated by under-investment in infrastructure.

77. **Intensive and unsustainable resource and fossil fuel use has resulted in land degradation, biodiversity loss, air pollution, and detrimental impacts on health and labor productivity.** The Kyrgyz Republic is one of the worst global performers in water use efficiency, and carbon efficiency is only a third of the UMIC average. The country is amongst the worst performers in agricultural land productivity, value added per worker (agriculture), and efficient use of carbon. The natural resource intensity of the country's economy is four times higher than the sub-regional and regional average. Severe land degradation impacts the provision of important ecosystem services such as food security, soil fertility, carbon sequestration, wood production, and groundwater recharge. It has an annual cost of US\$601 million (7 percent of 2021 GDP)⁷⁵. Air pollution costs US\$275⁷⁶ million annually (3 percent of 2021 GDP), accounting for more than one in 10 deaths in the country⁷⁷ and significant productivity losses. These impacts will be exacerbated by climate change.

78. **Natural resource degradation, aggravated by the impacts of climate change, raises risks for food security and agricultural sector development.** Food insecurity has already been rising in the Kyrgyz Republic in response to the shocks of COVID-19, political instability, and, most recently, the fallout from Russia's invasion of Ukraine. The World Food Program's August 2022 assessment found that 21 percent of households were food insecure, while 82 percent were using some asset-depleting coping strategies (relying on savings and money borrowing), with 16 percent using emergency coping strategies (selling assets or asking for assistance) to respond to rising food prices. Continued land degradation will exacerbate the problem in the short-term, while climate change impacts will be significant over the long-term. Without effective adaptation, agricultural yields are likely to suffer by up to 30 percent by 2050.⁷⁸ Under a global high emissions scenario (RCP8.5), it is estimated there could be up to 50 deaths

⁷⁵Global Mechanism of the UNCCD, 2018. Country Profile of Kyrgyzstan. Investing in Land Degradation Neutrality: Making the Case. An Overview of Indicators and Assessments. Bonn, Germany.

⁷⁶ The global health cost of PM2.5 air pollution: A case for action beyond 2021. <https://openknowledge.worldbank.org/handle/10986/36501> World Bank (2021).

⁷⁷ Health and Pollution Action Plan (2019).

⁷⁸ Reyer, C., Otto, I.M., Adams, S. et al. Climate change impacts in Central Asia and their implications for development. *Regional Environmental Change* 17, 1639–1650 (2017).

per million population in the country resulting from lack of food availability;⁷⁹ moreover, given the critical role of the agricultural sector for the livelihoods of the poor and as a potential high-value export sector, resource degradation, and climate change present important risks for growth and poverty reduction.

79. **Despite high vulnerability, awareness of climate change remains low, and citizens have few resources to help adapt to climate change and disasters.** Only 38 percent of respondents without a university education have heard of climate change.⁸⁰ However, most (over 60 percent) observe specific impacts of climate change in their village: more droughts; irregular temperatures; irregular rains; loss of vegetation; a loss of the viability of animal husbandry; increased flooding; and the disappearance of wild animals. When asked how their household has adapted to climate change, nearly half of the citizens report doing nothing, and six percent report sending their children to work. Only 2 percent believe that the level of available resources and training in their village to help cope with the impact of climate change is sufficient.

80. **Land degradation has deepened vulnerabilities for people and impacts the provision of critical ecosystem services, further exacerbated by climate change.** Evidence finds grassland net primary productivity is decreasing over time, with nearly 60 percent of Kyrgyzstan's grasslands experiencing degradation, particularly in northern parts of the country.⁸¹ This land degradation impacts the provision of important ecosystem services such as food security, soil fertility, carbon sequestration, and wood production. Land resource degradation and deforestation also lead to the loss of biodiversity and increased risk of natural hazards (e.g., mudflows, landslides).⁸² Hydro-based energy sources may also pose upstream risks to watersheds and increase sedimentation and land degradation.⁸³

81. **Air pollution is a major problem in the Kyrgyz Republic, particularly in urban centers such as Bishkek - one of the most polluted cities in the world.** Ambient air pollution has been a major environmental threat to the population. The sixth annual Environmental Performance Index (EPI) ranked the Kyrgyz Republic 114th among the lowest performers for Environmental Health Indicators and 132nd on Air Quality. At the national aggregate level, exposure to PM 2.5 and the air pollution-related health burden are below the LMIC average. Yet, the proportion of the population exposed to PM 2.4 jumps to 72 percent when using the 15 ug/m standard (GRID benchmarking).⁸⁴ In addition to the widely acknowledged health impacts, pollution, especially air pollution, has detrimental effects on labor productivity, health, and morbidity, undermining human capital development and economic growth. In addition to air pollution, almost the entire country lacks sufficient wastewater treatment and solid waste management, with all solid waste being improperly managed.

⁷⁹ World Bank Group (2021) Climate Country Risk Profile: Kyrgyz Republic.

⁸⁰ CASA1000 Community Support Project's 2021 baseline survey from the country's southern regions. The data was collected from a sample of 4,497 households in 14 districts and cities in Jalal-Abad, Osh and Batken regions from September to October 2021. Community Development and Investment Agency (ARIS) (2021). CASA1000 CSP baseline survey.

⁸¹ <https://onlinelibrary.wiley.com/doi/full/10.1002/ldr.3623>

⁸² BIOFIN 2019.

⁸³ Land degradation in the Kyrgyz Republic has a likely sedimentation hazard on hydropower projects such as Kambarata 1 (currently under construction) and Kambarata 2 (operational). World Bank, 2022. Forest Restoration Opportunities in the Kyrgyz Republic: Restoration Opportunity Assessment Methodology (ROAM) Report. Washington, D.C.: World Bank."

⁸⁴ World Bank concept on Green, Resilient, and Inclusive Development developed in 2020.

82. **Highly dependent on hydropower electricity generation is subject to water flow variations exacerbated by the threat of climate change, while the fossil fuel-dominated heating sector greatly contributes to GHG emissions and local air pollution.** The hydro-dominated electricity mix ensures the provision of a green electricity supply but makes it prone to periodic energy deficits due to hydraulic cycles and seasonality. The water flow of hydropower is subject to both yearly variations and significant seasonal changes. The yearly and seasonal variability of water flow is aggravated by the fact that most domestic electricity production relies on hydropower concentrated in the Naryn River basin in the Jalal-Abad Province. The seasonal flow variations have further worsened over the past few years and are likely to be exacerbated in the future with the threat of climate change. Meanwhile, the country relies mainly on coal to meet households' winter heating demands, leading to significant GHG emissions and local air pollution.

83. **Mining-related environmental damage presents risks for the country, which are accentuated by climate change.** The Kyrgyz Republic inherited 120 abundant mining tailing sites dating back to the 1940s, the radioactive and toxic pollution from which poses a serious threat to human life and the environment. The total volume of mining waste is estimated at 11,540 mln m³, half of which comprises radioactive residues. Some of these hazardous substances are located close to rivers with transboundary flows and are used for irrigation in the greater Fergana Valley. Because of Kyrgyzstan's high vulnerability to landslides, floods, and other natural disasters, there is an extremely high risk of explosions and other dangerous consequences of these abundant mine tailings for human life and productivity, and arable land and food security.

84. **Climate and environmental finance is scant and need far exceed capacities to meet international commitments on climate change, land restoration, and forestry.** Meeting climate commitments would require finance in the range of US\$10 billion, of which US\$7.2 billion for mitigation measures and US\$2.8 billion for adaptation.⁸⁵ While for mitigation, domestic sources are to fund 40 percent of the needs for climate finance, for adaptation, only 28 percent of the needs will be met. The financing gap is larger for international climate finance, private sector, and non-budgetary sources to the tune of US\$6.3 billion. As per BIOFIN (2019) - the funds allocated for environmental aspects, including biodiversity and adaptation to climate change, are meager and, on average, account for 0.5% of total budget expenditures (with allocations in the range of 742.8 million KGS). However, 7,348.1 million KGS are required per respective strategic documents related to the environment, biodiversity, and adaptation to climate change. For forestry alone, Kyrgyzstan will need additional investments of 4,550.4 million KGS (US\$94.8 million) in the forestry sector to maintain the productivity of ecosystem services.

Looking ahead – from Vulnerability to Resilience

85. **In sum, this updated diagnostic highlights that the Kyrgyz Republic needs to accelerate progress toward developing new drivers of growth.** Gold and remittances offer limited opportunities for further growth and are subject to volatility and external factors. Job availability, increasing food prices, and education remain the most significant concerns for the population. The persistent lack of economic opportunities is a major problem in rural areas, forcing most of the rural population, especially from the poor regions, to migrate and

⁸⁵ Revised Nationally Defined Contributions, 2021.

seek job opportunities abroad or else consider insecure jobs in low-productivity services sectors in cities.

