COUNTRY PRIVATE SECTOR DIAGNOSTIC

CREATING MARKETS IN THE KYRGYZ REPUBLIC

Unleashing the private sector
to rebuild development success

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ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AML	anti-money-laundering
AS	advisory services
ASA	advisory services and analytics
ATM	automated teller machine
BCS	bulk clearing system
BRI	Belt and Road Initiative
B2B	business-to-business
B2C	business-to-client
CAA	Civil Aviation Agency
CAGR	compound annual growth rate
CARS3	Third Phase of the Central Asia Regional Links Program
CASA	Central Asia-South Asia
CBT	community-based tourism
CDD	customer due diligence
CEM	country economic memorandum
CERT	Computer Security Incident Response Team
CFT	Countering the Financing of Terrorism
CIS	Commonwealth of Independent States
CMAW	Creating Markets Advisory Window
COVID-19	coronavirus
CPF	country partnership framework
CPSD	country private sector diagnostic
CRM	customer relationship management
CSD	central securities depository
DFS	digital financial services
DIGI CASA	Digital Central Asia-South Asia
DMC	destination management company
DMO	debt management office

DPA	deposit protection agency
DPF	deposit protection fund
DPO	development policy operation
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
ECE	early childhood education
e-ID	electronic identification
e-KYC	electronic know-your-customer
EU	European Union
FDI	foreign direct investment
FI	financial institution
FPS	fast payment system
FSU	former Soviet Union
GDP	gross domestic product
GDS	global distribution systems
GEI	Global Entrepreneurship Index
GIS	Geographic Information System
GMRA	Global Master Repurchase Agreement
GoKR	government of the Kyrgyz Republic
G2B	government-to-business
G2P	government-to-person
GVC	global value chain
HCI	Human Capital Index
IATA	International Air Transport Association
IBRD	International Bank for Reconstruction and Development
ICAAP	Internal Capital Adequacy Assessment Program
ICAO	International Civil Aviation Organization
ICT	information and communication technology
IFC	International Finance Corporation
IFI	international financial institution
ILO	International Labor Organization
IMF	International Monetary Fund

IPF	investment project financing
IPPA	Investment Protection and Promotion Agency
ISP	internet service provider
KCBTA	Kyrgyz Community-Based Tourism Association
KICB	Kyrgyz Investment and Credit Bank
KPO	Kyrgyz Post Office
KSE	Kyrgyz Stock Exchange
LOI	Law on Investment
LSM	Law on Securities Market
MFD	maximizing finance for development
MFI	microfinance institution
MFO	microfinance organization
MoCIT	Ministry of Culture, Information, and Tourism
MoE	Ministry of Economy
MoF	Ministry of Finance
MSMEs	micro, small, and medium enterprises
NLB	New Law on Banks
NSDS	National Sustainable Development Strategy
NSPF	non-state pension fund
NSSD 2040	National Strategy for Sustainable Development of the Kyrgyz Republic for 2018–40
O&M	operations and maintenance
OECD	Organization for Cooperation and Economic Development
OTA	online travel agents
PHC	primary health care
PKI	public key infrastructure
PMS	property management systems
POS	point-of-sale
PPD	public-private dialogue
PPP	purchasing power parity or public-private Partnership
P2B	person-to-business
P2G	person-to-government

QR	quick response
RCA	revealed comparative advantage
RKDF	Russian-Kyrgyz Development Fund
ROE	return on equity
RTGS	teal-time gross settlement
SCD	systematic country diagnostic
SECO	Swiss State Secretariat for Economic Affairs
SEs	state enterprises
SF	Social Fund
SIPC	Single Interbank Processing Center
SMEs	small and medium enterprises
SOEs	state-owned enterprises
SPS	sanitary and phytosanitary standards
SREP	Supervisory Review Evaluation Program
SSRSFM	State Service of Regulation and Supervision of the Financial Market
TA	technical assistance
TFA	Trade Facilitation Agreement
TSA	tourism satellite account
TTCI	Travel and Tourism Competitiveness Index
UNCTAD	United Nations Conference on Trade and Development
UNWTO	United Nations World Tourism Organization
USAID	United States Agency for International Development
WB/WBG	World Bank/World Bank Group
WEF	World Economic Forum
WHO	World Health Organization
WTO	World Trade Organization
WTTC	World Travel and Tourism Council

Note: *All dollar amounts are in U.S. dollars unless otherwise indicated.*

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 investments 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.

PART I: OVERVIEW

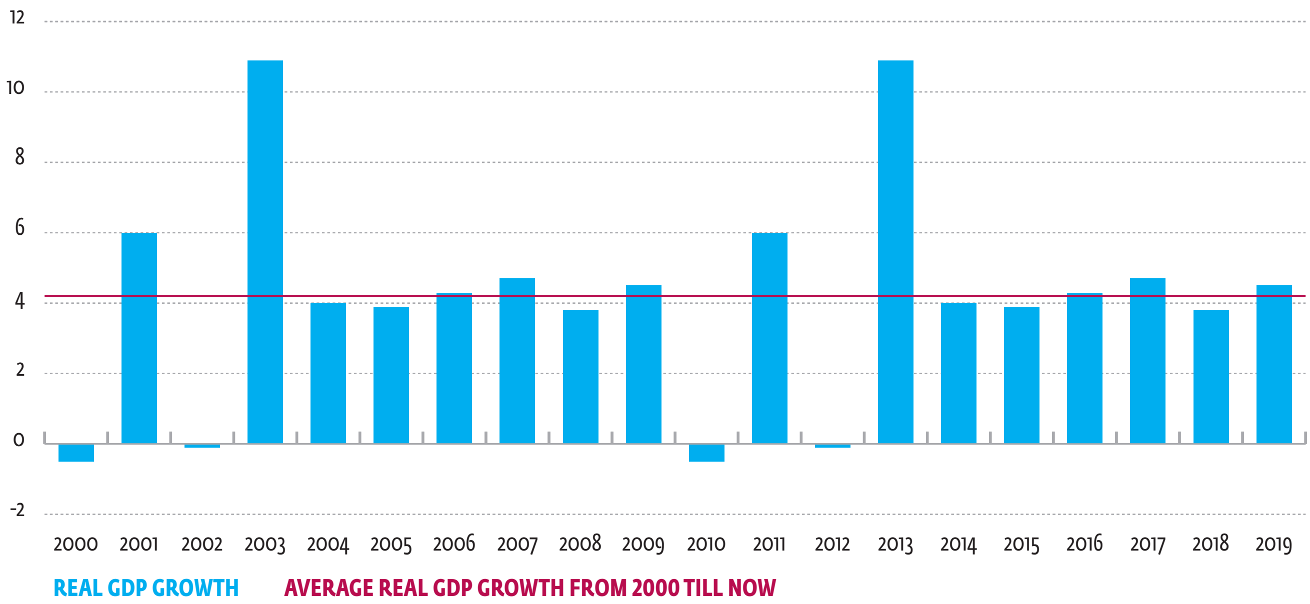
1. COUNTRY CONTEXT: THE KYRGYZ REPUBLIC AT A TURNING POINT

Main message: *The Kyrgyz Republic is at a critical juncture in its growth trajectory as it faces mounting pressures in the face of external shocks. If the Kyrgyz Republic can reduce its dependency on extractives and remittances by diversifying into service-oriented export industries, it will be able to create better, more numerous jobs for its youth through a more resilient and inclusive growth model. This new chapter of the country's development, however, will require tackling persistent challenges facing its business environment if the country wants to bring about economic diversification and create higher-productivity jobs. The current unstable domestic situation—a government turnover and the COVID-19 crisis, which has increased pressure on an already constrained government budget—poses a challenging environment for reforms. On the other hand, it also offers an opportunity to redirect its private sector development strategy and attract private investment in key enabling areas.*

THE KYRGYZ REPUBLIC NEEDS TO REGAIN ITS FOOTHOLD AS AN EARLY REFORMER IN THE REGION AND BUILD A MORE DYNAMIC AND RESILIENT ECONOMY

The economy of the Kyrgyz Republic has grown on the back of commodity exports and remittances, both of which are volatile and exclusionary, yet it lags behind countries with comparable economic capacity. Over the 2000–19 period, economic growth averaged 4.4 percent, and real GDP doubled in volume. Per capita GDP[12] growth, however, averaged only around 2.2 percent between 2010 and 2019 with an average GDP per capita[13] of US$1,309 in 2019. Strong gold production boosted economic growth in 2019 as the output from the Kyrgyz Republic's largest mine, Kumtor, rose by almost 15 percent year by year. Real GDP, then, increased from 3.8 percent in 2018 to 4.5 percent, driven by consumption and exports supported by gold. This rebound in growth helped to push per capita income levels back above lower-middle-income thresholds. The Kyrgyz Republic was recognized in the region as one of the early reformers among the economies of the former Soviet Union (FSU) after its independence. Specifically, the Kyrgyz Republic was the first FSU country to join the World Trade Organization (WTO) in 1998. As early as 1991, the country had already begun to implement market transition reforms related to price liberalization, small-scale privatization, private land ownership, trade openness, and foreign exchange systems, efforts that continued through 2014.[14] The implementation of politically challenging economic and social reforms contributed to macroeconomic stability and the rebuilding of basic institutions, thus averting a further decline in output

FIGURE 1.1 THE KYRGYZ REPUBLIC'S GROWTH PERFORMANCE 2000–19 (%)



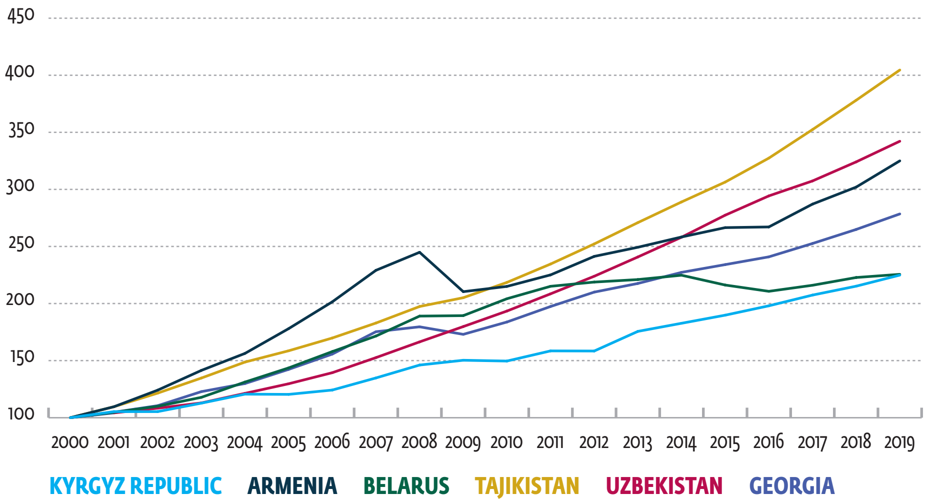
Source: World Bank World Development Indicators Database.

and the collapse of social services (UN Development Program 2005). The Kyrgyz Republic only attained lower-middle-income status 23 years after its independence (2014), though, a sign that it was lagging behind other FSU countries in Central Asia.[15]

The country is one of the poorest in the region despite reducing poverty following moderately inclusive growth. This is due in part because of the increasing demographic pressures arising from the needs of the youthful population and the hit to both gold exports and remittances due to the impacts of the COVID-19 pandemic. Between 2005 and 2011, the poverty rate, measured at the international US$3.20-a-day line, fell from 51.7 to 21.4 percent of the total population.[16] The country's per capita GDP (currently US$ 1,328) has subsequently lagged, and the decrease in its poverty rate has stalled at around 15.3 percent with no change between 2018 and 2019.[17] The population is expected to reach 7 million by 2030 and 8 million in 2050 (UN Department of Economic and Social Affairs 2017), creating rising demographic pressure to create more plentiful, high-quality jobs for a growing youthful population (about two-thirds of the total population are under the age of 35, and over half the population is under the age of 25). Youth are particularly stricken by poverty (40 percent) and unemployment. The COVID-19 crisis has led economists to project increases in the poverty rate as high as 21.1 percent in 2020 due to anticipated higher inflation, lower labor earnings, employment loss, and reduced remittances as a result of weakening growth in the Russian Federation, as well as lower incomes from the sale of agricultural products stemming from a shortage of imported agricultural inputs and disruption of spring field work (UN Department of Economic and Social Affairs 2017).

Growth has been limited because of low productivity and a lack of diversification. Most of the country's growth in the past decade came from factor accumulation (growth in capital and labor) and very little from TFP.[18] The World Bank notes that productivity growth—measured by examining TFP changes—has averaged half a percent a year since 2000, way too low for the country's ambitions, challenges, and potential (Izvorski and others 2020). Of the average annual growth rate of 4.3 percent between 2000 and 2017,

FIGURE 1.2 REAL GDP INDEX, THE KYRGYZ REPUBLIC AND SELECTED COUNTRIES



Source: World Bank World Development Indicators Database.

capital contributed 2.1 percentage points, labor 1.1, and TFP only 0.5 percent. Capital accumulation was dominant for industry (related to gold-extraction investments) and labor for services. Cumulative growth in the Kyrgyz Republic over 2000–19 was one of the lowest among the FSU republics (figure 1.2).

COVID-19 ADDS URGENCY TO TACKLING MACRO, FISCAL, AND STRUCTURAL CHALLENGES

The economic effect of the COVID-19 pandemic on the Kyrgyz Republic—a small, open economy reliant on services, remittances, and natural resources—is expected to be significant. Although the scope and duration of these effects are difficult to predict as the pandemic continues to unfold, it is clear that the crisis has significantly weakened the macroeconomic and poverty outlook. Since April, the government has introduced three support packages amounting to more than 7 percent of GDP. The first package of these anti-crisis economic measures, US$15 million (0.2 percent of GDP), included the postponement of tax payments, time-bound exemptions of property and land taxes, and temporary price controls on essential food items. Kyrgyz authorities prepared a second and, more recently, a third package, amounting to approximately US$540 million, which includes temporary tax exemptions for SMEs, support for the food security program targeted at helping vulnerable groups, and subsidized credit to banks to provide funding to SMEs through soft loans. Furthermore, the unprecedented level of uncertainty led the IMF to approve emergency support to the Kyrgyz Republic through the Rapid Financing Instrument and the Rapid Credit Facility in order to help provide a backstop, increase fiscal and external buffers, and shore up confidence. The IMF support also helps to preserve fiscal space for essential health expenditures related to COVID-19 and encourage additional donor support. The lockdown in March-May 2020, including border closures to contain the spread of the COVID-19 virus, was a major shock to the economy, reducing incomes of households and businesses. The economy was further affected by the political turmoil in October 2020 which severely damaged the investment climate and business environment. As a result, real GDP contracted by 8.6 percent in 2020. Twelve-month inflation rose to 9.7 percent in December 2020 from 3.1 percent a year earlier primarily due to depreciation of the exchange rate (19 percent). The general government deficit increased to 4.2 percent of GDP in 2020 from 0.5 percent in 2019 because of weaker revenues and increased expenditures.

The higher deficit along with the GDP contraction and the depreciation of the Som led to a rise of public debt to 68 percent of GDP in December 2020. Real GDP is projected to grow by 3.8 percent in 2021 as economic activity recovers in services and construction. Growth is forecast to increase to an average of 4.4 percent in 2022-23, assuming an improvement in the pandemic situation once vaccines are deployed, political stability is maintained, and external demand and trading conditions improve. The fiscal deficit is projected to decline to 3.9 percent of GDP in 2021 driven by higher tax revenues thanks to economic recovery. Over the medium term, the fiscal deficit is targeted to be reduced to 3 percent of GDP. Fiscal policy, then, can not serve as a source of growth in the short term and will be limited in its ability to mitigate the effects of COVID-19 on the economy in the medium term.

The country's current account deficit is expected to balloon because of the secondary effects of the pandemic. The current account deficit is expected to widen to 11.7 percent of GDP because of declining remittances (itself a result of the downturn in Russia) and tourism receipts. As the second-most remittance-dependent country in the world, this anticipated fall in remittances is expected to increase poverty among migrant family households. A simulation of the impact on poverty shows a 30 percent drop in remittances leading to over 32,000 households being pushed into poverty (World Bank 2020c). It is also anticipated that the economic downturn will disproportionately impact young people and women. More than one-fifth of the working-age population works in Russia and Kazakhstan, and many have already returned home to seek domestic employment opportunities (see box 1.1 for more on remittances). Youth, 12 percent of whom are not even currently employed or pursuing education or training, are likely to be hit the hardest by unemployment and the loss of livelihoods. The World Bank also notes that the spread of COVID-19 could jeopardize the progress that the Kyrgyz Republic has made in advancing respectable levels of access to health and education services. Higher gold prices offer some relief (gold accounts for more than half of the country's exports) and could mitigate these negative impacts.

Private investment is critical for a recovery due to the fact that fiscal policy can not serve as a source of growth in the short term. Total government spending has been high in the past decade, averaging around 35 percent of GDP between 2014 and 2019. Furthermore, this public spending has been neither growth-oriented nor directed towards the needs of the poor and the vulnerable: spending on wages and salaries has in fact been

BOX 1.1 REAL GDP INDEX, THE KYRGYZ REPUBLIC AND SELECTED COUNTRIES

The Kyrgyz Republic is one of the most remittance-dependent countries in the world: the contribution of remittances to GDP is estimated at nearly 28 percent (2019). More than one-fifth of the working-age population works in neighboring countries, mainly in Russia and Kazakhstan. The estimated number of Kyrgyz people working abroad overall are between one-half and one million. As a result, migrant worker remittances have become an important contributor to Kyrgyz growth performance. Remittances rose from almost zero in 2000 to US$1.3 billion by 2010 and US$2.1 billion in 2019. Remittances have helped to support domestic consumption and investment, chiefly in construction, and a general expansion in services. They have also served as a significant contributor to foreign currency earnings, boosting imports and GDP growth, without which the country would have been stuck with severe foreign exchange constraints and probably a stagnant GDP. Such large remittances are a precarious foundation for an economy. They can undermine a country's competitiveness either through significant real exchange-rate appreciation or through exposure to external shocks and the business cycles of the countries where migrants work. The slowdown of the Russian economy in 2009 and the recession of 2014–15, which followed a sharp decline in oil prices at the end of the commodity supercycle, interrupted the flow of remittances to the Kyrgyz Republic. Overreliance on remittances is also associated with other adverse effects that are further magnified through widespread economic shocks such as those from the current pandemic. Russia, for instance, has seen oil prices drop sharply and has the world's third highest number of COVID-19 infections.

much higher than in comparable countries.[19] Similarly, spending on goods and services is also high in relative terms. As such, the Kyrgyz Republic has one of the highest ratios of general government spending. Increasing structural fiscal imbalances and a high level of indebtedness fueled this expansionary fiscal policy (according to the IMF, total external debt stood at 76 percent of GDP in 2019). Such high government spending can crowd out private investment, slow economic growth, and lead to an unsustainable fiscal trajectory, and it is especially worrisome, given the vulnerabilities associated with the heavy dependence of the Kyrgyz Republic on remittance flows and gold prices.

The pandemic has already had documented negative effects on the Kyrgyz private sector, which without adequate liquidity to mitigate near-term shocks will severely hinder recovery. A recent survey of businesses conducted in April 2020 reflects the severity of the crisis on the private sector: 80 percent of respondents reported a decrease in revenue of more than 75 percent, and almost half of respondents had put their staff on leave without pay. Despite these measures, nearly two-thirds of respondents did not have enough liquidity to cover their operational expenses for more than one month.[20] Newly issued credit, moreover, dropped by 60 percent in April 2020 compared with the same period in 2019, a substantial decline in contrast to the prevailing trend over the past decade.[21] The longer the crisis extends, the greater the risk that otherwise well-performing MSMEs may fail. Longer-term effects would force businesses to put out additional costs for retraining employees, find new suppliers and markets, and attract new investment (World Bank 2020a).

STRATEGY FOR EXPANDING THE PRIVATE SECTOR'S CONTRIBUTION TO RECOVERY AND GROWTH AND STRUCTURE OF THE CPSD REPORT

To support economic recovery at a time when public finances and trading partners are more constrained than ever, the Kyrgyz Republic needs to redesign its growth model to enable better diversification, connectivity, and export competitiveness. In 2018, the Kyrgyz government unveiled its long-term sustainable development strategy covering the 20-year period up to 2040, focusing on firm growth: (a) closing infrastructure gaps; (b) creating a more attractive investment environment; (c) implementing private-public partnership (PPP) solutions and improving public asset management; and (d) strengthening and diversifying the financial sector. Improving the Kyrgyz Republic's connectedness with regional economies is particularly essential for increasing outputs, exports, investments, and job growth in the recovery phase. This report proposes a transition toward an export-oriented growth model in service sectors with low entry requirements (both capital and skills, and no barriers to export), piggybacking on the economy's more recent shift to service-orientation away from mining, textile, and agriculture. This will require tackling overdue reforms to the business environment that were postponed in periods of high but unsustainable growth in support of the domestic private sector and to attract foreign direct investment (FDI).

This CPSD highlights the policy priorities most relevant within the constraints of the Kyrgyz economy and post-COVID recovery conditions and identifies specific actions to facilitate private investments in potential high-growth sectors. The CPSD builds on the World Bank analysis in the Country Partnership Framework (CPF) and the Country Economic Memorandum (CEM) by focusing explicitly on areas where the Kyrgyz Republic can leverage its private sector for more resilient and inclusive growth. Among the array of cross-cutting and sector-specific challenges identified in prior analytical works, the CPSD emphasizes those policy actions that are most urgent for creating fiscal space in the post-COVID phase. The report is organized into two parts. Part I introduces the overall CPSD analysis and is structured as follows: Chapter 1 describes the evolving economic context in the Kyrgyz Republic and the rationale for examining the strength of the private sector. Chapter 2 describes the current state of the private sector, its opportunities for the future, and the key challenges it will face in the next stage of development. Chapter 3 describes the main constraints hindering the private sector from expanding investment and support development and focuses on cross-cutting policy issues, concluding with policy recommendations for these challenges. Part II presents a more detailed analysis that looks at whether there is potential for private investment in several key focus areas: infrastructure (particularly in the energy, transport, and digital sectors); building a digital economy; regional connectivity; financial services; and tourism. Ensuring sustainable and reliable energy access (chapter 4), which includes efforts to reform energy tariffs, is critical for enabling economic diversification and preserving fiscal space. Hydropower can provide energy access in a sustainable manner and can also be directed towards regional exports. Greater connectivity (chapter 5) and movement towards a digital economic transformation (chapter 6) could further promote business competitiveness, improve service delivery, and stimulate the growth of export-oriented sectors. The deployment of broadband technology could particularly improve productivity, lower the costs of doing business, and accelerate innovation. ICT is also a key enabler in several sectors, particularly digital finance. Increasing financial inclusion (chapter 7) is a necessary precondition for supporting MSME growth and channeling remittances towards domestic investments. The tourism sector (chapter 8) has traditionally developed and carved out a niche of domestic and world clientele, but because of the COVID-19 crisis, it currently enjoys weak short- to medium-term prospects.

2. STATE OF THE PRIVATE SECTOR

Main message: *The Kyrgyz Republic has a relatively large and entrepreneurial private sector concentrated in services, but it is largely informal, stagnant, and unproductive, and the business environment it has created limits competitiveness. With overreliance on a very small number of sectors that contribute to growth, the Kyrgyz Republic's private sector still has considerable potential to grow in underexploited areas. Leveraging the growth potential of the private sector requires the Kyrgyz government to work with firms on incentives to grow in size, formalize, diversify, invest in innovation, and integrate into regional markets for greater export competitiveness.*

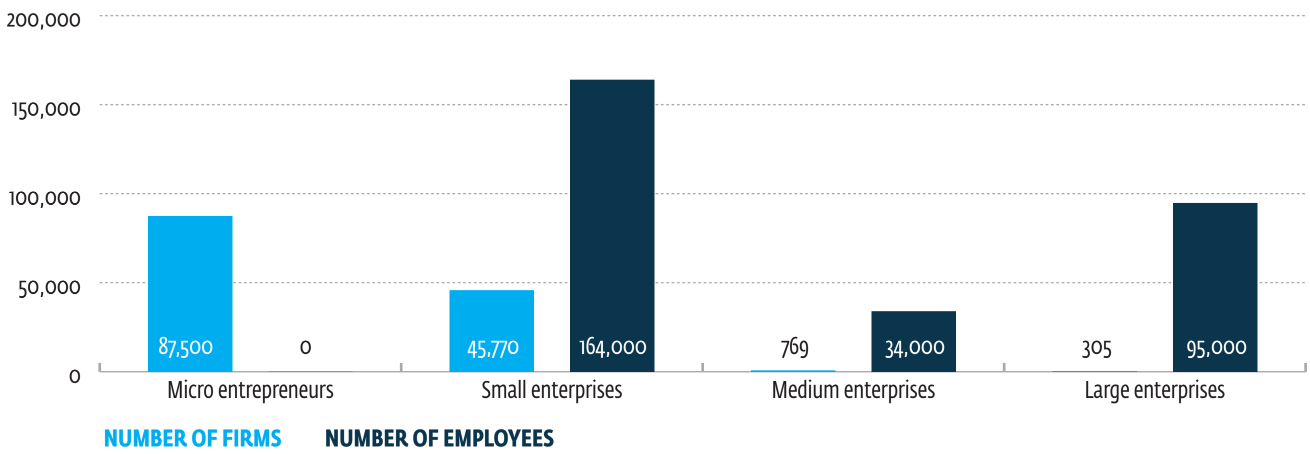
RELATIVELY LARGE PRIVATE SECTOR CONCENTRATED IN SERVICES BUT LAGGING IN COMPETITIVENESS

The Kyrgyz Republic boasts the highest percentage of GDP produced by the private sector (75 percent) among comparable countries in the region. The private sector concentrates on providing services, but it has followed a structurally similar path to diversification.[22] This reflects privatization efforts following independence that limited state ownership, which put the private sector's share of GDP in the Kyrgyz Republic ahead of several others in the region.[23] The role of SOEs has been limited with relatively low contributions to GDP and employment. The Kyrgyz Republic's structural transformation is nevertheless like that of other countries in the region with economies that transitioned from agriculture into services while the industrial share of national output remained 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 the service sector, tourism, transport, and communications have grown rapidly (albeit from small beginnings), while retail and wholesale trade have benefited from remittance-fueled domestic demand and intraregional trade. Of the 54.5 percent that services contribute to the Kyrgyz GDP, 16.7 percent comes from the export of services. This is a higher proportion than in Russia, Tajikistan, and Kazakhstan, but significantly lower than in Georgia, Armenia, and Moldova, for example, a sign of tremendous potential for growth.

A PRIVATE SECTOR DOMINATED BY MICROENTERPRISES AND STRUGGLING WITH A "MISSING MIDDLE"

Microenterprises dominate the private sector, while medium and large firms struggle with growth and contribution to employment. The number of individual entrepreneurs has doubled in the past decade and the second-largest category in number is small enterprises. While small enterprises have been slowly growing in number, the number is significantly lower than that of microentrepreneurs. They nonetheless account for the largest number of employees. Medium enterprises[24] are the smallest in terms of the number of firms and employees. While there are 305 large firms that employ around 14 percent of nonagricultural private sector workers, these large enterprises are mostly concentrated in mining, energy, banking, and communications (and 10 percent of them are SOEs) and pay taxes under the general regime. This distribution illustrates the fact that the Kyrgyz economy is missing the "middle" in terms of the contribution of medium-sized firms to output and employment (World Bank 2020b). Moreover, the share of firms in this category has fallen since 2007, while those of all the others have grown. The contribution of medium-sized firms in 2018 to value added and employment was also small (4.3 percent of GDP and 1.5 percent of employment), yet these firms account for 14.5 percent of the country's exports despite representing less than 0.2 percent of the number of firms. The largest contribution to both value added and employment comes from large firms, with 66.4 percent of GDP and 78.8 percent of employment (figure 2.1). This is significantly behind the developed countries of the EU-28 and other FSU countries like Armenia and Georgia (figures 2.2 and 2.3).

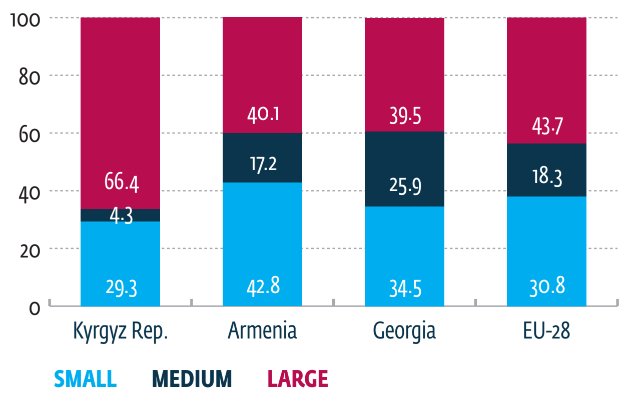
FIGURE 2.1 THE KYRGYZ REPUBLIC'S ENTERPRISE SECTOR DISAGGREGATED BY FIRMS AND EMPLOYEES, 2018



Source: The World Bank's analysis is based on National Statistical Committee, State Tax Service, and Staff Estimation (2018).

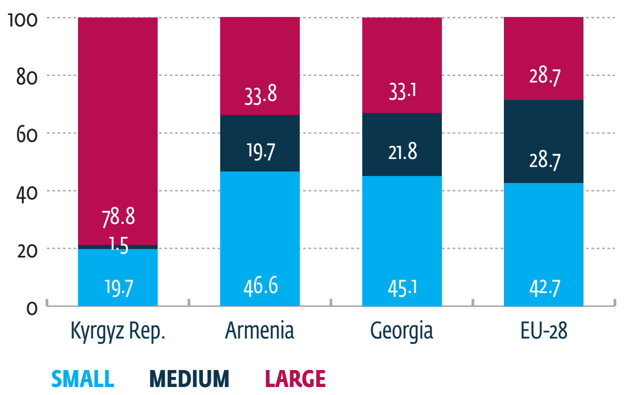
Notes: The number of enterprises refers to active enterprises in 2018, as defined by filing a return. The number of employees for patent-holding individual entrepreneurs is not collected by the government. The NSC reports close to 400,000 individual entrepreneurs, which overstates the number of individual entrepreneurs by double counting those engaged in multiple business activities and thus holding multiple patents, and it includes individual entrepreneurs that are no longer "actively" operating. Micro ones are those with 1 to 5 employees and often operating under the patent regime. Small enterprises are those with 6 to 19 employees. Medium-sized enterprises are those with 20 to 99 employees. Large ones have 100 or more employees.

