International Monetary Fund

Kyrgyz Republic and the IMF

Press Release:
IMF Executive Board Extends the Kyrgyz Republic's Three-Year PRGF Arrangement
February 10, 2005

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Kyrgyz Republic: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

February 4, 2005

The following item is a Letter of Intent of the government of Kyrgyz Republic, which describes the policies that Kyrgyz Republic intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Kyrgyz Republic, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Bishkek, Kyrgyz Republic
February 4, 2005

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

Dear Mr. de Rato:

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

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

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

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

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

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

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

Very truly yours,

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

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

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

February 4, 2005

I. Introduction

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

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

Program Performance During 2001-04

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

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

5. Fiscal consolidation was a central part of our strategy under the previous three-year program and contributed greatly to our macroeconomic performance. The overall general government deficit was reduced from over 9 percent of GDP in 2000 to close to 4 percent of GDP in 2004. As foreseen in our November 2001 Memorandum, the rationalization of the

externally-financed public investment program (PIP) played a key role in reducing the fiscal deficit and keeping our external debt strategy on track. The 2002 Paris Club debt relief was also crucial in this respect. A strong tax collection effort over this period also helped to reduce the fiscal deficit—general government tax revenues rose from 15 percent of GDP in 2000 to 18½ percent in 2004.

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

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

II. PROGRAM OBJECTIVES AND STRATEGY FOR 2005-2007

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

Key Projections, 2004-07

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

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

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

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

12. Because of the declining trend of gold production, export diversification is crucial. We realize that the key for further broadening the export base is preserving external

competitiveness through low inflation and strong productivity growth. Our enterprises must contain increases in unit labor costs to be able to maintain and increase their market shares both at home and abroad. Strong productivity is key in this respect, and to foster productivity growth we need higher private investment, governance reforms, more flexible labor market policies, and a significant decline in the energy sector's quasi-fiscal deficit.

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

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

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

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

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

III. Policies for January 1—December 31, 2005

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

A. Fiscal Policy

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

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

Box 1. The 2005 Fiscal Program

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

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

Government Finances, 2004 - 05

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

Sources: Kyrgyz authorities; and Fund staff estimates.

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

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

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

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

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

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

Box 2. Fiscal Institution Building

Several steps toward improving fiscal institutions will be taken:

1. Publish Medium-Term Fiscal Framework for 2006–08, including aggregate resource envelopes for each line ministry, by end-March, 2005.

2. Introduce new wage scales in the 2006 budget.

3. Amend the charter of the Ministry of Finance to clarify the authority and responsibilities of the permanent secretary and other high-level civil servants, by end-March 2005.

4. In close cooperation with World Bank staff, develop steps to improve the mechanism for inter-governmental transfers.

5. Submit for discussion in the Economic Policy Council an accelerated depreciation scheme for capital investments prepared by a task force including representatives from the private sector, by end-June 2005.

6. Complete the Treasury modernization project by end-2007.

7. Integrate all extrabudgetary funds into the 2006 budget.

B. Monetary and Exchange Rate Policies

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

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

25. We draw your attention to the significant improvement in servicing the government debt held by the NBKR and market participants. Meeting all interest and redemption payments as scheduled has contributed to a return of financial market confidence in

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

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

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

C. External Policies

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

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

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

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

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

D. Structural Policies

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

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

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

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

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

Box 3. Financial Sector Reforms

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

2. Ministry of Finance to restructure at least som 200 million of long-term government bonds held by the NBKR and make them available to commercial banks by end-September, 2005.

3. To strengthen the banking sector's funding base, wages of Ministry of Finance staff will be paid through banks, starting in July 2005. The practice will be extended to the other ministries in 2006.

4. Allow out of court procedures in collecting collateral, and simplify procedures for collateral registration, by end-June 2005.