86. **In addition to structural constraints identified by the original SCD, which remain relevant to date, new binding constraints have emerged since 2018, seriously threatening the sustainability and resilience of the Kyrgyz economy.** While the original SCD mentioned the cross-cutting challenges of climate change, the current update recognizes the prominence of resilience towards climate change. It suggests a stand-alone development pathway to ensure proper policy focuses on natural resource management, restoration, and climate-resilient infrastructure.

87. **Since 2020 the Kyrgyz economy has been confronted by three additional challenges, which may also be seen as triggers of change for the business-as-usual approach.** While the economy has been struggling to recover from the implications of the pandemic, implications of Russia's invasion of Ukraine has deteriorated the regional and global policy environment and imposed additional challenges. The domestic political situation has been stable since the 2020 political cycle. However, this stability is fragile and should be maintained and enhanced to create and enhance confidence in the public sector.

88. Moving from the current volatile, jobless, resource inefficient, and unsustainable growth model to a productivity-driven, inclusive, and more sustainable and resilient source of growth path will require systematic and genuine reform efforts supported by the following:

- Strengthened macroeconomic management, including improved SOE management and improved public financial management practices aimed at increasing the efficiency of public spending and aligning the public finance systems with broader government goals, including support for competition.
- Improved governance framework, including public service delivery and the rule of law.
- The improved business environment for private sector development and trade by reducing regulatory burdens on business, improving contract enforcement, improving external competitiveness by reducing trade costs and frictions, easing access to finance and financial sector development, as well as accelerating digital development and ICT.
- Improved inclusion and human capital enhancement by investing in early education and quality improvement of basic education and in public healthcare systems to ensure equal access to quality and affordable health services, including multisectoral integrated Gender Based Violence response services.
- Change the current unsustainable practice of natural resource use, including land management practices, and enhance preparedness and adaptation to climate change.

IV. TOWARDS RESILIENT DEVELOPMENT PATHWAYS

89. **Taking into account the diagnostics presented above, four pathways will be discussed that together enable the Kyrgyz Republic to achieve sustainable, inclusive, and resilient development.** The suggested pathways are informed by the priorities of the government’s mid-term Development Program up to 2026. The National Development Program aims for continued growth and improved living standards for the population. More specifically, it sets out an ambition to achieve 5 percent average annual GDP growth; upper-middle income country (UMIC) status by 2040; reduce the unemployment rate to 5 percent; ensure annual FDI flows of at least 13 percent of GDP; maintain public debt below 60 percent of GDP and reduce poverty to less than 20 percent of the population. While some of these goals may be over-ambitious,⁸⁶ they nevertheless set out a clear direction. But to make good progress against these goals, strong reform actions will be needed to strengthen policy and institutional frameworks, and initiation of such reforms should start now.

Pathway 1: Catalyze private sector-led growth by ushering in greater macroeconomic stability, greater contestability, better connectivity, and trade integration, and improved access to finance

90. **Removing obstacles to private sector growth and formalization was a key priority of the original SCD and remains so.** The SCD recommended improving the business climate, tackling external competitiveness constraints, addressing infrastructure bottlenecks, and removing constraints to mining and hydropower development. The business environment remains just as challenging as ever, with little progress in addressing logistical and competitiveness constraints.

91. **The authorities should strengthen frameworks for predictable fiscal management and inflation control to provide the stability needed to support private investment and growth.** A prerequisite to private sector-led growth is a stable macroeconomic framework that enables private investors to plan and invest for the longer term. Over the years, fiscal management has been fitful and prone to deviation from its targets, although the government has maintained stronger fiscal discipline in recent years. This practice should be continued and perhaps embedded in a longer-term fiscal strategy to support improved stability and, thereby, the investment environment. Similarly, continuing to strengthen the tools available to the monetary authorities and the coordination between fiscal and monetary policy will support a stable and low-inflation environment.

92. **Complementary reforms are needed to create fiscal space and prioritize essential spending.** The authorities will need to ensure that there is adequate space for critical spending, especially for high-return social and economic public investments. Further reforms will be necessary to streamline the public sector wage bill, implement public administration reforms, and reduce budget subsidies to SOEs in line with structural reforms of utility sectors. Such reforms must also enhance the social protection system to safeguard the most vulnerable population segments and provide targeted social assistance. A balance must be

⁸⁶ Achieving an UMI status by 2040 will require huge efforts from the Kyrgyz Republic given the current baseline and would require a “growth miracle” like that of South Korea which ensured average annual growth of about 8 percent throughout two decades (1960-80).

struck between the rules-based framework to gain and maintain fiscal space while improving the quality and effectiveness of services, including infrastructure.

93. **Strengthening financial and private sector resilience and enabling the growth and diversification of trade and FDI sources are critical to enhancing economic growth and generating jobs.** The private sector will need to develop into a driving force of productivity growth and expansion in new sectors for the Kyrgyz Republic by successfully engaging in internationally competitive markets. Several key issues need to be addressed for the private sector to enjoy a more enabling business environment, which will help to reduce informality and support business growth and dynamism. A priority is minimizing regulatory implementation gaps: for example, a maze of permissive documents at all levels of government and burdensome inspections creates huge costs for the private sector and increases opportunities for corruption; the lack of proper national quality infrastructure and standards aligned with EEU, and EU/China curbs exports, causing poor connectivity, and logistics.

94. **Private sector development requires reform efforts to improve the business environment.** The revision of the tax code in 2021 led to many improvements, such as risk-based audits, strengthened tax expenditure management, streamlining tax regimes by abolishing tax contracts and mandatory patent (license or certificate for specific economic activities) regimes, and the introduction of VAT on digital services. But the 2021 amendments to the tax legislation left small business taxation with multiple regimes and no incentives for small businesses to “graduate” from the patent regime to the simplified one and then to the general tax regime. Also, ineffective and burdensome government oversight encourages firms to stay small and informal. Political instability, corruption, a lack of transparency and consistency in regulations, and weak investor protection also conspire to deter foreign and domestic private investment. The gap between the *de jure* frameworks and enforcement also poses a significant challenge for investors.

95. **Several key issues must be addressed for the private sector to benefit from a more enabling environment.** Creating a one-stop shop for businesses and simplifying licensing and inspections will support more business entries, encourage entrepreneurial activities, and invest more time and resources in actual business rather than dealing with bureaucracy. In addition, further advancing the implementation of financial reporting requirements will increase corporate sector transparency and facilitate access to finance.

96. **Private sector-led growth cannot occur without greater contestability.** The operations of state-owned enterprises in various economic sectors have the potential to discourage private sector participation due to the lack of competitive neutrality that puts them in an advantageous position. Therefore, it is key to ensure competitive neutrality in taxes, access to finance, non-fiscal support and regulation between SOE and the private sector and improve SOE corporate governance. The initial step towards PPPs is a hopeful sign. Further, the government can strengthen competition agency oversight and enforcement capacity. The government can partner with the private sector and universities to establish innovation hubs and give policy incentives to invest in research and development, promote high-quality research, boost the commercialization of technologies, and help close the tech startup financing gaps.

97. **The inspection reform should be advanced by building public agencies' institutional capacity and improving business awareness.** The latter should include introducing

mechanisms to counsel and build awareness of required procedures to improve outcomes and compliance to change the current practice, which is biased towards punishing noncompliance.⁸⁷ Other reform directions may include creating an e-inspection management system to enable data interoperability and coordination of inspections, enabling risk-based inspections, and eliminating overlaps in inspection competencies provided in sectoral regulations.

98. **Deepening financial markets and promoting financial inclusion as the backbone of a resilient financial system is imperative to support the requisite private sector-led growth and job creation.** The Kyrgyz financial sector is bank-dominated, accounting for 71 percent of financial sector assets. The insurance sector is underdeveloped, with 1.1 percent of financial sector assets, and pension and investment funds are much smaller at just 0.02 percent. The lack of institutional investors inhibits the availability of long-term financing. Risk-capital is scarce, with the private equity market almost non-existent and capital markets small and illiquid. Firms, especially MSMEs, are underserved by the financial sector, and insufficient access to finance is a binding constraint for MSMEs to cope with crises and invest post-crises.

99. **Access to finance is crucial for firms to cope with shocks, adapt, transition, and grow in the green and digital economy.** However, Kyrgyz firms and individuals face severe constraints in accessing finance. Many struggle to obtain bank loans due to high interest rates and collateral requirements – only 26 percent of firms have access to bank credit compared to 94 percent globally. Beyond basic bank loans, the Kyrgyz market lacks depth in diversified financial products and services such as risk-sharing facilities, risk capital, investment products, insurance, and private pensions. The financial sector is also facing increased risks due to multiple ongoing crises, globally tightening monetary conditions, and the appreciation of US dollars in the banking sector, where about a quarter of bank loans is denominated in US dollars. The efficiency of NPL workouts and readiness of insolvency systems co-determine the resilience of the financial system and its ability to cope with NPLs. Currently, the insolvency regime is heavily liquidation oriented, whereby Kyrgyz banks have limited options for reducing their NPLs, forcing them to primarily work out their NPL portfolios by either maximizing loan repayments or restructuring defaulted loans. Financial sector development is reflective of building credibility and trust in the financial system and domestic economic management.

