



PEER REVIEW NOTE

# Monitoring competitiveness reforms in Kyrgyzstan

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## FOREWORD

In 2013, as part of the OECD Eurasia Competitiveness Programme, the OECD worked with the Government of Kyrgyzstan to assess and improve the country's competitiveness. The OECD, in co-operation with GIZ (the German Society for International Co-operation), proposed the adoption of a targeted and practical approach to support competitiveness reforms in Kyrgyzstan. The review led to policy recommendations in three priority areas: increasing access to finance for small and medium-sized enterprises (SMEs), developing human capital, and promoting investment and exports.

Three policy handbooks – one per policy area – were published as a result of this work. The handbooks were peer reviewed at the OECD Eurasia Competitiveness Roundtable in December 2013. The Roundtable was established in 2013 to provide OECD and Eurasian countries with the opportunity to discuss policy reforms, experiences and implementation, and to monitor progress in implementing recommendations. At the December 2013 roundtable a high-level delegation from the Government of Kyrgyzstan, represented by the Deputy Prime Minister, presented the final results and endorsed the recommendations given in the handbooks.

Since then, the OECD has monitored the implementation of the agreed recommendations through project steering group meetings and monitoring workshops held during several OECD missions to Bishkek from 2014 to 2016. These activities, which involved experts from Bulgaria, Ireland, Switzerland, Turkey and the United Kingdom, were implemented in co-operation with GIZ.

This note was developed in consultation with the Government of Kyrgyzstan, private sector companies, business associations, and development partners during the monitoring process. It assesses the implementation progress made in the last three years, and makes recommendations for further progress.

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The European Union co-funded the project and provided important support: Mr Pierre Amilhat, Director, Directorate-General for International Cooperation and Development (DG DEVCO), European Commission (EC); Mr Jobst von Kirchmann, Head of Unit DEVCO Central Asia, Middle East, Gulf, Pacific and Global Asia-Pacific Initiatives, DG DEVCO Unit H2, European Commission (EC); Ms B er enice Muraille, Head of Sector Central Asia, DG DEVCO, EC; Ms Anja Nagel, Head of Sector Global Initiatives, DG DEVCO, EC; Ms Laure Dupin, Programme Manager - External Relations, DG DEVCO, EC; Ms Anna Berdach, former Programme Manager - External Relations, DG DEVCO, EC; Mr Johannes Stenbaek Madsen, Head of Operations Section; and Mr Carl Frosio, Project manager, EU delegation to Kyrgyzstan.

This report was prepared under the guidance of Mr Andreas Schaal, Director, OECD Global Relations; Mr William Tompson, Head of the OECD Eurasia Division; and Mr Antonio Somma, Head of the OECD Eurasia Competitiveness Programme.

The main authors of this report are Mr Sebastian Kupferschmid, Economist/Policy Analyst, OECD Eurasia Division and Mr Arnault Prêtet, Project Co-ordinator, OECD Eurasia Division. The project was managed by Mr Grégory Lecomte, Project Manager, OECD Eurasia Division. Ms Cécile Delcuvellerie, Mr Samuel Delpéuch, Mr Damiano Fior and Ms Anna Morin provided analytical input and support. The report was reviewed and benefited from valuable inputs provided by Ms Marzena Kisielewska, Head of the South East Europe Division; Mr Clément Brenot, Project Co-ordinator, OECD South East Europe Division; Ms Jovana Pavlovic, Policy Analyst, OECD South East Europe Division; Mr Stuart Thompson, Policy Analyst, OECD Centre for Entrepreneurship, SMEs and Local Development; and Mr Jibrán Punthakey, Economist/Policy Analyst, OECD Eurasia Division.

Final editorial and visual support was provided by Ms Fiona Hinchcliffe, Editor; Ms Vanessa Vallée, Communications Manager, OECD Global Relations Secretariat; and Ms Anne Gimenez, Communications Officer, OECD Global Relations Secretariat. Valuable administrative support was provided by Ms Mariana Tanova, Assistant, OECD Eurasia Division.

## ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
BLP	Business Linkage Programmes
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
EEU	Eurasian Economic Union
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
GDP	Gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (German Society for International Co-operation)
IPA	Investment Promotion Agency
ISPAT	Investment Support and Promotion Agency of Turkey
KGS	Kyrgyzstan Som (currency)
OECD	Organisation for Economic Co-operation and Development
MLSP	Ministry of Labour and Social Protection
PFI	OECD Policy Framework for Investment
PPP	Public-private partnership
SFIVET	Swiss Federal Institute for Vocational Education and Training
SME	Small and medium-sized enterprise
SSC	Sector Skills Council
USAID	US Agency for International Development
USD	US dollars
VET	Vocational education and training
WB	World Bank
WG	Working group
WRF	Warehouse receipt finance
WTO	World Trade Organization
y-o-y	Year-on-year



## KEY INDICATORS: KYRGYZSTAN

<b>Country profile</b>	
Population, 2015	5.96 million
Surface area, 2015	199 949 km <sup>2</sup>
GDP (USD, current prices), 2015	6.5 billion
GDP per capita, (USD, current prices), 2015	1 103
Real GDP growth (y-o-y change), 2015	3.5%
Inflation (average consumer prices, y-o-y change), 2015	6.5%
Exports of goods and services (% of GDP), 2014	37.4%
Imports of goods and services (% of GDP), 2014	87.7%
FDI, net inflows (% of GDP), 2015	12%
General government net lending/borrowing (% of GDP), 2014	-3.1%
Unemployment (% of total labour force), 2015	8.1%
Remittances (% of GDP), 2015	25.7%

Sources: World Bank (2016), *World Development Indicators*, database, <http://data.worldbank.org/indicator>, (accessed 2 June 2016); IMF (2016), *World Economic Outlook: Too Slow for Too Long*, [www.imf.org/external/pubs/ft/weo/2016/01/](http://www.imf.org/external/pubs/ft/weo/2016/01/).

## EXECUTIVE SUMMARY

Kyrgyzstan has recently undertaken substantial reforms to improve its competitiveness. These reforms have addressed, among others, the three priority areas identified during joint work with the OECD in 2013: access to finance for small and medium-sized enterprises (SMEs), human capital development, and investment and export promotion. Foreign direct investment has increased, amounting to 12% of GDP in 2015. However, growth has been extremely volatile, due in large part to a combination of external shocks and heavy reliance on gold exports. GDP growth fell from 10.3% in 2013 to 3.5% in 2015. Kyrgyzstan needs to sustain its competitiveness reforms in order to reduce its vulnerability to external factors.

### ***Access to finance: Kyrgyzstan has improved supply-chain financing for agricultural producers***

Since 2013, the government has made significant progress in improving access to finance in agriculture. The 2013 OECD review recommended warehouse receipt finance (WRF) as a possible solution to help credit-constrained SMEs, especially in agriculture, where collateral requirements in the form of pledged fixed assets (buildings, machines) were a key barrier for companies. WRF would allow SMEs and farmers to pledge movable assets and inventory to finance working capital needs.

Following the OECD recommendations, a regional pilot of warehouse receipt credits has been implemented, with a focus on women entrepreneurs. Its results bode well for a roll out of such financing across the country. A draft regulatory framework for warehouse receipt finance was developed following the pilot, but needs to be finalised by the government. Further investments in warehouses will also be needed to realise the instrument's full potential. The Union of Bankers is helping the government disseminate information more widely to farmers and investors to promote the development and use of modern warehouses.

### ***Human capital: Kyrgyzstan is improving workplace training through public-private co-operation***

The development of workplace training, including internships and apprenticeships, can help bridge the skills gap, especially in agriculture. New laws and reforms in favour of workplace training would help increase labour productivity and the involvement of the private sector in human capital development.

The 2013 recommendations on workplace training have prompted a number of reforms. The government is currently designing a new regulatory framework – by amending the labour and tax codes – that is more supportive of public-private co-operation in education. The creation of career centres is improving stakeholder engagement in workplace training. Better matching of students and companies through mechanisms such as online job portals and promotional campaigns for employers would help raise mutual interest in workplace training and decrease transaction costs, especially in the agribusiness sector.

### ***Investment promotion: a more strategic approach is being implemented, including for the garment sector***

Kyrgyzstan's 1998 accession to the World Trade Organization and a more liberal trade regime than other Central Asian countries have supported the emergence of an intermediary trade sector that provides employment for low-skilled workers.

In line with OECD recommendations to further support trade and attract investment in priority sectors, the government has implemented far-reaching reforms. These include creating an active investment promotion agency and a dedicated strategy to attract foreign direct investment. Investment and export promotion efforts have already benefitted the garment sector, though the sector's opportunities could be reassessed in the context of Kyrgyzstan's 2015 membership of the Eurasian Economic Union.