5. Prepare a concept paper on further development of micro-financing by September 2005.

6. Establish a framework for credit and operational risk by end 2005.

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

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

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

E. Program Monitoring

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

38. Quantitative performance criteria and indicative targets for the first-year program are specified in Table 2. The quantitative performance criteria for end-June 2005 are: (i) a floor on NBKR net international reserves (NIR) in convertible currencies. The NIR floor would be adjusted upwards by 30 percent of any excess grant receipts; (ii) a ceiling on net domestic assets (NDA) of the NBKR. Given the uncertainty on the prospective Paris Club treatment of the Kyrgyz debt, the NDA adjustors cover deviations in debt relief from programmed levels; (iii) a ceiling on the cumulative (from January 1, 2005) primary deficit (excluding grants) of the general government. This criterion is subject to an adjustor allowing for spending of grants in excess of the programmed amount; (iv) a floor on cumulative (from January 1, 2005) cash tax collections of the State government; (v) a ceiling on the stock of budgetary arrears of the central government as defined in the Technical Memorandum of Understanding (TMU); (vi) a zero ceiling on the stock of Social Fund pension arrears; (vii) a floor on cumulative (from January 1, 2005) payroll collections in cash of the Social Fund; (viii) a zero ceiling on the stock of Social Fund arrears to the Medical Insurance Fund; (ix) a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturity of less than one year; (x); a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturity of one year or more; and (xi) a zero ceiling on new external payments arrears. Indicative targets are established for annual concessional borrowing for 2005-07 as specified in Table 2. This target would cover donors' loan disbursements under

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

Box 4. Structural Benchmarks for the 2005 Program

March 2005

1. Publish Medium-Term Budget Framework for 2006-2008, including aggregate resource envelopes for each line ministry.

2. Submit to parliament the new Tax Code as proposed by the governmental Expert Commission, including the recommendations of the Fund LEG department.

June 2005

1. Start the pilot project of paying Ministry of Finance salaries through the banking system.

2. Consolidate into the State Budget the Trade Union Social Insurance Fund and reduce the payroll tax rate by one percentage point.

3. Issue new instructions to ensure proper and timely functioning of the VAT refund mechanism.

September 2005

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

2. Submit to parliament amendments to the central bank law as specified in paragraph 33.

December 2005

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

Preconditions for the Introduction of a Deposit Protection System

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

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

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

1. All commercial banks operate in a transparent manner, including full implementation of IFRS and auditing according to International Association of Auditors.

2. All commercial banks are transparent in their operations as assessed against the following criteria:

    - Financial statements, financial results and auditors opinions are published in banks' annual reports.
    - Semi-annual results and summary of financial statements are published.
    - Ownership and changes in ownership above 5 percent are listed in the annual reports.
    - Shareholder meeting dates and agenda are published.

3. The majority of operating banks (80 percent or more in deposit-base terms) meet the prudential norms as established by the NBKR.

4. The majority of banks (75 percent or more of the number of banks) rate CAMELS 3 or better as rated by the NBKR.

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

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

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

1. Amendments and addenda as submitted to the parliament in September 2004 relating to the Civil Code, the Code of Civil Procedure, the Labor Code, the Tax

Code, the Code of Administrative Liability and the Joint-Stock Company Law to remove conflicts with banking legislation.

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

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

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

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

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

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

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

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

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

1/ Definitions are provided in the Technical Memorandum of Understanding (TMU).
2/ Fiscal deficit is defined to be the primary deficit excluding grants.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The Kyrgyz Republic's performance during the three-year PRGF-supported program will be assessed by the IMF on the basis of the observance of quantitative performance criteria and structural benchmarks. This memorandum and its attached tables define the quantitative performance criteria and indicative targets (Tables 1 and 2 of the Memorandum of Economic Policies (MEP), and the monitoring requirements.[1]

2. The program exchange rate of the Kyrgyz som to the U.S. dollar is set at som 42 = $1. The program cross exchange rates and program gold price referred to in the MEP or this TMU for 2005 are provided in Table 11.

I. QUANTITATIVE PERFORMANCE CRITERIA

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

Floor on net international reserves of the NBKR in convertible currency

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

5. Total gross international reserves of the NBKR shall be defined as the NBKR holdings of monetary gold, holdings of SDRs, any reserve position in the IMF, and any holdings of convertible currencies in cash, debt instruments (including accrued interest) or with foreign banks. Amounts pledged as collateral or in swaps or otherwise blocked, capital subscriptions in foreign financial institutions, and illiquid assets of the NBKR are excluded. Also excluded are net forward positions, defined as the difference between the face value of foreign currency denominated NBKR off-balance sheet claims on non-residents and foreign currency obligations to both residents and non-residents. In addition, net claims on other BRO countries are excluded from the floor. For program monitoring purposes, gross international reserves shall be valued at program exchange rates and gold prices.

[1] Central government and Republican government are synonymous in this memorandum. State government comprises central and local governments. General government comprises state government and the Social Fund.

6. Total international reserve liabilities of the NBKR in convertible currencies shall be defined as outstanding liabilities to the IMF and other convertible currency liabilities of the NBKR to non-residents with an original maturity of up to and including one year. For program monitoring purposes, total international reserve liabilities shall be valued at the program exchange rates. Thus calculated, the stock of net international reserves in convertible currencies amounted to $329 million as of December 31, 2004.

