© 2005 International Monetary Fund

February 2005
IMF Country Report No. 05/32

Kyrgyz Republic—Ex Post Assessment of Longer-Term Program Engagement

This Ex Post Assessment of Longer-Term Program Engagement for the Kyrgyz Republic was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on November 5, 2004. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Kyrgyz Republic or the Executive Board of the IMF.

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

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

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623 7430 ● Telefax: (202) 623 7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

Ex Post Assessment of Longer-Term Program Engagement

Prepared by a staff team from Middle East and Central Asian, Fiscal Affairs, and Policy Development and Review Departments[1]

Authorized for distribution by the Middle East and Central Asian and Policy Development and Review Departments

November 5, 2004

Contents | Page

[1] This paper was prepared by a team led by Mr. Symansky, and comprised Mr. Pani (both MCD), Mr. Ebrahim-zadeh (PDR), and Mr. Ogata (FAD), with contributions from members of the MCD Kyrgyz Team (Mr. Saavalainen, Mr. McDonald, and Ms. Savova).

Tables

Figures

Annex

SUMMARY

Early Fund-supported programs in the Kyrgyz Republic fell well short of expectations. While strong progress had been made in some areas, by the late 1990s the country continued to face daunting challenges, rooted in weak policy implementation, especially in the fiscal area, and revealed or exacerbated by external shocks. As in other transition countries, neither the authorities nor the IMF staff were able to fully recognize the difficulty of the problems faced in economic transformation. External debt service claimed a steadily increasing share of fiscal revenues, but in the past few years a strengthened commitment to prudent fiscal policies and improved policy capacity—along with a 2002 Paris Club debt flow rescheduling—have helped to turn around macroeconomic performance. Sustaining this turnaround requires a continuation of the current policy stance. Fiscal policy must deliver on its revenue targets, while addressing poverty and servicing large external debt obligations. New borrowing needs to be under highly concessional terms. Real progress is needed to combat corruption, and structural reforms—particularly in the financial and energy sectors—must be reinvigorated.

The future IMF role should be directed less at balance of payments support, and more toward ensuring that macroeconomic policies are appropriate and sustainable and that the reform process continues. Debt reduction must continue to be a main objective of any Fund-supported program. Despite shortfalls in the early IMF-supported programs, the experience over the past three years—during which the authorities have proven willing and able to implement the Fund's active and persistent advice and monitoring—strongly supports the case for continued IMF program involvement.

I. Introduction and Overview

1. **This report reviews the Kyrgyz Republic's performance under Fund-supported programs during 1993–2003.** It also discusses key challenges facing the country and suggests several policy considerations to be taken into account in the context of the authorities' intentions to request a successor PRGF arrangement for 2005–08. The staff discussed the paper with the authorities in October 2004. The main elements are reflected in the Article IV staff report.

2. **The Kyrgyz Republic has experienced three distinct periods of macroeconomic development since independence.** The period until 1996 was characterized by macroeconomic instability—a common development in the CIS after the collapse of the Soviet Union. Real GDP plummeted, inflation was high, and the nominal exchange rate depreciated. During this period structural reforms focused on price liberalization, currency reform, and restructuring loss-making public enterprises. The depth of the problems faced by the authorities, and the inability to respond sufficiently to these difficulties was underestimated—as it was in the other CIS countries.

3. **The period from 1996 to 2000 saw a resumption of growth and a decline in inflation.** However, the large external shock owing to the Russian financial crisis in 1998 undermined these positive developments. Export performance, although strong in the mid-1990s, was disappointing after the Russian crisis, and living standards fell. Monetary policy firmed during this period, but fiscal policy remained weak. Government expenditures (including a large externally-funded investment program) were predicated on optimistic growth projections. Fiscal slippages were common, as revenue grew largely in line with actual output which was much below the optimistic projections. Thus heavy government borrowing and the resulting large external debt accumulation combined with a sharp currency depreciation to create an unsustainable external debt situation. The country adopted ambitious structural reforms, but implementation stalled, particularly in the period leading up to the 2000 parliamentary and presidential elections.

4. **The period since 2001 has been characterized by successful macroeconomic stabilization, with further progress on structural reform, albeit at a pace slower than hoped.** Underlying growth (excluding the gold and energy sectors which tend to experience higher volatility) has been stable at around 5 percent per annum and overall economic activity has diversified somewhat, with less reliance on agriculture and export sales to traditional trading partners. Inflation was reduced and sustained in the low single digits—well below that in partner countries—and thus the real effective exchange rate has not appreciated as the nominal effective exchange rate has strengthened. Banking sector reforms and enhanced central bank capacity resolved most of the problems created by the 1999 banking crisis, and of the state-owned banks, only one has not been liquidated or privatized. To improve monetary policy control, indirect monetary instruments were developed. Improved macroeconomic performance and the banking system reforms have boosted money demand, leading to rapid remonetization. Debt reduction also played a prominent role in supporting the improved performance. Recently, exports (including

non-gold exports to non-CIS countries) have started to recover and official foreign reserves have been growing steadily. In addition the I-PRSP and PRSP have played a key role in budget development and fiscal policy. Structural reforms, in general, have become more focused, centering (in addition to the banking sector) on governance and the energy sector. Nevertheless, weakness in governance (e.g., relatively poor contract enforcement and insufficient reforms in public administration), and corruption—evidenced by a World Bank study that reported higher bribe levels than in the rest of the region, remain important obstacles to private investment and higher growth.

II. Performance Under IMF Arrangements

5. **The four Fund-supported programs since 1993 sought to achieve macroeconomic stability by strengthening public finances, pursuing a prudent monetary stance, and undertaking structural reforms in support of the programs' macroeconomic objectives.** From 2001, programs focused more directly on the large poverty problem and achieving debt sustainability. Performance criteria (PCs) under these arrangements covered NBKR net domestic assets (NDA) and net international reserves (NIR), government net domestic financing, various debt measures, and payment arrears. In some later programs, PCs also included state government tax revenue and floors on some individual expenditure categories; these included ceilings on wage and pension arrears as well as to the energy company, and floors on health and education spending to ensure that spending was targeted toward poverty-related areas. Structural conditionality (PCs and structural benchmarks) was used to support the reform agenda.

6. **Until the most recent PRGF arrangement, program outcomes fell short in many areas.** As a result, these arrangements either were terminated or their reviews were delayed; reviews often required several waivers of nonobservance of PCs. (Annex I)

- **The May 1993 SBA.** There were seven quantitative PCs and the first review required three waivers. There were also problems in achieving some of the structural benchmarks. Subsequent reviews were not completed

- **The March 1994 ESAF.** There were six quantitative PCs for the first year and the first review required three waivers (and one for a structural PC). Of 15 structural benchmarks, 13 were met. The second year review was delayed because of nonperformance, and after the delay, two waivers were required; of 12 structural benchmarks, 11 were met, two with a delay. For the third year review, all PCs were met and reviews were completed on time. Of the 12 structural benchmarks, 10 were met on time and one was met in part.

- **The June 1998 PRGF.** Several new PCs were added to the program and waivers were required for seven out of the twelve PCs for the completion of the first review. One of the 17 structural benchmarks was observed only partially and five were met after a delay. The second year reviews were delayed and required several waivers of both quantitative and structural PCs. This program included 25 structural benchmarks. The final review in the second year was not completed as several of the PCs were not met and 12 of the 25 structural benchmarks were not observed. The arrangement expired in February 2001 without the third year program in place. The situation changed with respect to the most recent PRGF arrangement.

- **The December 2001 PRGF.** All semi-annual program reviews were completed on time with critical PCs observed. There were only a few brief delays in meeting the structural PCs (e.g., parliamentary approvals of the VAT on large agricultural producers and of the real property tax in 2003).

Structural conditionality

7. **Except in the case of the 1993 SBA, the implementation record of structural performance criteria has been generally good.** From 1993–2003, each annual arrangement included an average of 12 structural measures. On average, only one was not met and another one was only partially observed, which compares favorably with the program implementation in other CIS countries. A significant exception is the second annual program supported by the 1998 PRGF, which contained 25 measures of which 7 were not met and another 5 were only partly met. The exceptionally large number of measures in this program may have strained the authorities' implementation capacity, resulting in low compliance—although more measures were implemented under that arrangement than during the previous and later annual programs.

8. **Structural conditionality was streamlined over time and became focused on fiscal and banking issues.** This reflected not only a change in the pattern of conditionality—the Fund started to focus increasingly on its "core" areas of competency—but also the progress made in the transition toward a market economy. Measures related to enterprise restructuring and privatization—key policy concerns since the country engaged in a wide-ranging privatization program in 1994, with the support of the World Bank—figured prominently in programs until 2001. Privatization-related measures declined sharply thereafter, as many of these targets had been met and the World Bank took the lead in others. However, the 2000 program still included measures to reform the civil service and changes in land legislation, while more recent programs contained measures to reduce subsidies by increasing energy prices and charging user fees for water and health services, as well as measures aimed at improving governance and the business climate by streamlining licensing procedures and strengthening the extra-judicial arbitration of commercial disputes. Since then, the World Bank and the AsDB have taken the lead in most of these reforms.

9. **As an example of the difficulties faced in implementing reforms in the social area, the government continuously failed to meet the PCs related to pension reform.** Initially included in the ESAF in 1995, this reform met with strong resistance in Parliament and was not implemented until 1999. Other delays or failures in the implementation of structural measures concerned mostly privatizations and enterprise restructurings, and appear to stem from a lack of institutional resources and the difficulty in attracting investors.

Issues related to compliance

10. **Most of the noncompliance with program targets in the first three arrangements (1993–2000) can be traced to over optimism.** This feeling of optimism was shared by the staff and the authorities, and was common in other CIS countries at that time. In the Kyrgyz case this led to a very ambitious public investment program (PIP)—largely financed through external loans—which has not delivered the anticipated growth record. At the same time, the 1998 Russian crises materially affected external demand for Kyrgyz goods and the large currency depreciation contributed to an unsustainable external debt burden. Throughout the period, fiscal policy consistently failed to achieve its goals. Moreover, at times, the government lacked a commitment to the reform agenda, particularly during the period leading to the 2000 election cycle. In many areas, the goals envisioned at the earlier stages of the transformation process have still not been accomplished (e.g., in the energy sector).

11. **In retrospect, the failure of the first few programs is not surprising**. It is only with hindsight that the difficult starting point that the country faced can be fully understood. Part of the problems that Kyrgyz confronted were shared by the other CIS counties—in particular, there was little understanding of what transition really entailed and there was no tradition of independent statehood; also the effect of geographical isolation was not fully appreciated. In addition, Kyrgyz faced its own unique difficulties: it was one of the poorest of the FSU countries, other countries in the region established barriers to trade, it was an energy importer and thus faced a terms of trade shock as energy was no longer provided at subsidized prices, and it initially did not have a product in demand by the rest of the world.

12. **Some failures reflect poor program design**. Even taking account of the overly optimistic growth and export forecasts, there are examples, especially on the fiscal side, where the program targets were unachievable under any reasonable assumptions. For example, after realizing tax revenue of 13.5 percent of GDP in 1993, the program target was set at 26.4 in 1994, but the outturn was less than 16 percent of GDP. Despite this projection error, the tax revenue forecast was set at 19 percent of GDP for 1995, and again the outturn was much lower.[2] Also, several of the program targets were based on unrealistic assumptions about the effects of the reforms. This was partly by design, as ambitious—although possibly unrealistic—program targets were developed to try to establish the momentum to fundamentally change the economy. To a significant extent this was largely related to revenue, as tax policy, and even more so, the tax administration reforms, were unlikely to produce the gains that were programmed. Additionally, economic restructuring takes time to realize tangible benefits. Furthermore, there were several occasions where the programs did not take sufficient account of the poor policy performance and lack of government

[2] The very ambitious revenue forecast reflected the assumption that there would to be a large payment of tax revenue from the SOEs, and that the unexpected decline in GDP would not have a major impact on revenue, thus raising the revenue ratio.

commitment when designing the next set of PCs. Lastly, the weak medium-term growth impact of the externally-funded public investment program might have been foreseen earlier.

13. **The success of the 2001–04 PRGF can be traced to the following factors:**

- PCs were realistic, yet sufficiently ambitious to support the stabilization effort;
- Structural PCs and benchmarks were streamlined;
- The program stressed transparency and timely reporting;
- The population appears to be realizing the costs of not moving ahead on structural reforms which has improved ownership;
- The population has also realized that there are costs and sometimes limited short-term benefits associated with foreign financed investment;
- Favorable external factors, as macroeconomic conditions in the other CIS countries and China have strengthened and the terms of trade for Kyrgyz have improved;
- Successful Paris Club negotiations; increased awareness among the population of the adverse effects of high debt on economic development and the need to establish a good track record for Paris Club creditors; and
- Relative political stability.

