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

In the context of the first review under the three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on August 30, 2005, with 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 October 7, 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 October 24, 2005 updating information on recent developments.
- a Press Release summarizing the views of the Executive Board as expressed during its October 24, 2005 discussion of the staff report that completed the 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*
Revised Memorandum of Economic Policies by the authorities of the Kyrgyz Republic*

*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.

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

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KYRGYZ REPUBLIC

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Juan Carlos Di Tata and Martin Fetherston

October 7, 2005

- Discussions for the first review under the 2005–08 Poverty Reduction and Growth Facility (PRGF) arrangement were held in Bishkek during August 16–30, 2005. The mission assisted the authorities in framing their economic policies for the remainder of 2005 and 2006. The staff team consisted of Messrs. Saavalainen (head), Naseer, and Kumah, Ms. Savova and Ms. Funke (EP) (all MCD), and Mr. Sadikov (EP, PDR). Mr. Mered (Resident Representative) and Mr. Dubashev of the Bishkek office assisted the mission. Mr. Zurbrügg (Executive Director for the Kyrgyz Republic) and Mr. Di Tata participated in the policy discussions during the last week of the mission's stay.
- The mission met with President Bakiev, Prime Minister Kulov, Deputy Prime Minister Usenov, Minister of Finance Japarov, National Bank Chairman Sarbanov, other senior government officials, and representatives of civil society and the business community.
- The Executive Board approved the current PRGF arrangement on February 23, 2005. Access under the arrangement amounts to SDR 8.88 million (10 percent of quota), of which SDR 1.27 million was disbursed upon approval.
- 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 (Appendix VI).
- Outreach work conducted by area department missions and the resident representative office comprises media contacts and meetings with representatives of civil society and the diplomatic and business communities.

Contents Page

Attachments

Appendices

EXECUTIVE SUMMARY

The political situation is stabilizing with the inauguration of Mr. Bakiev as the new President and parliamentary approval of Mr. Kulov as Prime Minister. The government has announced that fighting corruption and promoting private sector development and job creation are its key priorities.

Economic developments in the first half of 2005 were less favorable than expected. Real GDP growth slowed because of a decline in gold production and the uncertainties associated with the political transition following the 'people's revolution' in March. For the year as a whole, real GDP is projected to increase by 3 percent, down from 7 percent in 2004. The 12-month rate of inflation was contained at 4.6 percent in August 2005, and it is envisaged to remain at about that level during the remainder of the year. Despite the difficult political situation, the new authorities managed to observe all the end-June 2005 quantitative performance criteria and structural benchmarks under the program.

The discussions for the first review under the PRGF were conducted against the backdrop of high expectations raised by the revolution. The authorities agreed with the staff on the need for a realistic economic program to make policies predictable and credible, and to preserve macroeconomic stability. While the overall policy strategy remains broadly unchanged, the new government made some revisions to the program for the remainder of 2005 and 2006. Specifically, the revised fiscal program seeks to reduce the tax burden on labor and capital in order to support private sector activity. Planned tax reforms comprise the introduction of a 10 percent flat income tax, halving the profit tax rate to 10 percent, and a further reduction of the payroll tax rate. The revenue loss from these measures is expected to be offset by raising other taxes and eliminating tax loopholes. The fiscal program also envisages a significant increase in spending on housing and job creation by reallocating expenditures from other sectors of lower priority.

The program will continue to aim at achieving annual real GDP growth of 5–6 percent in 2006-07, with emphasis on low inflation (4-5 percent a year) to support competitiveness and economic diversification. Notwithstanding the abovementioned changes in tax and expenditure policies, fiscal consolidation will continue in order to ensure the achievement of external debt sustainability, following the Paris Club debt stock relief granted earlier this year. The primary fiscal deficit (before grants) is targeted to decline from 3.1 percent of GDP in 2005 to 2.9 percent in 2006; this compares with a deficit of 2.7 percent of GDP for 2006 in the original program.

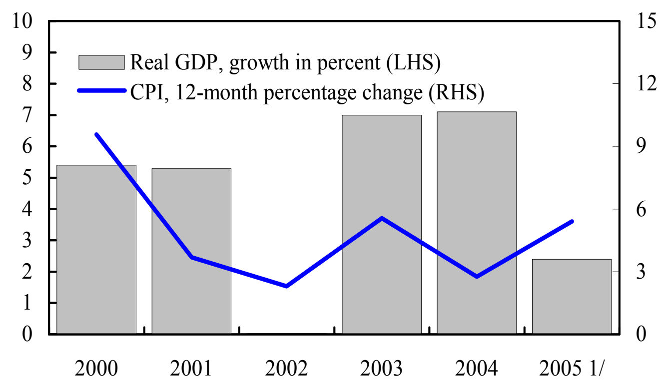
Structural reforms will continue to focus on developing the financial sector, addressing energy sector imbalances, and increasing labor market flexibility. Key structural measures include the establishment of a bank supervision framework for market, operational, country, and transfer risks, as well as steps to strengthen the central bank's internal auditing mechanism. The electricity sector's quasi-fiscal deficit—which was 8.7 percent of GDP in 2004—is targeted to decline to 6.3 percent in 2006. Labor market reforms aim at reducing restrictive hiring and firing practices.

I. Recent Developments

1. **With the inauguration of Mr. Bakiev as the new President and parliamentary approval of Mr. Kulov as Prime Minister in August, the political situation is stabilizing.**[1] The government has announced that fighting corruption, reforming taxation, and promoting housing and job creation are its key priorities. The new constitution under discussion—which is expected to redefine the distribution of power between the president, the prime minister, and parliament—will keep political issues high on the government's agenda in the coming months.

2. **Economic developments in the first half of 2005 were less favorable than originally envisaged.** Real GDP growth (year-on-year), slowed to 2.4 percent, from 7.1 percent in 2004. This slowdown was mainly caused by a decline in gold production and a weakening of the business environment following the revolution in late March. The 12-month rate of inflation rose from 2.8 percent in December 2004 to 4.6 percent in August 2005, reflecting price hikes after the spring political events and the impact of a delayed harvest. Although political developments had only a temporary adverse impact on the financial market, business expectations have weakened and investors appear to maintain a wait-and-see attitude that has slowed economic activity.

Growth and Inflation, 2000-05



Source: Kyrgyz authorities; and Fund staff estimates.
1/ January-June, 2005.

3. **The trade deficit widened to 5.4 percent of GDP in January-June 2005, from 4.9 percent in the same period of 2004.** Merchandise exports declined by 4½ percent because of the drop in gold production, while imports increased by 16 percent owing to higher oil prices and buoyant domestic demand. Nevertheless, the current account deficit remained broadly unchanged because of a significant increase in workers' remittances, mainly from Russia and Kazakhstan. Large negative errors and omissions in the balance of payments suggest that the spring political events led to some capital flight. However, gross international reserves remained at a comfortable level of 4.5 months of imports of goods and services at end-June 2005.

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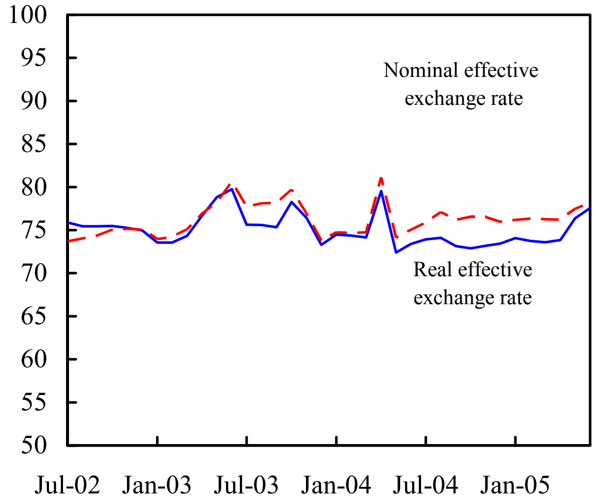
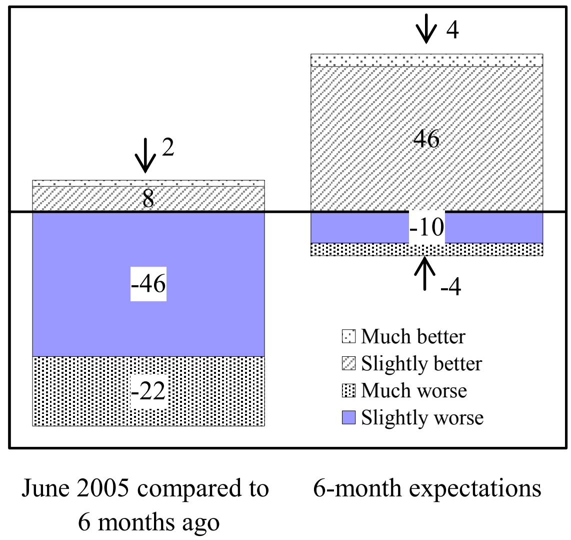
[1] After the March parliamentary elections, which were widely questioned, people took to the streets and President Akaev was ousted from power. An interim government was established in April, followed by presidential elections on July 10.

Real Nominal Effective Exchange Rates
(Index 1995=100) 1/



Source:Fund staff calculations.
1/ Effective exchange rate against the currencies of 17 trading partners, based on average trade weights for 2000-04. An increase indicates appreciation.

Business Sentiment on Economic Situation in June 2005
(Percent of respondents)



Source: International Business Council.

4. **In March 2005, Paris Club creditors decided to grant debt relief for the Kyrgyz Republic based on the Evian approach.** As a result, the NPV of official bilateral debt was reduced by 36 percent (Box 1). The authorities have completed bilateral negotiations with all Paris Club creditors, with the exception of Turkey. The debt relief agreements with Russia and Japan were signed in the first half of September 2005.

Box 1. Paris Club Agreement

On March 11, 2005, Paris Club creditors granted comprehensive debt treatment under the Evian approach on loans contracted by the Kyrgyz Republic before August 31, 2001. The full amount of principal payments on Official Development Assistance (ODA) credits will now be repaid over 40 years, with 13 years of grace, at interest rates at least as favorable as the original concessional rates applied to those loans. On commercial loans, the creditor countries agreed to cancel 50 percent of the debt and reschedule the remaining 50 percent over 23 years, with 7 years of grace, at market interest rates. Alternatively, creditors will reschedule 100 percent of the loans over 33 years, with 3 years of grace, with interest rates which will reduce the net present value of the debt by 50 percent. In addition, to grant cash flow relief during the program period, creditors decided to capitalize 85, 75, 70, and 65 percent of interest accrued in 2005, 2006, 2007, and 2008, respectively, and to extend the repayment period to 23 years, with 7 years of grace.

The agreement is expected to provide total cash relief (including on moratorium interest) of about US$198 million during the program period—very close to the figure of US$204 million assumed under the PRGF program. Staff simulations suggest that the agreement will result in a reduction of 36 percent in the NPV of official bilateral debt. The NPV of debt to exports and the NPV of debt to fiscal revenues will decline to 134 percent and 255 percent, respectively, in 2005.

Under the agreement with the Paris Club, the Kyrgyz Republic has committed to seeking comparable treatment from public and private external bilateral creditors not participating in the agreement.

Kyrgyz Republic: Debt Relief under Paris Club Agreement Compared to IMF Country Report No. 05/119
(in millions of U.S. dollars)

	2005	2006	2007	2008	Total
Actual agreement	51	50	48	48	198
Amortization payments	33	35	36	37	142
Interest payments	18	15	13	11	56
IMF Country Report No. 05/119 assumptions 1/	51	52	50	52	204
Amortization payments	31	34	33	37	135
Interest payments	19	18	16	15	69

1/ Assumes Naples terms.
Source: Fund staff estimates.

II. Performance Under the Program

5. **Notwithstanding the difficulties associated with the political transition, all the end-June 2005 quantitative performance criteria were observed (Table 1).** State government tax collections exceeded the program target by 0.5 percent of GDP owing to higher-than-anticipated revenues from income taxes and customs duties, and payroll tax collections by the Social Fund also surpassed the program's target by a comfortable margin. State government spending in the first half of 2005 was broadly in line with the program projections, despite unanticipated pay increases for the police and workers in public cultural institutions (museums, theaters, libraries, etc.), as well as higher social benefits. The ceiling on the general government's primary deficit (before grants) for the first half of 2005 was observed. The program's indicative target for the quasi-fiscal deficit (QFD) of the electricity sector was also met.

6. **The net international reserves (NIR) of the National Bank of the Kyrgyz Republic (NBKR) at end-June 2005 turned out slightly higher than targeted, while its net domestic assets (NDA) remained below the program ceiling by the equivalent of 4 percent of reserve money.** The 12-month growth of som broad money declined to

17 percent in June 2005, from 22 percent during 2004, while deposit dollarization increased owing to the uncertain political environment. Credit growth slowed to 45 percent, from 74 percent during 2004.

7. **Overall, the financial system has continued to improve, albeit slowly.** The banking sector's solvency and liquidity ratios remain high, bank profitability and the quality of loan portfolios have improved, and banking competition has intensified following the strong expansion of foreign (mainly Kazakh) ownership of banks in recent years. At present, foreign banks own over two-thirds of banking sector assets.

Selected Financial Indicators, 2002–05

(In percent at end-of-period, unless otherwise indicated)

	2002	2003	2004	2005 June
Net total capital/risk-weighted assets	36.4	35.3	23.0	27.5
Liquidity ratio 1/ 2/	82.7	93.2	91.1	83.5
Non-performing loans/total loans	13.3	11.2	6.4	7.0
Return on equity /3	5.1	8.0	15.5	17.3

Source: National Bank of the Kyrgyz Republic.

1/ Average weighted liquid assets/average weighted liabilities under 30 days.

2/ Period average, starting 2003.

3/ Net profits/net Tier 1 capital.

8. **The end-March and end-June 2005 structural benchmarks have been completed.** The medium-term budgetary framework (MTBF) was approved by the government in March, as originally envisaged, while the new Tax Code was submitted to Parliament in July, rather than in March as envisaged under the program. Regarding the end-June benchmarks, payment of salaries in the Ministry of Finance through the banking system was started; the Trade Union Social Insurance Fund was consolidated with the state budget; and the payroll tax rate was reduced by one additional percentage point, to 31 percent, from 33 percent in 2004.[2] In addition, new instructions were issued to ensure the proper and timely functioning of the VAT refund mechanism. The end-June indicative target on the electricity sector's quasi-fiscal deficit was observed, owing in part to the appreciation of the som vis-a-vis the U.S. dollar, as the cost recovery target is set in US dollar terms. Reflecting the sensitive political situation, the previous government's commitment to raise electricity tariffs on April 1 was not followed through.

[2] On January 1, 2005, the payroll tax rate had already been reduced by one percentage point, to 32 percent, following the consolidation of the Employment Fund with the State budget.

III. Policy Discussions

9. **With the program on track, the discussions with the authorities focused on the economic policies for the remainder of 2005 and 2006.** The discussions were conducted against the backdrop of high expectations created by the 'people's revolution'. The authorities indicated that they wanted to design a realistic and credible economic program aimed at promoting private sector development and employment creation, while preserving macroeconomic stability, and that the program's emphasis on macroeconomic stability and further fiscal consolidation would be maintained. However, the fiscal program envisages several changes in the area of tax policy. In addition, it incorporates new measures to promote hiring and job creation.

A. Macroeconomic Framework

10. **After a slowdown to 3 percent in 2005, real GDP is projected to grow by 5-6 percent a year over the medium term as envisaged in the original program (Table 3).** With continued sound macroeconomic policies, inflation is targeted to remain in the 4–5 percent range in 2005–07. Export diversification and low inflation to support external competitiveness will remain at the center of the economic policy strategy. Production of gold—the major export product—is expected to increase in 2006–08, while other exports would grow at 6–7 percent a year, in line with recent trends. With growing domestic demand, the external current account deficit is envisaged to remain at around 4–5 percent of GDP in the next few years. The government will also continue to rely on fiscal consolidation to achieve external debt sustainability, following the Paris Club debt stock relief granted earlier this year.

Key Projections, 2005–07

	2005	2006	2007
Real GDP (percentage change)	3.0	5.0	5.5
Inflation (eop, in percent)	4.7	4.5	4.3
External current account balance (percent of GDP)	-4.4	-4.7	-4.0
Gen. gov't. prim. fiscal balance excl. grants (percent of GDP)	-3.1	-2.9	-2.6
Broad money growth (eop, in percent)	15.4	14.8	15.1
Investment ratio	21.6	22.2	22.4
Savings ratio	17.2	17.5	18.4

Source: Kyrgyz authorities; and Fund staff estimates.

11. **Private investment is expected to become the main source of economic growth, provided that the fight against corruption is successful and the program's structural reforms are implemented effectively.** The investment ratio is projected to increase from an average of 21 percent in 2002–04 to 22½ percent in 2005–07. As public investment is expected to stabilize at 4½ percent of GDP, this increase would come entirely from the

private sector. With further fiscal consolidation, national savings are envisaged to improve in 2005-06, thus supporting capital accumulation and economic growth.

B. Fiscal Policy

12. **The authorities recognized the need for further fiscal adjustment to achieve external debt sustainability and provide safeguards for keeping inflation expectations at bay.** Thus, the fiscal program targets a decline in the general government primary fiscal deficit (before grants) from 3.1 percent of GDP in 2005 to 2.9 percent in 2006, and further to 2.6 percent in 2007. This adjustment path is broadly as envisaged in the original program (Tables 3 and 4). Domestic financing of the state government deficit by drawing down government deposits at the central bank will be limited to 0.5 percent of GDP in 2005[3]; in subsequent years the deficit would be entirely covered from foreign sources. Improvements in tax administration and steps to fight corruption are expected to raise the state tax ratio to 15.6 percent of GDP in 2005, from 14.9 percent in 2004 (Table 5). Most of this increase has already taken place in the first half of 2005, and the challenge will be to maintain these gains during the remainder of the year. Assessed against end-August data, tax collections appear to be on track with the program's target for the year.[4] Tax revenue of the general government is projected to remain broadly unchanged at 18.8 percent of GDP in 2006.

13. **During the discussions, the staff supported the authorities' plan to lower the tax burden on labor and capital in order to promote private sector growth.** The 2006 draft budget envisages (i) the introduction of a 10 percent flat income tax rate;[5] (ii) halving of the profit tax rate to 10 percent;[6] (iii) suspension of the VAT on large agricultural producers until adequate capacity is developed for its effective implementation; and (iv) a further reduction of two percentage points in the payroll tax rate, to 29 percent.[7] The revenue loss from these measures is expected to be broadly offset by tripling non-agricultural land taxes and the

[3] This is 0.2 percent of GDP higher than originally envisaged, reflecting delays in the privatization of Kyrgyz Telecom.

[4] Improved tax collections in 2005 reflect strong import growth—which is projected to continue in 2006—but also a stronger administrative effort, including some gains from the government's anti-corruption drive.

[5] This change implies the elimination of the 20 percent income tax bracket in the current personal income tax scheme.

[6] The lower profit tax would be applied to natural and authorized monopolies only starting in 2007.

[7] The revenue loss for the Social Fund would be offset by increasing state government transfers and a draw-down of cash reserves resulting from earlier overperformance in payroll tax collections.

motor vehicle tax, increasing excises, eliminating tax exemptions, and closing tax loopholes, including by abolishing most Free Economic Zones (Box 2). The authorities considered that the potential revenue losses from the income tax reductions would be smaller than estimated by the staff. It was agreed that the performance of these taxes will be closely monitored to determine whether additional measures would be needed to ensure revenue neutrality. Over the medium term, the program foresees further reductions in the payroll tax rate and production taxes, provided that pension increases can be kept moderate in real terms and the real property tax is implemented effectively.[8]

Box 2. Impact of New Tax Measures on the State Budget, 2006

(In millions of soms)

Total revenue loss	540
Introduction of a flat income tax rate of ten percent	250
Reduction of corporate income tax rate to ten percent	250
Suspension of VAT on large agricultural producers	40
Total revenue gain	490
Increase in excise tax on alcohol by 16 percent	80
Three-fold increase in taxes on non-agricultural land	220
Ten percent increase in agricultural land tax	20
Three-fold increase in motor vehicle tax	100
Elimination of Free Economic Zones	40
Elimination of selected income tax exemptions	30

Source: Kyrgyz authorities; and Fund staff estimates.

