February 2005
IMF Country Report No. 05/47

Kyrgyz Republic: 2004 Article IV Consultation and Request to Extend the PRGF Arrangement—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Kyrgyz Republic

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2004 Article IV consultation with the Kyrgyz Republic and request for an extension of the arrangement under the Poverty Reduction and Growth Facility (PRGF), the following documents have been released and are included in this package:

- the staff report for the combined 2004 Article IV consultation and request to extend the PRGF arrangement, prepared by a staff team of the IMF, following discussions that ended on October 6, 2004, 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 November 5, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of November 15, 2004 updating information on recent economic developments.

- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its November 19, 2004, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- a statement by the authorities of the Kyrgyz Republic.

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

Ex Post Assessment for Longer-Term Program Engagement
Statistical Appendix

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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INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

Staff Report for the 2004 Article IV Consultation and Request to Extend the PRGF Arrangement

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

Approved by Julian Berengaut and Donal Donovan

November 5, 2004

- The 2004 Article IV discussions were held in Bishkek, August 13–25, 2004, and Washington, September 30–October 6, 2004. Staff representatives were Mr. Saavalainen (head), Mr. McDonald, Ms. Mylenko (EP), and Ms. Weikert (sr. admin. ass't.) (all MCD), Mr. Ogata (FAD), Mr. Roache (EP, PDR), and Mr. Kenjeev (interpreter—BLS). Mr. Segni (World Bank) worked closely with the mission on financial sector issues. Mr. Zurbrügg, Executive Director, participated in key meetings. Mr. Mered (resident representative) and Mr. Dubashev assisted the Bishkek mission, which met with President Akayev, Prime Minister Tanaev, Deputy Prime Minister Otorbaev, Minister of Finance Abildaev, National Bank Chairman Sarbanov, senior officials, parliamentarians, and representatives of civil society and business.

- The Ex Post Assessment of Longer-Term Program Engagement accompanies this report.

- The Kyrgyz Republic accepted the obligations of Article VIII, Sections 2(a), 3, and 4, in 1995 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, other than restrictions for security reasons, which the authorities will soon notify to the Fund pursuant to Executive Board Decision No. 144-(52/51).

- In concluding the 2002 Article IV consultation on February 20, 2003, Directors commended the authorities' prudent monetary and fiscal policies, noting that growth had reduced poverty, particularly in rural areas. The managed float exchange rate policy had been successful. The external debt strategy was on track, and in this context Directors encouraged the authorities to continue their fiscal consolidation. They pointed to a likely decline in gold exports and the need to diversify the economy by strengthening the business environment, and emphasized this would require redoubling efforts to reduce corruption and improve governance, as well as reforms to improve tax administration. The fifth review under the Kyrgyz Republic's PRGF-supported program was completed on a lapse of time basis in June 2004.

- Relations with the IMF and World Bank are summarized in Appendices I and II and recent IMF technical assistance is described in Appendix III. The periodicity, availability, and quality of economic statistics are satisfactory and are discussed in Appendix IV. Annex I presents the staff's debt sustainability analysis. An updated Fiscal Transparency ROSC is provided in Attachment I and the authorities' request to extend the PRGF arrangement in Attachment II.

- The authorities have indicated they consent to the IMF publishing this staff report. Outreach work conducted by area department missions and the resident representative comprises media contacts and meetings with representatives of civil society and the diplomatic and business communities.

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Kyrgyz Republic: Basic Data

Social and demographic indicators

Area	199,900 sq. km.
Population density (2003)	25.2 per sq. km.
Population (2003)	5.0 million
Rate of population growth (2003)	1.1 percent
Life expectancy at birth (2003)	68.2 years
Male	64.5 years
Female	72.2 years
Mortality rate of children under five years of age (2003)	27.7 per thousand
Hospital beds per 1,000 inhabitants (2003)	5.6
Net primary school enrollment (2000)	95.0

	2000	2001	2002	2003 Prel.
	(In percent of GDP)			
Manufacturing	25.0	23.1	17.9	18.0
Agriculture and forestry	34.2	34.5	34.4	35.2
Construction	4.2	3.8	3.4	2.9
Transport and communications	3.7	4.2	5.1	5.1
Others	32.9	34.4	39.2	38.8

Sources: Kyrgyz authorities; National Statistical Committee; and Fund staff estimates.

EXECUTIVE SUMMARY

The Kyrgyz Republic faced severe macroeconomic imbalances following the 1998 Russian financial crisis. Disciplined policies during the current PRGF arrangement brought about a successful stabilization in 2001–03. Growth has strengthened and become more broad-based, inflation is low, and poverty rates have declined substantially. Heavy external borrowing in the 1990s and export growth far below projections created unsustainable external public debt levels, which the present PRGF-supported program has helped to reduce. Nevertheless, the debt burden remains among the country's key macroeconomic challenges, along with the need to diversify the gold-dominated export structure. Staff simulations indicate a need for further Paris Club debt relief.

Discussions focused on the economic outlook and medium-term challenges. With continued sound macroeconomic policies and effective structural reforms, annual real growth of 5 to 6 percent appears likely, supported by good growth prospects among key trade partners. The authorities stressed the large shadow economy as the main development concern. The staff also stressed corruption and weak governance as contributors to informal activity and as key impediments to investment.

The medium-term fiscal strategy balances the spending needs associated with the Millennium Development Goals against the constraints imposed by high external debt. There was broad agreement on the desired pace of fiscal consolidation—including bringing the state government fiscal deficit to 3.7 percent of GDP by 2007—and that scope existed to reduce certain tax rates. Views within the government diverged as to whether and how quickly the staff's proposed payroll tax rate reductions could be implemented. The agreed fiscal path incorporates additional poverty and related spending (largely on investments) in the next five years, financed with proceeds from government shares in Centerra (owner of the Kumtor gold mine) without compromising the previously envisaged debt path.

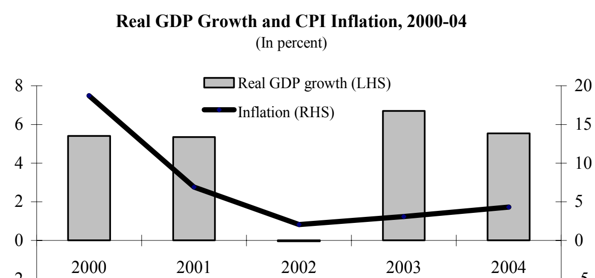
Rapid remonetization of the economy is among the main recent macroeconomic achievements. Real money demand has grown at annual rates of about 20 percent since 2001. The staff and authorities agreed that the managed float exchange rate regime has worked well for the country. The staff emphasized that price stability should remain the main objective of monetary policy and that the level of international reserves provided scope to de-emphasize the further accumulation of reserves in the medium-term. The high rate of private sector credit growth and its potential impact on loan portfolios was seen as a medium-term risk facing the financial sector. It called for strengthening bank supervision and safeguarding central bank independence.

The staff's Ex Post Assessment concludes that program implementation was uneven in the past but has improved significantly during the present PRGF arrangement. The reform agenda remains challenging and a low-access PRGF arrangement would be appropriate to support the government's reform efforts.

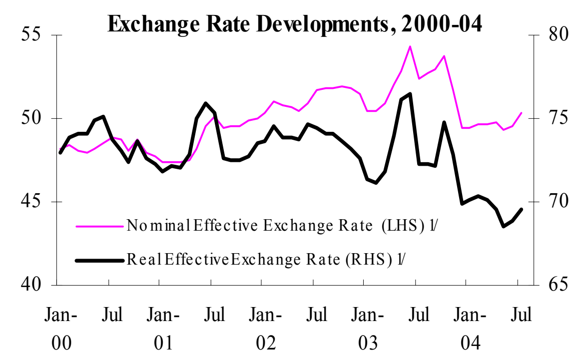
I. Recent Economic Developments

1. **The Kyrgyz Republic faced severe macroeconomic imbalances following the 1998 Russian financial crisis.** In 1998-99, growth slowed, exports contracted by a quarter, and the som depreciated by 60 percent against the U.S. dollar, exposing vulnerabilities stemming from the rapid external borrowing begun in the 1990s. After an initially inadequate policy response, macroeconomic policies and performance began to improve; however, the sharp increase in the ratio of debt service to fiscal revenues—from 14 percent in 1997 to over a third in 2000—strained the budget and brought to the forefront concerns over external debt sustainability.[1]

2. **Disciplined economic policies during the current PRGF arrangement underpin the successful macroeconomic stabilization in 2001-03.** Program ownership and policymaking capacity strengthened, as reflected in the timely completion of all program reviews so far.[2] The lynchpin of the strategy (IMF Country Report No. 01/223) was the recognition that the debt overhang fundamentally constrained policies and required a multi-year fiscal consolidation. This was to be achieved principally by strengthening tax collection and streamlining the externally financed public investment program (PIP).



Source: Kyrgyz authorities. Figures for 2004 are projections.



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

Monetary policy contained inflation to 4 percent on average in 2001–03—compared to 21 percent in 1998–2000—helping to stabilize the nominal and real effective exchange rates while fostering an environment more conducive to private investment. In 2003, per capita GDP was 36 percent higher than in 2000 and the poverty rate had declined from 52 to 41 percent. In key areas, outcomes were better than envisaged when the PRGF-supported program was approved.

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[1] For a discussion on the policies and outcomes in the 1990s, including an assessment of the effectiveness of the Fund's policy advice, see the Ex Post Assessment, Section III.

[2] The final program review is expected to be completed in early 2005. Tentative information suggests that all September 2004 performance criteria have been observed.

Selected Economic Indicators, 2000-03

	2000	2001	2002	2003 Orig. Prog.	2003 Actual
GDP per capita (U.S. dollars)	278	309	324	360	378
Real GDP (pct. change)	5.3	5.4	0.0	4.5	6.7
Inflation (p.a.)	18.7	6.9	2.1	5.5	3.1
Exchange rate (soms per U.S. dollar, p.a.)	47.8	48.4	46.9	...	43.7
Poverty rate (expend. approach)	52	48	44	...	41.0
Current account balance (pct. GDP)	-4.3	-1.5	-2.3	-6.5	-2.4
Gen. gov't. fiscal balance (pct. GDP)	-9.2	-5.1	-5.5	-4.3	-5.2
Som velocity	12.4	12.4	9.3	...	8.0
Official reserves (mos. g.n.f.s. imports)	4.2	3.8	4.0	3.6	4.3
External public debt (pct. GDP) 1/	111.1	100.0	98.8	101.4	93.8

Source: Kyrgyz authorities and staff estimates.
1/ Excluding Kumtor

3. **Growth has become more broad-based.** Real growth outside the volatile gold and energy sectors has averaged 5 percent since 2000, with strong growth in manufacturing industries such as food processing, textiles, and glass production. Productivity improvements (including greater capacity utilization) have contributed more to growth than has employment growth or capital accumulation. However, there are indications that new investment has been a significant factor supporting the 7 percent growth in January-September 2004.

Growth Performance, 1999-2004

	1999	2000	2001	2002	2003	2004 1/
			Percent change			
Real GDP	3.7	5.3	5.4	0.0	6.7	7.0
Excl. Kumtor gold	4.6	4.9	4.1	3.1	4.9	6.9
Excl. Kumtor and energy sector	...	4.3	5.0	3.9	4.6	6.8

1/ January-September.

4. **External current account deficits have moderated, despite recent rapid import growth.**[3] An improved external macroeconomic environment has contributed to an average 9 percent export volume growth in 2002–03. High growth in China, Kazakhstan, and Russia supported Kyrgyz exports, while gold exports recovered from the low 2002 levels that

[3] Estimates of the 2001-03 current account deficits are about 2 percent of GDP, compared to an average of about 15 percent in 1990-2000.

resulted from the Kumtor mine accident. In 2003, gold accounted for 14 percent of GDP and 44 percent of merchandise exports, partly reflecting higher world market prices. Electricity exports remained well below peak levels, but tourism and other services exports have been strong. High import volume growth mainly reflects strong domestic demand, but also increased oil prices and improved customs statistics.

5. **During 2001–03, external public debt fell from 111 to 94 percent of GDP.**[4] Progress under the authorities' external debt strategy owes much to fiscal consolidation. The general government fiscal deficit, which consistently had been above 9 percent of GDP from 1996–2000, was reduced to an average of 5 percent of GDP in 2001–2003. Tax revenue performance improved, owing mainly to better administration. State government collections rose 2½ percentage points during 2000–03, to 14.3 percent of GDP. At the same time, improved tax administration helped to maintain payroll tax collections despite a 4 percentage point rate reduction in 2002. The two tax steps taken in 2003—extending the VAT to agriculture and introducing a new real property tax—faced strong political resistance and their revenue impact remained marginal.

6. **Expenditure policy contained total expenditures while gradually allocating higher shares to social and poverty-related areas.** Social spending (including education, health, social security and welfare, and pensions) rose from an average 12 percent of GDP in 2000-01 to 14 percent in 2002-03. Overall pension increases outpaced nominal GDP growth during this period and much higher percentage increases were targeted at poor pensioners, helping to alleviate poverty among the elderly. The government wage bill rose from 5.1 percent of GDP in 2000 to 6.8 percent in 2003, mainly because of increases in the low-wage health and education sectors.

7. **Progress was made in strengthening fiscal institutions.** The annual rolling three-year fiscal framework has improved fiscal transparency, expenditure planning and expenditure execution, although weaknesses remain in the areas of commitment control and arrears tracking.[5] The computerization of the treasury, with IMF and World Bank technical assistance, was begun in 2003 and is progressing broadly according to schedule. However, it is expected to help substantially improve public expenditure management only in 2007. The August 2003 restructuring of the large taxpayer unit is expected to strengthen implementation of self assessment and enforcement. Customs modernization and computerization was implemented in 2004, assisted by the AsDB and USAID, and a new Customs Code takes effect in January 2005.

[4] Debt management has strengthened in recent years, reflecting greater attention to debt issues on the part of staff and the authorities and the presence of an IMF-supported resident advisor (Appendix III).

[5] A Fiscal Transparency ROSC update is provided in Attachment 1.

Financial Sector Developments

8. **Commercial banks continue to dominate financial intermediation.** Following the Kairat Bank privatization in June 2004, the Savings and Settlement Company (SSC) (operating as a narrow bank) is the only state-owned bank among the 20 banks in the country. Recently, foreign investment has shaped the landscape of commercial banking. At end-June 2004, seven foreign-owned banks accounted for half of bank loans and deposits, compared to five banks with 2 percent of loans and 21 percent of deposits at end-2001.

9. **The financial market remains shallow.** Both money and credit relative to GDP are low, even by CIS standards. However, financial soundness indicators suggest a slowly

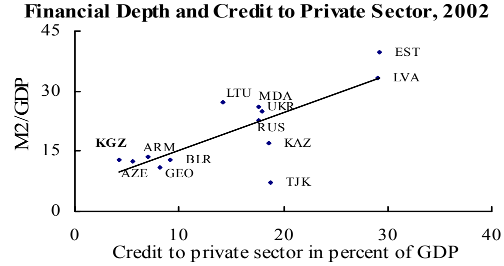
Kyrgyz Republic: Selected Financial Soundness Indicators, 2001–04
(In percent and end-of-period, unless otherwise indicated)

	2001	2002	2003	2004 July
Net total capital/risk-weighted assets	52.2	36.4	35.3	27.7
Liquidity ratio	85.0	82.7	93.2	88.4
Nonperforming loans/total loans	13.4	13.3	11.2	8.0
Loan-loss provisioning/nonperforming loans	47.1	51.2	46.9	57.6
Return on equity 1/	5.1	5.1	8.0	12.4
Return on assets	1.4	1.1	1.3	2.0
Loans/deposits	61.3	57.0	60.5	76.8
Share of foreign currency deposits in total deposits	59.1	63.2	65.7	67.1
Share of foreign currency loans in total loans	57.3	57.9	61.1	64.8

Source: National Bank of the Kyrgyz Republic.
1/ Net profits/net Tier 1 capital.

improving banking system. This reflects macroeconomic stabilization, the entry of foreign banks, and reforms of the sector and its regulatory framework. On aggregate, banks have become profitable and highly liquid, while the ratio of non-performing to total loans has fallen gradually. Bank deposits have begun to grow and commercial banking has expanded at an average annual rate of 40 percent in 2003 and 2004. Most of the bank lending and deposit taking, however, continues to take place in foreign currencies—mainly U.S. dollars.

Financial Depth and Credit to Private Sector, 2002



Source: IMF

II. Report on the Discussions

10. **Discussions focused on the macroeconomic outlook and medium-term policy challenges and strategy.** Specific attention was placed on external debt dynamics, conditions for private investment, and the ways and means of reducing the share of the shadow economy.

A. Economic Outlook

11. **The staff's medium-term baseline scenario assumes continued sound macroeconomic policies and continued implementation of structural reforms.** This would support real growth rates of 5 to 6 percent in the medium-term, including in 2005 despite a decline in gold exports. The overall fiscal deficit would decline gradually, from 5 percent of GDP in 2003 to 3¾ percent in 2007, helping to reduce the external debt overhang. Monetary policy would contain inflation to about 4 percent.

12. **A favorable external environment is envisaged for the next few years.** Strong growth prospects among key trade partners[6] and gradually improving market access for Kyrgyz goods and services is expected to underlie buoyant external demand. However,

Key Projections 2004-07

	2004	2005	2006	2007
Real GDP (pct. change)	5.5	5.0	5.5	5.5
Inflation (p.a.)	4.3	4.3	4.0	4.0
Current account balance (pct. of GDP)	-3.5	-5.4	-5.1	-3.8
Gen. gov't. fiscal balance (pct. of GDP)	-4.1	-4.6	-4.1	-3.7
Broad money growth (percent, eop)	19.7	15.0	15.0	15.0
Investment ratio	21.2	22.4	22.6	22.7
Savings ratio	17.7	17.0	17.5	18.9

Source: Kyrgyz authorities; staff estimates.

external current account deficits would increase until 2006, reflecting continued high domestic demand growth and new investments in gold projects. The scenario assumes that donors would fill the balance of payments financing gaps of 2½ to 3 percent of GDP beginning in 2005. This could include further Paris Club debt relief in early 2005. Overall, this baseline is broadly consistent with the authorities' recent PRSP annual progress report (IMF Country Report No. 04/200). Beyond 2007 the economy faces significant uncertainty with the expected decline of gold exports, emphasizing the need for export diversification.

13. **Three key risks to this macroeconomic scenario were identified.** First, a substantial negative terms of trade shock—such as from a protracted period of high oil prices or a drop in gold prices—could lead to lower growth and higher inflation. Second, a sharp slowdown in partner countries' demand for Kyrgyz exports—apart from slowing growth—could weaken the exchange rate and external debt ratios. Third, a loss of confidence in the banking system—such as could result if high rates of credit growth lead to weak loan

[6] Merchandise exports to China, Kazakhstan, and Russia are equivalent to 10 percent of Kyrgyz GDP and over half of non-gold merchandise exports.

portfolios and individual bank failures—could worsen the investment climate and reverse the shift away from the shadow economy.

