Infrastructure Financing in Kyrgyzstan

Jannat Salimova-Tekay
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<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>AIFC</td>
<td>Astana International Financial Center</td>
</tr>
<tr>
<td>AIIB</td>
<td>Asian Infrastructure Investment Bank</td>
</tr>
<tr>
<td>BRI</td>
<td>Belt and Road Initiative</td>
</tr>
<tr>
<td>CAREC</td>
<td>Central Asia Regional Economic Cooperation</td>
</tr>
<tr>
<td>COVID-19</td>
<td>Coronavirus disease of 2019</td>
</tr>
<tr>
<td>CIS</td>
<td>Commonwealth of Independent States</td>
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<tr>
<td>CPI</td>
<td>Corruption Perception Index</td>
</tr>
<tr>
<td>CPS</td>
<td>Country Partnership Framework</td>
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<tr>
<td>CTF</td>
<td>Clean Technology Fund</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>EDB</td>
<td>Eurasian Development Bank</td>
</tr>
<tr>
<td>EEU</td>
<td>Eurasian Economic Union</td>
</tr>
<tr>
<td>EFSD</td>
<td>Eurasian Fund for Stabilization and Development</td>
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<tr>
<td>ESCAP</td>
<td>Economic and Social Commission for Asia and the Pacific</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
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<tr>
<td>GCF</td>
<td>Green Climate Fund</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GEF</td>
<td>Global Environment Facility</td>
</tr>
<tr>
<td>HPP</td>
<td>Hydropower plant</td>
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<tr>
<td>ICT</td>
<td>Information and communication technologies</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>IFI</td>
<td>International financial institution</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IsDB</td>
<td>Islamic Development Bank</td>
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<tr>
<td>JSC</td>
<td>Joint-stock company</td>
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<tr>
<td>KSE</td>
<td>Kyrgyz Stock Exchange</td>
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<tr>
<td>KGS</td>
<td>Kyrgyz Som</td>
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<tr>
<td>kWh</td>
<td>Kilowatt hour</td>
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<tr>
<td>LLDC</td>
<td>Landlocked Development Country</td>
</tr>
<tr>
<td>LLC</td>
<td>Limited liability company</td>
</tr>
<tr>
<td>MSME</td>
<td>Micro, small and medium enterprises</td>
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<tr>
<td>NBKR</td>
<td>National Bank of Kyrgyz Republic</td>
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<tr>
<td>NSSD</td>
<td>National Strategy for Sustainable Development</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<tr>
<td>PPP</td>
<td>Public-private partnership</td>
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<tr>
<td>SCF</td>
<td>Strategic Climate Fund</td>
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<tr>
<td>SOE</td>
<td>State-owned enterprise</td>
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<tr>
<td>TA</td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNECE</td>
<td>United Nations Economic Commission for Europe</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
</tr>
<tr>
<td>WEF</td>
<td>World Economic Forum</td>
</tr>
<tr>
<td>WSS</td>
<td>Water Supply and Sanitation</td>
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<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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</table>
Abstract

This study assesses the landscape of Kyrgyzstan’s infrastructure financing. It starts with an analysis of the investment needs in the various sectors of infrastructure. It then proceeds with an assessment of the financing sources available to Kyrgyzstan in addressing these investment needs. Following an analysis of the challenges in developing infrastructure in Kyrgyzstan, the paper outlines the opportunities and modalities to expanding infrastructure finance and offers recommendations to unlock them.

Keywords: Kyrgyzstan, infrastructure, public-private partnership, SDGs, planning, tariff regulation, privatization

JEL classification: H54, H60
1. Introduction

This report was commissioned by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) and aims to conduct in-depth national study and prepare a report on infrastructure financing in Kyrgyzstan. The report covers infrastructure financing challenges, opportunities, modalities and recommendations for enabling regulations, governance, and policies in Kyrgyzstan.

Kyrgyzstan is a lower-middle income country located at the highest altitude among the countries of Central Asia. One-fifth of its predominantly young population have found employment abroad, mostly in the Commonwealth of Independent States (CIS), making the country’s economy dependent on remittances. As of end 2018, remittances contributed USD 2.1 billion, or 30 percent of GDP.1 Another important source of revenue for the economy is mining, particularly gold, whose contribution to GDP varies from 10 to 15 percent per annum.

Before the COVID-19 pandemic, Kyrgyzstan’s economy has been growing steadily, benefiting from a benign regional environment, particularly in Russia which is the main source of remittances and non-gold exports. However, the economy remained vulnerable to external shocks because of its reliance on remittances and gold exports, as well as the high level of public debt (56 percent of GDP; of which 80 percent is denominated in foreign currencies). The “twin deficit” (fiscal and current account deficits) is another long-term threat to financial and macroeconomic stability. Lastly, Kyrgyzstan is particularly vulnerable to climate change, with its energy and water sectors dependent on glacial melting which has accelerated in the recent years.

The pandemic has had a significant negative impact on the Kyrgyz economy. According to the IMF, which approved a USD 120.9 million rapid relief facility in March 2020, the outbreak has resulted in a balance-of-payments gap of around USD 400 million. With substantial output losses in major economic sectors—tourism, trade, services and construction—the country’s GDP in 2020 is estimated to contract by as much as 10 percent.

As a response to the shock, the Government has approved a fiscal stimulus package comprising 21 measures. They include tax exemptions, expenditure realignments, and trade incentives. The National Bank of the Kyrgyz Republic (NBKR) has also allowed som, the national currency, to float against the US Dollar, which has resulted in a considerable som depreciation.2 Another important step taken by the Government to weather the pandemic is the establishment of the Anti-Crisis Fund, capitalized with the proceeds of the COVID-19 relief facilities provided by the ADB, IMF, World Bank and other international development institutions.

Meanwhile, Kyrgyzstan’s infrastructure sector has suffered from chronic underinvestment, which is dampening the country’s competitiveness. While aspiring to become a logistics hub of the region, its transport infrastructure is largely underdeveloped and obsolete. The power sector, too, requires significant investments, especially given Kyrgyzstan’s commitments to regional power trade.

The report is organized as follows. Section 2 outlines the key infrastructure investment needs. Section 3 describes the sources of infrastructure financing from public, private, and public-private partnership (PPP) perspectives. Section 4 highlights infrastructure financing challenges along these three dimensions. Chapter 5 then outlines policy recommendations and the opportunities that these recommendations entail, if implemented. Finally, section 6 concludes with the key findings of the report.
Kyrgyzstan has relatively developed water and power infrastructure facilities. However, the Soviet times has inherited deficient transport infrastructure, both rails and roads (see figure 1).

As estimated by ESCAP (2019), Kyrgyzstan’s infrastructure needs are among the highest in the region (see figure 2). In particular, financing requirements to close the infrastructure gap, such as transport, energy and ICT, during the period 2018-2030 are estimated at about 19 percent of GDP per year. Among Asian landlocked developing countries (LLDC), such financing needs are only higher in Afghanistan (29 percent) and Nepal (20 percent). Around half of the infrastructure financing needs in Kyrgyzstan is in transport, followed by energy, ICT and water supply and sanitation (see table 1).