14. **Primary spending is programmed to decline to 25.6 percent of GDP in 2006, from 26.2 percent in 2005.** The staff shared the authorities' view on the need to strengthen the quality of public service delivery through well-targeted government wage increases. To that end, the program foresees that wages will be increased on average by 10 percent on May 1, 2006, with the increases focusing on the social sectors. Similarly, pension benefits will be raised by 10 percent during 2006. It was agreed that the room for wage and pension increases beyond those envisaged in the program would be re-assessed in early 2006, in the light of possible gains in revenue collection as a result of the government's anti-corruption drive.

15. **The program incorporates a package of expenditure measures to promote housing and job creation.** The cost of the package is estimated at som 750 million (¾ percent of GDP) in 2006, and will be financed by reallocating expenditures. Specifically, the package includes well-targeted interest rate and startup subsidies for housing loans

[8] The law on real property taxation has been approved by parliament, but the regulations on value assessment have not yet been passed. At this stage, the tax projections do not include any revenue from the eventual implementation of this tax.

through commercial banks, social housing projects, labor market training, public works, and a special investment program aimed at minimizing the damage caused by frequent natural disasters, particularly in the southern part of the country. Overall, social spending is targeted to increase from 15.1 percent of GDP projected for 2005 to 15.5 percent in 2006, and further to 16.1 percent in 2007. Prioritizing spending policies on wages and social spending will require strong expenditure discipline in non-priority areas.[9]

16. **Regarding fiscal institution building, the authorities will continue to focus on improving tax administration and expenditure management.** An action plan for the State Tax Inspectorate to streamline its operations, retrench redundant personnel, and introduce a merit-based wage mechanism will be prepared by end-March 2006 (structural benchmark under the program). A treasury modernization project is scheduled for completion by end-2007, and the inter-governmental transfer mechanism is being improved in collaboration with the World Bank.

C. Monetary and Exchange Rate Policies

17. **The remonetization process is projected to continue, albeit at a slower pace.** In this regard, the program accommodates broad money growth of about 15 percent a year during 2005–06, based on a further decline in money velocity (Tables 8 and 9).[10] With increased political and economic stability, growth of credit to the private sector is expected to accelerate in 2006, bringing the credit-to-GDP ratio to 8.7 percent—a level that is still low compared to other CIS countries. The authorities agreed with the staff that any administrative action to increase private sector credit would be counterproductive.

18. **The program's NIR target for end-December 2005 was raised by $22 million to $362 million (112 percent of reserve money), as a counterpart of a less expansionary NDA target.** NIR are targeted to remain broadly unchanged at end-June 2006, while the NDA target has been revised slightly upward to allow for some drawdown of government deposits at the central bank to finance the fiscal deficit.

19. **The current exchange rate policy based on a managed float system will be maintained, given that the Kyrgyz Republic remains vulnerable to external shocks because of its limited export diversification and downward rigidities of prices and wages.** A managed float could absorb exogenous shocks with smaller output and

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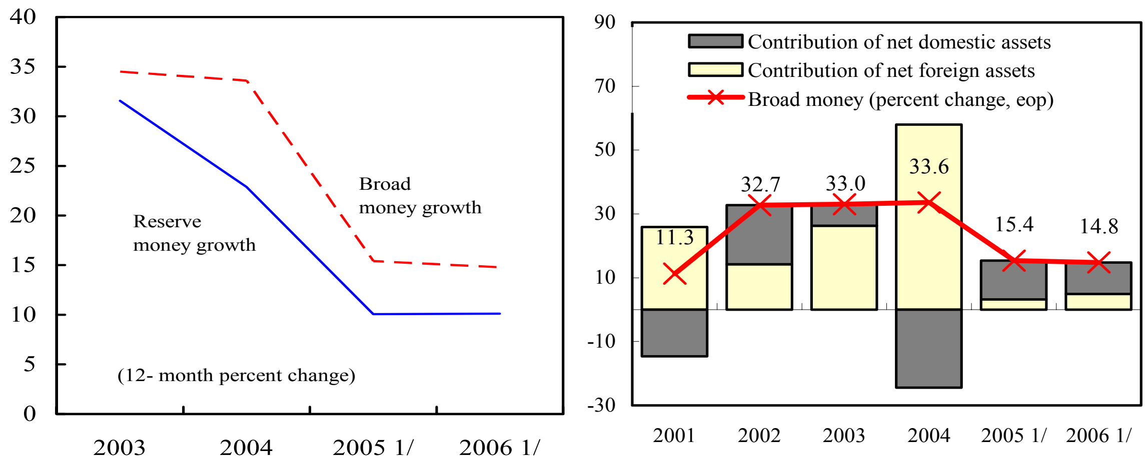
[9] Expenditures on "other goods and services"—the residual item in the fiscal accounts—are projected to remain broadly unchanged in real terms in 2006. Taking into account that carry-over expenditures in 2006 are envisaged to decline as expenditure management continues to improve, the underlying real growth is projected at 4–5 percent in 2006. This should provide enough room for containing non-priority spending without drastic cuts.

[10] In the original program, broad money growth was projected at 18 percent during 2005 and 17 percent during 2006.

employment fluctuations than a fixed exchange rate regime. The authorities do not intend to use the nominal exchange rate as a tool for promoting external competitiveness. The latter would be maintained through financial policies aimed at keeping inflation low and continuing structural reforms to support productivity growth.

Evolution of Main Monetary Aggregates



Source: Kyrgyz authorities; and Fund staff estimates.
1/ Program

20. **Further measures will be taken to deepen the government's securities market, which remains thin and limits the potential of monetary policy to control liquidity.** The government will continue to redeem government bonds held by the NBKR by som 200 million (about 2 percent of reserve money) a year, and these bonds will be reissued to commercial banks, thus increasing the volume of tradable securities. In addition, the government intends to cancel som 500 million of bonds against its deposits at the central bank. The authorities are also working to release the NBKR's gold pledge, as well as the government guarantee on the state-owned gold company Kyrgyzaltyn's revolving credit facility.[11]

D. External Policies

21. **The external current account deficit is projected to widen to 4½ percent of GDP in 2005 and 2006, from 2½ percent in 2004.** Exports of goods and services are expected to recover slightly during the remainder of 2005, as agricultural deliveries increase and gold production stops declining. The volume of exports is envisaged to recover by 5 percent in

[11] This facility was established in 1997 to finance Kyrgyzaltyn's purchases of ore from the Kumtor gold mine. The company refines ore, sells the gold in the market, and repays the loan. The procedure is repeated for each gold shipment.

2006, with an increase in shipments to CIS countries, especially Russia and Kazakhstan. Rising private consumption and recovering investment will cause import volumes to grow by about 8 percent a year in 2005–06. The widening of the current account deficit attributable to these factors, however, would be mitigated by larger workers' remittances. The capital account is likely to be weaker than originally envisaged in 2005 largely because of the capital flight associated with the spring political events. Taking into account the debt relief granted by Paris Club creditors and balance of payments support from donors, gross official reserves are projected to cover 4.7 months of imports of goods and services at end-2005. Assuming that workers' remittances continue to increase and capital flight is partially reversed, the import coverage of gross reserves would remain broadly unchanged in 2006.

22. **Building on recent progress, the government intends to continue its efforts to develop regional trade and transit systems.** Trade relations between Kazakhstan and the Kyrgyz Republic have improved following a meeting between the Presidents of these two countries in December 2003. Kazakhstan has eliminated all extra railway tariff charges on Kyrgyz traders, and now charges domestic tariffs on Kyrgyz goods shipped by rail through its territory. Also, in January 2005, the Kazakh parliament ratified the 1998 International Transport Agreement establishing permit-free transit of Kyrgyz trucks. In addition, an agreement between the customs authorities of the two countries signed in March 2005 establishes that transiting trucks will not have to pay a deposit at the border, and will not need to be accompanied by customs escorts. Regarding Uzbekistan, there has been no progress in alleviating trade restrictions, which in addition to tariff and non-tariff barriers include cumbersome customs clearance procedures and frequent border closures. With other main trade partners, no significant trade barriers exist.

23. **The March 2005 Paris Club agreement improved the prospects for achieving external debt sustainability during the program period.** The latest staff simulations suggest that solvency ratios will decline below the standard HIPC thresholds in 2006, and that debt service ratios have become manageable. Nevertheless, as earlier stress tests suggested, debt sustainability would remain vulnerable to internal and external shocks, underscoring the need to continue with strong stabilization policies and a cautious external borrowing policy.[12] The program continues to include indicative ceilings on concessional external borrowing.

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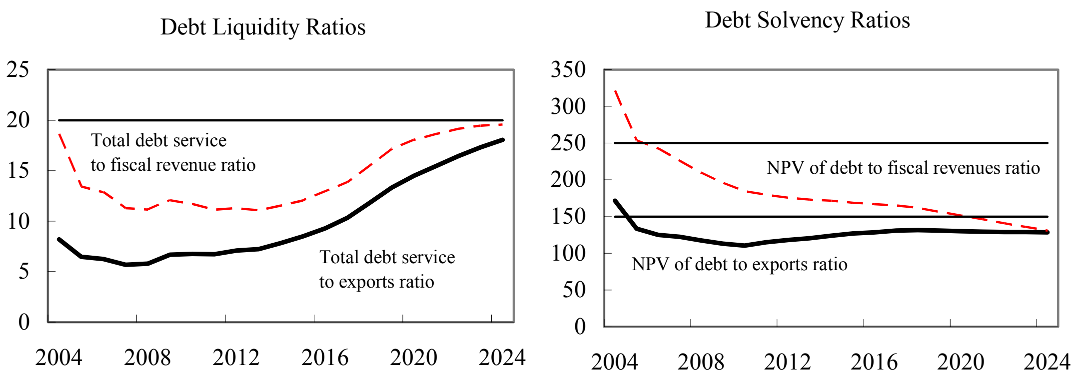
[12] For the impact of shocks, see IMF Country Report No. 05/119.



Sources: Kyrgyz authorities; and Fund staff estimates.

E. Structural Reform

24. **Structural measures will continue to focus on financial sector development, energy sector imbalances, and labor market reform.** Several actions are envisaged to strengthen confidence in the banking sector. Amendments to the Civil Code for legal independence of the central bank and legal protection of bank supervisors have already been submitted to parliament (end-September structural benchmarks). The authorities also intend to improve bank supervision by establishing a supervisory framework for market, operational, country, and transfer risks, as recommended by the September 2004 MFD mission (structural benchmark for end-June 2006). By the same date, an independent review of the NBKR's internal audit function will be completed (also structural benchmark). Moreover, on- and off-site bank inspections will be strengthened by increasing the NBKR's capacity for stress testing of individual banks. In addition, work on establishing a credit information bureau is under way with technical assistance from the EBRD.

25. **The authorities do not intend to establish a specialized state-owned bank for mortgage lending.** Instead, they will seek World Bank assistance to improve mortgage lending practices in the commercial banking sector. The Kyrgyz Agricultural Finance Corporation (KAFC), which has been extending micro loans to farmers with World Bank financing, will remain a non-bank institution until its privatization, which will be completed by end-2006. A banking license will be part of the privatization package. To improve access to microfinancing in remote areas, the Savings and Settlement Corporation (SSC), which has been operating as a narrow bank, will be allowed to start micro finance lending up to som 50 million.

26. **The authorities recognized that the successful implementation of a deposit insurance mechanism requires a sound banking sector and strong bank supervision.** To this end, the state of the banking system will be evaluated by the staffs of the Fund and the World Bank this autumn in the context of a Basel Core Principles assessment and stress testing of banks. Provided that the overall assessment is positive, an action plan will be developed for the implementation of a partial deposit insurance scheme contingent on the

availability of full funding before it is made operational. The NBKR is also preparing an action plan to improve the payments system, develop microfinance activities, and enhance the conditions for more effective use of collateral.

27. **A Fund safeguards assessment is in the process of being completed.** The recommendations of a previous assessment have been implemented, but further actions are needed to improve the oversight of the audit process and internal control systems, strengthening NBKR's autonomy, and enhance its internal audit function. The authorities indicated that they would take steps to address remaining vulnerabilities, including by commissioning an external review of the NBRK's audit department.

28. **Regarding the energy sector financial imbalances, the program framework comprising semi-annual indicative targets for the sector's quasi-fiscal deficit (QFD) will be maintained.** The QFD is targeted to decline from 8.7 percent of GDP in 2004 to 7.7 percent in 2005, and further to 6.3 percent in 2006. To achieve these objectives, the sector will need to reduce theft and significantly improve bill collection rates. The mission also encouraged the authorities to adjust tariffs in order to improve cost recovery. To support a more aggressive tariff policy, the fiscal program includes a social compensation package of 0.3 percent of GDP to protect vulnerable groups from the adverse effects of power tariff increases.[13]

29. **President Bakiev has stressed on several occasions that—apart from corruption—his main concern is high unemployment.** The official rate of unemployment was 9 percent in 2004, but the authorities believe that the true rate is significantly higher. The original program called for policies to increase labor market flexibility in order to reduce unemployment, which appears to be largely of a structural nature. The staff noted that in addition to reducing the high taxation of labor and providing better access to unemployment benefits, there was a need to eliminate potentially restrictive labor hiring and firing practices. To this end, the authorities have reviewed the Labor Code and a task force—including representatives from the private sector—has been set up. Concrete proposals on new legislative initiatives and other measures are expected by end-2005.

IV. Staff Appraisal

30. **The authorities are to be commended for keeping the program on track, notwithstanding the difficult political environment in the first half of the year.** The full observance of the program's quantitative performance criteria and structural benchmarks is evidence of progress in improving implementation capacity, especially in the NBKR and the Ministry of Finance. It is important for these key policy-making institutions to continue to ensure proper implementation of the program in the future.

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[13] The use of these funds will be monitored during 2006 in light of the progress made in improving cost recovery in the energy sector.

31. **The authorities' revised program for the remainder of 2005 and 2006 aims at achieving sustained growth with low inflation and declining poverty.** The program places increased emphasis on combating corruption and promoting private sector development and employment creation through the introduction of some policy changes, particularly in the area of fiscal policy. The program envisages a return to output growth rates of 5–6 percent a year following a temporary slowdown in 2005, inflation is targeted to remain in the low single digits.

32. **Successful implementation of the fiscal program, which seeks to continue with the process of fiscal consolidation to achieve debt sustainability, remains an important challenge.** The 'people's revolution' has raised expectations of a rapid increase in real incomes. However, financial constraints remain binding, and these expectations need to be managed skillfully to ensure public support for reforms. The new government's realistic approach in preparing the 2006 budget is encouraging, and prompt approval by parliament of the proposed budget will send a clear signal to the public and the donor community of the country's continued commitment to a prudent fiscal policy.

33. **The tax reforms envisaged in the program, which include lower income and payroll tax rates, should go a long way toward improving the investment climate.** Close monitoring of the revenue performance will be necessary to take timely corrective action in case of revenue shortfalls. On the expenditure side, it is crucial to keep the growth of the government wage bill within the program limits. At the same time, the authorities should move ahead decisively with their plans to reduce redundant employment in the public sector so as to create room for merit-based pay increases for key personnel to improve motivation and reduce incentives for corruption.

34. **The central bank has been successful in containing inflation and maintaining stability in the foreign exchange market.** Further progress is needed, however, in deepening the securities market to enhance the potential of indirect monetary instruments. The managed float exchange system in place is appropriate, as it provides flexibility to deal with external shocks while minimizing output losses. Looking ahead, it is crucial to take concrete steps to strengthen the independence of the central bank, in line with the authorities' pledge to improve governance in public institutions. Prompt approval of the amendments to the central bank law by parliament would be helpful in this regard.

35. **The new government's commitment to intensify the fight against corruption is welcome.** To gain credibility, the announcements made thus far need to be supported by concrete measures and tangible outcomes. In the fiscal area, the test is to achieve—and exceed—the program's tax collection targets and create more fiscal space. Further progress is also needed in reducing the electricity sector's quasi-fiscal deficit, which masks corrupt practices evidenced by low bill collection and high commercial losses.

36. **Additional efforts are required under the program to strengthen the financial system, improve fiscal institutions, and increase labor market flexibility.** Regarding the financial system, determined steps should be taken to strengthen the central bank's

supervision framework and its internal auditing functions. On fiscal institution building, the authorities' commitment to start reforming tax administration and improving treasury operations is welcomed. On the labor market, more needs to be done to address high hiring and firing costs in order to encourage employment creation.

37. **Apart from the downside risks associated with the implementation of the ambitious tax policy agenda, the main risks for the program continue to be the economy's vulnerability to external shocks and weaknesses in governance.** To manage these risks, it is crucial to achieve concrete results in improving governance in public administration and reducing corruption. Given the Kyrgyz Republic's strong track record in implementing this as well as the previous PRGF-supported program, the staff recommends the completion of the first review under the current PRGF arrangement.

Table 1. Kyrgyz Republic: Quantitative Program Targets for June 2005-December 2006 1/

(In millions of soms, unless otherwise indicated; eop)

	2004	2005									2006			
	December	March			June			September	December		March	June	September	December
	Actual	Benchmarks			PCs			Benchmarks	PCs		Benchmarks	PCs	Benchmarks	Benchmark
		Prog.	Adjusted	Prel.	Prog.	Adjusted	Prel.	Prog.	Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.
I. **Performance criteria**														
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	329	326	325	322	333	325	326	340	340	362	367	361	380	393
2. Ceiling on net domestic assets of the NBKR (eop stock)	-2,046	-1,390	-1,282	-1,583	-962	-834	-1,486	-1,289	-985	-1,477	-1,566	-1,200	-1,258	-1,397
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	n.a.	1,198	...	701	1,529	...	881	2,398	3,028	3,143	1,099	1,377	2,619	3,234
4. Cumulative floor on state government tax collections in cash	n.a.	3,191	...	3,529	6,929	...	7,440	10,970	15,318	15,853	3,599	7,933	12,462	17,580
5. Ceiling on the stock of central government budget arrears	0	0	...	0	0	...	0	0	0	0	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	...	0	0	...	0	0	0	0	0	0	0	0
7. Cumulative floor on payroll collections in cash of the Social Fund	n.a.	1,050	...	1,177	2,143	...	2,342	3,228	4,392	4,461	1,100	2,292	3,292	4,675
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	0	...	0	0	...	0	0	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	0	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	0	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	0	0	0	0	0	0
II. **Indicative targets**														
1. Ceiling on reserve money (NBKR liabilities)	12,380	12,909	...	12,603	12,943	...	12,765	12,894	13,247	13,624	13,750	13,850	14,596	15,000
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	7,776	...	...	...	4,700	...	4,557	...	8,400	7,850	...	3,910	...	7,110
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/	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).
2/ New concessional loans during the year.

Table 2. Kyrgyz Republic: Structural Conditionality for September 2005–June 2006

Structural benchmarks for end-September 2005

- Submit to parliament amendments to the civil code to provide for legal independence of the NBKR. The ministry of justice will revise the NBKR's institutional legal status accordingly.

- Submit to parliament amendments to the central bank Law as specified in paragraph 27 of the original Memorandum of Economic Policies.

Structural benchmarks for end-December 2005

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

- Prepare a payments system action plan, as specified in paragraph 44 of the Revised Memorandum of Economic Policies.

Structural benchmarks for end-March 2006

- Prepare, in close cooperation with the Fund staff, an action plan for the State Tax Inspectorate to streamline its operations, retrench redundant personnel, and introduce a merit-based pay system.

Structural benchmarks for end-June 2006

- Introduce the supervisory framework for market, country, and transfer risk as recommended by the September 2004 MFD technical assistance mission.

- Conduct an independent review of the NBKR's internal audit function. The review could be performed by an internal audit department of another central bank and should include a review of the capacity of the internal audit division.