FIGURE 2.2 VALUE-ADDED SHARE OF GDP OF FIRMS BY SIZE IN THE KYRGYZ AND COMPARABLE ECONOMIES



Sources: Organisation for Economic Co-operation and Development (OECD), Eurostat, and governmental statistics offices of countries. Data for 2018 or the most recent data.

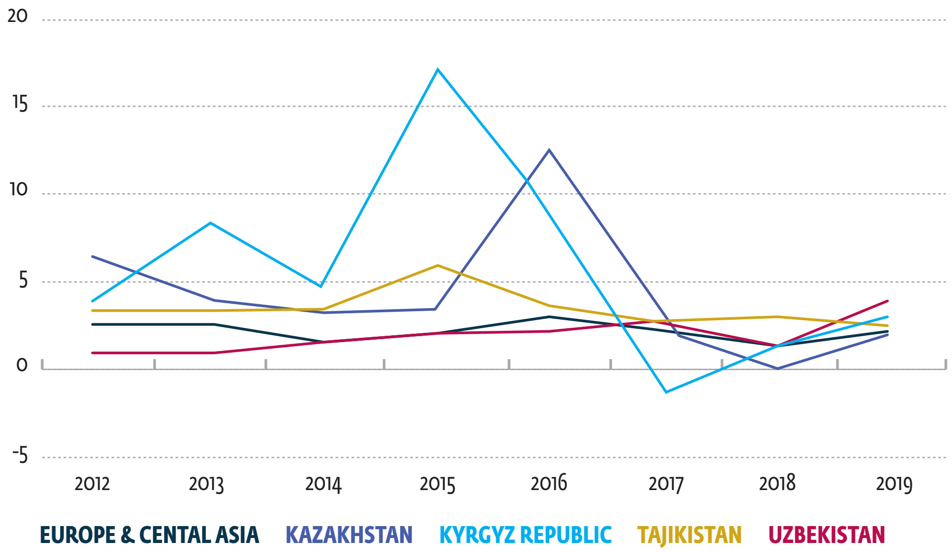
FIGURE 2.3 EMPLOYMENT BY SIZE OF FIRM IN THE KYRGYZ AND COMPARABLE ECONOMIES



Sources: OECD, Eurostat, and statistics offices of countries. Data either for 2018 or the most recent data.

Note: The employment figures do not include peasant farms in the Kyrgyz Republic in 2018.

FIGURE 2.4 FDI, NET INFLOWS (% OF GDP), KYRGYZ REPUBLIC AND NEIGHBORS



Source: WDI.

This distorted size distribution of firms partially reflects a challenging business environment characterized by low productivity and financial constraints that disincentivize growth by preventing the scaling-up of production and employment. Firms single out unfair competition from informal companies as a major obstacle to doing business, but informality is an outcome that reflects the various limitations and policies that affect private sector growth. One such regulatory distortion is the dual tax regime, designated as "patents," a form of tax registration designed for microenterprises to avoid complex tax procedures in favor of quick business entry and operations. As discussed in more detail in Chapter 3, though, this disincentivizes growth and compliance with tax and regulatory burdens that increase with firm size.

Growth potential for microenterprises and small businesses is further constrained by lower credit access resulting from the low risk appetite of banks and limited financial product innovation. The banking sector accounts for 77 percent of financial sector assets with a capital adequacy ratio of above 25 percent in 2019, which is significantly above the minimum regulatory requirement of 12 percent (World Bank 2020c). The ratio of liquid assets to total assets was 28 percent, suggesting a healthy liquidity situation. As part of the initial COVID-19 response measures deployed in March 2020, the government has also been providing further liquidity support (see box 2.1), while the National Bank of the Kyrgyz Republic (NBKR) has blocked commercial banks from levying fines for the nonpayment of loans, proposing a grace period of at least three months. As of mid-June, 132,000 borrowers have been affected by the pandemic: a total of 70 billion Kyrgyz soms (US$875 million) in loans were restructured, around 50 percent of the total credit portfolio. Financial institutions are struggling with an increase in loan delinquencies and concerns about reduced profitability, weaker asset quality, and lower deposit mobilization. This is expected to further restrict credit to smaller firms in the short to medium term.

THE KYRGYZ REPUBLIC STRUGGLES WITH ATTRACTING AND RETAINING FDI

Beyond the extractives sector (mining, quarrying, and petrochemicals), the Kyrgyz Republic has struggled to attract and retain foreign investment. The level of FDI inflows have fluctuated significantly from year to year and have been particularly limited in the past two years, lagging behind that of regional peers (figure 2.4). Inflows peaked in 2015, but fell to a negative of 1.4 percent as a share of GDP in 2017 (World Bank 2017). Net FDI inflows somewhat rebounded in 2018, about 1.8 percent of GDP, but it is clear that the Kyrgyz Republic has struggled over the years to sustain and increase FDI inflows.[25] The main reason for the decline in 2017 was a judicial dispute with the Canadian group Centerra Gold over control of the Kumtor gold mine in 2015, a dispute that was not resolved until 2019. This sent negative signals to other investors and consequently some investment projects were put on hold. There is little evidence of spillover effects into the local economy from FDI, nor are there any notable backward links.

EXPORTS OUTSIDE OF COMMODITIES ARE UNDERDEVELOPED AND DECREASING DUE TO THE LOW COMPETITIVENESS OF KYRGYZ FIRMS

Commodities have dominated exports, and the number of Kyrgyz exporters is comparatively small and decreasing. There were fewer exporters in 2012 than in 2006, and the number is significantly smaller than in other similar countries in the lower-middle-income category. While SMEs contribute about 60 percent of non-gold exports, the competitiveness of Kyrgyz products is limited in non-commodity sectors. According to the World Bank, exports of goods and services in the Kyrgyz Republic fell as a share of GDP to approximately 32 percent in 2018 from a high of 55 percent in 2009. This is below that in countries with similar levels of GDP per capita, and only commodity exports have kept the Kyrgyz Republic above the average level of lower-middle-income countries, if only barely.

The Kyrgyz Republic has also not exploited its trade potential despite its shared borders with several countries and growing demand in regional markets because of its failure to meet required standards. The Kyrgyz Republic was the first Central Asian country to join WTO in 1998, but it made little progress in achieving its commitments: in 2019 (World Bank 2020d), it accomplished 12.2 percent of its commitments, and it plans to reach 16.4 percent by 2020 without external assistance, which is unlikely, given the effects of the pandemic on cross-border trade. This is also an issue with the EAEU,

BOX 2.1 COMMODITIES DOMINATE KYRGYZ EXPORTS WITH LITTLE CONTRIBUTION TO JOBS AND DEVELOPMENT

The Kyrgyz Republic, together with Tajikistan, is the least abundant in natural capital in the Europe and Central Asia (ECA) region and is in the bottom 20 percent of all countries in the world measured on a per capita basis. Nonetheless, gold, other metals, and minerals account for 63 percent of exports, a share unchanged since 2000. Together with fuels, these exports account for 72 percent of the country's total. This is similar to the share of commodities in the exports of the six most resource-rich countries in ECA. Like other countries with natural resource endowments, the Kyrgyz Republic has integrated itself into the global economy through its commodity exports: more than one-third of the country's total exports (primarily gold) goes to Switzerland and the United Kingdom. Kazakhstan and Russia purchase a further 30 percent, but firms in this sector have created only minor backward links to its economy, accounting for less than 3 percent of jobs. Commodity production is operated as an enclave, an economy within the economy (World Bank 2020b).

the country having failed to its meet standards and technical regulations. Kazakhstan has taken sanitary and phyto-sanitary (SPS) emergency measures, for example, that temporarily restrict the import of potatoes and meat. Moreover, the Kyrgyz Republic is facing significant competition from Uzbek exports, which compete directly with theirs. Dramatic reforms to Uzbekistan's export regime have led to more direct competition among EAEU countries in the export of fruits, vegetables, and textiles, to name just a few. A reform of SPS standards is needed to take advantage of the country's direct borders and growing demand for agricultural products in the EAEU and China.

To pave the way for a strong and sustainable recovery, the Kyrgyz government needs to build a reform program that addresses several cross-cutting challenges to private sector investment and growth. Business environment constraints remain a significant challenge to SMEs that currently operate in an uneven playing field that incentivizes informality and limits growth and competitiveness. Moreover, the weakness of investor protections blocks foreign investment, especially in critical enabling sectors such as energy, and the country's underdeveloped PPP framework and regulatory regime further restricts Investment. The next chapter discusses these and other cross-cutting challenges to private sector development.

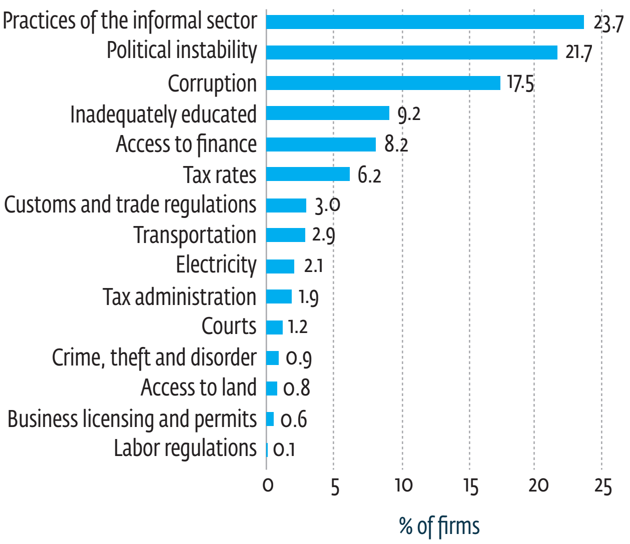
3. CROSS-CUTTING CHALLENGES

Main message: The Kyrgyz Republic has struggled with a diversified growth model in the absence of a policy environment that can facilitate private investment in sectors outside of extractives. Its largely informal private sector reflects distorted and cumbersome regulations that hinder formalization and firm growth while also undermining competitiveness. Weak investor protections, weak institutional oversight, and constant international disputes deter foreign investors. This adversely affects value chain development and knowledge spillovers. The limited application of PPP laws and low implementation capacity has also resulted in missed opportunities for private investment in much-needed infrastructure financing. With limited room for fiscal support in the short to medium term, economic recovery calls for a new urgency in reprioritizing reform efforts toward supporting private sector investment and growth.

THE REGULATORY ENVIRONMENT LIMITS THE GROWTH OF BUSINESSES AND ENCOURAGES INFORMALITY

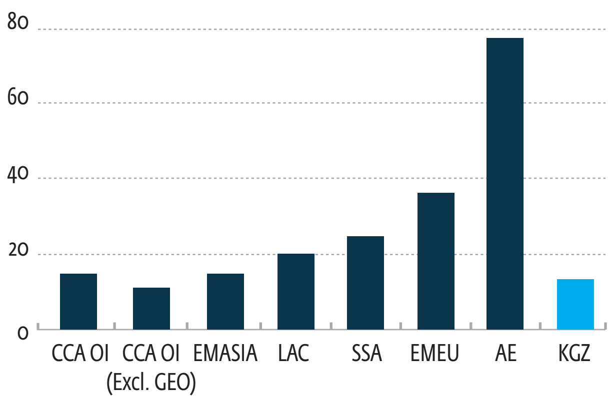
According to World Bank Enterprise Survey data,[26] informality persistently ranks as one of the top constraints to SMEs in the Kyrgyz Republic. In the 2019 survey, about 24 percent of firms surveyed report informality as the top constraint to business, and 39 percent rank it as a major constraint (figure 3.1), while informality has decreased over time (from approximately 42 percent of GDP in 1993 to 24 percent in 2017).[27] Unregistered firms also contribute significantly to employment (57 percent of workers; see figure 3.2). These firms are concentrated in trade (wholesale and retail) and agriculture

FIGURE 3.1 TOP BUSINESS ENVIRONMENT OBSTACLES FOR FIRMS



Source: World Bank Enterprise Survey 2019.

FIGURE 3.2 BUSINESS ENTRY DENSITY RATE



Sources: IMF staff calculations in the IMF Country Report May 2019.

Note: Business entry density rate is the number of newly registered firms per 1,000 working-age people. Data correspond to most recent value within the period 2014–16. Caucasus and Central Asia (CCA) countries are 2016 values. OE= oil exporters, OI = oil importers; EMEDU = emerging-market developing economies (EMDEs).

and provide mostly low-skilled jobs (World Bank 2019c). While microenterprises and small businesses are easy to set up, entrepreneurs stay informal to avoid burdensome regulation and interactions with the tax authority.

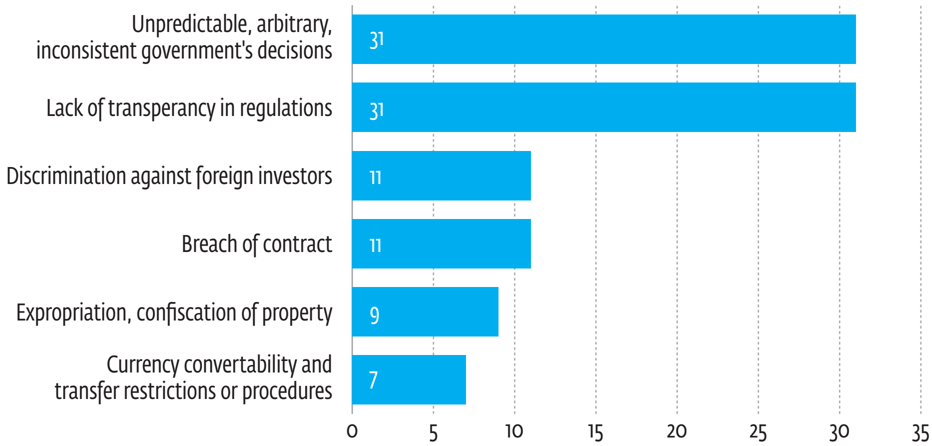
Kyrgyz firms that stay informal enjoy a favorable tax regime under the "patent" system while avoiding interactions with tax authorities. The patent regime is a form of tax registration designed for microbusinesses and entrepreneurs to avoid a significant tax burden and enable quick entry and operation. The number of issued "patents" directly correlates with the size of the informal sector. In order to qualify for the legal status of a "voluntary patent," a firm must remain small (as an individual entrepreneur or microenterprise) and have a turnover of less than 8 million soms (approximately US$110,000). This qualification threshold is significantly higher than in most countries in ECA, and the only higher threshold is maintained by Russia. Under this licensing regime, firms do not require any formal bookkeeping, and for the most part, they are not subject to inspection. Also, firms under the patent regime avoid social security contributions and pay no financial penalties, as they are not required to report incomes to the Social Fund (SF). Consequently, business growth and migration into the general tax regime is not particularly advantageous. Between 2014 and 2017, the number of patents grew by 37 percent, while the number of SMEs not under the patent regime grew by just 18 percent. The fact that some enterprises abuse the patent system and grow much larger (as informal entities) than allowed by the system is likely the main contributor to the issue of "the missing middle" in the Kyrgyz private sector.

Ineffective and burdensome government oversight also incentivizes informality, and previous reform attempts have failed to lift some of these restrictions. Despite efforts to reform business inspections, for example, they still focus on punishing noncompliance rather than counseling and building awareness of required procedures to improve outcomes and compliance (Arynova and others, forthcoming). The performance management system of the current state inspectorates focus on the number of inspections conducted, fees collected, and violations identified during inspections. Furthermore, firms that are formalized are likely to pay off inspection agents rather than comply, which adds to an already high cost of doing business. The State Tax Service, the SF, the Fire Safety Agency, and the Sanitary and Epidemiological Service are reported by firms as the most common inspection agencies. The limited coordination among these agencies and the lack of a central inspectorate or risk-based supervision results in many businesses being inspected despite their low or moderate risk level, which creates a notable burden on both the agencies and the businesses.[28] More than 800 different administrative procedures overseen by 25 government bodies apply to business operations.[29] Process of obtaining a permanent electricity connection or construction permit is cumbersome and costly according to focus groups with private sector. This process, together with the unreliability of supply and the lack of transparency of tariffs, means that the burden of getting electricity in the Kyrgyz Republic is high.

WEAK INVESTOR PROTECTIONS DETER INVESTORS AND CONSTRAIN RESOURCE MOBILIZATION

Lack of transparency and consistency, corruption, and weak investor protections are among the main barriers to investment in the Kyrgyz Republic. The country's investor protection is weak. Politically unstable environment, corruption, and lack of good corporate governance practices are linked to negative perceptions among investors. The most recent WBG Investment Climate Survey findings (World Bank 2015) highlighted a lack of transparency in regulations (the absence or lack of clarity concerning criteria for filling out an application or obtaining a license, for example); frequent changes in legislation without consultation with

FIGURE 3.3 CAUSES OF INVESTOR COMPLAINTS (% OF INVESTORS)

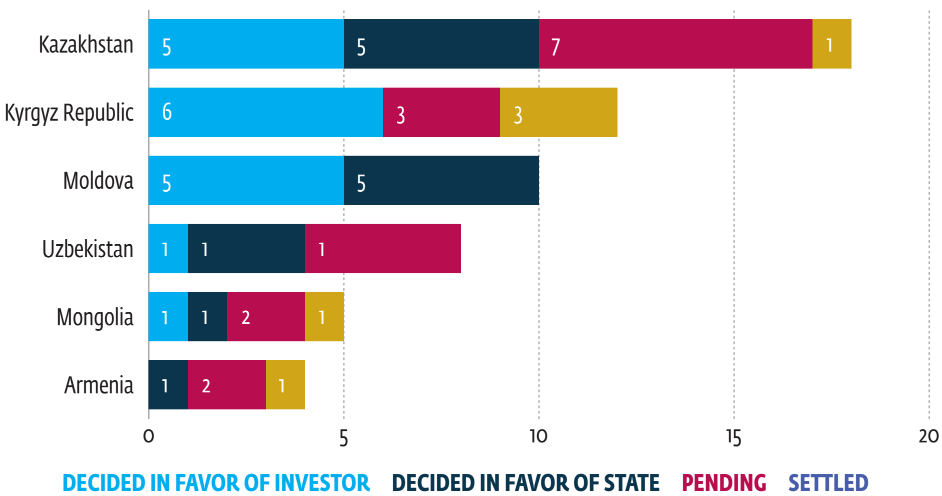


Source: WBG Survey of Foreign Investors 2015.

or notification of other stakeholders in the process; and inconsistency in governmental decisions and actions as significant obstacles. In addition, around 40 percent of investors thought that there is some level of discrimination against foreign investors in favor of local ones (figure 3.3).

The Kyrgyz Republic has one of the highest numbers of international disputes in which the state is a respondent among comparable countries in the region (figure 3.4) (UNCTAD 2019b). Cases are for the most part decided in favor of the investor, confirming 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.[30] The majority of the cases involve state breaches of investment agreements. Furthermore, a mechanism to prevent escalation of investor grievances into international investment disputes is missing.

FIGURE 3.4 INTERNATIONAL INVESTOR-STATE DISPUTES INITIATED BY INVESTOR, 1996–2018 (NUMBER OF CASES)



Source: UNCTAD Investment Dispute Settlement Navigator.

There is a need to develop a strong PPP Framework. The gap in financing for infrastructure development required in the near term is significant and can only be filled by considerably increasing private investment. 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. In reality, infrastructure financing needs are about US$5 billion in the medium to long term and cover the span of national highways, railways, and bridges; hydropower development; regional connectivity through EAEU; and a long list of public infrastructure facilities that require repair, construction, and effective management. Developing PPPs could be a game changer for the Kyrgyz Republic in its efforts to mobilize resources for infrastructure development in the post-COVID period, but the country lacks implementation capacity. The PPP Law approved in 2019 by Parliament outlines the government's objective of increasing the number of PPPs as laid out in the National Development Strategy with a simplified process for selection of a private partner in line with successful international practice. The country lacks a PPP authority with inter-ministry coordination, though, by which it could support adoption of the 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. The central PPP unit in the Ministry of Economy (MoE) was established in 2012 to coordinate across governmental agencies. It was entrusted with providing all the technical support and advisory work to the line ministries and agencies that generate the preliminary list of projects to be assessed for participation by the private sector. Nevertheless, PPP implementation capacity is still very small, and effective coordination between the government and the private sector is insufficient. Without dedicated staff to advance PPPs through an enabling framework and implementation of the PPP law, there have been just two PPPs signed in the Kyrgyz Republic in contrast to over 800 in Kazakhstan.

POLICY ACTIONS ON CROSS-CUTTING CONSTRAINTS FOR PRIVATE SECTOR–LED GROWTH

The Kyrgyz Republic can use this crisis to build a foundation of reforms that can unleash the growth potential of Kyrgyz firms through formalization and contribute to revenue mobilization, job creation, productivity, and competitiveness in a more diversified economy. Demonstrating that the Kyrgyz Republic is open for business requires a stronger policy environment in order to encourage the private sector to take advantage of new investment opportunities. The country's growth trajectory has evolved in a way that presents considerable barriers to SMEs and foreign investors keen to engage in sectors outside of well-established extractives. The COVID-19 crisis has magnified the vulnerabilities in this growth model. The time has come for reforms in relation to many cross-cutting issues. For a small, landlocked country with a relatively open economy, diversification, regional integration, and competitiveness must be core principles driving its private sector development plan. Below is a table outlining high-priority reforms addressing the cross-cutting constraints presented in the previous chapter.

TABLE 3.1 HIGH-PRIORITY CROSS-CUTTING POLICY REFORM RECOMMENDATIONS

	NEAR-TERM ACTIONS, OR "LOW-HANGING" FRUITS	MEDIUM-TERM ACTIONS TO SUPPORT BROADER RECOVERY
Reducing the regulatory burden	**Tax Regime:** • Lower the patent regime threshold and differentiate between microenterprises and small businesses. Incentivize small business registration of patents. • Fully digitize the tax registration procedure and databases.	**Trade:** Ensure animal-origin product traceability in dairy, meat, and horticultural products and align the process with EAEU and Chinese requirements.
	Inspections: Create a central inspectorate body to coordinate all inspections, and eliminate overlaps in inspection competencies provided per secondary and sectoral regulations.	**Inspections:** Create a central inspectorate body to coordinate all inspections, and eliminate overlaps in inspection competencies provided per secondary and sectoral regulations. • Create e-inspection management system to enable data interoperability and coordination of inspections. • Develop risk-based inspection checklists and dynamic risk models for inspection.
	Administrative procedures: Fully digitize the e-register and online one-stop shop for all permissive documents.	**Administrative procedures:** Create regulatory quality mechanism: for every new regulation adding a new burden for the private sector, two existing ones must be abolished.
Attracting private investment, with a focus on FDI	**PPP framework:** Build awareness and implementation capacity among line ministries and the Ministry of Finance in implementing PPP deals.	**PPP framework:** • Establish a dedicated PPP development agency as the main state authority responsible for generating PPP guidelines and maintaining transparency throughout the PPP process. • Ensure proper budgeting for the government's share of PPP deals.

PART II: SECTORAL ANALYSIS

Moving to the next stage of development requires structural reforms to attract and facilitate private investment among enabling sectors that address significant cross-cutting challenges. Reforms would also need to target high-potential service sectors that offer diversified sources of growth, employment, and opportunities for PPPs, reducing the government's fiscal burden. *This section analyzes sectors and enabling areas that offer opportunities for greater private sector participation based on investment momentum prior to the pandemic outbreak and that present fewer barriers to entry and growth post-COVID. Sectors examined include energy, transport and connectivity, digital infrastructure and economy, financial services, and tourism.*

METHODOLOGY AND SECTOR SELECTION CRITERIA

In addition to offering a macro-level view of market opportunities for the private sector, the CPSD also takes a sector-specific approach by identifying opportunities in potential high-growth areas in the Kyrgyz economy. The report applied the following selectivity filters to determine the sectors of focus:

- **Leveraging the WBG's ongoing CPF implementation and opportunities for engagement.** The CPF is focusing on sustainable agribusiness and supporting value chains, deepening and diversifying the financial sector, and enabling private investments and PPPs in support of infrastructure development in energy, connectivity (tourism and transport), ICT, health, and education.

- **Leveraging the Kyrgyz Republic's competitive advantages.** While it has not scored well in indexes that measure competitiveness and innovation, the Kyrgyz Republic does possess natural and human assets that could give it a competitive advantage in specific areas. The country is blessed with abundant hydropower that it could export to its neighbors. The Kyrgyz economy also produces certain goods— notably some food products and garments—that have either already filled niches in neighboring markets or have the potential to do so. It also boasts significant human capital. The Kyrgyz Republic is classified as a "medium human development" country, ranking behind El Salvador and just ahead of Morocco in the United Nations Development Program's Human Development Index. Also, its evident growth in the ICT sector in recent years shows potential.

- **Political economy** and other factors on the ground make some sectors ripe for engagement, whereas others call for a longer-term approach.

The CPSD uses a standardized methodology to assess the enabling (infrastructure, ICT, health, and education) and "nonenabling," or traded, sectors (agriculture and food processing, light manufacturing, mining, and tourism) through the lens of the filters noted. A sector scan was conducted using standardized CPSD quantitative methodology, and it resulted in the selection of the financial and tourism sectors, combined with the "digital agenda," as the focus areas for the Kyrgyz Republic CPSD. Annex 1 summarizes the key opportunities and challenges for each of the sectors analyzed. The chapters below present detailed analysis of energy, building a digital economy, regional connectivity, financial services, and tourism. Tourism faces considerable challenges to its potential development due to the COVID-19 pandemic and is therefore examined for its longer-term potential only. A more detailed analysis of the sectors is presented in Annex 4.

4. ENSURING SUSTAINABLE AND RELIABLE ENERGY ACCESS

Main message: *A reform priority for the government is creating and preserving fiscal space for investment in enabling infrastructure. Reforming energy tariffs is topmost among those priorities. The energy sector is also a critical enabler of investment, innovation and potential industrial expansion (assuming the existence of necessary infrastructure). This can be achieved by providing energy access in a financially sustainable manner, which requires attracting private investment to the sector. Hydropower is one subsector that can provide such access, in addition to its potential for regional exportability. While the effects of COVID-19 will relax the pressure for massive expansion of generating capacity in the short term, the Kyrgyz government has gained this window of opportunity for reforming the sector by capitalizing on a more commercially attractive investment proposition in renewable power.*

Energy is a critical enabler of economic growth and underpins private sector activity. Increasing the reliability and lowering the costs of electricity can directly and indirectly affect private sector competitiveness and diversification efforts. This sector is also a critical enabler for investments, innovations, and industries that have potential to expand if the necessary infrastructure is in place. In the case of the Kyrgyz Republic, the challenge is twofold: the Kyrgyz economy must expand new sectors for diversified growth and boost productivity. This means the top reform priority for the Kyrgyz government is creating and preserving fiscal space for investment in enabling infrastructure, including through the reform of energy tariffs. The COVID-19 crisis poses considerable risks to fiscal revenues. Maintaining fiscal space, particularly for effectively targeted spending, then, is a top priority that requires a market-oriented approach to the reform of the Kyrgyz energy sector. The review that follows pulls together the main performance issues and challenges in the energy sector in the Kyrgyz Republic and identifies the priority policy actions needed to increase reliable and sustainable energy access with private sector participation.

Increasing access to sustainable and reliable energy supply is even more urgent for COVID-19 recovery, because the sector is a significant fiscal burden when fiscal pressures are increasing. These goals were important for the Kyrgyz economy even before the pandemic outbreak, during which time the country had begun to face a depletion of nearly 40 percent of its export base and 20 percent of fiscal revenues stemming from gold mines. According to the Kyrgyz authorities, revenue losses might rise as high as 6.5 percent of GDP for the full year. The World Bank states that sector debt amounted to about 18 percent of GDP at the end of 2018. Now, increasing fiscal pressure related to spending targeted at COVID-19 response is putting greater pressure on the government to adopt reforms for improving the financial sustainability and off-take creditworthiness of power utilities. The key challenges to unlocking the potential of the energy sector and therefore realizing economy-wide spillover effects for firms are twofold: the Kyrgyz economy must confront financially unsustainable operations that deter private investors and also unreliable access without adequate generation capacity.

THE ENERGY SECTOR IS DOMINATED BY SOEs

SOEs remain a dominant player in the energy sector. Although the number of SOEs has substantially decreased since the 1990s, the number is still significant (table 4.1), so SOEs maintain a continuing presence in strategic or economically important sectors of the Kyrgyz economy such as energy, mining, railways, and banking. SOE contribution to GDP is low,[31] however, and they employ a modest 2 percent of the working-age population. The energy sector comprises the bulk of SOE assets and holds the largest share of liabilities among all SOEs in the country. Energy sector assets account for 62 percent of all nonfinancial assets of SOEs and over 91 percent of nonfinancial liabilities, which is equivalent to 21.2 percent of the country's GDP. The energy sector's leverage is quite high, with a debt-to-equity ratio (where debt is equal to liabilities) of approximately 1.5:1. Total liabilities of energy SOEs are nearly eight times their equity, which indicates an unsustainable level of indebtedness.

TABLE 4.1 THE NUMBER OF ENTERPRISES WITH STATE CAPITAL BY SECTOR

	OPEN JOINT-STOCK COMPANY SOEs	STATE ENTERPRISES (SEs)[32]
Fully owned by the government	16	not available
Government has majority ownership stake	22	not available
Limited-liability company[33]	1	not applicable
Total	**39**[34]	**104**[35]

Source: State Property Management Fund.

Note: In addition to these, the Kyrgyz government has a minority stake in another 15 enterprises.

While the energy sector holds the largest percentage of assets relative to other sectors, it is the only sector among SOEs that operates at a loss. Energy SOEs reported a combined loss of 9.3 billion soms for 2017 and 3.4 billion soms for 2018. SOEs in other sectors such as the financial sector have performed relatively well historically. In 2018, for example, state-owned financial institutions[36] experienced a 54 percent increase in net income. Overall, Kyrgyz SOEs have been posting aggregate profits for the past five years, and in 2018, nonfinancial SOEs reported an aggregate profit of 1.3 billion soms. This represents a substantial improvement from 2017, when nonfinancial SOEs incurred a loss of nearly 4 billion soms.[37]

CHALLENGES TO THE KYRGYZ ENERGY SECTOR: COST RECOVERY AND ATTRACTING FOREIGN DIRECT INVESTMENT (FDI)

The top challenge for the Kyrgyz energy sector is the lack of cost recovery, in part because Kyrgyz tariffs are among the lowest in the world. Residential users, who constitute 52 percent of consumption, pay US$0.01 per kilowatt hour, a tariff which covers 45 percent of the cost of service. The result is that the Kyrgyz government can not cover costs to prioritize operations and maintenance for reliable supply or invest in new generation capacity. Building capacity is necessary to ensure that power supply will be reliable, cost-effective, and supportive of downstream development in potential high-growth sectors, which will hopefully ensure that investors will expand their investments in the country. Furthermore, the country's significant subsidies (accounting for about 3 percent of GDP) are ineffectively targeted towards vulnerable households and instead disproportionately benefit the rich. While a reform of the institutional structure of the sector was announced in 2018, promising a possible reestablishment of the Ministry of Energy's policy leadership, no concrete proposals or plans have been announced since then. In addition, as the sector runs at a loss, quasi-fiscal deficits consisting of uncompensated foregone revenues and government-mandated or government-encouraged expenditures further increase contingent liabilities and fiscal risks.