III. Macroeconomic and Structural Performance During IMF Arrangements

A. Growth and Inflation

14. **Economic growth was initially disappointing, and began to improve only in 1996.** The adjustment costs of transition were underestimated, and real GDP declined during the first few years of transition—by 16 percent in 1993, 20 percent in 1994, and 5 percent in 1995 (Figure 1 and Table 1). This contraction, which also occurred in other transition economies, was, in the Kyrgyz case, primarily felt in agriculture and industry, with the latter closely linked to the dissolution of production and trade links across the Soviet Union and COMECON countries. Nevertheless, the output decline may be exaggerated, as official statistics failed to fully capture the emerging private sector. After 1995, while growth resumed, the projections were again overly optimistic and it was only in February 1999, that the programmed real GDP projections were equal to or even below the actual growth realized. Measured in dollars, official GDP exceeded the level it reached in 1997 only in 2003.[3] The weak growth performance is attributable to the following factors:

[3] The Kumtor gold mine accident was largely responsible for zero real GDP in 2002.

- The external environment remained weak, with other countries in the region failing to achieve the anticipated post-transition growth spurt;
- Reforms fundamental to the transition were not undertaken fully;
- Spillover effects of the 1998 Russian crisis depressed export demand and foreign investment, while the resulting exchange rate depreciation sharply reduced U.S. dollar GDP;
- Weak governance and corruption hindered output and export growth; and
- The public investment program failed to deliver the anticipated return.

15. **The expenditure-side GDP composition differs markedly from 1990s program projections (Table 2).** Public investment, financed through the ambitious PIP, was even greater than envisaged in the programs. While real export growth was generally disappointing during the last decade, the current account, in real terms, was frequently lower than programmed, as real imports were constrained. Not surprisingly, private demand was consistently below program projections.

16. **Price liberalization and a sharp increase in energy prices initially led to extremely high inflation.** Subsequent periods of high inflation partly resulted from credit growth fuelled by interenterprise arrears and from a sharp depreciation. However, the central bank has since paved the way for price stability, achieving low inflation since 2001, which compares favorably vis-à-vis other CIS countries.

B. Export Performance

17. **Until recently, export performance was disappointing as the country never realized the anticipated increase in exports expected from transition** (Table 3)**.** The export projections were a critical component of expected growth in the programs and of foreign financing that would be used to service external debt. Export growth projections were predicated on strong CIS growth and some increase in sales to non-CIS countries. Although exports grew in both real and dollar terms until 1997, non-gold exports declined thereafter and even today they have not even reached their 1997 value ($330 million in 2003 and $447 million in 1997) (Table 4). Gold exports—which began in 1997—compensated for weak non-gold exports, yet by 2003, total goods and services exports were only about 10 percent higher than in 1997.

18. **Kyrgyz producers have been able to remain competitive but it appears that this was not enough to offset other factors.** In 1995–2000, the nominal exchange rate depreciated significantly with respect to the U.S. dollar, and in real terms against most trading partners (Figure 2). The latter implies that inflation has not eroded the competitiveness gains derived from the earlier depreciation. Since 2000, the som has broadly stabilized in real terms. Despite this improvement in competitiveness, export volume

increases have not been as large as anticipated. It appears that other factors such as the Russian crisis and regional trade restrictions, which precluded export-oriented foreign direct investment, have seriously hindered export growth.

19. **Export projections underlying the programs of the late 1990s were particularly optimistic, and assumed that they would increase at a sustained rate over the medium term (Table 3).** Between 1995 and 1996, Kyrgyz exports increased at an average annual rate of 25 percent when real GDP started to bounce back in most CIS countries. This trend, however, came to a halt in 1997, when Kyrgyz non-gold exports declined by 16 percent (although exports including gold rose), owing to a fall in food exports to the CIS, and, to a lesser extent, to a decline in non-gold metal exports to non-CIS countries This resulted in an underestimation of the debt/export ratio—a key debt sustainability indicator. The current account balance also deteriorated, although less so, as imports adjusted to available financing. From 2001, export projections became more realistic, although a marked medium-term growth in exports is still envisaged.

20. The overestimation of exports in the late 1990s may be traced back to several factors, some of which might have been detected in a more accurate analysis of the available information:

- **The assessment of medium-term prospects for exports to other CIS countries was too optimistic.** The extent to which the major CIS partners could raise their protectionist barriers was probably underestimated. The Kyrgyz Republic joined a customs union with Russia, Belarus, and Kazakhstan in 1996, but it remained largely ineffective—Uzbekistan raised its trade barriers in 1997 and Kazakhstan followed after the Russian crisis. Furthermore, most of the 1994–96 growth consisted of exports of food and agricultural products—whose demand is comparatively income-inelastic. This limited export growth potential, even in the event of sustained GDP growth in partner countries;

- **Trade to non-CIS was slow to develop.** It was anticipated that the decline in trade to CIS partners would be replaced by new opportunities with non-traditional partners as progress in the reforms process would enable firms to sell in alternative markets. However, prospects for the development of non-traditional export outlets were (and remain) limited, owing to geographic and political factors—long distance from markets, poor transport infrastructure, political instability along key trade routes to the south, and protectionist measures in various countries including China;

- **The impact of the 1998 Russian crisis was thought to be transitory, and it took time for this crises to be properly assessed and incorporated in the projections.** Until 1999, programs implicitly assumed that these changes would be temporary and exports would resume their previous upward trend. In fact, the Russian crisis triggered a number of longer lasting, structural changes—including the break-up of most remaining vertical links dating back to the Soviet period, the diversification of CIS trade toward non-traditional partners, and the adoption or maintenance of protectionist policies by trading partners. Thus the demand for traditional Kyrgyz products faltered after the Russian crisis. In the two years following the crisis, total non-gold merchandise exports fell by one-third, and exports to CIS countries by almost one-half. As a proportion of 1997 exports, food and energy exports to the CIS fell by 14 percent, while light industry exports to non-CIS countries fell by 3 percent (Tables 3 and 4). Export growth stabilized after 1999, but never resumed the sustained expansion that occurred before 1997.

- **Optimistic assumptions on the effect that foreign investment and structural reforms would have on enhancing the diversification of exports to non-traditional products and markets.** The growth in productivity from inflows of foreign investment, which also stalled after the Russian crisis, fell short of expectations, in part because of the poor investment climate resulting from corruption. Also at that time, structural reforms were more limited in scope, were more slowly implemented, and produced results with a longer lag than envisaged in the programs.

- **Factors beyond the control of the authorities had a larger impact on competitiveness than originally envisaged.** Poor communications and high transport costs, as well as trade barriers imposed by other countries, have hampered the county's penetration of new export markets.

21. **In 1997, the Kyrgyz Republic began exporting gold**, at a rate of just under $200 million a year, equivalent to over one-third of total exports. Gold export projections were comparatively accurate, being based on proven resources and on the extractive capacity of the gold mine. To some extent, gold exports may have hurt the growth in other exports by generating pressures on the real exchange rate that have prevented more gains in cost competitiveness.

22. **The latest program's export projections—growth of 5 percent per year in export value during the remainder of the decade—may also be overoptimistic unless non-gold exports exhibit sustained growth.** Gold exports are projected to start declining in 2007, albeit more gradually than previously believed, as two new gold mines are expected to come on stream in the next few years. The gap would need to be filled by non-gold exports, which are projected to grow at an average rate of nearly 12 percent a year until 2010. In light of the past experience this could be optimistic although exports to main trade partner countries—Russia, Kazakhstan, and China—are expected to grow rapidly in the medium term and non-gold exports did grow substantially in 2002–03. While Kazakhstan has agreed to cut its transit fees in 2004, but implemented it only on a temporary basis, Uzbekistan still maintains a highly protectionist regime. A sustained growth of exports requires diversification into non-food industrial products and continued growth of small and medium-size businesses. Exports to non-CIS countries remain constrained by weak product quality, high transportation costs, security threats, and deficient infrastructure.

C. Current Account and External Debt Developments

23. **The rapid increase of external debt indicators—to unsustainable levels—mostly reflects external shocks, including the nominal exchange rate depreciations. However, foreign borrowing also grew rapidly, although generally less than programmed (Figure 3).** Loans were extended to support the balance of payments and finance the Public Investment Program. The fact that between 1995 and 1998, the dollar value of the Kyrgyz external public debt doubled, and tripled by end-2003, suggests that coordination within the donor community to limit the volume of financial assistance was not sufficient. The debt problem was further aggravated by the lack of a national debt strategy and a reliable monitoring system both of which obscured the cost of rapid debt accumulation. Multilateral debt now accounts for 68 percent of the total with the World Bank and the AsDB as the biggest creditors. Because of the high concessionality of the multilateral debt, however, in net present value terms its share is less—55 percent. Loans from both multilateral and bilateral creditors under the Public Investment Program were close to 50 percent of the nominal debt stock at end-2003.

24. **While Kyrgyz started transition with no external debt, the break-up of the FSU resulted in a sharp increase in the Kyrgyz external current account deficits which hovered at around 10–20 percent of GDP in the first half of the 1990s.** The programmed deficit increases were meant to facilitate a resumption in economic growth, as well as to protect the rapidly declining living standards. The first adjustment program allowed for a sharp increase in external borrowing and a current account deficit of about 18 percent of GDP in 1993 but recovering rapidly to 2.6 percent of GDP by 1998. This implied a rise in external debt from $438 million in 1993 to $1425 million by 1998. Nominal U.S. dollar GDP was expected to grow by about 47 percent over the same period, with the dollar value of exports nearly doubling in five years to $1335 million in 1998.

25. **Thus, the external debt-to-GDP ratio was programmed to more than double from an estimated 21 percent in 1993 to 46 percent in 1998—a level thought to be sustainable.** In the event, the 1994–98 current account deficit (in dollars) were less than expected, partly reflecting the unforeseen Kumtor gold exports starting in 1997 and the stock of external debt (in dollars) rose by less than programmed, but dollar GDP was far below projections, reflecting a sharp depreciation in the exchange rate between 1994–98. Consequently, the ratio of external debt to GDP reached 72 percent in 1998, compared with the projected ratio of 46 percent (Figure 4).

26. **Subsequent medium-term adjustment programs envisaged a comparatively low current account deficit relative to GDP and a more measured accumulation of external debt.** Again, a comparison of the projections with actual outcomes suggest that these projections were by and large, optimistic. The actual dollar GDP was generally below projections, particularly following the Russian crisis, as the som depreciated further against the dollar. Moreover, current account deficits generally exceeded projections because of imports associated with the Kumtor mine construction and the large public investment program. Combined with the decline in exports to the CIS, noted above, this led to the

external debt stock again exceeding projections and to external debt/GDP ratios far above those projected.

27. **The large externally-financed investment program was a major factor in the debt accumulation with the largest increase occurring 1998–2001.** No early assessment of the sustainability of the PIP was undertaken. However, to address issues of transparency in the context of the PIP, the 1997 program required that all external project borrowing be included in PIP. In this context, the AsDB has provided a resident advisor to assist in prioritizing PIP projects.

28. **The rapidly rising debt stock was recognized as a potential medium-term concern from 1996, but only in 2000 did programs begin seriously addressing the issue.** Staff reports cautioned against excessive external borrowing and stressed that loans should be on highly concessional terms. Nevertheless, the PC on external borrowing allowed some nonconcessional borrowing through 2000. It was not until 2000 that measures essential to more rigorously control the rising debt stock were included as part of conditionality. In 2000, the program introduced a new PC on the cash fiscal deficit, including the foreign-financed PIP; set zero ceilings on any new nonconcessional borrowing; and required submission to parliament of a law on contracting new external debt.

29. **Although weaknesses in external debt data were recognized, programs were slow in establishing a firm framework for improving and unifying the databases.** Later programs explicitly recognized a need to strengthen debt management capacity, but no specific recommendations were included, other than a recommendation to improve the harmonization of the databases between the Ministry of Finance and NBKR. Technical assistance for debt management was limited; an external debt management resident advisor was assigned in February 2000.

30. **Restoring external viability is likely to require debt stock relief by official bilateral creditors**. Staff debt simulations show that the net present value of debt to GDP and exports can be brought to sustainable levels only through a concessional debt relief from the bilateral creditors. The 2002 Paris Club flow rescheduling was a critical first step in addressing the problem of debt sustainability and temporarily eased the liquidity constraint, but did not address the solvency problem.

D. Policy Performance

Fiscal policy

31. **Fiscal policy initially aimed at gradually reducing the fiscal deficit in order to limit recourse to domestic financing that would generate inflationary pressures.** A relatively cautious fiscal deficit reduction path was targeted in the 1990s, with very ambitious revenue targets and expenditures constant in real terms. Ex-post, in light of the revenue shortfall and weak expenditure management capacity, a much steeper adjustment of real expenditures was warranted, although this might have adversely affected real consumption and poverty. This would also have required more technical support for treasury operations.

From 2001, the principal objectives were to address poverty concerns, while simultaneously coping with accumulating debt stock through fiscal consolidation. Fiscal consolidation was also important to keep inflation expectations at bay.

