

Kyrgyz Republic: 2001 Article IV Consultation and Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Kyrgyz Republic

- the Staff Report for the 2001 Article IV Consultation and Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **September 29, 2001**, with the officials of the Kyrgyz Republic Report on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on November 16, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Staff Supplement of **November 28, 2001**, updating information on recent economic developments.
- a Public Information Notice (PIN) and a Press Release, summarizing the **views of the Executive Board as expressed during its November 30, 2001, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for the Kyrgyz Republic

The documents listed below have been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

**Staff Report for the 2001 Article IV Consultation and Request for Three-Year
Arrangement Under the Poverty Reduction and Growth Facility**

Prepared by European II and Policy Development and Review Department
(In consultation with other departments)

Approved by Mohammad Shadman-Valavi and Michael Hadjimichael

November 16, 2001

Contents	Page
Basic Data	3
I. Introduction	4
II. Lessons from Previous Programs	5
III. Recent Economic Developments	8
IV. Program Discussions	11
A. Program Objectives and Strategy	11
B. Fiscal Policy	14
C. Monetary and Exchange Rate Policies	17
D. External Policies, Debt Strategy, and Program Financing	18
External policies	18
Debt strategy	19
Program financing	21
E. Structural Reforms	22
Structural reforms under Fund conditionality	22
The authorities' I-NSPR paper	25
V. Medium-Term Balance of Payments and Capacity to Repay the Fund	25
VI. Program Monitoring	26
VII. Staff Appraisal	26

Boxes

1. The 2002 Tax Policy Package.....	16
2. Structural Conditionality Streamlining Assessment.....	23

Figures

1. BRO Countries: Five-Year GDP Growth.....	6
2. Macroeconomic Indicators, 1996–2001.....	7
3. Indicators of Competitiveness and Interest Rates.....	10
4. Debt Sustainability Analysis.....	20

Appendices

1. Fund Relations.....	47
2. Relations with the World Bank Group.....	49
3. Relations with the Asian Development Bank.....	51
4. Technical Assistance Provided by the Fund 1996–2000.....	52
5. Statistical Issues.....	55
6. Debt Sustainability Analysis (DSA) and Debt Strategy.....	58

Tables

1. Selected Economic Indicators, 1997–2002.....	30
2. Medium-Term Projections, 1999–2004.....	31
3. General Government Finances.....	32
4. State Government Finances.....	34
5. Social Fund.....	36
6. Medium Term Expenditure Framework for General Budget (excluding PIP) by Functional Classification.....	37
7. NBKR Accounts, 2000–02.....	38
8. Monetary Survey, 2000–02.....	39
9. Quarterly Balance of Payments 1999–2002.....	40
10. External Financing Requirements: 1999–2004.....	41
11. Medium-Term Balance of Payments 1998–2010.....	42
12. External Payments Capacity, 1999–2006.....	43
13. Indicators of Fund Credit, 1999–2006.....	44
14. Prospective Use of Fund Resources, 1999–2006.....	45
15. Reviews and Disbursements Under the Proposed Three-Year PRGF Arrangement.....	46

Attachment

Memorandum of Economic Policies (MEP).....	67
--	----

I. INTRODUCTION

1. On June 26, 1998, the Executive Board approved a three-year PRGF arrangement in an amount equivalent to SDR 64.5 million (72.6 percent of quota) to support the Kyrgyz Republic's economic reforms.¹ Total disbursements under the PRGF arrangement amounted to SDR 44.69 million (50.3 percent of quota). The third and fourth reviews under the second annual arrangement were not completed because of nonobservance of several performance criteria and the uncertain balance of payments outlook in the absence of a credible external debt strategy.² In July 2001, the authorities' request for the third annual arrangement was withdrawn from the Board's agenda because parliament granted new tax reductions, which were not consistent with the program. The commitment period for the three-year PRGF arrangement expired on July 26, 2001.

2. Discussions on a new three-year PRGF arrangement and the 2001 Article IV consultations were held in Bishkek during September 11–29, 2001.³ In the attached letter dated November 16, 2001, the Prime Minister and the Chairman of the National Bank of the Kyrgyz Republic (NBKR) request approval of a new PRGF arrangement in an amount equivalent to SDR 73.4 million (82.6 percent of quota) for the period October 1, 2001–September 30, 2004. The authorities have also submitted for consideration by the Executive Boards of the Fund and the World Bank an Interim National Strategy for Poverty Reduction (I-NSPR) and a NSPR Progress Report describing their progress towards a full NSPR.⁴

3. During the last Article IV discussions on September 13, 2000, Executive Directors commended the authorities' actions to stabilize the economy, in particular the implementation of a sound monetary policy. However, Directors urged the authorities to pursue fiscal consolidation, including through restricting the growth of public investments and increasing tax revenue, and to ease the external debt burden. Regarding structural reforms, Directors noted that more progress was needed in banking sector reform, privatization, and improving the business environment. The authorities have been regularly providing the core minimum data to the Fund and have improved the quality, timeliness, and

¹ EBS/98/95, Supplement 1, (06/12/98). In the wake of the Russian financial crisis, access was augmented by SDR 8.88 million (10 percent of quota) on March 3, 1999.

² Most importantly, the fiscal deficit in 2000 was 2.9 percentage points of GDP higher than the program target of 6.8 percent. The deficit was financed by a drawdown of budgetary deposits at the National Bank of the Kyrgyz Republic (NBKR) leading to a breach of the quarterly ceilings on its net domestic assets (NDA) during the second half of the year.

³ The staff team consisted of Mr. Saavalainen (head), Mr. Ruggiero, Mr. Luna, Ms. Zakharova (all EU2), Mr. Kitabire (PDR), Mr. Vesperoni (FAD), Mr. Kenjeev (interpreter), and Ms. Burton (assistant). Mr. Mukhopadhyay, the Fund's resident representative in Bishkek, assisted the mission.

⁴ EBD/01/50 and Supplement 1.

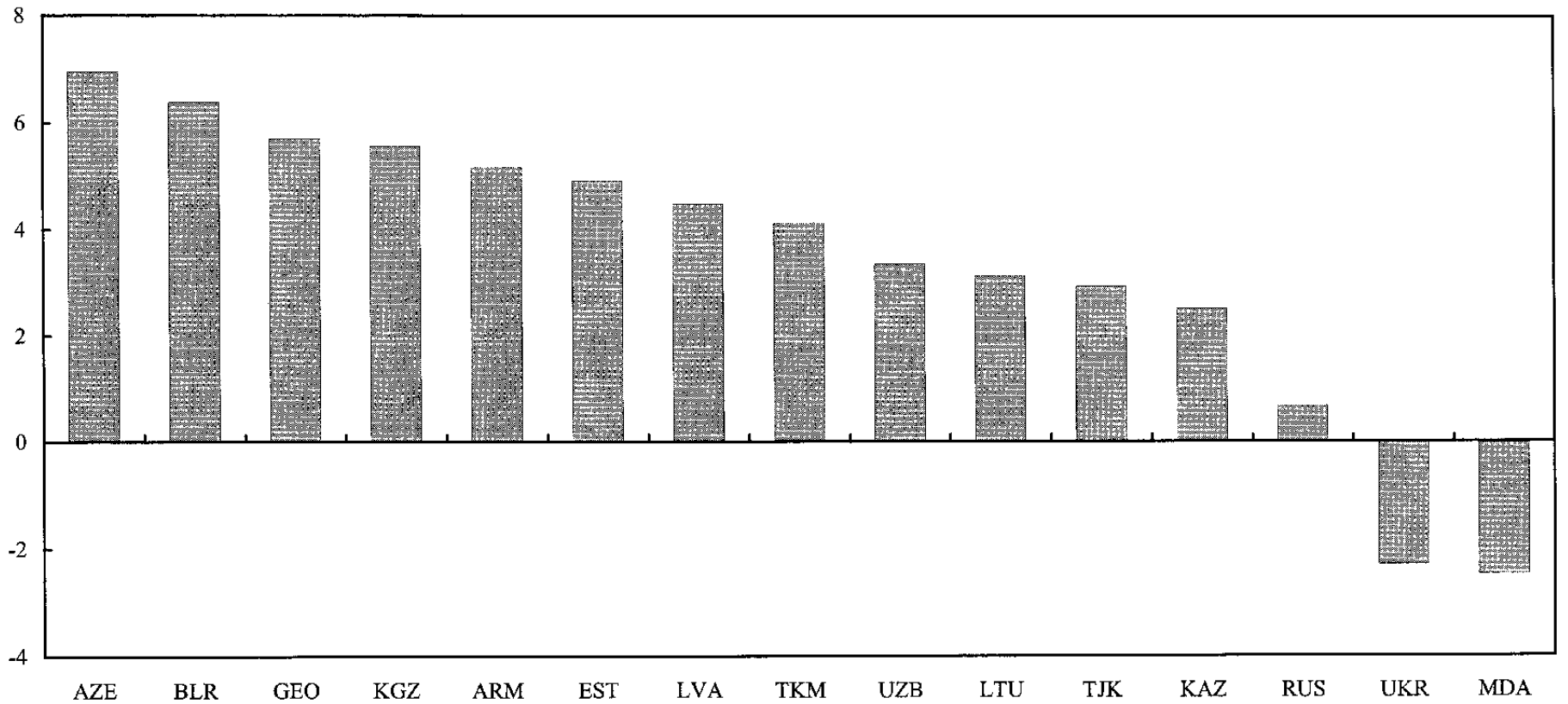
coverage of statistical information. Despite the remaining weaknesses, the quality of the Kyrgyz Republic's statistical data is adequate for program design and monitoring.

II. LESSONS FROM PREVIOUS PROGRAMS

4. **In the second half of the 1990s the Kyrgyz Republic's macroeconomic performance improved significantly, although the external debt position became unsustainable.** Real GDP grew at an average rate of 5.5 percent per annum in 1996–2000, faster than in most BRO-countries (Figure 1). The 12-month inflation rate declined from 32 percent at end-1995 to below 10 percent at end-2000. At the same time, the external current account deficit narrowed from an average of 20 percent of GDP in 1995–96 to 12 percent in 1999–2000 and the import coverage of gross official reserves increased from 1.3 months in 1995 to 3.7 months in 2000 (Figure 2). However, public external debt rose from 36 percent of GDP in 1995 to 132 percent in 2000.
5. **Several factors contributed to the economic growth.** In part it reflected a rebound from the output declines during 1992–95, but early progress in structural reforms also contributed to growth performance. Growth was also supported by the increasing demand for Kyrgyz goods as the economies of the trade partners recovered. In addition, foreign direct investment was buoyant; in particular the construction of the Kumtor gold mine followed by rapidly increasing gold production spurred growth. Despite the satisfactory growth performance, poverty indicators were worse in 2000 than in 1996, although they have improved somewhat since 1998.⁵
6. **The decline in inflation reflected a gradual tightening of monetary conditions although fiscal deficits remained large.** The growth of broad money declined from 23 percent in 1996 to 12 percent in 2000. Meanwhile, the overall fiscal deficit of the state budget was over 10 percent of GDP on average per annum, but this was financed from abroad rather than through money creation by the central bank. While the large fiscal deficits, sometimes significantly higher than targeted in the program, did not undermine stabilization in the short-run, public external debt outlook became unsustainable.
7. **The high debt burden has several origins.** First, the country faced severe external shocks in the 1990s. The break-up of the U.S.S.R., rising energy prices, and the Russian financial crisis in particular caused a sharp depreciation of the nominal exchange rate and a drastic deterioration in debt ratios. Second, rapidly expanding foreign borrowing to finance the Public Investment Program (PIP) did not generate sufficient growth to avoid the external debt problem. Third, coordination within the donor community regarding the volume of financial assistance was not sufficient to control the expansion of external debt. Fourth, the

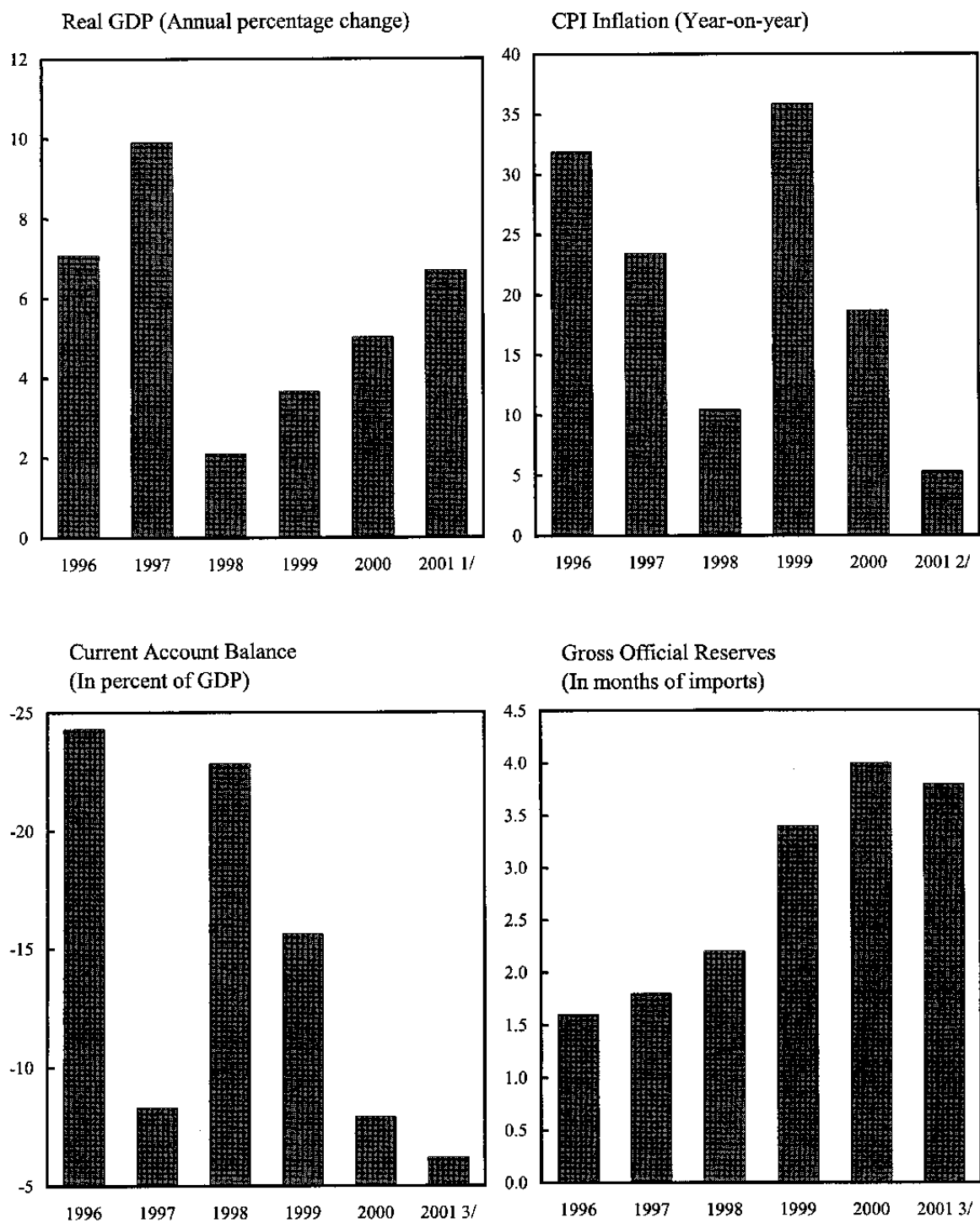
⁵ This deterioration could be explained by the sharp depreciation of the som after the Russian financial crisis in 1998, a change in income distribution in favor of profits, and inadequate targeting of social benefits.

Figure 1. BRO Countries: Five-Year GDP Growth
(Average Annual percentage change), 1996-2000



Source: World Economic Outlook.

Figure 2. Kyrgyz Republic: Macroeconomic Indicators, 1996-2001



Source: Data provided by the Kyrgyz authorities; and Fund staff estimates.

1/ First nine months of 2001 over the same period of 2000, preliminary estimate.

2/ As of end-September 2001.

3/ Projections.

lack of carefully designed national debt strategy and monitoring system obscured the cost of debt accumulation, thereby delaying the necessary fiscal adjustment.

8. **In this environment, the overall policy performance under the ESAF- and the PRGF-supported programs was mixed.** While the Kyrgyz authorities complied with nearly 70 percent of financial conditions under the Fund supported programs during 1994–2000, performance under the PRGF arrangement (1998–2000) was slightly weaker than under the ESAF arrangement (1994–97). The implementation rate for structural conditions was 86 percent during 1994–2000, better than the 79 percent average for transition economies since 1997.⁶ However, periods of good policy performance were often followed by periods of weak compliance, as evidenced by a partial implementation of the three-year PRGF-supported program adopted in 1998.

9. **Four conclusions can be drawn from the past.** First, fiscal policy has been the programs' Achilles heel as program targets have been missed repeatedly and external debt has accumulated rapidly. In particular, tax collection has remained weak and lagged behind other transition economies. In part, weaknesses in fiscal management reflected frequent changes in government and difficulties in cooperation with parliament, which often blocked the government's fiscal reform efforts. Second, despite several deviations from the program targets, monetary conditions remained consistent with lowering inflation and stabilizing the exchange rate, as the NBKR generally showed strong commitment to program implementation. Third, periodic breaks in structural reforms suggest that the country's implementation capacity and overall program ownership were weak, leading to reforms that lacked depth. Finally, there was heavy reliance on externally financed public investments without adequate consideration of the country's ability to maintain and operate these projects, and to service their external payments' obligations.

III. RECENT ECONOMIC DEVELOPMENTS

10. **Macroeconomic performance has continued to improve in 2001.** Real GDP growth accelerated from 5 percent in 2000 to 6.7 percent in the first nine months of 2001 compared to the same period a year ago. Growth has been driven by agriculture, mining, trade, and construction. The 12-month inflation dropped to 5.2 percent in September 2001 in part reflecting an appreciation of the nominal exchange rate vis-à-vis the U.S. dollar by 3 percent during the previous five months. However, as the Kyrgyz dollar wages are low, the real exchange rate (RER) has been broadly stable against the U.S. dollar, and depreciated

⁶ According to the EBRD's transition indicators, the Kyrgyz Republic has rated close to advanced market economies in the areas of trade and exchange systems and price liberalization since mid-1990s. The record remains weak in enterprise restructuring and improving business environment.

slightly against the Russian ruble over the last eighteen months (Figure 3), the Kyrgyz cost competitiveness has remained satisfactory.⁷

11. **Fiscal performance has improved.** In the first half of 2001, the annualized overall fiscal deficit of the state government declined to 4.6 percent of GDP, somewhat lower than the earlier agreed target, mainly owing to lower public investments. In June, the revised state budget for 2001, which targets a primary surplus (excluding PIP) of 2.1 percent of GDP, up from 0.3 percent of GDP in 2000, was approved by the lower house of parliament.⁸ However, owing to delays in disbursements of the balance of payments support at the end of the third quarter of 2001, the central government accumulated budgetary arrears amounting to 0.3 percent of GDP. Most of these arrears were cleared in October.

12. **Monetary conditions remained tight in the first half of 2001.** The targets agreed for the NBKR's net international reserves (NIR) and net domestic assets (NDA) were met during the track record period February–June 2001. The first six months recorded a decline of some broad money by 3.3 percent. In the third quarter, the NBKR bought significant amounts of foreign exchange in the market to strengthen its foreign reserve position. Nevertheless, despite the increase in reserve money, the nominal effective exchange rate remained stable, or even appreciated, suggesting that the demand for money has strengthened. Also nominal and real interest rates have declined. The NBKR has been monitoring closely these developments and is prepared to expand its open market operations to mop up liquidity if there are signs of weakening money demand.

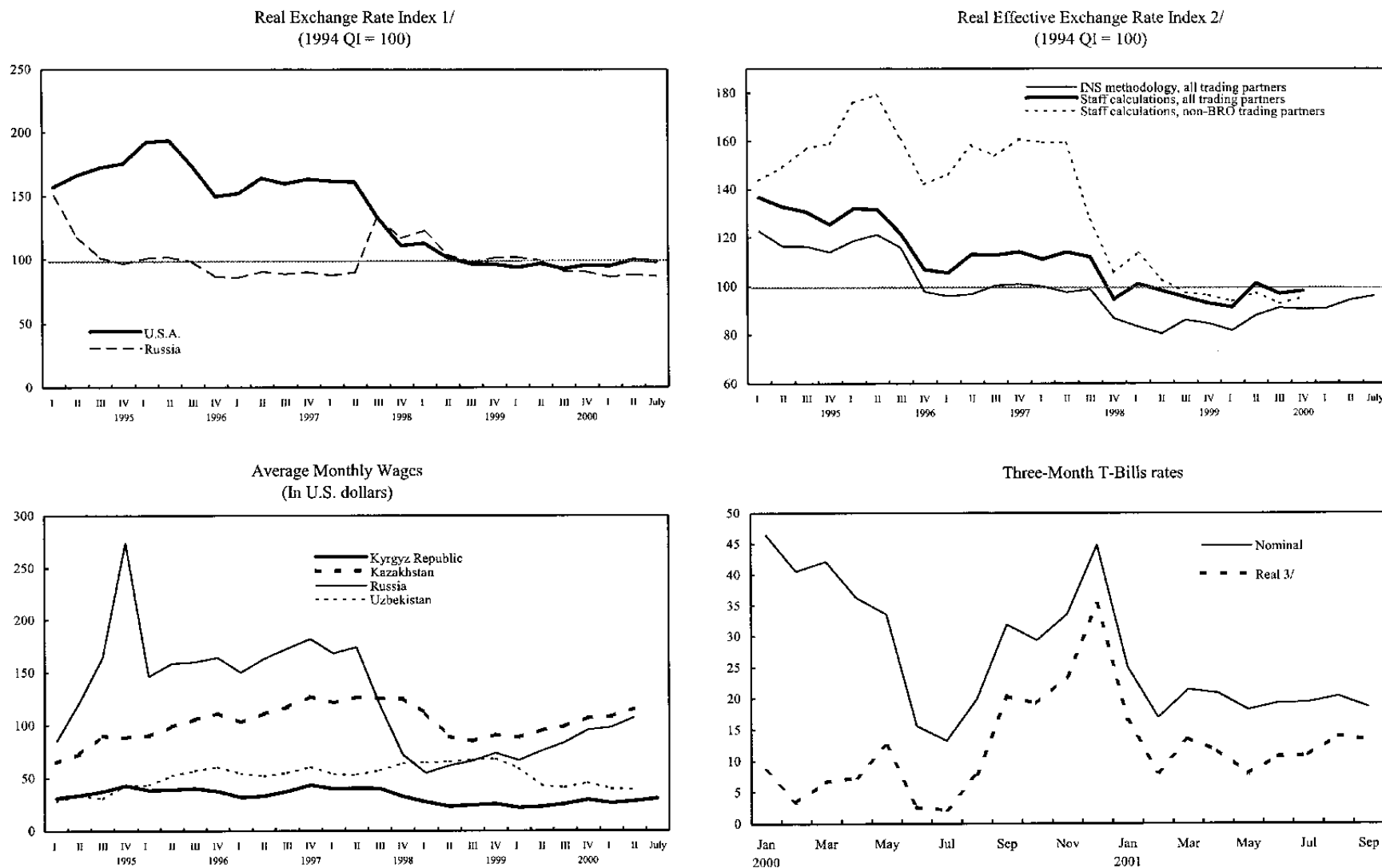
13. **Progress has been made in several structural reforms.** In the banking sector, in early 2001 the government recapitalized the systemically important Kairat Bank, acquired its ownership from the NBKR, and strengthened its management. In June–July, four problem banks were placed under liquidation and a fifth (Asia Universal—AUB) was recapitalized by its private shareholders. As a result, the capital base of the banking system has improved although the sector continues to suffer from low public confidence.⁹ In

⁷ The real effective exchange rate vis-à-vis all trading partners depreciated by 23 percent between 1995 and mid-2001.

⁸ As the original 2001 budget was inconsistent with the fiscal targets, the revision of the budget was a prior action for the planned third-annual arrangement and it included a number of new tax measures: (i) the application of the destination principle for VAT and excise taxes in trade with Russia; (ii) the inclusion of excise and customs tax in the VAT base; (iii) the increase in retail sales tax rate from 2 to 3 percent; (iv) the increase in land tax rates by 40 percent; and (v) shortening of the VAT payment date from two months to one month after the tax period, resulting in one extra month of VAT payments in 2001.

⁹ The problem banks held about 10 percent of total deposits at end-March 2001. At that time, the capital-asset ratio of the rest of the banking system was about 20 percent. Kairat bank accounted for 8 percent of total assets in the banking sector and 12 percent of all deposits.

Figure 3. Kyrgyz Republic: Indicators of Competitiveness and Interest Rates



Source: Kyrgyz authorities; and Fund staff estimates.

1/ The real exchange rate index is calculated using the consumer price index (CPI) from both countries. An increase in the index corresponds to an appreciation.

2/ The real effective exchange rate is the weighted trade average of the real exchange rate. An increase corresponds to an appreciation.

3/ Deflated by the 12-month rate of inflation.

addition, the restructuring of government administration began last December, with a reduction in the number of ministries from 17 to 12 and the number of public agencies and state committees from 49 to 29. However, the deepening of the civil service reform has met resistance from some ministries that were scheduled to undergo functional reviews. Household electricity tariffs were increased by 57 percent in April to improve cost recovery (to about 25 percent) and reduce the sector's quasi-fiscal deficit. To offset the adverse effects on the poor, pension benefits were raised by an average of 20 percent, as were other social benefits and allowances.

IV. PROGRAM DISCUSSIONS

14. **The authorities were motivated to re-establish a reform program that could be supported by the Fund.** They explained that policy slippages during the second annual PRGF arrangement had been temporary and in part outside their control (security problems in the south). They stressed that the government's successful implementation of all track record targets and prior actions for Board consideration of the planned third annual arrangement, as well as the renewed effort to implement structural measures in 2001, demonstrated their commitment to reforms. Regarding the income tax rate reductions that led to cancellation of the July Board meeting, they explained that those decisions were due to weak coordination of economic policy and that measures were being taken to improve policy coordination. To further underscore their ownership, the government committed to five prior actions for Board consideration of the new PRGF arrangement:

- observance of end-October financial policy targets—as specified in Table 1, Attachment I;
- adoption by parliament of the 2002 budget, as agreed with the Fund staff including a comprehensive set of new tax measures to offset the short-term revenue loss due to the reductions in the income tax rates;
- adoption by government and the NBKR of the new Regulatory Response Policy;
- establishing an Economic Policy Council (EPC) to enhance coordination, transparency, and effectiveness in the government's economic policy making and to minimize the probability of future program slippages; and
- ensuring that no official external arrears exist.

A. Program Objectives and Strategy

15. **The proposed program has three pillars: further macroeconomic stabilization, a credible external debt strategy, and more focused structural reforms.** Output is projected to increase by 4.5 percent in 2002 and inflation is targeted to decline from the projected 7 percent during 2001 to 6 percent during 2002 (Table 1). The central bank's gross foreign reserves are projected to increase from 3.3 months of imports at end-September to 3.9 months at end-December due to bunching of balance of payments support in the last quarter of 2001, before declining to 3.8 months of imports by the end of the first-year

program. These short-term targets incorporate the estimated impact of the recent downturn in the world economy and the September 11 tragedy. One half of the Kyrgyz exports are expected to remain unaffected as they consist of barter trade in energy with Uzbekistan and gold exports based on long-term contracts and hedged prices. Exports to CIS were not revised as growth in the region is projected to continue relatively strong. Negative effects on the demand for Kyrgyz exports due to a slowdown in non-CIS countries is projected to be offset by an improvement in the terms of trade generated by lower oil prices.

16. The tight fiscal and monetary stance is a necessary condition for the balance of payments adjustment and thus a crucial element in the authorities' debt strategy. The key policy parameters of the first-year program are an increase in the primary fiscal surplus (excluding the PIP) from the projected 2.1 percent in 2001 to 2.6 percent in 2002, and containing the growth of som broad money to 13.4 percent during the first-year program. Structural conditionality, as largely agreed in previous discussions, is concentrated on the banking sector reform, the privatization of four strategic state enterprises in the medium term, the reduction of the energy sector's quasi-fiscal deficit, and governance reforms.

17. In the medium term, the program aims to reduce inflation to 5 percent (Table 2). The external current account deficit will be limited to 5½ percent of GDP with official reserves remaining above 3 months of imports during 2002–04. The achievement of these targets requires continued fiscal restraint. Accordingly, the general government overall fiscal deficit is targeted to decline from the projected 6 percent of GDP in 2001 to 2½ percent in 2004. This would be achieved mainly through stronger tax policy which should increase the state budget's tax-to-GDP ratio from 13 percent in 2001 to 15½ percent in 2004, and streamlining of the foreign financed PIP from 6 percent of GDP in 2001 to 4 percent by 2004.¹⁰ Low inflation and the balance of payments adjustment will be supported by the continuation of a tight monetary policy, which would maintain the exchange rate stability. However, significant fiscal adjustment, tight monetary policy, and stability of the som will not be sufficient to achieve a sustainable external position in the medium term. As discussed below, to achieve the latter the Kyrgyz Republic needs to obtain financial support through debt reschedulings on highly concessional terms from the Paris Club.

18. Over the next three years, real GDP is projected to grow by 4½ percent per annum, below the rates seen in more advanced transition economies. At this stage, the medium-term projections are based on the assumption that the conflict in Afghanistan does not have major adverse effects in the Kyrgyz economy as about 80 percent of its foreign trade is with countries outside the sensitive region. With a slow growth of employment (0.5 percent per year) and only a modest increase in capital stock, the major contribution to growth is expected to come from improvements in total factor productivity. The anticipated acceleration in productivity growth reflects, in addition to the catch-up in the utilization rate

¹⁰ The authorities' I-NSPR recognizes that foreign borrowing for the PIP has become excessive relative to the country's debt servicing capacity, and that streamlining and prioritizing of this program is necessary.

of labor and capital, the expected impact of the structural reforms to be implemented under the program. The economy's gross investment ratio is projected to remain unchanged at 16 percent of GDP despite the projected streamlining of the PIP. With this streamlining as part of the authorities' debt reduction strategy, government investment is expected to fall from 8.5 percent of GDP in 2000 to 4.8 percent by 2004. The adverse impact on growth is likely to be small, as the efficiency of public investment is expected to improve with better prioritization and screening. In addition, the composition of the PIP is expected to shift towards more productive investments with a higher share of export oriented projects.¹¹

19. **The authorities believe that the decline in public investment will be compensated by higher private investment.** First, foreign direct investment (FDI) is expected to recover somewhat from its depressed level in 1998–2000 caused by higher risk premiums of foreign investors in the wake of the Russian crisis and Kyrgyz macroeconomic imbalances associated with it. However, the increase in the share of FDI in GDP is projected conservatively at 0.7 percentage point of GDP, as the conflict in Afghanistan is likely to keep FDI below historical levels at least in the short run.¹² Another source of nongovernment investment growth is the reduced crowding-out of the private sector by the public sector. As the overall fiscal balance (excluding PIP) of the general government swings from a deficit of 2.5 percent of GDP in 2000 to a surplus of 1.4 percent in 2004, the financing constraint of the private sector becomes less binding provided that these surpluses can be effectively recycled through the banking system. Therefore, a continuation of the progress in strengthening the banking sector becomes crucial to promote investment. Third, the 2002 tax reform (see below) with lower enterprise taxation should support profitability and investment in the medium term. Fourth, reflecting high hidden unemployment, real wage increases are expected to remain below the projected productivity growth, which would increase the profit share in value added, thus supporting private investment. Finally, the successful stabilization and structural reforms, especially improvements in business climate, would also contribute to private investment growth.

20. **In the proposed macroeconomic framework, consumption grows less than national income, implying an increase in total savings from 8 percent of GDP in 2000 to 10½ percent of GDP in 2004.** This is consistent with the debt strategy and, with unchanged investment ratio, would lead to an adjustment in the external current account deficit by about 2½ percentage points of GDP. The increase in the national savings is generated by an adjustment in government savings from -2½ percent of GDP in 2000 to 2 percent by 2004. This swing comes from a 3½ percentage points of GDP increase in total revenue of the

¹¹ In the initial 2001 PIP, export-oriented projects accounted for 18½ percent of GDP. This share is expected to increase to 29 percent in 2002. Export-oriented projects include, inter alia, investments in agricultural infrastructure, development of small- and medium-size industries, construction of a paper factory, and entrepreneurship training.

¹² This implies that FDI would rise from 2.2 percent of GDP in 2000 to 2.9 percent by 2004 compared with around 5 percent of GDP on average in 1995–98.

general government largely owing to new tax measures to be developed under the program and better tax compliance. On the expenditure side, while spending would grow in real terms, expenditure-to-GDP ratio should decline with better fiscal management. Interest payments are expected to decline due to debt rescheduling, creating room for social spending and poverty alleviation to accommodate the objectives outlined in the I-NSPR. Household savings are projected to decline somewhat due to the strong pent-up demand for consumer goods.

21. **The medium-term adjustment strategy relies heavily on the government's ability to generate savings and on private investment growth.** There are no other viable options at this stage. Relying on the recovery of private savings with less fiscal adjustment, including with no streamlining of the PIP was considered too risky. If such private savings failed to materialize while the fiscal adjustment was postponed further, external imbalances would remain large, eventually leading to a depreciation of the exchange rate with a highly detrimental impact on the external debt sustainability.

22. **The major risks derive from the hostilities in the region and the potential for political instability in the run-up to the presidential election in 2004.** Both may lead to a repeat of policy slippages observed during the second annual arrangement. Protracted hostilities in Central Asia could further isolate the country from world markets and adversely affect economic performance if the risk premia on private and foreign investment increase significantly. A sudden increase in the number of refugees and/or defense spending due to security concerns could destabilize the fiscal situation. On the domestic front, the government might find it increasingly difficult to work with parliament in the period leading to the presidential election. President Akayev has announced that he will not seek re-election and there are several potential presidential candidates in parliament building up their political base. In addition, under the influence of vested interest groups, parliament could prevent sufficient fiscal adjustment and structural reform.

B. Fiscal Policy

23. **The program aims at strong fiscal adjustment to promote macroeconomic stability and to address the external debt problem.** In the authorities' view, past fiscal slippages were in part due to weaknesses in the governance of public finances. Accordingly, they intend to restructure the Ministry of Finance to strengthen its control over the implementation of the budget and fiscal policy. In addition, a properly functioning treasury system is crucial for effective budget execution and control of spending commitments by line ministries to avoid expenditure arrears. At the same time, tax administration needs to be strengthened, as collection rates remain low (MEP, paragraph 14). The authorities are looking forward to the upcoming technical assistance missions from the Fund to help specify a new structure for the Ministry of Finance, initiate the stage II of the treasury reform, and recommend further measures to improve tax administration.

24. **Tax reform was the most contentious area of discussions.** For 2002, parliament had approved a reduction of the profit tax rate from 30 to 10 percent, and the unification of the individual income tax rates (ranging from 5 to 33 percent) at 10 percent, without

compensatory tax measures. The staff argued that tax rate reductions should be accompanied by measures to broaden the tax base, since the positive compliance effects of lower tax rates were highly uncertain, in particular in the short term. Eventually, the authorities (including the representatives of the parliament's tax committee) agreed that new measures were needed both to compensate for the short-term revenue losses and to raise the medium-term tax-to-GDP ratio.