The other main challenge for the sector is attracting private investors to help unlock the potential of the country's abundant hydropower resources as electricity demand increases. The Kyrgyz Republic can reap the full benefits of private sector–led growth if energy access is provided in a financially sustainable manner that can attract investors into the sector, including through potential PPPs. Uzbekistan's Ministry of Energy has utilized at least six PPPs as of March 2020 to update infrastructure, ensure energy security for firms and consumers, and proactively attract investments to the sector with a particular focus on renewables. The Kyrgyz government could use such models to facilitate private sector participation in renewables such as solar, as well as in the small- and medium-sized hydropower sector.

HYDROPOWER: A PROMISING RENEWABLE ENERGY ASSET

A subsector with particular potential for private investment is hydropower. The Kyrgyz Republic's untapped hydropower potential is enormous. The country's installed capacity of 3.1 gigawatts puts it in 40th place globally. The Kyrgyz hydropower potential is estimated at 140 to 170 terawatts, the 56th-largest in the world, only 10 percent of which is currently being used (Izvorski and others 2020). Increasing installed generation capacity is essential as the Kyrgyz Republic faces both growth and challenges in the seasonality of demand. Consumption increased 71 percent in the 2007–18 period while winter consumption was 2.6 times greater than that of summer in 2017. As a result, the country turned to electricity imports starting in 2014 to meet demand, despite its rising export and revenue generation potential as demand across the region increases. The Central Asia-South Asia (CASA) 1000 transmission line that would connect the Kyrgyz Republic and Tajikistan is expected to start operations in 2023, allowing the export of clean energy to the growing South Asian markets of Afghanistan and Pakistan. Exports via the new high-voltage line can generate an estimated US$90 million annually during the spring and summer months when surplus generation is available in the Kyrgyz Republic.

The energy sector in the Kyrgyz Republic has the potential to transform the country's economy with a new growth model that supports domestic industrial development and export-oriented sectors reaching regional neighbors and beyond. This requires the Kyrgyz energy sector to increase investment and diversification in energy sources such as hydropower and solar, accompanied by broad-based reforms of current policies. One of the main challenges going forward is the increasing risk to the security of the country's supply. The recent analysis undertaken by the World Bank indicates a significant supply-demand deficit in the electricity sector starting in 2020, which may possibly continue deteriorating in the future. In the case of no new generation capacity being commissioned in the medium term while waiting for the CASA 1000 project to come online in 2023 the deficit on an annual level could amount to between 900 to 3,000 gigawatt hours, depending on hydrological conditions. One of the means to close the medium-term gap is to focus on medium-size hydropower plants and solar projects. Another main challenge with the current dependence on hydropower is the seasonality of demand and supply. This is because of inflow regulation by the Toktogul Reservoir. Hydropower generation is concentrated in the winter, a time when electricity demand spikes because of indoor heating needs, whereas in the summer, the water is stored to enable winter generation and avoid overflows resulting from excess supply. As a result, additional reliance on thermal power is necessary during the winter, which is often generated from old, inefficient power plants and meanwhile, the country imports gas, heavy fuel, and electricity (more recently) during these peak energy-use months.

The World Bank has highlighted the potential for both regional integration and increased private investments if the Kyrgyz Republic could work towards a common energy market in the EAEU. Such a market would make possible a free flow of energy resources, competitive conditions and market-based pricing, regulation of natural monopolies in production and transit, coordinated tariff policies, and joint development of infrastructure. The International Finance Corporation (IFC) has been closely engaged with the World Bank team advising the Kyrgyz government with the aim of assessing potential for private participation in hydropower financing. There is no ministry of energy, which further deters investors in working with the Kyrgyz government on a bankable pipeline of projects. Furthermore, there is limited interest from international investors in the Kyrgyz Republic's energy sector, partly because of the performance issues noted but also because of the lack of scale, unlike the energy sector in neighboring Uzbekistan, which is undergoing major reforms and attracting FDI. While a sound PPP framework could open up the sector to greater numbers of PPPs, strong counterparts to the Uzbek energy sector's best practices are essential, and this is currently lacking in the Kyrgyz Republic.

GOVERNMENT REFORM PRIORITIES FOR PRIVATE INVESTMENTS IN ENERGY

Several policy actions are essential for improving the enabling environment in terms of economics, finance, and bankability. Current limiting factors that must be addressed include below-cost recovery tariffs, an absence of creditworthy off-takers and government guarantees, and the lack of a clear legal framework (the current framework contains considerable gaps). While the cost of power is low, getting access to it is extremely difficult for both new businesses and construction projects. Main policy actions include (a) strengthening the sector's financial viability; (b) replacing quasi-fiscal budget deficits with explicit subsidies; (c) protecting the poor and vulnerable from price adjustments; and (d) improving the regulatory framework for hydropower development.

The Kyrgyz government has an opportunity to increase the urgently needed fiscal space for economic recovery by implementing a financially sustainable growth model that leverages new generation potential with significantly greater private sector participation. To achieve this, the government must now undertake reform measures to achieve financial sustainability, institutional capacity building, and transparency.

Unlocking the potential of the energy sector does not have to be a long process: indeed, a motivated president could issue decrees to modernize the sector, such as was recently done in Uzbekistan. The following reforms (table 4.2) outline priority reforms to the sector that could be achieved within the CPSD time frame and that build upon WBG analysis and projects.

TABLE 4.2 THE KYRGYZ REPUBLIC ENERGY SECTOR DEVELOPMENT PRIORITY REFORMS

	NEAR-TERM ACTIONS, OR "LOW-HANGING" FRUITS	MEDIUM-TERM ACTIONS TO SUPPORT BROADER RECOVERY
Cost recovery reforms	**Hydropower:** Improve the regulatory framework for small-scale hydropower development, which includes fostering transparency and communication through governance reforms.	**Hydropower:** • Establish mechanisms to smooth volatile hydropower revenues. • Revise the regulatory framework for hydropower and other renewable energy forms and procurement so that project development is a competitive, transparent process.
	Tariffs: Implement the government's plan to increase tariffs to put the sector on a financially viable path that will stem technical and non-technical losses.	**Governance:** Increase accountability of sector companies by using consistent monitoring of key performance indicators and their publication, and credible initiatives to strengthen the oversight function of the company board.
PPPs and regional integration	**Regional:** Learn from the successes of neighbors such as Uzbekistan, where presidential decrees allowed for seemingly difficult reforms (breaking up the state-owned energy giant and investments in new sectors such as solar).	**PPP framework:** • Use PPPs or instruments such as build-own-transfer and build-own-operate vehicles. • Look at issuance of public bonds, such as green bonds in line with environmentally sustainable priorities for project development.

5. PROMOTING EXPORT-ORIENTED SECTORS THROUGH GREATER CONNECTIVITY

Main message: *For a small, landlocked country with an export-oriented growth strategy, building productive infrastructure assets and improving service delivery will positively affect costs for firms and improve competitiveness, yet all three transport modes in the Kyrgyz Republic (air, road, and rail) are severely constrained by the poor state of their infrastructure. Public investment in infrast ructure has grown over the past five years, but there is little fiscal space to continue such growth in investment. This calls for a strategic approach that must include the crowding-in of private capital.*

Poor connectivity infrastructure is one of the most significant binding constraints on increasing the diversification sources of future growth. Growth is severely constrained by the poor state of the connectivity infrastructure. Given its structural constraints as a small, landlocked market with steep mountainous terrain, the country is distant from both the regional commercial centers and the global supply chains necessary to support diversified export-driven growth. Although public investment in infrastructure has grown over the past five years to 7.6 percent, there is little fiscal space to continue such growth in investment. Nearly half of the country's GDP is created by service industries and about 40 percent by goods production, but the transport and storage of goods accounts for less than 4 percent of all services. This suggests that transport and warehouse logistics have not been fully developed to accommodate the current and growing markets the country seeks to unlock. This point is reiterated in the CEM, which notes that many firms are vertically integrated with their own transport and logistics services that could be more efficiently outsourced if a competitive market existed. This is a market failure that requires reforms by the Kyrgyz government to facilitate private investments in the development of the transport and logistics sectors.

Regional trade depends heavily on road transport, but density and quality are low while costs are high. Roads dominate the Kyrgyz Republic's transport system, accounting for approximately 95 percent of cargo and 96 percent of passenger traffic in 2015 (Asian Development Bank 2016). The quality of road connectivity, though, is one of the lowest in the region, ranking 110th out of 141 economies according to the World Economic Forum (WEF) Competitiveness Index 2019. Its lowest-performing areas were international shipments, logistics competence, and quality of trade and transport-related infrastructure. Only 38 percent of the road network, for instance, is paved. The Kyrgyz railway network is moreover characterized as limited in coverage, reliability, and efficiency. The country's rail density lags behind that of neighboring countries in the region, ranking 86th out of 141 countries compared to Tajikistan, which is 72nd, and

Kazakhstan, which is 66th (WEF 2019a). Further, the technical and gauge standards of the Kyrgyz rail network are not compatible with those of China, hampering development between those two countries. Railways are also state-owned, dilapidated, in need of significant upgrades, and unreliable.

Air connectivity is also significantly limited, and the country has the lowest amount of traffic and number of direct links in the region. The number of direct flights (26, most of them going to Russia) and air carriers (only 13) limits air travel. Because of poor safety practices, all Kyrgyz airlines are banned from flying to the EU. Within the broader region, only Tajikistan has fewer direct flights and carriers. Consequently, the WEF Competitiveness Index 2019 ranks the Kyrgyz Republic's air connectivity at 104th of 141 economies (WEF 2019a). Air connectivity challenges to private sector–led development in tourism is further explored in Chapter 8.

GOVERNMENT REFORM PRIORITIES IN CONNECTIVITY INFRASTRUCTURE

Investments in connective infrastructure would not just support private investment, create jobs, improve access to markets, and lower the cost of trade. They would also facilitate the delivery of services and internal labor mobility. The associated efficiency gains would also reduce business costs and reduce the pressure and reliance on natural resources. Improved rural connectivity can stimulate SME development in rural areas, allowing lagging regions to catch up economically. The main priority actions for the government as far as addressing connectivity challenges include (a) facilitating successful PPPs; (b) raising commercial finance for SOEs; (c) promoting regional integration across all three transport modes for increased market access; and (d) leveraging the Belt and Road Initiative (BRI) for the development of transportation and other sectors such as agriculture through the building up of cross-border and transit capacity.

TABLE 5.1 THE KYRGYZ REPUBLIC PRIORITY REFORMS TO ENCOURAGE INVESTMENT IN CONNECTIVITY INFRASTRUCTURE

	NEAR-TERM ACTIONS, OR "LOW-HANGING" FRUITS	MEDIUM-TERM ACTIONS TO SUPPORT BROADER RECOVERY
PPP framework	Invest more in capacity upgrading for the assessing and oversight of projects.	Close the regulatory implementation gap for successful PPPs.
Program implementation	Use existing data to evaluate various dimensions of institutional readiness within the sector, especially those that can expand the set of domestic and international financiers and investors and those that can improve financing terms and conditions.	Develop approaches that raise commercial finance for SOEs and government authorities for asset management or greenfield and brownfield assets.
Regional integration	**Air transport:** • Invest in links with neighbors that involve opportunities for leveraging logistics centers and warehousing facilities. • Reform supporting regulation and governance for service exports.	**Air transport:** Expand air links by upgrading Manas International Airport, potentially through a PPP.

6. ENABLING A DIGITAL ECONOMY

Main message: *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. These processes significantly reduce the cost of doing business. Additionally, extensive deployment of broadband accelerates innovation by introducing new consumer and government applications and services (in other words, new forms of commerce and financial intermediation). ICT is also a key development stimulus in several sectors, particularly digital finance. Currently, the Kyrgyz telecom sector lacks competitiveness because of limited competition and infrastructure sharing that result in low access and quality. The country needs to catch up in terms of households with internet access, mobile applications development, use of virtual social networks, internet shopping, ICT use, and government efficiency.*

THE KYRGYZ TELECOM SECTOR IS NOT COMPETITIVE IN THE FIXED BROADBAND SECTOR BUT RELATIVELY COMPETITIVE IN WIRELESS CONNECTIVITY

The Kyrgyz broadband sector remains small with low household fixed broadband penetration rates and speeds compared to benchmark countries. As of March 2020, the household penetration rate was 15.4 percent, which is significantly lower than the average penetration rate for the region (59.8 percent).[39] The market consists of nine wholesale providers,[40] each having their own fiber networks. Aside from the wholesale providers, each of the mobile network operators—Alfa Telecom, Sky Mobile, and Nurtelecom—have their own fiber-optic cable for supporting wireless data and voice services. The fixed retail broadband market is dominated by KyrgyzTelecom which covers approximately 65 percent of the retail market share and has the most extensive fiber footprint: as of the third quarter of 2019, KyrgyzTelecom's network was over 5,500 kilometers long (see figures 6.1 and 6.2).[41] The wireless penetration rate in the Kyrgyz Republic is relatively high (122.2 percent versus 85.3 percent across the region) and the segment is more competitive when compared to broadband (figure 6.3).

FIGURE 6.1 RETAIL SUBSCRIBERS MARKET SHARE BY PROVIDER AS OF MARCH 2020

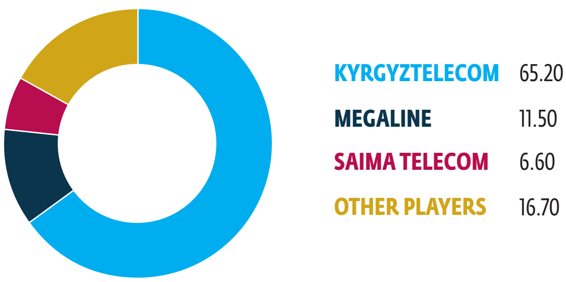


FIGURE 6.2 LENGTH OF FIBER-OPTIC CABLE LINES AS OF SEPTEMBER 30TH 2019

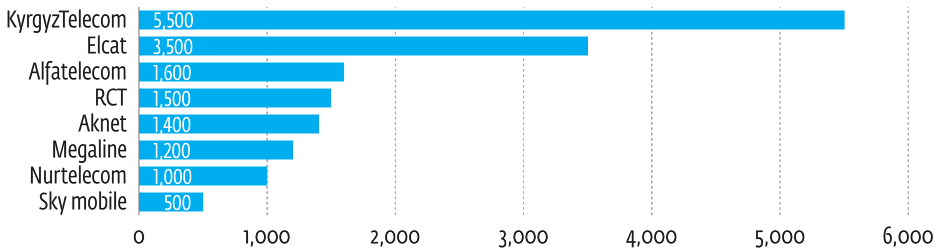
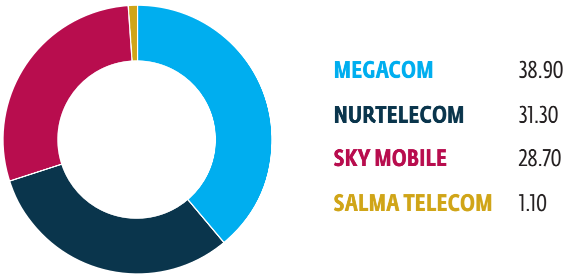


FIGURE 6.3 TOTAL SUBSCRIBERS MARKET SHARE BY NETWORK AS OF MARCH 2020



The Kyrgyz fixed broadband sector lacks competitiveness because of limited competition and infrastructure sharing. Global good practice recommends encouraging competition in the core backbone market and infrastructure sharing in the middle- and last-mile markets. Most countries with higher levels of penetration than the Kyrgyz Republic have several competing backbone providers that own fiber-optic infrastructure, most of them privately owned. The mountainous terrain of the Kyrgyz Republic poses particular challenges for telecom infrastructure deployment, but the lackluster performance of the market is also a result of the reluctance of the incumbent to modernize and improve current broadband market structures because of its high level of debt leverage (short-term and long-term), organizational structure inefficiencies, and poor quality of personnel training (box 6.1). In addition, there are concerns that

BOX 6.1 KYRGYZTELECOM

KyrgyzTelecom (KT) is a state-owned, fixed-line incumbent operator. It is owned by the Kyrgyz goverment (77.84 percent), the Kyrgyz Republic`s Social Fund (12.51 percent), individual investors, and legal entities (9.65 percent). As of the third quarter of 2019, its network was over 5,500 kilometers long. KyrgyzTelecom's fiber backbone has multiple cross-border interconnections with Kazakhstan, plus international terrestrial fiber connections to China, Tajikistan, and Uzbekistan, and in December 2017, it launched an alternative fiber link to Tajikistan (at Karamik in the Osh region).

KT has maintained a leading retail ISP market share that has been growing in recent years (it reached 65 percent by the end of June 2019). This consistent dominance of the retail market is due to KT's dominance of the wholesale backbone connectivity market, its internal cross-subsidies, and its ability to discriminate against competitors by charging prices for access to its infrastructure that are not based on underlying costs.

KT's fiber network suffers from quality issues and is not buried deeply enough along certain segments, which leads to network outages. The most recent publicly available financial report lacks any investment plans. Moreover, KT is heavily indebted to the Export-Import Bank of Korea and struggles with financial mismanagement. One incident of improper use of resources was the termination of contracts for the lease of data transmission lines (channels) to private companies at an underestimated cost or on deliberately unfavorable terms.

KyrgyzTelecom will gain a bigger share of the retail broadband market because of a lack of enforcement of competition policy. Other factors that hinder growth in the broadband sector include, for example, the legislation on urban planning that failed to adopt fiber installation in new buildings as a new civil engineering standard and the lack of infrastructure sharing regulation in Kyrgyz law relating to electrical and postal communications.

The Kyrgyz telecommunications and mobile markets have made gains in access, but there is room for greater inclusion and lower costs (National Institute for Strategic Studies of the Kyrgyz Republic 2017). The value-added of the ICT sector, which includes publishing, broadcasting, telecommunications, and computer and information services grew at an estimated 9.5 percent in 2016, contributing about 1.9 percent to the country's GDP and 0.2 percentage points to the overall GDP growth rate of 3.8 percent.[42] While the government retains control of the fixed-line operator (Kyrgyz Telecom) and the largest mobile operator (Alfa Telecom), the consumer marketplace is relatively competitive with three major mobile operators. Mobile penetration has replaced the fixed-line market gradually, even though the existing backbone infrastructure is an advantage. Regional disparities are a challenge, as only about 30 percent of Kyrgyz households have access to computers and tablets, and in rural areas, just 19 percent of households have access (in contrast to 44 percent in urban areas). Wholesale international bandwidth costs are relatively low at the monthly rate of US$22 per megabyte second, compared to Tajikistan (US$100) and Uzbekistan (US$91), but higher than Kazakhstan (US$12) and Russia (US$2). Through the Digital CASA project, the World Bank is seeking to reduce the cost of bandwidth to US$10 per megabyte second in five years and increase international internet bandwidth.

THE KYRGYZ REPUBLIC IS LAGGING IN ITS DIGITAL TRANSFORMATION

The Kyrgyz Republic is falling behind its peers in the Network Readiness Index Ranking, ranking 91st out of 121 countries in 2019. In comparison, Russia is ranked 48th and Kazakhstan is ranked 60th. The country needs to catch up in terms of households with internet access, mobile applications development, use of virtual social networks, internet shopping, and ICT use and government efficiency. Nevertheless, the Kyrgyz digital innovation sector has shown steady growth over the last six years, according to the Global Innovation Index (GII), and is ranking increasingly higher compared to its regional peers—going from 117th place in 2013 to 90th in 2019—with Kazakhstan ranked higher (79th) and Tajikistan (100th) lower. The GII emphasizes creative outputs such as intangible assets, creative goods and services, and online creativity as the areas needing the most improvement.

The platform market in the Kyrgyz Republic is relatively small and emerging, and there is a limited availability of secure online content (particularly services accessible and relevant to local populations). Digital platforms, defined as multi-sided marketplaces with business models that enable producers and users to create value together by interacting with each other,[43] have become an essential component of the digital economy. Most of these private digital platforms are concentrated in Asia and North America (China and the United States, in other words), and many of them enjoy dominant positions in several markets globally. By contrast, digital platforms from developing countries still have very limited market power. In the Kyrgyz Republic, the developing digital platform market is relatively small and uses B2C business models, and it represents the core of the market. Domestic platforms are launched in such niches as e-commerce, classifieds, online tickets, construction, and transportation services. Domestic food delivery and taxi platforms are also gaining momentum. Still, it is characterized by only a few local startups. E-commerce platforms are also among the most popular. According to a recent World Bank study,[44] domestic e-commerce platforms have been operating but are not sufficiently developed yet for active use by the population, mostly because service design is not user-oriented. The Kyrgyz Republic notably lags behind Kazakhstan and Uzbekistan in e-commerce progress, although it has slightly increased in recent years (UNCTAD 2019a). Platforms in the energy, health, transportation, and tourism sectors are either absent or limited to information portals. It is generally local banks that have developed financial platforms, while a few local companies and startups have developed their own payment tools. In 2019, use of internet banking was fairly small: 15 percent of the population used such services, and up to 5 percent made sales and purchases online. A relatively small internet user base, low online sales, barely affordable connection rates, and low household broadband penetration rate limit the growth of these platforms. Another crucial constraint is the digital divide within the country. The critical mass of users is concentrated in the larger cities of Bishkek and Osh, where most of the domestic and foreign platforms operate. Lack of regulation of digital platforms at the legislative level also acts as a deterrent to their development, although other laws that could boost e-commerce progress have been adopted, such as the 2017 law regarding electronic signatures.

To spur local digital platform development, policy makers need to enable scalable broadband infrastructure (especially in rural areas) and also create an empowering regulatory environment and an effective data interoperability and management policy. Large Russian platforms are taking over social media, web search engines, taxi services, and many other platforms, and these are crowding 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. The emergence and growth of local companies is consequently strongly constrained, although domestic platforms do seem to hold one comparative advantage: limited accessibility due to language barriers. Digital platform adoption in 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, the development of trust, privacy, secure transactions, and online dispute resolution would expand the user base of domestic platforms.

The country is lagging behind peers in terms of greenfield FDI in the communications and ICT sectors. According to FDI market data, the Kyrgyz Republic received the lowest amount of capital investment regionally between 2015 and 2020 (US$56.2 million), compared to six times as much in Tajikistan (although the country is only 1.5 times bigger in population) and ten times more in Kazakhstan and Uzbekistan. The Kyrgyz Republic received greenfield FDI in radio and TV broadcasting, communications equipment, and internet publishing and software. Its peers also included investments in wireless communication carriers, data processing, and hosting. Engagement of venture capital for startups can help to accelerate platform development in various sectors of the economy, while the creation of crowdfunding portals can provide new sources of funding for companies that can not attract capital from traditional sources.

TABLE 6.1 SUM OF CUMULATIVE CAPITAL INVESTMENTS ANNOUNCED AND OPENED BETWEEN 2015 AND 2020 FOR THE COMMUNICATIONS, SOFTWARE, AND IT SUBSECTORS (PER COUNTRY)

COUNTRY	POPULATION (THOUSAND PEOPLE, 2019)	CAPITAL INVESTMENT (US$ MILLIONS)	JOBS CREATED
Kazakhstan	18,513.93	572.9	1,346
Kyrgyz Republic	6,456.90	56.2	305
Tajikistan	9,321.02	301.1	804
Uzbekistan	33,580.65	528.6	1,201
Grand Total		**1,458.8**	**3,656**

Source: FDI markets database accessed July 2020.

INVESTMENT IN DIGITAL INFRASTRUCTURE AS AN ENABLER FOR KEY SECTORS

High-speed, reliable telecommunication infrastructure is a fundamental tool for economic development: it forms the foundation for the business processes and applications of the digital economy. Data streams passing through networks and data centers, structured and enriched by market players through digital platforms, allow the economy to form a digital picture of the world. This then gives the state, market players, and private consumers access to a range of digital services. Telecom technology is a contributor to economic growth at several levels. First, 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 the streamlining of supply chains, and it significantly reduces the cost of doing business. Second, extensive deployment of broadband accelerates innovation by introducing new consumer applications and services such as new forms of commerce and financial intermediation. Third, broadband allows enterprises to access inputs and markets more effectively by expanding their reach to labor pools, raw materials, and consumers through the outsourcing of services and virtual call centers (Katz 2012).

Additionally, the broader economic benefits of improved telecom infrastructure and increased access are significant. Multiple studies have shown that on average, approximately 80 new jobs are created for every 1,000 additional broadband users.[45] This would mean that full broadband deployment in the Kyrgyz Republic could create up to 500,000 new jobs. Moreover, according to the World Bank, low-income countries experienced about a 1.38 percentage point increase in GDP for each 10 percent increase in broadband penetration. In the Kyrgyz Republic, this means that in the eventuality of an 80 to 90 percent broadband penetration, the economy would enjoy 11 to 12.5 percent GDP growth (approximately US$930 million to US$1.055 billion).[46] Broadband allows for job creation through three key channels: (a) job positions created specifically for the deployment of broadband infrastructure (telecommunications technicians, construction workers, and manufacturers of telecommunications equipment); (b) job positions created as an indirect result of broadband deployment (distribution workers, transportation industry specialists, electric engineers); and (c) household spending based on the income generated from the direct and indirect jobs which fuels growth in employment in other sectors (Katz 2012).

In the Kyrgyz Republic, telecommunication technologies have been used to modernize the banking sector, but their adoption so far has been limited. As competition grew in the banking sector, banks started using new technologies such as SMS notifications as an information service for bank account owners to provide information on the initiatives of the bank or on the client's account. There is, though, much room for improvement, not only in client service delivery but also in mobile service affordability and revenue-cost optimization of financial institutions. Sberbank and Tinkoff banks are both examples of this application (box 6.2).

BOX 6.2 HOW SBERBANK AND TINKOFF BANK CREATED NEW REVENUE STREAMS AND SAVED COSTS THROUGH MOBILE TECHNOLOGY

Sberbank (Russia) saves about US$10 million annually by integrating a mobile player into its operating model just by replacing SMS notifications with its own push notifications. Tinkoff Bank (Russia) achieved similar results by integrating Tinkoff mobile applications into its operating model. This is because push notifications significantly decrease the cost of interaction with the client for the bank and consequently for the client. This has the potential to change mobile market structure by freeing resources that were previously spent on SMS notifications. These free funds can then be reallocated from telecom operators and used to introduce new client services. When a customer acquires an account, for example, they can acquire a mobile account as well. With this new asset, banks can offer service bundles to its customers (online music, pay TV, and so on) that provide new revenue streams. This is one of many examples where mobile technology can allow banks to make inquiries unnecessary, save time, improve service delivery, reduce costs, minimize risks, and introduce additional services.

Mining, extraction, and tourism are other sectors that could greatly benefit from the use of telecom infrastructure through improved connectivity. Broadband high-speed internet access allows enterprises in hard-to-reach areas to connect, which in turn enables the monetization of existing mineral resources and optimization of production processes. Broadband also supports companies in managing their supply chains more effectively by automating processes such as the processing of purchase orders, invoices, financial transactions, and operations. Broadband helps to deliver data faster, easier, and more securely than was previously possible, which in turn substantially increases the competitiveness of the energy and mining industries. One example is the Kazakhstan Bituminous Digital Platform. With the help of this platform, the company is planning to launch online monitoring, the updating and control of production processes, production optimization, the fixing of failure parameters, and the development of equipment solutions. This translates into significant savings in operating and capital expenses, as well as improvements in decision making. In the tourism sector, the inability to collect more reliable data through new digital tools leads to lags in evidence-based planning and marketing. This is very valuable when attempting to shift to higher-value markets and when sector volatility sector increases, as is the case now because of the global pandemic.

DIGITAL ID: A KEY ENABLER OF THE DIGITAL ECONOMY

The emergence of the digital economy has created a need for verifiable digital identity credentials and the ability to prove identity either digitally or without physical presence. Trust in a person or entity's identity is a cornerstone of economic and social transactions. Digital ID systems facilitate the secure identification and authentication of a person, entity, or device—both in-person and online—and bind the user of an online transaction with their "real-world" or legal identity. Combined with digital certificate services such as public key infrastructure (PKI), such systems are also the basis for e-signatures that enable knowledge, approval, acceptance, or obligation to be authenticated without requiring physical presence. Together, digital identity and e-signatures are essential foundations for the digital economy because they enable trusted transactions, streamline doing business, and create opportunities for innovation.

In addition to digital ID and PKI, data operability is another important element in the development of the digital economy. Enabling digital interoperability is the next step of expanding the digital ID framework. It represents a set of data about the users (businesses and citizens) gathered from different government sources and other institutions that can be shared. Many areas of economic development benefit from this integration of services and data exchange. To receive a credit or mortgage, for example, there would be no need to gather supporting documents or endure long wait times because the credit would be approved automatically based on data interoperability among many different agencies. One could also get car insurance online because of these strengthened data exchange capabilities, receive state aid, streamline applications for a pension, a disability allowance, or a childcare allowance. Best of all, recipients could get their benefits in a timely manner through such digital transactions.

ID systems could play a critical role in economic recovery from the ongoing global pandemic. If the Kyrgyz Republic is able to improve the coverage and service-delivery links within their ID systems, then recovery and stimulus packages will have a far greater impact for several reasons:

- Such digital transactions could provide or help provide important information about prospective beneficiaries to ensure that emergency assistance and recovery programs are well designed. They also facilitate accurate targeting of vulnerable beneficiaries, by ensuring that no person can be registered for the same benefit more than once and by enabling the verification of eligibility through checks against other registries.

- They could facilitate an increasingly secure and convenient delivery of services and payments through a multitude of potential authentication options to ensure that the intended beneficiary is indeed receiving the benefit. Through enhanced assurance at delivery provided through the uniqueness, authentication, and data exchange functions of a foundational digital ID system, fraud and leakages can be minimized while the convenience and security of delivery is improved.
- Digital transactions are important enablers of expanding financial access amidst the pandemic, especially because many countries are transitioning from cash to digital payments to reduce the need for physical contact for delivery. Several countries are leveraging them to enable remote bank account opening and to streamline processes for in-person bank account processes through a variety of electronic know-your-customer (KYC) mechanisms.