100. **Tax reform should proceed to create a simpler broad-based system that minimizes compliance burdens and supports economic growth.** The Kyrgyz Republic has a complex small business taxation system of multiple regimes with no incentives for small businesses to “graduate” from the patent regime to the simplified regime and thence to the general regime. As a result, compliance costs are high while incentives for aggressive tax planning persist. Meanwhile, on the international taxation front, there is a lack of general anti-avoidance rules, as well as thin capitalization and disguised dividend rules. In addition, a sales tax and VAT lead to unnecessary complications and economic distortion.

101. **Promoting entrepreneurship and innovation is key to productivity growth and private sector competitiveness.** However, the Kyrgyz Republic has one of the lowest new business entry density rates in Central Asia. The rate is more than three times higher in

⁸⁷ IFC (2021). Kyrgyz Republic Inspection Reform Case Study—The Reform Process (2006–19): What Can We Learn? Washington DC. https://www.ifc.org/wps/wcm/connect/145985d8-d571-4661-b51b-75ac94f17e53/Inspection+Reform+Case+Study_KR.pdf?MOD=AJPERES&CVID=ntEi3ad.

Kazakhstan and twice as high in Uzbekistan.⁸⁸ The Kyrgyz Republic also spends very little on research and development (R&D). R&D expenditure was a mere 0.09% of GDP in 2019, lower than in Uzbekistan and Kazakhstan and only a fraction of the average of other lower-middle-income countries in ECA⁸⁹. High administrative barriers to entry and barriers to operation discourage new business entries. Firms also perceive a high risk of anti-competitive practices in the Kyrgyz Republic⁹⁰. There is a need to assess further how firms' ability to compete might be impaired by government rules that impede competition on merit.

102. There is a need to develop a strong PPP Framework. With large infrastructure financing needs (circa US\$5 billion⁹¹) and constrained fiscal space, the Kyrgyz Republic needs to attract greater private financing in infrastructure, and an effective PPP framework is critical. The Parliament approved a PPP Law in 2019. Yet, the country lacks a PPP authority with inter-ministry coordination to support the law's adoption with clearly defined institutional and financial roles, an approval process for proposals submitted by line ministries or private sponsors, tariff-setting and adjustment policies and processes, and implementation oversight.⁹² The central PPP unit within the Ministry of Economy and Commerce was established back in 2012 and entrusted with providing technical support and advisory to the line ministries and agencies that generate the preliminary list of projects to be assessed for private sector participation. However, PPP implementation capacity remains very weak, and effective coordination between the government and the private sector is insufficient.⁹³

103. It will be necessary to deepen trade and global linkages for sustained growth. Regional integration and connectivity remain underutilized sources of growth. Despite measures to improve international integration, most notably WTO and Eurasian Economic Union (EEU) membership, the Kyrgyz Republic has yet to capitalize on access to these markets. This is both a consequence of the need to improve national standards, technical regulations, and quality infrastructure to meet the requirements of export markets and the fundamental competitiveness issues discussed in the following paragraphs. In addition, physical connectivity in air, road, and rail connections remains costly and inefficient. In the medium to longer term, the private sector will need to enhance its productivity and competitiveness by investing in promising sectors and enhancing integration into more sophisticated GVCs. Participation in GVCs has been primarily through exporting commodities, which have limited scope for job creation and knowledge spillovers.

104. Eliminating policy, administrative and legislative barriers for private sector expansion in two export-oriented sectors will be crucial to attaining high rates of sustainable growth: (i) mining and (ii) energy. Private sector participation should be expanded and incentivized under a sustainable and green transition framework focused on decarbonization, energy efficiency, and sustainable natural resource use and management. Thus far, the country has relied heavily upon one gold mine (Kumtor) for exports and fiscal

⁸⁸ The number of newly registered firms per 1,000 population is around 1 in the Kyrgyz Republic, thus below Uzbekistan at 2.7 and Kazakhstan at 3.5, which is at par with the world average.

⁸⁹ World Development Indicators.

⁹⁰ EIU Tracker (September 2022).

⁹¹ World Bank and IFC (2021). Unleashing the private sector to rebuild development success. The Kyrgyz Country Private Sector Diagnostic. Washington DC.

⁹² World Bank and IFC (2021). Unleashing the private sector to rebuild development success. The Kyrgyz Country Private Sector Diagnostic. Washington DC.

⁹³ World Bank and IFC (2021). Unleashing the private sector to rebuild development success. The Kyrgyz Country Private Sector Diagnostic. Washington DC.

revenues. This mine is nearing exhaustion. While the country enjoys a strong comparative advantage in mining, it has attracted little foreign investment (0.5 percent of GDP in 2021) as the risks are perceived to be high, given the absence of a modern legislative and regulatory framework and uncertainties surrounding property rights and the rule of law. In the interest of broad-based, foreign investment-driven growth, it is critical for an enabling environment for mining to be established. One that meets modern best practice standards such that the country can be competitive in raising related funds while also nurturing future growth streams. With the global push for greening and decarbonization, future trade mechanisms in the short, medium, and long-term, such as carbon adjustment mechanisms and/or taxes, will negatively impact trade and private sector development without the right regulatory framework for a just green transition in place.

105. **To provide a reliable, adequate, and sustainable energy supply for the country's citizens and businesses, enabling a dynamic private sector, the energy sector needs a broad sector reform and development program.** An efficient and sustainable energy sector is key to a healthy and dynamic private sector in the country. The government is launching an ambitious reform program articulated in an Energy Sector White Paper and Reform Roadmap, which presents the vision, challenges, opportunities, and an implementation roadmap for the next decade. It will also lay out investment requirements to achieve the vision and the necessary enabling environment to attract public and private resources, focusing on the government's medium- to long-term agenda for energy sector reforms. It will be centered on the following areas addressing the challenges facing the sector: (i) financial recovery and operational efficiency, (ii) affordability and social sustainability, (iii) environmental sustainability (including expansion of clean energy), and (iv) governance and accountability.

106. **Energy sector reforms and development should aim to improve financial and operational sustainability while strengthening social protection in a two-pronged approach.** Financial solutions involve phasing out energy subsidies through tariff adjustments while implementing social protection measures, streamlining regional agreements to strengthen connectivity and electricity trade, and working with energy companies to restructure their existing debt. Programs to support operational sustainability will entail improvements to the efficiency of energy utility operations and prioritization of investments as a critical next step in the medium to long term. With private sector participation, a scaling-up of clean energy, including renewable energy and energy efficiency, is important. To attract sustainable private financing, the government should focus on de-risking energy sector projects, particularly renewables. And it will be necessary to modernize sector governance and the regulatory framework to raise energy efficiency and incentivize private capital.

107. **Mobilizing private sector financing into the energy sector has been among government priorities.** Private sector participation is necessary to fully use the country's abundant renewable energy potential. The Government is interested in moving from public generation investments to increased private sector engagement enabled by Public Private Partnerships (PPP). To provide an institutional framework for developing and procuring PPPs across the economy, the government has adopted 'umbrella' legislation. Within this framework, a dedicated PPP unit under the Ministry of Economy and Commerce is mandated to identify, promote, and approve PPP transactions across all sectors. However, the PPP experience of the government and country alike has been very limited due to several challenges.

108. **Accelerating digital transformation is necessary to remain competitive.** The pandemic has sped up the global adoption of digital technologies and highlighted the importance and urgency of digital transformation. Only about 50 percent of the Kyrgyz population uses the internet regularly. To accelerate the digitalization of the economy, the Kyrgyz Republic must address barriers, including regulatory ones, policy issues, and the availability and reliability of international and domestic digital infrastructure. There should be a specific focus on last-mile connectivity in rural areas, data infrastructure, ecosystem, digital payments and ID systems, integration into international digital service and data platforms, and improvement of digital literacy and skills. The use of digital financial services that had been expanding rapidly has slowed down and fallen short of its potential. It is hindered by regulatory and technological impediments. The share of adults who made or received digital payments via e-wallets, cards, and the internet increased from 14 percent in 2014 to 36 percent in 2017 but only to 39.4 percent in 2021 (World Bank Findex Database 2022). Quick wins may include eliminating double taxation on international IP transit and ICT services and creating a public digital map to track key online information needed for digital supply. On the regulatory and legislative side, medium-term reforms include developing a framework for network infrastructure sharing among operators, amending the law on electrical and postal communications, developing and simplifying regulations on ICT infrastructure deployment in connecting households and across roads infrastructure and power lines, simplifying the construction permit for digital infrastructure and network expansion (antennas, fiber optic cables), developing regulations on digital platforms with ecosystem actors to speed up the digitization of government operations and increase interoperability, developing regulations on data classification and data sharing to enable data interoperability, and implementing digital ID enabling financial market access to information.⁹⁴ Moreover, the Kyrgyz Republic should implement legislation to create a level playing field for local digital startups and entrants, which are typically crowded out by large foreign platforms (e.g., from Russia and Kazakhstan).