B. Ex Post Assessment

14. **The Kyrgyz authorities assessed positively past cooperation with the Fund and welcomed the main conclusions of the EPA, but felt the EPA could have highlighted more the achievements of the 1990s.** They stressed the Fund's role in identifying a proper policy course and in building policymaking and technical capacity, including through technical assistance. Close cooperation with the Fund had helped to develop a consistent framework for macroeconomic policies and established a dialogue among key policy makers. The authorities recognized that a challenging reform agenda remains in front of them and agreed on the need to broaden support for their economic program, including by clearly articulating to the public the rationale for the government's strategy. The EPA concludes that a low access PRGF arrangement would be an appropriate means of IMF involvement over the next few years. Other highlights of the EPA discussion are presented in Box 1.

15. **The EPA concludes that Fund-provided technical assistance has been well received by the authorities.** Nevertheless, more "hands-on" assistance and, in certain areas, more systematic follow-up and monitoring of TA recommendations would be desirable. In statistics, recent TA missions have noted substantial progress in implementing earlier recommendations. Other areas with strong progress include treasury and customs modernization (paragraph 7), external debt monitoring, and the restructuring of debt between the NBKR and the Ministry of Finance. Important steps have been taken in response to TA in the areas of tax policy and tax administration, although overall effectiveness in these areas has been mixed. For example, while the authorities recognized the quality of assistance on the agricultural VAT, that TA remains ineffective because of strong opposition to the policy.

C. Policy Challenges and the Strategy Ahead

16. **The staff and the authorities agreed on the key aspects of the medium-term macroeconomic strategy.** During the last few years, the strategy has faced three major challenges, which continue to shape the policy landscape. As noted also in the EPA, the first challenge has been the high level of public external debt, which called for continuous fiscal adjustment and more cautious foreign borrowing.[7] Government net borrowing during 2001–03 amounted to $177 million compared to $404 million during the previous three-year period. The authorities agreed that even with further Paris Club debt relief in 2005, the fiscal consolidation would need to continue in order to ensure that debt sustainability is achieved during this decade. However, it was also recognized that the pace of fiscal adjustment could slow somewhat as the recent sale of part of the government ownership in

[7] Domestic public debt is small (about 7 percent of GDP) and is held mainly by the NBKR.

the Kumtor gold mine provides new financing to support poverty reduction without increasing external debt.[8]

Box 1. Highlights of the Ex Post Assessment (EPA)

The EPA draws attention to past policy implementation that often raised questions about program ownership. Successful periods were followed by relapses and, too often, reforms implemented on paper but not in practice. Tackling problems through issuance of presidential decrees, government resolutions, and legislative amendments does not bring results if enforcement is neglected, the EPA concludes. The authorities agreed that implementation had been a problem in the past, but the performance has improved and weaknesses in policy execution was a common feature in all CIS countries.

The key message of the EPA is the need to close this "implementation gap" to sustain success. A professional civil service that is granted the necessary authority while also being held accountable for its actions is critical to developing strong public administration. This will need to be accompanied by reductions in corruption—and in the public's perception of corruption—to garner public support for reforms. Efforts to increase the transparency of government operations are important to help generate the dynamic investment climate needed for growth and poverty reduction. Interestingly, the authorities felt that, with the benefit of hindsight, governance reforms should have been included in donor-supported programs at an earlier stage.

The EPA underscores the vulnerability resulting from high external debt, concluding that a concessional bilateral debt restructuring would improve the prospects for medium-term sustainability. Ensuring debt sustainability would also require a continued shift toward grant financing. The government's responsibility in this respect is to continue fiscal consolidation. Explicit limits on new concessional borrowing should be considered. In this context, the authorities stressed inadequate donor coordination as a factor contributing to external debt accumulation in the mid- to late-1990s. External borrowing from official sources sometimes overwhelmed the capacity for its effective, well-governed use.

The EPA concludes that a low access PRGF arrangement would be an appropriate means of IMF involvement over the next few years. It notes that although the country does not face a large balance of payments need, further Paris Club debt relief is essential to establishing debt sustainability, and that an IMF-supported program is an important complement to such debt relief.

17. **The second challenge has been the prospect of declining gold production.** The authorities agreed with the staff's view that, under these circumstances, export diversification is crucial not only to offset the negative impact on real incomes but also to avoid the re-emergence of spiraling external debt ratios. It was noted with satisfaction that

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[8] By 2007, the overall fiscal deficit is projected to decline to 3.7 percent of GDP, 0.8 percentage point higher than in the authorities' last PRSP update. The case for the Kyrgyz fiscal adjustment was discussed in IMF Country Report No. 04/200.

in 2002–03 non-gold, non-energy exports (in U.S. dollars) were about one third higher than in 2000–01 on average. The key for further broadening the export base is preserving external competitiveness through low inflation and strong productivity growth, to maintain competitive unit labor costs. The major trading partners—Kazakhstan and Russia—are resource rich countries and therefore likely to appreciate their real exchange rates in the medium term, allowing a good opportunity for the Kyrgyz Republic to preserve its current advantage in relative labor cost levels. To fully utilize this competitive edge, regional trade restrictions will need to be reduced further. To foster productivity growth, governance reform has to accelerate, corruption must be reduced, and the energy sector's quasi-fiscal deficit has to decline significantly to accelerate enterprise restructuring.

18. **The third challenge discussed was the constraint on domestic savings, and thus investment, caused by high poverty and weak institutions.** Although private savings show some signs of recovery, to increase national savings requires higher public savings. Promoting private savings requires solid growth of real incomes, building up trust in banks, and reducing the size of the informal economy thus bringing about a more efficient use of funds currently under the mattresses. Regarding private investment, apart from macroeconomic stability, several structural reforms are needed to improve the investment climate as also forcefully pointed out in the staff's EPA (Box 2).

19. **In the discussions, the authorities stressed the large share of the shadow economy as the main development concern, which they linked to high taxation driving enterprises underground.** The mission agreed and pointed out that the tax code reform under discussion should significantly simplify taxation to make it less intrusive. At the same time, some tax rates—notably the payroll tax rate—are highly punitive, and should be reduced. However, a significant reduction in the payroll tax rate requires compensating for the revenue loss by broadening the tax base, improving compliance, strengthening the performance of other taxes, and restraining expenditures, the staff emphasized.

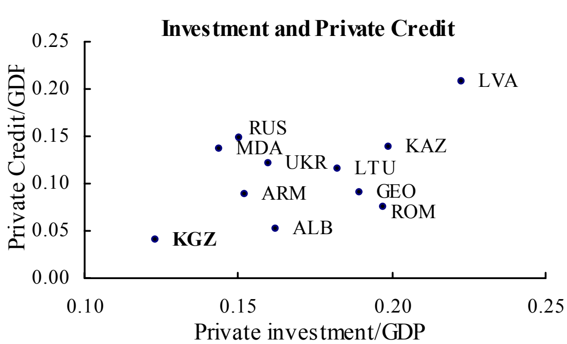
20. **The staff noted that corruption and poor governance are also important contributing factors to the growth of the informal economy (Box 3).** Recent research provides ample evidence of the strong link between the relative size of the shadow economy and poor governance. Tax and governance reforms would provide an incentive for businesses to formalize their operations. This would boost productivity as enterprises could better exploit economies of scale and draw on better functioning market institutions for more efficient services delivery. Thus, to reduce the size of the shadow economy—apart from taxation—future policies should reduce the regulatory burden, improve governance and lessen corruption.

Box 2. Determinants of Private Investment

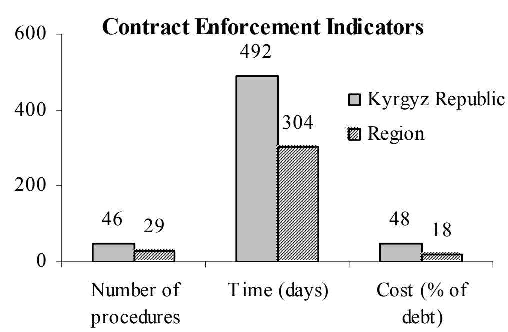
Strong and sustained economic growth in the Kyrgyz Republic requires higher private investment ratios in coming years. Private investment averaged 12 percent of GDP in 2002–03—well below other CIS countries. Continued macroeconomic stability will be critical to enhance growth and profit prospects and to reduce the cost of financing to stimulate private investment. This, however, must be complemented by reforms in the tax regime, the financial infrastructure, and governance. A simple **tax system** with minimal exemptions and clear rules can accelerate investment while ensuring tax compliance. Such a regime also limits tax inspectors' discretion, reducing corruption and improving governance in general. The expected Tax Code revisions—the harmonization of existing laws and new small business taxation scheme—are important in this respect.

Further development of the **financial infrastructure** is needed to enhance access to financial services and mobilize savings for private investment. Despite the ongoing remonetization, the Kyrgyz financial system remains underdeveloped, with the ratio of private credit to GDP of only 4 percent—much lower than in other countries in the region. Recent entries of foreign banks are a positive development, but further financial sector reforms are necessary to improve access to finance. Examples of areas to be addressed include enterprise accounting reform, land registration and title, the development of auditing capacity, and the framework for property and creditor rights.

Good **governance** is at the center of a supportive investment climate. An efficient regulatory framework, control of corruption, strong corporate governance, transparency, and accountability of public administration are essential parts of a growth-enhancing investment environment. A proper **regulatory framework** calls for minimal interference in private business operations, simple business registration procedures, strong contract enforcement, effective property rights, and efficient bankruptcy procedures. Weak contract enforcement is among the most frequently cited investment obstacles in the Kyrgyz Republic. Debt dispute resolution requires over 492 days, compared to 304 days average for the region.[1] The cost of debt resolution is also high at 48 percent of per capita income—compared to the 18 percent regional average.



Source: Kyrgyz authorities, Fund staff estimates



Source: World Bank

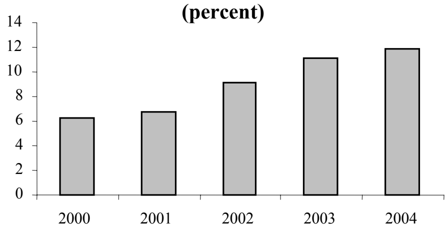
[1] Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Moldova, Russia, Ukraine, Uzbekistan

Box 3. The Kyrgyz Shadow Economy

The shadow economy consists of untaxed economic activity—legal and illegal—that would be taxable if reported. While difficult to measure, studies suggest that in 2000 the Kyrgyz shadow economy comprised about 40 percent of official GDP, about 5 percentage points higher than in the mid-1990s. As cash dominates informal transactions, the rapidly rising cash-to-GDP ratio since 2000 suggests that the shadow economy has expanded more rapidly than the formal economy in recent years, despite structural reforms and the successful macroeconomic stabilization. This suggests that official measures may underestimate economic growth in recent years.

Key factors affecting the size of the shadow economy are high taxes (especially payroll taxes), excessive government controls, and poor governance. These are all areas where international comparisons indicate that the Kyrgyz Republic could do better.

Cash-to-GDP Ratio, Kyrgyz Republic (percent)



Source: Kyrgyz authorities, Fund staff estimates

Shadow economy, 1999/2000
(per cent GDP)

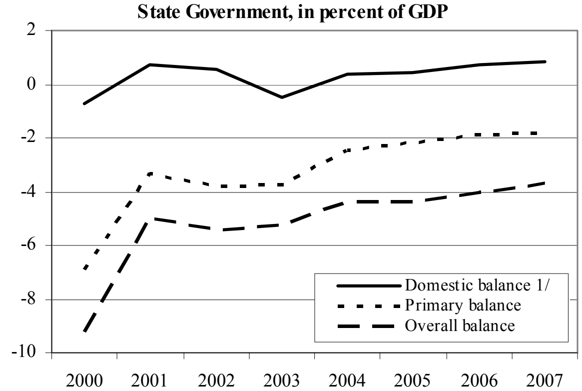
Kyrgyz Republic	39.8
Kazakhstan	43.2
Russia	46.1
Uzbekistan	34.1
CIS Average	46.1

Source: Schneider and Klinglmair, "Shadow Economies Around the World: What do we Know?" Institute for the Study of Labor Discussion Paper 1043, March 2004.

Fiscal Policy

21. **The staff stressed that the medium-term fiscal strategy must balance the spending requirements of meeting the Millennium Development Goals against the constraints imposed by high external debt.**[9] This tradeoff has been at the crux of economic strategy for the past three years and the recent receipt of $84 million (4 percent of GDP) in proceeds from the Kumtor financial restructuring allows the objectives to be addressed more urgently while maintaining the

Fiscal Deficit Measures, 2000-2007
State Government, in percent of GDP



Sources: Kyrgyz authorities; and Fund staff estimates and projections.
1/ Overall balance excluding foreign financed PIP and foreign interests.

[9] Progress toward the MDGs is presented in Table 10.

previously envisaged debt path. The staff has suggested to increase annual spending (relative to the previous baseline) for the next five years, to be used for poverty related expenditures (mainly on health and education investments), and discussions on this issue continue.

22. **While there was broad agreement on the desired pace of fiscal consolidation, views on some tax policy issues diverged within the government.** Both the staff and authorities felt that, following the rapid improvement in 2001-03, the ratio of general government tax revenues to GDP could remain at about 18 percent over the next few years. However, the staff stressed that an additional revenue effort could free further resources for poverty reduction and help to reduce the ratio of debt to tax revenue, an important indicator of debt sustainability. A gradual broadening of the tax base and improved tax administration would allow the reduction of certain tax rates. The broadening of the tax base would include fully implementing the personal property tax and the application of the normal VAT regime to large-scale agriculture—measures adopted by parliament in 2003 that remain ineffective. The staff and the Ministry of Finance favored gradually eliminating distortionary production taxes and cutting several percentage points from the payroll tax—which, at 33 percent, provides disincentives to formal hiring and full wage reporting. Social Fund officials, however, opposed reducing the payroll tax. Also, deep-rooted opposition has developed in some agencies and parliament to the personal property tax and the removal of the VAT exemption for agriculture.

23. **The staff supported efforts underway to remove tax code inconsistencies and ambiguities developed as a result of successive tax code revisions over the past several years.** The authorities began a review of the tax code in early 2004 that drew on expertise from both inside and outside the government, including the IMF Legal Department, USAID, and the Moscow-based Institute for Economies in Transition. The staff also supported the authorities' work in revamping small business taxation and recommended eliminating the present patent taxes and the realignment of the VAT and small business tax thresholds. These reforms, and particularly the small business tax reform, are intended to reduce discretion and discrimination in the tax system as a means to limit the scope for corruption.

24. **Achieving the fiscal consolidation path articulated by the Government also requires containing state government expenditures while ensuring adequate public investment and social spending.** The authorities welcomed staff suggestions to continue reorienting spending toward durable reductions in poverty, in line with the PRSP and MTFF. Increased social spending in recent years has been driven by current spending (e.g., wages and pensions), while capital spending was held to more moderate levels. Looking forward, this reorientation would be reflected partly in higher health and education investments and other poverty-related spending of ¾ percent of GDP annually. However, staff stressed that this additional spending should not lead to permanent expenditure increases and that budget planning must take account of the recurrent maintenance costs associated with higher investment. Key officials also emphasized a need for further increases in the overall public sector wage bill, citing the need to strengthen the quality of public services and reduce incentives for corruption. The staff saw merit in further, appropriately targeted increases and encouraged the Government to reform, in the medium-term, the civil service and its pay

structure so that key personnel can be provided with merit-based and more competitive salaries. Following such a catch-up, real wage increases could be modest—below the real GDP growth rate—leading to a gradual decline in the wage bill relative to GDP. Continued streamlining of the foreign-financed public investment program was seen as important, both because of the external debt strategy and to help control recurrent maintenance costs, where bottlenecks have appeared. On pension policy, the staff recommended that real benefits increase by 2–3 percent a year. Key Social Fund officials considered this insufficient.

The 2005 Budget

25. **The authorities were committed to minimizing the influence of election-related pressures on the 2005 budget.** The staff noted that sales proceeds from the sale of Centerra shares turned out higher than anticipated. This windfall gain provided some room for fiscal flexibility without increasing external debt provided that sales receipt will be allocated to investments and one-time projects to avoid permanent expenditure increases. The government will submit to parliament revisions to the 2005 budget in early November and is in discussions with the staff regarding the size of the 2005 deficit. The key issue is whether—in light of the higher sales receipt from Centerra shares—the state budget fiscal deficit could be kept at the 2004 level (4.4 percent of GDP) instead of 4.0 percent as recommended during the August mission. In any event, the government intends to reduce the use of foreign borrowing to finance the budget from 4.9 percent of GDP to 3.5 percent, as targeted earlier.

26. **The staff broadly supported the President's call for a socially-oriented budget and encouraged the authorities to draw on their PRSP update and medium-term fiscal framework.** Higher health and education sector wages (a 15 percent increase in 2005) and investments were a component of this vision. These wage increases are another open issue under discussion with the staff. A supplement to this staff report will be issued before the Board meeting on the results of these discussions.

D. Monetary and Exchange Rate Policies

27. **Rapid remonetization of the economy is among the main recent macroeconomic achievements.** With steady economic growth and low inflation, real money demand expanded by 20 percent on average in 2002–03, a trend that has continued so far in 2004. Higher money demand has been met primarily by balance of payments inflows, rather than by expanding the domestic component of the money supply.[10] Indeed, the NBKR's gross official reserves rose to the equivalent of 4.7 months of imports at end-June 2004, from 3.8 months at end-2001.

[10] With the NBKR prohibited from lending to the government and with its credit windows for commercial banks limited to liquidity management, the domestic component of monetary expansion remained small.