25. **The mission encouraged the authorities to roll back the profit tax rate reduction to 20 percent.** While the authorities first showed understanding for this proposal, the President concluded that neither he nor the government would be able to convince the parliament to change its earlier decision. The authorities more readily agreed to a partial rollback in personal income tax rates. A 20 percent income tax bracket will be introduced for high income earners and the tax deductible threshold will be raised for low income earners. In addition, a broad set of measures to compensate for the short-term revenue loss due to tax rate reductions was agreed, largely based on the expansion of the VAT and income tax bases (MEP, paragraph 13). After the mission's return to headquarters, however, the authorities suggested to roll back the profit tax reduction to 20 percent accompanied by a reduction in the employers' social security contribution rate from 29 to 25 percent. The staff agreed to this revision provided that a transfer from the state budget to the Social Fund to offset its revenue loss was ensured in the 2002 budget. Overall, the estimated revenue losses and compensatory measures amounted to 1.7 percent of GDP (Box 1).

26. **Other factors will improve tax performance in 2002.** These include the expiration of significant tax exemptions granted to the Kumtor gold mine (0.5 percentage point of GDP), an increase in custom duties due to a strong growth of dutiable imports (0.1 percentage point of GDP), and improvements in tax administration (0.2 percentage point of GDP). These factors together with the agreed compensatory measures are expected to increase the state tax-to-GDP ratio from 13.0 percent in 2001 to 13.8 percent in 2002.

27. **The new revenue measures in the 2002 budget are part of a broader tax reform agenda to raise the tax-to-GDP ratio in the medium term.** The staff agreed with the authorities on the main direction of broader tax policy and administration reforms, including the introduction of a new property tax and the need to review the taxation of key economic activities to enhance the elasticity of the tax system (e.g., mineral resources, and financial institutions and transactions). The authorities hope that the upcoming Fund technical assistance mission will help them to specify such measures.

Box 1. The 2002 Tax Policy Package	
(In percent of GDP)	
<i>Revenue Losses from Tax Rate Reductions</i>	<i>1.7</i>
Income Tax	1.1
Personal Income Tax	0.2
Profit Tax	0.9
Payroll Tax	0.4
Excise Tax on Vodka	0.2
<i>Compensatory Measures</i>	<i>1.7</i>
Unchanged profit tax rate for natural monopolies	0.3
Patent tax and simplified tax on small firms	0.1
Partial reversal of profit tax reduction	0.4
Elimination of exemptions in VAT	0.4
Land Tax	0.1
Increase in Retail Tax rate	0.2
Other 1/	0.2
<hr/> 1/ Includes strengthening the collection of VAT and excises on gasoline; taxation of interest income, and better control of FEZs.	

28. **On expenditure policy, program success largely hinges on keeping PIP spending in check and increasing its efficiency.** In the past, overruns in capital spending were frequently a reason for fiscal slippages while the contribution to growth has remained smaller than hoped for. The authorities have agreed to reduce PIP spending from 6 percent of GDP in 2001 to 5.5 percent in the 2002 budget. Close cooperation with donors to prioritize projects has started while a system to rank investments on the basis of their impact on exports and growth, and their relevance for poverty alleviation will be developed by end-2001. On wage policy, the staff agreed with the authorities that the current low level of civil servant wages may have negative effects on government efficiency and provide incentives for corruption. For 2002, the program assumes an increase in the average annual salary of general government employees in line with the expected productivity growth in the economy (4½ percent) plus compensation for inflation (7 percent). Additional salary increases may be granted in so far as there is evidence that budgetary savings are being generated by employment reductions. The room for such additional pay increases will be reviewed with

the Fund staff in May 2002.¹³ Keeping other current expenditures broadly unchanged in real terms, real social spending (education, health, and social security) could grow by about 6 percent in 2002.

C. Monetary and Exchange Rate Policies

29. **A tight monetary policy is critical for further reduction in inflation and the required balance of payments adjustment.** Despite recent achievements in stabilization, caution is warranted in setting the targets for monetary expansion, as confidence in economic policies will strengthen only gradually. Assuming a slight increase in the demand for real balances consistent with the anticipated growth of real GDP and declining inflation, some broad money would grow by 13½ percent during the first-year program.¹⁴ To achieve this target, reserve money is programmed to grow by 8 percent. The expected increase in the money multiplier reflects gradually improving confidence of depositors as banking sector reforms proceed (Section IV.E). The NBKR's net international reserves are expected to increase from an average of \$13 million in 2001 to \$18 million in 2002 provided that the expected official balance of payments support materializes.¹⁵

30. **The staff noted that the economy remains highly dollarized and a tight supply of money serves well for strengthening confidence in local currency.** It was agreed that the central bank's open market operations will be made more efficient, in line with suggestions made by the recent MAE mission. However, the room for liquidity management is limited because of the thinness of the security market. If necessary, the NBKR will resume its credit auctions on a temporary basis and/or the government could place part of its fiscal surplus in the commercial banking system thereby helping satisfy the private sector's liquidity needs.¹⁶

31. **On exchange rate policy, the NBKR agreed that a flexible regime is currently the most appropriate.** Interventions in the foreign exchange market will be directed only at the accumulation of reserves and smoothing temporary market fluctuations. In the event of unexpected supply of foreign exchange, the NBKR would build up reserves beyond the program targets if there are signs that money demand is strengthening more than projected. Conversely, if unanticipated capital outflows and weakened demand for money threaten the

¹³ At that time, the staff will also review the opportunity for increasing pensions and other social benefits. By then, the authorities are expected to have agreed with the World Bank staff a schedule for increasing energy tariffs over the next two years.

¹⁴ Credit to private sector is expected to increase from its current low level of 3.8 percent of GDP to 4.9 percent during the first year of the program. In part, this increase reflects credits from the newly established Kyrgyz Investment Credit Bank supported by the EBRD.

¹⁵ During the program period, NIR is programmed to increase from \$8 million to \$31 million.

¹⁶ In 2002, the overall fiscal balance excluding the foreign financed PIP is expected to record a surplus of 0.6 percent of GDP.

stability of the exchange rate, the NBKR will tighten monetary policy through open market operations.

32. **The government and the President agreed that the NBKR independence is crucial for the success of the new program.** At the same time, they noted that independence should be accompanied by accountability and transparency to minimize the risk of political backlash against the NBKR. To improve accountability, the authorities will introduce staggered terms of office for the Board members, and the Chairman of the NBKR will submit bi-annual reports to parliament and answer to floor questions on the conduct of monetary policy. In addition, the NBKR will broaden the amount of information available to the public by publishing its audited financial reports along with the auditors' conclusions on its website. As recommended by the recent TRE safeguard mission, the authorities also agreed to regularize the financial relations between the NBKR and the Ministry of Finance before end-March 2002 (MEP, paragraph 23).

D. External Policies, Debt Strategy, and Program Financing

External policies

33. **The external current account deficit is projected to decline from 8 percent of GDP in 2000 to 6–6½ percent in 2001 and 2002.** In 2001, despite an 8 percent increase in gold production, the volume of exports is expected to decline due to lower energy exports compared to the 2000 peak. The volume of imports is expected to fall by 6.4 percent on account of lower disbursements for PIP projects and energy imports from Uzbekistan. In 2002, the volume of exports is projected to increase by 2.6 percent, somewhat less than the export market growth, mainly because gold exports are projected to decline. Imports are projected to grow by 3.5 percent as the PIP will be further streamlined, and assuming that other imports grow in line with the Kyrgyz real GDP. The surplus in the capital account would narrow significantly in 2001 as disbursements of project and program loans decline but would stabilize at around 2 percent of GDP in 2002.

34. **On trade policy, the authorities intend to reduce the top import tariffs in line with their commitment to the WTO.** The highest tariff band, which covers mostly agricultural products, would be reduced from the current 20 percent to 17.5 percent in 2002. They will also reduce the number of tariff bands from six to four. In addition, tariff exemptions will be reviewed with the aim of reducing their volume and value limits. New exemptions will not be granted. The delays in refunds for VAT and excise taxes on imported inputs have acted as major obstacles for small and medium-size exporters. While some progress has been made, further efforts will be made to eliminate these delays (MEP, paragraph 39). The authorities were very disappointed that numerous fees were imposed by different oblasts in Kazakhstan and Uzbekistan for Kyrgyz transporters. They will attempt to negotiate single fees for transit with neighboring countries and hope for support from the international community in this effort. To improve the reporting of imports, the Kyrgyz customs authorities have formed a commission which, based on regularly conducted market surveys, will establish a list of reference prices for imports. Should this work not yield tangible results, the authorities will consider hiring a pre-shipment inspection company to

assist the customs authorities. The Kyrgyz exchange system is free of restrictions on payments and transfers for current international transactions. On capital account transactions, while standard registration requirements are in place, there are only a few restrictions, mainly on the issuance of corporate bonds and collective investment instruments by non-residents.

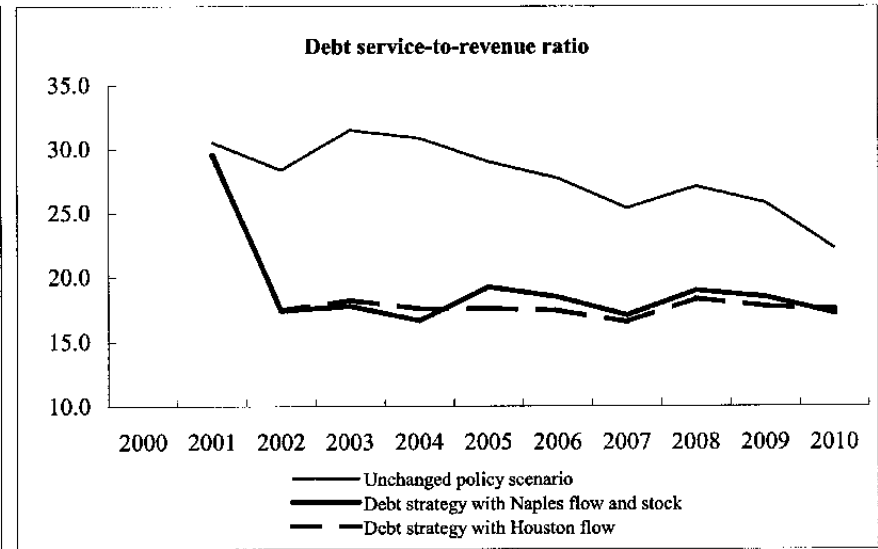
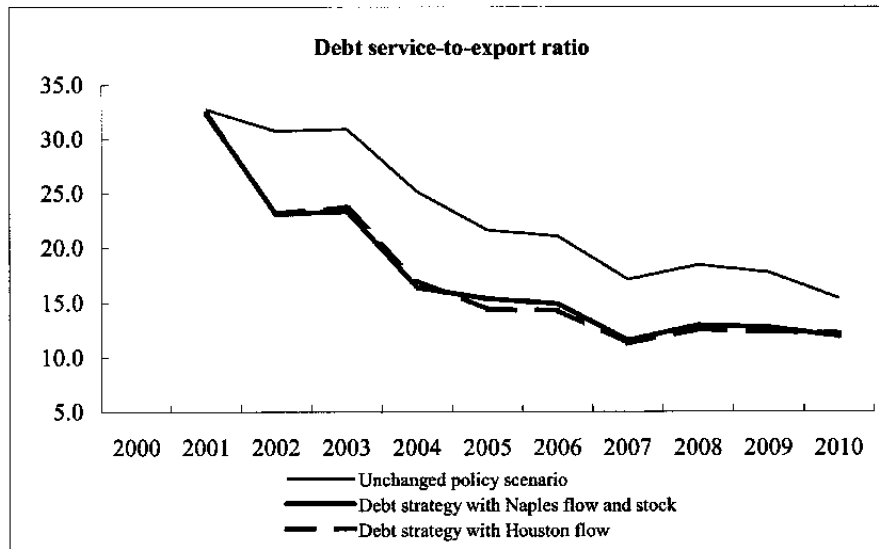
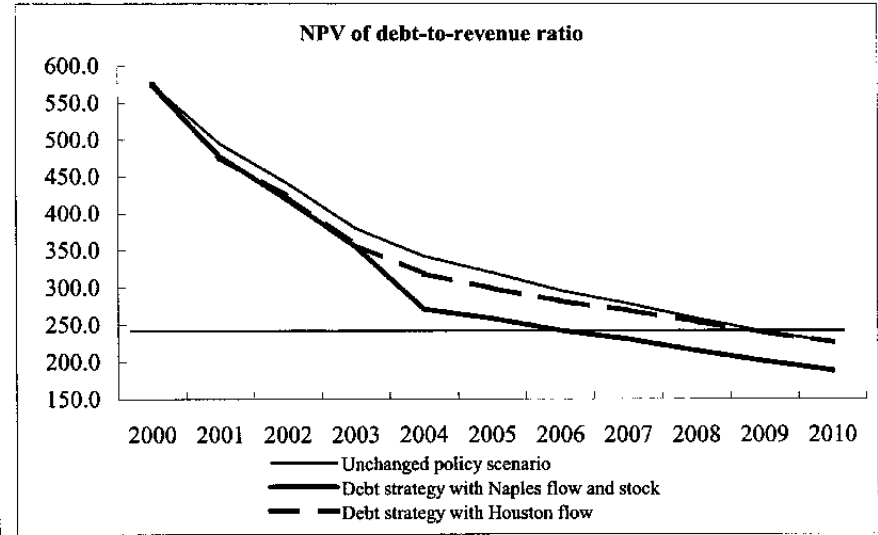
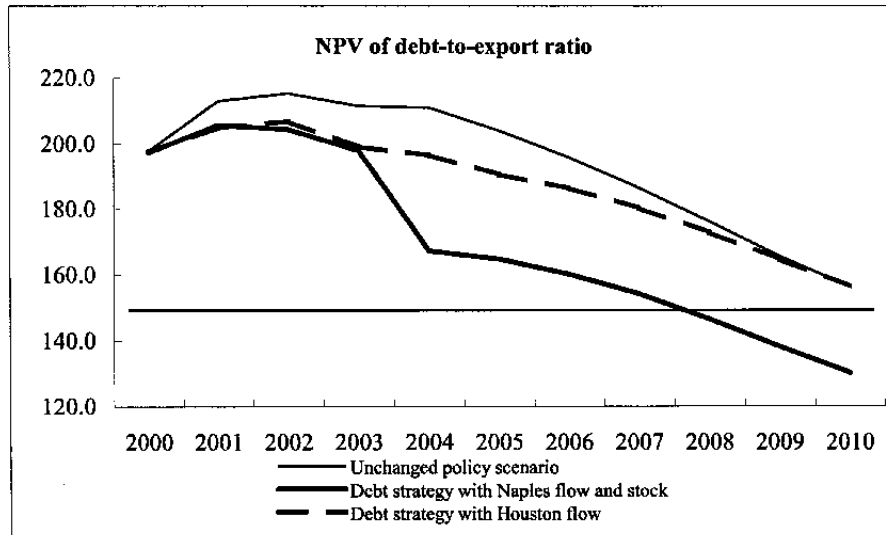
Debt strategy

35. **As a prior action for the planned Board meeting in July, the government adopted a comprehensive external debt strategy.**¹⁷ The authorities have now amended this strategy and intend to: (i) request flow and stock reschedulings of their bilateral debts from the Paris Club and private creditors on Naples terms; (ii) ensure comparability of treatment of creditors, as typically required by the Paris Club, if repaying debt early; and (iii) take further measures to improve their external debt management capacity. The external debt division of the Ministry of Finance has already been appointed as the unit responsible for monitoring and reporting on external obligations. Significant assistance continues to be provided by a Swiss-financed debt advisor to strengthen the organizational and technical aspects of debt management.

36. The staff's analysis (Appendix VI) suggests that without the implementation of the debt strategy, and a Paris Club debt rescheduling, the NPV of the Kyrgyz debt relative to exports would remain very high until 2006 and decline only slowly thereafter. The debt simulations also indicate that the implementation of the debt strategy combined with Paris Club debt reschedulings on less favorable than Naples terms (e.g., Houston terms), even if repeated several times, would not help solve the debt sustainability problem as the solvency ratios would remain excessively high (Figure 4). In addition, such a debt overhang would be detrimental for investment, growth, and the poverty reduction efforts. In contrast, with Naples terms flow and stock reschedulings, the NPV of debt-to-exports ratio would fall below the critical 150 percent level in 2007 and the NPV of debt relative to fiscal revenue would fall below 250 percent in 2006. The debt service-to-export ratio would fall below 10 percent in the coming few years (excluding the Kumtor debt) and not exceed 13 percent

¹⁷ The six elements of the strategy were: (i) a significant fiscal adjustment leading to a primary fiscal surplus (excluding the PIP) of 3.5 percent of GDP by 2005; (ii) a streamlining the PIP from 6 percent of GDP in 2001 to 5.5 percent in 2002 and to 3 percent by 2005; (iii) the privatization of the four large state-owned strategic enterprises (KyrgyzTelekom, KyrgyzAir, KyrgyzGaz, and the four distribution companies of KyrgyzEnergo) by 2005 and depositing 75 percent of these proceeds in a special Privatization Account in the NBKR to be used for debt reduction (starting in 2002, all other privatization receipts will also accrue to this special account); (iv) to the extent fiscal resources become available, the repayment of government debts ahead of schedule; (v) limiting the contracting of new public or publicly guaranteed debt to loans with a grant element of at least 45 percent; and (vi) pursuing actively with interested foreign investors debt-for-equity swaps for state-owned enterprises, provided that such swaps are compatible with Paris Club conditions.

Figure 4. Kyrgyz Republic: Debt Sustainability Analysis



thereafter. Debt service relative to fiscal revenue would remain at a manageable level between 15 percent and 20 percent in 2003–10.

Program financing

37. **The proposed level of access at 82.6 percent of quota is justified by the strength of the program and a severe balance of payments need (see Table 10 and the discussion below).** It equals to the initially granted access under the second PRGF arrangement, with slightly front-loaded disbursements. The proposed access is high relative to normal access under a third PRGF arrangement (de facto 60 percent). However, there are three considerations that justify this access. First, the balance of payments situation is very difficult as evidenced by the outlook of significant financing gaps in the coming years. Second, the proposed program is strong as indicated by the sizeable adjustment in the fiscal deficit and balance of payments as well as strong structural reforms in macrorelevant areas. And third, the proposed access could be seen as the normal access of 60 percent plus some 70 percent of the undisbursed amount under the third year of the previous PRGF arrangement. If all of the proposed seven loans were to be disbursed, the Fund's exposure in the Kyrgyz Republic would increase by SDR 4.9 million during 2001–04.

38. **During the first-year program, the financing gap is expected to be filled by program loans from multilateral financial institutions and debt rescheduling in the context of the Paris Club.** Between October 1, 2001 and September 30, 2002, the Kyrgyz Republic's external financing need amounts to \$119 million, which is expected to be satisfied only in part by credits from the Fund, the World Bank, and the AsDB. The Fund would disburse about \$30 million against repayments of \$21 million. The Kyrgyz Republic is also expected to receive disbursements of \$8 million from the World Bank through the second tranche disbursement of the Consolidated Structural Adjustment Credit (CSAC). In addition, \$48 million is expected from the AsDB, of which \$17.5 million through the second tranche of the Financial Sector Development and Resources Mobilization (FIRM) credit and \$30 million through the first and second tranches of the Corporate Governance loan. Taking account of the need to maintain external gross reserves at an average of 3.5 months of imports given the uncertainty in the region and the world economy, these disbursements would leave a financing gap of around \$55 million (3.3 percent of 2002 GDP) for the first-year program (Table 9). The Paris Club has indicated their willingness to consider the authorities' request for a rescheduling of the debt service payments falling due during the program period. Thus, the residual financing gap is expected to be covered through debt reschedulings by bilateral official and private creditors.

39. **Over the medium term, the financing gaps are expected to be high despite further compression of imports because gold exports decline and the scheduled external debt service remain significant (Table 11).** Without any debt relief, external debt service would increase from \$139 million in 2001 to an average of \$160 million per annum in 2002–04. The financing gaps are projected to almost double from around \$45 million in 2002 to an annual average of \$88 million in 2003–04, of which about half are expected to be closed by Paris Club debt reschedulings and the remainder by the IFIs and bilateral donors.

E. Structural Reforms

40. **Structural reforms will focus on areas that are macrorelevant and critical for the success of the program.** Priority is given to four areas: banking sector reform, privatization of the four strategic enterprises, reduction of the energy sector's quasi-fiscal deficit, and improving governance. These areas are prominent also in the authorities' I-NSPR. Fund conditionality includes one structural performance criterion and six structural benchmarks (Box 1, Attachment I). In addition, the authorities' Letter of Intent outlines their broader structural reform agenda. Box 2 explains the rationale for Fund conditionality.

Structural reforms under Fund conditionality

41. **To improve confidence in the banking sector the authorities will require adequate capitalization of banks** (MEP, paragraph 30). Apart from closing four insolvent banks and continuous monitoring of the fifth problem bank, the NBKR will require banks to implement a phased increase in the minimum level of own capital through April 1, 2003. Implementation of the first increase in capital requirement will be a structural benchmark for end-March 2002. In addition, the Kairat Bank's organization and branch network will be restructured and its financial condition strengthened.

42. **To prevent the re-emergence of problem banks, high priority is given to strengthening the NBKR's banking supervision.** The adoption by the NBKR and government of a Regulatory Response Policy (RRP), which clarifies the minimum supervisory action that the central bank will take under different circumstances, aims at achieving several objectives (MEP, paragraph 31–32). First, the RRP would ensure transparency and predictability of regulatory enforcement. Second, it would notify stakeholders that the new action rules are supported not only by the NBKR but also by the government, so as to reduce political maneuvering to circumvent prudential regulations. Third, it would protect the NBKR from accusations of discretion and arbitrariness.

43. **The Debt Restructuring Agency's (DEBRA) loan recovery efforts have suffered from legal obstacles and lack of enforcement powers.**¹⁸ It has collected only 30 percent of the som loans and almost none of the foreign currency loans that were transferred to its portfolio. To improve its efficiency, DEBRA's control has already been transferred from the NBKR to the Ministry of Finance. The authorities also agreed to submit to parliament amendments to existing legislation so that DEBRA will become the sole and exclusive liquidator of failed banks and thus make it a more powerful center of expertise in bank liquidation (MEP, paragraph 33).

¹⁸ DEBRA received the loans of eleven failed banks for recollection in 1996–2000. In addition, it received the problem assets of Kairat Bank in 2000.

Box 2. Structural Conditionality Streamlining Assessment

1. Coverage of Structural Conditionality in the Current Program

Structural conditionality focuses on four areas that are critical for the achievement of the program objectives. Banking sector reform is essential for establishing efficient financial intermediation and mobilizing savings to finance investment. Privatization of the four large-scale strategic enterprises KyrgyzTelecom, Kyrgyz Airlines, KyrgyzGaz, and the four power distribution companies of the former KyrgyzEnergo would improve their financial performance, increase the allocative efficiency in the economy, and reduce external debt. In addition, energy sector reform targets a reduction of the large quasi-fiscal deficit, which could undermine stabilization. Improved governance is crucial for reducing corruption and improving investment climate and business environment.

2. Status of Structural Conditionality from Earlier Programs

Measures that were not implemented or partially implemented during the second annual arrangement under the previous three-year PRGF fall into three broad categories:

- Measures that will be carried on under the new PRGF-supported program. Privatization of large strategic enterprises, and the introduction of a new system of property taxation fall under this category.
- Measures that are excluded from the new program as they are outside the Fund's core competence and are covered by the World Bank and the Asian Development Bank (AsDB) (Section 3 in this Box).
- Measures that are removed from the prospective program due to acceptable progress in implementation or lack of capacity for implementation at the present stage of economic reform (Section 4 this Box).

3. Structural Areas Covered by the World Bank

The World Bank covers previous structural conditions aimed at reducing regulatory barriers and licensing (e.g., elimination of sublicensing) under the Consolidation Structural Adjustment Credit (CSAC) and in the area of pension reform (e.g., reduction of early retirement privileges), through an upcoming Public Expenditure Review. World Bank structural conditionality and assistance cover also the following areas: effectiveness of taxation, financial conditions and industry structure of the power and gas sectors; land registration; and health sector reform. Under a prospective Governance Structural Adjustment Credit (expected to be finalized by end-2002), the Bank is expected to address public expenditure management and administration, and civil service reform.

4. Relevant Structural Conditions not Included in Current Program

Progress has been made in conducting audits of KyrgyzGazMunaizat, Kyrgyzgaz, and Munai. The authorities are reviewing the audit reports of KyrgyzGazMunaizat and Kyrgyzgaz conducted by PriceWaterhouse Coopers—and financed under the Bank's CSAC technical assistance. The audit of Munai has not been conducted. Regarding the banking sector, the staff has advised the authorities to delay the introduction of the deposit insurance scheme due to continuing difficulties in the banking system.

44. **The privatization of the four large-state owned enterprises has been the government's goal for some time but progress has been slow.** These privatizations are critical not only for the credibility of the authorities' debt strategy but also because their poor financial performance places a significant drag on potential output growth. As a structural performance criterion for end-December, 2001, the government will issue a resolution specifying a timeline for monitorable steps for restructuring and privatizing these enterprises in the medium term. The resolution would also provide targets for tariffs and bill collection rates over the period of the arrangement, and for transparent privatization procedures with

equal access for domestic and foreign investors. In drafting the privatization resolution, the authorities plan to co-operate closely with the staff of the World Bank and other IFIs who have been assisting the rehabilitation of these enterprises.

45. **The authorities recognize that eliminating the energy sector's quasi-fiscal deficit would significantly improve the prospects for fiscal stability.** This deficit is estimated to have declined from 10.5 percent of GDP in 2000 to 7.3 percent in the first seven months of 2001 with the recent tariff increases.¹⁹ The roots of the problem lie in poor bill collection, large numbers of tariff discounts, and below cost pricing of energy in the domestic market. The World Bank has the lead in assisting the authorities with the energy sector reform. Nevertheless, under the program the authorities have agreed to continue to maintain a zero ceiling on the stock of government agencies' arrears to KyrgyzEnergo and submit a new law to parliament to reduce by 20 percent the number of energy users eligible for discounted tariffs.

46. **Weak governance is a major reason for poor business climate and thus an impediment to higher economic growth.** These concerns are reflected also in the I-NSPR and a comprehensive set of governance measures was adopted under the program. These measures include, inter alia:

- Strengthening the government's economic policy making mechanism by establishing an Economic Policy Council (EPC) to increase coordination, transparency, and efficiency of the economic policy (MEP, paragraph 38);
- Simplifying and strengthening regulations on tax and customs administration and developing guidelines that will restrict the interference of law enforcement and other supervisory agencies in the operations of private enterprises. (MEP, paragraph 39);
- Enhancing the coverage, depth, and availability of information on the conduct of fiscal policy (MEP, paragraph 41–42); and
- Strengthening efforts to remove public sector impediments to private sector development. A Special Representative of the President for the Promotion of Foreign Investments has been granted with a wide mandate to improve investment climate and several working groups consisting of representatives of business community, public

¹⁹ The deficit is estimated as a difference between actual payments relative to cost recovery level payments. The latter includes depreciation to cover rehabilitation and replacement of assets in the medium term. In mid-2001, the average domestic electricity tariff was 0.62 cents/kwh with an 85 percent payment collection rate compared with an estimated domestic cost recovery level of 2.3 cents/kwh at 100 percent payment collection. If export proceeds were to be taken into account, the overall quasi-fiscal deficit in the electricity sector would decline to 4.6 percent of GDP in 2000.

administration, and international community have been established to identify new measures to improve business environment.

47. **The World Bank and the AsDB are also actively supporting the government's efforts to improve governance.** The World Bank's ongoing CSAC includes measures to reduce excessive inspections and licensing procedures. In addition, the upcoming three-year Governance SAC (GSAC) would include measures to enhance governance in public expenditure management and administration, and to reform the civil service. Structural conditionality under the AsDB's Corporate Governance Loan (CGL)—currently under discussion—is expected to include measures aimed at: (i) promoting corporate governance standards; (ii) disseminating international accounting, auditing, and valuation standards; (iii) launching legal and judicial reforms; and (iv) restructuring the enterprise sector.

The authorities' I-NSPR paper

48. **Following the submission of their I-NSPR to the Boards of the Fund and the World Bank in June (EBD/01/50), the authorities are now submitting a Preparation Status Report towards developing a full-fledged NSPR.** A Secretariat to coordinate the work on the Comprehensive Development Framework and the Poverty Reduction Strategy has been established, and the process of preparing the NSPR has advanced in a number of areas. Specifically, poverty data based on the Living Standards Measurement Survey for the year 2000 is now available and an updated poverty profile is expected by end-2001. With assistance from the World Bank, such data will be used to conduct a Poverty Assessment, with a view to explaining why economic growth in the Kyrgyz Republic has not been accompanied by a more significant reduction in poverty. The analysis and conclusions of the Poverty Assessment will shape the authorities' policies for poverty reduction, including the prioritization and costing of expenditure programs. A significant amount of technical assistance—in large part provided by the World Bank—will be needed to complete these exercises. The authorities have extended the deadline for finalizing the NSPR to end-September 2002.

V. MEDIUM-TERM BALANCE OF PAYMENTS AND CAPACITY TO REPAY THE FUND

49. **The external current account deficit is expected to decline to 5.4 percent of GDP by 2004 and to 4 percent by the end of the decade.** After peaking in 2001, gold exports are projected to decline (but remain significant in the next two years) and the Kumtor gold deposits are expected to be depleted by the end of the decade. Other mining projects could in part fill the gap depending on price developments in the world market. In the medium and long term, export growth is expected to be increasingly based on non-gold exports (mainly mining, agro-products, and tourism) provided that the recent gains in cost competitiveness and the very liberal foreign trade regime are maintained.²⁰ A well-educated labor force

²⁰ Although the RER vis-à-vis the U.S. dollar is projected to appreciate by about 2 percent per year in the medium and long term, productivity gains are expected to maintain cost competitiveness in the tradable goods sector.

provides a good basis for developing new export activities. Also, timely implementation of structural reforms in the next few years would support export industries, as would a reorientation of the PIP to strengthen export potential. It is also expected that the neighboring countries would gradually eliminate their informal trade barriers.

50. **Export diversification toward light manufactured goods, agricultural raw materials, and processed products is likely to take time, however.** Accordingly, export volumes are projected to grow at an average annual rate of 3¼ percent in 2001–10, less the anticipated market growth of Kyrgyz exports. Import volumes are expected to grow on average by 4½ percent per annum during the decade implying broadly unitary elasticity of imports relative to domestic demand growth. The balance of services has good prospects to improve with growing tourism. This, and declining interest payments would affect the weakening of the trade balance and the external current account deficit is projected to narrow from 8 percent of GDP in 2000 to about 4 percent by the end of the decade. The surplus in the capital account is expected to increase gradually as debt repayments decline and foreign direct investment stabilize at around 3 percent of GDP. Gross official reserves are expected to remain at around 3½ months of imports during the decade.

51. **The impact of the medium-term balance of payments outlook on the capacity to repay the Fund is shown in Table 10.** While the repayment ratios will increase significantly compared to the 1999–2000 levels, they are not alarming. Annual debt service to the Fund does not exceed 13 percent of gross reserves, and remains below 5 percent of exports. Debt service to the Fund as a share of total debt service reaches 18 percent in 2006, although it would increase if Paris Club reschedulings were to be granted. In the staff's view, these ratios are sustainable and the Kyrgyz Republic, as in the past, is expected to meet its obligations to the Fund on time. The Fund's stage-one safeguards assessment of the NBKR has been completed and the report on the on-site stage-two assessment is being finalized.

VI. PROGRAM MONITORING

52. **Implementation of the program will be monitored against semi-annual performance criteria, indicative targets, and through program reviews.** Quantitative performance criteria and indicative targets for the program period are shown in Attachment I to the MEP. Box 1 in the MEP describes the structural performance criterion and the structural benchmarks through end-March 2002. The first review of the program is expected to be completed before end-June 2001. This review will focus in particular on tax policy, expenditure management reform, and governance issues. At the time of the review, quantitative and structural performance criteria and benchmarks will be established for end-September 2002.

VII. STAFF APPRAISAL

53. The Kyrgyz authorities are to be commended for their achievements in macroeconomic stabilization. Continuing growth, low inflation, and stability in the foreign exchange market provide a solid foundation for the new program. The new government has indicated on several occasions that they aim to re-establish their reputation as a strong

performer under Fund supported economic programs. The staff is optimistic, but remains mindful about the challenges involved.

54. It was regrettable that the authorities' request for a third annual arrangement under the previous PRGF had to be withdrawn from the Board's agenda because of the tax reductions which were not consistent with the fiscal program. Even more so as the government had implemented a set of difficult prior actions before that program was to be brought for the consideration of the Executive Board. The President believes that the risk for such slippages can be reduced significantly with the new Economic Policy Council that will make policy planning and implementation more effective and ensure better coalition building with parliament. The staff shares this view for which the first test is parliamentary approval of the 2002 budget with an ambitious set of tax measures.

55. The prudent execution of fiscal and monetary policies explains the good stabilization performance this year. To continue on this path, strong policy coordination is needed within the government, as the proposed program's fiscal policy is very ambitious. The staff believes that the targeted fiscal adjustment is feasible if the economy continues to grow at the rate observed recently and if the set of tax measures to be approved with the 2002 budget are put in place without delay. However, higher tax ratios are needed to sustain the adjustment in the medium term as further expenditure cuts could undermine the authorities' poverty reduction efforts. In this respect, much work remains to be done in the coming year to expand tax reform, including through renewed efforts to strengthen tax administration.

56. Success in fiscal consolidation also depends significantly on the efforts to streamline the Public Investment Program. Good progress has been made in this process as the Ministry of Finance has shown strong determination as well as close cooperation with the line ministries and international donors. This provides a good basis for improvements in the efficiency of public investment. In view of the external debt problem, particular efforts should be made to prioritize the investment program to maximize its impact on the country's export potential.

57. The National Bank of the Kyrgyz Republic has been successful in containing inflation and maintaining stability in the foreign exchange market. A continuation of the tight monetary policy is needed and it will require skill and patience as the NBKR has to strike a balance between maintaining low inflation and satisfying the economy's liquidity needs. The staff believes that the cautious stance adopted in defining the pace of monetary expansion is appropriate. Regarding the exchange rate regime, the staff agrees with the NBKR that the flexible exchange rate policy will continue to serve the country well. In view of the low level of labor costs, the Kyrgyz cost competitiveness is considered satisfactory.

58. The banking system is now healthier, but still in a recovery phase. Further reforms are needed to build confidence among depositors before banks are able to mobilize any significant savings to finance investment. The role of the NBKR's banking supervision department is crucial in this task and the new Regulatory Response Policy provides a good tool for improving financial discipline and confidence in the banking sector. Under these circumstances, the President's support to the national bank's independence is very important.

59. The program's streamlined conditionality suggests that more ownership and efficient implementation of structural reforms can be expected. While the field has narrowed, it still covers the areas that are critical for the development of a low-income, highly-indebted transition economy. Apart from the bank restructuring, the privatization of large strategic enterprises, efforts to reduce the high quasi-fiscal deficit generated by the energy sector, and a comprehensive set of measures to address governance problems are all areas where progress is crucial for macroeconomic stability, sustained economic growth, and poverty alleviation.

