Kyrgyz Republic and the IMF

Press Release:
IMF Executive Board Completes First Review of the Kyrgyz Republic's Three-Year PRGF Arrangement and Approves US$1.8 Million Disbursement
October 24, 2005

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

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

October 7, 2005

Bishkek, Kyrgyz Republic
October 7, 2005

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

Dear Mr. de Rato:

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

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

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

4. The government of the Kyrgyz Republic will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic policies and achieving the objectives of the program. The government believes that the policies and measures set forth in the original program and the RMEP are adequate to achieve the objectives of the program supported by the PRGF arrangement, but will take further measures to that end if deemed necessary. During the implementation of the current arrangement, the Kyrgyz Republic will consult with the Managing Director on the adoption of any measures that may be appropriate, at the initiative of the government or whenever the Managing Director requests such a consultation.

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

Very truly yours,

/s/ /s/

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

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

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

October 7, 2005

I. Introduction

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

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

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

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

Program Performance During 2005

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

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

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

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

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

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

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

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

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

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

II. PROGRAM OBJECTIVES AND STRATEGY FOR 2005-2007

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

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

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

Key Projections, 2005-07

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

Source: Kyrgyz authorities; and Fund staff estimates.

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

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

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

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

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

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

III. Policies for 2005 and 2006

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

A. Fiscal Policy

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

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

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

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

Box 1. Tax Policy Measures in the 2006 Budget

1. Introduce a flat personal income tax rate of 10 percent with a som 650 basic deductible.
2. Reduce the corporate income tax rate from 20 to 10 percent as of January 1, 2006, and for natural and authorized monopolies from January 1, 2007.
3. Suspend VAT on large agricultural producers.
4. Increase the excise tax rate on alcohol by 16 percent on average. Keep the other excises currently in place.
5. Increase non-agricultural land tax rates and those of subsistence plots by a factor of three.
6. Increase the agriculture land tax rates by 10 percent.
7. Increase the motor vehicle tax by a factor of three.
8. Abolish the FEZs, except in Bishkek.
9. Eliminate the profit tax exemptions on credit unions, and income tax exemptions on lottery winnings and on in-kind gifts from enterprises.

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

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

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

28. On capital spending, further reductions of the foreign-financed public investment program relative to GDP are needed for the success of the external debt strategy and to help control recurrent maintenance costs, where bottlenecks have emerged. We have also completed the work of a task force which assessed future needs for contingency expenditures (such as those related to natural disasters), which have been taken into account in preparing the 2006 budget.

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

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

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

Box 2. Strengthening Fiscal Institutions

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

B. Monetary and Exchange Rate Policies

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

32. Bank deposits and private sector credit were growing rapidly in 2003-04. Solid credit growth is important to building a financing base for the business sector, diversifying the economy, and raising the economy's growth prospects. With the remonetization slowing, credit growth is also expected to slow, especially in 2005, owing in part to the uncertainties associated with political developments. Looking ahead, we expect credit growth to recover as these uncertainties are reduced. We will refrain from adopting any administrative measures aimed at expanding commercial banks' lending activities. The financial position of the banking sector continues to be satisfactory, with financial soundness indicators appearing to show no signs of imminent vulnerabilities.

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

C. External Policies

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

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

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

Box 3. The Revised Debt Strategy

1. In addition to continued fiscal adjustment, as described in paragraphs 9 and 22, we will maintain the 45 percent grant element requirement on all new public borrowing. Local governments will not borrow without the specific authorization of the Ministry of Finance.
2. To increase our debt servicing capacity, the state government tax revenue will be increased by 1.2 percentage point of GDP during 2005-07, notwithstanding the envisaged reduction in tax rates.
3. We will streamline the foreign financed Public Investment Program from 3½ percent of GDP in 2004 to about 3 percent by 2007.
4. We will neither contract nor guarantee any nonconcessional public debt. In addition, we will limit concessional public borrowing as specified in Table 2 of the RMEP and the Technical Memorandum of Understanding (Annex II).
5. In accordance with the Paris Club comparability of treatment clause, we will not introduce any early external debt repayment schemes from potential privatization proceeds without specific consultation with Paris Club Creditors. In addition, we will not seek any debt-for-equity swaps for state-owned enterprises without specific consultation with Paris Club Creditors.

