COUNTRY PRIVATE SECTOR DIAGNOSTIC

CREATING MARKETS IN THE KYRGYZ REPUBLIC

Unleashing the private sector
to rebuild development success

EXECUTIVE SUMMARY

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EXECUTIVE SUMMARY

This Country Private Sector Diagnostic (CPSD) for the Kyrgyz Republic assesses the barriers and opportunities for a more forceful development of the private sector in the country. With the conviction that higher and more sustainable economic growth can be achieved by enhancing the role of the private sector in the Kyrgyz economy, this CPSD identifies policy reforms needed to increase private investment and create market opportunities in sectors that may enable, accelerate, and diversify economic growth.

Between 2000 and 2019, GDP growth rate averaged 4.4 percent, enabling the Kyrgyz Republic's ascension to lower-middle-income country status by 2014. Three decades ago, the country emerged from the collapse of the Soviet Union as one of the poorest countries in Central Asia. The opening of the economy, the reduction of state control, and factor market deregulation enabled a resource reallocation from agriculture in rural areas to services in urban centers. The structural shift from agriculture to services generated gains in productivity and labor incomes, although these gains from factor reallocation were exhausted by the turn of the millennium as the growth rate of urbanization flattened and outmigration absorbed the surplus of agricultural labor. Economic growth was supported by favorable terms of trade triggered by high commodity prices. On the supply side, growth was driven by commodity exports (gold) and the expansion of non-tradable sectors (services and construction). On the demand side, remittances and household consumption supported the GDP expansion. Economic growth facilitated improvements in the welfare of the population and poverty sank by 50 percent (from 60 percent in 2000 to 30 percent in 2010), but since then, further reductions have been marginal.

Economic growth has been unstable as its sources lacked diversity and were vulnerable to external shocks. The Kyrgyz economy is poorly diversified and dependent on export commodities. Gold accounted for 8 percent of GDP, 36 percent of exports, and 25 percent of government revenues. Gold production is, furthermore, concentrated in just one mine, which is scheduled to cease extraction in a few years. The Kyrgyz Republic is also one of the most remittance-dependent countries in the world. More than one-fifth of the working-age population works in neighboring countries, mainly in Kazakhstan and the Russian Federation. Corresponding to 30 percent of GDP, remittance flows supported domestic demand and the growth of services (retail and wholesale trade) and construction. Due to poor diversification and dependence on export commodities and remittances, the Kyrgyz Republic experienced several successive external and domestic shocks that produced large swings in economic output. GDP growth cycles were short-lived and acute. Indeed, up to 2014, the Kyrgyz economy did not experience a single season of growth (over 4 percent per annum) over a sustained period (more than three years).

The economic approach that enabled the Kyrgyz Republic to achieve lower-middle-income status is an inadequate tool for continuing to push the country up the income ladder. Most of the country's growth came from factor accumulation (mainly growth in capital) and very little from total factor productivity (TFP) growth, which stagnated in the early 2000s as gains from factor reallocation petered out. Capital-intensive extractive industry and public investments mainly financed by official development aid flows made capital accumulation the main contributor to growth (49 percent), while the contribution of labor and human capital averaged 38 percent. The contribution of TFP to growth was just 13 percent over the 2000–19 period. Unpredictable commodity markets and lack of diversification has made GDP growth very volatile. Gold export receipts caused a "Dutch disease" that undermined the competitiveness of other tradable sectors. Large remittances not only exposed domestic demand to external labor market shocks and to the business cycles of countries where migrants work, it also undermined the sustainability of growth, one major reason being the effects on the country's competitiveness by significant real exchange–rate appreciation associated with the overwhelming role of remittances (about 30 percent of GDP).

If the Kyrgyz Republic wants to inaugurate a new era of faster, more sustainable economic growth, it must more aggressively develop its private sector to support economic diversification and improve productivity. The economic model has relied on two volatile sources of growth, and the country's dependence on commodity exports and remittances also poses significant risks not only to sustained growth but also to the country's macroeconomic stability. Promoting diversification to reduce its reliance on remittances and commodities exports requires deliberate policies to promote the development of economic sectors in which the country has comparative advantages. The government should support export diversification by capitalizing on current trade agreements and relationships with neighboring countries where the Kyrgyz Republic holds some competitive advantage, particularly in export services. Given its limited potential and competitiveness in developing its manufacturing sector, diversification efforts should focus on export services that could generate jobs and reverse the outmigration flow that has constrained the contribution of labor and human capital to growth. Faster and more sustainable growth needs to be anchored in productivity and competitiveness enhancements that will require an expanded role of the private sector fostered by a conducive business environment and efficient enabling sectors (digital, physical, and financial infrastructure). Lower gold extraction revenues and ODA flows and the exhaustion of fiscal buffers in recent years have reduced the fiscal space necessary for investments, which suggests that private investment will be required to maintain a strong contribution of capital accumulation to growth.