## SUMMARY OF MONITORING ASSESSMENT

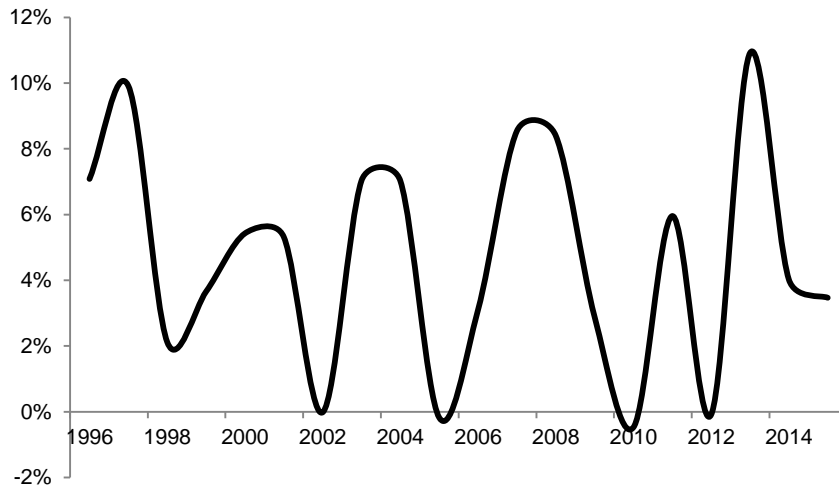
Policy area	Overall 2013 recommendation	Detailed 2013 recommendations	2016 monitoring assessment		
			Progress status	Way forward	
<b>Access to finance for SMEs</b>	Warehouse receipt finance could help improve access to finance in the agricultural sector.	1. In the short term, Kyrgyzstan should set up a pilot warehouse receipt scheme.		Completed.	
		2. Establishing the regulatory framework for WRF could provide necessary protection and insurance.		Adopt the regulatory framework for WRF and consider the creation of an insurance product for WRF.	
		3. Promotion of the storage business is needed to attract potential investors.		Expand promotion and information activities to farmers and investors, attract investments using the new Investment Promotion Agency (IPA).	
<b>Human capital development</b>	Kyrgyzstan should bridge skill gaps through enhanced public-private co-operation and workplace training.	1. The government was urged to set the necessary regulatory framework for workplace training with appropriate incentives.		Agree on and adopt the next version of the amendments to labour and tax codes (tax and social contributions' exemptions); establish a <i>Convention de Stage</i> .	
		2. Engagement of the private sector could be increased in workplace training programmes.		Further strengthen the National Council for Professional Skills Development and the sub-sector skills' councils	
		3. The government could support more efficient students matching with available training places, including in agribusiness education.		Expand career centres, and develop incentives and promotional actions directed toward employers (e.g. events/training hosted by VET schools, labelling, funding).	
<b>Business internationalisation</b>	Kyrgyzstan was invited to expand its investment promotion activities.	1. Kyrgyzstan could strengthen its investment and export promotion policies and activities.		Finalise the investment promotion strategy, develop a sector-prioritisation methodology and structure the IPA team to better reach out to investors.	
		2. Garment and textile sector could be a potential sector of focus for piloting investment promotion.		Facilitate SMEs' collective buying agreements and align the garment investment promotion strategy with the investment promotion sector prioritisation.	
<b>Key</b>	Completed	Close to completion	Being implemented	Initiated	Not started

## INTRODUCTION

1. Following its independence in 1991, Kyrgyzstan undertook significant reforms oriented towards a market economy, making it one of the boldest reformers in the region (Pomfret, 2006). It established its own currency in 1993, eliminated capital controls, ended price subsidies and introduced a liberal trade regime (ADB, 2012). By 1998, the country had become a member of the World Trade Organization (WTO) (Pomfret, 2006). The country experienced a steady, however volatile, annual average growth rate of 5.6% from 1996-2000 and 4.1% over 2001-15 that was fuelled by external factors, mainly gold exports and remittances. Foreign direct investment (FDI) increased more than five-fold between 2005 and 2014, amounting to 12% of GDP in 2015, and was highly concentrated in gold mining.

2. However, the market-oriented reforms alone did not result in an immediate improvement in the economic situation. Kyrgyzstan's economy contracted by perhaps as much as half in the early 1990s, public spending fell by 90%, and hyperinflation hit purchasing power (Pomfret, 2006). The resulting increase in inequality and poverty contributed to a lack of public and private domestic funding sources. In 1996, the economy returned to growth for the first time since independence, and the country recorded an average annual GDP growth rate of 5.6% over 1996-2000, despite the crisis in Russia in 1998 (ADB, 2012). Over 2001-15, the average rate of GDP growth slowed, however, to just 4.1%, and was very volatile (Figure 1).

**Figure 1. Kyrgyzstan's annual GDP growth, 1996-2015**



Source: World Bank (2016), *World Development Indicators*, database, <http://data.worldbank.org/indicator>, (accessed 2 June 2016)

3. The private sector is the main driver of the Kyrgyz economy, generating about 75% of GDP in 2004 and 84% of employment. It is mainly composed of small entities: peasant farmers, individual entrepreneurs, and small and medium-sized enterprises, which accounted for 99.7% of registered businesses in 2011 (ADB, 2013a). Most are informal and are concentrated in the service sector. The informal sector occupies a significant share of the economy, employing almost 70% of the work force in 2011 (ADB, 2013a). Self-employed workers represented 40% of employment. Foreign direct investment (FDI) increased more than five-fold between 2005 and 2014, but was highly volatile, amounting to 11.2% of GDP in 2011, 4.5% in 2012, 8.6% in 2013, 2.9% in 2014, and 12% in 2015 (UNCTAD, 2016b). FDI is

mostly concentrated in gold mining activities. Major investors are from Canada and China, and to a lesser extent the United Kingdom, the Russian Federation, and Kazakhstan (UNCTAD, 2016a).

4. Apart from gold mining, other key sectors of Kyrgyzstan's economy are agriculture, garment manufacturing, and services. After a steep decline in the post-independence years, agriculture regained growth from 1994 onwards and contributed 18% of GDP in 2012 (OECD, 2014a). Kyrgyzstan has also become a trade hub for Central Asia, partly due to its early accession to the WTO<sup>1</sup> and a preferential trade agreement with the Russian Federation, which benefited the garment and textile sector. Textile products have become Kyrgyzstan's second-largest export after gold. However, the sector is highly dependent on Russia, which is the destination of more than 95% of Kyrgyzstan's garment exports (ADB, 2013a).

5. Kyrgyzstan's volatile economic growth stems from its high dependency on external growth drivers, namely gold prices and remittances. GDP growth reached 6% in 2011, driven mainly by gold production, which accounted for 12% of GDP and more than half of Kyrgyzstan's exports (Reuters, 2013). In 2011, remittances represented 27.6% of GDP (World Bank, 2016). These inflows were able to cushion the collapsing gold output that caused an overall GDP decline in 2012 (Figure 1). Gold and remittances still represented respectively 7% and 30% of GDP in 2014 (Economist Intelligence Unit, 2015).

6. Kyrgyzstan's GDP per capita in purchasing power parity terms reached USD 3 300 in 2014, which classifies it as a lower middle income country. As a result of external shocks, such as Russia's slowdown, Kyrgyzstan's economic growth decreased to 1.7% in 2015 from a peak of 10.9% in 2013. Exports to Russia plunged 6.4% in 2014, the country's gold production slowed, and remittances from Russia fell from 31% to 25% of GDP in 2015 (Economist Intelligence Unit, 2015). A modest recovery is expected in 2016-17, contingent on a recovery in exports to Russia and positive effects from membership of the Eurasian Economic Union (EEU) (World Bank, 2016).

7. Kyrgyzstan became a member of the EEU in May 2015, with free movement of goods, services, capital and labour taking effect in August 2015. The EEU members include Belarus, Armenia, Kazakhstan, Kyrgyzstan and Russia, representing a market of 170 million people, a combined GDP of roughly USD 1.6 trillion (2015, at current exchange rates) and a foreign trade turnover of about USD 580 billion. EEU member economies are the destination of around 65% of Kyrgyzstan's non-gold exports and the source of 43.5% of its imports (EEC, 2016; Kubayeva, 2015). Integration into the EEU has so far had mixed effects on the Kyrgyz economy. It may have given Kyrgyz workers in Russia an advantage over immigrants from non-members like Tajikistan,<sup>2</sup> but Kyrgyzstan has also been affected by *ad hoc* restrictions and non-tariff barriers imposed by Russia. The effects of lower tariffs within the EEU are thwarted by an increase of tariffs vis-à-vis China, for which Kyrgyzstan is the biggest regional re-export hub for trade with Kazakhstan and Russia. However, the impact of this should abate somewhat as WTO-mandated annual tariff reductions are implemented. A key challenge for Kyrgyzstan arising from its EEU membership will be harmonising its domestic regulatory system with EEU standards, especially in agriculture and food exports (World Bank, 2016).

## NOTES

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<sup>1</sup> Kyrgyzstan joined the WTO in 1998, ahead of China (2001) and more than a decade before the Russian Federation or its Central Asian neighbours.

