I. Project Context

Country Context

The Central Asia region, including the Republics of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan is undergoing a rapid transformation. Since the early 2000s, economic growth in the five republics has been fueled by strong exports in response to robust global commodity demand and prices as well as remittances reflecting strong growth in Russia. The structure of the economies is greatly biased towards heavy industries and extractive activities (40 percent of Gross Domestic Product (GDP) on average ). The share of agriculture is high in the smaller economies, like the Kyrgyz Republic and Tajikistan. The most recent IMF economic outlookforecasts continued growth over the medium term, especially in resource rich countries while uncertainty regarding the future performance of the global economy and its impact on the region remains an issue.

Trade in the Central Asia region is very asymmetric. Exports are dominated by commodities, with Kazakhstan being the main exporter (over 85 percent). Import patterns are more balanced between countries, as the import basket is more diversified. One of the main features of importing is its reorientation towards China at the expense of Russia and other regions. The growth rate of trade with China has been twice as fast in Central Asia compared to the rest of the world (40 percent per
year over 2001–10 as compared to 20 percent elsewhere). This also reflects an evolving regional trade environment, which intertwined political and economic influences. Tajikistan joined the World Trade Organization (WTO) in 2013 and Kazakhstan is in the final stages of the process. All countries of the region, except Turkmenistan are signatories of a Free Trade Agreement among the 8 member states of the Commonwealth of Independent States.

The main extra-regional exports from the southern part of the region are mineral commodities, steel, and cotton. Significant unrealized potential appears to exist in trade with countries in the broader region, especially China, India, Pakistan and Turkey. Regional trade is relatively small, representing only a few percent of the total trade of Central Asia reflecting relatively low complementarity and similar asset base. Still, it is very important for the Kyrgyz Republic and Uzbekistan. The basket of products is more diversified than for extra-regional exports and is likely to be even greater if trade through non-standard channels (also referred to as “bazaar” channel because of its transactions take place at or through bazaars) is taken into account, reportedly, those values of flows represented 16 percent of Kyrgyz Republic’s GDP in 2010. This is also known to exist in other Central Asian countries.

In the past 20 years, the economic gap between the five Central Asian Republics, which was already significant in 1990, has widened further. GDP per capita in the Kyrgyz Republic and Tajikistan in 1990 amounted to 36.9 and 30.1 percent of the GDP per capita in Kazakhstan in the same year. In 2011, GDP per capita in the Kyrgyz Republic was 9.9 percent of that of Kazakhstan’s, and Tajikistan’s GDP as a portion of the region’s GDP dropped from 5.7 percent in 1990 to 2.4 percent in 2011, according to official statistics. In the region, the Kyrgyz Republic and the Republic of Tajikistan are considered the most remote and poorest where in 2011 about 37 percent and 47 percent of the population lived below the poverty line, with a GDP per capita of US $1,157 and US$951 (2012) respectively. Both countries lack natural resources such as oil and gas, but have reportedly substantial potential in hydropower development and mineral resources. Lack of resources, a challenging regional context and a difficult business environment is preventing the countries from exploiting this potential. Sustainable growth and diversified export base will require better human, physical and institutional capital. While strong demand and prices for commodities have supported growth in the region so far, diversifying the “assets base” in the region will be critical to the diversification of the economies. This will require improvements in the quality of infrastructure, institutions and service delivery, as well as better human capital.

Notwithstanding the widening gap in economic development between countries, the Governments in the region face similar development challenges to connect peripheral areas with regional and global economic centers of activities. In part, this can be attributed to the impacts of the breakup of the Former Soviet Union which formerly shaped important features of the transport networks through a unified economic and transport complex built without consideration for administrative borders. Nowadays, there is a need to address access to shifting global markets, increasing trade integration with neighboring countries and growing urban and rural disparities. This trend is reflected in greater labor migration from rural areas due to lack of employment opportunities, hindering the development of those areas. Analysis of the poor in the region also indicates that the concentration of poverty lies in marginal geographical areas characterized by lack of transport connectivity. This may trigger socio-economic tensions.

At the core of these challenges is the need to rebuild a regional framework of connectivity that links population centers and economic hubs across borders in the Central Asia region, in particular in the highly populated Ferghana Valley where more than 10 million people reside or 27% of Uzbekistan’s, 31% of Tajikistan and 51% of Kyrgyz Republic’s population. Relatively small investments in cross-border transport links are proven to have an impact on agglomeration processes disproportionate to the simple economic value-added from reduced transportation costs.
However, this will only be achieved if reforms in other areas are addressed, including trade facilitation, non-tariff barriers and the like. The region in general ranks relatively poorly on the Logistics Performance Index. Logistics costs in the region are already very high in an international comparison, accounting to about 18-23 percent of exported value and 16-18 percent of imported value according to a recent study which greatly impact trade, the competitiveness of domestic products as well as potential for economic diversification due to the rise of costs of inputs and costs of exports.

While railways are the backbone for connectivity solution of the region to regional and international markets, the share of road transport in overall traffic flows has been continually increasing. This is particularly true for short-distance (and at times even for longer distances) and intra-regional movements, especially in countries such as the Kyrgyz Republic and Tajikistan given their relatively small rail network. Road transport is sometimes the only option given alpine topography of the region. It is also favored for time-sensitive items such as fruits and vegetables, textiles and clothing and other consumer goods which constitute a large share of the region’s non-oil sector. Passenger transport in the region is almost exclusively done by cars and buses and served only to some extent by air and railways.