32. **Throughout the period of IMF engagement, fiscal slippages were often responsible for failure to meet the program objectives and the cause of delays or suspension of various arrangements (Figure 5).** There were multiple reasons for the weaknesses of fiscal policy. First, overoptimistic output projections—although much less in local currency than in dollars—adversely affected revenue forecasts in the early programs (Figure 6). Second, collecting revenues from state owned enterprises was often difficult, in part because weak accounting practices distorted estimates of the enterprises' capacity to pay. Third, the government often failed to adjust expenditure targets or to introduce meaningful revenue enhancing reforms to meet critical expenditure needs. Fourth, the authorities were unable to tackle fundamental policy reforms in areas such as pensions and government wages. Fifth, tax administration was slow to extend taxation to the developing private sector. However the failure of fiscal policy is easy to recognize with hindsight, and the Kyrgyz performance is comparable to the other CIS countries. Indeed, the experience of both industrial and developing countries is that fiscal adjustment is difficult in the face of falling output and adverse external conditions.

33. **Revenue potential was overestimated in 1993–95.** Even after accounting for optimistic GDP projections, it appears that the revenue projections were optimistic relative to GDP (see the 1995 revenue projection cited earlier). Although major revenue reforms were enacted in 1993, weak tax administration limited the benefits arising from these measures. The ambitious targets were used to mobilize the policy effort ─ an approach consistent the tradition of central planning. Part of the shortfall in these forecasts can be explained by uncertainty regarding the capabilities of the post-transition tax administration. However, only after two years of poor performance were more realistic revenue targets were included in the program.

34. **After the initial overestimation of revenue in 1993–94, subsequent revenue targets were more modest.** Although, on average, revenue was overestimated, it was by much smaller amounts than during the earlier period. Throughout the late 1990s, programmed revenue were more realistic and appropriate considering the nascent stage of economy, the weak administration capacity, and the need to streamline tax measures. Tax revenue increased slowly from about 13 percent of GDP in 2000 to around 15 percent of GDP today. Of course, it is easier to introduce revenue reforms and collect taxes when the economy is improving.

35. **More recently, tax policy was largely aimed at lowering rates to help broaden the base by reducing the return to tax evasion while simplifying the system to improve efficiencies.** Such measures included: an introduction of a modern invoice credit system and destination principle under VAT, together with reductions in custom duties and sales tax; reducing the number of personal income tax brackets and lowering the top marginal rate; lowering the corporate income tax rate; and removing distortionary exemptions. Only modest

revenue gains were envisaged from these measures. Improving tax and customs administration has been among the key structural measures under the 2001 PRGF-supported program, although no substantial immediate revenue gains were envisaged. Despite the reforms implemented by the authorities, much remains to be done.

36. **Expenditure policy during the ESAF- and the first PRGF-supported programs was dominated by the objective to meet cash deficit targets, with virtually no real reduction of total current expenditure** (Figure 7)**.** In light of the poor revenue performance, more cautious expenditure planning might have avoided the painful adjustment process. However, at the time, cash sequestration was the only available expenditure measure to control deficits. Nevertheless, the lack of hard budget constraints on public enterprises and across-the-board expenditure reductions often resulted in cuts that were unsustainable and often led to arrears (Figure 8). For example, to absorb the rapidly increasing interest burdens associated with the rising external debt, a rapid wage bill reduction was programmed that enjoyed short-term success but created a backlash in 1998 that contributed to the accumulation of new arrears. In retrospect, successfully reducing the wage bill would have required systemic and comprehensive changes in wage and employment policy. After 2000, when the primary balance (excluding PIP) turned positive and the interest burden eased, available resources were directed toward the wage bill, especially for underpaid social sector workers.

37. **More ambitious expenditure reductions may have been warranted in response to revenue constraints**. Aggregate government spending was determined mainly by a fiscal deficit objective, with not enough recognition given to the limited capacity to implement savings in spending. In the absence of a comprehensive government wage and employment policy there were several unsuccessful reform attempts, due to the complexity of the issue, the lack of effective policy advice from international institutions, and ad hoc wage adjustments. While a significant portion of the social safety net was provided through the pension system, insufficient consideration was given to medium-term sustainability; more targeted expenditure measures would have been preferable.[4] In addition, the rising interest obligations were not incorporated at an early stage, and fiscal policy was not adjusted accordingly. Weak commitment control left the Ministry of Finance unable to prevent spending agencies from entering into contractual obligations, leading to overspending and, occasionally, payment arrears. Technical assistance from the Fund and other donors in this area is continuing under the treasury modernization project.

38. **Tangible social improvements and poverty reduction were observed only in recent years.** While the first PRGF program introduced floors on budgetary expenditure on health and education from 1998, targets were mostly missed in earlier years. The social and poverty situation deteriorated due to the severe macroeconomic imbalances in the aftermath of 1998 Russian crisis, with per capita GDP falling by about a quarter from pre-crisis level

[4] Such measures included the Unified Monthly Benefit which specifically targets the poor.

and the poverty rate increased by more than 10 percent to reach 55 percent in 1999. These trends were reversed in recent years, and by end-2003 per capita GDP has risen by 36 percent fro its 2000 level while the poverty rate has declined to 41 percent. In addition, progress towards meeting the MDG targets are mostly on track.

39. **The large increase in the externally funded public invest program (PIP) became a major fiscal policy issue in the aftermath of the 1998 Russian crisis.** Due to apparent lack of donor coordination and limited coherence in budgetary planning, the quality of the projects, and the failure to achieve the stated objectives, fundamental questions have been raised about the PIP. The PIP's sheer size─it reached 9.5 percent of GDP in 1999─posed concerns about fiscal and external debt sustainability.[5] In addition, international experience suggests that governance needs to be well-developed if these large public investment programs are to meet expectations.

40. **In order to address issues related to the PIP, the second annual arrangement under the 1998 PRGF placed conditionality (a PC) on the foreign-financed PIP in the fiscal deficit.** In addition, an AsDB-funded PIP advisor helped the government prioritize existing and planned projects.[6] The 2001 PRGF arrangement did not place a PC on the PIP, but took a more comprehensive approach by targeting the deficit. In addition, the government's external debt strategy set targets for the size of the PIP in the medium term. By 2003, the PIP had been reduced to below 4 percent of GDP, apparently without adversely affecting economic growth. In its latest Medium-Term Budget Framework, the government intends to reduce the foreign financed PIP to around 3 percent of GDP by 2007, while maintaining total public investment at around 4½ percent of GDP through increased domestic and grant-financed investment.

41. **The I-PRSP and PRSP have played a prominent role in the formulation of fiscal policy starting in 2001.** The I-PRSP was developed in 2001 and the PRSP was endorsed by the Executive Board in 2003 and the update endorsed in June 2004. Fund-supported programs have been fully consistent with the PRSP. The PRSP now plays a prominent role in the development of the annual budget and the medium-term fiscal framework.

E. Monetary Policy and Financial Sector Development

42. **The NBKR's monetary policy has been generally prudent and the central bank has played a vital role in anchoring price stability.** Until the mid-1990s, however, monetary expansion remained high, largely accommodating the extensive borrowing requirements of the public sector. In the second half of the decade the growth of monetary

[5] Many projects are multi-year and require continuous funding to realize their stated objectives. Also, most infrastructure projects imply future maintenance costs that have to be financed domestically.

[6] The proposal is to rank projects by their economic internal rate of return (for economic projects only), implementation efficiency, poverty impact, and level of concessionality.

aggregates was gradually brought under control as broad money growth declined from 78 percent in 1995 to an average rate of about 20 percent in 1996–2000 (Figure 9). During this period, the monetary program's PCs were mostly observed—in cases where they were not, the failure reflected the slippages in fiscal policy which left the NDA targets unobserved.

43. **The major achievement under the 2001 PRGF has been the economy's rapid remonetization.** Significantly improved price stability, growth, and a generally stable macroeconomic environment strengthened money demand and confidence in banks. The money supply has increased by 20 percent on average in 2002–03 in real terms with little adverse price or exchange rate effects. Bank deposits have grown rapidly, although they still remain low relative to GDP. With improved funding, bank credits to the private sector have begun to grow fast, although from a very low level.

44. **Throughout the Fund-supported programs, exchange rate policy has been based on a managed float regime.** During the early programs and at times of high inflation, the NBKR allowed the som to depreciate. Towards the end of the ESAF-supported program, but before the Russian crisis, the som had stabilized vis-à-vis the U.S. dollar, hovering at around 17 soms per dollar from late 1996 to early 1998. In response to the Russian crisis, the som depreciated rapidly—by about 40 percent during 1998 and by 60 percent overall by end-1999. During the 2001 PRGF-supported program, the som strengthened against the U.S. dollar by about 14 percent. The programs' exchange rate typically is only a technical assumption—usually a fixed rate in the Kyrgyz programs. However, the NBKR has shown some tendency to try to keep the rate stable, and during some periods—especially those that coincided with highly volatile external developments—the som was de facto pegged to the dollar or to a basket of currencies The exchange rate policy under such a "quasi-peg" paid attention mostly to the U.S. dollar movements but more recently also to fluctuations in the Russian ruble and Kazakh tenge. **Over time, the central bank's approach to managing the exchange rate has become more flexible.** Although the fluctuations in the nominal exchange rate in recent years have increased, the NBKR still appears to be very cautious in accepting market based nominal appreciations, in part because of pressure from export lobbies.

F. Structural Policies

45. **In the early years of transition the Kyrgyz Republic was among the fastest reformers.** The aggregate score of the 1994 EBRD Transition Report for market and trade reforms, privatization, and banking reforms placed the country near the Baltics and slightly above Russia. Price and trade liberalization were largely completed by the mid-1990s, with delays in price liberalization reflecting the state's continued interference in setting prices and margins. Trade liberalization proceeded rapidly and the Kyrgyz Republic adopted one of the most liberal trade regime in the CIS region, paving the way for accession to the World Trade Organization in 1998. However, the payoff to this liberalization were limited because of the protectionist policies in partner and transit countries.

46. **Small scale privatization was also completed rapidly, while large-scale privatization slowed after the mid-1990s.** However, this process was not fully effective, as shares of privatized companies were often transferred to state and labor collectives. Over 200 medium-size and large enterprises remain primarily in government hands, often with weak corporate governance. Overall, the privatization process has been relatively successful when compared to other CIS countries, with the share of the private sector in the economy rising from 30 to 65 percent between 1994 and 2003.

47. **Institutional fiscal reforms have mainly focused on the establishment of a treasury and on the development of tax and customs administrations.** In 1995, the Kyrgyz Republic became the first CIS country to establish a modern market-based treasury system. However, because of the lack of funds and technical assistance, the system still operates largely on a manual basis which has kept expenditure control less effective than hoped for. A World Bank loan for the computerization of the Treasury was approved in 2003 and the modernization is expected to be completed in 2007. Several reforms in tax and customs administrations were developed but implementation has not lived up to expectations. Corruption perception surveys typically rank these two institutions, together with the police, as the most corrupt.

48. **The NBKR has made progress, albeit slowly, in implementing financial sector reforms**. The monetary authorities successfully launched a new currency in 1993 and were largely maintained tight credit conditions that help create a non-inflationary environment following very high rates of inflation in the early 1990's. With IMF assistance, banking laws—including the central bank law that took effect in 1998—were drafted that ensured de jure independence of the NBKR.

49. **The banking crisis that began in 1998 with the Russian financial crisis was the major setback in financial sector reforms.** It culminated in 1999 with the closure of the country's three biggest banks. There were two main reasons for the banking crisis. First, the large currency mismatch had developed in banks' portfolios, as large dollar-denominated credits had been extended to the enterprise sector, the earnings of which were mainly in domestic currency. With the collapse of the nominal exchange rate in the context of the Russian crisis, banks were unable to recover their loans rendering large parts of the asset portfolio nonperforming. The second reason was the government default in redeeming its bonds issued to a state-owned natural gas company who used these bonds to secure its liabilities with banks. In the end, three major banks were liquidated and part of their assets transferred to a new state-owned Kairat Bank. Kairat operated as a narrow bank until its privatization in early 2004. The battered public confidence in the banking system as a result of the crisis set the tone for banking sector developments for several years to come. In 2000, a comprehensive bank restructuring plan was developed, with IMF assistance, and restructuring measures were put in place.

50. **Public confidence in the private banking system remained very low at the beginning of the 2001 PRGF-supported program.** This was evidenced by the deposit-to-GDP and asset-to-GDP ratios of 4 and 7 percent in 2000, respectively, among

the lowest levels in the CIS region. Since then, banking sector restructuring has advanced with these financial ratios roughly doubling by mid-2004, but still remaining low compared with other CIS countries. At the same time, the financial market remains under-developed and cash-driven, limiting the scope for monetary policy. Because of the shallow securities market, indirect monetary policy instruments were ineffective generally in influencing monetary conditions, although there has been some recent progress in this regard. Treasury bill issuance have expanded, with the stock held outside the NBKR rising from 200 million soms in 1996 to nearly 900 million soms in 2003. However, the stock remains small (7 percent of reserve money). In addition, the high risk premia sometimes demanded by the market made significant borrowing inconsistent with debt sustainability. Furthermore, tasks related to regularization of the auction calendar, extension of maturities, and development of a secondary market remain outstanding. The NBKR took steps in the mid 1990's to develop an inter bank credit auction. Despite some improvements, the roster of indirect monetary instruments remains limited.

