

**Kyrgyz Republic: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for New Three-Year PRGF Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Kyrgyz Republic**

In the context of the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for the Kyrgyz Republic and its request for a new three-year PRGF arrangement, the following documents have been released and are included in this package:

- the staff report for the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for new three-year PRGF arrangement, prepared by a staff team of the IMF, following discussions that ended on December 18, 2004, the officials of the Kyrgyz Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 8, 2005. 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 statement of February 23, 2005 updating information on recent economic developments.
- a Press Release summarizing the views of the Executive Board as expressed during its February 23, 2005 discussion of the staff report that completed the request and review.
- a statement by the Executive Director for the Kyrgyz Republic.

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

Letter of Intent sent to the IMF by the authorities of the Kyrgyz Republic\*  
Memorandum of Economic and Financial Policies by the authorities of the  
Kyrgyz Republic\*  
Technical Memorandum of Understanding\*  
\*May also be included in Staff Report

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

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KYRGYZ REPUBLIC

**Sixth Review Under the Three-Year Arrangement Under  
the Poverty Reduction and Growth Facility and Request  
for New Three-Year PRGF Arrangement**

Prepared by the Middle East and Central Asia Department  
(in cooperation with other Departments)

Approved by Juan Carlos Di Tata and Donal Donovan

February 8, 2005

- Discussions for the sixth review under the Poverty Reduction and Growth Facility (PRGF) arrangement and a new three-year PRGF arrangement were held in Bishkek during December 7–18, 2004. The staff team consisted of Mr. Saavalainen (head), Mr. McDonald, Mr. Kumah, Ms. Mylenko (EP) (all MCD), Mr. Ogata (FAD), and Mr. Roache (EP, PDR). Mr. Mered (Resident Representative) and Mr. Dubashev of the Bishkek office assisted the mission. Mr. Inderbinen, Advisor to the Executive Director, participated in several meetings.
- The mission met with President Akayev, Prime Minister Tanaev, Deputy Prime Minister Otorbaev, Minister of Finance Abildaev, National Bank Chairman Sarbanov, other senior officials, members of parliament, and representatives of civil society and the business community.
- In June 2004, the Executive Board completed the fifth review under the arrangement on a lapse of time basis. On November 19, 2004, the Board concluded the 2004 Article IV consultation and considered the staff's Ex Post Assessment of the Longer-Term Use of Fund Resources.
- The authorities' Letter of Intent and Memorandum of Economic Policies are presented in Attachments I and II. Relations with the IMF, World Bank, Asian Development Bank, and European Bank for Reconstruction and Development are summarized in Appendices I–IV. The Fund's provision of technical assistance is described in Appendix V. The periodicity, availability, and quality of economic statistics are satisfactory and are discussed in Appendix VI.
- Outreach work conducted by area department missions and the resident representative office includes media contacts and meetings with representatives of civil society and the diplomatic and business communities.

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## EXECUTIVE SUMMARY

**Macroeconomic developments in 2004 under the current PRGF-supported program continued to be favorable, and the authorities were able to observe all the quantitative performance criteria for end-September 2004.** In the last Board meeting conducted in November 2004, Executive Directors considered that a new low access three-year PRGF arrangement would be an appropriate means to continue assisting the Kyrgyz authorities in their reform efforts.

**The new program aims at 5–6 percent real GDP growth in 2005–07, led by private investment.** Fiscal consolidation will continue in light of the high public external debt, which remains the main policy constraint, even with further Paris Club debt relief in 2005. The primary fiscal deficit (before grants) is envisaged to decline from 3¼ percent of GDP in 2004 to 3 percent in 2005, and further to 2¾ percent in 2007. The 2005 budget, which has already been approved by parliament, is in line with the program. Monetary policy will seek to accommodate remonetization while containing annual inflation at 4 percent. The current exchange rate policy consisting of a managed float regime will be maintained. To ensure that the external debt ratios fall, the program introduces a new indicative target for concessional public borrowing.

**With gold production trending downward, the Kyrgyz Republic needs to diversify exports in order to preserve the recent solid growth rates.** Low inflation and strong productivity growth to contain unit labor costs are crucial to set up favorable conditions for nongold exports. The key to boost productivity is higher private investment, and the program focuses on improving the investment climate. On taxation, relevant measures include a reduction of payroll taxes, the introduction of a new tax code and a simplified tax system for small businesses, and improvements in VAT refunding.

**The program's structural policies focus on reforming the financial sector, increasing labor market flexibility, and reducing the energy sector quasi-fiscal deficit.** Emphasis is also placed on building fiscal institutions and promoting fiscal transparency; the lead in other areas of governance is left to the World Bank and other IFIs. The authorities committed to avoiding excessive government interference in the economy and making the regulatory framework more predictable to discourage informal activities.

**The program's financing gaps—2½ percent of GDP a year in 2005–07—are expected to be filled through debt relief by Paris Club creditors, and external assistance from the Fund, the World Bank, and the Asian Development Bank.**

## I. INTRODUCTION

1. **Disciplined economic policies under the current PRGF arrangement led to a successful macroeconomic stabilization in 2001-03.** Real GDP growth averaged 4 percent a year over this period and the poverty headcount index fell from 52 percent in 2000 to 41 percent in 2003. The 12-month rate of inflation was kept below 4 percent most of the time since 2001, with the nominal effective exchange rate remaining broadly stable. The real effective exchange rate depreciated slightly in 2001-03, maintaining a satisfactory competitiveness of Kyrgyz goods<sup>1</sup>. The balance of payments strengthened, and the import coverage of official gross reserves reached 4.1 months at end-2003. External debt indicators also began to improve. In most areas, outcomes were better than initially envisaged.

Selected Economic Indicators, 2000-03

	2000	2001	2002	2003	
				Orig. Prog.	Actual
GDP per capita (U.S. dollars)	278	309	324	360	378
Real GDP (pct. change)	5.3	5.4	0.0	4.5	6.7
Inflation (p.a.)	18.7	6.9	2.1	5.5	3.1
Exchange rate (soms per U.S. dollar, p.a.)	47.8	48.4	46.9	...	43.7
Poverty rate (expend. approach)	52	48	44	...	41
Current account balance (pct. GDP)	-4.3	-1.5	-2.6	-6.5	-2.8
Gen. gov't. fiscal balance (pct. GDP)	-9.2	-5.1	-5.5	-4.3	-5.2
Som velocity	12.4	12.4	9.3	...	8.0
Official reserves (mos. g.n.f.s. imports)	4.1	3.8	4.0	3.6	4.1
External public debt (pct. GDP) 1/	130	100	99	101	96

Source: Kyrgyz authorities and staff estimates.

1/ Excluding Kumtor

2. **In completing the last Article IV consultation on November 19, 2004, Executive Directors agreed with the main conclusions of the Ex Post Assessment of the Kyrgyz Longer-Term Use of Fund Resources prepared by an independent staff team.** Directors noted that program ownership and policymaking capacity had strengthened considerably. The Government's renewed fiscal discipline combined with sound monetary policy had been key factors behind the timely completion of all five program reviews in 2002-04. Looking forward, Directors stressed the importance of continued fiscal consolidation and further Paris Club debt relief to achieve external debt sustainability. They underscored the need to strengthen spending controls and the targeting of expenditure at high quality poverty reduction projects. Directors also urged the central bank to preserve a proper balance in accommodating remonetization while keeping inflation pressures at bay.

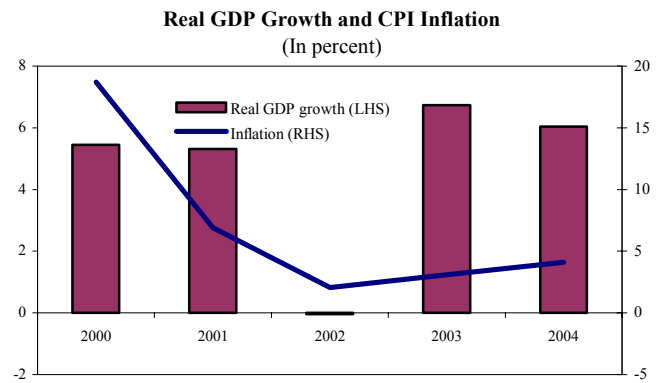
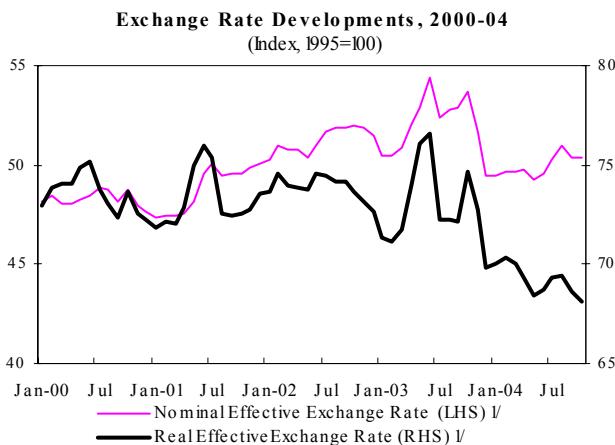
<sup>1</sup> In mid-2004, the average monthly wage in the Kyrgyz Republic was US\$47, compared to over US\$200 in Kazakhstan and Russia.

3. **Executive Directors encouraged the authorities to approach structural reforms with renewed vigor.** While overall progress had been satisfactory in recent years, reforms had slowed in certain areas, especially the energy sector. The importance of strengthening enforcement of legislative and regulatory initiatives was also emphasized. Directors thought that a low-access PRGF arrangement would be an appropriate means to continue assisting the Kyrgyz authorities in their reform efforts.

4. **Parliamentary elections will be held on February 27, 2005, followed by the presidential election in October.** EXR and MCD have proposed—and the authorities have agreed—that a seminar on medium-term economic policies will be organized for the new parliament this spring.

**A. Recent Economic Developments and Performance Under the Program**

5. **Macroeconomic developments continued to be favorable in 2004.** Real GDP growth for the year is estimated at 6 percent, and consumer price inflation remained low, at just 4 percent for the year. The solid growth performance and exchange rate stability helped increase per capita GDP to US\$411 in 2004, for a total increase of 50 percent relative to 2000, resulting in a further reduction in the poverty rate to 35 percent.



Source: Kyrgyz authorities.

Sources: Kyrgyz authorities, and staff estimates.  
 / The US, Euro Area, Russia, and Kazakhstan, 25 percent weight each, (+, appreciation).



Kyrgyz Republic: Poverty Indicators, 1998–2004

	1998	1999	2000	2001	2002	2003	2004 Est.
Poverty rate (in percent) 1/	55	55	52	48	44	41	35
GINI coefficient	0.36	0.37	0.33	0.32	0.33	0.30	...
Per capita GDP (U.S. dollars)	341	257	278	309	324	378	411

Sources: Kyrgyz authorities; World Bank; and Fund staff estimates.

1/ National definition; based on per capita expenditure adjusted for household size.

6. **The external current account deficit increased slightly to 3.2 percent of GDP in 2004, with both exports and imports growing at a fast pace.** Gold exports in US dollar terms increased by 15 percent while nongold exports—particularly to CIS countries—grew even faster, by more than 30 percent. Energy imports, as well as other imports from CIS countries, also grew rapidly. International reserves rose sharply in 2004, owing largely to the partial sale of government shares in the Canadian-owned operator (Centerra) of the Kumtor gold mine. Continued fiscal consolidation led to a reduction of the external debt-to-GDP ratio to an estimated 92 percent by year’s end, from 96 percent in 2003.

7. **Under the program, all the end-September 2004 performance criteria (PC) were observed (Table 1).** The NBKR’s net domestic assets remained well below the program ceiling, and its net international reserves (NIR) increased by US\$37 million to US\$329 million by year’s end—significantly more than programmed.<sup>2</sup> Cumulative state government tax collections exceeded the program target by some 500 million, or 0.6 percent of GDP, because of better tax administration and strong performance in VAT collections on imported goods. Payroll tax collections also surpassed the program’s target. The performance criterion on the fiscal deficit through end-September 2004 was observed with a small margin, and the quasi-fiscal deficit (QFD) of the electricity sector during the first half of 2004 was within the program’s indicative target.

8. **On the structural front, the benchmarks for June-September 2004 were observed, although in certain cases with some delays (Table 2).** The small business tax reform was submitted to the Economic Policy Council in September, and to Parliament in December with some amendments. The reform is expected to take effect in July 2005. In the financial sector, the audits of the Kyrgyz Agricultural Finance Corporation (KAFC) were completed as originally envisaged. Also, the government submitted proposals to parliament aimed at: (i) removing inconsistencies between banking and other legislation, and (ii) requiring future bills approved by parliament to incorporate all the amendments needed to assure conformity with other relevant legislation. Regarding governance in the mining sector, the authorities prepared a detailed template for reporting Kyrgyz Altyn’s financial data, in

<sup>2</sup> At end-2004, the NBRK’s net international reserves covered 111 percent of reserve money.

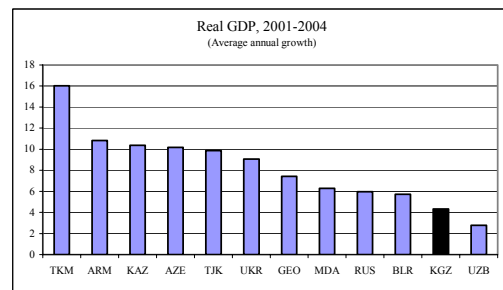
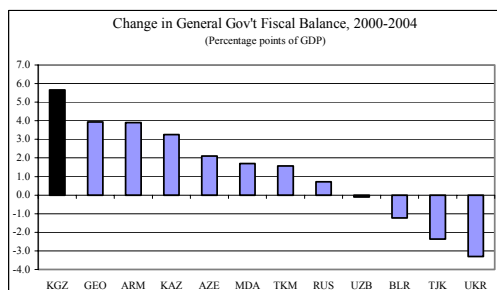
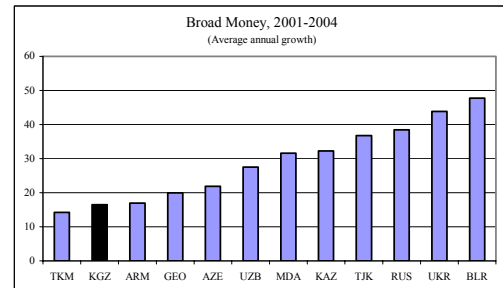
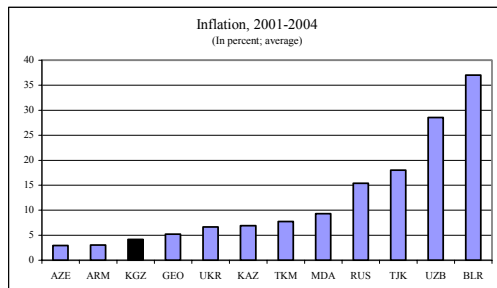
line with the Extractive Industries Transparency Initiative (EITI). They also issued the first semi-annual report in September, making the Kyrgyz Republic the most advanced country in implementing this initiative. The authorities also reorganized mining sector supervision in line with the World Bank recommendations, and completed a risk assurance and control audit of the state-owned mining company Kyrgyz Altyn in January 2005.

9. **Although the electricity sector quasi-fiscal deficit declined in 2004, the government failed to raise power tariffs as required under the World Bank’s Consolidated Structural Adjustment Credit (CSAC).** Also, parliament passed only part of the legislation allowing concession arrangements for state-owned power distribution companies. As a result, the CSAC operation was canceled. The conditionality under the Asian Development Bank’s Corporate Governance Loan and Customs Modernization project was observed.

### B. Macroeconomic Performance in Comparison to Other CIS Countries

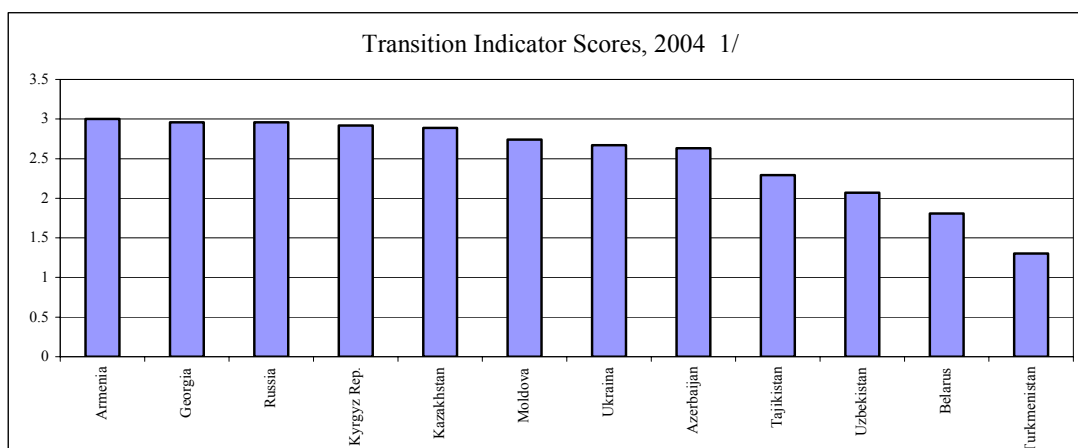
10. **Improved policy implementation in 2001-04 underpins an economic performance that compares well with other CIS countries.** Average consumer price inflation during this period was lower than in all but two CIS countries with the strong performance reflecting a prudent monetary stance during a period of rapid remonetization of the economy. There was also a strong turnaround in the fiscal position, which constituted the pillar of the country’s stabilization and debt strategy.

CIS Countries: Recent Macroeconomic Performance 1/



Source: World Economic Outlook.  
1/ 2004 figures are forecasts.

11. **Recent economic growth rates, however, have lagged behind those experienced by most of the other CIS countries.** Several CIS countries have benefited from sharp increases in earnings from oil and other natural resources, which were reflected in higher spending and growth rates. In the Kyrgyz Republic, rising revenues from gold exports, rather than spent, were used to reduce the Kumtor gold mine’s external debt. And flat growth in 2002—owing to an accident in the above-mentioned mine—affected the average growth rate for the period. In addition, the Kyrgyz economic circumstances differ in important ways from those of many other CIS countries, mainly because of the country’s distance from key markets and its difficulties in accessing markets in neighboring countries owing to trade restrictions. Although the pace of structural reforms has been relatively fast by regional standards, this has not been enough to offset the negative impact of these other factors.



Source: EBRD.

1/ The chart reports simple unweighted averages for several reform areas.

## II. POLICY DISCUSSIONS

12. **The policy discussions on a new three-year economic program were conducted against the background of the recommendations arising from the last Article IV consultation and the Ex Post Assessment discussed by the Executive Board.** The authorities were encouraged by the results achieved under the previous program, and indicated their intention to maintain the same policy strategy. Consistent with this approach, the new program seeks to consolidate the gains that have been made in recent years, with more emphasis on improving the investment climate and increasing labor market flexibility.

13. **The authorities recognized that closing the “policy implementation gap” identified in the Ex Post Assessment was key to pursuing stronger macroeconomic and structural policies.** In this regard, strengthening the government’s capacity to follow through on its commitments, including legislative and regulatory initiatives, was regarded as an important challenge of the new program. The authorities agreed that developing a

professional civil service and improving public sector transparency and accountability were crucial to strengthen implementation capacity.

### A. Macroeconomic Framework

14. **The new program’s macroeconomic framework is broadly consistent with the authorities’ recent PRSP progress report (IMF Country Report No. 04/200 dt. July 2004).** Sound macroeconomic policies and the effective implementation of structural reforms are expected to support real growth rates of 5–6 percent in the medium term (Table 3). Growth is projected to be led by private investment, with only a modest contribution from net exports, owing to a buoyant demand for imports of investment goods, especially in the gold sector. The program targets the primary fiscal deficit (before grants) to decline from 3¼ percent of GDP in 2004 to 3 percent in 2005, and further to 2¾ percent in 2007. Monetary policy will aim at containing annual inflation at 4 percent.

Key Projections, 2004-07

	2004	2005	2006	2007
Real GDP (percent change)	6.0	5.0	5.9	5.5
Inflation (average, in percent)	4.1	4.0	3.7	4.0
External current account balance (percent of GDP)	-3.2	-6.0	-4.4	-4.0
Gen. gov't. prim. fiscal balance (excl. grants, percent of GDP)	-3.2	-3.0	-2.7	-2.7
Broad money growth (eop, in percent)	28.7	18.0	16.9	15.1
Investment ratio	20.9	22.3	22.7	23.2
Savings ratio	17.7	16.4	18.3	19.2

15. **The investment ratio is projected to increase from an average of 20 percent in 2001–04 to 23 percent in 2005–07.** As productivity gains from higher capacity use and other catch-up efficiency improvements are gradually exhausted, higher investment would become the main factor supporting productivity growth. Debt-financed public investment would continue to decline over the program period and private investment would rise—in line with recent trends—from an average of 15 percent in 2001–04 to 18 percent in 2005–07. Higher national savings would reflect both continued fiscal consolidation and an increase in private savings as real incomes grow and the banking system becomes more trustworthy.

### B. Policy Strategy

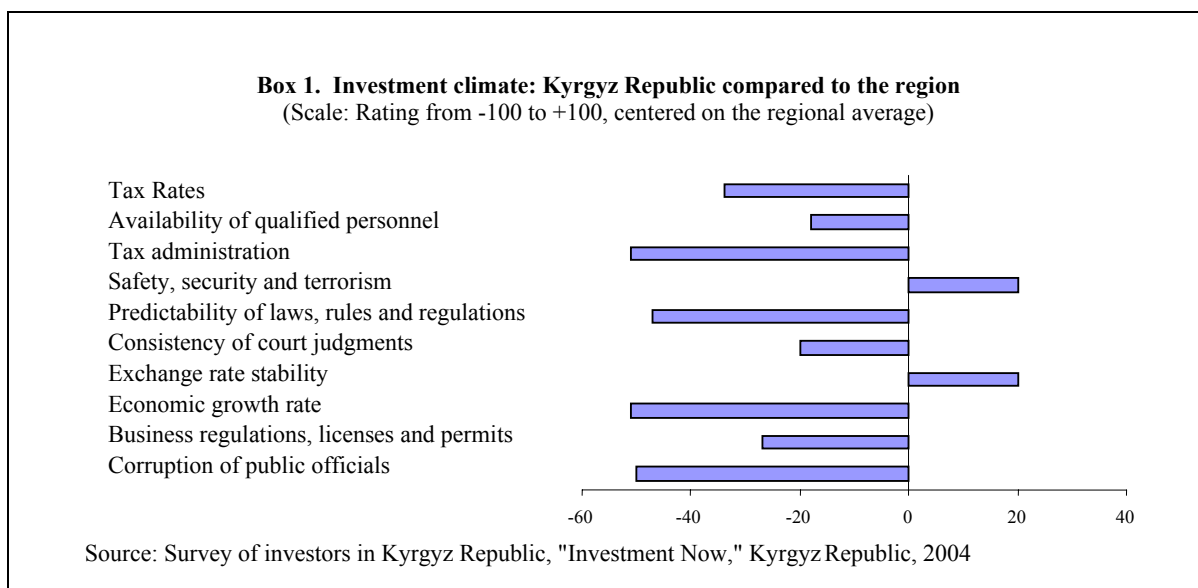
16. **The high public external debt continues to be the main policy constraint affecting the Kyrgyz Republic.** The authorities agreed that even with further Paris Club debt relief in 2005, fiscal consolidation would need to continue in the coming years in order to reduce the debt overhang. However, the pace of fiscal adjustment would be slower, as the

privatization of the Kumtor gold mine would provide a new non-debt creating source of financing. A continued shift toward grant financing will also help reduce the debt burden. The program introduces new indicative limits on concessional borrowing to help ensure that external debt ratios remain on a declining path.

17. **With gold production trending downward, export diversification is crucial for lasting growth and further poverty reduction.** The authorities regarded low inflation and strong productivity growth as critical to contain unit labor costs and stimulate nongold exports, which have increased by an average 12 percent a year in U.S. dollar terms since 2001. The staff noted that real appreciation pressures in resource rich countries such as Kazakhstan and Russia provided a good opportunity for the Kyrgyz Republic to preserve its current advantage in labor costs. Increased focus on policies to promote labor market flexibility to keep real wage increases in line with productivity growth would also support this objective.

18. **The staff fully agreed with the authorities that export diversification would be facilitated by a removal of trade restrictions by neighboring countries.** The authorities indicated that, with the support of the international community, they would continue with their efforts to obtain a more liberal treatment of Kyrgyz exports, particularly in the Kazakh and Uzbek markets.

19. **The authorities and the staff shared the view that the key to boost productivity was higher private investment.** In this regard, reforms during the three-year program would focus on improving the investment climate in areas where the country lags behind its neighbors (Box 1). On taxation, these include reducing payroll tax rates, introducing a new tax code and a simplified tax system for small businesses, improving VAT reimbursements, and strengthening tax administration. At the same time, enhancing the availability of qualified personnel requires the adoption of measures aimed at promoting labor mobility, reducing skill mismatches, and streamlining hiring and firing regulations. In addition, creditor rights should be strengthened and reforms should be introduced in the judiciary to reduce corruption.



20. **The authorities identified the large shadow economy as one of their main concerns.** They closely linked the size of the informal sector to the tax system—including the high taxes on labor—and to excessive discretion in tax administration. The staff stressed that a less intrusive role of the state in the economy would provide an incentive for businesses to formalize their operations. The authorities committed to avoiding excessive government interference in private sector activities and making the regulatory framework more predictable to discourage informal activities.

### C. Fiscal Policy

#### The medium-term fiscal framework

21. **The authorities fully recognized the importance of further reducing the fiscal deficit in order to limit new borrowing.** Following a strong revenue performance in 2001–04, the state tax revenue is programmed to rise modestly during the three-year program period from 15 percent of GDP in 2004 to 15.6 percent in 2007 (Tables 4–6). Solid economic growth, a gradual broadening of the tax base, and improved tax administration, would allow for reductions in certain tax rates. In particular, the authorities agreed on the need to lower the current payroll tax rate of 33 percent, which has discouraged formal hiring and full wage reporting. This tax rate will be reduced by 2 percentage points in 2005, and further cuts are foreseen later in the program by limiting pension increases to 2–3 percent a year in real terms.<sup>3</sup> The authorities also pointed to a prospective increase in land tax rates as a step that

<sup>3</sup> The payroll tax collection is projected to decline by half a percentage point of GDP during 2005–07.

would provide further scope for reducing labor taxation. Broadening the tax base by fully imposing the property tax would also help replace a number of distortive local taxes. With these policies, the general government tax revenue would remain broadly constant at 18½ percent of GDP during the program period.

**22. The discussions on expenditure focused on improving the targeting of spending priorities.** In this connection, social outlays are targeted to rise by 1½ percentage points of GDP during the program period, to close to 16 percent of GDP in 2007, by placing special emphasis on health and education (Table 7). Overall, the staff supported the authorities' plans to raise spending by ¾ percentage point of GDP a year relative to the envelope envisaged in the PRSP baseline.<sup>4</sup> The extra spending—made possible by the sale of Government shares in Centerra—would focus on nonrecurrent, socially oriented investment projects, which should not lead to permanent expenditure increases beyond those related to maintenance costs. Regarding wages, the program envisages increases in the wage bill of the general government by 5–6 percent a year in real terms. The authorities agreed that a wage reform was needed in 2006 with the aim of improving the provision of key public services. The reform would seek to streamline government employment in order to provide room for making salaries of key personnel more competitive and reducing incentives for corruption.

### **The fiscal program for 2005**

**23. Parliamentary approval of the 2005 State and Social Fund budgets sets the stage for the program's short-term fiscal policy.** In December 2004, Parliament approved a 2005 government budget containing more conservative projections than those envisaged in the fiscal program agreed with the staff (Box 2). The more conservative budget gives the government some room for maneuver, particularly in light of this year's parliamentary and presidential election.

**24. The overall state budget deficit will remain unchanged at 4.4 percent of GDP in 2005 while the Social Fund budget would be broadly in balance.** At this stage, only grants from the European Union are included in the budget. The deficit is expected to be covered by (net) foreign loans (1.7 percent of GDP), privatization proceeds (0.3 percent), Paris Club debt relief (2.1 percent of GDP) and a drawdown of government deposits in the central bank (0.3 percent of GDP). The general government primary deficit before grants—which constitutes a performance criterion under the program—would decline from 3.2 percent of GDP in 2004 to 3.0 percent in 2005.

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<sup>4</sup> As reported in the government's Medium-Term Budget Framework 2005-2007, published in March 2004.

Box 2. The 2005 Fiscal Program  
(In percent of GDP)

	2005 Budget	2005 Program
General government		
Total revenue and grants	22.0	22.2
o/w: tax revenue	18.3	18.5
grants	0.5	0.5
Total expenditure	26.5	27.1
o/w: wages	6.1	6.1
SG goods and services	5.4	5.8
public investment	4.2	4.5
Net lending	-0.4	-0.4
Surplus (+)/ deficit (-)	-4.1	-4.5
Primary balance before grants	-2.6	-3.0
State Government (central and local governments)		
Tax revenue	15.0	15.2
Wage and Social Fund contributions	7.2	7.2
Surplus (+) / deficit (-)	-4.0	-4.4

Sources: Kyrgyz authorities, and Fund staff estimates.