Table 3. Kyrgyz Republic: Selected Economic Indicators, 2001–07

	2001	2002	2003	2004	2005		2006		2007
	Actual	Actual	Actual	Actual	Prog. 1/	Rev. Prog.	Prog. 1/	Rev. Prog.	Proj.
National accounts									
Nominal GDP (in billions of soms)	73.9	75.4	83.9	94.1	100.8	101.4	111.1	111.5	122.9
Nominal GDP (in millions of U.S. dollars)	1,525	1,606	1,921	2,210	2,399	2,414	2,646	2,655	2,926
Real GDP (growth in percent)	5.3	0.0	7.0	7.1	5.0	3.0	5.9	5.0	5.5
GDP per capita (in U.S. dollars)	308	321	380	433	465	468	508	510	556
Consumer prices (percent change, eop)	3.7	2.3	5.6	2.8	4.0	4.7	3.7	4.5	4.3
Consumer prices (percent change, average)	6.9	2.1	3.1	4.1	4.0	4.3	3.7	4.5	4.3
Unemployment rate	7.8	8.6	8.9	9.0	...	...	...	...	...
Poverty rate (consumption approach)	56	55	50	46	...	...	...	...	...
GINI coefficient	0.32	0.33	0.30	...	...	...	...	...	...
Investment and savings									
Investment	19.6	20.3	20.5	20.9	22.3	21.6	22.7	22.2	22.4
Public	5.3	6.1	4.8	4.5	4.5	4.4	4.6	4.2	4.3
Private	14.3	14.3	15.8	16.4	17.9	17.2	18.1	18.0	18.1
Savings	18.1	16.8	17.6	18.5	16.4	17.2	18.3	17.5	18.4
Public	-0.5	-0.2	-0.9	-0.1	-0.5	-0.7	-0.1	0.2	1.1
Private	18.6	16.9	18.5	18.7	16.8	17.8	18.4	17.3	17.3
Savings Investment balance	1.5	3.6	3.0	2.4	6.0	4.4	4.4	4.7	4.0
General government finances (in percent of GDP) 2/									
Total revenue and grants	20.4	22.8	22.2	23.0	22.2	22.9	22.5	23.0	23.6
Tax revenue	15.7	17.5	17.7	18.4	18.5	18.9	18.4	18.8	19.0
Total expenditure (including net lending)	26.0	28.1	27.4	27.1	26.7	27.5	26.5	26.6	26.6
Of which : current expenditure	21.8	22.6	23.1	23.1	22.7	23.5	20.6	22.8	22.5
Capital expenditure	5.3	6.1	4.8	4.5	4.5	4.4	4.6	4.2	4.3
Overall fiscal balance (cash basis)	-5.2	-5.6	-5.4	-4.2	-4.5	-4.6	-4.1	-3.6	-3.0
Primary balance excluding grants	-4.4	-5.1	-4.3	-3.4	-3.0	-3.1	-2.7	-2.9	-2.6
Monetary sector 3/									
Net foreign assets (percent change, eop)	36.0	12.4	41.3	83.8	-4.7	3.5	12.4	5.7	11.8
Net domestic assets (percent change, eop)	-12.7	35.5	5.8	-52.3	107.5	73.2	22.9	39.4	19.2
Credit to private sector (in percent of GDP)	3.8	4.0	4.7	7.0	9.3	7.4	10.4	8.7	9.7
Broad money (percent change, eop)	12.2	35.1	34.5	33.6	13.6	15.4	16.9	14.8	15.1
Velocity of broad money 4/	9.4	7.0	6.0	5.6	4.3	4.5	4.2	4.4	4.2
Interest rate 5/	36.4	30.2	25.1	22.6	...	...	...	...	...
External sector									
Current account balance (in percent of GDP)	-1.5	-3.6	-3.0	-2.4	-6.0	-4.4	-4.4	-4.7	-4.0
Export of goods and services (million U.S. dollars)	561	640	745	942	921	967	1,008	1,045	1,128
Export growth (percent change)	-2.1	14.2	16.4	26.4	3.5	2.7	9.4	8.0	8.0
Import of goods and services (million U.S. dollars)	591	756	875	1,135	1,142	1,265	1,213	1,401	1,493
Import growth (percent change)	-9.9	28.0	15.7	29.7	9.9	11.4	6.2	10.7	6.6
Gross official reserves (million U.S. dollars) 6/	230	290	359	544	514	544	528	557	584
Gross reserves (months of imports, eop)	3.6	4.0	3.8	5.2	5.1	4.7	4.9	4.6	4.4
External public debt outstanding (in percent of GDP) 7/	100	99	96	89	84	83	80	78	73
Debt service-to-export ratio (in percent) 7/	13	10	8	8	19	6	15	6	6
Memorandum items									
Exchange rate (soms per U.S. dollar, average)	48.4	46.9	43.7	42.6	...	...	...	...	...
Real effective exchange rate									
Index (1995=100)	72.2	75.7	76.7	74.2	...	...	...	...	...
Percent change	4.7	4.7	1.3	-3.2	...	...	...	...	...

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

1/ IMF Country Report No. 05/119.
2/ General government comprises state government and Social Fund finances. State government comprises central and local governments.
3/ Projections use the program exchange rate.
4/ 12-month GDP over average quarterly broad money.
5/ Weighted average interest rate on som denominated loans.
6/ Gross reserves exclude international reserves of the NBKR that are pledged or blocked.
7/ Excluding Kumtor gold mine.

Table 4. Kyrgyz Republic: General Government Finances, 2002–07

	2003 Act.	2004 Act.	2005 Act.	2005 1Q Prog.	2005 1Q Act.	2005 2Q Prog.	2005 2Q Act.	2005 3Q Prog.	2005 4Q Rev. Prog.	2005 Prog.	2005 Rev. Prog.	2006 1Q Rev. Prog.	2006 2Q Rev. Prog.	2006 3Q Rev. Prog.	2006 4Q Rev. Prog.	2006 Rev. Prog.	2007 Proj.
(In millions of soms)																	
Total revenue and grants	17,158	18,634	21,628	4,860	5,231	5,480	5,809	5,823	6,261	22,354	23,191	5,356	6,189	6,444	7,699	25,688	29,051
Of which: tax revenue 1/	13,174	14,820	17,280	4,032	4,533	4,587	4,795	4,840	4,995	18,601	19,162	4,414	5,231	5,234	6,127	21,005	23,370
grants	833	418	613	78	0	0	0	207	0	492	222	212	0	236	420	868	1,385
Total expenditure (excluding net lending)	21,617	23,413	25,961	6,268	6,214	6,848	6,837	6,780	8,629	27,329	28,304	6,473	7,313	7,715	8,612	30,113	32,961
Current expenditure	17,055	19,393	21,732	5,325	5,386	5,685	6,052	5,462	7,202	22,826	23,858	5,550	6,056	6,404	7,406	25,416	27,678
Capital expenditure (including PIP)	4,562	4,020	4,229	943	828	1,163	786	1,318	1,427	4,503	4,447	923	1,257	1,311	1,206	4,697	5,283
Financial balance	-4,459	-4,778	-4,333	-1,408	-983	-1,368	-1,028	-957	-2,367	-4,975	-5,113	-1,117	-1,124	-1,271	-913	-4,425	-3,910
Net lending	-443	-414	-439	-76	-90	-112	-123	-101	-139	-451	-451	-79	-117	-105	-160	-461	-262
Accrual surplus (+) / deficit (-)	-4,016	-4,365	-3,894	-1,332	-893	-1,255	-906	-856	-2,229	-4,524	-4,662	-1,037	-1,008	-1,166	-753	-3,964	-3,648
Cash surplus (+) / deficit (-)	-4,203	-4,541	-3,908	-1,332	-684	-1,255	-808	-856	-2,229	-4,524	-4,662	-1,037	-1,008	-1,166	-753	-3,964	-3,648
Primary balance excluding grant	-3,823	-3,632	-3,231	-1,198	-701	-331	-180	-869	-1,570	-3,028	-3,143	-1,099	-278	-1,242	-615	-3,234	-3,251
Total financing	4,203	4,541	3,908	992	684	588	808	396	2,229	2,192	4,662	1,037	1,008	1,166	753	3,964	3,648
External financing	3,933	3,690	4,724	440	659	176	869	785	1,383	1,490	3,886	648	1,067	1,305	900	3,920	3,973
Domestic financing	33	556	-4,455	496	142	354	13	-473	705	281	695	354	-63	-375	-150	-234	-665
Change in Social Fund cash balance	107	-12	-162	26	-143	28	-97	54	130	90	12	10	-21	211	-131	69	0
Exceptional financing 2/	130	307	3,801	30	26	30	22	30	11	330	69	25	25	25	134	210	340
Financing gap	0	0	0	340	0	667	0	459	0	2,332	0	0	0	0	0	0	0
(In percent of GDP)																	
Total revenue and grants	22.8	22.2	23.0	4.8	5.2	5.4	5.7	5.8	6.2	22.2	22.9	4.8	5.6	5.8	6.9	23.0	23.6
Of which : tax revenue 1/	17.5	17.7	18.4	4.0	4.5	4.6	4.7	4.8	4.9	18.5	18.9	4.0	4.7	4.7	5.5	18.8	19.0
grants	1.1	0.5	0.7	0.1	0.0	0.0	0.0	0.2	0.0	0.5	0.2	0.2	0.0	0.2	0.4	0.8	1.1
Total expenditure (excluding net lending)	28.7	27.9	27.6	6.2	6.1	6.8	6.7	6.7	8.5	27.1	27.9	5.8	6.6	6.9	7.7	27.0	26.8
Current expenditure	22.6	23.1	23.1	5.3	5.3	5.6	6.0	5.4	7.1	22.7	23.5	5.0	5.4	5.7	6.6	22.8	22.5
Capital expenditure (including PIP)	6.1	4.8	4.5	0.9	0.8	1.2	0.8	1.3	1.4	4.5	4.4	0.8	1.1	1.2	1.1	4.2	4.3
Net lending	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4	-0.1	-0.1	-0.1	-0.1	-0.4	-0.2
Accrual surplus (+) / deficit (-)	-5.3	-5.2	-4.1	-1.3	-0.9	-1.2	-0.9	-0.8	-2.2	-4.5	-4.6	-0.9	-0.9	-1.0	-0.7	-3.6	-3.0
Cash surplus (+) / deficit (-)	-5.6	-5.4	-4.2	-1.3	-0.7	-1.2	-0.8	-0.8	-2.2	-4.5	-4.6	-0.9	-0.9	-1.0	-0.7	-3.6	-3.0
Primary balance excluding grants	-5.1	-4.3	-3.4	-1.2	-0.7	-0.3	-0.2	-0.9	-1.5	-3.0	-3.1	-1.0	-0.2	-1.1	-0.6	-2.9	-2.6
Total financing	5.6	5.4	4.2	1.0	0.7	0.6	0.8	0.4	2.2	2.2	4.6	0.9	0.9	1.0	0.7	3.6	3.0
External financing	5.2	4.4	5.0	0.4	0.6	0.2	0.9	0.8	1.4	1.5	3.8	0.6	1.0	1.2	0.8	3.5	3.2
Domestic financing	0.0	0.7	-4.7	0.5	0.1	0.4	0.0	-0.5	0.7	0.3	0.7	0.3	-0.1	-0.3	-0.1	-0.2	-0.5
Change in Social Fund cash balance	0.1	0.0	-0.2	0.0	-0.1	0.0	-0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.2	-0.1	0.1	0.0
Exceptional financing 2/	0.2	0.4	4.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.1	0.0	0.0	0.0	0.1	0.2	0.3
Financing gap	0.0	0.0	0.0	0.3	0.0	0.7	0.0	0.5	0.0	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:																	
Social spending	14.1	14.0	14.2	3.5	3.4	3.7	3.8	3.6	4.6	15.0	15.1	3.4	3.7	3.9	4.5	15.5	16.1

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. Includes som 3,589 million related to the Kumtor mine restructuring for 2004.

Table 5. Kyrgyz Republic: State Government Finances, 2002–07

(In millions of soms)

	2002	2003	2004	2005						2005		2006				2006	2007
				1Q		2Q		3Q	4Q Rev.		Rev.	1Q	2Q	3Q	4Q	Rev.	
	Act.	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Prog.	Prog.	Rev. Prog.				Prog.	Proj.
Total revenue and grants	14,402	15,666	18,233	4,003	4,212	4,616	4,894	5,009	5,523	19,011	19,802	4,520	5,272	5,719	6,669	22,179	25,231
Total revenue	13,569	15,248	17,620	3,926	4,212	4,616	4,894	4,802	5,523	18,519	19,581	4,308	5,272	5,483	6,249	21,311	23,846
Current revenue	13,439	15,112	17,405	3,886	4,196	4,573	4,882	4,759	5,522	18,346	19,550	4,306	5,265	5,465	6,237	21,273	23,743
Tax revenue	10,475	11,916	13,987	3,191	3,529	3,738	3,911	4,041	4,259	15,318	15,853	3,599	4,334	4,529	5,117	17,580	19,637
Income tax	2,199	2,381	2,636	615	871	635	834	690	707	2,677	3,098	767	656	720	960	3,102	3,350
VAT 1/	4,794	5,526	6,830	1,570	1,527	1,960	1,645	2,037	1,973	7,739	7,100	1,513	2,076	2,003	2,365	7,956	9,025
Excises	1,082	1,164	1,245	301	286	321	278	362	334	1,366	1,318	349	369	385	377	1,480	1,726
Customs	419	423	449	110	210	132	412	149	451	550	1,362	302	372	419	506	1,600	1,735
Land tax	318	312	335	56	52	56	53	113	153	376	376	113	104	186	213	616	679
Road Tax and Emergency Fund	1,030	1,128	1,270	293	302	357	359	390	403	1,464	1,443	281	407	421	410	1,520	1,675
Retail sales tax	410	471	548	129	135	141	149	158	142	586	586	145	158	174	174	652	733
Other 2/	223	512	673	116	146	137	182	143	97	559	569	129	192	221	112	653	714
Nontax revenue	2,964	3,195	3,419	696	667	835	971	717	1,263	3,028	3,697	707	930	936	1,120	3,693	4,106
Capital revenue	130	137	215	40	16	43	11	43	2	173	31	2	7	18	12	38	103
Grants	833	418	613	78	0	0	0	207	0	492	222	212	0	236	420	868	1,385
Total expenditure (excluding net lending)	18,710	20,580	22,729	5,386	5,338	5,956	6,019	5,912	7,761	23,895	24,903	5,626	6,417	6,778	7,713	26,535	29,141
Current expenditure	14,148	16,560	18,500	4,444	4,510	4,794	5,233	4,594	6,335	19,393	20,457	4,703	5,160	5,467	6,507	21,838	23,858
Wages and Social Fund contributions	4,876	5,652	6,538	1,392	1,213	1,616	1,839	1,863	2,546	7,247	7,706	1,425	2,162	2,632	2,137	8,355	9,215
Transfers and subsidies 3/	2,558	2,692	2,879	697	681	723	870	1,014	709	3,366	3,017	866	800	810	1,020	3,496	3,814
Transfers to Social Fund	787	1,122	1,090	244	244	244	244	244	244	976	976	296	296	297	297	1,186	1,417
Interest	1,213	1,326	1,290	212	192	925	726	194	658	1,988	1,740	150	730	160	559	1,599	1,782
Purchases of other goods and services 4/	4,714	5,767	6,704	1,899	2,180	1,285	1,554	1,279	2,177	5,815	7,017	1,967	1,173	1,568	2,494	7,202	7,630
Capital expenditure (including PIP)	4,562	4,020	4,229	943	828	1,163	786	1,318	1,427	4,503	4,447	923	1,257	1,311	1,206	4,697	5,283
Financial balance	-4,308	-4,914	-4,496	-1,383	-1,126	-1,340	-1,125	-903	-2,238	-4,885	-5,101	-1,107	-1,146	-1,060	-1,044	-4,356	-3,910
Net lending	-443	-414	-439	-76	-90	-112	-123	-101	-139	-451	-451	-79	-117	-105	-160	-461	-262
Accrual surplus (+) / deficit (-)	-3,865	-4,500	-4,058	-1,306	-1,036	-1,228	-1,002	-802	-2,099	-4,434	-4,650	-1,027	-1,029	-955	-884	-3,895	-3,648
Expenditure arrears	-231	-53	-13	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash surplus (+) / deficit (-)	-4,096	-4,553	-4,070	-1,306	-1,036	-1,228	-1,002	-802	-2,099	-4,434	-4,650	-1,027	-1,029	-955	-884	-3,895	-3,648
Primary balance excluding grants	-3,716	-3,644	-3,393	-1,173	-844	-303	-276	-815	-1,441	-2,938	-3,132	-1,089	-299	-1,031	-746	-3,165	-3,251
Total financing	4,096	4,553	4,070	966	1,036	560	1,002	342	2,099	2,102	4,650	1,027	1,029	955	884	3,895	3,648
External financing	3,933	3,690	4,724	440	659	176	869	785	1,383	1,490	3,886	648	1,067	1,305	900	3,920	3,973
Public investment program (PIP)	3,630	3,036	3,187	660	641	880	661	1,012	1,012	3,325	3,326	698	898	964	784	3,345	3,686
Disbursements (BOP support)	356	218	1,247	0	0	0	0	0	210	0	210	0	0	420	0	420	420
Total amortization	-878	-1,474	-1,532	-220	-210	-704	-671	-227	-652	-1,835	-1,750	-231	-704	-267	-796	-1,999	-2,191
Arrears and rescheduling	825	1,911	1,823	0	228	0	879	0	813	0	2,100	181	874	187	912	2,153	2,058
Domestic financing	33	556	-4,455	496	351	354	111	-473	705	281	695	354	-63	-375	-150	-234	-665
Exceptional financing 5/	130	307	3,801	30	26	30	22	30	11	330	69	25	25	25	134	210	340
Financing gap	0	0	0	340	0	667	0	459	0	2,332	0	0	0	0	0	0	0

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

1/ In 2005, the VAT and customs revenues were reclassified leading to lower VAT and higher customs duty collections.
2/ Mainly mineral resource tax and real property tax.
3/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).
4/ Includes carry-forward expenditure from previous fiscal year (som 1,021 million in 2004, som 922 million in 2005, and som 562 million in 2006).
5/ Mainly privatization proceeds. Includes som 3,472 million related to the Kumtor mine restructuring for 2004.