Figure 1: Quality of infrastructure in Kyrgyzstan (2019)

Figure 2: Infrastructure financing needs in Asian LLDCs

Table 1: Infrastructure financing needs in Kyrgyzstan, (% of GDP, 2018)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Sector</th>
<th>% of GDP</th>
</tr>
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<tbody>
<tr>
<td>1.</td>
<td>Transport</td>
<td>10</td>
</tr>
<tr>
<td>2.</td>
<td>Energy</td>
<td>5</td>
</tr>
<tr>
<td>3.</td>
<td>Information and Communications Technology</td>
<td>3</td>
</tr>
<tr>
<td>4.</td>
<td>Water supply and sanitation</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>19</td>
</tr>
</tbody>
</table>

Source: ESCAP, 2019.

A. POWER

In the energy sector, the electric power transmission and distribution systems are sufficient to provide adequate electricity for all regions of the country. The power sector constitutes a significant part of Kyrgyzstan’s infrastructure plans, mostly due to its vast hydropower potential. More than half of all investments that the country was planning to spend on infrastructure projects between 2000 and 2018 (USD 14 billion) was directed to energy projects, followed by transport at close to 40 percent (figure 3).

Historically, Kyrgyzstan has been a net importer of coal, oil and natural gas. However, with the gradual development of its hydropower potential it became a net exporter of electricity. Among the electricity generation, oil and gas, and electric power transmission and distribution, the bulk of the investment goes to the electricity generation, mostly hydropower (see figure 4 below).

The Kyrgyzstan’s hydropower potential is significant, ranked third among the CIS after Russia and Tajikistan. Historically, the country’s power system has been part of the Central Asia power system, connected to all countries of the region plus Russia (via Kazakhstan). Kyrgyzstan also joined the Central Asia-South Asia transmission project (CASA-1000), which aims to establish interconnections between the grids of Afghanistan, Kyrgyzstan, Pakistan and Tajikistan. The project will allow Kyrgyzstan to export its seasonal surplus of hydropower.

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In addition to the hydropower development, Kyrgyzstan also plans to invest in its coal reserves in Kara-Keche, Besh-Burkhan, Zhergalan, Solukta and Tash-Kumir, and expand its oil reserves from 85,000 tons to 110,000 tons by 2030. Investments in the rehabilitation of transmission and distribution sectors are also considered to be a priority, given the high level of wear and tear (up to 45.3 percent in 2018).

B. TRANSPORTATION

Transport system is critical to Kyrgyzstan’s economic development given the mountainous geography and lack of access to sea. However, the country’s transport connectivity remains largely underdeveloped, ranked at 129th out of 141 countries according to the World Economic Forum. Given limited development in rail infrastructure, road transport accounts for 95 percent of all passenger and freight traffics.

Meanwhile, the country’s geographical location exhibits a great potential for commercial transport and trade between China, Russia, Kazakhstan, South Asia and the Middle East. Kyrgyzstan aspires to become a transit hub for goods and visitors between the Chinese and Western markets, as it is situated at the crossroads of major Eurasian transport corridors. Achieving this ambition will require significant investments in infrastructure improvements.

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During the period, Kyrgyzstan has implemented several national programs to improve the transport sector. They helped rehabilitate 830 km of transport corridors, pave 530 km of national and local roads, complete 800 km of non-skid surfacing, build 29 new roads and fix more than 56 existing bridges. The most notable of them are:

- Country development strategy (2009-2011);
- Program for the development of road and water transport (2009-2011);
- Transport and communications development program (2009-2011);
- Strategy for the development of roads (2007-2010);
- Strategy for the development of road transport (2012-2015);
- Strategy for the development of rail transport in Kyrgyzstan (2014-2020); and

According to OECD (2019), Kyrgyzstan plans to spend more than half of its USD 5.5 billion investments in railway construction (56 percent) and road building (37 percent). Error! Reference source not found. and the subsequent paragraphs provide more details on each of the transport modes.

Road transportation is the backbone of Kyrgyzstan’s infrastructure, with up to 95 percent of total cargo and passenger transportation is carried by road. Yet, Kyrgyzstan is ranked at 110th in the world on road connectivity by the World Economic Forum. The responsibility for road network maintenance is split between the Ministry of Transport and local government agencies. As indicated by the EBRD, the shortage of funding for road maintenance has resulted in one-third of the main network being in substandard conditions. Meanwhile, UNECE estimates Kyrgyzstan’s road reconstruction cost at around USD 650-900 per km, and of new construction – at around USD 2,700-3,200 per km.

Figure 5: Transport investment, planned and under construction (USD million, %, 2019)


11 EBRD, Kyrgyz Republic Diagnostics, 2019.
Kyrgyzstan’s railway network is the least extensive in the CIS, at 2.1 km per 1,000 km². It is connected only to Kazakhstan and Uzbekistan, as constructed in the Soviet times. It is in wide gauge, while China, Kyrgyzstan’s key trade partner, has a narrow gauge. This hampers trade and logistics between the two countries. The 2012-20 rail development strategy adopted by the Ministry of Transport and Roads puts emphasis on the electrification of the Lugovaya to Alamedin railway section (Bishkek). The cost of the project is estimated to be USD 300 million. At the moment, the Ministry of Transport and Roads and Kyrgyz Temir Jolu, the national railway operator, have been working to attract investors in the project.

Other transport includes intermodal and air projects, most of them being privately developed. OECD expects these investments to total USD 291 million.\(^{13}\)

### C. ICT

Available assessments point to a need for more investment, innovation and efficient regulation in the ICT sector. For example, Kyrgyzstan was rated at 3.7 out of 7 in the Networked Readiness Index\(^ {14}\), while the World Economic Forum ranked the country at 65\(^{th}\) out of 141 in 2019 (no change in the past 3 years).\(^ {15}\)

The market has over 300 registered operators as of June 2019. However, it is divided among a few major players:

- Fixed communications: Kyrgyztelecom, SaimaTelecom, and Sapatcom.
- Mobile communications: Alfa Telecom JSC (MegaCom), SkyMobile LLC (Beeline), NUR Telecom LLC (Oi), and SALAM.
- Internet: Kyrgyztelecom, Asiainfo, EiCat, and Intra Net.

Internet penetration is low and distributed unevenly among the regions. The WEF report indicates that the fixed-broadband subscription of the internet at the 95\(^{th}\) place, compared to 65\(^{th}\) and 76\(^{th}\) in Kazakhstan and Mongolia, respectively. 4G coverage is at 40 percent and 3G at 99 percent.\(^ {16}\)

Most ICT projects are financed by international donors. From 2011 to 2015, the total amount of ICT investments reached approximately USD 50 million (KGS 3 billion), where around 85 percent of this amount was funded by international institutions in the form of loans, grants, and technical assistance and only 15 percent was from the state budget.\(^ {17}\)

In order to leapfrog into the digital economy, Kyrgyzstan will need to invest more in ICT. This includes broadband connectivity for remote areas, data centers and digital public services. In order to facilitate this transition, the Government has adopted a concept program “Digital Kyrgyzstan 2019-2023”, which outlines the key priorities in the country’s ICT development.