<sup>2</sup> Remittance flows to the latter have fallen far more dramatically as the Russian economy has slowed.

## **CHAPTER 1. ACCESS TO FINANCE FOR SMALL AND MEDIUM-SIZED ENTERPRISES**

8. Agriculture accounted for over 30% of Kyrgyzstan's employment and 17% of its GDP in 2014 (National Statistical Committee of the Kyrgyz Republic, 2016; World Bank, 2016). The sector is also socially important, being the main source of employment for most of the country's poorest people (Dubashov, Kruse and Ismailakhunova, 2015). Output and productivity increases in agriculture could therefore have a strong impact on Kyrgyzstan's poverty rate.

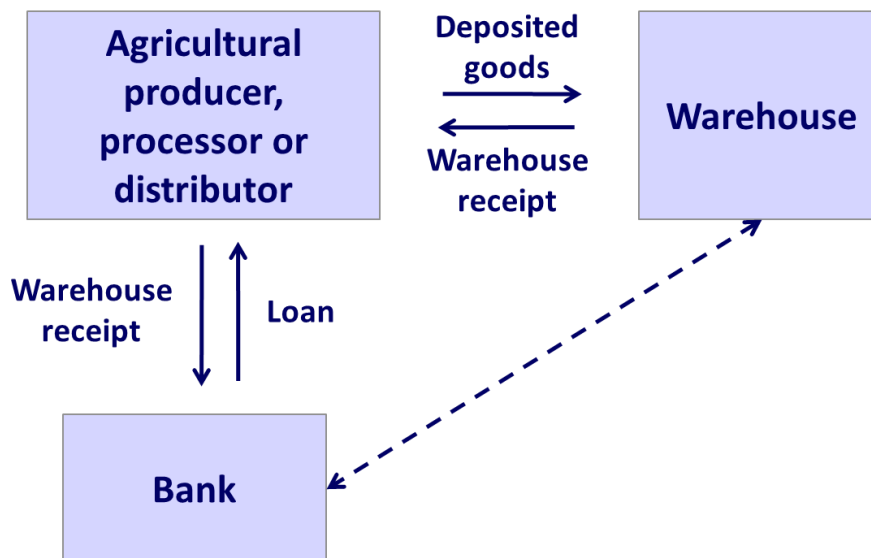
9. Access to finance was a key barrier to SMEs in Kyrgyzstan in 2013, as most SMEs had to rely on internal funds as well as credit provided by families and friends. Farmers and agricultural SMEs were particularly credit-constrained. Overall, only 18% of companies in the sector were using bank finance; 79% of respondents to an OECD sector survey reported using internal funds to finance their working capital (OECD, 2014a). In addition to high interest rates, ranging from 18% to 24%, one of the sector's key challenges was the difficulty of providing adequate collateral when seeking a bank loan (OECD, 2014a). In 2013, 80% of agricultural companies seeking credit were asked to provide collateral equivalent to 120% or more of the total loan amount, usually in the form of real estate. Warehouse receipt finance (WRF) was selected as a financial tool with the potential to alleviate part of the collateral constraints and thus facilitate access to finance in the sector.

### **Overview of 2013 recommendations**

10. WRF can increase access to finance as it allows farmers to pledge movable assets and inventory to obtain financing for working capital. In addition, WRF allows the farmer to pledge fixed assets for long-term financing for capital expenditures and investments (OECD, 2014a). The basic operation of a WRF scheme is described in Figure 2.

11. The benefits associated with WRF extend beyond bridging the collateral gap. By providing the infrastructure to easily store, aggregate, and – over the long term, also package – goods, it can enable farmers to overcome seasonal price fluctuations and thus sell their produce at higher prices. It can also increase the integration of the agribusiness supply chain as a whole, facilitating co-ordination between farmers, traders, input suppliers, and processors.

Figure 2. How warehouse-receipt financing works



Source: OECD (2014a), "Improving supply chain financing in The Kyrgyz Republic: the case of agriculture", *Private Sector Development Policy Handbook*, <https://www.oecd.org/globalrelations/SupplyChainFinancing.pdf>.

12. The OECD review in 2013 made three recommendations for introducing WRF to Kyrgyzstan (OECD, 2014a):

***Recommendation 1: Set up a pilot WRF scheme***

13. A pilot WRF scheme at the local level was proposed to allow for a viable assessment of WRF in practice, as well as to gain the support of farmers and banks. The pilot was thought to be useful to build trust between different stakeholders, such as farmers, warehouse operators, traders and banks.

***Recommendation 2: Establish a regulatory framework for WRF***

14. In 2013 Kyrgyzstan had a law on collateral that regulated moveable assets, as well as a central collateral registration system. Some other elements of a regulatory environment for warehouse receipts were also already in place. For example, the civil code contains basic legal norms that characterise warehouse certificates and warehouse receipts (Legislative Assembly of the Kyrgyz Republic, 1998). However, there were no provisions for the use of warehouse receipts as collateral for credit. Therefore, there was a need to develop a legal framework for WRF to allow it to be streamlined at a national level. Setting up the legal background for the registration, certification and inspection of warehouses not only involved having the relevant legislation, but also required an agency to oversee these tasks and ensure compliance with financial and technical standards (Box 1).

15. A sustainable system for collecting and disseminating agricultural information and prices was also needed, and existing insurance products needed to be standardised to protect producers and banks from large swings in agricultural prices. Finally, an indemnity fund was expected to help protect banks from warehouse defaults (OECD, 2014a).



### ***Recommendation 3: Promote the storage business to attract potential investors***

16. Storage capacity in Kyrgyzstan was unevenly distributed around the country, and few warehouses had more than basic equipment. The WRF solution requires sound and modern storage facilities. Achieving this meant further promoting the storage business and attracting investment. The 2013 review suggested that investment promotion for the storage business could be added to the national investment promotion strategy (OECD, 2014a). One way to support the development of storage businesses would be through public-private partnerships (PPPs), for example to provide land or facilities.

### **Findings of the 2016 monitoring assessment**

17. The Government of Kyrgyzstan, with the support of the German Society for International Co-operation (GIZ) and the Asian Development Bank (ADB), has made substantial progress in preparing the appropriate regulatory framework for WRF. A pilot has been conducted and has demonstrated the potential of WRF. The expansion of the scheme is threatened, however, by the poor state of warehouse infrastructure in the country.

### ***Monitoring of recommendation 1 shows a successful pilot WRF scheme***

*Recommendation 1: Set up a pilot WRF scheme at sub-national level*

18. The launch of a pilot WRF was supported by the GIZ, which held meetings and interviews with 32 warehouse owners in two *oblasts* (Chui and Issyk-Kul) to identify possible pilot warehouses. As no comprehensive register of warehouses existed, warehouses were identified based on information from local authorities, bank branches, and existing donor projects involving warehouses. Twenty of the warehouse owners interviewed agreed to co-operate in pilot credits (Abakirov, 2014).

19. Three banks – the Commercial Bank of Kyrgyzstan, Bank Asia and OJSC Aiyl Bank – agreed to participate in pilot activities. Local branch managers of these banks were briefed on the functioning and benefits of WRF. Co-operation was established between these local banks and ADB’s project on women entrepreneurship in Kyrgyzstan (ADB, 2013b). The project channels funds for innovative financial solutions to women entrepreneurs through intermediary financial institutions. Aiyl Bank identified WRF as an innovative financial solution and was therefore able to provide loans through WRF at an interest rate of 12%. Nine loans were agreed during the pilot phase (the harvest season of 2014-15) worth a total of KGS 3 million (USD 55 000).

20. The pilot also included the creation of initial warehouse certificates modelled on good practices by other countries. Receipts were signed by all parties and contained key information such as the type of produce, quality, price of storage, dates, parties responsible, etc. Other pilot activities included awareness-raising events, initially to inform the financial institutions of the potential benefits of WRF.

21. The successful implementation of the pilot, although limited in scope, demonstrates the potential of WRF to help agricultural SMEs access finance.

22. Participants in the pilot mentioned the following challenges and key insights:

- The lack of a legal basis for WRF. This was the main stumbling block as it increased the level of risk for banks, forcing them to set aside additional reserves and decreasing profit margins.<sup>3</sup>

- The lack of a clear system for warehouse licensing.
- The fact that the majority of warehouses were poorly equipped for WRF.
- The lack of a risk insurance system for warehouses, banks and farmers.

23. The key lessons learnt from the pilot phase were used to inform the discussions and to develop a regulatory framework for WRF in Kyrgyzstan (see next section).