COVID-19 AMPLIFIES THE VOLATILITY AND VULNERABILITY OF THE KYRGYZ REPUBLIC'S MAIN PRIVATE SECTOR DRIVERS: COMMODITIES AND REMITTANCES

The pandemic has already negatively impacted the Kyrgyz private sector, which, without adequate liquidity to mitigate near-term shocks, will severely hinder economic recovery. A survey of businesses conducted in April 2020 reflects the severity of the crisis in the private sector: 80 percent of respondents had reported a decrease of more than 75 percent in revenues, and almost half of respondents had put their staff on leave without pay. Nearly two-thirds of respondents did not have enough reserves to cover their operational expenses for more than one month.[1] In the financial sector, newly issued credit dropped by 60 percent in April 2020 compared with the same period in 2019, a substantial decline in contrast to an increasing trend over the past decade.[2] This is likely to deprive firms of critical financing when it is needed most to cover operational expenses and survive the COVID-19 crisis. In the tourism sector, an IFC survey conducted in May 2020 revealed that 60 percent of respondents were temporarily closed, and another 14 percent were fully closed. While only 14 percent were unable to service their debt, another 50 percent reported having just enough liquidity to service debt for just three more months. Moreover, 40 percent claimed they would go bankrupt if the crisis and subsequent lockdown did not end within six months. In the information and communication technology (ICT) sector, many countries have taken advantage of the COVID-19 quarantine that enabled home-based work to incentivize their diaspora or other digital nomads to move their residence "home." The Kyrgyz government could use the return of qualified service sector migrants as an opportunity to introduce and reform policies that incentivize domestic and foreign investment within those sectors.

Although the scope and duration of the COVID-19 pandemic are uncertain, its economic impact on a small, open economy reliant on services, remittances, and natural resources is expected to be significant. Real GDP contracted by 8.6 percent in 2020. The Kyrgyz Republic's current account deficit is expected to rise to 13.1 percent of GDP because of a significant drop in remittances triggered by the economic downturn in Russia, which has seen oil prices drop sharply and has the world's third highest COVID-19 caseload. The budget deficit increased to 4.8 percent of GDP, while public debt reached 68 percent of GDP in December 2020. The Kyrgyz government has launched a health care contingency plan and an initial package of economic measures totaling US$31 million (0.4 percent of GDP). It is currently preparing a second, much larger package of economic measures worth US$400 million (5.2 percent of GDP).

In the wake of the COVID-19 pandemic, fostering a robust and sustainable recovery will require continued diversification. Although dependence on external markets is common among small economies, export concentration on commodities has intensified the Kyrgyz economy's vulnerability to shocks. The pandemic and the fall in commodity prices have highlighted the vulnerability associated with the undiversified drivers of economic growth. In addition, risks related to the high dependence on remittances have been heightened by COVID-19. Remittances to countries in Europe and Central Asia are estimated to fall by 16 percent to US$48 billion as the pandemic and the fall in oil prices are likely to have wide-ranging impacts on economies, with nearly all countries in the region posting double-digit declines in remittances in 2020. The depreciation of the Russian ruble is also likely to weaken outward remittances from Russia.

Tighter budget constraints are expected to limit the government's ability to foster economic activity, so an enhanced role for the private sector will be crucial to the recovery. The pandemic's impact on the government's financial position has highlighted its inadequate fiscal buffers, declining revenues, and increased spending pressures. The necessity of fiscal consolidation will constrain public spending over the foreseeable future, and the private sector will need to take a more active role in infrastructure investment, service provision, and economic growth.