51. **Energy sector reforms under Fund-supported programs centered on reducing the sector's large quasi-fiscal deficit.** Program conditionality in this area first began only in 1998, however, and of 14 measures in 1998–2003, two thirds were applied in 2000–01. The earlier measures addressed the privatization of the electricity companies but have later focused directly on the aggregate quasi-fiscal deficit of the electricity sector, leaving the details of tariff policy, bill collection, and governance issues to the World Bank and the authorities.

52. **Overall structural reform progress has been "stop-and-go."** Following the rapid progress until mid-1990s, the pace slowed down—or even backtracked in the second half of the decade as evidenced by the 1998/99 banking crisis—to accelerate only after 2001. Indeed, the EBRD's aggregate transition score did not improve during the second half of the 1990s while it rose from 2.1 in 1999 to 2.8 in 2003. Major remaining weaknesses are enterprise restructuring and corporate governance, poor environment for competition, and a shallow financial market.

53. **Ongoing governance problems have hampered program implementation.** Vested interest groups continue to strongly influence government decisions in key areas such as agriculture and energy. Bureaucratic and complex regulation and licensing procedures provide scope for graft and corruption. High labor and production tax rates and, in some areas, an overly complex tax system, also provide such scope, and tend to drive enterprises underground. As a result, the business climate is not conducive to free and open competition and investment. A more transparent privatization process may have helped in this regard. Overall the government often adopted an impressive set of structural reform measures, but implementation was weak, partly because the task was much more difficult than initially presumed. Filling this "implementation gap" is a key challenge for the future programs. Part of the reason that these governance problems were not addressed at an earlier stage was that these issues were not evident until after transformation took place. The more open economic environment provided opportunities that had not previously existed.

G. Technical Assistance

54. **In the initial programs, Fund technical assistance (TA) centered on developing the institutions needed in a market economy.** In the monetary area this included transforming a monolithic banking system into a two-tier system, especially concentrating on the rapid development of central banking operations. TA efforts also helped create a modern treasury system and helped formulate tax policy. In the statistics area, the TA helped develop basic price, national accounts, and balance of payments databases. More recently TA has focused on banking sector reforms, customs, and specific tax administration issues. Also an FSAP has been completed as well as fiscal and data ROSCs. TA has been well received but more systematic follow-up and monitoring of IMF recommendations, combined with some hands-on assistance, would have been desirable. Currently the NBKR and the MoF operate relatively well and technical assistance is becoming more sophisticated with a narrower focus.

H. Cooperation with the World Bank

55. **Cooperation with the World Bank has generally been good during the Fund arrangements.** The IMF has led on macro stabilization issues and provided support in fiscal management (tax policy and tax administration and public expenditure management), central banking (including banking supervision and monetary policy), and statistics. Although the World Bank has been the driving force in privatization, Fund programs worked closely with Bank operations in this area. An area of conflict has been the World Bank's role in the PIP. The Bank and other IFIs have provided a significant amount of PIP financing and the Fund staff has been somewhat critical about the size and timing of the investment projects against the backdrop of the country's external debt problem.

IV. Policy Challenges and Goals for Future IMF Involvement

56. **The Kyrgyz Republic still faces a challenging reform agenda.** The country has recently realized steady growth and stable inflation while accumulating foreign exchange reserves. Looking forward, however, one sees three major challenges:

- Preserving the recent macroeconomic gains;
- Completing the structural reform agenda; and
- Restoring external debt sustainability, while freeing resources for poverty reduction.

From this standpoint, a robust successor PRGF program could be a key component of the government's effort. It would provide the basis for further Paris Club debt relief and help to mobilize the grants needed to meet poverty alleviation goals, while moving toward debt sustainability.

57. **A low-access PRGF appears to be the most appropriate vehicle for close IMF involvement over the next few years.** The Kyrgyz Republic, because of its recent macroeconomic achievements, does not face a large balance of payments need. Moving to a surveillance-only mode appears premature since eligibility for further debt relief from the Paris Club is essential to establish debt sustainability. A standard access PRGF could be a possibility, given the country's vulnerability to external shocks. However, given the current macroeconomic and external outlook, a low-access PRGF is likely to be preferred; the Fund's major role would be to help ensure that the government continues with recent policies conducive to consolidation of a stable macroeconomic environment. At the same time such involvement would provide assurances to the international community and foreign investors that the country is on the right track.

58. **There is broad agreement between staff and the authorities that reforms needs to continue and build on the most recent successes.** This will require addressing long-standing roadblocks to support growth and poverty reduction in the previous program. There is a need to broaden support for the program and to articulate clearly to the public the rationale for the government's strategy. Of course there are risks.

59. **Uneven policy implementation had raised questions about program ownership.** Success in one year has been followed by failures in subsequent periods and, too often, reforms have been implemented on paper but resisted in practice. In the late 1990s, this partly reflected frequent changes in governments or key government officials. Cohesion has also been lacking within the government, as reform-minded policymakers were unable to find acceptance for new reform measures or to gain support for enforcement of already agreed measures. There are also indications that vested interest groups have strong influenced government or parliamentary decision-making.

60. **Closing the "implementation gap" is a difficult task, but a key to sustained success.** Strong implementation requires a strong and legitimate state. Tackling problems through issuance of presidential decrees and government resolutions and legislative amendments does not bring results if enforcement and implementation are neglected. A professional civil service with authority and accountability to the civil society—as foreseen by the new Civil Service Law—and strong progress in reforming public administration will be crucial.

61. **Exogenous shocks have complicated program implementation and remain a significant risk for a small landlocked economy with concentrated export earnings.** The energy price shock in the early 1990s, the 1998 Russian crises, and volatile gold and oil prices also explain weak policy implementation. Similarly, the need for realistic forecasts and plausible but meaningful policy responses suggests a strong focus is needed on capacity building. These weaknesses, combined with an extremely unstable environment and difficult initial conditions, were reflected in a mixed forecasting record of both the government and the IMF staff. Related to this was the failure to quickly address an emerging debt sustainability problem that arose from both the generous concessional balance of payments loans, the large public investment program, and other loans with a low grant element. The

evidence from the most recent program indicates, however, that noticeable strides have been made in these areas and this progress needs to be maintained.

62. **Strengthened program ownership would help alleviate the implementation problem.** Further progress in strengthening the policymaking institutions is needed, however, before program design will become truly country-led. At the same time, to garner public support for governmental reforms, a tangible reduction in corruption is critical, and in this regard, efforts to increase the transparency of government operations are important to help generate the dynamic investment climate needed.

63. **Key macroeconomic challenges ahead are to achieve fiscal consolidation to underpin a continued prudent monetary stance, while addressing needed poverty related expenditures.** As the tax-to-GDP ratio is broadly consistent with the country's income level, and tax rates are considered to be relatively high, no significant increase in the tax ratio is needed. Instead, a reinvigorated effort to reduce the shadow economy is needed and would provide more resources for poverty reduction. This hinges on improving tax administration to reap the potential from the current tax system and ensure fair and corruption-free taxation. Payroll and production tax rates are excessive and their reduction would help to discourage tax evasion. However, doing this while realizing appropriate revenue targets will require broadening the tax base by eliminating exemptions and improving compliance. Furthermore, improving tax administration takes time before substantive revenue is realized. A successful implementation of the extension of VAT to agricultural producers would be an important base-broadening measure and the authorities need to address the reasons for the apparent difficulties in implementing this measure.

64. **Fiscal consolidation will also require improved public expenditure management.** As noted earlier, the lack of effective commitment control has often resulted in arrears and ad hoc control measures. While some effort has been directed in this area, more progress is needed to avoid arrears in the future. Budgetary design and implementation could be strengthened by using conservative assumptions to forestall future fiscal crises and to improve strategic planning .

65. **High external indebtedness leaves the economy vulnerable.** The latest debt sustainability analysis indicates that a steady improvement in debt indicators to sustainable levels is feasible, although external obligations will remain burdensome. Stress tests nevertheless indicate that the economy would remain vulnerable to shocks such as sluggish export growth or a large currency depreciation. Accordingly, a concessional restructuring of bilateral debt in line with the Paris Club's would improve debt indicators and the prospects for medium-term sustainability. Ensuring debt sustainability would also require a continued shift toward grant financing. The government's responsibility in this respect is to continue on a path of fiscal consolidation. Consideration should be given in future programs to place explicit limits on new concessional borrowing and seek to ensure a high grant element to such borrowing.

66. **Bolder efforts are needed to improve the business climate and ensure the recovery of private investment.** Impediments include opaque regulations, erratic enforcement, sluggish administrative procedures, and demands for bribes. To remove these, both petty and large-scale corruption needs to be fought effectively. Petty corruption should be combated by enforcing penalties and through civil service reform. Large-scale corruption can be curbed by reducing rent-seeking opportunities, reining in complicit law enforcement agencies, and imposing stiff criminal sanctions for corrupt practices by high-level government officials. Greater transparency should help in this effort.

67. **More efficient public resource mobilization hinges on improving public enterprise management.** The government needs to follow through on its privatization programs, especially for the larger SOEs. The recent sale of the Kairat Bank and the ongoing privatization of the Kyrgyz Telekom are important steps in this regard.

68. **The Kyrgyz Republic will continue to require extensive technical assistance.** TA provided during previous programs by the Fund, the Bank, and other donors contributed to substantial improvements in the legal and regulatory framework for macroeconomic policy, as well as other areas. Implementation of this advice has been effective in support of monetary and financial sector reform, but full realization of key fiscal reforms depend critically on further TA. In public expenditure management this includes completing the treasury modernization project and implementing a full TSA system. There is also a need for further financial sector TA. In particular, various banking supervision issues remain pending, including prudential rules for market, operational, country, and transfer risks and competition from foreign banks. Moreover, the operational independence and structure of the central bank remain problematic, with recent or upcoming changes in laws appearing to run counter to best practice, while the NBKR operational capacity continues to be constrained by staff shortages and a lack of training. Staff shortages and insufficient training are also problems in many areas related to macroeconomic policymaking.

Table 1. Selected Data: 1992–2003 1/

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Real GDP (index)	156.6	132.3	105.7	100.0	107.1	117.7	120.2	124.6	131.4	138.4	138.3	147.5
Real GDP growth (percent change)	-13.9	-15.5	-20.1	-5.4	7.1	9.9	2.1	3.7	5.4	5.3	0.0	6.7
Gross domestic investment (index)	3.7	21.1	38.0	100.0	199.1	224.6	178.3	296.8	441.7	449.2	448.7	494.7
Gross domestic investment to GDP	14.6	11.9	9.4	18.3	25.2	21.7	15.4	18.0	20.0	18.0	17.6	17.6
Real gross domestic investment (index)	174.4	85.0	54.5	100.0	150.9	137.9	99.1	121.4	152.2	144.7	141.7	151.5
Real gross domestic investment growth (percent change)		-51.3	-35.8	83.4	50.9	-8.6	-28.1	22.5	25.4	-4.9	-2.1	7.0
Exports (U.S. dollars value)		83.0	83.1	100.0	129.9	154.2	146.2	129.0	140.0	137.1	155.6	182.4
Exports growth (percent change)			0.1	20.3	29.9	18.7	-5.2	-11.8	8.6	-2.1	13.5	17.2
Imports (U.S. dollars value)		76.0	72.5	100.0	133.1	109.9	158.4	119.3	111.5	96.2	118.6	138.6
Imports growth (percent change)			-4.6	38.0	33.1	-17.5	44.2	-24.7	-6.5	-13.8	23.3	16.9
Terms of trade (1997=100)					102.0	100.0	97.7	98.6	91.6	91.2	91.3	94.9
Gross International Reserves (In millions of U.S. dollars)				0.0	0.0	0.0	0.0	682.5	205.5	221.8	279.0	332.6
GIR (in mon. of next year's g.n.f.s. imports)				0.0	0.0	0.0	0.0	12.5	4.4	3.8	4.1	4.4
External debt (In millions of U.S. dollars) 2/			413.7	799.7	1,104.4	1,297.4	1,545.2	1,677.0	1,778.8	1,710.4	1,744.7	1,797.3
External debt/g.n.f.s. exports (in percent) 2/			121.7	195.5	207.9	205.7	258.4	317.9	310.6	305.0	274.1	240.9
External debt service/exports (in percent) 2/			1.7	9.4	4.5	9.0	21.8	26.2	26.8	27.4	17.5	21.2
Inflation (percent change; period average)	-71.3	1,086.2	180.7	43.5	32.0	23.4	10.5	35.9	18.7	6.9	2.1	3.1
REER			94.5	100.0	96.4	83.5	81.1	70.6	65.0	70.1	74.3	77.6
Narrow money (Reserve money/CPI)			79.2	100.0	145.2	133.2	142.8	130.5	115.1	118.0	134.3	187.6
Broad money (Broad money/CPI)			67.7	100.0	141.5	123.7	131.8	118.9	108.1	109.8	123.9	162.6
Govt revenues in constant prices		196.9	132.8	100.0	104.6	113.1	126.6	158.8	154.5	179.6	200.7	216.6
Primary govt spending in constant prices				100.0	82.8	85.2	97.1	100.7	95.9	93.9	102.3	106.6

1/ Index (1995=100), unless otherwise indicated.
2/ Public and publicly-guaranteed debt.