Pathway 2: Promote inclusion by investing in human capital and improved public services with reforms in social protection

109. **Building human capital will be critical in driving longer-term growth inclusively.** First, following COVID-19, much needs to be done to reverse learning losses and adverse health impacts. To support sustained growth, pathways to improved educational outcomes lie in investment in the resilience, learning recovery, and quality enhancement of basic education through the digitization of teaching, enhanced remediation programs with continuous learning assessments, and improved educational content, teacher capacity, monitoring and assessment, and governance systems. Investing in expanding equitable access to quality ECE programs is also necessary to enhance children's readiness for school education and improve learning outcomes in subsequent education cycles. Tertiary education needs to upgrade its academic programs' quality and market relevance to supply high-skilled professionals. Collaboration with industries needs to be mainstreamed. The capacity development of faculty members and administrators of higher education is essential. Greater investment and capacity building are needed to boost the quality and relevance of research and innovation in higher education.

⁹⁴ World Bank and IFC (2021). Unleashing the private sector to rebuild development success. The Kyrgyz Country Private Sector Diagnostic. Washington DC.

110. **It is critical to ensure public access to essential services in the health sector, prioritizing accessible, affordable primary health care provision.** While achieving gains in recent years, further reform of the Kyrgyz health sector is needed to address current systemic fragilities. There is a need to design an explicit package of state-guaranteed health services and develop provider payment methods to reap the full benefits of the reforms.

111. **The Kyrgyz Republic is facing a rapid transition in its burden of disease, whereby non-communicable diseases (NCD) such as hypertension, diabetes, and cancer account for an increasing share of the loss of healthy lives.** Yet the health system is poorly prepared for this transition, as it does not offer the required services, and its model of care does not foster continuity of care, which is critical for NCDs. The government plans major infrastructure investments, including building 20-30 hospitals. This should ideally be accompanied by reforms to restructure the existing service delivery network, make the best use of existing resources, and be part of a consistent sector masterplan.

112. **On the health financing side, there is a need to further develop health financing tools, including the SGBP and provider payment methods.** The Kyrgyz Republic was a pioneer among former Soviet countries in introducing a single purchasing agency, the Mandatory Health Insurance Fund (MHIF), and new provider payment mechanisms beginning in the 1990s. The MHIF consolidates funds from the contributory and subsidized health insurance schemes and has started putting in place mechanisms to link financing with the production of services. However, its mandate, funding, and tools remain insufficient to be able to act as a strategic purchaser and provide the population with guaranteed access to a basic package of services. Value for money can be improved by strengthening the Health Insurance Fund's strategic purchasing function through refined provider payment methods and improved capacity.

113. **Improving access to safe water and sanitation services, in particular in rural areas,⁹⁵ will also contribute to poverty alleviation efforts and promote human development.** The importance of increasing access to safely managed WSS services is recognized in the National Development Strategy 2018-2040 as a key pillar, and the Community Drinking Water Supply and Wastewater Disposal National Development Program set out ambitious targets for increasing access – to reach 90 percent coverage for water services and 70 percent coverage for wastewater services by 2026 at the national level. Access to safe drinking water and sanitation reduces health risks and, in turn, costs for medical treatment and frees up time for education and other productive activities, especially for women. Safe disposal of wastewater will help improve the quality of surface waters with benefits for the environment and economic sectors that depend on water. Any interventions, however, will need to be accompanied by broader principles for sector development, such as (i) a clear separation of sector management function (policy, operation, and regulation), (ii) autonomy, accountability, and efficiency in service delivery, (iii) principles of cost-recovery and financial sustainability, and (iv) environmental sustainability and climate resilience. A comprehensive national program that operationalizes these principles and includes comprehensive sanitation development and investments has yet to be developed. However, a new WSS law has been drafted and is subject to approval.

⁹⁵ It is estimated that investments in the amount of US\$400 million (around 5 percent of 2021 GDP) will be needed to ensure universal access to safely managed drinking water supply in the rural areas of the Kyrgyz Republic.

114. The Kyrgyz Republic **enjoys a more progressive legal framework than most neighboring countries, paving the way for women’s economic and social participation.** Gender equality achievements include updates to laws aiming to protect women and girls from domestic violence and to increase the enrollment of women in tertiary education. The National Development Strategy for the Kyrgyz Republic (2018-2040) recognizes the need to expand women’s economic opportunities, with attention to shifting their employment from the informal to the formal labor market, reducing wage gaps, and creating working conditions and infrastructure sensitive to the needs of women, and to combining work and family responsibilities. It also has specific provisions for the state to help cover the costs of care for children under the age of three, as well as maternity benefits and remuneration of labor for persons in families taking care of children with disabilities—among other provisions and goals. If implemented fully, these measures could reduce substantial gender gaps in labor force participation (LFP), employment rates, and the prevailing high degree of labor market segregation in the Kyrgyz Republic.

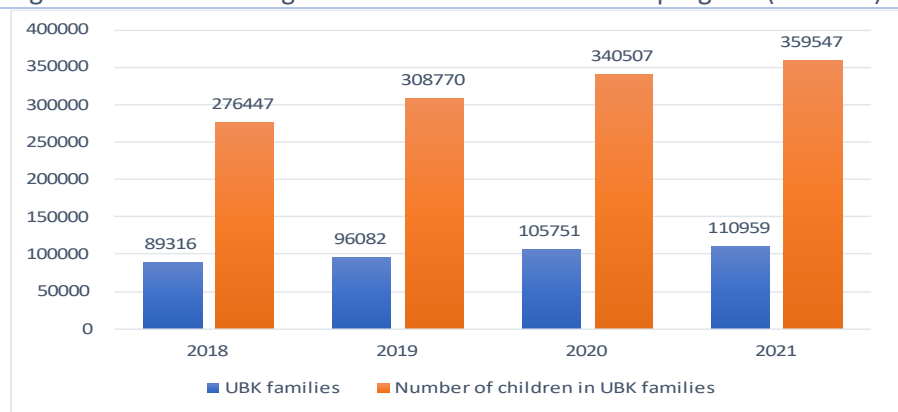
115. **But more focus on addressing gender-based violence (GBV) is needed.** There is a need for much greater policy and investment attention to combatting violence against women. While the Kyrgyz Republic criminalizes domestic violence, including acts such as marital rape (and sexual harassment), sanctions and penalties for domestic violence are generally weakly enforced. The country’s criminal code provides for non-custodial punishments only. Women and girls seeking redress in the Kyrgyz Republic face inadequate access to effective justice from a criminal code that grants provisions for pardoning perpetrators. Parliamentarians in the country in February 2021 (awaiting presidential signature) also passed an amendment to the law, which will further formalize a mechanism to enable victims to ‘come to terms’ with the perpetrator. What is needed is systematic legislative reviews; the inclusion in the law of sexual harassment as a form of GBV; the criminalization of domestic violence and marital rape; and judicial and criminal system strengthening. Legislative reform should also include penalties for non-compliance and a duty on the State to establish frameworks to monitor sexual harassment in workplaces through national labor auditing processes. There is also a need to expand the provision of protective and recovery services with a strong focus on investment, both in chronically underfunded traditional GBV services such as shelters and crisis centers (with a priority focus on rural areas) and in innovative ‘stop-gap’ service models that expand provision at a lower cost to meet the urgent and growing need, e.g., mobile GBV units.

116. **Addressing these economic and social challenges will be crucial for the Kyrgyz Republic’s efforts to improve gender equality.** There is a need and scope for designing an operation to comprehensively address barriers to women’s economic empowerment using holistic, behavioral approaches that have proven most effective in changing the mindsets of men and women in communities and, in turn, preventing GBV and discrimination against women’s leadership and paid work. There is also a need for the health care system to prioritize medical and psycho-social support services for GBV survivors.