D. Structural Policies

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

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

Financial sector reforms

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

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

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

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

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

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

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

Box 4. Financial Sector Reforms

1. Increase the minimum capital requirement for banks to som 60 million at end-2005, and to som 100 million at end-2007.
2. Following a successful pilot project involving the Ministry of Finance, the line ministries' wages will be gradually paid through banks, starting on January 1, 2006.
3. Prepare a concept paper to further develop micro-finance activities.
4. Prepare a payments system action plan.
5. Introduce the supervisory framework for market, country, and transfer risks by end-June 2006.
6. Conduct an independent review of the NBKR's internal audit function.

Labor market reforms

45. The government is committed to promoting policies aimed at reducing unemployment and increasing labor market flexibility. Unemployment has remained high despite solid economic growth, which suggests labor market problems of a largely structural nature. In this

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

Quasi-fiscal deficit of the electricity sector

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

Governance

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

E. Program Monitoring

48. The program will continue to be monitored through semi-annual reviews. For that purpose, we have revised the quantitative performance criteria, indicative targets and structural benchmarks for end-December 2005, and have established quantitative performance criteria and indicative targets for end-June 2006. In addition, structural benchmarks have been established for March and June 2006.

49. Progress in implementing the quantitative performance criteria and indicative targets for the first-year program are specified in Table 1, and those for the period until end-2006 are presented in Table 2. The quantitative performance criteria are: (i) a floor on NBKR net

international reserves (NIR) in convertible currencies, to be adjusted upward by 30 percent of any excess cash grant receipts; (ii) a ceiling on the net domestic assets (NDA) of the NBKR, to be adjusted for deviations in debt relief from programmed levels; (iii) a ceiling on the cumulative (from January 1, each year) primary deficit (excluding grants) of the general government, to be adjusted for spending of grants in excess of the programmed amounts; (iv) a floor on the cumulative (from January 1, each year) cash tax collections of the State government; (v) a ceiling on the stock of budgetary arrears of the central government as defined in the Technical Memorandum of Understanding (TMU); (vi) a zero ceiling on the stock of Social Fund pension arrears; (vii) a floor on cumulative (from January 1, each year) payroll cash collections by the Social Fund; (viii) a zero ceiling on the stock of Social Fund arrears with the Medical Insurance Fund; (ix) a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturities of less than one year; (x) a zero ceiling on contracting or guaranteeing of new nonconcessional external debt with maturities of one year or more; and (xi) a zero ceiling on new external payments arrears.

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

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

Box 5. Structural Benchmarks

End-September 2005

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

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

End-December 2005

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

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

End-March 2006

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

End-June 2006

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

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

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

	2005					
	March			June		
	Benchmarks			Performance Criteria		
	Prog.	Adjusted	Prel.	Prog.	Adjusted	Prel.
I. **Performance criteria**						
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	326	325	322	333	325	326
2. Ceiling on net domestic assets of the NBKR (eop stock)	-1,390	-1,282	-1,583	-962	-834	-1,486
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	1,198	...	701	1,529	...	881
4. Cumulative floor on state government tax collections in cash	3,191	...	3,529	6,929	...	7,440
5. Ceiling on the stock of central government budget arrears	0	...	0	0	...	0
6. Ceiling on the stock of Social Fund pension arrears	0	...	0	0	...	0
7. Cumulative floor on payroll collections in cash of the Social Fund	1,050	...	1,177	2,143	...	2,342
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	...	0	0	...	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	0	...	0	0	...	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	0	...	0	0	...	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	...	0	0	...	0
II. **Indicative targets**						
1. Ceiling on reserve money (NBKR liabilities)	12,909	...	12,603	12,943	...	12,765
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	...	...	...	4,700	...	4,557
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/	(as indicated in paragraph 29 of the TMU)					

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

1/ Definitions are provided in the Technical Memorandum of Understanding (TMU).
2/ New concessional loans during the year.