25. **General government tax revenue is projected to grow in line with GDP in 2005.** An increase in the VAT threshold and the elimination of the voluntary patent tax are expected to be offset by the introduction of the new simplified small business tax. The payroll tax rate will be reduced by one percentage point on January 1, 2005, and by another percentage point later in the year. On the expenditure side, the program allows for a 10 percent increase in the wages of teachers, doctors, and nurses in July 2005. Other pay increases would be considered in the spring 2005, once there is evidence that revenues perform as projected. Spending on goods and services (excluding carry-forward outlays) will be maintained in real terms. Pensions will be increased by 8 percent on average, with higher increases for poor pensioners.

26. **The staff and the authorities shared the view that measures to strengthen fiscal institutions are important to strengthen governance in the public sector.** As a result, the program includes further reforms (MEP, Box 2) in the areas of fiscal transparency, the civil service, and fiscal decentralization. A particularly important step is to incorporate aggregate resource envelopes for each line ministry in the 2006–08 Medium-Term Budget Framework. This should help in producing better costing estimates and clearer priorities during the 2006 PRSP process. Tax administration reforms would continue to focus on restructuring the Large Taxpayer Unit, enhancing VAT administration, and further simplifying business



taxation. Other structural fiscal measures would concentrate on reforming tax administration, modernizing the Treasury, and improving the budget process. Technical assistance is expected from FAD, the World Bank, USAID, and DFID.

#### **D. Monetary and Exchange Rate Policy**

27. **After a rapid remonetization in 2002–04, the growth of money demand is expected to slow in 2005–07.**<sup>5</sup> The program accommodates broad money growth of 18 percent during 2005, followed by 17 and 15 percent in 2006 and 2007, respectively (Tables 8 and 9). Credit to the non-government sector is projected to grow rapidly, from 7 percent of GDP at end-2004 to 11½ percent in 2007.

28. **The staff agreed with the NBKR that the recent expansion of credit to the private sector was a welcome development.** Indeed, recent surveys conclude that financing constraints for small and medium size businesses have become less binding. The staff stressed, however, that the strong credit growth entailed risks and that there was the need to monitor closely the quality of bank portfolios to preserve the health of the banking system.

29. **The program envisages several measures to strengthen the financial sector.** First, central bank independence and the legal protection of supervisors will be enhanced through measures that constitute structural benchmarks under the program (MEP, paragraph 33). Second, the government will increase its supply of securities with longer maturities to provide alternative investment opportunities to banks. Third, a new Mortgage Law and amendments to collateral legislation will be introduced to reduce lending risks.

30. **The current exchange rate policy consisting of a managed float regime will be maintained.** The authorities agreed that the country remained vulnerable owing to the limited diversification of its commodity-based export structure, and that a managed float could absorb exogenous shocks with smaller output and employment losses than a fixed exchange rate regime.

#### **E. External Policies, Program Financing, and Capacity to Repay the Fund**

31. **The Kyrgyz Republic has one of the most liberal trade regimes among transition economies (for details, see IMF Country Report No. 05/47 dt. February 2005).** However, given the trade restrictions imposed by its neighboring countries, the benefits from free trade remain below potential. The authorities appealed to the international community to support their efforts for improving the trading environment in Central Asia.

32. **The program has balance of payments financing gaps of 2½–3 percent of GDP in 2005–07, notwithstanding an envisaged decline in the import cover of official gross**

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<sup>5</sup> In 2001–04, the Kyrgyz broad money-to-GDP ratio increased faster than in most CIS countries.

**reserves from 5½ months in 2004 to 4¾ in 2007 (Tables 10 and 11).** The financing gaps reflect a current account deficit averaging 4½ percent of GDP, of which only two-thirds can be financed by a capital account surplus. Overall, financing gaps would amount to \$220 million in 2005–07. The program assumes that Paris Club creditors would cover \$147 million of this amount, the balance being filled by the Fund, the World Bank, and the Asian Development Bank. This assumption is consistent with both a Houston terms debt rescheduling and a Naples terms stock operation with capitalization of interest payments. Assuming the Paris Club debt relief and with total Fund and World Bank disbursements amounting to \$9 million during 2005, the first year program is fully financed. The Paris Club has not yet provided financing assurances for the program but is expected to do so shortly.

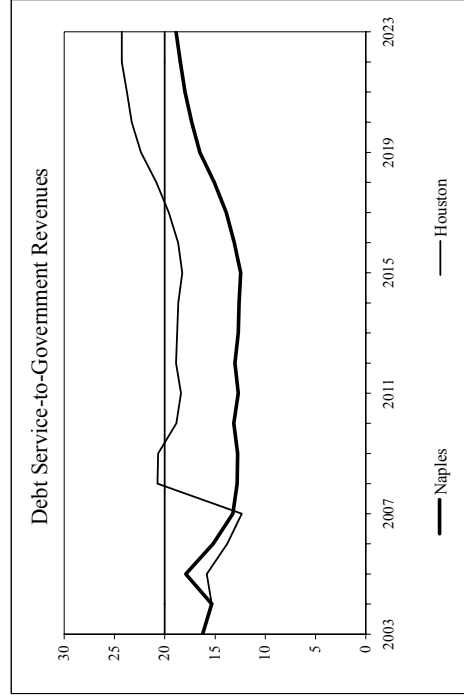
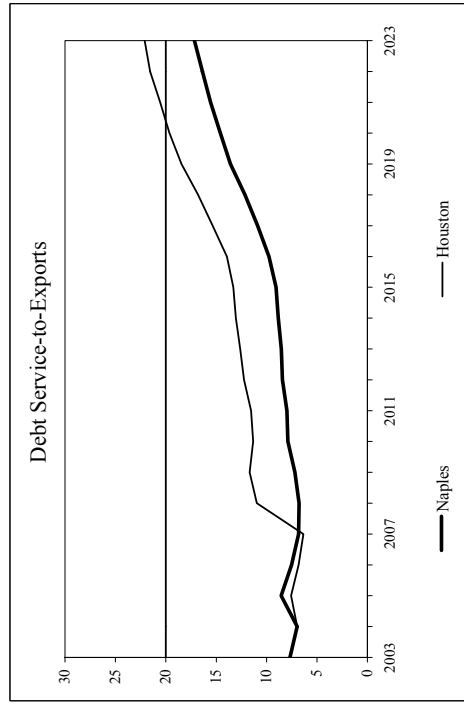
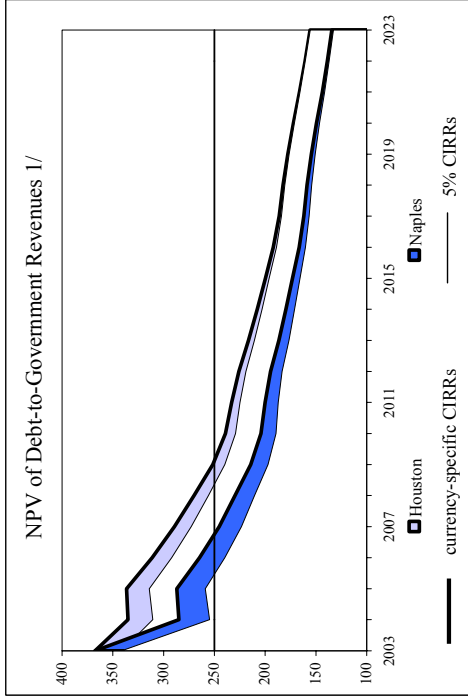
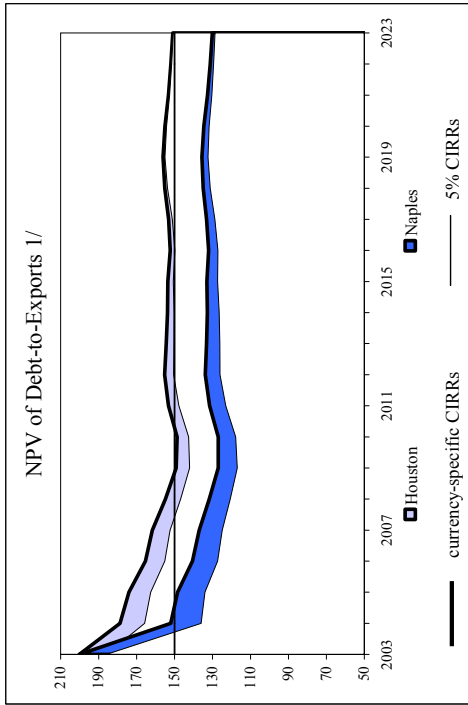
33. **Medium-term external debt sustainability would require further substantial debt relief from Paris Club creditors (Annex I).** The staff's updated Debt Sustainability Analysis suggests that a rescheduling under Houston terms would ease the debt situation only temporarily. After 2007, debt service relative to fiscal revenue would again become unmanageable. Even if a Houston treatment is repeated in 2008, the present value of debt-to-exports ratio would rise again above the 150 percent benchmark in the early 2010s. In contrast, a rescheduling under Naples terms would bring both key solvency ratios—debt to exports and to fiscal revenues—permanently below the respective sustainability thresholds. Stock operations under Toronto and London terms would also bring about debt sustainability but with a smaller cushion against external shocks.

34. **Access under the arrangement is proposed at 10 percent of quota.** The proposal takes into account the fact that this is the Kyrgyz Republic's fourth ESAF/PRGF request and that the country has limited balance of payments needs following the expected debt relief. The lower level of access also reflects the need to limit recourse to additional external borrowing to ensure the achievement of debt sustainability.

35. **Irrespective of the terms of the prospective debt rescheduling, the authorities agreed that their debt strategy needed to be strengthened to ensure that debt ratios continue to decline.** Accordingly, the program's debt strategy—in addition to the fiscal consolidation and efforts to increase tax collection—includes of the following key elements (MEP, paragraph 29):

- maintaining a 45 percent grant element requirement for new concessional borrowing and a zero limit for nonconcessional borrowing;
- introducing an indicative program limit for concessional borrowing; and
- refraining from debt-equity swaps without specific consultation with the Paris Club.

Kyrgyz Republic: Debt Sustainability Analysis



Source: Kyrgyz Ministry of Finance and IMF staff simulations.

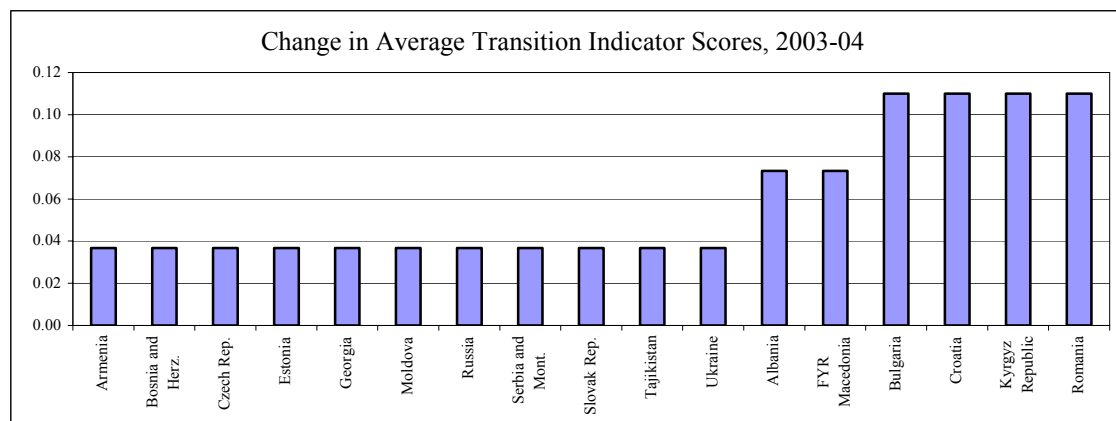
1/ The bands depict ratios at end-2004 CIRR rates and 5% discount rates; both at end-November 2004 exchange rates. Concessional financing of financial gap: 66 percent for 2008-12; 50 percent for 2013-17; and 25 percent for 2018-23.

36. **The impact of the medium-term balance of payments outlook on the capacity to repay the Fund is presented in Table 12.** All repayment ratios are expected to decline in the second half of this decade. Debt service to the Fund, which amounts to \$32 million in 2005, would decline gradually to \$22 million by the end of the decade. With the proposed low access under the new program, outstanding Fund credit would fall below 10 percent of GDP by 2010. These debt service ratios are manageable and the Kyrgyz Republic is expected to meet its obligations to the Fund.

## F. Structural Policies

37. **Despite some setbacks in reforming the energy sector, the EBRD Transition Indicators identify the Kyrgyz Republic as the most progressive CIS country during 2004.** The reports cites progress in large scale privatization and further infrastructure build-up as a basis for this assessment.

38. **Program discussions on structural policies focused on financial sector reform, labor market reform, and the energy sector quasi-fiscal deficit.** The staff stressed that the Fund-supported program had to cover these structural policies because of their significant macroeconomic relevance. The authorities agreed that these reforms have a direct bearing on the macroeconomic framework and are crucial to complement the structural reform agenda agreed with the World Bank, the AsDB, and the EBRD<sup>6</sup>.



Source: EBRD.

Note: No change was recorded in Azerbaijan, Belarus, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Slovenia, Turkmenistan, and Uzbekistan.

<sup>6</sup> Under the Governance Structural Adjustment Credit (GSAC), the World Bank covers broad-based reforms in public administration and related areas. AsDB lending supports corporate governance, capital market development, and customs reform. EBRD operations focus on support for banks and small and medium size enterprises.

39. **Further reforms are critical to support the growing confidence in the financial system (MEP, paragraph 33).** The authorities agreed with the staff's proposal to further consolidate the banking sector and strengthen its capital base by increasing the minimum capital requirement. To protect the solvency of the central bank, the program stipulates that its capital should not be allowed to fall below 10 percent of its monetary liabilities. There was also agreement that the deposit protection system should not be introduced while the banking system continues to be fragile. Therefore, the MEP includes a detailed set of preconditions for the implementation of deposit insurance. The authorities are also working closely with the Fund and the Bank for privatizing the Kyrgyz Agricultural Finance Corporation, and a credit information agency is being developed with the assistance of the EBRD.

40. **The authorities readily supported the staff's view that new policies needed to be developed to promote labor market flexibility.** The solid economic growth experienced in recent years has not reduced unemployment, which remains high at 9 percent of the labor force, owing to several structural factors. The program contains a number of measures aimed at promoting labor market flexibility:

- Beginning with the 2005 Budget, the extrabudgetary Employment Fund will be transferred to the Ministry of Labor and Social Protection to provide a better social safety net for the unemployed.
- As discussed above, the payroll tax rate will be gradually lowered over the medium-term to reduce the cost of labor.
- The Labor Code will be reviewed with the objective of removing regulations that excessively restrict employment restructuring in enterprises.

In addition, the government will appoint a special task force, including representatives from the private sector, to prepare additional proposals by end-June 2005 to improve the functioning of the labor market.

41. **The new program also addresses tariff policy to ensure progress in reducing the quasi-fiscal deficit (QFD) of the electricity sector.** The authorities agreed with the staff that further reductions in the QFD will speed up enterprise restructuring and improve financial discipline, yielding important macroeconomic benefits. To that end, the present framework with semi-annual QFDs as indicative targets for the program will be maintained. The program will seek to reduce the QFD by 1.3 percentage points of GDP every year during 2005–07. To support this effort and improve the prospects for privatizing power distribution companies, the authorities intend to increase electricity tariffs by 15 percent on April 1, 2005. The fiscal program includes a social compensation package of 0.3 percent of GDP to protect vulnerable groups in the context of power tariff increases.

42. **The authorities agreed that much remains to be done to improve the business climate.** In this regard, they noted that specific policies were being designed by the Consultative Council of Good Governance chaired by the President of the Republic. Working groups have been set up to make concrete proposals for enhancing legal predictability,

streamlining licensing and permit mechanisms, and improving the inspection and auditing environment. In parallel, conditionality under the World Bank GSAC covers other reforms such as steps to develop a professional civil service, the introduction of income and asset declarations for high-ranking officials, and other measures to increase the effectiveness of the public administration.

### III. PROGRAM MONITORING AND RISKS

43. **Implementation of the program will be monitored against semi-annual performance criteria, indicative targets, and structural benchmarks, and through program reviews.** Quantitative performance criteria and indicative targets for the program are shown in Table 2 of the MEP. Box 4 of the MEP describes the structural benchmarks through end-December 2005. The first review under the arrangement, based on the June 30, 2005 test date, is expected to be completed on or after August 15. This review will focus on progress in (i) implementing the revised small business taxation and the new tax code; and (ii) improving the investment climate. At the time of the review, quantitative performance criteria for end-December 2005 may be revised and, as appropriate, additional structural conditionality introduced.

44. **The vulnerability to external shocks is considered to be the main risk for the success of the program.** A substantial terms-of-trade shock, for example a protracted period of high oil prices combined with a drop in gold prices, could undermine the balance of payments prospects and significantly increase the financing gaps. Similarly, a sharp slowdown of trade partners' growth could weaken exports and external debt ratios. On the domestic front, the risks are related to the projected rapid credit growth which could lead to bank failures with adverse effects on financial intermediation and investment. The targeted fiscal adjustment is at risk if the progress in tax collections achieved in recent years is not maintained. In addition, if policies to improve governance and reduce corruption fail, the investment climate will remain weak and the program's growth projections could turn out optimistic.

### IV. STAFF APPRAISAL

45. **The Kyrgyz authorities are to be commended for their achievements during the 2001-04 PRGF-supported program.** Economic growth was solid, inflation was among the lowest in the region, and the foreign exchange market remained stable. At the same time, progress was made in implementing structural reforms, in particular toward the end of the program period. These results were reflected in an impressive decline in poverty rates, from 52 percent in 2000 to 35 percent in 2004. All the end-September 2004 performance criteria were observed, and the authorities completed all the program reviews in 2004-04 on time.

46. **The new program covering the period 2005-07 builds on the government's recent achievements with the overriding objectives of preserving solid growth with low inflation and further reducing poverty.** The program's success will depend largely on addressing two important issues. First, there is the need to strengthen the government's

implementation capacity. This is particularly important for improving the investment climate and managing the risks associated with the country's vulnerability to external shocks. Despite improvements in this area, the previous program continued to suffer from inconsistencies between commitments and enforcement. Second, the debt overhang continues to limit the government's policy choices. Even with Paris Club debt relief, fiscal adjustment continues to be critical. In addition, strengthening of the debt strategy—including by limiting concessional public borrowing—is necessary to achieve debt sustainability.

47. **The government's capacity to maintain fiscal discipline will be tested this year in light of the parliamentary and presidential elections.** The approved budget provides a good base, but strong efforts will be necessary during the year to adhere to the program's targets as failure to comply with them will seriously undermine the credibility of the Kyrgyz policies. In this regard, it is important that the government stand firm against politically motivated spending pressures.

48. **Regarding fiscal revenue, prompt approval of the new tax code and small business taxation by the new parliament will be an important step toward simplifying the tax system and making it more equitable.** The staff welcomes the wide participation of the public, including the business community and civil society, in preparing the new tax code. The staff also welcomes the authorities' commitment to start reducing the high labor taxation. Although the envisaged reduction in the payroll tax rate in 2005 is modest, this first step will provide an important signal that over the medium term taxation will be more supportive of employment.

49. **The fiscal program is properly cautious about the 2005 wage increases and the authorities should make every effort to avoid slippages in this area.** The staff welcomes the government's plan to prepare a major wage reform in the context of the 2006 budget. In this regard, bringing up the salaries of key personnel to more competitive levels would require reductions of redundant employment in several government agencies. This would permit improving the quality of public services while reducing incentives for corruption.

50. **While the NBKR's monetary policy has been prudent, financial sector reform needs further attention.** In this connection, the authorities' commitment to strengthen the legal framework to support the central bank independence and protect bank supervisors in their duties is welcome. Looking ahead, bank supervision faces the difficult challenge of preserving soundness of the banking system, as growth of credit to the private sector is expected to remain high. The planned deepening of the government securities market should help in this regard by providing alternative investment options to banks as their deposit base expands. In light of the vulnerabilities associated with the commodity-based export structure, the current exchange rate policy consisting of a managed float seems appropriate and should be maintained.

51. **Preserving external competitiveness is crucial to provide favorable conditions for export diversification.** This requires a strong implementation of structural reforms necessary to boost productivity growth. In particular, there is the need to move ahead with

reforms to increase flexibility in the labor market and improve cost recovery in the energy sector. Regarding the labor market, efforts are needed to increase labor mobility, reduce skill mismatches, and streamline labor regulations that impede enterprise restructuring. The energy sector reform must be reinvigorated to improve bill collection and reduce losses. Moreover, energy tariffs should be raised to ensure cost recovery while providing adequate protection to vulnerable groups.

52. **The success of the new program depends, to a large extent, on improving the investment climate to stimulate private sector development.** While private investment has started to recover, the authorities should place high priority on reforms that improve investor confidence. In addition to the tax reforms that are underway, a less intrusive regulatory framework and a well-functioning judicial system constitute key building blocks for a propitious business climate.

53. **Apart from external uncertainties, a possible risk for the program is insufficient progress in improving governance and reducing corruption.** While several aspects of the program address governance concerns, such as the measures to strengthen fiscal institutions and transparency of policies, the lead in governance reforms lies increasingly with other IFIs with specific expertise on these issues. The Consultative Council of Good Governance—chaired by the President and with participation of the Bishkek international community—has made a promising start in this area, but more tangible and decisive measures are needed.

54. **In sum, the proposed program is based on a strong commitment on the part of the authorities to continue with their reform efforts.** The experience suggests that, despite the forthcoming political transition, the program has a good chance of success. On this basis, the staff recommends the completion of the sixth review under the current PRGF arrangement and approval of the new PRGF arrangement by the Executive Board.



Table 1. Kyrgyz Republic: Third-Year Quantitative Program Targets  
(in millions of soms, unless otherwise indicated; eop)

	June 2004			September 2004		
	Indicative Targets			Performance Criteria		
	Program	Adjusted	Actual	Program	Adjusted	Actual
<b>I. Performance criteria</b>						
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars) 1/	221.1	158.6	161.3	221.7	267.2	280.1
2. Ceiling on net domestic assets of the NBKR (eop stock) 1/	-4	2,916	2,851	152	-1,683	-2,197
3. Ceiling on cumulative fiscal deficit of the state government	3,264		3,395	4,229		4,155
4. Cumulative floor on state government tax collections in cash	9,513		9,900	13,008		13,528
5. Ceiling on the stock of central government budget arrears	0		0	0		0
6. Ceiling on the stock of Social Fund pension arrears	0		0	0		0
7. Floor on payroll collections in cash of the Social Fund	2,863		2,972	3,777		4,002
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0		0	0		0
9. Ceiling on contracting or guaranteeing by the state government or NBKR of new nonconcessional external debt of less than one year (in millions of U.S. dollars)	0		0	0		0
10. Ceiling on contracting or guaranteeing by the state government or NBKR of new nonconcessional external debt with a maturity of one year or more (cumulative, in millions of U.S. dollars)	0		0	0		0
11. Ceiling on accumulation of new external payment arrears (in millions of U.S. dollars)	0		0	0		0
<b>II. Indicative targets</b>						
1. Ceiling on reserve money (NBKR liabilities) 1/	10,689		10,786	10,868		10,882
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	4,900		4,244	....		...

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

1/ Valued at the program exchange rates specified in IMF Country Report No. 04/198 dt. July 2004.

**Table 2. Kyrgyz Republic: Structural Conditionality  
in the Third Annual Program**

**Structural benchmarks for end-June 2004**

- Complete external audit of the 2003 financial statements of KAFC as well as the assessment of its loan portfolio, both conducted by a reputable international firm. **Observed in September.**
- Develop and adopt a detailed template for disclosing and reporting to the government Kyrgyz Altyn's financial data, and submit the first semi-annual draft report to Fund staff by end-September 2004. **Observed.**

**Structural benchmarks for end-August 2004**

- Draft and submit to the Economic Policy Council small business tax reform package, as described in paragraph 21 of the SMEP. **Observed in September.**

**Structural benchmarks for end-September 2004**

- Submit to parliament legislative amendments to remove conflicts between banking and other legislation, as identified in Box 1, item 1. **Observed.**
- Submit to parliament an amendment to the Law on Normative Legal Acts requiring that any new bill approved by parliament incorporate all amendments necessary to bring related laws into conformity with the proposed bill. **Observed.**
- Complete a risk assurance and control audit with reference to the 2002 and 2003 accounts of Kyrgyz Altyn, conducted by a reputable international firm. **Observed in January 2005.**
- Issue regulation for reorganizing mining supervision in line with World Bank 2001 Mining Report recommendations. **Observed.**

Table 3. Kyrgyz Republic: Selected Economic Indicators, 2000-07

	2000	2001	2002	2003	2004		2005	2006	2007
	Actual	Actual	Actual	Actual	Prog. 1/	Est.	Proj.	Proj.	Proj.
<b>National Accounts</b>									
Nominal GDP (in billions of soms)	65.4	73.9	75.4	83.4	91.8	92.3	100.8	111.1	121.7
Nominal GDP (in millions of U.S. dollars)	1,367	1,525	1,606	1,911	2,085	2,167	2,399	2,646	2,898
Real GDP (growth in percent)	5.3	5.4	0.0	6.7	4.5	6.0	5.0	5.9	5.5
GDP per capita (in U.S. dollars)	278	309	324	378	413	425	465	508	551
Consumer prices (percent change, avg)	18.7	6.9	2.1	3.1	4.9	4.1	4.0	3.7	4.0
Unemployment rate	7.5	7.8	8.6	9.0	...	...	...	...	...
Poverty rate	52.0	48.0	44.0	41.0	...	35.0	...	...	...
<b>Investment and savings</b>									
Investment	20.0	19.6	20.3	20.7	18.0	20.9	22.3	22.7	23.2
Public	8.1	5.3	5.9	4.8	4.2	4.2	4.5	4.6	4.6
Private	11.9	14.3	14.4	15.9	13.8	16.7	17.9	18.1	18.6
Savings	15.7	18.1	17.8	17.8	14.1	17.7	16.4	18.3	19.2
Public	-2.4	-0.5	-0.2	0.0	-0.7	-0.4	-0.5	-0.1	0.6
Private	18.1	18.6	17.9	17.8	14.8	18.1	16.8	18.4	18.6
Savings/Investment balance	4.3	1.5	2.6	2.8	3.9	3.2	6.0	4.4	4.0
<b>General government finances (percent of GDP) 2/</b>									
Total revenue and grants	18.5	20.4	22.8	22.2	22.0	23.0	22.2	22.5	22.9
Tax revenue	15.1	15.8	17.6	17.8	18.0	18.5	18.5	18.4	18.6
Total expenditure (including net lending)	29.9	25.9	28.0	27.3	26.3	27.3	26.7	26.5	26.6
o/w: Non-interest current expenditure	18.5	19.6	21.1	21.5	20.6	21.3	20.7	20.6	20.5
Public Investment Program (PIP)	6.8	4.4	4.7	3.6	3.5	3.5	3.3	3.0	3.0
Overall fiscal balance (cash basis)	-9.2	-5.1	-5.5	-5.2	-4.3	-4.2	-4.5	-4.1	-3.7
Primary balance 3/	-6.9	-3.4	-3.9	-3.7	-2.4	-2.5	-2.5	-2.1	-2.0
<b>Monetary sector 4/</b>									
Net foreign assets (percent change, eop)	34.2	36.0	12.4	41.3	49.0	76.9	-1.0	12.4	10.1
Net domestic assets (percent change, eop)	34.3	-12.7	35.5	5.8	-54.9	-52.6	108.6	22.9	22.9
Credit to the private sector (percent of GDP)	4.2	3.8	4.0	4.7	4.8	6.9	9.3	10.4	11.4
Broad money (percent change, eop)	11.9	12.2	35.1	34.5	9.9	28.7	18.0	16.9	15.1
Velocity of broad money 5/	8.9	9.4	7.0	6.0	5.7	5.6	4.3	4.2	4.0
Interest rate 6/	...	36.4	30.2	25.1	...	...	...	...	...
<b>External sector</b>									
Current account balance (percent of GDP)	-4.3	-1.5	-2.6	-2.8	-3.9	-3.2	-6.0	-4.4	-4.0
Export of goods and services (million USD)	573	561	640	745	...	890	921	1,008	1,089
Export growth (percent change)	8.6	-2.1	14.2	16.4	7.5	19.4	3.5	9.4	8.0
Import of goods and services (million USD)	656	591	735	872	...	1,039	1,142	1,213	1,294
Import growth (percent change)	-7.1	-9.9	24.3	18.8	7.5	19.1	9.9	6.2	6.7
Gross official reserves (million USD)	206	230	290	359	440	519	514	528	542
Gross reserves (months of imports, eop) 7/	4.1	3.8	4.0	4.1	5.4	5.5	5.1	4.9	4.7
External public debt outstanding (percent of GDP) 8/	130	100	99	96	87	92	84	80	76
Debt service-to-export ratio (in percent) 9/	22	13	10	8	...	11	19	15	12
<b>Memorandum items</b>									
Exchange rate (soms per U.S. dollar, avg)	47.8	48.4	46.9	43.7	...	42.6	...	...	...

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

1/ IMF Country Report No. 04/198.