***Monitoring of recommendation 2 reveals the development of a draft regulatory framework***

*Recommendation 2: Establish the legal and regulatory framework for WRF*

24. The regulatory framework for WRF was developed by a working group (WG) under the leadership of the Ministry of Economy, supported by the OECD and GIZ. The WG was established during the peer review of Kyrgyzstan in 2013, and had helped to develop the original policy recommendations. It outlined the aspects which needed to be covered by the new legislation:

- standards for the warehouses to be included in the register, as well as procedures in case of a violation of the standards
- the creation of a registry of warehouses and an agency to implement the regulatory framework
- the rights and obligations of all parties involved, including warehouse owners, bankers and farmers
- specification of the content and information provided in the different types of warehouse receipts
- the transfer of rights, and the termination of warehouse receipts and certificates.

25. The work of the WG was supported by policy practitioners from Ukraine and Bulgaria, based on good practices and key lessons learnt in these countries (Box 1). The WG's efforts led to the drafting of a new law that closely resembles the Bulgarian system.

#### **Box 8. Bulgaria shows how specialised agencies can help to implement the regulatory framework**

While laws for WRF are a necessary prerequisite, to ensure their smooth functioning they should be complemented by additional structures. The Bulgarian Government has established public warehouses, an indemnity fund and a specialised agency under the Ministry of Agriculture, in addition to the basic legal framework.

The newly created agency, the National Grain Service of Bulgaria, organises, implements and controls the licensing process for public grain warehouses. Its functions also consist of:

- maintaining public registers of public grain warehouses
- carrying out initial and periodic checks of the financial, operational and technical conditions of public grain warehouses, as well as the quality and quantity of the stored grain
- collecting orders for printing warehouse receipts.

By effectively controlling the public warehouses and their performance, the National Grain Service helps to build trust among stakeholders, and is a key enabler of WRF in Bulgaria.

*Source: Winn, Miller and Gegenbauer (2009), The Use of Structured Finance Instruments in Agriculture in Eastern Europe and Central Asia.*

26. Business associations, especially the Union of Bankers, participated in and supported the drafting of the law. The draft law was subject to public discussions during a roundtable organised in Bishkek on 23 May 2016. It was also circulated for discussion by stakeholders in other cities in Kyrgyzstan (Osh, Jalal-Abad and Naryn). This public-private dialogue approach is expected to help the new policy instrument be broadly accepted and to decrease potential risks associated with WRF.

27. While Kyrgyzstan's progress in developing the legislation for WRF is commendable, its progress in establishing a conducive environment for WRF is lagging. The most critical gap is the lack of widespread information on market prices for agricultural produce, which are crucial for a well-functioning WRF system. Although government websites provide general information on agriculture, the level of detail is limited. Exact and current prices as well as forecasts are necessary to assess the value of collateral and to decide the optimal date for selling produce.

28. Similarly, there are no standard insurance products for WRF at this stage. To build confidence in the system, insurance products need to be expanded to protect against bankruptcy and fraud. Insurance companies were contacted to participate in the initial phase of the pilot. While they signalled general interest, in the absence of a regulatory framework they preferred not to insure WRF or to create appropriate products. They also expressed doubts about the quality of the warehouses.

29. Finally, the government should consider establishing an indemnity fund, which would work like a credit guarantee fund (CGF) tailored to WRF. This would provide an additional level of protection for the banks involved in WRF by providing an additional guarantee. This fund would be complementary to other insurance products, as it would fully reimburse damages and cover cases of default instead of insuring against large price swings.

#### ***Monitoring of recommendation 3 highlights poor investment in warehouses***

*Recommendation 3: Promote the storage business*

30. The quality and quantity of warehouses that are fit for WRF appear to be limited. Suitable warehouses need to be found and modernised if this financial tool is to fulfil its potential. However, information on warehouses in Kyrgyzstan is outdated: the 2003 agricultural census provides the latest reliable nationwide data. It identified 1 476 facilities in Kyrgyzstan each with a capacity of more than 500 tonnes.

31. To obtain more accurate information and to assess the readiness of warehouses for WRF, a survey was undertaken with the support of GIZ. The survey did not aim to cover all warehouses nationwide, but rather to obtain reliable, detailed and accurate data on the condition of warehouses that could be eligible for WRF. This identified 50 warehouses with a storage capacity of more than 500 tonnes. These were contacted for interviews.

32. Initial interviews revealed that 20 of the 50 warehouses did not meet the basic infrastructure requirements for WRF. Besides the technical issues, the survey also identified a number of challenges:

- The warehouses require substantial investments and renovation, as most of them were built during the 1970s.
- Most lack additional services that would add value (e.g. sorting, consolidation, splitting of goods and produce, or transportation services).
- Some warehouses lack minimal security, such as fences.
- Several warehouses were not equipped with refrigerators, thus increasing the risk of losses due to decay.
- Written contracts between owners of warehouses and owners of produce were rare – trust-based oral agreements were more usual.

33. Due to a lack of warehouse capacity, a number of producers and traders reported that they are building new warehouses with refrigeration equipment (Abakirov, 2014). For example, in the Kochkor region the authorities have allocated 17 hectares of land for warehouse construction. In addition, several banks have shown interest in investing in warehouses and providing credit for their construction once there is an established WRF regulatory framework. Warehouse owners who were interviewed by the OECD argued that investments in warehouses paid off. Several of them have further invested in modernising equipment by purchasing cooling and security technology.

### **The way forward**

34. The finalisation of the law on WRF is the necessary next step for the full roll out of WRF. Once adopted, the government will need to implement the law “On warehouses and storage certificates”, adopt a number of regulations, and monitor the development and impact of WRF and warehouses. It will be crucial to ensure the safety and quality of the first warehouses selected. After a few years following the initial harvest seasons, further support and adjustments might be needed to effectively roll out the instrument to the whole country. Turkey has lessons to share on the continuous efforts needed to improve the WRF system (Box 2).

### **Box 9. Continuous and incremental improvements to Turkey's WRF system**

In Turkey, banks have traditionally been large users of warehouse-receipt financing to support the country's important tobacco exports. Many Turkish banks have set up their own warehousing subsidiaries to store the goods that they are financing. Nevertheless, in the large domestic grain market, which was heavily regulated until the late 1990s, warehouse receipt financing was rare.

To support policy liberalisation, a warehouse receipt system was developed as part of the World Bank-funded Agricultural Reform Implementation Project. The programme aimed to reduce distorted incentives and government subsidies, and substitute them with a support system to provide agricultural producers with incentives to increase productivity in response to real comparative advantage. Warehouse receipts presented an alternative approach to costly government price support. Turkey developed proper licensing and inspection procedures, and built institutional capacities in this area. A Law on Licenced Warehousing adopted in 2005 defined the procedure for the authorisation and oversight of warehouses (including ministry-issued licences and insurance schemes for stored goods) and gave legal content to the warehouse receipt, which could then be pledged as a guarantee.

This legal framework has been improved through subsequent regulations: the 2011 Regulation on Electronic Warehouse Receipt facilitates the issuing of e-warehouse receipts, and the 2013 Regulation of Agricultural Products Licensed Warehousing consolidates the legal framework for commodity-specific exchange. These organised markets (most of which already owned warehousing infrastructure) received financial and technical support to improve their capacity and use of warehouse receipts in their daily transactions. Large exchanges also invested in building more storage facilities, which provided potential opportunities for growth of the warehouse receipt system.

*Source:* FAO/EBRD (2015), "Designing warehouse receipt legislation: Regulatory options and recent trends", [www.fao.org/3/a-i4318e.pdf](http://www.fao.org/3/a-i4318e.pdf).

35. Once the legal framework has been established, further work should also include the creation of a proper insurance product for WRF. Such products can help prevent losses from inappropriate storage and thus improve the solvency of the overall WRF system. In the long term, such efforts can be further facilitated through the creation of a specialised credit guarantee fund for WRF.

36. Special training needs to be conducted, particularly for staff of the Ministry of Agriculture and Land Reclamation, the body which will keep the register and monitor the warehouses. Carrying out promotional and information activities for the operators of warehouses and agricultural producers is equally important to increase knowledge of and interest in this new product.

37. Current efforts and investments to improve the quality and quantity of storage facilities in Kyrgyzstan appear insufficient. In the short term, and once the legislative framework is in place, banks might be willing to provide loans for creating storage areas and use them for providing WRF. This could mitigate the problems of non-existent insurance products for WRF and limited trust in the system. In the long term, the newly created Investment Promotion Agency (see Chapter 3) and increased efforts to implement PPPs could attract investment in storage infrastructure.

## NOTES

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<sup>3</sup> National Bank of the Kyrgyz Republic regulations limit the maximum loan amount granted in the scope of WRF to KGS 100 000 (USD 1 800). More specifically, the lack of a dedicated regulatory framework forced the National Bank to treat WRF credits as unsecured credits, thus limiting the amount of credit awarded. WRF were applied as collateral of up to KGS 100 000; any amounts in excess of this threshold were secured with “regular” forms of collateral.