Developing an effective digital ID platform must be built on several pillars:

- Regulation aimed at enabling legal exchange of information between the state, citizens, and commercial and nonprofit organizations with the consent of the citizens and businesses and subject to suitable privacy and data protection regulations
- Data exchange technology solutions provided between government and commercial organizations considering the registry of consent and compliance with regulatory exchange requirements
- An agency that exercises control over legal entities in the field of personal data protection in accordance with international data protection laws
- Technical solutions for the provision and withdrawal of consent in digital and physical form with an opt-out opportunity that allows citizens and businesses to exercise the right to be forgotten in digital and physical ways (for example, by post office or any governmental agency–like one-stop shop)

GOVERNMENT REFORM PRIORITIES IN SPURRING A DIGITAL TRANSFORMATION

The Kyrgyz government should focus its reforms on policies that encourage broader ICT adoption and incentivize digital platform uptake. The government has prioritized the ICT sector through the formation of the High Technology Park (HTP) of the Kyrgyz Republic. The HTP is a special tax regime that started in 2008 and applies to companies in software development, export of information technology and software, and creation and provision of services through interactive service centers. HTP residents do not pay social contributions as employers, while employees pay 12 percent (versus 10 percent) and receive favorable tax treatment. In consultation with ICT business associations, the government could consider introducing several initiatives such as (a) the creation of a tax credit for information technology companies that donate computer equipment, software, or training to schools; (b) a reduction of the value-added tax (VAT) on computers and software to encourage greater availability; and (c) support for the approval of an electronic signature law in order to initiate growth in e-commerce applications.

TABLE 6.2 THE KYRGYZ REPUBLIC PRIORITY REFORMS TO ENCOURAGE INVESTMENT IN DIGITAL INFRASTRUCTURE

	NEAR-TERM ACTIONS, OR "LOW-HANGING" FRUITS	MEDIUM-TERM ACTIONS TO SUPPORT BROADER RECOVERY
Fiber network	Create a digital map that will track information on existing fiber-optic route capacities and assets (including underground duct poles and building access).	**Broadband network** • Create a legislative framework for network infrastructure sharing among operators. • Study the possibility of conducting optical fiber using the infrastructure of power lines. • Pass legislation to allow cable entry and other engineering structures to connect facilities to a common cable duct and simplify the process. • Provide access to civil infrastructure to the market players. • Allow in-building cables to be shared by operators. • Remove access restrictions to under-utilized fiber-optic networks managed by telecom operators with exclusive market power. • Simplify construction permit process for laying fiber optics or expanding digital network (antennas).
Program implementation	Make use of existing data to evaluate various dimensions of institutional readiness within the sector.	Develop approaches that raise commercial finance for SOEs and government authorities for asset management or greenfield and brownfield assets.
Financing telecom infrastructure	Provide lines of credit to last-mile operators without pledge obligation or with limited pledge obligation.	Provide preferential interest rates to telecom operators for the development of telecom infrastructure.
Digital platforms	Speed up the process of digitizing government operations in the Tunduk system.	• Develop regulations that classify data and ensure data interoperability, address the functioning of mechanisms for storing and transmitting data from the specified information systems, ensure their synchronization and automatic updating, as well as develop a technology for providing citizen consent to the use of their data. • Co-develop the regulations regarding digital platforms with ecosystem actors (including promotion and application of the electronic signature law and regulation on crowdfunding).
Financing ICT businesses	Promote creation of crowdfunding portals to provide new sources of funding for companies that can not attract capital from traditional sources.	• Support venture capital firms in financing startups that develop platforms in diversified sectors of the economy. • Attract local and foreign investments to help develop the national transport and logistics capacity to increase use of digital e-commerce platforms and improve their quality of service.
Tax incentives	• Consider reducing VAT on computers and software. • Eliminate double taxation of transit traffic and IT services.	• Develop a tax credit system for information technology companies that donate computer equipment, software, or training to schools. • Incentivize operators for the development of telecom infrastructure.

7. FINANCIAL INCLUSION: MSMEs AND DIGITAL FINANCE

Main message: *Increasing financial inclusion is a necessary precondition to supporting MSME growth and channeling remittances towards domestic investments. Digital finance can allow for quick development of innovative products that can increase access, decrease cost, and improve the quality of finance in the Kyrgyz Republic. The main challenge in the sector is a non-level playing field for MSMEs seeking access to finance. Another challenge is that 62 percent of the adult population (including microentrepreneurs) are still not financially included. Digital finance, outside of just the banking sector, is a way to increase access to financial services for informal microentrepreneurs to support formalization of the informal and fragmented private sector.*

THE KYRGYZ FINANCIAL SECTOR IS BANK DOMINATED

The Kyrgyz financial sector is dominated by banks, relatively concentrated, and has a small institutional investor base. The assets of commercial banks and nonbank financial institutions (NBFIs) comprised 249 billion soms (US$3 billion) and 27 billion soms (US$338 million), respectively, which is equivalent to 38 percent of GDP (end of 2019). The banking sector accounts for 77 percent of the financial sector, and the five largest banks accounted for 69 percent of the assets. Assets of the pension funds, the Kyrgyz Republic SF, insurance companies, and institutional funds combined accounted for approximately 2 percent of GDP (see annex 3 for more details).

The ownership structure of the banking sector is characterized by a strong reliance on foreign capital. Approximately 48 percent of the total paid-in capital is from foreign sources, which is 11 billion soms (US$138 million) out of 23 billion soms (US$338 million). There are 14 banks that have foreign capital holdings of more than 50 percent and four more banks that have foreign participation. There are two state-owned banks (Ayil Bank, RSK Bank) in addition to Keremet Bank (formerly Rosin Bank), which was taken over by the NBKR in October 2018. The takeover is considered problematic because of the moral hazard created in rescuing an insolvent bank after it conducted illegal and risky actions, the conflict of interest in overseeing a bank that it owns, and the takeover resulting in quasi-fiscal activities, given its effect on the balance sheet of the NBKR. The other eight banks are owned by the domestic private sector.

Kyrgyz commercial banks have limited long-term financing in local currency loans over three-year terms. In terms of maturity, 52 billion soms of the total commercial bank loan portfolio of 128 billion soms (41 percent) has a maturity of longer than three years, representing 22 percent of total assets of banks and NBFIs. In local currency, however, this is only 30 percent of the total loan portfolio of the banking sector. Although there is no data on the exact maturity of the loans, anecdotal evidence points to tenors that do not go beyond seven years. Deposits, most of which are short-term, provide most bank funding. Only 15 billion soms out of total deposits of 133 billion soms (11 percent) have a maturity of longer than one year, which means that 89 percent have a maturity of shorter than one year. This represents 63 percent of total liabilities. There is not much room, then, for maturity conversion into long-term finance. Additionally, there is anecdotal evidence that banks do not have much capacity for maturity conversion because the capacity for adequate asset and liability management is low.

One of the country's most influential financial institutions, the Russian-Kyrgyz Development Fund (RKDF), has more than 10 percent of the market share and is distorting the performance of the banking sector. The balance sheet of the RKDF is US$559 million financed by US$523 million in equity (end of 2018). Securities holdings total US$334 million, loans to banks total US$89 million, and loans to customers total US$92 million. The last category comprises direct lending in the form of large investment loans for project financing and indirect lending in the form of loans to SMEs through the fund's network of partner banks and microfinance institutions (MFIs). The RKDF is distorting the banking sector's performance by offering preferential rates to the best and largest corporate borrowers. Subsidized lending by the RKDF is putting pressure on the profitability of the banking sector by dominating the corporate segment as banks compete for the remaining medium-sized companies (which are not numerous), while small companies and microbusinesses are mostly covered by MFIs. Anecdotal evidence even suggests that corporates will not borrow from banks, preferring to wait for an opportunity to get a loan from the RKDF.

The COVID-19 pandemic has the potential to negatively impact the banking sector. At the end of 2019, banks were highly capitalized and liquid and had reasonable asset quality despite low profitability. The capital adequacy ratio stood at 24 percent at the end of 2019, on average twice the minimum requirement of 12 percent, and the liquidity ratio at 64 percent, well above the minimum requirement of 45 percent (table 7.1). The nonperforming loan (NPL) ratio was 8 percent. The return on equity (ROE) was 7.7 percent, which is significantly lower than the seven-year "risk free" treasury securities issued in 2019 that were priced at 11 to 12 percent. The single biggest factor driving profitability decline is the level of noninterest income generated by banks, which did not keep pace with the growth of the banking sector. This is worrisome because noninterest income is a source of income diversification and can play a role as a buffer in situations where interest rate spread diminishes. It is highly likely that the private sector crisis as a result of the COVID-related supply shock and decreased demand will negatively impact the banking sector. In addition, rising expected losses might lead to growing risk aversion and a decreased willingness to extend new loans or renew existing loans. This might deprive firms of critical financing when it is needed most to cover operational expenses and recover from the crisis, thus creating a negative feedback loop between the financial and private sectors.

TABLE 7.1 BANKING SECTOR INDICATORS (2018–20)

	END OF 2018	END OF 2019	FEBRUARY 2020
Capital adequacy	23.7	24	22.7
Gross NPL ratio	7.5	8	8.1
Liquidity ratio	66.9	64	68.7
Loan to deposits	101	103	101
Return on equity	9.5	7.7	8.3
Return on assets	1.4	1.2	1.3

Source: NBKR.

The banking crisis preparedness framework also has significant weaknesses. Although a new banking law was adopted in December 2017, there are still critical weaknesses in the law that require amendment, such as the lack of a resolution authority with appropriate powers, an ineffective bank resolution regime, and the possibility of reversing NBKR decisions. These weaknesses hinder NBKR in its ability to initiate bank resolution and take action against “unfit” shareholders if needed. In addition, there are also critical weaknesses in the Budget Code of the Kyrgyz Republic and the Deposit Protection Law such as the lack of backstop capacity at the Ministry of Finance (MoF) for the Deposit Protection Agency (DPA) in the event of the failure of a large bank for which the DPA does not have enough funds. Deposit payout in the event of a bank failure can lag because of the need for court confirmation. Lastly, although the supervisory capacity of NBKR has strengthened after its transition from a compliance-based supervisory approach to one that is more risk-based, there is a need to further strengthen the capacity of its supervisory staff, in particular in the areas of anti-money laundering and countering the financing of terrorism (AML/CFT). The institutional capacity of the DPA also needs further strengthening.

THERE IS A NEED TO INCREASE FINANCIAL ACCESS FOR INFORMAL ENTREPRENEURS

There is a need to increase access to financial services for informal microentrepreneurs (patent and certificate holders) to support formalization of the informal and fragmented private sector. Despite the enormous increase in account ownership at financial institutions by adults, 62 percent of the adult population (including microentrepreneurs) is still not financially included. There is a need to increase physical and digital access to financial services (including agency banking); address issues of customer due diligence and interoperability; foster innovations such as e-factoring, e-invoicing, e-loans, and e-insurance; and invest in financial literacy. The introduction of innovative financial products should be supported by the establishment of PKI to develop digital identification and customer due diligence (e-KYC), as well as by the amending of regulations to allow e-KYC. All these elements should be part of the National Financial Inclusion Strategy 2020 championed by NBKR.

Much of the economic activity in the Kyrgyz Republic happens informally outside the financial sector. Financial inclusion would be a first step to becoming formally active. Account ownership of adults at a financial institution or mobile money provider increased from 4 percent in 2011 to 18 percent in 2014 before jumping to 38 percent in 2017 (World Bank Findex Database 2018). This resulted from government efforts to channel social benefits, pensions, and state salaries through bank accounts. This is lower, however, than the median of lower-income countries (58 percent) and the median of the ECA region (65 percent). According to the Global Findex Database 2018, there are different reasons why adults in the Kyrgyz Republic do not have an account at a financial institution, such as the following: distance (21 percent), high cost (22 percent), lack of necessary documents (20 percent), lack of trust (24 percent), and insufficient funds (51 percent). On the other hand, of the small-, medium- and large-sized enterprises, 96 percent, 98 percent, and 100 percent, respectively, have a financial account (Enterprise Survey 2020). Individual entrepreneurs (certificate holders and patent holders) are mostly operating without financial accounts. With support from the IFC and the World Bank, NBKR is working on identifying and addressing key issues and their root causes and establishing a national financial inclusion strategy.

INCREASING FINANCIAL INCLUSION FOR INDIVIDUALS WOULD BENEFIT MICROENTREPRENEURS AND HELP CHANNEL REMITTANCES TOWARDS DOMESTIC INVESTMENT OPPORTUNITIES

Physical access to financial services outside "brick-and-mortar" banks is growing. Although there are 25 banks in the country with 321 branches (NBKR 2020), the country has the lowest bank branch penetration in the region, and it is mostly concentrated in urban areas, which can be attributed to the country's mountainous topography and its limited infrastructure (table 7.2). The number of bank branches per 100,000 adults is 8, whereas the ECA median in 2017 was 24. MFIs play an important role in the Kyrgyz financial system, even though the sector size has decreased significantly after the three largest transformed into banks in 2012, 2015, and 2016, respectively. The microfinance sector is represented by two main types of MFIs: microfinance organizations (MFOs), 137 companies, and credit unions, 95 companies – with a total of 350,692 borrowers in 2018, compared to 471,526 bank borrowers (International Monetary Fund 2018). Further, the number of bank retail outlets is growing in the Kyrgyz Republic. There were 464 retail outlets in 2010 and 1,039 in 2018 (International Monetary Fund 2018). In addition, there are currently 1,620 ATMs and 10,867 point-of-sale (POS) terminals (NBKR 2019), of which 2,067 are in bank branches and 8,800 in trade and service outlets, whereas there were only 5,900 POS terminals in 2015. The Kyrgyz Post Office (KPO) with a network of approximately 900 post offices is expected to play an important role in offering access to financial services after its modernization (supported by the World Bank).

TABLE 7.2 PHYSICAL ACCESS TO FINANCIAL SERVICES

	KYRGYZ REPUBLIC	KAZAKHSTAN	TAJIKISTAN	RUSSIA	UZBEKISTAN
Bank branches per 100,000 adults	8	3	29	26	36
Bank retail outlets per 100,000 adults	24	N/A	N/A	1	N/A
ATMs per 100,000 adults	37	84	12	161	28

Source: IMF 2018 FAS.

Electronic transactions are also increasing. The national payment infrastructure comprises the following components: the Bulk Clearing System (BCS), Real Time Gross Settlement (RTGS), the Society for Worldwide Interbank Financial Telecommunication (SWIFT) Service Bureau, the Single Interbank Processing Center (SIPC), the Interbank Communication Network, banks, and payment organizations. In 2013, NBKR as part of the World Bank Investment Program completed the modernization of the national payment infrastructure through the implementation of the BCS, RTGS, and SIPC. In 2019, the BCS, RTGS, and SIPC processed 10 million, 495,000, and 48 million transactions, respectively.

Remittances are an important source of income for households, but processing of incoming remittances is dominated by one firm. Incoming remittances in 2019 were 173 billion soms (US$2.2 billion), approximately 25 percent of GDP. Most came from Russia (79 percent) and a much smaller portion from Kazakhstan (9 percent), while outgoing remittances were 47 billion soms (US$88 million). The market is dominated by Zolotaya Korona, which serves 76 percent of the market. Unistream, Western Union, Contact, and Money Gram have 9 percent, 8 percent, 5 percent, and 2 percent of the market, respectively. It is expected, however, that as result of the COVID-19 crisis, incoming remittances will see a sharp decrease.

DIGITAL FINANCIAL SERVICES CAN OFFER A SOLUTION TO ACCESS CHALLENGES BUT THEIR DEVELOPMENT IS NASCENT

Digital financial services are growing. 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 (World Bank 2018a). Card issuance went up to 2.4 million in 2018 (International Monetary Fund 2018). There are six international payment cards operating in the Kyrgyz Republic and one national payment card. The number of e-wallets has increased sharply in recent years, from 374,025 in 2016 to 1.96 million in 2019 (NBKR 2020). Currently, the fees for more than 100 state and municipal services can be paid via e-wallets, including road tolls, traffic penalties, and communal services, and hotels, restaurants, and supermarkets now accept QR code payments. Banks currently operate 11 e-wallet providers, sometimes in combination with mobile network operators (NBKR 2020). Internet transactions, however, lag behind. According to Findex 2018 (World Bank 2018a), only 5 percent of the respondents used the internet for payments or buying goods in 2017. Anecdotal evidence suggests that there is enormous market potential for e-commerce.

The development of digital financial services is hindered by regulatory and technological impediments. There is so great a lack of customer due diligence that in 2018, there were 950,000 "unidentified" e-wallets (out of a total of 1.2 million) in use in the Kyrgyz Republic, which creates challenges for AML/CFT and the formal economy. Mobile network operators allow the use of an e-wallet mobile application without the identification process, or in other words, the mobile application and registration for an e-wallet do not require formal identification, even with prepaid SIM cards. Although they have limits on the amount and type of transactions such as monthly limits on the maximum number of transactions and no possibility for transfers to another "unidentified" e-wallet or from a mobile phone to an e-wallet, there are ways to commit fraud. A person with several prepaid SIM cards, for example, can send an amount above the defined limit to a person with an "identified" e-wallet out of the country, who can in turn send money to other "unidentified" e-wallets. This is a risk associated with the informal economy: it makes the tracking of cross-border financial transactions difficult. There is anecdotal evidence that unauthorized cross-border activity—exporters offering goods and services in other EAEU country without a paper trail, bypassing the formal payment of taxes—is happening on a large scale. NBKR recently mandated that users of mobile e-wallet applications must be identified by October 1, 2020 (not done at the time of publication of CPSD). Currently, the identification process requires a user to present an ID and passport in person at a commercial bank, as well as further AML/CFT checks. The financial sector side is often reluctant to use digital certificates for online identification because of information security issues (often, only a default PIN is set when issuing smart cards with digital certificates). The lack of an online and automated identification process makes this deadline for the identification of e-wallet users unfeasible.

Establishment of PKI would support electronic identification (e-ID). PKI is a foundational element of the digital identity of people, devices, and services (e-ID), and e-KYC allows for the establishment of digital identity remotely without a physical presence, which is essential for the provision of digital services in the Kyrgyz Republic (B2B and B2C), especially in the financial sector. The Kyrgyz banking sector does not use PKI because of reliability and information security issues. As a result, a physical KYC is required, which impedes the leverage of digital financial services, particularly in rural areas. It is recommended that alternative methods of online identification (for example, biometric or video identification) be explored. This would allow SMEs to benefit from agency banking platforms.

There is a lack of data interoperability and interoperability between different financial institutions and financial products. At present, non-state financial institutions (FIs) are linked to Tunduk, but can only exchange open data. This limits data interoperability and exchange and prevents further development of financial services significantly. Although the number of digital payments is increasing, it is very difficult to transfer money from one bank account to another or from a bank account to an e-wallet account. To improve interoperability between banks and nonbanks, it is important to strengthen the SIPC in terms of its business model, technology, and ownership. This could be achieved if more people used electronic payments instead of cash, its technology is upgraded, and it allowed nonbanks and mobile network operators to have an ownership share. NBKR could enhance retail payment infrastructure by introducing a fast payment system (FPS) to allow interoperability between different financial institutions using different payment instruments and channels. An FPS ensures real-time settlement on the beneficiary account 24 hours a day, 7 days a week. Various financial institutions would need a conducive regulatory environment to make this happen. The Kyrgyz economy would also benefit from the introduction of open banking, which would grant regulated nonbank service providers access to the information of bank customers. Some commercial banks are making plans to develop software applications to allow the integration of e-commerce platforms with online and mobile banking in order to allow the charging of funds directly to customer bank accounts without additional payment means (such as credit cards). The implementation of such services will require legal, procedural, and technological improvements.

IT infrastructure does not support high levels of digital finance. There is high mobile phone and internet coverage in the Kyrgyz Republic. Of the adult population, 91 percent own a mobile phone, and 50 percent have internet access, but basic IT infrastructure to support digital financial services is not fully in place. This hinders access to and development of digital financial services. According to the report "The State of Mobile Connectivity" (Bahia and Suardi 2019), infrastructure is lacking in terms of network coverage (mostly 2G and 3G, with barely any 4G) and network performance (limited mobile broadband, secure servers, and internet exchange points). Mobile tariffs are also not very affordable in terms of devices and data, and also, mobile connectivity is not considered very relevant. In addition, the apps available in the local language are very few in number. IT security is also considered weak. At the same time, consumers are considered ready: they own mobile phones and have basic skills, which indicates market potential.

INNOVATIVE FINANCIAL PRODUCTS IN PAYMENT, CREDIT, AND INSURANCE AND FINANCIAL LITERACY WOULD GO A LONG WAY IN INCREASING ACCESS

If financial institutions developed innovative products targeted to SMEs, that would increase their competitiveness and allow them to grow in the following ways:

- SMEs could benefit from a simple, affordable cross-border payment service using a cross-border digital payment platform. SWIFT, for instance, has developed a new standard for cross-border payment services, SWIFT Global Payment Innovation. Though it's not currently part of the ecosystem, such a payment service could support the enterprises that trade with China or other countries.

- SMEs could also benefit from innovative credit products such as e-factoring, e-invoicing, e-lending, and crowdfunding. The expansion of textile wholesalers operating within trade and market complexes like the Dordoi Bazaar, for example, could be supported by the provision of loans through e-factoring (that is, using an invoice and accounts receivables as collateral). Digital solutions factoring companies can calculate offers based on a company's reputation and invoicing activity. Simultaneously, the introduction of e-invoicing could decrease informality by giving SMEs formal access to finance. The use of this type of financial product depends on financial service providers being able to remotely identify people via e-KYC.
- Farmers could use e-insurance to insure their crops. This in turn would support credit products because a farmer could use an insured future crop as collateral for a loan. Without such insurance, it is currently very risky to lend to farmers. The current lack of data interoperability prevents this from happening anyway, though.

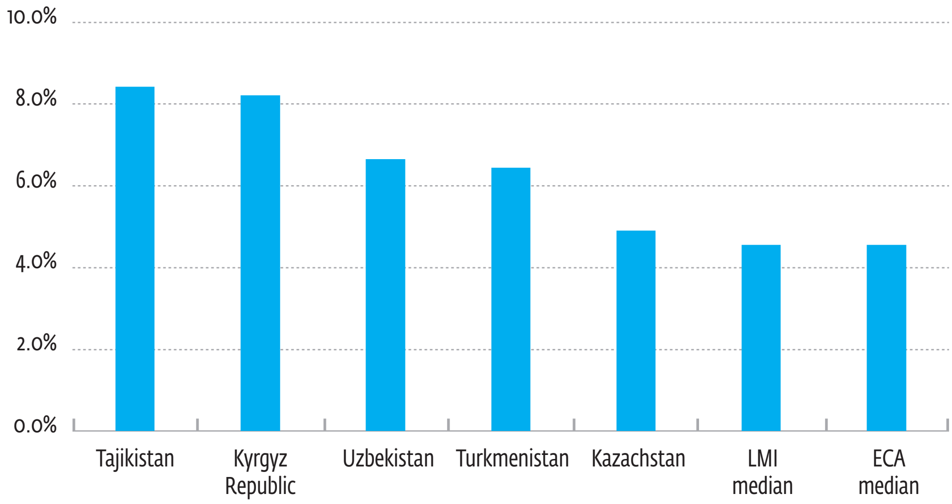
There is a strong need for financial education. In 2014, the Kyrgyz Republic was among the 12 countries with the lowest financial literacy levels in the world: only 19 percent of adults were considered financially literate (Klapper, Lusardi, and van Oudheusden 2014). This education level is similar to neighboring countries such as Tajikistan (17 percent) and Uzbekistan (21 percent) but is much lower than that of Kazakhstan (40 percent) and Turkmenistan (41 percent). The global lowest and highest levels are 13 and 71 percent, respectively. Financial education is needed to increase the level of personal savings in the country. In 2018, the OECD conducted a survey in the Kyrgyz Republic to measure the different dimensions of financial literacy such as knowledge, behavior, and attitudes (OECD 2018). The scores on behavior and attitudes were considerably higher than the score on knowledge. It seems that there is insufficient understanding of key concepts such as interest and principal and a low level of confidence when it comes to working with numbers and simple calculations. This is particularly common in rural areas.

THE COST OF CREDIT IS A SIGNIFICANT IMPEDIMENT TO MSME LENDING

Bringing the cost of credit down structurally will stimulate private sector lending. Currently the Kyrgyz financial system struggles with high net interest margins and high collateral requirements. This would require operating on several levels, starting with the need to increase the minimum capital requirement of banks to ignite consolidation of the banking sector and establish economies of scale. This could bring down the cost-to-income ratio of banks and decrease the cost of credit. Second, increasing the depth of credit information reporting on corporates would allow banks to rely more on the creditworthiness of borrowers than on collateral. Third, amending the law governing secured transactions to allow the registration and usage of all encumbrances (the assignments of receivables, the transfer or retention of titles, leases, and tax liens) and upgrading the collateral registry system. Fourth, strengthening the insolvency regime to prevent the liquidation of viable companies that are in financial distress. One final helpful change would involve tailoring financial products to specific sectors such as agriculture or tourism and developing new types of products such as value-chain financing.

High net interest margins are rooted in high operational costs. The banking sector net interest margin in the Kyrgyz Republic is considered very high, standing at 8.25 percent at the end of 2018 (World Bank FinStats 2020), especially in comparison with peer

FIGURE 7.1 NET INTEREST MARGIN, KYRGYZ REPUBLIC AND PEER COUNTRIES, 2017



Source: World Bank Finstats 2020.

countries (figure 7.1). The high net interest margin in the country is mostly driven by high operating costs and not so much by loan loss provision or pre-tax profit (Teodoru 2020). There are many relatively small banks that do not have the economies of scale to recover from the high cost of lending to small businesses and microenterprises. Fifteen out of the country's 25 banks have a market share between 0 and 3 percent. Of those 25, 10 banks have a cost-to-income ratio of higher than 70 percent, and half of these have structural losses (a cost-to-income ratio of higher than 100 percent). This could be done by consolidating the banking sector and by increasing the minimum capital requirement from 600 million to amounts closer to 1 to 1.5 billion soms, taking care at the same time to avoid disincentivizing competition in the sector.

High collateral requirements are rooted in the lack of reliable financial reporting by borrowers, the weak rule of law, unreliable valuation of collateral, and a shallow secured transaction regime. Until recently, NBKR required 120 percent collateral for loans (this requirement was eliminated in January 2020), but according to results of the 2019 Enterprise Survey, 94 percent of firms that received loans had to provide collateral averaging 244 percent of the loan value, ranging from an average of 201 percent for firms in the services sector to an average of 289 percent in manufacturing. This is partially because banks do not have reliable means for the valuation of collateral. As a result, banks use severe haircuts for the valuation of property used as collateral for loans. The banks themselves perform the estimations without attracting external professional estimators. In urban areas, banks want to de-risk and require a larger amount of real estate for a smaller loan. In rural areas, real estate is mostly taken as moral collateral, because it is more difficult to sell real estate in rural areas. More advanced banks such as Kyrgyz Investment and Credit Bank (KICB), Bai Tushum, and Demir Bank have started to accept mixed collateral: real estate, contract financing, and goods turnover. Furthermore, according to the World Bank Governance Indicators in 2018 (World Bank 2018d), the Kyrgyz Republic had a score of –0.91 for Rule of Law (–2.5 is considered weak; 2.5 is considered strong), which means that it is considered difficult to take possession of collateral claims. Strengthening the legal framework to make it easier to take possession of collateral claims might lead to the relaxing of collateral policies by banks.

Additionally, the state credit bureau is not yet able to report on the creditworthiness of all borrowers. The Kyrgyz Credit Bureau, Ishenim, is currently tracking the credit histories of more than 1.6 million businesses and people across the country, while in 2019, private credit bureau coverage stood at 39.2 percent[47] (World Bank 2019f). In 2015 a new law on credit reporting was adopted that paved the way for easy, effective sharing of credit information, which has enabled many to get credit, start a business, and expand to new markets. Under this law, NBKR exercises greater oversight over the credit bureau, helps prevent banks from issuing multiple loans to the same person, and keeps consumers from over-borrowing. In 2018, 238 financial institutions (25 banks, 120 microfinance organizations, and 93 credit unions) reported data to and extracted data from Ishenim, whereas in 2013, only 107 institutions did so. The credit bureau has limited credit information on companies because companies are reluctant to give commercial banks permission to share their information with the credit bureau. The number of requests for credit information on companies is 0.3 percent on average, and additionally, Ishenim has only partly automated information exchange with financial institutions. It did implement a new technology solution for credit history and credit information exchange in 2017 in cooperation with the CreditInfo Group, but at the time of implantation, only 20 percent of all users provided their information electronically, while the rest provided their information manually. The country's tax authority and business registry likewise have no automated data exchange capability. Another challenge is the large informal sector, which further impedes the collection of quality data on businesses operating in the Kyrgyz Republic and on formal access to finance.

Expanding the secured transactions regime would allow for increasing access to finance, particularly for MSMEs. The secured transaction law was adopted on July 15, 2016 and entered into force on January 27, 2017. This amendment to the existing legal and regulatory framework, which had only allowed the registration of movable collateral through seven regional offices, enabled online registration of movable collateral. There were bylaws prepared, including regulations on the procedures for online registration and single state registration. Nevertheless, the legal and regulatory framework needs to be amended to allow registration of all encumbrances (instead of only pledges). This includes assignments of receivables, transfers, or retentions of titles, leases, and tax liens. It is currently very difficult for lenders to find out whether collateral is already encumbered when they are deciding to accept an asset as collateral. This will be important as the economy attempts to recover from the COVID-19 crisis and new value-chain lending is needed. Additionally, the Ministry of Justice implemented an IT solution for the movable collateral registry in 2017. Agreements for the use of the IT solution were signed with 54 financial institutions, which enabled them to register pledges online. Since the start of its use, 8,323 pledges have been registered. The recent upgrade enables automated data exchange with the State Registration Service to receive information on natural persons and movable properties (vehicles).