Table 2. Kyrgyz Republic: GDP Growth by Components, 1997–2004
(Average real growth in the first four year of projections, in percent of previous year's GDP)

	November 1997		June 1998		February 1999		January 2000	
	Program	Actual	Program	Actual	Program	Actual	Program	Actual
Real GDP	5.4	5.2	4.8	4.1	3.6	3.6	3.4	4.3
Public investment	0.4	1.4	0.7	0.7	0.1	0.1	-0.7	-1.2
Current account	4.0	3.7	0.7	0.9	1.9	4.5	0.7	3.1
Exports	5.2	3.9	1.3	-0.2	5.2	0.1	2.0	-0.2
Imports	-1.6	-0.5	-1.2	1.0	-3.1	1.7	-1.4	0.8
Other current account	0.5	0.3	0.6	0.1	-0.1	2.7	0.1	2.5
Public consumption	0.9	0.6	0.1	0.8	0.7	0.9	0.6	0.8
Private investment and consumption	0.1	-0.4	3.3	1.8	0.8	-1.9	2.7	1.7

	Aug. 2000	June 2001	Nov. 2001	Feb. 2003	July 2003	Dec. 2003	June 2004
	Program	Program	Program	Program	Program	Program	Program
Real GDP	5.1	4.6	4.6	5.1	5.1	4.7	4.9
Public investment	-0.4	-0.6	-0.6	-0.2	-0.1	-0.2	0.1
Current account	3.0	0.4	0.3	-0.5	-0.8	-0.5	-0.4
Exports	1.8	-2.5	-1.9	0.7	0.8	-0.3	0.8
Imports	0.5	2.1	1.1	-1.0	-1.3	-0.1	-1.3
Other current account	0.6	0.8	1.2	-0.2	-0.3	0.0	0.2
Public consumption	-0.4	0.5	0.8	1.4	1.3	0.9	0.6
Private investment and consumption	2.9	4.3	4.0	4.4	4.7	4.5	4.5

Sources: IMF programs and staff reports, various years.

Table 3. Kyrgyz Republic: Program Projections and Actual Values, 1996–2004

(Selected indicators; in percent)

Program Document	Date	Average Growth of Exports Over the First Four Years of Projections		Debt/Export Ratio in the Fourth Year of Projections		Average Real Growth Rates Over the First Four Years of Projections	
		Projections	Actuals	Projections	Actuals	Projections	Actuals
ESAF, 2nd annual, mid-term review	June 1996	15.4	3.1	169.8	293.7	8.1 1/	8.5 1/
ESAF, 3rd annual, request	March 1997	14.4	-1.0	159.6	348.2	...	...
ESAF, 3rd annual, mid-term review	November 1997	12.7	-1.0	171.0	348.2	5.4	5.2
ESAF (PRGF) Request	June 1998	7.3	-6.6	187.8	339.2	4.8	4.1
ESAF (PRGF) 1st annual, mid-term review	February 1999	9.6	-3.9	208.1	356.0	3.6	3.6
ESAF (PRGF) 2nd annual, request	January 2000	7.6	6.3	295.2	303.7	3.4	4.3
ESAF (PRGF) 2nd annual, 1st and 2nd reviews	August 2000	8.3	6.3	272.0	303.7	5.1	4.3
PRGF, 5th review	January 2004	6.7	...	262.3	...	4.9	...

Program Document	Date	Average Growth of Imports Over the First Four Years of Projections		Average Current Account Balance in the First Four Years of Projections (In Percent of GDP)	
		Projections	Actuals	Projections	Actuals
ESAF, 2nd annual, mid-term review	June 1996	5.1	-1.8	-8.5	-17.6
ESAF, 3rd annual, request	March 1997	3.8	-10.3	-10.6	-13.4
ESAF, 3rd annual, mid-term review	November 1997	1.8	-10.3	-8.7	-13.4
ESAF (PRGF) Request	June 1998	6.9	-9.1	-5.9	-12.1
ESAF (PRGF) 1st annual, mid-term review	February 1999	3.4	-7.6	-9.7	-7.4
ESAF (PRGF) 2nd annual, request	January 2000	5.7	5.3	-11.5	-4.1
ESAF (PRGF) 2nd annual, 1st and 2nd reviews	August 2000	1.9	5.3	-7.1	-4.1
PRGF, 5th review	January 2004	7.9	...	-4.2	...

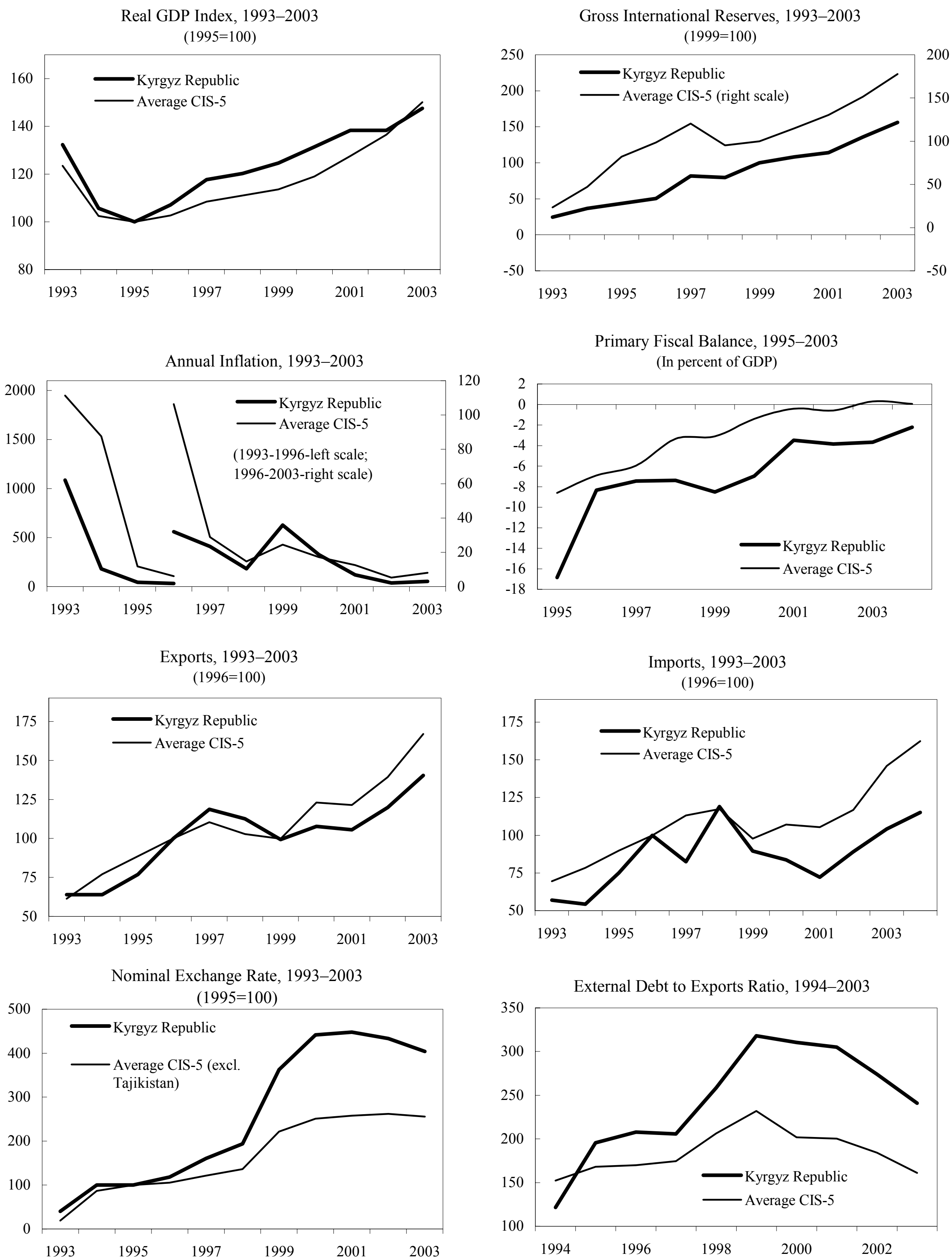
Sources: IMF programs and staff reports, various years.
1/ Average growth over the first two years of projections.

Table 4. Kyrgyz Republic: Exports, 1993–2003

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
					(In millions of dollars)						
Total exports	334.9	339.9	409.0	531.1	630.8	585.1	462.6	510.9	480.3	498.0	590.0
Gold	0	0	0	0	184.0	195.8	183.1	195.3	224.6	162.7	260.0
Non-gold	334.9	339.9	409.0	531.1	446.8	389.3	279.5	315.6	255.7	335.3	330.0
To CIS countries	222.7	222.8	269.3	393.9	346.2	302.0	191.5	213.7	172.2	170.0	202.0
o/w: food	44.5	53.1	74.2	117.7	72.1	45.3	15.6	8.6	10.5	...	...
agriculture	4.5	3.9	38.2	47.7	33.5	42.9	47.5	35.7	30.7	...	...
energy	31.4	72.6	45.5	78.0	86.5	28.3	53.1	82.0	51.5	28.0	26.0
To other countries	112.2	117.1	139.7	137.2	100.6	87.3	88.0	101.9	83.5	165.3	128.0
o/w: other metals	28.9	47.4	50.8	34.1	10.0	31.3	19.4	8.0	81.0	...	...
light industry	9.2	48.1	54.4	36.0	38.0	26.0	18.3	25.1	13.8	...	...
					(Change over previous year, in percent of previous year's total exports))						
Total exports	...	1.5	20.3	29.9	18.8	-7.2	-20.9	10.4	-6.0	3.7	18.5
Gold	...	0.0	0.0	0.0	34.6	1.9	-2.2	2.6	5.7	-12.9	19.5
Non-gold	...	1.5	20.3	29.9	-15.9	-9.1	-18.8	7.8	-11.7	16.6	-1.1
To the CIS	...	0.0	13.7	30.5	-9.0	-7.0	-18.9	4.8	-8.1	-0.5	6.4
o/w: food	...	2.6	6.2	10.6	-8.6	-4.2	-5.1	-1.5	0.4	...	...
agriculture	...	-0.2	10.1	2.3	-2.7	1.5	0.8	-2.6	-1.0	...	...
energy	...	12.3	-8.0	7.9	1.6	-9.2	4.2	6.2	-6.0	-4.9	-0.4
To other countries	...	1.5	6.6	-0.6	-6.9	-2.1	0.1	3.0	-3.6	17.0	-7.5
o/w: other metals	...	5.5	1.0	-4.1	-4.5	3.4	-2.0	-2.5	14.3	...	...
light industry	...	11.6	1.9	-4.5	0.4	-1.9	-1.3	1.5	-2.2	...	...

Sources: IMF programs and staff reports, various years.

Figure 1. Macroeconomic Indicators: Kyrgyz Republic vs. Other CIS Countries 1/

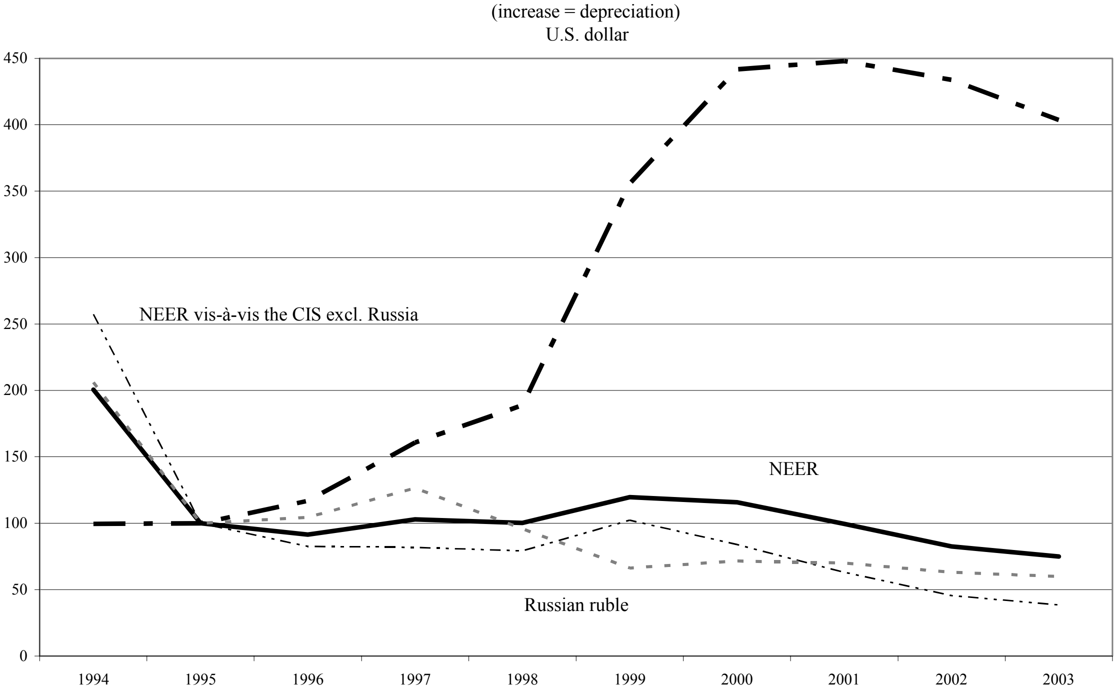


Sources: IMF (FSU) database; and staff estimates.