## CHAPTER 2. HUMAN CAPITAL

38. In 2013, limited human capital development was identified as an important constraint to Kyrgyzstan's competitiveness, especially in agribusiness. Skills gaps – disparities between the skills of the existing workforce and the needs of employers – were negatively affecting labour productivity. For example, labour productivity in agriculture was the second lowest in the region, at USD 1 414 per worker in 2013, equivalent to only 8% of the average for OECD countries (World Bank, 2016). This was due to several factors, including limited skills and lack of machinery. Agricultural sector employers surveyed by the OECD mentioned employees' lack of skills and training as one of the top barriers to their activities (OECD, 2014b).

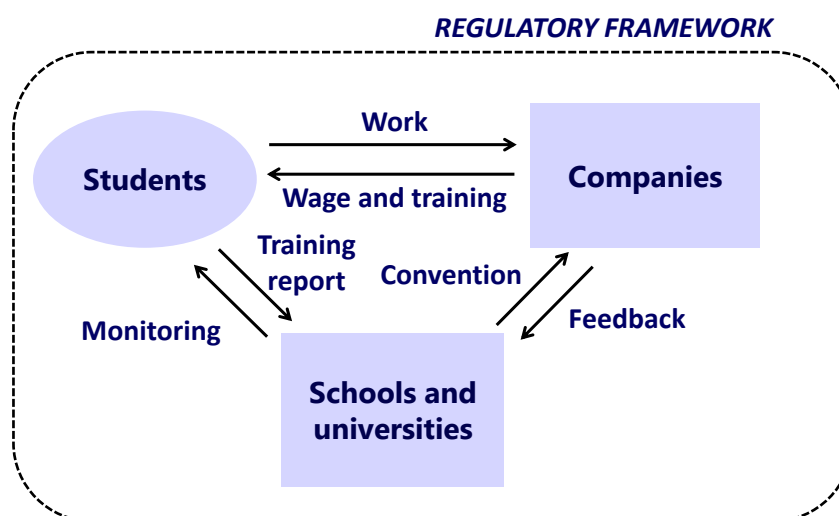
39. Skills gaps were widened by the limited involvement of private companies in human capital development, in particular in workplace training. Partnership agreements signed between educational institutions and private companies appeared to be limited to a few cases – such as several Bishkek Vocational Schools in the fields of transportation, telecommunications, and garment manufacturing. The 2013 OECD survey showed that less than one-quarter of employers in agribusiness processing were working with educational institutions, and only 24% were providing students with workplace training, apprenticeship, internship and mentoring (OECD, 2014b).

40. Policy recommendations were prepared with and endorsed by the government to foster the development of human capital by using workplace training activities, using agribusiness as a case study (OECD, 2014b). The three recommendations made in 2013 are outlined below.

### **Overview of 2013 recommendations**

41. The 2013 review concluded that the government could bridge the skills gap through workplace training and raising the overall involvement of the private sector in vocational education and training (VET). Workplace training, such as internships and apprenticeships, teaches students the practical skills demanded by the labour market. It can “help close the skill gap by facilitating students' access to modern technology and to the latest innovations in the industry and accelerating the transfer of knowledge between the educational system and firms” (OECD, 2014b). It can also provide employers with a properly trained labour force, help them promote employment in the sector and improve their interactions with educational institutions. Workplace training programmes build tripartite relationships among the employer, the student and the education institution, based on formal and contractual links (Figure 3).

Figure 3. How workplace training programmes work



Source: Adapted from OECD (2012), "Enhancing skills through public-private partnerships in education in Ukraine, the case of agribusiness", *Private Sector Development Policy Handbook*, <https://www.oecd.org/countries/ukraine/UkrainePPPEducation.pdf>.

**Recommendation 1: Put in place a regulatory and incentives framework for workplace training**

42. The labour code regulates training and retraining of staff, including workplace training. The 2013 review recommended measures to enhance the regulatory framework and define the legal boundaries for all parties involved, in particular by setting up a minimum wage for interns and apprentices, establishing duration requirements of training, and considering the inclusion of financial incentives to encourage employers to offer workplace training, such as tax incentives and exemptions from contributions to the social fund.

43. It also suggested that the government could further strengthen the legal framework by establishing formal tripartite conventions that define the responsibilities and duties among the employer, the student and the education institution. These conventions could include information on the duration of the internship, missions assigned to the intern, competences to be developed through the internship, compensation, code of conduct, insurance and termination of the internship.

**Recommendation 2: Increase private sector involvement in workplace training**

44. Co-operation between employers and educational institutions on workplace training programmes is crucial for their success. However, the 2013 review concluded that this co-operation could be expanded beyond the limited bilateral partnerships common at the time by engaging students, companies, and educational institutions alike. By engaging all parties in sustainable and formal co-operation, this would create a greater sense of ownership of the programmes. Business associations could also play a key role in collecting business needs, structuring the activities and contributions of business, and mobilising them.

45. Employers' involvement could be stimulated by providing internships on a competitive basis to ensure that the most motivated and qualified students are selected.

46. Kyrgyzstan had established public-private skills councils at the national level through the National Council for Professional Skills Development, and at sector level through sector sub-councils, including in agriculture. However, the review recommended that these exchange platforms be revitalised to



ensure an on-going dialogue on public-private co-operation in education among employers, business associations, education institutions, and the ministries of education and labour. Discussions could address topics such as skill requirements and forecasts, workplace training activities, private involvement in education and possible public-private partnerships (OECD, 2014b).

***Recommendation 3: Improve matching of students with training places, including in agribusiness***

47. The review advised the government to establish a national job portal that would help match students and companies, and promote the image of specific sectors and career paths (OECD, 2014b). This electronic platform would bring together available job offers, and provide information on career paths and training opportunities in educational institutions.

48. To strengthen and formalise co-operation with employers, the review suggested that education institutions could also establish career centres as points of contact between students and employers. They could be in charge of reaching out to businesses and co-ordinating activities with them, including creating and following up on workplace training programmes. For example, the education institutions could implement a monitoring system for internships by occasionally visiting and interviewing employers during the internship period. At the end of a workplace training programme, firms could prepare a feedback report for the student and the education institution. This would not only act as a formal certificate, but would also outline the competencies developed by the student and how his/her skills match the companies' needs. This feedback would guide schools on adjusting curricula, while helping the student upgrade skills to match work opportunities.

49. In 2013, companies were paying income tax and social contributions on the wages of interns and vocational trainees. The review recommended that the government consider exempting internships and apprenticeships from tax and social charges to give them additional incentives to take on interns (OECD, 2014b).

**Findings of the 2016 monitoring assessment**

50. The government has conducted a number of important reforms in line with the 2013 policy recommendations, particularly to the regulatory framework. These reforms have been implemented with the involvement of business associations through the Chamber of Commerce and Industry.

***Monitoring of recommendation 1 reveals new draft regulations for workplace training***

*Recommendation 1: Put in place a regulatory and incentives framework for workplace training*

51. The Government of Kyrgyzstan has drafted amendments to the labour code to develop workplace training activities. The policy process has been broadly consultative, involving private companies through the Chamber of Commerce and Industry, and the public by posting the draft law on the Internet for comments.

52. The amendments emphasise the principle of promoting both the interests of students and companies. Their objectives are to improve skills matches for the benefit of employees and employers; to encourage companies to use workplace training activities; and ultimately to provide jobs and employment. Another objective is to reduce the high rate of emigration driven by high unemployment, although other factors – such as low salaries – are also to blame (Government of Kyrgyzstan, 2016a).

53. The draft amendments make a clearer distinction between vocational training contracts (on-the-job and formal training for current employees) and student internships/apprenticeships than in the previous version of the labour code's articles. They define the expected content of student contracts (for internships and apprenticeships) and introduce training contracts (including retraining for existing employees). These will help to facilitate arrangements between employers, employees and students, and to standardise contractual practices. The contract should include the names of the parties, the student's/employee's specialities, the employer's and the student's/employee's obligations, and the training period. The training contract should specify the employee's conditions and pay during the training. Changes to the contract can only be made with the agreement of both parties (Government of Kyrgyzstan, 2016a).

54. However, the amendments to the labour code do not establish a mechanism governing the relations among the employer, the student and the education institution during an internship. Many details are left out of the contract, and are subject to an agreement between the parties, including financial matters, such as payment or reimbursement of expenses, and the detailed organisation of the training period.

55. The draft amendments set an upper limit of 12 months for the duration of internships and apprenticeships. This can help avoid the abuse of internships as positions of permanent employment by employers. This upper limit is in line with laws in France (6 months), Germany and Italy (12 months), which include restrictions on renewing the internship contract (OECD, 2014b).

56. The updated labour code also proposes introducing mandatory compensation and a salary cap for interns. Mandatory compensation is a welcome addition, as it avoids companies benefiting from unpaid labour. Such measures are in line with several OECD countries, such as France and Germany, although legislation in OECD countries typically provides for a minimum compensation level instead of a maximum (OECD, 2014b). This salary cap might help contain the tax exemptions and insurance premiums stipulated in the draft tax code (see below). In Switzerland, the average salary of an apprentice is around 25-30% of a permanent employee's salary according to the Swiss Federal Institute for Vocational Education and Training (SFIVET).