MOVING TO THE NEXT STAGE

A new development model promoting diversification and higher, more sustainable growth requires attracting and facilitating private investment that is critically grounded on structural reforms in four pillar areas:

- **Developing critical energy infrastructure as a key enabler.** A necessary condition for attracting private sector investments and fostering export diversification is the delivery of reliable, affordable, and sustainable energy. In addition to supporting export potential, increasing access to a sustainable, reliable energy supply would also free up government resources. This is even more urgent for the COVID-19 recovery at a time when fiscal pressures are increasing just as the energy sector has become a significant fiscal burden. These goals were important for the Kyrgyz economy even before the pandemic outbreak because the country faced depletion of its export base and fiscal revenues stemming from gold mines. One of the key objectives in this area, then, is the attraction of private investors to help unlock the potential of its abundant hydropower resources.

- **Developing the digital economy.** A competitive ICT infrastructure and a digital economy constitute critical conditions for developing export-oriented services. It is imperative that the Kyrgyz government accelerate its digital transformation program to increase access to reliable broadband, lower business costs (including those of government services), boost productivity, and develop a digital backbone that can support the country in its effort to diversify and accelerate economic growth. Digital development can also have a positive spillover into other focus areas revolving around the development of small and medium enterprises (SMEs) and closing the financial gap they face, as well as export diversification.

- **Diversification into export-oriented services.** Reforms would need to target high-potential service sectors that offer diversified sources of growth and jobs. The country's small and hard-to-reach market adds significant costs to investment and trade, so service subsectors such as financial services, tourism, and ICT could offer more competitive and diversified avenues of potential growth.

- **Leveling the playing field for SMEs and narrowing the financing gap.** The development of sector-oriented parts of the economy depends on the strengthening of the country's private sector by streamlining regulatory burdens, improving governance, and promoting a business environment conducive to growth. These are all interrelated and necessary conditions for SMEs to face a level playing field as well. In addition, ensuring their access to credit relies on the ability to use digital finance. Broader online access and advances in fintech will increase the competitiveness of export sectors. Investing in the value proposition of the financial sector, chiefly digital finance, would contribute to the formalization of the private sector. It would also reduce the cost of financing for micro, small, and medium enterprises (MSMEs) while increasing the access, quality, and variety of financing to SMEs by spurring the development of innovative financial products, all of which would aid SME growth and employment creation.

ENSURING SUSTAINABLE AND RELIABLE ENERGY ACCESS

The Kyrgyz government needs to adopt reforms to improve the sustainability and creditworthiness of energy utilities, especially given increasing fiscal pressures that targeted COVID-19 spending has created. The energy sector accounts for 62 percent of total nonfinancial state-owned enterprise (SOE) assets and holds the largest share of liabilities among all SOEs in the country (91 percent). The World Bank reports that energy sector debt amounted to about 18 percent of GDP at the end of 2018 with the sector representing 4 percent of GDP and hydropower accounting for two-thirds of the production. Residential users, which make up 52 percent of consumption, pay a tariff that covers 45 percent of the cost of services, among the lowest in the world. The result is that the Kyrgyz government can not cover costs to prioritize operations and maintenance when assets are old and in poor condition. The World Bank notes that the pandemic has increased the already unsustainable sector deficit due to a revenue shortfall, shortage of working capital, increased debt service costs, and inability to service debts.

The Kyrgyz Republic relies on oil and gas imports for more than half of its energy needs, with an uptick in imports during the winter months when hydropower production is low. The impacts of COVID-19 will relax the pressure for a massive expansion of generating capacity in the short term, which gives the Kyrgyz government a window of opportunity to reform the sector, capitalizing on a more commercially attractive investment proposition based on renewable energy. Energy investments can not be delayed, as neighboring countries are already adding capacity. In addition to hydropower, a subsector in which only 10 percent of existing power potential is being utilized, the Kyrgyz Republic has significant amounts of coal, moderate amounts of oil and natural gas, and other renewable energy resources (primarily solar) that could be further developed. As part of COVID-19 recovery, a more resilient Kyrgyz economy would need the energy sector to become more financially sustainable through revenue generation, such as through the scaling-up of renewable generation.