2/ General government comprises state government and the Social Fund. State government comprises central and local governments.

3/ Overall balance less interest payments.

4/ Projections are based on program exchange rates specified in the TMU.

5/ 12 month GDP over average quarterly broad money.

6/ Weighted average interest rate on som denominated loans

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

8/ Excluding Kumtor gold mine.

9/ Excluding Kumtor gold mine, and accounting for Paris Club Debt relief up to 2004 only.

Table 4. Kyrgyz Republic: General Government Finances, 2001-07

	2001	2002	2003	2004	2005				2005	2006	2007
					1Q	2Q	3Q	4Q			
	Act.	Act.	Act.	Proj.	Projections						
(In millions of soms)											
Total revenue and grants	15,051	17,158	18,635	21,265	4,860	5,480	5,823	6,191	22,354	24,955	27,835
Of which: tax revenue 1/	11,608	13,174	14,820	17,049	4,032	4,587	4,840	5,142	18,601	20,487	22,605
Of which: Grants	622	833	418	723	78	0	207	207	492	672	882
Total expenditure	19,630	21,579	23,224	25,652	6,268	6,848	6,780	7,433	27,329	30,135	32,704
Current expenditure	15,715	17,107	19,204	21,272	5,325	5,685	5,462	6,354	22,826	25,023	27,105
Capital expenditure (including PIP)	3,915	4,472	4,020	4,380	943	1,163	1,318	1,079	4,503	5,111	5,599
Financial balance	-4,578	-4,421	-4,590	-4,387	-1,408	-1,368	-957	-1,242	-4,975	-5,180	-4,868
Net lending	-509	-443	-414	-501	-76	-112	-101	-162	-451	-667	-365
Accrual surplus (+) / deficit (-)	-4,069	-3,978	-4,176	-3,886	-1,332	-1,255	-856	-1,080	-4,524	-4,513	-4,503
Cash surplus (+) / deficit (-)	-3,795	-4,150	-4,352	-3,880	-1,332	-1,255	-856	-1,080	-4,524	-4,513	-4,503
Primary balance excluding grants	-3,189	-3,745	-3,490	-2,968	-1,198	-331	-869	-630	-3,028	-3,028	-3,281
Total financing	3,795	4,150	4,352	3,880	992	588	396	216	2,192	1,022	1,416
External financing	4,208	3,933	3,513	4,681	440	176	785	89	1,490	1,304	1,495
Domestic financing	-834	33	556	-4,574	496	354	-473	-96	281	-691	-419
Change in Social Fund cash balance	121	54	-23	-159	26	28	54	-17	90	69	0
Exceptional Financing 2/	299	130	307	3,933	30	30	30	240	330	340	340
Financing Gap	0	0	0	0	340	667	459	865	2,332	3,491	3,088
(In percent of GDP)											
Total revenue and grants	20.4	22.8	22.3	23.0	4.8	5.4	5.8	6.1	22.2	22.5	22.9
of which: tax revenue 1/	15.7	17.5	17.8	18.5	4.0	4.6	4.8	5.1	18.5	18.4	18.6
Grants	0.8	1.1	0.5	0.8	0.1	0.0	0.2	0.2	0.5	0.6	0.7
Total expenditure	26.6	28.6	27.8	27.8	6.2	6.8	6.7	7.4	27.1	27.1	26.9
Current expenditure	21.3	22.7	23.0	23.1	5.3	5.6	5.4	6.3	22.7	22.5	22.3
Capital expenditure (including PIP)	5.3	5.9	4.8	4.7	0.9	1.2	1.3	1.1	4.5	4.6	4.6
Net lending	-0.7	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	-0.4	-0.6	-0.3
Accrual surplus (+) / deficit (-)	-5.5	-5.3	-5.0	-4.2	-1.3	-1.2	-0.8	-1.1	-4.5	-4.1	-3.7
Cash surplus (+) / deficit (-)	-5.1	-5.5	-5.2	-4.2	-1.3	-1.2	-0.8	-1.1	-4.5	-4.1	-3.7
Primary balance excluding grants	-4.3	-5.0	-4.2	-3.2	-1.2	-0.3	-0.9	-0.6	-3.0	-2.7	-2.7
Total financing	5.1	5.5	5.2	4.2	1.0	0.6	0.4	0.2	2.2	0.9	1.2
External financing	5.7	5.2	4.2	5.1	0.4	0.2	0.8	0.1	1.5	1.2	1.2
Domestic financing	-1.1	0.0	0.7	-5.0	0.5	0.4	-0.5	-0.1	0.3	-0.6	-0.3
Change in Social Fund cash balance	0.2	0.1	0.0	-0.2	0.0	0.0	0.1	0.0	0.1	0.1	0.0
Exceptional Financing 2/	0.4	0.2	0.4	4.3	0.0	0.0	0.0	0.2	0.3	0.3	0.3
Financing Gap	0.0	0.0	0.0	0.0	0.3	0.7	0.5	0.9	2.3	3.1	2.5
Memorandum items:											
Social spending	12.1	14.1	14.0	14.3	3.5	3.7	3.6	4.2	15.0	15.3	15.8
Primary balance excl. grants and gold projects	-5.1	-6.0	-5.3	-4.2	-1.4	-0.5	-1.0	-0.8	-3.7	-3.2	-3.4
Underlying fiscal balance 3/	-0.8	-1.3	-1.7	-0.7	-0.7	0.4	0.0	0.0	-0.4	-0.2	-0.4
Domestic balance 4/	0.6	0.5	-0.5	0.1	-0.6	0.2	0.3	0.2	0.1	0.5	0.7

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

1/ Includes payroll tax revenue (contribution to the Social Fund), net of the government contribution to the Social Fund.

2/ Mainly privatization proceeds. For revised 2004 projection, includes som 3,589 million related to the Kumtor mine restructuring.

3/ Primary balance excluding gold projects, grants and the foreign-financed PIP.

4/ Overall balance (in cash) excluding the foreign-financed PIP and foreign interest payments.

Table 5. Kyrgyz Republic: State Government Finances, 2001-07 (In Millions of Soms)

	2001	2002	2003	2004	2005				2005	2006	2007
					1Q	2Q	3Q	4Q			
					Projections						
Act.	Act.	Act.	Proj.								
(In millions of soms)											
Total revenue and grants	12,544	14,402	15,666	17,995	4,003	4,616	5,009	5,382	19,011	21,462	24,212
Total revenue	11,922	13,569	15,249	17,271	3,926	4,616	4,802	5,175	18,519	20,790	23,330
Current revenue	11,864	13,439	15,112	17,053	3,886	4,573	4,759	5,128	18,346	20,599	23,120
Tax revenue	9,188	10,475	11,917	13,841	3,191	3,738	4,041	4,347	15,318	17,056	19,046
Income tax	2,008	2,199	2,381	2,521	615	635	690	737	2,677	3,000	3,525
VAT	4,221	4,794	5,526	6,782	1,570	1,960	2,037	2,172	7,739	8,752	9,765
Excises	1,103	1,082	1,164	1,257	301	321	362	383	1,366	1,503	1,656
Customs	301	419	423	440	110	132	149	160	550	600	650
Land tax	209	318	312	346	56	56	113	150	376	376	376
Road tax and Emergency Fund	990	1,030	1,173	1,275	293	357	390	425	1,464	1,525	1,575
Retail sales tax	305	410	471	553	129	141	158	158	586	645	711
Other 1/	50	223	467	667	116	137	143	163	559	655	789
Nontax revenue	2,677	2,964	3,195	3,212	696	835	717	780	3,028	3,543	4,074
Capital revenue	57	130	137	218	40	43	43	47	173	191	210
Grants	622	833	418	723	78	0	207	207	492	672	882
Total expenditure	16,880	18,710	20,403	22,541	5,386	5,956	5,912	6,641	23,895	26,573	29,080
Current expenditure	12,966	14,238	16,383	18,161	4,444	4,794	4,594	5,562	19,393	21,462	23,481
Wages and Social Fund contributions	4,301	4,876	5,673	6,548	1,392	1,616	1,863	2,377	7,247	7,867	8,662
Transfers and subsidies 2/	2,221	2,558	2,689	2,882	697	723	1,014	931	3,366	3,712	4,066
Transfers to Social Fund	398	840	1,122	1,090	244	244	244	244	976	1,091	1,267
Interest	1,228	1,238	1,280	1,636	212	925	194	658	1,988	2,157	2,104
Purchases of other goods and services 3/	4,818	4,726	5,618	6,005	1,899	1,285	1,279	1,351	5,815	6,634	7,383
Capital expenditure (including PIP)	3,915	4,472	4,020	4,380	943	1,163	1,318	1,079	4,503	5,111	5,599
Domestically financed capital expenditure	676	932	984	1,168	283	283	306	306	1,177	1,778	1,947
Foreign financed PIP	3,239	3,541	3,036	3,212	660	880	1,012	773	3,325	3,333	3,651
Financial balance	-4,337	-4,308	-4,736	-4,546	-1,383	-1,340	-903	-1,259	-4,885	-5,111	-4,868
Net lending	-509	-443	-414	-501	-76	-112	-101	-162	-451	-667	-365
Accrual surplus (+) / deficit (-)	-3,828	-3,865	-4,323	-4,045	-1,306	-1,228	-802	-1,098	-4,434	-4,445	-4,503
Expenditure arrears	155	-231	-53	6	0	0	0	0	0	0	0
Cash surplus (+) / deficit (-)	-3,673	-4,096	-4,376	-4,039	-1,306	-1,228	-802	-1,098	-4,434	-4,445	-4,503
Primary balance excluding grants	-3,068	-3,691	-3,513	-3,126	-1,173	-303	-815	-647	-2,938	-2,960	-3,281
Total financing	3,673	4,096	4,376	4,039	966	560	342	233	2,102	954	1,416
External financing	4,208	3,933	3,513	4,681	440	176	785	89	1,490	1,304	1,495
Public investment program (PIP)	3,239	3,630	2,858	3,212	660	880	1,012	773	3,325	3,333	3,651
Disbursements (BOP support)	2,007	356	218	1,247	0	0	0	0	0	0	0
Total amortization	-1,833	-878	-1,474	-1,645	-220	-704	-227	-684	-1,835	-2,029	-2,157
Arrears and rescheduling	795	825	1,911	1,867	0	0	0	0	0	0	0
Domestic financing	-834	33	556	-4,574	496	354	-473	-96	281	-691	-419
Exceptional Financing 4/	299	130	307	3,933	30	30	30	240	330	340	340
Financing Gap	0	0	0	0	340	667	459	865	2,332	3,491	3,088
Memorandum item:											
Primary balance	-2,446	-2,858	-3,095	-2,403	-1,095	-303	-608	-440	-2,446	-2,288	-2,399
Domestic balance 5/	529	428	-427	-35	-529	185	327	208	191	599	815
Underlying balance 6/	-439	-939	-1,403	-786	-696	394	14	-57	-345	-166	-450

Sources: Kyrgyz authorities; and Fund staff estimates.

1/ Mainly mineral resource tax and real property tax.

2/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).

3/ Includes carry-forward expenditure from previous fiscal year (Som 1,022 million in 2004 and 539 million in 2005).

4/ Mainly privatization proceeds. For revised 2004 projection, includes som 3,589 million related to the Kumtor mine restructuring.

5/ Overall balance (in cash) excluding the foreign-financed PIP and foreign interest payments.

6/ Primary balance excluding gold projects, grants and the foreign-financed PIP.

Table 5 (Concluded). Kyrgyz Republic: State Government Finances, 2001-07 (In Percent of GDP)

	2001	2002	2003	2004	2005				2005	2006	2007
	Act.	Act.	Act.	Proj.	1Q	2Q	3Q	4Q	Projections		
(In percent of GDP)											
Total revenue and grants	17.0	19.1	18.8	19.5	4.0	4.6	5.0	5.3	18.9	19.3	19.9
Total revenue	16.1	18.0	18.3	18.7	3.9	4.6	4.8	5.1	18.4	18.7	19.2
Current revenue	16.1	17.8	18.1	18.5	3.9	4.5	4.7	5.1	18.2	18.5	19.0
Tax revenue	12.4	13.9	14.3	15.0	3.2	3.7	4.0	4.3	15.2	15.4	15.6
Income tax	2.7	2.9	2.9	2.7	0.6	0.6	0.7	0.7	2.7	2.7	2.9
VAT	5.7	6.4	6.6	7.4	1.6	1.9	2.0	2.2	7.7	7.9	8.0
Excises	1.5	1.4	1.4	1.4	0.3	0.3	0.4	0.4	1.4	1.4	1.4
Customs	0.4	0.6	0.5	0.5	0.1	0.1	0.1	0.2	0.5	0.5	0.5
Land tax	0.3	0.4	0.4	0.4	0.1	0.1	0.1	0.1	0.4	0.3	0.3
Road tax and Emergency Fund	1.3	1.4	1.4	1.4	0.3	0.4	0.4	0.4	1.5	1.4	1.3
Retail sales tax	0.4	0.5	0.6	0.6	0.1	0.1	0.2	0.2	0.6	0.6	0.6
Other 1/	0.1	0.3	0.6	0.7	0.1	0.1	0.1	0.2	0.6	0.6	0.6
Nontax revenue	3.6	3.9	3.8	3.5	0.7	0.8	0.7	0.8	3.0	3.2	3.3
Capital revenue	0.1	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.2	0.2	0.2
Grants	0.8	1.1	0.5	0.8	0.1	0.0	0.2	0.2	0.5	0.6	0.7
Total expenditure	22.8	24.8	24.5	24.4	5.3	5.9	5.9	6.6	23.7	23.9	23.9
Current expenditure	17.5	18.9	19.6	19.7	4.4	4.8	4.6	5.5	19.2	19.3	19.3
Wages and Social Fund contributions	5.8	6.5	6.8	7.1	1.4	1.6	1.8	2.4	7.2	7.1	7.1
Transfers and subsidies 2/	3.0	3.4	3.2	3.1	0.7	0.7	1.0	0.9	3.3	3.3	3.3
Transfers to Social Fund	0.5	1.1	1.3	1.2	0.2	0.2	0.2	0.2	1.0	1.0	1.0
Interest	1.7	1.6	1.5	1.8	0.2	0.9	0.2	0.7	2.0	1.9	1.7
Purchases of other goods and services 3/	6.5	6.3	6.7	6.5	1.9	1.3	1.3	1.3	5.8	6.0	6.1
Capital expenditure (including PIP)	5.3	5.9	4.8	4.7	0.9	1.2	1.3	1.1	4.5	4.6	4.6
Domestically financed capital expenditure	0.9	1.2	1.2	1.3	0.3	0.3	0.3	0.3	1.2	1.6	1.6
Foreign financed PIP	4.4	4.7	3.6	3.5	0.7	0.9	1.0	0.8	3.3	3.0	3.0
Financial balance	-5.9	-5.7	-5.7	-4.9	-1.4	-1.3	-0.9	-1.2	-4.8	-4.6	-4.0
Net lending	-0.7	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	-0.4	-0.6	-0.3
Accrual surplus (+) / deficit (-)	-5.2	-5.1	-5.2	-4.4	-1.3	-1.2	-0.8	-1.1	-4.4	-4.0	-3.7
Cash surplus (+) / deficit (-)	-5.0	-5.4	-5.2	-4.4	-1.3	-1.2	-0.8	-1.1	-4.4	-4.0	-3.7
Primary balance excluding grants	-4.2	-4.9	-4.2	-3.4	-1.2	-0.3	-0.8	-0.6	-2.9	-2.7	-2.7
Total financing	5.0	5.4	5.2	4.4	1.0	0.6	0.3	0.2	2.1	0.9	1.2
External financing	5.7	5.2	4.2	5.1	0.4	0.2	0.8	0.1	1.5	1.2	1.2
Public investment program (PIP)	4.4	4.8	3.4	3.5	0.7	0.9	1.0	0.8	3.3	3.0	3.0
Disbursements (BOP support)	2.7	0.5	0.3	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total amortization	-2.5	-1.2	-1.8	-1.8	-0.2	-0.7	-0.2	-0.7	-1.8	-1.8	-1.8
Arrears and rescheduling	1.1	1.1	2.3	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	-1.1	0.0	0.7	-5.0	0.5	0.4	-0.5	-0.1	0.3	-0.6	-0.3
Exceptional Financing 4/	0.4	0.2	0.4	4.3	0.0	0.0	0.0	0.2	0.3	0.3	0.3
Financing Gap	0.0	0.0	0.0	0.0	0.3	0.7	0.5	0.9	2.3	3.1	2.5
Memorandum item:											
Primary balance	-3.3	-3.8	-3.7	-2.6	-1.1	-0.3	-0.6	-0.4	-2.4	-2.1	-2.0
Domestic balance 5/	0.7	0.6	-0.5	0.0	-0.5	0.2	0.3	0.2	0.2	0.5	0.7
Underlying balance 6/	-0.6	-1.2	-1.7	-0.9	-0.7	0.4	0.0	-0.1	-0.3	-0.1	-0.4

Sources: Kyrgyz authorities; and Fund staff estimates.

1/ Mainly mineral resource tax and real property tax.

2/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).

3/ Includes carry-forward expenditure from previous fiscal year (1.1 percent of GDP in 2004 and 0.5 percent of GDP in 2005).

4/ Mainly privatization proceeds. For revised 2004 projection, includes some 3,589 million related to the Kumtor mine restructuring.

5/ Overall balance (in cash) excluding the foreign-financed PIP and foreign interest payments.

6/ Primary balance excluding gold projects, grants and the foreign-financed PIP.

Table 6. Kyrgyz Republic: Social Fund Operations, 2001-07

	2001	2002	2003	2004	2005				2005	2006	2007
					1Q	2Q	3Q	4Q			
	Act.	Act.	Act.	Proj.	Projections						
(In millions of soms)											
Total revenue	3,306	3,573	3,892	4,329	1,086	1,131	1,122	1,203	4,542	4,795	5,057
Total contribution	3,218	3,516	3,827	4,267	1,071	1,116	1,107	1,188	4,482	4,733	4,992
Contribution from government	798	817	924	1,059	230	267	308	393	1,199	1,302	1,434
Contribution from non-government	2,420	2,699	2,903	3,208	841	849	799	795	3,283	3,431	3,559
Other revenue	88	57	65	62	15	15	15	15	60	62	65
Total expenditure	3,945	4,510	4,867	5,260	1,356	1,403	1,420	1,429	5,608	5,955	6,324
Pension fund (cash)	3,504	4,070	4,537	4,856	1,272	1,315	1,333	1,336	5,257	5,572	5,906
O/w wage	47	46	59	64	18	18	18	18	72	78	85
Social Insurance Fund (cash)	143	150	108	104	28	30	29	32	119	129	141
Employment Fund (cash)	97	106	96	104	0	0	0	0	0	0	0
Medical Insurance Fund (cash)	81	142	250	196	56	58	57	62	233	254	276
Net accumulation of arrears	120	43	-123	0	0	0	0	0	0	0	0
Overall balance	-640	-937	-975	-931	-270	-272	-298	-227	-1,066	-1,160	-1,267
Budgetary transfer	398	840	1,122	1,090	244	244	244	244	976	1,091	1,267
Net accumulation of arrears	120	43	-123	0	0	0	0	0	0	0	0
Cash balance	-121	-54	23	159	-26	-28	-54	17	-90	-69	0
(In percent of GDP)											
Total revenue	4.5	4.7	4.7	4.7	1.2	1.2	1.2	1.3	4.5	4.3	4.2
Total contribution	4.4	4.7	4.6	4.6	1.2	1.2	1.2	1.3	4.4	4.3	4.1
Contribution from government	1.1	1.1	1.1	1.1	0.2	0.3	0.3	0.4	1.2	1.2	1.2
Contribution from non-government	3.3	3.6	3.5	3.5	0.9	0.9	0.9	0.9	3.3	3.1	2.9
Other revenue	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Total expenditure	5.3	6.0	5.8	5.7	1.5	1.5	1.5	1.5	5.6	5.4	5.2
Pension fund (cash)	4.7	5.4	5.4	5.3	1.4	1.4	1.4	1.4	5.2	5.0	4.9
Social Insurance Fund (cash)	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Employment Fund (cash)	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medical Insurance Fund (cash)	0.1	0.2	0.3	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Net accumulation of arrears	0.2	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	-1.2	-1.2	-1.0	-0.3	-0.3	-0.3	-0.2	-1.1	-1.0	-1.0
Budgetary transfer	0.5	1.1	1.3	1.2	0.3	0.3	0.3	0.3	1.0	1.0	1.0
Net accumulation of arrears	0.2	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash balance	-0.2	-0.1	0.0	0.2	0.0	0.0	-0.1	0.0	-0.1	-0.1	0.0
Memorandum item:											
Average monthly pension (in som; eop) 1/	559	603	663	719	752	783	783	783	783	828	875
Payroll tax rate (in percent)	37	33	33	33	32	32	32	32	32	31	30
Payroll tax collection in cash											
Cash collection (in millions of som)	...	3,211	3,728	4,221	1,050	1,094	1,085	1,164	4,392	4,685	4,942
Cash collection ratio (in percent)	...	91.3	97.4	98.9	98.0	98.0	98.0	98.0	98.0	99.0	99.0

Sources: Kyrgyz authorities; and Fund staff estimates.

1/ Includes payments introduced in June 2002 to compensate for electricity tariff increase.

Table 7. Kyrgyz Republic: Medium-term Expenditure Framework for General Government  
by Functional Classification, 2000-07  
(In percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007
	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.
Total expenditure 1/	29.9	25.9	28.1	27.3	27.3	26.7	26.5	26.6
I. General public services	3.0	2.6	2.8	2.4	2.4	2.1	2.1	2.0
II. Defense	1.9	1.3	1.4	1.3	1.2	1.1	1.1	1.0
III. Public order and safety affairs	1.1	1.0	1.3	1.1	1.1	1.0	0.9	0.9
Social spending	12.2	12.1	14.1	14.0	14.3	15.0	15.3	15.8
IV. Education	3.5	3.6	4.2	4.2	4.2	4.4	4.6	4.9
V. Health	2.1	1.8	2.0	2.0	2.1	2.2	2.4	2.6
VI. Social security and welfare affairs 2/	1.9	2.0	2.5	2.4	2.8	3.1	3.2	3.4
VII. Pension Fund 3/	4.8	4.8	5.4	5.4	5.3	5.2	5.0	4.9
VIII. Housing and community services	1.1	1.1	1.5	1.3	1.3	1.2	1.1	1.1
IX. Recreational, cultural and religious activities	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.4
X. Energy complex (electricity production)	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4
XI. Agriculture, water resources, forestry	3.2	2.3	2.6	2.3	2.2	2.0	1.9	1.8
XII. Mining and mineral resources	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2
XIII. Transportation and communication	3.1	2.0	2.5	2.2	2.1	1.9	1.8	1.8
XIV. Other economic affairs and services	1.3	0.8	0.9	0.8	0.8	0.7	0.7	0.6
XV. Other	1.4	1.3	0.8	0.7	0.7	0.6	0.6	0.6
XVI. Unidentified expenditure	0.5	0.3	-1.1	0.0	0.0	0.0	0.0	0.0

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

1/ Including PIP and net lending.

2/ Excluding net transfers to the Pension Fund.

3/ Social Fund operations net of transfers to other funds.



Table 8. Kyrgyz Republic: NBKR Accounts, 2003-07  
(In millions of soms, end-period stocks) 1/

	2003		2004		2005		2006		2007		
	Act.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.	
Net foreign assets	7,879	8,180	8,087	13,257	14,627	14,509	14,098	14,377	14,407	16,165	17,744
Net international reserves	6,657	6,973	7,003	12,246	13,799	13,681	13,986	14,265	14,295	16,053	17,632
Other foreign assets	1,273	1,258	1,135	1,063	880	880	163	163	163	163	163
Balance with CIS countries	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51
Long-term foreign liabilities	-2,330	-2,368	-2,368	-2,368	-2,357	-2,347	-2,326	-2,321	-2,300	-2,300	-2,300
Net domestic assets	4,526	4,565	5,066	-9	110	747	1,171	838	1,139	177	-560
Domestic credit (net)	5,248	5,177	5,632	708	834	1,373	1,670	1,305	1,489	527	-210
Claims on government (net), o/w:	4,989	5,113	5,476	328	421	917	1,121	648	602	-189	-708
Loan to government in forex (Turkish loan)	1,868	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905
Total government deposits	-1,531	-1,432	-1,072	-6,223	-6,135	-5,638	-5,234	-5,707	-5,753	-6,344	-6,663
Treasury bonds 2/	4,303	4,290	4,092	4,096	4,100	4,100	3,900	3,900	3,900	3,700	3,500
Treasury bills	350	350	550	550	550	550	550	550	550	550	550
Repos	-147	-331	-231	2	40	102	200	313	546	374	156
Claims on commercial banks	405	395	387	378	374	354	350	344	342	342	342
Other items net 3/	-721	-612	-566	-717	-724	-626	-500	-468	-350	-350	-350
Reserve money	10,075	10,377	10,786	10,881	12,380	12,909	12,943	12,894	13,247	14,042	14,884
Currency outside commercial banks	9,317	9,640	9,996	10,030	...	...	...	...	...	...	...
Deposits of commercial banks in forex	0	0	0	0	...	...	...	...	...	...	...
Currency holdings of commercial banks	306	259	304	553	...	...	...	...	...	...	...
Reserves of commercial banks	452	477	487	588	...	...	...	...	...	...	...
Memorandum items:											
Reserve money growth (12 month)	31.6	31.8	28.0	25.5	22.9	24.4	20.0	18.5	7.0	6.0	6.0
Gross reserves (in millions of U.S. dollars)	359.2	375.7	367.2	491.8	519.2	523.6	521.5	520.5	514.0	528.2	541.9
in months of imports	4.8	4.0	3.9	5.2	5.5	5.2	5.2	5.1	5.1	4.9	4.7
Net international reserves (performance criterion; in millions of U.S. dollars) 4/	158.5	166.0	166.7	291.6	328.5	325.7	333.0	339.6	340.4	382.2	419.8
Net domestic assets (performance criterion) 5/	2,376	2,388	2,897	-2,169	-2,046	-1,390	-962	-1,289	-985	-1,948	-2,685

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

1/ Programmed and actual foreign exchange assets and liabilities are valued at the exchange rate of 42 soms per U.S. dollar, 1.4899 U.S. dollar per SDR and a gold price of U.S. dollar 426.2 per Troy ounce.  
2/ As of December 2002, includes government securities issued to replace restructured bonds, as well as those issued for revaluation losses, lost capital in the Central Asia Development Bank, and capitalized past interest arrears on bonds.

3/ As of December 2002, includes revaluation losses, lost capital in the Central Asia Development Bank, and capitalized past interest arrears on bonds.

4/ Non-adjusted.

5/ Excludes counterpart of the loan by the Eximbank of Turkey and the EBRD/IDA enterprise loan which are channeled through the NBKR.

Table 9. Kyrgyz Republic: Monetary Survey, 2003-07  
(In millions of soms, end-period stocks) 1/

	2003			2004			2005			2006			2007		
	Act.	Mar.	Dec.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Proj.	Dec.	Proj.	Dec.	Proj.
Net foreign assets	10,059	10,579	17,791	10,686	16,127	17,791	17,862	17,451	17,881	17,609	17,881	17,609	17,881	17,881	21,786
NBKR	7,879	8,180	14,627	8,087	13,257	14,627	14,509	14,098	14,377	14,407	14,377	14,407	14,377	14,407	17,744
Commercial banks	2,180	2,399	3,164	2,599	2,870	3,164	3,353	3,353	3,505	3,202	3,505	3,202	3,505	3,202	4,042
Long-term NBKR foreign liabilities	-2,330	-2,368	-2,357	-2,368	-2,368	-2,357	-2,347	-2,326	-2,321	-2,300	-2,321	-2,300	-2,300	-2,300	-2,300
Net domestic assets	6,754	6,731	3,203	7,522	2,792	3,203	3,848	4,833	5,160	6,680	4,833	6,680	5,160	6,680	10,088
Claims on government (net)	5,549	5,743	740	6,107	966	740	1,236	1,440	967	921	1,236	921	967	921	-389
Credit from the NBKR	4,989	5,113	421	5,476	328	421	917	1,121	648	602	1,121	602	648	602	-708
of which: Turkish loan	1,868	1,996	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905
Credit from commercial banks	560	630	319	631	638	319	319	319	319	319	319	319	319	319	319
Treasury bonds	134	118	63	63	63	63	63	63	63	63	63	63	63	63	63
Treasury bills	515	646	718	718	718	718	718	718	718	718	718	718	718	718	718
Other	-89	-134	-462	-150	-143	-462	-462	-462	-462	-462	-462	-462	-462	-462	-462
Repos actual value	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to other govt, net	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to the rest of the economy	3,776	4,024	6,302	4,867	5,657	6,302	6,352	7,006	7,774	9,223	7,774	9,223	7,774	9,223	13,941
of which: in forex	2,549	2,588	3,253	4,030	4,030	3,253	3,253	3,253	3,253	3,253	3,253	3,253	3,253	3,253	3,253
Other items net	-2,572	-3,036	-3,838	-3,452	-3,831	-3,838	-3,740	-3,614	-3,582	-3,464	-3,582	-3,464	-3,582	-3,464	-3,464
Broad money	14,483	14,942	18,637	15,841	16,552	18,637	19,364	19,958	20,720	21,990	20,720	21,990	20,720	21,990	25,696
Currency outside banks	9,315	9,637	10,845	9,987	9,917	10,845	11,423	11,338	11,295	11,604	11,295	11,604	11,295	11,604	13,038
Deposits	5,168	5,304	7,792	5,853	6,634	7,792	7,940	8,620	9,425	10,385	9,425	10,385	9,425	10,385	16,536
of which: in forex	3,396	3,374	4,448	3,964	4,448	4,448	4,685	4,827	5,043	5,317	5,043	5,317	5,043	5,317	7,028
Broad money: som component	11,086	11,568	14,102	11,876	12,103	14,102	14,679	15,131	15,678	16,672	15,678	16,672	15,678	16,672	22,547
Memorandum items:															
Velocity (quarterly) 2/	6.0	5.7	5.6	5.6	5.7	5.6	5.3	5.0	4.8	4.3	5.0	4.3	4.8	4.3	4.0
Som velocity (quarterly) 2/	8.0	7.5	7.3	7.5	7.7	7.3	7.0	6.8	6.5	6.4	6.8	6.4	6.5	6.4	5.4
Som money growth (12-month percent change)	34.5	32.6	28.7	32.9	14.5	28.7	29.6	26.0	25.2	18.0	26.0	18.0	25.2	18.0	15.1
Som broad money growth (12-month percent change)	33.5	32.1	27.2	32.1	14.5	27.2	26.9	27.4	29.5	18.2	27.4	18.2	29.5	18.2	15.4
Multiplier	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.6	1.7	1.5	1.6	1.6	1.7	2.0
Credit to the rest of the economy (in percent of GDP)	4.7	4.9	6.9	5.7	6.4	6.9	6.9	6.9	6.9	9.3	6.9	9.3	6.9	9.3	11.4

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

1/ Programmed and actual foreign exchange assets and liabilities are valued at the exchange rate of 42 soms per U.S. dollar, 1.4899 U.S. dollar per SDR and a gold price of U.S. dollar 426.2 per Troy ounce.