57. The drafting process has now been transferred from the Ministry of Economy to the Parliament's Commission on Social Issues. Although this might lead to substantial revisions to the next versions of the draft amendments, it shows that the process is moving forward.

### ***Monitoring of recommendation 2 highlights greater private stakeholder participation***

*Recommendation 2: Increase private sector involvement in workplace training*

58. The engagement of stakeholders in VET reforms and workplace training activities has increased since 2013, for instance with the development of several career centres. The strong involvement of the Chamber of Commerce and Industry in preparing the amendments to the labour code is a positive sign in this regard. Some higher education and VET institutions have also developed action plans for increasing business involvement and establishing boards of trustees, which aim to involve companies in the governance of educational institutions. However, these still need to be implemented in most educational institutions. A first step would be to assess these initial initiatives and to launch additional ones with government support. This could lay the foundations for a strong co-operation model in education in Kyrgyzstan.

59. The governance of the Kyrgyz education system involves meetings between educational institutions and companies through the National Business Council and sub-sector councils. The frequency

of these meetings has increased in recent years, especially in the agribusiness sector, according to interviews carried out by the OECD with the Agency of Vocational and Educational Training of Kyrgyzstan and local experts on education as part of the horizontal policy assessment (Asian Development Bank, 2015; OECD, 2016). The Agency of VET of Kyrgyzstan also conducts regular consultations with employers. These efforts need to be sustained to improve the consultation with and involvement of the private sector in education when designing and implementing reforms to the education system.

60. However, a vibrant internship market has still not developed. Competitive recruitment processes for interns and apprenticeships remain rare and have only been reported in selected sectors, such as banking. This may reflect the lack of employers' interest and engagement in conducting proper recruitment processes and might foster adverse selection of students. Employers report that they lack incentives for hiring interns, and need too much time to retrain them on the job. Agribusiness companies also point to the limited attractiveness of their sector to students and the small number of qualified applicants available for internships (OECD, 2016).

***Monitoring of recommendation 3 is held back by insufficient matching instruments and incentives***

*Recommendation 3: Improve matching of students with training places, including in agribusiness*

61. Kyrgyzstan is drafting amendments to the tax code to increase the incentives for companies to recruit interns and apprentices, and to promote the active participation of companies in workplace training. According to the draft amendments, companies would be exempt from paying taxes on income, social contributions, and insurance premiums on wages paid to interns/apprentices and vocational trainees. They could also deduct the cost of the preparation and implementation of training activities (Government of Kyrgyzstan, 2016b).

62. Instruments to match supply and demand among the private sector, students and education institutions are still insufficiently developed, including in agriculture. In OECD countries, career centres within educational institutions are useful contact points to build sustainable operational relations between students and companies, share internship opportunities, and seek more involvement from companies in teaching and training activities (OECD, 2016). Although there have been some initiatives to set up career centres within educational institutions, and job portals and fairs, for instance in the agricultural sector, these are fragmented and of limited scale and impact (Box 3).

### **Box 10. Initiatives in Kyrgyzstan to match supply and demand**

Several tertiary schools in Kyrgyzstan have established career centres to improve connections with companies. These include the Bishkek Academy of Finance and Economics, Talas State University, and the Academy of Public Administration under the President of the Kyrgyz Republic in Bishkek (OECD, 2016).

Several job internship platforms have also been established, but with limited scope and number of applicants. These platforms aim to help match internship demand with offers by public and private stakeholders. For instance, the national internship programme organised by the Youth Foundation “Instream”, in partnership with the Ministry of Education, has set up an electronic platform where applicants can submit internship requests (Instream, 2016).

Fairs are organised periodically in Kyrgyzstan to promote markets and products in selected sectors, including agro-processing. Job fairs are also regularly held to promote training and retraining opportunities in the sector and involving education institutions. Their impact on hiring and on raising the interest of students in careers in sectors such as agriculture remains limited, however.

### **The way forward**

63. The government needs to enact, implement and monitor the amendments to the labour and tax codes: this is a prerequisite for the development of workplace training activities in Kyrgyzstan. The government will submit the amendments to Parliament in 2016. Effective implementation will require careful monitoring of the impact on business and educational institutions’ practices, and adjustments may be needed. For example, among the OECD countries, France has passed several amendments to its provisions for internships and professional training in the labour and education codes over recent years to avoid abuse by the parties involved. In the latest version (2014), the maximum duration of internships was reduced from 12 months to 6 months, the number of interns has been limited within each company, and new rights concerning leave and expenses have been granted (Ministry of Labour, 2014). Switzerland also has lessons to share on the duration and organisation of workplace training (Box 5).

64. A formal requirement for internship agreements could be introduced: this could further formalise internship relations, and build trust among companies, students and education institutions by strengthening mutual rights and obligations. The government could prepare a draft document to be discussed with employers, including the Chamber of Commerce and Industry, and publish it as a template for internships on the website of the Ministry of Labour and Social Protection (MLSPP). This would mirror practices in France, which has amended its labour code to introduce mandatory internship agreements (Box 4). The *Convention de stage* is a simple, flexible contract signed by the parties that regulates their relationships and specifies the objectives and the conditions of the internship. An interns’ report after completing workplace training could also be a formal requirement.

### Box 11. The *Convention de stage* in France

France established the *Convention de stage* to simplify and formalise internship relationships among students, companies and educational institutions. The *Convention de stage* is regulated by law, but remains flexible enough to be adapted to the various needs and conditions of internships. It governs the relations, rights and duties of students and companies during the course of the internship. It helps better define roles and responsibilities for all parties and enshrines them in a legal document to ensure that each party fulfils its obligations.

The French Ministry of Labour has published a template on its website to simplify procedures and minimise the administrative workload for businesses, while adequately protecting students. A typical *Convention de stage* includes information on registration at a university or school; signatories: the intern, a representative of the university and a representative of the firm; objectives (acquisition of competencies); activities of the intern; duration; compensation; management; accident labour protection; termination of the contract; code of conduct; and the requirement for an internship report. The document is signed in three copies, one for each party.

Source: Ministry of Labour, Employment, Vocational Training and Social Dialogue (2016), Template *Convention de Stage* (in French), available at [http://travail-emploi.gouv.fr/IMG/pdf/convention\\_stage\\_tripartite.pdf](http://travail-emploi.gouv.fr/IMG/pdf/convention_stage_tripartite.pdf), accessed June 3, 2016.

65. Beyond the establishment of internships, education institutions could also prepare companies better: for example by conducting preparatory sessions for companies to explain the requirements, conditions and benefits of the internship as well as the expected role of the supervisor. This preparation could raise companies' awareness, increase the quality of the workplace training, and minimise bureaucracy for businesses. Education institutions should also provide support during the internship. In Switzerland, before hiring an apprentice each company must have one employee trained in managing an internship/apprenticeship process and supervising interns.

66. Promotional websites and events could be part of the education promotion and communications strategy in specific sectors, in addition to existing career fairs. The Ministry of Agriculture, in particular, could consider revitalising the sector's image by promoting career paths and opportunities in the sector in association with educational institutions and companies. This could include the creation of a dedicated website for agricultural education promotion and information (or at least a dedicated space on the ministry's existing website), presentations of and training by companies in VET institutions and schools, and active involvement of agricultural schools in education promotion and fairs.

67. Career centres in educational institutions need to be further expanded to become key contact points between businesses and the education system. Existing career centres should be assessed according to the number of internships and jobs found by students and the number of companies met and partnerships signed. They should share good practices with similar teams in other education institutions and follow the principles described below for creating new career centres. Where career centres do not exist, they could be created in most tertiary education institutions, replicating the example of several OECD countries. The assessment and adjustment of existing career centres would help build a model to be rolled out in education institutions. These centres could proactively investigate labour market opportunities and administer workplace training offers by liaising with companies, making these offers available to students, and monitoring the internship/apprenticeship period on behalf of the educational institution. Business and engineering schools in France have created career centres that are very active in matching students and training places through a wide range of activities, including online job and internship platforms, managing students' professional curricula, following-up on legal provisions, mentorship, communicating with companies, and organising career fairs.

68. Public-private dialogue on VET could be further supported through the National Council and the sub-sector councils: this will involve more regular meetings with precise agenda and the inclusive

involvement of stakeholders. For example, in the United Kingdom, the UK Commission for Employment and Skills and Sector Skills Councils help ministries identify skills needs and solutions, create the conditions for increased investment in skills, and raise skill levels across the economy. These councils are industry-led and gather a limited number of members, including business leaders from large firms, SMEs, trade unions, central and local government representatives, NGOs, and education institutions (UK Commission for Employment and Skills, 2012). Switzerland also offers a good example of close public-private collaboration in education. Education institutions, the government, and companies partner to run the VET system, including workplace-training activities (Box 5).