The Kyrgyz Republic still has an outdated insolvency law and limited insolvency practices. The use of reorganization mechanisms to save viable but financially distressed enterprises is limited. The current legal system needs to be strengthened by consolidating the capacity building of the main players (judges, insolvency administrators, the legal and business community, and so forth). The practical application of the rules and the policy incentives that they create have biased the insolvency system towards liquidation. Secured creditors have a very powerful position in Kyrgyz bankruptcy law in view of their ability to execute their security at almost any time during an insolvency process, which makes it hard to achieve a reorganization of viable enterprises or an efficient liquidation of unviable ones. Bankruptcies are expected to increase as a result of the COVID-19 pandemic. In order to flatten the bankruptcy curve, the Kyrgyz government should consider emergency measures such as limiting creditor-initiated insolvency filing, suspending the director's duty to file for insolvency, initiating out-of-court settlements, and allowing debt forgiveness for microentrepreneurs to prevent them from being saddled with debt for life with no chance of reentering the economy.

The COVID-19 crisis is expected to negatively affect access to credit, especially for MSMEs. The COVID-19 pandemic is expected to significantly affect MSMEs facing constraints such as payroll, utility, rents, and supplier payments in meeting short-term operating expenses. The situation is expected to worsen as the financial sector's risk aversion rises in anticipation of higher NPLs. Targeted interventions are necessary to avoid the bankruptcy of otherwise viable businesses, permanent layoffs, long-term disruptions in productivity and growth, and the negative feedback loops between the real and financial sectors. The Kyrgyz government consequently needs to take swift action in the several areas mentioned above to ensure that there are mechanisms to stem the negative fallout.

FINANCIAL PRODUCTS ARE NOT TAILORED TO SPECIFIC SECTORS, AND THIS MAKES ACCESS TO FINANCE A KEY CHALLENGE WITHIN THOSE SECTORS

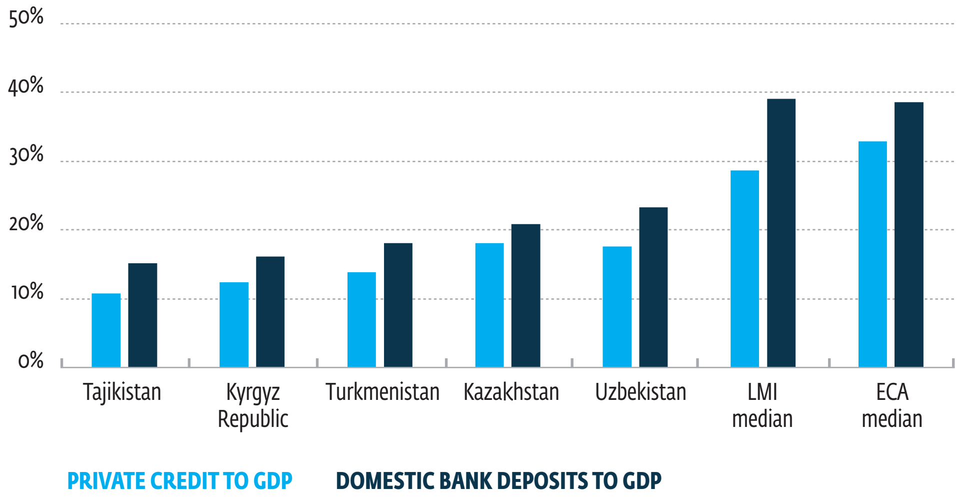
Agricultural development loans can be accessed through commercial banks and microcredit institutions throughout the country, however, these loans are subject to interest rates of 20 percent or more. These high interest rates, which are coupled with short repayment periods, continue to severely limit access to financial services for a large percentage of farmers, who often have limited financial management skills and unstable income. In response to this, the government has developed a program that offers agricultural subsidies to farmers through five different commercial banks[48] in a project called Financing Agriculture 6. Farmers can obtain a loan in soms for up to 36 months with an interest rate varying from 6 to 10 percent regardless of the market rate. The government then compensates the banks for any difference in the average market interest rate on loans. The aim is to provide state support to both businesses and individuals working within the agricultural sector (World Bank 2019c). According to the IMF, most of the private banks have recently stopped extending subsidized loans because of the lack of payment of the subsidized portion by the Kyrgyz government. There might, however, be scope for tailoring financial products to the specifics of, for instance, the agricultural sector by accepting the receipt of the sale of a future crop (cash flow lending) or a crop that is stored in a warehouse as collateral, or by developing crop insurance products.

The financial sector in the Kyrgyz Republic is not well-equipped to finance tourism development. According to an 2019 IFC study that surveyed 309 tourism service providers, (a) only 15 percent were able to borrow from a financial institution for the purpose of financing construction, gaining working capital, or acquiring new assets; (b) 15 percent tried to get finance but did not receive it because of a lack of collateral; and (c) 70 percent did not try because of the high cost of credit (between 16 and 24 percent per annum), the availability of cheaper (informal) sources of credit, or because they had neither physical nor digital access to financial institutions. On the supply side, IFC surveyed 11 financial institutions and found that only 4 percent of their lending portfolios were explicitly allocated to tourism. Their lending focused primarily on hotel development instead. The loans issued were in the form of investment capital for construction or renovation with loan tenor of 3 to 5 years and working capital up to 24 months. Though it is understood implicitly that tourism loans are also classified as loans to SMEs, it is not clear how large this portion is. Loans under 200,000 soms (US$2,800) could even be obtained with just a guarantor and no committed collateral. The IFC estimated that the financial sectors provided approximately US$100 million of finance to the tourist sector (explicitly and implicitly).[49] The IFC also estimates a financing gap of US$300 million in the tourism sector. The survey cites a number of key barriers to lending to the tourism sector: the seasonal ebbs and flows of business; a lack of understanding of the tourism sector by the banking industry; underdevelopment in the sector; and the high indebtedness and low profitability of the borrowers.

LAYING THE FOUNDATION FOR MOBILIZING DOMESTIC RESOURCES AND ATTRACTING FOREIGN INVESTORS IS CRUCIAL TO FUTURE PRIVATE SECTOR GROWTH

Resource mobilization via the financial sector is low in the Kyrgyz Republic: domestic bank deposits amount to 16 percent of GDP, of which 89 percent is shorter than one year, and no retail investment exists. As a result, there is very little long-term financing available. Private credit to GDP is only 12 percent, which is lower than in other similar countries (figure 7.2). This means there is insufficient long-term finance for firms to invest in fixed assets and for government to invest in strategic infrastructure. There is a need to lay the foundation to help mobilize domestic resources and attract foreign investors, as well as to set the preconditions for capital markets development. For the sake of protecting investor safeguards, this requires, first of all, the strengthening of the capacity of the State Service for Financial Market Regulation and Supervision (SSRSFM), as well as the strengthening of the Law on Securities Market (LSM) and the Law on Investment (LOI). Secondly, this requires a more diversified, deeper base of investors, which is currently lacking. This would entail making the pension and insurance sector an environment conducive to foreign investment and mobilizing retail savings through collective investment vehicles such as mutual funds. Thirdly, a more developed government bond market is needed to establish a yield curve that capital market participants can use as a benchmark for pricing financial products with a longer tenure. Currently, the primary and secondary government bond markets are very shallow and nonfunctioning. An upgrade of market infrastructure for the government bond market, the corporate bond market, and the equity market could support this needed development. All these elements should be part of a roadmap for capital market development that is currently missing and should emphasize the preconditions outlined above as important first steps.

FIGURE 7.2 PRIVATE CREDIT TO GDP AND DOMESTIC BANK DEPOSITS TO GDP, CENTRAL ASIA, 2017



Source: World Bank FinStats (2020).

SSRSFM does not have the right mandate or resources to fulfill its role, and the LSM and LOI do not sufficiently protect investors. The main task of SSRSFM is to create conditions for the sustainable economic growth of the state and improve the investment climate by developing the nonbanking financial market, accounting systems, and financial reporting. It issues licenses and monitors the regulatory compliance and noncompliance of 17 insurance companies, 35 stock market brokers, 75 audit firms, two pension funds, two stock exchanges, the lottery, and pawnbrokers. This deserves some reevaluation. The mandates of SSRSFM are broad and ambitious, as they combine responsibilities of several other government institutions. Some important objectives important to securities regulators in many countries—protecting investors; ensuring market fairness, efficiency, and transparency; reducing systemic risks—are, however, considered low priorities. Lastly, SSRSFM does not have enough resources (only 54 employees, including support staff) to fulfill its role. The LSM for its part is missing many critical components, notably (a) a legal requirement that holders of securities be treated in a fair, equitable manner; (b) disclosure requirements relating to information necessary to making informed decisions with respect to tender offers or takeover bids; and (c) legal provisions that require independence and clear oversight of auditors. The LOI has a different set of rules for the three types of collective investment schemes (investment asset trusts, joint-stock investment funds, and unit investment funds), which creates opportunities for arbitrage. Furthermore, the overall Commonwealth of Independent States (CIS) legal framework lacks some standards of conduct, disclosure requirements, and conditions for asset valuation and pricing of units.

The demand for securities is limited, and the base of investors is small and lacking in diversity. Banks, pension funds, insurers, and investment funds are relatively small and invest mostly in government paper. Retail investors are nonexistent, and the number of foreign investors is negligible. There are 25 banks that invest 10 percent of their total assets of 220 billion soms in government and NBKR securities. There are two voluntary pension funds operating in the Kyrgyz Republic: the SF and the Nonstate Pension Fund (NSPF). The SF, which was established in 2010, requires 27.25 percent of payroll, a very high percentage by international standards that deters many enterprises from entering the formal economy. It has an equivalent fund valued at 1.2 percent of GDP (roughly 4 billion soms, or US$60 million). According to regulations concerning the SF (with assets equivalent to 6.5 percent of GDP), it is obliged to maintain an asset structure comprised of 30 percent in deposits and 70 percent in treasury securities. The NSPF is a voluntary fund that has accumulated around 700 million soms (US$10 million) deposited in commercial banks and invested in real estate. There are 17 insurance companies, nine of which have foreign capital (4 billion soms in total assets). There are no insurance brokers operating in the market. Collected insurance premiums and paid insurance compensations are mostly comprised of nonlife insurance services. Life insurance products are almost negligible. There are nine investment funds that have an aggregate capital of approximately 40 million soms (US$580,000) invested in treasury securities. It is important to diversify and deepen the investor base starting with collective investment schemes, which could help establish demand in primary markets. A framework for collective investment schemes could be further developed to allow for increased retail participation. This would have the added benefits of strengthening both demand for government securities across the whole yield curve and liquidity in money markets. Mutual funds are a cornerstone for capital market development in small economies and warrant further development in the Kyrgyz Republic, given that they provide professional management of retail savings, thus reducing the cost and the risk of investment.

The supply of securities is limited and the need for longer-term financing is significant. There is a limited amount of stocks and bonds in the Kyrgyz Republic: market capitalization amounts to US$379 million (26.5 billion soms), which is 4.8 percent of GDP. There have been no initial public offerings (IPOs) in the last 10 years. The need of medium-sized and large enterprises for longer-term financing is significant, and the government's need for the same is also pronounced, but the bank-dominated financial sector is unable to meet this demand. The persistent shortage of long-term deposits explains why the majority of bank loans are issued as short-term credits unsuitable for financing investment projects with long payback periods. SMEs need longer-term finance to invest in fixed assets. Large corporations currently finance their capital expenditures from their own sources and from banks. After accounting for financing available from commercial banks, RKDF, and the European Bank for Reconstruction and Development (EBRD), there is a net gap of US$100 million in long-term financing for firms in the Kyrgyz Republic. A combination of stock market equity, private equity, bond issuance, mezzanine financing, and other diverse, long-term financing instruments should be able to fill this gap. The Kyrgyz government also needs funds to finance infrastructure in the form of roads, energy and power plants, schools and hospitals, irrigation capability, and so forth. The national investment needs in infrastructure are enormous. According to Bhattacharya, infrastructure investment needs for the decade lasting from 2010 to 2020 were estimated at close to US$9 billion, or 13 percent of GDP, but there is no infrastructure financing available. The financial sector could be leveraged to accommodate funding needs in several ways. As an example, a public institution or development bank could develop credit enhancements and guarantees to cover specific risks that would help mobilize funds from international investors with technical assistance support. A connection with the Digital CASA project is another example of possibilities currently being explored.

The money market, an important building block of capital markets, is not functioning optimally to establish a reliable yield curve for instruments with tenures lasting less than one year. The hurdles to the development of the interbank market include high volatility in short-term interest rates, small market size, and weak demand for short-term liquidity in the local currency, the som. The NBKR seeks to maintain the inflation rate at 5 to 7 percent over the medium term in accordance with its core objective, maintaining price stability through monetary policy, and as part of its plans to gradually transition to an inflation-targeting regime. The main monetary policy instrument for inflation targeting is the key policy rate supported by the interest rate corridor. Currently, the interest rate corridor is considered too wide. The policy rate of the NBKR is 5 percent, while the overnight deposit rate (the floor) and the overnight loan rate (the ceiling) are 2.75 and 5.75 percent, respectively. It is crucial to bring short-term money market rates closer to the policy rate and further narrow the interest rate corridor. This will increase the role of the interest rate as the operational target of the NBKR's monetary policy.[50] Kyrgyz money markets are relatively small, but there are some signs of improvement in the interbank market. In 2018, the volume of borrowing on repo terms increased threefold from 10.3 to 31.3 billion soms. The money market currently accounts for 98 percent of repo transactions. The total volume of local currency operations in the interbank credit market (which includes loans issued by the NBKR) increased in 2018 by 76.7 percent compared to 2017 and amounted to 52.5 billion soms. Smaller banks may be reluctant, though, to rely on the interbank market amid concerns that they could be exposed to potential losses due to short-term volatility. In addition, there appears to be anecdotal evidence of mistrust among participants that may be exacerbated by improper transfer of collateral ownership rights in repo transactions (NBKR notes or government paper), an issue that could be redressed through a global master repurchase agreement. In 2018, the average daily volume of excess liquidity withdrawn from the banking system amounted to 12.3 billion soms (in 2017, it was 11.7 billion). The NBKR uses open market operations, mandatory reserve requirements, and the issuance of short- and medium-term notes to address the liquidity surplus in the banking system. The issuance of short-term notes by the NBKR, though, directly competes with the issuance of short-term notes by the MoF. Although it is understandable that the NBKR would want to absorb excess liquidity, it is also important to maintain a balanced supply on the short end of the yield curve. It is therefore recommended that the NBKR and the MoF coordinate their issuance and avoid conflicts between government debt management and monetary policy operations.

The government domestic debt market, which is also an important building block of capital markets, is too shallow to establish a yield curve longer than one year. Domestic government debt is only 15 percent of total government debt (8 percent of GDP) and comprises both marketable debt (T-bills and T-bonds) and nonmarketable debt (liabilities of the state acquired mainly though different bank consolidation schemes). Approximately 75 percent of marketable debts are fixed-rate bonds issued with tenors of two, three, five, seven, and 10 years; 25 percent are T-bills mostly with an original maturity of 12 months (three- and six-month T-bills account for only 0.3 and 3 percent of the domestic debt, respectively). The government bond market is dominated by a few domestic investors, primarily commercial banks and the SF. In September 2019, none of the eight planned auctions (T-bills and T-bonds combined) were successful, reflecting the systemic inability of the Debt Management Office (DMO) in the MoF to sell the amount it offered. Clearly, there is a significant difference between the terms and conditions at which the market is ready to buy securities and the rate the MoF is ready to accept. This might be because of historically high yields across securities of different tenors and heightened risk aversion in the market in relation to government securities resulting from fears of the som's depreciation. The MoF should consider being a market taker instead of a market maker. In the first quarter of 2019, no secondary market transactions were reported. The nonexistence of the secondary market can be attributed to the lack of market making, the limited number of active market participants in the primary market, the large number and relatively low size of outstanding treasury securities, and the lack of a diversified investor base. It is recommended that a group of stakeholders—NBKR, SSRSFM, the Kyrgyz Stock Exchange (KSE), and market participants—develop a strategic action plan for primary and secondary market development.

The corporate bond and equity markets are at a nascent stage. The KSE, the only stock trading platform in the Kyrgyz Republic, has a total of 26 listed companies and issuers. Sixteen of these issue ordinary shares, three issue combined ordinary and preference shares, and seven issue corporate bonds (this includes one issuer of mortgage-backed bonds). The total market capitalization of all securities at listing was 28.9 billion soms (US$413 million equivalent), of which the listings of banks and nonbank finance constitute 54 percent, whereas those of non-finance corporates (real sector) constitute 46 percent. Manas International Airport (7.5 billion soms or US$107 million) and the banking sector dominate the equity market, and together, they take 71 percent of the market. Bond market issuances are predominantly by non-finance corporates, constituting 64 percent of the capitalization. Bond issuance by the banking and nonbanking sectors constitute 20 and 16 percent, respectively. Additionally, the market infrastructure of the KSE and the Joint-Stock Company Central Securities Depository (JSC CSD) is outdated and needs to be replaced. The trading system of the KSE was taken over from the Kazakhstan Stock Exchange in 2001 without a software source code, which makes it impossible to either customize for mobile and online trading or meet interoperability requirements and integrate with external markets. The most challenging issue the JSC CSD faces is a lack of electronic communication and automated data exchange with all the participants in the value chain, particularly with private registrars.

GOVERNMENT REFORM PRIORITIES IN INCREASING ACCESS TO FINANCE

Given the significant role access to finance plays as an enabler of private sector development and mobilizer of private investment, it is imperative that the Kyrgyz government undertakes the necessary reforms in the near to medium term to ensure a strong recovery from the current crisis. The CPSD took a more in-depth look at the financial sector in the Kyrgyz Republic because of its critical role in attracting private investment, growing the private sector by allowing SMEs to grow, and channeling funds into domestic investments. Combined with a focus on transforming the country digitally, the Kyrgyz Republic may additionally be able to leapfrog some of these reforms by making use of digital financial instruments. This comes at a time when the Kyrgyz government needs to use every possible tool for attracting private investment to ensure full fiscal recovery in the post-COVID period. Table 7.3 analyzes top-priority reforms and the theory of change that underpins the recommendations.

TABLE 7.3 THEORY OF CHANGE: KYRGYZ REPUBLIC FINANCIAL SECTOR DEEP DIVE

DEVELOPMENT CHALLENGE	ACTIVITIES	INTERMEDIATE OUTCOME	IMPACT	IFC INTERVENTION	WORLD BANK INTERVENTION
FINANCIAL INCLUSION: FINANCIALLY INCLUDE INDIVIDUAL, INFORMAL ENTREPRENEURS TO SUPPORT FORMALIZATION OF THE PRIVATE SECTOR					
Low account ownership at 38 percent reflects an informal private sector based on cash transactions, which makes it difficult to transfer funds electronically to individuals and microbusinesses that are in need of support because of the COVID-19 crisis. **Physical access beyond "brick and mortar" establishments is growing (bank branches and retail outlets, microfinance organizations, post offices), but it has its limitations because the country is mountainous. Digital financial services (DFS) are growing in terms of card issuance and e-wallets, but have yet to reach their full potential.** **There are one million unidentified e-wallets.** **There are several regulatory and technological impediments such as the lack of digital identification, interoperability, and IT infrastructure.** **Financial illiteracy is high, one particularly misunderstood key concept being interest rates. Consumer protection is at an early stage of development.**	**Short term (up to two years)** Adjust the regulatory framework to allow application of simplified customer due diligence (CDD) requirements. Implement digital identification (e-ID), digital signature, data protection, and cybersecurity risk management. Invest in the interoperability platform at the Single Interbank Processing Center. Establish strategic action plan for financial inclusion and financial literacy. Develop a robust consumer protection framework and implement market conduct supervision.	Amend simplified CDD regulation to allow for non-face-to-face identification and verification of currently unidentified e-wallet users. Make PKI allow electronic signature. Make FPS achieve interoperability between financial institutions (banks, mobile network operators, microfinance organizations, and credit unions). Put regulations in place for merchant aggregators and facilitators using Application Program Interface (API), transaction initiation service provider (TISP), and account access service provider (AASP). Strategic action plan for financial literacy is implemented, increasing financial literacy. NBKR starts market conduct supervision and robust internal dispute resolution mechanisms established at FIs.	The Kyrgyz people will be financially included in terms of account ownership. Account usage for digital transactions (G2P, P2G, B2B, P2B, P2P) will increase. Economy will transition from informal cash to more formal digital payments. Transparency of financial transactions will increase, which supports the fight against corruption. Trust in formal financial institutions will increase.	DFS, including simplified CDD (existing IFC advisory service [AS] #601347: $1 million, closes end of 2020). Potential AS provided to FIs on product digitalization, processes and procedures. National financial inclusion strategy and product development support provided to FIs (existing IFC AS #602131: $1.9 million, closes FY23). Capacity building of Single Interbank Processing Center (IFC #601347).	Development and implementation of interoperability platform (World Bank IPF potential $5 million). Harnessing Innovation for Financial Inclusion 2 (World Bank TA pipeline). Modernization of Kyrgyz Post increases access to financial services via post offices (World Bank IPF P125689, $6 million, closes FY20, possible extension FY21; potential for World Bank IPF to support second phase of modernization, $5 million).
FINANCIAL EFFICIENCY: ADDRESS STRUCTURAL ISSUES OF ACCESS TO CREDIT FACED BY MSMES					
High net interest margin as result of high operating costs. High collateral requirements by banks. Increasing risk aversity of banks and MFIs as a result of COVID-19. Curtailment of existing and new credit lines for MSMEs that are in need of liquidity. NBKR is giving liquidity assistance to banks. Kyrgyz government has very limited funds to support MSMEs. **Financial products are not tailored to specific sectors such as agriculture, tourism, housing, informal entrepreneurs, or finance supply chain.** **Secured transaction frameworks only accept security pledges, and not all encumbrances (assignments of receivables, transfer or retention of titles, leases, tax liens) are included.** **Credit reporting regime does not adequately cover businesses. Ishenim has virtually no credit information on corporates. Credit reporting is constrained by principle of consent.** **Insolvency and debt resolution regimes have critical weaknesses. The insolvency law is not used to restructure financially distressed but viable companies. It is very likely that the COVID-19 crisis will result in a spike of bankruptcies.**	**Short term (up to two years)** Expand risk-sharing facility to accommodate risk aversion of banks and MFIs. Increase minimum capital requirements from 600 million to 1 to 1.5 billion soms in order to consolidate sector, increase economies of scale, and force weak banks out of market. Tailor financial products, for example, to the needs of agriculture, tourism, infrastructure, and value-chain finance. Amend secured transactions law. Upgrade collateral registry system. Amend credit reporting law and connect Ishenim to business registration system. Strengthen debt resolution and legal and institutional insolvency regime. Prevent COVID-19-related bankruptcies.	Risk-sharing facility is operational. Regulations that determine minimal capital requirement of 1 to 1.5 billion soms are adopted. New financial products are developed. Secured transaction law is adopted and new collateral registry system is launched. Amendment to credit reporting law is adopted. Technological connection between credit bureau and business registry is put in place. Insolvency law is adopted and capacity building of key stakeholders such as insolvency administrators is achieved. COVID-19 bankruptcy procedures are suspended to give viable.	Banks and MFIs start using risk-sharing facility to increase access to credit. Banks will achieve economies of scale, allowing for decrease of operational costs and final cost of credit. Access to credit as a result of lower costs and higher transparency on clients (credit reporting, registered collateral) will increase. The number of companies successfully reorganized and creditor recovery rate increases.	Expand risk-sharing facility to increase the risk appetite of banks. Invest in modernization of the banking sector to decrease operational costs (IFC investment in KICB). Tailor financial products to the needs of agriculture, tourism, and value-chain finance, for example. Use existing IFC AS to strengthen secured transactions, credit bureau regime (IFC #569391, $2.5 million, closed FY20).	Expand risk-sharing facility to increase the risk appetite of banks. Invest in technology of collateral registry and develop secured transaction regime. Existing World Bank IPF P125689, US$1.3 million, closes FY20, needs more resources to continue reform. Invest in technology of Ishenim and develop credit reporting regime; assist Kyrgyz government in developing a new insolvency law and strengthening the capacity of insolvency administrators.

DEVELOPMENT CHALLENGE	ACTIVITIES	INTERMEDIATE OUTCOME	IMPACT	IFC INTERVENTION	WORLD BANK INTERVENTION
FINANCIAL DEPTH: LAY THE FOUNDATION FOR MOBILIZING DOMESTIC RESOURCES AND ATTRACTING FOREIGN INVESTORS					
Limited retail resources are intermediated through the financial sector both in terms of savings (low savings and GDP) and investment resulting from cash-dominated informal sector with low trust, low financial literacy, and limited deposit protection. Grossly undeveloped investor base lacks depth and diversity. **Lack of transparency and investor protection is thwarting the attraction of international foreign investors.** **Long-term finance (7 to 20 years) is not available, which produces:** • **Limited-term deposits** • **Very limited corporate debt issuance** • **No reliable yield curve reflecting the true market costs of financial intermediation** • **Limited PPP projects** **Money market, government bond market (dependence on concessional foreign debt), and corporate bond and equity market are shallow, affecting liquidity and risk mitigation of longer-tenor funding. Law on Securities and Law on Investment have many weaknesses.**	**Short term (up to two years)** Strengthen institutional capacity of SSRSFM and PPP unit of MoE. Enhance Law on Securities and Law on Investment. Establish national capital markets strategy, focusing on laying the foundation for mobilizing resources/attracting investors. **Medium term (three to five years)** Spur growth of longer-term retail saving and investors base. Develop money market (Global Master Repurchase Agreement). NBKR and MoF should coordinate bond issuance and government bond market by increasing issuance government bonds and making MoF a market taker instead of market maker. **Long term** Develop insurance and pension sector. Diversify investor base by attracting institutional and foreign investors.	Capital market strategy is established to mobilize domestic resources and attract foreign investors. Law on Securities and Law on Investment adopted. Institutional capacity of SSRSFM built for effective oversight of capital markets.	Domestic resource mobilization increases (via retail savings and investment, institutional investors). Inflow of foreign investors increases. Availability of liquid money market at lower cost increases. There is a more highly developed secondary market for government bonds and a more reliable yield curve available. The corporate bond market takes off with new issuances. Long-term finance becomes more available.	Offer long-term local currency facility via issuance of IFC bond or other instruments to address market failure. Consider coinvestment in corporate bonds.	Offer long-term local currency facility to address market failure (credit line). Develop capital market strategy. Review and strengthen Law on Securities and Law on Investment. Revisit insurance and pension law from a market development and risk mitigation perspective. Build institutional capacity of SSRSFM. Consider the possibility of supporting the development of a pipeline of companies that have size, quality, and appetite to issue bonds.

8. TOURISM DEVELOPMENT

Main message: *Prior to the COVID-19 pandemic outbreak, the Kyrgyz Republic had come to a critical juncture. The Kyrgyz government was turning its attention to tourism sector development to tap into its natural and cultural assets and develop a strategy to stimulate the growth of high-value markets. The global downturn in tourism has put a halt to such plans for the sector in the near to medium term. This does, however, present an opportunity for the government to develop enabling infrastructure that is critical to both sector recovery and attracting high-value tourists—energy access, transportation infrastructure, broadband access—once travel restrictions have been lifted and the sector gradually recovers. Currently, domestic and regional travel, although limited, has the potential to provide quick income for rural workers and SMEs during this recovery period. Additionally, crisis recovery may make joint initiatives that have been in the works for years such as the Central Asia Regional Energy Market and the launch of a regional visa more accessible and important than ever.*

PRIORITIZED TOURISM AS A GROWTH SECTOR WITHIN SERVICES NEEDS TO SHIFT ITS STRATEGY TO FIT THE OUTLOOK FOR THE GLOBAL TOURISM INDUSTRY

The Kyrgyz Republic was well-positioned to increase the contribution of tourism to GDP and jobs prior to COVID-19 because of its natural and cultural assets that align with global trends, growth in arrivals from high-value markets, and successful regional destinations that provide benchmarks for growth. With a wealth of soft adventure, natural, and cultural assets, the Kyrgyz Republic can tap into the large and fast-growing soft adventure and winter tourism segment. In 2018, the global adventure tourism market was valued at US$586.3 billion and was projected to increase to US$1.6 trillion by 2026 (Chouhan, Vig, and Deshmukh 2019). Soft adventure tourism[51] is specifically estimated to have attracted 238 million tourists in 2016, generating US$470 billion in revenue (Euromonitor International 2018). Additionally, although the Kyrgyz Republic is smaller in absolute size, growth in high-value long-haul travel markets has been strong in the past five years, reflecting an increased awareness of the country as a destination. Lastly, the Kyrgyz Republic has an opportunity to replicate recent successes of regional destinations like Georgia, Armenia, and Mongolia that have translated arrivals growth into a positive economic impact and jobs. This, however, would require a long-term look at the sector that might help industry planners understand which quick-win reforms they could implement within the three- to five-year industry recovery period that would position them to take advantage of the sector's rebound.

The Kyrgyz government had set ambitious targets for tourism growth, aiming to receive 6 million international tourist arrivals by 2023. In the Kyrgyz Republic Tourism Development Program and Action Plan 2019–23, the government also set targets to boost the total contribution of tourism to GDP from 3.8 to 7 percent. The government hopes that meeting these targets would move the country up the World Economic Forum's Travel and Tourism Competitiveness Index to 70th place by 2023 (it was 110th in 2018). To support this vision, IFC conducted a tourism-sector deep dive assessment to identify the key regulatory and sector barriers that hinder industry growth. It took a broad, holistic view of tourism development, examining overarching regulatory constraints to long-term growth and increased investment in the tourism sector. The report drew from and built upon the work of donors and research partners that have supported specific segments of the tourism sector or specific destinations, including the Swiss State Secretariat for Economic Affairs (SECO) and USAID's effort supporting community-based tourism, product development, and marketing; infrastructure investment by the World Bank; USAID and EU tourism development projects; sector investments by the EBRD and the RKDF; and master planning at the regional level by the ADB. To achieve these ambitious targets, critical reforms creating an enabling environment to attract private capital and investments in air connectivity, quality accommodations, and product development must be made.