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

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

	2005			2006			
	September	December		March	June	September	December
	Benchmarks	Performance Criteria		Benchmarks	Performance Criteria	Benchmarks	Benchmarks
	Prog.	Prog.	Rev. Prog.	Prog.	Prog.	Prog.	Prog.
I. **Performance criteria**							
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	340	340	362	367	361	380	393
2. Ceiling on net domestic assets of the NBKR (eop stock)	-1,289	-985	-1,477	-1,566	-1,200	-1,258	-1,397
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	2,398	3,028	3,143	1,099	1,377	2,619	3,234
4. Cumulative floor on state government tax collections in cash	10,970	15,318	15,853	3,599	7,933	12,462	17,580
5. Ceiling on the stock of central government budget arrears	0	0	0	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0	0	0
7. Cumulative floor on payroll collections in cash of the Social Fund	3,228	4,392	4,461	1,100	2,292	3,292	4,675
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	0	0	0	0	0	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	0	0	0	0	0	0	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	0	0	0	0	0	0	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	0	0	0
II. **Indicative targets**							
1. Ceiling on reserve money (NBKR liabilities)	12,894	13,247	13,624	13,750	13,850	14,596	15,000
2. Ceiling on the electricity sector quasi-fiscal deficit (in millions of som)	...	8,400	7,850	...	3,910	...	7,110
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/	(as specified in paragraph 29 of the TMU)						

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

1/ Definitions are provided in the Technical Memorandum of Understanding (TMU).
2/ New concessional loans during the year.

PRECONDITIONS FOR THE INTRODUCTION OF A DEPOSIT PROTECTION SYSTEM

The Law on Deposit Protection System will not be submitted to Parliament before the following preconditions are considered to have been met. This will be monitored under the PRGF-supported program.

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

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

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

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

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

1. Amendments and addenda as submitted to the parliament in September 2004 relating to the Civil Code, the Code of Civil Procedure, the Labor Code, the Tax Code, the Code of Administrative Liability and the Joint-Stock Company Law, to remove conflicts with banking legislation.
2. Anti-money laundering legislation.
3. Amendments and addenda to the Law "On Banks and Banking Activity" to introduce consolidated bank supervision, as well as to the revision of the Central Bank Law as specified in paragraph 40.

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

REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The Kyrgyz Republic's performance during the period January 1, 2005—December 31, 2007 under the three-year PRGF-supported program will be assessed by the IMF on the basis of the observance of quantitative performance criteria and structural benchmarks. This memorandum and its attached tables define the quantitative performance criteria and indicative targets under the PRGF arrangement.[1] This update reflects the changes made to the program as defined in the Revised Memorandum of Economic Policies (RMEP).

2. The program exchange rate of the Kyrgyz som to the U.S. dollar is set at som 42 = $1. The program cross exchange rates and program gold price referred to in the RMEP or this TMU for 2005 and the first-half of 2006 are provided in Table 11.

I. QUANTITATIVE PERFORMANCE CRITERIA

3. The quantitative targets (i.e., quantitative benchmarks for end-March 2006, and quantitative performance criteria for end-December 2005 and end-June 2006) presented in Table 2 of the RMEP are defined below.

Floor on net international reserves of the NBKR in convertible currency

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

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

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

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

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

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

	(In millions of U.S. dollars)
December 31, 2004 (actual)	329
March 31, 2005 (benchmark)	326
June 30, 2005 (performance criterion)	333
September 30, 2005 (benchmark)	340
December 31, 2005 (performance criterion)	362
March 31, 2006 (benchmark)	367
June 30, 2006 (performance criterion)	361

1/ End-of-period stocks.

8. The floor on net international reserves of the NBKR will be adjusted:
(i) upward/downward by 100 percent for any excess/shortfall in net foreign financing defined in paragraph 9 below; (ii) upward by 30 percent for any non-programmed cash grants; and (iii) upward/downward by 100 percent for any excess/shortfall in cash privatization receipts in foreign exchange. Valued at the program exchange rate, the program cash privatization receipts are equivalent to $2.96 million for 2005 and $5 million for the fourth quarter of 2006, respectively. The total adjustment in respect of adjustors (i) and (iii) is to be limited to $25 million, valued at the program exchange rate. The NIR floor will also be adjusted upward/downward by 100 percent for any excess/shortfall in the net effect of the releases and related amortization payments of the NBKR's pledged reserves; the program net effect is plus $14.92 million in the last quarter of 2005.