60. The Kyrgyz Republic's external debt is a serious problem. The government's debt strategy goes a long way toward solving this issue and indicates that the authorities are committed to tackle it. While a Paris Club rescheduling could close the financing gap during the program period, with non-concessional reschedulings the Kyrgyz Republic would be left very vulnerable. In the staff's view, debt reschedulings on Naples terms by Paris Club and other creditors would provide good prospects for external debt sustainability.

61. On other external policies, the Kyrgyz authorities are to be commended for their commitment to maintain a free trade and exchange regime. It is regrettable, however, that despite the Kyrgyz efforts, the country continues to suffer from various restrictions imposed by the neighboring countries on its foreign trade. The staff hopes that the international community will give strong support for the elimination of such restrictions.

62. The program faces three major risks. First, protracted hostilities in the region and the downturn in world economy might affect economic performance and outlook more than expected now. In the event of serious negative spillover effects on trade and investment climate, the Kyrgyz Republic, as other frontline countries, is likely to need broad based assistance from the international community. Second, the political environment could become more unpredictable and difficulties might increase in the work with parliament during the period leading to the presidential election. In addition, there is always a risk that vested interests could prevent a sufficient fiscal adjustment and key reforms. In the staff's view, however, these domestic political risks as well as those associated with the influence of vested interests, can be overcome by a more careful coalition building with parliament.

63. The staff supports the authorities' request for the new three-year PRGF arrangement and recommends that the Kyrgyz Republic remain on a standard 12-month consultation cycle.

Table 1. Kyrgyz Republic: Selected Economic Indicators, 1997–2002

	1997	1998	1999	2000 Act.	2001 Proj.	2002 Proj.
GDP						
Nominal GDP (in billions of soms)	30.7	34.2	48.7	62.2	70.9	80.2
Nominal GDP (in millions of U.S. dollars)	1,767	1,630	1,243	1,302	1,447	1,637
Real GDP (growth in percent)	9.9	2.1	3.7	5.0	5.0	4.5
GDP per capita (in U.S. dollars)	371	338	254	263	289	324
Prices and wages						
Consumer prices (percent change, cop)	13.0	16.8	39.9	9.6	7.0	6.0
Consumer prices (percent change, avg)	23.5	10.5	35.9	18.7	7.7	7.5
Nominal exchange rate (eop)	17.4	29.4	45.3	48.9	...	...
Exchange rate (soms per U.S. dollar, average)	17.4	21.0	39.1	47.8	...	...
Average real wage (1994=100)	114.6	129.7	118.0	120.8	131.5	135.5
Average monthly wage (in U.S. dollars)	36.1	37.4	24.7	24.7	28.2	31.2
(In percent of GDP)						
State government finances						
Total revenue and grants	16.2	18.0	17.7	15.9	18.1	17.3
Tax revenue	12.5	14.2	12.3	12.3	13.0	13.8
Total expenditure	25.3	28.8	30.4	26.1	24.1	22.2
Non-interest current expenditure	19.9	20.6	17.3	15.2	15.7	14.6
Public Investment Program (PIP)	3.1	5.7	9.4	7.1	6.0	5.5
Overall fiscal balance (including PIP, cash basis)	-9.2	-9.5	-11.9	-9.7	-6.0	-4.9
Primary balance 1/	-7.5	-7.4	-9.0	-6.8	-4.0	-2.9
Primary balance (excl. PIP)	-4.4	-1.7	0.4	0.3	2.1	2.6
(Percent change, unless stated otherwise)						
Money and credit 2/						
Reserve money (end-of-period)	21.1	6.8	23.4	12.3	5.1	8.0
Broad money (end-of-period)	25.4	17.2	33.9	10.2	3.0	12.4
Velocity of broad money 3/	8.4	8.6	8.5	10.0	11.2	10.8
Money multiplier	1.4	1.5	1.6	1.6	1.5	1.6
External sector						
Export growth (goods and services, percent change) 4/	20.1	-11.5	-11.8	8.6	-4.3	2.9
Import growth (goods and services, percent change) 4/	-20.8	14.0	-24.7	-7.2	-5.3	4.9
Current account balance (in percent of GDP)	-8.3	-22.9	-15.6	-7.9	-6.2	-6.3
Gross international reserves (months of imports, end-period) 5/	1.8	2.2	3.4	4.0	3.9	3.7
External debt outstanding in percent of GDP 6/	83.4	95.3	134.5	132.4	125.0	114.9
Debt service-to-export ratio 7/	11.7	19.2	21.7	22.5	28.3	29.1
Debt service-to-fiscal revenue ratio 8/	14.4	16.3	21.1	37.0	27.9	22.4

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Overall balance less interest payments.

2/ 1999 estimate shown at actual exchange rate.

3/ Annualized quarterly GDP/end-of-period broad money.

4/ In U.S. dollars; includes the operations of the Kumtor gold mining company.

5/ Gross reserves exclude international reserves of NBKR that are pledged or blocked.

6/ Includes Kumtor.

7/ Public and publicly guaranteed debt service in percent of exports of goods and non-factor services. Includes Kumtor.

8/ Public and publicly guaranteed debt service in percent of state government fiscal revenue. Excludes Kumtor.

Table 2. Kyrgyz Republic: Medium-Term Projections, 1999-2004

	1999 Actual	2000 Actual	2001	2002	2003	2004
			Projections			
(Annual percentage change, unless otherwise stated)						
Income and prices						
Nominal GDP (in billions of soms)	48.7	62.2	70.9	80.2	90.0	98.9
Nominal GDP (in millions of U.S. dollars)	1243	1302	1447	1637	1837	2019
GDP per capita (in U.S. dollars)	254	263	289	324	360	392
Real GDP	3.7	5.0	5.0	4.5	4.5	4.2
GDP deflator	37.6	21.5	8.6	8.2	7.4	5.5
Consumer prices (average)	35.9	18.7	7.7	7.5	5.5	5.0
(In percent of GDP)						
Savings and investment balance						
Total Investment	18.0	16.0	16.0	16.1	15.8	16.1
Government	10.5	8.5	7.1	6.3	5.9	4.8
PIP (Public Investment Program)	9.4	7.1	6.0	5.5	5.0	4.0
Capital investment (budget)	1.1	1.4	1.0	0.8	0.9	0.8
Non-government	7.6	7.5	8.9	9.8	10.0	11.3
Total domestic savings	2.4	8.1	9.8	9.8	9.4	10.7
Government	-3.2	-2.4	0.5	0.8	1.1	1.9
Non-government	5.6	10.5	9.3	9.0	8.2	8.8
Foreign savings	15.6	7.9	6.2	6.3	6.5	5.4
State Government						
Total revenue and grants	17.7	15.9	18.1	17.3	18.3	19.0
<i>Of which:</i> Tax revenue	12.3	12.3	13.0	13.8	14.6	15.4
Nontax revenue	3.1	2.6	3.4	3.0	3.0	3.1
Grants	2.0	1.0	1.5	0.5	0.6	0.5
Total expenditures ^{2/}	30.4	26.1	24.1	22.2	22.6	21.6
Non-interest current expenditures	17.3	15.2	15.7	14.6	14.8	15.1
Interest	2.9	2.9	2.0	2.0	2.4	2.1
Capital expenditures and net lending	10.1	8.0	6.3	5.6	5.5	4.4
State government balance (cash basis)	-11.9	-9.7	-6.0	-4.9	-4.3	-2.6
Primary balance	-9.0	-6.8	-4.0	-2.9	-2.0	-0.5
Primary balance (excluding PIP)	0.4	0.3	2.1	2.6	3.0	3.5
(In millions of U.S. dollars, unless otherwise stated)						
External Sector						
Exports	462.6	510.9	482.7	496.2	513.2	526.2
Imports	546.9	502.1	483.9	507.5	537.5	562.5
Gross international reserves ^{4/}	184.3	205.5	210.4	213.3	214.4	214.6
Gross international reserves (months of imports, end-period) ^{4/}	3.4	4.0	3.9	3.7	3.6	3.5

Sources: Data provided by the Kyrgyz authorities; and Fund staff estimates and projections.

1/ Excluding transfers from government.

2/ Includes PIP and excludes transfers to Social Fund.

3/ In U.S. dollars; includes the operations of the Kumtor gold mining company.

4/ Gross reserves exclude international reserves of NBKR that are pledged or blocked.

Table 3. Kyrgyz Republic: General Government Finances
(In million of som)

	2000	2001				2002					2003 proj.	2004 proj.
		H1 prel.	Q3 proj.	Q4 prog.	Annual prog.	Q1 prog.	Q2 prog.	Q3 prog.	Q4 prog.	Annual prog.		
Total revenue and grants	12,196	6,603	4,095	5,026	15,724	3,307	3,741	4,528	5,454	17,029	19,991	22,826
Total revenue	11,588	6,472	3,754	4,442	14,669	3,307	3,741	4,320	5,267	16,634	19,491	22,326
Total tax revenue	9,976	5,281	3,116	3,747	12,144	2,767	3,161	3,745	4,573	14,247	16,717	19,217
State taxes	7,676	4,063	2,342	2,844	9,250	2,154	2,498	2,876	3,576	11,104	13,154	15,234
Income tax	1,379	983	496	606	2,085	403	467	538	669	2,077	2,448	2,866
VAT	2,976	1,757	1,059	1,219	4,035	951	1,103	1,269	1,578	4,901	5,901	6,632
Excises	1,518	547	279	359	1,184	235	272	314	390	1,211	1,479	1,772
Customs	275	128	99	99	325	86	100	115	143	443	470	631
Road Tax	1,059	440	225	285	951	225	261	301	374	1,162	1,366	1,502
Other	468	209	184	277	670	254	295	340	422	1,311	1,490	1,830
Social Security Revenue 1/	2,300	1,218	774	902	2,895	612	663	869	998	3,142	3,563	3,983
Nontax revenue	1,588	1,179	605	640	2,425	539	580	575	693	2,387	2,706	3,046
Capital revenue	24	12	33	55	100	1	0	0	0	1	68	64
Grants	608	131	340	584	1,055	0	0	208	187	395	500	500
Total expenditure	18,597	8,392	5,346	6,145	19,883	4,407	4,987	5,727	5,773	20,894	23,895	25,375
Current expenditure	13,599	6,864	4,124	4,413	15,401	3,671	3,749	4,265	4,710	16,395	18,980	20,977
Wages	2,686	1,659	831	925	3,416	863	964	961	1,047	3,835	4,186	4,523
Transfers and subsidies	1,628	786	716	690	2,192	492	492	492	492	1,968	1,950	2,143
Purchases of goods and services	4,092	2,225	1,194	993	4,412	1,152	719	1,390	1,272	4,533	5,712	6,723
Social fund expenditure	3,376	1,717	1,051	1,192	3,961	941	1,000	1,186	1,345	4,472	5,005	5,522
Interest	1,818	476	331	613	1,420	223	574	235	555	1,588	2,127	2,066
Net lending	-311	-150	-131	-236	-517	-25	-30	-60	-457	-573	-350	-350
Capital expenditure (including PIP)	5,309	1,678	1,353	1,969	4,999	762	1,268	1,522	1,521	5,072	5,265	4,748
Domestically financed expenditure	897	131	103	485	719	100	165	198	198	662	765	791
Foreign financed PIP	4,412	1,547	1,250	1,483	4,281	662	1,103	1,323	1,323	4,410	4,500	3,957
Accrual surplus (+) / deficit (-)	-6,401	-1,789	-1,251	-1,119	-4,159	-1,101	-1,246	-1,198	-320	-3,865	-3,904	-2,549
Net Repayment/rescheduling of arrears	-427	-200	71	196	68	0	0	0	50	50	0	0
Cash surplus (+) / deficit (-)	-5,974	-1,589	-1,322	-1,316	-4,227	-1,101	-1,246	-1,198	-370	-3,915	-3,904	-2,549
Total financing	5,974	1,589	1,322	1,316	4,227	1,101	1,246	1,198	370	3,915	3,904	2,549
External financing, of which:	5,784	921	678	2,676	4,274	628	404	2,134	1,405	4,571	144	-308
Public investment program (PIP)	4,412	1,547	1,250	1,483	4,281	662	1,103	1,323	1,323	4,410	4,500	3,957
Disbursements (BOP support)	1,604	0	0	1,862	1,862	0	0	858	735	1,593	0	0
Total amortization	-1,621	-626	-572	-670	-1,868	-34	-699	-46	-653	-1,432	-4,356	-4,264
Arrears and rescheduling	1,389	0	0	0	0	0	0	0	0	0	0	0
Domestic financing	21	403	644	-2,298	-1,251	296	-149	-1,124	-1,785	-2,761	-1,309	-985
NBKR	-43	252	675	-2,350	-1,423	...	...	...	...	...	...	...
Other	64	151	-30	51	171	...	...	...	...	...	...	...
Exceptional Financing 2/	170	266	0	0	266	85	0	85	0	170	140	110
Financing Gap	0	0	0	938	938	91	991	103	750	1,935	4,928	3,731
Memorandum items:												
Primary surplus (+) / deficit (-) (w/o PIP)	256	434	259	781	1,474	-216	431	360	1,508	2,083	2,723	3,474
Primary surplus (+) / deficit (-) (incl. PIP)	-4,156	-1,113	-991	-703	-2,807	-878	-671	-963	185	-2,327	-1,777	-483
Quasi-Fiscal Deficit 3/	6,531	...	...	...	5,176	...	...	...	...	...	...	...

Source: Ministry of Finance and Fund staff projections.

1/ Excluding government contributions.

2/ Mainly privatization proceeds.

3/ In the electricity sector. The figure for 2001 corresponds to the first seven months

Table 3.1. Kyrgyz Republic: General Government Finances (concluded)
(In percent of annual GDP)

	2000	2001		2001	2002				2002	2003	2004	
		H1 prel.	Q3 proj.	Q4 prog.	Annual prog.	Q1 prog.	Q2 prog.	Q3 prog.	Q4 prog.			Annual prog.
Total revenue and grants	19.6	9.3	5.8	7.1	22.2	4.1	4.7	5.6	6.8	21.2	22.2	23.1
Total revenue	18.6	9.1	5.3	6.3	20.7	4.1	4.7	5.4	6.6	20.7	21.7	22.6
Total tax revenue	16.0	7.4	4.4	5.3	17.1	3.5	3.9	4.7	5.7	17.8	18.6	19.4
State taxes	12.3	5.7	3.3	4.0	13.0	2.7	3.1	3.6	4.5	13.8	14.6	15.4
Income tax	2.2	1.4	0.7	0.9	2.9	0.5	0.6	0.7	0.8	2.6	2.7	2.9
VAT	4.8	2.5	1.5	1.7	5.7	1.2	1.4	1.6	2.0	6.1	6.6	6.7
Excises	2.4	0.8	0.4	0.5	1.7	0.3	0.3	0.4	0.5	1.5	1.6	1.8
Customs	0.4	0.2	0.1	0.1	0.5	0.1	0.1	0.1	0.2	0.6	0.5	0.6
Road Tax	1.7	0.6	0.3	0.4	1.3	0.3	0.3	0.4	0.5	1.4	1.5	1.5
Other	0.8	0.3	0.3	0.4	0.9	0.3	0.4	0.4	0.5	1.6	1.7	1.8
Social Security Revenue 1/	3.7	1.7	1.1	1.3	4.1	0.8	0.8	1.1	1.2	3.9	4.0	4.0
Nontax revenue	2.6	1.7	0.9	0.9	3.4	0.7	0.7	0.7	0.9	3.0	3.0	3.1
Capital revenue	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Grants	1.0	0.2	0.5	0.8	1.5	0.0	0.0	0.3	0.2	0.5	0.6	0.5
Total expenditure	29.9	11.8	7.5	8.7	28.0	5.5	6.2	7.1	7.2	26.1	26.5	25.7
Current expenditure	21.9	9.7	5.8	6.2	21.7	4.6	4.7	5.3	5.9	20.4	21.1	21.2
Wages	4.3	2.3	1.2	1.3	4.8	1.1	1.2	1.2	1.3	4.8	4.7	4.6
Transfers and subsidies	2.6	1.1	1.0	1.0	3.1	0.6	0.6	0.6	0.6	2.5	2.2	2.2
Purchases of goods and services	6.6	3.1	1.7	1.4	6.2	1.4	0.9	1.7	1.6	5.7	6.3	6.8
Social fund expenditure	5.4	2.4	1.5	1.7	5.6	1.2	1.2	1.5	1.7	5.6	5.6	5.6
Interest	2.9	0.7	0.5	0.9	2.0	0.3	0.7	0.3	0.7	2.0	2.4	2.1
Net lending	-0.5	-0.2	-0.2	-0.3	-0.7	0.0	0.0	-0.1	-0.6	-0.7	-0.4	-0.4
Capital expenditure (including PIP)	8.5	2.4	1.9	2.8	7.1	0.9	1.6	1.9	1.9	6.3	5.9	4.8
Domestically financed expenditure	1.4	0.2	0.1	0.7	1.0	0.1	0.2	0.2	0.2	0.8	0.9	0.8
Foreign financed PIP	7.1	2.2	1.8	2.1	6.0	0.8	1.4	1.7	1.7	5.5	5.0	4.0
Accrual surplus (+) / deficit (-)	-10.3	-2.5	-1.8	-1.6	-5.9	-1.4	-1.6	-1.5	-0.4	-4.8	-4.3	-2.6
Net Repayment/rescheduling of arrears	-0.7	-0.3	0.1	0.3	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Cash surplus (+) / deficit (-)	-9.6	-2.2	-1.9	-1.9	-6.0	-1.4	-1.6	-1.5	-0.5	-4.9	-4.3	-2.6
Total financing	9.6	2.2	1.9	1.9	6.0	1.4	1.6	1.5	0.5	4.9	4.3	2.6
External financing, of which:	9.3	1.3	1.0	3.8	6.0	0.8	0.5	2.7	1.8	5.7	0.2	-0.3
Public investment program (PIP)	7.1	2.2	1.8	2.1	6.0	0.8	1.4	1.7	1.7	5.5	5.0	4.0
Disbursements (BOP support)	2.6	0.0	0.0	2.6	2.6	0.0	0.0	1.1	0.9	2.0	0.0	0.0
Total amortization	-2.6	-0.9	-0.8	-0.9	-2.6	0.0	-0.9	-0.1	-0.8	-1.8	-4.8	-4.3
Arrears and rescheduling	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	0.0	0.6	0.9	-3.2	-1.8	0.4	-0.2	-1.4	-2.2	-3.4	-1.5	-1.0
NBKR	-0.1	0.4	1.0	-3.3	-2.0	...	...	...	...	...	...	...
Other	0.1	0.2	0.0	0.1	0.2	...	...	...	...	...	...	...
Exceptional Financing 2/	0.3	0.4	0.0	0.0	0.4	0.1	0.0	0.1	0.0	0.2	0.2	0.1
Financing Gap	0.0	0.0	0.0	1.3	1.3	0.1	1.2	0.1	0.9	2.4	5.5	3.8
Memorandum items:	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary surplus (+) / deficit (-) (w/o PIP)	0.4	0.6	0.4	1.1	2.1	-0.3	0.5	0.4	1.9	2.6	3.0	3.5
Primary surplus (+) / deficit (-) (incl. PIP)	-6.7	-1.6	-1.4	-1.0	-4.0	-1.1	-0.8	-1.2	0.2	-2.9	-2.0	-0.5
Quasi-Fiscal Deficit 3/	10.5	...	...	...	7.3	...	...	...	...	...	...	...

Source: Ministry of Finance and Fund staff projections.

1/ Excluding government contributions.

2/ Mainly privatization proceeds.

3/ In the electricity sector. The figure for 2001 corresponds to the first seven months

Table 4. Kyrgyz Republic: State Government Finances
(In million of soms)

	2000		2001				2002				2003	2004
	H1 prel.	Q3 proj.	Q4 prog.	Annual prog.	Q1 prog.	Q2 prog.	Q3 prog.	Q4 prog.	Annual prog.	proj.	proj.	
Total revenue and grants	9,896	5,385	3,321	4,124	12,829	2,694	3,078	3,659	4,456	13,887	16,428	18,844
Total revenue	9,288	5,254	2,981	3,540	11,774	2,694	3,078	3,451	4,269	13,492	15,928	18,344
Tax revenue	7,676	4,063	2,342	2,844	9,250	2,154	2,498	2,876	3,576	11,104	13,154	15,234
Income tax	1,379	983	496	606	2,085	403	467	538	669	2,077	2,448	2,866
VAT	2,976	1,757	1,059	1,219	4,035	951	1,103	1,269	1,578	4,901	5,901	6,632
Excises	1,518	547	279	359	1,184	235	272	314	390	1,211	1,479	1,772
Customs	275	128	99	99	325	86	100	115	143	443	470	631
Road tax	1,059	440	225	285	951	225	261	301	374	1,162	1,366	1,502
Other	468	209	184	277	670	254	295	340	422	1,311	1,490	1,830
Nontax revenue	1,588	1,179	605	640	2,425	539	580	575	693	2,387	2,706	3,046
Capital revenue	24	12	33	55	100	1	0	0	0	1	68	64
Grants	608	131	340	584	1,055	0	0	208	187	395	500	500
Total expenditure	16,261	7,195	4,602	5,259	17,056	3,794	4,335	4,885	4,788	17,802	20,332	21,393
Current expenditure	11,263	5,666	3,381	3,527	12,574	3,058	3,097	3,423	3,725	13,303	15,417	16,994
Wages and Social Fund contributions	3,354	1,980	1,040	1,132	4,152	1,024	1,145	1,139	1,239	4,547	4,964	5,363
Transfers and subsidies 1/	2,000	985	815	790	2,590	659	659	659	659	2,636	2,614	2,842
Interest	1,818	476	331	613	1,420	223	574	235	555	1,588	2,127	2,066
Purchases of goods and services	4,092	2,225	1,194	993	4,412	1,152	719	1,390	1,272	4,533	5,712	6,723
Net lending	-311	-150	-131	-236	-517	-25	-30	-60	-457	-573	-350	-350
Capital expenditure (including PIP)	5,309	1,678	1,353	1,969	4,999	762	1,268	1,522	1,521	5,072	5,265	4,748
Domestically financed capital expenditure 2/	897	131	103	485	719	100	165	198	198	662	765	791
Foreign financed PIP	4,412	1,547	1,250	1,483	4,281	662	1,103	1,323	1,323	4,410	4,500	3,957
Accrual surplus (+) / deficit (-)	-6,365	-1,810	-1,282	-1,136	-4,227	-1,100	-1,257	-1,226	-332	-3,915	-3,904	-2,549
Net repayment of arrears	-334	-200	71	129	0	0	0	0	0	0	0	0
Cash surplus (+) / deficit (-)	-6,032	-1,610	-1,352	-1,264	-4,227	-1,100	-1,257	-1,226	-332	-3,915	-3,904	-2,549
Total financing	6,032	1,610	1,352	1,264	4,227	1,100	1,257	1,226	332	3,915	3,904	2,549
External financing	5,784	921	678	2,676	4,274	628	404	2,134	1,405	4,571	144	-308
Public investment program (PIP)	4,412	1,547	1,250	1,483	4,281	662	1,103	1,323	1,323	4,410	4,500	3,957
Disbursements (BOP support)	1,604	0	0	1,862	1,862	0	0	858	735	1,593	0	0
Total amortization	-1,621	-626	-572	-670	-1,868	-34	-699	-46	-653	-1,432	-4,356	-4,264
Arrears and rescheduling	1,389	0	0	0	0	0	0	0	0	0	0	0
Domestic financing	78	424	675	-2,350	-1,251	296	-138	-1,096	-1,823	-2,761	-1,309	-985
NBKR	-43	252	675	-2,350	-1,423	...	...	...	...	...	...	...
Others	122	172	0	0	172	...	...	...	...	...	...	...
Exceptional Financing 2/	170	266	0	0	266	85	0	85	0	170	140	110
Financing Gap	0	0	0	938	938	91	991	103	750	1,935	4,928	3,731
Memorandum items:												
Primary surplus (+) / deficit (-) (w/o PIP)	198	413	229	832	1,474	-216	420	333	1,546	2,083	2,723	3,474
Primary surplus (+) / deficit (-) (including PIP)	-4,214	-1,134	-1,021	-651	-2,807	-877	-682	-991	223	-2,327	-1,777	-483
Tax revenue collection in cash	7,375	4,017	2,296	2,787	...	4,942	7,440	10,316	...	...	...	...
Cumulative net foreign financing to the budget 3/	...	...	...	1,436	...	1,402	703	1,722	1,992	...	...	...

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ The following offset transactions were carried out in 2000, but were not included in the budget: in kind grants worth Som 244 million were received, of which Som 160 million were granted as allowances to the poor, and new housing facilities. Som 84 million were granted to the military. These transactions are shown in Q3, 2001.

2/ Mainly privatization proceeds.

3/ Consistent with the definition of net foreign financing as defined in the Technical Memorandum of Understanding.

Table 4.1. Kyrgyz Republic: State Government Finances (concluded)
(In percent of annual GDP)

	2000	2001				2002				2002	2003	2004
		H1 prel.	Q3 proj.	Q4 prog.	Annual prog.	Q1 prog.	Q2 prog.	Q3 prog.	Q4 prog.	Annual prog.	proj.	proj.
Total revenue and grants	15.9	7.6	4.7	5.8	18.1	3.4	3.8	4.6	5.6	17.3	18.3	19.0
Total revenue	14.9	7.4	4.2	5.0	16.6	3.4	3.8	4.3	5.3	16.8	17.7	18.5
Tax revenue	12.3	5.7	3.3	4.0	13.0	2.7	3.1	3.6	4.5	13.8	14.6	15.4
Income tax	2.2	1.4	0.7	0.9	2.9	0.5	0.6	0.7	0.8	2.6	2.7	2.9
VAT	4.8	2.5	1.5	1.7	5.7	1.2	1.4	1.6	2.0	6.1	6.6	6.7
Excises	2.4	0.8	0.4	0.5	1.7	0.3	0.3	0.4	0.5	1.5	1.6	1.8
Customs	0.4	0.2	0.1	0.1	0.5	0.1	0.1	0.1	0.2	0.6	0.5	0.6
Road tax	1.7	0.6	0.3	0.4	1.3	0.3	0.3	0.4	0.5	1.4	1.5	1.5
Other	0.8	0.3	0.3	0.4	0.9	0.3	0.4	0.4	0.5	1.6	1.7	1.8
Nontax revenue	2.6	1.7	0.9	0.9	3.4	0.7	0.7	0.7	0.9	3.0	3.0	3.1
Capital revenue	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Grants	1.0	0.2	0.5	0.8	1.5	0.0	0.0	0.3	0.2	0.5	0.6	0.5
Total expenditure	26.1	10.1	6.5	7.4	24.1	4.7	5.4	6.1	6.0	22.2	22.6	21.6
Current expenditure	18.1	8.0	4.8	5.0	17.7	3.8	3.9	4.3	4.6	16.6	17.1	17.2
Wages and Social Fund contributions	5.4	2.8	1.5	1.6	5.9	1.3	1.4	1.4	1.5	5.7	5.5	5.4
Transfers and subsidies 1/	3.2	1.4	1.1	1.1	3.7	0.8	0.8	0.8	0.8	3.3	2.9	2.9
Interest	2.9	0.7	0.5	0.9	2.0	0.3	0.7	0.3	0.7	2.0	2.4	2.1
Purchases of goods and services	6.6	3.1	1.7	1.4	6.2	1.4	0.9	1.7	1.6	5.7	6.3	6.8
Net lending	-0.5	-0.2	-0.2	-0.3	-0.7	0.0	0.0	-0.1	-0.6	-0.7	-0.4	-0.4
Capital expenditure (including PIP)	8.5	2.4	1.9	2.8	7.1	0.9	1.6	1.9	1.9	6.3	5.9	4.8
Domestically financed capital expenditure 2/	1.4	0.2	0.1	0.7	1.0	0.1	0.2	0.2	0.2	0.8	0.9	0.8
Foreign financed PIP	7.1	2.2	1.8	2.1	6.0	0.8	1.4	1.7	1.7	5.5	5.0	4.0
Accrual surplus (+) / deficit (-)	-10.2	-2.6	-1.8	-1.6	-6.0	-1.4	-1.6	-1.5	-0.4	-4.9	-4.3	-2.6
Net repayment of arrears	-0.5	-0.3	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash surplus (+) / deficit (-)	-9.7	-2.3	-1.9	-1.8	-6.0	-1.4	-1.6	-1.5	-0.4	-4.9	-4.3	-2.6
Total financing	9.7	2.3	1.9	1.8	6.0	1.4	1.6	1.5	0.4	4.9	4.3	2.6
External financing	9.3	1.3	1.0	3.8	6.0	0.8	0.5	2.7	1.8	5.7	0.2	-0.3
Public investment program (PIP)	7.1	2.2	1.8	2.1	6.0	0.8	1.4	1.7	1.7	5.5	5.0	4.0
Disbursements (BOP support)	2.6	0.0	0.0	2.6	2.6	0.0	0.0	1.1	0.9	2.0	0.0	0.0
Total amortization	-2.6	-0.9	-0.8	-0.9	-2.6	0.0	-0.9	-0.1	-0.8	-1.8	-4.8	-4.3
Arrears and rescheduling	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	0.1	0.6	1.0	-3.3	-1.8	0.4	-0.2	-1.4	-2.3	-3.4	-1.5	-1.0
NBKR	-0.1	0.4	1.0	-3.3	-2.0	...	...	...	...	...	...	...
Others	0.2	0.2	0.0	0.0	0.2	...	...	...	...	...	...	...
Exceptional Financing 2/	0.3	0.4	0.0	0.0	0.4	0.1	0.0	0.1	0.0	0.2	0.2	0.1
Financing Gap	0.0	0.0	0.0	1.3	1.3	0.1	1.2	0.1	0.9	2.4	5.5	3.8
Memorandum items:												
Primary surplus (+) / deficit (-) (w/o PIP)	0.3	0.6	0.3	1.2	2.1	-0.3	0.5	0.4	1.9	2.6	3.0	3.5
Primary surplus (+) / deficit (-) (including PIP)	-6.8	-1.6	-1.4	-0.9	-4.0	-1.1	-0.9	-1.2	0.3	-2.9	-2.0	-0.5
Tax revenue collection in cash	11.9	5.7	3.2	3.9	...	6.2	9.3	12.9	...	...	...	...
Cumulative net foreign financing to the budget 3/	...	...	...	2.0	...	1.7	0.9	2.1	2.5	...	...	...

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ The following offset transactions were carried out in 2000, but were not included in the budget: in kind grants worth Som 244 million were received, of which Som 160 million were granted as allowances to the poor, and new housing facilities. Som 84 million were granted to the military. These transactions are shown in Q3, 2001.

2/ Mainly privatization proceeds.

3/ Consistent with the definition of net foreign financing as defined in the Technical Memorandum of Understanding.