Despite the Kyrgyz Republic's ambitions for growth in its tourism and hospitality industries, the COVID-19 era has battered the sector in ways that must be addressed. According to industry associations, all preordered incoming tour packages to the Kyrgyz Republic for April and May were cancelled. Given that most tour operators earn the bulk of their income during the summer season, early cancellations and slow forward bookings will result in significant income losses in the 2020 tourism season. The IFC survey conducted in May 2020 revealed that 60 percent of respondents had temporarily closed, and another 14 percent had fully closed. Fourteen percent are already unable to service their debt, while another 50 percent have enough liquidity to service debt for only three more months. Moreover, 40 percent would go bankrupt if the crisis and subsequent lockdown last nine months. Tourism and hospitality businesses in the Issyk-Kul region will see a significant reduction in their annual incomes, as SMEs in particular rely on the two months of summer tourism to generate income for the whole year, although they did manage to resurrect some of the summer season, thus partially flattening the impact of COVID-19. On an industry level, transport, food, and beverage industries have experienced the most damage thus far, while tour operators are struggling to retain staff, their most valued asset. Additionally, local movement restrictions imposed in the early months of the crisis forced the closing of cafés and restaurants, temporary bans on private and public transport, and limitations on transportation between regions. Those companies with a high share of rental expenses (restaurants, cafés, hotels, sanatoriums) could face bankruptcy in the near future, although, according to the IFC survey, companies could potentially survive six to nine months, but we should take into account that summer season was somewhat successful, which could prolong this. Tour operators value highly qualified personnel because they have often been trained in-house, and so far, tour operators have made efforts to preserve their staff.

Regionally, the Kyrgyz Republic's tourism industry is particularly vulnerable to the impacts of the COVID-19 crisis. While tourism is not a large driver of the economy right now, it does support many SMEs and rural businesses throughout the country, especially in rural areas with limited alternative income opportunities. Additionally, the country has overall low tourism resilience. In the World Bank's Tourism Resilience Risk assessment (developed to assess the effects of COVID-19), the Kyrgyz Republic ranks second to last out of 10 countries in the region, followed only by Tajikistan. This means that the Kyrgyz Republic's tourism sector has a high-risk exposure, so the industry will need specific and targeted support in the recovery period. Specific recommendations related to COVID-19 recovery have been enumerated below.

COVID-19'S IMPACT MEANS THAT CRITICAL REFORMS TO ENABLING SECTORS THAT CAN BETTER POSITION THE COUNTRY AS A HIGH-VALUE DESTINATION ARE NEEDED

The impact of COVID-19 on the Kyrgyz Republic and its tourism sector will be lasting because global travel and tourism demand will likely take years to fully recover. The global pause in the industry and potential structural changes in demand, distribution channels, and connectivity, on the other hand, present an opportunity for the Kyrgyz government to develop a more sustainable and valuable tourism sector. The sector should be well-positioned to meet the needs of global travelers, take advantage of anticipated changes in demand for more authentic and less crowded experiences, and deal with systemic issues that existed before the COVID-19 crisis. While tourism currently only contributes 3.85 percent to GDP, the government has identified the sector as a key priority for job creation, especially among rural populations, women, and youth. In order to increase long-term competitiveness of the sector and increase its contribution to GDP and job creation, the government must continue to address tourism development challenges, even during the downturn in global demand. The travel and tourism industry can be resilient, and global demand will rebound in the long term. Moreover, the government has identified soft adventure and winter tourism as two segments they want to develop in the post-COVID period. This is heavily dependent on where it can attract private investment and the impact it will have in repositioning the sector.

There are significant institutional, sectoral, environmental, and infrastructure barriers to tourism growth. Although the Kyrgyz government has prioritized the development of winter and soft adventure tourism, a lack of targeted marketing, destination management, and investment are limiting the country's potential to tap into latent demand and increase tourism's contribution to the economy. Sector issues such as low destination awareness, poor tourism coordination and destination planning, and a lack of market intelligence and sector performance data threaten both existing tourism through poor destination management and new tourism growth. Economy-wide issues such as unclear and restrictive business regulations and uncoordinated investment planning and promotion hinder business growth and new tourism investments. The country also faces challenges with hard and soft infrastructure that limits air and ground connectivity and results in a low usage of appropriate digital technology. Clearly, there are limitations on investing in sector-specific infrastructure, and with such a lack of demand for private investment, the clear path to growth in the near to medium term is to prioritize those reforms with positive, potentially widespread economic effects, including for the tourism sector itself. This includes infrastructure (energy, transport, and digital), financing, and the overhaul of restrictive business regulations. Annex 4 presents a detailed analysis of the sector, with emphasis on increasing the growth of higher spending, long-haul markets, aids to tourism arrival growth that translate into economic value and employment, the diversification and improvement of the quality of supply that spreads the benefits of tourism and increases its value, and the addressing of structural issues in sector management that prevent integrated approaches to tourism development.

PRIORITIZATION OF DEVELOPMENT-ENABLING REFORMS IN THE TOURISM SECTOR IS NECESSARY FOR THE SECTOR'S POST-COVID RECOVERY TO BE STRONG

Even with the fiscal strain imposed by the crisis, the Kyrgyz Republic can open markets and facilitate investments necessary to achieve high growth from existing and new markets by focusing on high-priority reforms and the development of two selected market segments. These reforms can also ensure better management of growth, resulting in greater dispersion of the economic benefits of tourism and ensuring that destinations are sustainably managed for tourists and residents alike. These reforms are summarized in the theory of change for boosting tourism investment and increasing its economic impact laid out in annex 4. While all the recommendations included here are still crucial to creating the platform that could empower tourism to drive growth, there are a few key recommendations that should be acted upon in the face of the pandemic and economic crises. First, government prioritization of tourism in the response period will be essential for ensuring that businesses are kept alive and able to reopen in the recovery period. The Department of Tourism must expand its authority and scope to be able to handle the industry crisis. Second, in both the short and medium terms, the country's connectivity needs will require ensuring that air transport services and infrastructure are maintained and positioned to grow. Finally, there is an urgent need for sector coordination among public, private, and donor stakeholders to ensure that scarce resources are used efficiently across enabling sectors country-wide and focus on two high potential market segments.

APPENDIX A
OPPORTUNITIES AND CHALLENGES FOR KYRGYZ ECONOMIC SECTORS

SECTOR	OPPORTUNITIES	CHALLENGES
ENABLING		
Education	• While the market for private education providers has so far been limited, the Ministry of Education has expressed an interest in PPPs in education, especially early childhood education (ECE). • "EdTech" could present an opportunity for private sector participation in education.	• There is a limited market for private education service providers. • The sector is beset by corruption. • Private players that do exist generally suffer from low capacity.
Energy	• There is a strong potential for the export of hydropower, which is considered a clean source of renewable energy, despite the fact that its scale could have significant environmental impacts. • Improving supply quality and reliability would address a major business constraint. • The sector is almost exclusively publicly owned, and there is less scope for engaging the domestic private sector.	• It will be almost impossible to draw the needed investment to the sector until residential tariffs are raised to cost-recovery levels. • Raising tariffs is politically controversial and unlikely to happen in the short to medium term. • WBG is already fully engaged in the sector, so there is little value added for new analysis at this stage.
Finance	• Improving access to finance for firms, especially long-term financing, could be an important growth catalyst and remove a major business constraint. • Stock market development could continue expanding. • There is an opportunity to promote inclusion (especially in rural areas) by leveraging ICT to increase access to finance (e-payments, mobile banking).	• The financial sector is small and relatively unsophisticated. • The number of MFIs is decreasing and heavily reliant on foreign sources (including donors) for funding. • The share of NPLs in bank portfolios has been rising. • The World Bank is already fully engaged in the sector • RKDF has a distortionary effect.
Health	• Better healthcare fosters inclusion and productivity. • Despite an aging health infrastructure, Kyrgyz medical professionals may enjoy a positive reputation in other EAEU countries, thus providing the basis for medical tourism. • There has been recent success with PPPs in health services (including with the IFC). • One potential area for private participation may be the provision of digital health services.	• Major constraints include an aging health infrastructure, an excess of hospital capacity, and training programs that are focused on theory rather than practical skills. • A traditional orientation toward formalized, vertical health management has led to low investment in personnel and devalued primary providers. • Notwithstanding the recent experience of PPPs, the system is heavily centralized and offers relatively few opportunities for private participation if not changed.

SECTOR	OPPORTUNITIES	CHALLENGES
ICT	• ICT can be an equalizer for the country by helping it overcome its landlocked geography. • The Kyrgyz Republic already has relatively open and robust telecommunications and mobile markets. • Greater ICT use by businesses tends to boost productivity, which filters through the economy, increasing GDP growth. • Increasing Internet and broadband access should have a positive correlation with job creation (1.38 percent on average for lower- and middle-income countries). • The sector is considered a pillar of the country's national sustainable development strategy going forward to 2040. • DIGI CASA is targeting digital platforms, regulatory work, and connectivity—a massive encompassing program in the CPF—and CPF has already earmarked this sector for potential maximizing finance for development (MFD).	• Despite the ongoing rollout of e-government initiatives, public sector capacity is a challenge (keeping up to date with fast-moving issues such as open data policy and cybersecurity will require a significant ramping up of digital literacy). • Digital literacy and skills also need to be strengthened in the private sector. • High-speed internet remains costly for individuals and businesses, but this will change with implementation of the World Bank's DIGI CASA project. • Changes in the regulatory framework have a mixed or impact on businesses, which do not have restrictions on freedom that are more common in neighboring countries, but they also pay higher costs to pay for the increased emphasis on security. This will be changed through DIGI CASA.
Transportation	• Air connectivity and deficient road and rail infrastructure are significant constraints to trade and a critical concern to the agriculture and tourism sectors, the activity of which depends on both domestic transportation and access to foreign destinations. • There is a record of completed PPP transactions in the transportation sector. • The World Bank Central Asia Regional Links Program (CARS3) is focusing on enabling road connectivity, as well as improving civil aviation compliance. • Open skies regulation will enable better air connectivity.	• All Kyrgyz airlines are banned from flying to the EU due to substandard safety practices. • The Kyrgyz Republic may need to compete with regional neighbors that are also trying to strengthen air connectivity. • Massive infrastructure investments are needed. • The rail network is in need of complete overhaul and reform.
OTHER		
Agriculture and agribusiness	• Most of the population lives in rural areas and their livelihood is tied to agriculture. Development of the sector could help foster inclusion by giving subsistence farmers access to economies of scale and linking them to commercial markets. • The Kyrgyz Republic enjoys comparative advantages in horticulture (stone fruit) and milk. • There are some opportunities for job creation in both primary production and processing.	• The fact that the country enjoys revealed comparative advantages (RCAs) for only a few products means that agribusiness can not be a mass source of new job creation (possibly fruits and dairy if improvements are made). • International SPS standards need to be implemented. • Inefficient trade procedures form a particular barrier for perishable goods.

SECTOR	OPPORTUNITIES	CHALLENGES
Light manufacturing	• There is a small cluster of about 500 private garment SMEs in the vicinity of Bishkek employing up to 300,000 workers (mostly women). • There could be opportunities competing in niche markets in the EAEU, as the Kyrgyz Republic is, for instance, the fifth-largest source of garment imports to Russia.	• The longer-term outlook for the industry is uncertain compared with other nonenabling sectors (agriculture and tourism). • The global garment industry is highly sensitive to wage increases, especially at the lower end of the value chain where Kyrgyz firms are operating • Over the longer term, Kyrgyz firms could have difficulty competing with firms in other countries on the basis of scale.
Mining	• The Kyrgyz Republic is rich in mineral wealth, boasting almost 100 gold deposits, of which 60 are state-controlled.	• While profitable, the sector is problematic for economic diversification. Most of the country's currently exploitable wealth is concentrated in a single gold mine. • There has been no significant new investment in the sector since the 1990s, though exploration is underway at about 150 sites. • The sector is not labor intensive. Although it accounts for three-quarters of manufacturing production, it employs only 3.1 percent of the workforce.
Tourism	• Tourism growth will likely increase demand for service jobs. • The tourism sector is dominated by a growing number of small private enterprises (especially sole traders), so engaging the sector could help build general private sector capacity. • The Kyrgyz Republic is located near and is potentially of historical interest to the fast-growing Chinese outbound tourism market. • There is an opportunity to leverage regional synergies by catering to the Silk Road cultural tourism market (for example, in coordinating visa regulations and marketing).	• Many service jobs created will be lower-paying positions. • Tourist-related infrastructure (transportation, facilities, signage, accommodation) needs to be upgraded. • The lack of good air connectivity with key tourism markets limits tourist arrivals. • Product development is currently poor. • Outreach and destination management are very poor. • SMEs lack access to finance.

APPENDIX B
PUBLIC-PRIVATE PARTNERSHIP PROJECTS

NO.	PROJECT NAME	MINISTRY OR AGENCY	TOTAL COST	CURRENT STATUS
1	Hemodialysis service arrangement in the cities of Bishkek, Osh, and Jalalabad	(1) Ministry of Health of the Kyrgyz Republic (public partner) (2) Fresenius Medical Care (Germany, private partner)	€10 million	Implementation
2	Reconstruction of Kyzyl-Kyrgyzstan Children Movie Theater	(1) Ministry of Culture and Tourism of the Kyrgyz Republic (public partner) (2) Burana Grant (or KR, private partner)	US$30 million	Implementation
3	E-ticketing and electronic payment system on public transport	Bishkek City Municipality	US$2 million	Implementation
4	Issyk-Kul Hotel-Trade Complex	Administration Office of President and the Kyrgyz government	US$42 million	Implementation
5	Installing CT Scanners in health facilities of the Kyrgyz Republic	Ministry of Health of the Kyrgyz Republic	US$4.5 million	Design
6	Reconstruction of Norus Ski Resort	Administration Offices of President and the Kyrgyz government	US$18 million	Design
7	Arranging centralized laboratory for health facilities of Bishkek city	Ministry of Health of the Kyrgyz Republic	€7 million	Design
8	Arranging municipal parking lots along the roads in Bishkek City	Bishkek City Municipality	US$16.9 million	Design
9	Construction of 10 preschool facilities in Bishkek City	Bishkek City Municipality	US$5.2 million	Design
10	Enhancing public transport in Bishkek City	Bishkek City Municipality	US$45.6 million	Design
11	Construction of customs-logistical complex in At-Bashy district of Naryn Province	State Customs Service of the Kyrgyz Republic	US$9 million	Design
12	Construction of belt highway in Uzgen City, Osh Province	Ministry of Transport and Roads of the Kyrgyz Republic	US$15–25 million	Design
13	Construction of the rehabilitation center	Ministry of Health of the Kyrgyz Republic	US$11 million	Design
14	Construction and operation of teaching hospital under Kyrgyz State Medical Academy (KSMA)	Ministry of Health of the Kyrgyz Republic	US$100 million	Design
15	Construction of Edelweiss Tourist-Sports Resort	State Agency on Youth, Physical Education, and Sports of the Kyrgyz Republic	US$5.8 million	Design
16	Construction of 20 schools under PPP in the Kyrgyz Republic	Ministry of Education and Science of the Kyrgyz Republic	US$30 million	Design
17	Upgrading the airports of Open JSC Manas	Ministry of Transport and Roads of the Kyrgyz Republic	TBD	Initiation

NO.	PROJECT NAME	MINISTRY OR AGENCY	TOTAL COST	CURRENT STATUS
18	Construction of mainstream school and bakery in Kok-Jar Village	Alamydyn Rayon State Administration	US$2 million	Initiation
19	Construction of the ethnic city in the southern part of Bishkek City at Boz-Boltok Mountain	Ministry of Culture, Information, and Tourism of the Kyrgyz Republic	TBD	Initiation
20	Comprehensive PPP-based development of SOE Kyrgyzavtobekety	SOE Kyrgyzavtobekety	TBD	Initiation
21	Construction and operation of kindergarten in Prigorodnyi Village	Prigorodnyi Village Administration	US$750,000	Initiation
22	Construction and operation of kindergarten in Panfilovskoye Village	Kurama Village Administration	US$750, 0000	Initiation
23	Sports and Recreation Center	State Committee on Defence Affairs of the Kyrgyz Republic	US$3–5 million	Initiation

APPENDIX C
STRUCTURE OF THE KYRGYZ FINANCIAL SECTOR, END OF 2019

	NO.	FINANCIAL SECTOR ASSET (SOMS, BILLIONS)	% OF FINANCIAL SECTOR ASSETS	% OF GDP
Commercial Banks	**25**	**249**	**77**	**38**
State-owned	2			
National bank–owned	1			
Privately owned, domestic	18			
Privately owned, foreign	14			
Nonbank Financial Institutions	**232**	**27**	**8**	**4**
Microfinance organizations	137	25		
Credit unions (including FC CU)	96	2		
Pension Funds	**2**	**5**	**2**	**1**
State-owned	1			
Privately owned	1			
Insurance Companies	**19**	**4**	**1**	**1**
State-owned	1			
Privately owned	18			
Investment Funds	9	0.08	0	0
Russian-Kyrgyz Development Fund	1	39	12	6
State Guarantee Fund	1	0.08	0	0
Exchange offices	401			
Stock exchange	1	27B**		
Total	**691**	**289**	**100**	**49**

Source: World Bank calculations.

Notes: * = More than 50 percent of holdings; ** = market capitalization of the Kyrgyz Stock Exchange.

APPENDIX D
TOURISM DEVELOPMENT: SHORT-TERM WINS AND LONG-TERM PLANS

THE KYRGYZ REPUBLIC'S TOURISM SECTOR IS LESS COMPETITIVE THAN THOSE OF ITS REGIONAL PEERS

Relative to other regional destinations, the Kyrgyz tourism sector is less competitive and is lagging in terms of contribution to the economy and employment. In 2008, the Kyrgyz Republic was ahead of Georgia in terms of overall international arrivals at 2.4 million visitors compared to 1.3 million, respectively. While international arrivals in the Kyrgyz Republic have remained relatively stable (they grew only 10 percent overall between 2013 and 2017), Georgia and Kazakhstan's arrivals grew 31 percent 12.6 percent, respectively, during the same period. The significant growth in Georgia's international arrivals resulted from a series of policy and regulatory decisions, particularly in relation to doing business, air access, and visa regulations, combined with targeted investments in destination awareness, infrastructure, and tourism services.

Comparable regional destinations capitalize on tourism for economic and employment impacts, whereas the Kyrgyz Republic trails in terms of overall total tourism contribution to GDP and employment. This is true when compared both to destinations with larger tourism industries (Georgia) and destinations with smaller ones (Armenia and Mongolia). In Georgia, tourism provides 33.7 percent of GDP and almost 30 percent of employment. In the Kyrgyz Republic, by comparison, tourism contributes only 3.85 percent to GDP and employs only 3.6 percent of the workforce. In Armenia, despite an overall lower number of tourist arrivals, tourism employs almost 12.5 percent of the workforce and contributes 14 percent to GDP. The tourist industry in Mongolia similarly employs around 11 percent of the workforce and contributes almost 12 percent of GDP, despite the country recording only 543,000 arrivals in 2018. While this may be an indication of weaknesses in other sectors, it demonstrates the employment and economic potential of tourism for the Kyrgyz Republic.

While the Kyrgyz Republic ranks well on indicators related to reasons to travel (strong natural and cultural assets, for instance), it has not been able to achieve economic growth from tourism on a par with comparable destinations. In terms of reasons to travel, the Kyrgyz Republic has a high supply and quality of natural and cultural assets. It has the highest number of intangible UNESCO heritage listings after Mongolia, for example, which places it well ahead of Georgia. The country also has a relatively strong natural asset base and the most attractive natural assets of all the benchmark countries. The Kyrgyz Republic is also a more competitive destination in terms of price than most of the benchmark countries, although this is likely to be the result of including day visitors in overall tourism flows, as noted earlier. These strong ratings on tourism assets have nonetheless failed to translate into economic growth compared to other regional destinations.

The Kyrgyz Republic struggles to address issues that hinder access for visitors, ranking lower than most of its competitors in indicators involving ease of travel to a destination. While the Kyrgyz Republic has benefited from the liberalization of air access, the country's performance is still low in terms of indicators that measure air travel, both quantitative and qualitative. In 2017, the Kyrgyz government announced an open skies policy for its air space with the goal of enticing new airlines. Despite these policy changes, the Kyrgyz Republic is still serviced by only 13 carriers with limited direct connections (26), compared to 33 carriers and 41 direct flight connections to Georgia and 27 carriers and 39 direct flight connections to Kazakhstan. In terms of infrastructure, flights, and number of carriers, the Kyrgyz Republic performs worse than all its peers and is also poor in terms of ground transportation and tourist service infrastructure. Encouragingly, the Kyrgyz Republic has an open visa regime where visitors from 68 countries have visa-free access, the highest number among its peers. Currently, 64 percent of all people wanting to travel to the Kyrgyz Republic can do so either without a visa, with an e-visa, or by acquiring a visa on arrival.[52]

The Kyrgyz Republic currently lags behind comparable destinations in terms of the prioritization of travel and tourism. The country ranks remarkably low (110th out of 140 countries) on the WEF's Travel and Tourism Competitiveness Report in terms of the importance it places on travel and tourism. Comparatively, Georgia ranks 28th and Armenia 74th. The same applies to the rest of the elements that comprise the "Enabling Environment" indicator. This shows that for the Kyrgyz Republic to take advantage of the economic potential of the tourism industry, several regulatory and policy reforms should be put in place. Placing importance on tourism and a fostering a strongly enabling environment have been recognized as key enabling factors in stimulating the growth of tourism in Georgia. The successes of comparable regional destinations in increasing the numbers of international arrivals, generating tourism returns, and increasing the employment benefits from the sector illustrate a potential pathway for tourism in the Kyrgyz Republic. The recent tourism success of Georgia demonstrates the tourism appeal of Central Asian countries from a market demand perspective. It also offers an example of how governments should prioritize tourism development with targeted policy interventions, official encouragement of environment reforms, and investment in tourism infrastructure and product development.

THE BARRIERS TO PRIVATE SECTOR TOURISM GROWTH INVOLVE A NUMBER OF CROSS-CUTTING ISSUES

Main message: *The barriers to development of the tourism sector in the Kyrgyz Republic are clustered around five cross-cutting issues that impact the private sector broadly in the country: low government prioritization and a lack of professional management of the sector; limited investment in transportation connectivity; poor digital connectivity; poor investor protections and investment promotion; and informality of businesses driven by a lack of incentives for business growth.*

Low government prioritization of tourism and a lack of professional management across the sector mean that growth is ad hoc rather than strategic, leaving key aspects of the tourism value chain underdeveloped.

Future visitor growth is limited by low destination awareness. The opportunity to build awareness of the Kyrgyz Republic as a tourism destination is constrained by the lack of a strategic marketing plan, a small marketing budget, and low marketing skills, which limit the conversion from awareness to demand, particularly with high-value segments.

There is currently no coordinated marketing approach and only a limited public budget for marketing and destination awareness. A key part of the coordinated approach to tourism development is the creation of a strategic marketing plan that leverages public funding and private sector support of tour operators and hotels.

Marketing has been opportunistic and ad hoc rather than strategic, consistent, and timely. Existing destination awareness has been built on sporadic, donor-funded marketing support for targeted industry initiatives and marketing done independently by tour operators. While tour operators support destination marketing, the presence of only a few international brand hotels (located only in Bishkek) limits the private sector destination marketing budget for the country.

The Kyrgyz Republic's ability to strategically grow sustainable, high-value tourism and attract investors to the sector is hampered by poor tourism sector performance data and market intelligence. Existing tourism data is of poor quality, as it lacks detailed visitor arrival statistics, proper supply-side data, and tourism investment tracking data. This limits the ability of the Department of Tourism to create long-term plans, identify investment opportunities, understand demand and trends, measure marketing returns on investment, and manage destinations to ensure the satisfaction of both tourists and communities. International standards for collecting and reporting visitor data such as those recommended by the International Air Transport Association (IATA) and UNWTO are not in place (UN WTO 2002). With no single source of information on tourists coming to the Kyrgyz Republic, operators struggle to develop sound business proposals such as justifying the introduction of new flights from foreign airlines. Private sector investment, especially in accommodations, also relies on quality tourism data to provide trends, market demand information, and confidence in the long-term stability of the market. Supporting investment in international-class accommodation in second-tier cities such as Osh requires sound tourism data on supply and demand. Robust tourism statistics could, furthermore, mitigate the negative impact of political instability on investor confidence.

To enhance the quality of tourism data and market intelligence, the Department of Tourism needs clear authority to implement changes within data collection and processing systems. Currently, tourism data is collected by the Border Guard and State Security and processed by the Bureau of Statistics. Existing mechanisms for data collection, processing, validation, and access are weak, all of which negatively impact the quality of the data. These agencies also do not have a clear understanding of the importance and utility of this data and therefore do not have an incentive to improve it. The Bureau of Statistics is aware of the challenges but lacks capacity to implement needed change. Support for both the bureau and the Department of Tourism is critical to addressing this issue.

Tourism planning, coordination, regulation, and investment promotion is fractured and lacks an effective structure. Currently, the Department of Tourism sits within the social sector rather than the economic sector, which limits the overall prioritization of tourism as a key sector for economic growth. This is further hampered by the department's small annual budget, its paltry amount of authority, minimal internal capacity, and low convening power. The lack of convening power compounds a lack of clarity as to who runs tourism planning, development, and regulation, as well as the scope of responsibility of each organization involved. Many agencies on the national, state, and local levels are involved in tourism planning and management, but there is a lack of formal coordination mechanisms and of skills in tourism development.

Destination planning is required to improve tourism-related public infrastructure in a coordinated and efficient manner, making it responsive to future demand and growth trends. Limited national-level coordination of tourism growth means that the transportation infrastructure is not capable of supporting tourist dispersal around the country. Public transport systems within cities and between key population nodes are underdeveloped, and border crossings can be unpredictable, limiting the efficiency of road travel within the region. While road connectivity also remains a challenge, important projects like the Third Phase of CARS3 and the ADB's Almaty-Bishkek Economic Corridor initiative are beginning to address these issues in high-priority areas. Further investment and public planning are still needed, then, to ensure the sustainability of destination and population growth. Key destinations like Karakol already experience water supply shortages and will need to address solid waste management challenges soon.

Product development has largely been driven by the private sector, while forward-looking and strategic government-led product development is still lacking. Destination product development is mostly driven by national tour operators, associations, and SMEs within destinations. This includes development of key accommodations and services, as well as specific itineraries and experiences for high-value niche markets like alpinism and cultural tourism. The Kyrgyz Community-Based Tourism Association (KCBTA) has been a leader in this area, and its chapters in southern Issy-Kul have been developing and promoting new cultural festivals and working with service providers to increase their quality and add new products. The one exception is the popular and successful biannual World Nomad Games, which ran from 2014 to 2018, which was developed and supported by the Kyrgyz government in partnership with Kazakhstan, Azerbaijan, and Turkey. With an enhanced Department of Tourism and improved investment planning and promotion agency, the government could develop a product development strategic plan focusing on leveraging Kyrgyz cultural heritage sites through PPPs. Specific heritage sites to be considered include the Sulaiman-Too complex and the Uzgen museum complex.

While the government has begun to address transportation, an overall lack of professional management in the sector has resulted in limited investment in air connectivity, a necessary element for tourism growth.

Increasing connectivity between the Kyrgyz Republic and other regional, long-haul markets is critical to increasing tourism and attracting high value markets. As mentioned in chapter 4, no direct air connections exist between the Kyrgyz Republic and Western Europe, despite the country's other relatively good air connections with regional markets. European travellers must connect through Moscow, Istanbul, or Dubai, which increases both the cost of the flights and duration of the journey. Bishkek is connected directly to only 14 countries through Manas International Airport (MIA), where more than 60 percent of the country's air passengers arrive (table D.1). Osh International Airport ranks second in volume to Manas, with more than 1.4 million passengers

TABLE D.1 PASSENGERS TO AND FROM MANAS AIRPORT BY COUNTRY AND YEAR, 2014–18

COUNTRY	2014			2018			VARIATION, 2014–18		
	DEPARTURES	ARRIVALS	TOTAL	DEPARTURES	ARRIVALS	TOTAL	DEPARTURES	ARRIVALS	TOTAL
Russia	337,359	335,589	672,948	790,780	745,688	1,536,468	134.4%	122.2%	128.3%
Turkey	127,114	119,006	246,120	326,899	321,540	648,439	157.2%	170.2%	163.5%
Kazakhstan	31,745	30,892	62,637	102,670	108,606	211,276	223.4%	251.6%	237.3%
UAE	21,568	21,600	43,168	92,123	92,689	184,812	32.1%	329.1%	328.1%
China	32,909	31,208	64,117	53,179	48,814	101,993	61.6%	56.4%	59.1%
Uzbekistan	17,125	14,844	31,969	42,368	46,075	88,443	147.4%	210.4%	176.7%
India	212	339	551	33,306	37,404	70,710	15,610.4%	10,933.6%	12,733.0%
Egypt	0	0	0	5,998	5,874	11,872	–	–	–
Azerbaijan	512	463	975	38	16	54	−92.6%	−96.5%	−94.5%
Belarus	43	56	99	88	110	198	104.7%	96.4%	100.0%
Mongolia	2,590	2,679	5,269	4,858	4,701	9,559	87.6%	75.5%	8.4%
Tajikistan	10,665	11,545	22,210	16,050	16,812	32,862	50.5%	45.6%	48.0%
Thailand	0	0	0	2,939	2,816	5,755	–	–	–
Turkmenistan	58	64	122	198	0	198	241.4%	−100.0%	62.3%

Sources: Official data of JSC International Airport Manas and data from air transport industry news magazine Russian Aviation Insider.

in 2017. It recorded the highest growth, around 37 percent in 2016, which was mainly because of the new flight connection with Zhukovsky International Airport near Moscow.

To support strong growth of the tourism sector and further diversify markets, the Kyrgyz government must invest in improved air connectivity through airport upgrades and enhanced airport management. The Kyrgyz Republic has good connections to regional markets serving business people, passengers visiting friends and relatives, and short-stay holiday visitors. To significantly grow higher-value, long-haul markets from Europe, the Middle East, and Asia, airlines need to launch new routes linking to these source markets. While the 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 interest from international carriers. Consultations with stakeholders, for example, indicate that total ground costs per passenger as a percentage of total costs[53] for round trips between Manas and selected destinations, when compared to those for the same destinations from Almaty, are generally significantly higher. The government is working with IFC through a PPP process for the upgrading of Manas and potentially other key regional airports.

The government is investing in public infrastructure projects that address transportation and connectivity constraints and support advancement of the tourism sector. The

Civil Aviation Agency (CAA) has been engaging with the International Civil Aviation Organization (ICAO) to undergo assessment to have the Kyrgyz Republic removed from the European Union's air safety list (the so-called blacklist),[54] which should help encourage new carriers to enter the destination. The International Bank for Reconstruction and Development (IBRD) CARS3 project which commenced in December 2019 will provide support to the CAA and Kyrgyz Aviation College for institutional and regulatory reforms (including an organizational review of the CAA and a review of aviation rules), training of CAA safety inspectors, and improved software and equipment for certification, investigation, and record keeping. Together, these activities will support improved safety and service provision in the aviation sector and assist the Kyrgyz Republic in conforming with ICAO requirements. Furthermore, the CARS3 project will also support the rehabilitation of regional road connections of the Issyk-Kul Oblast, focusing on the main road connection to Kazakhstan as well as several access roads of regional importance that will improve access to tourism sites, enabling visitors to circulate throughout the country and spread the benefits of tourism.