28. **The authorities were satisfied with the managed float exchange rate regime.** The staff agreed and emphasized that price stability should remain the main objective of monetary policy and, in this context, noted that the NBKR should be more willing to let the nominal exchange rate appreciate.[11] The authorities also expressed interest in moving to inflation-targeting in the medium-term. This was a reasonable goal, in the staff's view, but the preconditions for such a regime remained distant, given unstable monetary transmission mechanisms and the current macroeconomic modeling capacity. There was broad agreement that the level of international reserves provided scope to de-emphasize the further buildup of reserves in the medium-term. The staff observed that financial intermediation remained relatively shallow, making it difficult for the NBKR to manage banking system liquidity. With a view to facilitating monetary management, the staff and authorities explored means of deepening the government securities market.[12]

29. **The staff saw the high rate of private sector credit growth and its potential impact on loan portfolios as a key medium-term risk facing the financial sector.** The authorities emphasized that the stock of credit was relatively low, but they recognized the need for increased vigilance and effective monitoring of individual banks. The authorities and staff shared the view to a large extent that high credit growth reflected the desired remonetization of the economy. Recent experience in many other transition economies with high credit growth was instructive in this respect. However, it was agreed that the NBKR should strengthen bank supervision to safeguard against the vulnerabilities presented by the rapid credit growth. In this context the staff stressed the importance of strengthening the independence of the NBKR and its bank supervision department and encouraged the Government and parliament to fully support these efforts. The staff welcomed the authorities' openness to foreign participation in the banking system, which was bringing additional competition and expertise and had resulted in a broader range of banking services and lower interest rates. Nevertheless, extensive foreign participation presented a new challenge to the supervisory authorities, and the staff recommended they seek close cooperation with their counterpart foreign supervisors.[13]

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[11] Staff stressed that exchange rate flexibility would also help to ensure borrowers' and lenders' awareness of exchange rate risk.

[12] In the staff's view, a deeper government securities market could provide banks with liquid collateral and an alternative asset management tool. This would also help establish a benchmark short-term yield curve and foster the interbank market to support the development of a secondary market. The September 2004 MFD mission recommended actions in this area.

[13] Foreign-owned banks, mainly Kazakh, accounted for 60 percent of banking sector assets (and about half of loans and deposits) as of mid-2004.

E. External Policies

30. **The staff presented various debt scenarios that indicate a need for further Paris Club debt relief (Annex I).** Staff simulations suggest that an improvement in debt indicators to sustainable levels is feasible, although external obligations will remain burdensome. Paris Club debt relief on Houston terms would temporarily alleviate the debt problem, but only a concessional restructuring would improve debt indicators permanently. As suggested by the stress tests, however, debt sustainability would remain vulnerable to shocks.

31. **The staff welcomed the Kyrgyz Republic's liberal trade regime, marked by few non-tariff barriers, low import tariffs, and comprehensive WTO tariff bindings.**[14] The authorities noted that the Eurasian Economic Community (EAEC) provided for a common external tariff (CET) by 2005, but that provisions allowed EAEC members to postpone implementation. About one-third of Kyrgyz MFN tariff rates were in line with the present CET, with about half below. Some counterparts expected that the CET may need to change prior to the WTO accession of Russia and other EAEC members. The authorities appreciated that the Fund's bilateral and multilateral surveillance had begun highlighting the negative impact of industrial countries' trade restrictions on low-income countries and urged the Fund to do more in this respect.

32. **The authorities welcomed recent steps by neighboring countries to improve market access and the transit of Kyrgyz goods.** However, they stressed that important restrictions remained, including local taxes and fees imposed in Kazakhstan on road transit and the uncertainty of an agreement on rail transit.

F. Structural Policies

33. **A comprehensive structural reform agenda is being implemented mainly under the lending programs of the Fund, World Bank, and AsDB.[15]** In addition to fiscal and banking sector reforms, the discussions focused on the electricity sector quasi-fiscal deficit (QFD), which was 12 percent of GDP in 2002, and governance.[16] On the former, the authorities noted that they had met their 2003 and June 2004 QFD reduction targets, mainly

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[14] The authorities reported a simple average import tariff of 5.1 percent, with 42 percent of tariff lines carrying zero duties and other "bands" at 5, 10, 12, and 15 percent (excluding higher seasonal rates on refined sugar). They indicated that all tariff lines are bound in the WTO at rates of 15 percent or less (except refined sugar, with a 30 percent bound rate), with applied rates on many products below the bound rates.

[15] Apart from the energy sector reforms, the World Bank currently has a comprehensive agenda under its Governance Structural Adjustment Credit. The AsDB has focused on corporate governance, financial market development, and customs reform.

[16] Reliable data on the stock of liabilities related to quasi-fiscal deficits are not available.

through improved collections. They reiterated their commitment to broadly halve the electricity sector QFD by 2006 and supported the present Fund monitoring framework and the use of semi-annual QFD targets. The staff urged the authorities to work closely with the World Bank in devising and implementing the specific tariff, bill collection, and management measures needed to meet this goal. The planned further reduction of the QFD by about 3 percentage points of GDP would accelerate enterprise restructuring and improve financial discipline more generally, yielding important macroeconomic benefits.[17]

34. **In the financial sector, the authorities were satisfied that most 2003 FSAP recommendations on legal and regulatory reforms have been implemented.** They regretted, however, that amendments proposed by the NBKR on the legislative framework for anti-money laundering and combating the financing of terrorism (AML/CFT), with IMF technical assistance, had not yet passed parliament. Aspects of the June 2003 Financial Action Task Force (FATF) recommendations are reflected in the AML law that was submitted to parliament during 2004. Legislative amendments have been drafted that aim to remove conflicts between banking and other legislation and to avoid the introduction of such inconsistencies in the future. A new Law on Bank Bankruptcy and Conservatorship has taken effect, but amendments to certain other laws are needed before it can be implemented effectively.

35. **Regarding governance, the staff regretted that establishment of the National Integrity Council in 2003 has not yet led to concrete governance reforms.** Initial efforts to develop the agenda lacked tangible measures and a clear time schedule. On the other hand, a major step in the mining sector is the increased transparency resulting from the adoption of the Extractive Industries Transparency Initiative (EITI), spearheaded under the Fund-supported program and being implemented with World Bank and DFID assistance. More generally, the staff noted that many specific governance policies were outside the Fund's competence and that further steps would need to be taken under the guidance of the World Bank and other development institutions and donors. The Fund would focus on fiscal and financial sector reforms, and in other areas only if they had a significant macroeconomic impact (e.g., electricity sector QFD). The authorities, however, urged that the Fund remain engaged on a broad front, noting that the public attached particular significance to the Fund's endorsement of and engagement with the reforms.

G. Statistical and Other Issues

36. **The Kyrgyz Republic's economic statistics are adequate for effective surveillance.** The authorities subscribed to the Fund's SDDS effective February 2004 and a

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[17] The QFD is monitored under the Fund's PRGF-supported program, but the World Bank leads in the provision of policy advice affecting tariffs, collections, and losses. However, reforms under the World Bank Consolidated Structural Adjustment Credit have stalled recently.

Data ROSC module was published in November 2003. Nevertheless, methodological improvements are ongoing. The NBKR's official balance of payments is being revised to incorporate newly available data on migrants' transfers, estimated at 5 percent of GDP in 2003, and the staff has revised its BOP estimates accordingly.

37. The authorities are requesting an extension of the PRGF arrangement (Attachment II) to allow for the disbursement of rephased amounts that would follow the completion of the sixth review under the PRGF.

III. Staff Appraisal

38. **The Kyrgyz Republic has achieved strong economic performance over the past few years, reflecting a generally favorable external economic environment and prudent fiscal and monetary policies.** Economic growth has begun to broaden, inflation has remained low, and the balance of payments has strengthened. This performance has contributed to strong real income growth and declining poverty. With continued prudent macroeconomic policies and further structural reform, the country's medium-term economic outlook is positive. Nevertheless—as the accompanying Ex Post Assessment stresses—a successor PRGF arrangement and further Paris Club debt relief are needed to continue the recent favorable developments.

39. **Economic policymaking strengthened under the present three-year PRGF arrangement.** The staff notes the authorities' good record of responding to Fund policy advice, particularly regarding improved fiscal discipline. Strengthened administration has led to better tax compliance, while expenditure growth has been contained and spending has increasingly focused on social priorities. Steady improvements in the three-year medium-term fiscal frameworks underlie strengthened fiscal planning and discipline and have helped line ministries to better understand budgetary tradeoffs. However, spending controls require further attention, as government decisions have sometimes overruled the Ministry of Finance efforts to keep expenditures on the budgeted track.

40. **The staff supports the authorities' revised spending plans to address urgent social needs.** These plans mainly reflect higher-than-anticipated receipts from the sale of Centerra gold company shares. Under the revised spending plans, fiscal deficits over the next few years would be somewhat higher than previously foreseen, but without implying additional borrowing. The authorities should work closely with the World Bank to ensure that additional spending is targeted at high quality social sector investments and one-time poverty alleviation projects because of the temporary nature of Centerra proceeds. While there is some risk that the receipts would be inefficiently used or inappropriately targeted, on balance the staff feels that the urgency of spending needs and the authorities' improving capacity to plan and efficiently implement spending justify accepting this risk. External budget financing should be contained in the future and consideration given to setting explicit limits also on concessional borrowing.

41. **With the size of the shadow economy a growing concern, payroll tax rate reductions should begin with the 2005 budget.** The staff welcomes the steps toward overhauling the tax code and, in particular, small business taxation. The authorities should swiftly complete the process, in line with staff recommendations, and bring the changes into effect with the 2005 budget. In light of the external debt burden and social spending priorities, the authorities should view the projected path of tax revenues as a minimum. The staff urges additional efforts to broaden the tax base and improve tax administration, leading to a gradual rise in the ratio of tax revenues to GDP.

42. **The NBKR's sound monetary policy is a key factor behind the country's sustained macroeconomic stability, having facilitated the rapid remonetization of the economy while achieving price stability.** Nevertheless, high rates of private sector credit growth—albeit from a low level—need to be monitored carefully for their impact on the quality of banks' loan portfolios. Financial sector indicators do not indicate any immediate banking vulnerabilities at present, but the NBKR must be prepared to act quickly should pressures emerge. Therefore, further strengthening of bank supervision will be important and the Government and Parliament should support the NBKR's effective independence in this respect. The increasing role of foreign banks is an overall benefit to the economy but presents additional challenges to banking supervision, requiring enhanced cooperation with foreign counterparts.

43. **The Kyrgyz Republic's managed float exchange rate regime remains appropriate.** Facing strong demand, the som has strengthened but, as inflation continues to be several percentage points below that in partner countries, the real effective exchange rate has remained stable. Other indicators such as unit labor costs also suggest that competitiveness remains adequate.

44. **The authorities should approach structural reforms with renewed vigor.** The period leading up to the 2005 elections has been marked by increasing reluctance to implement reforms despite earlier commitments, in particular in the energy sector restructuring. Governance measures should be more concrete. At the same time, all public policy decisions must consider the implications for corruption and governance, minimizing opportunities for public officials to exercise undue discretion. This includes areas such as tax policy, tax administration, public procurement, economic regulation, privatization, and the management of public enterprises. These are critical concerns of domestic and foreign investors.

45. **The staff believes that a robust successor PRGF program is needed to support the government's reform effort.** It would provide the basis for further Paris Club debt relief and help mobilize the grants needed to meet poverty alleviation goals, while moving toward debt sustainability. A low-access PRGF appears to be the most appropriate vehicle for close IMF involvement over the next few years as the country, because of its recent macroeconomic achievements, does not face a large balance of payments need. The Fund's major role would be to help ensure that the government continues with recent policies conducive to consolidation of a stable macroeconomic environment. At the same time, such

involvement would reassure the international community and foreign investors that the country is on the right track.

46. **The staff supports the authorities' request to extend the PRGF arrangement and welcomes their consent to publish this Article IV staff report and related documents**. It is recommended that the next Article IV consultation be held in accordance with the July 2002 decision on consultation cycles.

Table 1. Kyrgyz Republic: Selected Economic Indicators, 2000-07

	2000	2001	2002	2003		2004		2005	2006	2007
	Actual	Actual	Actual	Prog. 1/	Prel.	Prog. 2/	Proj.	Proj.	Proj.	Proj.
National Accounts										
Nominal GDP (in billions of soms)	65.4	73.9	75.4	82.2	83.4	91.8	91.8	100.8	111.1	122.3
Nominal GDP (in millions of U.S. dollars)	1,367	1,525	1,606	1,901	1,911	2,085	2,086	2,291	2,524	2,780
Real GDP (growth in percent)	5.3	5.4	0.0	5.2	6.7	4.5	5.5	5.0	5.5	5.5
GDP per capita (in U.S. dollars)	278	309	324	376	378	413	409	444	485	529
Consumer prices (percent change, avg)	18.7	6.9	2.1	2.7	3.1	4.9	4.3	4.3	4.0	4.0
Unemployment rate	7.5	7.8	8.6	...	9.0	...	...	...	...	...
Poverty rate	52	48	44	...	41	...	...	...	...	...
Investment and savings										
Investment	20.0	19.6	20.3	17.2	20.6	18.0	21.2	22.4	22.6	22.7
Public	8.1	5.3	5.9	4.6	4.8	4.2	4.2	4.2	4.4	4.5
Private	11.9	14.3	14.4	12.7	15.8	13.8	17.0	18.3	18.2	18.2
Savings	15.7	18.2	18.0	13.7	18.2	14.1	18.1	16.6	18.0	19.4
Public	-2.4	-0.5	-0.2	-0.9	-0.9	-0.7	-0.4	-0.8	-0.2	0.5
Private	18.1	18.7	18.2	14.6	19.1	14.8	18.6	17.5	18.2	18.9
Savings/Investment balance	4.3	1.5	2.3	3.5	2.4	3.9	3.1	5.8	4.6	3.3
General government finances (percent of GDP) 3/										
Total revenue and grants	18.5	20.4	22.8	21.9	22.2	22.0	22.3	21.9	21.7	21.7
Tax revenue	15.1	15.8	17.6	17.8	17.8	18.0	18.4	18.2	18.1	18.1
Total expenditure (including net lending)	28.5	25.9	28.0	26.7	27.1	26.3	26.4	26.5	25.8	25.4
o/w: Non-interest current expenditure	18.5	19.6	21.1	21.1	21.3	20.6	20.7	20.5	19.9	19.3
o/w: Public Investment Program (PIP)	6.8	4.4	4.7	3.7	3.6	3.5	3.5	3.3	3.0	3.0
Overall fiscal balance (cash basis)	-9.2	-5.1	-5.5	-4.9	-5.2	-4.3	-4.1	-4.6	-4.1	-3.7
Primary balance 4/	-6.9	-3.5	-3.9	-3.3	-3.7	-2.4	-2.2	-2.4	-1.9	-1.8
Monetary sector 5/										
Net foreign assets (percent change, eop)	34.2	36.0	12.4	...	41.3	49.0	57.4	8.1	13.4	12.3
Net domestic assets (percent change, eop)	34.3	-12.7	35.5	...	5.8	-54.9	-46.3	38.4	13.3	18.0
Credit to private sector (percent of GDP)	4.2	3.8	4.0	...	4.7	4.8	7.3	8.1	8.6	9.2
Broad money (percent change, eop)	11.9	12.2	33.7	22.7	34.5	9.9	19.7	15.0	15.0	15.0
Velocity of broad money 6/	8.9	9.4	7.0	6.2	6.0	5.7	5.6	5.0	4.8	4.6
Interest rate 7/	...	36.4	30.2	...	25.1	...	22.6	...	...	...
External sector										
Current account balance (percent of GDP)	-4.3	-1.5	-2.3	-3.5	-2.4	-3.9	-3.1	-5.8	-4.6	-3.3
Export of goods and services (million USD)	573	561	640	...	745	...	866	900	990	1,086
Export growth (percent change)	8.6	-2.1	14.2	9.4	16.4	7.5	16.2	3.9	10.0	9.7
Import of goods and services (million USD)	656	590	731	...	860	...	1,013	1,108	1,194	1,274
Import growth (percent change)	-7.1	-10.0	23.8	9.4	17.8	10.5	17.7	9.3	7.8	6.7
Gross official reserves (million USD)	206	230	290	315	359	440	500	490	509	535
Gross reserves (months of imports, eop) 8/	4.2	3.8	4.0	4.7	4.3	5.4	5.4	4.9	4.8	4.7
External public debt outstanding (percent of GDP) 9/	111	100	99	95	94	87	91	86	81	76
Memorandum items										
Exchange rate (soms per U.S. dollar, avg)	47.8	48.4	46.9	...	43.7	...	...	...	...	...

1/ IMF Country Report No. 04/16.
2/ IMF Country Report No. 04/198.
3/ General government comprises state government and Social Fund finances. State government comprises central and local governments.
4/ Overall balance less interest payments.
5/ Projections use program exchange rate.
6/ 12 month GDP over average quarterly broad money.
7/ Weighted average interest rate on som denominated loans.
8/ Gross reserves exclude international reserves of NBKR that are pledged or blocked.
9/ Public and publicly guaranteed debt (excluding Kumtor)

Table 2. Kyrgyz Republic: General Government Finances, 2001-07

	2001	2002	2003	2004	2004	2005	2006	2007
	Act.	Act.	Act.	Prog.	Proj.	Revised projections		
				(In millions of soms)				
Total revenue and grants	15,051	17,158	18,639	20,170	20,487	22,046	24,117	26,493
Of which: tax revenue 1/	11,696	13,231	14,890	16,542	16,880	18,332	20,154	22,168
Total expenditure	19,630	21,579	23,224	24,564	24,728	27,124	29,283	31,386
Current expenditure	15,715	17,107	19,204	20,691	20,855	22,922	24,396	25,882
Capital expenditure (including PIP)	3,915	4,472	4,020	3,873	3,873	4,203	4,886	5,505
Net lending	-509	-443	-414	-446	-446	-451	-666	-367
Accrual surplus (+) / deficit (-)	-4,069	-3,978	-4,171	-3,949	-3,795	-4,627	-4,499	-4,526
Cash surplus (+) / deficit (-)	-3,795	-4,150	-4,347	-3,943	-3,789	-4,627	-4,499	-4,526
Total financing	3,795	4,150	4,347	3,943	3,789	2,345	1,193	1,581
External financing	4,208	3,933	3,513	4,648	4,794	1,565	1,191	1,806
Domestic financing	-834	33	556	-3,614	-4,728	248	-404	-355
Change in Social Fund cash balance	121	54	-28	-96	-250	193	57	0
Exceptional Financing 2/	299	130	307	3,005	3,973	340	350	130
Financing Gap	0	0	0	0	0	2,282	3,306	2,945
				(In percent of GDP)				
Total revenue and grants	20.4	22.8	22.3	22.0	22.3	21.9	21.7	21.7
Total revenue	19.5	21.7	21.8	21.4	21.8	21.4	21.3	21.3
Of which: tax revenue 1/	15.8	17.6	17.8	18.0	18.4	18.2	18.1	18.1
Total expenditure	26.6	28.6	27.8	26.8	26.9	26.9	26.4	25.7
Current expenditure	21.3	22.7	23.0	22.6	22.7	22.7	22.0	21.2
Capital expenditure (including PIP)	5.3	5.9	4.8	4.2	4.2	4.2	4.4	4.5
Net lending	-0.7	-0.6	-0.5	-0.5	-0.5	-0.4	-0.6	-0.3
Accrual surplus (+) / deficit (-)	-5.5	-5.3	-5.0	-4.3	-4.1	-4.6	-4.1	-3.7
Cash surplus (+) / deficit (-)	-5.1	-5.5	-5.2	-4.3	-4.1	-4.6	-4.1	-3.7
Total financing	5.1	5.5	5.2	4.3	4.1	2.3	1.1	1.3
External financing	5.7	5.2	4.2	5.1	5.2	1.6	1.1	1.5
Domestic financing	-1.1	0.0	0.7	-3.9	-5.1	0.2	-0.4	-0.3
Change in Social Fund cash balance	0.2	0.1	0.0	-0.1	-0.3	0.2	0.1	0.0
Exceptional Financing 2/	0.4	0.2	0.4	3.3	4.3	0.3	0.3	0.1
Financing Gap	0.0	0.0	0.0	0.0	0.0	2.3	3.0	2.4
Memorandum items:								
Social spending	12.1	14.1	14.0	14.1	14.2	14.5	14.7	14.9
External public debt	100	99	94	89.8	91	86	81	76
NPV of external public debt	77	82	70	54.5	66	65	60	56
Primary balance	-3.5	-3.9	-3.7	-2.4	-2.2	-2.4	-1.9	-1.8
Primary balance excluding grant	-4.3	-5.0	-4.2	-2.9	-2.7	-2.9	-2.3	-2.2
Underlying fiscal balance 3/	-0.8	-1.3	-1.6	-0.4	-0.2	-0.3	0.2	0.2
Domestic balance 4/	0.6	0.5	-0.5	0.5	0.7	0.3	0.7	0.8

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

1/ Includes payroll tax revenue (contribution to the Social Fund), net of the government contribution to the Social Fund.
2/ Mainly privatization proceeds. For revised 2004 projection, includes som 3,589 million related to the Kumtor mine restructuring.
3/ Primary balance excluding gold projects, grant and foreign financed PIP.
4/ Overall balance (in cash) excluding foreign financed PIP and foreign interest payments.