117. **The social protection programs transitioning towards a more inclusive targeting approach would help to protect the most vulnerable population.** Scaling up the existing social protection programs, and extending their coverage, could help mitigate the adverse effects of the loss of labor and remittance incomes. In protecting the children of low-income families, removing or modifying asset-related eligibility criteria and raising the eligibility threshold to the poverty line could help the poorest. The current social assistance system

consists of several programs, including UBK, a lump-sum birth grant, categorical monthly social benefits (targeting families with disabled members), energy subsidies, and temporary support for vulnerable groups. UBK is the largest social assistance program, providing monthly transfers to households with children whose per capita income is below the Guaranteed Minimum Income (GMI) of KGS 1,000 (equivalent of US\$12) per month per person but is underfunded. The program has been expanded over the past few years (Figure 38), but its contribution to poverty reduction and closing the poverty gap is very limited (1.2 and 0.3 percentage points, respectively). Overall coverage remains low at 8.5 percent of the population (significantly less than the poverty rate), implying the exclusion of a significant part of the poor population. This is partly due to limited budgetary resources dedicated to the program and a very low-income eligibility threshold. These characteristics leave the poorest, including those supported by UBK, in a situation when rising above poverty is very difficult and exposed to future shocks. This is exacerbated by the fact that households have been severely affected by the COVID-19 pandemic without a social protection response.

Figure 38: Total coverage of the UBK Social Assistance program (2018-21)



Source: Ministry of Labor and Social Issues of the Kyrgyz Republic

118. **Community-driven development (CDD) approaches can effectively address the most important needs of rural communities.** Most of the country's rural poor work in the informal sector and beyond the reach of formal social safety nets, which increases the importance of community-level mechanisms to deliver livelihood opportunities. Women are largely excluded from decision-making, and violence against women is widespread. Gender norms tend to be regressive, hindering women's economic opportunities and contributing to GBV. At the same time, given the high levels of social cohesion and social capital within communities and among the institutionalized, the GoKR can continue to rely on local self-governments (LSGs) and communities to help improve access to basic infrastructure and services, empower vulnerable groups to actively engage in project activities using digital and traditional citizen engagement (CE) methods, and institute robust grievance systems. Such approaches, mirrored by similar cross-border programs, can provide an opportunity to address transboundary fragility, conflict, and violence (FCV) drivers through expanding cross-border economic activities (focusing on women and youth) and supporting cross-border dialogue on natural resource management. Strengthening channels for participation and voice in local governance, especially among women and the poor, making government agencies and service providers transparent, responsive, and more accountable to citizens/service users would notably address bottlenecks in service delivery.

Pathway 3: Build an effective state based on the rule of law, high governance standards, and strengthened risk-management capacities

119. **A subdued macroeconomic outlook for the medium-term and elevated government spending will necessitate a stronger emphasis on improving the efficiency of public spending.** With fiscal buffers largely depleted, it is important for the government to improve the efficiency of public spending, enable better service delivery, and develop instruments for strategic reallocation of resources. While the Kyrgyz Republic has program budgeting in place, currently, there is no comprehensive tagging of climate-related spending. The performance of PFM systems is hindered by the lack of a modern integrated Financial Management Information System (IFMIS) and unfinished accounting and internal audits reforms, undermining budget reliability and service delivery.

120. **Strengthening SOEs' corporate governance is vital to getting the most out of public assets.** SOEs operate in strategic and economically important sectors, such as energy, mining, transport, and banking. Yet, they generally reveal weak financial performance and service delivery and present a significant burden on the budget, especially in the energy sector. The governance of SOEs is weak and needs significant strengthening to rationalize the state presence in the economy and improve ownership function,⁹⁶ transparency, procurement, performance management, and corporate governance practices at the level of individual SOEs. There is a critical need to systematize the gold company and the energy sector SOEs' relationship with the budget to properly calculate and compensate them for their quasi-fiscal activities and alleviate their debt burden, as well as improve the budget process and documentation to capture the full impact of fiscal transactions with SOEs on the budget and address the risks posed to fiscal sustainability.

121. **The capacity of local government to provide sustainable services is a constraint.** While there are certainly deficiencies in the services that local governments provide, the lack of adequate public services in rural areas partly reflects financial constraints at the local level. Capacity issues include the availability of the right human resources to deliver services, financial resources to maintain the existing infrastructure and replace it, and institutional as well as administrative capacity to ensure local governments are capable of delivering the services they are entrusted with, and also that they are politically responsible for prioritizing their resources to provide adequate levels of service. The poor quality of service provision merits a careful look at expenditure assignments to ensure that services are provided by the level of government best positioned to do so while retaining the accountability link. Before revising the legal delineation of functional assignments, the Government of Kyrgyzstan should adopt a strategic policy document with clearly stated strategic decisions as to what level of government should be responsible for which attribute (e.g., regulation, financing, provision) of which public service. The system of intergovernmental fiscal relations needs to provide sufficient flexibility to aiyl okmotus (rural municipalities) in discharging their competencies such that they can adapt to the limited scale of their service provision. In the water supply

⁹⁶ The ownership function is an essential element of SOEs' governance. Overall, it entails the way the state exercises its ownership rights, the institutional arrangements and whether they follow a centralized, decentralized or a dual model, the mandate of various institutions that exercise the rights as owner, and how the state performs this function as an "active owner," etc. In the Kyrgyz Republic it involves the selection of a model, including whether to adopt a company model or not, and the assigning of roles to institutions.

and solid waste disposal, substantial benefits could be gained from the regionalization of services by creating joint enterprises established by a group of local governments.

122. **In addition to broad governance issues, implementation capacity is constrained, leading to significant gaps between *de jure* design of regulation and *de facto* implementation (regulatory implementation gap).** Weak management tools and capacity are prevalent in the public sector. Insufficient policy prioritization and ineffective coordination mechanisms hinder the implementation of policies.⁹⁷ Human resource management practices allow for political influence and excessive discretion in determining salaries and appointments⁹⁸, resulting in compensation disparities across the public sector. Low salaries in the public sector make it difficult to attract, retain, and motivate competent staff.⁹⁹ Despite bureaucratic cost-cutting exercises pursued over many years, overlapping functions and redundancies across institutions and competency and skill gaps remain. There is no government-wide Human Resources Management Information System (HRMIS) to ensure that the pay of all government employees correctly reflects their position, qualifications, and experience. Personnel data is of low quality and inconsistent between sources, and such gaps create additional risk and delay for firms and opportunities for rent-seeking and corruption. They also undermine the efficiency of public investments and the quality of service delivery by the public sector. Overall, the Kyrgyz Republic scores poorly on the Worldwide Governance Indicators, particularly in government effectiveness, the rule of law, and control of corruption.

123. **The implementation capacity of the state will need to be strengthened to build resilience and combat climate change described under Pathway 4.** Climate change creates unique challenges for the public sector from an institutional and information perspective. The key question is how well the government system is geared to pursuing the right policies and implementing these in practice, which has been a weakness in the Kyrgyz Republic. Policy choices for climate change mitigation, adaptation, and a combination of the two come down to spending, taxing, and regulation. The ability to administer them is critical for success. On the policy side, climate policies need to be credible (so businesses and households can be confident that policies will be sustained in the long run, whereby behavioral adjustments and investments pay off). Climate policies must have clear accountability (with clear institutional mandates and a strong central government involvement). Both adaptation and mitigation will require significant resources, with public expenditures complementing and providing incentives to households' and businesses' investments in climate-resilient and low-carbon technologies and infrastructure, shifting resources from declining, carbon-intensive technologies and thereby reducing the risk of stranded assets and future carbon liabilities. This would require strengthened budgeting to align resources with policy objectives, as well as better non-financial asset management and continued implementation of IPSAS compliance accounting standards for climate change risk monitoring. Finally, stronger public investment management would be essential for ensuring that assets created because of investment are climate resilient and minimize transition and physical risks. Infrastructure built today will likely serve the Kyrgyz Republic for the next 20 to 50 years.

124. **To sustain gains over the medium term, the country will need to manage fragility and emerging sources of risk.** At the national level, risks stem from the poor delineation of

⁹⁷ BTI 2022.

https://bti-project.org/fileadmin/api/content/en/downloads/reports/country_report_2022_KGZ.pdf

⁹⁸ OECD, 2020. Anti-Corruption Reforms in Eastern Europe and Central Asia.

⁹⁹ PER, wage bill chapter.

political power among government branches, constant jockeying among elite groups for control of resources, and entrenched corruption in government agencies. Subnational risks include urban overpopulation, youth unemployment marginalization, and inter-ethnic tension. Long-term stability and growth depend on meaningful reconciliation in the south and the promotion of a national identity that includes all ethnic minorities, alongside tackling governance/corruption challenges. In the past, political instability and civil unrest have been inextricably linked to perceptions of misgovernance.