### D. WATER AND IRRIGATION INVESTMENT NEEDS

Despite abundant water resources, Kyrgyzstan is vulnerable to unsafe drinking water. Only 60 percent of the population has access to tap drinking water.\(^ {18}\) Reliability of water supply is also lower compared to its peers, such as Azerbaijan and Kazakhstan.


\(^ {16}\) UNESCAP, An In-Depth National Study on ICT Infrastructure Deployment along Road Transport and Energy Infrastructure in Kyrgyzstan, 2020.


\(^ {18}\) EBRD, Kyrgyz Republic Diagnostics, 2019.
According to the OECD, Kyrgyzstan implemented USD 245 million worth of planned and ongoing projects in water infrastructure. Most of it (82 percent) is in water supply and irrigation (figure 6).\textsuperscript{19} Given the current state of water infrastructure and chronic underinvestment in the past years, these projects are not considered to be enough. According to the EBRD estimates, Kyrgyzstan’s water sector requires additional USD 450 million, including USD 200-250 million for rural areas.\textsuperscript{20}

Water supply and sanitation in Kyrgyzstan remains one of the weakest infrastructure sectors. About 40 percent of population have access to water supply, while such ratio stands at only 10 percent for sanitation services. The Government has planned to increase these figures to 90 and 70 percent, respectively, by 2020. Due to the outdated water supply and sanitation infrastructure, Kyrgyzstan spends over USD 100 million per annum for this sector.\textsuperscript{21}

In 2020, the Government introduced a program aimed at ensuring quality drinking water supply to the citizens by 2026. The planned investment amount is USD 825 million (KGS 70 billion). Of this amount, USD 23.5 million is from the state budget, while the rest will be funded by international institutions.\textsuperscript{22}

Figure 6: Water investments, planned and under construction, (USD million, %, 2019)
3. Infrastructure Financing Sources

A. PUBLIC FINANCING

Infrastructure development has been consistently featured in all mid- and long-term National Development Strategies adopted by the Parliament. However, it is not always accompanied by adequate budget allocations. This is partially due to the unclear responsibilities for planning and implementation of public infrastructure investment. The budgets for infrastructure-related public investments are thinly spread among the various Ministries and local authorities. Most of public infrastructure investment has therefore been financed from external sovereign loans.

There is a large segment of state-owned enterprises (SOEs), primarily operating in the power and transport sectors. Almost half of the 106 SOEs registered in Kyrgyzstan in 2019 are unprofitable. None of them is being credit-rated by an international rating agency. Many of them carry the financial burden of keeping tariffs below cost recovery. The Budget Code precludes the SOEs from obtaining sovereign guarantees or direct borrowing. This has further limited the financing of infrastructure projects, making sovereign loans from IFI the primary modality. Other modalities include bilateral financing agreements (e.g. with China, Russia, etc) and regional cooperation initiatives (e.g. CAREC, BRI, etc).

1. IFI Sovereign Borrowing

Given the “twin deficits”, Kyrgyzstan's ability to assume additional debt is subject to ceilings approved by the Parliament. It is closely monitored jointly by the IMF and the World Bank in their annual debt sustainability analyses. Any additional debt is assumed after the careful consultations amongst the Government, international financial institutions and donors. The debt situation is also monitored by the Paris Club, which has arranged for several rounds of debt forgiveness for Kyrgyzstan in the past.

All major international financial institutions operating in Kyrgyzstan treat infrastructure projects as a top priority. The most prominent of them, ADB, the World Bank and the EBRD, have started their operations since Kyrgyzstan’s independence in the 1990s. They acknowledge that closing the infrastructure gap should help the country alleviate poverty, contribute to sustainable development and facilitate regional trade. As a low-income country, Kyrgyzstan was eligible to concessional loans and blended financing structures with grants. Figure 7 below demonstrates that investments in transport and power enjoy the largest inflows of external debt financing.

a) Asian Development Bank

ADB mainly supports energy, transport, water and road infrastructure facilities, and provides assistance to government agencies in developing the legislation on public-private partnerships and e-procurement. Under its 2018-2022 Country Partnership Strategy (CPS), ADB has provided loans and grants worth USD 641 million. As shown on figure 8, the six priority sectors are: energy (20-25 percent of total loans and grants); transport (20-25 percent); agriculture, natural resources, and rural development (15-20 percent); education (10-15 percent); public sector management (10-15 percent); and water supply and other municipal infrastructure and services (10-15 percent). Meanwhile, ADB also helped reconstruct about 1,000 kilometers of the main transport corridors and roads, including those part of the Central Asia Regional Economic Cooperation (CAREC). In the energy sector, the most notable projects supported by ADB is the rehabilitation of Toktogul HPP, Kyrgyzstan’s largest power plant, and Uch-Kurgan HPP. ADB committed USD 375 million for these two projects.

Figure 7: Top sectors receiving investment as of 2018 (USD billion)

![Figure 7: Top sectors receiving investment as of 2018 (USD billion)](image)


Figure 8: ADB cumulative lending, grant and TA (in USD million, 2019)

![Figure 8: ADB cumulative lending, grant and TA (in USD million, 2019)](image)

Source: Asian Development Bank, ADB and Kyrgyz Republic: Fact Sheet (May 2020)


b) The World Bank

The World Bank supports Kyrgyzstan in the areas of infrastructure investments (energy, water supply, sewerage and irrigation, roads) and financial sector. The activities are in the form of investments and loans and advices on policy reforms. Financial sector activities are carried out in cooperation with IFC and aims to provide long-term financing for the banking and micro-financial sector, SMEs, and energy efficiency projects. Since Kyrgyzstan joined the World Bank in 1992, it has provided financial assistance worth more than USD 1.83 billion (see figure 9).26

As of 2020, EBRD’s investment portfolio in Kyrgyzstan stood at EUR 180 million (approx. USD 218 million), spanning over 195 projects. The portfolio consists largely of investments in sustainable infrastructure (55 percent), covering utilities, transport and power. Another 19 percent is invested in industry, commerce and agribusiness, and 26 percent to financial institutions (figure 10). The EBRD actively applies blending finance techniques in its operations in Kyrgyzstan by adding donor-funded grants to its commercially priced loans, to make them more affordable.

Figure 9: World Bank commitments by sector (2018-2020, USD million)


Figure 10: EBRD portfolio composition (% of total, as of October 31, 2020)


**d) Other Development Banks**

Eurasian Development Bank (EDB) along with its Eurasian Fund for Stabilization and Development (EFSD) is a multilateral development institution established by Russia and Kazakhstan in January 2006. Kyrgyzstan became a full member EDB in 2011. As of November 2020, EDB committed USD 115 million for 9 projects, while EFSD invested USD 383 million in 7 projects. Most of these projects are aimed at supporting SMEs and developing the energy and transport sectors.\(^{27}\)

Islamic Development Bank (IsDB) has been active in Kyrgyzstan since 1993 when the country became its member. As of 2020, IsDB had 44 completed projects and 26 ongoing projects.\(^{28}\) It contributed USD 401 million of funds. IsDB is financing the reconstruction of Issyk Kuli Ring Road and rural water supply and sanitation improvement in Batken and Talas regions.