Table 3. Kyrgyz Republic: State Government Finances, 2001-07 (In Millions of Soms)

	2001	2002	2003	2004	2004	2005	2006	2007
	Act.	Act.	Act.	Prog.	Proj.	Revised projections		
				(In millions of soms)				
Total revenue and grants	12,544	14,402	15,666	17,011	17,175	18,832	20,824	23,059
Total revenue	11,922	13,569	15,249	16,494	16,678	18,318	20,388	22,619
Current revenue	11,864	13,439	15,112	16,404	16,588	18,195	20,253	22,469
Tax revenue	9,188	10,475	11,917	13,383	13,567	15,118	16,861	18,733
Income tax	2,008	2,199	2,381	2,454	2,381	2,698	2,953	3,377
VAT	4,221	4,794	5,526	6,302	6,705	7,548	8,445	9,266
Excises	1,103	1,082	1,164	1,352	1,234	1,316	1,569	1,747
Customs	301	419	423	452	482	570	573	634
Land tax	209	318	312	411	388	376	389	403
Road tax and Emergency Fund	990	1,030	1,173	1,333	1,229	1,464	1,613	1,777
Retail sales tax	305	410	471	570	544	586	646	712
Other 1/	50	223	467	510	603	559	672	818
Nontax revenue	2,677	2,964	3,195	3,021	3,021	3,078	3,392	3,736
Capital revenue	57	130	137	90	90	123	136	149
Grants	622	833	418	517	497	513	436	440
Total expenditure	16,880	18,710	20,403	21,501	21,665	23,717	25,933	27,952
Current expenditure	12,966	14,238	16,383	17,628	17,793	19,515	21,046	22,447
Wages and Social Fund contributions	4,301	4,876	5,673	6,581	6,580	7,367	7,990	8,589
Transfers and subsidies 2/	2,221	2,558	2,689	2,523	2,704	3,023	3,332	3,670
Transfers to Social Fund	398	840	1,122	1,090	1,090	1,002	1,238	1,408
Interest	1,228	1,238	1,280	1,783	1,791	2,255	2,348	2,305
Purchases of other goods and services 3/	4,818	4,726	5,618	5,652	5,627	5,867	6,138	6,474
Capital expenditure (including PIP)	3,915	4,472	4,020	3,873	3,873	4,203	4,886	5,505
Domestically financed capital expenditure	676	932	984	661	661	877	1,555	1,835
Foreign financed PIP	3,239	3,541	3,036	3,212	3,212	3,326	3,332	3,670
Financial balance	-4,337	-4,308	-4,736	-4,491	-4,491	-4,885	-5,109	-4,893
Net lending	-509	-443	-414	-446	-446	-451	-666	-367
Accrual surplus (+) / deficit (-)	-3,828	-3,865	-4,323	-4,045	-4,045	-4,434	-4,442	-4,526
Expenditure arrears	155	-231	-53	6	6	0	0	0
Cash surplus (+) / deficit (-)	-3,673	-4,096	-4,376	-4,039	-4,039	-4,434	-4,442	-4,526
Total financing	3,673	4,096	4,376	4,039	4,039	2,152	1,137	1,581
External financing	4,208	3,933	3,513	4,648	4,794	1,565	1,191	1,806
Public investment program (PIP)	3,239	3,630	2,858	3,212	3,212	3,326	3,332	3,670
Disbursements (BOP support)	2,007	356	218	1,100	1,247	220	0	440
Total amortization	-1,833	-878	-1,474	-1,680	-1,680	-1,981	-2,141	-2,304
Arrears and rescheduling	795	825	1,911	2,016	2,016	0	0	0
Domestic financing	-834	33	556	-3,614	-4,728	248	-404	-355
Exceptional Financing 4/	299	130	307	3,005	3,973	340	350	130
Financing Gap	0	0	0	0	0	2,282	3,306	2,945
Memorandum item:								
Primary balance	-2,446	-2,858	-3,095	-2,256	-2,248	-2,179	-2,094	-2,221
Domestic balance 5/	529	428	-427	343	351	458	791	1,011
Underlying balance 6/	-439	-939	-1,403	-432	-404	-99	262	188

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

1/ Mainly mineral resource tax and real property tax.
2/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).
3/ Includes carry-forward expenditure from previous fiscal year (Som 1,022 million in 2004 and 539 million in 2005).
4/ Mainly privatization proceeds. For revised 2004 projection, includes som 3,589 million related to the Kumtor mine restructuring.
5/ Overall balance (in cash) excluding foreign financed PIP and foreign interest payments.
6/ Primary balance excluding gold projects, grant and foreign financed PIP.

Table 4. Kyrgyz Republic: State Government Finances, 2001-07 (In Percent of GDP)

	2001	2002	2003	2004	2004	2005	2006	2007
	Act.	Act.	Act.	Prog.	Proj.	Revised projections		
				(In percent of GDP)				
Total revenue and grants	17.0	19.1	18.8	18.5	18.7	18.7	18.8	18.8
Total revenue	16.1	18.0	18.3	18.0	18.2	18.2	18.4	18.5
Current revenue	16.1	17.8	18.1	17.9	18.1	18.1	18.2	18.4
Tax revenue	12.4	13.9	14.3	14.6	14.8	15.0	15.2	15.3
Income tax	2.7	2.9	2.9	2.7	2.6	2.7	2.7	2.8
VAT	5.7	6.4	6.6	6.9	7.3	7.5	7.6	7.6
Excises	1.5	1.4	1.4	1.5	1.3	1.3	1.4	1.4
Customs	0.4	0.6	0.5	0.5	0.5	0.6	0.5	0.5
Land tax	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Road tax and Emergency Fund	1.3	1.4	1.4	1.5	1.3	1.5	1.5	1.5
Retail sales tax	0.4	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Other 1/	0.1	0.3	0.6	0.6	0.7	0.6	0.6	0.7
Nontax revenue	3.6	3.9	3.8	3.3	3.3	3.1	3.1	3.1
Capital revenue	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Grants	0.8	1.1	0.5	0.6	0.5	0.5	0.4	0.4
Total expenditure	22.8	24.8	24.5	23.4	23.6	23.5	23.4	22.8
Current expenditure	17.5	18.9	19.6	19.2	19.4	19.4	19.0	18.3
Wages and Social Fund contributions	5.8	6.5	6.8	7.2	7.2	7.3	7.2	7.0
Transfers and subsidies 2/	3.0	3.4	3.2	2.7	2.9	3.0	3.0	3.0
Transfers to Social Fund	0.5	1.1	1.3	1.2	1.2	1.0	1.1	1.2
Interest	1.7	1.6	1.5	1.9	2.0	2.2	2.1	1.9
Purchases of other goods and services 3/	6.5	6.3	6.7	6.2	6.1	5.8	5.5	5.3
Capital expenditure (including PIP)	5.3	5.9	4.8	4.2	4.2	4.2	4.4	4.5
Domestically financed capital expenditure	0.9	1.2	1.2	0.7	0.7	0.9	1.4	1.5
Foreign financed PIP	4.4	4.7	3.6	3.5	3.5	3.3	3.0	3.0
Financial balance	-5.9	-5.7	-5.7	-4.9	-4.9	-4.8	-4.6	-4.0
Net lending	-0.7	-0.6	-0.5	-0.5	-0.5	-0.4	-0.6	-0.3
Accrual surplus (+) / deficit (-)	-5.2	-5.1	-5.2	-4.4	-4.4	-4.4	-4.0	-3.7
Cash surplus (+) / deficit (-)	-5.0	-5.4	-5.2	-4.4	-4.4	-4.4	-4.0	-3.7
Total financing	5.0	5.4	5.2	4.4	4.4	2.1	1.0	1.3
External financing	5.7	5.2	4.2	5.1	5.2	1.6	1.1	1.5
Public investment program (PIP)	4.4	4.8	3.4	3.5	3.5	3.3	3.0	3.0
Disbursements (BOP support)	2.7	0.5	0.3	1.2	1.4	0.2	0.0	0.4
Total amortization	-2.5	-1.2	-1.8	-1.8	-1.8	-2.0	-1.9	-1.9
Arrears and rescheduling	1.1	1.1	2.3	2.2	2.2	0.0	0.0	0.0
Domestic financing	-1.1	0.0	0.7	-3.9	-5.1	0.2	-0.4	-0.3
Exceptional Financing 4/	0.4	0.2	0.4	3.3	4.3	0.3	0.3	0.1
Financing Gap	0.0	0.0	0.0	0.0	0.0	2.3	3.0	2.4
Memorandum item:								
Primary balance	-3.3	-3.8	-3.7	-2.5	-2.4	-2.2	-1.9	-1.8
Domestic balance 5/	0.7	0.6	-0.5	0.4	0.4	0.5	0.7	0.8
Underlying balance 6/	-0.6	-1.2	-1.7	-0.5	-0.4	-0.1	0.2	0.2

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

1/ Mainly mineral resource tax and real property tax.
2/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).
3/ Includes carry-forward expenditure from previous fiscal year (1.1 percent of GDP in 2004 and 0.5 percent of GDP in 2005).
4/ Mainly privatization proceeds. For revised 2004 projection, includes som 3,589 million related to the Kumtor mine restructuring.
5/ Overall balance (in cash) excluding foreign financed PIP and foreign interest payments.
6/ Primary balance excluding gold projects, grant and foreign financed PIP.

Table 5. Kyrgyz Republic: Social Fund Operations, 2001-07

	2001	2002	2003	2004	2004	2005	2006	2007
	Act.	Act.	Act.	Prog.	Proj.	Revised projections		
				(In millions of soms)				
Total revenue	3,306	3,573	3,897	4,266	4,420	4,381	4,615	4,856
Total contribution	3,218	3,516	3,840	4,204	4,358	4,318	4,550	4,788
Contribution from government	798	817	924	1,107	1,107	1,167	1,322	1,422
Contribution from non-government	2,420	2,699	2,916	3,097	3,251	3,152	3,228	3,367
Other revenue	88	57	57	62	62	63	65	68
Total expenditure	3,945	4,510	4,867	5,260	5,260	5,576	5,910	6,265
Pension fund (cash)	3,504	4,070	4,537	4,856	4,856	5,147	5,456	5,783
O/w wage	47	46	59	63	64	70	76	83
Social Insurance Fund (cash)	143	150	108	104	104	111	117	124
Employment Fund (cash)	97	106	96	104	104	111	117	124
Medical Insurance Fund (cash)	81	142	250	196	196	207	220	233
Net accumulation of arrears	120	43	-123	0	0	0	0	0
To pension fund	28	-3	-25	0	0	0	0	0
To social insurance	0	0	0	0	0	0	0	0
To employment fund	35	3	-19	0	0	0	0	0
To medical fund	57	43	-80	0	0	0	0	0
Overall balance	-640	-937	-971	-994	-840	-1,195	-1,295	-1,408
Budgetary transfer	398	840	1,122	1,090	1,090	1,002	1,238	1,408
Carry-forward from previous year						250	57	0
Net accumulation of arrears	120	43	-123	0	0	0	0	0
Cash balance	-121	-54	28	96	250	57	0	0
				(In percent of GDP)				
Total revenue	4.5	4.7	4.7	4.6	4.8	4.3	4.2	4.0
Total contribution	4.4	4.7	4.6	4.6	4.7	4.3	4.1	3.9
Contribution from government	1.1	1.1	1.1	1.2	1.2	1.2	1.2	1.2
Contribution from non-government	3.3	3.6	3.5	3.4	3.5	3.1	2.9	2.8
Other revenue	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total expenditure	5.3	6.0	5.8	5.7	5.7	5.5	5.3	5.1
Pension fund (cash)	4.7	5.4	5.4	5.3	5.3	5.1	4.9	4.7
Social Insurance Fund (cash)	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Employment Fund (cash)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Medical Insurance Fund (cash)	0.1	0.2	0.3	0.2	0.2	0.2	0.2	0.2
Net accumulation of arrears	0.2	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.9	-1.2	-1.2	-1.1	-0.9	-1.2	-1.2	-1.2
Budgetary transfer	0.5	1.1	1.3	1.2	1.2	1.0	1.1	1.2
Carry-forward from previous year						0.2	0.1	0.0
Net accumulation of arrears	0.2	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Cash balance	-0.2	-0.1	0.0	0.1	0.3	0.1	0.0	0.0
Memorandum item:								
Average monthly pension (in som; eop) 1/	559	603	663	718.5	719	763	806	852
Payroll tax rate (in percent)	37	33	33	33	33	30	29	28
Payroll tax collection in cash								
Cash collection (in millions of som)	…	3,211	3,644	3,994	3,994	4,210	4,550	4,788
Cash collection ratio (in percent)	…	91.3	94.9	95.0	91.6	97.5	100.0	100.0

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

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

Table 6. Kyrgyz Republic: Medium-term Expenditure Framework for General Government
by Functional Classification, 2000-07
(In percent of GDP)

		2000 Act.	2001 Act.	2002 Act.	2003 Act.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.
	Total expenditure 1/	29.9	25.9	28.1	27.3	26.4	26.5	25.8	25.4
I.	General public services	3.0	2.6	2.8	2.4	2.2	2.2	2.0	1.9
II.	Defense	1.9	1.3	1.4	1.3	1.2	1.1	1.1	1.0
III.	Public order and safety affairs	1.1	1.0	1.3	1.1	1.0	1.0	0.9	0.9
	Social spending	12.2	12.1	14.1	14.0	14.2	14.5	14.7	14.9
IV.	Education	3.5	3.6	4.2	4.2	4.2	4.4	4.6	4.8
V.	Health	2.1	1.8	2.0	2.0	2.1	2.2	2.3	2.4
VI.	Social security and welfare affairs 2/	1.9	2.0	2.5	2.4	2.7	2.8	2.9	3.0
VII.	Pension Fund 3/	4.8	4.8	5.4	5.4	5.3	5.1	4.9	4.7
VIII.	Housing and community services	1.1	1.1	1.5	1.3	1.2	1.2	1.1	1.0
IX.	Recreational, cultural and religious activities	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.3
X	Energy complex (electricity production)	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4
XI.	Agriculture, water resources, forestry	3.2	2.3	2.6	2.3	2.1	2.1	1.9	1.8
XII.	Mining and mineral resources	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2
XIII.	Transportation and communication	3.1	2.0	2.5	2.2	2.0	2.0	1.8	1.7
XIV.	Other economic affairs and services	1.3	0.8	0.9	0.8	0.7	0.7	0.6	0.6
XV.	Other	1.4	1.3	0.8	0.7	0.7	0.7	0.6	0.6
XVI.	Unidentified expenditure	0.5	0.3	-1.1	0.0	0.0	0.0	0.0	0.0

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

1/ Including PIP and net lending.
2/ Excluding net transfer to Pension Fund.
3/ Social Fund operation net of transfers to other funds.