Table 5. Kyrgyz Republic: Social Fund
(In million soms)

	2000	2001				2002				2003 proj.	2004 proj.	
		H1 prel.	Q3 proj.	Q4 prog.	Annual prog.	Q1 prog.	Q2 prog.	Q3 prog.	Q4 prog.			Annual prog.
Total revenues	3375	1759	1094	1224	4077	951	1022	1228	1373	4574	5061	5583
Total contributions received	2971	1526	970	1095	3591	784	849	1037	1172	3843	4321	4796
of which contributions from the government	703	342	221	221	785	172	192	191	208	764	835	902
Total transfers from State budget	372	199	99	100	398	167	167	167	167	667	664	699
Other revenue	32	34	26	28	89	16	16	16	16	64	76	89
Total expenditures	3410	1738	1064	1207	4010	952	1011	1200	1360	4524	5061	5583
Pension Fund	2978	1589	927	1009	3525	882	919	1051	1144	3996	4495	4986
of which wages	34	21	13	15	49	11	11	14	16	52	57	62
Social Insurance Fund	128	63	44	54	161	29	37	46	56	168	180	190
Employment Fund	122	36	39	70	145	18	21	43	77	158	170	179
Medical Insurance Fund	89	50	54	75	179	23	33	61	84	201	216	228
Net Accumulation of Arrears	93	0	0	0	0	0	0	0	0	0	0	0
Accrual surplus(+)/ deficit (-)	-35	21	30	16	68	-1	11	27	12	50	0	0
Net Accumulation (+) Repayment (-) of arrears	93	0	0	-68	-68	0	0	0	-50	-50	0	0
Cash surplus(+)/ deficit (-)	58	21	30	-51	0	-1	11	27	-38	0	0	0
In percent of annual GDP												
Total revenues	5.4	2.5	1.5	1.7	5.8	1.2	1.3	1.5	1.7	5.7	5.6	5.6
Total contributions received	4.8	2.2	1.4	1.5	5.1	1.0	1.1	1.3	1.5	4.8	4.8	4.8
of which contributions from the government	1.1	0.5	0.3	0.3	1.1	0.2	0.2	0.2	0.3	1.0	0.9	0.9
Total transfers from State budget	0.6	0.3	0.1	0.1	0.6	0.2	0.2	0.2	0.2	0.8	0.7	0.7
Other revenue	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Total expenditures	5.5	2.5	1.5	1.7	5.7	1.2	1.3	1.5	1.7	5.6	5.6	5.6
Pension Fund	4.8	2.2	1.3	1.4	5.0	1.1	1.1	1.3	1.4	5.0	5.0	5.0
of which wages	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Social Insurance Fund	0.2	0.1	0.1	0.1	0.2	0.0	0.0	0.1	0.1	0.2	0.2	0.2
Employment Fund	0.2	0.1	0.1	0.1	0.2	0.0	0.0	0.1	0.1	0.2	0.2	0.2
Medical Insurance Fund	0.1	0.1	0.1	0.1	0.3	0.0	0.0	0.1	0.1	0.3	0.2	0.2
Net Accumulation of Arrears	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Accrual surplus(+)/ deficit (-)	-0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0
Net Accumulation (+) Repayment (-) of arrears	0.1	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0
Cash surplus(+)/ deficit (-)	0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

Table 6. Medium Term Expenditure Framework for General Budget (excluding PIP)
by Functional Classification
(As percent of GDP)

	2000 Actual	2001 prog.	2002 prog.	2003 proj.	2004 proj.	2005 proj.
Total Expenditure of General Government	22.8	22.0	20.6	21.5	21.7	21.5
I. General public services	3.2	3.0	2.7	2.7	2.7	2.6
II. Defense	1.9	1.5	1.5	1.5	1.5	1.5
III. Public order and safety affairs	1.2	1.2	0.9	1.0	1.0	1.0
Social Spending	13.1	13.3	13.1	13.4	13.5	13.6
IV. Education	3.7	3.7	3.7	3.8	3.8	3.8
V. Health	2.1	2.1	2.1	2.2	2.2	2.2
VI. Social security and welfare affairs	1.8	1.8	1.8	1.8	1.9	1.9
VII. Social Fund	5.5	5.7	5.6	5.6	5.6	5.7
VIII. Housing and community services	1.1	1.0	0.7	0.8	0.8	0.8
IX. Recreational, cultural and religious activities	0.5	0.5	0.4	0.4	0.4	0.4
X. Energy complex (electricity production)	0.0	0.0	0.0	0.0	0.0	0.0
XI. Agriculture, water resources, forestry	0.8	0.7	0.5	0.5	0.5	0.6
XII. Mining and mineral resources	0.1	0.1	0.1	0.1	0.1	0.1
XIII. Transportation and communication	0.7	0.7	0.6	0.6	0.6	0.6
XIV. Other economic affairs and services	0.2	0.2	0.1	0.1	0.1	0.1

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

Table 7. Kyrgyz Republic: NBKR Accounts, 2000–2002
(In millions of soms, end-of-period stocks)

	2000 1/	2001						2002 2/			
	Dec Act.	Mar Act. 1/	Jun. Act. 1/	Jun. Act. 2/	Sep. Prel. 2/	Oct. P.A. 2/	Dec. Prog. 2/	Mar. Prog.	Jun. Prog.	Sep. Prog.	Dec. Proj.
Net foreign assets (NFA)	3,590	3,160	2,734	2,926	2,854	3,473	3,642	3,215	1,623	2,760	2,229
Net international reserves 3/	756	382	330	604	376	995	1,164	737	370	1,507	977
Claims on other BRO countries	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51
Medium-term NBKR liabilities	-2,677	-2,677	-2,671	-2,592	-2,718	-2,718	-2,718	-2,718	-2,718	-2,718	-2,718
Net domestic assets (NDA)	3,901	4,137	4,200	3,928	4,873	4,282	4,134	4,357	5,867	5,367	5,954
Credit to state government, net	3,870	4,158	4,023	3,973	4,698	4,000	2,760	3,056	2,579	2,082	1,593
Direct credits	0	0	0	0	0	0	0	0	0	0	0
Budget account deposits	-1,091	-773	-841	-829	-283	-981	-2,221	-1,925	-2,403	-2,899	-3,478
in foreign currency	...	...	...	-381	-125	-725	-2,071	-1,775	-1,703	-2,399	-2,728
of which: ADB	...	...	...	0	0	-617	-1,572	-1,371	-1,300	-2,049	-2,038
IDA	...	...	...	-5	-7	-7	-399	-304	-303	-250	-600
Government bonds 4/	2,891	2,860	2,793	2,793	2,846	2,846	2,846	2,846	2,846	2,846	2,936
Treasury bills (actual value)	-161	-152	-147	-147	-143	-144	-147	-147	-147	-147	-237
Turkish loan onlending	2,071	2,071	2,071	2,009	2,135	2,135	2,135	2,135	2,135	2,135	2,135
Credit to other government, net	0	0	0	0	0	0	0	0	0	0	0
Credit to banks	628	517	510	498	495	495	495	495	544	544	544
Of which:											
EBRD credit line	483	373	382	371	367	367	367	367	367	367	367
Other items, net 5/	-597	-538	-333	-544	-320	-213	879	806	2,745	2,741	3,817
Reserve money	4,813	4,619	4,262	4,262	5,010	5,037	5,058	4,854	4,772	5,409	5,465
Currency in circulation	4,115	3,903	3,999	3,999	4,673	...	...	...	...	...	...
Bank deposits	699	716	264	263	336	...	...	...	...	...	...
in foreign currency	272	153	22	21	10	...	...	...	...	...	...
Memorandum items:											
NIR (in U.S. dollars)	15.0	7.6	6.5	12.3	7.7	20.3	23.8	15.0	7.6	30.8	19.9
Gross Reserves (in U.S. dollars)	205.5	194.0	188.0	193.8	181.0	...	212.4	198.8	200.5	218.9	210.0
in months of imports	3.7	3.4	0.0	0.0	3.3	...	3.9	3.4	3.4	3.8	3.6
Cumulative net for. financing (in som)	...	...	...	...	0.0	846.7	1,425.3	1,391.8	105.9	1,125.0	1,394.1
Cash Grants	...	...	0.0	0.0	207.8	0.0	243.6	243.6	243.6	451.4	638.4
Disbursements: BoP Sup loans	...	...	0.0	0.0	0.0	857.5	1,862.0	1,862.0	1,862.0	2,719.5	3,454.5
Amortization	...	...	0.0	0.0	0.0	10.8	680.3	713.8	1,999.7	2,046.0	2,698.8
MOF	...	...	0.0	0.0	0.0	0.0	669.6	703.1	1,402.1	1,448.4	2,101.2
NBKR (w/o payments to IMF)	...	...	0.0	0.0	0.0	10.8	10.8	10.8	597.6	597.6	597.6
MLT liabilities of NBKR (in U.S. doll	-53.0	-53.0	-52.9	-52.9	-55.5	-55.5	-55.5	-55.5	-55.5	-55.5	-55.5
Annual growth rate of:											
Reserve money	19.0	...	...	-2.3	5.2	...	5.1	5.1	12.0	8.0	8.1
Exchange rate	50.5	50.5	50.5	49.0	49.0	...	...	...	...	...	...

Sources: National Bank of the Kyrgyz Republic; and Fund staff estimates and projections.

1/ Foreign exchange assets and liabilities are valued at 50.5 soms per US dollar, 1.306 U.S. dollar per SDR and a gold price of US\$ 275.0 per Troy ounce.

2/ Foreign exchange assets and liabilities are valued at the (new) program rate of 49 soms per US dollar, 1.259 U.S. dollar per SDR and a gold price of US\$ 265.0 per Troy ounce.

3/ From December 1999, gross reserves exclude international reserves of the NBKR that are pledged or blocked.

4/ Reflects the acquisition of government bonds by the NBKR as part of the restructuring of the financial sector, leading to a corresponding reduction in credit to the economy.

5/ Includes Repo operations

Table 8. Kyrgyz Republic: Monetary Survey, 2000–2002
(In millions of soms, end-of-period stocks)

	2000 1/	2001						2002 2/			
	Dec. Act	Mar Act. 1/	Jun. Act. 1/	Jun. Act. 2/	Sep. Prel. 2/	Oct. P.A. 2/	Dec. Prog. 2/	Mar. Prog.	Jun. Prog.	Sep. Prog.	Dec. Proj.
Net foreign assets (NFA)	4,345	3,964	3,664	3,829	4,335	4,953	5,299	4,837	3,916	4,618	4,131
NFA of com. Banks	755	804	931	903	1,480	1,480	1,657	1,623	2,294	1,858	1,902
Medium-term NBKR liabilities	-2,677	-2,677	-2,671	-2,592	-2,718	-2,718	-2,718	-2,718	-2,718	-2,718	-2,718
Net domestic assets (NDA)	5,799	5,894	6,056	5,754	6,028	5,476	5,216	6,011	6,907	6,702	7,347
Credit to state government, net	4,045	4,250	4,375	4,327	5,051	4,353	3,113	3,409	2,932	2,435	1,946
Credit from the NBKR	3,870	4,158	4,023	3,973	4,698	4,000	2,760	3,056	2,579	2,082	1,593
Credit from commercial banks	175	92	353	354	353	353	353	353	353	353	353
Credit to other government, net	0	0	0	0	0	0	0	0	0	0	0
Credit to rest of the economy	2,761	2,807	2,827	2,765	2,724	2,870	2,912	3,319	3,705	3,895	4,273
Other items, net	-985	-1,162	-1,147	-1,338	-1,747	-1,747	-809	-717	271	372	1,128
Broad money	7,467	7,181	7,049	6,991	7,645	7,711	7,797	8,130	8,106	8,602	8,760
Som Broad money	5,288	5,179	5,111	5,111	5,753	5,816	5,897	6,191	6,006	6,522	6,610
Currency outside banks	4,114	3,902	3,997	3,997	4,659	4,408	4,751	4,954	4,939	5,242	5,338
Deposits	3,353	3,279	3,053	2,995	2,987	3,303	3,046	3,176	3,167	3,360	3,422
Som deposits	1,173	1,276	1,115	1,115	1,094	1,408	1,146	1,237	1,067	1,280	1,272
Foreign currency deposits	2,179	2,002	1,938	1,880	1,893	1,895	1,900	1,939	2,100	2,080	2,150
Memorandum items:											
Velocity (quarterly)	10.2	7.4	...	8.9	11.6	...	11.2	7.4	8.4	11.2	10.8
Velocity (quar) som component	14.3	10.2		12.2	15.4	...	14.8	9.8	11.3	14.8	14.3
Annual growth rate of:											
Broad money	11.8	...	0.3	0.3	-0.1	...	3.0	10.8	15.9	12.5	12.4
Broad money som component	11.3		0.6	0.6	1.7	...	6.0	15.0	17.5	13.4	12.1
Money multiplier	1.6	1.6	1.7	1.6	1.5	1.5	1.5	1.7	1.7	1.6	1.6
Som Money multiplier	1.1	1.1	1.2	1.2	1.1	1.2	1.2	1.3	1.3	1.2	1.2
Reverse Repos (accrual basis)	177.5	134.5	69.0	69.0	0.0	-66.0	-220.0	-55.0	-395.0	-290.0	-610.0
Exchange rate	50.5	50.5	50.5	49.0	49.0	49.0	...	...	...	...	...

Sources: National Bank of the Kyrgyz Republic; and Fund staff estimates and projections.

1/ Foreign exchange assets and liabilities are valued at 50.5 soms per dollar, 1.306 US dollar per SDR and gold price US\$ 275.0 per Troy ounce

2/ Foreign exchange assets and liabilities are valued at the (new) program exchange rate of 49 soms per dollar, 1.259 US dollar per SDR and gold price US\$ 265.0 per Troy ounce

3/ From December 1999, gross reserves exclude international reserves of the NBKR that are pledged or blocked.

Table 9. Kyrgyz Republic: Quarterly Balance of Payments: 1999–2002
(In millions of U.S. dollars)

	1999	2000	2001	2001	2001	2001	2001	2002	2002	2002	2002	2002
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
	Act.	Act.	Prov.	Prov.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-194.8	-103.1	5.2	-12.8	-30.8	-51.4	-89.8	-56.9	0.7	-18.2	-28.7	-103.1
(excluding official transfers)	-268.8	-193.7	-3.5	-27.5	-49.4	-70.6	-151.0	-66.8	-13.8	-32.3	-47.1	-160.0
Trade balance	-84.4	8.8	23.2	14.2	-13.3	-25.3	-1.2	-23.4	20.0	-4.7	-3.2	-11.3
Exports, fob	462.6	510.9	115.2	109.5	128.6	129.4	482.7	105.4	136.6	132.4	121.7	496.2
CIS countries	191.5	213.7	35.7	44.2	61.0	44.8	185.7	32.4	63.6	59.4	48.6	203.9
Energy	53.1	82.0	2.5	14.0	32.1	1.7	50.3	4.3	16.8	16.8	10.1	48.1
Other	138.4	131.7	33.2	30.2	28.9	43.1	135.4	28.0	46.7	54.5	26.5	155.8
Non-CIS	271.0	297.2	79.5	65.3	67.6	84.6	297.0	73.1	73.1	73.1	73.1	292.3
Gold	183.1	195.3	61.1	49.2	45.9	57.1	213.3	49.0	49.0	49.0	49.0	195.9
Imports, fob	546.9	502.1	92.0	95.3	141.9	154.8	483.9	128.9	116.7	137.1	124.9	507.5
CIS countries	244.6	275.0	54.5	47.8	76.5	90.2	269.0	70.1	58.0	78.4	66.2	272.7
Energy	109.0	115.7	28.5	20.5	29.9	36.7	115.6	36.4	19.2	19.2	29.3	104.1
Other	135.6	159.3	26.0	27.3	46.6	53.5	153.4	33.7	38.8	47.2	48.9	168.6
Non-CIS	302.4	227.1	37.5	47.5	65.4	64.6	214.9	58.7	58.7	58.7	58.7	234.8
Services (net)	-163.4	-176.3	-22.2	-33.3	-28.8	-39.3	-123.5	-37.9	-27.8	-22.2	-37.9	-125.7
Non-interest service	-89.4	-87.0	-14.9	-14.9	-18.6	-18.6	-67.0	-29.3	-9.2	-12.2	-20.3	-71.0
Interest payments (scheduled)	-67.3	-50.9	-5.7	-12.6	-8.6	-14.3	-41.1	-4.5	-14.6	-6.0	-13.5	-38.7
Other net income	-6.7	-38.5	-1.6	-5.8	-1.6	-6.4	-15.4	-4.0	-4.0	-4.0	-4.0	-16.0
Transfers (net)	52.9	64.4	4.2	6.3	11.2	13.2	34.9	4.4	8.5	8.6	12.3	33.9
Official	73.9	90.5	8.7	14.7	18.6	19.2	61.2	9.9	14.5	14.1	18.3	56.9
Private	-21.0	-26.1	-4.5	-8.4	-7.4	-6.0	-26.3	-5.5	-6.0	-5.5	-6.0	-23.0
Capital account balance	220.2	81.0	10.5	-19.4	8.9	10.4	10.4	46.3	-39.9	21.8	-5.8	22.4
Commercial banks	-4.6	-1.9	-1.0	-2.5	-11.7	-3.6	-18.8	0.7	-13.7	8.9	-0.9	-5.0
Medium-and long-term loans, net	133.3	36.1	10.6	-11.4	13.0	-14.5	-2.3	6.6	-27.8	11.7	2.2	-7.5
Disbursement	196.6	131.7	15.9	24.9	25.9	28.4	95.1	18.0	28.5	14.0	34.5	95.0
CIS	8.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-CIS	188.1	131.7	15.9	24.9	25.9	28.4	95.1	18.0	28.5	14.0	34.5	95.0
Of which PIP	118.1	92.3	11.6	20.4	25.5	30.3	87.7	13.5	22.5	27.0	27.0	90.0
Amortization (scheduled)	-63.3	-95.7	-5.3	-36.3	-12.9	-42.9	-97.4	-11.4	-56.3	-2.3	-32.3	-102.5
CIS	-1.5	-13.2	-0.3	-0.3	-10.9	-10.9	-22.4	-0.3	-0.3	-0.3	-0.3	-1.4
Non-CIS	-61.8	-82.5	-5.0	-36.0	-2.0	-32.0	-75.0	-11.1	-56.0	-2.0	-32.0	-101.1
Of which Kumtor	-49.3	-59.9	0.0	-25.3	0.0	-24.0	-49.3	0.0	-25.3	0.0	-24.0	-49.3
Foreign direct investment	38.4	28.5	10.9	4.5	19.4	0.5	35.3	38.8	1.4	1.0	-7.4	33.8
Other assets (including acc. pay. & receiv.)	53.1	18.3	-10.0	-10.0	-11.8	28.0	-3.8	0.3	0.3	0.3	0.3	1.1
Errors and omissions & short term capital	-7.2	7.0	-22.5	31.1	17.2	0.0	25.8	0.0	0.0	0.0	0.0	0.0
Overall balance	18.2	-15.1	-6.8	-1.1	-4.7	-41.0	-53.6	-10.6	-39.2	3.6	-34.6	-80.8
Financing	-18.2	15.1	6.8	1.1	4.7	21.9	34.5	8.7	7.5	-5.7	25.8	36.3
NIR	-41.7	-13.9	7.4	1.1	4.7	-16.1	-2.9	8.7	7.5	-23.2	10.8	3.8
Gross official reserves (- increase) 1/	-61.2	-21.2	10.3	6.6	7.6	-29.4	-4.9	13.6	-1.7	-18.3	3.6	-2.9
IMF (net)	19.5	7.3	-2.9	-5.5	-2.9	9.3	-2.0	-4.9	9.2	-4.9	7.2	6.7
Purchases and disbursements	26.8	18.7	0.0	0.0	0.0	14.8	14.8	0.0	14.7	0.0	14.7	29.4
Repurchases and repayments	-7.3	-11.4	-2.9	-5.5	-2.9	-5.5	-16.8	-4.9	-5.5	-4.9	-7.5	-22.7
Exceptional Financing (including arrears)	23.7	29.1	-0.6	0.0	0.0	38.0	37.4	0.0	0.0	17.5	15.0	32.5
Accumulation of arrears (net)	23.7	-0.2	-0.6	0.0	0.0	0.0	-0.6	0.0	0.0	0.0	0.0	0.0
Debt conversion or rescheduling	0.0	29.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BOP support loans (ADB) 2/			0.0	0.0	0.0	30.0	30.0	0.0	0.0	17.5	0.0	17.5
BOP support loans (WB) 2/			0.0	0.0	0.0	8.0	8.0	0.0	0.0	0.0	15.0	15.0
Financing gap (-) (after fiscal measures)	0.0	0.0	0.0	0.0	0.0	-19.1	-19.1	-1.9	-31.7	-2.1	-8.8	-44.5
Memorandum Items												
Gross reserves in months of imports			3.6	3.5	3.4	3.9		3.4	3.5	3.8	3.7	

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Valued at end-year exchange rates. Gross reserves exclude NBKR pledges to secure government-guaranteed loans and blocked deposits.

2/ BOP support loans for 1999 and 2000 are shown as part of disbursements under capital account.

Table 10: Kyrgyz Republic: External Financing Requirements: 1999–2004
(In millions of U.S. dollars)

	1999 Actual	2000 Actual	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.
1. Gross Financing requirements	400.6	322.2	270.8	288.1	341.7	316.7
External current account deficit (excluding official transfers)	268.8	193.7	151.0	160.0	173.5	173.6
Debt Amortization	63.3	95.7	97.4	102.5	138.2	114.1
Repayment of Arrears	0.0	0.2	0.6	0.0	0.0	0.0
Gross Reserves	61.2	21.2	4.9	2.9	2.1	1.2
IMF repurchases and repayments	7.3	11.4	16.8	22.7	27.9	27.8
2. Available financing	400.6	322.2	251.7	243.6	241.1	240.6
Foreign Direct Investment	38.4	28.5	35.3	33.8	56.0	58.0
Medium and long term loans	196.6	131.7	95.1	95.0	97.8	90.8
Balance of payments Support 1/	...	...	38.0	32.5	0.0	0.0
World Bank	...	...	8.0	15.0	0.0	0.0
AsDB	...	...	30.0	17.5	0.0	0.0
IMF purchases	26.8	18.7	14.8	29.4	24.0	24.0
Accumulation of Arrears	23.7	0.0	0.0	0.0	0.0	0.0
Debt Rescheduling	0.0	29.3	0.0	0.0	0.0	0.0
Other flows 2/	115.2	114.0	68.5	52.9	63.3	67.8
3. Financing gap	0.0	0.0	-19.1	-44.5	-100.6	-76.1

Source: Kyrgyz authorities and Fund staff estimates and projections.

1/ BOP support loans for 1999-2000 are shown as part of official disbursements.

2/ Includes official transfers, errors and omissions, capital account transactions of commercial banks and other assets.

Table 11. Kyrgyz Republic: Medium-Term Balance of Payments, 1998-2010
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
		Prel. est.						Projection				
Current account balance 1/	-194.8	-103.1	-89.8	-103.1	-118.7	-108.8	-102.3	-114.4	-113.1	-121.5	-136.5	-148.1
Trade balance	-84.4	8.8	-1.2	-11.3	-24.2	-36.3	-19.8	-19.3	-39.9	-69.5	-97.4	-124.3
Exports, fob	462.6	510.9	482.7	496.2	513.2	526.2	569.7	607.8	648.4	688.5	742.6	805.6
CIS countries	191.5	213.7	185.7	203.9	222.4	244.2	266.8	291.0	319.5	352.5	388.9	429.0
Other countries	271.0	297.2	297.0	292.3	290.9	282.0	302.8	316.8	328.8	336.0	353.7	376.6
Of which : Gold	183.1	195.3	213.3	195.9	185.4	166.5	178.8	173.2	151.6	100.1	62.0	46.9
Imports, fob	546.9	502.1	483.9	507.5	537.5	562.5	589.4	627.1	688.3	758.0	840.0	929.9
CIS countries	244.6	275.0	269.0	272.7	286.2	310.2	335.7	360.7	407.0	458.0	515.5	579.9
Other countries	302.4	227.1	214.9	234.8	251.3	252.3	253.7	266.4	281.3	300.1	324.6	350.0
Services (net)	-163.4	-176.3	-123.5	-125.7	-134.3	-122.3	-117.3	-109.9	-88.0	-76.8	-63.9	-48.6
Non-interest service	-89.4	-87.0	-67.0	-71.0	-79.4	-75.0	-70.4	-65.8	-61.8	-51.6	-39.5	-25.4
Receipts	64.9	61.8	65.7	68.1	70.9	73.3	83.6	95.2	109.3	126.3	148.7	177.0
Payments	-154.3	-148.8	-132.7	-139.0	-150.3	-148.3	-154.0	-160.9	-171.1	-177.9	-188.1	-202.4
Interest payments (scheduled)	-67.3	-50.9	-41.1	-38.7	-44.8	-39.3	-36.9	-34.1	-31.2	-30.2	-29.4	-28.2
Other net income	-6.7	-38.5	-15.4	-16.0	-10.0	-8.0	-10.0	-10.0	5.0	5.0	5.0	5.0
Transfers (net)	52.9	64.4	34.9	33.9	39.8	49.8	34.8	14.8	14.8	24.8	24.8	24.8
Capital account balance	220.2	81.0	10.4	22.4	24.1	37.7	72.1	77.5	100.0	111.8	125.4	131.3
Commercial banks	-4.6	-1.9	-18.8	-5.0	5.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium-and long-term loans, net	133.3	36.1	-2.3	-7.5	-40.4	-23.3	12.1	9.5	24.7	14.8	18.4	33.3
Disbursement	196.6	131.7	95.1	95.0	97.8	90.8	106.4	82.0	84.0	89.0	97.0	105.0
Amortization (scheduled)	-63.3	-95.7	-97.4	-102.5	-138.2	-114.1	-94.4	-72.5	-59.3	-74.2	-78.6	-71.7
Foreign direct investment	38.4	28.5	35.3	33.8	56.0	58.0	58.0	66.0	73.3	95.0	105.0	96.0
Other assets (including accounts payable and receivable)	53.1	18.3	-3.8	1.1	3.5	3.0	2.0	2.0	2.0	2.0	2.0	2.0
Errors and omissions and short term capital	-7.2	7.0	25.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	18.2	-15.1	-53.6	-80.8	-94.6	-71.1	-30.2	-36.9	-13.2	-9.7	-11.2	-16.8
Financing	-18.1	15.1	34.5	36.3	-6.0	-5.0	-49.0	-47.0	-47.0	-45.0	-45.0	-43.4
Net international reserves	-41.7	-13.9	-2.9	3.8	-6.0	-5.0	-49.0	-47.0	-47.0	-45.0	-45.0	-43.4
Gross official reserves (- increase)	-61.2	-21.2	-4.9	-2.9	-2.1	-1.2	-22.3	-23.3	-22.1	-24.9	-30.3	-31.9
IMF (net)	19.5	7.3	-2.0	6.7	-3.9	-3.8	-26.7	-23.7	-24.9	-20.1	-14.7	-11.5
Purchases and disbursements	26.8	18.7	14.8	29.4	24.0	24.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases and repayments	-7.3	-11.4	-16.8	-22.7	-27.9	-27.8	-26.7	-23.7	-24.9	-20.1	-14.7	-11.5
Exceptional Financing (including arrears)	23.7	29.1	37.4	32.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of Arrears (net)	23.7	-0.2	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt conversion or rescheduling	0.0	29.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BOP support loans (ADB) 2/			30.0	17.5	...	...	...	...	...	...	...	...
BOP support loans (WB) 2/			8.0	15.0	...	...	...	...	...	...	...	...
Financing gap (-)	0.0	0.0	-19.1	-44.5	-100.6	-76.1	-79.2	-83.9	-60.2	-54.7	-56.2	-60.2
Memorandum items:												
GDP (in millions of U.S. dollars)	1243	1302	1447	1637	1837	2019	2214	2426	2656	2907	3184	3488
Current account balance (in percent of GDP)	-15.7	-7.9	-6.2	-6.3	-6.5	-5.4	-4.6	-4.7	-4.3	-4.2	-4.3	-4.2
Growth of exports of goods (volume)	-4.7%	8.8%	-6.5%	2.6%	3.9%	0.5%	6.2%	5.1%	4.9%	4.2%	5.8%	6.4%
Growth of imports of goods (volume)	-17.9%	-16.8%	-6.4%	3.5%	7.8%	3.2%	4.3%	5.0%	7.6%	7.9%	8.6%	8%
External public debt (in millions of U.S. dollars)3/	1677.0	1723.9	1808.6	1879.8	1906.7	1925.1	1963.3	2031.1	2092.8	2124.3	2178.2	2252.6
as percent of GDP	135%	132%	125%	115%	104%	95%	89%	84%	79%	73%	68%	65%
External public debt 4/	1358.6	1520.3	1657.2	1780.4	1859.4	1899.9	1947.0	2014.8	2076.5	2124.3	2178.2	2252.6
Gross reserves 5/	184.3	205.5	210.4	213.3	215.4	216.5	238.9	262.2	284.3	309.2	339.5	371.4
In months of subsequent year's imports	3.4	4.0	3.9	3.7	3.6	3.5	3.6	3.7	3.6	3.6	3.6	3.6
In percent of short term debt by remaining maturity	172.1	179.9	168.1	128.4	151.7	179.0	248.4	311.3	301.5	331.3	407.9	446.2
Financing gap as percentage of GDP	0.0	0.0	-1.3	-2.7	-5.5	-3.8	-3.6	-3.5	-2.3	-1.9	-1.8	-1.7

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Including transfers.

2/ BOP support loans for 1998-2000 are shown as part of disbursements under capital account.

3/ Public and publicly guaranteed debt.

4/ Public and publicly guaranteed debt excluding Kumtor-related debt.

5/ Valued at end-year exchange rates. Gross reserves exclude NBKR pledges to secure government-guaranteed loans and blocked deposits.

Table 12. Kyrgyz Republic: External Payments Capacity, 1999–2006
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006
		Prel.			Projections			
I. Non-interest current account	-180.4	-116.6	-83.6	-98.3	-113.7	-119.3	-100.2	-95.1
Exports	462.6	510.9	482.7	496.2	513.2	526.2	569.7	607.8
Imports	-546.9	-502.1	-483.9	-507.5	-537.5	-562.5	-589.4	-627.1
Service credit	64.9	61.8	65.7	68.1	70.9	73.3	83.6	95.2
Service debit (excluding interest payments)	-161.0	-187.3	-148.1	-155.0	-160.3	-156.3	-164.0	-170.9
II. Transfers and capital account	355.9	266.7	187.4	188.1	226.1	225.6	201.2	164.8
Private transfers	-21.0	-26.1	-26.3	-23.0	-15.0	-15.0	-5.0	-5.0
Official transfers	73.9	90.5	61.2	56.9	54.8	64.8	39.8	19.8
Official disbursements	223.3	150.3	109.9	124.4	121.8	114.8	106.4	82.0
Multilateral	120.1	102.7	119.5	108.2	83.5	90.0	76.4	87.0
IMF	26.8	18.7	14.8	29.4	24.0	24.0	0.0	0.0
World Bank	22.7	52.6	29.3	38.5	40.4	58.8	39.8	43.0
ADB	47.8	18.7	54.2	40.9	33.1	23.6	30.0	43.0
EBRD	17.9	6.9	4.8	2.2	2.0	2.2	4.1	0.0
Others (including gap financing)	4.9	5.8	35.6	41.7	84.5	57.5	81.7	84.9
Bilateral	103.2	47.6	22.7	25.1	22.9	14.2	4.8	6.9
Identified	103.2	47.6	22.7	25.1	22.9	14.2	4.8	6.9
Others (including gap financing)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Guaranteed	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-guaranteed	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment	38.4	28.5	35.3	33.8	56.0	58.0	58.0	66.0
Others	38.4	28.5	35.3	33.8	56.0	58.0	58.0	66.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other net capital	41.4	23.5	7.3	-4.0	8.5	3.0	2.0	2.0
III. Exceptional financing (including arrears)	23.7	29.1	37.4	32.5	0.0	0.0	0.0	0.0
Accumulation of Arrears (net)	23.7	-0.2	-0.6	0.0	0.0	0.0	0.0	0.0
Debt conversion or rescheduling	0.0	29.3	0.0	0.0	0.0	0.0	0.0	0.0
BOP support loans (ADB) 1/			30.0	17.5	...	...	...	...
BOP support loans (WB) 1/			8.0	15.0	...	...	...	...
IV. Increase in gross international reserves	-61.2	-21.2	-4.9	-2.9	-2.1	-1.2	-22.3	-23.3
V. Payments capacity (I + II + III + IV)	138.0	157.9	136.3	119.5	110.4	105.1	78.7	46.4
VI. Debt service payments	138.0	158.0	155.4	163.9	210.9	181.3	157.9	130.3
Multilateral	20.5	32.8	39.7	47.8	54.3	52.2	50.4	49.7
IMF	9.5	13.4	23.9	28.5	28.2	26.9	23.9	25.0
World Bank	2.4	2.7	2.9	3.1	4.5	7.0	9.3	11.4
ADB	1.3	2.3	2.8	3.5	4.1	4.3	6.0	9.0
EBRD	2.0	11.9	9.4	10.0	15.2	10.3	13.9	18.4
Others (including gap financing)	5.3	2.5	0.7	2.7	2.2	3.7	-2.7	-14.1
Bilateral	31.4	35.0	40.1	21.4	45.3	48.1	48.7	49.4
Russia	18.9	22.5	8.6	12.7	10.9	10.2	25.1	23.9
Others	12.6	12.5	31.5	8.7	34.4	37.9	23.6	25.4
Commercial	86.0	90.1	76.3	94.7	111.3	81.0	58.8	31.1
Guaranteed	7.4	11.3	13.1	25.2	12.0	10.0	10.0	10.0
Non-guaranteed	78.6	78.8	63.2	69.5	99.3	71.0	48.8	21.1
Memorandum items:								
External public debt (in percent of GDP) 2/	135	132	125	115	104	95	89	84
External public debt (in percent of GDP-NPV terms) 2/	66.6	86.0	80.3	72.7	63.1	57.3	52.9	49.6
External public debt (in percent of total exports-NPV terms) 2/	138.2	197.8	211.5	211.7	205.0	198.6	191.1	184.7
External public debt to fiscal revenue (in NPV terms) 2/	426.3	575.9	490.8	433.2	368.2	322.1	300.0	279.5
Export concentration								
Share of gold, electricity and tobacco exports in total exports	60.8	60.7	56.6	53.8	50.1	49.2	46.5	41.9

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ BOP support loans for 1999- 2000 are shown as part of official disbursements.

2/ Includes Kuruntor debt

Table 13. Kyrgyz Republic: Indicators of Fund Credit, 1999–2006
(In percent, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006
Outstanding Fund credit (end-of-period)								
In millions of SDRs	138.7	144.3	143.3	148.5	146.0	143.3	122.5	103.9
In millions of U.S. dollars	190.4	188.0	181.1	186.0	183.1	180.2	154.2	131.0
In percent of quota	156.2	162.5	161.3	167.3	164.4	161.4	137.9	117.0
In percent of GDP	15.3	14.4	12.5	11.4	10.0	8.9	7.0	5.4
In percent of total exports	36.1	32.8	33.0	33.0	31.3	30.1	23.6	18.6
In percent of external public debt (including Kumtor)	11.4	10.9	10.0	9.9	9.6	9.4	7.9	6.4
In percent of external public debt (excluding Kumtor)	14.0	12.4	10.9	10.4	9.8	9.5	7.9	6.5
In percent of gross reserves at the beginning of the period	146.0	102.0	88.1	88.4	85.8	83.7	71.2	54.8
Debt service due to the Fund								
In millions of SDRs	6.9	10.2	13.2	19.0	22.2	22.1	21.2	18.8
In millions of U.S. dollars	9.5	13.4	16.7	23.8	27.9	27.8	26.7	23.7
<i>Of which:</i>								
Repurchases and repayments	7.4	11.3	16.1	22.7	27.2	27.3	26.3	23.5
Charges/interests	2.1	2.0	0.5	1.0	0.7	0.5	0.4	0.2
In percent of quota 1/	7.8	11.5	14.9	21.4	25.1	24.9	23.8	21.2
In percent of GDP	0.8	1.0	1.2	1.5	1.5	1.4	1.2	1.0
In percent of total exports	1.8	2.3	3.0	4.2	4.8	4.6	4.1	3.4
In percent of total debt service (including Kumtor)	6.9	8.5	10.7	14.5	13.2	15.4	16.9	18.2
In percent of debt service (excluding Kumtor)	15.9	16.9	18.1	22.4	18.6	18.8	19.0	20.9
In percent of gross reserves at the beginning of the period	7.3	7.2	8.1	11.3	13.1	12.9	12.3	9.9

Sources: IMF, Treasurer's Department; and Fund staff calculations.

Table 14. Kyrgyz Republic: Prospective Use of Fund Resources, 1999–2006

	Outstanding	2001	2002	2003	2004	2005	2006
	End-Dec. 2000	Year					
(In millions of SDRs)							
SBA transactions	0.00						
Purchases		0.00	0.00	0.00	0.00	0.00	0.00
Repurchases		0.00	0.00	0.00	0.00	0.00	0.00
STF transactions	14.78						
Purchases		0.00	0.00	0.00	0.00	0.00	0.00
Repurchases		5.38	5.38	4.03	0.00	0.00	0.00
PRGF transactions	129.53						
Disbursements		11.72	23.44	19.12	19.10	0.00	0.00
Repayments		7.40	12.79	17.63	21.74	20.87	18.61
Total Fund credit outstanding	144.31	143.26	148.53	145.99	143.34	122.47	103.86
(In percent of quota)							
Total Fund credit outstanding 1/	162.51	161.32	167.26	164.40	161.42	137.92	116.96
Disbursements under PRGF		13.20	26.40	21.53	21.51	0.00	0.00

Sources: IMF, Treasurer's Department; and Fund staff calculations.

1/ Relative to the quota of SDR 88.8 million.

Table 15. Kyrgyz Republic: Reviews and Disbursements
Under the Proposed Three-Year PRGF Arrangement

Date	Action	Disbursement
November 2001	Approve three year Arrangement.	SDR 11.72 million
December 2001	Indicative targets.	
On or after May 15, 2002	Complete first review based on end-March 2002 performance criteria.	SDR 11.72 million
June 2002	Indicative targets.	
On or after November 15, 2002	Complete second review based on end-September 2002 performance criteria and adopt conditions and disbursements for the second year of the arrangement.	SDR 11.72 million
On or after May 15, 2003	Complete third review based on end-March 2003 performance criteria.	SDR 9.56 million
June 2003	Indicative targets.	
On or after November 15, 2003	Complete fourth review based on end-September 2003 performance criteria and adopt conditions and disbursements for the third year of the arrangement.	SDR 9.56 million
On or after May 15, 2004	Complete fifth review based on end-March 2004 performance criteria.	SDR 9.55 million
June 2004	Indicative targets	
On or after November 15, 2004	Complete sixth review based on end-September 2004 performance criteria.	SDR 9.55 million

Kyrgyz Republic: Fund Relations
(As of September 30, 2001)

I. **Membership Status:** Joined: 05/08/1992; Article VIII

II. General Resources Account:	<u>SDR Million</u>	<u>Percent of Quota</u>
Quota	88.80	100.0
Fund Holdings of Currency	99.55	112.1
Reserve position in Fund	0.00	0.0

III. SDR Department:	<u>SDR Million</u>	<u>Percent Allocation</u>
Holdings	2.83	N/A

IV. Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>Percent of Quota</u>
Systemic Transformation	10.75	12.1
ESAF/PRGF arrangements	124.61	140.3

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESAF/PRGF	06/26/1998	06/25/2001	73.38	44.69
ESAF	07/20/1994	03/31/1998	88.15	88.15
Stand-by	05/12/1993	04/11/1994	27.09	11.61

VI. **Projected Obligations to Fund:**(SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	3/31/2001	2001	2002	2003	2004	2005
Principal		4.4	18.2	21.7	21.7	20.9
Charges/Interest		0.4	0.8	0.6	0.4	0.3
Total		4.8	19.0	22.3	22.1	21.2

VII. **Implementation of HIPC Initiative:** not applicable.

VIII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the NBKR is subject to a full Stage One safeguards assessment with respect to the ESAF/PRGF arrangement approved June 26, 1998, which has expired on July 25, 2001. A Stage One safeguards assessment of the NBKR was completed on July 5, 2001. The assessment concluded that high risks may exist in financial reporting framework and internal controls systems, and recommended a Stage Two (on-site) assessment. A Stage Two assessment is currently in progress and is expected to be completed before end-November 2001.