2/ 12 month GDP over average quarterly broad money.

Table 10. Kyrgyz Republic: Quarterly Balance of Payments: 2003 - 05  
(in millions of USD)

	2003	2004					2005				
	Year Est.	Q1 Act.	Q2 Act.	Q3 Prel.	Q4 Prog.	Year Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.	Year Prog.
<b>Current account balance 1/ excluding transfers</b>	-54	-2	-17	-13	-34	-66	-56	-30	-30	-27	-143
	-186	-55	-64	-47	-62	-228	-91	-95	-63	-65	-314
<b>Trade balance</b>	-133	-31	-40	-56	-56	-184	-75	-67	-61	-72	-276
Exports, fob	590	159	177	179	184	698	171	167	188	178	703
CIS countries	202	55	62	73	75	265	73	72	89	78	313
of which : Energy	26	2	6	13	11	32	8	11	24	10	52
Non-CIS countries	388	104	115	105	109	433	98	94	98	99	390
of which: Gold	260	67	83	75	75	300	58	86	42	61	245
Imports, fob	723	190	217	235	240	882	246	234	249	250	979
CIS countries 2/	394	114	131	141	148	533	153	145	150	153	601
of which: Energy	172	56	51	52	56	216	60	52	57	64	234
Non-CIS countries	329	76	86	94	92	349	93	88	99	97	378
<b>Services (net)</b>	-54	-23	-24	9	-6	-44	-16	-15	6	-14	-39
Non-interest service	5	3	3	14	14	35	7	12	22	14	55
Receipts	155	40	49	51	52	192	48	50	66	54	218
Payments	-149	-37	-46	-36	-38	-157	-41	-38	-44	-41	-163
Interest payments (scheduled)	-27	-8	-11	-3	-4	-27	-4	-18	-4	-18	-44
Other net income	-32	-19	-16	-2	-15	-52	-20	-9	-12	-10	-50
<b>Transfers (net)</b>	132	52	47	34	28	162	36	52	25	59	171
Official	37	12	10	13	15	50	1	12	11	19	43
Private	95	41	37	21	13	112	35	40	14	40	128
<b>Capital account balance</b>	6	3	-6	132	34	163	44	21	25	5	95
Commercial banks	-14	-10	-3	-2	-7	-22	-5	0	-4	-1	-9
Medium-and long-term loans, net	-12	-14	-7	13	9	1	-3	-3	-5	-5	-16
Disbursement	74	10	10	19	42	80	16	18	26	26	86
o/w foreign financed PIP	73	8	9	18	40	75	15	16	24	24	79
Amortization (scheduled)	-86	-24	-16	-6	-33	-79	-16	-37	-17	-33	-102
Foreign direct investment (net)	46	16	102	12	13	144	34	19	18	7	78
Portfolio investment (net)	6	7	1	1	2	12	4	1	5	0	10
Other assets 3/	-20	4	-100	107	17	28	13	5	11	3	32
<b>Errors and omissions and short term capital 4/</b>	54	0	0	0	0	0	0	0	0	0	0
<b>Overall balance</b>	5	0	-23	118	1	97	-12	-9	-5	-22	-48
<b>Financing</b>	-5	0	23	-119	-1	-97	3	-7	-7	-1	-12
Net international reserves	-53	-8	-1	-119	-37	-165	3	-7	-7	-1	-12
Gross official reserves (- increase)	-55	-17	9	-125	-28	-160	-4	2	1	6	5
IMF (net)	2	9	-9	0	-4	-4	7	-9	-8	-7	-17
Purchases and disbursements	32	14	0	14	0	28	14	0	0	0	14
Repurchases and repayments	-30	-5	-9	-8	-9	-32	-7	-9	-8	-7	-31
Exceptional Financing (including arrears)	42	8	16	0	18	42	0	0	0	0	0
Accumulation of Arrears (net)	-1	1	0	0	0	0	0	0	0	0	0
Debt rescheduling	43	7	16	0	19	42	0	0	0	0	0
BOP support loans (ADB)	0	0	8	0	18	25	0	0	0	0	0
BOP support loans (WB)	6	0	0	0	0	0	0	0	0	0	0
<b>Financing gap (-)</b>	0	0	0	0	0	0	-10	-16	-11	-23	-60
<b>Memorandum items:</b>											
Gross reserves	359	376	367	492	519	519	524	522	520	514	514
in months of subsequent year's imports	4.1	3.9	3.9	5.2	5.5	5.5	5.2	5.2	5.1	5.1	5.1

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

1/ Including transfers.

2/ Includes a positive adjustment factor to account for unrecorded CIS non-energy imports 2000-05

3/ Includes derivative gains/ losses

4/ Includes balancing item for unrecorded import adjustment

Table 11. Kyrgyz Republic: Medium-Term Balance of Payments, 2001-10  
(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	Actual	Actual	Actual	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
<b>Current account balance 1/</b>										
excluding transfers	-24	-41	-54	-66	-143	-117	-117	-112	-151	-186
	-96	-149	-186	-228	-314	-298	-302	-301	-342	-392
<b>Trade balance</b>	14	-89	-133	-184	-276	-273	-288	-301	-375	-458
Exports, fob	480	498	590	698	703	769	824	889	895	903
CIS countries	172	170	202	265	313	336	367	396	429	465
Non-CIS countries	308	328	388	433	390	433	457	493	466	438
of which: Gold	225	163	260	300	245	274	281	297	247	194
Imports, fob	466	587	723	882	979	1042	1112	1190	1270	1361
CIS countries 2/	250	312	394	533	601	638	679	726	775	836
Non-CIS countries	216	275	329	349	378	404	433	464	495	525
<b>Services (net)</b>	-110	-60	-54	-44	-39	-25	-14	0	33	66
Non-interest service	-44	-5	5	35	55	68	83	104	131	162
Receipts	80	142	155	192	218	239	265	293	325	361
Payments	-125	-148	-149	-157	-163	-171	-182	-188	-194	-199
Interest payments (scheduled)	-39	-32	-27	-27	-44	-38	-37	-40	-43	-46
Other net income	-26	-23	-32	-52	-50	-55	-60	-65	-55	-50
<b>Transfers (net)</b>	72	108	132	162	171	181	186	189	192	206
Official	53	50	37	50	43	53	56	59	62	66
Private	20	59	95	112	128	128	130	130	130	140
<b>Capital account balance</b>	-18	2	6	163	95	73	80	83	116	137
Commercial banks	-13	-10	-14	-22	-9	-10	-10	-11	-12	-12
Medium-and long-term loans, net	-24	24	-12	1	-16	5	27	32	33	3
Disbursement	74	82	74	80	86	85	96	107	120	144
o/w foreign financed PIP	69	77	73	75	79	75	82	88	95	102
Amortization (scheduled)	-97	-58	-86	-79	-102	-80	-69	-75	-87	-142
Foreign direct investment (net)	-1	5	46	144	78	48	42	40	55	89
Portfolio investment (net)	1	-12	6	12	10	6	5	8	20	26
Other assets 3/	18	-5	-20	28	32	24	16	14	20	32
<b>Errors and omissions and short term capital 4/</b>	0	73	54	0	0	0	0	0	0	0
<b>Overall balance</b>	-42	34	5	97	-48	-44	-37	-29	-34	-48
<b>Financing</b>	42	-34	-5	-97	-12	-42	-38	-38	-26	-35
Net international reserves	-18	-63	-53	-165	-12	-42	-38	-38	-26	-35
Gross official reserves (- increase)	-16	-57	-55	-160	5	-14	-14	-16	-4	-12
IMF (net)	-2	-6	2	-4	-17	-28	-24	-22	-22	-23
Purchases and disbursements	15	15	32	28	14	0	0	0	0	0
Repurchases and repayments	-17	-21	-30	-32	-31	-28	-24	-22	-22	-23
Exceptional Financing (including arrears)	19	21	42	42	0	0	0	0	0	0
Accumulation of Arrears (net)	-15	1	-1	0	0	0	0	0	0	0
Debt rescheduling	34	20	43	42	0	0	0	0	0	0
BOP support loans (ADB) 5/	33	8	0	25	0	0	0	0	0	0
BOP support loans (WB) 5/	8	0	6	0	0	0	0	0	0	0
<b>Financing gap (-)</b>	0	0	0	0	-60	-86	-74	-67	-60	-83
<b>Memorandum items:</b>										
GDP (in millions of U.S. dollars)	1,527	1,608	1,911	2,097	2,399	2,646	2,898	3,186	3,456	3,752
Current account balance (in percent of GDP)	-1.5	-2.6	-2.8	-3.2	-6.0	-4.4	-4.0	-3.5	-4.4	-4.9
Growth of exports of goods and services (volume, percent)	-3.2	7.3	9.5	15.4	2.5	9.2	7.2	7.8	2.2	2.5
Growth of imports of goods and services (volume, percent)	-9.9	16.1	14.8	15.6	8.0	5.7	5.7	5.0	4.7	4.9
External Public Debt (US\$ million) 6/	1,522	1,587	1,827	1,939	2,017	2,111	2,197	2,268	2,329	2,446
as percent of GDP	100	99	96	92	84	80	76	71	67	65
External Public Debt (NPV US\$ million) 6/	1,181	1,310	1,331	1,354	1,456	1,499	1,546	1,610	1,653	1,734
as percent of GDP	77	82	70	65	61	57	53	51	48	46
as percent of exports 7/	213	222	205	178	171	160	154	147	142	142
debt service-to-exports ratio 8/	13	10	8	11	19	15	12	12	12	17
Gross reserves 9/	230	290	359	519	514	528	542	558	562	574
in months of subsequent year's imports	3.8	4.0	4.1	5.5	5.1	4.9	4.7	4.6	4.3	4.2
Financing gap as percent of GDP	0.0	0.0	0.0	0.0	-2.5	-3.2	-2.6	-2.1	-1.7	-2.2

Sources: Kyrgyz authorities and Fund staff estimates and projections.

1/ Including transfers.

2/ Includes a positive adjustment factor to account for unrecorded CIS non-energy imports 2000-05

3/ Includes derivative gains/ losses

4/ Includes balancing item for unrecorded import adjustment

5/ BOP support loans for 2005 onward, except for firm commitments, are included within the financing gap.

Loans for 2000 are shown as part of disbursements under capital account.

6/ Public and publicly guaranteed debt (excluding Kumtor)

7/ Based on three-year average exports of goods and nonfactor services.

8/ Accounting for Paris Club debt relief up to 2004 only.

9/ Valued at end-year exchange rates.

Table 12. Kyrgyz Republic: External Payments Capacity, 2002-10  
(In millions of U.S. dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
	Projections								
I. Non-interest current account (excluding transfers)	-117	-160	-201	-271	-260	-265	-261	-299	-346
Exports	498	590	698	703	769	824	889	895	903
Imports	-587	-723	-882	-979	-1,042	-1,112	-1,190	-1,270	-1,361
Service credit	142	155	192	218	239	265	293	325	361
Service debit (excluding interest payments)	-170	-182	-209	-213	-226	-242	-253	-249	-249
II. Transfers and capital account	241	278	403	368	335	335	347	395	485
Private transfers	59	95	112	128	128	130	130	130	140
Official transfers	50	37	50	43	53	56	59	62	66
Official disbursements	77	73	75	79	75	82	88	95	102
Commercial credit	5	1	5	7	10	14	19	25	42
Foreign direct investment	5	46	144	78	48	42	40	55	89
Other net capital	46	27	18	33	20	11	11	28	46
III. Exceptional financing (including arrears)	29	48	67	0	0	0	0	0	0
Accumulation of Arrears (net)	1	-1	0	0	0	0	0	0	0
Debt conversion or rescheduling	20	43	42	0	0	0	0	0	0
BOP support loans (ADB) 1/	8	0	25	0	0	0	0	0	0
BOP support loans (WB) 1/	0	5	0	0	0	0	0	0	0
IV. Change in net international reserves (- increase)	-63	-54	-165	-12	-42	-38	-38	-26	-38
V. Payments capacity (I + II + III + IV)	90	113	105	86	33	31	48	70	102
VI. Debt service payments	90	113	106	146	118	106	114	130	188
VII. Financing gap (-)	0	0	0	-60	-86	-74	-67	-60	-86
Memorandum items:									
External public debt (in percent of GDP) 2/	99	96	92	84	80	76	71	67	65
External public debt (in percent of GDP-NPV terms) 2/	82	70	65	61	57	53	51	48	46
External public debt (in percent of total exports-NPV terms) 2/	222	205	178	171	160	154	147	142	142
External public debt to fiscal revenue (in NPV terms) 2/	377	316	299	295	275	258	244	228	218
Export concentration									
Share of gold and energy (as percentage of total exports)	30	38	37	32	33	31	31	26	22

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

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

2/ Excludes Kumtor debt

3/ Accounting for Paris Club debt relief up to 2004 only.

Table 13. Kyrgyz Republic: Indicators of Fund Credit, 2000-10  
(In percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Outstanding Fund credit (end-of-period)</b>											
In millions of SDRs	144.3	142.7	136.3	135.9	133.3	124.5	108.4	94.8	81.2	66.5	50.4
In millions of U.S. dollars	190.3	181.7	176.4	190.1	195.7	185.4	161.4	141.2	121.0	99.0	75.2
In percent of quota	162.5	160.7	153.4	153.0	150.1	140.2	122.0	106.7	91.5	74.9	56.8
In percent of GDP	13.9	11.9	11.0	9.9	9.3	7.7	6.1	4.9	3.8	2.9	2.0
In percent of total exports	33.2	32.4	27.6	25.5	22.0	20.1	16.0	13.0	10.2	8.1	5.9
In percent of external public debt (incl. Kumtor)	10.7	10.6	10.1	9.9	9.8	9.1	7.6	6.4	5.3	4.2	3.1
In percent of external public debt (excl. Kumtor)	12.5	11.9	11.1	10.4	10.1	9.2	7.6	6.4	5.3	4.3	3.1
In percent of gross reserves (beginning of period)	76.5	88.2	76.7	65.5	54.5	35.7	31.4	26.7	22.3	17.8	13.4
<b>Debt service due to the Fund</b>											
In millions of SDRs	10.2	14.6	19.1	22.4	22.1	21.5	19.2	16.6	15.2	15.0	16.3
In millions of U.S. dollars	13.5	18.6	24.7	31.3	32.4	32.1	28.6	24.7	22.6	22.4	24.2
<i>Of which:</i>											
Charges/interests	2.1	1.6	1.2	1.0	0.5	0.9	0.8	0.6	0.5	0.4	0.3
Repurchases and repayments	11.5	17.0	23.5	30.3	31.9	31.1	27.7	24.0	22.0	21.9	22.6
In percent of quota 1/	11.5	16.4	21.5	25.2	24.9	24.2	21.6	18.7	17.1	16.9	18.3
In percent of GDP	1.0	1.2	1.5	1.6	1.5	1.3	1.1	0.9	0.7	0.6	0.6
In percent of total exports	2.4	3.3	3.9	4.2	3.6	3.5	2.8	2.3	1.9	1.8	1.9
In percent of total debt service (incl. Kumtor)	8.8	12.1	22.1	21.9	23.5	18.1	19.5	19.1	16.6	14.7	11.5
In percent of debt service (excl. Kumtor)	20.4	26.4	37.8	54.7	50.2	26.8	24.2	21.5	18.2	16.4	17.6
In percent of gross reserves (beginning of period)	5.4	9.0	10.7	10.8	9.0	6.2	5.6	4.7	4.2	4.0	4.3

Sources: IMF, Finance Department, and Fund staff calculations.  
1/ Relative to the quota of SDR 88.8 million.

Table 14. Kyrgyz Republic: Prospective Use of Fund Resources, 2004-10  
(in millions of SDR, unless otherwise stated)

	Outstanding End-Dec. 2004	2005	2006	2007	2008	2009	2010
PRGF transactions	133.3						
Disbursements		12.1	2.5	2.5	1.3	0.0	0.0
Repayments		20.9	18.6	16.1	14.8	14.7	16.0
Total Fund credit outstanding	133.3	124.5	108.4	94.8	81.2	66.5	50.4
		(in percent of quota)					
Total Fund credit outstanding 1/	150.1	140.2	122.0	106.7	91.5	74.9	56.8
Disbursements under PRGF	...	13.6	2.8	2.8	1.4	0.0	0.0

Sources: IMF, Finance Department; and Fund staff calculations.

1/ Relative to the quota of SDR 88.8 million.

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

Date	Action	Associated Disbursement
On or after February 23, 2005	Board approval of the three-year arrangement (February 23, 2005).	SDR 1.26 million
On or after August 15, 2005	Complete first review based on end-June 2005 performance criteria.	SDR 1.27 million
On or after February 15, 2006	Complete second review based on end-December 2005 performance criteria, and adopt conditions and disbursements for the second year of the arrangement.	SDR 1.27 million
On or after August 15, 2006	Complete third review based on end-June 2006 performance criteria.	SDR 1.27 million
On or after February 15, 2007	Complete fourth review based on end-December 2006 performance criteria, and adopt conditions and disbursements for the third year of the arrangement.	SDR 1.27 million
On or after August 15, 2007	Complete fifth review based on end-June 2006 performance criteria.	SDR 1.27 million
On or after February 15, 2008	Complete sixth review based on end-December 2006 performance criteria.	SDR 1.27 million



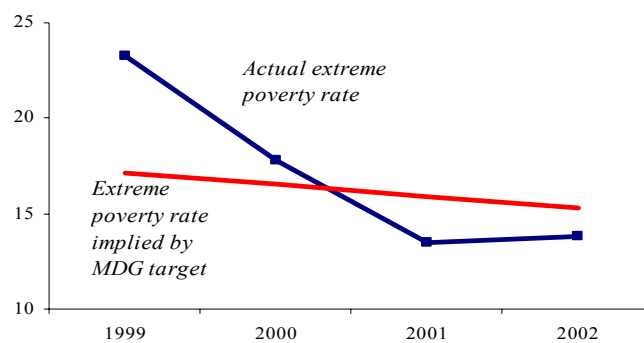
Table 16. Kyrgyz Republic: Millennium Development Goals

	1990	2000	2015	ON track/ Target OFF track
<b>Goal 1. Eradicate extreme poverty and hunger</b>				
Target: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.				
National poverty line, extreme poverty (corresponds to \$1.43 a day in PPP terms 1/)	19.1	17.8	9.55	on track
<b>Goal 2. Achieve universal primary education</b>				
Target : Ensure that, by 2015, children will be able to complete a full course of primary schooling				
Net primary enrollment ratio (percent of relevant age group)	92	95	100	on track
<b>Goal 3. Promote gender equality and empower women</b>				
Target : Eliminate gender disparity in primary and secondary education preferably by 2005 and at all levels of education by 2015				
Ratio of girls to boys in primary and secondary education (percent)	100.2	98.8	100	on track
<b>Goal 4. Reduce child mortality</b>				
Target : reduce by two-thirds between 1990 and 2015, the under-five mortality rate				
Under-five mortality rate (per 1,000)	42.2	33.2	14.067	on track
<b>Goal 5. Improve maternal health</b>				
Target : Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.				
Maternal mortality ratio ( WHO modeled estimate, per 100,000 live births)	50	42.3	12.5	off track
<b>Goal 6. Combat HIV/AIDS, malaria and other diseases</b>				
Target: Halt by 2015, and begin to reverse, the spread of HIV/AIDS				
HIV prevalence among females (percent ages 15-24)	...	...	...	n/a
Target : Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases				
Tuberculosis cases detected under DOTS (percent)	3	37	1.5	off track
<b>Goal 7. Ensure environmental sustainability</b>				
Target: Halve by 2015 proportion of people without access to safe drinking water				
Access to improved water source (percent of population)		77		on track

Sources: Kyrgyz Authorities, World Bank, Fund staff estimates

1/ Poverty indicator for 1996 was used as a proxy for 1990

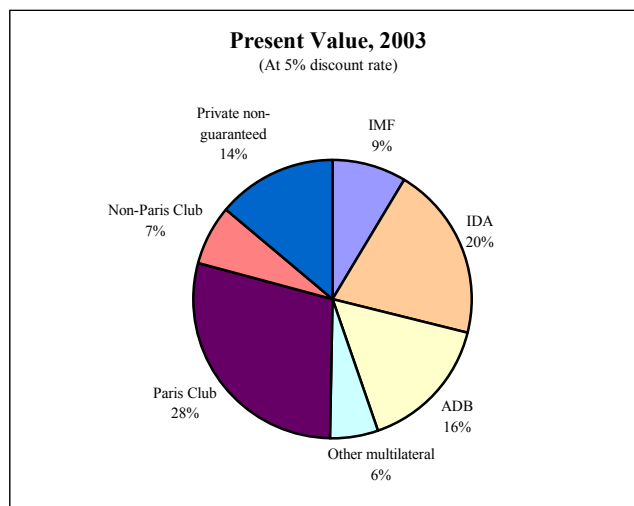
**Achieving the MDGs: Extreme Poverty Target**



## SUSTAINABILITY OF THE KYRGYZ REPUBLIC’S PUBLIC EXTERNAL DEBT<sup>1</sup>

1. This update of the Debt Sustainability Analysis (DSA) reflects the macroeconomic framework underlying the new PRGF program and staff projections through 2023. It assumes continued implementation of prudent macroeconomic policies and economic reforms, improvements in the business climate, and export diversification to lessen the impact of declining gold production. The results are broadly similar to the simulations presented in the November 2004 Article IV Staff Report.

2. **The DSA is based on the stock of the Kyrgyz Republic’s public and publicly guaranteed external debt.** At the end of 2004, this debt amounted to \$1,939 million (92 percent of GDP). In present value terms, 57 percent of this debt was owed to IFIs and 43 percent to bilateral creditors (Table 1).



3. **While the debt situation improved since the Paris Club flow rescheduling of March 2002, it remained unsustainable at the end of 2004.** Net foreign borrowing declined during the previous program period and debt ratios improved also because of stronger export performance and tax collection. Applying a 5 percent discount factor to all debt, the PV of debt-to-exports ratio fell by 35 percentage points between 2001 and 2004, to 167 percent. The PV of debt relative to government revenue fell from 480 percent at end-2001 to 313 percent at end-2004 (Table 2)<sup>2</sup>.

4. **The DSA has six components:** (1) a medium-term baseline scenario, which assumes no further Paris Club debt relief; (2) a scenario with a second flow rescheduling on Houston terms; (3) a scenario with a debt stock operation on Toronto terms; (4) a scenario with a debt stock operation on London terms; (5) a scenario with a debt stock operation on Naples terms and; (6) a set of stress tests around a baseline assuming no rescheduling, which explore the robustness of debt sustainability to alternative macroeconomic assumptions.

5. The key macroeconomic assumptions underlying the DSA include:

<sup>1</sup> The Kyrgyz Republic’s external debt is defined as public and publicly guaranteed debt to non-residents. The analysis excludes private sector debt, such as the Kumtor gold mine debt.

<sup>2</sup> Applying the CIRR rates as a discount factor, the PV of debt-to-export ratio was 179 percent and the PV of debt-to-fiscal revenue ratio was 335 percent at end-2004 (Table 3).

- Real GDP growth averages 5 percent a year in the medium- and long-term.
- Real GDP growth of important trade partners<sup>3</sup> (including Russia, Kazakhstan, China and the OECD) averages 4.3 percent a year through the forecast horizon.
- Export volume growth averages 5.4 percent a year in 2005-10, and 4.2 percent a year in 2011-2023.
- Import volume growth averages 5.6 percent a year in 2005-10, 3.9 percent a year in 2011-2015 (partly reflecting the reduction in gold project investments), and 4.3 percent a year thereafter.
- Foreign direct investment is projected at 1.9 percent of GDP on average in 2005–10 and 2.4 percent thereafter.
- New borrowing is contracted mostly on concessional terms, although the proportion of new debt contracted on these terms declines through the DSA horizon. The proportion of the balance of payments financing gaps filled on concessional terms is assumed to be 100 percent until 2008, 66 percent in 2008-12, 50 percent in 2013–17, and 25 percent thereafter. The balance of the gaps are assumed to be covered on market terms.
- State government revenues are projected at an average 16 percent of GDP in 2005–10, and would increase by 0.2 percentage points each year thereafter.

6. **The simulations suggest that during the next twenty years, debt sustainability (using HIPC thresholds as yardsticks) could be achieved only through a concessional debt stock operation.** With a Paris Club stock operation under Naples terms, and using a 5 percent discount rate, the end-2004 present value of total and bilateral debt would decline by 19 percent and 45 percent, respectively. Using currency-specific CIRRs<sup>4</sup>, the declines in the PV of total and bilateral debt would be 13 percent and 35 percent, respectively. A Naples treatment would reduce the PV of debt-to-GDP ratio below the 40 percent level by 2009 using the 5 percent discount rate. The PV of debt-to-exports ratio would fall below the 150 percent benchmark at the time of the operation and stabilize at 125–130 at the beginning of the next decade. The PV of debt-to-fiscal revenue would decline below 250 percent in 2006 and continue to fall thereafter.

7. **A Paris Club stock operation on London terms, assuming a 5 percent discount rate, would reduce the end-2004 present value of total and bilateral debt by 16 percent and 38 percent, respectively.** The London treatment would reduce the PV debt-to-GDP ratio below the 40 percent level by 2011. The PV debt-to-exports ratio would fall below the

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<sup>3</sup> Weighted by Kyrgyz Republic non-gold export shares.

<sup>4</sup> Commercial Interest Reference Rates as published by the OECD.

150 percent benchmark at the time of the operation and stabilize around 130 starting in 2008, but would be 3 percentage points higher on average than under the Naples treatment. The PV debt-to-fiscal revenue would decline below 250 percent in 2006 and continue to fall thereafter, but would stay on average 5 percentage points higher than under Naples terms.

8. **A Paris Club stock operation on Toronto terms, assuming a 5 percent discount rate, would reduce the end-2004 present value of total and bilateral debt by 13 percent and 23 percent respectively.** Toronto treatment would reduce the PV debt-to-GDP ratio below the 40 percent level by 2014. The PV debt-to-exports ratio would fall below the 150 percent benchmark in 2005 and stabilize at 135-140 in the early 2010s. The PV debt-to-fiscal revenue would decline below 250 percent in 2007 and continue to fall thereafter, but would stay on average 16 percentage points higher than under Naples terms.

9. **A Paris Club flow rescheduling under Houston terms would have a neutral impact on the end-2004 present value of total and bilateral debt under all discount rate assumptions.** Houston treatment would reduce the PV debt-to-GDP ratio below the 40 percent level by 2017. The PV debt-to-exports ratio would fall below the 150 percent benchmark by 2009, but would rise to, or modestly above, that level in 2012. The PV debt-to-fiscal revenue would decline below 250 percent in 2009. It would continue to fall thereafter, but would stay on average 37 percentage points higher than under Naples terms.