Asian Infrastructure Investment Bank (AIIB) approved its first project for Kyrgyzstan in August 2021 – a USD50 million fund to address financial liquidity faced by SMEs as a result of the COVID-19 pandemic.

**B. PRIVATE FINANCING**

Private financing has not played a major role in the infrastructure projects, underpinned by the dominance of SOEs in the major infrastructure segments and the availability of external donor funding. At the same time, financial sector development remains at an early stage, thus unable to provide financing in sufficient amounts, tenors and interest rates to address the needs of infrastructure projects. International private financing is constrained by a high level of perceived political risk and excessive regulation.

1. **Foreign Direct Investment**

Kyrgyzstan’s is open to foreign direct investment (FDI), and its contribution to economic growth has been publicly recognized by the government. In general, FDI inflows are rather sizeable but volatile at between 7 and 24 percent of GDP (figure 11). This is partly explained by its direction historically towards extractive industries and downstream oil & gas and garment manufacturing. Such concentration has resulted in limited economic diversification and underinvestment in key infrastructure sectors. Figure 12 displays the sectoral breakdown.

![Figure 11: Kyrgyzstan’s net FDI and GDP, 2008-2019](image-url)

**Source:** World Bank data bank.

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\(^{27}\) Eurasian Development Bank, Kyrgyzstan, [https://eabr.org/en/about/states-participants/kirgizstan/](https://eabr.org/en/about/states-participants/kirgizstan/).

\(^{28}\) IsDB, Kyrgyz Republic, [www.isdb.org/kyrgyz](http://www.isdb.org/kyrgyz).
2. Banks

The banking system in Kyrgyzstan is small compared to its peers in the CIS. It is established in two tiers: the first tier being the National Bank of the Kyrgyz Republic (NBKR), which serves a central bank; the second tier comprises private and state-owned commercial banks. As of September 2020, the banking sector had 23 commercial banks, with total assets at USD 3.15 billion. Most of the banks are privately owned, with some of them under foreign ownership.

In general, Kyrgyzstan’s financial institutions are constrained by limited access to funding. This is often quoted as the main reason why private sector loans lag behind the OECD benchmarks (figure 13). As a result, local banks are mostly involved in more attractive retail operations, with the bulk of their portfolios concentrated on consumer loans and mortgages to citizens. At end-2019, the loan portfolio of commercial banks totaled to USD 1.7 billion (KGS 144.36 billion). Less than 3 percent of this amount was directed towards infrastructure-related assets (i.e. transportation logistics and ICT), as presented in Table 2.

3. Capital Markets

Kyrgyzstan’s capital markets are at the very early stage of development. It is not connected with the global financial system and lacks institutional investors. Trading activities are shallow, and total market capitalization is relatively small at about USD 340 million (4 percent of GDP).29 Since the launch of the Kyrgyz Stock Exchange (KSE) in 1994, there has only been one initial public offering (in 2020), of Salym Finance microfinance company (USD 0.6 million raised). Table 3 shows the recent bond issues and amounts raised.

29 EBRD, Kyrgyz Republic Diagnostics, 2019
**Figure 13:** Domestic credit to private sector (% of GDP, 2019)


**Table 2:** Sectoral breakdown of commercial bank loans (in KGS billion, December 2019)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Amount (KGS billion)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Consumer loans</td>
<td>17.2</td>
<td>11.91%</td>
</tr>
<tr>
<td>2 Others</td>
<td>14</td>
<td>9.70%</td>
</tr>
<tr>
<td>3 Mortgage</td>
<td>15.3</td>
<td>10.60%</td>
</tr>
<tr>
<td>4 Construction</td>
<td>13</td>
<td>9.01%</td>
</tr>
<tr>
<td>5 Industry</td>
<td>11.6</td>
<td>8.04%</td>
</tr>
<tr>
<td>6 Social services</td>
<td>5.1</td>
<td>3.53%</td>
</tr>
<tr>
<td>7 Transportation and storage</td>
<td>3</td>
<td>2.08%</td>
</tr>
<tr>
<td>8 Information and communication</td>
<td>0.26</td>
<td>0.18%</td>
</tr>
<tr>
<td>9 Trade</td>
<td>37.2</td>
<td>25.77%</td>
</tr>
<tr>
<td>10 Agriculture</td>
<td>27.7</td>
<td>19.19%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>144.36</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>


**Table 3:** KSE listings 2019

<table>
<thead>
<tr>
<th>No.</th>
<th>Company Name</th>
<th>Sector</th>
<th>Offering (KGS million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>LLC “IHSAN-ORIX”</td>
<td>Trade</td>
<td>50</td>
</tr>
<tr>
<td>2</td>
<td>Ayu LLC</td>
<td>Beverages</td>
<td>100</td>
</tr>
<tr>
<td>3</td>
<td>Pervaya Metaibaza LLC</td>
<td>Metals</td>
<td>70</td>
</tr>
<tr>
<td>4</td>
<td>JSC Kyrgyz Investment and Credit Bank</td>
<td>Finance</td>
<td>350</td>
</tr>
<tr>
<td>5</td>
<td>JSC microfinance company “Salym Finance”</td>
<td>Finance</td>
<td>175</td>
</tr>
<tr>
<td>6</td>
<td>JSC Microfinance Company ABN</td>
<td>Finance</td>
<td>30</td>
</tr>
<tr>
<td>7</td>
<td>LLC “BARKAD”</td>
<td>Agriculture</td>
<td>90</td>
</tr>
<tr>
<td>8</td>
<td>JSC “Trading House Min Turkun”</td>
<td>Trade</td>
<td>213</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>1,078</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Source: [www.kse.kg/en/Listingeng](http://www.kse.kg/en/Listingeng).*
C. PUBLIC-PRIVATE PARTNERSHIPS

The first PPP Law of Kyrgyzstan, adopted in 2012, set the legal, institutional and financial basis for structuring PPP projects. Amendments were made in 2019 to streamline the decision-making process and eliminate unnecessary bureaucracy. In addition to this law, the Government also approved a PPP Development Program 2016-2021, aimed at improving the PPP administration process, build confidence and increase awareness of PPP issues.30

The PPP Law is to be applied primarily for the power, transport and ICT infrastructure sectors and social sphere, while excluding extractive industries and privatization. The law also proclaims the main principles to guide future PPP projects: competitiveness, transparency, sanctity of contract and rule of law. In terms of contract forms, the law allows for any type of long-term asset life-cycle agreements encompassing design, construction and operation, along with finance structuring and risk sharing mechanisms.

Institutionally, the PPP Law prescribes the participation of at least three parties from the Government: (i) a grantor and project initiator; (ii) an authorized body; and (iii) a risk management body. Grantor could be a ministry, a local authority or a government agency. It is responsible for initiating and structuring the project, obtaining necessary approvals, running the tender process, and signing the documentation on behalf of the Government. The authorized body, as currently set by a government resolution, is the Ministry of Economy. Its role is to formulate general PPP policies and guidelines, approve PPP-related strategies and programs, and coordinate the evaluation and approval process of the PPP projects. The risk manager authority role has been delegated to the Ministry of Finance. Its role is to scrutinize draft contracts and tender documentation for possible state risks.