IX. **Exchange rate arrangements:**

The currency of the Kyrgyz Republic has been the som (100 tyjyn = 1 som) since May 15, 1993. The National Bank of Kyrgyz Republic publishes daily the exchange rate of the som in terms of the U.S. dollar, which is determined in the interbank foreign exchange market.

X. **Article IV Consultations:**

The last Article IV consultation discussions were held in May/July 2000 and the Article IV consultation was completed by the Executive Board on September 13, 2000.

XI. **FSAP Participation and ROSC Assessment:**

The Kyrgyz Republic has not yet participated in an FSAP. A ROSC Fiscal Transparency mission was held on March 2-13, 2001. The ROSC Fiscal Transparency Module will be submitted to the Board concurrently with the upcoming Article IV consultation.

XII. **Resident representative:**

The fifth resident representative of the Fund in the Kyrgyz Republic, Mr. Bhaswar Mukhopadhyay, took up his post in Bishkek on March 17, 2001.

Kyrgyz Republic—Relations with the World Bank Group
(As of September 30, 2001)

64. On May 7, 1998, the World Bank endorsed a three-year Country Assistance Strategy (CAS) to support the Kyrgyz Government's development priorities in attaining sustained growth (particularly in the rural sector), alleviating poverty, strengthening public finances, and improving institutional capacity. A CAS Progress Report for FY02 is under preparation, which is based on the Government's Interim National Poverty Reduction Strategy Paper and Comprehensive Development Framework.

65. International Development Association (IDA). As of September 30, 2001 IDA has approved 24 projects totaling approximately \$600.3 million (after cancellations), of which about \$419.5 million has been disbursed. Six structural adjustment credits provided quick disbursing support for the government's economic reform programs in privatization, enterprise restructuring, agricultural policy, financial sector, public sector resource management and pension reform. Four investment operations have also been completed supporting reform and rehabilitation of the telecommunication sector, social safety nets, health, and rural finance.

66. The active portfolio includes 14 operations:

- A balance of payments support operation (Consolidation Structural Adjustment Credit) assisting with reforms in the power and gas sector, and improvements to the business environment (reducing the cost on business from licensing and inspections). The first tranche of the CSAC was disbursed at the end of 2000.
- Two operations supporting energy sector rehabilitation and reform (Power and District Heating and a Technical Assistance Credit supporting the CSAC program).
- Seven operations supporting provision of key public goods and reform in agriculture (irrigation rehabilitation, flood emergency, on-farm irrigation, rural finance, agricultural support services, sheep and wool development, and land registration—the latter also provides the basis for the introduction of a tax of non-movable property in rural and urban areas).
- Two operations supporting capacity building in the financial sector (a line of credit and a financial sector technical assistance credit).
- A second health sector operation providing support for sectoral restructuring and reform program.
- A urban transport operation

67. The World Bank Group's operational objectives for the next 12 months are to support completion of a full Poverty Reduction Strategy through focused analytical work and technical assistance, the enhancement of portfolio performance, and the ongoing structural

reforms in energy, business environment, public expenditure management, health and water and sanitation and agriculture. The Bank will also undertake a Public Expenditure Review, a Pension Note Update, and a Poverty Assessment. A CAS for the fiscal years 2003–2005 will be prepared upon completion of the Government's full Poverty Reduction Strategy Paper, expected to be finalized in Fall 2002.

68. IFC has focused on institution building, technical assistance, and strategic investments. Building upon IFC's initial investment in the financial sector, the Demir Kyrgyz International Bank, IFC played an instrumental role in the establishment of the largest bank in the country the Kyrgyz Investment and Credit Bank, with a \$1.4 million equity investment. IFC developed a strategic partnership with FINCA by investing \$1.0 million in a fund to support microenterprises. This investment was accompanied by technical assistance to FINCA to facilitate its transformation and to the government in developing the appropriate regulatory framework. IFC has also provided technical assistance to review and develop the legal and regulatory framework for leasing. Under the Extending IFC's Reach Initiative, IFC has undertaken promotional and business development activities with small and medium-sized enterprises and approved three investments of \$470,000, \$300,000 and \$1.4 million for agribusiness, packaging and pasta production projects respectively. IFC is playing a catalytic role in the development of SEAF-CAESIF, a regional equity fund that will provide equity, quasi-equity and debt financing as well as technical and managerial assistance to growth-oriented SMEs.

69. The primary focus of IFC activities in the period leading up to the next CAS will be to improve the business environment, provide support for SMEs and closely coordinating with the World Bank to create a framework that will facilitate foreign investment in mining, utilities and infrastructure. With financial support from the Swiss Government, IFC draw upon the resources of the Private Enterprise Partnership to advise on improving the business environment, provide training and support services for SMEs, continue past IFC efforts to develop leasing activities, and support agri-business for local and export markets. Technical assistance with a focus on project development is currently being undertaken in the tourism sector. IFC will work with IDA on a possible agricultural marketing and processing project, which could provide the basis and framework for collaboration in agricultural leasing. IFC will investigate opportunities for development of the IT sector. IFC will cooperate with IDA and the government in developing a legal and regulatory framework that will facilitate new foreign investment in mining in future years.

70. MIGA has supported the development of private sector in Kyrgyz Republic by extending guarantees to foreign direct investments in four projects in the manufacturing, services, and mining sectors. As of June 30, 2000, the total amount of foreign direct investment facilitated, as a result of MIGA guarantees, is over \$360 million. MIGA has also provided capacity building in foreign investment techniques to the State Committee on Foreign Investments and Economic Development, in an initiative supported by the Swiss government. MIGA plans to continue to assist the development of Kyrgyz Republic through its guarantee program and capacity building. Data on the Kyrgyz Republic is also featured in MIGA's Privatization Link service, which connects potential investors to information on companies slated for divestiture via the Internet.

Kyrgyz Republic—Relations with the Asian Development Bank (AsDB)
(As of June 30, 2001)

In November 1996 the Board of the Asian Development Bank endorsed the Country Operational Strategy (COS). The strategy confirmed the principal objectives of the Interim Operational Strategy that had guided AsDB's operations in the Kyrgyz Republic since 1994. These objectives are: (i) support for the government's reform through encouraging institutional changes, strengthening institutional capacity, and improving the provision of public services; (ii) encouraging private sector development; and (iii) improving long-term growth potential through investment in both physical infrastructure and human development and preserving the environment. In achieving these objectives, the COS has deliberately adopted a sharp focus on a small number of strategic areas, including (i) improvement in the provision of public services, particularly social services provided by local governments and the management of reform by the central government; (ii) agriculture, including rural finance; (iii) human development, especially education; and (iv) infrastructure rehabilitation. In 1999, in response to the negative effects of the Russian crisis, the AsDB's reach was broadened to include assistance to the financial sector. This selective approach has enabled the AsDB to maintain a strong sector presence and a well-focused policy dialogue.

1 To date, AsDB has approved 18 loans, all on concessional terms, totaling \$452.2 million, of which about \$263 million had been disbursed by 30 June 2001. Lending for fast disbursing, policy based projects has accounted for about 12 percent of total lending.

2 Besides loan operations, AsDB has extended technical assistance (TA) grants totaling about \$26 million since 1994. The TA operations follow the sharp sectoral focus of the COS and complement the AsDB's loan operations. A high proportion of the TA assistance is for supporting the government's efforts for institution strengthening and capacity building, with a view to supporting sustainable economic development.

3 In 1997 the AsDB initiated support for enhanced subregional economic cooperation among the Central Asian republics and the western-most province of the People's Republic of China. In 1998, the AsDB approved a Private Sector Strategy for Central Asia. The thrust of the strategy is to complement the AsDB's public sector operations with various instruments including nonguaranteed equity participation and loans to privately sponsored projects.

4 With the adoption in 1999 of poverty reduction as the AsDB's overarching objective, deliberate shifts are being made in the operational program to ensure more explicit support for projects which include beneficiaries living below the poverty line and for projects, which will assist others to remain out of poverty.

Kyrgyz Republic: Technical Assistance Provided by the Fund, 1996–2000
(As of August 15, 2001)

<i>Dept.</i>	<i>Subject/Identified Need</i>	<i>Timing</i>	<i>Counterpart</i>
FAD	Review status of revenue administration; evaluate need for further technical assistance	June 1997	Ministry of Finance
	Review status of revenue administration; evaluation need for further technical assistance	January 1998	Ministry of Finance
	Tax policy and administration	April 1998–May 1999 (long-term peripatetic advisor)	Ministry of Finance
	Tax Policy and Administration	March 1999	Ministry of Finance
	Expenditure control and Fiscal Transparency	May 1999	Ministry of Finance
	Customs Administration	September 1999	Ministry of Finance
	ROSC Fiscal Transparency Module	March 2–13, 2001	Ministry of Finance
MAE	Foreign exchange operations	June 1996	National Bank of the Kyrgyz Republic
	Modernization of the central bank; foreign exchange operations, monetary policy implementation, personnel organization	December 1996	National Bank of the Kyrgyz Republic
	Foreign exchange operations, monetary operations, government securities market and central bank organization	September 1997	National Bank of the Kyrgyz Republic
	Foreign Exchange Management	June–July 1998	National Bank of the Kyrgyz Republic

Kyrgyz Republic: Technical Assistance Provided by the Fund, 1996–2000
(As of August 15, 2001)

<i>Dept.</i>	<i>Subject/Identified Need</i>	<i>Timing</i>	<i>Counterpart</i>
	Central bank operations and liquidity management	October 1998	National Bank of the Kyrgyz Republic
	Banking Supervision	March–April 1999	National Bank of the Kyrgyz Republic
	Central Bank operation and liquidity management	December 2–15, 1999	National Bank of the Kyrgyz Republic
	Banking System Stabilization and Research	January 21–February 3, 2000	National Bank of the Kyrgyz Republic
	Banking and Payment Systems Reform	November 10–23, 2000	National Bank of the Kyrgyz Republic
	Bank Restructuring (short-term expert)	April 9–May 16, 2001	National Bank of the Kyrgyz Republic
	Financial Institutions (short-term expert)	April 23–May 7, 2001	National Bank of the Kyrgyz Republic
	Banking Sector Reform, Central Bank Law, Monetary Operations	July 23–August 4, 2001	National Bank of the Kyrgyz Republic
STA	Trade Statistics	August 1996	National Statistical Committee
	Balance of Payments Statistics	July 1997	National Statistical Committee
	Review of monetary statistics and finalization of IFS page	February 1998	National Bank of the Kyrgyz Republic
	Review of trade statistics procedures	March 1998	National Statistical Committee
	Money and Banking Statistics	March 1999	National Bank of the Kyrgyz Republic
	Balance of Payments Statistics	October–November, 1999	National Bank of the Kyrgyz Republic

Kyrgyz Republic: Technical Assistance Provided by the Fund, 1996–2000
(As of August 15, 2001)

<i>Dept.</i>	<i>Subject/Identified Need</i>	<i>Timing</i>	<i>Counterpart</i>
	Price Statistics	March 1–15, 2000	National Statistical Committee
	National Accounts Statistics	March 2–15, 2000	National Statistical Committee
	GDDS Metadata Preparation	December 14–22, 2000	National Statistical Committee

List of Resident Advisors

FAD	Establishment of Treasury	Mr. Chaturvedi	Oct. 1994–Aug. 1996
FAD	Tax Administration	Mr. Walker	Oct. 1994–Dec. 1996
FAD	Tax Policy Advisor	Mrs. Guevara	Jun.–Dec. 1999
FAD	Customs Administration Advisor	Mr. Sawyer	Mar.–Jun. 2000 and From Aug.–Nov. 2000
MAE	General Policy	Mr. Aurikko	Sep. 1995–Aug. 1996
MAE	Accounting	Mr. Listman	Oct. 1995–Jun. 1996
MAE	Accounting	Mr. Seng	May 1996–Dec. 1997
MAE	Banking Supervision Advisor	Mr. Franson	Sep. 1999–Feb. 2001
MAE	Banking Supervision/Restructuring Advisor	Mr. Svartsman	Nov. 2001–Nov. 2002
PDR	External Debt Advisor	Mr. Azarbajevani	From Feb. 2000
STA	Balance of Payments	Mr. Hafiz	Jun. 1996–May 1997
STA	Multitopic General Advisor	Mr. Khawaja	Apr. 1996–Apr. 1999

Kyrgyz Republic–Statistical Issues

General framework

1. The NSC maintains a comprehensive and regularly updated data web site largely incorporating Fund dissemination standards metadata structure and format, with good coverage and timeliness (<http://stat-gvc.bishkek.su>). The Kyrgyz Republic is presently participating in the Fund's General Data Dissemination System (GDDS).

National accounts

2. In general, data dissemination of national accounts statistics is prompt. Technical assistance has been received from the IMF, EUROSTAT, OECD, World Bank, and bilateral donors. While significant progress has been made in improving the national accounts estimation process, problems persist with respect to the quality of the primary data. Difficulties also remain in properly estimating the degree of underreporting, especially in the private sector. To improve the coverage and reliability of primary data, work has been undertaken to introduce scientific sampling procedures. Improved sampling procedures have been adopted for household surveys and new report forms are being introduced for the survey of enterprises. The NSC has established a division of sample surveys, which would assist in improving the sampling techniques. However, subannual national accounts statistics are still collected on a cumulative basis rather than by discrete time periods.

Prices, wages, and employment

3. The new CPI has been published since January 1995, and the new PPI has been published since October 1996. They are both calculated according to international standards although their coverage needs to be improved. The coverage of the PPI, which was already broadened in May 1997, is to be expanded further in the coming years.

4. Progress has been made in computing unit value indices for imports and exports. Work continues with regard to computation of these indices using a standard index presentation and the development of an export price index.

5. Problems exist in the compilation of the average wage, especially with respect to the valuation of payments in kind and the coverage of the private sector. Also, the monthly statistics are not comparable with the annual data due to different coverage and classifications.

6. Employment data have similar inconsistencies between annual and monthly data. The coverage of unemployment includes an estimate of unregistered unemployed.

Fiscal accounts

7. The coverage of the budget has been improved significantly since 1995 with the assistance of the IMF and the World Bank. While expenditure data is set up according to GFS standards, some specific expenditure items are misclassified in the budget and treasury accounts. Data for inclusion in the GFS Yearbook covering budgetary central government and local government were provided for the first time in 1999. However, at present no detail is provided for financing data, aside from a domestic/foreign dissection.

8. The provision of data on external debt service has improved. The External Debt Division of the Ministry of Finance is now solely responsible for monitoring external debt. The unit has benefited from the on-site training provided by a Swiss-financed long-term consultant and has computerized its database. Data on actual debt service payments on public and publicly guaranteed payments and outstanding loans as well as revised projections are provided on a monthly basis. The quality and timeliness of external debt data is adequate.

Monetary sector

9. The authorities introduced new charts of accounts for the NBKR and the commercial banks during 1997, with the assistance of a resident MAE advisor and the USAID. A money and banking statistics mission in March 1999 reviewed the compilation of the monetary data and found that the classification of accounts is generally in accordance with the Fund's methodology. However, the mission identified areas where the charts of accounts and accompanying instructions need to be improved. Monetary data for *IFS* publication have been reported on a regular monthly basis with a lag of about one month.

External sector

10. The compilation of balance of payments statistics has improved with the assistance of a technical assistance mission on balance of payments statistics that visited the NBKR during 1999. Data on imports and exports are now based on customs records. However, the shuttle trade with the countries of the customs union—Russian Federation, Belarus and Kazakhstan—is not accurately estimated. Dissemination of international trade statistics started in June 1998. The NBKR compiles balance of payments statistics in cooperation with the NSC. The responsibility of compiling services data has recently been given to the NSC. Coordination with the NSC has been intensified, but coverage deficiencies remain with respect to trade, services, and direct investment. A progress report sent by the NBKR on the implementation of the recommendations of the mission mentions that work is underway to improve the coverage of direct investment in the free economic zone and to introduce revised forms for surveying enterprises.

Kyrgyz Republic: Core Statistical Indicators
(As of May 22, 2001)

	Exchange Rates	Internat'l Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of Latest Observation	10/01	10/01	10/01	10/01	9/01	9/01	Sept. 01	Q2/01	Q2/01	Jun/01	Apr/01	Apr/01
Date Received	11/05/01	11/05/01	11/05/01	11/05/01	11/05/01	11/05/01	Nov. 01	Aug/10	Aug/10	7/30/01	5/15/01	May/01
Frequency of Data	D	D	D	D	M	W	M	Q	Q	M	M	M
Frequency of Reporting	D	D	D	D	M	W	M	Q	Q	M	M	M
Source of Update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting	C	C	C	C	C	C	C	C	C	C	C	C
Confidentiality	C	A	A	A	C	C	C	C	C	C	C	C
Frequency of Publication	W	M	M	M	M	W	M	Q	Q	M	M	Y

Explanation of abbreviations:

Frequency of data, reporting and publication: D-daily, W-weekly, M-monthly, Q-quarterly, Y-yearly in conjunction with staff visits.

Source of data: A-direct reporting by National Bank, Ministry of Finance, Ministry of Statistics and Analysis or other official agency.

Mode of reporting: C-cable or facsimile; F-floppy provided. Most data are provided to the Resident Representative's office and then forwarded to headquarters.

Confidentiality: A for use by the staff only; C-unrestricted use.

Kyrgyz Republic—Debt Sustainability Analysis (DSA) and Debt Strategy²¹

1. At end-2000, the Kyrgyz Republic's total external debt amounted to \$1,7 billion, 57 percent of which was owed to International Financial Institutions (IFI) (Table 1). Bilateral debts accounted for 29 percent of the total and the remainder was due to commercial creditors (14 percent)²². The World Bank is the largest multilateral creditor (\$378 million) followed by the Asian Development Bank (ASDB) (\$256 million) and the IMF (\$191 million). Russia and Japan are the largest bilateral creditors. As the bulk of the debt is highly concessional, the net present value (NPV) of total debt amounted to \$1,1 billion. Excluding the Kumtor-related debt, the stock of public and publicly guaranteed debt in NPV terms amounted to \$820 million, or 63 percent of GDP.

2. Despite the recent reschedulings of the debts to Russia and Turkey,²³ (which resulted in a \$20 million reduction in NPV of debt, or about 3.5 percent of exports), debt indicators remain high. The NPV of debt-to-export ratio²⁴ was 197 percent with the NPV of debt relative to fiscal revenue at about 570 percent at end-2000. Especially worrisome are the liquidity ratios. Debt service to exports ratio and debt service-to-fiscal revenue²⁵ ratio²⁶ were both about 30 percent.

²¹ The DSA is based on loan-by-loan data as of end 2000 provided by the Ministry of Finance External Debt Division as well as information from some major creditors.

²² These were mainly associated with the Kumtor gold mine. The Kumtor project is a joint venture between the Kyrgyz government and a Canadian company, which is expected to produce for export around 650,000 ounces of gold for each of the next three years. Thereafter, production will decrease and the mine will be decommissioned at the end of 2008. While the Kyrgyz government is the majority shareholder with two thirds of the total, the authorities deem these external loans of the joint-venture as private debt given the structure of the financing arrangement. Kumtor's outstanding debt amounted to about \$260 million at end-2000. Of this amount, \$55 million was due to the IFC and EBRD and is hence recorded in the multilateral component of the debt. Kumtor is fully servicing its debt.

²³ Rescheduling agreements with Russia and Turkey were reached in April 2001. Russia agreed to reschedule \$59 million at 5 percent interest rate, 2 year grace period and 15 year maturity. Turkey agreed to reschedule the whole debt (\$43 million) at 2 percent interest rate, 2 years grace period, and 20 years maturity. The Kyrgyz authorities also negotiated reschedulings with Berliner Bank (\$1.25 million) and Ailtech Service debts (\$0.199 million), which were in arrears at end-2000. Another end-2000 arrear to Kazcommerz Bank (\$2.7 million) was paid in March 2001.

²⁴ Following a standard procedure, the debt service-to-export ratio is built on a three-year export average.

²⁵ Fiscal revenue is defined as state government (including local government) total revenue minus grants.

Revised macro assumption and “unchanged policy scenario”

3. The recent Board paper²⁷ on external debt in five low-income CIS countries concluded that the debt situation in the Kyrgyz Republic was most distressing. Figure 1 shows the path of the Board paper’s NPV of debt-to-export ratio. This baseline was built on macroeconomic assumptions that were considered optimistic by the Board. In the revised “unchanged policy” scenario, new macroeconomic assumptions have been applied. Most notably, real GDP growth in 2001–10 was lowered from 4.7 percent per annum to 4.2 percent based on a recent analysis of the Kyrgyz Republic’s potential output growth.²⁸ Moreover, the balance of payments adjustment assumed in the debt paper relied on a large increase in private savings (by about 7 percentage points of GDP) over the decade. In the revised macroeconomic framework, the balance of payments adjustment is brought about by an increase in government savings by about 4½ percentage points of GDP. On the investment side, streamlining the Public Investment Program (PIP) implies a somewhat lower gross investment ratio than in the Board debt paper. To stress the impact of such difference, in the “unchanged policy” scenario the PIP is maintained at an average of 6.4 percent of GDP in 2001–05 and reduced to an average of 3.2 percent of GDP in 2006–10 according to the original projections of the Ministry of Finance PIP Unit.

4. With new macroeconomic assumptions, the debt ratios are substantially higher than in the Board debt paper. The NPV of debt-to-export ratio is above 210 percent in 2001, remains above 200 percent until 2006 and is still above 150 percent in 2010.²⁹ In this scenario, the country would remain very vulnerable to exogenous shocks that could compromise its capacity to honor its debt.

²⁶ In the following, the NPV of debt ratios include the debts of state-owned enterprises, hence also the debt of Kumtor. Kumtor related debt service is included in the debt service-to-export ratio as a liquidity indicator of the economy. However, Kumtor related debt service is excluded from the debt service-to-fiscal revenue ratio because this debt is not guaranteed by the government. If the debt service-to-export ratio were calculated without Kumtor, gold exports should be excluded also from the denominator as Kumtor accounts for virtually all gold exports. Such ratios would be somewhat higher without changing the conclusions of the analysis.

²⁷ SM/01/06: “Republic of Armenia, Georgia, Kyrgyz Republic, Republic of Moldova, and Republic of Tajikistan—External Debt and Fiscal Sustainability.”

²⁸ See “Kyrgyz Republic—Selected Issues and Statistical Appendix (SM/00/197)”, Section III.

²⁹ The 150 percent sustainability benchmark was chosen in the context of the HIPC initiative. The empirically significant risk threshold was found to be 200 percent (see Underwood, J. 1990 “The sustainability of international debt”, International Finance Division, the World Bank mimeo). Hence, the range 150–200 percent is to be considered a buffer zone. However, combined with very high debt service ratios, a level of about 170 percent points to a high vulnerability to exogenous shocks.

Debt strategy

5. The implementation of the authorities' debt strategy helps alleviate the debt burden and improve debt ratios significantly. The first measure is the gradual reduction of PIP from 6 percent of GDP in 2001 to 3 percent in 2005 and maintaining it at that level through the remainder of the decade. The strong fiscal adjustment in part through the streamlining of the PIP and the associated decline in imports contributes to a significant adjustment in the balance of payments during 2001–10 with a decline of the current account deficit from 8 percent in 2000 to about 4 percent by the end of the decade. The impact on net exports of the declining gold production is expected to be offset through export diversification. The real exchange rate is expected to appreciate during the decade somewhat but, as this strengthening represents largely the expected productivity gains from structural reforms, the tradable goods sector is expected to remain competitive.

6. Second, the debt strategy imposes higher concessionality on all new borrowing as the required grant element was increased from 35 percent to 45 percent.³⁰ The impact of this measure on the debt indicators is rather small, however. The merit of this measure is in its safeguarding nature: it will discourage the government from contracting expensive loans and signals the need for a high degree of concessionality in financial support from the donor community.

7. The third measure is the repayment of \$100 million of debt ahead of schedule during 2002–05. This scheme consists of several elements. First, 75 percent of privatization receipts³¹ from the sale of four large state-owned enterprises (Kyrgyz Telecom, Kyrgyz Airlines, KyrgyzGaz and the distribution activities of Kyrgyz Energo) would be used for advanced repayments respecting the comparability of treatment of creditors. Second, starting from 2002, 75 percent of all other privatization receipts will be earmarked for debt reduction. Third, the tax holidays granted to the Kumtor gold mine project will expire in May 2002 and Kumtor profit taxes, royalties and concession taxes are likely to be a significant source of funding for the debt reduction strategy. Finally, part of the advanced repayments may be obtained through debt-equity swaps.

8. The combined effect of this set of measures is substantial. The NPV of debt-to-export ratio declines by 13 percentage points by 2004, and falls below 150 percent in 2010. Similarly, the NPV of debt-to-government revenues ratio improves by 20 percentage points by 2004, and declines below 250 percent in 2008.

³⁰ In the previous programs, the concessionality limit was set to 35 percent. At the new level, some bilateral donors, notably Kuwait Fund and the Arab Development Fund, would need to increase the grant element in new potential lending to the Kyrgyz Republic.

³¹ According to the program, a special account will be opened with the NBKR to collect all privatization receipts. At least 75 percent of these funds will be devoted to debt reduction.

Paris Club

9. Even after the successful implementation of the measures under the direct control of the Kyrgyz authorities, however, the debt indicators, and especially the liquidity ratios, remain excessively high in the medium term. By 2004, the debt service-to-export ratio and the debt service-to-government revenue ratios would still be at 24 percent and 29 percent, respectively.

10. Two scenarios were developed to illustrate the impact of a possible relief from Paris Club reschedulings. First, successive flow reschedulings on Houston terms were simulated over the period December 2001–December 2010. Second, a flow rescheduling under Naples terms with consolidation period December 2001–December 2004 followed by a stock rescheduling on Naples terms. A rescheduling on Houston terms³² (as recently granted to Georgia) extended for the whole decade would greatly reduce to the liquidity problem as shown in Figure 4 in the main text maintaining the debt service below 20 percent of government revenues starting in 2002 and below 15 percent of export starting in 2005. However, the NPV of the stock of debt would not decrease as the rescheduling is on non-concessional terms. The NPV of debt-to-export ratio would remain above 190 percent for the next 5 years and would not fall below 150 percent by the end of the decade.

11. In contrast, Paris Club flow rescheduling on Naples terms for the period December 2001–December 2004 would have a similar impact on liquidity indicators during the 3 year consolidation period without worsening the NPV of debt. However, even this flow rescheduling on concession terms would not provide a lasting benefit. The debt service-to-fiscal revenue ratio after the consolidation period would increase again. It would rise to 27 percent by 2005 and would not decline below 20 percent for the rest of the decade.

12. A stock rescheduling under Naples terms with operation date of December 2004 would provide a lasting improvement in the NPV-of-debt and liquidity ratios. With the stock rescheduling, NPV of debt-to-export ratio would fall below 150 percent in 2008 and NPV of debt-to-revenue ratio would decrease below 250 in 2006. Debt service-to-fiscal revenue ratio would remain consistently between 15 percent and 20 percent from 2002 onward, and the debt service-to-export ratio at or below 15 percent starting from 2005.

³² Houston terms fall under the non-concessional debt restructuring terms. During the chosen consolidation period (two years for Georgia with an option for a third), principal payments to bilateral donors are rescheduled over 20 years with a 3 year grace period. Interest rate is at market rates (or at the original rates if these are lower than the market rates).

Figure 1. Kyrgyz Republic: Debt Sustainability Analysis. Board Paper vs New Baseline

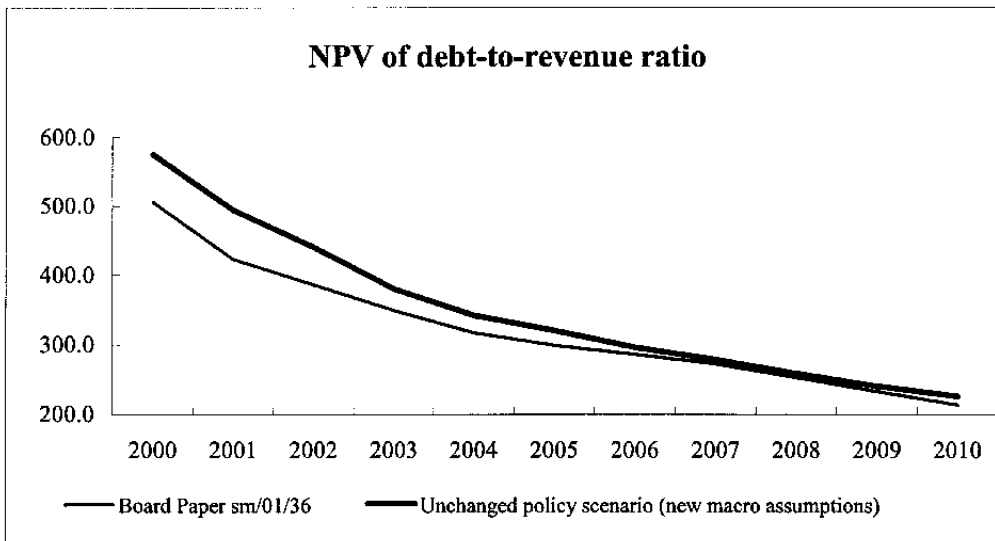
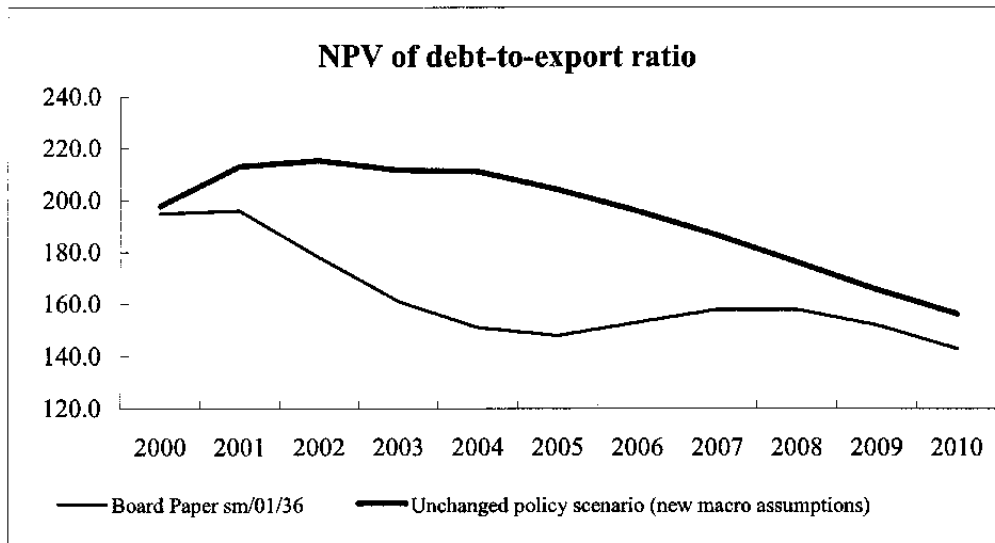


Table 1. Kyrgyz Republic: Debt by Creditor, at the end of 2000.
(million of USD)

	Debt	In percent of total	In percent of GDP	Net Present Value	In percent of total
Multilateral	979.3	57	75	525.2	47
<i>Of which</i>					
ADB	256.3	15	20	98.3	9
EBRD	103.9	6	8	98.6	9
IDA	378.5	22	29	141.4	13
IMF	191.1	11	15	146.2	13
Bilateral	502.1	29	39	354.1	32
Paris Club	418.9	24	32	296.0	26
Denmark	6.5	0	0.5	5.3	0.5
France	4.1	0	0.3	3.1	0.3
Germany	26.3	2	2	14.9	1
Japan	190.8	11	15	117.4	10
Russia	186.0	11	14	153.5	13.7
Non Paris Club	88.4	5	7	59.9	5
India	1.2	0	0.1	1.2	0.1
Korea	12.9	0.7	1.0	6.5	0.6
Kuwait	7.0	0.4	0.5	5.6	0.5
Pakistan	8.9	0.5	0.7	6.6	0.6
Turkey	43.5	3	3	27.0	2
Uzbekistan	14.9	1	1	13.0	1
Commercial	242.5	14	19	239.9	21
Total	1723.9	100	132	1119.2	100

Source: Kyrgyz Authorities and Fund staff calculations.