POOR DIGITAL CONNECTIVITY AND A LACK OF USE OF DIGITAL TECHNOLOGY ARE CAUSING INEFFICIENCIES IN TOURISM-SECTOR PUBLIC MANAGEMENT AND PRIVATE SECTOR GROWTH.

The sector is not leveraging technology for enhanced sector management, marketing, and visitor safety. Currently there is a limited use of digital tools for tourism statistics collection, analysis, and dissemination. This impairs evidenced-based strategic planning and effective marketing, and it stems from a low tourism budget, lack of knowledge, and lack of access to skilled experts in the space. Furthermore, the use of digital technology to enhance visitor safety and emergency planning is too limited.

A national geographic information system (GIS) is required for the development of transport, communication, and tourism infrastructure and for the implementation of visitor safety systems. A common national spatial information management system with vector and orthophoto data and the capability to define additional specific layers such as infrastructure, land registry, and tourism objects does not exist in the Kyrgyz Republic. Current policy and legislation do not stipulate the necessity of and the principles for developing a national spatial information system for integrated management and the sharing of geospatial data. As a result, the Address Information System is not based on national-level geospatial data and instead uses external resources such as vector data from the Open Street Map. As a first step toward enabling a good practice model for a national GIS, it will be necessary to review the current legal environment and make the necessary regulatory adjustments.[55]

The government interoperability platform, Tunduk, does not support exchange of geospatial data and does not provide other data on tourism through a single point of contact. There are no IT solutions in the Kyrgyz Republic capable of sharing geospatial data that can be reused to develop new IT services. In general, there is a lack of data exchange in tourism as relevant registries are not digitized and information systems are not interoperable. A fully implemented horizontal government interoperability platform is a prerequisite for a systemic approach to data exchange and the digitalization of both government and business services.

The e-government platform still lacks the capacity to digitalize permitting processes. The e-government platform lacks an e-payment mechanism, and the PKI for digital identity management and digital signatures needs improvement. Tunduk, the interoperability platform, is newly implemented and requires further expansion.

The government data center is to be delivered within the World Bank Digital CASA project, yet the work has not been progressing as planned because of the project implementation unit's lack of capacity. All these are prerequisites for the digitalization of business licensing and permitting, the implementing of services for online applications, the tracking of application status, and the receiving of permits in digital format, as enabled by Moldova e-Permitting, for example.

The lack of e-identification significantly impedes wider penetration of online B2B and B2C services. The PKI infrastructure currently implemented lacks a reliable mechanism for issuing digital certificates, which prevents businesses from applying the PKI to online identification. Mobile identification could be a solution, because mobile telecom operators in the Kyrgyz Republic are well-developed and possess the technology to implement the mobile ID. This could decrease the costs of online identification and enable improvement of the national PKI infrastructure and greater penetration of online services in both the financial and tourism sectors.

Tourism has benefited from the introduction of the e-wallet in the Kyrgyz Republic, but fees for using the service charged to tourism agents and operators are still high. Most of the e-wallet providers charge travel agents high fees for online payments. One interview-based assessment estimated that up to 6 percent of revenue goes to the e-wallet providers. An ongoing private sector initiative seeking to reduce these costs to make the service integrating online payments more inclusive has had some positive effect on fees.

The low level of digitalization of B2B and B2C prevents the creation of discounted bundle products in tourism. Online customer relationship management (CRM) systems customized for tourism such as Nemo and Emerald, which enable operators to provide digital services and create service bundles, are not yet available in the Kyrgyz Republic. Operators are thus required to seek the support of foreign or international software vendors for CRM systems, which increases costs and reduces the feasibility of introducing such digital platforms. Similarly, a lack of digital e-insurance services means that travel agents must create insurance policies manually. This prevents them from combining insurance with other products such as flight bookings and hotel reservations to create service bundles at discounted prices.

POOR INVESTOR PROTECTION, LOW INVESTMENT PROMOTION, AND A LACK OF APPROPRIATE FINANCING ARE HINDERING TOURISM SECTOR INVESTMENT AND STIFLING GROWTH.

While domestic investment in tourism continues to grow, a range of issues including access to land, poor market intelligence, and a poor enabling environment hinders FDI in tourism. Domestic investors continue to invest in the tourism sector in, for instance, large cities like Bishkek and second-tier cities like Karakol and Osh, which are all expanding and upgrading the quality of accommodations. Investments in second-tier cities, though, are not linked with international brands, reducing the overall quality of accommodation stock. Key enabling environment issues identified by domestic investors include reliable access to land and limited market intelligence driven by poor national statistics. As noted earlier, tourism FDI in the Kyrgyz Republic remains low, representing just 7 percent of total FDI in 2018. All barriers described in this report contribute to low tourism FDI, but the specific and systemic conditions that limit FDI are explored in the paragraphs below.

Low access to long-term finance restricts access to dedicated long-term investors, limits asset improvement, and prohibits continuous destination development in line with market demand. While some financial institutions are actively investing in tourism in the Kyrgyz Republic, few providers are willing to offer facilities that match the requirements of the sector. A recent study carried out for IFC examining access to finance identified a financing gap in the tourism sector of US$322 million (International Finance Corporation [forthcoming]). Current financial products are poorly aligned with tourism's need for long-term development finance because they involve high borrowing costs (16 to 24 percent), short tenors (3 to 5 years), a lack of tailored financial products, and excessive security requirements. Most tourism businesses that require the financing of fixed assets such as accommodations have difficulty meeting these requirements. The high degree of seasonality restricts the ability of borrowers to consistently generate enough cash to service short-tenor loans, while the absence of a mature market in land, especially in the rural areas attractive for tourism, makes it virtually impossible to meet the security requirements of most active lenders. Informal businesses have no access to commercial finance. There is a low understanding of the sector by financiers, driven by the lack of tourism data and reliable statistics.

While there is confidence in long-term tourism growth, the Kyrgyz government will need to increase destination management practices in order to safeguard investments, better regulate the industry, and maintain positive community sentiment regarding tourism. There is no effective mechanism for destination management in place. Without this, key tourism assets will be degraded by overuse and investments connected to these assets will lose value. Improved destination management will lead to greater certainty, help maintain positive returns, and drive new investment. Forward planning for public investment is also required to build investor confidence by ensuring adequate investments in water, waste management, electricity, and improved border crossings facilities to keep up with demand.

A lack of vision, strategy, and capacity at the Investment Protection and Promotion Agency (IPPA) leads to poor supply-demand balance in key destinations, opportunistic and ad hoc investments, and investments that are not aligned with destination development needs. The IPPA lacks the authority and capacity to manage tourism investment promotion and planning, leaving investments to develop in an ad hoc and opportunistic manner. Capacity at the IPPA is limited because of the unclear roles of different agencies, low understanding of investment fundamentals, unclear targeting, and a lack of investment data or investor tracking systems. The absence of an overall investment strategy leads to a disconnect between demand and supply. This is also the result of a lack of planning concerning areas where investment is needed most based on current and potential market demand.

Multiple agencies are involved in investment planning and promotion, yet there is no adequate system for a coordinated approach. Several agencies are involved in investment promotion in the tourism sector. In addition to the IPPA and the Department of Tourism, Kyrgyz Tourism, a recently formed state enterprise, is charged with developing tourism projects such as rehabilitating former government-owned tourism assets and taking these to market. The State Commission on Architecture and Construction engages directly with private investors as part of its function in planning the development of specialized tourism assets in the Issyk-Kul region, and individual oblast governments are also developing strategies that include tourism development and tourism investor outreach programs. It is not unusual to have multiple agencies engaged in tourism investment promotion. The absence of clear, easily identifiable leadership and coordination protocols in the Kyrgyz Republic, along with the lack of an articulated plan for tourism development and agreed-upon tourism investment strategy, causes confusion in regard to jurisdictional responsibilities, a lack of transparency, and preferential treatment of some investors.

CURRENT BUSINESS REGULATIONS, INCLUDING THE PATENT SYSTEM AND LAND CATEGORIZATION LAWS, DISINCENTIVIZE BUSINESS EXPANSION AND GROWTH, AND THEY INSTEAD ENCOURAGE BUSINESS TO REMAIN INFORMAL.

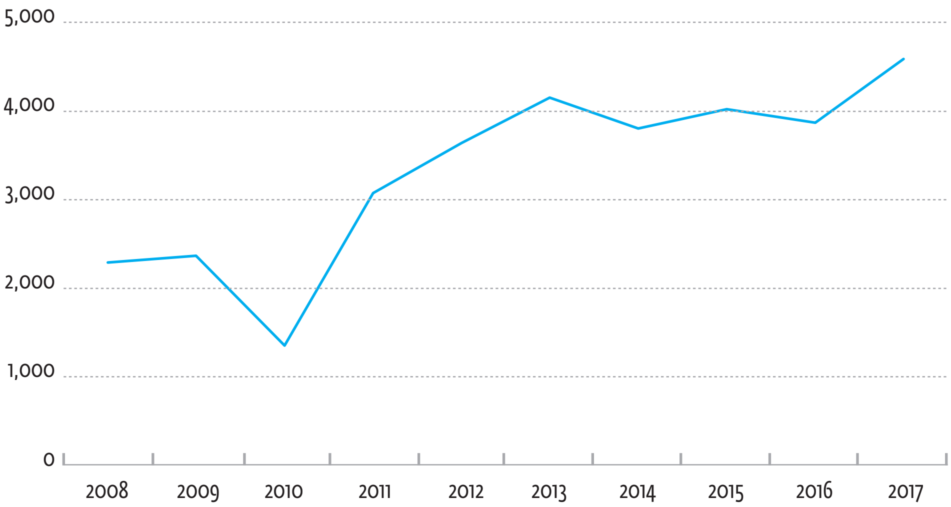
Strategic planning and destination development will require revisions to tourism-related regulations on land categorization. Land in the Kyrgyz Republic is categorized into seven classes with restrictions on the types of activities that can be conducted and the length of leases.[56] For tourism to be successful in rural areas, the recategorization of land types as forest and pastureland is required. The limiting of leases in forest areas and pastureland to five years discourages private investment in tourism developments that are required to improve standards and address destination management issues like waste management and sanitation. The short lease period is insufficient for commercial investments, especially in the permanent or semipermanent structures needed for high-quality yurt camps and rural accommodation. The current moratorium on land transfers is also impacting the availability of land. The Kyrgyz government must prioritize land for tourism investment and lead the land transformation process to make these plots investment-ready.

Strengthening the enforcement of laws and the rule of law in general is a precondition for all the recommended improvements required to stimulate the growth of tourism in the Kyrgyz Republic. There is currently no clear community engagement strategy or process to help resolve or avoid conflict between investors and communities. This creates tension around benefit sharing from tourism growth and is driven mainly by a mistrust of central authorities, concerns regarding rights to the use of resources, and the decentralization of power in the region. Additionally, no systems are in place for investors to identify areas for investment or for communities to promote investment opportunities on their lands. This is further complicated by the low frequency of contract enforcement within the legal system. A newly enacted ombudsman law aims to address some of these issues. In addition, there is a general fear of decision making within the government, which contributes to an uncertain environment and a lack of timely decisions.

Tourism regulations and licensing are being used as revenue-generating mechanisms instead of as incentives to improve quality control and standards. All interviewed tourism operators complained about interactions with the local public bodies relating to the development of tourism accommodation facilities. As reported by operators, authorities overuse the prerogatives of their local autonomy in many cases and discourage potential investors. While a low degree of regulation can help support growth and new business entrants, it means there is no formal system for quality control of accommodations, guiding services, and other tourism-related businesses outside of health regulations that apply to food and beverage outlets.

It is not possible to identify all the permits and licenses required for engaging in tourism-related commercial activities in the Kyrgyz Republic. There is no easily accessible national portal that enables the filtering of applicable permits and licenses. An inventory of tourism-related permits and licenses was initiated on the national level in 2019 with the goal of establishing an online registry of administrative requirements.

FIGURE D.1 VISITOR ARRIVALS TO THE KYRGYZ REPUBLIC, 2008–17



Source: UNWTO 2018b.

The initiative's first steps were the mapping of licenses and permits in tourism and the publishing of information online by implementing the E-Registry of Administrative Requirements. The inventory and the e-registry will provide a basis for expanding to other sectors and a template for the simplification and digitalization of procedures in the next phase.

EXPANDING THE GROWTH OF HIGHER-SPENDING, LONG-HAUL MARKETS IS NECESSARY TO INCREASING SECTOR VALUE

Strong growth in international visitor arrivals since 2011 demonstrates the country's demand potential, although a recent slowdown in growth rates between 2013 and 2017 indicates cooling market interest. Tourism demand measured by visitor arrivals to the country has experienced strong growth over the longer term. Total visitor arrivals were 4.56 million in 2017, more than double the 2008 figure of 2.27 million, as figure D.1 shows (UN WTO 2018b). Following a decline in 2010, visitor arrivals grew by an average of 7.11 percent (a compound annual growth rate, or CAGR) between 2011 and 2017. This is higher than the global growth rate of 5.05 percent and the growth rate for the ECA region (4.55 percent) over the same period. On the other hand, these longer-term growth trends mask a recent slowdown in arrivals. Between 2013 and 2017, visitors to the Kyrgyz Republic grew by only 2.53 percent CAGR compared to the global rate of 4.91 percent and 4.21 percent CAGR for the ECA region, which indicated an overall slowing of demand.

The Kyrgyz Republic has been dependent on lower-value, regional markets that are susceptible to instability. According to the United Nations World Tourism Organization (UNWTO) data on arrivals at national borders for nonresident visitors to the Kyrgyz Republic in the year 2017, the main source countries for visitors to the Kyrgyz Republic are Kazakhstan (60 percent of all arrivals), Uzbekistan (15 percent), and Russia (10 percent). Each of these, though, have shown considerable fluctuations in recent years. Overall growth of the top 10 markets was limited to 9.6 percent between 2013 and 2017 with an average annual increase equivalent to 2.3 percent. Visitors from Kazakhstan, who are more likely to be impacted by negative political and weather events in the Kyrgyz Republic, were the main drivers of this volatility (UN WTO 2018a). On average, the Kazakh market has declined by 2.7 percent over this period. While official immigration statistics do not track purpose of visit, a 2015 study by the University of Central Asia found that 41.5 percent of visitors arrived in the Kyrgyz Republic for leisure, 37.5 percent for business, and 21 percent to visit family and friends (Jenish 2017). Overall, national tourism statistics in the country are weak and sometimes unreliable, with little to no disaggregation at the regional level.

Changing trends in the Kyrgyz Republic's top 10 source markets have begun to impact their relative importance, indicating an opportunity to stimulate growth in new markets. While regional markets remain important, comprising 95 percent of total arrivals in 2017,[57] they mask rapid growth in emerging, long-haul markets. Kazakhstan remains the largest market, but it has declined by over 10 percent since 2013, while Russia, the third-largest market, has shown very little growth over the same period. The fall in visitors from Kazakhstan has been more than compensated for by a significant increase in visitors from Uzbekistan.[58] Strong increases in emerging markets such as India, the Republic of Korea, and Turkey have also contributed to the Kyrgyz Republic's above-average growth in arrivals since 2013. On a regional basis, arrivals from the Eastern Mediterranean region of Europe increased 135 percent in five years, an average annual change of 23.8 percent. Over the same period, Northeast Asia arrivals increased 42 percent, an average annual change of more than 9 percent, and arrivals from South Asia increased 304 percent, a 41.6 percent average annual change. Tourism flows to the Kyrgyz Republic from other markets such as the Middle East and Europe are also registering high growth. These quantitative findings are supported by qualitative interviews conducted during the CPSD fieldwork that recorded tour operators and hotels reporting a strong increase from emerging markets in the Middle East and Southeast Asia in recent years, with a specific interest in nature-based tourism.

TOURISM ARRIVALS GROWTH IS NOT TRANSLATING INTO ECONOMIC VALUE OR EMPLOYMENT

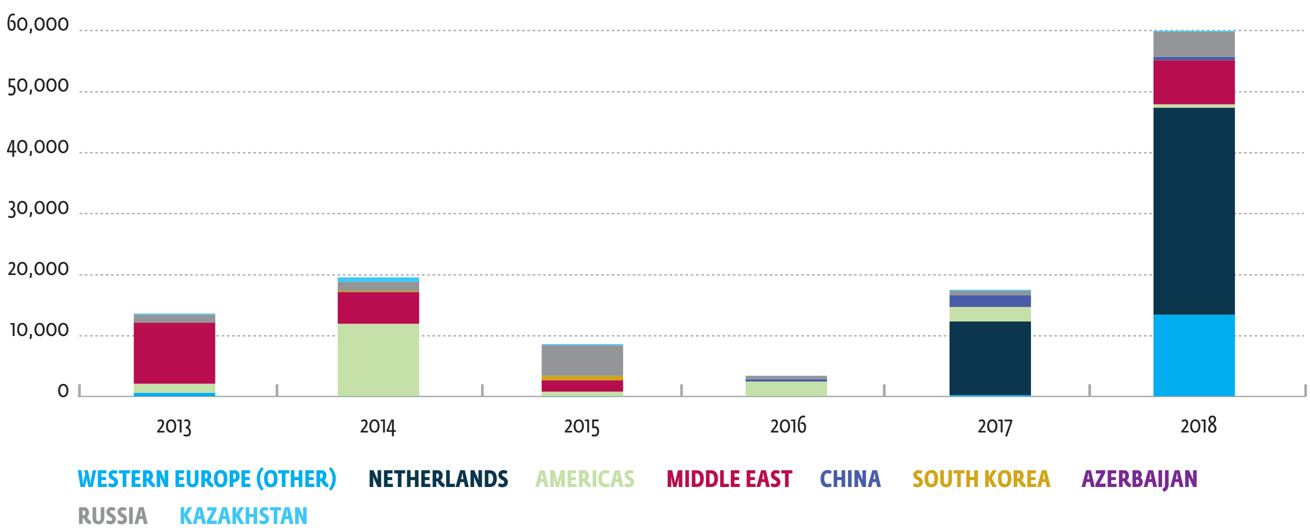
Despite growth in visitor arrivals, the contribution of tourism to the Kyrgyz economy has been below potential and is well below that of several regional competitors. In terms of GDP, the sector represents 3.85 percent of the economy currently (UN WTO 2019). This is similar to Uzbekistan at 3.39 percent, but compares unfavorably with Armenia at 14 percent, Georgia at 33.7 percent, Kazakhstan at 5.69 percent, Mongolia at 11.79 percent, and Tajikistan at 8 percent. The World Travel and Tourism Council (WTTC) estimates that tourism will grow to 4.3 percent of the economy by 2029 (World Travel and Tourism Council 2019), still a relatively small portion, not accounting for post-COVID trends.

Tourist spending is low and has been declining, amounting to US$429 million in 2017, down from US$530 million in 2013 (UN WTO 2019). The 2017 figure represents around US$94 per day per arrival compared to US$128 per day in 2013. Except for Tajikistan, spending by tourists in the Kyrgyz Republic is considerably lower than in its regional peers. This is likely to reflect the miscounting of day visitors, especially those from Uzbekistan, who are included in the overall tourist figures. Distortions of this kind make it difficult to make accurate comparisons with neighboring countries where more robust data capture methodologies are in place.[59] Hotel and accommodation providers are the primary beneficiaries of tourism spending, earning about 70 percent of the country's tourism revenues in 2017, while spending by niche-market travelers is mainly directed to tour operators, agencies, communities, and attractions. An analysis by Jenish (2017) found that 80 percent of tourist spending for mainstream regional markets like Kazakhstan and Russia is directed to accommodation providers, while only 20 percent of soft adventure and about 11 percent of hard adventure tourist spending flow to accommodation, meaning that more spending is diverted to tour operators, service providers, and attractions. Large, local companies engaged in construction or other activities as their core business typically own the larger and more established hotels. Regional destinations have a strong supply of guesthouses that are mainly run from people's homes and have developed in an ad hoc manner over time. Few have been able to transition to formal hotels. There are a handful of large, professionally run destination management companies based in Bishkek that focus on different market segments (mountaineering, hard adventure, cultural activities, package tours). Donor-supported development projects have also successfully supported connections with international outbound operators, and this has contributed to longer-term growth in adventure tourism markets.

The Kyrgyz Republic is also not currently experiencing the potential employment benefits from the tourism sector. The tourism sector directly provided about 1.3 percent of total employment in 2018, according to the WTTC. The number of tourist sector employees is projected to rise to the equivalent of 1.98 percent of total employment by 2029. When indirect and induced effects are considered, the sector contributes almost about 3.7 percent of total employment, but despite the growth in tourism arrivals, contribution to employment has remained relatively constant over the past four years. When compared to the tourism industries in similar countries in the region, Kyrgyz tourism is not creating jobs at the same rate. These figures are likely to be affected by the way the Kyrgyz Republic reports visitor statistics, as noted earlier.

Despite recent growth, FDI in tourism remains a small overall percentage of total FDI, compared to other regional destinations. Between 2013 and 2018, total tourism FDI grew at an average of 35 percent per annum (CAGR) while total FDI declined by 2 percent per annum CAGR (National Statistics Committee of the Kyrgyz Republic 2019). This resulted in tourism FDI increasing in importance from 1 percent of total FDI in 2013 to 7 percent of FDI in 2018. The high average growth rate is the result of the 2018 figure, which was three times the highest most recent figure (figure D.2). While the level of tourism FDI has varied over the past five years, so too has the source of investment: the importance of Western European investors (especially from the Netherlands) has increased while that of investors from CIS countries and the Americas has been decreasing.

FIGURE D.2 TOURISM FDI BY REGION OF INVESTOR, 2013–18 (US$, 2010S)



Source: National Statistics Committee of the Kyrgyz Republic 2019.

A DIVERSIFIED AND HIGH-QUALITY SUPPLY IS REQUIRED TO SPREAD THE BENEFITS OF TOURISM AND INCREASE ITS VALUE

Tourist activity in the Kyrgyz Republic is centered around three key locations: Bishkek, Issyk-Kul, and Osh, and adventure tourism has more recently expanded into the Song Kol Lake area. The main concentration of accommodations and tourism services is in Bishkek, representing 35.5 percent of total hotel stock. In terms of the number of hotels, the strongest growth has occurred in the Issyk-Kul and Talas regions since 2015, and they now represent 22 and 3 percent of hotel properties, respectively. Osh City and the Chuy, Naryn, and Jalalabad regions each account for between 7 and 9 percent of total hotel room space.

Investment is not keeping up with demand, and low investment in high-quality internationally branded accommodation outside Bishkek limits revenue and the benefits of tourism. In Karakol, there is a critical accommodation shortage during peak seasons with informal accommodations and guesthouses filling the gaps. The key second-tier cities of Osh and Karakol have no internationally branded hotels, and no hotel above an international three-star rating quality. The absence of medium- to high-quality, internationally branded accommodation limits the country's ability to attract high-yielding markets, which in turn limits the ability to generate enough marketing expenditure and skills to drive destination development outside of Bishkek. It also limits the spread of benefits through increased employment opportunities at larger accommodation facilities. Hotels supply most of the accommodation, whereas camps (mainly yurt-based) play a crucial role in rural areas. Most yurt camps, including individual yurts, dormitory-style yurts, and camping, are run by tour operators to provide accommodations for their package tour guests or by individuals who cater to specific regional markets. There is a lack of high-end yurt accommodations or "glamping"-style accommodations. Operators report that the short length of land leases discourages investment in more permanent infrastructure for amenities and services in rural areas where visitors prefer to stay.

The Kyrgyz Republic has strong product offerings in adventure and cultural tourism which include specific niche markets like trekking, biking, and horse riding, all highly popular among tour operators. Recent research among 20 Kyrgyz destination management companies (DMCs) illustrates that most sell products focused on adventure activities, both hard and soft, and cultural activities, including those focused on the nomadic lifestyle. Tour operators also have a specific focus on technical adventure activities like trekking, mountaineering, climbing, and horseback riding that require a degree of skill and experience. Notably, these products are also higher-value, providing more income to rural communities.

Tourism services throughout the value chain suffer from low quality standards, resulting in substandard offerings from the private sector. Within the accommodation sector, this is driven by a lack of internationally branded and professionally managed hotels. Many hotels, especially in second-tier cities, lack basic amenities and services that tourists seek such as English-speaking front desk staff, quality food and beverages, quality housekeeping, and laundry and concierge services. At the guesthouse level, there is also a general lack of understanding of the needs of international tourists in terms of infrastructure, cleanliness, and services. Beyond accommodation, quality issues across the tourism value chain impact restaurants, guides, transportation, and other services. The underlying issue is that most businesses are owned and managed by first-time tourism entrepreneurs who do not have formal qualifications or previous hands-on experience. This is exacerbated by low investment from international companies that would professionalize the sector and raise standards through increased competition.

Community-based tourism is an emerging market in which there has been strong growth, spreading the benefit of tourism to rural areas and small businesses, although spending tends to be low. According to the Kyrgyz Community-Based Tourism Association (2016), there were 15 community-based tourism (CBT) groups representing 284 individual business members operating in the country. They also support several nonmember businesses such as guides, cooks, porters, drivers, horse owners, and artisans. The total number of visitors these communities serve has increased 45.5 percent since 2010. While overall spending by community-based tourists is relatively low, it has been growing (it has increased 75 percent since 2012), demonstrating the potential of this product and market segment.

Online tourism promotion facilities exist but could be modernized by introducing information-reach content and interactive online services. The country's current tourism promotion portal is static and requires manual updates, which impedes online accessibility of reliable, up-to-date information on tourism. The portal can be modernized by introducing information-reach content and interactive online services. There are also no digital registries of tourism operators and certified persons such as guides and instructors, which limits access by consumers. Currently, it is difficult to choose a tour operator, as there is neither a complete and updated database of registered operators nor a mechanism to determine reliability. The same applies to specialized, trained guides. As many tourist attractions are specific to mountain tourism, which involves significant risk and requires well-trained guides and instructors, a mechanism is necessary to ensure that (a) professionals are properly trained and have the appropriate level of experience, and that (b) this information is available online.

STRUCTURAL ISSUES IN SECTOR MANAGEMENT PREVENT AN INTEGRATED APPROACH TO TOURISM DEVELOPMENT LINKED TO ECONOMIC DEVELOPMENT

Within the current government framework, tourism is mapped as a social sector, not an economic one, and this limits direct influence on national economic development strategies. The sector is currently managed by the Department of Tourism within the Ministry of Culture, Information, and Tourism. Additionally, the Department of Tourism has a weak institutional structure, limited budget for both administration and marketing, and little authority. The latter affects the convening power of the department to bring together the variety of stakeholders required for overall sector management and strategic destination development planning. Taken together, these structural issues result in a lack of an integrated approach to tourism planning.

A low level of regulation and an easy "patent" system support new tourism entrepreneurs but restrict the transition from small enterprises to medium and large enterprises and negatively impact quality control. Most tourism businesses are operated as small firms or are run by self-employed entrepreneurs who pay a flat tax or "patent" fee on a monthly or annual basis. This fee does not increase with revenues and the system does not require holders to keep regular accounts or report on revenue. While this system allows easy entry to the tourism sector for informal businesses and individual entrepreneurs, it disincentivizes businesses from growing into medium-sized enterprises on which tax burdens would be higher. This ultimately limits both the amount of business firms can generate from the tourism sector and the quality of products and services available for tourists. It also works against building performance data for the sector (such as guest numbers by location and revenue by enterprise type), as many firms and tourism businesses remain outside the reporting system.

Tourism enterprises face difficult labor conditions, including low skill levels, high staff turnover, and high employment-related costs for formal firms. High staff turnover is associated with a scarce skills pool and a related labor drain to other countries. This leads to poaching, a poor return on investment in skills training for employees, and inconsistent quality of service, and it also places downward pressure on competitiveness. In addition, the cost of tax compliance is high for firms with formal employees, SF contributions being especially high (25 percent).

Tourism agencies and operators face difficulties in managing their interactions with local public authorities. All tourism operators interviewed during the World Bank mission complained about their experiences in dealing with local public bodies, especially in relation to obtaining information on processes and securing approvals for the development of tourist accommodation facilities. There are some exceptions, notably Karakol and Balykchy, where local authorities are introducing investment-promotion internet portals to more effectively disseminate information on economic and social opportunities and attract investments.

RECOMMENDATIONS

The Kyrgyz government must focus on improving key tourism system enablers that form prerequisites to tourism growth such as public infrastructure, security, access, asset base, and sustainability (table D.2).

The government should continue placing a high priority on connectivity improvements with the support of regional and global partners and expand to meet the needs of future demand. One specific reform to support this growth is initiating the PPP for the Manas International Airport to improve both infrastructure and operational management. Regional airport development can then be supported as needed, based firmly on a solid understanding of demand. The positive work being conducted under the CARS3 Project and ADB's Almaty-Bishkek Corridor Development should be continued and expanded. The government should furthermore continue to expand the visa-free regime and open air routes. The latter will require a concerted effort to incentivize foreign carriers to come into the country.

The relatively high penetration and low costs of mobile broadband in the Kyrgyz Republic provide an opportunity for the use of mobile applications in tourism. Mobile apps are the most used means for planning travel and leisure activities. Travel agencies and physical bookings are almost entirely outdated. It is known that travel-based mobile applications are the fifth-most downloaded category and that 60 percent of users prefer mobile apps for planning their travel and leisure tours. Travelers use mobile applications for online ticketing, hotel booking, gathering information on a destination, locating local attractions and food outlets, and examining reviews and feedback, among other activities.

If these reforms are made, the Kyrgyz Republic will see short-term improvements in visitor experience with increased access facilitated by improvements in road and air infrastructure. A critical objective is to link key markets with high potential demand via air routes. In the long term, the country will benefit from diversified and increased visitor arrivals and increased private sector engagement in tourism and destination management.

The government should strengthen the capacity of the Department of Tourism to ensure that tourism development is driven by an agency with adequate convening authority and consistent funding to address barriers to growth and investment.

Tourism sector growth and management must be led by a dedicated government agency with sufficient authority and convening power. This could be developed through the creation of a national tourism board (with representation from government agencies) that includes both social and economic ministries and the private sector. The board should have a direct connection to the prime minister's office through a formal committee in order to have the appropriate level of convening power across the multiple agencies needed to effectively manage tourism growth.