Since 2016, the Government has also set a Council on PPP under the Cabinet of Ministers. It is chaired by a Vice Prime Minister, and includes the Minister of Economy, the Minister of Finance, the Minister of Justice, the Director of the Agency for the Promotion and Protection of Investments, and the Director of the State Agency for Local Government Affairs. The role of this Council is to coordinate efforts by the Government and international donor community on PPP development in Kyrgyzstan.

From the financial perspective, the PPP Law facilitates two types of support mechanisms: financial and economic. The financial support allows for provision of loans on concessional terms, credit enhancement instruments, tariff subsidies, and minimum revenue guarantees. The economic support envisages provision of land and property rights, licensing and permit support, tax relief, among others.

Despite this support, public-private partnership has played a small role on infrastructure financing in Kyrgyzstan. Since the adoption of the first law in 2012, only one project has been signed (box 1).
Box 1: Dialysis Centers PPP Project

The Ministry of Health has invited IFC’s PPP structuring unit in 2015 to assist with the preparing and conducting a competitive tender process for this landmark PPP project. The assignment was financed by Germany’s Ministry of Economic Cooperation and Development, through KfW development bank. Advisory assistance was provided by the IFC and the governments of Germany, Austria, Hungary and Switzerland.

The international call for a two-stage bidding was announced in January 2017. The key bidding parameter was the service tariff to be paid by the Ministry of Health to the private party. Of the five applications submitted for the prequalification stage, two have been chosen to proceed for the bid submission stage. In June 2017, the Ministry of Health announced that Fresenius Medical Care as the preferred bidder for proceeding with negotiations. The PPP agreement was signed in August 2017 between Fresenius Medical Care and the Ministry of Health.

According to the 10-year PPP Agreement, Fresenius should design, construct, equip and operate 4 dialysis centers across three regions of Kyrgyzstan: Bishkek, Osh and Jalal-Abad. All four centers started operations in 2018, allowing hundreds of patients to receive high-quality hemodialysis services at new hemodialysis centers. The facilities of these centers enable dialysis treatments for all patients with kidney disease. The total project costs are more than USD 10 million.


D. CHINA FDI AND BRI

China is one of the most important economic partners of Kyrgyzstan. As the largest investor in the country, there are 397 Chinese enterprises and 170 Kyrgyz-Chinese joint ventures. Tax revenues from the enterprises with Chinese investments amounted to USD 45.5 million (KGS 3.8 billion) in 2018. In this same year, 39 percent of total FDI volume came from China (reaching USD 338 million), while 45 percent of total external debt is owed to the Exim Bank of China (figure 14). Meanwhile, Chinese investments are mostly directed to the oil refinery and gold mining (figure 15).

In the energy sector, Chinese companies own two of the five largest oil refineries in Kyrgyzstan, namely Junda and Tokmok, with the capacity of 800,000 and 470,000 tons, respectively. Both refineries were built and financed entirely by Chinese companies. Crude oil is delivered to Kyrgyzstan through Russia and Kazakhstan. Another important energy project pursued by Chinese investors is the construction of a gas pipeline through the Alai and Chon-Alai districts of the Osh region in 2019. SINO-Pipeline International Co. Ltd of China is carrying out the construction of the Kyrgyz branch of the Central Asia-China gas pipeline. In 2013, Kyrgyzstan's Parliament ratified an agreement with the Exim Bank of China for a USD 386 million loan to finance two new 150 MW units at the Bishkek Power Plant. The general contractor under the project was a Chinese company, Tebian Electric Apparatus Stock Co.

In gold mining, one of Kyrgyzstan's largest gold deposits is majority owned by the Chinese investors. Taldy-Bulak Levoberezhny (estimated at 65 tons in reserves) is being developed by Altyntek LLC, which is majority owned by the Chinese company Superb Pacific Limited. The total investment by China in the project exceeds USD 246 million. However, despite potential

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35. www.gem.wiki/Bishkek_power_station.
benefits generated by this investment, there are some concerns over its environmental damage, as stated in a local newspaper article.37

In the transport sector, during the period 2011 and 2017, USD 1.1 billion of the Chinese FDI worth USD 4.1 billion has been directed to road constructions in the form of concessional loans.38 The aim of these projects is to improve connectivity within Kyrgyzstan in the directions of north-south and east-west. The following are major projects financed by China:

1. Rehabilitation of Osh-Sarytash- Irkeshtam road (section from 190 to 240 km);
2. Rehabilitation of Osh-Sarytash- Irkeshtam road (section from 123 to 190 km);
3. Rehabilitation of Bishkek-Naryn- Torugart road (section from 9 to 272 km);
4. Alternative road North-South (sections Kazarman-Jalal-Abad and Balykchi-Aral);
5. Rehabilitation of Osh-Batken-Isfana road (sections from 220 to 232 km and from 248 to 360 km) and Bishkek-Balykchi road (section from 147 to 172 km);

The China-Kyrgyzstan-Uzbekistan railroad project is among some of the most expected endeavors in the region. The plan has been under discussion for 20 years. If completed, it would connect Fergana Valley with China via Kyrgyzstan in a 500-km railway line.39 This project is considered to be a part of the Belt and Road Initiative (BRI). According to the Railway Strategy for CAREC 2017-2030, the project is expected to cost around USD 5 billion. Kyrgyzstan also engaged with other projects under the BRI (box 2).

38 Roman Mogilevskii, Kyrgyzstan and the Belt and Road Initiative, WORKING PAPER #50, 2019.
39 Fergana Valley is an intermountain depression in Central Asia, spread across Kyrgyzstan, Uzbekistan and Tajikistan.
Box 2: The Belt and Road Initiative in Kyrgyzstan

The Belt and Road Initiative (BRI) is one of the most ambitious development initiatives launched by China in 2013 to improve the connectivity and cooperation between China and Europe. Kyrgyzstan lies on two of the BRI routes passing through Central Asia and Caucasus, making it an important player of the BRI. Studies find the BRI could help boost Kyrgyzstan’s GDP by 9-32 percent over the long term, if accompanied with policy reforms on trade facilitation and logistics that would reduce border-crossing delays by half. The completion of BRI transport projects is also forecast to increase Kyrgyzstan’s exports by 7.3 percent.

The BRI could support Kyrgyzstan’s infrastructure development on various fronts. Examples of road projects include Bishkek-Naryn-Torugart, Alternative road North-South, Osh-Sarytash-Irkeshtam and Osh-Batken-Isfana. Other BRI projects are gas pipeline Kyrgyzstan-China and the development of the street network in Bishkek city. Most BRI projects are being implemented in the background of many ongoing regional economic cooperation initiatives including the CAREC and EAEU.