Undertaking infrastructure projects through PPPs could be a game changer for the Kyrgyz Republic efforts to mobilize resources after the COVID-19 pandemic ends, but the country significantly lacks implementation capacity. The existing PPP law outlines the government's objective of increasing the number of PPPs as laid out in the national development strategy, which calls for a simplified process for the selection of a private partner in line with successful international practice. The Kyrgyz Republic unfortunately lacks a PPP authority to support the implementation of this law 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, and a plan for inter-ministry coordination. Low staff capacity in line ministries as well as the Ministry of Finance (MoF) hinders the process of implementing PPPs and understanding how they work. The lack of dedicated staff for advancing PPPs through an enabling framework and implementation plan for the PPP law has meant that just two PPPs were signed in the Kyrgyz Republic in contrast to Kazakhstan's more than 800. The Kyrgyz government has identified 23 projects requiring US$500 million in the near term, but these will not adequately cover the need for connecting fragmented markets across the country, especially along the north-south divide. There is also no mechanism to identify potential PPPs and no clear guidelines on how to create a pipeline of projects. Infrastructure financing needs are estimated at US$5 billion in the medium to long term, which covers the maintenance and construction of national highways, railways, and bridges, as well as regional power trade connectivity through the Eurasian Economic Union (EAEU).

ENABLING A DIGITAL ECONOMY

The Kyrgyz government needs to launch an ambitious reform program, starting with its response to the current crisis. Within this context, the CPSD assesses opportunities for private sector investments in high-growth-potential sectors that have economy-wide spillovers: digital infrastructure development, financial services, and tourism. When feasible, private investments in these sectors need to be stimulated by critical improvements to energy infrastructure. Prior to COVID-19, consultations with Kyrgyz government authorities, private sector associations, and development partners had suggested that having a more in-depth look at the challenges and opportunities across these sectors would add the most value. As the government plans for post-COVID recovery, the need for policies to facilitate greater connectivity, financial resilience, and new sources of revenue (particularly foreign exchange) is more urgent than ever.

The Kyrgyz Republic needs a more focused and accelerated digital transformation strategy. The deployment of broadband technology across business enterprises improves productivity by facilitating the adoption of more efficient business processes such as marketing, inventory optimization, and streamlining of supply chains, all of which significantly reduce the cost of doing business. Moreover, extensive deployment of broadband accelerates innovation by introducing new consumer and government applications and services such as new forms of commerce and financial intermediation. ICT is also a key enabler in several sectors, particularly digital finance. Currently, the Kyrgyz telecom sector lacks competitiveness due to limited competition and infrastructure sharing, which results in low access and quality. The country needs to catch up in terms of providing households with internet access, mobile applications development, use of virtual social networks, internet shopping and ICT use, and government efficiency.

To spur local digital platform development, policy makers need to enable scalable broadband infrastructure (especially in rural areas), create an enabling regulatory environment, and an effective data interoperability and management policy. Large Russian platforms are taking over social media, web search, taxi services, and many other platforms, and this crowds out new local market entrants. Platforms from Kazakhstan pose significant competition in the specific niches of online tickets and e-commerce. International platforms also hold prominent market positions. Consequently, the emergence and growth of local companies is strongly constrained with language barriers being the only comparative advantage that domestic platforms have. Digital platform adoption in the Kyrgyz Republic requires an ecosystem approach to coregulation that involves all key public and private stakeholders. Lastly, the adoption of policies aimed at enhanced cybersecurity, building trust, privacy, secure transactions, and online dispute resolution would expand the user base of domestic platforms.

While the Kyrgyz government has prioritized the expansion of digital infrastructure and services, large investments are needed in regional fiber-optic connectivity. Digital connectivity presents a unique opportunity for the land-locked country to enable the export of services, but as the World Bank has noted, the high-speed internet service offered by the Kyrgyz telecommunications sector is limited and costly, which is particularly challenging without direct connection to submarine cables. As of January 2020, the number of internet users accounted for 47 percent of the population (with an annual growth rate of 10 percent since 2007), a rate that is significantly lower than those of neighboring Kazakhstan (77 percent) and Uzbekistan (47 percent), and the overall market has been shrinking. Fixed internet speed furthermore lags at about half of the global average (35 megabytes per second). The main challenge is that regulation of the sector inhibits competition. Other factors limiting the growth of broadband include the lack of civil engineering standards that include fiber installation in new buildings and the lack of infrastructure-sharing regulation.