1/ CIS 5–simple average of Armenia, Georgia, Moldova, Tajikistan, and Kyrgyz Republic.

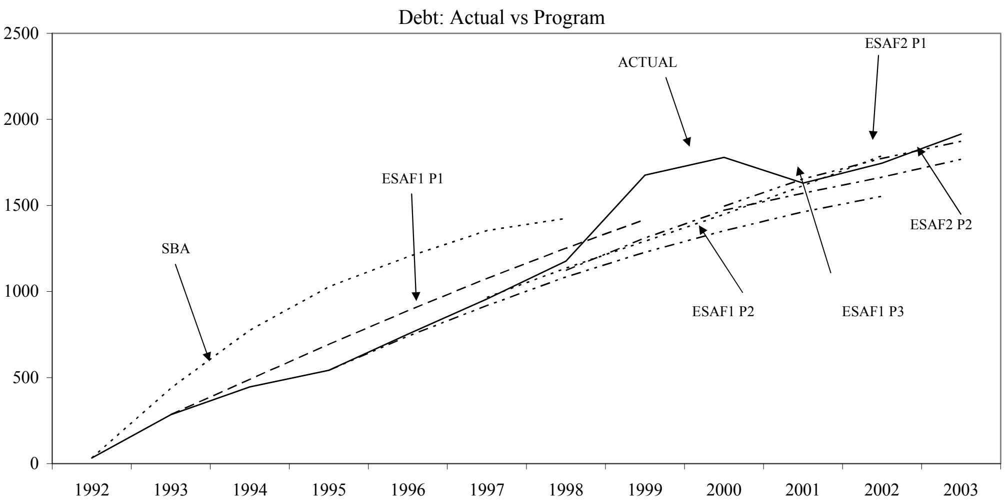
Figure 2. Kyrgyz Republic: Nominal and Real Exchange Rate, 1994–2003

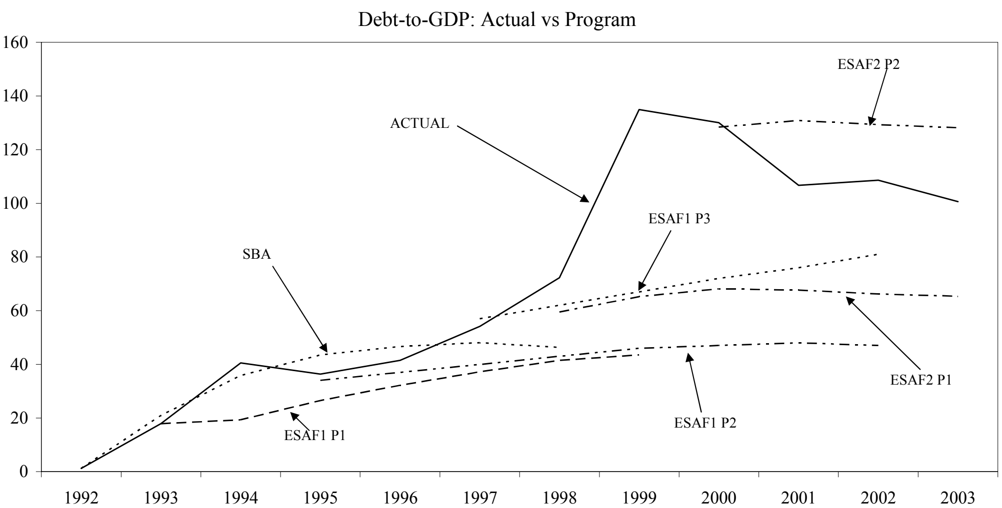
Nominal Exchange Rates, 1994–2003
(increase = depreciation)



Real Exchange Rate, 1994–2003
(increase = appreciation)

Figure 3. Debt Indicators: Actual vs Program





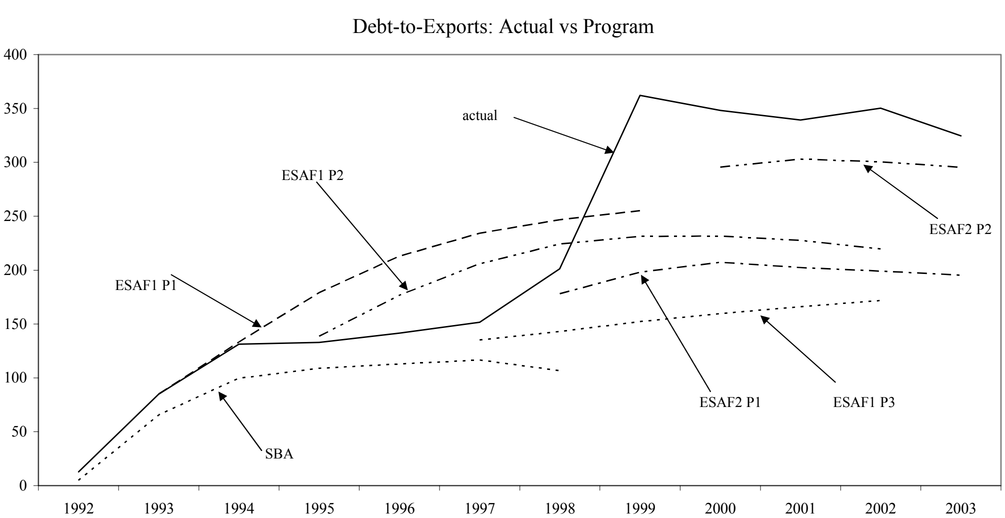
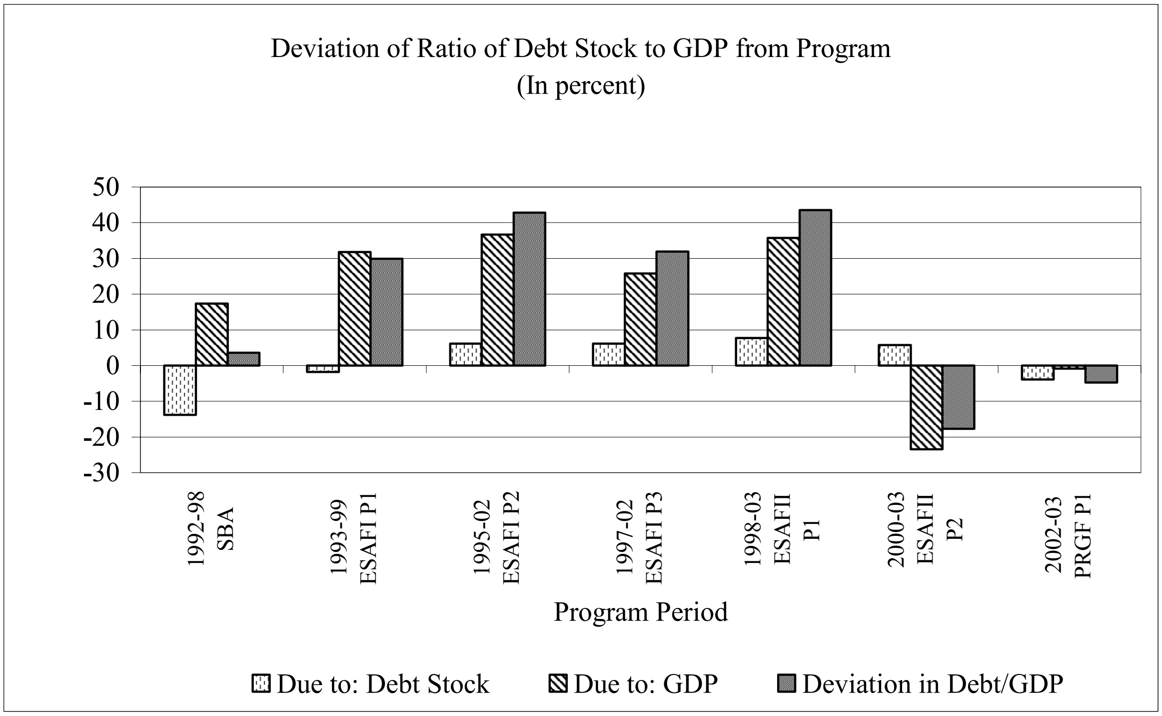


Figure 4. Decomposition of Projection Errors in Debt Indicators



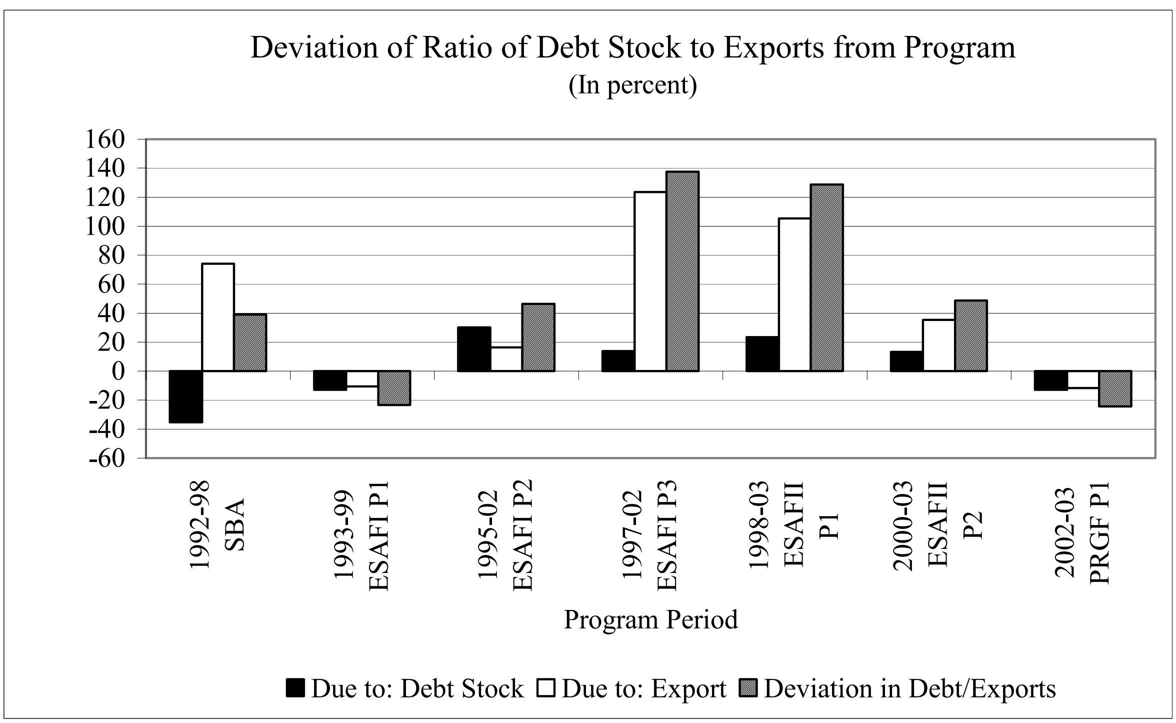


Figure 5a. Kyrgyz Republic: State Government Fiscal Cash Balance Excluding PIP
(In percent of GDP)

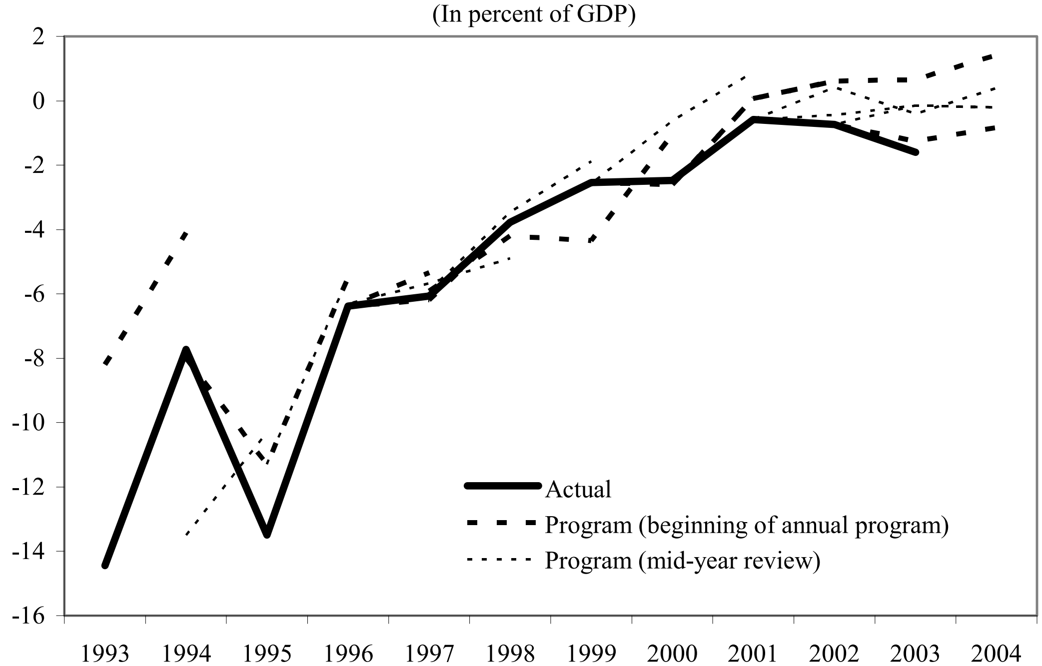


Figure 5b. Kyrgyz Republic: Net Accumulation of Expenditure Arrears
(In millions of som; 1995 prices)