9. 'Net foreign financing and cash grants' is defined as balance of payment support loans plus cash grants to the state government budget plus any changes in the balance of unused PIP funds held at the NBKR minus amortization (excluding repayments to the Fund) and interest payments on external debt made by the Ministry of Finance and NBKR. This

definition applies to the adjustors to NIR and NDA. The program cumulative net foreign financing is given in Table 2. The balance of unused PIP funds was equivalent to $0.03 million as of December 31, 2004.

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

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

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

Ceiling on the net domestic assets of the NBKR

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

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

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

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

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

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

	(In millions of soms)
December 31, 2004 (actual)	-2,046
March 31, 2005 (benchmark)	-1,390
June 30, 2005 (performance criterion)	-962
September 30, 2005 (benchmark)	-1,289
December 31, 2005 (performance criterion)	-1477
March 31, 2006 (benchmark)	-1566
June 30, 2006 (performance criterion)	-1200

1/ End-of-period stocks.

13. The ceiling on net domestic assets of the NBKR will be adjusted: (i) downward/upward by 100 percent of the excess/shortfall in net foreign financing of the state government budget; (ii) downward by 30 percent for any non-programmed cash grants; and (iii) downward/upward by 100 percent of the excess/shortfall of cash privatization receipts. The total adjustment for shortfalls in adjustors (i) and (iii) is to be limited to $25 million, valued at the program exchange rate, excluding the amortization payments for the release of the NBKR's pledged foreign reserves.

Ceiling on the cumulative primary fiscal deficit of the general government

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

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

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

16. The program ceilings on the cumulative primary deficit (excluding grants) of the general government are reported in Table 4 below.

Table 4. Ceilings on the Primary Deficit (excluding grants) of the General Government 1/

	(In millions of soms)
March 31, 2005 (benchmark)	1,198
June 30, 2005 (performance criterion)	1,529
September 30, 2005 (benchmark)	2,398
December 31, 2005 (performance criterion)	3,143
March 31, 2006 (benchmark)	1,099
June 30, 2006 (performance criterion)	1,377

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

Cumulative floor on state government tax collections in cash

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

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

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

	(In millions of soms)
March 31, 2005 (benchmark)	3,191
June 30, 2005 (performance criterion)	6,929
September 30, 2005 (benchmark)	10,970
December 31, 2005 (performance criterion)	15,853
March 31, 2006 (benchmark)	3,599
June 30, 2006 (performance criterion)	7,932

1/ Cumulative from the beginning of the calendar year.

Ceiling on the stock of central government budget arrears

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

Ceiling on the stock of Social Fund pension arrears

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

Floor on the Social Fund payroll tax collections in cash

21. Payroll tax collections in cash correspond to the total contributions collected by the Social Fund from both employers and employees for a given period. If the Trade Union Social Insurance Fund is transferred to the state government, the program floors for Social

Fund cash tax collections will be adjusted downward by 1/32 of the remaining floors, prorated to the periods between the date of the transfer and the test dates.

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

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

	(In millions of soms)
March 31, 2005 (benchmark)	1,050
June 30, 2005 (performance criterion)	2,143
September 30, 2005 (benchmark)	3,228
December 31, 2005 (performance criterion)	4,461
March 31, 2006 (benchmark)	1,100
June 30, 2006 (performance criterion)	2,292

1/ Cumulative from the beginning of the calendar year.