Spurring the formalization of the economy and improving tax compliance is contingent upon strengthening payment system infrastructure to support e-commerce and encouraging a shift towards a digital economy. Digital ID and cybersecurity capability have not been fully implemented, which undermines e-governance efforts. In turn, the lack of digital ID and interoperability impedes the wider penetration of online business-to-business (B2B) and business-to-consumer (B2C) services. This lack of data governance and interoperability impacts digital service development across sectors. Moreover, current data privacy regulations prevent data sharing with the credit bureau, impacting access to finance for businesses. The government can implement specific, targeted reforms to accelerate digital transformation through the establishment of a seamless, open-access, and cross-border fiber-optic backbone and by streamlining the legal and regulatory framework, particularly for digital identification, data security, and interoperability.

PROMOTING FINANCIAL INCLUSION AND DIGITAL FINANCE TO SUPPORT MSMES

There is a need to increase access to financial services for informal microentrepreneurs in order to support their formalization and to diversify the financial sector beyond the dominant banks that lack the outreach and products critical to recovery and growth for MSMEs. Digital financial services offer solutions, but they are hindered by regulatory and technological impediments. Currently, 62 percent of the adult population (including microentrepreneurs) is still left out of the financial system. Individual entrepreneurs are mostly operating without financial accounts. Much of the economic activity in the Kyrgyz Republic happens informally outside the financial sector, so increasing individual financial inclusion could be a first step to becoming formally active. Private sector credit to GDP is, moreover, relatively low at 12 percent, and there is insufficient long-term financing for firms to invest in fixed assets and for the government to invest in strategic infrastructure. In addition, increased use of digital financial services could aid the efforts to support MSMEs through increased access to credit and liquidity in sectors severely impacted by COVID-19 such as tourism, light manufacturing, and the wholesale and retail trades. The share of adults who made digital payments via e-wallets, cards, and the internet increased from 14 percent in 2014 to 36 percent in 2017[3]. Card issuance and the number of e-wallets have also increased sharply in recent years. Anecdotal evidence suggests that there is an enormous market potential for e-commerce, but internet transactions are lagging. According to Findex 2018, only 5 percent of the respondents were using the internet for payments or buying goods. Additionally, one single firm dominates the processing of incoming remittances, and as remittances are an important source of income for many households, this creates limitations on price and access innovation.

INVESTING IN TOURISM FOR FURTHER EXPORT SERVICE DIVERSIFICATION

Prior to the COVID-19 pandemic outbreak, the Kyrgyz Republic was at a critical juncture of realizing its potential for growth and job creation in tourism, and it should leverage this downturn to position itself for a return to growth in the sector in two key market segments: soft adventure[4] and winter tourism. The country is best known for the soft adventure attractions of Lake Issyk-Kul, ecotourism and cultural tourism in highland areas, and developing ski bases around Bishkek. It has still not leveraged its natural asset base to create a competitive destination for two priority market segments. Tourism contributed 4 percent to GDP and employed 3.6 percent of the workforce prior to the pandemic, and this was continuously increasing in the five previous years. Unfortunately, COVID-19 is expected to impact the tourism sector significantly in the short to medium term because global travel and tourism demand will likely take years to fully recover. There are nonetheless some initial signs of recovery: some airlines have resumed flights and the domestic tourism industry has managed to save part of the summer season. The global pause in the industry and potential structural changes in demand, distribution channels, and connectivity could present an opportunity for the government to address the sector's challenges and focus on developing the soft adventure and winter tourism market segments that have not developed because of low destination awareness and outreach, low tourism investments, poor destination management, and the lack of high-quality accommodation outside the capital.

The Kyrgyz government must focus on improving key tourism growth enablers such as improved air connectivity. Air travel is limited by the number of direct flights (26), many of which go to Russia (primarily catering to the migrant labor community) by a limited number of air carriers. Poor safety practices have moreover resulted in a ban on flights by all Kyrgyz airlines to the EU, which has been redirecting travelers to specific hubs, thus increasing both the cost of the flights and the duration of the journey. Consequently, the World Economic Forum (WEF) Competitiveness Index 2019 ranks the air connectivity of the Kyrgyz Republic at 104th out of 141 economies (WEF 2019a). While the Kyrgyz government has taken positive steps to liberalize air space by introducing an open skies policy in early 2017, the high operational costs at Manas International Airport, regulatory challenges, infrastructure issues, and poor management dampen the interest of international carriers. With international carriers resuming flights to Bishkek in August 2020, there are positive market signals indicating demand. Whether the Kyrgyz Republic can benefit from that demand depends on the policy actions that are taken in the COVID-19 recovery period to increase air and ground connectivity to key source markets for winter and soft adventure tourists.