Source: CSIS Reconnecting Asia Project, U.S. Global Investors
4. Infrastructure Financing Challenges

The sheer magnitude of Kyrgyzstan’s infrastructure needs is a challenge in itself. The country possesses an enormous hydropower potential in its tributaries to Syr Darya river. The power generated at the Nurek Cascade, if completed, could potentially become a major source of export revenue from its neighbors in Central and South Asia. However, Kambarata-I HPP alone, a reservoir-based 2,000 MW hydropower station, will require around USD 2 billion of capital expenditures. If adequate investment in major rail and road projects is made, the proximity and border with China could transform Kyrgyzstan into a transport, logistic and trade hub for the entire CIS region. It is therefore important to address the challenges facing the country in arranging sufficient financing of these transformative projects.

A. PUBLIC FINANCING

The Kyrgyz government’s ability to finance infrastructure projects is held back by small fiscal space, limited external borrowing capacity, and less efficient spending patterns. Institutional weakness in planning, selecting and implementing large-scale infrastructure projects also plays an important role. This subsection examines these challenges in greater detail.

1. Fiscal Space

a) Fiscal Balance

The fiscal deficits in Kyrgyzstan have been wide in recent years. The IMF expects the fiscal shortfall to reach 7.8 percent of GDP at end-2020, mainly due to lower government revenue and higher health-related expenditures. While generous fiscal support to cope with the pandemic is considered appropriate, Kyrgyzstan needs to bring fiscal deficits to a more sustainable level (figure 16).

Public revenues are highly prone to external shocks given the reliance on gold prices and workers’ remittances. While commodity prices have been volatile over the past decade, remittances are influenced by macroeconomic conditions in Russia and Kazakhstan, which are in turn driven by changes in global oil prices. On the expenditure side, public wages have increased while there is an effort to maintain domestic utility prices. For instance, subsidies to the energy SOEs have reached 3 percent of GDP in 2018.

b) Public Expenditure

The latest data shows that government expenditure stood at 34.1 percent of GDP in 2018 (figure 17). Notwithstanding the
potential to increase fiscal space by improving the quality of tax administration, the bulk of efficiency gains could come from optimizing public spending. In particular, government expenditures on wages and salaries to public sector employees is considered to be higher than in its regional peers. Improved public investment management is also critical for ensuring public money is effectively spent.43

**Figure 16: Fiscal balance for Kyrgyz Republic, (% of GDP, annual)**

![Fiscal balance for Kyrgyz Republic, (% of GDP, annual)](image1)

*Source: IMF.*

**Figure 17: General government expenditure for Kyrgyz Republic, (% of GDP, annual)**

![General government expenditure for Kyrgyz Republic, (% of GDP, annual)](image2)

*Source: ADB.*
c) Borrowing and Debt

The public debt-to-GDP ratio in Kyrgyzstan is one of the highest in the region of Central Asia, at 54.1 percent by the end of 2019 (figure 18). In the past, the country had benefitted from debt restructuring and forgiveness granted by the Paris Club in 2002 and 2005 and by Russia in 2018. Presently, amid the COVID-19 pandemic, Kyrgyzstan has resorted to additional borrowing from IMF -- jointly with the ADB, EBRD and the World Bank -- in the form of relief facilities. Going forward, the higher public debt level may further constrain the country’s ability to borrow to finance major infrastructure projects.

There are additional vulnerabilities to Kyrgyzstan’s public debt situation. One of them comes from a large share of Kyrgyzstan’s public debt burden being dominated in foreign currencies, making debt servicing vulnerable to volatility in the exchange rates. Another concern is related to the concentration in terms of creditors, with the Exim Bank of China accounting for around 40 percent of all external public debt at the end of 2018.44

2. The Current Account

Kyrgyzstan’s persistent trade deficit has been financed by FDI and external borrowing (figure 19). The main sources of inflows are remittances and exports of gold and agriculture produce. The key import items include fuel, transport equipment and machinery, and textiles and clothing. Kazakhstan, Russia and the UK are among the major trading partners (figure 20). Meanwhile, Kyrgyzstan is a member of both WTO and the Eurasian Economic Union (EEU). EEU helps facilitate labor mobility and inflow of remittances as Kazakhstan and Russia are the key member countries.

Figure 18: Government debt for Kyrgyz Republic, (% of GDP, annual)

Source: IMF.

Figure 19: Current account balance for Kyrgyz Republic, (% of GDP, annual)


Figure 20: Trade highlights of the Kyrgyz Republic (% of total, 2017)


3. Utility Subsidies

The pricing distortions in Kyrgyzstan’s end-user utility tariffs are prevalent. Revenues of the energy companies have remained below cost recovery for over a decade, and the energy sector companies’ cumulative debt reached KGS 96.7 billion (USD 1.2 billion, or 19.6 percent of GDP) at end-2017. The tariff reform proposed in 2017 is yet to be implemented. It is estimated that the subsidies to cover the cost of producing heat and electricity have reached 3 percent of GDP.
in 2018. Indeed, utility tariff rates in Kyrgyzstan are among the lowest in the world at less than USc1/kWh, according to a World Bank research (figure 21). Without increasing the tariffs, Kyrgyzstan will continue to lose revenues, reduce inefficient public expenditures, and forgo potential infrastructure investments. Measures should however be put in place to mitigate the effect of higher tariffs on the poor and vulnerable population groups.

4. Strategic Planning

Kyrgyzstan’s key strategic development plans are outlined in the National Development Strategies, which are adopted by the Parliament for the period of 3-4 years. The “National Strategy for Sustainable Development of the Kyrgyz Republic for 2018-2040” (NSSD 2040) has been the first attempt at long-term strategic planning, which is welcomed by the business community. However, with an unclear legal framework for strategic planning and a weak institutional structure for national, sectoral and regional investment formulation, the goals set in the NSSD 2040 risk not fully implemented.

The challenge for infrastructure investment is not only in strategic planning, however. There are also unclear responsibilities for project selection, evaluation, implementation and monitoring, scattered amongst the various central agencies and ministries, and the subnational governments. For example, in the case of planning for road reconstruction, the responsibility is split between the local authorities and the Ministry of Transport and Roads.

B. PRIVATE FINANCING

The main challenges to private financing of infrastructure projects in Kyrgyzstan are related to investment climate. Among others, these include frequent changes in the government, corruption and relatively weak rules of law, which together hamper private sector development and deter foreign direct investment.

Figure 21: Generation and transmission actual vs cost-recovery tariffs (KGS/kWh)

Note: Actual tariffs are a weighted average of tariffs for Kumtor, LIC, consumer resellers, wholesale resellers, and the distribution companies.

46 IMF Selected Issues – Kyrgyz Republic, 2019
www.imf.org/~/media/Files/Publications/CR/2019/1KGZEA2019002.ashx
1. **Doing Business**

Political instability and everchanging regulatory environment are often quoted as the highest impediments to infrastructure private investment. According to the World Bank’s Doing Business 2020, Kyrgyzstan was ranked 80th out of 190 economies worldwide, and 20th among the 24 countries of the East Europe and Central Asia region. In another survey, which looks the at business environment, the sample enterprises cited corruption and political instability as some of the most important constraints to their operations (figure 22).

On perceived corruption, Kyrgyzstan was ranked at the 126th place out of 198 countries in 2019, according to the Transparency International's Corruption Perception Index. Similarly, according to a survey on investor perceptions, 80 percent of surveyed firms identified corruption, poor transparency, and unpredictability of government decisions as key constraints on business operations. Bribe-taking is reported to be relatively common. Finally, an analysis by the World Bank also points to Kyrgyzstan’s performance in the areas such as the rules of law, control of corruption and political instability have deteriorated in recent years.