10. **Sensitivity analyses presented in Tables 4 and 5 use a non-rescheduling scenario as a baseline.** Shocks to important macro-variables such as export growth, GDP growth and the exchange rate are applied, both separately and jointly. The analyses suggest that debt sustainability remains vulnerable to shocks. In particular, shocks to export growth present the greatest vulnerability during this decade. Assuming that export value growth remains one standard deviation below its 1997-2003 historical average, the PV debt-to-exports ratio would reach 240 percent by 2010 and deteriorate to 327 percent by 2015<sup>5</sup>. This same shock would result in a PV of debt-to-GDP of 62 percent in 2010 and 51 percent in 2015. Assuming that new loans are contracted on less concessional terms than projected<sup>6</sup>, the PV debt-to-exports ratio would rise to 171 percent and 199 percent in 2010 and 2015, respectively. The same shock would result in a PV debt-to-GDP ratio of 58 percent and 57 percent in 2010 and 2015, respectively. There is less vulnerability to shocks to non-debt creating flows. These flows are projected to be low in the baseline (about 2 percent of GDP), which implies that potential deviations in this area have little impact on debt sustainability.

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<sup>5</sup> Compared to 137 and 147 percent respectively under the no-rescheduling stress test baseline scenario.

<sup>6</sup> Assumes that the interest rate on new borrowing is 2 percentage points higher than in the baseline, while grace and maturity periods are the same.

Table 1. Kyrgyz Republic: Structure of the External Debt, as of end-September 2004 1/

	Stock of debt		Present value	
	In US dollars	in percent of public debt	In US dollars	in percent of public debt
Total external debt	2082.92		1412.5	
Public and publicly guaranteed	1920.34	100.0	1255.0	100.0
Multilateral	1319.06	68.7	735.2	58.6
ADB	466.07	24.3	264.5	21.1
IDA	563.28	29.3	301.7	24.0
IMF	201.71	10.5	94.2	7.5
EBRD	37.53	2.0	36.9	2.9
Islamic Development Fund	28.57	1.5	23.9	1.9
OPEC	6.85	0.4	6.2	0.5
IFAD	8.48	0.4	4.6	0.4
Nordic Fund	6.56	0.3	3.2	0.3
Bilateral	601.29	31.3	519.8	41.4
Paris Club	486.07	25.3	424.6	33.8
Japan	246.25	12.8	192.5	15.3
Russia	181.59	9.5	190.1	15.1
Germany-KFW	35.54	1.9	20.99	1.7
Germany-Berliner	4.79	0.2	4.6	0.4
Germany-HRM	6.87	0.4	7.1	0.6
Denmark	5.88	0.3	4.4	0.4
France	5.15	0.3	4.8	0.4
Non-Paris Club	115.21	6.0	95.2	7.6
Turkey	45.06	2.3	35.6	2.8
Kuwait	20.36	1.1	19.7	1.6
Korea	15.74	0.8	11.1	0.9
China	13.59	0.7	9.9	0.8
Uzbekistan	11.11	0.6	10.3	0.8
Pakistan	8.33	0.4	7.9	0.6
India	1.02	0.1	0.7	0.1
Private non-guaranteed	162.58	n.a.	157.5	n.a.
<i>Of which: Kumtor</i>	65.03	n.a.	68.4	n.a.

Source: Kyrgyz authorities; and staff estimates.

1/ Based on end-September 2004 figures, and assuming a 5% discount rate for all loans.

Table 2. Kyrgyz Republic: Debt Rescheduling Scenarios (at 5 Percent Discount Factor), 2003-2023 1/  
(In millions of US dollars; ratios as percent, based on 5% discount rates for all loans)

Paris Club	Debt Indicators	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
No new rescheduling	PV of debt	1,204	1,263	1,365	1,408	1,457	1,526	1,574	1,661	1,796	1,927	2,042	2,167	2,302	2,431	2,592	2,789	2,981	3,168	3,349	3,551	3,768	
	Debt service	57	65	120	118	115	125	137	147	1796	163	175	191	208	235	270	314	369	421	470	526	576	
	PV of debt-to-GDP	62	57	57	53	50	48	46	44	44	43	42	41	39	38	38	37	37	36	36	35	34	33
	PV of debt-to-exports 2/	186	167	160	150	145	139	135	135	141	144	144	144	144	144	145	147	149	148	146	145	145	149
	PV of debt-to-revenues	342	313	310	282	259	243	228	218	214	209	201	194	187	181	176	173	169	164	159	154	149	149
	Debt service-to-exports 3/	8	7	13	12	11	11	11	11	11	11	12	12	12	13	14	16	17	18	19	20	21	21
Debt service-to-revenues	16	16	27	24	20	20	20	20	18	18	18	17	17	17	17	18	19	21	22	22	23	23	
Houston terms	PV of debt	1,204	1,255	1,385	1,458	1,534	1,606	1,658	1,748	1,886	2,021	2,139	2,268	2,408	2,541	2,706	2,910	3,109	3,304	3,494	3,705	3,931	
	Debt service	57	62	70	69	70	130	143	144	154	175	191	209	225	251	289	336	395	450	502	562	615	
	PV of debt-to-GDP	186	166	163	155	152	147	142	143	148	150	150	151	150	151	151	151	155	154	153	152	151	
	PV of debt-to-exports 2/	342	311	314	292	273	256	240	229	225	219	211	203	196	189	184	181	176	171	166	160	156	
	PV of debt-to-revenues	8	7	8	7	6	11	12	11	12	12	13	13	13	14	15	17	18	20	21	22	22	
	Debt service-to-exports 3/	16	15	16	14	12	21	21	19	19	18	19	19	18	19	20	21	22	22	23	24	24	
Debt service-to-revenues																							
Toronto terms	PV of debt	1,204	1,145	1,260	1,319	1,382	1,451	1,502	1,588	1,720	1,849	1,957	2,078	2,210	2,335	2,492	2,683	2,868	3,048	3,222	3,416	3,626	
	Debt service	57	62	84	81	80	86	94	107	113	127	166	180	195	220	251	293	345	395	444	497	554	
	PV of debt-to-GDP	62	52	53	50	48	46	43	42	42	41	41	39	38	37	36	36	35	34	34	33	32	
	PV of debt-to-exports 2/	186	151	148	140	137	133	129	130	135	138	138	138	138	138	139	142	143	142	141	140	139	
	PV of debt-to-revenues	342	283	286	264	246	231	217	208	205	200	193	186	180	174	169	167	163	158	153	148	143	
	Debt service-to-exports 3/	8	7	9	8	7	7	7	8	8	9	11	11	11	12	12	13	15	16	17	18	19	
Debt service-to-revenues	16	15	19	16	14	14	14	14	14	14	14	16	16	16	16	17	18	20	21	21	22		
London terms	PV of debt	1,204	1,066	1,179	1,234	1,295	1,360	1,406	1,489	1,616	1,740	1,843	1,961	2,089	2,210	2,363	2,546	2,722	2,892	3,056	3,239	3,437	
	Debt service	57	62	82	79	78	84	92	104	111	125	134	147	160	184	215	255	305	350	395	444	497	
	PV of debt-to-GDP	62	49	49	47	45	43	41	40	39	39	38	37	36	35	34	34	33	33	32	31	30	
	PV of debt-to-exports 2/	186	141	138	131	129	124	121	121	127	130	130	130	131	130	132	134	136	135	134	133	132	
	PV of debt-to-revenues	342	264	267	247	230	217	203	195	193	188	182	176	170	164	161	158	154	150	145	140	136	
	Debt service-to-exports 3/	8	7	9	8	7	7	7	8	8	9	9	9	9	10	11	13	14	15	16	17	18	
Debt service-to-revenues	16	15	19	16	14	13	13	13	14	14	14	13	13	13	14	15	16	17	18	19	19		
Naples terms	PV of debt	1,204	1,029	1,142	1,197	1,256	1,320	1,365	1,445	1,570	1,692	1,794	1,909	2,035	2,154	2,304	2,484	2,656	2,823	2,983	3,161	3,354	
	Debt service	57	62	80	77	75	81	89	101	108	122	130	143	155	178	207	246	294	337	384	430	482	
	PV of debt-to-GDP	62	47	48	45	43	41	39	38	38	38	37	36	35	34	33	33	33	32	31	30	30	
	PV of debt-to-exports 2/	186	136	134	127	125	121	117	118	123	126	126	127	127	127	129	131	132	132	130	129	129	
	PV of debt-to-revenues	342	255	259	240	223	210	197	189	187	183	177	171	166	160	157	154	151	146	141	137	133	
	Debt service-to-exports 3/	8	7	9	8	7	7	7	7	8	8	9	9	9	10	11	12	14	15	16	17	17	
Debt service-to-revenues	16	15	18	15	13	13	13	13	13	13	13	13	13	13	13	14	15	17	18	19	19		
Memorandum items:	PV of Kuntor debt	104	68	31	21	16	15	15	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
	Kuntor debt service	64	41	40	12	6	1	1	16	0	0	0	0	0	0	0	0	0	0	0	0	0	

Source: Kyrgyz Ministry of Finance; and Fund staff estimates.

1/ Excluding private non-guaranteed debt and Kuntor. Estimated for end-2004.

2/ Three-year average exports.

3/ Current-year exports.

Table 3. Kyrgyz Republic: Debt Rescheduling Scenarios (at CIRR Discount Factors), 2003-2023 1/  
(In millions of US dollars; ratios as percent, based on currency-specific discount rates)

Paris Club	Debt Indicators	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
No new rescheduling	PV of debt	1,296	1,354	1,456	1,499	1,546	1,610	1,653	1,734	1,863	1,990	2,099	2,219	2,349	2,472	2,628	2,820	3,007	3,190	3,368	3,566	3,780	
	Debt service	57	65	72	79	86	93	100	107	114	121	128	135	142	149	156	163	170	177	184	191	198	205
	PV of debt-to-GDP	67	62	61	57	53	51	48	46	45	44	43	42	40	39	38	38	38	37	36	35	34	33
	PV of debt-to-revenues 2/	200	179	171	159	154	147	142	141	146	148	148	147	147	146	147	149	149	150	149	147	146	145
	PV of debt-to-revenues	367	335	330	300	275	257	239	227	222	222	216	207	199	191	184	179	175	171	165	160	154	150
	Debt service-to-revenues 3/	8	7	13	12	11	11	11	11	11	11	11	12	12	12	13	14	16	17	18	19	20	21
Houston terms	PV of debt	1,296	1,354	1,483	1,554	1,627	1,694	1,740	1,823	1,956	2,085	2,197	2,320	2,453	2,580	2,740	2,938	3,131	3,321	3,507	3,713	3,937	
	Debt service	57	62	70	76	82	88	94	100	107	114	121	128	135	142	149	156	163	170	177	184	191	198
	PV of debt-to-GDP	67	62	62	59	56	53	50	49	48	47	45	43	42	41	40	39	38	38	38	36	36	35
	PV of debt-to-revenues 2/	200	179	174	165	162	155	149	149	153	155	154	154	154	152	153	155	155	156	155	153	152	151
	PV of debt-to-revenues	367	335	336	311	289	270	252	239	233	226	216	208	200	192	186	182	178	172	172	166	161	156
	Debt service-to-revenues 3/	8	7	8	7	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6
Naples terms	PV of debt	1,296	1,151	1,265	1,320	1,380	1,441	1,482	1,558	1,679	1,797	1,894	2,004	2,124	2,238	2,382	2,555	2,721	2,881	3,035	3,206	3,392	
	Debt service	57	62	79	76	74	80	88	100	107	120	129	141	153	176	204	243	291	334	380	426	477	
	PV of debt-to-GDP	67	52	53	50	48	45	43	41	41	40	39	38	36	35	35	34	33	33	32	31	30	
	PV of debt-to-revenues 2/	200	152	148	140	137	132	127	127	132	134	133	133	133	132	133	135	135	136	135	133	131	
	PV of debt-to-revenues	367	285	287	265	245	230	214	204	200	195	186	179	173	166	162	159	154	149	144	139	134	
	Debt service-to-revenues 3/	8	7	9	8	7	7	7	8	8	8	8	9	9	9	10	11	12	14	15	16	17	
Memorandum items:	PV of Kumtor debt	104	68	31	21	16	15	15	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
	Kumtor debt service	64	41	40	12	6	1	1	16	0	0	0	0	0	0	0	0	0	0	0	0	0	

Source: Kyrgyz Ministry of Finance; and Fund staff estimates.

1/ Excluding private non-guaranteed debt and Kumtor.

2/ Three-year average exports.

3/ Current-year exports.

Table 4. Country: External Debt Sustainability Framework, Baseline Scenario, 2000-2023 1/  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections							
	2000	2001	2002	2003		2004	2005	2006	2007	2008	2010	2015	2023
<b>External debt (nominal) 1/</b>	133.4	110.0	108.5	98.7		93.1	89.6	87.4	72.3	67.6	60.5	39.0	20.0
o/w public and publicly guaranteed (PPG)	111.1	99.8	98.7	88.7		85.8	84.4	83.2	68.7	64.6	58.2	38.9	20.0
Change in external debt	-7.2	-23.4	-1.4	-9.8		-5.6	-3.5	-2.2	-15.1	-4.6	-3.4	-3.6	-1.7
Identified net debt-creating flows	-9.8	-12.2	-3.3	-16.8		-9.1	-1.1	-2.0	-1.4	-1.4	-0.1	0.4	1.0
<b>Non-interest current account deficit</b>	0.6	-1.0	0.6	1.4	5.5	1.9	4.2	3.0	2.8	2.3	3.7	3.4	2.6
Deficit in balance of goods and services	6.1	2.0	5.9	6.7		7.1	9.2	7.7	7.1	6.2	7.9	7.0	5.7
Exports	41.9	36.7	39.8	39.0		42.5	38.4	38.1	37.6	37.1	33.7	28.8	24.3
Imports	47.9	38.7	45.7	45.7		49.5	47.6	45.8	44.7	43.3	41.5	35.7	30.1
Net current transfers (negative = inflow)	-7.9	-4.7	-6.7	-6.9	-5.2	-7.7	-7.1	-6.9	-6.4	-5.9	-5.5	-3.6	-3.2
o/w official	-4.8	-3.5	-3.1	-1.9		-2.4	-1.8	-2.0	-1.9	-1.8	-1.8	-0.3	-0.1
Other current account flows (negative = net inflow)	2.4	1.7	1.4	1.7		2.5	2.1	2.1	2.1	2.0	1.3	0.1	0.1
<b>Net FDI (negative = inflow)</b>	0.5	0.1	-0.3	-2.4	-2.1	-6.9	-3.3	-1.8	-1.4	-1.3	-2.4	-2.5	-2.4
<b>Endogenous debt dynamics 2/</b>	-10.9	-11.2	-3.6	-15.8		-4.1	-2.0	-3.1	-2.7	-2.4	-1.4	-0.5	0.7
Contribution from nominal interest rate	3.7	2.6	2.0	1.4		1.3	1.8	1.4	1.3	1.2	1.2	1.3	1.6
Contribution from real GDP growth	-8.6	-6.5	0.0	-6.1		-5.4	-3.8	-4.5	-3.9	-3.7	-2.6	-1.8	-0.8
Contribution from price and exchange rate changes	-6.0	-7.4	-5.6	-11.1		...	...	...	...	...	...	...	...
<b>Residual 3/</b>	2.6	-11.3	1.9	7.0		3.5	-2.4	-0.3	-13.8	-3.2	-3.4	-4.0	-2.7
o/w exceptional financing	-2.2	-1.3	-1.3	-2.2		-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPV of external debt 4/	...	...	...	77.1		72.0	62.7	57.9	54.2	52.2	48.4	42.5	36.3
In percent of exports	...	...	...	197.6		169.7	163.3	152.0	144.2	140.7	143.8	147.8	149.0
<b>NPV of PPG external debt</b>	...	...	...	67.0		64.7	57.5	53.7	50.7	49.2	46.1	42.4	36.3
In percent of exports	...	...	...	171.8		152.4	149.6	140.9	134.9	132.7	136.9	147.4	149.0
<b>PPG debt service-to-exports ratio (in percent)</b>	24.8	24.3	14.1	6.6		7.2	11.4	10.5	9.1	9.6	13.6	13.0	20.8
<b>PPG debt service-to-fiscal revenues ratio (in percent)</b>	...	...	...	16.3		17.1	28.9	25.6	22.5	22.0	20.1	19.5	26.2
<b>Key macroeconomic assumptions</b>													
Real GDP growth (in percent)	6.8	5.4	0.0	6.7	5.3	6.0	5.0	5.9	5.5	5.7	4.3	4.6	4.2
GDP deflator in US dollar terms (change in percent)	4.5	5.8	5.4	11.4	-5.0	14.3	3.5	9.3	4.4	4.0	4.0	4.0	4.3
Effective interest rate (percent) 6/	3.0	2.2	1.9	1.5	3.6	1.4	2.2	1.8	1.6	1.9	2.1	3.3	7.9
Growth of exports of G&S (US dollar terms, in percent)	8.6	-2.1	14.2	16.4	2.9	13.5	19.4	3.5	9.4	8.5	3.6	5.7	6.7
Growth of imports of G&S (US dollar terms, in percent)	-7.1	-9.9	24.3	18.8	-4.0	19.3	19.1	9.9	6.2	6.7	6.5	6.1	6.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	44.5	55.7	56.2	56.2	30.5	32.6	5.0	5.0
<i>Memorandum item:</i>													
Nominal GDP (millions of US dollars)	1,368	1,526	1,608	1,911	0	2,097	2,399	2,646	2,898	3,186	3,752	5,833	11,352

Source: Kyrgyz Ministry of Finance; and Fund staff estimates.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - \rho](1 + r + p) / (1 + r + p + g)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $\rho$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Total change in external debt, less identified net debt creating flows. Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments.

For projections, it also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ The projected year's imports

6/ Current-year interest payments divided by previous period debt stock.

7/ Historical averages and standard deviations are generally derived since 1997, subject to data availability.



Table 5. Country: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2003-23  
(In percent)

	Estimate		Projections						
	2003	2004	2005	2006	2007	2008	2010	2015	2023
<b>NPV of debt-to-GDP ratio</b>									
<b>Baseline</b>	67	65	57	54	51	49	46	<b>42</b>	36
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2004-23 1/	67	75	74	74	76	79	81	<b>94</b>	118
A2. New public sector loans on less favorable terms in 2004-23 2/	67	66	60	59	57	58	58	<b>57</b>	58
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	67	69	64	60	57	55	52	<b>47</b>	41
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	67	74	78	74	70	67	62	<b>51</b>	39
B3. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	67	75	74	69	65	63	58	<b>49</b>	38
B4. Combination of B1-B3 using one-half standard deviation shocks	67	81	95	89	84	81	74	<b>62</b>	46
B5. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	67	91	81	76	71	69	65	<b>60</b>	51
<b>NPV of debt-to-exports ratio 6/</b>									
<b>Baseline</b>	172	152	150	141	135	133	137	<b>147</b>	149
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2004-23 1/	172	176	193	193	203	213	240	<b>327</b>	483
A2. New public sector loans on less favorable terms in 2004-23 2/	172	155	158	154	153	155	171	<b>199</b>	237
<b>B. Bound Tests</b>									
B1. Export value growth at historical average minus one standard deviation in 2004-05 3/	172	234	315	298	286	280	282	<b>275</b>	246
B2. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	172	177	192	182	174	171	172	<b>171</b>	157
B3. Combination of B1-B2 using one-half standard deviation shocks	172	221	276	261	250	245	246	<b>239</b>	213
<b>Debt service ratio 6/</b>									
<b>Baseline</b>	7	7	11	11	9	10	14	<b>13</b>	21
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2004-23 1/	8	8	16	15	14	15	18	<b>27</b>	58
A2. New public sector loans on less favorable terms in 2004-23 2/	8	7	13	12	12	12	11	<b>14</b>	30
<b>B. Bound Tests</b>									
B1. Export value growth at historical average minus one standard deviation in 2004-05 3/	8	10	22	21	20	19	24	<b>25</b>	36
B2. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	8	7	14	13	12	12	15	<b>15</b>	23
B3. Combination of B1-B2 using one-half standard deviation shocks	8	9	19	19	17	17	21	<b>22</b>	31

Source: Kyrgyz Ministry of Finance; and Fund staff estimates.

1/ Average 1997-2003 variables include real GDP growth, non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Relative to current year exports as opposed to the three-year average used in table 2.

7/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Bishkek, Kyrgyz Republic  
February 4, 2005

Mr. Rodrigo de Rato  
Managing Director  
International Monetary Fund  
700 19<sup>th</sup> Street, N.W.  
Washington, D.C. 20431

Dear Mr. de Rato:

1. On behalf of the government of the Kyrgyz Republic, we hereby transmit the attached Memorandum of Economic Policies (MEP) setting out the objectives and policies that the government intends to pursue in 2005-07. The MEP is derived from the first progress report on the implementation of the Kyrgyz Republic Poverty Reduction Strategy, as presented to you and the President of the World Bank in June 2004. The government intends to make the contents of this letter and those of the attached MEP and Technical Memorandum of Understanding (TMU), as well as the staff report on the sixth review and request for the new three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), available to the public, and authorizes the staff to arrange for them to be posted on the IMF website after Executive Board approval.

2. The performance criteria, indicative targets, and structural benchmarks under the program are set out in Table 2 of the MEP. The first review under the PRGF arrangement is expected to be completed on or after August 15, 2005, and the second review on or after February 15, 2006.

3. In support of the program, the government of the Kyrgyz Republic hereby requests a new three-year arrangement under the PRGF in an amount equivalent to SDR 8.88 million (10 percent of quota), including a disbursement equivalent to SDR 1.26 million upon Board approval of the arrangement. The government will also be requesting assistance from bilateral and multilateral donors to support its economic program.

4. As noted in Table 1 of the MEP, we have observed all the performance criteria for end-September 2004 under the current PRGF arrangement. Therefore, we also request the final disbursement of SDR 9.56 million upon Board completion of the sixth review. We also request cancellation of the current PRGF arrangement following disbursement of the final loan.

5. The government of the Kyrgyz Republic will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic policies and achieving the objectives of the new program. The government believes that the policies and measures set forth in the MEP are adequate to achieve the objectives of the program to be supported by the new PRGF arrangement, but will take further measures to that end if deemed necessary. During the implementation of the current and new arrangements, the Kyrgyz Republic will consult with the Managing Director on the adoption

of any measures that may be appropriate, at the initiative of the government or whenever the Managing Director requests such a consultation.

6. We assure you, Mr. Managing Director, that the government of the Kyrgyz Republic is determined to fully implement the program and we hope we can count on the support of the Fund in our endeavors.

Very truly yours,

/s/

Nikolai Tanaev  
Prime Minister  
Kyrgyz Republic

/s/

Ulan Sarbanov  
Chairman  
National Bank of the Kyrgyz Republic

Attachments (2)  
Memorandum of Economic Policies, 2005–07  
Technical Memorandum of Understanding

## **Memorandum of Economic Policies of the Government of the Kyrgyz Republic for 2005–07**

February 4, 2005

### **I. INTRODUCTION**

1. Following broad discussions with public and private stakeholders, the Government of the Kyrgyz Republic in June 2004 published the first update of the Kyrgyz Republic's National Poverty Reduction Strategy (NPRS). The donor community has expressed its continuing support of the NPRS, including most recently at the Consultative Group meeting of November 3, 2004.

2. This Memorandum presents a brief summary of developments under the government's 2001-04 program, outlines the medium-term objectives and policy framework for 2005-07, and sets out specific economic policies for 2005, for which we are seeking support under a new PRGF arrangement. The policies described in the Memorandum are consistent with our NPRS framework, the government's Medium-Term Budget Framework for 2005-07, and the 2005 budget as passed by parliament in December 2004. We believe our program is strong and are committed to its effective implementation.

#### **Program Performance During 2001-04**

3. We are proud of the sharp improvement in economic policy implementation under the most recent PRGF-supported program. The IMF Executive Board called attention to this improvement during the 2004 Article IV consultation in November. With the help of the Fund and other donors, the policy path we have followed over the past three years has contributed to macroeconomic stability, to achieving sustained growth, and to significant reductions in poverty. In fact, with the Fund's consistent support and technical assistance, we were very successful in achieving the program's broad objectives as spelled out in paragraph 8 of our November 2001 Memorandum to the IMF Managing Director.

4. Economic growth began to broaden during this period, GDP per capita (in U.S. dollar terms) increased by 36 percent, and the poverty headcount index fell from 52 percent in 2000 to 41 percent in 2003. The 12-month rate of inflation remained below 4 percent most of the time since 2001, and the som appreciated by 9 percent against the U.S. dollar in 2001–03. Meanwhile, the real effective exchange rate remained broadly stable. The balance of payments strengthened and official gross reserves reached 4.3 months of import coverage at end-2003, rising to 5½ months of imports at end-2004. External debt indicators began to decline. In most key areas, macroeconomic outcomes were better than initially targeted.

5. Fiscal consolidation was a central part of our strategy under the previous three-year program and contributed greatly to our macroeconomic performance. The overall general government deficit was reduced from over 9 percent of GDP in 2000 to close to 4 percent of GDP in 2004. As foreseen in our November 2001 Memorandum, the rationalization of the externally-financed public investment program (PIP) played a key role in reducing the fiscal

deficit and keeping our external debt strategy on track. The 2002 Paris Club debt relief was also crucial in this respect. A strong tax collection effort over this period also helped to reduce the fiscal deficit—general government tax revenues rose from 15 percent of GDP in 2000 to 18½ percent in 2004.

6. The successful macroeconomic stabilization both contributed to and was reinforced by ongoing remonetization. The NBKR's monetary policy effectively accommodated this remonetization while maintaining inflation at low levels. In turn, the som has been broadly stable against the basket of currencies of our major trading partners. Rapid private sector credit growth since 2001 is contributing positively to the development of small- and medium-sized businesses. At the same time, the NBKR has been reinforcing bank supervision in light of the risks that accompany rapid credit growth.

7. Although with some delays, our structural reform agenda progressed well. In addition to various initiatives to strengthen the financial sector, we have begun to reduce the quasi-fiscal deficit of the electricity sector and have strengthened the institutional framework to fight corruption. Nevertheless, we recognize the need to redouble our efforts in this area and address governance reforms with urgency.

## **II. PROGRAM OBJECTIVES AND STRATEGY FOR 2005-2007**

8. Our new program is derived from the earlier work on the National Poverty Reduction Strategy (NPRS), which was updated in the spring of 2004. The program aims to further consolidate macroeconomic stability while raising growth prospects and reducing poverty. We will use this Memorandum for the 2006-08 Medium-Term Budget Framework (to be published in March 2005), which in turn will serve as an input in drafting the new NPRS paper in 2006. Continued sound macroeconomic policies and effective implementation of structural reforms would support real growth rates of 6 percent over the medium term, although in 2005 growth could slow temporarily because of a 25 percent decline in gold production (Table 3). Growth would be led by private investment, while the contribution from net exports would be small owing to buoyant imports to satisfy pent-up demand for consumption and investment goods. Monetary policy would aim to contain annual inflation to 4 percent. The general government primary fiscal deficit (excluding grants) is targeted to decline from 4¼ percent of GDP in 2003 to 2¾ percent in 2007. This should help reduce the external debt overhang and promote private investment.

## Key Projections, 2004-07

	2004	2005	2006	2007
Real GDP (percent change)	6.0	5.0	5.9	5.5
Inflation (average, in percent)	4.1	4.0	3.7	4.0
External current account balance (percent of GDP)	-3.2	-6.0	-4.4	-4.0
Gen. gov't. prim. fiscal balance (excl. grants, percent of GDP)	-3.2	-3.0	-2.7	-2.7
Broad money growth (eop, in percent)	28.7	18.0	16.9	15.1
Investment ratio	20.9	22.3	22.7	23.2
Savings ratio	17.7	16.4	18.3	19.2

9. The investment ratio is projected to increase from an average of 20 percent of GDP in 2001–04 to 23 percent in 2005–07. Higher investment would support productivity growth, which so far has been driven by gains in capacity utilization and catch-up efficiency improvements. The debt-financed public investment program will be further streamlined, while private investment is expected to increase in line with recent trends, to 19 percent of GDP by 2007, from 16 percent in 2003. Higher national savings would reflect the continued fiscal consolidation and an increase in private savings as the banking system becomes more trustworthy.

10. We recognize that at times our economic programs have suffered from a “policy implementation gap.” While the efforts of the government and the parliament have produced a significant amount of new legislation and regulations, their implementation has not always been as efficient as hoped. In this respect, an overarching objective of the new program is to create a professional civil service with the necessary qualifications to significantly strengthen the implementation capacity of public administration. This will need to be accompanied by policies to effectively reduce corruption and garner public support for our economic and social reforms. Transparency of government is crucial in this respect, as it also would enhance the accountability of civil servants, an important factor for efficient policy implementation.

11. The high level of our public external debt continues to shape the policy landscape, calling for continuous fiscal adjustment and cautious foreign borrowing in 2005–07. Even with further Paris Club debt relief in 2005, the process of fiscal consolidation would need to be continued in order to ensure that debt sustainability is achieved during this decade. However, we believe that the pace of fiscal adjustment could be slower as the recent sale of part of the government equity in the Kumtor gold mine provides new source of financing to support poverty reduction. Achieving debt sustainability will also require a continued shift toward grant financing from international donors. We are also introducing explicit debt limits on concessional borrowing.