#### **Box 12. Public-private collaboration in education in Switzerland**

In Switzerland, vocational education and training are based on the dual-track system involving education institutions and employers, which is the country's central concept. "Dual" means part-time: 3.5 to 4 working days are spent by the apprentice in a host company, combined with 1 to 1.5 working days of classes at a public vocational school. Switzerland has also defined a template for apprenticeship contracts to ensure these contracts cover all the required conditions; they are signed by the three parties.

Employers and professional associations are engaged with and actively contribute to professional education. The Swiss Vocational and Professional Education and Training (FPVET) system is collectively managed as a public-private partnership. It works efficiently because on the one hand it is close to the needs of the economy and market-driven, and on the other it is given state recognition and quality control.

Three main partners play a specific role in the management and implementation of the VPET system (based on the Federal Act on Vocational and Professional Education and Training of 2002):

- The Confederation (federal government) is responsible for strategic planning and development of the entire system. It seeks to achieve comparability and transparency as well as national recognition of qualifications and encourages innovation.
- The Cantons (state government) are mainly responsible for the overall supervision of VET programmes. They ensure the quality of work-based training and of classroom instruction, monitor examinations and ensure that apprenticeship contracts are in line with statutory provisions. Furthermore the Cantons are responsible for general implementation. They run vocational schools, issue VET accreditation to host companies, provide young people and adults with vocational and career guidance counselling, and take responsibility for the training of instructors.
- The private sector is represented by trade and branch associations as well as their member companies and social partners (employer's unions and trade unions). These associations are mainly responsible for defining and continuously updating training content, with the involvement of representatives of the VET-schools and Cantons. Individual companies create apprenticeship positions and pay a salary to the apprentices. Companies need to have at least one professional instructor who meets the required professional skills and personal characteristics. Host companies must also obtain a permit from the local cantonal authority.

Building on a long tradition of vocational education and training, Swiss companies consider apprenticeships as beneficial for several reasons. First, the net profit generated by an apprentice exceeds the net expenditures in most branches due to the productive work of apprentices. Second, apprenticeships help companies make sure that they have the necessary number of employees with the required competencies, and reduce recruitment costs if the apprentice stays in the company. Third, they boost the reputation of the company, as Switzerland has implemented a specific and prestigious label for companies training apprentices. Finally, professional organisations have the possibility to create their own VPET fund to support workplace training.

Sources: Strahm, R., B. Geiger, C. Oertle and Swars E. (2016), *Vocational and Professional Education and Training in Switzerland: Success factors and challenges for sustainable implementation abroad*, [www.hep-verlag.ch/media/import/preview/vocationaleducation.pdf](http://www.hep-verlag.ch/media/import/preview/vocationaleducation.pdf); Fazekas, M. and S. Field (2013), *A Skills beyond School Review of Switzerland*, <http://dx.doi.org/10.1787/9789264062665-en>

69. Online job platforms are useful tools to match students and employers. Existing platforms could be further supported by the MLSP. In addition, dedicated sections on existing websites, such as the official sites of the Agency of Primary and Secondary Vocational Education and the MSLP, could be used to display job offers. This would be cheaper than creating and maintaining new job platforms. Until these platforms are implemented, educational institutions need to use pin-boards and so on to display offers for students. They could also use youth centres and other local information centres to disseminate job and internship offers. A good model is the platform established by the French Ministry of Agriculture (Box 6)

**Box 13. Promotional actions in agriculture in France**

The French Ministry of Agriculture promotes and provides information on agricultural education on a dedicated platform ([www.educagri.fr](http://www.educagri.fr)). Students and young workers can find information on education institutions, training paths, degrees, certification and internships on the website.

The ministry also organises career fairs to bring together companies and job seekers as well as educational institutions, who can promote their training and retraining offers to employers and job seekers. This includes annual "open door" days in all agricultural education institutions in France.

*Source:* Ministry of Agriculture, Food and Forests of France (2016), "*Enseignement agricole*", website (in French), Ministry of Agriculture, Food and Forests, Paris, [www.educagri.fr](http://www.educagri.fr) (accessed June 3, 2016).

70. The assessment of the 2013 recommendations indicates that incentives and promotional actions for employers need to be increased. Companies cite the insufficient initial, formal training of students as the main reason for their limited interest in internships and apprenticeships. Awareness and interest of employers could be raised of the new amendments and incentives: informing companies of the new tax and financial incentives for hiring interns and apprentices might promote greater uptake of this effective means to train this upcoming branch of the labour force. This may also call for increasing companies' involvement in educational institutions, which for instance, could invite them to give lectures, training and company presentations and to organise regular meetings with directors, teaching staff and career advisers. Kyrgyzstan could also study Switzerland and France's instruments (Boxes 5 and 6) and consider implementing some of them to raise employers' awareness of the functioning and benefits of workplace training.

## CHAPTER 3. BUSINESS INTERNATIONALISATION

71. Kyrgyzstan is a relatively open economy: foreign trade represented 125% of the country's GDP in 2014 (World Bank, 2016). Its early membership of the WTO and its comparatively liberal trade regime have supported the emergence of an intermediary trade sector that provides employment for low-skilled workers, many of them women. For example, WTO membership has promoted the emergence of a competitive garment export sector in Kyrgyzstan in which women are strongly represented (UNDP, 2015).

72. Kyrgyzstan's membership of the EEU in August 2015 shifts the context for business internationalisation. While EEU membership will give the country unfettered access to a large market, it might nevertheless have an adverse impact on investments in Kyrgyzstan. In particular, the higher tariffs at EEU external borders, such as between Kyrgyzstan and China, might undermine Kyrgyzstan's foreign trade, especially in view of the important role of non-EEU inputs (especially in the garment sector) and re-export activities from China, Turkey and other countries in Kyrgyzstan's foreign trade.

### Overview of 2013 recommendations

73. The 2013 review found that Kyrgyzstan's investment and export promotion policies and institutions were limited both in scope and quality (OECD, 2014c). The country lacked basic investment promotion activities, an active investment promotion agency (IPA) and a dedicated strategy to attract foreign direct investment. The review urged the government, with the support of the OECD and GIZ, to work on policies and tools to strengthen the internationalisation of SMEs. A public-private working group and a policy assessment of investment and export promotion tools identified priority areas for action. Two sets of recommendations were provided to the government:

#### *Recommendation 1: Strengthen investment and export-promotion policies and activities*

74. This recommendation involved starting sector-specific investment promotion activities, establishing business linkage programmes, and creating a new IPA. The first step was for the government to take a systematic approach to assessing sectors, and to designing and implementing investment promotion activities in these sectors. This would involve: (1) identifying priority sectors for the country; (2) analysing global trends; (3) assessing Kyrgyzstan's strengths and weaknesses; (4) finding and addressing target investors; and (5) preparing investment promotion activities. It was recommended that this approach be included in a national investment strategy for the priority sectors selected. Business linkage programmes could then increase business opportunities and positive spill-overs by encouraging contracts between local suppliers and investors. Kyrgyzstan was also urged to create an IPA that adopted best practices from OECD countries, especially Ireland and Turkey. The role of the IPA would be to sustain investment promotion activities, create a point of contact for investors, and facilitate their relations with ministries (OECD, 2014c).

#### *Recommendation 2: Use garment and textile manufacturing as a pilot sector for investment promotion*

75. In 2013, garment and textile manufacturing were estimated to represent 5-15% of GDP and 4-12% of employment. The sector consisted primarily of SMEs, mainly owned by women. Garment production increased ten-fold between 2003 and 2013, largely driven by the rise in exports, especially to Russia and Kazakhstan (Choi et al., 2014). This export-driven growth was favoured by Kyrgyzstan's accession to the WTO in 1998, the implementation of an open trade regime, and simplified customs clearance procedures (Choi et al., 2014).



76. Companies in the garment industry were facing competition challenges driven by the lack of a sector strategy, weak promotion, limited technical capacities, and outdated technology. Overall, the OECD recommended that the sector could be better supported by: (1) investment promotion activities; (2) a coherent sector strategy; (3) investments in mid-level technical skills and modernisation of the VET system, for example through the “Shvei Profi” technical training centre; and (4) the establishment of a garment cluster based around the Technopolis industrial park project (OECD, 2014c).

### **Findings of the 2016 monitoring assessment**

77. The trade environment for Kyrgyzstan’s garment sector has changed substantially since the 2013 peer review. Until 2011 the sector benefited from low tariffs on inputs thanks to Kyrgyzstan’s WTO membership. It also benefitted from special trade agreements and tariff-free garment exports to Russia, whereas Russia levied tariffs on garment imports from other countries. The situation changed with Russia’s WTO membership in December 2011, with significant consequences for the Kyrgyz garment industry. Russia’s WTO membership implied the gradual lowering of import tariffs up until 2020. These measures have started to progressively decrease Kyrgyzstan’s trade advantage with Russia. In particular, Russia’s overall tariffs on textiles and garments were phased out in 2015, the year Kyrgyzstan joined the EEU.