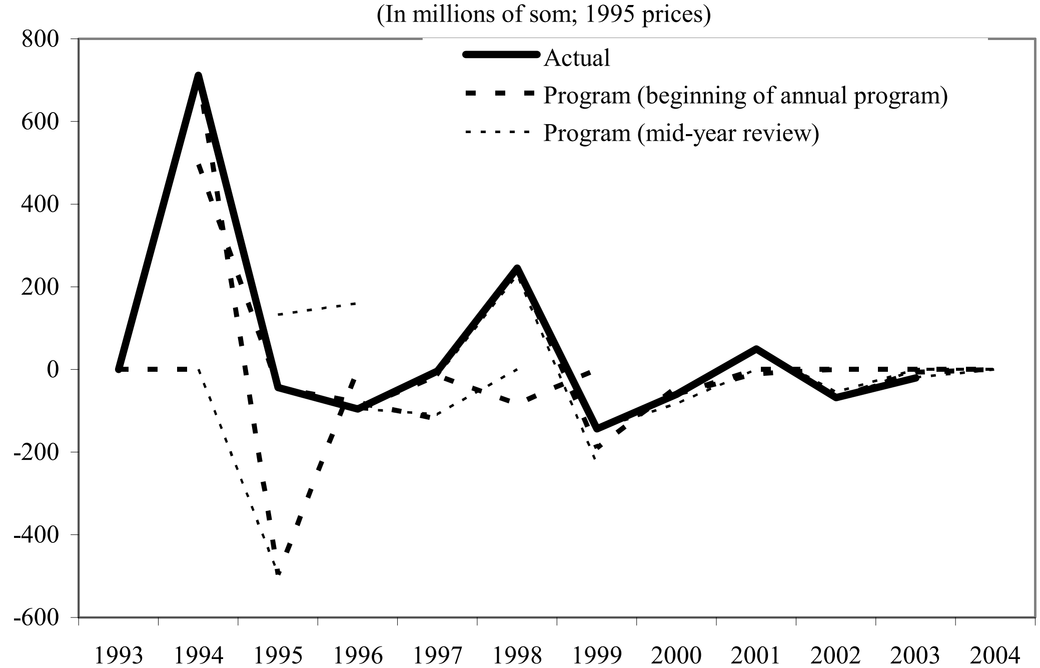
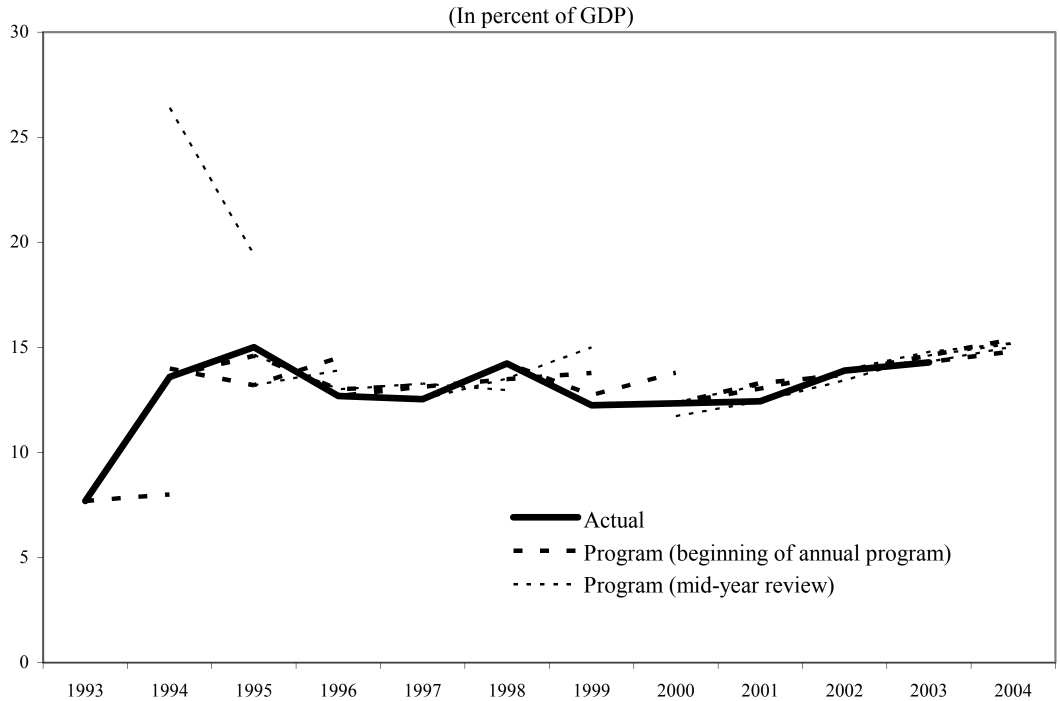


Figure 6. Kyrgyz Republic: State Government Tax Revenue



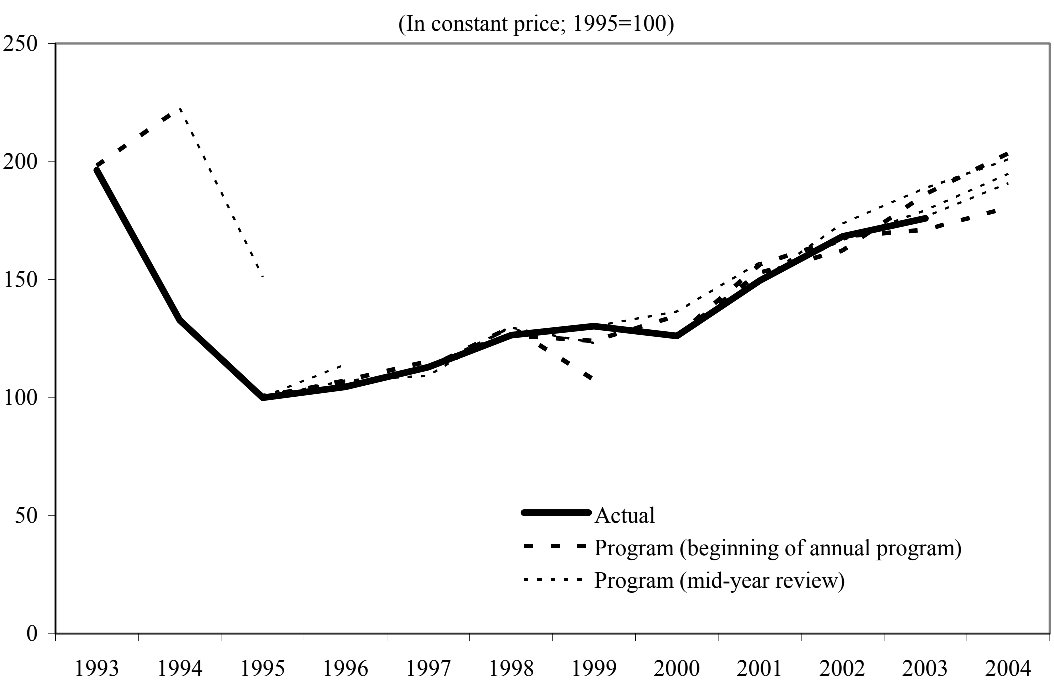
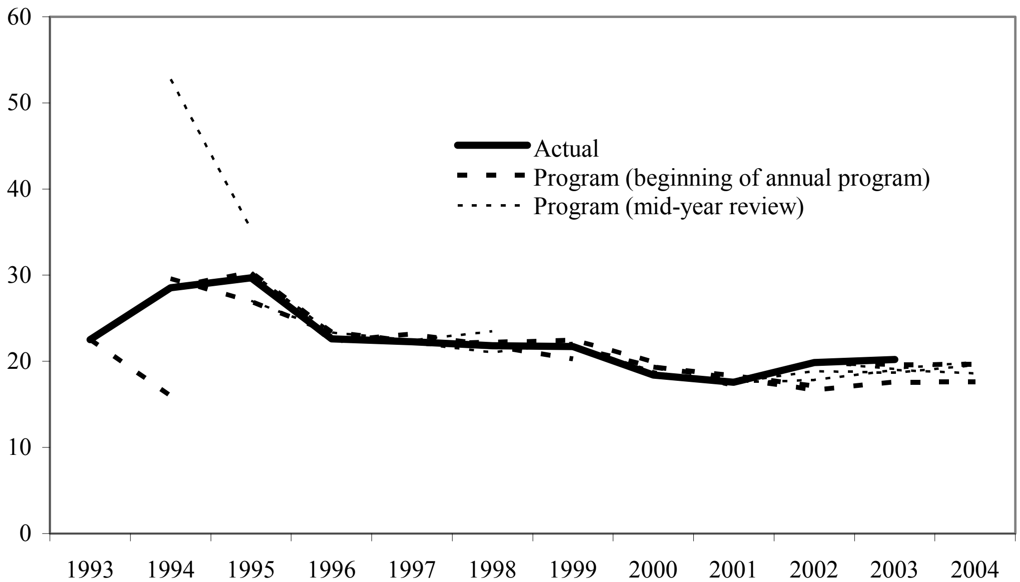


Figure 7. Kyrgyz Republic: State Government Cash Expenditure

Including net lending, excluding foreign financed PIP
(In percent of GDP)



Including net lending and foreign financed PIP
(In percent of GDP)

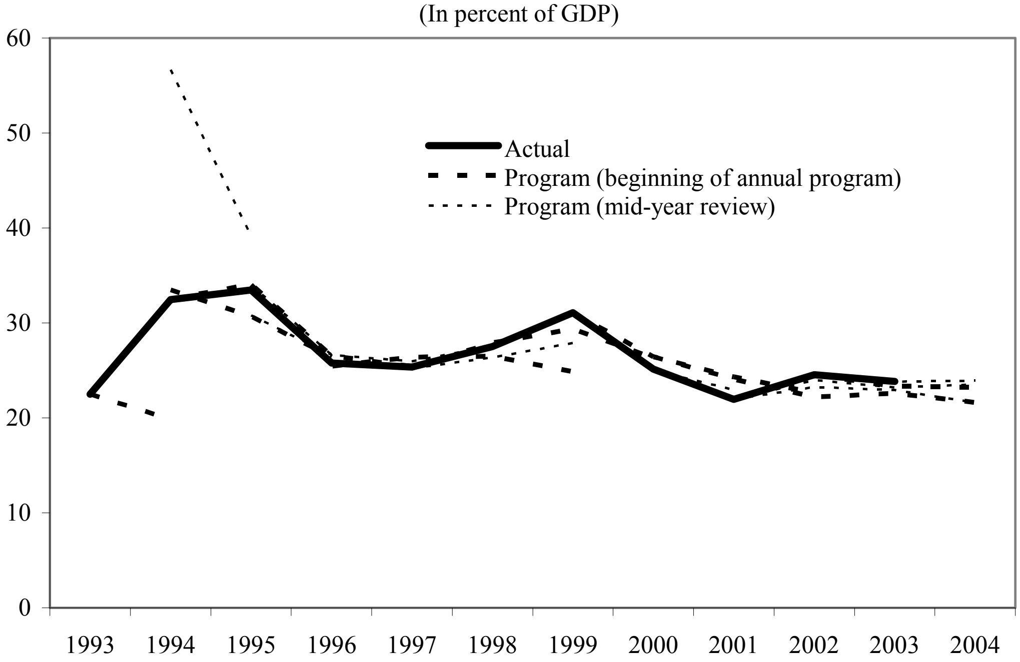
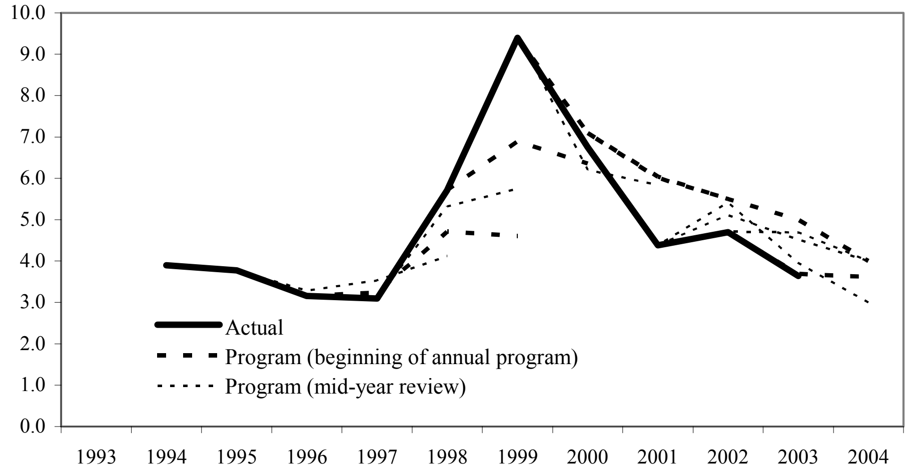
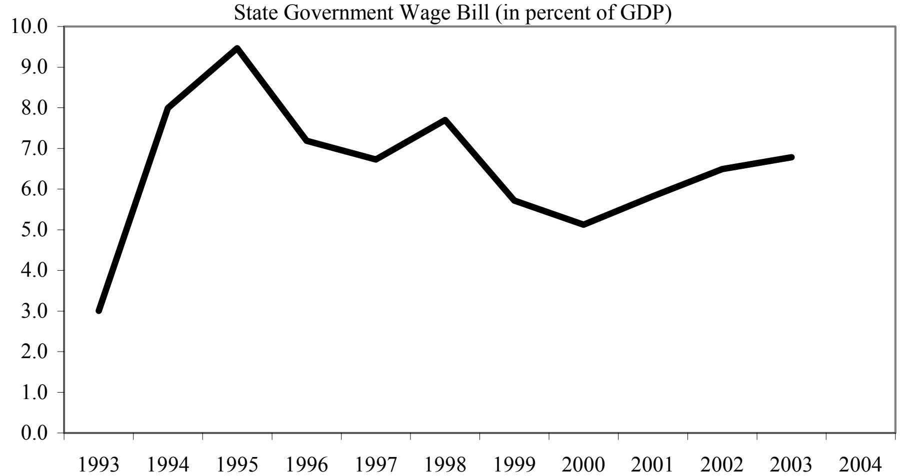