Table 7. Kyrgyz Republic: NBKR Accounts, 2002-07
(In millions of soms, end-period stocks) 1/

	2002	2003	2004								2005	2006	2007
	Act.	Act.	Mar. Prog.	Mar Act.	Jun. Prog.	Jun. Act.	Sep. Prog.	Sep. Act.	Dec. Prog	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.
Net foreign assets	5,725	8,090	7,114	8,239	8,231	8,143	11,844	13,296	12,662	13,604	14,528	16,578	18,774
Net international reserves	4,480	6,917	5,924	7,083	7,090	7,096	10,704	12,325	11,521	12,637	13,561	15,612	17,807
Other foreign assets	1,297	1,224	1,241	1,208	1,192	1,098	1,192	1,022	1,192	1,018	1,018	1,018	1,018
Balance with CIS countries	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51	-51
Long-term foreign liabilities	-2,475	-2,441	-2,474	-2,480	-2,458	-2,480	-2,458	-2,480	-2,382	-2,404	-2,480	-2,480	-2,480
Net domestic assets	4,407	4,427	4,925	4,618	2,277	5,124	2,433	66	1,664	387	640	-205	-1,150
Domestic credit (net)	5,530	5,318	5,551	5,268	2,886	5,730	3,067	754	2,328	862	1,115	270	-675
Claims on government (net), o/w:	5,058	5,046	5,324	5,192	2,323	5,561	2,199	361	1,280	209	117	-626	-1,327
Loan to government in forex (Turkish loan)	1,917	1,956	1,956	1,996	1,996	1,996	1,996	1,996	1,941	1,941	1,832	1,722	1,613
Total government deposits	-1,928	-1,564	-1,281	-1,444	-4,259	-1,078	-4,383	-6,280	-5,247	-6,378	-6,130	-6,534	-6,889
Treasury bonds 2/	4,219	4,303	4,298	4,290	4,036	4,092	4,036	4,096	4,036	4,096	3,866	3,636	3,400
Treasury bills	850	350	350	350	550	550	550	550	550	550	550	550	550
Repos	0	-147	-200	-331	155	-231	460	2	640	263	607	506	261
Claims on commercial banks	472	419	427	408	408	400	408	390	408	390	390	390	390
Other items net 3/	-1,123	-891	-626	-650	-609	-606	-634	-687	-664	-475	-475	-475	-475
Reserve money	7,658	10,075	9,566	10,377	8,049	10,786	11,819	10,882	11,944	11,587	12,687	13,893	15,143
Currency outside commercial banks	…	9,317	…	9,640	…	9,996	…	10,030	...	...	…	…	…
Deposits of commercial banks in forex	…	0	…	0	…	0	…	0	…	…	…	…	…
Currency holdings of commercial banks	…	306	…	259	…	304	…	297	…	…	…	…	…
Reserves of commercial banks	…	452	…	478	…	487	…	554	…	…	…	…	…
Memorandum items:													
Reserve money growth (12 month)	42.9	31.6	21.5	31.8	-4.5	28.0	36.3	25.5	18.5	15.0	9.5	9.5	9.0
Reserve money growth (quarterly, annualized)	82.2	82.2	12.0	12.5	-63.8	16.7	364.8	3.6	4.3	28.5	…	…	…
Gross reserves (in millions of U.S. dollars)	290	359	318	371	437	364	430	...	440	500	490	509	535
in months of imports	4.3	4.8	4.5	4.5	5.3	4.6	5.3	...	5.4	5.4	4.9	4.8	4.7
Net international reserves (in millions of U.S. dollars) 4/	102	157	135	161	161	161	243	280	262	287	308	355	405
change over previous period (in millions of U.S. dollars)	28	28	-5	4	0	0	82	119	19	7	21	47	50
Net domestic assets 5/	2,143	2,174	2,656	2,338	-4	2,851	152	-2,197	-562	-1,822	-1,459	-2,195	-3,031

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

1/ Programmed and actual foreign exchange assets and liabilities are valued at the exchange rate of 44 soms per U.S. dollar, 1.4318 U.S. dollar per SDR and a gold price of U.S. dollar 384.6 per Troy ounce.
2/ As of December 2002, includes government securities issued to replace restructured bonds, as well as those issued for revaluation losses, lost capital in the Central Asia Development Bank, and capitalized past interest arrears on bonds.
3/ As of December 2002, includes revaluation losses, lost capital in the Central Asia Development Bank, and capitalized past interest arrears on bonds.
4/ Non-adjusted.
5/ Excludes counterpart of the loan by the Eximbank of Turkey and the EBRD/IDA enterprise loan which are channeled through the NBKR.

Table 8. Kyrgyz Republic: Monetary Survey, 2002-07
(In millions of soms, end-period stocks) 1/

	2002	2003	2004								2005	2006	2007
			Mar.	Mar.	Jun.	Jun.	Sep.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.
	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prel.	Prog	Proj.	Proj.	Proj.	Proj.
Net foreign assets	7,343	10,374	9,371	10,753	10,868	10,866	14,653	16,496	15,453	16,328	17,648	20,006	22,466
NBKR	5,741	8,090	7,114	8,239	8,231	8,143	11,844	13,296	12,662	13,604	14,528	16,578	18,774
Commercial banks	1,602	2,284	2,257	2,514	2,637	2,723	2,808	3,200	2,791	2,724	3,120	3,428	3,692
Long-term NBKR foreign liabilities	-2,475	-2,441	-2,474	-2,480	-2,458	-2,480	-2,458	-2,480	-2,382	-2,404	-2,480	-2,480	-2,480
Net domestic assets	6,019	6,712	6,908	6,830	7,116	7,644	3,713	2,818	3,026	3,605	4,991	5,657	6,675
Claims on government (net), o/w:	5,556	5,604	5,885	5,819	2,982	6,190	2,880	994	1,812	605	514	-230	-930
Credit from the NBKR	5,063	5,046	5,324	5,192	2,323	5,561	2,199	361	1,280	209	117	-626	-1,327
of which: Turkish loan	...	1,956	1,956	1,956	1,996	1,996	1,996	1,996	1,941	1,941	1,832	1,722	1,613
Credit from commercial banks	493	558	561	627	659	629	681	633	531	396	396	396	396
Treasury bonds	126	134	162	118	118	63	118	63	118	63	63	63	63
Treasury bills	438	515	469	646	646	718	646	718	646	715	715	715	715
Other	-71	-91	-70	-137	-105	-152	-83	-148	-233	-382	-382	-382	-382
Repos actual value	...	0	0	0	0	0	0	0	0	0	…	…	…
Credit to other govt, net	...	0	0	0	0	0	0	0	0	0	…	…	…
Credit to the rest of the economy, o/w:	2,999	3,898	3,581	4,147	7,229	5,022	3,953	5,803	4,364	6,689	8,167	9,576	11,294
in forex	2,039	2,670	…	2,711	…	3,408	…	4,091	…	…	…	…	…
Other items net	-2,535	-2,790	-2,558	-3,136	-3,095	-3,568	-3,120	-3,979	-3,151	-3,689	-3,689	-3,689	-3,689
Broad money	10,887	14,644	13,806	15,102	15,526	16,029	15,908	16,833	16,096	17,529	20,159	23,182	26,660
Currency outside banks	6,873	9,315	8,962	9,637	9,818	9,987	10,038	10,025	10,135	10,922	12,828	14,596	16,599
Deposits, o/w:	4,014	5,329	4,844	5,465	5,708	6,042	5,870	6,808	5,962	6,607	7,330	8,586	10,060
in forex	2,583	3,558	3,100	3,535	3,596	4,153	3,581	4,781	3,517	3,898	3,812	4,284	4,819
Broad money: som component	8,304	11,086	10,706	11,568	11,930	11,876	12,327	12,052	12,579	13,631	16,347	18,898	21,841
Memorandum items:													
Velocity (quarterly) 2/	7.0	6.0	6.0	5.7	5.7	5.6	5.7	5.7	5.7	5.6	5.0	4.8	4.6
Som velocity (quarterly) 2/	9.3	8.0	7.8	7.5	7.4	7.5	7.4	7.7	7.4	7.4	6.9	6.4	6.0
Broad money growth (12 months)	35.1	34.5	21.2	32.6	28.7	32.9	22.7	14.9	9.9	19.7	15.0	15.0	15.0
Som broad money growth (12 months)	34.2	33.5	22.2	32.1	27.5	26.9	26.9	8.7	13.5	23.0	19.9	15.6	15.6
Multiplier	1.4	1.5	1.4	1.5	1.9	1.5	1.3	1.5	1.3	1.5	1.6	1.7	1.8
Credit to the rest of the economy	4.0	4.7	…	4.9	…	5.7	…	6.3	4.8	7.3	8.1	8.6	9.2

Source: National Bank of the Kyrgyz Republic; and Fund staff estimates and projections.
1/ Programmed and actual foreign exchange assets and liabilities valued at 44 soms per U.S. dollar, 1.4318 U.S. dollar per SDR and gold price of U.S. dollar 384.6 per Troy ounce.
2/ 12 month GDP over average quarterly broad money.

Table 9. Kyrgyz Republic: Medium-Term Balance of Payments, 2000-10
(In millions of U.S. dollars)

	2000 Actual	2001 Actual	2002 Actual	2003 Actual	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.
Current account balance 1/	-59	-23	-37	-45	-65	-134	-115	-91	-79	-103	-128
excluding transfers	-167	-95	-145	-177	-213	-290	-277	-257	-243	-266	-285
Trade balance	4	15	-85	-122	-181	-255	-271	-279	-299	-354	-411
Exports, fob	511	480	498	590	672	683	745	804	857	871	888
CIS countries	214	172	170	202	251	297	318	348	376	407	441
of which : Energy	82	52	28	26	33	52	58	62	67	73	78
Non-CIS countries	297	308	328	388	422	386	426	456	481	463	447
of which: Gold	195	225	163	260	271	223	247	255	256	212	166
Imports, fob	507	465	583	713	854	939	1016	1084	1156	1224	1300
CIS countries 2/	280	275	343	434	533	602	665	707	756	809	856
of which: Energy	120	117	145	172	216	227	230	238	244	251	247
Non-CIS countries	227	190	240	279	321	337	351	376	400	416	443
Services (net)	-171	-110	-60	-55	-32	-34	-6	22	56	88	126
Non-interest service	-87	-44	-5	7	35	48	68	92	129	163	202
Receipts	62	80	142	155	194	217	246	282	326	365	411
Payments	-149	-125	-148	-148	-159	-169	-178	-191	-196	-203	-209
Interest payments (scheduled)	-51	-39	-32	-27	-29	-44	-35	-32	-33	-35	-36
Other net income	-33	-26	-23	-35	-37	-38	-39	-37	-40	-40	-40
Transfers (net)	108	72	108	132	148	156	162	166	164	163	157
Official	66	53	50	37	43	41	37	26	24	23	17
Private	42	20	59	95	105	115	125	140	140	140	140
Capital account balance	56	23	10	-4	125	94	83	63	56	75	109
Commercial banks	-2	-13	-10	-13	-10	-9	-7	-6	-4	-4	-4
Medium-and long-term loans, net	41	17	32	-23	-5	-18	5	16	14	14	29
Disbursement	131	115	90	80	74	79	78	85	92	103	109
o/w foreign financed PIP	92	69	77	73	73	76	75	82	88	95	102
Amortization (scheduled)	-91	-97	-58	-102	-79	-96	-74	-70	-78	-89	-80
Foreign direct investment (net)	-7	-1	5	46	116	83	68	42	39	55	73
Portfolio investment (net)	-1	1	-12	6	7	9	7	6	5	5	5
Other assets 3/	26	18	-5	-20	17	29	10	5	2	5	5
Errors and omissions and short term capital 4/	-13	-42	61	53	0	0	0	0	0	0	0
Overall balance	-16	-42	34	4	60	-40	-33	-29	-23	-27	-20
Financing	16	42	-34	-4	-60	-16	-47	-40	-25	-26	-38
Net international reserves	-14	-18	-63	-54	-130	-21	-47	-50	-25	-26	-38
Gross official reserves (- increase)	-21	-16	-57	-55	-141	10	-19	-26	-3	-4	-12
IMF (net)	7	-2	-6	1	10	-31	-28	-24	-22	-22	-26
Purchases and disbursements	19	15	15	32	43	0	0	0	0	0	0
Repurchases and repayments	-11	-17	-21	-30	-32	-31	-28	-24	-22	-22	-26
Exceptional Financing (including arrears)	30	19	21	45	42	0	0	0	0	0	0
Accumulation of Arrears (net)	1	-15	1	2	0	0	0	0	0	0	0
Debt rescheduling	29	34	20	43	42	0	0	0	0	0	0
BOP support loans (ADB) 5/	0	33	8	0	28	0	0	0	0	0	0
BOP support loans (WB) 5/	0	8	0	5	0	5	0	10	0	0	0
Financing gap (-)	0	0	0	0	0	-56	-79	-69	-48	-53	-58
Memorandum items:											
GDP (in millions of U.S. dollars)	1,368	1,527	1,608	1,911	2,087	2,291	2,524	2,780	3,037	3,309	3,594
Current account balance (in percent of GDP)	-4.3	-1.5	-2.3	-2.4	-3.1	-5.8	-4.6	-3.3	-2.6	-3.1	-3.6
Growth of exports of goods and services(volume, percent)	10.5	-3.2	7.3	9.5	14.4	2.8	9.0	7.9	7.3	3.1	3.5
Growth of imports of goods and services (volume, percent)	0.5	-10.1	15.7	13.8	14.3	7.2	5.9	5.0	4.4	3.6	3.8
External Public Debt (US$ million) 6/	1,520	1,522	1,587	1,797	1,907	1,967	2,041	2,126	2,178	2,226	2,294
as percent of GDP	111	100	99	94	91	86	81	76	72	67	64
External Public Debt (NPV US$ million) 6/	1,119	1,181	1,310	1,331	1,383	1,479	1,511	1,556	1,590	1,618	1,662
as percent of GDP	82	77	82	70	66	65	60	56	52	49	46
as percent of exports 7/	198	213	222	205	184	177	164	157	146	138	134
debt-to-exports service ratio 6/ 8/	12	13	10	8	11	19	14	12	11	12	11
Gross reserves 9/	206	230	290	359	500	490	509	535	538	542	554
in months of subsequent year's imports	4.2	3.8	4.0	4.3	5.4	4.9	4.8	4.7	4.5	4.3	4.1
Financing gap as percent of GDP	0.0	0.0	0.0	0.0	0.0	-2.4	-3.1	-2.5	-1.6	-1.6	-1.6

Sources: Kyrgyz authorities and Fund staff estimates and projections.

1/ Including transfers.
2/ Includes a positive adjustment factor to account for unrecorded CIS non-energy imports 2000-05
3/ Includes derivative gains/ losses
4/ Includes balancing item for unrecorded import adjustment
5/ BOP support loans for 2005 onward, except for firm commitments, are included within the financing gap. Loans for 2000 are shown as part of disbursements under capital account.
6/ Public and publicly guaranteed debt (excluding Kumtor)
7/ Based on three-year average exports of goods and nonfactor services.
8/ Assuming Paris Club debt relief up to 2004 only.
9/ Valued at end-year exchange rates.

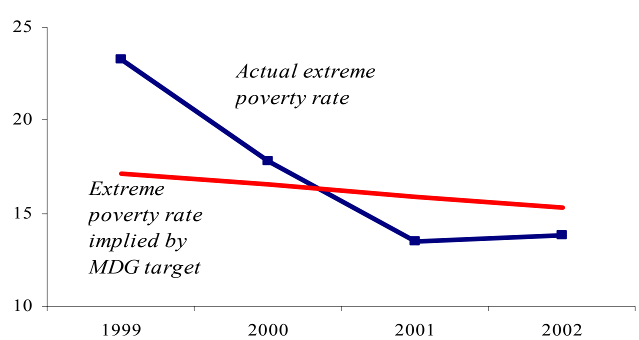
Table 10. Kyrgyz Republic: Millennium Development Goals

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

Sources: Kyrgyz Authorities, World Bank, Fund staff estimates

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

Achieving MDG: Extreme Poverty Target



**Update to the Report on the Observance of Standards and Codes
2001 Fiscal Transparency Module**

This update on developments since the March 2002 Report on Observance of Standards and Codes-Fiscal Transparency was prepared on the basis of information provided by the Kyrgyz authorities. For a full description of institutions and practices, it should be read in conjunction with the original report.[1] *The recommendations in the original report remain valid except where noted below.*

The authorities have regularized financial relations between the National Bank of the Kyrgyz Republic (NBKR) and the Ministry of Finance (MOF). Drawing on MFD technical assistance, a scheme to restructure NBKR-held government bonds was developed, under which both government deposits at NBKR and NBKR claims on government carry positive interest rates. The decree clarifying relations between the MOF and NBKR took effect on June 21, 2002.[2]

Some progress was achieved toward reducing the commercial activities of ministries. The president has issued a decree initiating work towards transferring all obligatory payments (or "special means") to the budget. An inter-ministerial working group was established to review and reform the obligatory payments system. A new regulation expected to take effect in late 2004 would require that license fees, fines, penalties and other obligatory payments received by ministries and government agencies be processed directly through the treasury system and credited to the single treasury account. As an intermediate measure, license fees collected by six ministries and agencies have been directly credited to the budget since 2003. The process is expected to be completed by 2006. In accordance with the Law on the Republican Budget, all "special means" revenues and the expenditures they finance are shown as separate items in the respective republican budget and local budgets. Since 2002, the Central Treasury holds a separate account at NBKR (and transit accounts at agent banks for the regional offices of the treasury) for "special means" that are not yet credited to the Treasury Single Account to manage operations under "special means."

A new tax code is expected to enter into force in January 2005, drawing on technical assistance from the Fund (LEG) and other entities. A high-level commission was created in January 2004 to draft the new tax code, with a view to removing internal inconsistencies

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[1] The original report "Kyrgyz Republic: Report on the Observance of Standards and Codes–Fiscal Transparency Module" was published in March 2002 (IMF Country Report No. 02/54) and is available on the IMF website at http://www.imf.org/external/np/rosc/rosc.asp.

[2] The Joint Decree of Government of the Kyrgyz Republic and NBKR "On settlement of the financial relations between the Government of the Kyrgyz Republic and National Bank of the Kyrgyz Republic."

and ambiguous expressions, and to expanding the coverage of the code to include all tax regulations. An initial draft new tax code prepared by the commission in May 2004, with assistance from international experts mainly through USAID was posted on the web for public comments. The final draft will be submitted to parliament in October 2004.

Four large extra-budgetary funds are gradually integrated into the Treasury system, following the government action plan approved in June 2004. The Economic Development Fund was integrated in July 2004. The State Reserve Fund will be integrated by the end of 2004 and the State Property Fund by mid-2005. All the necessary documents have been signed that would reorganize the Enterprises Support Fund as a joint stock company in 2005.

The Treasury modernization project supported by the World Bank Governance Technical Assistance Credit is underway and is expected to be completed by 2007. The regulatory framework and manuals for treasury operations have been developed. Due to delays with the tender process for selecting a consulting firm for design of the automated treasury management system (ATMS), it is now expected that the system will not be implemented before the summer of 2005.

Pending the full automation of the Treasury system, the cash forecasting function of the Treasury has been improved and a manual commitment control and arrears tracking system has been put in place. A cash forecasting unit was created within the Central Treasury in 2003. The manual control system established in 2003 was significantly improved in 2004 with the introduction of systematic reporting from budget institutions. The Regulation for Drafting and Approving the Financial Plan for Central Government Budget Expenditures, approved in April 2003, guides the preparation of monthly cash flow forecasts and financial plans for central government budget expenditures.

Significant improvements were made by the government in the publication of fiscal information. Following the Regulation on the Central Treasury, a monthly budget implementation report is available on the MOF website.[3] The National Statistics Committee (NSC) subsequently publishes this information in its monthly statistical bulletin. The quarterly bulletin published monthly by the MOF since 2003 discusses issues related to budget preparation and execution and includes information on government debt. The bulletin is published within three months after the end of the quarter, and is available on the MOF website as well as in paper copies.[4] The MOF reports data on government debt (also

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[3] Preliminary information on budget execution is placed on the MOF website by the 10th of the following month. Once numbers are reconciled with revenue agencies, the final report will be place on the website (after the 20th of the following month).

[4] The First Quarter 2004 Bulletin has not been published due to a shortage of financial resources.

available on the MOF website) to NBKR and NSC, which subsequently include it in their reports. The Chamber of Accounts audits budget execution and publishes an annual report (reports for 2001 and 2002 are available on the Government website). A three-year rolling medium term budget framework (see below), updated annually and available on the MOF website, includes detailed technical notes on assumptions underlying budget preparation and planning.