On a detailed level, the board will require strengthened capacity and the development of knowledge in tourism sector planning and growth along with an adequately sized budget to fund policy and strategy creation, product development, destination management, marketing, and promotion. Regulations and policies implemented by the board should be streamlined to grow tourism strategically, manage growth, and improve quality and standards with the focus on priority destinations in the short term. Further integration of the private sector into destination management through formal public-private dialogue (PPD) and tourism agency board participation is necessary for the successful long-term management of the sector.

Together, these reforms will result in destinations that are better managed with increased investment in destination infrastructure (water supply, roads, border control, waste management, supply of electricity) in line with projected growth. Ultimately, this will result in improved resident sentiment and overall investment growth through a strategic approach. With formal PPDs and an improved regulatory environment, the industry will be able to forge stronger links with SMEs, resulting in the increased formalization and growth of SMEs and informal entrepreneurs. Finally, adequately funded and strategic destination marketing to market segments with key growth potential will diversify and increase visitor arrivals and disperse them throughout the country. Overall, these activities will increase rural incomes for both SMEs and individuals.

The government must improve its practices around tourism data and statistics by working across government agencies to collect accurate national visitor arrivals data, create strong market intelligence, and analyze and report on overall sector performance. Together these data tools can be used to inform planning, policies, and destination management and to facilitate investment.

Tourism data must begin with improved collection, processing, and dissemination of tourism arrivals statistics at the borders to enhance information availability, reliability, and accuracy. This requires a coordinated approach across the Department of Tourism, National Statistics Office, and National Border Guard, as well as intensive capacity building within these agencies. This effort should be paired with capacity building that directly involves tourism firms and the IT sector so that they can develop digital platforms for data analytics along with the capacity to understand, interpret, and use tourism statistics and data for evidence-based decision making in their businesses. Previous reviews conducted by other development agencies in the Kyrgyz Republic have provided a clear road map for the enhancement and improvement of tourism data. These plans should be updated and implemented to gain the full benefit of tourism data.

Improvements in national arrivals data will need to be paired with strengthened supply-side data and improved knowledge of visitor trends and preferences. The National Statistics Committee regularly conducts supply-side data collection but the methodologies need to be strengthened and expanded throughout the country for this data to be accurate, inclusive, and reliable. Additionally, little is currently known about visitor travel preferences, patterns, and spending. The development and launch of an international visitor survey, currently proposed under the IFC Growth and Competitiveness project, will provide this data, but it will be dependent on access to reliable national arrivals data for extrapolation.

With reliable data, the Department of Tourism can then leverage baseline data on tourism arrivals to conduct regular market demand assessments in order to understand current, future, and untapped demand. This will flow into long-term marketing strategies and annual marketing action plans that are metric-driven, efficient, and coordinated. Improved tourism data will provide necessary information for tourism master planning and destination management to ensure sensitive and popular destinations are not overburdened. Finally, robust visitor data is a necessary element in building long-term investor confidence and demonstrating the potential of the Kyrgyz tourism sector.

With accurate, reliable, and timely tourism sector performance data and market intelligence, private and public tourism stakeholders in the Kyrgyz Republic will have the evidence-based knowledge to strategically make sustainable, high value tourism grow and to attract investors to the sector.

Based on sound tourism sector data, the Kyrgyz government must increase coordination among the multiple public sector stakeholders and implement overarching regulatory reforms to strategically induce tourism growth in a sustainable manner.

Detailed and strategic master planning for tourism is needed in priority areas to plan for investments to meet demand expectations and unlock untapped demand. Master planning will identify specific areas for priority tourism development based on tourism assets and attractiveness, land availability, carrying capacity, environmental impact, access to available utilities, and other key criteria. Available access to plots of land in key priority destinations is essential to attracting investors in a strategic and planned manner.

To facilitate master planning, the government must address land categorization issues to ensure that land is made available for tourism development through a formal and structured process. Once land has been identified for tourism and transformed into a land classification that allows for commercial development, the Department of Tourism must work cooperatively with other government agencies to ensure that land plots are investment-ready. This should be done through forward planning with appropriate agencies for adequate trunk and last-mile infrastructure such as water, waste management, roads, and electricity. There is also an opportunity for the government to develop its cultural heritage assets into high-value tourism products. In order to do so, they must be thoroughly mapped and documented, improved through appropriate public investments in line with market demands, and then managed through a PPP structure that promotes private sector operations for high quality and innovative travel destination experiences.

A strategic master plan will create a consolidated vision for tourism growth with a specific action plan to accomplish that vision. Together with increased and facilitated access to land in key destinations and improved tracking and promotion of tourism investment opportunities, the Kyrgyz Republic can enhance the supply-side offering through strategic investments that are aligned with market demand and increase the number and value of tourist arrivals to the country.

The Kyrgyz government must leverage digital tools across the government and specifically within the tourism sector to increase visitor safety, streamline business efficiency, and ensure tourism data is accurate, reliable, and timely.

Digital registries of tourism operators and certified professionals should be developed and updated. The first must contain up-to-date, exhaustive data on Kyrgyz tourism operators. The registry of certified professionals in tourism should contain detailed information on authorized or certified persons (guides and trainers) for the provision of specific services (such as mountain tourism). Along with the registries, a mechanism for determining the reliability of tour operators and certified professionals should be developed that enables consumers to give reputation feedback and makes the online certification of professionals possible.

Emergency services are of particular urgency in the Kyrgyz Republic for developing mountain tourism. These services need to be able to operate in locations where there are no cellular connections. Solutions include a mobile application that can emit an emergency Wi-Fi signal over several kilometers.

For an efficient mechanism of interaction between businesses and central and local public authorities, the government should establish investment promotion portals. The interaction mechanism must be implemented through a customer relationship management (CRM) system to eliminate abusive interpretations, ensure compliance with the legal framework, and create a basis for the implementation of an efficient procedure for issuing permits and licenses.

To enable investors and businesses to understand and adhere to regulatory requirements, the government should consider establishing an e-registry of administrative procedures. The e-registry would publish online all permits and licenses required to engage in tourism-related business activity. It should allow the filtering of applicable administrative requirements according to business activities and object types (for example, hotels or restaurants) and the identification of steps, costs, and prerequisites, as well as the relevant public authorities.

E-government infrastructure, including PKI, e-ID, government cloud, e-payment, and interoperability should be implemented to enable digitalization of G2B services in tourism. The national e-permitting platform should be established on top of the e-government infrastructure, which includes a portal supporting the submission of online applications, an e-payment system, a national PKI and online identification system, and the government cloud. Emerging mobile broadband and technology in the Kyrgyz Republic provide an opportunity to leverage e-KYC capability that enables remote, first-time customer identification and mobile ID service. These will dovetail with the digitalization of G2B services, including the national e-permitting system for processing various business authorizations (permits and licenses) in tourism. A national e-permitting system will put in place a systematic approach to digitalization and support the continuous simplification and improvement of business licensing and permitting.

The government should strengthen cybersecurity capacities and establish a national computer security incident response team (CERT). While the government has already undertaken some cybersecurity initiatives, further action is needed regarding the implementation of a comprehensive legal and regulatory framework, a national cybersecurity strategy, and a national CERT team.

To address IT challenges for tourism sector growth, the government must develop the foundation for a national geospatial information system. This will require reviewing the legal framework for enabling the system, establishing a national geospatial data source, defining the mechanism for exchanging geospatial data, and mobilizing the system. It will also require establishing a national geospatial data fund that will contain the vector and orthophoto data needed to implement the GIS solutions applicable in different sectors of the Kyrgyz economy. The national geospatial information system should be able to provide the basic layers such as administrative-territorial division, transport infrastructure, communication infrastructure, and buildings, as well as layers specific to certain sectors and industries (such as tourism maps). Based on these layers and open data, it will be possible for the government and the private sector to introduce new online services that use GIS.

The Kyrgyz Republic also has an opportunity to exploit digital processes to create an integrated dynamic between visitor statistics, destination development, and marketing in a way that destination management constantly evolves based on visitor feedback. By leveraging new technology for tourism measurements, the government could significantly improve the interpretation of data on arrivals, travel patterns, and visitor behavior, as well as resident satisfaction with tourism growth. This information is necessary to make evidenced-based and proactive decisions around maximum carrying capacity for attractions and sensitive environmental areas, for destination planning and development, and for effective marketing. The introduction of digital technology for tourism market intelligence can also support an increased understanding of the visitor path to purchase and create positive feedback loops so that tourism stakeholders can understand shifts in travel patterns and react to them in an almost real-time manner.

Mobile applications are powerful marketing tools. Through mobile apps, travel agents and operators can enhance their visibility and presence in the competitive travel industry. The operators can entice new customers by offering promotional discounts and cost-effective packages. The use of loyalty programs and the offering of discounts on future bookings will ensure more visits and more revenue. Data generated by mobile applications facilitates the individualization of service offers. IT companies in the Kyrgyz Republic have experience in developing mobile applications, as most startups in the country develop outsourced software for the foreign market. These developments often involve mobile applications across different industries. These capacities can be used and supported in the local context to stimulate growth of the mobile apps for tourism used by local companies (through government-organized hackathons, for example).

Social media advertising is an opportunity for small tourism operators. Lacking access to online travel agents and global distribution systems (GDSs), small tourism operators can use social media for promotion and access to markets. Training courses for businesses should be organized to familiarize operators with online promotion campaigns and develop the abilities to carry out advertising campaigns through global online services such as social media. Russia, for example, is an important market for Kyrgyz tourism and the most popular social media platforms in the Russian Federation such as VK, Instagram, Odnoklassniki, and Facebook are important tools for accessing this market. The training should also educate operators on using online travel agents and other online services for market access. The online training courses will prepare professionals in tourism for certifications and continuously develop their skills. The courses can also serve as an online reputation-building mechanism for those professionals.

The national tourism promotion portal, www.discoverykyrgyzstan.org, should be updated to extend the spectrum of data provided and to implement online services for tourists and tourism operators. The portal must apply the interoperability and data exchange available through Tunduk for obtaining data relevant to tourism from the official registries and IT systems. The management of the portal can be improved by identifying an owner and a model for updating the content.

The Kyrgyz government must strengthen its investment promotion function to ensure that tourism investment promotion, planning, and regulation are based on clear and accurate tourism data implemented by a centralized agency with enough capacity and in line with an overarching development strategy.

For tourism to grow, increase its contribution to the economy, and improve the distribution of benefits across the country, the government needs to mobilize targeted investments that will attract emerging and growing markets. To do this, it will need to implement a series of reforms and activities designed to strengthen and coordinate the overall investment promotion function. Specific reforms include a review and revision of

IPPA regulations as well as the building of its internal capacity; the development of collaboration protocols between all agencies involved in investment promotion; the preparation of a detailed private investment mobilization strategy; and the design and implementation of a structured investor outreach program.

Building the internal capacity of the IPPA will strengthen its investment promotion capabilities and position it to lead and coordinate the overall investment promotion function.

As part of its coordination role, a strengthened IPPA should take the lead in the development of collaboration protocols between all agencies involved in tourism investment promotion, including the Department of Tourism, the National Statistics Office, and specialized agencies such as Kyrgyz Tourism and the State Commission on Architecture and Construction, as well as regional authorities and diplomatic missions in situations where these have an investment promotion role. These protocols should be based on an agreed-upon national tourism investment plan and mobilization strategy and a shared view of the role of each agency.

It will also be necessary to develop a detailed private investment mobilization strategy that includes individual strategies for key destinations and products. The strategy should spell out clear guidelines on the nature, scale, and timing of required private investments; identification of key partners and action plans for different types of investments; documentation of specific tourism value propositions for key destinations and products; potential investor lists by asset class, category of investment, general classes of entrepreneurship, and MSME opportunities; and mechanisms for investor or MSME support. Firm-level support could include promotion, facilitation, financial support, marketing support, assistance in processing licenses and permits, and training and capacity-building support, while policy-level actions needed include a clear statement of the timetable, accountabilities, and costs required for implementing the strategy.

The next step would be the development of a professional outreach program for implementing the strategy and securing targeted investment. This should include the selection of outreach mechanisms such as direct contact, investment conferences, trade shows, briefing diplomatic representatives, and SME forums and chambers, Another part of such a program would involve the preparation of supporting documentation (project profiles, incentive packages), the identification of possible terms and conditions of offer for key investment and mechanisms for taking specific opportunities to market, and the budgeting, timing, and scheduling for implementation of the outreach program. The government might consider outsourcing all or part of the outreach program.

With these reforms in place, investment promotion will be coordinated and regulated based on clear, agreed-upon plans. Furthermore, established aftercare programs must be in place so that investments will be properly monitored and managed going forward. Together, these initiatives should lead to increased and improved investment in tourism that are in line with the strategy, along with a diversified and expanded pool of investors.

To successfully implement tourism master planning and encourage investment, financial institutions must develop instruments and new financing products for longer-term investments needed to attract anchor investors that underpin destination development.

The existing finance products in the Kyrgyz Republic are short-term and do not align well with the seasonality and longer payoff periods typically experienced in the tourism sector. In order to support the financially sustainable growth of tourism (especially among the accommodation sector in second-tier cities) and build on improved sector data, financial institutions should be encouraged to develop new products that meet industry needs, notably longer-term facilities with more flexible repayment structures. This will require building the capacity of financial institutions to manage tourism lending portfolios based on a sound understanding of the specific characteristics of tourism businesses, enhanced skills in structuring financial products, accepted risk assessment techniques, and internationally recognized standards for portfolio monitoring and management. Additionally, financing for MSMEs must assist these enterprises to both formalize and expand. The financial products MSMEs currently use have high interest rates and short repayment periods, which puts pressure on MSMEs and limits their growth.

With appropriate financial products in place for both large and small investors, the tourism sector has the potential to expand to meet growing demand. These financial instruments will assist larger investors in entering new markets in priority destinations outside of Bishkek and create new hubs for tourism. Investments in larger, potentially internationally branded hotels in second-tier cities will create anchor businesses to support destination development, definition, and marketing. It will also raise the profile of secondary destinations, spreading the benefit and the burden of tourism from overcrowded destinations during peak periods. Furthermore, the availability of appropriate financial products for MSMEs will help these smaller businesses to focus on strategic instead of opportunistic investments, enabling sustainable growth for microenterprises, small and medium businesses. These improvements in financial products will also have to be paired with changes to the patent system (noted above) to incentivize business growth.

Insurance services in the Kyrgyz Republic should be strengthened by establishing the foundation for the implementation of e-insurance. This in turn could enable the development of integrated services in tourism through service bundles. A regulatory framework to conduct insurance business through electronic means must be established. The framework would promote the purchasing of e-insurance by providing sufficient protection for consumers using websites, mobile applications, and other online systems.

TABLE D.2 THEORY OF CHANGE: KYRGYZ REPUBLIC TOURISM SECTOR DEEP DIVE

DEVELOPMENT CHALLENGES	INTERVENTIONS	INTERMEDIATE OUTCOMES	IMPACTS	IFC INTERVENTIONS	WORLD BANK INTERVENTIONS
SHORT-TERM INTERVENTIONS					
• **Ill-informed tourism policy and planning.** • **Lack of market intelligence due to poor tourism data collection and analysis.** • **Outdated digital legislation (GIS, privacy, cybersecurity).** • **Limited digital infrastructure and skills.** • **Poor national spatial data management.** • **Limited strategic destination development and tourism planning caused by low institutional capacity, lack of resources, and poor coordination.**	Support the establishment of an interagency working group. Strengthen institutional structure and authority at the Department of Tourism. Provide technical advice on reviewing legal framework on digital identity, data privacy, cybersecurity, and national spatial data management.	Improved national tourism statistics collection and analysis . Strengthened market intelligence and supply-demand dynamics.	Clear policy and planning direction. Increased destination competitiveness.		WAVES project s upporting improvement of national tourism statistics and development of a tourism satellite account (TSA) methodology. Planned joint-tax administration and statistics improvement project that will include the implementation of TSA. Potential lending operation to develop key destinations including infrastructure support, strengthening of the overall destination planning and coordination function and investment promotion, marketing, planning, and institutional strengthening. Potential lending operation to support the digitalization of administrative procedures in tourism, implementation of an integrated G2B service delivery, development of IT skills and capacities for B2B and B2C digital platforms, and new digital business model, and, additionally, to create foundation for developing national spatial information system.
• **Low destination awareness caused by ad hoc and inconsistent marketing.**	Increase marketing spending in priority market segments (winter and soft adventure).	Improved destination awareness among selected segments.	Increased arrivals from targeted countries for these priority market segments. Increased destination competitiveness.	Existing IFC AS project conducting a tourism demand assessment to determine key markets with growth potential.	
• **Absence of targeted investment promotion strategy, low capacity, and poor coordination among agencies involved in IPPA.**	Strengthen institutional structure at IPPA. Develop investment promotion strategy, outreach plan, and coordination protocols. Support Kyrgyz government in its design strategy for mobilizing private investment, including investment in state-owned assets such as sanatoriums.	Reinforced IPPA capabilities. Investment promotion strategy implemented Investment strategy implemented.	Increased targeted investments in the tourism sector.	Potential IFC investments in internationally branded hotels in second-tier cities Privatization of sanatoriums and tourism facilities.	

DEVELOPMENT CHALLENGES	INTERVENTIONS	INTERMEDIATE OUTCOMES	IMPACTS	IFC INTERVENTIONS	WORLD BANK INTERVENTIONS
• **Lagging asset investment and improvement because of a lack of appropriate financial products for tourism investment** • **Lack of international quality accommodations and suitable products outside of Bishkek constraining access to high-value markets.**	Support efforts of IPPA and financial institutions to create appropriate products. Provide technical advice for reviewing legal framework on insurance, including legal prerequisites for e-insurance. Map administrative procedures in tourism and implement the e-registry of administrative procedures. Review, streamline, and simplify administrative procedures in tourism to prepare for digitalization. Launch privatization efforts of tourism facilities, sanatoriums, and SOE assets in phases by region, district, or by certain properties to test market sentiment.	Demonstrated demand for tourism-specific financial products. Development of tourism-specific financial products. Enhanced enabling environment. Implemented e-registry of administrative procedures in tourism.	Improved tourism assets and supply. An increase in targeted investments in the tourism sector. Increased destination sustainability. Increased destination competitiveness. Administrative requirements in tourism easily identifiable and accessible by businesses.	Existing IFC AS project conducting financial gaps assessment and working with financial institutions. Existing IFC AS project to finalize the mapping of administrative procedures in tourism and implement the e-registry. IFC investment in possible credit line facility for financial institutions to enable medium- to long-term financing for services, including building capacity of financial sector for expanding sector lending.	
• **Limited air connectivity to long-haul, high-value markets, poor airport infrastructure and management, and inadequate ground connectivity into and throughout the country limiting access to the destination.**	Implement the PPP approach to airport privatization and upgrades starting with Manas International Airport and then extending to regional airports. Reduce nonairline costs for operating in the Kyrgyz Republic. Support the expansion of a visa-free regime. Support the implementation of incentive scheme for attracting foreign carriers. Pursue road rehabilitation, extension, and management.	Improved airport management and airport infrastructure. Reduced bureaucratic burden and cost for visa-free tourists. Increased air capacity.	Increased tourist arrivals. Increased destination competitiveness.	PPP advisory to Kyrgyz government for Manas International Airport privatization. Potential IFC investment in PPP Manas International Airport privatization and upgrades .	Continued CARS3 project effort to strengthen regional connectivity and ground transportation.

DEVELOPMENT CHALLENGES	INTERVENTIONS	INTERMEDIATE OUTCOMES	IMPACTS	IFC INTERVENTIONS	WORLD BANK INTERVENTIONS
MEDIUM-TERM INTERVENTIONS					
• **Limited investment in tourism because of burdensome procedures, limited regulatory transparency, and lack of digitalization of documents and procedures.**	Support the development of a digital, one-stop shop for regulatory and administrative tourism procedures (e-permitting). Develop national registries in tourism with lists of operators and certified professionals.	IEnhanced enabling environment.	Increased destination competitiveness.	IFC AS project for streamlining administrative procedures to help boost investments.	
• **Limited strategic destination development and tourism planning caused by low tourism institutional capacity, paltry resources, poor coordination, and limited use of digital tools.**	Support the creation of a national tourism board with an integrated private sector role and adequate funding. Create a detailed and strategic marketing plan based on improved tourism data and market intelligence. Invest significant budgeted marketing funds in two priority market segments based on tourism demand assessment. Promote increased budgetary resources for Department of Tourism based on informed marketing plan. Upgrade national e-ID by introducing mobile ID, interoperability, Tunduk, government cloud, and other horizontal e-government levers to enable digitalization of G2B, as well as B2B and B2C. Improve cybersecurity by establishing national CERT.	Development and implementation of strategic marketing plan. Increased Department of Tourism capacity, resources, and sustainability. Establishment of National Tourism Board.	Improved destination marketing. Improved private sector representation and private-public relations. Improved destination planning. Increased arrivals. Increased destination competitiveness and sustainability.		Potential lending operation (see above) with components covering upgraded data, institutional development, and integrated planning and destination development.

DEVELOPMENT CHALLENGES	INTERVENTIONS	INTERMEDIATE OUTCOMES	IMPACTS	IFC INTERVENTIONS	WORLD BANK INTERVENTIONS
• **Inadequate destination management due to lack of long-term tourism master plan, which creates destination management challenges and poor investment coordination and promotion.**	With quality tourism data and a strengthened tourism agency, develop a tourism master plan. Provide targeted support to IPPA to identify investments and improve coordination.	Development and implementation of tourism master plan. Key tourism investments identified. Investment-ready projects prepared.	Improved long-term destination management and sustainability. Increased critical tourism investment.		
• **Limited private sector access to markets and deficient promotion resulting from poor digital skills.**	Develop online training courses for businesses for online promotion of tourism and online training for tour guides and professionals. Increase capacity building for developing web and mobile applications related to tourism, including CRMs and integration with GDSs and OTAs. Provide financial support to IT companies working on digital services and products for tourism.	Private sector digital skills enhanced. Digital products and services for tourism available.	Increased access to markets. Improved firm-level competitiveness.	Possible investment in IT companies developing new digital business models, digital services, and mobile software applications useful for tourism industry.	Potential lending operation (see above) with component focused on access to markets.

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ENDNOTES

1. "COVID-19's Impact on the Business Environment in Kyrgyz Republic," a survey with 1,053 respondents, was conducted by the OSCE Program Office in Bishkek, the JIA Business Association, and the Entrepreneurs Support Center.
2. The decline in newly issued credit started in March 2020. It dropped by 9 percent below March 2019 levels and reversed a decade-long growth trend. Data from the National Bank of the Kyrgyz Republic.
3. World Bank Findex Database 2018.
4. Soft tourism is one of the forms of sustainable tourism in contrast to large-scale unsustainable tourism development. It encompasses environmental and social sustainability and a new culture of travel.
5. Tajikistan (70 percent), Turkmenistan (62 percent), Kazakhstan (60 percent), Uzbekistan (55 percent), and Russia (30 percent); different sources used.
6. The patent is a type of document that allows the patent holder to conduct certain types of entrepreneurial activities and take advantage of special favorable categories of the tax regime (either mandatory or voluntary).
7. Microenterprises are those with 1–5 employees and often operate under the patent regime.
8. Small enterprises are those with 6–19 employees.
9. Medium-sized enterprises are those with 20–99 employees.
10. National Statistical Committee, State Tax Service, and Staff Estimation (2018) analyzed in the Emergency Support for MSMEs Project (P174028), World Bank, July 2020.
11. World Bank. 2019a. Background Research Note on a Mechanism on Responding to Investor's Issues/Disputes in the Kyrgyz Republic
12. At constant 2010 US$.
13. At constant 2010 US$.
14. These are the European Bank for Reconstruction and Development's transition indicators.
15. Kazakhstan and Turkmenistan attained upper-middle-income status in 2006 and 2012, respectively, and Uzbekistan attained lower-middle-income status in 2011.
16. Two series of poverty estimates are discussed here for the Kyrgyz Republic: estimates based on the international poverty line in terms of 2005 purchasing power parity, and the national official poverty estimates. The former is better suited to cross-country comparisons, while the latter is calibrated by national authorities to the local context. Long-run comparisons of poverty rates in this report rely on the international approach because a break in the national series in 2008 complicates comparisons of the pre- and post-2008 periods. This break is not present in the series used for the international poverty estimates.
17. World Bank, Macro Poverty Outlook April 2020.
18. A value-added approach to measuring growth in the economy as a combination of capital and labor, and a measure of productivity that captures how efficient and productive labor and capital are in creating value.
19. In other words, Armenia, Azerbaijan, Belarus, Bulgaria, Georgia, Kazakhstan, Moldova, Russian, and Uzbekistan.
20. "COVID-19's impact on the business environment in Kyrgyz Republic," a survey with 1,053 respondents conducted by the Organization for Security and Cooperation in Europe (OSCE) Program Office in Bishkek, the Business Association, and the Entrepreneurs Support Center.
21. The decline in newly issued credit started in March 2020, at which time it dropped by 9 percent from its levels in March 2019, reversing a decade-long growth trend. Data are from the National Bank of the Kyrgyz Republic.
22. Different sources used.
23. Tajikistan (70 percent), Turkmenistan (62 percent), Kazakhstan (60 percent), Uzbekistan (55 percent), and Russia (30 percent).
24. Medium-sized enterprises are those with 20–99 employees.
25. Moldova is in the same lower-middle-income group and Tajikistan is in the lower-income group, as defined by the World Bank Group (WBG).

26. In Europe and Central Asia, this is a joint WBG and European Bank for Reconstruction and Development initiative that conducts firm-level surveys of a representative sample of an economy's private sector, mainly focusing on the manufacturing sector.
27. The National Statistical Committee of Kyrgyzstan.
28. This applies to legal entities whose turnover exceeds 30 million soms.
29. OSCE assessment 2019
30. Based on World Bank staff calculations.
31. They contributed 22.6 percent of the GDP in 2018.
32. A noncorporatized legal form, a remnant of the Soviet system of state ownership.
33. This company falls into the SOE category.
34. This includes one limited liability company.
35. In addition to 104 operational SOEs, one is in the bankruptcy process and one in feasibility.
36. Comprising two banks, one insurance company, and three companies engaged in other financial services.
37. The bulk of the 2017 loss by all SOEs is attributable to a single adjustment posted by the JSC National Transmission Company (NESK) with respect to correcting their valuation of foreign currency–denominated loans and proper valuation of the fixed assets for approximately 10 billion soms.
38. Despite the Kyrgyz Republic having a border with China (which has access to the sea), that route was barely used for commercial trade for a long time, as it runs through difficult mountainous terrain, it has no railway connection, and the cost of trucking goods is high. Aware of this issue, the Kyrgyz government is discussing building a railway in order to better make use of this route.
39. Telegeography.
40. Kyrgyztelecom, ElCat, RCT, MegaCom, Beeline, O!, IPNet, Aknet and Asia Info.
41. Its largest retail Internet Service Provider (ISP) rivals are MegaLine (exclusively Bishkek-based) and Saima Telecom (covering Bishkek and Chuy). Other ISPs include ElCat (a well-established player in wholesale and corporate segments), AsiaInfo, Global Telecom Asia (My), Aknet, Extra Line (Homeline), and I-Space (MaLink).
42. NBKR (2017).
43. Still et al., 2017
44. Digital Economy Express Assessment of the Kyrgyz Republic, 2019
45. Almqvist 2010
46. The calculation is based upon country's current GDP as well as Kelly and Rossotto's Broadband Strategies Handbook.
47. Private credit bureau coverage reports the number of individuals or firms listed by a private credit bureau with current information on repayment history, unpaid debts, or credit outstanding. The number is expressed as a percentage of the adult population.
48. The Kyrgyzstan Commercial Bank, Ayil Bank, Bakai Bank, Optima Bank, and the Kyrgyz Investment and Credit Bank.
49. IFC Financing Gap assessment in tourism sector, February 2019.
50. The NBKR announced on February 25, 2020 that it was increasing the policy rate from 4.25 to 5 percent because it expected inflation to increase to 5 percent by the end of 2020 (reaching the lower bound of the inflation rate target). It should be noted that it is the perception of market participants that the NBKR is targeting the low volatility of the exchange rate instead of targeting inflation via the interest rate.
51. The soft adventure segment is composed of less-risky adventure activities (hiking, trekking, kayaking) usually in a natural setting that require little or no experience and are less physically demanding.
52. Recent changes to visa policy now allow official residents of the United Arab Emirates, Kuwait, Qatar, Brunei-Dar as-Salaam, Oman, and Bahrain to receive a visa on arrival in the Kyrgyz Republic.
53. Total costs are the sum of airline and non-airline costs. Airline-related costs include expenditures for maintenance, repair, and overhaul (MRO), as well as for fuel, crew, ownership (operating lease), and en-route charges by air navigation, while non-airline related costs include air traffic service (ATS), airport and landing charges, ground handling fees, security, and passenger taxes.
54. Due to the outdated aircraft fleet, the EU blacklisted Kyrgyz airlines in 2006, which are now forbidden to operate flights to European cities.
55. These include the Law of the Kyrgyz Republic of March 20th, 2002, No. 43, On Geodesy and Cartography; Decree of the Government of the Kyrgyz Republic of February 11, 2002, No. 64, On Approval Concept of Creating a Unified Information System for Real Estate in the Kyrgyz Republic; and Resolution of the Government of the Kyrgyz Republic of October 7, 2010, No. 235, On the Establishment of a Unified State Coordinate System.

56. According to recent amendments to the land code (April 2019), there are seven categories of land with the following purposes: agricultural; inhabited locality; industry, transport, communication, energetics, defense and other purposes; protected areas; forestry fund; water fund; and reserves.
57. These include Armenia, Azerbaijan, Belarus, the Czech Republic, Georgia, Hungary, Kazakhstan, Lithuania, Moldova, Republic of Poland, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan, which comprise Central and Eastern Europe as defined by the UNWTO.
58. The large increase in arrivals from Uzbekistan in 2017 is because of the opening of the border between the countries. While industry reports an increase in overnight tourist arrivals from Uzbekistan in the Issyk-Kul area in 2018, it appears that a significant share of arrivals from Uzbekistan were same-day visitors.
59. With the exception of Armenia, the total number of visitors for all countries has been used for the sake of consistency. The total number of visitors includes both overnight visitors (tourists) and same-day visitors. The Kyrgyz government's visitor statistics do not appear to distinguish between same-day and overnight visitors (tourists).

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