Table 5 (concluded). Kyrgyz Republic: State Government Finances, 2002–07

(In percent of GDP)

	2002	2003	2004	2005						2005		2006				2006	2007
				1Q		2Q		3Q	4Q			1Q	2Q	3Q	4Q		
	Act.	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Rev. Prog.				Rev. Prog.	Proj.
Total revenue and grants	19.1	18.7	19.4	4.0	4.2	4.6	4.8	5.0	5.4	18.9	19.5	4.1	4.7	5.1	6.0	19.9	20.5
Total revenue	18.0	18.2	18.7	3.9	4.2	4.6	4.8	4.8	5.4	18.4	19.3	3.9	4.7	4.9	5.6	19.1	19.4
Current revenue	17.8	18.0	18.5	3.9	4.1	4.5	4.8	4.7	5.4	18.2	19.3	3.9	4.7	4.9	5.6	19.1	19.3
Tax revenue	13.9	14.2	14.9	3.2	3.5	3.7	3.9	4.0	4.2	15.2	15.6	3.2	3.9	4.1	4.6	15.8	16.0
Income tax	2.9	2.8	2.8	0.6	0.9	0.6	0.8	0.7	0.7	2.7	3.1	0.7	0.6	0.6	0.9	2.8	2.7
VAT 1/	6.4	6.6	7.3	1.6	1.5	1.9	1.6	2.0	1.9	7.7	7.0	1.4	1.9	1.8	2.1	7.1	7.3
Excises	1.4	1.4	1.3	0.3	0.3	0.3	0.3	0.4	0.3	1.4	1.3	0.3	0.3	0.3	0.3	1.3	1.4
Customs	0.6	0.5	0.5	0.1	0.2	0.1	0.4	0.1	0.4	0.5	1.3	0.3	0.3	0.4	0.5	1.4	1.4
Land tax	0.4	0.4	0.4	0.1	0.1	0.1	0.1	0.1	0.2	0.4	0.4	0.1	0.1	0.2	0.2	0.6	0.6
Road Tax and Emergency Fund	1.4	1.3	1.4	0.3	0.3	0.4	0.4	0.4	0.4	1.5	1.4	0.3	0.4	0.4	0.4	1.4	1.4
Retail sales tax	0.5	0.6	0.6	0.1	0.1	0.1	0.1	0.2	0.1	0.6	0.6	0.1	0.1	0.2	0.2	0.6	0.6
Other 2/	0.3	0.6	0.7	0.1	0.1	0.1	0.2	0.1	0.1	0.6	0.6	0.1	0.2	0.2	0.1	0.6	0.6
Nontax revenue	3.9	3.8	3.6	0.7	0.7	0.8	1.0	0.7	1.2	3.0	3.6	0.6	0.8	0.8	1.0	3.3	3.3
Capital revenue	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Grants	1.1	0.5	0.7	0.1	0.0	0.0	0.0	0.2	0.0	0.5	0.2	0.2	0.0	0.2	0.4	0.8	1.1
Total expenditure (excluding net lending)	24.8	24.5	24.2	5.3	5.3	5.9	5.9	5.9	7.7	23.7	24.6	5.0	5.8	6.1	6.9	23.8	23.7
Current expenditure	18.8	19.7	19.7	4.4	4.4	4.8	5.2	4.6	6.2	19.2	20.2	4.2	4.6	4.9	5.8	19.6	19.4
Wages and Social Fund contributions	6.5	6.7	6.9	1.4	1.2	1.6	1.8	1.8	2.5	7.2	7.6	1.3	1.9	2.4	1.9	7.5	7.5
Transfers and subsidies 3/	3.4	3.2	3.1	0.7	0.7	0.7	0.9	1.0	0.7	3.3	3.0	0.8	0.7	0.7	0.9	3.1	3.1
Transfers to Social Fund	1.0	1.3	1.2	0.2	0.2	0.2	0.2	0.2	0.2	1.0	1.0	0.3	0.3	0.3	0.3	1.1	1.2
Interest	1.6	1.6	1.4	0.2	0.2	0.9	0.7	0.2	0.6	2.0	1.7	0.1	0.7	0.1	0.5	1.4	1.5
Purchases of other goods and services 4/	6.3	6.9	7.1	1.9	2.1	1.3	1.5	1.3	2.1	5.8	6.9	1.8	1.1	1.4	2.2	6.5	6.2
Capital expenditure (including PIP)	6.1	4.8	4.5	0.9	0.8	1.2	0.8	1.3	1.4	4.5	4.4	0.8	1.1	1.2	1.1	4.2	4.3
Financial balance	-5.7	-5.9	-4.8	-1.4	-1.1	-1.3	-1.1	-0.9	-2.2	-4.8	-5.0	-1.0	-1.0	-1.0	-0.9	-3.9	-3.2
Net lending	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4	-0.1	-0.1	-0.1	-0.1	-0.4	-0.2
Accrual surplus (+) / deficit (-)	-5.1	-5.4	-4.3	-1.3	-1.0	-1.2	-1.0	-0.8	-2.1	-4.4	-4.6	-0.9	-0.9	-0.9	-0.8	-3.5	-3.0
Cash surplus (+) / deficit (-)	-5.4	-5.4	-4.3	-1.3	-1.0	-1.2	-1.0	-0.8	-2.1	-4.4	-4.6	-0.9	-0.9	-0.9	-0.8	-3.5	-3.0
Primary balance excluding grants	-4.9	-4.3	-3.6	-1.2	-0.8	-0.3	-0.3	-0.8	-1.4	-2.9	-3.1	-1.0	-0.3	-0.9	-0.7	-2.8	-2.6
Total financing	5.4	5.4	4.3	1.0	1.0	0.6	1.0	0.3	2.1	2.1	4.6	0.9	0.9	0.9	0.8	3.5	3.0
External financing	5.2	4.4	5.0	0.4	0.6	0.2	0.9	0.8	1.4	1.5	3.8	0.6	1.0	1.2	0.8	3.5	3.2
Public investment program (PIP)	4.8	3.6	3.4	0.7	0.6	0.9	0.7	1.0	1.0	3.3	3.3	0.6	0.8	0.9	0.7	3.0	3.0
Disbursements (BOP support)	0.5	0.3	1.3	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.2	0.0	0.0	0.4	0.0	0.4	0.3
Total amortization	-1.2	-1.8	-1.6	-0.2	-0.2	-0.7	-0.7	-0.2	-0.6	-1.8	-1.7	-0.2	-0.6	-0.2	-0.7	-1.8	-1.8
Arrears and rescheduling	1.1	2.3	1.9	0.0	0.2	0.0	0.9	0.0	0.8	0.0	2.1	0.2	0.8	0.2	0.8	1.9	1.7
Domestic financing	0.0	0.7	-4.7	0.5	0.3	0.4	0.1	-0.5	0.7	0.3	0.7	0.3	-0.1	-0.3	-0.1	-0.2	-0.5
Exceptional financing 5/	0.2	0.4	4.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.1	0.0	0.0	0.0	0.1	0.2	0.3
Financing gap	0.0	0.0	0.0	0.3	0.0	0.7	0.0	0.5	0.0	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:																	
Primary balance	-3.8	-3.8	-3.0	-1.1	-0.9	-0.3	-0.6	-0.6	-1.7	-2.4	-2.9	-0.8	-0.6	-0.7	-0.6	-2.1	-1.5
Domestic balance 6/	0.7	-0.6	0.0	-0.5	-0.3	0.2	0.2	0.3	-0.6	0.2	-0.1	-0.2	0.3	0.1	0.3	0.6	0.5
Underlying balance 7/	-1.2	-1.8	-1.1	-0.7	-0.4	0.4	-0.1	0.0	-0.9	-0.3	-0.5	-0.5	0.1	-0.2	-0.4	-0.3	-0.3

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

1/ In 2005, the VAT and customs revenues were reclassified leading to lower VAT and higher customs duty collections.
2/ Mainly mineral resource tax and real property tax.
3/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).
4/ Includes carry-forward expenditure from previous fiscal year (1.1 percent of GDP in 2004, 0.9 percent of GDP in 2005 and 0.5 percent of GDP in 2006).
5/ Mainly privatization proceeds. Includes som 3,472 million related to the Kumtor mine restructuring for 2004.
6/ Overall balance (in cash) excluding foreign financed PIP and foreign interest payments.
7/ Primary balance excluding gold projects, grant and foreign financed PIP.

Table 6. Kyrgyz Republic: Social Fund Operations, 2002–07

	2002	2003	2004	2005						2005		2006				2006	
				1Q		2Q		3Q	4Q Rev.		Rev.	1Q	2Q	3Q	4Q	Rev.	2007
	Act.	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Prog.	Prog.	Rev. Prog.				Prog.	Proj.
	(In millions of soms)																
Total revenue	3,573	3,881	4,446	1,086	1,216	1,131	1,221	1,122	1,174	4,542	4,633	1,143	1,237	1,041	1,384	4,806	5,211
Total contribution	3,516	3,816	4,344	1,071	1,201	1,116	1,189	1,107	1,172	4,482	4,553	1,122	1,216	1,020	1,363	4,722	5,124
Contribution from government	817	913	1,051	230	197	267	305	308	436	1,199	1,244	307	320	316	354	1,297	1,391
Contribution from nongovernment	2,699	2,903	3,293	841	1,004	849	883	799	736	3,283	3,309	815	896	704	1,009	3,426	3,733
Other revenue	57	65	102	15	15	15	32	15	2	60	80	21	21	21	21	84	87
Total expenditure	4,510	4,867	5,373	1,356	1,317	1,403	1,368	1,420	1,547	5,608	5,621	1,449	1,512	1,550	1,550	6,061	6,628
Pension fund (cash)	4,070	4,537	4,885	1,272	1,247	1,315	1,260	1,333	1,485	5,257	5,326	1,382	1,445	1,483	1,483	5,793	6,336
Of which: wage	46	59	64	18	18	18	18	18	18	72	72	21	20	19	19	79	86
Social Insurance Fund (cash)	150	108	158	28	35	30	32	29	0	119	67	0	0	0	0	0	0
Employment Fund (cash)	106	96	113	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Medical Insurance Fund (cash)	142	250	218	56	35	58	76	57	62	233	227	67	67	67	67	268	292
Net accumulation of arrears	43	-123	-1	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance	-937	-987	-926	-270	-101	-272	-147	-298	-374	-1,066	-988	-306	-274	-508	-166	-1,255	-1,417
Budgetary transfer	787	1,122	1,090	244	244	244	244	244	244	976	976	296	296	297	297	1,186	1,417
Net accumulation of arrears	43	-123	-1	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash balance	-107	12	162	-26	143	-28	97	-54	-130	-90	-12	-10	21	-211	131	-69	0
	(In percent of GDP)																
Total revenue	4.7	4.6	4.7	1.2	1.2	1.2	1.2	1.2	1.2	4.5	4.6	1.0	1.1	0.9	1.2	4.3	4.2
Total contribution	4.7	4.5	4.6	1.2	1.2	1.2	1.2	1.2	1.2	4.4	4.5	1.0	1.1	0.9	1.2	4.2	4.2
Contribution from government	1.1	1.1	1.1	0.2	0.2	0.3	0.3	0.3	0.4	1.2	1.2	0.3	0.3	0.3	0.3	1.2	1.1
Contribution from nongovernment	3.6	3.5	3.5	0.9	1.0	0.9	0.9	0.9	0.7	3.3	3.3	0.7	0.8	0.6	0.9	3.1	3.0
Other revenue	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1
Total expenditure	6.0	5.8	5.7	1.5	1.3	1.5	1.3	1.5	1.5	5.6	5.5	1.3	1.4	1.4	1.4	5.4	5.4
Pension fund (cash)	5.4	5.4	5.2	1.4	1.2	1.4	1.2	1.4	1.5	5.2	5.3	1.2	1.3	1.3	1.3	5.2	5.2
Social Insurance Fund (cash)	0.2	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Employment Fund (cash)	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medical Insurance Fund (cash)	0.2	0.3	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.2
Net accumulation of arrears	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.2	-1.2	-1.0	-0.3	-0.1	-0.3	-0.1	-0.3	-0.4	-1.1	-1.0	-0.3	-0.2	-0.5	-0.1	-1.1	-1.2
Budgetary transfer	1.0	1.3	1.2	0.3	0.2	0.3	0.2	0.3	0.2	1.0	1.0	0.3	0.3	0.3	0.3	1.1	1.2
Net accumulation of arrears	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash balance	-0.1	0.0	0.2	0.0	0.1	0.0	0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	-0.2	0.1	-0.1	0.0
Memorandum item:																	
Average monthly pension (in som; eop) 1/	603	663	719	752	752	783	780	783	780	783	780	814	870	870	870	860	906
Payroll tax rate (in percent)	33	33	33	32	32	32	32	32	31	32	31	30	30	29	29	29	28

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

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

Table 7. Kyrgyz Republic: Medium-Term Expenditure Framework for General Government

by Functional Classification, 2000–08

(In percent of GDP)

		2000	2001	2002	2003	2004	2005	2006	2007	2008
		Act.	Act.	Act.	Act.	Act.	Rev.	Prog.	Proj.	
	Total expenditure 1/	29.9	25.9	28.1	27.4	27.1	27.5	26.6	26.6	26.3
I.	General public services	3.0	2.6	2.8	2.5	2.4	2.3	2.0	1.9	1.8
II.	Defense	1.9	1.3	1.4	1.3	1.2	1.2	1.1	1.0	0.9
III.	Public order and safety affairs	1.1	1.0	1.3	1.1	1.1	1.0	0.9	0.9	0.8
	Social spending	12.2	12.1	14.1	14.0	14.2	15.1	15.5	16.1	16.6
IV.	Education	3.5	3.6	4.2	4.2	4.2	4.5	4.7	5.0	5.3
V.	Health	2.1	1.8	2.0	2.0	2.1	2.4	2.5	2.7	2.9
VI.	Social security and welfare affairs 2/	1.9	2.0	2.5	2.4	2.7	3.0	3.1	3.2	3.4
VII.	Pension Fund 3/	4.8	4.8	5.4	5.4	5.2	5.3	5.2	5.2	5.0
VIII.	Housing and community services	1.1	1.1	1.5	1.3	1.3	1.2	1.1	1.0	1.0
IX.	Recreational, cultural and religious activities	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.3	0.3
X	Energy complex (electricity production)	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.3
XI.	Agriculture, water resources, forestry	3.2	2.3	2.6	2.3	2.2	2.1	1.9	1.8	1.7
XII.	Mining and mineral resources	0.2	0.2	0.3	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	2.0	1.8	1.7	1.6
XIV.	Other economic affairs and services	1.3	0.8	0.9	0.8	0.8	0.7	0.6	0.6	0.6
XV.	Other	1.4	1.3	0.8	0.7	0.7	0.7	0.6	0.6	0.5
XVI.	Unidentified expenditure	0.5	0.3	-1.1	0.0	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 transfer to the Social Fund, but including the contingency item for social compensation in case of electricity tariff increases.

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

Table 8. Kyrgyz Republic: NBKR Accounts, 2002–06

(In millions of soms, end-period stocks) 1/

	2002	2003	2004	2005							2006			
	Dec.	Dec.	Dec.	Mar.		Jun.		Sep.	Dec.		Mar.	Jun.	Sep.	Dec.
	Act.	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Rev. Prog.	Rev. Prog.			
Net foreign assets	5,725	7,879	14,627	14,509	14,396	14,098	14,443	14,377	14,407	15,313	15,528	15,262	16,065	16,609
Net international reserves	4,480	6,657	13,799	13,681	13,542	13,986	13,705	14,265	14,295	15,201	15,416	15,150	15,953	16,497
Other foreign assets	1,297	1,273	880	880	905	163	790	163	163	163	163	163	163	163
Balance with CIS countries	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51
Long-term foreign liabilities	-2,475	-2,330	-2,357	-2,347	-2,357	-2,326	-2,336	-2,321	-2,300	-2,374	-2,374	-2,374	-2,374	-2,374
Net domestic assets	4,407	4,526	110	747	564	1,171	657	838	1,139	685	596	962	904	765
Domestic credit (net)	5,530	5,248	834	1,462	1,307	1,760	1,468	1,395	1,489	1,446	1,356	1,577	1,420	1,181
Claims on government (net)	5,058	4,989	421	917	975	1,121	1,108	648	602	721	1,060	971	547	695
Loan to government in forex (Turkish loan)	1,917	1,868	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,943	1,943	1,943	1,943	1,943
Total government deposits	-1,928	-1,531	-6,135	-5,638	-5,567	-5,234	-5,237	-5,707	-5,753	-5,635	-5,295	-5,384	-5,809	-5,661
Treasury bonds 2/	4,219	4,303	4,100	4,100	4,087	3,900	3,890	3,900	3,900	3,900	3,900	3,900	3,900	3,200
Treasury bills	850	350	550	550	550	550	550	550	550	550	550	550	550	550
Repos	0	-147	40	191	-33	289	0	402	546	384	-45	264	532	144
Claims on commercial banks	472	405	374	354	364	350	360	344	342	341	341	341	341	342
Other items net 3/	-1,123	-721	-724	-715	-743	-589	-810	-557	-350	-760	-760	-615	-515	-415
Reserve money	7,658	10,075	12,380	12,909	12,603	12,943	12,765	12,894	13,247	13,624	13,750	13,850	14,596	15,000
Currency outside commercial banks	…	9,317	11,128	…	11,413	…	11,271	…	…	...	11,000	11,080	11,677	12,000
Deposits of commercial banks	…	758	1,253	…	1,190	…	1,494	…	…	...	2,750	2,770	2,919	3,000
Memorandum items:														
Reserve money growth (12 month)	42.9	31.6	22.9	24.4	21.5	20.0	18.3	18.5	7.0	10.1	9.1	8.5	10.0	10.1
Gross reserves (in millions of U.S. dollars)	289.7	359.2	543.8	523.6	530.8	521.5	525.7	520.5	514.0	544.0	540.0	531.0	543.0	557.0
in months of imports	4.0	3.8	5.2	5.2	4.8	5.2	4.5	5.1	5.1	4.7	4.4	4.4	4.5	4.6
Net international reserves (in millions of U.S. dollars) 4/	101.8	158.5	328.5	325.7	322.4	333.0	326.3	339.6	340.4	361.9	367.0	360.7	379.8	392.8
Net domestic assets 5/	2,143	2,376	-2,046	-1,390	-1,583	-962	-1,486	-1,289	-985	-1,477	-1,566	-1,200	-1,258	-1,397

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

1/ At program exchange rates (including 42 soms per dollar) specified in the TMU of IMF Country Report No. 05/119.

2/ As of December 2002, includes government securities issues 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/ Nonadjusted.

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, 2002–06

(In millions of soms, end-period stocks) 1/

	2002	2003	2004	2005							2006			
	Dec.	Dec.	Dec.	Mar.		Jun.		Sep.	Dec.		Mar.	Jun.	Sep.	Dec.
	Act.	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Rev. Prog.	Rev. Prog.			
Net foreign assets	7,343	10,059	18,487	17,862	18,356	17,451	19,270	17,881	17,609	19,131	20,444	18,374	21,612	20,231
NBKR	5,741	7,879	14,627	14,509	14,396	14,098	14,443	14,377	14,407	15,313	15,528	15,262	16,065	16,609
Commercial banks	1,602	2,180	3,860	3,353	3,960	3,353	4,827	3,505	3,202	3,819	4,916	3,112	5,547	3,622
Long-term NBKR foreign liabilities	-2,475	-2,330	-2,357	-2,347	-2,357	-2,326	-2,336	-2,321	-2,300	-2,374	-2,374	-2,374	-2,374	-2,374
Net domestic assets	6,019	6,754	3,220	3,848	3,853	4,833	4,277	5,160	6,680	5,577	4,617	7,950	5,172	7,776
Claims on government (net)	5,556	5,549	1,131	1,236	1,322	1,440	1,345	967	921	1,827	2,076	2,008	1,628	1,593
Credit from the NBKR	5,063	4,989	421	917	975	1,121	1,108	648	602	721	1,060	971	547	695
Of which: Turkish loan	...	1,868	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,905	1,943	1,943	1,943	1,943
Credit from commercial banks	493	560	711	319	346	319	237	319	319	1,106	1,016	1,036	1,081	899
Treasury bonds	126	134	63	63	72	63	69	63	63	88	413	413	413	413
Treasury bills	438	515	797	718	845	718	940	717	718	940	950	950	950	950
Other	-71	-89	-150	-462	-570	-462	-772	-462	-462	-357	-347	-327	-282	-464
Credit to the rest of the economy:	2,999	3,776	6,588	6,352	6,830	7,006	7,087	7,774	9,223	7,550	6,631	9,405	7,977	9,712
Of which: credit in foreign exchange	2,039	2,549	4,752	4,647	4,857	4,790	5,094	4,973	5,277	5,360	5,445	5,748	5,858	5,896
Other items net	-2,535	-2,572	-4,500	-3,740	-4,298	-3,614	-4,155	-3,582	-3,464	-3,874	-3,874	-3,729	-3,629	-3,529
Broad money	10,887	14,483	19,350	19,364	19,853	19,958	21,211	20,720	21,990	22,334	22,687	23,950	24,410	25,633
Currency outside banks	6,873	9,315	11,124	11,366	11,409	11,338	11,269	11,295	11,604	12,190	11,000	11,080	11,677	12,000
Deposits	4,014	5,168	8,226	7,998	8,443	8,620	9,942	9,425	10,385	10,145	11,687	12,870	12,733	13,633
Of which: foreign exchange deposits	2,583	3,396	5,781	4,719	6,172	4,827	7,370	5,043	5,317	7,101	5,900	6,300	7,350	8,125
Broad money: som component	8,304	11,086	13,568	14,645	13,681	15,131	13,841	15,678	16,672	15,233	16,787	17,650	17,060	17,508
Memorandum items:														
Velocity (quarterly) 2/	7.0	6.0	5.6	...	...	...	...	...	4.3	4.5	...	...	...	4.4
Som velocity (quarterly) 2/	9.3	8.0	7.4	...	...	...	...	...	6.4	6.7	...	...	...	6.4
Broad money growth (12-month percent change)	35.1	34.5	33.6	29.6	32.9	26.0	33.9	25.2	13.6	15.4	14.3	12.9	15.1	14.8
Som broad money growth (12-month percent change)	34.2	33.5	22.4	26.6	18.3	27.4	16.5	29.5	22.9	12.3	13.1	12.7	15.1	14.9
Multiplier	1.44	1.45	1.56	1.50	1.58	1.54	1.66	1.61	1.66	1.64	1.65	1.73	1.67	1.71
Credit to the rest of the economy (in percent of GDP)	4.0	4.7	7.0	...	7.1	...	7.3	...	9.3	7.4	...	...	...	8.7
Dollarization indicators (in percent) 3/														
Asset dollarization	68.0	67.5	72.1	...	71.1	...	71.9	...	57.2	71.0	...	...	...	60.7
Liability dollarization	23.7	23.5	29.9	...	31.1	...	34.7	...	24.2	31.8	...	...	...	31.7

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

1/ At Program exchange rates (including 42 soms per dollar) specified in the TMU of IMF Country Report No. 05/119.