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

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

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

1/ End-of-period stocks.

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

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

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

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

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

Ceiling on the net domestic assets of the NBKR

10. Net domestic assets of the NBKR are defined as reserve money of the NBKR (defined below) minus the NBKR's net foreign assets[2] minus the medium- and long-term NBKR obligations (MLT) minus the counterpart of the loan by the Eximbank of Turkey minus the counterpart of the EBRD and IDA enterprise loans (Equation 1).

(1) NDA=RM–NFA–MLT–Turkish Loan–EBRD-IDA Enterprise Loan

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

[2] The NBKR's net foreign assets consist of net international reserves, as defined in this TMU, plus other foreign assets plus the net claims on other BRO countries.

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

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

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

1/ End-of-period stocks.

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

Ceiling on the cumulative fiscal deficit of the general government

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

15. The change in the stock of net claims of the domestic and foreign banking systems on the general government is defined as the change in the stock of claims of these banking

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

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

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

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

1/ Cumulative beginning from January 1, 2005.

Cumulative floor on state government tax collections in cash

17. Tax collections in cash correspond to the line "IV. Tax Receipts" in the Treasury Report and comprise the following categories: 1.0 taxes on income and profits; 2.0 taxes on goods and services; 3.0 specific taxes on services; 4.0 taxes on property; and 5.0 taxes on international trade. Cumulative tax collections in cash include collections of tax arrears but exclude tax offsets.

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

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

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

1/ Cumulative from January 1, 2005.

Ceiling on the stock of central government budget arrears

19. For the purposes of the program, central government budget arrears are defined as an overdue payment obligation of the Republican budget arising since the start of the three-year program period (January 1, 2005) and related to: (i) wages; (ii) Social Fund payroll contributions; (iii) mandatory transfers to the Social Fund; (iv) categorical grants; (v) payments of electricity bills; and (vi) allowances for poor families. A payment is defined to be overdue if it remains unpaid after its due date for (iii) and (iv); for 30 days after its due date for (i) and (ii); for 60 days after its due date for (v); and for 40 days after its due date for (vi). Thus defined, there were no central government budgetary arrears as of December 31, 2004. The program ceilings on the stock of central government budget arrears are zero at each test date. No new arrears will be accumulated by the central government.

Ceiling on the stock of Social Fund pension arrears

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

Floor on the Social Fund payroll tax collections in cash

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

22. The program floors for the Social Fund tax collections in cash are reported in Table 6 below.

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

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

1/ Cumulative from January 1, 2005.

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

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

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

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

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

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

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

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

Ceiling on new external payments arrears

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

II. Indicative Targets

Ceiling on reserve money

26. For the purposes of the program, reserve money consists of currency issued by the NBKR and balances on commercial banks' correspondent accounts with the NBKR. The indicative program limits are reported in Table 7 below.

Table 7. Ceilings on Reserve Money 1/

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

1/ End-of-period stocks.

Ceiling on the quasi-fiscal deficit of the electricity sector

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

(1) $QFD=Q*MC - R$;

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

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

where:

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

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

R is the total cash revenue;

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

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

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

Ccash is the ratio of annual average cash collections to total billing to end-users.

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

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

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

1/ Cumulative from the beginning of the calendar year.

Ceiling on contracting or guaranteeing of concessional external debt

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

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

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

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

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

30. For program purposes, a debt is considered concessional if the grant element is at least 45 percent, calculated by using currency specific discount rates based on the Commercial Interest Reference Rates (CIRRs) published by the OECD. The average of the CIRRs over the last 10 years will be used for debts with a maturity of at least 15 years and the average CIRR of the preceding six months will be used for shorter maturities.

III. Reporting Requirements Under the Program

31. The government and the NBKR will provide the Fund with the necessary economic and financial statistical data to monitor economic developments and the quantitative targets.

In particular, the government and the NBKR will provide the following specific information:[4]

The balance sheet of the NBKR

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

Monetary survey

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

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

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

International reserves and key financial indicators

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

Banking system data

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

External debt

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

Budgetary and extrabudgetary data

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

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

Table 10. Kyrgyz Republic: Electricity Quasi-Fiscal Deficit

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

1/ Generation plus imports minus exports minus normative losses.

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

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

4/ Nominal tariff times cash collection rate

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

Balance of payments data

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

Other general economic information

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

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

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