Increasing connectivity of people and businesses to local and global services, markets and opportunities across borders is a priority of current policies and investments of the governments of the Central Asian Republics. This agenda is also at the core of the support intended by the World Bank and other development partners. Support towards these objectives has been underway for several years through, for example investments in transport infrastructure and upgrades of energy systems and networks. Efforts to rehabilitate six strategic transport corridors in the Central Asia region have been spelled out in the on-going Transport and Trade Facilitation Strategy and Action Plan for 2008-2017 and endorsed by Central Asia Regional Economic Cooperation (CAREC). Within CAREC, medium-term priority projects in the transport sector to be implemented during the period from 2011 to 2015 have obtained confirmed financing in the amount of US$15.5 billion from development partners and governments. Additionally, within the framework of CAREC, the countries are currently working together on improving border crossing facilities under the ADB-financed Regional Improvement of Border Services (RIBS) Project (approved in April 2013).

**Sectoral and institutional Context**

Landlocked, largely mountainous, with a multi-ethnic population of about 5.5 million and a GNI per capita of US$880 in 2011 (Atlas methodology), the Kyrgyz Republic is one of the poorest countries in the Europe and Central Asia region. Due to its elevation and topography, barely 7 percent of the land is arable, the rest consisting of glaciers, mountains, and pastureland or steppe that support livestock grazing . The Kyrgyz economy’s rate of growth has been volatile reflecting its reliance on a few sectors (gold production concentrated in a single mine Kumtor as well as re-exports) as well as numerous domestic and external shocks, including two revolutions since 2005. GDP growth averaged just over 4 percent annually over 2003-2012, with varying year-to-year rates ranging from 8.5 percent in 2007 and -0.9 percent in 2012. Characterized by significant informal activities, the Kyrgyz economy relies heavily on the performance of a few sectors and remittances: industry as well as agriculture accounts each for about 20 percent of GDP while services generate about 50 percent of GDP out of which transport has a significant share (data).

Employment is concentrated in sectors with low productivity and weak governance and poor infrastructure continue to hinder competitiveness. During 1998-2008, labor has moved away from high productivity, formal sectors, such as mining and manufacturing, to low productivity sectors with high levels of informality such as agriculture and services, in particular construction, trade,
and tourism. Moreover, despite numerous regulatory reforms in recent years, these have not yet translated into actual improvements in the business environment. Recent economic performance has been sound and the medium-term outlook is favorable though with significant risks. GDP expanded by 8 percent in the first eight months of 2013 driven by a recovery in gold production at Kumtor mine following the 2012 disruption as a result of unexpected ice movement, strong private transfers and more credit to the private sector.

Going forward, real GDP growth in the Kyrgyz Republic is projected to be between 7.5 (2015) and 5.0 (2017), expected to be largely driven by increased efficiency of public spending and development of a vibrant private sector. Growing regional integration and improved infrastructure are seen to support the growth of the country’s vibrant, but largely informal trade and transit sector. The current government’s National Sustainable Development Strategy (NSDS), 2013-17 focuses on investments that will further integrate the country with growing markets such as Russia, China and neighboring Central Asian countries while support local development in peripheral region. The NSDS recognizes that achieving sustained economic development in the Kyrgyz Republic will require improvements in transport connectivity and logistics and expresses the determination of the government to address these issues. Nonetheless, the risks to the Kyrgyz external environment are significant. Russia’s growth forecasts have been reduced recently and larger slowdown could potentially be unfolding in China. Gold prices add an additional layer of uncertainty given the importance of gold exports for the balance of payments and underscore the importance of upgrading assets (infrastructure and institutions) to diversify export earnings.

II. Proposed Development Objectives

The Central Asia Road Links (CARs) program is the result of a collaborative effort initiated by respective governments in the Central Asia region which has been developed as a regional, multi-phase program considered as a regional transformational project under IDA17. The program has the overall objective to increase transport connectivity between neighboring countries in Central Asia along priority cross-border road links whilst supporting improvements in road operations and maintenance practices.

The project development objective (PDO) of the First Phase of the Central Asia Road Links Program (CARs-1) is to increase transport connectivity between the Kyrgyz Republic and Tajikistan along priority cross-border road links in Batken Oblast whilst supporting improvements in road operations and maintenance practices. The road sections to be financed under CARs-1 prioritize connectivity between the Osh and Batken Oblast in the Kyrgyz Republic and Sugd Oblast in Tajikistan as they build lateral spurs from the Osh-Isfana axis to the Tajik border.

III. Project Description

Component Name
Rehabilitation of Priority Road Sections in Batken Oblast
Comments (optional)

Component Name
Improvement of Road Operations and Maintenance Practices
Comments (optional)
IV. Financing (in USD Million)

| Total Project Cost: | 54.00 |
| Total Bank Financing: | 45.00 |
| Financing Gap: | 0.00 |

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V. Implementation

The overall responsibility for the implementation of all activities under CARs-1 will lay with the Ministry of Transport and Communications of the Kyrgyz Republic (MOTC), including fiduciary responsibility for project execution. The Investment Project Implementation Group (IPIG) within the MOTC will be responsible for day-to-day administration of project activities which include, inter alia: (a) the management of designated accounts; (b) financial management and reporting on the overall project; (c) ensuring the execution of the audit of the project; (d) preparation of quarterly financial and bi-annual progress reports; (e) the management of the environmental and social safeguards aspects; and (f) undertaking all procurement and contract management activities for all components.

VI. Safeguard Policies (including public consultation)

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Comments (optional)

VII. Contact point

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