The budget planning process has improved significantly with the annual publication, beginning in 2003, of rolling three-year medium-term budget frameworks (MTBFs). Although much remains to be done, the MTBF and attached technical notes, which covers the Social Fund and the public investment program (PIP), specify macroeconomic assumptions and the overall fiscal framework that underlies the annual budget preparation. It also helps to operationalize the authorities' poverty reduction strategy paper (PRSP) by prioritizing and sequencing the stated objectives. Monthly budget execution reports with detailed analyses are provided to main legislative and executive offices for use in decision making. Although all extra-budgetary funds, except the Social Fund, will be integrated into the Treasury system by mid-2005, other issues related to the coverage of the annual budget documents remain.

Little progress has been made to improve the reporting of the government quasi-fiscal activities. While this was identified as one of the important steps to improve transparency and clarify the role of the government vis-à-vis the rest of the economy, government quasi-fiscal activities remain unreported in the budget documents. Publication of the electricity sector quasi-fiscal deficit in the MOF quarterly bulletin is a welcome exception.

Bishkek, Kyrgyz Republic
October 27, 2004

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

Dear Mr. de Rato:

On behalf of the authorities of the Kyrgyz Republic, we hereby request an extension, through April 5, 2005, of the PRGF arrangement due to expire December 5, 2004.

The extension is needed to allow for the disbursement of rephased amounts that would follow completion of the sixth review.

Sincerely yours,

/s/	/s/
Nikolai Tanaev	Ulan Sarbanov
Prime Minister	Chairman
Kyrgyz Republic	National Bank of the Kyrgyz Republic

SUSTAINABILITY OF THE KYRGYZ REPUBLIC'S PUBLIC EXTERNAL DEBT[1]

Background

1. **The stock of the Kyrgyz Republic's public and publicly guaranteed external debt amounted to $1,790 million (94 percent of GDP) at end-2003.** Of this debt, 68 percent was owed to IFIs and 32 percent to bilaterals. The World Bank was the largest multilateral creditor, followed by the Asian Development Bank and the IMF. Japan and Russia accounted for 71 percent of the bilateral debt. Because of the high concessionality of the IFI loans, in present value terms (PV), 56 percent of the debt was multilateral and 44 percent bilateral (Table 1). The lower concessionality of the bilateral debt implies that any Paris Club debt relief has a much larger impact on debt sustainability than judged on the basis of absolute debt values.

2. **While the debt situation has improved since the Paris Club flow rescheduling in March 2001, it remained unsustainable at end-2003.** Net foreign borrowing slowed considerably—to $177 million in 2001-03, compared to $404 million in 1998-2000. Debt ratios improved because of stronger export performance since 2000—the PV debt-to-exports ratio fell by 14 percentage points between 2001 and 2003, to 205 percent. The PV debt relative to government revenue fell from 480 percent at end-2001 to 380 percent at end-2003. Rising tax revenue explains the improvement--the state tax revenue-to-GDP ratio increased from 12.4 percent of GDP in 2001 to 14.3 percent in 2003. Debt service ratios were brought down significantly with the 2002 Paris Club flow reschedulings.

3. **Fiscal consolidation has been the key component of the Kyrgyz debt reduction strategy.** Earlier, large fiscal deficits financed through external loans contributed to an unsustainable external position. Between 2000 and 2003, however, the primary fiscal deficit declined by 3 percentage points of GDP, to 3.7 percent, as borrowing under the PIP and program loans slowed.

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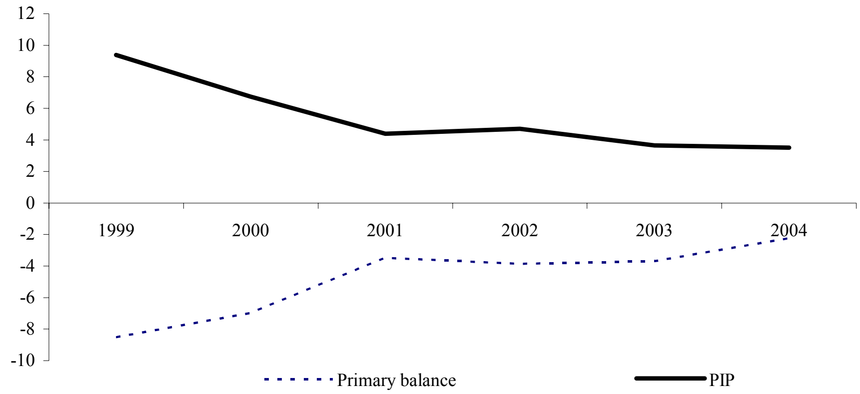
[1] The Kyrgyz Republic's external debt is defined as public and publicly guaranteed debt to non-residents. The analysis excludes private sector debt, including the Kumtor gold mine debt, amounting to about 10 percent of GDP at end-2003. The Kumtor debt was included in public debt in earlier simulations as the state-owned KyrgyzAltyn owned 66 percent of the mine. Now the Kumtor gold mine is owned by Centerra company which is listed in the Toronto Stock Exchange and only 20 percent of its shares are held by KyrgyzAltyn.

Kyrgyz Republic: Primary Balance and PIP, 1999–04
(In percent of GDP)



Source: Kyrgyz Republic Ministry of Finance.

4. **The assumptions underlying the Debt Sustainability Analysis (DSA) reflect the staff's latest projections and are broadly consistent with the authorities' National Poverty Reduction Strategy (NPRS) progress report of June 2004.** Real GDP is projected to increase by about 5 percent a year in the medium and long term. Export volumes are anticipated to grow by about 5 ½ percent a year during 2005-10, and 3-3 ½ percent a year thereafter, compared to annual growth of 7.5 percent in 2001–04. This slowdown reflects the declining trend in gold production. Import volumes are expected to grow at an average annual rate of 5 ¾ percent in 2005-10 but slow to 3 ½ percent in outer years. These assumptions imply a current account deficit of about 4 percent of GDP during the average year. Growth in the CIS area is assumed at 4 ½ percent per year and in the OECD countries at just over 3 percent per year. It is presumed that the real effective exchange rate would remain broadly constant.

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

6. **The analysis is based on loan specific CIRRs and exchange rates which are incorporated into the Debt-Pro debt analysis program.**[3] The loan-specific approach is

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[2] The Paris Club treatments are computed to be effective as of December 2004.

[3] At end-2003, the CIRR for the U.S. dollar denominated loans was 4.5 percent and the U.S. dollar exchange rate against the SDR was 1.49.

important in the Kyrgyz case because a significant part of the bilateral debt is in other currencies than the U.S. dollar. The Fund's low-income country template does not provide sufficient degree of detail in this respect. An additional benefit from using the Debt-Pro template together with the low-income country template, is that alternative Paris Club debt treatments can be simulated. Stress tests are run with the Fund's low-income country template against the baseline which is close to the Debt-Pro baseline.[4] The som-U.S. dollar exchange rate and nominal rates to other currencies are assumed constant.

7. **The simulations suggest that without further debt rescheduling, debt service relative to fiscal revenue would rise to levels beyond those before the 2002 Paris Club flow rescheduling.** Such a high debt service requirement would risk the onset of a debt default as allocating on average 25 percent of fiscal revenue to debt service in 2005–07 would unduly compress the government wage bill, investment, and social spending. Continuing with Houston terms would relieve the liquidity constraint temporarily—but without resolving the solvency problem, as called for under the Paris Club Evian approach.[5] Although the debt-to-fiscal revenue ratio could become manageable by mid-2010s, the debt-to-exports ratio would remain high. As an illustration, the PV debt-to-exports ratio would only temporarily fall under the threshold used in assessing the HIPC countries debt sustainability.

8. **The simulations suggest that during the next twenty years, debt sustainability (using the HIPC thresholds as a yardstick) could be achieved only through a concessional debt stock operation.** With a Paris Club stock operation under Naples terms, the PV debt-to-exports ratio would stabilize at 120-130 starting in 2008. The PV debt-to-fiscal revenue would decline below 250 percent in 2009 and continue to fall thereafter even with a conservative assumption that state tax revenue relative to GDP would increase only from 15 percent of GDP in 2004 to 16 percent by 2010 and stay at that level thereafter.

9. **In the simulations, the long-run debt sustainability is very sensitive to the financing pattern of the balance of payments.** The simulations assume that the financing gaps of the balance of payments would be filled on concessional terms until 2008, half on concessional and half on market terms in 2008–15, and two-thirds on market terms after 2015. Under these assumptions, although the solvency ratios would decline to sustainable levels under the Naples terms debt relief, debt service becomes increasingly expensive.

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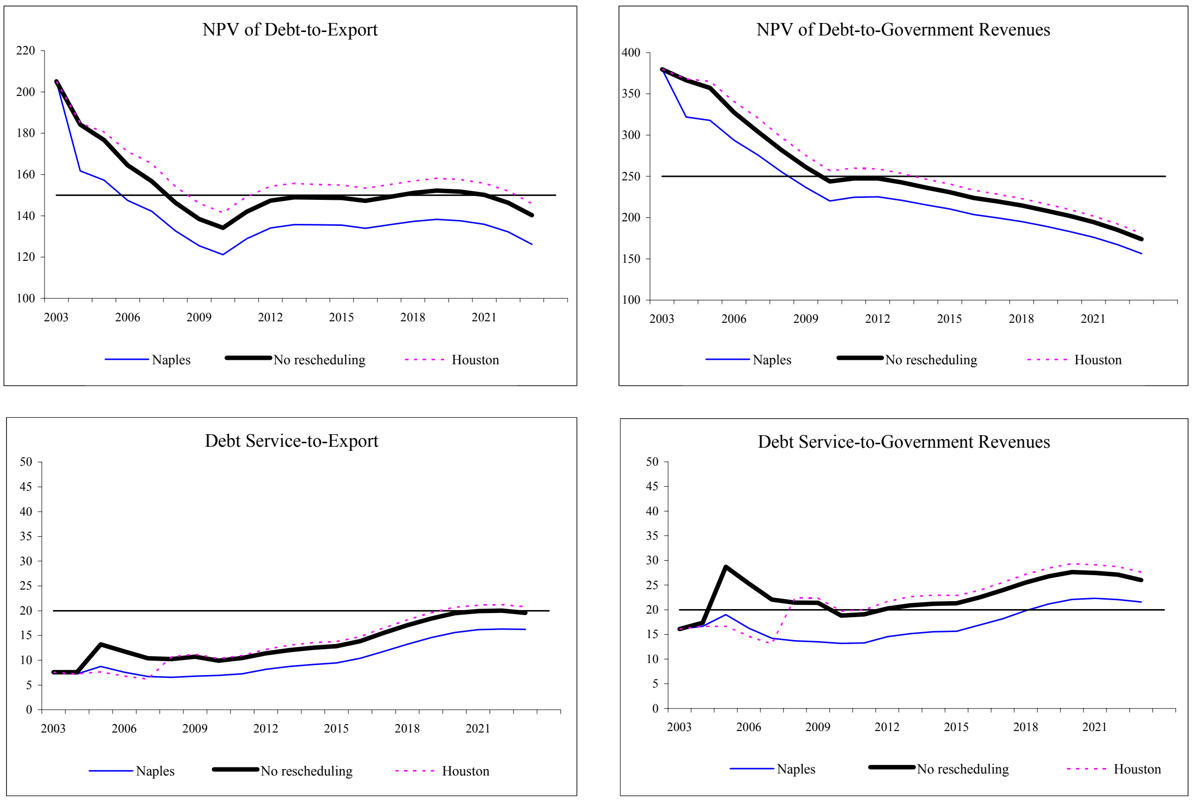
[4] Debt service ratios are identical and the small differences in the debt-to-export ratios mainly reflect the measurement of debt relative to the current years exports in the Fund low-income template as opposed to the three-year average exports in the Debt Pro framework.

[5] Debt service ratios would rise abruptly at the end of a Houston flow rescheduling unless a subsequent rescheduling was agreed (in which case the debt service-to-revenue ratio would remain below 20 percent). The simulations suggest that a Houston rescheduling would not keep the NPV debt-export ratio below the 150 percent benchmark.

Assuming that 20 percent debt service ratios are manageable, this benchmark (relative to fiscal revenue) would not be exceeded before 2018, however.

Kyrgyz Republic: Debt Sustainability Analysis



Source: Kyrgyz Ministry of Finance and IMF staff simulations.

Stress Tests

10. **The stress tests assume that key macroeconomic variables are at their recent historical averages, or below them by a factor reflecting their historical volatility (Table 3).** Historical averages and standard deviations are computed for 1997–2003.

Kyrgyz Republic: Selected Economic Indicators, 1997–2003 Averages

	Historical Average
Current account deficit, excl. interest payments (in percent of GDP)	7.6
Export growth (US dollar terms, in percent)	7.2
Official grants to GDP ratio	3.9
Net non-debt creating capital inflows (in percent of GDP)	2.1
Effective interest rate (in percent) 1/	3.7
Real GDP growth rate (in percent)	5.0
Price of main export commodity (US dollars)	315

Source: Staff estimates

1/ Includes change in arrears, exceptional financing, change in gross foreign assets, and valuation adjustments.

11. **The simulations suggest that debt sustainability remains vulnerable to macroeconomic shocks.** The medium-term debt dynamics are highly sensitive to current account performance, in particular to export growth assumptions. With key macro variables at their historical levels—which are significantly worse than in recent years--the PV debt-to-exports ratio could be more than 100 percentage points higher than in the baseline simulation at the end of this decade. This reflects the larger current account deficit than currently projected, and thus, a return to higher foreign borrowing. Consequently, by 2010, the ratio of debt service-to-exports would be 7 percentage points higher (at 18 percent) than in the baseline.

12. **A sudden negative shock to exports which would keep the export values permanently at a lower level—such as an increase in trade restrictions or a loss of important market shares—would also undermine the efforts to achieve debt sustainability during this decade.** On the other hand, non-debt creating capital inflows (mainly foreign direct investment) are projected so low (about 2 percent of GDP) that possible disappointments in this area have little impact to debt sustainability.

Table 1. Kyrgyz Republic: Structure of the External Debt, end-2003

	Stock of debt		Present value	
	In US dollars	in percent of public debt	In US dollars	in percent of public debt
Total external debt	1990.3		1518.0	
Public and publicly guaranteed	1797.2	100.0	1330.5	100.0
Multilateral	1222.4	68.0	751.2	56.5
ADB	401.5	22.3	240.0	18.0
IDA	529.1	29.4	309.0	23.2
IMF	201.9	11.2	121.9	9.2
EBRD	45.2	2.5	44.7	3.4
Islamic Development Fund	23.7	1.3	21.2	1.6
OPEC	7.3	0.4	6.9	0.5
IFAD	7.2	0.4	4.2	0.3
Nordic Fund	6.4	0.4	3.2	0.2
Bilateral	574.9	32.0	579.4	43.5
Paris Club	461.5	25.7	479.1	36.0
Japan	230.7	12.8	250.3	18.8
Russia	176.2	9.8	188.4	14.2
Germany-KFW	33.3	1.9	20.1	1.5
Germany-Berliner	5.4	0.3	4.3	0.3
Germany-HRM	5.0	0.3	7.0	0.5
Denmark	5.8	0.3	4.4	0.3
France	5.1	0.3	4.6	0.3
Non-Paris Club	113.4	6.3	100.2	7.5
Turkey	45.8	2.5	37.0	2.8
Kuwait	18.6	1.0	18.7	1.4
Korea	14.2	0.8	8.9	0.7
China	13.4	0.7	9.7	0.7
Uzbekistan	11.4	0.6	11.2	0.8
Pakistan	9.0	0.5	12.9	1.0
India	1.0	0.1	1.7	0.1
Private non-guaranteed	193.1	n.a.	187.5	n.a.
Of which: Kumtor	98.1	n.a.	107.2	n.a.

Table 2. Kyrgyz Republic: Debt Rescheduling Scenarios, 2003-2023 1/

(In millions of US dollars; ratios as percent)

Paris Club	Debt Indicators	2003	2004	2005	2006	2007	2008	2009	2010	2015	2023
No new rescheduling	PV of debt	1,331	1,383	1,479	1,511	1,556	1,590	1,618	1,663	2,460	3,825
	Debt service	56	65	119	117	113	121	133	128	227	572
	PV of debt-to-GDP	69	66	65	60	56	53	49	47	44	33
	PV of debt-to-exports 2/	205	184	177	164	157	146	138	134	149	140
	PV of debt-to-revenues	380	367	357	328	304	281	261	244	231	174
	Debt service-to-exports 3/	8	8	13	12	10	10	11	10	13	20
	Debt service-to-revenues	16	17	29	25	22	21	21	19	21	26
Houston terms	PV of debt	1,331	1,388	1,512	1,571	1,640	1,676	1,706	1,753	2,564	3,975
	Debt service	56	63	69	67	67	126	138	135	244	608
	PV of debt-to-GDP	69	67	66	62	59	55	52	49	46	35
	PV of debt-to-exports 2/	205	185	181	171	165	154	146	141	155	146
	PV of debt-to-revenues	380	368	365	341	320	297	275	257	241	181
	Debt service-to-exports 3/	8	7	8	7	6	11	11	10	14	21
	Debt service-to-revenues	16	17	17	15	13	22	22	20	23	28
Naples terms	PV of debt	1,331	1,214	1,316	1,355	1,411	1,441	1,466	1,502	2,242	3,438
	Debt service	56	63	79	75	73	78	84	90	167	475
	PV of debt-to-GDP	69	58	57	54	51	48	45	42	40	30
	PV of debt-to-exports 2/	205	162	157	147	142	133	125	121	135	126
	PV of debt-to-revenues	380	322	318	294	276	255	237	220	210	156
	Debt service-to-exports 3/	8	7	9	8	7	7	7	7	9	16
	Debt service-to-revenues	16	17	19	16	14	14	14	13	16	22
	Memorandum items:										
	PV of Kumtor debt	107	53	15	5	0	0	0	0	0	0
	Kumtor debt service	64	59	40	11	5	0	0	0	0	0

Source: Kyrgyz Ministry of Finance and IMF staff simulations.

1/ Excluding private non-guaranteed debt and Kumtor.
2/ Three-year average exports.
3/ Current-year exports.