12. Because of the declining trend of gold production, export diversification is crucial. We realize that the key for further broadening the export base is preserving external competitiveness through low inflation and strong productivity growth. Our enterprises must contain increases in unit labor costs to be able to maintain and increase their market shares both at home and abroad. Strong productivity is key in this respect, and to foster productivity growth we need higher private investment, governance reforms, more flexible labor market policies, and a significant decline in the energy sector's quasi-fiscal deficit.

13. We want to stress, however, that export diversification would be a less challenging task if neighboring countries would remove their trade restrictions. To this end, we appeal to the international community to encourage our neighbors to grant more liberal treatment of Kyrgyz goods in their markets.

14. High poverty and weak institutions constrain domestic savings, and thus investment. Although private savings show signs of recovery, increasing national savings requires also higher public savings through further fiscal adjustment. Apart from solid growth of real incomes, supporting private savings calls for continued reforms in the financial sector to build up trust in banks. On private investment, in addition to macroeconomic stability, several structural reforms are needed to improve the investment climate. In particular, we should focus on:

- Reforming the labor market to promote mobility, reduce skill mismatch, and streamline hiring and firing regulations.
- Strengthening creditor rights by improving the legal and regulatory framework for secured transactions, the property registration system, and bankruptcy procedures.
- Reforming the judicial system.

15. The large size of the shadow economy is one of our main concerns. We believe that high tax rates are an important factor driving enterprises underground. The new tax code and small business tax reform should simplify taxation and make it less intrusive. At the same time, we want to reduce the payroll tax rate by several percentage points during the program period. We realize, though, that a significant cut in the payroll tax rate over the medium term requires compensating for the revenue loss by broadening the tax base, improving compliance, strengthening the performance of other taxes, and restraining spending.

16. Reducing corruption and improving governance to contain the informal economy is of equal importance. A professional, less intrusive public administration would provide an incentive for businesses to formalize their operations, as enterprises could better exploit economies of scale and draw on better functioning institutions for a more efficient delivery of services. To this end, apart from keeping the government at arm's length from private activities, we will lessen the regulatory burden and make laws, rules, and regulations more predictable. In addition, we will adopt a new Competition Law to ensure a level market-based playing field for entrepreneurial activities.

### **III. Policies for January 1—December 31, 2005**

17. Within the general policy strategy described above, we have set specific targets for our first-year economic program (January 1–December 31, 2005) as detailed in Table 2. The implementation of these policies will start immediately. The principal goal of the 2005 program is to maintain the rate of economic growth at about 5 percent despite a projected drop in gold production of 25 percent as the quality of the ore is expected to decline sharply after a good year in 2004. Consumer price inflation is targeted at 4 percent during the first-year program. The program is expected to lead to an improvement in GDP per capita (in U.S. dollar terms) to \$438 in 2005—almost 60 percent higher than in 2000—which should help alleviate poverty further. On the external side, we expect the import cover of official reserves to decline to 5.1 months at end-2005, from 5.5 months in 2004.

#### **A. Fiscal Policy**

18. In the medium term, further fiscal consolidation is needed on two accounts. First, it is needed for reducing the debt overhang which constrains growth. Second, it is critical to developing sufficient national savings to maintain a satisfactory external balance. The government's 2005 State and Social Fund budgets—which were approved by parliament in December 2004—provide a good basis for the program's fiscal strategy (Box 1).

19. On the revenue side, the ratio of general government tax revenues to GDP is expected to remain around 18½ percent through 2007. A gradual broadening of the tax base and improved tax administration would offset the impact of reducing the tax rates on production taxes and the payroll tax. If the parliament can broaden the tax base by providing regulations for a full implementation of the property tax, numerous local taxes (for instance, hotel, resort, and advertisement taxes) could be eliminated. We will also consider raising land tax rates and the related social insurance contribution rates of farmers by 50 percent, on average, later in 2005. This is justifiable because the VAT regime would cover only the largest farms following the increase in the VAT threshold to som 2.5 million, as proposed in the new small business legislation now before parliament. Sale of collateral will not be subject to VAT. The higher social insurance contribution by farmers would provide further room for reducing labor taxation.



**Box 1. The 2005 Fiscal Program**

As a result of discussions that began in mid-2004, the staff and authorities have reached understandings on the main parameters of the 2005 general government budget, as follows:

**REVENUE**

General government tax revenue is programmed to remain at 18½ percent of GDP in 2005. The small business tax reform is expected to be revenue neutral as the increase in the VAT threshold would be compensated by the new small business tax.

Government Finances, 2004 - 05

	2004 Proj.	2005 Prog.	2004 Proj.	2005 Prog.
General government	(In millions of soms)		(In percent GDP)	
Total revenue and grants	21,265	22,354	23.0	22.2
o/w: tax revenue	17,049	18,601	18.5	18.5
grants	723	492	0.8	0.5
Total expenditure	25,652	27,329	27.8	27.1
Net lending	-501	-451	-0.5	-0.4
Surplus (+)/ deficit (-)	-3,880	-4,524	-4.2	-4.5
Primary balance excluding grants	-2,968	-3,028	-3.2	-3.0
State Government (central and local governments)				
Total revenue and grants	17,995	19,011	19.5	18.9
o/w: Tax revenue	13,841	15,318	15.0	15.2
Total expenditure	22,541	23,895	24.4	23.7
o/w: Wage and Social Fund contribution	6,548	7,247	7.1	7.2
Goods and services	6,005	5,815	6.5	5.8
Public investment	4,380	4,503	4.7	4.5
Surplus (+) / deficit (-)	-4,039	-4,434	-4.4	-4.4

Sources: Kyrgyz authorities; and Fund staff estimates.

The payroll tax rate will be reduced by 1 percentage point to 32 percent from January 1, 2005, and by another percentage point later in the year. At this stage, only grants from the European Union are included in the budget.

**EXPENDITURE**

Wages for teachers, doctors, and nurses will be raised in July 2005 with pay increases for other government employees to be considered in spring 2005 if resources (such as a higher land tax rate) become available. Spending on goods and services (excluding carry-forward outlays) will be kept unchanged in real terms. Additional expenditure over the PRSP envelope (\$16 million in 2005) will be allocated to poverty reducing non-recurrent spending, mainly investments in health and education. Pension benefits will be increased by 8 percent on average, with higher increases for poor pensioners. Public investment will be maintained at 4½ percent of GDP, despite the reduction in the foreign financed public investment program (PIP) from 3.5 percent of GDP in 2004 to 3.3 percent in 2005. The Government shall effect early payments of som 100 million during 2005, as defined under the previous program, to depositors of former Sberbank and three other liquidated commercial banks.

**DEFICIT**

The state budget deficit will remain at its 2004 level (4.4 percent of GDP), while the Social Fund budget is expected to draw down accumulated cash deposits (0.1 percent of GDP). Excluding grants, the general government primary deficit would decline from 3.2 percent of GDP in 2004 to 3.0 percent in 2005.

20. Fiscal consolidation also requires better targeting of government expenditures to ensure adequate public investment and social spending. In 2005-07, current and capital expenditures are projected to stabilize at 22½ percent and 4½ percent of GDP respectively. Total expenditures would be ¾ percentage point of GDP higher than in the expenditure envelope envisaged by our latest PRSP baseline. We will ensure that this added spending does not lead to permanent expenditure increases beyond the recurrent maintenance costs associated with higher investment. A task force is working to develop the details of this spending. On social policy, in close cooperation with Fund and the World Bank staff, we will redefine the concept of poverty-related spending to be used as a yardstick, as the current classification is too broad. The new classification will be published as part of the 2006-08 MTBF.

21. The need to strengthen the quality of public services and reduce incentives for corruption requires further well-targeted increases in public sector wages. The civil service wage structure will be reformed in the context of the 2006 budget so that key personnel can be provided with merit-based and more competitive salaries. The reform will be carried out while keeping the government wage bill broadly constant relative to GDP in the coming years. In the 2006-08 Medium-Term Budget Framework we will specify where government employment could be streamlined to provide room for higher wages. On pension policy, real benefits will be increased by 2–3 percent a year after 2005. Keeping the growth of pay-as-you-go pension benefits below the wage bill growth would provide further room for reducing the payroll tax rate while improving pensioners' purchasing power. Reflecting the consolidation of the Employment Fund with the State budget, we will ensure that this Fund's 2005 estimated outlays of some 114 million will be covered, despite the change in its financing arrangements. On capital spending, the public investment ratio should stabilize at the average 2003-04 level (4½ percent of GDP) during the program period. Further—albeit much smaller than before—reductions of the foreign-financed public investment program relative to GDP are needed for the success of the external debt strategy and to help control recurrent maintenance costs, where bottlenecks have appeared. We will also assign a task force to assess future needs for contingency expenditures (such as those related to natural disasters) and complete a report on this issue by end-April 2005 to be considered in preparing the 2006 budget.

22. On fiscal institution building, we will focus on fiscal transparency, civil service reform, wage reform, and fiscal decentralization. Specific policies and implementation timelines are spelled out in Box 2. Otherwise, fiscal structural measures would follow the current strategy focusing on reforming tax administration and improving the budget process by drawing on technical assistance from FAD, the World Bank, USAID, and DFID. The tax administration reform would continue to focus on restructuring the LTU, enhancing the capacity of VAT administration, and implementing self-assessment principles, which should make it possible to reduce the number of tax inspectors and, in turn, provide scope to increase their wages.

### **Box 2. Fiscal Institution Building**

Several steps toward improving fiscal institutions will be taken:

1. Publish Medium-Term Fiscal Framework for 2006–08, including aggregate resource envelopes for each line ministry, by end-March, 2005.
2. Introduce new wage scales in the 2006 budget.
3. Amend the charter of the Ministry of Finance to clarify the authority and responsibilities of the permanent secretary and other high-level civil servants, by end-March 2005.
4. In close cooperation with World Bank staff, develop steps to improve the mechanism for inter-governmental transfers.
5. Submit for discussion in the Economic Policy Council an accelerated depreciation scheme for capital investments prepared by a task force including representatives from the private sector, by end-June 2005.
6. Complete the Treasury modernization project by end-2007.
7. Integrate all extrabudgetary funds into the 2006 budget.

### **B. Monetary and Exchange Rate Policies**

23. Price stability will continue to be the main objective of monetary policy. Remonetization is expected to continue at a slower pace and the program will accommodate it by assuming 18 percent broad money growth in 2005, followed by 17 and 15 per cent annual increases in 2006 and 2007, respectively. This implies an annual 7 percent decline in money velocity. The money multiplier will increase from 1.5 at end-2003 to 1.7 in 2005 and further to 2.0 in 2007.

24. With the remonetization, both bank deposits and private sector credit are growing rapidly. Solid credit growth is important to building a financing base for the business sector, diversifying the economy, and raising growth prospects. So long as financial soundness indicators do not indicate imminent vulnerabilities, the NBKR will not constrain this growth through administrative measures, including higher reserve requirements. At the same time, the NBKR and the government will increase the range of government securities issued by the NBKR. In order to deepen the financial market and provide alternative investment opportunities for banks, in 2005, at least some 200 million of government bonds currently held by the NBKR will be redeemed and re-issued to commercial banks. The sale of these securities will be completed by September 2005. We will also adopt a new Mortgage Law and improve collateral mechanisms to promote housing finance through commercial banks.

25. We draw your attention to the significant improvement in servicing the government debt held by the NBKR and market participants. Meeting all interest and redemption

payments as scheduled has contributed to a return of financial market confidence in government paper. The Ministry of Finance reaffirms the priority it gives to ensuring the timely completion of all government debt obligations and the central role this plays in maintaining confidence in the financial market.

26. Our new program will continue to operate under a managed float exchange rate regime as our country characteristics make exogenous real shocks difficult to manage under a fixed exchange rate. We will not target the exchange rate for competitiveness reasons.

27. We will strengthen the legal basis for central bank independence. To this end, we will submit to parliament amendments to the Civil Code to provide for legal independence of the NBKR and revise the legal status of the NBKR as registered by the Ministry of Justice. We will also present to parliament amendments to the central bank law—in accordance with the Basle Core Principles for Banking Supervision—to ensure legal protection for NBKR employees in performing their official duties. Amendments to the central bank law would also include provisions regarding the accountability of the Chairman, the composition of the Board, and a specific exemption for the NBKR from the profit tax—any other NBKR tax exemptions will be specified in the Tax Code and the Customs Code, just as for government agencies. These measures are structural benchmarks under the program. A requirement will be introduced setting the NBKR's capital and general reserves (but excluding the unrealized revaluation reserve) to 10 percent of monetary liabilities. With all these amendments, the NBKR will be able to report in accordance with International Financial Reporting Standards (IFRS).

### **C. External Policies**

28. The current account deficit is projected to increase in 2005–06, reflecting higher investments, including in two new gold projects. The projected surplus in the capital account—mainly driven by donor loans for the Public Investment Program and FDI flows to the gold sector—would not, however, be enough to cover the current account deficit. Even with a decline in the official reserve coverage of imports from the projected 5½ months in 2004 to 5 months in 2007, we need further donor support to cover the balance of payments financing gaps. For 2005–07, such gaps appear at 2½–3 percent of GDP and amount cumulatively to about \$230 million. We hope to cover these gaps through financial assistance from the IMF, the World Bank, the Asian Development Bank, and bilateral donors, as well as Paris Club rescheduling.

29. Our external debt burden is so high that we need to request further debt relief from our Paris Club creditors on concessional terms, which is the only way to ensure that we can solve our debt problem in a permanent way. For our part, we will revise our external debt strategy adopted in 2002 in the following way:

- We will reduce the primary fiscal deficit (excluding grants) from the projected 3.2 percent of GDP in 2004 to 2.7 percent in 2007. This includes streamlining the foreign loan-financed Public Investment Program from the projected 3.5 percent of GDP in 2004 to 3.0 percent in 2007.

- To increase our debt servicing capacity, the State government tax revenue will be increased by 0.6 percentage point of GDP during 2005-07, despite our efforts to gradually reduce the rates of distortionary production taxes (the emergency tax and the road tax).
- We will maintain the 45 percent grant element requirement on all new public borrowing. Local governments cannot borrow without the specific authorization of the Ministry of Finance.
- We will neither contract nor guarantee any nonconcessional public debt. In addition, we will limit concessional public borrowing as specified in Table 2 and the Technical Memorandum of Understanding (Annex II).
- In accordance with the Paris Club comparability of treatment clause, we will not introduce any early external debt repayment schemes from potential privatization proceeds without specific consultation with the Paris Club.
- We will not seek any debt-for-equity swaps for state-owned enterprises without specific consultations with the Paris Club.

30. 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. We will not introduce or intensify import restrictions for balance of payments reasons.

#### **D. Structural Policies**

31. The government is implementing a comprehensive structural reform agenda under the lending programs of the Fund, World Bank, and AsDB. With the World Bank we have a large, ongoing agenda under its Governance Structural Adjustment Credit. In addition, we are discussing a new loan operation with Bank staff covering, *inter alia*, the public finances, the regulatory system, and pension reform. With the AsDB, we are discussing a new financial sector reform credit which we will closely coordinate with the Fund staff.

32. We would like the Fund to remain engaged on a broad front of structural reforms because the public attaches particular significance to the Fund's advice. We understand, however, that the Fund-supported program should only cover structural policies with significant macroeconomic impact, and that other IFIs have particular expertise in other areas. Under the PRGF-supported program, we will focus on three key areas:

- financial sector reform;
- labor market reform; and
- the energy sector quasi-fiscal deficit.

33. In the financial sector, further reforms are critical because of the changing monetary environment caused by the rapid remonetization of the economy. Therefore, to strengthen the

banking system's capital base, the minimum own funds requirement will be raised. The program also contains measures to improve bank supervision, which include: (i) introducing the supervisory framework for market, operational, country, and transfer risk, as recommended by the September 2004 IMF MFD technical assistance mission; and (ii) strengthening on- and off-site inspection by increasing the NBKR's capacity for stress testing of individual banks. We will also request technical assistance from the Fund LEG Department to organize seminars and training for judges dealing with banking legislation. Further attention will be paid to measures to improve the payments system, make the collateral system more effective, streamline legislation on deposit collection, and identify priorities in developing micro-financing. Specific measures in these areas are presented in Box 3. On deposit insurance, we have defined detailed preconditions for its implementation as specified in Annex I. We are also working with the EBRD to establish an effective credit information agency. We will continue to work on the development of the Kyrgyz Agricultural Finance Corporation, including the appropriateness of issuing a banking license, and re-visit our plans together with the staffs of the IMF and World Bank in spring 2005. Additionally, we will review the existing legislation to improve the functioning of the time deposit market.

### **Box 3. Financial Sector Reforms**

1. Increase the minimum capital requirement to som 60 million at end-2005 and to som 100 million at end-2007.
2. Ministry of Finance to restructure at least som 200 million of long-term government bonds held by the NBKR and make them available to commercial banks by end-September, 2005.
3. To strengthen the banking sector's funding base, wages of Ministry of Finance staff will be paid through banks, starting in July 2005. The practice will be extended to the other ministries in 2006.
4. Allow out of court procedures in collecting collateral, and simplify procedures for collateral registration, by end-June 2005.
5. Prepare a concept paper on further development of micro-financing by September 2005.
6. Establish a framework for credit and operational risk by end 2005.

34. Policies will be developed to promote labor market flexibility, as the solid economic growth experienced in recent years, which has not been accompanied by a declining number of job seekers, suggests that unemployment—currently 9 percent of the labor force—is largely structural. The first step will be to transfer the extra budgetary Employment Fund to the Ministry of Labor and Social Protection and improve access to unemployment benefits to promote labor market mobility. The Labor Code will be reviewed with a view of removing regulations that excessively restrict employment restructuring in enterprises. Proposals for revisions will be presented to Fund staff by end-March 2005. Reducing the high labor taxation, as discussed earlier, will also improve the functioning of the labor market. The

government will assign a special task force—including representatives from the private sector—to prepare further proposals to promote labor market flexibility by end-June 2005.

35. Further efforts will be made to reduce the quasi-fiscal deficit (QFD) of the electricity sector, through tariff policy. We will maintain the present framework that uses aggregate, semi-annual QFDs as indicative targets for the program—a reduction of the QFD by 1.3 percentage point of GDP per year in 2005–07. This would require speeding up enterprise restructuring and improving financial discipline, and would yield important macroeconomic benefits. On tariff policy, we will increase electricity tariffs by 15 percent from April 1, 2005 to improve cost recovery and attract foreign investors to the sector.

36. On governance, we will take further concrete measures as planned by the Consultative Council of Good Governance chaired by the President. In addition, we are working in several areas to improve governance under the World Bank GSAC operation. The most urgent initiatives include revisions to the Civil Service Law; provisions for appointments of state secretaries; income and asset declarations of high-ranking officials; and other measures to increase the effectiveness of public administration. We have also begun work in several areas to improve the investment climate. These include better predictability of the legal system, streamlined licensing and permit mechanisms, and improving the inspection and auditing environment. Progress in these areas will be monitored by the Consultative Council of Good Governance.

### **E. Program Monitoring**

37. The program will be monitored through semi-annual reviews based on end-June and end-December performance criteria and indicative targets. Structural benchmarks will also be part of the review process. The first year program will cover the period January 1–December 31, 2005. The three-year arrangement envisages seven equal loan disbursements of SDR 1.3 million.

38. Quantitative performance criteria and indicative targets for the first-year program are specified in Table 2. The quantitative performance criteria for end-June 2005 are: (i) a floor on NBKR net international reserves (NIR) in convertible currencies. The NIR floor would be adjusted upwards by 30 percent of any excess grant receipts; (ii) a ceiling on net domestic assets (NDA) of the NBKR. Given the uncertainty on the prospective Paris Club treatment of the Kyrgyz debt, the NDA adjustors cover deviations in debt relief from programmed levels; (iii) a ceiling on the cumulative (from January 1, 2005) primary deficit (excluding grants) of the general government. This criterion is subject to an adjustor allowing for spending of grants in excess of the programmed amount; (iv) a floor on cumulative (from January 1, 2005) cash tax collections of the State government; (v) a ceiling on the stock of budgetary arrears of the central government as defined in the Technical Memorandum of Understanding (TMU); (vi) a zero ceiling on the stock of Social Fund pension arrears; (vii) a floor on cumulative (from January 1, 2005) payroll collections in cash of the Social Fund; (viii) a zero ceiling on the stock of Social Fund arrears to the Medical Insurance Fund; (ix) a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturity of less than one year; (x); a zero ceiling on contracting or guaranteeing of new nonconcessional

external debt with maturity of one year or more; and (xi) a zero ceiling on new external payments arrears. Indicative targets are established for annual concessional borrowing for 2005-07 as specified in Table 2. This target would cover donors' loan disbursements under the Public Investment Program and their new BOP-support loans; thus supplementing the PC establishing 45 percent minimum requirement on loan concessionality. Semi-annual indicative targets would be applied in 2005 to reserve money and electricity sector quasi-fiscal deficits. Box 4 contains the structural benchmarks under the program. The TMU attached to this Memorandum specifies the quantitative targets included in Table 2, the program adjustors, and reporting requirements. The first review under the program will take place on or after August 15, 2005 based on performance as of end-June 2005 and will focus on: (i) progress in implementing the revised small business taxation and the new tax code, and (ii) progress toward improving the investment climate, as discussed in paragraph 16. At the time of the first review, revised performance criteria and additional structural benchmarks may be established for end-December 2005.

#### **Box 4. Structural Benchmarks for the 2005 Program**

##### **March 2005**

1. Publish Medium-Term Budget Framework for 2006-2008, including aggregate resource envelopes for each line ministry.
2. Submit to parliament the new Tax Code as proposed by the governmental Expert Commission, including the recommendations of the Fund LEG department.

##### **June 2005**

1. Start the pilot project of paying Ministry of Finance salaries through the banking system.
2. Consolidate into the State Budget the Trade Union Social Insurance Fund and reduce the payroll tax rate by one percentage point.
3. Issue new instructions to ensure proper and timely functioning of the VAT refund mechanism.

##### **September 2005**

1. Submit to parliament amendments to the Civil Code to provide for legal independence of the NBKR. Accordingly, the Ministry of Justice will revise the NBKR's institutional legal status.
2. Submit to parliament amendments to the central bank law as specified in paragraph 33.

##### **December 2005**

1. Enforce the decision to increase the minimum own funds requirement for banks from som 30 million to som 60 million.



## **PRECONDITIONS FOR THE INTRODUCTION OF A DEPOSIT PROTECTION SYSTEM**

*The Law on Deposit Protection System will not be submitted to Parliament before the following preconditions are considered to have been met. This will be monitored under the PRGF-supported program. The NBKR will submit the first progress report to Fund staff by end-September 2005.*

**I. Stable financial environment with low and stable inflation, sustained growth and solid financial depth indicators, as assessed under the review process of the PRGF-supported program.**

**II. Sound banking system, as assessed using the following minimum criteria:**

1. All commercial banks operate in a transparent manner, including full implementation of IFRS and auditing according to International Association of Auditors.
2. All commercial banks are transparent in their operations as assessed against the following criteria:
  - Financial statements, financial results and auditors opinions are published in banks' annual reports.
  - Semi-annual results and summary of financial statements are published.
  - Ownership and changes in ownership above 5 percent are listed in the annual reports.
  - Shareholder meeting dates and agenda are published.
3. The majority of operating banks (80 percent or more in deposit-base terms) meet the prudential norms as established by the NBKR.
4. The majority of banks (75 percent or more of the number of banks) rate CAMELS 3 or better as rated by the NBKR.

**III. Sound Banking Supervision as assessed based on a functional review completed by IMF and World Bank under the FSAP reassessment, expected in fall 2005.**

**IV. Possible Government participation in the financing of the scheme will be assessed once other preconditions are observed.**

**V. Adoption of the following laws, regulations and amendments:**

1. Amendments and addenda as submitted to the parliament in September 2004 relating to the Civil Code, the Code of Civil Procedure, the Labor Code, the Tax Code, the Code of Administrative Liability and the Joint-Stock Company Law to remove conflicts with banking legislation.

2. Amendments and addenda to the Law “On Banks and Banking Activity” and to the Law “On Auditing” to bring the legal norms in conformity with the international practice. In particular, such amendments to the banking laws should be drafted and approved to enable the NBKR to:

- reject bank auditors’ conclusions and require to repeat the external audit at the bank’s expense;
- demand that the auditors submit and discuss the audit results and working materials with the supervision department;
- exchange information between the external auditor and the supervision department.

Table 1. Kyrgyz Republic: Third-Year Quantitative Program Targets  
(in millions of soms, unless otherwise indicated; eop)

	June 2004			September 2004		
	Indicative Targets			Performance Criteria		
	Program	Adjusted	Actual	Program	Adjusted	Actual
<b>I. Performance criteria</b>						
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars) 1/	221.1	158.6	161.3	221.7	267.2	280.1
2. Ceiling on net domestic assets of the NBKR (eop stock) 1/	-4	2,916	2,851	152	-1,683	-2,197
3. Ceiling on cumulative fiscal deficit of the state government	3,264		3,395	4,229		4,155
4. Cumulative floor on state government tax collections in cash	9,513		9,900	13,008		13,528
5. Ceiling on the stock of central government budget arrears	0		0	0		0
6. Ceiling on the stock of Social Fund pension arrears	0		0	0		0
7. Floor on payroll collections in cash of the Social Fund	2,863		2,972	3,777		4,002
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0		0	0		0
9. Ceiling on contracting or guaranteeing by the state government or NBKR of new nonconcessional external debt of less than one year (in millions of U.S. dollars)	0		0	0		0
10. Ceiling on contracting or guaranteeing by the state government or NBKR of new nonconcessional external debt with a maturity of one year or more (cumulative, in millions of U.S. dollars)	0		0	0		0
11. Ceiling on accumulation of new external payment arrears (in millions of U.S. dollars)	0		0	0		0
<b>II. Indicative targets</b>						
1. Ceiling on reserve money (NBKR liabilities) 1/	10,689		10,786	10,868		10,882
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	4,900		4,244	....		...

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

1/ Valued at the program exchange rates specified in IMF Country Report No. 04/198.

Table 2. Kyrgyz Republic: First-Year Quantitative Program Targets 1/  
(in millions of soms, unless otherwise indicated; eop)

	2004		2005			
	December	March	June	September	December	
	Actual	Benchmarks	PCs	Benchmarks	PCs	
<b>I. Performance criteria</b>						
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	329	326	333	340	340	340
2. Ceiling on net domestic assets of the NBKR (eop stock)	-2,046	-1,390	-962	-1,289	-985	-985
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	n.a.	1,198	1,529	2,398	3,028	3,028
4. Cumulative floor on state government tax collections in cash	n.a.	3,191	6,929	10,970	15,318	15,318
5. Ceiling on the stock of central government budget arrears	0	0	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0	0
7. Cumulative floor on payroll collections in cash of the Social Fund	n.a.	1,050	2,143	3,228	4,392	4,392
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	0	0	0	0	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	n.a.	0	0	0	0	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	n.a.	0	0	0	0	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	0	0
<b>II. Indicative targets</b>						
1. Ceiling on reserve money (NBKR liabilities)	12,380	12,909	12,943	12,894	13,247	13,247
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	[ ... ]	...	4,700	...	8,400	8,400
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars)	n.a.	(as specified in paragraph 29 of the TMU)				

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

1/ Definitions are provided in the Technical Memorandum of Understanding (TMU).

## TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The Kyrgyz Republic's performance during the three-year PRGF-supported program will be assessed by the IMF on the basis of the observance of quantitative performance criteria and structural benchmarks. This memorandum and its attached tables define the quantitative performance criteria and indicative targets (Tables 1 and 2 of the Memorandum of Economic Policies (MEP), and the monitoring requirements.<sup>1</sup>
2. The program exchange rate of the Kyrgyz som to the U.S. dollar is set at som 42 = \$1. The program cross exchange rates and program gold price referred to in the MEP or this TMU for 2005 are provided in Table 11.

### I. QUANTITATIVE PERFORMANCE CRITERIA

3. The quantitative targets (i.e., quantitative benchmarks for end-March 2005 and end-September 2005, and quantitative performance criteria for end-June 2005 and end-December 2005) presented in Table 2 of the MEP are defined below.

#### **Floor on net international reserves of the NBKR in convertible currency**

4. The program contains a floor on the stock of net 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 international reserve liabilities of the NBKR in convertible currencies.
5. Total gross 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 (including accrued interest) or with foreign banks. Amounts pledged as collateral or in swaps or otherwise blocked, capital subscriptions in foreign financial institutions, and illiquid assets of the NBKR are excluded. Also excluded are 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. In addition, net claims on other BRO countries are excluded from the floor. For program monitoring purposes, gross international reserves shall be valued at program exchange rates and gold prices.

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<sup>1</sup> Central government and Republican government are synonymous in this memorandum. State government comprises central and local governments. General government comprises state government and the Social Fund.

6. Total international 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. For program monitoring purposes, total international reserve liabilities shall be valued at the program exchange rates. Thus calculated, the stock of net international reserves in convertible currencies amounted to \$329 million as of December 31, 2004.

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

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

	(In millions of U.S. dollars)
December 31, 2004 (actual)	329
March 31, 2005 (benchmark)	326
June 30, 2005 (performance criterion)	333
September 30, 2005 (benchmark)	340
December 31, 2005 (performance criterion)	340

1/ End-of-period stocks.