2/ 12-month GDP over average quarterly broad money.

3/ Asset dollarization is measured as the ratio of credit extended in foreign exchange to total banking system credit to the private sector, and liability dollarization as the share of foreign exchange deposits in broad money.

Table 10. Kyrgyz Republic: Quarterly Balance of Payments: 2004–06

(In millions of U.S. dollars)

	2004	2005						2006				
						Q4	Year					
	Year	Q1	Q2		Q3	Rev.	Rev.	Q1	Q2	Q3	Q4	Year
	Act.	Act.	Prog.	Prel.	Prog.	Prog.	Prog.	Rev. Prog.				
Current account balance 1/	-53	-14	-30	-35	-30	-26	-106	-36	-29	-37	-22	-124
excluding transfers	-284	-84	-95	-104	-63	-101	-393	-111	-99	-126	-109	-447
Trade balance	-171	-58	-67	-72	-61	-67	-285	-88	-71	-114	-70	-342
Exports, fob	733	167	167	160	188	215	738	186	175	205	226	793
CIS countries	278	67	72	66	89	91	310	81	75	90	96	342
Of which: Energy	31	3	11	6	24	15	38	9	4	19	11	42
Non-CIS countries	456	101	94	94	98	124	427	106	100	115	130	451
Of which: Gold	287	68	86	58	42	56	248	61	54	70	65	251
Imports, fob	904	226	234	232	249	281	1023	275	246	319	296	1135
CIS countries 2/	554	137	145	141	150	183	644	173	159	199	192	723
Of which: Energy	240	64	52	61	57	91	299	85	79	90	94	348
Non-CIS countries	350	88	88	91	99	98	380	102	87	120	104	412
Services (net)	-112	-26	-15	-32	6	-34	-108	-23	-29	-13	-40	-105
Non-interest service	-22	-6	12	5	22	-6	-12	-4	-6	0	-3	-14
Receipts	209	56	50	58	66	53	229	56	49	79	67	252
Payments	-231	-63	-38	-53	-44	-59	-242	-61	-55	-80	-70	-266
Interest payments (scheduled)	-37	-4	-18	-17	-4	-16	-40	-3	-13	-3	-16	-35
Other net income	-53	-16	-9	-20	-12	-11	-55	-16	-10	-9	-21	-56
Transfers (net)	231	69	52	69	25	75	287	76	70	89	87	322
Official	46	7	12	9	11	13	41	15	10	17	17	60
Private	185	63	40	60	14	62	246	60	60	72	70	263
Capital account balance	97	67	21	1	25	20	130	37	3	44	8	90
Commercial banks	-24	85	0	-3	-4	-4	75	-4	-5	-15	-6	-30
Medium-and long-term loans, net	12	2	-3	-18	-5	-5	-12	6	2	14	-2	20
Disbursement	82	17	18	18	26	27	89	19	25	28	22	95
Of which: foreign financed PIP	75	15	16	16	24	24	79	16	21	23	19	80
Amortization (scheduled)	-70	-16	-37	-36	-17	-33	-101	-14	-23	-14	-25	-75
Foreign direct investment (net)	131	11	19	12	18	19	60	24	3	26	11	65
Portfolio investment (net)	-2	-13	1	3	5	7	4	7	2	9	2	20
Other assets 3/	-20	-18	5	7	11	3	2	4	1	9	3	16
Errors and omissions and short-term capital 4/	44	-70	0	3	0	0	-68	0	0	0	0	0
Overall balance	88	-18	-9	-31	-5	-6	-44	1	-27	7	-14	-34
Financing	-88	18	-7	31	-7	6	44	-1	27	-7	14	34
Net international reserves	-161	12	-7	10	-7	-19	-13	-5	6	-21	-17	-36
Gross official reserves (- increase)	-161	3	2	19	1	-14	0	4	9	-12	-14	-13
IMF (net)	-1	9	-9	-9	-8	-5	-13	-9	-3	-9	-3	-23
Purchases and disbursements	28	16	0	0	0	2	18	0	2	0	2	4
Repurchases and repayments	-29	-7	-9	-9	-8	-7	-31	-9	-5	-9	-5	-27
Exceptional financing (including arrears)	45	6	0	21	0	20	51	4	20	4	21	50
Accumulation of arrears (net)	2	0	0	0	0	0	0	0	0	0	0	0
Debt rescheduling	44	6	0	21	0	20	51	4	20	4	21	50
BOP support loans (ADB)	28	0	0	0	0	0	0	0	0	10	0	10
BOP support loans (WB)	0	0	0	0	0	5	5	0	0	0	10	10
Financing gap (-)	0	0	-16	0	-11	0	0	0	0	0	0	0
Memorandum items:												
Gross reserves	544	541	522	522	520	544	544	540	531	543	557	557
in months of subsequent year's imports	5.2	4.6	5.2	4.5	5.1	4.7	4.7	4.4	4.4	4.5	4.6	4.6

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

1/ Includes transfers.
2/ Includes a positive adjustment factor to account for unrecorded CIS nonenergy imports 2000–05.
3/ Includes derivative gains/losses.
4/ Includes balancing item for unrecorded i
5/ IMF Country Report No. 05/119.

Table 11. Kyrgyz Republic: Medium-Term Balance of Payments, 2002–10

(In millions of U.S. dollars)

	2002	2003	2004	2005		2006	2007	2008	2009	2010
	Actual	Actual	Actual	Prog.	Rev. Prog.	Rev. Prog.		Proj.		
Current account balance 1/	-57	-57	-53	-143	-106	-124	-117	-119	-148	-168
excluding transfers	-169	-191	-284	-314	-393	-447	-461	-478	-521	-569
Trade balance	-109	-134	-171	-276	-285	-342	-350	-365	-439	-517
Exports, fob	498	590	733	703	738	793	857	922	933	944
CIS countries	170	202	278	313	310	342	360	385	425	473
Non-CIS countries	328	388	456	390	427	451	497	538	508	471
Of which: Gold	163	260	287	245	248	251	292	327	283	231
Imports, fob	607	724	904	979	1023	1135	1207	1288	1372	1461
CIS countries 2/	312	394	554	601	644	723	760	803	849	899
Non-CIS countries /3	295	329	350	378	380	412	447	485	522	562
Services (net)	-60	-57	-112	-39	-108	-105	-110	-112	-83	-52
Noninterest service	-7	3	-22	55	-12	-14	-15	-13	6	28
Receipts	142	155	209	218	229	252	271	290	322	358
Payments	-149	-151	-231	-163	-242	-266	-285	-302	-316	-330
Interest payments (scheduled)	-32	-27	-37	-44	-40	-35	-34	-34	-34	-35
Other net income	-20	-34	-53	-50	-55	-56	-62	-66	-54	-44
Transfers (net)	111	134	231	171	287	322	344	359	373	401
Official	53	39	46	43	41	60	54	49	44	44
Private	59	95	185	128	246	263	290	309	329	357
Capital account balance	3	-10	97	95	130	90	105	117	139	138
Commercial banks	-10	-14	-24	-9	75	-30	-32	-36	-20	-18
Medium-and long-term loans, net	25	-28	12	-16	-12	20	29	41	48	29
Disbursement	82	74	82	86	89	95	103	117	136	157
Of which: foreign financed PIP	77	66	75	79	79	80	88	97	106	115
Amortization (scheduled)	-57	-102	-70	-102	-101	-75	-73	-76	-88	-128
Foreign direct investment (net)	5	46	131	78	60	65	60	57	66	73
Portfolio investment (net)	-12	6	-2	10	4	20	22	23	23	30
Other assets 4/	-5	-20	-20	32	2	16	25	32	21	24
Errors and omissions and short term capital 5/	89	72	44	0	-68	0	0	0	0	0
Overall balance	34	5	88	-48	-44	-34	-12	-2	-9	-30
Financing	-34	-5	-88	-12	44	34	12	2	9	30
Net international reserves	-63	-53	-161	-12	-13	-36	-47	-46	-34	2
Gross official reserves (- increase)	-57	-55	-161	5	0	-13	-27	-26	-12	25
IMF (net)	-6	2	-1	-17	-13	-23	-20	-20	-21	-24
Purchases and disbursements	15	32	28	14	18	4	4	2	0	0
Repurchases and repayments	-21	-30	-29	-31	-31	-27	-24	-22	-21	-24
Exceptional financing (including arrears)	21	42	45	0	51	50	48	48	43	28
Accumulation of arrears (net)	1	-1	2	0	0	0	0	0	0	0
Debt relief and rescheduling	19	43	44	0	51	50	48	48	43	28
On principal	6	30	27	0	33	35	36	37	40	27
On interest	14	13	17	0	18	15	13	11	3	2
on moratorium interest	0	0	0	0	0	0	0	0	0	0
BOP support loans (ADB)	8	0	28	0	0	10	10	0	0	0
BOP support loans (WB)	0	6	0	0	5	10	0	0	0	0
Financing gap (-)	0	0	0	-60	0	0	0	0	0	0
Memorandum items:										
GDP (in millions of U.S. dollars)	1,606	1,921	2,210	2,399	2,414	2,655	2,925	3,235	3,524	3,842
Current account balance (in percent of GDP)	-3.6	-3.0	-2.4	-6.0	-4.4	-4.7	-4.0	-3.7	-4.2	-4.4
Growth of exports of goods and services(volume, percent)	7.3	9.5	22.2	2.5	-0.6	5.3	7.3	6.7	2.1	2.2
Growth of imports of goods and services (volume, percent)	19.6	11.8	26.0	8.0	8.2	8.0	5.2	5.1	4.4	4.4
External public debt (US$ million) 6/	1,587	1,827	1,960	2,017	2,016	2,075	2,135	2,187	2,234	2,286
As percent of GDP	99	96	89	84	83	78	73	68	63	59
External public debt (NPV US$ million) 6/	1,310	1,331	1,330	1,456	1,183	1,232	1,282	1,322	1,353	1,386
As percent of GDP	82	70	60	61	49	46	44	41	38	36
As percent of exports 7/	222	205	171	171	134	125	123	117	113	110
Debt-to-exports service ratio 6/	10	8	8	19	6	6	6	7	7	7
Gross reserves 8/	290	359	544	514	544	557	584	610	622	596
In months of subsequent year's imports	4.0	3.8	5.2	5.1	4.7	4.6	4.4	4.3	4.2	3.8
Financing gap as percent of GDP	0.0	0.0	0.0	-2.5	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Kyrgyz authorities and Fund staff estimates and projections.

1/ Includes transfers.
2/ Includes a positive adjustment factor to account for unrecorded CIS non-energy imports 2000-05.
3/ Includes a positive adjustment factor to account for unrecorded imports from China in 2002.
4/ Includes derivative gains/ losses.
5/ Includes balancing item for unrecorded import adjustment.
6/ Public and publicly guaranteed debt (excluding Kumtor).
7/ Based on three-year average exports of goods and nonfactor services.
8/ Valued at end-year exchange rates.

Table 12. Kyrgyz Republic: Indicators of Fund Credit, 2000–10

(In percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
								Proj.			
Outstanding Fund credit (end-of-period)											
In millions of SDRs	144.3	142.7	136.2	135.9	133.2	124.5	108.4	94.8	81.2	66.5	50.3
In millions of U.S. dollars	190.3	181.7	176.4	190.0	197.3	184.2	157.7	138.1	118.5	97.0	73.3
In percent of quota	162.5	160.7	153.4	153.0	150.1	140.2	122.0	106.7	91.5	74.9	56.6
In percent of GDP	13.9	11.9	11.0	10.0	8.9	7.6	5.9	4.7	3.7	2.8	1.9
In percent of total exports	33.2	32.4	27.6	25.5	20.9	19.0	15.1	12.2	9.8	7.7	5.6
In percent of external public debt (including Kumtor)	10.7	10.6	10.1	9.9	9.9	9.1	7.6	6.5	5.4	4.3	3.2
In percent of external public debt (excluding Kumtor)	12.5	11.9	11.1	10.4	10.1	9.1	7.6	6.5	5.4	4.3	3.2
In percent of gross reserves (beginning of period)	76.5	88.2	76.7	65.5	54.9	33.9	29.0	24.8	20.3	15.9	11.8
Debt service due to the Fund											
In millions of SDRs	10.2	14.6	19.1	22.4	22.4	21.5	19.2	16.6	15.3	15.1	16.5
In millions of U.S. dollars	13.5	18.6	24.7	31.3	33.2	31.9	27.9	24.2	22.2	22.0	24.1
Of which:											
Charges/interests	2.1	1.6	1.2	1.0	1.0	1.0	0.8	0.7	0.6	0.5	0.4
Repurchases and repayments	11.5	17.0	23.5	30.3	32.2	30.9	27.1	23.5	21.6	21.5	23.7
In percent of quota 1/	11.5	16.4	21.5	25.2	25.3	24.3	21.6	18.7	17.2	17.0	18.6
In percent of GDP	1.0	1.2	1.5	1.6	1.5	1.3	1.1	0.8	0.7	0.6	0.6
In percent of total exports	2.4	3.3	3.9	4.2	3.5	3.3	2.7	2.1	1.8	1.8	1.9
In percent of external public debt (including Kumtor)	8.8	12.1	22.3	19.7	24.5	26.4	32.2	29.5	26.7	21.8	15.2
In percent of external public debt (excluding Kumtor)	20.4	26.4	37.8	54.7	43.1	50.9	42.8	37.8	31.6	26.3	27.4
In percent of gross reserves (beginning of period)	5.4	9.0	10.7	10.8	9.3	5.9	5.1	4.4	3.8	3.6	3.9

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

1/ Relative to the quota of SDR 88.8 million.

Table 13. Kyrgyz Republic: Prospective Use of Fund Resources, 2005–10

	2005	2006	2007	2008	2009	2010
	Projections					
	(In millions of SDR, unless otherwise stated)					
PRGF transactions						
Disbursements	12.1	2.5	2.5	1.3	0.0	0.0
Repayments	20.9	18.6	16.1	14.8	14.7	16.2
Total Fund credit outstanding	124.5	108.4	94.8	81.2	66.5	50.3
	(In percent of quota)					
Total Fund credit outstanding 1/	140.2	122.0	106.7	91.5	74.9	56.6
Disbursements under PRGF	13.6	2.9	2.9	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 14. Kyrgyz Republic: Reviews and Disbursements Under the Three-Year PRGF Arrangement

Date	Action	Associated Disbursement
February 23, 2005	Approved three-year arrangement.	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 2007 performance criteria.	SDR 1.27 million
On or after February 15, 2008	Complete sixth review based on end-December 2007 performance criteria.	SDR 1.27 million

Bishkek, Kyrgyz Republic
October 7, 2005

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

Dear Mr. de Rato:

1. On February 23, 2005, the IMF Executive Board endorsed the Kyrgyz Republic's three-year economic program, and approved a new Poverty Reduction and Growth Facility (PRGF) arrangement in support of that program.

2. On behalf of the new government of the Kyrgyz Republic, we hereby transmit the attached Revised Memorandum of Economic Policies (RMEP), which includes the Kyrgyz Republic's earlier program commitments to the IMF, describes in detail the implementation of the program to date, and sets out the objectives and policies that the new government intends to pursue in 2005-07. The RMEP is consistent with the ongoing work on the second progress report on the implementation of the Kyrgyz Republic Poverty Reduction Strategy. The government intends to make the contents of this letter and those of the attached RMEP and its Technical Memorandum of Understanding (TMU), as well as the staff report on the first review under the 2005-08 PRGF arrangement, available to the public, and authorizes the staff to arrange for them to be posted on the IMF website after completion of the review by Executive Board approval.

3. The performance criteria, indicative targets, and structural benchmarks under the PRGF arrangement are set out in Table 1 and 2 of the RMEP. The second review under the PRGF arrangement is expected to be completed on or after February 15, 2006, and the third review on or after August 15, 2006. As noted in Table 1 of the RMEP, we have observed all the performance criteria for end-June 2005 under the arrangement. Therefore, we request the disbursement of SDR 1.27 million upon Board completion of the first review.

4. 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 program. The government believes that the policies and measures set forth in the original program and the RMEP are adequate to achieve the objectives of the program supported by the PRGF arrangement, but will take further measures to that end if deemed necessary. During the implementation of the current arrangement, 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.

5. We would like to assure you, Mr. Managing Director, that the new government of the Kyrgyz Republic is determined to fully implement the program. We look forward to the continued support of the Fund in our endeavors.

Very truly yours,

/s/	/s/
Felix Kulov Prime Minister Kyrgyz Republic	Ulan Sarbanov Chairman National Bank of the Kyrgyz Republic

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

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

October 7, 2005

I. Introduction

1. Following the presidential elections on July 10, 2005, the new government of the Kyrgyz Republic has reviewed the economic program for 2005-07. The government remains committed to implementing policies that support the development of an efficient market economy with sustained economic growth, price stability, and declining poverty. At the same time, the government plans to place increased emphasis on combating corruption, and on encouraging private sector development and employment creation through the introduction of some policy changes, particularly in the area of tax policy.

2. This Revised Memorandum of Economic Policies (RMEP) sets forth the government's economic objectives and policy strategy through end-2007, and describes specific economic policies for the remainder of 2005 and 2006. We seek to implement these policies with the continued support of the International Monetary Fund under the current Poverty Reduction and Growth Facility (PRGF) arrangement.

3. Under the 2001-04 PRGF-supported program, economic growth broadened and nominal GDP per capita (in U.S. dollar terms) increased by 36 percent. As a result, the poverty headcount index fell from 52 percent in 2000 to 46 percent in 2004. The central bank's monetary policy successfully accommodated an increase in money demand, and inflation was contained at low single digit levels. The 12-month rate of inflation remained below 4 percent for most of the time since 2001, and the som strengthened by 14 percent against the U.S. dollar in 2001–04. Meanwhile, the real effective exchange rate remained broadly stable.

4. Fiscal discipline improved over the last four years. The general government overall fiscal deficit declined from over 9 percent of GDP in 2000 to close to 4 percent in 2004, reflecting largely an increase in tax revenue from 15 percent of GDP to 18½ percent. The balance of payments strengthened with gross official reserves covering 5 months of imports of goods and services at end-2004. In addition, external debt indicators improved following the streamlining of the debt-financed public investment program (PIP), and debt relief granted by the Paris Club in 2002.

Program Performance During 2005

5. Despite the uncertainties associated with the political transition, macroeconomic developments were satisfactory in the first half of 2005. Real GDP increased by 2.4 percent on a year-on-year basis, but excluding the Kumtor gold mine and the energy sector, GDP growth reached 4.8 percent. Non-gold, non-energy growth has been mainly driven by light

industries, construction, and the services sector. The 12-month rate of inflation was 4.6 percent as of end-August 2005.