78. Kyrgyzstan’s accession to the EEU has also had impacts on the sector – both positive and negative. On the one hand, the EEU provides Kyrgyzstan with free access to a market of more than 170 million people. On the other hand, the implementation of a common external value-based tariff negatively affects the garment industry, which relies on fabrics imported from countries outside the EEU. Kyrgyzstan’s simplified tariff regime that was previously in place has been replaced by an average EEU ad valorem tariff of 8.1% in 2015, which will be lowered to 6.9% in 2020 (Choi et al., 2014). According to estimations, membership of the EEU will increase the cost of imports, and thus overall garment production costs by 3.6% to 7.7% (Choi et al., 2014). This uncertain trade environment has delayed domestic and foreign investment in the sector.

### ***Monitoring of recommendation 1 highlights the creation of an Investment Promotion Agency and drafting of a strategy***

*Recommendation 1: Strengthen investment and export-promotion policies and activities*

79. Kyrgyzstan established an IPA in March 2014 under the aegis of the Ministry of Economy. The agency consists of four departments: investment project promotion, investor support, information analysis and PPP development. Discussions are currently under way to upgrade the status of the IPA to an autonomous body under the government.

80. The mission of the IPA is to “Improve the investment climate of Kyrgyzstan and to build confidence through long-term, fruitful partnerships with international investors”. To this end, it participates in the development and implementation of measures to stimulate investment activity and to increase the investment attractiveness of the country. It supports interaction among state bodies, local authorities, the business community and the private sector to promote investment through PPPs and private investment. In addition, the IPA participates in developing national infrastructure projects and investment programmes.

81. The IPA targets specific expertise in the tourism, garment and agro-processing sectors, although the final list of priority sectors is still to be defined in the forthcoming National Investment Promotion Strategy (see below). In terms of geography, the IPA focuses its work on investors from Turkey, China, Korea, Kazakhstan, Russia, the Middle East and India. The National Sustainable Development Strategy for

the period of 2013-17 had already identified investment policy as a priority, including the establishment of the IPA. However, it did not include a focus on sectors.

82. Kyrgyzstan is also developing a National Investment Promotion Strategy in order to develop a targeted, strategic and multi-stakeholder approach to foreign direct investment. Several workshops were held in 2016 to draft the new investment strategy. They involved the private sector, the various ministries and government agencies relevant to foreign direct investment, the IPA and donors. Several international experts participated in the workshops, including two from Ireland and one from Turkey. The workshops focused on methodological aspects and good practices in investment promotion, including the selection of sectors, the identification of competitive advantages, and the creation of a business case for investing in Kyrgyzstan. Following the workshops, three core sectors were initially selected: garments, tourism and agro-processing. The list of sectors is expected to increase to reflect priorities defined by the government.

83. In 2015 the IPA had a staff of 21 experts selected through open competition. Staff speak English, as well as other relevant languages (Russian, Turkish, Japanese, German, French, etc.). Staff participate in training and study tours in Kyrgyzstan and abroad, for example in Germany. They also organise and attend investment forums abroad and in Kyrgyzstan.

84. Investment promotion tools have been created by the IPA, especially websites that target potential investors ([www.invest.gov.kg](http://www.invest.gov.kg), [www.ppp.gov.kg](http://www.ppp.gov.kg)). They provide easily accessible and up-to-date information on investment opportunities for external investors. Similarly, the IPA has published brochures on Kyrgyzstan's business environment, and its Facebook page is regularly updated.

85. However, many aspects of the IPA's work are still in their infancy. For example, there is no department concerned with the monitoring and evaluation of the IPA's activities. Similarly, although an investors' support division exists, aftercare and post-investment services are not provided in a systematic manner as staff and expertise are limited at this stage of the IPA's development.

***Monitoring of recommendation 2 shows positive impacts on investment in the garment sector***

*Recommendation 2: Use garment and textile manufacturing as a pilot sector for investment promotion*

86. Horizontal investment and export promotion efforts have already benefited the garment sector. One example of a recent investment facilitated by the IPA consists of a Turkish company constructing a textile factory. This investment marks an important step towards locating a greater share of the textile and garment supply chain in Kyrgyzstan.

87. An export promotion strategy has been drafted and approved, highlighting the role of exports for the garment sector and its SMEs. The strategy mentions a number of activities, including participation in trade fairs, and the provision of market information, trade facilitation and financial support schemes. In addition, support has already been given to firm-level strategies. With USAID support, the Kyrgyzstan Centre for Textile and Apparel Research is helping companies with activities such as marketing, compliance, human resources, sourcing, and line productivity.

88. Progress on developing the skills needed for the garment sector's workforce has stalled, however. There is no systematic co-operation between educational institutions and enterprises. The quality and quantity of VET for garment workers have not improved – for example, the “Shvei Proffi” technical training centre is still not working as its teaching licence remains suspended.

89. The industry-wide organisation of clusters and co-operatives is still as limited as in 2013. For example, work on the Technopolis project, which was intended to host a garment cluster, has stalled. Despite efforts to allocate land for building the Technopolis and to develop a business plan, and numerous study trips to Baku, Ljubljana and Urumqi, the project has yet to materialise, and funding is still not secured.

### **The way forward**

90. Kyrgyzstan has made significant progress in improving its investment and export promotion climate. However, further success demands greater effort to sustain the progress made.

91. Kyrgyzstan has identified three priority sectors in its draft investment promotion strategy (agroprocessing, garments, and tourism) based on the government's strategic objectives, as well as their contribution to employment and value added. The government should continue to assess the garment sector in light of EEU accession to identify whether and how its business environment has evolved. It would be important to continue attracting investments to the textile sector to ensure the competitive supply of inputs. This could also be achieved by facilitating collective buying agreements by SMEs in the garment sector or clusters within it. If the future outlook for the garment sector is likely to be negative, the country could consider other industries that require similar skill sets, such as light electronics assembly.

92. Policy practitioners and experts should be continuously involved in drafting and further developing the strategy. The final investment promotion strategy should incorporate their inputs. Launching and presenting the strategy at a high-level event would serve to increase its reach and signal to potential investors the importance given to FDI by the Government of Kyrgyzstan.

93. The strategy should include a concrete action plan with a corresponding timetable and the means to monitor performance. The plan should set specific targets, such as the amount of new FDI investments, SME investments, the regional spread, and the amount of new exports. It should also set agreed outcomes, such as net employment creation, corporate tax revenues earned, and the economic value added.

94. Building sector-specific expertise and investment promotion capacity within the IPA is a key task. Greater sector-specific expertise would allow for targeted promotional activities. Good practice indicates that sector-specific expertise is a key success factor for IPAs around the world. The example of Turkey is an interesting case in point (Box 7). Building this capacity should involve hands-on training from policy practitioners with experience working in other IPAs, as well as study tours and training. Stronger co-operation with Turkey's Investment Support and Promotion Agency (ISPAT) would provide valuable contact with experienced policy practitioners in the field of investment promotion.

#### **Box 14. Turkey's Investment Support and Promotion Agency and its sector-oriented activities**

The Investment Support and Promotion Agency of Turkey (ISPAT) was created in 2007 to boost Turkey's attractiveness among foreign investors. ISPAT operates as an intermediary and facilitator between investors and authorities and strives to decrease the cost, time and number of procedures for investors. It does so by providing sector reports and analysis, offering support for site selection and real estate prospecting, facilitating meetings with local authorities, and providing aftercare services.

Turkey's increasing level of FDI inflows, as well as positive results in international assessments, are testament to the agency's success. The World Bank's Global Investment Promotion Best Practices Survey ranked ISPAT's website as the seventh best investment promotion website in the world.

ISPAT assesses Turkey's investment needs in target sectors, and develops and implements sector-specific promotion strategies to attract investments. First, the assessment of Turkey's investment needs is based on criteria that mirror the country's economic priorities, such as the level of import substitution, technology intensity, employment and export potential. Second, ISPAT assesses how these needs can be targeted by investors through the presence of industry clusters, regional potential, access to raw materials, low cost of entry in the market and a favourable competitive environment. Third, ISPAT prepares sector-specific action plans to promote and generate investments for sectors that are both of interest to investors and in line with Turkey's priorities.

Source: ISPAT (2016), *Investment Attraction with Sectoral Focus*, presentation to the IPA of Kyrgyzstan, Bishkek, 19 May 2016

95. Developing the skills and expertise required for aftercare services and supply chain development, such as FDI-SME linkage programmes, is a priority. While investment promotion activities are a key component for attracting investments and ensuring competitiveness, the government should not lose focus on improving the overall investment climate in Kyrgyzstan.

96. The IPA should also work on supporting companies in the target sectors through tailored export promotion activities, such as export-oriented marketing and consulting. Export costs are often very high for SMEs. Providing good market knowledge of recent trends in target markets, demand shifts and standards can be of great value to ensure the competitiveness of companies in the priority sectors.

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