IMPROVING THE INVESTMENT CLIMATE TO UNLEASH THE POTENTIAL OF THE PRIVATE SECTOR HELD BACK BY A "MISSING MIDDLE"

The Kyrgyz Republic has a large and entrepreneurial private sector concentrated in services. Among comparable countries in the region, the Kyrgyz Republic boasts the highest percentage of GDP produced by the private sector (75 percent), and this economic activity is concentrated in the service sectors.[5] Over the past two decades, the economy has transitioned from agriculture into services, while the industrial share of output remained relatively flat. Services accounted for 54 percent of GDP at the end of 2019, followed by industry, agriculture, and construction at 21, 14, and 11 percent, respectively. Within services, tourism, transport, and communications have grown rapidly (albeit from a low base), while retail and wholesale trade has benefitted from remittance-fueled domestic demand and intraregional trade. Of the 54 percent that services contribute to the Kyrgyz GDP, 16.7 percent comes from the export of services. This is a higher proportion than in Kazakhstan, Russia, and Tajikistan but significantly lower than in Armenia, Georgia, and Moldova, and it shows a potential for growth.

Despite these positive signs, a poor business environment encourages informality and limits firm growth. The Kyrgyz private sector struggles with informality and a "missing middle." Firms are largely informal and concentrated in wholesale and retail trade and agriculture. Both sectors offer predominantly low-skilled jobs, and the former consists of the highest number of business entities operating under the patent regime,[6] mostly individual entrepreneurs or micro firms. The patent regime is a vehicle that allows patent holders to take advantage of the distortionary distribution of the tax burden and avoid cumbersome administrative requirements. Microenterprises dominate the private sector,[7] and the number of individual entrepreneurs has doubled over the past decade. Small enterprises[8] represent the second largest group, and their proportion has been slowly growing. Medium-sized firms[9] represent the smallest proportion of firms, and since 2007, their share of the total number of firms has fallen. Among MSMEs, SMEs contribute a total of 61 percent of non-gold exports. Medium-sized firms account for 14.5 percent of the country's exports despite representing less than 0.2 percent of the number of firms. This supports the claim that key indicators of firm performance—value addition per worker and export volume, for instance—increase with size.[10] In part, this reflects not only low productivity but also financial constraints that prevent the scaling-up of production and employment. It also betrays a lack of structural reforms that has resulted in burdensome regulations, an investment climate that incentivizes informality, and a playing field that is tilted against MSMEs.

The Kyrgyz Republic was struggling to attract and retain FDI even before the COVID-19 outbreak due to an adverse investment climate, the small size of the domestic market, and the low attractiveness of other sectors beyond extractive industries. FDI has lagged behind the level of its regional peers, and this has led to underdeveloped exports outside of commodities. Beyond mining and quarrying and petroleum product manufacturing, the country has been unable to attract private investment on a scale that would provide enough quality jobs for the country's growing labor force. Moreover, FDI inflows have fluctuated significantly from year to year and have been particularly limited in the past two years. In 2017, net inflows of FDI as a share of GDP fell to a negative 1.4 percent as the government became embroiled in a judicial dispute over control of the Kumtor gold mine in 2015, a dispute that was not resolved until 2019. This high-profile dispute sent negative signals to other investors and, consequently, some investment projects were put on hold. Notably, the Kyrgyz Republic has one of the highest numbers of international disputes with the state as a respondent, the majority of which involve breaches of investment agreements by the state. Investors suffer from inconsistent regulations and limited investor protection mechanisms[11] (World Bank 2019a). Poor investor protections, a cumbersome business environment, and a lack of investment projects, as well as the reluctance of the government to promote private investment participation in the provision of infrastructure including PPPs are some of the key reasons for low FDI inflows.