125. Conflict prevention remains a priority. Contested border delimitation and management of transboundary resources can provoke inter-community confrontations and frictions with neighboring countries. Localized conflicts due to environmental stressors and population pressures have become increasingly frequent in the Ferghana Valley, and violent incidents related to natural resources regularly flare up on the Tajikistan border (Batken/Isfara). For example, citizens in the country's southern regions report that the most common sources of disputes in their communities are water (52%) and land (39%).¹⁰⁰ Conflict risks are exacerbated by the lack of effective arrangements over shared common resources (land, water, infrastructure) and dispute resolution mechanisms amid population density and growing climate stressors along the Ferghana Valley borders.¹⁰¹ The increasing presence of security forces in the border areas has undermined the role of informal, community-based institutions in defusing tensions and resolving conflict. Perceived inequities in living standards and access to basic infrastructure and services increase local resentment, particularly among communities on the Kyrgyz Republic side of the border.¹⁰² Opportunities to support conflict prevention include engaging with and supporting community-based institutions on both sides of the border to rebuild trust and investing in basic infrastructure and services and livelihoods support in border communities.

Pathway 4: Strengthen natural resource efficiency to build climate resilience, reduce vulnerability, and support green growth

126. Facilitating the green transition will help to shift the Kyrgyz economy to a more resilient path, with positive spillovers on growth, welfare, and the environment. Inefficient management of the country's abundant resources undermines growth opportunities and raises risks for vulnerable households dependent on natural resources for their livelihoods. Climate change aggravates the risks stemming from resource degradation. Facilitating the green transition – by more efficient management of natural resources, tackling environmental externalities, and promoting a low-carbon, sustainable economy – offers opportunities to harness resources more sustainably to support a more diversified growth path, more resilient livelihoods, and improved human and ecosystem health.

127. Strengthening the management of water resources is critical to driving opportunities for sustainable growth and improving the resilience of households. The main opportunities for diversified growth in the Kyrgyz economy – notably agriculture and energy exports, but

¹⁰⁰ CASA1000 CSP baseline survey.

¹⁰¹ World Bank, United Nations, United Kingdom Foreign Commonwealth and Development Office. (2021). Central Asia & Afghanistan Border Areas: Regional Risk and Resilience Assessment Summary of Findings, November 2021.

<https://documents1.worldbank.org/curated/en/099330012232131334/pdf/P1752340b67521097092610c048ec6641f8.pdf>

¹⁰² Ibid.

also mining and, indirectly, tourism – are highly dependent on water. Water is also a crucial input for the multi-dimensional poverty reduction of farmers, in particular in the southern region, who depend on irrigation services. The Kyrgyz Republic is abundant in water resources, but they are inefficiently managed. Overall water efficiency remained extremely low at 0.9 US\$/m³ in 2019, compared to the global average of 19 US\$/m³.¹⁰³ Moreover, climate change is expected to contribute to increased water scarcity. The country's water resources are considered the most vulnerable to climate change and are expected to account for over half of the economic losses in the absence of adaptation measures.¹⁰⁴ In the face of increasing hydrologic uncertainty and the competing demands of different user groups, the use of safe multipurpose dam infrastructure will play an important role in the country's quest for improved water management, climate resilience, and carbon-neutral energy production. More broadly, integrated water resources management solutions, investments, and policies that harness water's productive potential underpin the country's green, resilient, inclusive, and sustainable development prospects. Sustainable management of this resource will require coordination and cooperation with other Central Asian countries on the water-energy nexus going forward.

128. Efficient water use in agriculture will be essential in achieving a green economy. Agriculture accounts for 93 percent of total water use in the country and employs almost 20 percent of the population. To ensure food security and other social needs, support profitable farms that create jobs, reduce GHG emissions¹⁰⁵, and bolster resilience to climate extremes and other shocks, agriculture must become more productive, resource-efficient, and environmentally sustainable. This will require improvements in water service provision – the development of modernized energy and water-efficient irrigation networks are key pillars in the National Development Strategy 2018-2040 and soil water management. Sustaining the agricultural water resource, enhancing the resilience of farming, and improving the quality of water service provision will all require a mix of (i) institutional strengthening by supporting reforms that increase accountability; (ii) modernizing infrastructure and promoting innovation; and (iii) encouraging data-based and participatory decision-making by all stakeholders.

129. Investments in large public infrastructure, such as irrigation canals, major roads, and electric grids, must be complemented with adequate small-scale infrastructure to promote on-farm service provision and market access. Increased attention is also needed to smallholder agricultural productivity through the adoption of more climate-adapted technologies and practices. Such agricultural investments can support economic diversification through increased production in export-oriented sectors like horticulture, dairy, and meat, which also benefit nutrition security. In addition, farmers' links with markets and agri-food enterprises require more investment to develop market pull mechanisms fully.

130. Exploiting huge and largely untapped hydropower and solar resources offers the Kyrgyz Republic a cost-effective pathway to meet growing energy demand, diversify the

¹⁰³ <https://www.fao.org/sustainable-development-goals/indicators/641/en/>

¹⁰⁴ GoKR has identified the following priority sectors for adaptation: water resources, agriculture, energy, emergencies, healthcare, and forest and biodiversity.

¹⁰⁵ Drinking water and wastewater services are among the largest energy consumers in local municipalities, thus contributing to significant GHG emissions. Estimates suggest that energy costs in water utilities alone account for more than 20 percent of operational expenses. Optimizing energy use for water service provision will simultaneously improve the financial performance of service providers and reduce GHG emissions.

power mix, expand green exports, and help ensure low carbon growth for the country and region. To date, less than one-fifth of the country's hydropower potential has been exploited, while the ongoing least-cost expansion plan under finalization includes significant new hydro and solar capacity. Certain high-potential projects have been identified, including the Kambarata-1 Project, which alone can increase hydropower output by over 30 percent. Moreover, the country's mountainous terrain is ideal for small hydropower investments. On the solar side, the country has an estimated technical solar power potential of 650 GW, which remains to be exploited. The quality of the solar power is comparable to some of the best in the region, with an estimated annual power and heat output of about 300 kWh/m² and up to 750 kWh/m², respectively. Developing non-hydro renewable energy, such as solar, will also help diversify the generation mix and reduce reliance on hydro resources, which are subject to yearly and seasonal variability of water flow, likely to be exacerbated in the future by climate change. Furthermore, the development of flagship regional projects, such as Kambarata 1 in the Kyrgyz Republic and large solar schemes, will help scale up electricity exchanges and strengthen regional interconnections, contributing to greening the regional power mix.

131. **At the same time, critical investments are needed in existing energy infrastructure to improve efficiency and strengthen resilience to climate change.** Under-investment in the maintenance and rehabilitation of aging energy infrastructure has resulted in poor reliability and high losses, leading to frequent supply disruptions, especially during the winter season when energy demand is high, and hydropower production is low. The below cost of service tariff and, thereby, the weak financial state of the sector is the main cause of the underinvestment. Undertaking tariff reforms will improve the sector's financial viability and incentivize greater efficiencies on both the supply and demand sides. Investments in infrastructure will help reduce systemic losses and increase efficiency, reliability, and resilience, reducing GHG emissions and contributing to climate change adaptation and resilience. Deployment of other renewable energy modes and investments to improve energy efficiency will help meet domestic and export demand at a low cost, diversify sources of supply and improve resilience to seasonal hydro variability, drought, and climate change. When coupled with improvements in the urban transport system, air quality management, clean heating, and renewable investments, those modes can help reduce urban air pollution and improve health outcomes.

132. **Infrastructure investments should be complemented by strengthened policy, regulation, and institutions to advance energy and water sector reform and strengthened sustainable service delivery.** This will require the development of a National Water and Investment and Development Program 2027-2040 (aligned with the National Water Strategy 2040¹⁰⁶) that includes principles of climate-resilient design, as well as strengthening the institutional capacity of national counterparts to plan and respond to climate-induced risks, such as floods and droughts.

133. **Addressing the problem of land and forest degradation is critical to improve agricultural productivity and reduce risks to rural livelihoods.** At an annual cost of US\$601 million (16 percent of GDP),¹⁰⁷ the Kyrgyz Republic's severe land degradation impacts the provision of important ecosystem services such as food security, soil fertility, carbon sequestration, wood production, and groundwater

¹⁰⁷ Global Mechanism of the UNCCD, 2018. Country Profile of Kyrgyzstan. Investing in Land Degradation Neutrality: Making the Case. An Overview of Indicators and Assessments. Bonn, Germany.

recharge. The rural population depends on livestock herding, putting additional pressure on natural ecosystems and leading to the degradation of grassland areas, especially near villages, if not sustainably managed. While only about 6.9 percent of Kyrgyzstan's land area is covered by forests, 41 percent of the population lives in mountainous regions. It relies on forest resources such as timber, fuel wood, and pasture. Unsustainable timber harvesting from mountain slopes, coupled with extended periods of drought and increased rainfall intensity, can cause mudslides and soil erosion, affecting agriculture. Restoring and supporting the more sustainable management of degraded landscapes and forests will increase their resilience to natural disasters and climate change and enhance the resilience of natural resource-based livelihoods for vulnerable members of communities, including women and youth. For example, natural capital accounts published by the World Bank show that 95.2 percent (or US\$148.9 million) of revenues generated from forests stay within nearby communities.