6. The trade deficit widened in January-June 2005 relative to the same period of 2004. Imports grew by 12½ percent year-on-year, reflecting higher oil prices and domestic demand. Non-gold exports increased by 5 percent, while gold exports fell by 16 percent. The nominal exchange rate came under pressure during the spring political events but National Bank of Kyrgyz Republic (NBKR) interventions were successful in stabilizing the currency. More recently, the NBKR has been a net buyer in the foreign exchange market. Short-term interest rates increased in April but declined subsequently.

7. In March 2005, Paris Club creditors granted debt relief under the Evian approach for our bilateral public debt. The agreement is expected to result in a reduction of 36 percent in the NPV of official bilateral debt in 2005, which will reduce significantly both the NPV of debt-to-exports ratio and the debt-to-fiscal revenue ratio.

8. Despite the difficult political situation in the spring, all the end-June 2005 performance criteria under the PRGF arrangement were observed. The NIR of the central bank exceeded the program's adjusted floor and the NDA came out below the program's ceiling by a comfortable margin. Similarly, the January-June fiscal deficit target was met, with state government tax collections and the Social Fund payroll tax collections surpassing the program's target by 0.5 percent of GDP and 0.2 percent of GDP, respectively.

9. Overall, fiscal developments turned out better than envisaged at the time of the parliamentary approval of the 2005 budget. The general government primary deficit (excluding grants) remains on track and is expected to decline from 3.5 percent of GDP in 2004 to 3.1 percent in 2005. General government tax revenue was programmed to remain at 18.5 percent of GDP in 2005. However, based on the more favorable developments in the first half of the year, the revenue projection has been revised upwards to 18.9 percent of GDP. As envisaged in the program, the payroll tax rate was reduced by one percentage point to 32 percent on January 1, 2005, and by another percentage point on July 1.

10. On July 1, 2005 the wages of teachers, doctors, and middle-level health care providers were increased by 15 percent, and those of cultural workers by 30 percent, and on May 1, 2005 those of the staff of the ministry of interior by 50 percent. Pension benefits were raised by 8 percent on average on April 1, 2005, with higher increases for poor pensioners. The Government has also begun to effect early payments (som 100 million in 2005) to depositors of the former Sberbank and three other liquidated commercial banks.

11. All the structural benchmarks for end-March and end-June 2005 were completed. The Medium-Term Budget Framework for 2006-2008--including aggregate resource envelopes for each line ministry—was published on March 28. We have also submitted to parliament the new Tax Code as prepared by the governmental expert commission, which incorporates the recommendations of the Fund LEG department. The new Tax Code includes a small business tax reform to offset the revenue impact of an increase in the general VAT threshold

from som 0.5 million to som 2.5 million as of January 1, 2006. Owing to the spring political events, the submission was delayed until late June, compared with the end-March date envisaged in the program. All the end-June benchmarks were implemented on time. The Ministry of Finance started to pay salaries through the banking system in May, and the Trade Union Social Insurance Fund has been consolidated with the state budget. Moreover, on June 28 new instructions were issued to ensure proper and timely functioning of the VAT refund mechanism.

12. Regarding other structural measures envisaged under the program, legislation has been changed to allow out-of-court procedures in collecting collateral, and the procedures for collateral registration have been simplified. Also, the Ministry of Finance has continued to restructure the government debt to the NBKR by redeeming som 200 million of medium-term bonds. These bonds will gradually be replaced with new government securities available to commercial banks.

II. PROGRAM OBJECTIVES AND STRATEGY FOR 2005-2007

13. The new economic program is consistent with the Kyrgyz Republic's earlier commitments to the Fund and the National Poverty Reduction Strategy (NPRS), an update of which will be completed shortly. The five pillars of our economic policies are (i) political and economic stability, (ii), removal of bureaucratic and corruption-related barriers to development, (iii) reducing tax distortions to ensure healthy public finances, (iv) developing a better business climate to expand the production base, and (v) supporting private sector activities to strengthen the economy's revenue sources.

14. We will place special emphasis on raising growth prospects and reducing poverty through a comprehensive campaign against corruption that will increase revenues and, thus, create room for an increase in social spending. Sound macroeconomic policies and effective implementation of structural reforms would support real growth rates of 5-6 percent over the medium term. Growth would be led by private investment; the contribution from net exports would be smaller owing to buoyant imports to satisfy pent-up demand for consumption and investment goods. Monetary policy will aim to contain end of period (eop) annual inflation at 4½ percent. The general government primary fiscal deficit (excluding grants) is targeted to decline from 3.4 percent of GDP in 2004 to 2.6 percent in 2007. This should help reduce the external debt overhang and promote private investment.

15. The still high level of the public external debt calls for continuous fiscal adjustment and cautious foreign borrowing in 2005-07. Even with the Paris Club debt relief, the process of fiscal consolidation needs to be continued in order to ensure that debt sustainability is achieved during the current PRGF arrangement. This will also require a continued shift in the composition of donor assistance from loans to grants.

Key Projections, 2005-07

	2005	2006	2007
Real GDP (percentage change)	3.0	5.0	5.5
Inflation (eop, in percent)	4.7	4.5	4.3
External current account balance (percent of GDP)	-4.4	-4.7	-4.0
Gen. gov't. prim. fiscal balance excl. grants (percent of GDP)	-3.1	-2.9	-2.6
Broad money growth (eop, in percent)	15.4	14.8	15.1
Investment ratio	21.6	22.2	22.4
Savings ratio	17.2	17.5	18.4

Source: Kyrgyz authorities; and Fund staff estimates.

16. One of the key objectives of our program is to raise the investment ratio from an average of 20 percent of GDP in 2001–04 to 22 percent in 2005–07, in an effort to support productivity growth. The debt-financed public investment program will be further streamlined, while private investment is expected to increase to 18 percent of GDP by 2008, from 16 percent in 2004. Higher national savings would reflect the continued fiscal consolidation.

17. Improving the investment climate requires both macroeconomic stability and structural reforms to strengthen the banking system, increased flexibility in the labor market, and enhanced efficiency in the energy sector. In addition, the legal and regulatory frameworks must become more predictable, the administration of justice should be improved significantly, and to the extent that the fiscal situation allows it, the tax burden should be reduced. More specifically, the envisaged changes in taxation, in particular, lowering the profit and personal income tax rates, will further simplify the tax regime and improve the business environment.

18. Export diversification and the preservation of external competitiveness will play a key role in sustaining economic growth and reducing poverty over the medium term. Addressing these challenges would be facilitated if neighboring countries remove trade restrictions. In this regard, we appeal to the international community to encourage our trading partners to enhance the access of Kyrgyz goods to their markets.

19. Our strategy places special emphasis on eliminating corruption from the public administration. This factor explains why the Kyrgyz Republic's past economic programs suffered from a "policy implementation gap"—a significant amount of new legislation and regulations were introduced but transparent implementation was lacking. In this respect, an overarching objective of the new government is to create a professional civil service with the necessary qualifications to significantly strengthen implementation capacity. This will need to be accompanied by policies to strengthen governance and reduce corruption in order to garner public support for economic and social reforms. Transparency is crucial in this respect, as it would enhance the accountability of civil servants, a key factor for efficient

policy implementation. The tax and customs administrations, the police, and other law enforcement agencies will be placed under special scrutiny to ensure that corruption practices are eradicated from these institutions. Reforms in these areas are also key for reducing the incentives for informal economic activities.

20. Poverty reduction continues to be our main objective. The challenge is to sustain economic growth while ensuring that the poor receive an appropriate share of the growth dividends. The 2005 fiscal program already incorporates additional expenditures of $16 million—made possible by the sale of part of the government's Centerra shares—for poverty reducing non-recurrent spending, including mainly investments in health and education. In addition, the stronger revenue performance so far in 2005 and our efforts against corruption, especially in the tax and customs administrations, will make it possible to introduce new initiatives to promote job creation and housing investment. We realize, however, that in addition to improving compliance, the cuts in tax rates and new spending initiatives require a broadening of the tax base. We believe that modifying other taxes, closing tax loopholes, and streamlining tax exemptions will create sufficient room for a budget neutral implementation of our policies.

III. Policies for 2005 and 2006

21. Within the general economic policy strategy described above, we have set specific targets for the period October 1, 2005–December 31, 2006, as quantified in Table 2. The principal goal of the 2005 program is to achieve a rate of economic growth of about 3 percent, notwithstanding a significant drop in gold production. In 2006, economic activity is expected to rebound to over 5 percent as gold production is not expected to decline further. Annual (eop) consumer price inflation is targeted at 4½ percent during both 2005 and 2006. The program is expected to lead to an improvement in GDP per capita (in U.S. dollar terms) to about $470 in 2005—a level almost 70 percent higher than in 2000—which should help further alleviate poverty. On the external side, we expect the import cover of official reserves to remain at a comfortable level of 4¾ months.

A. Fiscal Policy

22. In the medium term, further fiscal consolidation is necessary on two accounts. First, there is a need to reduce the debt overhang which constrains growth. Second, developing sufficient national savings is critical to maintaining a satisfactory external balance. Keeping the 2005 State and Social Fund budgets on the envisaged track will provide a good basis for the program's fiscal strategy. The 2006 State and Social Fund budget—which was submitted to parliament in September— will target a primary deficit (excluding grants) of 2.9 percent of GDP, which will be fully financed from foreign sources.

23. The ratio of general government tax revenue to GDP is envisaged to increase to 18.9 percent in 2005, from 18.4 in 2004 and stay at about that level in 2006. A broader tax base, tax increases elsewhere, and improved tax administration—as a result of our efforts against corruption—would offset the impact of reducing the corporate, personal income, and payroll

tax rates in 2006 (Box 1). We also expect that parliament will broaden the tax base further by approving regulations for a full and efficient implementation of the property tax. This will help revenue performance, which will provide room to reduce road and emergency taxes, if sufficient resources become available. Once the property tax is firmly in place, numerous local taxes (for instance, hotel, resort, and advertisement taxes) could also be eliminated. In the 2006 budget, we will also raise land tax by 10 percent in order to adjust it for the past three year's inflation and the social insurance contribution rates of farmers by 10 percent. This is justified because the VAT regime in the agriculture sector will be suspended until adequate administration capacity is developed for its effective implementation. We will reduce the current stock of VAT refund arrears, which amounts to som 300 million, to som 200 million by end-2005, and to zero by end-September 2006.

24. In cooperation with the Fund staff, we will investigate the possibility of introducing a "minimum presumptive taxable income" to make our personal income taxation simpler and more effective. We will also submit our proposal for a limited capital amnesty for Fund staff assessment and discuss this issue during the February review mission. We will not expand the present patent tax regime.

Box 1. Tax Policy Measures in the 2006 Budget

1. Introduce a flat personal income tax rate of 10 percent with a som 650 basic deductible.

2. Reduce the corporate income tax rate from 20 to 10 percent as of January 1, 2006, and for natural and authorized monopolies from January 1, 2007.

3. Suspend VAT on large agricultural producers.

4. Increase the excise tax rate on alcohol by 16 percent on average. Keep the other excises currently in place.

5. Increase non-agricultural land tax rates and those of subsistence plots by a factor of three.

6. Increase the agriculture land tax rates by 10 percent.

7. Increase the motor vehicle tax by a factor of three.

8. Abolish the FEZs, except in Bishkek.

9. Eliminate the profit tax exemptions on credit unions, and income tax exemptions on lottery winnings and on in-kind gifts from enterprises.

25. Expenditure policies will be aimed at reducing poverty and supporting private sector development. In 2005-07, general government current and capital expenditures are projected to stabilize at around 23 percent and 4¼ percent of GDP, respectively. We have already redefined the concept of poverty-related spending to be used as a yardstick, to ensure that increased expenditures will be allocated for projects that reduce poverty and support private sector activities. The poverty spending according to the new classification will be published as part of the 2007-09 MTBF, due in March 2006.

26. The need to strengthen the quality of public services and reduce incentives for corruption requires well-targeted increases in public sector wages. The civil service wage structure will be reformed in the 2006 budget so that key personnel can be provided with more competitive salaries based on performance. Government wages will be increased by 10 percent on average as of May 1, 2006 with increases focusing on the social sector. The room for additional wage increases during 2006 will be assessed during the program review mission in February 2006. At that time, we will also assess the results of our efforts to reduce the number of civil servants in order to provide room for higher wages for key personnel. The reform in the wage structure will be carried out while keeping the government wage bill broadly constant relative to GDP in the coming years. To streamline government employment, we intend to, inter alia, cut the number of employees in the government central apparatus, and reduce the number of ministries, state commissions, and state agencies.

27. On pension policy, average benefits will be increased by 10 percent in 2006, with an increase of the base pension in January, and an additional increase of pensions on May 1. Room for further pension increase will be assessed during the February mission. These increases will improve the pensioners' purchasing power, provided that the program's inflation target is achieved. At the same time, the programmed Social Fund's payroll tax collections would allow us to reduce the payroll tax rate further, from 31 to 29 percent in 2006. Our medium-term target is to reduce the rate further to 25 percent if resources are available. The 2006 budget will also include a contingency of som 300 million for additional social transfers to vulnerable groups in the event of electricity tariff increases. The potential use of these funds will be reviewed during the forthcoming program missions in light of the progress made in improving cost recovery in the energy sector.

28. On capital spending, further 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 emerged. We have also completed the work of a task force which assessed future needs for contingency expenditures (such as those related to natural disasters), which have been taken into account in preparing the 2006 budget.

29. Our revised fiscal framework for 2006 includes a special employment and housing promotion package amounting to som 750 million, which comprises (i) a well targeted som 200 million special housing program consisting of start-up and interest rate subsidies for loans through commercial banks; (ii) social housing projects to promote labor mobility; (iii) increased funding for employment training and retraining; (iv) a public works program for

remote areas; and (v) a special investment program (river banks, mudslide dams, etc.) to minimize the physical impact of natural disasters, particularly in the south of the country.

30. On fiscal institution building, as noted above, we will focus on transparency, civil service reform, wage reform, and fiscal decentralization. In this regard, specific policies and implementation timelines are spelled out in Box 2. Other structural fiscal measures will follow the current strategy, focusing on reforming tax administration and improving the budget process by drawing on technical assistance from the Fund's Fiscal Affairs Department (FAD), the World Bank, USAID, and DFID. In particular, we will prepare an action plan for the State Tax Inspectorate with a view to streamlining its operations, retrenching redundant personnel, and introducing a merit pay system. This will be done in consultation with a forthcoming FAD mission and the Fund's new regional tax advisor.

Box 2. Strengthening Fiscal Institutions

1. In close cooperation with World Bank staff, develop steps to improve the mechanism for inter-governmental transfers.
2. Introduce new wage scales in the 2006 budget while adhering to the programmed increase in the wage bill.
3. Consolidate the Social Fund budget with the 2006 State Budget.
4. Complete the Treasury modernization project by end-2007.

B. Monetary and Exchange Rate Policies

31. Price stability will continue to be the NBKR's main objective. Remonetization is expected to continue, albeit at a slower pace. The program assumes broad money growth of 15 percent in 2005, followed by a similar increase in 2006. This implies some decline in money velocity. Base money growth is targeted at 10 percent both during 2005 and 2006. Exchange rate policy will continue to be conducted in the context of a managed float system, with central bank intervention aimed at smoothing exchange rate fluctuations. We will not target the nominal exchange rate for competitiveness reasons.

32. Bank deposits and private sector credit were growing rapidly in 2003-04. Solid credit growth is important to building a financing base for the business sector, diversifying the economy, and raising the economy's growth prospects. With the remonetization slowing, credit growth is also expected to slow, especially in 2005, owing in part to the uncertainties associated with political developments. Looking ahead, we expect credit growth to recover as these uncertainties are reduced. We will refrain from adopting any administrative measures aimed at expanding commercial banks' lending activities. The financial position of the

banking sector continues to be satisfactory, with financial soundness indicators appearing to show no signs of imminent vulnerabilities.

33. There has been a significant improvement in servicing the government debt held by the NBKR and market participants. All interest and redemption payments have been met as scheduled in 2004 and 2005, which has contributed to increased market confidence in government securities. In this regard, the government reaffirms the priority given to continue fulfilling all debt obligations on a timely basis. To improve the functioning of the securities market and provide alternative investment opportunities, the NBKR and the government will increase the range of government securities available to banks. In this regard, by end-September 2005, and by end-September 2006, at least som 200 million of government bonds currently held by the NBKR will be redeemed and re-issued to commercial banks. In addition, to improve the structure of the central bank balance sheet in 2006, the government intends to cancel som 500 million of its bond debt against a similar amount of government deposits at the central bank. This will help reduce the interest costs for the state budget. In addition, the Ministry of Finance and the NBKR will start work to simplify debt instruments.

C. External Policies

34. The current account deficit is projected to increase in 2005–06, in part reflecting higher oil prices and new investments, including in the gold sector. The deficit is expected to be covered by donor loans for the Public Investment Program, FDI flows to the gold sector, as well as through debt relief from Paris Club creditors. With this, and the prospective financial assistance from the IMF, the World Bank, the Asian Development Bank, and bilateral donors, our economic program will be fully financed. To make further progress towards resolving the Kyrgyz debt problem, our external debt strategy will contain the following elements (Box 3):

35. The state-owned gold company Kyrgyzaltyn's trade financing facility for Kumtor gold shipments expires at end-September 2005. We intend to replace it with a financing arrangement with the EBRD, which will allow us to cancel the related government loan guarantee and release the NBKR's gold pledge, which has also been used to guarantee the current facility. To enter into this arrangement with the EBRD in November, bridge financing will be provided from the budget through a special arrangement.

36. During the three-year period of the PRGF arrangement, 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 or conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles. Moreover, we will not introduce or intensify import restrictions for balance of payments reasons.

Box 3. The Revised Debt Strategy

1. In addition to continued fiscal adjustment, as described in paragraphs 9 and 22, we will maintain the 45 percent grant element requirement on all new public borrowing. Local governments will not borrow without the specific authorization of the Ministry of Finance.

2. To increase our debt servicing capacity, the state government tax revenue will be increased by 1.2 percentage point of GDP during 2005-07, notwithstanding the envisaged reduction in tax rates.

3. We will streamline the foreign financed Public Investment Program from 3½ percent of GDP in 2004 to about 3 percent by 2007.

4. We will neither contract nor guarantee any nonconcessional public debt. In addition, we will limit concessional public borrowing as specified in Table 2 of the RMEP and the Technical Memorandum of Understanding (Annex II).

5. 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 Paris Club Creditors. In addition, we will not seek any debt-for-equity swaps for state-owned enterprises without specific consultation with Paris Club Creditors.

D. Structural Policies

37. The government is implementing a comprehensive structural reform agenda under the lending programs with the Fund, the World Bank, and the AsDB. Regarding the World Bank, we are implementing several reforms under the Governance Structural Adjustment Credit. At the same time, we are close to completing the discussions on a new PRSG grant operation covering, inter alia, public finance management, the regulatory system, and pension reform. We are also discussing a new financial sector reform credit with the AsDB. These discussions will continue to be closely coordinated with Fund staff.

38. We would like the Fund to remain engaged on a broad range of structural reforms, as the public attaches particular significance to Fund advice. We understand, however, that Fund-supported programs concentrate on structural policies with a significant macroeconomic impact, and that other IFIs have particular expertise in other areas. Our reforms in 2005-07 will focus on three key areas: (i) the financial sector; (ii) the labor market; and (iii) the energy sector quasi-fiscal deficit.

Financial sector reforms

39. Our intention is to strengthen the banking sector over the medium-term by increasing its capital base and encouraging mergers and acquisitions to make domestic banks stronger in an increasingly competitive market environment. In this respect, an increase in the minimum own funds requirement for banks to som 60 million by end-2005, and to som 100 million by end-2007, has already been approved.