Table 2. Kyrgyz Republic: Sustainability Ratios

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Debt Paper Ratios 1/											
NPV of debt-to-export ratio debt paper	195.0	196.0	178.0	161.0	151.0	148.0	153.0	158.0	158.0	152.0	143.0
NPV of debt-to-revenue ratio debt paper	506.0	423.0	386.0	349.0	317.0	299.0	286.0	272.0	253.0	233.0	214.0
Total Debt Service-to Export ratio debt paper		33	32	20	20	18	20	17	17	16	14
Total Debt Service-to-government revenues		47	46	34	32	31	32	28	27	26	23
Unchanged Policy (PIP Unit projected disbursements)											
UP. NPV of debt-to-exports ratio	197.8	213.1	215.4	211.6	211.1	204.1	195.9	186.5	176.2	165.6	156.3
UP. NPV of debt-to-revenue ratio	576.0	494.6	440.8	379.9	342.3	320.4	296.5	278.6	258.8	240.6	226.2
UP. Total Debt Service to Exports Ratio		32.8	30.7	31.0	25.1	21.6	21.1	17.1	18.4	17.7	15.4
UP. Total Debt Service to Gov. Revenues Ratio		30.5	28.3	31.5	30.9	29.0	27.7	25.4	27.0	25.8	22.2
DEBT STRATEGY											
DS. NPV of debt-to-exports ratio	197.8	211.5	211.7	205.0	198.6	191.1	184.7	176.7	167.1	156.8	147.5
DS. NPV of debt-to-revenue ratio	575.9	490.8	433.2	368.2	322.1	300.0	279.5	263.9	245.5	227.9	213.4
DS. Total Debt Service to Exports Ratio		32.4	30.4	30.6	24.2	20.3	19.4	15.6	16.8	16.3	14.4
DS. Total Debt Service to Gov. Revenues Ratio		29.8	27.6	30.9	29.4	27.1	25.3	23.2	24.6	23.7	20.9
DEBT STRATEGY plus HOUSTON FLOW (12-2001 12-2010)											
DSH. NPV of debt-to-exports ratio	197.5	205.0	206.9	199.1	196.6	190.6	186.4	180.4	172.8	164.7	156.4
DSH. NPV of debt-to-revenue ratio	575.1	475.9	423.4	357.5	318.7	299.2	282.1	269.4	253.9	239.2	226.4
DSH. Total Debt Service to Exports Ratio		32.3	23.2	23.7	17.0	14.4	14.3	11.3	12.6	12.3	12.2
DSH. Total Debt Service to Gov. Revenues Ratio		29.5	17.5	18.2	17.5	17.6	17.4	16.5	18.3	17.7	17.5
DEBT STRATEGY plus NAPLES FLOW (12-2001 12-2004)											
DSN. NPV of debt-to-exports ratio	197.5	205.7	205.9	198.0	194.1	187.9	181.4	173.5	163.9	153.8	144.7
DSN. NPV of debt-to-revenue ratio	575.1	477.4	421.4	355.5	314.7	294.9	274.6	259.1	240.8	223.4	209.4
DSN. Total Debt Service to Exports Ratio		32.3	23.1	23.4	16.5	20.5	19.6	15.8	16.9	16.1	14.0
DSN. Total Debt Service to Gov. Revenues Ratio		29.5	17.4	17.9	17.0	27.4	25.5	23.4	24.8	23.4	20.3
DEBT STRATEGY plus NAPLES STOCK (12-2004)											
DSNS. NPV of debt-to-exports ratio	197.3	205.8	204.4	197.9	167.3	164.9	160.3	154.3	146.6	138.2	130.2
DSNS. NPV of debt-to-revenue ratio	574.6	477.6	418.4	355.3	271.3	258.8	242.5	230.5	215.4	200.7	188.5
DSNS. Total Debt Service to Exports Ratio		32.3	23.1	23.3	16.4	15.4	14.9	11.5	12.9	12.7	11.9
DSNS. Total Debt Service to Gov. Revenues Ratio		29.6	17.4	17.8	16.7	19.2	18.5	17.1	19.0	18.4	17.2

Source: Kyrgyz authorities and Fund staff projections

1/ SM/01/06 "Republic of Armenia, Georgia, Kyrgyz Republic, Republic of Moldova, and Republic of Tajikistan--External Debt and Fiscal Sustainability

Bishkek, Kyrgyz Republic
November 16, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C.20431

Dear Mr. Köhler:

1. On behalf of the government of the Kyrgyz Republic, we are pleased to transmit herewith our request for the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). In this context, we prepared an Interim National Strategy for Poverty Reduction (I-NSPR), which sets forth the main elements of our approach to poverty reduction and macroeconomic policies and structural reforms supporting it. The I-NSPR was submitted to you on June 13, 2001. We have also prepared a NSPR Preparation Status Report describing our progress toward the full NSPR. The Status Report will be forwarded to you under a separate cover.
2. The attached Memorandum of Economic Policies (MEP) describes in detail the objectives, policies, and measures for the three-year program covering the period October 1, 2001–September 30, 2004. In support of this program, the Kyrgyz Republic requests approval of the three-year PRGF arrangement, in an amount equivalent to SDR 73.4 million (82.6 percent of quota).
3. We believe that the policies and measures set forth in the Memorandum are adequate to achieve the objectives of our program, and we stand ready to take any additional measures that may become necessary for this purpose in consultation with the Fund staff. The government will provide the Fund with such information as the Fund requests in connection with the Kyrgyz Republic's policies and developments under the program.

Yours sincerely,

/s/
Kurmanbek Bakiev
Prime Minister
Kyrgyz Republic

/s/
Ulan Sarbanov
Chairman
National Bank of the Kyrgyz Republic

**Memorandum of Economic Policies (MEP)
for the Period October 1, 2001–September 30, 2002/2004**

I. INTRODUCTION

1. The Kyrgyz Republic has been implementing economic reforms under financial support from the International Monetary Fund (IMF) since 1993. More recently, such reforms were supported under a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) approved on June 26, 1998. This three-year arrangement expired on July 26, 2001 after the implementation of the first and second annual arrangements. We have now designed a new three-year program to support our macroeconomic and structural reforms incorporated in the Interim National Strategy for Poverty Reduction (I-NSPR). The I-NSPR was submitted to the IMF's and World Bank's Boards in May 2001. We have prepared this Memorandum to outline our policy objectives for 2001–04 with special focus on those policies that are crucial for the period October 1, 2001–September 30, 2002.
2. Admittedly, our policy implementation was uneven during the previous PRGF-supported program as slippages in fiscal policy led to non-observance of key budgetary and monetary policy targets. While tax revenue were in line with program targets, weaknesses in expenditure control, including higher-than-programmed spending under the Public Investment Program (PIP) and factors that were either temporary or outside our control, led to an overrun of expenditure and accumulation of pension and external arrears. As a result, our economic program went off track and the last two reviews under the second year PRGF arrangement were not concluded.
3. Regarding structural reforms, we made progress in a number of areas, including the removal of the moratorium on land sales, the drafting of a new law on state debt, the regular auditing of the NBKR's foreign reserves, the adoption of several bank restructuring measures, as well as measures to control free economic zones. Nevertheless, progress was slow toward the privatization of large strategic enterprises, the development of the property tax system, and the streamlining of the PIP.
4. In the first eight months of 2001, our policy implementation has improved significantly. We have successfully met all the track record targets agreed with the Fund staff for key fiscal and monetary policy variables for the period February–June 2001. We have not incurred any new external, wage, or pension arrears and all payments to KyrgyzEnergo have been made on time. Although the republican budget accumulated some social transfer arrears, these will be eliminated in due course. To improve the financial conditions of KyrgyzEnergo, we increased electricity tariffs by 57 percent last spring. To offset temporary adverse effects on the poor from the increase in energy tariffs, we adjusted pensions benefits by 20 percent and raised other social benefits and allowances. Parliament approved the revised state budget for 2001 in June in line with the understandings reached with the Fund staff. The government has also adopted a comprehensive external debt strategy.

5. On the structural side, we initiated the restructuring of government administration by reducing the number of ministries and state committees and have reduced the size of the central administration so far during 2001 by 10 percent. With technical assistance from the Asian Development Bank (AsDB), we finalized a review of the PIP and are strengthening the capacity of the Ministry of Finance to prioritize these projects. In addition, the NBKR initiated the liquidation of four problem banks and ensured the recapitalization by its owners of the remaining fifth problem bank. Finally, we settled external debt arrears to Bankgesellschaft Berlin AG ("Berliner Bank") and Aventis Crop Science company.

6. Our macroeconomic performance has improved significantly in 2001. Most notably, real GDP growth accelerated to 7.4 percent in the first eight months of the year, and the 12-month inflation declined to 6.4 percent in August. At the same time, our national currency, the som, has remained stable, and nominal as well as real interest rates have declined significantly. The trade balance was in a surplus in the first half of the year and the current account balance improved significantly although it still remained in deficit. We are also encouraged by the most recent indicators of poverty. Although poverty rates in 2000 were still higher than in 1996, the decline in these rates since 1998 suggests that the steady growth of output and real incomes since 1996 are beginning to reduce poverty.

7. We believe that these achievements demonstrate our commitment to and ownership of further reforms. To continue on this path, this memorandum details the measures that are essential for maintaining macroeconomic stability and growth, reducing our external debt, and strengthening structural reforms. In the latter area, we welcome the initiative to streamline Fund conditionality to cover only those structural measures that are critical for the success of our program. However, to provide a fuller picture of our economic policy strategy, we also want to outline our broader structural policy agenda in this memorandum.

II. PROGRAM OBJECTIVES AND POLICIES

8. Our macroeconomic program aims at maintaining economic growth at about 4–5 percent in 2002–2004 and reducing inflation to 5 percent by 2004. Achievement of these goals is a necessary condition to attain further gains in poverty reduction. In addition, the implementation of the policies detailed in the I-NSPR will ensure that the benefits from growth will accrue also to the poor. The key policy parameter in our medium-term program is a decline in the overall fiscal deficit in order to bring about the balance of payment adjustment which will support our debt reduction strategy. Our program aims to reduce the general government deficit from 9.7 percent of GDP in 2000 to 6.0 percent in 2001, to 4.9 percent in 2002, and further to 2½ percent by 2004. The bulk of the fiscal adjustment will come from restraining the foreign financed PIP while at the same time achieving an increase in the state budget primary fiscal surplus (excluding the PIP) from 0.3 percent of GDP in 2000 to 3½ percent by 2004. To sustain this adjustment, we intend to increase tax revenue of the state budget from 13.0 percent of GDP in 2001 to more than 15 percent by 2004. The targeted balance of payments adjustment will be supported by the continuation of a tight monetary policy.

9. The principal goal of the first-year program is to sustain the current rate of economic growth at around 5 percent in 2001 and 2002. At the same time, inflation should decline to 7 percent during 2001 and to 6 percent during 2002. With a sustained stability in the foreign exchange market, these developments would lead to an improvement in GDP per capita (in U.S. dollar terms) by around 23 percent from 2000 to 2002 which would help alleviate poverty. On the external side, we expect the import cover of official reserves to remain above 3½ months during the program period.

10. Our first-year program will be based on a significant fiscal adjustment, a continuation of a tight monetary policy, and more focused structural reforms. To demonstrate our ownership of the new program we will implement the following prior actions before the scheduled Executive Board meeting in late November 2001:

- First, we will implement monetary and fiscal policies so as to achieve the end-October financial policy targets as specified in Table 1.
- Second, we recognize that the adoption by parliament of the 2002 general government budget as agreed with Fund staff (including the tax measures as specified in paragraph 12 and 13), is a precondition for the Executive Board approval of the new program.
- Third, the government and the NBKR will adopt and publish in the mass media the new Regulatory Response Policy (RRP) as agreed with the recent IMF MAE mission.
- Fourth, a Presidential decree will be issued to establish an Economic Policy Council (as specified in paragraph 38) to enhance coordination, transparency, and effectiveness in the government's economic policy making.
- Fifth, we will ensure that there are no pending official external arrears.

Fiscal policy

11. A strong fiscal adjustment is needed to address our medium-term balance of payments and external debt problem. We are therefore resolutely implementing the revised state budget for 2001, which targets a surplus in the primary fiscal balance (excluding the PIP) of 2.1 percent of GDP with the overall cash deficit amounting to 6 percent of GDP, down from 9.7 percent in 2000.¹ This deficit will be financed primarily through external assistance on concessional terms, with only a small amount (0.4 percent of GDP) covered by privatization receipts. The draft 2002 budget, which was presented to parliament in October,

¹ The State budget covers local and central government finances, while the general government, when the concept is used, also includes extrabudgetary funds (most notably the Social Fund).

is a further step towards fiscal consolidation as it targets a surplus in the primary fiscal balance (excluding the PIP) of 2.6 percent of GDP with the overall cash deficit declining to 4.9 percent of GDP. This deficit will be financed mainly through external donor assistance on concessional terms. However, due to high external debt service obligations, there remains a financing gap of 2.4 percent of GDP. We hope that this gap can be closed through Paris Club debt reschedulings on Naples terms.

12. Strong tax revenue performance will be critical to achieve the programmed fiscal adjustment. The new measures included in the revised 2001 budget are projected to increase tax revenues by around 0.7 percentage point of GDP to 13.0 percent. We recognize that the reductions of income tax rates and the excise tax rate on vodka approved in July 2001 should not derail our earlier revenue targets for 2002 and over the medium-term. Therefore, we are willing to revise our earlier tax rate decisions. In addition to the 10 percent individual income tax rate, we will introduce another tax bracket at a rate of 20 percent for high-income individuals. To support especially low income families, we will increase the general basic income tax deduction by the equivalent of som 3000 per annum. We will also increase the profit tax rate to 20 percent and maintain a 30 percent rate for natural monopolies in 2002, in order to ensure sufficient tax collection. We believe that reducing taxes on labor from the current high levels would further decrease incentives to operate in the underground economy. Therefore, we will lower employers' social security contributions by 4 percentage points to 25 percent and compensate the Social Fund for the projected revenue loss through a state budget transfer of som 310 million in 2002. Such a transfer mechanism will be maintained in future years to ensure that the Social Fund revenue are sufficient to meet its benefit commitments. The appropriate medium-term level of social security contribution will be assessed in the context of the World Bank's upcoming assessment of the financial viability of the Social Fund. A quarterly reporting and monitoring mechanism will be established for profit and payroll taxes, and if tax collection fails to achieve the projected levels, the level of appropriate profit and payroll tax rates will be reassessed for the 2003 budget.

13. These tax rate reductions will be accompanied by a broadening of the tax base—including by removing several tax exemptions—and by improvements in tax and customs administration. The 2002 budget proposal contains new tax measures to compensate for the tax rate reductions and reduce tax arbitrage opportunities by: (i) allowing interest rate deductibility and raising withholding tax on interest income from 5 to 10 percent in corporate income taxation; (ii) imposing a tax on interest income at 10 percent and eliminating interest expense exemptions in personal income taxation; (iii) reducing VAT exemptions on agricultural produce and processed agricultural products by lowering the tax credit rate from 10–12 percent to 5–7 percent; (iv) imposing a patent tax on selected businesses on a pilot basis;² (v) introducing a simplified tax regime for small enterprises; (vi) eliminating VAT

² The patent system will be established on a pilot basis in 2002 for six hard-to-tax economic activities. Enterprises under the patent system will be required to submit their financial reports to the State Tax Inspectorate (STI). We will assess the results of the pilot in 2003 on the basis of the reports collected by STI.

exemptions on imports of fixed assets; (vii) eliminating VAT exemptions on residential housing and school materials, and the tax exemption for profit from the sale of renovated houses; (viii) increasing the retail sales tax rate from 3 to 4 percent; (ix) increasing the tax on non-agricultural land from som 0.17 to som 1; (x) improving the accuracy in assessing the tax liability of the construction sector; and (xi) strengthening the collection of VAT and excises on gasoline. We will also take the following measures to limit abuse in Free Economic Zones (FEZs): (i) complete the fencing of all FEZs and put their borders under Customs control; (ii) exclude all retail trade and services such as banking and dentistry from the FEZs; (iii) prohibit the export of goods into the domestic market unless there has been at least 30 percent value added within the FEZ; and (iv) limit domestic shipments to 30 percent of production. While tax offsets have been eliminated at the central government level, some offsets remain at the local government level, but they will be eliminated as of January 1, 2002. In addition, during the program period we will not introduce any new tax exemptions for either domestic or foreign investors. As a result of these measures and expected improvements in tax administration, the state tax revenue to GDP ratio is expected to increase to 13.8 percent of GDP in 2002. We believe that our tax projections, aiming at an increase in general government gross tax ratio by 3 percentage points of GDP in 2001–2004, are realistic but, if deviations occur, we stand ready to introduce corrective actions to ensure achievement of the program's revenue targets.

14. Stronger tax collection efforts are crucial to achieve the revenue targets of our fiscal program. We intend to implement a number of measures during the program period to enhance efficiency of tax administration, including by strengthening the operations of the Large Taxpayer Unit, introducing cash registers for better compliance control, regularizing the data exchange between the STI and SCC, and initiating the integration of tax collection agencies. We expect the upcoming technical assistance mission from the Fund to help us specify our plans in this area. The recommendations of the FAD mission will be included in the program at the time of the first review.

15. Over the medium term, the tax reform will contain the following actions. With assistance from USAID, we are drafting the enabling legislation for the introduction of a new local tax on real property. We expect to present the draft in parliament by end-2001 and will accelerate our work in property registration and value assessment so as to start implementation by end-September 2002. During the program period we also intend to strengthen mineral resource taxation, review the taxation of financial institutions and transactions (e.g., insurance companies, leasing companies, private pension funds) as well as capital gain taxation (e.g., appreciation of securities and properties). These and other measures to strengthen the tax base will be investigated during the upcoming FAD mission and incorporated in the program during forthcoming reviews.

16. On the expenditure side, the revised budget includes a reduction of the PIP from \$92 million in 2000 to \$85 million in 2001. As part of our debt reduction and medium-term fiscal strategy, the 2002 budget targets a reduction in PIP spending to 5.5 percent of GDP and to 3 percent of GDP by 2005. This amount could be higher to the extent that we can attract grants instead of loans to finance the PIP. We have started intensive co-operation with

international donors to conduct project-specific reviews in order to control the efficiency in project implementation and to make the volume of the PIP consistent with our debt service capacity. By end-2001, we will also establish clear guidelines for prioritizing alternative investments on the basis of their likely impact on growth, export potential, and poverty reduction. The three year rolling PIP plan will be updated annually with the quantitative target for the following year to be decided in close cooperation with the Fund staff before end-August each year. The streamlining of existing projects and inclusion of new projects under the PIP will also take into account our ability to carry the maintenance costs once these investments mature. In September this year, we held a meeting with donors to review the draft 2002 PIP plan and prioritize available external assistance. In this context, we continue to appeal to international donors to look into options for converting existing or new loans into grants which would make an important contribution to our poverty alleviation strategy.

17. The current low level of public sector wages, on average \$24 per month (around 20 percent lower than the average economy-wide wage), is an obstacle to retaining high quality personnel while providing potential incentives for corruption. In 2002, we intend to increase the average annual salary of general government employees in line with the projected economy wide pay increases by limiting the average increase to the expected productivity growth in the economy (4½ percent) plus compensation for inflation (7 percent). The new wage rates could become effective as of January 1, 2002. With a view of making expenditure adjustments sustainable in the medium term, while improving efficiency in the civil service, we will develop a plan by end-December 2001 to reduce general government employment by 5 percent in 2002 compared to 2001. In so far as there is evidence that budgetary savings are being generated during 2002 by employment reductions, we will grant additional salary increases for key personnel. The room for such additional pay increases, as well as for raising benefits for non-working pensioners, will be reviewed with the Fund staff in May 2002.

18. Taking account of the projected increase in the tax-to-GDP ratio, the reduction in interest payments due to the debt reschedulings agreed in 2001, and the targeted streamlining in capital expenditures, non-interest current expenditures could remain broadly unchanged in real terms in 2002. However, with expected interest payment reschedulings by Paris Club, such spending could grow 4–5 percent in real terms in 2002. More importantly, priority spending on education, health, and social security could grow by about 6 percent in real terms in 2001–2002. A government's priority in 2001–2002 will continue to be timely payment of pensions, central government wages and transfers to local governments for wage payments, central government transfers to the Social Fund, and energy bills. Ceilings on the stock of arrears on these payments are included among the program's performance criteria as specified in Table 1 and Technical Annex. We intend to clear all central government arrears on transfers to the Social Fund before November 15, 2001, and on allowances to poor families by end-March 2002. By this date, we will also develop amendments to improve the targeting of these allowances.

19. The attainment of high-quality expenditure and fiscal management systems is an essential component of our effort to sustain fiscal consolidation in the medium-term. With

this objective in mind, during the first-year program, with technical assistance from the Fund we will develop action plans and concrete measures in the following two areas. First, we will proceed to the next stage of treasury reform by establishing a commitment control and arrears tracking system and initiating the consolidation of the extrabudgetary funds in the treasury system. The substantial data management requirements of such a system will necessitate the computerization of the treasury, which we plan to undertake provided financing from international donors is available on a grant or highly concessional basis. We will develop a more specific treasury development plan by the time of the first review. Second, we intend to restructure the Ministry of Finance with the aim of further strengthening its position in the control and implementation of fiscal policy. In this context, we plan to enhance the role of the Budget Department in the preparation, execution, and monitoring of the budget. In addition, we will review the budgetary process to improve coordination between different ministries and improve their accountability on their spending plans. A presidential decree on the restructuring of the Ministry of Finance will be prepared in close cooperation with the Fund staff and it will be adopted by end-March, 2002.

Monetary and exchange rate policies

20. The challenge for monetary policy is to strike a balance between the economy's liquidity demands and the need to further reduce inflation. This requires an appropriately tight monetary stance characterized by the programmed increase in som broad money by 13½ percent during the program period. In view of the expected further decline in inflation and continued growth of real GDP, we expect that the demand for real balances will increase. Thus, som money velocity is projected to decline somewhat during the program period. We expect net international reserves to increase from \$15 million at end-2000 to \$23.8 million at end-2001, and to decrease to \$20 million by end-2002 provided that the expected official balance of payments support materializes. With NDA of the NBKR programmed to increase from som 4,873 million at end-September 2001 to som 5,367 million at end-September 2002, reserve money is projected to expand by 8 percent during this period. In line with the expected improvement in financial intermediation stemming from structural reforms in the banking system, the money multiplier is projected to increase slightly.

21. The NBKR will continue its policy of a de facto flexible exchange rate, and will intervene in the foreign exchange market only to smooth temporary market fluctuations and to accumulate reserves. In the event of unexpected private capital inflows, and if there are signs that money demand strengthens more than projected, the NBKR would build-up reserves beyond the program targets. If unanticipated foreign exchange outflows threaten observance of the program's foreign reserve targets, the NBKR will not resist a depreciation of the som but will tighten financial policies to restore stability in the foreign exchange market. The NBKR stands ready to avoid an excessive squeeze of money supply which may result from heavy debt service by increasing its reliance on open market operations. We are prepared to adjust the monetary targets, in close consultation with the Fund staff, should any of the assumptions underlying the monetary program change during the program period.

22. We will ensure that the NBKR's decision-making and operations continue to be independent from outside interference while at the same time increasing its accountability and transparency. In order to improve accountability, we will consider introducing staggered terms of office for the Board members. In order to strengthen transparency, we will institute bi-annual reports to parliament from the Chairman of the NBKR on monetary developments and the conduct of monetary policy. These reports would be supplemented by oral statements of the Chairman in parliament where he would also answer questions from people's representatives. In addition, we intend to increase the amount of information available to the public. In 2002, the NBKR will place on its website its audited financial statements and conclusions of the external auditor.

23. We will regularize the financial relations between the NBKR and the Ministry of Finance before end-March 2002 and request technical assistance from the Fund for this effort. All non-interest bearing government bonds currently held by the NBKR will be converted into long-term bonds that bear a positive real rate of interest. At the same time, the NBKR will start paying interest on all government deposits. NBKR profits will be transferred to the budget, while ensuring sufficient capital for the NBKR.

External sector policies

24. An open foreign trade system is essential to reap the benefits from globalization. Our external policies will aim at maintaining a liberal trading system by refraining from introducing any new export taxes or nontariff barriers. In the 2002 budget, we will reduce the tariff bands from six to four by moving all the items currently taxed at 20 percent to the 17.5 percent bracket and moving all the items taxed at 6.5 percent to the 5 percent bracket. We will aim at reducing the maximum rate to 10 percent by the end of 2004.

25. In addition, we will eliminate delays in refunding VAT and excise taxes paid on imported inputs. We will also review existing tariff exemptions with the aim of reducing their volume and value limits, and will grant no new exemptions. In order to reduce transportation costs of trade by road, we will attempt to negotiate single transit fees with Kazakhstan and other neighboring countries.

26. During the three-year period of the arrangement under the PRGF, the government and the NBKR will not, without Fund approval, introduce new or intensify existing restrictions on payments and transfers for current international transactions, nor introduce any multiple currency practices, conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles, nor introduce or intensify import restrictions for balance of payments reasons.

Debt strategy

27. We are acutely aware that the current high level of external debt poses a serious risk for macroeconomic stability in the medium-term. We are strengthening our debt management capacity by developing transparent procedures and control mechanisms for repaying, contracting, or guaranteeing public external debt. In spring 2001, we also concluded

rescheduling agreements for all debt to Turkey and for one-third of the debt to Russia. More importantly, as a prior action to the planned Board meeting on the third annual arrangement, the government had issued a special resolution on a comprehensive debt strategy comprising the following six elements:

- A medium-term fiscal strategy that leads to a primary fiscal surplus (excluding the PIP) of 3.5 percent of GDP by 2005. This strategy will be based on increasing the state budget's tax revenue-to-GDP ratio by 2.6 percentage points of GDP in 2001–2005, and on seeking grants, rather than foreign borrowing, for poverty alleviation. Given the overall objective of alleviating poverty, social spending will be increased in real terms; if needed, at the expense of other spending.
- Streamlining the PIP from 7.1 percent of GDP in 2000 to 3 percent of GDP by 2005 as discussed in paragraph 16.
- Privatization of large state-owned strategic enterprises, with the special objective to privatize KyrgyzTelecom, Kyrgyz Airlines, KyrgyzGaz, and the four power distribution companies spun off from KyrgyzEnergO before 2005. These privatization receipts will be deposited into a special Privatization Account in the NBKR. At least 75 percent of these funds will be available for debt reduction only, with the remaining amounts being allocated for restructuring of other to-be-privatized enterprises, the development of the irrigation sector, and counterpart funding of foreign-financed investment projects. Starting from 2002, privatization receipts from other sources will also be accumulated in this account.
- Repaying non-concessional government debts ahead of schedule (provided that resources exist), in order to avoid penalties and to eliminate the high cost of carrying such debt.
- Not contracting any new public or publicly guaranteed nonconcessional debt. At the same time, the required level of concessionality will be increased so that the grant element will be at least 45 percent, unless new loans are committed for replacing old debt originally contracted at less favorable terms.
- Seeking debt-for-equity swaps for enterprises other than the above mentioned strategic enterprises.

We will refine this strategy in three respects. First, to ensure that our three-year program is fully financed, we intend to seek Paris Club debt reschedulings on Naples terms. Second, as typically requested by the Paris Club, we will ensure comparability of treatment of creditors when repaying debt early. Finally, we will further improve the Ministry of Finance's external debt management capacity through the ongoing Swiss-financed technical assistance program. We are also strengthening the PIP unit of the Ministry of Finance and, by end-2001, we will (i) produce the first 5-year rolling plan; (ii) evaluate the impact on growth and export

potential of projects; and (iii) approve a priority list of specific projects with the view of strengthening the country's export potential.

Structural reforms

28. We believe that strengthening structural reforms is essential for maintaining economic growth and alleviating poverty. This requires better conditions for private sector development and less government intervention in the economy. Although reforms are required across a number of areas, four core areas appear critical for sustained growth, low inflation, external debt reduction, and poverty alleviation. These are banking sector reform, privatization of strategic enterprises, energy sector reform, and good governance. Our broader agenda of structural reforms outside Fund conditionality is discussed in section III below.

29. A healthy **banking sector** is essential for establishing efficient financial intermediation and mobilizing domestic savings to finance investment. In addition, bolstering confidence in banks should reduce dollarization and thus enhance the efficacy of monetary policy and resource allocation. Under the new program, we want to move decisively to (i) ensure that all banks are adequately capitalized; (ii) complete the restructuring of Kairat Bank; (iii) strengthen the legislative and institutional arrangements within the banking sector; (iv) enhance the debt recovery capacity of the Debt Recovery Agency (DEBRA); and (v) resolve the development options for the Saving and Settlement Company (SSC).

30. To improve the soundness of our banking system, in mid-2001 the NBKR closed four insolvent banks. The fifth problem bank, Asia Universal (AUB), has been recapitalized by its private shareholders. The bank has not provided, however, supporting documentation on the quality of some of its assets and financial operations. To solve this matter, the NBKR has required AUB to provide this additional information and should the bank financial standing prove unsatisfactory, the NBKR will require: (i) AUB to make the appropriate provisions or capital reductions; and (ii) its private shareholders to recapitalize the bank if these adjustments make the bank insolvent. The NBKR should place the bank under temporary administration if it does not comply with capital adequacy requirements by end-2001. Regarding capital requirements more generally, the NBKR will issue a regulation requiring all banks to maintain a minimum level of own capital (Tier I capital minus at least the cross ownership of shares) of som 25 millions starting from April 1, 2002. Capital requirements for 2003 will be set in the context of the first review The application of this new capital requirement will be a structural benchmark for end-March 2002. In March–April 2001, we capitalized Kairat Bank by issuing government bonds to replace its non-performing assets, transferred its ownership from the National Bank to the government, and strengthened its management. We are taking actions to ensure its return to profitability by restructuring its organization and branch network and strengthening its financial condition on the basis of a plan agreed with the Asian Development Bank in the context of the Financial Intermediation and Resource Mobilization loan.

31. To prevent the re-emergence of problem banks, we will enhance banking supervision and modify existing legislation and institutional arrangements, in particular, the NBKR will not introduce the requirement to keep the capital of commercial banks in foreign currency. While the Banking Act and the National Bank Law establish a framework for concluding effective banking supervision, we will make the NBKR's regulatory enforcement powers more effective. To this effect, the government and the NBKR will adopt a Regulatory Response Policy (RRP) as specified by the recent MAE mission. The adoption of the RRP is a prior action for Executive Board consideration of the new program. The policy will clarify the timing and amount of minimum action that the NBKR will take under different circumstances. The publication of the RRP in the mass media, will make all stakeholders aware that the rules and practices are supported at the highest levels of government.

32. Furthermore, with a view to streamlining the courts' examination of appeals against NBKR's regulatory actions, we will submit to parliament amendments to existing legislation to provide that: (i) individuals who appeal against the NBKR bankruptcy sanctions must do so in the court of arbitration which has jurisdiction over matters involving legal entities; (ii) the NBKR sanctions are binding and effective until all appeals and court proceedings have been resolved; and (iii) the arbitration court will make a final decision on a case rather than remand such case to a lower court thereby creating an endless loop of appeals.

33. We intend to enhance DEBRA's debt recovery capacity. To this end, we have already transferred its control from the NBKR to the Ministry of Finance. In addition, (i) we will submit to parliament proposed amendments to existing legislation so that the legal entity DEBRA will become the sole and exclusive liquidator of failed banks; and (ii) we will eliminate obstacles to debt recovery and realization on debt collateral by DEBRA and, more generally, by all banks, by submitting to parliament amendments to eliminate conflicts in existing legislation (in the Law on Pledges and in the Civil Code) to facilitate the process of execution of pledges. The implementation of these two measures will be structural benchmarks under the program for end-December, 2001. We will also to improve bank governance to raise public confidence in the banking system. With this objective in mind, DEBRA will establish an asset recovery program that would include negotiations with debtors, recovery from former shareholders, and sales of noncore assets of liquidated banks. DEBRA will also initiate inquiries, prepare cases, and make criminal referrals to the Ministry of Interior for all transactions involving malfeasance, mismanagement, or fraud by officials of the banks under liquidation. The government will fully support DEBRA in these endeavors, including through public statements.

34. We will prepare a development plan for the SSC in close consultation with Fund staff. We will analyze two options. Under the first option, the SSC would be sold to an investor through a tender. Under the second option, the SSC would be developed into a postal giro system. Under both options, ways have to be found to ensure the maintenance of the payment system and the availability of banking services in remote areas. Should we choose the second option, we would ensure that the privatization strategy is transparent and provides equal access to the process for foreign and domestic investors. The deadline for approval by the NBKR of this development plan is end-March, 2002.

35. **Privatization** of the large state monopolies (KyrgyzAir, KyrgyzTelecom, four power distribution companies spun off from the break-up of KyrgyzEnergo, and KyrgyzGaz) is deemed critical for the success of the medium-term program. These enterprises account for a relatively large share of economic activity, and their poor performance places a significant drag on potential output growth. Moreover, the sale of these assets would make an important contribution to debt reduction. As the sale of these assets is likely to take time, we will continue our restructuring efforts of these enterprises while preparing them for privatization. In this regard, we will ensure that tariff policies and bill collection rates generate adequate revenue for these enterprises and that the management of these resources becomes more efficient and transparent, including through unbundling the KyrgyzEnergo's distribution, transmission, and power generation operations. To underscore the importance we associate with this privatization objective, we have agreed to include as a performance criterion under the program the issuance, by end-December 2001, of a government resolution specifying the time schedule for specific and monitorable steps for privatization of these enterprises by 2005. This resolution will provide transparent privatization procedures and equal access for domestic and foreign investors. As a minimum, the resolution will specify the expected dates for the selection of financial advisors, the completion of due diligence, and for holding the tender of each enterprise. In addition, the resolution will outline our restructuring plans for these enterprises, including targets for tariff and bill collection rates over the period of the arrangement. The privatization timeline for the four strategic enterprises will be advertised through the media, including the State Property Fund website. Of course, the specific timing of the implementation schedule will have to take into account actual market conditions.

36. We will place great emphasis on reforming the **energy sector** with a view to reducing its large quasi-fiscal deficit, which stems primarily from pricing energy below cost in the domestic market. Eliminating this deficit would significantly improve the allocative efficiency of the economy to spur growth of real incomes. We are working closely with the World Bank in this area and, under Bank conditionality, we are in the process of specifying measures aiming at achieving full cost recovery by end-2003, and restructuring and privatization of enterprises operating in this sector. We will also place particular attention to reducing commercial losses of energy enterprises. To further improve collection ratios of energy bills, we continue to include a zero ceiling on the stock of government agencies' arrears to KyrgyzEnergo as a continuous quantitative performance criterion under Fund conditionality. In addition, as a structural benchmark for end-December 2001, we will submit to parliament a new law which will reduce by at least 20 percent the number of energy users eligible for special privileges under the existing electricity tariff structure. At the same time, all incomes should be included in the assessment of eligibility under income criteria, and social cash benefits for first and second category invalids will be increased by som 20 per month but they will not be included among the users with privileged electricity tariffs.

37. We have approved a significant number of laws, decrees, resolutions, and decisions to improve the legal, regulatory, and administrative systems to improve business environment. The business community, however, still regards poor **governance** as a major impediment for improving productivity and economic growth. Furthermore, at times lack of coordination in economic policy making has resulted in contradictory policy choices. The government is

highly committed to improve governance. We will make every effort to enhance transparency and accountability of government operations and improve decision-making. In the paragraphs below, we have identified a set of key areas and measures that we believe are important for better governance.

38. We are aware of the need to strengthen our economic policy making mechanism to increase coordination, transparency, and efficiency. With this objective in mind, we will establish an Economic Policy Council (EPC) within the government consisting of the Prime Minister and key economic ministers. All economic policy issues, including program monitoring, will be discussed in the weekly meetings of this body. The Chairman of the NBKR will be a non-voting, independent member of the EPC. All matters for EPC consideration will be prepared by a permanent Secretariat consisting of representatives from the President's and PM's offices and the Ministry of Finance. The chairpersons of the key Parliamentary committees will be invited regularly for discussions with the EPC. To ensure that the donor community is kept abreast of our policy choices, the resident representatives of the IFIs could be invited to meetings as observers, as necessary.

39. In parallel with our ambitious privatization program, we intend to remove major public sector impediments to private sector development by simplifying the relations between the government and the users of government services. In the fiscal area, we aim to move forward with reforms in tax and customs administration. In particular, we intend to make abuse in tax inspections subject to penalties under the criminal code and revise the protocols for tax inspections. In addition, by end-March 2002 we will develop guidelines that will restrict the interference of law enforcement and other supervisory agencies in the operations of private enterprises. In the area of tax administration, we will eliminate the backlog in VAT refunds for imported intermediate goods. We will also approve new streamlined regulations to simplify access to claims without compromising their validation. In the context of the ongoing customs modernization project, we are drafting a new Customs Code and we are considering hiring a pre-shipment inspection company. Such measure is expected to reduce misreporting by importers and customs officers, as well as increase tax and customs revenue. To engage the stakeholders on a discussion of reform proposals, the planned State Customs Services Working Group will publish its first review of administrative constraints in customs administration.