134. Landscape restoration and sustainable management of resources will boost the contribution of natural capital to economic growth through sustainable livelihoods and green jobs. To succeed, investments and capacity building are required to support the Government in meeting the international commitments it pledged to in the Astana Resolution in 2018, namely, to bring over 2.5 million hectares into restoration under the Bonn Challenge by 2030. The National Development Program and the National Sustainable Strategy for the Kyrgyz Republic also commit to a transition to resource-efficient and low-carbon development based on rational use of the natural environment. Implementing a Restoration Opportunities Assessment Methodology (ROAM) and the resulting landscape restoration assessment will raise political awareness, support decision-making, and promote collaboration among Central Asian countries on transboundary landscape restoration. In particular, the Naryn River Basin, upstream from the Toktogul Dam, is a key area of the country where land degradation causes the sedimentation of reservoirs and increases the local population's vulnerability.

135. Landscape and forest restoration could reduce erosion by an estimated 38 percent¹⁰⁸ and help Kyrgyzstan absorb carbon, mitigate climate risks, and sustain the livelihoods of the poorest. To support this objective, investments are needed to restore degraded croplands and pastures, improve the management of protected areas, strengthen glacier monitoring, and support integrated forest and rangeland management. They should be complemented by efforts to reinforce the capacity of institutions for sustainable forest management, support land reform, introduce monitoring systems for water and soil, institutionalize natural capital accounts, and better manage climate and disaster risks. This can deliver multiple benefits¹⁰⁹, such as enhanced water retention and mitigation of hydrological extremes, increased soil fertility, carbon storage, and enhanced agricultural and livestock productivity. It will require planning to support long-term investments. For example, to preserve the productivity of ecosystems, Kyrgyzstan will have to allocate KGS4,550.4 million (US\$95 million) to forest-related activities annually if the temperature rises by +1.5°C and precipitation declines by 10 percent.¹¹⁰

136. Enhancing governance and accountability and strengthening public sector capacity towards the green transition is of key importance in developing the pathway to natural resource management and mitigating, as well as building resilience to climate change.

¹⁰⁸ Forest Landscape Restoration Opportunities in the Kyrgyz Republic, World Bank, 2022.

¹⁰⁹ UNCCD Global Land Outlook.

¹¹⁰ Kyrgyz Republic Program on Adaptation to Climate Change and Forest and Biodiversity Sector 2015-2017.

Consistent with good international practices, green transition priorities should be anchored by a long-term low-carbon development strategy that prioritizes green investments, embraces systematic innovation, and manages risks and trade-offs. The Kyrgyz Republic recognizes the importance of climate change, reflected in its ambition of Nationally Defined Contributions (NDC) set in 2021.¹¹¹ Implementation of climate and a broader green transition policy is supported by the National Development Strategy of the Kyrgyz Republic for 2018-2040,¹¹² as well as by sectoral policy documents in the field of emergencies, healthcare, forestry and biodiversity, agriculture, industry, energy, waste, and water resources management. Across all these sectors, infrastructure investments must be complemented by strengthened policy, regulation, and institutions to advance reforms and strengthen sustainable service delivery.

¹¹¹Under the “Business as Usual” scenario, the Kyrgyz Republic commits in its NDC to reducing GHG emissions by 16.63 percent and 15.97 percent by 2025 and 2030 while increasing those levels to 36.61 percent and 43.62 percent, respectively, by the same dates in the event of international support; Source: <https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Kyrgyzstan%20First/%D0%9E%D0%9D%D0%A3%D0%92%20ENG%20%D0%BE%D1%82%2008102021.pdf>

¹¹²Approved by the Presidential Decree of the Kyrgyz Republic of October 31, 2018, No. 221.

V. POLICY PRIORITIES AND HIGH-LEVEL OUTCOMES

Prioritization of the Suggested Policies

137. Table 5 reflects the recommended policies for all four development pathways suggested by the current SCD Update. The team applied the same filters/criteria used by the original SCD to derive priority policy directions for each pathway. The filters refer to the impact of the proposed policies on twin goals, the reform potential, the time horizon of impacts, complementarities, and the evidence base. These filters are applied to each of the recommended policies to derive a uniform ranking (based on absolute or relative ranking) and derive priority policies, giving a clearer direction for each pathway where efforts should concentrate in the near future. For instance, a policy recommendation is perceived as a priority when receiving a “strong” label in all five-dimension filters. If none of the policies receives five out of five, then a policy recommendation receiving a four “strong” label is considered a priority. This approach leads to the following results:

- Among the main recommendations for pathway 1 on catalyzing private sector-led growth, recommendations to reduce the cost of compliance with inspection and tax administration and to improve access to finance seem to have a larger impact on the twin goals of reducing poverty and improving shared prosperity, promising greater reform potential, a shorter realization time horizon, stronger complementarities across the economy, and a stronger evidence base.
- Policy priorities for pathway 2 on inclusion and human capital development relate to ensuring access to essential healthcare services and improving the protection of the most vulnerable among the population by transitioning towards a more inclusive targeting approach of the social protection programs.
- Priorities for pathway 3 on building an effective state refer to addressing policy uncertainty, making the public administration more transparent and accountable, as well as policy recommendations to clearly delineate functional responsibilities among different tiers and types of government and separating various intergovernmental transfers.
- Policy priorities for pathway 4 on green growth and climate change-focused strategies and practices refer to reinforcing the sustainable management and use of energy, water, and land resources to support improved livelihoods and economic outcomes and increase resilience to climate change.

Table 5: Suggested Policy Recommendations and Priorities

Pathways	Suggested Policies	Impact on twin goals			Reform potential		Time horizon of impacts			Complementarities			Evidence Base			
		Small	Medium	Large	Low	Medium	High	Short	Medium	Long	Weak	Medium	Strong	Weak	Medium	Strong
Pathway 1 Catalyze private sector-led growth	Maintain a stable macroeconomic and fiscal policy framework			V		V		V					V			V
	Improve the business climate, including the legislative, institutional, and policy environment, to better facilitate private sector productivity growth and entrepreneurship for job creation			V		V		V					V			V
	Reduce the cost of compliance with inspection and the tax administration by moving to risk-based inspection and audit practices			V			V	V					V			V
	Facilitate integration to higher value-added GVCs and tackle external competitiveness constraints			V			V			V		V				V
	Remove constraints to environmentally responsible development and exports of the mining and hydropower industries		V			V			V				V		V	
	Improve access to finance			V			V	V					V			V
	Implement broad-based energy sector reforms to ensure (i) financial recovery and operational efficiency, (ii) affordability and social sustainability, (iii) environmental sustainability, and (iv) governance and accountability		V			V				V			V			V
	Accelerate digital transformation		V		V				V				V	V		
	Strategic interventions in the transport and logistics sectors with an emphasis on the green, resilient, and inclusive development agenda	V				V				V			V		V	
	Facilitate Public-Private Partnerships, upgrade PPP regulations, and ensure transparency throughout the PPP process		V			V			V			V			V	
Pathway 2 Promote inclusion	Enhance access to quality ECE services and learning recovery, improve the quality of basic education, and boost the quality and relevance of higher education and research capacity			V		V		V				V			V	
	Ensure access to essential health services, prioritizing high quality, accessible, and affordable primary healthcare services			V		V	V					V			V	
	Expand access to safe water and sanitation services, underpinned by financial and institutional reforms in the WSS sector			V		V			V			V			V	
	Improve protection of the most vulnerable among the population by transitioning towards a more inclusive targeting approach of the social protection programs			V		V	V					V			V	

	Ensure services for GBV survivors and upgrade domestic legislation to meet minimum legal standards in criminalizing GBV	V		V		V		V		V	
	Reduce gender gaps in incomes		V	V		V		V		V	
	Involve vulnerable or disadvantaged individuals and groups in the public consultation process and project activities	V		V		V		V		V	
	Improve air pollution reduction, given its impact on human capital and morbidity, particularly in urban centers such as Bishkek	V		V		V		V		V	
Pathway 3 Build an effective state	Address policy uncertainty and make public administration more transparent and accountable	V		V		V		V		V	
	Enhance the rule of law	V		V		V		V		V	
	Clearly delineate functional responsibilities among various tiers and types of local government and separate intergovernmental transfers supporting two distinct categories of local government functions: 1) own functions and 2) delegated functions	V		V		V		V		V	
	Continue implementation of the public financial management reforms with the deployment of the FMIS and completion of key reforms in budgeting, accounting, and internal controls	V		V		V		V		V	
	Improve revenue mobilization efforts by broadening the tax base and improve the tax system to create incentives for formalization	V		V		V		V		V	
	Improve the governance of SOEs	V		V		V		V		V	
Pathway 4 Strengthen natural resource efficiency to build climate resilience, reduce vulnerability, and support green growth											
	Prioritize landscape restoration and sustainable management of resources to facilitate sustainable livelihoods and the creation of green jobs		V	V		V		V		V	
	Promote sustainable forest ecosystem management to absorb carbon, mitigate climate risks, and sustain the livelihoods of the poorest		V	V		V		V		V	
	Strengthen policy and regulatory frameworks and institutional capacity at the national and local levels to promote sustainable water and energy resource management		V	V		V		V		V	
	Reinforce adequate small-scale infrastructure to promote on-farm service provision and market access		V	V		V		V		V	
	Upgrade and modernize water supply infrastructure and promote climate-smart irrigation practices		V	V		V		V		V	
	Invest in energy infrastructure to ensure climate change resilience and sustainability	V		V		V		V		V	