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

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

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

24. In connection with the contracting or guaranteeing of external debt by the state government of the Kyrgyz Republic, the NBKR, or any other agency acting on behalf of the state government of the Kyrgyz Republic, 'debt' is understood to have the meaning set out in point 9 of the Guidelines on Performance Criteria with respect to External Debt in Fund arrangements (Decision No. 12274-00/85, dated August 24, 2000).[3]

---

[3] Debt is understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the

(continued)

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

Ceiling on new external payments arrears

25. For the purposes of the program, external payments arrears will consist of all debt-service obligations (i.e., payments of principal or interest) arising in respect of any debt contracted or guaranteed or assumed by the state government of the Kyrgyz Republic, or the NBKR, or any agency acting on behalf of the state government of the Kyrgyz Republic since the Kyrgyz Republic's independence, including, without limitations, unpaid penalties,

---

form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debt can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

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

interest charges or judicially awarded damages associated with these arrears owed by the state government of the Kyrgyz Republic, or the NBKR, or any agency acting on behalf of the state government of the Kyrgyz Republic, on imports received subsequent to independence. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, including Paris Club creditors; and more specifically, to external payments arrears in respect of which a creditor has agreed that no payment needs to be made pending negotiations.

II. Indicative Targets

Ceiling on reserve money

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

Table 7. Ceilings on Reserve Money 1/

	(In millions of soms)
December 31, 2004 (actual)	12,380
March 31, 2005 (indicative target)	12,909
June 30, 2005 (indicative target)	12,943
September 30, 2005 (indicative target)	12,894
December 31, 2005 (indicative target)	13624
March 31, 2006 (indicative target)	13,750
June 30, 2006 (indicative target)	13,850

1/ End-of-period stocks.

Ceiling on the quasi-fiscal deficit of the electricity sector

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

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

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

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

where:

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

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

R is the total cash revenue;

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

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

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

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

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

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

	(In millions of soms)
December 31, 2004 (indicative target)	8,650
June 30, 2005 (indicative target)	4,700
December 31, 2005 (indicative target)	7,850
June 30, 2006 (indicative target)	3,910
December 31, 2006 (indicative target)	7,110

1/ Cumulative from the beginning of the calendar year.

Ceiling on contracting or guaranteeing of concessional external debt

29. The annual ceiling on the contracting or guaranteeing of new concessional external debt by the state government of the Kyrgyz Republic or the NBKR or any other agency working on behalf of the state government is set by the U.S. dollar nominal sum of project loan agreements yet to be signed and agreed, plus balance of payments support loans required to fill the external financing gap, as programmed. Pursuant to monitoring this indicative target ceiling, the Ministry of Finance will provide quarterly information on the total nominal U.S. dollar value of: (a) new project and program loans signed and agreed during the previous three-month period; (b) new project and program loans planned, but yet to be signed and agreed, during the previous three-month period. The annual indicative ceilings on the contracting or guaranteeing of new medium- and long-term concessional external loans for 2005-06 are specified in Table 9.

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

(In millions of US dollars)

With disbursements beginning in:	Signed or Contracted	
	2005	2006
2005	77	---
2006	112	0
2007	0	0

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

These ceilings are nominal debt lumped by the year in which their disbursements commenced. For 2005, the limit implies contracting loans of which $77 million will start disbursing in 2005, $112 million in 2006 and zero in 2007. The ceiling for contracting and guaranteeing new concessional loans in 2006 will be adjusted upward by the full amount of any shortfall from the ceiling during 2005.

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

III. Reporting Requirements Under the Program

31. The government and the NBKR will provide the Fund with the necessary economic and financial statistical data to monitor economic developments and the quantitative targets. In particular, the government and the NBKR will provide the following specific information:[4]

The balance sheet of the NBKR

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

Monetary survey

33. Monthly banking system data, in the form of a monetary survey, will be reported to the Fund by the NBKR within 14 days of the end of the month. The information provided will clearly identify the following items: net foreign assets and net domestic assets of the banking system, medium- and long-term liabilities, net credit from the banking system to the

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

general government, financing provided to the rest of the economy, other items net, and broad money. The monetary survey will be provided valued at the actual exchange rate as well as according to the valuation applied under the program, as specified in Section I.

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

International reserves and key financial indicators

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

Banking system data

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

External debt

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

Budgetary and extra budgetary data

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

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

Table 10. Kyrgyz Republic: Electricity Quasi-Fiscal Deficit

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

1/ Generation plus imports minus exports minus normative losses.

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

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

4/ Nominal tariff times cash collection rate.

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

Balance of payments data

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

Other general economic information

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

Table 11. Program Cross Exchange Rates

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