40. We also plan to reduce the scope and size of the public sector and enhance its efficiency. To pursue this objective, we have already completed a reduction in the number of government ministries and state agencies by 20 percent and their employees by 10 percent and we have agreed to further reduce employment in the general government by 5 percent in 2002. We will also restructure the Ministry of Finance and push ahead with the next phase of treasury reform. In these latter two areas, we will rely on the recommendations of the forthcoming FAD mission. We will also further reform the public administration based on the review of the ongoing and planned functional reviews of key ministries, including the Ministry of Finance, the Ministry of Justice, the Ministry of Labor and Social Protection, and the Ministry of Agriculture, which we intend to complete during the first program year.

41. We will monitor closely the impact that these and other reforms will have on the efficiency of government operations. To achieve this, in cooperation with the World Bank, we will complete: (i) a household survey evaluating public services; (ii) an enterprise survey to collect information on business environment; and (iii) a public officials' survey to elicit information on the internal processes of the public administration. We intend to publish the results of these surveys during the first program year.

42. To enhance public sector accountability and performance through better management of public resources, policy formulation, and delivery of public services, we will implement the following measures. In the 2002 cycle of budget documents, we will start: (i) reporting on the general government, which consists of the consolidated state and Social Fund budgets; (ii) including in the budget documents the underlying macroeconomic framework and data on public debt and tax and expenditure arrears in the previous period; (iii) publishing a quarterly fiscal bulletin reporting on budget execution including PIP, tax and expenditure arrears, use of privatization proceeds, and the budget execution of the Social Fund; and (v) broadening the coverage of the public information on the budget to extrabudgetary funds. The publication of the quarterly fiscal bulletin will be a structural benchmark for end-March 2002. As part of the 2002 budget submission to parliament, we will also report the new borrowing of state owned enterprises. We will also include in the 2003 budget documents a three-year fiscal plan. The latter will identify medium-term sector strategies that will form the basis for expenditure allocations each year. Starting in 2002, we will publish the Chamber of Accounts' audits of state finances.

III. THE GOVERNMENT'S BROADER REFORM AGENDA

43. The reforms that we have incorporated as structural conditionality in the Fund-supported economic program are essential for achieving macroeconomic stability and ensuring the successful implementation of the program. However, our reform agenda encompasses a wider range of structural measures, many of which are covered by programs agreed to with other International Financial Institutions and donors. In May 2001, we completed an interim National Strategy for Poverty Reduction (I-NSPR), with assistance from the Fund, the World Bank, and the Asian Development Bank, and through a consultative process involving political parties, local authorities, NGOs, the media, and bilateral donors. While we intend to develop a full-fledged National Strategy for Poverty Reduction in the second half of 2002, the I-NSPR is an important tool providing a general macroeconomic framework and establishing key areas for structural reform and focusing external assistance. The I-NSPR sets out the main elements of our three-year approach to broader structural reforms and poverty reduction and it is consistent with the economic program supported by the Fund under the PRGF. The I-NSPR sets out additional reform initiatives in, among others, the following areas: infrastructure, agriculture, small and medium size enterprise development, and social protection.

44. Infrastructure development is essential for promoting economic growth. While part of development is supported by our PIP within the overall budgetary framework, we will also work to create favorable conditions for attracting private investment in infrastructure,

including through deregulation and privatization. In particular, in the telecommunication sector we intend to pursue a medium-term tariff policy to achieve full cost recovery. Agricultural reform will include, among others, the design of a plan to auction land through the Land Redistribution Fund and the implementation of a program to increase capacity of the Agricultural Finance Corporation (KAFC) to appraise and supervise loans while maintaining positive real interest rates in lending. The reform efforts in this area are supported by the World Bank and the AsDB.

45. Fostering domestic and foreign private investment is essential for the success of our macroeconomic program and it is high on the government agenda. We are developing numerous initiatives to establish a more favorable environment for private investment. Most notably, a presidential task force was recently established consisting of representatives of the government, international, and business community, with the objective of eliminating formal and informal barriers for private sector development and to improve the investment climate.

46. Support of small and medium sized enterprises (SME) has significant potential for employment generation. In this area, we will aim at improving access to financing, simplifying the taxation of SMEs, and to streamline state regulations and fight corruption, reducing licensing and inspections to a minimum by developing inspection codes.

47. The system of social protection needs to be revamped. We will enhance the financial stability of the Social Fund by broadening the base of social insurance contributions, further extending the system of individual social security identification numbers, raise the collection level of social security contributions, including through enforcement action, and reducing further in-kind payments to the Social Fund. We will also reduce early retirement privileges while ensuring that the base pension is at least 12 percent of the average wage.

48. We are also actively working with other international financial institutions to improve governance. The World Bank's ongoing Consolidated Structural Adjustment Credit includes measures to reduce excessive inspections and licensing procedures. In addition, the World Bank's three-year Governance SAC (GSAC), currently under discussion, is expected to include reform measures to enhance governance in the areas of public expenditure management, public administration and civil service. Structural conditionality under the AsDB's Corporate Governance Loan (CGL), currently under discussion, is expected to include measures aimed at: (i) promoting corporate governance standards; (ii) introducing international accounting, auditing, and valuation standards; (iii) strengthening governance of commercial banks and the legal framework to enhance creditors' rights; (iv) launching legal and judicial reforms; and (v) restructuring the enterprise sector.

IV. PROGRAM MONITORING

49. The first-year program will be monitored through two reviews by the Fund's Executive Board based on semi-annual performance criteria (end-March 2002 and end-September 2002), indicative targets (end-December 2001 and end-June 2002), and structural benchmarks. The program will cover the period October 1, 2001–September 30, 2002.

Quantitative performance criteria and indicative targets for the program are specified in Table 1. The quantitative performance criteria for end-March 2001 are: (i) a floor on net international reserves in convertible currencies of the NBKR; (ii) a ceiling on net domestic assets of the NBKR; (iii) a ceiling on the cumulative fiscal deficit of the state budget; (iv) a floor on cumulative tax collections in cash; (v) a ceiling on the stock of budget arrears of the central government as defined in Table 1 and Technical Annex; (vi) a zero ceiling on the stock of pension arrears; (vii) a zero ceiling on contracting or guaranteeing external debt of less than one year, excluding normal import credits; (ix) ceilings on contracting or guaranteeing new non-concessional debt (with a grant element lower than 45 percent over a maturity of one year); and (x) a zero ceiling on new external arrears. Box 1 contains one structural performance criterion and the six structural benchmarks under the program. The Technical Annex to this Memorandum defines the quantitative targets of Table 1 and specifies reporting requirements. The first review of the program will take place on or after May 15, 2002, based on performance as of end-March 2002. At the time of the first review, quantitative and structural performance criteria as well as structural benchmarks will be established for end-September 2002.

50. The government and the NBKR believe that the policies and measures set forth in this Memorandum are adequate to achieve the objectives of the program. However, in consultation with the Fund staff we will take any further measures, that may be needed to assure the success of the program. These consultations can be initiated by the government or whenever the Managing Director requests consultations.

Box 1. Structural Performance Criterion and Benchmarks

Structural performance criterion

By end-December, 2001

- Issue a government resolution specifying an action plan and time schedule for the privatization of KyrgyzAirlines, KyrgyzTelecom, the four power distribution companies of the former KyrgyzEnergo, and KyrgyzGaz.

Structural benchmarks

By end-December 2001

- Submit to parliament a new law on Energy Use Privileges to reduce the number of privileged energy users by at least 20 percent.
- Strengthen the debt recovery capacity of DEBRA as defined in paragraph 33.
- Submit to parliament amendments to conflicting legislation in the Law on Pledges and in the Civil Code to facilitate the execution of pledges.

By end-March 2002

- Publish a quarterly fiscal bulletin reporting on budget execution including PIP, tax and expenditure arrears, and use of privatization proceeds. The bulletin should also include Social Fund budget execution.
- Introduce new minimum capital requirements on own capital (Tier I capital minus at least the cross ownership of shares) of som 25 million for all banks.
- Regularize the financial relations between the NBKR and the Ministry of Finance in line with recommendation of the IMF Safeguards Assessment mission.

Table I. Kyrgyz Republic: Quantitative Program Targets
(In millions of soms, unless otherwise indicated, e.o.p.)

	2001					2002 2/		
	June Target 1/	June Act. 1/	Sept Prelim. 2/	October Prior Action 2/	December Benchmarks 2/	March Performance Criteria	June Indicative targets	Sept Indicative targets
I. Performance criteria								
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars) 3/	-4.3	6.5	7.7	20.3	23.8	15.0	7.6	30.8
2. Ceiling on net domestic assets of the NBKR (eop stock) 4/	2,626	1,725	2,371	1,779	1631	1,853	3,368	2,865
3. Ceiling on cumulative fiscal deficit of the state government 5/	1,217	918	2,271	n.a	1,264	2,364	3,622	4,848
4. Cumulative floor on state government tax collections in cash 6/	2,121	2,161	4,456	850	2,787	4,942	7,440	10,316
5. Ceiling on the stock of central government budget arrears 7/	0	0	208	9	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0	0	0	0
7. Ceiling on contracting or guaranteeing new external debt of less than one year 8/ (in millions of U.S. dollars)	0	0	0	0	0	0	0	0
8. Ceiling on contracting or guaranteeing of new nonconcessional external debt 9/ (cumulative, in millions of U.S. dollars)	12	12	0	0	0	0	0	0
9. Ceiling on new external arrears (in millions of U.S. dollars) 10/	0	0	0	0	0	0	0	0
II. Indicative targets								
1. Ceiling on reserve money (NBKR liabilities)	4,579	4,240	5,010	5,037	5,058	4,853	4,775	5,409

Sources: Data provided by the Kyrgyz authorities; and Fund staff estimates and projections.

1/ Targets under the earlier planned third year program under the second PRGF arrangement. Foreign exchange components valued at the exchange rate US\$1 = som 50.5, gold holdings valued at US\$275 per ounce, SDR valued at SDR 1 = US\$1.306. Targets exclude claims and liabilities to BRO countries.

2/ Foreign exchange components valued at the exchange rate US\$1 = som 49, gold holdings valued at US\$265 per ounce, SDR valued at SDR 1 = US\$1.259. Targets exclude claims and liabilities to BRO countries. To the extent that the actual data for end-September 2001 deviates from the preliminary values, the program targets will be adjusted accordingly.

3/ Excludes swaps and international reserves of NBKR that are pledged or blocked.

4/ Excludes counterpart of the loan by the Eximbank of Turkey and the EBRD/IDA enterprise loan which are channeled through the NBKR. Starting September 2001 NDA do not include commercial banks' forex deposits with the NBKR.

5/ For June and September 2001, cumulative beginning as of April 1, 2001. From December onwards, cumulative beginning as of October 1, 2001. State government comprises central and local government finances.

6/ For June and September 2001, cumulative beginning as of April 1, 2001. From October onwards, cumulative beginning as of October 1, 2001. Includes collection of tax arrears but excludes tax offsets.

7/ Central government budget arrears comprise wages, payroll contributions and mandatory transfers to the Social Fund, categorical grants, and payments to KyrgyzEnergy.

8/ As specified in the Technical Memorandum of Understanding (TMU), external debt is defined as in Executive Board's Decision no. 12274 (00/85) of August 24, 2000. Includes leases and other instruments giving rise to external debt.

9/ As specified in the TMU, external debt is defined as in Executive Board's Decision no. 12274 (00/85) of August 24, 2000. A debt is classified as concessional if its grant element is at least 45 percent, calculated using a discount rate based on the 10-year average of OECD commercial interest reference rates (CIRR), for debts of maturity greater than 15 years; for debts of maturity 15 years or less, the discount rate should be based on the six month average of the OECD CIRR. The ceilings include loans, leases, supplier's credits and other instruments giving rise to external debt on nonconcessional terms. IMF lending is excluded from the ceiling on new nonconcessional borrowing.

10/ On a continuous basis.

Adjustors

1. The floor on net international reserves of the NBKR will be adjusted: (i) upward/downward by 100 percent for excesses/shortfalls of the use of net foreign financing of the state budget and cash grants; (ii) upward/downward by 100 percent for excess/shortfall of cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (ii) is limited to US\$ 15 million each.

2. The ceiling on net domestic assets of the NBKR will be adjusted: (i) downward/upward by 100 percent for excesses/shortfalls of the use of net foreign financing of the state budget and cash grants; (ii) downward/upward by 100 percent for excess/shortfall of cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (ii) is limited to US\$ 15 million each valued at the program exchange rate.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The Kyrgyz Republic's performance under the PRGF-supported program will be assessed by the IMF on the basis of the observance of quantitative and structural performance criteria and benchmarks. This annex and the tables attached to the Memorandum of Economic Policies (MEP) define the quantitative performance criteria and indicative targets, the structural benchmarks and performance criteria (Box 1 attached to the MEP), as well as the monitoring requirements.

V. QUANTITATIVE TARGETS

2. Quantitative targets are summarized in Table 1 of the MEP and defined below. This annex sets quantitative prior actions for end-October 2001, quantitative benchmarks for end-December 2001, quantitative performance criteria for end-March 2002, and indicative targets for end-June 2002 and end-September 2002. At the time of the first review, quantitative performance criteria will be set for end-September 2002.

Floor on net international reserves of the NBKR in convertible currency

3. The program contains a floor on the minimum amount of the stock of net official international reserves of the NBKR in convertible currencies. This floor will be calculated as the difference between total gross international reserves in convertible currencies at the NBKR and total official reserve liabilities of the NBKR in convertible currencies.

4. Total gross official international reserves of the NBKR shall be defined as the NBKR holdings of monetary gold, holdings of SDRs; any reserve position in the IMF; and any holdings of convertible currencies in cash, debt instruments or with foreign banks. Amounts pledged as collateral or in swaps or otherwise blocked, and capital subscriptions in foreign financial institutions and non-liquid assets of the NBKR are excluded. Excluded are also net forward positions, defined as the difference between the face value of foreign currency denominated NBKR off-balance sheet claims on non-residents and foreign currency obligations to both residents and non-residents. For program monitoring purposes, official international reserves shall be valued at a fixed program exchange rate of som 49 per U.S. dollar and \$1.259 per SDR. Official gold holdings shall be valued at \$265 per troy ounce. Program cross exchange rates are listed in Table 8.

5. Official reserve liabilities of the NBKR in convertible currencies shall be defined as outstanding liabilities to the IMF and other convertible currency liabilities of the NBKR to non-residents with an original maturity of up to and including one year. However, net claims on other BRO countries are excluded from the ceiling. The change in NIR will be calculated as the sum of program loan disbursements and cash grants net of external debt service payment due by the NBKR and the government of the Kyrgyz Republic excluding payments due on pledged loans. Thus calculated, the stock of net official international reserves in convertible currencies amounted to \$7.7 million as of September 30, 2001.

6. The floors on the NIR of the NBKR in convertible currencies during the program period are reported in Table 1 below.

Table 1. Floors on NIR of the NBKR in Convertible Currencies 1/

	(In million of U.S. dollars)
October 31 (prior action)	20.3
December 31, 2001 (indicative target)	23.8
March 31, 2002 (performance criterion)	15.0
June 30, 2002 (indicative target)	7.6
September 30, 2002 (indicative target)	30.8

1/ End-of-period stocks.

7. The floor on net international reserves of the NBKR will be adjusted: (i) upward/downward by 100 percent for any excess/shortfall in net foreign financing and cash grants; and (ii) upward/downward by 100 percent for any excess/shortfall in cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (ii) is to be limited to \$15 million each.

8. Net foreign financing is defined as balance of payment support loans plus cash grants minus amortization payments by the Ministry of Finance and NBKR (excluding repayments to the Fund). This definition applies to the adjustors to NIR and NDA. The cumulative net foreign financing for the program period is as follows:

Table 2. Projected Net Foreign Financing and Cash Grants 1/

	(In millions of soms)
October 30, 2001	846.7
December 31, 2001	1,425.3
March 31, 2002	1,391.8
June 30, 2002	105.9
September 30, 2002	1,125.0

1/ Cumulative from October 1, 2001. Based on accounting exchange rate of som 49=\$1

Ceiling on the net domestic assets of the NBKR

9. Net domestic assets of the NBKR are defined as reserve money of the NBKR (defined below) minus the NBKR's net foreign assets³ minus the medium- and long-term NBKR obligations (MLT) minus the counterpart of the loan by the Eximbank of Turkey minus the counterpart of the EBRD enterprise loan (see equation 1 below).

$$NDA = RM - NFA - MLT - \text{Turkish Loan} - \text{EBRD Enterprise Loan} \quad (1)$$

10. Thus defined, the NBKR's net domestic assets consist of: (a) gross credit to the State government from the NBKR minus deposits of the State government with the NBKR⁴ minus the counterpart of the loan by the Eximbank of Turkey; (b) gross credit to subnational governments from the NBKR minus deposits of subnational governments with the NBKR; (c) gross outstanding credit to domestic banks by the NBKR minus the counterpart of the EBRD enterprise loan; and (d) all other net assets of the NBKR (other items net). Thus defined, the stock of the NBKR's net domestic assets amounted to som 2,371 million on September 30, 2001.

11. The ceilings on the net domestic assets of the NBKR during the program period are reported in Table 3 below.

Table 3. Ceilings on the Net Domestic Assets of the NBKR 1/

	(In millions of soms)
October 31, 2001 (prior action)	1,779
December 31, 2001 (indicative target)	1,631
March 31, 2002 (performance criterion)	1,853
June 30, 2002 (indicative target)	3,368
September 30, 2002 (indicative target)	2,865

1/ End-of-period stocks.

³The NBKR's net foreign assets consist of net international reserves, as defined in this Annex, plus other foreign assets plus the net claims on other CIS countries. The value of the latter is kept constant at som -51 million for program monitoring purposes.

⁴ Deposits of the State government include the special account to accommodate the expected Paris Club debt-relief on principal repayments. Counterpart entry is recorded in other items net of the NBKR. Cumulative deposits in this fund during the program period are projected to be: som 938 million (December 31, 2001); som 1,030 million (March 31, 2002); som 2,018 million (June 30, 2002); som 2,119 million (September 30, 2002); and som 2,556 million (December 31, 2002).

12. The ceiling on net domestic assets of the NBKR will be adjusted:
 (i) downward/upward by 100 percent of the excess/shortfall in net foreign financing and cash grants; and (ii) downward/upward by 100 percent of the excess/shortfall of cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (ii) is to be limited to \$15 million each valued at the program exchange rate

Ceiling on the cumulative fiscal deficit of the state government ⁵

13. The ceiling on the state government fiscal deficit is defined as the negative sum of:
 (i) the change in the stock of net claims of the domestic banking system and nonfinancial institutions—including state-owned enterprises and public companies—and households on the state government; (ii) the change in the stock of net claims of foreign banking system and nonfinancial institutions and households on the state government; (iii) net privatization receipts; (iv) net foreign loans disbursed to the state government for budgetary support; and (v) net foreign loans disbursed to the state government for project financing. The fiscal balance will be measured excluding valuation gains and losses on all foreign currency denominated assets and liabilities arising from exchange rate fluctuations.

14. The change in the stock of net claims of the domestic and foreign banking systems on the state government are defined as the change in the stock of claims of these banking systems on the state government less the change in the stock of all deposits of the state government with these banking systems. The claims of these banking systems on the state government include: (i) bank loans to state government; (ii) securities or bills issued by the state government held by banks with the exception of those issued in relation with bank rescue operations; and (iii) overdrafts on the current accounts of the state government with banks.

15. The ceilings on the cumulative fiscal deficit of the state government during the program period are reported in Table 4 below.

Table 4. Ceilings on the Cumulative Fiscal Deficit of the State Government 1/

	(In millions of soms)
December 31, 2001 (indicative target)	1,264
March 31, 2002 (performance criterion)	2,364
June 30, 2002 (indicative target)	3,622
September 30, 2002 (indicative target)	4,848

1/ Cumulative beginning from October 1, 2001.

⁵ State government comprises central government and local government finances. Central government and Republican government are synonymous in this memorandum.

Floor on cumulative tax collections in cash

16. Cumulative tax collections in cash correspond to the line “IV. Tax Receipts” in the Treasury Report and comprise the following categories: 1.0 taxes on income and profits; 4.0 taxes on property; 5.1 VAT on domestic and imported products; 5.1.1.0 retail sales tax; 5.2 excises on domestic and imported products; 5.4 specific taxes on services; 5.5 taxes on use of goods and services; 5.6 taxes on use of natural resources; 6.0 taxes on international trade; 7.0 other taxes. Thus defined, cumulative tax collections in cash since January 1, 2001 amounted to som 6,112 million as of September 30, 2001. Cumulative tax collections in cash include collections of tax arrears but exclude tax offsets.

17. The floors for the cumulative tax collection in cash during the program period are reported in Table 5 below.

Table 5. Cumulative Floors on Tax Collections in Cash 1/

	(In millions of soms)
October 31, 2001 (prior action)	850
December 31, 2001 (indicative target)	2,787
March 31, 2002 (performance criterion)	4,942
June 30, 2002 (indicative target)	7,440
September 30, 2002 (indicative target)	10,316

1/ Cumulative from October 1, 2001.

Ceiling on the stock of central government budget arrears

18. For the purposes of the program, central government budget arrears are defined as an overdue payment obligation of the Republican budget related to: (i) wages; (ii) Social Fund payroll contributions; (iii) mandatory transfers to the Social Fund; (iv) categorical grants; and (v) payments to KyrgyzEnergo. A payment is defined to be overdue if it remains unpaid after its due date for (iii) and (iv); for 30 days after its due date for (i) and (ii); and 60 days after its due date for (v). As of September 30, 2001, the stock of thus defined central government budgetary arrears was som 207.7 million.

19. The ceilings on the stock of central government budget arrears during the program period are reported in Table 6 below.

Table 6. Stock of Central Government Budget Arrears

	(In millions of soms)
October 31, (prior action)	9
December 31, 2001 (indicative target)	0
March 31, 2002 (performance criterion)	0
June 30, 2002 (indicative target)	0
September 30, 2002 (indicative target)	0

Ceiling on the outstanding stock of Social Fund pension arrears

20. A pension payment by the Social Fund is defined as overdue if it remains unpaid for 30 days after its due date. As of September 30, 2001, the stock of pension arrears was zero.

Ceilings on contracting or guaranteeing of new external debt by the government or the NBKR

21. The contracting or guaranteeing of external debt by the government of the Kyrgyz Republic, the NBKR, or any other agency acting on behalf of the government, is understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.⁶

⁶ Executive Board's Decision No. 12274 (00/85) August 24, 2000.

22. Under the definition of debt above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

23. External debt limits apply to the **contracting or guaranteeing of short term external debt** (with an original maturity of less than one year, except normal import-related credits and NBKR reserve liabilities); **and contracting or guaranteeing of nonconcessional medium- and long-term external debt** (with original maturities of one year or more). Disbursements under the Fund's PRGF are excluded from the ceilings on external debt. The limit on the contracting or guaranteeing of short-term external debt is zero throughout the program period. Excluded from these external debt limits is the contracting or guaranteeing of new external debt that constitutes a rescheduling or refinancing of existing debt at terms more favorable to the debtor.

24. For program purposes, a debt is considered concessional if the grant element is at least 45 percent, calculated by using currency specific discount rates based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the debt maturity. A lower grant element will be considered only for new loans committed to replace old debt originally contracted at less favorable terms. The average of the CIRRs over the last 10 years will be used for debts with a maturity of at least 15 years and the average CIRR of the preceding six months will be used for shorter maturities.

Ceiling on new external arrears

25. For the purposes of the program, external arrears of the government of the Kyrgyz Republic or the NBKR will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of loans contracted or guaranteed by the state government or the NBKR since the Kyrgyz Republic's independence, unpaid penalties or interest charges associated with these arrears, and overdue payments owed by the state government or the NBKR on imports received subsequent to independence, unless these debt-service obligations in the view of the parties involved are not to be regarded as arrears for the purposes of the program. No such new arrears shall be incurred prior to the commencement of the three year arrangement or during the period of the arrangement.

Ceiling on reserve money

26. For the purposes of the program, reserve money consists of currency issued by the NBKR and balances on commercial banks' correspondent accounts with the NBKR. The stock of reserve money amounted to som 5,010 million as of end-September, 2001. The indicative limits for the program periods are reported in Table 7 below.

Table 7. Ceilings on Reserve Money 1/

	(In millions of soms)
October 30, 2001 (indicative target)	5,037
December 31, 2001 (indicative target)	5,058
March 30, 2002 (indicative target)	4,853
June 30, 2002 (indicative target)	4,775
September 30, 2002 (indicative target)	5,409

1/ End-of-period stocks.

VI. DISBURSEMENTS UNDER THE PROGRAM

27. The three-year PRGF arrangement envisages seven loan disbursements: the first, equivalent to SDR 11.72 million (13.2 percent of quota), upon approval of the arrangement; the second, equivalent to SDR 11.72 million (13.2 percent of quota), on completion of the first review based on the end-March 2002 performance criteria; the third, equivalent to SDR 11.72 million (13.2 percent of quota), on completion of the second review based on the performance criteria at end-September 2002; the fourth, equivalent to SDR 9.56 million (10.1 percent of quota), on completion of the third review based on end-March 2003 performance criteria; the fifth, equivalent to SDR 9.56 million (10.1 of quota), upon completion of the fourth review based on end-September 2003 performance criteria; the sixth, equivalent to SDR 9.55 million (10.1 percent of quota), on completion of the fifth review based on end-March 2004 performance criteria; and the seventh, equivalent to SDR 9.55 million (10.1 percent of quota) on completion of the sixth review based on end-September 2004 performance criteria. The end-September 2002 performance criteria will be established at the time of the first review. Performance criteria beyond September 2002 will be established in successive reviews.

VII. REPORTING REQUIREMENTS UNDER THE PROGRAM

28. The government and the NBKR will provide the Fund with the necessary economic and financial statistical data to monitor economic developments and the quantitative targets. In particular, the government and the NBKR will provide the following specific information:⁷

⁷Any correction or revisions to the data previously reported should be clearly indicated and documented as to the reasons for revision.

The balance sheet of the NBKR

29. The NBKR will provide to the Fund its balance sheet every Monday. The information provided will clearly identify the following items in the definitions specified above: the net foreign assets of the NBKR; the net international reserves; medium- and long-term liabilities; the net domestic assets of the NBKR; net credit from the NBKR to the general and other governments; net credit provided to commercial banks, other items net; and reserve money. The balance sheet will be provided valued at the actual exchange rate as well as according to the valuation applied under the program, as specified in Section I. The above information should be provided to the IMF Resident Representative and/or transmitted by e-mail to the Fund.

Monetary survey

30. Monthly banking system data, in the form of a monetary survey, will be reported to the Fund by the NBKR within 14 days of the end of the month. The information provided should clearly identify the following items: net foreign assets and net domestic assets of the banking system, medium- and long-term liabilities, net credit from the banking system to the general and other governments, financing provided to the rest of the economy, other items net, and broad money. The monetary survey will be provided valued at the actual exchange rate as well as according to the valuation applied under the program, as specified in Section I.

31. The NBKR will provide monthly data to the Fund within seven days after the end of the month on the amount of holdings of treasury bills, GKO's, state obligations, state bonds, and other securities issued by the state government, differentiated by the following categories of holders: the NBKR, resident banks, resident nonbanks, and nonresidents. The information will be provided in both the book (nominal) value and the actual value, where applicable.

International reserves and key financial indicators

32. The NBKR will provide detailed monthly data within 14 days from the end of the month on the composition of both its gross and net international reserves in convertible currencies and holdings of monetary gold. These data will be provided at two alternative sets of the exchange rates and the gold price: first, at those used to derive the NFA position in the NBKR accounts; second, at those specified in the program (Section I). In addition, weekly reports should be sent to the Fund every Monday on: (a) exchange rates (including the official and interbank exchange rates), foreign exchange interbank market turnover, and the volume of NBKR foreign exchange sales and purchases in the interbank market and with other parties; and (b) treasury bill yields and the amount of treasury bill sales and redemptions. On the 25th day of the month following the reference month, the NBKR will provide data on bank deposit and lending rates by maturity.

Banking system data

33. The NBKR will provide detailed bank-by-bank data within 14 days of the end of the month on commercial banks' compliance with: (a) prudential requirements; and (b) reserve requirements, as well as any penalties, sanctions and other administrative actions imposed on banks.

External debt

34. The Ministry of Finance, together with the NBKR, will provide monthly information on the disbursements, principal and interest payment—both actual and falling due; on contracting and guaranteeing of medium- and long-term external loans by the state government and the NBKR; and any stock of outstanding arrears on external debt service payments within 21 days of the end of each month. In addition, the Ministry of Finance will also report the total amount of outstanding government guarantees and external arrears on a monthly basis. While NBKR will provide the debt service payment data on private debt, the Ministry of Finance will provide data on debt service on public and publicly guaranteed loans.

Budgetary and extrabudgetary data

35. In addition to the monthly treasury report, the Ministry of Finance and the Social Fund will report monthly on all their recorded expenditure arrears, in particular on those defined above in this Annex. This information will be provided to the Fund staff within 26 days from the end of each reference month. The Ministry of Finance will also provide monthly reports on the disbursements and use under the public investment program and budgetary grants with a one-month time lag.

Balance of payments data

36. The NBKR will provide current account and capital account data, including data on foreign trade, services, official and private transfers, foreign investment, and disbursements of public and private loans, on a quarterly basis, with at most a two-month lag. The NBKR will also provide monthly foreign trade data with a two-month lag.

Other general economic information

37. The National Statistics Committee will notify the Fund of the monthly Consumer Price Index by category by the 5th business day of the following month, and convey quarterly GDP estimates within two months of the end of each quarter.

Table 8. Program Cross Exchange Rates

Currency Names		National Currency/US\$	US\$/National Currency
ATS	Austrian schilling	16.2219	0.06164506
GBP	UK pound sterling	0.7105	1.407459536
BEF	Belgium franc	47.5566	0.021027576
DKK	Danish krone	8.7845	0.113836872
EUR	euro	1.1788	0.848320326
INR	Indian rupee	47.04	0.021258503
ITL	Italian lira	2282.6645	0.000438085
CAD	Canadian dollar	1.5233	0.656469507
CNY	Chinese yuan	8.277	0.120816721
KRW	South Korean won	1299.9	0.00076929
DEM	Deutschemark	2.3057	0.433707768
NLG	Dutch guilder	2.5979	0.384926287
NOK	Norwegian krone	9.2985	0.107544228
PTE	Portuguese escudo	236.3478	0.004231053
TRL	Turkish lira	1259000	0.000000794
FIM	Finnish markka	7.0094	0.142665563
FRF	French franc	7.7331	0.129314247
SEK	Swedish krona	10.8441	0.092216044
CHF	Swiss franc	1.7947	0.557196189
JPY	Japanese yen	124.3054	0.008044703
AZM	Azerbaijani manat	4648	0.000215146
AMD	Armenian dram	554.11	0.001804696
BYR	Byelorussian ruble	1380	0.000724638
KZT	Kazakh tenge	146.5	0.006825939
LVL	Latvian lats	0.639	1.564945227
LTL	Lithuanian litas	4	0.25
MDL	Moldavian lei	12.9102	0.077458134
RUR	Russian ruble	29.1098	0.034352692
TJS	Tajik somoni	2.35	0.425531915
UZS	Uzbek sum	375.77	0.002661202
UAH	Ukrainian hryvnia	5.3828	0.185776919
EEK	Estonian kroon	18.4458	0.054212883

INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

**Staff Report for the 2001 Article IV Consultation and Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility
Supplementary Information**

Prepared by European II and Policy Development and Review Departments
(In consultation with other departments)

Approved by Mohammad Shadman-Valavi and Michael Hadjimichael

November 28, 2001

1. This supplement reports on key economic developments since the staff report (EBS/01/187) was issued, and on the implementation of the prior actions of the program.
2. **Data for end-October suggest that strong macroeconomic performance has continued.** Real GDP grew by 6 percent in the first ten months of 2001 compared to the same period a year ago. Despite the rapid growth of reserve money in the third quarter, the 12-month rate of inflation declined to 4.1 percent in October and the nominal exchange rate remained stable. The nominal interest rate on three-month T-bills had declined to 15 percent by mid-November.
3. **The nine quantitative prior actions for end-October were observed with one small deviation (Table 1).** The end-October targets for NIR and NDA were met by wide margins, and the floor on tax collection in cash was exceeded. Central government wages, electricity bill, grants, and social transfer payments were paid as scheduled. However, there was a two-week delay in the payments of one third of pensions because the Social Fund could not convert into cash in a timely manner the contributions received in-kind from the agricultural sector.
4. **The general government budget for 2002, as agreed with the Fund staff, was approved by the lower house of parliament on November 19 and by the upper house on November 20.** Both houses approved new tax measures amounting to about som 1.3 billion (1.7 percent of GDP), specified in paragraphs 12 and 13 of the authorities Memorandum of Economic Policies (Attachment I, EBS/01/187), with the exception of the broadening the VAT coverage in the construction sector (impact som 70 million). The government has re-submitted this measure with amendments for reconsideration by the parliament. However, after consulting the staff, the government proposed and parliament approved additional tax measures to compensate for the revenue loss resulting from the postponement of the amendments to the construction sector's VAT. These measures are: (i) continuing the 30 percent profit tax rate in 2002 for 16 enterprises that enjoy a government-imposed monopoly in the domestic market in addition to the natural

monopolies previously agreed upon with the staff (impact som 30 million); and (ii) broadening the coverage and an increase in existing tax rates on hotel and recreational resort services (impact som 40 million).

5. The two prior actions on structural reform were observed. As agreed with the Fund staff, the Regulatory Response Policy to strengthen bank supervision was approved by the government and the National Bank of the Kyrgyz Republic (NBKR) on October 31, and published in the mass media on November 16. The Presidential decree establishing the Economic Policy Council was issued on November 15. The Kyrgyz Republic has also continued to service its external debt obligations in a timely manner.

Staff appraisal

In the staff's view, the authorities have implemented the prior actions in a satisfactory manner. The short delay in part of the pension payments was corrected and compensatory measures were approved by parliament to prevent a reduction in the budget's revenue base. On the basis of the appropriate corrective action, and as the deviations from the agreed prior actions were small, the staff continues to support the authorities request for the new PRGF arrangement.

Table 1. Kyrgyz Republic: Quantitative Program Targets
(In millions of soms, unless otherwise indicated, e.o.p.)

	2001			
	Sept Actual 1/	October Prior Action 1/		October Actual
		Program	Adjusted	
I. Performance criteria				
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars) 2/	7.7	20.3	18.9	26.2
2. Ceiling on net domestic assets of the NBKR (eop stock) 3/	2,371	1,779	1,846	1,629
3. Ceiling on cumulative fiscal deficit of the state government 4/	2,271	n.a	n.a	n.a
4. Cumulative floor on state government tax collections in cash 5/	4,456	850	850	865
5. Ceiling on the stock of central government budget arrears 6/	208	9	9	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	73
7. Ceiling on contracting or guaranteeing new external debt of less than one year 7/ (in millions of U.S. dollars)	0	0	0	0
8. Ceiling on contracting or guaranteeing of new nonconcessional external debt 8/ (cumulative, in millions of U.S. dollars)	0	0	0	0
9. Ceiling on new external arrears (in millions of U.S. dollars) 9/	0	0	0	0
II. Indicative targets				
1. Ceiling on reserve money (NBKR liabilities)	5,010	5,037	5,037	5,168

Sources: Data provided by the Kyrgyz authorities; and Fund staff estimates and projections.