UNLEASHING PRIVATE SECTOR GROWTH FOR DEVELOPMENT: PRIORITY POLICY RECOMMENDATIONS

The Kyrgyz Republic could achieve faster, more sustainable, and more diversified economic growth by expanding the role of the private sector in the economy. This CPSD identifies the most binding impediments to promote private investment in the country. Efforts towards a more transparent and predictable environment to signal to investors that the Kyrgyz Republic is once again a reformer are critical to the transition to a new private sector–led development model. The table that follows provides an overview of the six high priority policy reform areas. For each, the table distinguishes between short-term and medium-term actions. These recommendations include (a) prioritizing hydropower investments for expanded generation; (b) accelerating development of digital infrastructure and digital ID; (c) reducing the regulatory burden; (d) attracting private investments, with a focus on FDI; (e) strengthening financial sector resilience, inclusiveness, and efficiency; and (f) investing in tourism development and promotion.

TABLE E.1 HIGH-PRIORITY POLICY REFORM RECOMMENDATIONS

	NEAR-TERM, OR "LOW-HANGING" FRUITS	MEDIUM-TERM ACTIONS TO SUPPORT BROADER RECOVERY
Prioritizing hydropower investment for expanded generation	• Lay foundation for financial viability of the sector through a targeted lifeline tariff, mechanisms to smooth energy payments and prevent bunching in winter months, and targeted social protection systems for the poor.	• Stem technical and non-technical losses through smart meters installation and debt recovery efforts. • Adapt risk-mitigation instruments to address short-term/seasonal shocks in the hydropower sector.
Accelerating development of digital infrastructure and digital ID	• Develop a mechanism to incentivize financing for last mile operators for the development of telecommunication infrastructure and telecommunication services. • Create a public digital map to track key online information needed for digital supply. • Eliminate double taxation on international IP transit and ICT services.	**Develop and implement a fiber regulatory package:** • Develop legislative framework on network infrastructure sharing among operators and add amendments to the Law of the Kyrgyz Republic "On electrical and postal communications". • Develop and simplify regulations regarding ICT infrastructure deployment in connecting households and across roads infrastructure and power lines – at the construction and connection phase. • Simplify construction permit for digital nfrastructure and network expansion (antennas, fiber optic cables). **Digital demand and digital ID:** • Develop the regulation regarding digital platforms with ecosystem actors to speed up digitizing government operations and increase interoperability. • Develop regulation on data classification and data sharing to enable data interoperability. • Implement digital ID enabling access to the information for financial market.
Reducing the regulatory burden	• Lower the patent regime threshold and differentiate between micro and small businesses. Ensure small business registration. **Inspections:** • Create a central inspectorate body to coordinate all inspections; eliminate overlaps in inspection competencies provided in sectoral regulations. **Administrative procedures:** • Fully digitize the e-register, and create online one-stop shop for all permissive documents.	**Inspections:** • Create e-inspection management system to enable data interoperability and coordination of inspections, enabling risk-based inspections. **Administrative procedures:** • Create regulatory quality mechanism - for every new regulation adding new burden for private sector, two existing ones must be abolished.

	NEAR-TERM, OR "LOW-HANGING" FRUITS	MEDIUM-TERM ACTIONS TO SUPPORT BROADER RECOVERY
Attracting private investment, with a focus on FDI	• Amend the Law on Investments and establish a unified investor grievance mechanism. • Build awareness and implementing capacity among line ministries in implementing PPP deals.	• Establish a dedicated PPP development agency, as the main state authority responsible for PPP guidelines and maintaining transparency throughout the PPP process. • Ensure animal-origin product traceability in dairy, meat, and horticulture products and align it with EAEU and Chinese requirements.
Strengthening financial sector resilience, inclusiveness, and efficiency	• Strengthen secured transactions, credit reporting, and the debt resolution and insolvency regime. • Expand risk-sharing facilities to accommodate risk aversion of banks and MFIs due to COVID-19. • Adjust the regulatory framework to allow application of simplified Customer Due Diligence (CDD) requirements.	• Invest in an interoperability platform at Single Interbank Processing Center (SIPC). • Develop a National Financial Inclusion Strategy including tailored products and services for agribusiness and tourism SMEs; and a strategy for mobilizing longer-term funding and attracting a diversified base of investors.
Investing in tourism development and promotion	• Invest in destination promotion and COVID-19 focus recovery campaigns in priority markets segments (soft adventure and winter tourism). • Implement a PPP approach to airport privatization/upgrades and reduce nonairline costs.	• Strengthen the authority of the Department of Tourism and establish interagency working group to address key sectoral issues. • Improve safety standards to meet ICAO compliance requirements. • Launch privatization/PPP efforts of tourism facilities/ sanatoriums/SOE assets in phases.

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