8. 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 of the state government budget and in the amount of interest payments by the Ministry of Finance;  
 (ii) upward by 30 percent for any non-programmed cash grants; and (iii) upward/downward by 100 percent for any excess/shortfall in cash privatization receipts. Valued at the program exchange rate, the programmed cash privatization receipts for end-2005 are equivalent to \$2.96 million, all of which are expected in the fourth quarter. The adjustment for shortfalls in adjustors (i) and (iii) is to be limited to \$15 million each, valued at the program exchange rate. In the case of a release of the NBKR's pledged foreign reserves, the NIR floor will be adjusted upward/downward by 100 percent for any excess/shortfall in the net effect of the releases and related amortization payments; the programmed net effect is plus \$17.05 million in the second quarter of 2005.

9. 'Net foreign financing and cash grants' is defined as balance of payment support loans plus cash grants to the state government budget plus any changes in the balance of unused PIP funds held in the NBKR plus rescheduling of interest payments to bilateral creditors (net of moratorium interest payments) following the Paris Club agreement minus amortization (net of rescheduling and excluding repayments to the Fund) by the Ministry of Finance and NBKR. This definition applies to the adjustors to NIR and NDA. The

programmed cumulative net foreign financing is as follows (Table 2). The balance of unused PIP funds was equivalent to \$0.03 million as of December 31, 2004.

Table 2. Projected Net Foreign Financing and Cash Grants  
Cumulative from January 1, 2005

	(In millions of U.S. dollars)
March 31, 2005	2.3
June 30, 2005	6.8
September 30, 2005	12.0
December 31, 2005	16.4

**Ceiling on the net domestic assets of the NBKR**

10. Net domestic assets of the NBKR are defined as reserve money of the NBKR (defined below) minus the NBKR’s net foreign assets<sup>2</sup> 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 and IDA enterprise loans (Equation 1).

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

11. Thus defined, the NBKR’s net domestic assets consist of: (a) gross credit to the general government from the NBKR minus deposits of the general government with the NBKR minus the counterpart of the loan by the Eximbank of Turkey; (b) gross credit to domestic banks by the NBKR minus the counterpart of the EBRD and IDA enterprise loans; and (c) all other net assets of the NBKR (other items net). Thus defined, the stock of the NBKR’s net domestic assets amounted to som -2,046 million on December 31, 2004.

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<sup>2</sup> The NBKR’s net foreign assets consist of net international reserves, as defined in this TMU, plus other foreign assets plus the net claims on other BRO countries.

12. The program ceilings on the NDA of the NBKR are reported in Table 3 below.

Table 3. Ceilings on the NDA of the NBKR 1/

	(In millions of soms)
December 31, 2004 (actual)	-2,046
March 31, 2005 (benchmark)	-1,390
June 30, 2005 (performance criterion)	-962
September 30, 2005 (benchmark)	-1,289
December 31, 2005 (performance criterion)	-985

1/ End-of-period stocks.

13. 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 of the state government budget; (ii) downward by 30 percent for any non-programmed cash grants; and (iii) downward/upward by 100 percent of the excess/shortfall of cash privatization receipts. The adjustment for shortfalls in adjustors (i) and (iii) is to be limited to \$15 million each, valued at the program exchange rate, excluding the amortization payments for the release of the NBKR's pledged foreign reserves.

**Ceiling on the cumulative fiscal deficit of the general government**

14. The general government fiscal deficit—(primary deficit excluding grants)—is defined as the 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 general government; (ii) the change in the stock of net claims of the foreign banking system and nonfinancial institutions and households on the general government; (iii) net privatization receipts; (iv) net foreign loans disbursed to the state government for budgetary support; (v) net foreign loans disbursed to the general government for project financing; and (vi) rescheduling of bilateral debt (principal and interest payments) following the Paris Club agreement. From this total, foreign grants received by the general government and interest accrued to the general government, are deducted. The fiscal balance will be measured at the program exchange rates, unless foreign currency denominated assets or liabilities are converted into domestic currency upon receipt or accrual. The ceiling of the cumulative general government fiscal deficit will be adjusted upward by the full amount of any excess in programmed foreign grants.



15. The change in the stock of net claims of the domestic and foreign banking systems on the general government is defined as the change in the stock of claims of these banking systems on the general government less the change in the stock of all deposits of the general government with these banking systems. The claims of these banking systems on the general government include: (i) bank loans to general government; (ii) securities or bills issued by the general 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 general government with banks.

16. The program ceilings on the cumulative fiscal deficit of the general government are reported in Table 4 below.

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

	(In millions of soms)
March 31, 2005 (benchmark)	1,198
June 30, 2005 (performance criterion)	1,529
September 30, 2005 (benchmark)	2,398
December 31, 2005 (performance criterion)	3,028

1/ Cumulative beginning from January 1, 2005.

**Cumulative floor on state government tax collections in cash**

17. 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; 2.0 taxes on goods and services; 3.0 specific taxes on services; 4.0 taxes on property; and 5.0 taxes on international trade. Cumulative tax collections in cash include collections of tax arrears but exclude tax offsets.

18. The program floors for the cumulative state government cash tax collection are reported in Table 5 below.

Table 5. Floors on Cumulative State Government Cash Tax Collections 1/

	(In millions of soms )
March 31, 2005 (benchmark)	3,191
June 30, 2005 (performance criterion)	6,929
September 30, 2005 (benchmark)	10,970
December 31, 2005 (performance criterion)	15,318

1/ Cumulative from January 1, 2005.

**Ceiling on the stock of central government budget arrears**

19. For the purposes of the program, central government budget arrears are defined as an overdue payment obligation of the Republican budget arising since the start of the three-year program period (January 1, 2005) and related to: (i) wages; (ii) Social Fund payroll contributions; (iii) mandatory transfers to the Social Fund; (iv) categorical grants; (v) payments of electricity bills; and (vi) allowances for poor families. 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); for 60 days after its due date for (v); and for 40 days after its due date for (vi). Thus defined, there were no central government budgetary arrears as of December 31, 2004. The program ceilings on the stock of central government budget arrears are zero at each test date. No new arrears will be accumulated by the central government.

**Ceiling on the stock of Social Fund pension arrears**

20. A pension payment by the Social Fund is defined as overdue if it has come due since the start of the three-year program period (January 1, 2005) and remains unpaid for 30 days or more after its due date. The program ceilings on the stock of Social Fund pension arrears are zero at each test date. No new pension arrears will be accumulated.

**Floor on the Social Fund payroll tax collections in cash**

21. Payroll tax collections in cash correspond to the total contributions collected by the Social Fund from both employers and employees for a given period. If the Trade Union Social Insurance Fund is transferred to the state government, the program floors for Social Fund cash tax collections will be adjusted downward by 1/32 of the remaining floors, prorated to the periods between the date of the transfer and the test dates.
22. The program floors for the Social Fund tax collections in cash are reported in Table 6 below.

Table 6. Floor on Social Fund Cash Payroll Tax Collections 1/

	(In millions of soms)
March 31, 2005 (benchmark)	1,050
June 30, 2005 (performance criterion)	2,143
September 30, 2005 (benchmark)	3,228
December 31, 2005 (performance criterion)	4,392

1/ Cumulative from January 1, 2005.

**Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund**

23. Social Fund arrears to the Medical Insurance Fund are defined as overdue transfer obligations of the former to the latter as defined by law and refer to arrears incurred starting January 1, 2005. A transfer is defined to be overdue if the value date of any transfer obligation is more than 5 business days after the due date. The program ceilings on the stock of Social Fund pension arrears to the Medical Insurance Fund are zero at each test date.

**Ceilings on contracting or guaranteeing of new external debt by the state government of the Kyrgyz Republic or the NBKR or any other agency acting on behalf of the state government**

24. In connection with the contracting or guaranteeing of external debt by the state government of the Kyrgyz Republic, the NBKR, or any other agency acting on behalf of the state government of the Kyrgyz Republic, 'debt' is understood to have the meaning set out in

point 9 of the Guidelines on Performance Criteria with respect to External Debt in Fund arrangements (Decision No. 12274-00/85, dated August 24, 2000).<sup>3</sup>

External debt ceilings apply to (i) the contracting or guaranteeing of short term external debt (i.e. external debt with an original maturity of less than one year, except normal import-related credits and NBKR reserve liabilities); and (ii) contracting or guaranteeing of **nonconcessional** medium- and long-term external debt (i.e., external debt with an original maturity of one year or more). Disbursements by the Fund from the PRGF Trust are excluded from the ceilings on external debt. Also excluded from these external debt ceilings is the contracting or guaranteeing of new external debt that constitutes a rescheduling or refinancing of existing external debt at terms more favorable to the debtor. The limit on the contracting or guaranteeing of short-term external debt is zero on a continuous basis throughout the period of the arrangement. The limit on the contracting or guaranteeing of medium- and long-term nonconcessional external debt is zero as specified in Table 2 of the MEP.

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<sup>3</sup> Debt 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.

Under the above definition of debt, 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.

### **Ceiling on new external payments arrears**

25. For the purposes of the program, external payments arrears will consist of all debt-service obligations (i.e., payments of principal or interest) arising in respect of any debt contracted or guaranteed or assumed by the state government of the Kyrgyz Republic, or the NBKR, or any agency acting on behalf of the state government of the Kyrgyz Republic since the Kyrgyz Republic's independence, including, without limitations, unpaid penalties, interest charges or judicially awarded damages associated with these arrears owed by the state government of the Kyrgyz Republic, or the NBKR, or any agency acting on behalf of the state government of the Kyrgyz Republic, on imports received subsequent to independence. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, including Paris Club creditors; and more specifically, to external payments arrears in respect of which a creditor has agreed that no payment needs to be made pending negotiations.

## **II. INDICATIVE TARGETS**

### **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 indicative program limits are reported in Table 7 below.

Table 7. Ceilings on Reserve Money 1/

	(In millions of soms)
December 31, 2004 (actual)	12,380
March 31, 2005 (indicative target)	12,909
June 30, 2005 (indicative target)	12,943
September 30, 2005 (indicative target)	12,894
December 31, 2005 (indicative target)	13,247

1/ End-of-period stocks.

### **Ceiling on the quasi-fiscal deficit of the electricity sector**

27. The quasi-fiscal deficit (QFD) of the electricity sector is defined as cost of production minus cash revenues:

$$(1) \text{ QFD} = \text{Q} * \text{MC} - \text{R};$$

$$(2) Q = 1/(1-\ell) * (\sum C_i);$$

$$(3) R = (\sum C_i) * T * C_{\text{cash}},$$

where:

Q is the domestic supply (generation plus import minus export) minus normative losses;

MC is the marginal cost of production required for efficient supply of Q;

R is the total cash revenue;

$\sum C_i$  is the sum of consumption by all end-users (households, industry, agriculture, budgetary institutions, and other);

$\ell$  is the annual average loss rate of excessive (i.e., above normative) technical and commercial losses in percent of Q;

T is the annual weighted average of posted (or nominal) tariffs for end-users; and

C<sub>cash</sub> is the ratio of annual average cash collections to total billing to end-users.

28. For the purposes of the program, the marginal cost is equal to U.S. cents 2.3 per kilowatt hour, and normative losses (including own use) are defined as 15 percent of domestic supply. Total billing of end-users is defined as consumption times the posted nominal tariff. The cash collection component is the amount of bills paid in cash to the energy companies, and excludes any form of cash-to-cash settlements, off-sets, barter, or other non-cash payments. Thus defined, the QFD in the electricity sector amounted to some 4,244 million (or 4.6 percent of projected annual GDP) in January-June 2004. The indicative ceiling on the quasi-fiscal deficit in the electricity sector is as follows (Table 8).

Table 8. Ceiling on Quasi-Fiscal Deficit in the Electricity Sector 1/

	(In millions of soms)
December 31, 2004 (indicative target)	8,650
June 30, 2005 (indicative target)	4,700
December 31, 2005 (indicative target)	8,400

1/ Cumulative from the beginning of the calendar year.

**Ceiling on contracting or guaranteeing of concessional external debt**

29. The annual ceiling on the contracting or guaranteeing of new concessional external debt by the state government of the Kyrgyz Republic or the NBKR or any other agency working on behalf of the state government is set by the U.S. dollar nominal sum of project loan agreements yet to be signed and agreed, plus balance of payments support loans required to fill the external financing gap, as programmed. Pursuant to monitoring this indicative target ceiling, the Ministry of Finance will provide quarterly information on the total nominal U.S. dollar value of: (a) new project and program loans signed and agreed during the previous three-month period; (b) new project and program loans planned, but yet to be signed and agreed, during the previous three-month period. The annual indicative ceilings on the contracting or guaranteeing of new medium- and long-term concessional external loans for 2005 are specified in Table 9.

Table 9. The 2005 Annual Indicative Ceiling on Contracting and Guaranteeing of New Concessional Loans 1/

With disbursements beginning in:	(In millions of US dollars)
2005	77
2006	142
2007	0

1/ New concessional loans signed in 2005, excluding contingency amounts.

These ceilings are nominal debt lumped by the year in which their disbursements commenced—for 2005, the limit implies contracting loans of which \$77 million will start disbursing in 2005, \$142 million in 2006 and zero in 2007.

30. 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. 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.

### **III. REPORTING REQUIREMENTS UNDER THE PROGRAM**

31. 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:<sup>4</sup>

#### **The balance sheet of the NBKR**

32. The NBKR will provide to the Fund its balance sheet on a daily basis. The information provided will clearly identify the following items in the definitions specified above: the gross foreign assets and liabilities of the NBKR, decomposed by currency and instrument for the assets and by currency and creditor for the liabilities; the net foreign assets of the NBKR; the net international reserves of the NBKR; medium- and long-term liabilities; the net domestic assets of the NBKR; net credit from the NBKR to the general government; net credit from the NBKR to commercial banks; the balance of unused PIP funds held in the NBKR; 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 will be provided to the IMF Resident Representative and/or transmitted by e-mail to the Fund.

#### **Monetary survey**

33. 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 will 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 government, 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.

34. 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, state obligations, state bonds,

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<sup>4</sup>Any correction or revisions to the data previously reported should be clearly indicated and documented as to the reasons for revision.



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**

35. 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 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, on a daily basis; and (b) treasury bill yields and the amount of treasury bill sales and redemptions on a weekly basis every Monday. On the 25th day of the month following the reference month, the NBKR will provide indicators of financial soundness of the banking system, including the ratios of regulatory capital to risk-weighted assets, non-performing loans to total loans, and return on equity, as well as data on bank deposit and lending rates by maturity.

### **Banking system data**

36. 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 as well as any penalties, sanctions and other administrative actions imposed on banks; and (b) reserve requirements on a weekly basis.

### **External debt**

37. 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 the 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**

38. 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 TMU. 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.

39. The State Energy Agency, in consultation with the Ministry of Finance and the World Bank, will submit to Fund staff each March and September their semi-annual report on the electricity sector QFD according to the format specified in Table 10 below.

Table 10. Kyrgyz Republic: Electricity Quasi-Fiscal Deficit

	Period
Production (GWh) 1/	
Losses (GWh)	
Loss Rate (in percent) 2/	
Consumption (GWh)	
Tariff (\$ct/kWh) 3/	
Cash Collection Rate (in percent)	
Effective Tariff (\$ct/kWh) 4/	
cash effect. rate	
total effect. rate	
Cost Recovery Tariff (\$ct/kWh) 5/	
Quasi-Fiscal Deficit	
in percent of GDP	
in \$ millions	
in millions of soms	

1/ Generation plus imports minus exports minus normative losses.

2/ Excess technical and commercial losses as percent of production.

3/ Average posted tariff, calculated as quotient of total bill and consumption volume.

4/ Nominal tariff times cash collection rate

5/ Marginal costs, derived from marginal incremental capital cost.

### Balance of payments data

40. 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

41. 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 11. Program Cross Exchange Rates  
(as at end-November, 2004)

Currency Names		National Currency/US\$	US\$/National Currency
SDR		0.6712	1.4899
GBP	UK pound sterling	0.5481	1.8243
DKK	Danish krone	5.8893	0.1698
EUR	Euro	0.7920	1.2625
INR	Indian rupee	45.6184	0.0219
CAD	Canadian dollar	1.2444	0.8036
CNY	Chinese yuan	8.2765	0.1208
KRW	South Korean won	1,697.3875	0.0006
NOK	Norwegian krone	6.5116	0.1536
TRL	Turkish lira	1,480,190.1408	0.0000
SEK	Swedish krona	7.2007	0.1389
CHF	Swiss franc	1.2185	0.8207
JPY	Japanese yen	107.5896	0.0093
AZM	Azerbaijani manat	4,905.0092	0.0002
AMD	Armenian dram	507.0856	0.0020
BYR	Belarusian rubel	2,171.0169	0.0005
KZT	Kazakh tenge	132.4847	0.0075
LVL	Latvian lats	0.5380	1.8587
LTL	Lithuanian litas	2.7422	0.3647
MDL	Moldavian lei	12.3694	0.0808
RUR	Russian ruble	29.1158	0.0343
TJS	Tajik somoni	3.0229	0.3308
UZS	Uzbek sum	1,043.1117	0.0010
UAH	Ukrainian hryvnia	5.3065	0.1884
EEK	Estonian kroon	12.3927	0.0807
AUD	Australian dollar	1.3556	0.7377
Gold (\$/troy ounce)			426.2000

**KYRGYZ REPUBLIC—FUND RELATIONS**  
(As of November 30, 2004)

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

II. <b>General Resources Account</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
Quota	88.80	100.00
Fund Holdings of Currency	88.80	100.00
Reserve Position	0.00	0.01

III. <b>SDR Department</b>	<b>SDR Million</b>	<b>Percent of Allocation</b>
Holdings	16.38	N/A

IV. <b>Outstanding Purchases and Loans</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
PRGF Arrangements	136.47	153.69

V. **Latest Financial Arrangements**

<b>Type</b>	<b>Approval Date</b>	<b>Expiration Date</b>	<b>Amount Approved (SDR Million)</b>	<b>Amount Drawn (SDR Million)</b>
PRGF	12/06/2001	04/05/2005	73.40	63.84
PRGF	06/26/1998	07/25/2001	73.38	44.69
ESAF	07/20/1994	03/31/1998	88.15	88.15

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

	<b>Forthcoming</b>				
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Principal	3.23	20.87	18.61	16.12	14.80
Charges/Interest	0.35	0.62	0.52	0.43	0.35
Total	3.57	21.49	19.13	16.55	15.15

**VII. Implementation of HIPC Initiative.** Not Applicable.

**VIII. Safeguards Assessments**

Under the Fund's safeguards assessment policy, the National Bank of the Kyrgyz Republic is subject to an assessment with respect to the PRGF arrangement, which was approved on December 06, 2001 and is currently scheduled to expire on December 05, 2004. A safeguards assessment of the NBKR was completed on January 18, 2002, and identified potential vulnerabilities in the financial reporting framework and in the system of internal controls. Since then, measures to address these vulnerabilities have been implemented.

**IX. Exchange Rate Arrangements**

The currency of the Kyrgyz Republic has been the som (100 tyiyn =1 som) since May 15, 1993. The Kyrgyz Republic's exchange regime is classified as a managed float with no pre-announced path for the exchange rate. The National Bank of the 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. The Kyrgyz Republic maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions maintained for security reasons that have been notified to the Fund pursuant to Executive Board decision No. 144-(52/51).

**X. Article IV Consultations**

The Kyrgyz Republic is on the 24-month consultation cycle. The last Article IV consultation discussions were held in August-October 2004 and the Article IV consultation was completed by the Executive Board on November 19, 2004. At the same time, the Executive Board considered the staff's Ex Post Assessment of Long-Term Program Engagement of the Kyrgyz Republic.

**XI. FSAP Participation and ROSC Assessment**

The FSAP missions were held in May and September 2002, and the discussions were concluded during the 2002 Article IV consultation. A ROSC Fiscal Transparency mission was held in March 2001 and the ROSC Fiscal Transparency Module was published on March 13, 2002. A ROSC Data mission was held in November 2002 and the ROSC Data Module was published on November 10, 2003.

**XII. Resident Representative**

The sixth resident representative of the Fund in the Kyrgyz Republic, Mr. Michael Mered, has held his post in Bishkek from July 19, 2004.

**KYRGYZ REPUBLIC--RELATIONS WITH THE WORLD BANK GROUP**  
(as of January 25, 2005)

1. On May 15, 2003, the World Bank Boards of Directors endorsed a Country Assistance Strategy (CAS) FY 03–06 for the World Bank Group based on the Kyrgyz Government’s National Poverty Reduction Strategy Paper, which aims at assisting the authorities in capitalizing major reforms to date while maintaining a reform and growth course, which will both reduce poverty and enhance prospects for debt sustainability.
2. **International Development Association (IDA).** Between 1992 and 2004, IDA has approved 30 operations totaling approximately \$679 million (after cancellations), of which about \$642 million has been disbursed. Eight structural adjustment credits, including recently closed CSAC project, have already been completed, which provided quick disbursing support for the Government’s economic reform programs in privatization, enterprise restructuring, agricultural policy, financial sector, public sector resource management, pension reform and energy reform. Seven investment operations have also been completed, supporting reform and rehabilitation of the telecommunication sector, social safety nets, health, rural finance, private enterprises and livestock development.
3. The active portfolio includes 16 operations and one GEF financed Regional project. Furthermore, Rural Education, Small Town Infrastructure and Agribusiness and Marketing Projects totaling \$38,1 million have been approved on December 14, 2004 by the Board, out of which \$18 million is on grant basis.
  - A balance of payments support operation (GSAC) and accompanying Governance Technical Adjustment Credit (GTAC), supporting the Government’s efforts to strengthen the governance framework. The first tranche of GSAC was disbursed in June 2003.
  - Four operations supporting energy, infrastructure and industry sector rehabilitation and reform (Power and District Heating, Urban Transport, Rural Water Supply and Sanitation Project and a Technical Assistance Credit, supporting energy reform 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, and real estate and land registration—the latter also provides the basis for the introduction of a tax of non-movable property in rural and urban areas).
  - An operation supporting capacity building in the financial and banking system.
  - A second health sector operation continuing support for sectoral restructuring and the authorities’ reform program.

- Village Investment Project based on CDD initiative to empower village communities to identify and implement high priority investments and infrastructure needed to facilitate local enterprise and thereby generate local employment and growth.

4. The World Bank Group's operational objectives for the next 12 months are to support the ongoing structural reforms in energy, the business environment, the banking sector, governance, public expenditure management, intergovernmental finance, pension system and social protection, health, water and sanitation, and agriculture, and to enhance the portfolio performance. It will continue providing the Government with economic sector work and assisting it with capacity building. In this endeavor, the Bank has recently delivered Public Expenditure Review, Poverty Assessment, Financial Sector Assessment, Country Procurement Assessment, and Country Financial Accountability Assessment reports. The World Bank Group has also delivered a Governance Survey, a Mining Strategy Paper, and engaged in an active dialogue on energy, health, and pension policies. The Bank is in the process of finalizing a Country Economic Memorandum on Growth and Trade.

5. **International Finance Corporation (IFC).** IFC strategy focuses on institution and capacity building through investment and technical assistance, that will promote private sector development, especially SMEs, and support the transformation into a market based economy.

IFC's portfolio has grown steadily to \$17.4 million ( as of January 1, 2005). Building upon IFC's initial investment in the financial sector, the Demir Kyrgyz International Bank, IFC has 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 micro enterprises. 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. The largest investment in the existing portfolio is the Kumtor gold mine, with additional investments in a packaging plant (Altyn-Ajydar). In 2002, under the Small Enterprise Fund (SEF) procedure, IFC has disbursed a direct investment into a pasta plant (Akun) in the amount of \$1.4 million. The IFC Board also approved in May 2002 a Micro and Small Enterprise facility for Central Asia, with IFC investment of \$45 million. The same year, the Central Asia Small Enterprise Fund (CASEF) was set up on collaboration with other lenders. The amount of IFC's investment into this fund is \$2.5 million. The fund will provide equity, quasi-equity, and debt financing, as well as technical and managerial assistance to growth-oriented SMEs. With financial support from the Swiss Government, IFC draws 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 developing tourism has been undertaken in the sector. IFC reviewed the IT sector, including its investment opportunities and development potential. In 2005, IFC has been actively continuing its investment and technical assistance program in the Republic. This year, IFC is planning to finance directly a packaging production enterprise and a microfinance company, to provide several credit lines to local commercial banks for small business financing and for

financing leasing activities. IFC is also planning to start a regional technical assistance project on improving corporate governance in enterprises of Central Asia, as well as provide technical assistance to improve the legal and regulatory framework for housing finance.

6. **Multilateral Investment Guarantee Agency (MIGA).** MIGA has supported private sector development in the Kyrgyz Republic by extending guarantees to foreign direct investments in four projects in the manufacturing, services, and mining sectors. Three are currently outstanding – two related to airport services at Manas airport and one related to the Kumtor gold mine. The total amount of foreign direct investment facilitated by 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, under an initiative supported by the Swiss Government. MIGA plans to continue to assist the development of the Kyrgyz Republic through its guarantee program and capacity building. Data on the Kyrgyz Republic are also featured in MIGA's Privatization Link service, which connects potential investors to information on companies slated for divestiture via the Internet.

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**KYRGYZ REPUBLIC—RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)**  
(As of January 25, 2005)

1. The Kyrgyz Republic became a member of the Asian Development Bank (AsDB) in 1994 and began receiving assistance in the same year. The country has received 22 loans with a total amount of \$532.7 million (as of August 31, 2004). Of the total loans, eight loans have been closed and thirteen loans are ongoing of which two are likely to be closed in 2004. Seven out of the 21 loans are program loans totaling \$224 million provided to support policy reforms to facilitate the transition to a market economy. The remaining 14 are project loans totaling \$318.7 million provided to support various investment activities. At present, 13 loans with a net loan amount of \$283.5 million are ongoing. These loans have an un-disbursed balance of \$126.6 million as of August 31, 2004. All these loans were provided on concessional terms from the Bank's special fund resources—Asian Development Fund (ADF).
  
2. ADB's average annual lending level during 2002 and 2003 was \$15.25 million. This was much lower than the lending levels in the past largely due to the Government's policy of restrained borrowings as part of its debt reduction strategy. This strategy envisages a reduction in the size of largely externally funded PIP from about 6 percent of GDP in 2001 to about 3 percent of GDP by 2005. ADB's annual lending level began with \$40 million in 1994. It reached the peak level of \$89.2 million by 1997. Thereafter, the lending levels fell slightly and hovered between \$65 million and \$75 million through 2001. For 2005-2006 a \$40 million program was prepared but the indicated annual ADF allocations for the period is about \$31.5 million. Future lending levels will depend on the availability of ADF resources and the countries performance in promoting sound economic and social policies, good governance, and portfolio performance. In addition ADB had provided 52 technical assistance (TA) projects amounting to \$31.47 million. Of these 14 are project preparatory TAs amounting to \$9.69 million and the remaining 38 TAs for \$21.78 million are advisory TAs for capacity building, policy advise, institutional strengthening and training.
  
3. The overall performance of ADB's Kyrgyz portfolio is satisfactory although there has been some deterioration in its risk profile since the September 2003 review. The Government complied with almost all project-related measures agreed last year. But compliance with the actions pertaining to generic problems is mixed. The increasing scarcity of budgetary resources is the biggest risk to project implementation in the immediate future. The during 2004 joint portfolio review of ADB, the World Bank, Islamic Development Bank, and KfW Development Bank demonstrated to the Government that adoption of flexible quarterly and annual ceilings on the public investment program could ease the budgetary problem to a large extent. Further, the capacity of the MOF for monitoring and managing externally financed projects is weak and needs to be improved.
  
4. ADB's assistance to the country has sought to support this fundamental development objective of the Government's National Poverty Reduction Strategy by fostering growth and providing selective support for the social sectors. The overall objective of ADB strategy for

2004-2006 is poverty reduction by promoting private sector-led economic growth and human development. The major areas of support to reduce poverty are: (i) agriculture and rural development: to induce further productivity and to expand exports; (ii) financial sector: to deepen financial intermediation, improve companies' access to finances, and facilitate the access of the population to financial services; (iii) regional cooperation: to reduce cross-border transport and trade bottlenecks; and (iv) investments in basic education and early childhood development. The focus of the strategy will be on the poorer areas of the country.

5. Allocation of ADF resources to the country are based on Government's accomplishment of performance targets (triggers) in five areas. The Government accomplished the relevant triggers by: (i) making steady progress in macroeconomic management and structural reforms in the financial sector, customs administration, (ii) making progress in prioritizing on going PIP projects, (iii) adhering to the national debt reduction strategy; (iv) finalizing the NPRS and (v) implementing a package of legal and judicial reforms for improving the investment climate for the private sector. Accordingly, based on performance, allocation for the Kyrgyz Republic for 2005 and beyond could be any where between \$14.4 million to \$32 million based on the availability of ADF resources. Within this range, annual lending between \$22.3 million and \$27.6 million seem more probable. The annual allocation for TAs was also reduced from \$2.0 million to \$1.9 million for the period 2005-2007. From 2005 onwards, up to 50 percent of ADF assistance to the country will be in the form of grants.