High-Level Outcomes and Supporting Objectives

138. **The suggested development pathways are expected to lead to the following high-level outcomes:** (i) improved access of the population to more and better-paid jobs facilitated by a reformed state; (ii) promoting inclusive well-being and improved access to essential healthcare and primary basic education services by the poorest and most vulnerable; and (iii) bolstering climate resilience through energy reforms, infrastructure linkages, and modernized natural resource management. Table 6 below presents a detailed list of HLOs and the supporting policy objectives.

Table 6: High-level Outcomes and Supporting Objectives

High-level Outcomes	Supporting objectives
1. Improved population access to more, formal and better-quality jobs.	➤ Stable, rules-based macro-fiscal framework and strengthened public financial management.
	➤ Reforms of the state to foster contestability, the rule of law, and improved governance.
	➤ Deeper financial markets and promoted financial inclusion upon the backbone of a resilient financial system.
	➤ Reformed business and trade/investment environment, supporting digital transformation.
2. Improved access to essential healthcare and primary basic education services for the bottom 40% percent of the population, especially in rural areas of the southern regions.	➤ Counter learning losses, promote early education, and raise tertiary standards to upskill labor.
	➤ Support inclusive community development to improve access to basic social services, reduce risks of exclusion, stimulate female labor force participation, and strengthen women's agency.
	➤ Build resilient health and social protection systems.
3. Reduced population health risks through investment in primary healthcare facilities, especially in remote and rural areas.	
4. Reduced transient poverty through facilitated access and improved administration of social safety net programs.	
5. Improved delivery of public services to the population, especially water and sanitation services to the rural population.	➤ Enhance resilience to climate change and disaster risks through improved natural resource and energy management.
	➤ Improve sustainability and climate-resilient infrastructure.
6. Enhanced resilience of household assets to natural disasters through investment in climate-resilient infrastructure, especially in the country's rural regions.	
7. Preserved living standards of rural population with increased agricultural sector productivity through improved irrigation water efficiency.	

VI. KNOWLEDGE AND DATA SOURCES

139. **Since the SCD publication of 2018, the World Bank team has produced several important analytical reports which expanded the country's knowledge base and helped to identify the main constraints for sustainable progress on poverty reduction and shared prosperity.** A bibliography of existing documents in key areas will be completed, including work carried out by external stakeholders. The World Bank Group's multi-GP teams have completed two volumes of the Public Expenditure Review (2020-21), Country Economic Memorandum (2020), the Country Private Sector Diagnostics (2020), Poverty and Equity Assessment (2022) and Gender Assessment (ongoing). In addition, key datasets include Household Budget Surveys, Labor Force Surveys, Listening to the Kyrgyz Republic panel survey, and other specialized datasets such as Governance Indicators, etc. As the diagnostic is performed, the team will identify data and knowledge gaps that could help strengthen the evidence base going forward. Annex 2 provides the list of knowledge products produced by the World Bank teams since the 2018 SCD.

140. **The current knowledge gap refers to an independent and detailed analysis of labor force dynamics and recent company-level developments.**

- **Labor migration and remittance** have driven not only economic growth but poverty reduction as well. The complexity of the labor migration phenomenon and remittance's impact calls for further research and, importantly, better data to monitor and provide policy-relevant evidence. In particular, it is critical to understand the impacts of the conflict on migration and remittances, as well as the impacts of migration on the human capital development of households and specific groups (children, women, etc.). Given the policy relevance of this issue for inclusive growth, it is important to take up this line of research in the future.
- **The pattern of poverty reduction across districts** is highly heterogeneous, and some drivers of poverty reduction in a particular oblast might be local-specific due to differences in access to markets, human development, and sectorial specialization. This points to the need for a deeper qualitative understanding of spatial disparities, particularly the main drivers of and constraints to progress toward regionally inclusive prosperity. The latter will help the government and development partners to set more efficient and locally specific policies and programs. In this regard, the recently conducted Census 2022 might be a rich source of information that could paint a more comprehensive picture.
- **Competition and market contestability** are critical in facilitating broad-based private sector development and inclusive growth. Over the past two decades, significant reform efforts have been undertaken to open up the Kyrgyz economy and introduce market-based mechanisms; however, Kyrgyzstan underperforms concerning the implementation of pro-market and pro-competition policies. There is very little knowledge about the regulatory and implementation gaps that curb the effectiveness of competition policy to allow for the efficient private investment of benefit to consumers and the economy in general.

141. **In addition, there are critical knowledge gaps on the determinants of agricultural and services productivity, obstacles to creating more productive, stable jobs, and their implications for poverty reduction.**

142. **Finally, the recent tax and pension reforms will impact the population's welfare and economic growth.** More detailed analyses of the 2022 tax and pension reforms and their

economic, fiscal, and distributional impacts might be important for poverty reduction and its related policy agenda.

Annex 1

Table 7: Recent analytical work in the Kyrgyz Republic by the World Bank Group and others

Report	Year
Options for Agribusiness Value-Chain Development	2018
Capacity Building Support to the New Energy Regulator of the Kyrgyz Republic	2018
Feedback Incentives and Business Tax Inspections	2018
Improving capacity in PFM	2018
Kyrgyz Republic Economic Diversification Study	2018
Measuring Seismic Risk in the Kyrgyz Republic	2018
Improving Energy Efficiency in Public Buildings	2019
Development of a Strategic Program for Climate Resilience in the Kyrgyz Republic	2019
Procurement Oversight for the Kyrgyz Republic Rehabilitation of the Bishkek-Osh Road Section, Phase IV	2019
Procurement Oversight for the Kyrgyz Republic Agricultural Machinery Supplies Project	2019
Technical Assistance on Public Investment Management	2019
Tax Administration Reform Development	2019
Towards a more sustainable and effective UHC in the Kyrgyz Republic	2019
Sustaining and Extending Health Gains in the Kyrgyz Republic	2019
Kyrgyz Republic Growth Analysis	2019
CMC: Debt Management Reform Plan follow-up, Kyrgyz Republic	2019
Roadmap and Options for Social Assistance System Reform	2019
Social Protection Response to Energy Sector Reforms	2019
Leveraging Modernization of Delivery Mechanisms to Strengthen Safety Nets	2020
Kyrgyz Republic Country Economic Memorandum	2020
Efficient heating technologies	2020
Kyrgyz Republic HRITF Impact Evaluation	2020
TA for energy tariff reform, including poverty and social impact assessment and communication and outreach strategy	2020
Harnessing Innovation for Financial Inclusion (Kyrgyz Republic)	2020
Kyrgyz: Supporting RBF scale up	2020
Strengthening Student Assessment for Improved Learning	2020
Building the Right Skills for Human Capital	2020
Kyrgyz Republic Integrated Hydropower Development in the Naryn River Basin	2021
Kyrgyz Republic Public Expenditure Review	2021
Policy Options to address the Vulnerability of Migrants to COVID-19 and Beyond	2021
Kyrgyzstan Financial Sector Development	2022

Annex 2

Table 8: Focal points for SCD Update

Names	Global Practice
Audrey Sacks	Social Development
Emiko Todoroki	FCI
Yun Wu	Energy and Extractives
Irina Goncharova	Governance/Procurement
Verena Schaidreiter	Water and Sanitation
Tolkun Jukusheva	DRM. Resilience
Aidai Bayalieva	Environment
Laurent Loic Yves Bossavie	Social Protection
Christel Vermeersch	Health
Oleksii Balabushko	Governance
Shiro Nakata	Education
Tahira Syed	Agriculture
Talaibek Torokulovich Koshmatov	Agriculture
Saida Ismailakhunova	Poverty and Equity
Gohar Gyulumyan	MTI
Bakyt Dubashov	MTI
Aliya Karakulova	Transport
Talant Sultanov	Digital Development
Sandra Sergeant	Digital Development