2. **Financial Sector**

Access to finance has been challenging in Kyrgyzstan. Figure 23 provides a comparison between Kyrgyzstan and lower-middle-income or Europe/Central Asian economies. It suggests that the financial system is shallow, while open market operations are hampered by small volume of securities available. More broadly, the transmission of changes in the policy interest rate to market lending rates is modest, given limited bank competition and high bank operating costs.

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**Figure 22: World Economic Forum 2017 Executive Opinion Survey**

<table>
<thead>
<tr>
<th>Issue</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insufficient capacity to innovate</td>
<td>3.6</td>
</tr>
<tr>
<td>Crime and theft</td>
<td>4.7</td>
</tr>
<tr>
<td>Inadequately educated workforce</td>
<td>5.3</td>
</tr>
<tr>
<td>Inadequate supply of infrastructure</td>
<td>5.7</td>
</tr>
<tr>
<td>Tax rates</td>
<td>5.8</td>
</tr>
<tr>
<td>Inflation</td>
<td>5.9</td>
</tr>
<tr>
<td>Inefficient government bureacracy</td>
<td>6.4</td>
</tr>
<tr>
<td>Tax regulations</td>
<td>6.9</td>
</tr>
<tr>
<td>Access to financing</td>
<td>8</td>
</tr>
<tr>
<td>Government instability/coups</td>
<td>10.2</td>
</tr>
<tr>
<td>Political instability</td>
<td>11.2</td>
</tr>
<tr>
<td>Corruption</td>
<td>22.4</td>
</tr>
</tbody>
</table>

High collateral requirement is one of the factors that explains limited domestic financial sector development. In particular, regulation on asset classification requires loan collateral coverage of at least 120 percent of the loan amount to be classified as a ‘standard’ asset in terms of the risk level. In reality, commercial banks’ collateral requirements can be higher. Consequently, 40-50 percent of potential borrowers fail to obtain loans from banks. Although actions have been taken to alleviate the collateral constraints (e.g. establishing a credit guarantee fund, which provides guarantees amounting to USD 11 million as of January 2019), the size of financial sector remains inadequate for infrastructure projects.

Dollarization of economy is another important factor impeding the development of the financial sector. After the 2015 currency shock, Kyrgyzstan’s banking sector is yet to fully recover. The regulatory measures taken by the central bank have resulted in a reduction of deposit and loan dollarization rates (table 4), but it is still not sufficient to make resources available from banks for infrastructure projects.

Figure 23: Use of financial services in the Kyrgyz Republic, 2019

Table 4: Dollarization of bBanking in Kyrgyzstan (% of total)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan dollarization</td>
<td>37.8</td>
<td>37.6</td>
<td>37.6</td>
</tr>
<tr>
<td>Deposit dollarization</td>
<td>46.4</td>
<td>41.5</td>
<td>41.5</td>
</tr>
</tbody>
</table>
C. PPP FINANCING

Although current legislation places no barriers to PPP in the infrastructure sector, lack of long-term local-currency financing is regarded as the main impediment to the development of PPP in Kyrgyzstan (figure 24). Given this potential barrier, the Government has requested the ADB to assist with the creation of a fund aimed at financing the preparation of PPP projects in 2014. As a result, the state budget received USD 2 million in 2014, USD 1 million in 2015, and USD 1 million in 2016 to promote PPP projects. Out of these proceeds, the allocated USD 1.3 million for consulting services for the preparation of feasibility studies for 8 projects with a total project cost of over USD 79 million.51

In 2016, the Government has adopted the 2016-2021 Program for the Development of PPP, which has identified certain challenges to PPP.52 The key challenges to be addressed are as follows:

1. Lack of PPP project pipelines at the subnational level, impeding the wholistic long-term planning approach on the national level.
2. Weak institutional capacity in the preparation and implementation of PPP projects on the public side.
3. The perceived high risk of PPP projects by private investors.
4. Limited access to finance PPP projects both from the public and private parties, thus increasing the reliance on equity and/or foreign currency debt from IFIs.
5. Limited awareness and experience of the private sector in the PPP.

Figure 24: PPP Index Scores for Kyrgyz Republic (2018)

Source: Infrascope.

51 www.ppp.gov.kg/ru/finansovyе-instrumentы/fond-finansirovaniya-podgotovki-proektov/
ПОСТАНОВЛЕНИЕ № 327 от 16 июня 2016 года
Infrastructure investment needs in Kyrgyzstan are massive. Meeting these needs would help the country to alleviate poverty, adapt to climate change, and ensure future economic development. Given the currently low level of private sector involvement in infrastructure and a high level of perceived political risks, public financing will remain the main source of infrastructure investment in Kyrgyzstan. Optimizing the capacity for sovereign borrowing is therefore the main focus of recommendations presented in the first part of this section. This will be followed by suggestions on other potential infrastructure financing opportunities.

A. POLICY RECOMMENDATIONS

Any policy recommendations on improving infrastructure financing in Kyrgyzstan will need to take into consideration the debt sustainability and the need for strengthening the capacity of government authorities responsible for infrastructure sector reform and development. Three areas of infrastructure development are pertinent going forward: (a) a need for tighter fiscal discipline and removal of inefficient supply-side subsidies; (b) institutional strengthening in sector planning and regulation; (c) and a better use of PPP procurement mechanisms.

1. Fiscal Discipline

An urgent need for additional borrowing to curb the impacts of the pandemic has pushed up the public debt to 66 percent of GDP at end-2020. Given the uncertainty of the crisis, Kyrgyzstan could face a need for additional rapid relief loans to close the fiscal and balance-of-payments gaps. Yet, once the crisis subsides, maintaining fiscal discipline will become essential for macroeconomic stability. This will most likely require more efficient public finance management, a detailed plan to reduce fiscal deficits, and great caution when raising or guaranteeing new debt.53

Policy Recommendation 1:

• Exercise caution and seek concessional terms while committing new debt obligations.
• Carefully choose viable projects to be financed.
• Eliminate supply-side utility subsidies and other quasi-fiscal deficits.

2. Tariff Reform

With more than 80 percent of electricity consumption billed at below cost recovery, Kyrgyzstan risks jeopardizing the financial sustainability of its entire power sector. At the same time, the implicit subsidies are de
facto free loans to the SOEs to cover the electricity consumption of both the rich and the poor. Among the cited reasons for lack of progress in the utility tariff reforms is political sensitivity, due to perceived lack of affordability among low-income households. However, the existing practice of blanket subsidies does not benefit low-income households to the extent that it benefits wealthier users. The distorted pricing system also discourages investment in energy efficiency and innovation, thus exacerbating the technological lagging. Therefore, the way forward should be the gradual replacement of subsidies to SOEs by a comprehensive social support system on the demand side to protect those truly in need, while increasing the overall tariffs to cost recovery on the supply side. This effort should be supported by a public awareness campaign.