Table 3. Kyrgyz Republic: External Debt Sustainability Framework, Baseline Scenario, 2000–23 1/

(In percent of GDP, unless otherwise indicated)

	Actual				Historical Average 6/	Standard Deviation 6/	Projections							
	2000	2001	2002	2003			2004	2005	2006	2007	2008	2010	2015	2023
External debt (nominal) 1/	133.4	110.0	108.5	104.2	...	...	98.8	91.4	85.2	80.1	74.8	66.3	53.4	36.3
o/w public and publicly guaranteed (PPG)	111.1	99.8	98.7	94.1	...	...	91.4	85.9	80.8	76.5	71.7	63.8	53.3	36.3
Change in external debt	-7.2	-23.4	-1.4	-4.4	...	...	-5.4	-7.4	-6.1	-5.1	-5.3	-3.8	-2.5	-2.6
Identified net debt-creating flows	-9.8	-12.3	-3.6	-17.2	...	...	-7.2	-1.5	-2.6	-2.1	-2.0	-1.1	-1.7	-2.7
Non-interest current account deficit	0.6	-1.1	0.3	1.0	5.4	7.4	2.1	3.5	3.7	2.6	1.9	2.8	1.0	0.8
Deficit in balance of goods and services	6.1	1.9	5.6	6.0	...	...	7.0	9.1	8.1	6.7	5.6	5.8	5.5	4.7
Exports	41.9	36.7	39.8	39.0	...	...	41.5	39.3	39.2	39.1	38.9	36.1	31.3	25.1
Imports	47.9	38.7	45.4	45.0	...	...	48.5	48.4	47.3	45.8	44.5	42.0	36.8	29.8
Net current transfers (negative = inflow)	-7.9	-4.7	-6.7	-6.9	-5.2	1.9	-7.1	-6.8	-6.4	-6.0	-5.4	-4.4	-3.9	-2.9
o/w official	-4.8	-3.5	-3.1	-1.9	...	...	-2.1	-1.8	-1.4	-0.9	-0.8	-0.5	-0.2	-0.1
Other current account flows (negative = net inflow)	2.4	1.7	1.4	1.8	...	...	2.2	1.2	2.1	1.8	1.7	1.3	-0.6	-1.1
Net FDI (negative = inflow)	0.5	0.1	-0.3	-2.4	-2.1	2.6	-5.5	-2.4	-3.1	-1.6	-1.3	-2.0	-1.6	-3.2
Endogenous debt dynamics 2/	-10.9	-11.2	-3.6	-15.8	...	...	-3.8	-2.5	-3.2	-3.1	-2.6	-1.9	-1.0	-0.3
Contribution from nominal interest rate	3.7	2.6	2.0	1.4	...	...	1.4	1.9	1.4	1.2	1.1	1.0	1.4	1.5
Contribution from real GDP growth	-8.6	-6.5	0.0	-6.1	...	...	-5.2	-4.5	-4.6	-4.3	-3.7	-2.9	-2.5	-1.7
Contribution from price and exchange rate changes	-6.0	-7.4	-5.6	-11.1	...	...	…	…	…	…	…	…	…	…
Residual 3/	2.6	-11.2	2.1	12.9	...	...	1.9	-5.9	-3.5	-3.0	-3.3	-2.7	-0.9	0.2
o/w exceptional financing	-2.2	-1.3	-1.3	-2.3	...	...	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPV of external debt 4/	...	...	...	78.9	...	...	73.6	67.4	61.9	57.4	54.1	48.7	42.7	35.1
In percent of exports	...	...	...	202.2	...	...	177.4	171.5	157.7	146.8	139.0	134.7	136.4	139.9
NPV of PPG external debt	...	...	...	68.8	...	...	66.3	61.9	57.5	53.7	51.0	46.3	42.6	35.1
In percent of exports	...	...	...	176.4	...	...	159.6	157.5	146.5	137.4	131.0	128.0	136.0	139.9
PPG debt service-to-exports ratio (in percent)	24.8	24.3	14.1	8.7	...	...	9.5	14.6	12.6	11.1	11.3	10.9	13.0	19.6
PPG debt service-to-fiscal revenues ratio (in percent)	...	...	...	16.1	...	...	17.4	28.7	25.3	22.1	21.4	18.8	21.3	26.0
Key macroeconomic assumptions														
Real GDP growth (in percent)	6.8	5.4	0.0	6.7	5.3	5.7	5.5	5.0	5.5	5.5	5.0	4.5	4.9	4.9
GDP deflator in US dollar terms (change in percent)	4.5	5.8	5.4	11.4	-5.0	14.3	3.5	4.6	4.4	4.4	4.0	4.0	4.4	4.3
Effective interest rate (percent) 5/	3.0	2.2	1.9	1.5	3.6	1.4	1.5	2.1	1.7	1.5	1.5	1.5	2.8	4.1
Growth of exports of G&S (US dollar terms, in percent)	8.6	-2.1	14.2	16.4	2.9	13.5	16.2	3.9	10.0	9.7	8.9	5.1	7.1	7.5
Growth of imports of G&S (US dollar terms, in percent)	-7.1	-10.0	23.8	17.8	-4.1	19.2	17.7	9.3	7.8	6.7	6.2	5.7	6.6	6.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	38.0	50.4	50.6	50.6	31.5	31.1	1.1	1.1
Memorandum item:														
Nominal GDP (millions of US dollars)	1,368	1,526	1,608	1,911 0	...	...	2,087	2,291	2,524	2,780	3,037	3,594	5,641	11,665

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Total change in external debt, less identified net debt creating flows. Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments.
For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived since 1997, subject to data availability.

Table 4. Kyrgyz Republic: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2003–23
(In percent)

	Estimate	Projections								
	2003	2004	2005	2006	2007	2008	2009	2010	2015	2023
NPV of debt-to-GDP ratio										
Baseline	69	66	62	57	54	51	48	46	43	35
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2004-23 1/	69	75	75	76	76	78	78	79	93	122
A2. New public sector loans on less favorable terms in 2004-23 2/	69	67	65	63	61	59	58	58	57	55
B. Bound Tests										
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	69	70	69	64	60	57	54	52	48	39
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	69	75	83	78	73	69	65	62	51	37
B3. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	69	76	77	72	67	64	60	57	49	37
B4. Combination of B1-B3 using one-half standard deviation shocks	69	81	95	88	83	79	74	70	58	43
B5. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	69	93	87	81	76	72	68	65	60	49
NPV of debt-to-exports ratio 6/										
Baseline	176	160	158	146	137	131	129	128	136	140
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2004-23 1/	176	181	192	193	195	200	210	220	296	487
A2. New public sector loans on less favorable terms in 2004-23 2/	176	162	166	160	155	153	156	159	182	219
B. Bound Tests										
B1. Export value growth at historical average minus one standard deviation in 2004-05 3/	176	236	319	298	281	268	263	257	246	225
B2. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	176	182	195	182	171	164	161	157	155	146
B3. Combination of B1-B2 using one-half standard deviation shocks	176	221	275	257	242	231	227	222	213	194
Debt service ratio 6/										
Baseline	9	9	15	13	11	11	12	11	13	20
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2004-23 1/	8	8	15	14	13	14	16	16	26	57
A2. New public sector loans on less favorable terms in 2004-23 2/	8	8	13	12	11	11	11	10	14	27
B. Bound Tests										
B1. Export value growth at historical average minus one standard deviation in 2004-05 3/	8	10	21	21	19	18	20	21	24	33
B2. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	8	8	14	13	12	11	13	13	15	21
B3. Combination of B1-B2 using one-half standard deviation shocks	8	9	18	18	16	16	18	18	21	28

Source: Staff projections and simulations.

1/ Average 1997-2003) variables include real GDP growth, non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Relative to current year exports as opposed to the three-year average used in table 2.

KYRGYZ REPUBLIC—FUND RELATIONS
(As of August 31, 2004)

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

II. **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 Million**	**Percent of Allocation**
Holdings	12.32	N/A

IV. **Outstanding Purchases and Loans**	**SDR Million**	**Percent of Quota**
PRGF Arrangements	141.47	159.31

V. **Latest Financial Arrangements**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	12/06/2001	12/05/2004	73.40	63.84
PRGF	06/26/1998	07/25/2001	73.38	44.69
ESAF	07/20/1994	03/31/1998	88.15	88.15

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

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	8.22	20.87	18.61	16.12	14.80
Charges/Interest	0.35	0.62	0.52	0.43	0.35
Total	8.57	21.49	19.13	16.55	15.15

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

VIII. **Safeguards Assessments**

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

IX. **Exchange Rate Arrangements**

The currency of the Kyrgyz Republic has been the som (100 tyiyn =1 som) since May 15, 1993. The Kyrgyz Republic's exchange regime is classified as a managed float with no pre-announced path for the exchange rate. The National Bank of the Kyrgyz Republic publishes daily the exchange rate of the som in terms of the U.S. dollar, which is determined in the interbank foreign exchange market.

X. **Article IV Consultations**

The Kyrgyz Republic is on the 24-month consultation cycle. The last Article IV consultation discussions were held in October 2002 and the Article IV consultation was completed by the Executive Board on February 20, 2003.

XI. **FSAP Participation and ROSC Assessment**

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

XII. **Resident Representative**

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

KYRGYZ REPUBLIC—RELATIONS WITH THE WORLD BANK GROUP
(As of September 2004)

On May 15, 2003, the World Bank Boards of Directors endorsed a Country Assistance Strategy (CAS) FY 03–06 for the World Bank Group based on the Kyrgyz Government's National Poverty Reduction Strategy Paper, which aims at assisting the authorities in capitalizing major reforms to date while maintaining a reform and growth course, which will both reduce poverty and enhance prospects for debt sustainability.

International Development Association (IDA). Between 1992 and 2004, IDA has approved 29 credits and 2 grants totaling approximately $658 million (after cancellations), of which about $517 million has been disbursed. Six structural adjustment credits 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, and pension reform. Seven investment operations have also been completed, supporting reform and rehabilitation of the telecommunication sector, social safety nets, health, rural finance, private enterprises, and livestock development.

The active portfolio includes 17 operations:

- A balance of payments support operation (Consolidation Structural Adjustment Credit, CSAC), assisting with reforms in the power and gas sector and improvements to the business environment (reducing the cost on business from licensing and inspections). The first tranche of the CSAC was disbursed at the end of 2000 and the second at the end of 2001. Because of luck of progress in energy reform implementation, the disbursement of the third tranche has been delayed. Therefore, at the request of the Government, the closing date of the credit was extended to December 31, 2004.

- A balance of payments support operation (Governance Structural Adjustment Credit, 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.

- Two operations supporting energy sector rehabilitation and reform (Power and District Heating and a Technical Assistance Credit, supporting the CSAC program).

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

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

- A second health sector operation continuing support for sectoral restructuring and the authorities' reform program.
- A rural water supply and sanitation operation (approved together with the CAS Progress Report).
- An urban transport operation.
- A community driven development (CDD) initiative to support the above-mentioned activities (Village Investment Project), designed to empower village comminutes to identify and implement high priority investments and infrastructure needed to facilitate local enterprise and thereby generate local employment and growth.

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

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

IFC's portfolio has grown steadily to $17.8 million (as of September 2004). Building upon IFC's initial investment in the financial sector, the Demir Kyrgyz International Bank, IFC has played an instrumental role in the establishment of the largest bank in the country, the Kyrgyz Investment and Credit Bank, with a $1.4 million equity investment. IFC developed a strategic partnership with FINCA by investing $1.0 million in a fund to support microenterprises. This investment was accompanied by technical assistance to FINCA to facilitate its transformation and to the government in developing the appropriate regulatory framework. IFC has also provided technical assistance to review and develop the legal and regulatory framework for leasing. The largest investment in the existing portfolio is the Kumtor gold mine, with additional investments in a packaging plant (Altyn-Ajydar). In 2002, under the Small Enterprise Fund (SEF) procedure, IFC has disbursed a direct investment into a pasta plant (Akun) in the amount of $1.4 million. The IFC Board also approved in May 2002 a Micro and Small Enterprise facility for Central Asia, with IFC investment of $45 million. The same year, the Central Asia Small Enterprise Fund (CASEF) was set up on collaboration with other lenders. The amount of IFC's investment into this fund is $2.5 million. The fund will provide equity, quasi-equity, and debt financing, as well as technical and managerial assistance to growth-oriented SMEs. With financial support from the Swiss Government, IFC draws upon the resources of the Private Enterprise Partnership to advise on improving the business environment, provide training and support services for SMEs, continue past IFC efforts to develop leasing activities, and support agri-business for local and export markets. Technical assistance with a focus on developing tourism has been undertaken in the sector. IFC reviewed the IT sector, including its investment opportunities and development potential.

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—TECHNICAL ASSISTANCE PROVIDED BY THE FUND, MARCH 2003–MAY 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	Regularization of Financial Relations between the NBKR and the Ministry of Finance	April 23-May 3, 2002; October 31-November 8, 2002; and February 27 – March 6, 2003	National Bank of the Kyrgyz Republic
	Financial Sector Assessment Program (in cooperation with the World Bank)	May 5-18, 2002; August 26-September 9, 2002; and October 29-November 6, 2002	National Bank of the Kyrgyz Republic
	Review of the Capital Adequacy and Dividend Arrangements for the National Bank of the Kyrgyz Republic	August 18–28, 2003	National Bank of the Kyrgyz Republic
	Review of Debt Restructuring Operation and 2003 Financial Reporting	October 28–November 10, 2003	National Bank of the Kyrgyz Republic
	Monetary Operations, Banking System Development, and Central Bank Autonomy	September 13-23, 2004	National Bank of the Kyrgyz Republic
LEG	Update of the AML/CFT Legislation (jointly with MFD)	February 5-11, 2004	National Bank of the Kyrgyz Republic
	Review of Bank Legislation	March 1-4, 2004 April 26-May 6, 2004	National Bank of the Kyrgyz Republic
	Review of Tax Legislation	July 27 - August 5, 2004	Ministry of Finance
STA	ROSC Data Assessment	Nov. 5-21, 2002	National Statistical Committee
	SDDS Subscription	January 28–February 5, 2004	National Statistical Committee
	Balance of Payments Statistics	March 15–29, 2004	National Bank of the Kyrgyz Republic
	Monetary and Financial Statistics	April 27-May 11, 2004	National Bank of the Kyrgyz Republic

List of Resident Advisors

MFD	Banking Supervision/Restructuring Advisor	Mr. Svartsman	Jan. 2004–Jan. 2005
MFD	Public Debt Policy and Management	Mr. 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 constrain future statistical development, especially for the NSC.

2. The NSC maintains a comprehensive and regularly updated data web site largely incorporating international methodological recommendations, with adequate coverage and timeliness (http://stat-gvc.bishkek.su). The Kyrgyz Republic subscribes to the Special Data Dissemination Standard (SDDS).

3. A data ROSC mission in November 2002 assessed the Kyrgyz Republic's data dissemination practices against the GDDS and undertook an in-depth assessment of the quality of national accounts, price, government finance, monetary, and balance of payments statistics. The mission concluded that the quality of the Kyrgyz Republic's macroeconomic statistics had improved significantly in the last few years. The authorities had established a good track record of implementing recommendations of past technical assistance missions in the area of statistics and had demonstrated commitment to pursue plans and programs to further improve their statistics. The mission recommended that, a program of regular intersectoral consistency checks be introduced to reduce the sometimes significant, unexplained discrepancies between the government finance, monetary and balance of payments datasets. The authorities' response to the data module ROSC (posted on the IMF website (www.imf.org/external/np/rosc)) includes an update on the status of implementation of the ROSC mission's recommendations.

4. The SDDS subscription mission in January/February 2004 found that Kyrgyz Republic met most of the SDDS requirements and made recommendations on two remaining requirements related to the reserves template and external debt. The recommendations were successfully implemented by the authorities prior to Kyrgyz Republic's subscription in late February 2004.

National accounts

5. In general, dissemination of national accounts statistics is prompt. Technical assistance has been received from the IMF, EUROSTAT, OECD, World Bank, and bilateral donors. While significant progress has been made in improving the national accounts estimation process, problems persist with respect to the quality of the source data, due mainly to excessively tight collection deadlines associated with the present national accounts release schedule; efforts are needed to improve the quality of the source data for quarterly GDP

estimates. Moreover, subannual national accounts statistics are still prepared on a cumulative basis rather than by discrete time periods. Difficulties also remain in properly estimating the degree of underreporting, especially in the private sector. To improve the coverage and reliability of primary data, work has been undertaken to introduce scientific sampling procedures. Improved sampling procedures have been adopted for household surveys and new report forms are being introduced for the enterprise survey. The NSC has established a division of sample surveys, which would assist in improving the sampling techniques.

Prices, wages, and employment

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

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

8. Progress has been made in computing unit value indices for imports and exports. Work continues with regard to computation of these indices using a standard index presentation and the development of an export price index. However, problems in customs administration have led to incomplete coverage of trade and the lack of an appropriate valuation system. Moreover, the quality of data processing by customs has suffered due to the use of an outdated computer software system.

9. Problems exist in the compilation of the average wage, especially with respect to the valuation of payments in kind and the coverage of the private sector. Monthly and annual data are not comparable because of different coverage and classifications. These problems extend to employment data as well. The coverage of unemployment includes an estimate of unregistered unemployed.

Fiscal accounts

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

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

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

Monetary sector

12. The authorities introduced new charts of accounts for the NBKR and the commercial banks during 1997, with the assistance of a resident MAE advisor and USAID. The 1999 monetary and financial statistics mission reviewed the compilation of the monetary data and recommended improvements to the NBKR's chart of accounts and to the accompanying instructions.

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

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

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

External sector

16. Data on the balance of payments and international investment position are compiled and disseminated on a quarterly basis. The 2002 data ROSC mission noted that the compilation of BOP statistics broadly follows the *Balance of Payments Manual, Fifth Edition (BPM5)*. The NBKR has good arrangements with other agencies to ensure the timely flow of data. However, because of legal issues related to secrecy provisions, high value transactions cannot be verified with respondents, which limit the ability to cross-check the accuracy of data. Although the data collection program has been expanded in the recent past, coverage deficiencies remain with respect to trade, services, and foreign direct investment. The NBKR enterprise surveys lack an up-to-date register and have inadequate coverage of enterprises, particularly those in free economic zones. There is also a need to improve compilation procedures for achieving temporal consistency of data, and investigating and reconciling discrepancies.

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

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

KYRGYZ REPUBLIC—CORE STATISTICAL INDICATORS
(As of October 18, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of Latest Observation	9/30/04	09/30/04	09/30/0	09/30/04	09/30/04	09/30/04	Sept/04	Sept//04	Aug/04	Sept/04	Sept/04	Sept/04
Date Received	10/04/04	10/04/04	10/04/04	10/04/04	10/04/04	10/04/04	10/11/04	10/12/04	09/15/04	10/12/04	10/12/04	10/14/04
Frequency of Data	D	D	D	D	M	W	M	Q	Q	M	M	M
Frequency of Reporting	D	D	D	D	M	W	M	Q	Q	M	M	M
Source of Update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting	E	E	E	E	E	E	E	E	E	C	E	C
Confidentiality	C	A	A	A	C	C	C	C	C	C	C	C
Frequency of Publication	W	M	M	M	M	W	M	Q	Q	M	M	Y

Explanation of abbreviations:
Frequency of data, reporting and publication: D-daily, W-weekly, M-monthly, Q-quarterly, Y-yearly in conjunction with staff visits.
Source of data: A-direct reporting by National Bank, Ministry of Finance, Ministry of Statistics and Analysis or other official agency.
Mode of reporting: C-cable or facsimile; E-electronic news reporting; F-floppy provided. Most data are provided to the Resident Representative's office and then forwarded to headquarters.
Confidentiality: A for use by the staff only; C-unrestricted use.

INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

Staff Report for the 2004 Article IV Consultation and Poverty Reduction and Growth Facility—Request for Extension of the Arrangement Supplementary Information

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

Approved by Julian Berengaut and Donal Donovan

November 15, 2004

1. This supplement reports on developments since the staff report was issued.

Recent Developments

2. **The Statistics Committee reports that real GDP increased by 6.8 percent in January–October 2004 over the same period a year ago.** The October 12-month rate of inflation was 3.1 percent. The nominal exchange rate against the U.S. dollar has appreciated by 6 percent since the beginning of the year.

The 2005 Budget Discussions

3. **During a recent visit to Bishkek, the staff reached understandings with the authorities on three hitherto unsettled issues to be reflected in the government's revised 2005 budget proposal.**[1] First, the funds received from the sale of Centerra gold shares exceeded program expectations by US$20 million. Because of this, there was room for more spending on poverty reduction projects without increasing external debt. Provided that the additional spending is allocated to poverty reduction without permanently increasing recurrent and capital expenditure, the staff supported an increase in the 2005 fiscal deficit target from 4.0 percent to 4.4 percent.

4. **Second, because of the higher-than-expected tax base, revenue projections of the state government for 2005 could be raised by 0.1 percentage point of GDP.** Given the higher projected revenues and reallocations in the budget, the staff estimates indicated that a 10 percent increase in wages for teachers, doctors and nurses beginning in July 2005 was feasible. Wage increases beyond these would not be feasible unless other revenue sources are identified. The room for other wage increases of government employees would be reassessed in May 2005.

[1] The second draft will be submitted to Parliament in late November 2004.

5. **Third, the authorities agreed to reduce the payroll tax rate from 33 percent to 32 percent in 2005, to be followed by further reductions in the coming years.** Despite the payroll tax reductions, pensions could increase on average by 8 percent in 2005 and be differentiated in favor of poorer pensioners.

6. **The staff also reached agreement with the authorities on the specifics of the small business tax reform package.** The main feature of the reform package is to unify the VAT threshold with the small business tax threshold at an annual turnover of som 2.5 million ($56,800) and eliminate the voluntary patent system, which had become a major loophole.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 05/4
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2004 Article IV Consultation with the Kyrgyz Republic

On November 19, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kyrgyz Republic.[1]

Background

The Kyrgyz Republic has enjoyed strong economic performance since the last Article IV consultation in February 2003. Real GDP growth was 6.7 percent in 2003 and 7 percent in January-September 2004. Economic activity is becoming more broad-based, and annual real GDP growth outside the Kumtor gold mine and the energy sector has been steadily at or above 4 percent since 2000. Productivity improvements, including greater capacity utilization, have made an important contribution to growth, although investment has been an important factor this year. Per capita U.S. dollar GDP rose by 1/3 from 2000 to 2003, during which time the official poverty rate fell from 52 to 41 percent. At about 3 to 4 percent, annual inflation rates remain low. External current account deficits in 2002 and 2003 were equivalent to about 2½ percent of GDP, with both imports and exports growing rapidly. Private transfers received from Kyrgyz working abroad have become an important source of income, reaching about 5 percent of GDP. External debt has stabilized, while the ratio of debt to GDP (and other debt ratios) have begun to fall. With the receipt of about $80 million in privatization

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

proceeds resulting from the sale of government shares in Centerra, the Canadian company that operates the Kumtor gold mine, official reserves of the central bank have reached nearly $500 million, equivalent to about 5 months of imports.

The Kyrgyz Republic's good economic performance owes much to its macroeconomic policies. The general government fiscal deficit has been gradually reduced from 5½ percent of GDP in 2002 and is on target toward 4 percent of GDP this year. Fiscal consolidation has helped to stabilize external debt, particularly by containing the externally-financed public investment program. Tax performance has improved gradually, and the ratio of general government tax revenues to GDP will reach about 18 percent this year, compared to 16 percent in 2001. The 2001-04 Paris Club debt rescheduling has been an important factor allowing more spending on social and anti-poverty priorities. Social spending (including education, health, social security and welfare, and the pension fund) rose from 12 percent of GDP in 2000-01 to 14 percent presently.

The exchange rate of the som has been broadly stable. Low inflation has allowed for a modest nominal appreciation while maintaining external competitiveness. Ratios of money and credit to GDP remain low, even by Commonwealth of Independent States standards. Nevertheless, remonetization is progressing and growth rates of private sector credit are high. The banking sector is being reshaped by foreign investment, with seven foreign banks now operating in the country and accounting for one half of bank loans and deposits. Most bank lending and deposit taking continues to take place in U.S. dollars or other foreign currencies. Financial soundness indicators suggest a gradually strengthening banking system.

In June 2004 the IMF Executive Board completed the fifth review under the three-year economic program supported by the Poverty Reduction and Growth Facility (PRGF).

Executive Board Assessment

Directors commended the Kyrgyz authorities for the economy's strong performance in recent years, reflecting prudent fiscal and monetary policies and a favorable external environment. Economic growth has begun to broaden, inflation has remained low, the balance of payments has strengthened, external debt has been reduced, and poverty has declined albeit from high levels. Nevertheless, Directors noted that important challenges remain. The still heavy external debt burden calls for continued fiscal discipline while ensuring adequate spending to support poverty reduction efforts. The anticipated decline in gold exports calls for actions to diversify exports and preserve cost competitiveness through low inflation and structural reforms to boost productivity growth. Further efforts will also be needed to improve the investment climate by advancing tax reform, improving public administration, addressing corruption and governance problems that contribute to the growing shadow economy, and strengthening the financial sector.

Directors recognized the authorities' good record of responding to Fund policy advice, both under surveillance and the most recent PRGF-supported program. While the strengthening of policy implementation has been particularly evident in the fiscal area, Directors underscored that further fiscal consolidation is essential. The gradual reduction of fiscal deficits needs to be continued for the success of the external debt strategy, and spending controls need to be further strengthened to keep expenditures on the budgeted track. Directors welcomed the partial sale of state-held shares in the Centerra gold company which provides more flexibility to increase poverty-related investments, without compromising the prospects for debt sustainability. Going forward, they supported the gradual reorientation of spending toward poverty-reducing areas, in line with the country's poverty reduction strategy, but underscored the importance of ensuring the quality of social sector and poverty reduction projects. Over the medium term, the authorities were also encouraged to embark on a reform of the civil service.

Directors welcomed the gradual increases in the ratio of tax revenues to GDP in recent years even though some tax rates have been reduced. This performance mainly reflects improved administrative efficiency, and Directors looked forward to more concrete steps toward broadening the tax base and further efforts to improve tax administration. They supported the recent efforts to overhaul the tax code and to simplify and strengthen small business taxation, and welcomed plans to gradually reduce the payroll tax rate, beginning in 2005, which will be a key step in the effort to contain the shadow economy.

Directors commended the National Bank of the Kyrgyz Republic's (NBKR) skillful monetary and exchange rate management. They observed that the rapid growth of private sector credit calls for strong bank supervision and close monitoring of the quality of banks' loan portfolios. They welcomed the increasing foreign participation in the banking system, but saw this development as calling for enhanced cooperation with foreign supervisory counterparts. Directors also stressed the need for strengthening central bank independence, and deepening financial markets. They welcomed the progress in implementing most of the Financial Sector Assessment Program recommendations, and looked forward to steps to addressing the remaining issues, including in the area of combating money laundering and the financing of terrorism. Directors agreed that the managed float exchange rate regime remains appropriate under the country's circumstances, while encouraging the authorities to allow more flexibility in the exchange rate, including by allowing it to appreciate when warranted by market forces.

Directors took note of updated staff projections of the Kyrgyz Republic's external debt suggesting that further Paris Club debt relief appears necessary. Directors underscored, however, that reaching and maintaining debt sustainability will also require continued implementation of sound macroeconomic policies and structural reforms as well as a prudent debt strategy. Many Directors highlighted the importance, in this context, of containing both concessional and non-concessional borrowing in the future, with several of them encouraging a continued shift to grant financing.

Directors urged the authorities to approach structural reforms with renewed vigor. While financial sector reform is advancing, energy sector reform needs to be accelerated, in particular by taking further measures to improve cost recovery, including through tariff increases. On governance, Directors welcomed the adoption of the Extractive Industries Transparency Initiative, but stressed that concrete and wide-ranging steps will be needed to improve the business climate. It will be important that all public policy decisions carefully consider the implications for corruption and governance to minimize opportunities for public officials to exercise undue discretion. Directors commended the Kyrgyz Republic's liberal trade policies. They encouraged the authorities to work with other Eurasian Economic Community members to ensure that tariffs and other trade policies remain as liberal as they are today and to foster close regional cooperation.

Directors agreed with the general conclusions of the ex post assessment (EPA) on the lessons from past Fund engagement and the guidelines for future Fund support. They noted that policy implementation had been uneven in early programs reflecting a variety of factors, including the difficult, unchartered, and rapidly changing conditions of the transition to a market-based economy as well as weaknesses in Fund program design and sequencing. Directors were, however, encouraged that policy implementation has improved considerably under the current PRGF arrangement. Directors also highlighted the lessons of the EPA on the importance of avoiding the build-up of unsustainable debt. Looking ahead, they stressed the need to reduce the gap between legislative initiatives and policy implementation as a signal of strong ownership of reform policies, as well as to pay particular attention to weaknesses in public administration and governance issues that contributed to serious setbacks under earlier programs.

Kyrgyz Republic: Selected Economic Indicators

	2000	2001	2002	2003
Nominal GDP (billions of soms)	65.4	73.9	75.4	83.4
Nominal GDP (millions of U.S. dollars)	1367	1525	1606	1911
Real GDP growth (percent)	5.3	5.4	0.0	6.7
Consumer prices (percent change, per. avg.)	18.7	6.9	2.1	3.1
Poverty rate (percent)	52	48	44	41
		In percent of GDP		
General government balance	-9.2	-5.1	-5.5	-5.2
Tax revenue	15.1	15.8	17.6	17.8
Total expenditure and net lending	28.5	25.9	28.0	27.1
of which: Non-interest current expenditures	18.5	19.6	21.1	21.3
Current account balance	-4.3	-1.5	-2.3	-2.4
Official reserves (millions of U.S. dollars)	206	230	290	359
External public debt	111	100	99	94
Broad money (percent change)	11.9	12.2	33.7	34.5
Credit to private sector	4.2	3.8	4.0	4.7

Sources: Kyrgyz authorities; and Fund staff estimates.

Statement by Fritz Zurbrügg, Executive Director for the Kyrgyz Republic
November 19, 2004

The discussions in Bishkek and Washington on the 2004 Article IV Consultation and the Ex Post Assessment provided an excellent opportunity to take stock of past and current economic performance in the Kyrgyz Republic. My Kyrgyz authorities thank both teams for the very good papers and the constructive dialogue.

This Board discussion comes at a time at which all of the important macroeconomic indicators have developed more positively than expected. While favourable external economic conditions have contributed to this outcome, a strong track record of economic policy implementation was a key factor. In this context, my authorities are convinced that the Fund's support under the current PRGF program played an important role. Performance under the program has been strong. All program reviews have been completed according to schedule so far. The latest review was completed on a lapse of time basis in June, and current information indicates that all September 2004 performance criteria have been observed. The structural reform efforts have become increasingly effective over the recent past, as noted in the Ex Post Assessment. Moving forward, my Kyrgyz authorities are committed to build on these achievements. In order to maintain macroeconomic stability and secure external sustainability, they look forward to benefit from continued technical assistance and financial support from the Fund and the donor community.

Recent economic developments

Following a strong growth performance of 6.7 percent last year, the staff now project real growth for 2004 at 5.5 percent, a full percent higher than at the time of the last review in June. Inflation remains low, compared both to the initial target under the current program and to other countries in the CIS. Fiscal consolidation has continued, with revenue performance again improving and expenditure under control. Also, the share of social spending in total expenditure has increased. The sound macroeconomic management has been conducive to productivity improvements and the diversification of the economy. Manufacturing has developed favourably over the last year, and the contribution of the non-gold and non-energy sectors to overall output growth has increased. This said, my authorities are aware that efforts to further diversify the economy will be necessary to offset the expected decline in gold production over the medium term.

Price stability and productivity gains have also preserved low unit labour costs and external competitiveness. Exports have benefited from rapid growth in the Kyrgyz Republic's main trading partners. Non-traditional exports, including tourism and other services, have performed strongly. While import growth has also been strong, due mainly to domestic demand, the current account deficit has fallen well below the level anticipated at the outset of the PRGF program. My authorities are confident that the economic outlook for the region will continue to support export performance over the near term. For the longer term, they believe that enhanced economic cooperation within the region would greatly benefit trade and development, not only of the Kyrgyz Republic, but of the region as a whole. For their part, the Kyrgyz authorities remain strongly committed to an open trade regime.

On the structural side, the authorities are committed to continue the reforms necessary for further productivity gains and export diversification. Recent achievements in structural adjustment include the privatization of Kairat bank in early 2004, as recommended by many Directors at the time of the last Board discussion. On governance, the Kyrgyz Republic has adopted the Extractive Industries Transparency Initiative (EITI), which is being implemented with support from the World Bank and the UK's DFID. The authorities are also on track to meet the program targets to reduce the overall quasi-fiscal deficit of the electricity sector.

Fiscal policy

Further consolidation continues to be the main objective of fiscal policy. At the same time, my authorities are aware of the need to increase poverty-oriented expenditure. This is to ensure that the benefits of growth reach the poor and most vulnerable segments of the population. To this end, the higher-than anticipated proceeds from the sale of Centerra shares will allow for more room for social expenditure in the 2005 budget, especially in the health and education sectors. The emphasis will be placed on investment spending.

On taxation, the authorities believe that revenue can be sustained at the present level of 18 percent of GDP. However, they are alert to the need to improve the tax system. This includes improving the incentive structure for businesses to remain within the formal economy. To this end, the payroll tax rate will be successively reduced in 2005 and in the years ahead. To compensate for the effect on revenue, measures to broaden the tax base, to remove tax code inconsistencies, and to improve tax administration are to be implemented. These include measures foreseen under the small business tax reform package, on which agreement has recently been reached with the staff.

Monetary and financial sector policies

Sound policy implementation by the National Bank (NBKR) has been critical to securing overall macroeconomic stability. The monetary authorities are committed to staying this course. In the current context, they believe that the rapid growth in private credit reflects the ongoing remontization of the economy. My authorities are, however, alert to the fact that this will necessitate a careful monitoring of the banks' assets. The NBKR is also aware of the additional demands on banking supervision of the increased participation of foreign-owned banks.

Looking ahead, the financial sector is set to gain further strength through the implementation of the new Law on Bank Bankruptcy and Conservatorship, and the full implementation of the 2003 FSAP recommendations. The authorities are also committed to introducing the measures foreseen to combat money laundering and the financing of terrorism, once the requisite legislation has been passed by parliament.

External debt

Reducing the vulnerability stemming from high levels of public external debt has been a cornerstone of the authorities' economic program. Over the past years, the external debt-to-GDP ratio has fallen to under 100 percent, mainly because of improved debt management and successful fiscal consolidation. Also, the 2002 Paris Club rescheduling has temporarily eased the debt service burden. Gaining external viability will hinge critically on continued growth and prudent balance of payments financing. However, as the staff's debt sustainability analysis (DSA) shows, the debt service will rise rapidly in the years immediately ahead, which would result in considerable fiscal strain in the absence of further rescheduling. It is clear that long-term solvency will only be attained through a concessional debt stock treatment by Paris Club creditors. My Kyrgyz authorities, for their part, are fully aware that reaching and maintaining external sustainability will also require continued implementation of sound macroeconomic policies and structural reforms.

Ex post assessment

My authorities are grateful for the in-depth and candid assessment of policy performance under past Fund-supported programs. The Ex Post Assessment (EPA) illustrates the considerable accomplishments that have been made over the last decade. Price and trade liberalization were undertaken early on, as were the sale of state-owned assets and far-reaching fiscal reforms. Following the backlash suffered in the late 1990s, economic restructuring regained momentum under the current PRGF arrangement. Important reforms of the financial sector were initiated, in the course of which the economy has been largely remonetized. Price stability has been secured by prudent monetary policy. Reforms have helped increase the share of private sector output in GDP, which has more than doubled since 1994. Per-capita income has increased by over a third since 2000. Also, considerable progress has been made in reducing the incidence of poverty, particularly in rural areas.

It is clear from the EPA that the process of transition to a market-based economy has not always followed a linear path. Certain set-backs were due to weaknesses in public administration and governance, which have yet to be fully addressed. Areas in which important further reforms are required include large-scale privatization, corporate governance, and the further deepening of financial markets.

However, it is important to bear in mind that the reforms of the 1990s were undertaken under very difficult and rapidly changing conditions. It took both the authorities and the Fund considerable time to understand the full magnitude of the challenges of transition. Since the difficulties involved were initially underestimated, the targets under past programs were often set at overly ambitious levels. It is also important to note that some of the problems in implementing reforms only became apparent once the process of structural change was well underway. This particularly pertains to the area of governance, where new challenges emerged with the implementation of market-oriented reforms. It is also noteworthy that the longer-term impact of adverse external developments, in particular of the Russian crisis of 1998, was initially misjudged. Overall, my authorities believe that, given the constraints of a small landlocked economy, they have coped relatively well with the daunting challenges of transition.

Looking ahead, the findings of the EPA contain valuable lessons for the further reform process. My authorities remain committed to further advancing this process, and are confident that lasting effort to close the ‘implementation gap’ will bear fruit. The Fund’s support has been critical throughout the process of transition. The Kyrgyz authorities continue to count on this support, and on that of the international community more broadly, in bringing their reform efforts forward.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Extends the Kyrgyz Republic's Three-Year PRGF Arrangement

On November 19, 2004 the Executive Board of the International Monetary Fund (IMF) extended the three-year Poverty Reduction and Growth Facility (PRGF) arrangement for the Kyrgyz Republic until April 5, 2005 to enable completion of the sixth and final review of the Kyrgyz Republic's economic performance under the arrangement.

The Executive Board approved the three-year arrangement effective on December 6, 2001 (see Press Release No. 01/49) for a total amount equivalent to SDR 73.4 million (about US$110.4 million).

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 the Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies 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 5½-year grace period on principal payments.