6. ADB coordinates its activities closely with the EBRD, IMF, IsDB, World Bank, the UN System, and bilateral donors at all levels of development cooperation. There have been significant strides forward in aid coordination since the last CG meeting held in Bishkek in November 2002 when both the Government and the donors agreed to focus on improving significantly efforts in this direction. Since then efforts are being made to share sectoral and operational information and better coordinate lending and technical assistance activities. In 2003, ADB and World Bank, which together account for over 75 percent of the PIP, conducted a joint portfolio review. The Kyrgyz Republic is one of the partnership countries selected for harmonization of donor procedures at the Rome conference on harmonization held in February 2002. The Kyrgyz Resident Mission (KYRM), which plays a pivotal role in aid coordination, is participating in the working group set up by the Government to identify areas for harmonization of donor procedures. The areas identified for harmonization in the immediate future are: (i) procedures for procurement of goods and services, (ii) financial management and monitoring of projects, and (iii) project implementation units. World Bank and ADB procurement documentation has been harmonized in these areas.

**KYRGYZ REPUBLIC—RELATIONS WITH THE EUROPEAN BANK FOR  
RECONSTRUCTION AND DEVELOPMENT (EBRD)**  
(As of January 25, 2005)

1. The EBRD facilitates transition to a market-based economy through its direct support for private sector investments and support for key infrastructure that is vital for private investment, and targeted technical assistance. Under its recently introduced Early Transition Countries (ETCs) Initiative, which is of particular relevance to the Kyrgyz Republic, the Bank is introducing new innovative instruments, and will consider smaller, more difficult and higher risk projects. The ETCI also foresees appropriate technical cooperation (TC) to support investment expansion. According to the Strategy for the Kyrgyz Republic, approved in November 2004, the Bank's priorities for the period of 2004-2006 are: (1) Foster the private sector; (2) Strengthen the financial sector; (3) Provide support for essential infrastructure; (4) Strengthen the policy dialogue with the authorities to improve the investment climate and support their reform efforts.

2. As of end-December 2004 the Bank had approved 29 projects (including restructurings) for total value of EUR707.7 million, out of which the Bank financed 22 percent for a gross commitment of EUR 156.1 million. During the past three years, the Bank expanded its activities in the Financial Sector:

- Kyrgyz Micro and Small Enterprises Financing Facility (MSEFF). As of December 2004, more than USD 23 million (revolving) were disbursed to 14,395 small and medium-size enterprises (SMEs) via five participating commercial banks.
- Equity investments in Ineximbank, Demir Bank and KICB.
- Expansion of the Bank's Trade Facilitation Program (TFP). Four commercial banks participate in the TFP.
- In 2004 Bank signed a new co-financing facility (CFF) of EUR 3.1 million to KICB. A new ETC product is provided to leading local commercial banks to meet the financing needs of newly emerging medium-sized private companies.

The remaining Private Sector portfolio includes:

- Five investments (equivalent to USD 2.7 million) via the Direct Investment Facility.
- Equity participation in Centerra Gold (the Bank's senior and subordinated loans have been fully repaid).
- Loan to Hyatt-Regency Hotel.
- Loan to Interglass plant (in December 2004).

The Bank is implementing/monitoring four projects to public sector entities:

- Modernization of the telecommunications network.
- Two projects to upgrade electricity transmission networks.
- Development of the agribusiness sector (KAC).

3. The Bank also implements grant-funded technical cooperation (TC) to support its investment portfolio, including in the financial sector (MSEFF, among others), natural resources/environment, agribusiness and infrastructure. Total TC provided is equivalent to more than EUR 16 million.

4. Finally, the Bank has maintained an active dialogue with the government. For example, the Bank was instrumental in founding the International Business Council (IBC) which is devoted to working with the government on improving the investment climate.

**KYRGYZ REPUBLIC—TECHNICAL ASSISTANCE PROVIDED BY THE FUND,  
MARCH 2003–DECEMBER 2004**

<b>Dept.</b>	<b>Subject/Identified Need</b>	<b>Timing</b>	<b>Counterpart</b>
FAD	Improving the Effectiveness of the Large Taxpayer Unit	February 24 – March 7, 2003	Ministry of Finance
	Treasury Management Information System	July 21–29, 2003	Ministry of Finance
	VAT on agriculture	November 3–11, 2003	Ministry of Finance
	Priorities for Tax Administration Reform	July 22 – August 5, 2004	Ministry of Finance
MFD	Regularization of Financial Relations between the NBKR and the Ministry of Finance	April 23-May 3, 2002; October 31-November 8, 2002; and February 27 – March 6, 2003	National Bank of the Kyrgyz Republic
	Financial Sector Assessment Program (in cooperation with the World Bank)	May 5-18, 2002; August 26-September 9, 2002; and October 29-November 6, 2002	National Bank of the Kyrgyz Republic
	Review of the Capital Adequacy and Dividend Arrangements for the National Bank of the Kyrgyz Republic	August 18–28, 2003	National Bank of the Kyrgyz Republic
	Review of Debt Restructuring Operation and 2003 Financial Reporting	October 28–November 10, 2003	National Bank of the Kyrgyz Republic
	Monetary Operations, Banking System Development, and Central Bank Autonomy	September 13-23, 2004	National Bank of the Kyrgyz Republic
	Review of NBKR Debt Restructuring Arrangements, Options for Deepening Financial Markets and Amendments to the NBKR Law	December 7-18, 2004	National Bank of the Kyrgyz Republic
LEG	Update of the AML/CFT Legislation (jointly with MFD)	February 5-11, 2004	National Bank of the Kyrgyz Republic
	Review of Bank Legislation	March 1-4, 2004 April 26-May 6, 2004	National Bank of the Kyrgyz Republic
	Review of Tax Legislation	July 27 - August 5, 2004	Ministry of Finance
STA	ROSC Data Assessment	Nov. 5-21, 2002	National Statistical Committee
	SDDS Subscription	January 28–February 5, 2004	National Statistical Committee
	Balance of Payments Statistics	March 15–29, 2004	National Bank of the Kyrgyz Republic
	Monetary and Financial Statistics	April 27-May 11, 2004	National Bank of the Kyrgyz Republic

**List of Resident Advisors**

MFD	Banking Supervision/Restructuring Advisor	Mr. Svartsman	Jan. 2004–Jan. 2005
MFD	Public Debt Policy and Management	Mr. Azarbajevani	Dec. 2002–Dec. 2004

## KYRGYZ REPUBLIC—STATISTICAL ISSUES

### General framework

1. The three institutions responsible for collecting, compiling and disseminating macroeconomic statistics, National Statistics Committee (NSC), the Ministry of Finance (MOF), and the National Bank of Kyrgyz Republic (NBKR), have legal and institutional environments that support statistical quality and the respective staffs are well-versed in current methodologies. Unlike staff resources, however, computer and financial resources are not in general commensurate with current needs and constrain future statistical development, especially for the NSC.
2. The NSC maintains a comprehensive and regularly updated data web site largely incorporating international methodological recommendations, with adequate coverage and timeliness (<http://stat-gvc.bishkek.su>). The Kyrgyz Republic subscribes to the Special Data Dissemination Standard (SDDS).
3. A data ROSC mission in November 2002 assessed the Kyrgyz Republic's data dissemination practices against the GDDS and undertook an in-depth assessment of the quality of national accounts, price, government finance, monetary, and balance of payments statistics. The mission concluded that the quality of the Kyrgyz Republic's macroeconomic statistics had improved significantly in the last few years. The authorities had established a good track record of implementing recommendations of past technical assistance missions in statistics and had demonstrated commitment to pursue plans and programs to further improve their statistics. The mission recommended that, a program of regular intersectoral consistency checks be introduced to reduce the sometimes significant, unexplained discrepancies between the government finance, monetary and balance of payments datasets. The authorities' response to the data module ROSC (posted on the IMF website ([www.imf.org/external/np/rosc](http://www.imf.org/external/np/rosc))) includes an update on the status of implementation of the ROSC mission's recommendations.
4. The SDDS subscription mission in January/February 2004 found that Kyrgyz Republic met most of the SDDS requirements and made recommendations on two remaining requirements related to the reserves template and external debt. The recommendations were successfully implemented by the authorities prior to Kyrgyz Republic's subscription in late February 2004.

### National accounts

5. In general, 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 source data, due mainly to excessively tight collection deadlines associated with the present national accounts release schedule. Efforts are needed to improve the quality of the source data for quarterly GDP estimates. Moreover, subannual national accounts statistics are still prepared on a cumulative

basis rather than by discrete time periods. 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 enterprise survey. The NSC has established a division of sample surveys, which would assist in improving the sampling techniques.

### **Prices, wages, and employment**

6. The concepts and definitions used in the new consumer price index (CPI), which has been published since January 1995, are broadly consistent with international standards. The price index covers all urban resident households of all sizes and income levels, but excludes rural households, which comprise the majority of the population. The ROSC mission recommended that the authorities expand the coverage of the CPI to include rural households.

7. The new producer price index (PPI), which has been published since October 1996, is compiled broadly in accordance with international standards, although its coverage needs to be improved. The coverage of the PPI was broadened in May 1997 and is expected to be further expanded in the coming years.

8. 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. However, problems in customs administration have led to incomplete coverage of trade and the lack of an appropriate valuation system. Moreover, the quality of data processing by customs has suffered due to the use of an outdated computer software system.

9. 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. Monthly and annual data are not comparable because of different coverage and classifications. These problems extend to employment data as well. The coverage of unemployment includes an estimate of unregistered unemployed.

### **Fiscal accounts**

10. The scope of central government statistics falls short of international standards in that it excludes data for the Social Fund and the externally-financed Public Investment Program, although these data are published separately. Among the other limitations are the exclusion of financial transactions with domestic banks and the discrepancies between the deficit and financing data. The authorities do not disseminate any details on financing data. While revenue and expenditure data generally accord with GFS international standards, there are misclassifications in both categories (for example, some nontax revenues are classified as, taxes and certain expenditure items are misclassified in the budget and treasury accounts). Monthly GFS data for IFS publication have been reported up to July 2003. GFS data are

reported each year for the *GFS Yearbook* with the latest data being for 2001 and only include budgetary central government and local government data..

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

### **Monetary sector**

12. The November 2002 ROSC mission found that: (1) the residency criterion was not uniformly applied, as the currency denomination was used to classify some transactions with foreign and domestic units, (2) deposits with banks in liquidation were included in broad money, and (3) source data did not provide sufficient information for a more detailed sectoral breakdown (e.g., subsectorization of nonbanks institutions as recommended in the *Monetary and Financial Statistics Manual I (MFSM)*).

13. An STA mission on monetary and financial statistics was in Bishkek (April 27–May 11, 2004) to (1) follow up on the implementation of the ROSC mission's recommendations, (2) expand the institutional coverage of the broad money survey, and (3) assist the National Bank of the Kyrgyz Republic in implementing the methodology in the *MFSM*. This mission found that the NBKR made substantial progress in implementing the ROSC mission's recommendations pertaining to monetary statistics. To address the outstanding issues, the mission further recommended that the NBKR (1) improve the basic source data for monetary statistics compilation to allow for proper classification of the transactions with foreign and domestic units in the monetary accounts; (2) fully implement the *MFSM*'s methodology concerning accrual accounting for monetary statistics compilation; (3) exclude deposits with banks in liquidation from monetary aggregates and classify them as restricted deposits; and (4) set up a working group to follow up on consistency between monetary and balance of payments statistics. The mission also recommended expanding the current broad money survey to include the accounts of credit unions and micro-finance companies.

14. Monthly monetary data for *IFS* publication are reported on a regular and timely basis. Since December 2002, monetary data are reported electronically to STA. Beginning May 2004, the NBKR is reporting monetary data to STA through the Internet, by using the Integrated Correspondence System.

### **External sector**

15. Data on the balance of payments and international investment position are compiled and disseminated on a quarterly basis. The 2002 data ROSC mission noted that the compilation of BOP statistics broadly follows the *Balance of Payments Manual, Fifth Edition (BPM5)*. The NBKR has good arrangements with other agencies to ensure the timely flow of



data. However, because of legal issues related to secrecy provisions, high value transactions cannot be verified with respondents, which limit the ability to cross-check the accuracy of data. Although the data collection program has been expanded in the recent past, coverage deficiencies remain with respect to trade, services, and foreign direct investment. The NBKR enterprise surveys lack an up-to-date register and have inadequate coverage of enterprises, particularly those in free economic zones. There is also a need to improve compilation procedures for achieving temporal consistency of data, and investigating and reconciling discrepancies.

16. The NSC conducts a quarterly sample survey for the estimation of shuttle trade, and uses customs records on the number of people crossing the border with CIS countries to derive the sample. However, the high value limits applied for free import of goods by individuals has resulted in the proliferation of a large industry engaging in shuttle trade, complicating estimation.

An STA mission on balance of payments statistics was in Bishkek (March 15–29, 2004) in response to the authorities' request for technical assistance to address compilation issues, and to assess training needs. The mission noted that while improvements have been made in several areas of the balance of payments, further improvements are needed in the areas of the international transactions reporting system, data sampling methods, data validation and data coverage particularly on trade, services, private sector external debt and foreign direct investment. The mission developed a questionnaire for collecting data on foreign direct investment, and provided guidelines on the collection of data on external debt.

**KYRGYZ REPUBLIC—CORE STATISTICAL INDICATORS**  
(As of January 11, 2005)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve 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	01/10/05	01/10/05	01/10/05	01/10/05	11/30/04	11/30/04	Dec/04	Dec//04	Dec/04	Nov/04	Dec/04	Sept/04
Date Received	01/10/05	01/10/05	01/10/05	01/10/05	12/15/04	12/15/04	01/05/05	01/11/05	01/10/05	12/28/04	01/11/05	12/08/04
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	E	E	E	E	E	E	E	E	E	C	E	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; E-electronic news reporting; 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.												

**Statement by the IMF Staff Representative  
February 23, 2005**

The following information has become available since the staff report was issued on February 9, 2005. It does not change the thrust of the staff appraisal.

**Recent developments**

- In a letter dated February 14, 2005, the Paris Club informed the Fund that the creditors of the Kyrgyz Republic had granted financial assurances for the new PRGF-supported program. The precise terms and conditions of the debt relief will be determined in the context of Paris Club negotiations scheduled for March 9–10, 2005.
- Preliminary 2004 economic data indicate that real GDP grew by 7.1 percent in 2004, compared to the projected 6.0 percent. Excluding operations of the Kumtor gold mine and the energy sector, real GDP growth reached 7.6 percent. Average consumer price inflation was 4.1 percent, as projected.
- The general government fiscal deficit declined from 5.2 percent of GDP in 2003 to 4.1 percent in 2004—slightly lower than expected. Broad money growth (34 percent) was higher than projected (29 percent), with bank deposits increasing faster than anticipated.
- Regarding regional trade policies, in early February 2005, the parliament of Kazakhstan ratified a new road transit agreement that streamlines cumbersome permit requirements for Kyrgyz traders. On January 21, 2005, the parliament of the Kyrgyz Republic approved an amendment to the Law on Pledges, simplifying collateral provisions and allowing out-of-court settlement of disputes related to foreclosures.



Press Release No. 05/40  
FOR IMMEDIATE RELEASE  
February 23, 2005

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Approves US\$13.6 Million PRGF Arrangement for the Kyrgyz Republic**

The Executive Board of the International Monetary Fund (IMF) approved today a three-year SDR 8.88 million (about US\$13.6 million) arrangement under the Poverty Reduction and Growth Facility (PRGF) for the Kyrgyz Republic, which is designed to support the government's economic program for 2005-2007. This arrangement will become effective on March 15, 2005. In addition, the Executive Board also completed the sixth and final review of the Kyrgyz Republic's performance under its current PRGF arrangement with the Fund.

As a result of the Executive Board's approvals, the Kyrgyz Republic will be able to draw immediately an amount equivalent to SDR 9.56 million (about US\$14.6 million) under the current arrangement, and an amount equivalent to SDR 1.26 million (about US\$1.9 million) when the new arrangement becomes effective in March 2005.

Total disbursements under the current PRGF arrangement amounted to SDR 73.4 million (about US\$ 112.3 million (see [Press Release No. 01/49](#))).

Following the Executive Board's discussion of the Kyrgyz Republic, Agustín Carstens, Deputy Managing Director and Acting Chair, said

“The Kyrgyz Republic's economic performance under the PRGF-supported program was strong in 2001-04, as seen in solid economic growth, low inflation, and a comfortable foreign reserves position. Importantly, there was also a significant decline in poverty levels.

“The authorities' new three-year PRGF-supported program aims at preserving strong growth with low inflation and further reducing poverty. The success of the program will depend largely on the government's determination to adhere to its policy commitments and to reduce the external debt overhang. Even with further Paris Club debt relief, continued fiscal adjustment will be critical for maintaining macroeconomic stability. Achieving the program's fiscal targets will require containing expenditure pressures, particularly during this election year. Developing a strategy for government wage reform, aimed at reducing overstaffing in order to create room for raising the wages of key personnel, is also a high priority.

“The central bank's monetary policy has been prudent. The central bank's independence should be strengthened to maintain monetary stability and the effectiveness of bank supervision. The

authorities are committed to ensuring that any signs of prudential weakness are addressed promptly and effectively.

“Strong structural policies will be crucial to boost productivity growth and help diversify the economy. Regarding the labor market, reducing the high payroll tax rate should support employment, and increasing labor market flexibility should promote private investment and enterprise restructuring. The program envisages measures to reinvigorate energy sector reform so as to cut further the sector’s quasi-fiscal deficit. In addition to these measures, a less intrusive regulatory framework and keeping an arm’s-length relationship between the government and private sector activities should foster the development of a more propitious business environment,” Mr. Carstens said.

## **ANNEX**

### **Background**

The Kyrgyz Republic has made substantial economic progress over the past several years. Disciplined economic policies led to a successful macroeconomic stabilization with growth averaging 4.7 percent per annum in 2001-04 and per capita GDP rising to US\$425 at end-2004. In addition, the poverty rate has declined from 52 percent in 2000 to 35 percent in 2004. The 12-month rate of inflation was kept below 4 percent most of the time since 2001 and official gross reserves reached 5.5 months of imports at the end of 2004. The key challenge facing the country is to maintain steady economic growth to further reduce poverty and bring its external debt down to sustainable levels.

### **Program Summary**

Key macroeconomic objectives for 2005-07 are to achieve an annual real GDP growth rate of 5-6 percent; reduce the primary fiscal deficit (before grants) to 3 percent in 2005 and further to 2¾ percent in 2007. The government will continue building fiscal institutions and promoting fiscal transparency.

Monetary policy will seek to accommodate remonetization while containing annual inflation at 4 percent. The current exchange rate policy of a managed float regime will be maintained. To ensure that the external debt ratio is reduced, the program introduces a new indicative target for concessional public borrowing.

The investment ratio is projected to increase from an average of 20 percent in 2001-04 to 23 percent in 2005-07. Debt-financed public investment would continue to decline over the program period and private investment would rise—in line with recent trends—from an average of 15 percent in 2001-04 to 18 percent in 2005-07.

The structural reform agenda under the program will focus on reforming the financial sector, increasing labor market flexibility, and reducing the energy sector quasi-fiscal deficit.

The financing gaps under the program—2½ percent of an annual GDP in 2005-07—are expected to be filled through debt relief by Paris Club creditors, and external assistance from the Fund, the World Bank, and the Asian Development Bank.

Kyrgyz Republic: Selected Economic Indicators, 2000–07

	2000	2001	2002	2003	Prog. Est. 2004	Projections		
						2005	2006	2007
Nominal GDP (in billions of soms)	65.4	73.9	75.4	83.4	92.3	100.8	111.1	121.7
Nominal GDP (in millions of U.S. dollars)	1,367	1,525	1,606	1,911	2,167	2,399	2,646	2,898
Real GDP (growth in percent)	5.3	5.4	0.0	6.7	6.0	5.0	5.9	5.5
Consumer prices (percent change, average)	18.7	6.9	2.1	3.1	4.1	4.0	3.7	4.0
Poverty rate	52.0	48.0	44.0	41.0	35.0	...	...	...
	(In percent of GDP)							
Overall fiscal balance (cash basis)	-9.2	-5.1	-5.5	-5.2	-4.2	-4.5	-4.1	-3.7
Total revenue and grants	18.5	20.4	22.8	22.2	23.0	22.2	22.5	22.9
Tax revenue	15.1	15.8	17.6	17.8	18.5	18.5	18.4	18.6
Total expenditure (including net lending)	29.9	25.9	28.0	27.3	27.3	26.7	26.5	26.6
<i>Of which:</i> Noninterest current expenditure	18.5	19.6	21.1	21.5	21.3	20.7	20.6	20.5
External current account balance	-4.3	-1.5	-2.6	-2.8	-3.2	-6.0	-4.4	-4.0
Gross official reserves (million of U.S. dollars)	206	230	290	359	519	514	528	542
External public debt	130	100	99	96	92	84	80	76
Credit to the private sector	4.2	3.8	4.0	4.7	6.9	9.3	10.4	11.4
Broad money (percent change, e.o.p.)	11.9	12.2	35.1	34.5	28.7	18.0	16.9	15.1

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

**Statement by Fritz Zurbrügg, Executive Director for the Kyrgyz Republic  
February 23, 2005**

My Kyrgyz authorities are grateful to staff for their continued support of the economic program and the constructive policy dialogue. Performance under the 2001 PRGF arrangement has been strong. All reviews were completed according to schedule, and the outcome for most key macro-variables was better than envisaged at the outset of the arrangement. Macroeconomic performance compares favourably with most other transition countries. Also, the poverty incidence has been significantly reduced.

While taking pride in these developments, my authorities are convinced that they have to stay the course of economic stability and keep up the momentum of structural reform. They believe that the proposed low-access PRGF arrangement will provide a good framework to make further progress. Under the arrangement, fiscal consolidation will continue, and measures will be taken to strengthen fiscal institutions, reform the civil service, to improve the investment climate, and to enhance overall governance. Monetary policy will continue to focus on price stability.

**Fiscal policy**

My Kyrgyz authorities are committed to further consolidating the fiscal position. They are encouraged by recent gains in revenue performance, which have exceeded the target under the 2004 program. The increase is mainly due to strengthened tax administration, and better VAT and Payroll tax collection. Looking ahead, the general government revenue is projected to increase in lockstep with GDP growth. The primary deficit of the general government excluding grants, which was already cut by 1 percent of GDP over the last year, will be reduced to 3 percent of GDP under the 2005 program. To ensure this, both current and capital expenditure will be held constant in relation to GDP, while social spending is set to increase to nearly 16 percent of GDP by end-2007. Also, the tax base will be broadened. Here, the authorities intend to ensure the full implementation of the existing property tax. They are hopeful that the requisite regulations will be passed by the new parliament soon. The authorities will also consider to significantly increase the land tax rates and the social security contributions by farmers later in the year.

The ongoing efforts to improve revenue performance are being undertaken in conjunction with steps to simplify the tax system, and in particular to reduce the high taxation of labour. The authorities see this as critical to reduce the extent of the informal economy, on which a number of Directors expressed concern in past Board discussions. Thus, the payroll tax will be reduced by 2 percent in the first annual program, and further reductions are foreseen over the life of the new arrangement.

An important step to strengthen fiscal institutions is the consolidation of the Employment Fund and the Social Insurance Fund into the State Budget. The latter will be completed by June 2005. This will improve fiscal transparency and enable a better monitoring of the



overall fiscal stance. The further measures to improve fiscal administration will focus on strengthening the large taxpayer unit and the capacity for VAT collection; introducing self-assessment principles into the tax system; and improving intergovernmental transfers. These efforts will continue to benefit from technical assistance by FAD, as well as the World Bank and bilateral donors, which is gratefully acknowledged.

Further, the authorities will be seeking to improve expenditure management. The targeting of social expenditure will be enhanced by a new classification of poverty-reducing spending. The authorities will be working on the latter in close collaboration with Fund and World Bank staff. The new classification of poverty-related expenditure will be included in the Medium-Term Fiscal Framework, which is to be published by end-March. Also, along with the wage increases envisaged under the program, new public sector wage scales will be introduced in 2006.

### **Monetary policy**

The monetary stance will continue to focus on maintaining price stability. Past outcomes are encouraging, and end-2004 consumer price inflation was low at 4 percent, as expected. Moving forward, the National Bank (NBKR) will support the ongoing remonetization of the economy by allowing for an adequate growth of broad money. At the same time, the NBKR will continue to carefully monitor the increase in private sector credit, and stands ready to undertake whatever may be necessary to preserve the soundness of the financial sector. To help achieve this, the program contains measures to strengthen central bank independence and to improve banking supervision.

The current exchange rate regime will be maintained. The managed float is well suited to absorb exogenous shocks, and has served well in past periods of external volatility. The authorities also underline that the NBKR has no intention to resist nominal exchange rate movements for reasons of external competitiveness.

### **Structural reforms**

One of the main goals of the proposed arrangement is to enhance the climate for private investment. My authorities are well aware that investment conditions in the Kyrgyz Republic are less favorable than in other countries in the region. To rectify this, work is in train to make the legal system more predictable, to streamline business licensing, and to improve the auditing environment. Credit constraints on private investment will be alleviated by simplifying procedures for collateral registration and collection, and by the further development of micro-finance institutions.

With the assistance of the World Bank, the civil service will be reformed. The overall aim is to strengthen the capacity and effectiveness of public administration. Steps envisaged include creating positions for career state secretaries, and improving transparency by making income and asset declarations by senior officials mandatory. A more professional civil service will be key to closing the 'implementation gap' of reforms that was identified in the November ex-

post assessment of performance under Fund programs. Also, improvements to overall governance will be sought under the guidance of the Consultative Council of Good Governance.

Efforts will also be made to improve labour market flexibility and to keep wage movements on a par with productivity gains. This will be important to preserve external competitiveness and to diversify exports. Besides lowering the Payroll tax, as mentioned above, steps in this area include the review of the Labour Code, with a view to removing overly restrictive regulations. Also, the Ministry of Labor and Social Protection will streamline the provision of benefits and promote labour mobility.

Financial sector reform includes measures to enhance the bank supervision, improve the payments system, and to simplify the collection of collateral. Amendments to the Civil Code and to the National Bank Law to strengthen the NBKR's independence are to be submitted to parliament by September. The amendments will allow the Ministry of Justice to revise the legal status of the central bank, and grant legal protection for NBKR employees in performing official duties. Further, the Ministry of Finance will redeem part of the government bonds held by the central bank and re-issue them to the private sector. This will provide commercial banks with an additional investment opportunity and help stem the current expansion of private sector credit. Over the longer term, the increased range of government paper will contribute to financial deepening, in which the Kyrgyz Republic lags behind other transition countries. The authorities also intend to introduce a deposit insurance scheme, once the conditions detailed in Annex I to the Memorandum of Economic Policies are met. Finally, the authorities will continue to work with both IMF and World Bank staff on the privatization of the Kyrgyz Agricultural Finance Corporation.

Building on recent achievements, efforts to reduce the quasi-fiscal deficit (QFD) of the energy sector will continue. To this effect, electricity tariffs will be increased by 15 percent from April. The indicative target under the program is set to ensure that the QFD of the electricity sector will decrease by 1.3 percent of GDP annually in 2005-07.

Finally, my authorities remain fully committed to an open trade regime. At the same time, they believe that the gains from openness would be greatly enhanced if trade barriers within Central Asia were reduced. This would be to the benefit of the region as a whole.

### **External debt**

Reducing the high level of foreign indebtedness remains a cornerstone of the authorities' macroeconomic policy. Thanks solid growth rates and continued fiscal adjustment, the outstanding stock of external public debt has been reduced from 130 percent of GDP in 2000 to an estimated 92 percent of GDP at end-2004. The 2002 flow rescheduling granted by Paris Club creditors has served to temporarily reduce the debt service burden. The authorities are well aware that to achieve debt sustainability will require further fiscal restraint and a prudent debt management. To this end, the requirement of a 45 percent grant element for all new public borrowing will be maintained. No new debt on unconcessional terms will be contracted.

or guaranteed. The Public Investment Program, a major factor of past debt accumulation, will be further reduced. Also, as suggested by several Directors at the time of the last Board meeting—and in accordance with the new debt sustainability framework for low-income countries currently under discussion—an indicative ceiling has been established on the contracting or guaranteeing of new concessional external debt.

Nonetheless, without a further debt treatment by official creditors, public debt service would rise to an untenable level in the time immediately ahead. Also, as the debt sustainability analysis (DSA) of staff shows, a further flow rescheduling by the Paris Club would imply that the external debt-to-exports ratio would remain above 150 percent over the projection period. This also holds true when a uniform 5 percent discount rate is used, which corrects the impact on the NPV of debt of certain currency-specific CRRs that are currently at a very low level. Reducing debt stock and debt service ratios to sustainable levels will thus require a concessional debt stock treatment by Paris Club creditors. The terms of the debt treatment should provide for an adequate cushion to absorb external shocks, to which the Kyrgyz economy remains highly susceptible.

For their part, my Kyrgyz authorities are committed to implementing the broad agenda of reforms covered by the proposed arrangement. They are convinced that these will contribute to a more diversified and resilient economy, and enable growth and further increases in per-capita income.