1/ Foreign exchange components valued at the exchange rate US\$1 = som 49, gold holdings valued at US\$265 per ounce, SDR valued at SDR 1 = US\$1.259. Targets exclude claims and liabilities to BRO countries. To the extent that the actual data for end-September 2001 deviates from the preliminary values, the program targets will be adjusted accordingly.

2/ Excludes swaps and international reserves of NBKR that are pledged or blocked.

3/ Excludes counterpart of the loan by the Eximbank of Turkey and the EBRD/IDA enterprise loan which are channeled through the NBKR. Starting September 2001 NDA do not include commercial banks' forex deposits with the NBKR.

4/ For September 2001, cumulative begins on April 1, 2001. State government comprises central and local government finances.

5/ For September 2001, cumulative begins on April 1, 2001. From October onwards, cumulative beginning as of October 1, 2001. Includes collection of tax arrears but excludes tax offsets.

6/ Central government budget arrears comprise wages, payroll contributions and mandatory transfers to the Social Fund, categorical grants, and payments to KyrgyzEnergO.

7/ As specified in the Technical Memorandum of Understanding (TMU), external debt is defined as in Executive Board's Decision no. 12274 (00/85) of August 24, 2000. Includes leases and other instruments giving rise to external debt.

8/ As specified in the TMU, external debt is defined as in Executive Board's Decision no. 12274 (00/85) of August 24, 2000. A debt is classified as concessional if its grant element is at least 45 percent, calculated using a discount rate based on the 10-year average of OECD commercial interest reference rates (CIRR), for debts of maturity greater than 15 years; for debts of maturity 15 years or less, the discount rate should be based on the six month average of the OECD CIRR. The ceilings include loans, leases, supplier's credits and other instruments giving rise to external debt on nonconcessional terms. IMF lending is excluded from the ceiling on new nonconcessional borrowing.

9/ On a continuous basis.

Adjustors

1. The floor on net international reserves of the NBKR will be adjusted: (i) upward/downward by 100 percent for excesses/shortfalls of the use of net foreign financing of the state budget and cash grants; (ii) upward/downward by 100 percent for excess/shortfall of cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (ii) is limited to US\$ 15 million each.

2. The ceiling on net domestic assets of the NBKR will be adjusted: (i) downward/upward by 100 percent for excesses/shortfalls of the use of net foreign financing of the state budget and cash grants; (ii) downward/upward by 100 percent for excess/shortfall of cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (ii) is limited to US\$ 15 million each valued at the program exchange rate.



Press Release No. 01/49
FOR IMMEDIATE RELEASE
November 30, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves In Principle Three-Year, US\$93 Million PRGF Arrangement for the Kyrgyz Republic

The Executive Board of the International Monetary Fund (IMF) today approved in principle a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for the Kyrgyz Republic for SDR 73.4 million (about US\$93 million) to support the government's 2001-04 economic program.

A final decision by the Executive Board is pending discussion of the Kyrgyz Republic's Interim Poverty Reduction Strategy Paper (I-PRSP), entitled Interim National Strategy for Poverty Reduction (I-NSPR), by the World Bank's Executive Board, which is expected on December 4, 2001. The final decision will enable the immediate release of a first loan under the PRGF arrangement of SDR 11.7 million (about US\$15 million).

After the Executive Board's discussion on the Kyrgyz Republic, Eduardo Aninat, Deputy Managing Director and Acting Chairman, said:

"The Fund commends the Kyrgyz Republic's recent achievements in macroeconomic stabilization, and the authorities' renewed commitment to strengthen the foundations for economic growth and poverty reduction through sustained fiscal adjustment and structural reform is encouraging. The recent approval by parliament of a prudent 2002 budget represents an important step forward. The new tax policy measures should now be implemented promptly, and a sustained effort will be needed to strengthen tax administration and revenue performance over the medium term. Regarding expenditure management, apart from ensuring timely payment of wages and social benefits, it is particularly important that the Ministry of Finance, in close cooperation with line ministries and international donors, continues to streamline the Public Investment Program while raising the efficiency of public investment.

"The program's monetary policy is appropriately tight to support further gains in lowering inflation and instilling confidence in the som. In late June, the National Bank took an important step towards strengthening the banking system by liquidating four insolvent banks, thereby demonstrating clearly that violations of prudential banking regulations will not be tolerated. Reform efforts to improve confidence in the banking sector will need to be continued, and the new Regulatory Response Policy, which enhances the enforcement powers of the bank supervision authorities, is especially welcome in this respect.

“The authorities’ comprehensive external debt strategy shows their determination to tackle the problem of the country’s debt burden, but success hinges critically on a strong fiscal adjustment. It will also be crucial to accelerate privatization and devote such proceeds to reducing the stock of external debt, and to contract new loans only at highly concessional terms. Concerted efforts by external creditors will also be required to achieve external debt sustainability in the longer term.

“An Economic Policy Council has recently been established to help upgrade the country’s economic policy making capacity and improve governance. The Fund looks forward to further steps to reduce impediments to private sector development, enhance the transparency in the management of public finances, and simplify tax and custom administration regulations.

“The National Strategy for Poverty Reduction has benefited from a broad-based participatory process. Over the next twelve months, the challenge is to finalize the poverty reduction strategy by carefully assessing the cost of alternative policies, setting spending priorities in the context of a medium-term fiscal framework, and defining in more detail key policies in the area of social policy and public administration reform,” Mr. Aninat said.

Recent Economic Developments

In 2001, macroeconomic performance in the Kyrgyz Republic continued to improve. Real GDP growth accelerated to 6.7 percent in the first nine months of 2001, compared with 5 percent in the same period in 2000. Growth has been driven by agriculture, mining, trade, and construction. Twelve-month inflation dropped to 5.2 percent in September 2001 in part reflecting an appreciation of the nominal exchange rate vis-à-vis the U.S. dollar. However, as Kyrgyz dollar wages are low, the Kyrgyz cost of competitiveness has remained satisfactory.

Fiscal performance has improved. In the first half of 2001, the state government's annualized overall fiscal deficit declined to 4.6 percent of GDP, mainly owing to lower public investments. Monetary conditions remained tight in the first half of 2001. In the third quarter, the National Bank of the Kyrgyz Republic (NBKR) bought significant amounts of foreign exchange in the market to strengthen its foreign reserve position. Nevertheless, despite the increase in reserve money, the nominal effective exchange rate remained stable, or even appreciated, suggesting that the demand for money has strengthened. Nominal and real interest rates have also declined. On structural reforms, progress has been made in several areas, particularly in the banking sector and in government administration.

Program Summary

The proposed economic program for 2001-04 has three pillars: further macroeconomic stabilization, a credible external debt strategy, and more focused structural reforms. Output is projected to increase by 4.5 percent in 2002, and inflation is targeted to decline to 6 percent during 2002 from the 7 percent projected for 2001. The central bank's gross foreign reserves are expected to increase to 3.9 months of imports at end-December due to bunching of balance of payments support in the last quarter of 2001, before declining to 3.8 months of imports by the end of the first-year program. These short-term targets incorporate the estimated impact of the recent downturn in the world economy and the September 11 tragedy.

Over the next three years, real GDP is projected to grow by 4.5 percent per annum, below the rates seen in more advanced transition economies. At this stage, the medium-term projections are based on the assumption that the conflict in Afghanistan does not have a major adverse effects in the Kyrgyz economy, as about 80 percent of its foreign trade is with countries outside the sensitive region. The anticipated acceleration in productivity growth reflects, in addition to the catch-up in the utilization rate of labor and capital, the expected impact of the structural reforms to be implemented under the program. The economy's gross investment ratio is projected to remain unchanged at 16 percent of GDP despite the projected streamlining of the Public Investment Program (PIP). Government investment is expected to fall to 4.8 percent of GDP by 2004 from 8.5 percent in 2000. The authorities believe that the decline in public investment will be compensated by higher private investment.

On the fiscal side, the program aims at strong adjustment to promote macroeconomic stability and to address the external debt problem. The authorities intend to restructure the Ministry of Finance to strengthen its control over the implementation of the budget and fiscal policy. This

will entail initiating the next stage of the treasury reform and further measures to improve tax administration. A broader tax reform will include new revenue measures in the 2002 budget to raise the tax-to-GDP ratio in the medium term.

A tight monetary policy is critical for further reducing inflation and the required balance of payments adjustment. The economy remains highly dollarized and a tight supply of money serves well for strengthening confidence in the local currency. On exchange rate policy, the NBKR agreed that a flexible regime is currently the most appropriate. Interventions in the foreign exchange market will be directed only at the accumulation of reserves and smoothing temporary market fluctuations.

The external current account deficit is projected to decline to 6-6.5 percent of GDP in 2001 and 2002 from 8 percent in 2000. In 2002, the volume of exports is projected to increase by 2.6 percent, mainly because gold exports are projected to decline. As the PIP will be further streamlined, imports are projected to grow only by 3.5 percent. The surplus in the capital account is expected to narrow significantly in 2001 as disbursements of project and program loans decline before stabilizing at around 2 percent of GDP in 2002.

The government plans to amend its comprehensive external debt strategy and intends to request rescheduling of the Kyrgyz Republic's bilateral debts from the Paris Club and private creditors on Naples terms; ensure comparability of treatment of creditors, as typically required by the Paris Club if repaying debt early; and take further measures to improve the country's external debt management capacity.

Structural reforms will focus on areas that are macrorelevant and critical for the success of the program. Priority is given to four areas: banking sector reform, privatization of the four strategic enterprises, reduction of the energy sector's quasi-fiscal deficit, and improving governance.

The Poverty Reduction Process

The I-NSPR sets out the main elements of the three-year approach to broader structural reform and poverty reduction consistent with the economic program supported by the Fund under the PRGF. In addition, it outlines reform initiatives in the areas of infrastructure, agriculture, small and medium-size enterprise development, and social protection. The authorities intend to develop a full-fledged NSPR in the second half of 2002.

The Kyrgyz Republic joined the IMF on May 8, 1992. Its quota¹ is SDR 88.8 million (about US\$113 million), and its outstanding use of IMF resources totaled SDR 134 million (about US\$170 million) as of October 31, 2001.

¹ A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Kyrgyz Republic: Selected Economic Indicators, 1997-2002

	1997	1998	1999	2000 Act.	2001 Proj.	2002 Proj.
GDP						
Nominal GDP (in billions of soms)	30.7	34.2	48.7	62.2	70.9	80.2
Nominal GDP (in millions of U.S. dollars)	1,767	1,630	1,243	1,302	1,447	1,637
Real GDP (growth in percent)	9.9	2.1	3.7	5.0	5.0	4.5
GDP per capita (in U.S. dollars)	371	338	254	263	289	324
Prices and wages						
Consumer prices (percent change, eop)	13.0	16.8	39.9	9.6	7.0	6.0
Consumer prices (percent change, avg)	23.5	10.5	35.9	18.7	7.7	7.5
Nominal exchange rate (eop)	17.4	29.4	45.3	48.9	...	...
Exchange rate (soms per U.S. dollar, average)	17.4	21.0	39.1	47.8	...	...
Average real wage (1994=100)	114.6	129.7	118.0	120.8	131.5	135.5
Average monthly wage (in U.S. dollars)	36.1	37.4	24.7	24.7	28.2	31.2
State government finances						
Total revenue and grants	16.2	18.0	17.7	15.9	18.1	17.3
Tax revenue	12.5	14.2	12.3	12.3	13.0	13.8
Total expenditure	25.3	28.8	30.4	26.1	24.1	22.2
Non-interest current expenditure	19.9	20.6	17.3	15.2	15.7	14.6
Public Investment Program (PIP)	3.1	5.7	9.4	7.1	6.0	5.5
Overall fiscal balance (including PIP, cash basis)	-9.2	-9.5	-11.9	-9.7	-6.0	-4.9
Primary balance 1/	-7.5	-7.4	-9.0	-6.8	-4.0	-2.9
Primary balance (excl. PIP)	-4.4	-1.7	0.4	0.3	2.1	2.6
Money and credit 2/						
Reserve money (end-of-period)	21.1	6.8	23.4	12.3	5.1	8.0
Broad money (end-of-period)	25.4	17.2	33.9	10.2	3.0	12.4
Velocity of broad money 3/	8.4	8.6	8.5	10.0	11.2	10.8
Money multiplier	1.4	1.5	1.6	1.6	1.5	1.6
External sector						
Export growth (goods and services, percent change) 4/	20.1	-11.5	-11.8	8.6	-4.3	2.9
Import growth (goods and services, percent change) 4/	-20.8	14.0	-24.7	-7.2	-5.3	4.9
Current account balance (in percent of GDP)	-8.3	-22.9	-15.6	-7.9	-6.2	-6.3
Gross international reserves (months of imports, end-period) 5/	1.8	2.2	3.4	4.0	3.9	3.7
External debt outstanding in percent of GDP 6/	83.4	95.3	134.5	132.4	125.0	114.9
Debt service-to-export ratio 7/	11.7	19.2	21.7	22.5	28.3	29.1
Debt service-to-fiscal revenue ratio 8/	14.4	16.3	21.1	37.0	27.9	22.4

Sources: Kyrgyz authorities; and IMF staff estimates and projections.

1/ Overall balance less interest payments.

2/ 1999 estimate shown at actual exchange rate.

3/ Annualized quarterly GDP/end-of-period broad money.

4/ In U.S. dollars; includes the operations of the Kumtor gold mining company.

5/ Gross reserves exclude international reserves of NBKR that are pledged or blocked.

6/ Includes Kumtor.

7/ Public and publicly guaranteed debt service in percent of exports of goods and non-factor services.

Includes Kumtor.

8/ Public and publicly guaranteed debt service in percent of state government fiscal revenue. Excludes Kumtor.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 01/126
FOR IMMEDIATE RELEASE
December 19, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with the Kyrgyz Republic

On November 30, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kyrgyz Republic.¹

Background

Over the past two years, macroeconomic performance in the Kyrgyz Republic has improved significantly. Real GDP growth accelerated to 5 percent in 2000 from 3.7 percent in 1999, and to 6.7 percent in the first nine months of 2001 compared with the same period a year earlier. Growth was mainly driven by agriculture, mining, trade, and construction.

The proposed program has three pillars: further macroeconomic stabilization, a credible external debt strategy, and more focused structural conditionality. The key policy parameters of the first-year program are an increase in the primary fiscal surplus excluding the Public Investment Program (PIP), to 2½ percent of GDP in 2002 from 0.3 percent of GDP in 2000, and containing the growth of broad money to 13½ percent during the program period. The first-year program aims at maintaining economic growth at 5 percent in 2001 and 4.5 percent in 2002 with a further reduction of inflation to 7 percent during 2001 and to 6 percent during 2002. Over the next 3 years, average real GDP growth is projected at around 4½ percent.

The major contribution to growth is expected to come from improvements in total factor productivity as a result of the expected impact of the structural reforms to be implemented under the program. The economy's gross investment ratio is projected to remain unchanged at 16 percent of GDP despite the planned streamlining of the PIP. The government's share of

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the November 30, 2001 Executive Board discussion based on the staff report.

investment is expected to fall from 8.5 percent of GDP in 2000 by about 4 percentage points of GDP by 2004, mainly as a result of the PIP streamlining and reorientation towards export-enhancing projects. The streamlining of the PIP is a component of the debt reduction strategy. The authorities expect that the decline in government investment will be compensated by higher private investment.

The authorities agree that a continuation of a strong fiscal adjustment is needed to address the external debt problem but also to restore policy credibility. To this end, they have already approved the 2002 budget, which includes new tax measures to both compensate for the income tax reductions approved by parliament in July 2001 and increase the tax-to-GDP ratio. On the expenditure side, the authorities expect to lower PIP spending to 5.5 percent of GDP from 6 percent of GDP in 2001. The overall cash deficit would be reduced to 4.9 percent of GDP in 2002 from 6.0 percent of GDP in 2001 and 9.6 percent in 2000.

The authorities plan to maintain a tight monetary policy for lower inflation, a stable exchange rate, and the required balance of payments adjustment. The National Bank intends to continue with the flexible exchange rate regime and to intervene in the foreign exchange rate market only to accumulate reserves and smooth temporary market fluctuations.

The external current account deficit and the capital account surplus are both projected to narrow in 2001 as a percent of GDP and to stabilize in 2002. On trade, the authorities intend, in line with their commitment to the WTO, to reduce the top import tariff from 20 percent to 17.5 percent in the 2002 budget, while reducing the number of tariff bands from six to four.

The proposed first-year program is financed. The \$91 million external financing needed during the first-year program is expected to be met through a combination of debt reschedulings in the context of the Paris Club and balance of payments support from multilateral institutions. The average financing gap for 2003–04, estimated at US\$31 million after Paris Club debt reschedulings and support from Fund resources, is expected to be covered by customary balance of payments support from other international financial institutions and bilateral donors. The government will continue to be prudent in its external borrowing and is implementing the comprehensive debt strategy approved in 2001.

The program focuses structural conditionality on areas that are macro relevant and critical for the success of the program. Priority is given to four areas: banking sector reform, privatization of the four strategic enterprises, reduction of the energy sector's quasi-fiscal deficit, and improving governance. The authorities have elaborated their plans to combat poverty in their Interim National Strategy for Poverty Reduction (I-NSPR). About half the population of the Kyrgyz Republic live in poverty. The strategy paper outlines a set of macroeconomic policies and structural reforms aimed at supporting economic growth and poverty reduction. A full-fledged NSPR will be prepared by September 2002.

Executive Board Assessment

Directors commended the authorities' recent macroeconomic policy performance, which has resulted in strong growth, low inflation, and stability in the foreign exchange market. The government's commitment to a deepening of structural reform has already resulted in an

improved implementation record in 2001, but resolute implementation of the new economic program will be needed to enhance prospects for sustained growth and poverty reduction, and a resolution of the country's debt problem.

While acknowledging the improved fiscal performance, Directors underscored the need to stay firmly on course in implementing the 2002 budget in order to avoid repeating the fiscal slippages of past years. They stressed that achieving the budget's revenue targets will require greater efficiency in tax administration and prompt implementation of the tax policy measures approved as part of the 2002 budget. Over the medium term, broader reforms, aimed at improving tax revenue performance to generate sufficient resources for additional social spending and reducing the external debt burden, should be placed high on the agenda.

On the expenditure side, Directors urged the authorities to move forward with the Treasury reform and welcomed their intention to enhance the control of the Ministry of Finance over the implementation of the budget. They highlighted, in particular, the importance of ensuring, through close cooperation with line ministries and international donors, that the PIP is adequately streamlined, kept in check, and prioritized with a view to raising the efficiency of public investment.

Directors commended the National Bank of the Kyrgyz Republic on its monetary and exchange rate policy. They agreed that an appropriately tight monetary policy should be continued to consolidate the recent gains in reducing inflation and building confidence in the currency, and that the flexible exchange rate regime should continue to serve the country well. Interventions in the foreign exchange market should take place only to accumulate reserves and smooth temporary market fluctuations.

Directors welcomed the recent actions to strengthen the banking system, including the liquidation of four insolvent banks, but stressed that banking sector reforms will need to be sustained to re-establish public trust in banks and mobilize savings to support investment. They urged the authorities to be ready to implement the new Regulatory Response Policy whenever necessary. Directors also looked forward to further steps to strengthen the powers of the debt recovery agency and the regulatory authority of the central bank.

Directors commended the authorities for their ambitious external debt strategy. They stressed the critical importance of a strong medium-term fiscal adjustment through increased revenue collection and a streamlined PIP at a level compatible with the country's debt service capacity. The commitment to devote the proceeds from privatization to external debt reduction is welcome, and Directors recommended the authorities to work closely with the World Bank and other International Financial Institutions to accelerate the divestiture of the large strategic enterprises. They also urged the authorities to improve their debt management capacity and maintain strict discipline in external borrowing. Directors welcomed the willingness of Paris Club creditors to reschedule debt service payments falling due in the period ahead, while noting that, over the medium term, debt reschedulings on highly concessional terms will be needed to improve the prospects for growth and for achieving debt sustainability.

Directors looked forward to a sustained implementation of the authorities' streamlined structural reform agenda. In addition to banking sector reforms, they stressed the importance

of reducing the quasi-fiscal deficit of the energy sector. Directors welcomed the authorities' efforts to improve governance, including the recent establishment of the Economic Policy Council, which should improve the efficiency and coordination of economic policy making. Strong efforts will be required over an extended period of time, however, to improve the business environment. They urged the authorities to reduce the impediments to private sector growth, enhance transparency in the management of public finances, and simplify tax and customs administration.

Directors commended the work done in developing the National Strategy for Poverty Reduction, in particular, the comprehensive poverty diagnosis and the participatory process that have underpinned the development of the strategy. They noted, however, that much remains to be done in assessing the costs of the proposed policies, setting spending priorities in the context of a medium-term fiscal framework, and defining in detail key policies in the areas of social safety net and public administration reform.

Directors welcomed the Report on Standards and Codes on fiscal transparency. They encouraged the authorities to implement its recommendations, including the proposals for further improving the integrity and quality of fiscal data.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with the Kyrgyz Republic is also available.

Kyrgyz Republic: Selected Economic Indicators, 1997–2002

	1997	1998	1999	2000 Act.	2001 Proj.	2002 Proj.
GDP						
Nominal GDP (in billions of soms)	30.7	34.2	48.7	62.2	70.9	80.2
Nominal GDP (in millions of U.S. dollars)	1,767	1,630	1,243	1,302	1,447	1,637
Real GDP (growth in percent)	9.9	2.1	3.7	5.0	5.0	4.5
GDP per capita (in U.S. dollars)	371	338	254	263	289	324
Prices and wages						
Consumer prices (percent change, eop)	13.0	16.8	39.9	9.6	7.0	6.0
Consumer prices (percent change, avg)	23.5	10.5	35.9	18.7	7.7	7.5
Nominal exchange rate (eop)	17.4	29.4	45.3	48.9	...	...
Exchange rate (soms per U.S. dollar, average)	17.4	21.0	39.1	47.8	...	...
Average real wage (1994=100)	114.6	129.7	118.0	120.8	131.5	135.5
Average monthly wage (in U.S. dollars)	36.1	37.4	24.7	24.7	28.2	31.2
			(In percent of GDP)			
State government finances						
Total revenue and grants	16.2	18.0	17.7	15.9	18.1	17.3
Tax revenue	12.5	14.2	12.3	12.3	13.0	13.8
Total expenditure	25.3	28.8	30.4	26.1	24.1	22.2
Non-interest current expenditure	19.9	20.6	17.3	15.2	15.7	14.6
Public Investment Program (PIP)	3.1	5.7	9.4	7.1	6.0	5.5
Overall fiscal balance (including PIP, cash basis)	-9.2	-9.5	-11.9	-9.7	-6.0	-4.9
Primary balance 1/	-7.5	-7.4	-9.0	-6.8	-4.0	-2.9
Primary balance (excl. PIP)	-4.4	-1.7	0.4	0.3	2.1	2.6
			(Percent change, unless stated otherwise)			
Money and credit 2/						
Reserve money (end-of-period)	21.1	6.8	23.4	12.3	5.1	8.0
Broad money (end-of-period)	25.4	17.2	33.9	10.2	3.0	12.4
Velocity of broad money 3/	8.4	8.6	8.5	10.0	11.2	10.8
Money multiplier	1.4	1.5	1.6	1.6	1.5	1.6
External sector						
Export growth (goods and services, percent change) 4/	20.1	-11.5	-11.8	8.6	-4.3	2.9
Import growth (goods and services, percent change) 4/	-20.8	14.0	-24.7	-7.2	-5.3	4.9
Current account balance (in percent of GDP)	-8.3	-22.9	-15.6	-7.9	-6.2	-6.3
Gross international reserves (months of imports, end-period) 5/	1.8	2.2	3.4	4.0	3.9	3.7
External debt outstanding in percent of GDP 6/	83.4	95.3	134.5	132.4	125.0	114.9
Debt service-to-export ratio 7/	11.7	19.2	21.7	22.5	28.3	29.1
Debt service-to-fiscal revenue ratio 8/	14.4	16.3	21.1	37.0	27.9	22.4

Sources: Kyrgyz authorities; and IMF staff estimates and projections.

1/ Overall balance less interest payments.

2/ 1999 estimate shown at actual exchange rate.

3/ Annualized quarterly GDP/end-of-period broad money.

4/ In U.S. dollars; includes the operations of the Kumtor gold mining company.

5/ Gross reserves exclude international reserves of NBKR that are pledged or blocked.

6/ Includes Kumtor.

7/ Public and publicly guaranteed debt service in percent of exports of goods and non-factor services. Includes Kumtor.

8/ Public and publicly guaranteed debt service in percent of state government fiscal revenue. Excludes Kumtor.

**Statement by Roberto F. Cippà, Executive Director and Narynbek Davletov,
Assistant to Executive Director for the Kyrgyz Republic
November 30, 2001**

Our Kyrgyz authorities would like to thank the staff for the thorough report and express their appreciation for the staff's advice and assistance in the preparation of the new program. They regret that the previous PRGF arrangement could not be concluded and make every effort to address the underlying problems that have contributed to the policy slippages. To improve coordination, transparency, and effectiveness in the government's economic policy making, an Economic Policy Council (EPC) has been established. To improve budget transparency, a web site has been constructed to give the media and the general public access to budget documents. To strengthen the control and implementation of fiscal policy, the authorities intend to proceed to the next stage of the treasury reform and to restructure the Ministry of Finance with the help of the upcoming technical assistance missions from the Fund.

In 2001, policy implementation has improved significantly. All the track record targets for key fiscal and monetary policy variables for the period February-June and the end-October financial policy targets have been met, with one short delay in part of the pension payments. The parliament also approved the revised budget for 2001 as well as the 2002 budget with an ambitious set of new tax measures. Macroeconomic performance, which has been satisfactory under the previous PRGF program, has further improved. Real GDP growth has accelerated to 6 percent in the first ten months of the year, and the 12-month inflation rate has declined to about 4 percent in October.

Although persisting security problems at the south border of the country, the impact of the September terrorist attacks in the United States, and the ongoing military operations in Afghanistan pose serious risks and add to the already numerous challenges the country is facing, the authorities are confident that the positive macroeconomic achievements, the stabilization of the political situation after the Presidential election, and the appointment of a new government all provide a very good basis for successful performance under the new PRGF program. They are fully committed to the new program and are looking for an opportunity to re-establish their reputation as a strong performer under Fund supported economic programs. The proposed program rests on three pillars: further macroeconomic stabilization, a credible external debt strategy, and more focused structural reforms.

Macroeconomic Stabilization

Under previous Fund programs, the Kyrgyz Republic has made considerable progress towards macroeconomic stabilization. The Kyrgyz authorities are confident that by continuing the implementation of stability-oriented macroeconomic policies and by increasing the pace of structural reforms, they will be able to secure high and sustainable growth, which remains the main pillar of their development and poverty strategy. The authorities are also confident that an open foreign trade system is essential to reap the benefits from globalization and remain committed to maintain a free trade and exchange regime.

As pointed out by the staff, fiscal policy has been the Achilles heel of previous programs. Improving fiscal management and achieving further fiscal consolidation therefore remains a top priority. The authorities fully recognize the importance of fiscal adjustment in pursuing the multiple goals of poverty alleviation, solving the debt problem, and restoring policy credibility. They believe that the fiscal program underlying the new PRGF arrangement is sufficiently ambitious, while remaining feasible. The revised state budget for 2001, which targets a primary surplus of 2.1 percent of GDP (excluding the Public Investment Program, PIP) with the overall cash deficit declining from 9.7 percent to 6 percent of GDP, is being resolutely implemented. The budget 2002 is set to further improve the surplus in the primary fiscal balance to 2.6 percent of GDP with the overall cash deficit declining to 4.9 percent. The authorities are confident that the combination of new tax revenue measures, stricter expenditure control, and better policy coordination will enable the achievement of the fiscal targets. In case of unexpected deviations from the targets they stand ready to introduce additional corrective measures.

The new tax measures included in the revised 2001 budget are projected to increase tax revenues by about 0.7 percent of GDP to 13.0 percent. The authorities have also revised earlier tax rate decisions and established a transfer mechanism to compensate the Social Fund for the projected revenue loss through a state budget transfer of Som 310 million in 2002. The new revenue measures in the 2002 budget are part of a broader tax reform agenda to raise the tax-to-GDP ratio in the medium term. On the expenditure side, fiscal consolidation will depend on the success in streamlining PIP. The high volume of foreign-financed public investment over the past years has been beneficial for the Kyrgyz Republic, given the large demand for infrastructure spending. However, the high investment volume also led to a bunching of debt service payments in the medium term and faced capacity and resource constraints in terms of domestic absorption and availability of funds to cover recurrent costs and domestic counterpart payments. In view of the large pressures stemming from the high stock of external debt and the necessity of fiscal consolidation, the authorities are scaling down the PIP to a more sustainable level. They are confident that a negative growth impact can be avoided through better prioritization of public investment projects and higher private sector investment.

The monetary authorities fully concur with staff on the need to continue with an appropriately tight monetary policy stance to consolidate the significant gains that have been achieved in disinflation and exchange rate stability; achievements that have contributed considerably to restoring confidence in the national currency. The National Bank of the Kyrgyz Republic (NBKR) will continue to implement a flexible exchange rate regime, intervening in the foreign exchange market only to smooth temporary market fluctuations. It is also worth emphasizing that our authorities are fully cognizant of the importance of guaranteeing the NBKR's full independence. A new charter for the NBKR's Council and legislative changes that are necessary in this connection will ensure the NBKR's independence while increasing, at the same time, its accountability and transparency.

External Debt Strategy

The staff's analysis gives a compelling demonstration of the fact that the current high level of external debt poses a serious risk for macroeconomic stability in the medium-term. In an effort to make the debt situation more sustainable, the Kyrgyz government has recently adopted a comprehensive debt strategy and continued its work on improving its debt management capacity. The debt strategy envisages raising the primary fiscal surplus, considerably reducing the public investment program, using 75 percent of future privatization revenues for debt reduction, repaying ahead of schedule external debt respecting the principal of equal treatment of bilateral creditors, and raising the level of concessionality of all new external borrowing to at least 45 percent. All these measures will help in reducing the debt burden but, as clearly stated by the staff, even after successful implementation of the debt strategy the debt indicators will remain excessively high. What is needed in this situation is securing the full cooperation and understanding of all external creditors, which would result in agreeing on an adequately generous restructuring of the Kyrgyz foreign debt. As shown in the staff paper, a stock rescheduling under Naples terms would go a long way toward restoring the long-term viability of the Kyrgyz Republic's external position.

However, before the new debt strategy will start bearing fruit and any comprehensive debt rearrangement will be possible, the Kyrgyz authorities are making strong efforts to maintain orderly relations with their creditors and to avoid external payment arrears by concluding bilateral rescheduling agreements. The recently signed rescheduling agreements with Russia and Turkey have significantly contributed to alleviating the current fiscal and balance of payments pressures. Our authorities are grateful to the Russian and Turkish governments for offering this kind of support. However, such conventional, non-concessional rescheduling agreements provide only a very short-term relief and result in a rather marginal reduction of debt indicators calculated in NPV terms. As noted above, a more comprehensive and bold approach is needed to provide a lasting solution to the Kyrgyz debt problem. Accordingly, the authorities have started negotiations with the Paris Club.

More Focused Structural Reforms

Structural reforms are the key factor deciding about the assumed improvement in total factor productivity that underpins the medium-term growth scenario. The authorities recognize that the implementation of structural reforms has been more uneven than planned. They are confident that by better focusing on those areas that are critical for the success of the program, i.e., banking sector reform, privatization of strategic enterprises, reduction of the quasi-fiscal deficits in the energy sector, and improving governance, progress will be more continuous. The parliament has approved the state property privatization concept for the years 2001-2003, and efforts to privatize the four strategic enterprises (Kyrgyz Telecom, Kyrgyz Energo, Kyrgyz Gas and Kyrgyz Airlines) have been intensified. Further progress has also been made in liberalizing foreign trade, in line with the commitments to the WTO. As regards trade relations, our Kyrgyz authorities hope that the restrictions imposed by some neighboring countries will soon be eliminated, as these represent a serious obstacle for the Kyrgyz Republic to be able to fully develop its economic potential.

As regards the banking sector, the Kyrgyz authorities' near-term strategy encompasses activities in three main areas: strengthening the capital base of the solvent banks and liquidating banks that fail to meet the capital requirements, improving supervision and strengthening the legislative framework for the banking sector, and enhancing the effectiveness of the Debt Recovery Agency (DEBRA). After last year's significant increase in the combined capital of the Kyrgyz banks, the authorities proceeded with recapitalization of the systemically important Kairat Bank and transferred its ownership from the central bank to the Ministry of Finance. The authorities acted decisively to solve the problem of five undercapitalized private banks by revoking the licenses of four of them and by ensuring capital increase and change of management in the fifth bank (Asia Universal). To enhance banking supervision the NBKR and the government adopted a Regulatory Response Policy (RRP), which will improve the effectiveness and transparency of NBKR's supervision by clearly presenting the types of actions to be initiated in response to various weaknesses and irregularities. The existing legislation will also be amended to strengthen the legal powers and protection of the NBKR and its employees in performing their supervisory functions. The debt recovery capacity of DEBRA will be enhanced by making it the exclusive liquidator of failed banks and by eliminating legal obstacles to debt recovery and access to collateral.

National Strategy for Poverty Reduction

A specific feature of the Kyrgyz I-NSPR is its full integration with the long-term Comprehensive Development Framework (CDF), which has been developed under the World Bank's pilot program. Like the CDF, the I-NSPR rests on three pillars of poverty mitigation, economic growth, and governance reform. The macroeconomic framework of the PRGF program and the new comprehensive debt strategy constitute integral parts of the I-NSPR because the Kyrgyz authorities realize that their goals of poverty eradication and social development cannot be achieved without securing macroeconomic stability and establishing conditions for sustainable long-term growth. A broad dialogue with all stakeholders has been a hallmark of the Kyrgyz authorities' efforts to develop the poverty reduction strategy. While the I-NSPR is being implemented, the government has put into operation measures for the preparation of the final NSPR document, which it intends to complete by September 2002 with the support of technical assistance from the staffs of the Bank and the Fund.

In several areas, such as health, education or access to electricity the main challenge is to maintain or restore the relatively high earlier standards, which already have been eroded or are seriously threatened by the shrinking availability of public resources. Despite the very difficult fiscal position, the authorities plan to more than double their spending on health, education and other social programs until 2005. Faced with serious resource constraints, our authorities intend to focus their attention on supporting such sectors or activities as agriculture and agribusiness or small and medium-size enterprise development, because these can bring the richest dividend in terms of poverty reduction and employment creation. Our authorities also realize that without effective governance and adequate management capacities the benefits of improved macroeconomic performance would not be fully shared

by the poorest segments of the population. They intend to improve their institutional capabilities through such measures as public administration reform, decentralization, public finance reform and improvements in corporate governance. Our authorities note with satisfaction that in the Joint Staff Assessment the staffs have concluded that the I-NRSP and the progress on the development of the full NRSP provide a sound basis for the provision of Bank and Fund concessional assistance.