**Policy Recommendation 2:**

- Formulate and approve a program of social support to vulnerable households.
- Implement a step-by-step tariff increase program with a simultaneous financial recovery plan.
- Involve the civil society and NGOs in a wide public consultations and awareness campaign.
- Strengthen the institutional capacity of business regulatory bodies and ensure their independence.

### 3. Sector Planning

**Kyrgyzstan needs master plans for all infrastructure sectors.** For instance, renewable energy is declared as a priority in the NSSD 2040 but is not featured in the Government plans. The master plans should also contain consideration of regional integration relating to initiatives such as EEU, BRI and CAREC. More importantly, institutional development and strengthening is needed for regulatory reform, transparency and governance. Lastly, the master plans should give clear signals to private investors on the government’s commitments on future infrastructure development.

**Policy Recommendation 3:**

- Adopt sector-specific Master Plans with the emphasis on climate change, regional cooperation and sector-specific reforms.
- Strengthen the institutional and regulatory capacity of each infrastructure sector and clarify their roles and responsibilities in planning, implementation and monitoring.

### 4. PPP Institutional Capacity

**Although Kyrgyzstan’s PPP Law identifies infrastructure investment as a priority, for this procurement mode to work, the government may need to introduce changes in sector-specific legislation and strengthen off-takers’ creditworthiness.** For instance, in renewable energy, where the Power Purchase Agreements (PPAs) should be signed with local distribution companies and whose financial sustainability is unclear, the government may need to provide credit enhancement. Another clear area for improvement is the institutional capacity of the agencies responsible for the planning, implementation and monitoring of the projects.

**Policy Recommendation 4:**

- Strengthen the infrastructure-related expertise and capacity of the PPP Center within the Ministry of Economy.
- Carefully select infrastructure projects for the implementation under the principles of PPP (e.g. small hydropower projects).
- In the absence of local financing, allow for the use of credit enhancement instruments (e.g. risk-specific state guarantees).
B. ADDITIONAL FINANCING MODALITIES

Kyrgyzstan has several untapped options to consider as additional infrastructure financing modalities. While exploring these options, policymakers should keep in mind the country’s borrowing capacity and the foreign currency risks.

1. Offshore Bond Issues

Offshore bond issues have become a widespread mechanism to tap on the funds from international institutional investors seeking diversification and impact investments. Below are some of the examples that could be considered.

1. Diaspora bonds – pioneered by India and Israel, this instrument has been used since the 1950s. Often issued at a “patriotism” discount to common sovereign borrowing costs, these bonds could bring up to USD 50 billion a year for developing countries. Kyrgyzstan could consider this option to fund large-scale hydropower projects. Also, they could be issued in stock markets of countries where a bulk of Kyrgyzstan’s remittances originate, such as the Moscow Stock Exchange or Astana Financial Center. This could also be beneficial considering the high correlations among the Kyrgyz som, the Russian ruble and the Kazakh tenge. However, similar to most other investment instruments, a successful issuance of diaspora bonds requires a stable political environment, strong and transparent legal systems, and positive prospects for economic growth.

2. Sovereign Eurobonds – Kyrgyzstan has been preparing for an issue of Eurobonds since 2015, when it first obtained an international credit rating by Moody’s at B2, a rating regarded as non-investment grade. However, there have been instances of successful issuances from the Central Asian region, e.g. Mongolia’s so-called “Genghis bonds” listed in 2012 on Singapore Stock Exchange.

2. Climate Finance

The climate finance framework provides a great opportunity for Kyrgyzstan given its relatively low emission rates, vulnerability to climate change (glacial melting) and energy poverty. Some of the financing facilities in the area include:

1. Global Environment Facility (GEF) with 182 member countries and provides grants to countries with projects related to biodiversity, climate change mitigation and adaptation, land degradation, the ozone layer, and persistent organic pollutants.

2. Climate Investment Fund, comprising two separate funds – the Clean Technology Fund (CTF), and the Strategic Climate Fund (SCF). The CTF provides large-scale financial resources for investing in clean technology projects that are based on low-carbon technologies.

3. Green Climate Fund (GCF) provides financing to support building climate-resilient infrastructure. Available to least developed countries, the GCF aims to limit or reduce their greenhouse gas emissions and adapt to climate change.

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3. Islamic Finance

It is estimated that financial assets associated with Islamic finance currently stands at over USD 2.5 trillion globally, and is projected to reach USD 3.8 trillion by 2023.\(^{55}\) Islamic banking accounts for 70 percent of total Islamic finance assets, or about $1.7 trillion. The Islamic insurance industry (takaful) and capital markets have shown strong growth in recent years. In Kyrgyzstan, a major development on Islamic finance took place in 2006 when EcoIslamicBank, the country’s first Sharia compliant financial institution, started its doors. By the end of 2018, its share in MSME lending stood at 6%.\(^ {56}\) More broadly, it is estimated that Islamic finance can potentially provide USD 450 million of funds to MSMEs.\(^ {57}\)

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55 https://aifc.kz/islamic-finance/.
6. Conclusions and Recommendations

This report examined the current state, challenges, and opportunities in infrastructure financing in Kyrgyzstan. Within infrastructure sector, the focus is on power, transport, ICT and water supply.

**Current State:** Kyrgyzstan’s infrastructure investment needs are massive. In addition to being essential to the country’s ability to alleviate poverty, these investments can have a significant transformational effect on the economy by providing additional export revenues and improving cross-border trade and mobility. The focus of the Government is currently on financing (a) large hydropower projects given the country’s commitment to regional electricity trade; and (b) public transport given the Soviet legacy of underdeveloped road and rail networks. Historically, infrastructure projects have been financed by sovereign loans from international development institutions. Private investment is yet to gain momentum, while PPP is relatively new.

**Challenges:** to meet its infrastructure needs, Kyrgyzstan’s key challenge is chronic fiscal deficit and high level of external debt. The economic slump caused by the pandemic and the uncertainty surrounding its duration are exacerbating such fiscal challenge. Another important challenge requiring urgent attention is the massive quasi-fiscal deficit that stems from a decades-long suppression of utility tariffs.

The financial sector (banks and capital markets) is unable to provide large and long-term funding to cater to the needs of infrastructure projects. The stability of local banks is undermined by a high degree of dollarization, while the capital market remains shallow and underdeveloped.

Public-private partnership (PPP) is a new procurement modality and has already been successfully used for a healthcare project. However, leveraging PPP in the power and transport sectors will require further market reforms, better regulations, and reliance on credit enhancement instruments, which is currently constrained by a limited borrowing capacity.

**Opportunities and Modalities:** Going forward, Kyrgyzstan’s main financing modality would remain in the realm of concessional sovereign loans from international financial institutions. However, new modalities should also be explored, such as diaspora bonds or issuances of sovereign bonds in the neighboring countries. When exploring these options, careful consideration should be given to their impact on the foreign currency risk and external debt stock.

Among others, policy priorities include reducing pricing distortions in the infrastructure sector, careful selection of projects, and wise structuring of project financing using concessional loans and grants. More broadly, infrastructure financing in Kyrgyzstan will benefit from increased capacity of both public and private entities on project selection and implementation. infrastructure projects.
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