40. As part of the government's commitment to improve governance in public institutions, we will strengthen the legal basis for central bank independence. To this end, we have submitted to parliament amendments to the Civil Code to provide for legal independence of the NBKR and revise its legal status by the Ministry of Justice. We have also presented 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. Submitted amendments also include provisions regarding the reporting mechanism of the annual report by the Chairman to parliament. In addition, these arrangements include a requirement for setting the NBKR's capital and general reserves (excluding unrealized revaluation reserves) at the level equivalent to 10 percent of the monetary liabilities. The actions related to the central bank law constituted a structural benchmark for end-September 2005. All these amendments support the NBKR's efforts to be fully compliant with the International Financial Reporting Standards (IFRS). Any NBKR tax exemptions will be specified in the Tax Code and the Customs Code, in line with best international practices. We will also continue implementing the recommendations of the Monetary and Financial Department (MFD) technical assistance report of September 2004 and those of the IMF Safeguards Assessment Report of October 2005.

41. To strengthen bank supervision, we will: (i) establish the supervisory framework for market, operational, country, and transfer risks, as recommended by the September 2004 MFD mission; and (ii) improve the NBKR's on- and off-site inspections by increasing our capacity for stress testing of individual banks. We are also working with the EBRD in establishing an effective credit information agency to improve risk management practices in the banking sector. In addition, we have requested technical assistance from the Fund Legal Department to organize seminars and training for judges dealing with banking legislation.

42. Regarding housing financing, we are of the view that establishing a specialized state-owned mortgage bank would not be an appropriate course of action, as the recovery of the banking sector should not be undermined through government intervention. In this regard, we believe that the best way to enhance the allocation of savings to housing investment is to strengthen the legal framework for mortgage lending, lower costs in collateral recovery, strengthen the enforcement of bank legislation, and create appropriate conditions for the development of deposits with longer maturities. We will seek World Bank technical assistance to develop concrete measures in these areas. The Kyrgyz Agricultural Finance Corporation (KAFC), which has been extending micro loans to farmers with World Bank financing, will not be involved in housing financing and will remain as a non-bank microfinance institution until its privatization. In this connection, we will issue a sale tender by end-December 2005, with the aim of completing the privatization process by end-2006 in

accordance with the plan developed by the government and NBKR, in close cooperation with the EBRD staff. A banking license will be part of the privatization package. To improve access to financial services in remote areas, the Savings and Settlement Corporation (SSC) will expand its operations into micro lending. For this purpose, the SSC will be issued a limited micro finance license to lend up to som 50 million.

43. We recognize that the successful implementation of a deposit insurance scheme requires a sound banking sector and strong bank supervision. The state of the banking system will be evaluated by the staffs of the Fund and the World Bank this autumn in the context of a Basel Core Principles assessment and stress testing of the banks. By end-2005, an action plan will be developed on contingent implementation of the deposit protection system, which will be submitted to Fund staff for comments before its approval.

44. Further attention will be paid to measures to improve the payments system, develop microfinance activities, and improve the conditions for an effective use of collateral. On the payments system, by end-2005, the government and the NBKR will approve a revised action plan to increase non-cash payments in the economy which will include (i) transition to government wage payments through the unified system of plastic cards; (ii) enhancing tax and customs duty collection through commercial banks; and (iii) a gradual transition to non-cash payment of utility bills. Additionally, we will review the existing legislation to improve the functioning of the time deposit market. Specific short-term financial sector measures are presented in Box 4.

Box 4. Financial Sector Reforms

1. Increase the minimum capital requirement for banks to som 60 million at end-2005, and to som 100 million at end-2007.

2. Following a successful pilot project involving the Ministry of Finance, the line ministries' wages will be gradually paid through banks, starting on January 1, 2006.

3. Prepare a concept paper to further develop micro-finance activities.

4. Prepare a payments system action plan.

5. Introduce the supervisory framework for market, country, and transfer risks by end-June 2006.

6. Conduct an independent review of the NBKR's internal audit function.

Labor market reforms

45. The government is committed to promoting policies aimed at reducing unemployment and increasing labor market flexibility. Unemployment has remained high despite solid economic growth, which suggests labor market problems of a largely structural nature. In this regard, reducing high labor taxation, as discussed earlier, is crucial in promoting employment and providing incentives for employers to bring their activities out of the shadow economy. In addition, we have recently reviewed our Labor Code with the view of removing regulations that excessively restrict personnel restructuring by enterprises. We also intend to propose to parliament further measures to increase labor market flexibility. To this end, the government recently established a special task force, including representatives from the private sector, which is expected to complete its work by end-2005.

Quasi-fiscal deficit of the electricity sector

46. Further efforts will be made to reduce the quasi-fiscal deficit (QFD) of the electricity sector, including through tariff policy, management reforms to reduce theft and corruption, and improvements in bill collection. The present framework that relies on aggregate, semi-annual QFDs as indicative targets for the program will be maintained. Following the achievement of the mid-2005 target, we will seek to reduce the QFD by one percentage point of GDP, to 7.7 percent of GDP, for 2005 as a whole. Regarding 2006, our goal is to reduce the QFD further to 6.3 percent of GDP. With technical assistance from the World Bank, we will also seek long-term foreign management contracts to improve corporate governance in the power sector. We believe that enhanced financial discipline in the sector will speed up enterprise restructuring and yield important macroeconomic benefits. In this connection, the government will work closely with the World Bank and other development partners to adopt a comprehensive strategy aimed at addressing the sector's current problems.

Governance

47. We are working in several areas to improve governance under the World Bank GSAC operation. Important initiatives—many of which are already in place—include revisions to the Civil Service Law; provisions for the appointment of state secretaries; income and asset declarations by high-ranking officials; and steps to increase the effectiveness of the public administration. We have also begun work to reduce government interference in private sector operations by improving the predictability of the legal system, streamlining licensing and permit mechanisms, and strengthening the inspection and auditing environment. Progress in these areas will be monitored by the Consultative Council of Good Governance.

E. Program Monitoring

48. The program will continue to be monitored through semi-annual reviews. For that purpose, we have revised the quantitative performance criteria, indicative targets and structural benchmarks for end-December 2005, and have established quantitative

performance criteria and indicative targets for end-June 2006. In addition, structural benchmarks have been established for March and June 2006.

49. Progress in implementing the quantitative performance criteria and indicative targets for the first-year program are specified in Table 1, and those for the period until end-2006 are presented in Table 2. The quantitative performance criteria are: (i) a floor on NBKR net international reserves (NIR) in convertible currencies, to be adjusted upward by 30 percent of any excess cash grant receipts; (ii) a ceiling on the net domestic assets (NDA) of the NBKR, to be adjusted for deviations in debt relief from programmed levels; (iii) a ceiling on the cumulative (from January 1, each year) primary deficit (excluding grants) of the general government, to be adjusted for spending of grants in excess of the programmed amounts; (iv) a floor on the cumulative (from January 1, each year) 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, each year) payroll cash collections by the Social Fund; (viii) a zero ceiling on the stock of Social Fund arrears with the Medical Insurance Fund; (ix) a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturities of less than one year; (x) a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturities of one year or more; and (xi) a zero ceiling on new external payments arrears.

50. Indicative targets have also been established for annual concessional borrowing for 2005-07, as specified in Table 2. These targets cover donors' loan disbursements under the Public Investment Program and new BOP-support loans; they supplement the performance criterion establishing a 45 percent minimum requirement on loan concessionality. In addition, semi-annual indicative targets have been established for reserve money and the electricity sector quasi-fiscal deficit. Box 5 contains the structural benchmarks under the program until mid-2006. The TMU attached to this Memorandum specifies the quantitative targets included in Table 2, the program adjustors, and reporting requirements.

51. The first review under the program is expected to be brought for Executive Board consideration in late October 2005, based on performance as of end-June 2005. The second review is expected to take place on or after February 15, 2006, based on the end-December 2005 performance criteria and structural benchmarks. The second review will pay particular attention to: (i) implementation of the new tax code and tax policy initiatives, and the revenue performance; and (ii) progress toward improving the investment climate. At the time of the second review, the performance criteria and structural benchmarks for end-June 2006 may be revised and performance criteria and structural benchmarks for end-December 2006 will be established.

Box 5. Structural Benchmarks

End-September 2005

1. Submit to parliament amendments to the Civil Code to provide for legal independence of the NBKR. The Ministry of Justice will revise the NBKR's institutional legal status accordingly.

2. Submit to parliament amendments to the Central Bank Law as specified in paragraph 40.

End-December 2005

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

2. Prepare a payments system action plan, as specified in paragraph 44.

End-March 2006

1. Prepare, in consultation with the Fund staff, an action plan for the State Tax Inspectorate to streamline its operations, retrench redundant personnel, and introduce a merit pay system.

End-June 2006

1. Introduce the supervisory framework for market, country, and transfer risk as recommended by the September 2004 MFD technical assistance mission.

2. Conduct an independent review of the NBKR's internal audit function. The review could be performed by an internal audit department of another central bank and should include a review of the capacity of the internal audit division.

Table 1. Kyrgyz Republic: Quantitative Program Targets for January-June 2005 1/
(in millions of soms, unless otherwise indicated; eop)

	2005					
	March			June		
	Benchmarks			Performance Criteria		
	Prog.	Adjusted	Prel.	Prog.	Adjusted	Prel.
I. **Performance criteria**						
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	326	325	322	333	325	326
2. Ceiling on net domestic assets of the NBKR (eop stock)	-1,390	-1,282	-1,583	-962	-834	-1,486
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	1,198	...	701	1,529	...	881
4. Cumulative floor on state government tax collections in cash	3,191	...	3,529	6,929	...	7,440
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. Cumulative floor on payroll collections in cash of the Social Fund	1,050	...	1,177	2,143	...	2,342
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, 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)	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)	0	...	0	0	...	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	...	0	0	...	0
II. **Indicative targets**						
1. Ceiling on reserve money (NBKR liabilities)	12,909	...	12,603	12,943	...	12,765
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	...	...	...	4,700	...	4,557
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/	(as indicated 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).
2/ New concessional loans during the year.

Table 2. Kyrgyz Republic: Quantitative Program Targets for September 2005–December 2006 1/

(In millions of soms, unless otherwise indicated; eop)

	2005			2006			
	September	December		March	June	September	December
	Benchmarks	Performance Criteria		Benchmarks	Performance Criteria	Benchmarks	Benchmarks
	Prog.	Prog.	Rev. Prog.	Prog.	Prog.	Prog.	Prog.
I. **Performance criteria**							
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	340	340	362	367	361	380	393
2. Ceiling on net domestic assets of the NBKR (eop stock)	-1,289	-985	-1,477	-1,566	-1,200	-1,258	-1,397
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	2,398	3,028	3,143	1,099	1,377	2,619	3,234
4. Cumulative floor on state government tax collections in cash	10,970	15,318	15,853	3,599	7,933	12,462	17,580
5. Ceiling on the stock of central government budget arrears	0	0	0	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0	0	0
7. Cumulative floor on payroll collections in cash of the Social Fund	3,228	4,392	4,461	1,100	2,292	3,292	4,675
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	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)	0	0	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)	0	0	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	0
II. **Indicative targets**							
1. Ceiling on reserve money (NBKR liabilities)	12,894	13,247	13,624	13,750	13,850	14,596	15,000
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	...	8,400	7,850	...	3,910	...	7,110
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/				(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).
2/ New concessional loans during the year.

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.

I. Stable financial environment with low and stable inflation, sustained growth and solid financial depth indicators, as assessed through the reviews under 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 the International Association of Auditors.
2. All commercial banks conduct their operations transparently, 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 total number of banks) rate CAMELS 3 or better, as defined by the NBKR.

III. Sound Banking Supervision, based on the results of the envisaged Fund and World Bank financial sector missions.

IV. 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. Anti-money laundering legislation.
3. Amendments and addenda to the Law "On Banks and Banking Activity" to introduce consolidated bank supervision, as well as to the revision of the Central Bank Law as specified in paragraph 40.

V. The specifics of government participation in the scheme will be assessed at the time of the finalization of the action plan.

REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The Kyrgyz Republic's performance during the period January 1, 2005—December 31, 2007 under 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 under the PRGF arrangement.[1] This update reflects the changes made to the program as defined in the Revised Memorandum of Economic Policies (RMEP).

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 RMEP or this TMU for 2005 and the first-half of 2006 are provided in Table 11.

I. QUANTITATIVE PERFORMANCE CRITERIA

3. The quantitative targets (i.e., quantitative benchmarks for end-March 2006, and quantitative performance criteria for end-December 2005 and end-June 2006) presented in Table 2 of the RMEP 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 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 or with foreign banks, and debt instruments (including accrued interest). 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 Commonwealth of Independent States (CIS) countries are excluded from the floor. For program monitoring purposes, gross international reserves shall be valued at program exchange rates and gold prices.

[1] 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)	362
March 31, 2006 (benchmark)	367
June 30, 2006 (performance criterion)	361

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 defined in paragraph 9 below; (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 in foreign exchange. Valued at the program exchange rate, the program cash privatization receipts are equivalent to $2.96 million for 2005 and $5 million for the fourth quarter of 2006, respectively. The total adjustment in respect of adjustors (i) and (iii) is to be limited to $25 million, valued at the program exchange rate. The NIR floor will also be adjusted upward/downward by 100 percent for any excess/shortfall in the net effect of the releases and related amortization payments of the NBKR's pledged reserves; the program net effect is plus $14.92 million in the last 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 at the NBKR minus amortization (excluding repayments to the Fund) and interest payments on external debt made by the Ministry of Finance and NBKR. This

definition applies to the adjustors to NIR and NDA. The program cumulative net foreign financing is given in 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 1/

	(In millions of U.S. dollars) 2/
March 31, 2005	2.3
June 30, 2005	6.8
September 30, 2005	12.0
October 1-December 31, 2005	-4.4
March 31, 2006	0.8
June 30, 2006	-8.0
September 30, 2006	2.0
December 31, 2006	17.2

1/ New definition of net foreign financing applies beginning October 1, 2005.
2/ Cumulative from the beginning of the calendar year, except for October-December 2005.

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[2] 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) NDA=RM–NFA–MLT–Turkish Loan–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.

[2] 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 CIS 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)	-1477
March 31, 2006 (benchmark)	-1566
June 30, 2006 (performance criterion)	-1200

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 total adjustment for shortfalls in adjustors (i) and (iii) is to be limited to $25 million, valued at the program exchange rate, excluding the amortization payments for the release of the NBKR's pledged foreign reserves.

Ceiling on the cumulative primary fiscal deficit of the general government

14. The general government primary fiscal deficit excluding grants is defined as the sum of: (i) the change in the stock of net claims of the domestic banking system and non-financial 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 non-financial 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 accrued interest on 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 program 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 primary deficit (excluding grants) of the general government are reported in Table 4 below.

Table 4. Ceilings on the Primary Deficit (excluding grants) 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)	3,143
March 31, 2006 (benchmark)	1,099
June 30, 2006 (performance criterion)	1,377

1/ Cumulative beginning from the beginning of the calendar year.

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 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)	15,853
March 31, 2006 (benchmark)	3,599
June 30, 2006 (performance criterion)	7,932

1/ Cumulative from the beginning of the calendar year.

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 to 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 June 30, 2005. 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)	4,461
March 31, 2006 (benchmark)	1,100
June 30, 2006 (performance criterion)	2,292

1/ Cumulative from the beginning of the calendar year.

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).[3]

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[3] 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

(continued…)

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 **non-concessional** 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 non-concessional external debt is zero as specified in Table 2 of the RMEP.

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,

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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. Debt 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.

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)	13624
March 31, 2006 (indicative target)	13,750
June 30, 2006 (indicative target)	13,850

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) $QFD = Q*MC - R$;

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

(3) $R = (\sum Ci) * T * Ccash$,

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;

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

ℓ 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

Ccash 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, barters, or other non-cash payments. Thus defined, the QFD in the electricity sector amounted to som 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)	7,850
June 30, 2006 (indicative target)	3,910
December 31, 2006 (indicative target)	7,110

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 2005-06 are specified in Table 9.

Table 9. The 2005-06 Annual Indicative Ceiling on Contracting and Guaranteeing of New Concessional Loans 1/

(In millions of US dollars)

With disbursements beginning in:	Signed or Contracted	
	2005	2006
2005	77	---
2006	112	0
2007	0	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, $112 million in 2006 and zero in 2007. The ceiling for contracting and guaranteeing new concessional loans in 2006 will be adjusted upward by the full amount of any shortfall from the ceiling during 2005.

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:[4]

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

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

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, GKOs, state obligations, state bonds, and other securities issued by the state government, differentiated by the following categories of holders: the NBKR, resident banks, resident nonbanks, and nonresidents. The information will be provided in both the book (nominal) value and the actual value, where applicable.

International reserves and key financial indicators

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 extra budgetary 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

	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 August 31, 2005)

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

II. **General Resources Account**

General Resources Account	SDR Million	Percent of Quota
Quota	88.80	100.00
Fund Holdings of Currency	88.80	100.00
Reserve Position	0.00	0.01

III. **SDR Department**

SDR Department	SDR Million	Percent of Allocation
Holdings	9.48	N/A

IV. **Outstanding Purchases and Loans**

Outstanding Purchases and Loans	SDR Million	Percent of Quota
PRGF Arrangements	130.00	146.39

V. **Latest Financial Arrangements**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	03/15/2005	03/14/2008	8.88	1.26
PRGF	12/06/2001	04/05/2005	73.40	73.40
PRGF	06/26/1998	07/25/2001	73.38	44.69

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	6.80	18.61	16.12	14.80	14.73
Charges/Interest	0.32	0.57	0.48	0.40	0.33
Total	7.12	19.18	16.60	15.20	15.05

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

VIII. **Safeguards Assessments**

An updated safeguards assessment of the National Bank of Kyrgyz Republic (NBKR) with respect to the PRGF arrangement approved on February 23, 2005 is about to be completed. The assessment found that the NBKR's safeguards framework has been strengthened since the previous assessment completed in 2002; in particular, the government debt held by the NBKR was restructured, a Board resolution was adopted to exclude unrealized revaluation gains from distributable profits, annual audits of the year-end net international reserve were conducted, and disclosures in financial statements were enhanced. However, a number of areas were identified where further steps would solidify the progress achieved, which include improving oversight of the audit processes and the internal control systems by establishing an audit committee, strengthening the legal framework for NBKR's autonomy, discontinuing the pledge of gold reserves and enhancing the NBKR's internal audit function.

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 Longer-Term Program Engagement.

XI. **FSAP Participation and ROSC Assessment**

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 September 15, 2005)

1. The current Country Assistance Strategy (CAS) for the World Bank Group was endorsed by the World Bank Board of Directors in May 2003 and covers the period FY 03-06. The CAS is 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 2005, IDA has approved 33 operations totaling approximately $796 million (after cancellations), of which about $642 million has been disbursed. Eight structural adjustment credits, including a 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. Ten investment operations have also been completed, supporting reform and rehabilitation of the telecommunications sector, social safety nets, health, rural finance, private enterprises and livestock development.

3. The active portfolio consists of 19 operations, including two regional projects. Three projects totaling $38.1 million were approved in FY 2005 (Rural Education, Small Town Infrastructure, and Agribusiness and Marketing) out of which $18 million are financed on a grant basis. The portfolio includes:

- 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.

- Five operations supporting energy, infrastructure and industry sector rehabilitation and reform (Power and District Heating, Urban Transport, Rural Water Supply and Sanitation Project, Small Town Infrastructure and a Technical Assistance Credit supporting the energy reform program).

- Six operations supporting provision of key public goods and reform in agriculture (irrigation rehabilitation, on-farm irrigation, agricultural support services, real estate and land registration and agribusiness and marketing—the latter also provides the basis for the introduction of a tax on non-movable property in rural and urban areas).

- An operation supporting capacity building in the financial and banking system.

- Two projects to provide support to selective social sectors: a second health sector operation continuing support for the national reform program, including sectoral restructuring, and a rural education project to improve learning conditions in primary and secondary schools, with priority on the rural areas.

- A Village Investment Project based on CDD initiative to empower village communities to identify and implement high priority investments and infrastructure to facilitate the development of 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, the pension system, social protection, health, water and sanitation, and agriculture, and to enhance the portfolio performance. It will continue assisting the Government with economic sector work and capacity building. In this endeavor, the Bank has delivered a Public Expenditure Review, Poverty Assessment, Financial Sector Assessment, Country Procurement Assessment, Country Financial Accountability Assessment, Governance Survey, and Mining Strategy Papers. The World Bank Group has also delivered a Country Economic Memorandum on Growth and Trade and an Agriculture Policy Update, and has engaged in an active dialogue on energy, health, and pension policies.