Figure 8. Kyrgyz Republic: Selected State Government Expenditure Items

Foreign financed PIP (in percent of GDP)



State Government Wage Bill (in percent of GDP)



State Government Interest Payments (in percent of GDP)

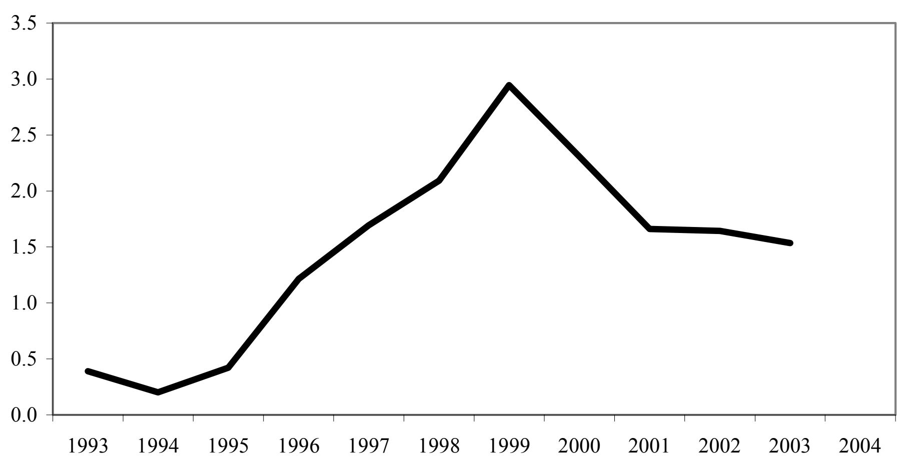
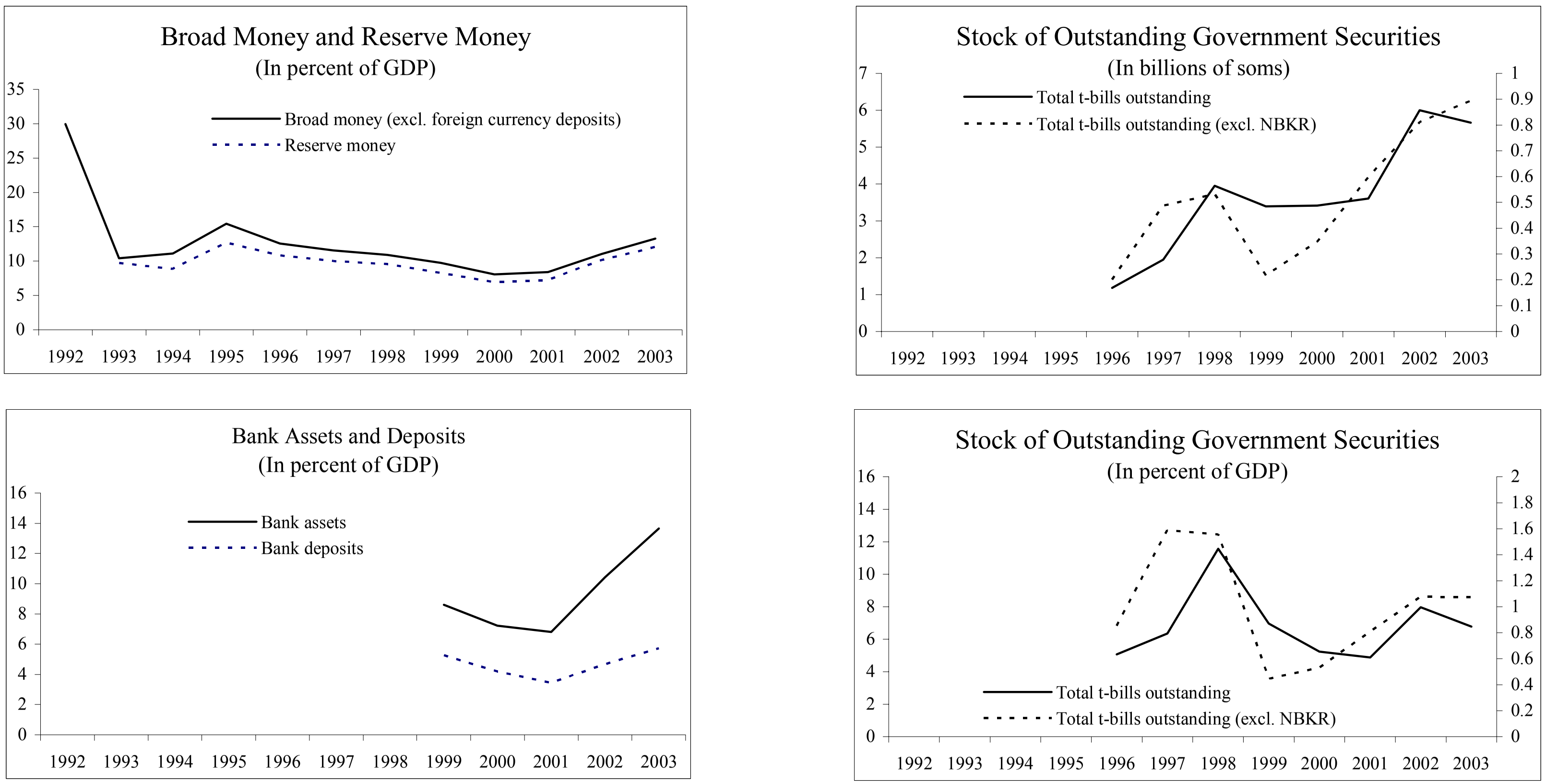


Figure 9. Selected Financial and Monetary Indicators



Sources: MCD database and NBKR.

Kyrgyz Republic: Summary Indicators of Program Compliance

Membership: Joined May 08, 1992. **Article VIII**: Yes. **Quota**: SDR 88.8 million.
Active arrangement: Three-year PRGF arrangement approved December 6, 2001.
Outstanding Fund credit: SDR 141.5 million (159 percent of quota) as of August 31, 2004.

Arrangement 1

- Eleven-month SBA approved May 12, 1993 in the amount of SDR 27.09 million. (In addition, a purchase from the Systemic Transformation Facility was approved for SDR 16.125 million.)

- Three reviews were planned, based, respectively, on test dates of end-June, end-September, and end-December. Performance criteria covered: (i) NIR, (ii) NDA, (iii) net domestic financing by the banking system of the general government, (iv) general government use of foreign counterpart funds, (v) short-term debt, (vi) public sector and central bank contracting or guaranteeing of new medium- and long-term external debt, and (vii) government external payment arrears.

- In completing the first review on September 20, 1993, waivers were required for PCs (ii), (iii), and (vi).

- Subsequent reviews were not completed, apparently due to slippages in fiscal and monetary policies, and the total amount drawn under the arrangement was SDR 11.610 million (SDR 9.675 million upon approval and SDR 1.935 million upon completion of the first review).

Arrangement 2

- Three-year ESAF arrangement approved July 20, 1994, in the amount of SDR 88.150 million (originally SDR 70.95 million; augmented in December 1995). Semi-annual reviews were planned, with the first due by end-March 1995, to be based on the end-December 1994 test date.

- The program used performance criteria on: (i) NIR, (ii) reserve money, (iii) net domestic financing by the banking system of general government, (iv) short-term debt, (v) public sector and central bank contracting or guaranteeing of new medium- and long-term external debt, and (vi) government external payment arrears. Structural PCs were also used.

- In completing the first review on March 31, 1995, waivers of nonobservance were required for PCs (ii), (iii), (vi), and for a structural PC regarding the initiation of bankruptcy proceedings.

- Presentation of the second annual arrangement to the board was delayed until December 11, 1995 because of weaknesses in budget revenues. (Access was augmented at this time, as noted above.) This followed an informal staff-monitored program with monthly monitoring, which was put in place in May 1995 and covered June-August. The second annual arrangement moved away from the reserve money PC and back to NDA. The mid-term review under the second annual program was to be based on end-March 1996 PCs and to be completed by end-June 1996. It was in fact completed on July 31, 1996, and required waivers for two quantitative PCs (NIR and NDA) and a structural PC.

- The third annual arrangement was presented to the board in March 27, 1997 and at this time the arrangement was extended to end-March 1998. PCs were set for end-June 1997. All PCs were met, and the mid-term review was completed in December 1997.

- Access under the PRGF arrangement was fully disbursed (SDR 88.150 million). However, the extension associated with delays in the second-year arrangement led to the arrangement covering 44 months.

Arrangement 3

- Three-year ESAF approved on June 26, 1998, for SDR 64.5 million. Due to the impact of the Russian financial crisis on the Kyrgyz balance of payments, the amount was augmented to SDR 73.38 million at the time of the completion of the mid-term review under the first annual arrangement. The arrangement was extended by one month (to July 25, 2001). Performance criteria were set for end-September 1998. In addition to the PCs used in the earlier arrangement, PCs were introduced on tax revenues; the state government fiscal deficit; wage and pension arrears and arrears to Kyrgyz Energo; and (floors) on health and education spending. In completing the mid-term review under the first-year arrangement in March 1999, waivers were required for 7 of the 12 end-September PCs, partly reflecting the impact of the Russian financial crisis.

- The second-year arrangement was approved in March 2000, as policy slippages (especially in the fiscal area) caused delays in reaching understandings for the second annual program. At this time quarterly PCs were introduced, while three mid-term reviews were planned under the annual arrangement. The first review was scheduled to be completed by end-June but was postponed and was considered together with the second review on September 13, 2000. At that time waivers were required for the nonobservance of several quantitative PCs at both the March and June test dates, and a waiver was required for the nonobservance of an end-June structural PC. The final reviews were not completed because four quantitative PCs for end-September 2000 and three for end-December 2000 were not observed, while the staff also had concerns with the authorities' external debt strategy.

- Following a period of informal monitoring using monthly targets in early 2001, and discussions on a credible external debt strategy, the staff prepared a report that would have underlied board consideration of a third-year arrangement in July 2001. However, the authorities' request for the third-year arrangement was withdrawn from the board agenda because parliament had introduced tax reductions inconsistent with the program.

- Of the augmented access of SDR 73.380 million, only SDR 44.690 million was disbursed.

Arrangement 4

- Three-year PRGF arrangement approved December 6, 2001 for SDR 73.400 million. The program foresaw semi-annual reviews, to be based on test dates at end-March and end-September. The PCs on certain expenditure areas from the previous arrangement were dropped (as a fiscal deficit PC had been adopted), while other changes to program monitoring were minor.

- Thus far all reviews have been completed on time. Waivers have been relatively few: the continuous PC on external arrears was breached (although quickly remedied) during the period covered by the second review, implementation of two structural PCs relating to tax policy and required for the completion of the third review were delayed by a few weeks, and the end-September 2003 fiscal deficit PC (relating to the fourth review) was breached slightly because of a delay in an EU grant. In total, SDR 54.28 million of the total SDR 73.400 million has been disbursed, with remaining disbursements of SDR 9.55 million each associated with the completion of the fifth and sixth reviews, the latter based on end-September PCs. All end-March PCs were observed and the fifth review is scheduled for board consideration on June 28, in line with the original schedule under the arrangement.

Note: The staff report for the request for a new arrangement (IMF Country Report No. 01/223), contains background and an assessment of the earlier arrangements, including indicators of program compliance.