5. **International Finance Corporation (IFC).** The IFC strategy focuses on institution and capacity building through investment and technical assistance to 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 establishing 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 to develop 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 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. In the same year, the Central Asia Small Enterprise Fund (CASEF) was set up in 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 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 has also reviewed the IT sector, including its investment opportunities and development

potential. In 2005, IFC has continued implementing its investment and technical assistance program in the Republic. IFC is planning to directly finance a packaging production enterprise and a microfinance company to provide several credit lines to local commercial banks for small business financing and leasing activities. It is also planning to start a regional technical assistance project to improve corporate governance in enterprises of Central Asia, as well as to 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 September 20, 2005)

1. The Kyrgyz Republic became a member of the AsDB in 1994 and began receiving assistance in the same year. The country has received 24 loans for a total amount of $573 million (as of June 31, 2005). Of the total loans, fifteen loans have been closed and nine loans are ongoing. Six out of the 24 loans are program loans totaling $184 million provided to support policy reforms to facilitate the transition to a market economy. The remaining 18 are project loans totaling $389 million provided to support various investment activities. At present, 9 loans for a net loan amount of $185.3 million are ongoing. These loans have an un-disbursed balance of $134.2 million as of July 25, 2005. All these loans were provided on concessional terms from the Bank's special fund resources—Asian Development Fund (ADF).

2. AsDB'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 strategy. This strategy envisages a reduction in the size of the largely externally funded PIP from about 6 percent of GDP in 2001 to about 3 percent of GDP by 2005. AsDB's annual lending began with $40 million in 1994 and reached the peak level of $89.2 million by 1997. Thereafter, 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 country's performance in promoting sound economic and social policies and good governance, and its portfolio performance. In addition, AsDB had provided 52 technical assistance (TA) projects amounting to $31.6 million as of December 2004. Of these, 13 are project preparatory TAs amounting to $9 million and the remaining 39 TAs for $22.6 million are advisory TAs for capacity building, policy advice, institutional strengthening and training.

3. The overall performance of the AsDB'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 issues is mixed. The increasing scarcity of budgetary resources is the biggest risk to project implementation in the immediate future. The joint portfolio review of AsDB, the World Bank, Islamic Development Bank, and KfW Development Bank during 2004 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. AsDB's assistance to the country has sought to support the development objectives of the Government's National Poverty Reduction Strategy by fostering growth and providing selective support for the social sectors. The overall objective of the AsDB 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 improvements in 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) investment in basic education and early childhood development. The focus of the strategy will be on the poorer areas of the country.

5. The allocation of ADF resources to the country is based on the Government's attainment of performance targets (triggers) in five areas: (i) making steady progress in macroeconomic management and structural reforms in the financial sector, and 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 would range between \$14.4 million and \$32 million based on the availability of ADF resources. Annual lending would range between \$22.3 million and \$27.6 million. The annual allocation for TAs has been 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. AsDB 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 coordination efforts. Since then efforts are being made to share sectoral and operational information and better coordinate lending and technical assistance activities. In 2003, AsDB 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.

7. 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 AsDB procurement documentation has been harmonized in these areas.

8. In September 2005, AsDB together with other major bilateral and multilateral agencies providing assistance to Kyrgyz Republic, participated in discussions of a joint Country Support Strategy for more effective aid delivery.

KYRGYZ REPUBLIC—RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of September 20, 2005)

1. The EBRD facilitates the transition to a market-based economy through its direct support for private sector investment and key infrastructure, and targeted technical assistance. Under its recently introduced Early Transition Countries' Initiative (ETCI), which is of particular relevance to the Kyrgyz Republic, the Bank is introducing innovative instruments, and will consider smaller, more difficult and riskier projects. The ETCI also foresees 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: (i) foster the private sector; (ii) strengthen the financial sector; (iii) provide support for essential infrastructure; and (iv) strengthen the policy dialogue with the authorities to improve the investment climate and support their reform efforts.

2. As of August 2005, the Bank had approved 33 projects (including restructurings) for a total value of EUR 717.7 million, out of which the Bank had financed 25 percent for a gross commitment of EUR 167.1 million. During the past three years, the Bank expanded its activities in the financial sector to include:

- The Kyrgyz Micro and Small Enterprises Financing Facility 1 of USD 20 million (MSEFF) approved in 2002 had fully utilized and MSEFF 2 of USD 30 million approved at the beginning of 2005 with component of rural agricultural financing.

- As of August 2005, more than USD 48 million (revolving) were disbursed to 27,557 small and medium-size enterprises (SMEs) via five participating local commercial banks and first non banking financial institution "Bai-Tushum" added recently by signing Credit agreement for 2 million USD on 12th of September 2005.

- Equity investments in Ineximbank, Demir Bank and KICB.

- Expansion of the Bank's Trade Facilitation Program (TFP). Four commercial banks are participants in the TFP.

- In 2004, the 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 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 loan have been fully repaid).

- Loan to Hyatt-Regency Hotel.

- Loan to Interglass plant, USD 6 million 2004
- Loan to Limatex (cotton-processing plant), USD 1 million 2005
- Loan to Raduga Invest (resort on Issyk-Kul lake), USD 6 million 2005

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

- Modernization of the telecommunications network (USD 9.4 million 1994).
- Two projects to upgrade electricity transmission networks in Issyk-Kul and Talas regions(USD 38 million 1995 and USD 24.7 million 1997 respectively).
- Development of the agribusiness sector (KAC) (USD 6.8 million).

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. The most recent ones- TC for Universal Access in telecommunication sector and training of the Judges – legal reforms. 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

Dept.	Subject/Identified Need	Timing	Counterpart
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	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
	Payments System	January 25—February 7, 2005 and April 12-25, 2005	National Bank of the Kyrgyz Republic
	Bank Supervision and Regulation	February 23—March 8, 2005, May 18-28, 2005 and July 17-28, 2005	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	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. Azarbayejani	Dec. 2002–Dec. 2004

Kyrgyz Republic: Statistical Issues

General framework

1. The three institutions responsible for collecting, compiling and disseminating macroeconomic statistics – the 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 therefore constrain statistical development, especially for the NSC.

2. The NSC maintains a comprehensive and regularly-updated web site with data that largely incorporate international methodological recommendations and adequate coverage and timeliness (http://www.stat.kg). 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, prices, 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 improve further 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 and 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) includes an update on the status of implementation of the ROSC mission's recommendations.

4. In February 2004, following improvements in compilation and dissemination of the reserves template and external debt data, the Kyrgyz Republic subscribed to the SDDS.

National accounts

5. In general, dissemination of national accounts statistics is timely. Technical assistance has been received from the IMF, EUROSTAT, OECD, the World Bank, and bilateral donors. While significant progress has been made in improving the national accounts estimation process, problems persist regarding the quality of the source data, due mainly to excessively tight collection deadlines associated with the 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 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. While revenue and expenditure data generally accord with *GFSM 1986*, 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 April 2005. 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 (including timeliness) of external debt data are adequate. The External Debt Division of the MOF 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 the computerization of its database.

Monetary sector

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

13. An STA mission on monetary and financial statistics was in Bishkek during April 27–May 11, 2004 to (i) follow up on the implementation of the ROSC mission's recommendations; (ii) expand the institutional coverage of the broad money survey; and (iii) assist the NBKR in implementing the methodology in the *MFSM*. This mission found that the NBKR had 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 (i) improve the basic source data to allow for proper classification of the transactions with foreign and domestic units; (ii) fully implement the *MFSM*'s methodology concerning accrual accounting; (iii) exclude deposits with banks in liquidation from monetary aggregates and classify them as restricted deposits; and (iv) 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 have been reported electronically to STA. As of May 2004, the NBKR reports monetary data to STA through the Internet 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 balance of payments 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, limiting 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 have fostered a large shuttle trade, which has complicated estimation of this activity.

17. An STA mission on balance of payments statistics was in Bishkek during 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, further improvements were needed in the international transactions reporting system; data sampling methods; and data validation and coverage, particularly on trade, services, private sector external debt and foreign direct investment. The mission developed a questionnaire for collecting data on foreign direct investments and provided guidelines on the collection of data on external debt. To strengthen further the capacity for compiling external sector statistics, STA provided training to officials of the NBKR on balance of payments and external debt statistics through courses held at the IMF Institute in Washington D.C. in May and July 2005, respectively.

KYRGYZ REPUBLIC: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(as of September 26, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	8/19/05	8/22/05	D	D	W		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	July. 05	8/29/05	M	M	M		
Reserve/Base Money	8/19/05	8/22/05	D	D	M	LO, O, LO, LO	LO, O, O, LO, LO
Broad Money	7/30/05	8/18/05	M	M	M		
Central Bank Balance Sheet	8/19/05	8/22/05	D	D	M		
Consolidated Balance Sheet of the Banking System	7/31/05	8/22/05	M	M	M		
Interest Rates[2]	8/22/05	8/29/05	W	W	W		
Consumer Price Index	July 05	8/09/05	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	7/31/05	8/22/05	M	M	Y	O, LNO, LO, O	LO, O, O, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	7/31/05	8/22/05	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	July 05	8/29/05	M	M	Y		
External Current Account Balance	June 05	7/18/05	Q	Q	Q	LO, LO, LO, LO	O, LO, LO, LO, LO
Exports and Imports of Goods and Services	June 05	7/18/05	Q	Q	Q		
GDP/GNP	July 05	8/22/05	M	M	M	O, O, LO, O	LO, LO, LO, O, O
Gross External Debt	July 05	8/29/05	M	M	Y		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign and domestic financing only.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC (published on November 2003, and based on the findings of the mission that took place during November 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative
October 24, 2005

The following information has become available since the staff report was issued on October 7, 2005. It does not change the thrust of the staff appraisal.

- Preliminary data suggest that real GDP declined by 0.4 percent in January-September 2005 (year on year), compared with a growth rate of 2.4 percent in January-June. Excluding operations of the Kumtor gold mine and the energy sector, real GDP increased by 1.1 percent. The growth of nominal GDP, however, was broadly in line with the staff's projection. The 12-month rate of consumer price inflation was 4.7 percent in September, as projected. The nominal exchange rate against the U.S. dollar has remained stable.

- The program's quantitative benchmarks for end-September appear to have been observed. Tax collections continued to exceed the targets and the primary fiscal deficit (before grants) remained ½ percent of GDP below the program ceiling. Net official international reserves exceeded the program floor by a wide margin, as a result of sizeable unsterilized intervention. The 12-month rate of growth of broad money (40 percent) was higher than projected (25 percent), with reserve money and bank deposits increasing faster than anticipated.

- The end-September structural benchmarks have reportedly been completed. Amendments to the Civil Code to provide for the legal independence of the NBKR were submitted to Parliament on September 29. At the same time, a revised central bank law was brought to parliament in order to improve the NBKR's accountability and strengthen the legal protection of its employees while discharging their duties.

- President Bakiev has recently stated that the Kyrgyz Republic should seek assistance under the Multilateral Debt Cancellation Initiative. Discussions on the authorities intentions in this regard will continue during the November staff visit.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 05/237
FOR IMMEDIATE RELEASE
October 24, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review of the Kyrgyz Republic's Three-Year PRGF Arrangement and Approves US$1.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the first review of the Kyrgyz Republic's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. This enables the Kyrgyz Republic to draw an amount equivalent to SDR 1.27 million (about US$1.8 million).

The Executive Board approved the three-year arrangement on February 23, 2005, which became effective on March 15, 2005 (see Press Release No. 05/40), for a total amount of SDR 8.88 million (about US$12.8 million) to support the government's economic program for 2005–2007.[1]

Following the Executive Board's discussion of the Kyrgyz Republic, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair made the following statement:

"The authorities are to be commended for preserving macroeconomic stability and keeping the PRGF-supported program on track despite the difficult political environment. As economic growth has slowed recently, it will be important to maintain strong performance under the program in order to boost confidence and help turn around the recent weakening of business sentiment.

"The new government's commitment to combating corruption and promoting private sector development is particularly welcome. Concrete results are now needed to gain credibility in the fight against corruption. Progress in raising tax collections and in reducing the energy sector's financial imbalances will be important measures of the success of this effort.

"Successful implementation of the fiscal program continues to be an important challenge. The tax reforms envisaged in the program—in particular the lower income and payroll tax rates—should go a long way toward improving the investment climate. The new government's realistic approach in preparing the 2006 budget is encouraging, and prompt approval by parliament of the proposed budget would send a clear signal of the country's continued commitment to a prudent fiscal policy. The authorities should also adhere to their commitment to

[1] The staff report on the Kyrgyz Republic is expected to be made available.

enhance transparency in the mining sector under the Extractive Industries Transparency Initiative.

"While the central bank has been successful in containing inflation and maintaining stability in the foreign exchange market, further progress is needed in deepening the securities market to enhance the potential of indirect monetary instruments. It will also be important to take concrete steps to strengthen the independence of the central bank, in line with the authorities' pledge to improve governance in public institutions.

"The Paris Club debt restructuring agreement has improved the prospects for debt sustainability and offered welcome breathing space. It is essential that the authorities pursue strong stabilization policies and maintain a cautious external borrowing policy, given the still high debt levels," Mr. Carstens said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

Statement by Fritz Zurbrügg, Executive Director for Kyrgyz Republic and Sandriddin Djienbekov, Advisor to Executive Director October 24, 2005

On behalf of our Kyrgyz authorities, we would like to thank Fund management and staff for the continued support and constructive policy dialogue. This support has been particularly important during the months following the March revolution. Political transitions are often associated with economic disruptions, which can rapidly undo the benefits of years of stability-oriented macroeconomic policies. From the outset, the new government has underscored the importance of staying the course on macroeconomic stability and keeping up the momentum of structural reform. Following the inauguration of President Bakiev and the parliamentary approval of the members of the cabinet, the political situation has stabilized significantly.

Our authorities consider this first review under the Poverty Reduction and Growth Facility (PRGF) as a tangible signal of their commitment to stable economic policies. The PRGF program is fully on track and all quantitative performance criteria and structural benchmarks were observed. The authorities are convinced that their main goals of combating corruption, promoting private sector development, and creating employment opportunities fit very well in the overall thrust of the PRGF. In a very constructive atmosphere, an agreement was reached between the authorities and staff on how to integrate the new government's priorities in a revised Memorandum of Economic Policies.

Looking forward, our Kyrgyz authorities are fully aware that many challenges remain to achieve the overarching goals of increasing growth prospects and reducing poverty. A strong civil society, the respect for democratic principles, and the effective implementation of the broad range of economic reforms will be crucial in tackling these challenges. In this context, the authorities look forward to a continued close cooperation with the international community.

Macroeconomic Developments

As noted above, the overall macroeconomic picture is in line with program projections. As regards inflation, the price hikes following the March events have pushed the 12-month inflation rate to 4.7 percent in September 2005. Barring any further exogenous shocks during the last quarter, year-end inflation is expected to stay below five percent. The nominal exchange rate vis-à-vis the US dollar has remained stable, reflecting an appropriate policy response of the monetary authorities.

As regards economic activity, real GDP growth has slowed markedly during this year and may even have halted. However, for the year as a whole, growth is projected at 3 percent, down from 7 percent in 2004. This seems achievable, since the projected decline in gold production has run its course and the delayed harvests should boost growth, but much depends on a rapid reestablishment of the business confidence. The latter will also be crucial for ensuring that the authorities' stated goal of 8 percent growth in 2006, which is significantly higher than staff's estimate, can be achieved.

The authorities recognize these less-than-favorable trends and are taking them seriously. However, they are confident that the reestablishment of political stability and the implementation of the planned reforms should ensure that the negative effects of the March events will remain moderate and of a temporary nature.

Fiscal Policy

As underscored in the revised Memorandum, the Kyrgyz authorities remain convinced of the merits of fiscal consolidation. The debt overhang stemming from the still high level of public debt constrains growth. Furthermore, higher national savings are an important element to allow an increase in the investment ratio. The continued adherence to a prudent fiscal policy is demonstrated by maintaining spending in line with program projections. Furthermore, tax collection has once again outperformed the program target.

Given the new government's emphasis on private sector development and improvement of the business climate, measures to reduce the tax burden on labor and capital, as well as a simplification of the tax regime have a high priority. Finding the right balance between tax reductions and fiscal consolidation was an intensely debated issue during the review discussions. The authorities think that an appropriate balance has been found and that the most important of their proposed initiatives have been taken into account. The main measures included in the 2006 draft budget are (i) the introduction of a 10 percent flat income tax rate; (ii) halving of the profit tax rate to 10 percent; (iii) suspension of the VAT on large agricultural producers until adequate capacity is developed for its effective implementation; and (iv) a further reduction of two percentage points in the payroll tax rate, to 29 percent. The authorities are confident that the revenue loss from these measures will be broadly offset by broadening the tax base and increasing non-agricultural land taxes and the motor vehicle tax. However, they stand ready to take additional measures, should these be necessary to ensure revenue neutrality.

Monetary and Exchange Rate Policy

The message in the area of monetary and exchange rate policy is one of continuity. Further steps to strengthen the independence of the central bank and enhance the potential of indirect monetary instruments are under way and will help to further strengthen the financial system. As noted above, the authorities have been successful in containing inflation. As regards the exchange rate policy, the authorities find that a managed float continues to be useful in providing the flexibility to deal with external shocks, while minimizing output losses. In their Memorandum, they reiterate their commitment not to target the nominal exchange rate for competitiveness reasons.

Structural Reforms

The new government is committed to continuing the implementation of the comprehensive structural reform agenda with its development partners. The authorities realize that many of the reforms are not in the Fund's core mandate. We would like to reiterate the point made in the revised Memorandum, namely that the authorities look forward to Fund engagement in

all macro-relevant structural policies. Fund advice enjoys high esteem in the Kyrgyz public. Financial sector reform continues to be a priority, particularly given the objective of promoting private sector development. Besides steps to grant legal independence of the central bank and legal protection of bank supervisors, the authorities intend to improve bank supervision by establishing a framework for risk supervision and strengthening on- and off-site bank inspections. Also, an independent review of the NBKR's internal audit function will be completed.

Given the new government's strong focus on combating corruption, improving governance in all areas has gained additional impetus. While many initiatives are already in place, the parliament recently ratified the United Nations Convention against Corruption. Furthermore, the authorities are working on a wide range of areas with the World Bank with an aim at reducing government interference in private sector operations. The new government has also recently reiterated its full commitment to adhering to the Kyrgyz Republic's engagements under the Extractive Industries Transparency Initiative (EITI). They will work towards meeting all EITI criteria, including regular publication of payments and revenues information, independent auditing, and closely involving civil society.

External Debt

Reducing the high level of external debt remains an important instrument to ensure the social and economic development of the Kyrgyz Republic. Our authorities are thankful for the March 2005 Paris Club agreement, which has helped reduce debt service ratios. Looking forward, the continuation of tight fiscal policies and a strict observation of the ceilings on concessional external borrowing should help ensure that debt ratios remain sustainable in the medium term. However, as the staff rightly points out, the country remains vulnerable to shocks. In this context, our authorities take note of the recent staff calculations, indicating that the debt indicators at end-2004 show that the Kyrgyz Republic is eligible for the HIPC initiative. With a ratio of 345 percent, the NPV of the external debt significantly exceeds the HIPC threshold under the revenue window.

The authorities are grateful for staff's work in completing the necessary analysis and the debt reconciliation process. Given the impressive track record under successive PRGF arrangements and the PRSP implementation, our authorities are confident that the HIPC process can be advanced expeditiously once the Kyrgyz Republic's eligibility is determined with certainty.

Our Kyrgyz authorities are also very appreciative of the recent global initiative to cancel the debt of HIPC countries to the Fund, World Bank, and the African Development Fund. They look forward to a decision on the modalities of this initiative. As President Bakiev has recently stated, the additional debt relief would be an important contribution to the Kyrgyz Republic's efforts to achieve the Millennium Development Goals.