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June 2, 2021

**Statement by Mr. Palei and Mr. Biriukov on Kyrgyz Republic
(Preliminary)
Executive Board Meeting
June 4, 2021**

1. We thank staff for the comprehensive set of reports and Mr. Trabinski and Mr. Imashov for additional clarifications provided in their Buff statement. We commend the authorities for the decisive response to the virus outbreak, which cushioned the impact of the shocks on the economy. We also appreciate the Fund's rapid response to the authorities' request for assistance at the outset of the pandemic. **We broadly concur with the thrust of the staff appraisal** and offer the following comments for emphasis.
2. **An appropriate balance should be found between short-term fiscal support to the economy and medium-term fiscal sustainability.** Moderately expansionary fiscal stance in 2021 is appropriate as economic output remains below its potential level and uncertainties associated with the vaccine rollout are still in place. Prudent fiscal policy will have to be restored once the recovery is on a firmer footing to preserve strong debt-carrying capacity and create fiscal space for development needs. Reducing tax exemptions and energy subsidies, as the situation permits, tightening management of the public wage bill, and improving tax administration could be sources of fiscal consolidation over the medium term.
3. **Monetary policy should remain proactive.** Recent rate hikes in response to increased inflationary pressures reveal the NBKR's strong focus on controlling inflation and anchoring inflation expectations. We support the NBKR's intention to adopt inflation targeting in the medium term. Smooth transition will require preparatory work to strengthen the central bank's autonomy. More developed money market will be also required to increase the role of the interest rate as the operational target of monetary policy. In addition, we also commend the NBRK for the increased flexibility of the exchange rates, a crucial buffer against external shocks. While an adequate level of international reserves is necessary for economic and financial stability, we also agree that FX interventions should be used to avoid excessive swings in the exchange rates.

4. **We take a positive note that the banking sector remains in good financial health.** The NBKR remains appropriately committed to continuous supervisory vigilance and comprehensive stress-testing to monitor systemic vulnerabilities. A delayed response of non-performing loans to an underlying weakening of the economy calls for vigilance and continued monitoring of the developments in this sector. We also agree with staff that preparing a comprehensive NPL resolution strategy is essential.

5. **On the structural front, the authorities face the challenge of transformation of a rapidly increasing labor force into productive employment.** In this respect, among other things, it will be critical to reprioritize the education budget and develop an education reform strategy. Currently the Kyrgyz Republic underperforms on school enrollment and test scores despite spending more per capita on education than some of its peers.

6. **We note the Kyrgyz authorities historically were among the leaders in many structural reforms, cooperating closely with the World Bank, IMF, and other international institutions.** In the staff report, we noted in paragraphs 21 and 21 that even under the very challenging pressures of the pandemic they persevered with efforts to further improve governance, including through the adoption of the new procurement law in the beginning of 2021 and the Anti-Corruption Strategy. In Annex IV staff also addressed some of the impediments to higher growth in the Kyrgyz Republic, including the improvements in access to electricity and finance. In the Ease of Doing Business Database the Kyrgyz Republic is currently ranked in the middle, but higher than some of the users of the Fund's precautionary instruments. The key components of the ranking are in accordance with staff's call to invest in infrastructure and education. We encourage the Kyrgyz authorities to intensify their collaboration with the World Bank on related further structural reforms.

7. **We also welcome the authorities' intention to collaborate with the Fund on preparing Fiscal Transparency Evaluation.** According to the authoritative Open Budget Index, the Kyrgyz Republic is already ranked higher than many emerging market and advanced economies¹. *We would like staff to elaborate on the authorities' reforms in the area of fiscal transparency that read to their unusually high ranking.* At the same time, given the Fund's expertise in this area, we expect additional useful recommendations for the authorities. *Staff may want to clarify possible timeline for conducting the evaluation.*

8. **At the same time, in some of their illustrations, staff referred to highly questionable perceptions-based World Governance Indicators, criticized by many Directors on multiple occasions.** We encourage staff to follow the IMF framework on governance and provide more balanced charts and illustrations, while avoiding simplistic references to the complex developments. Otherwise, such references may mislead some observers into making misleading statements about the state of governance in the Kyrgyz Republic. *Staff comments would be appreciated.*

¹ See <https://www.internationalbudget.org/open-budget-survey/rankings>

9. **With respect to the update on the conflict related to the situation with the Kumtor Gold Company and to the company's alleged damage to the lives and ecology, we agree with staff that constructive cooperation is advisable.** We look forward to further clarifications on the arbitration and other legal deliberations. *At the same time, staff may want to elaborate on their reasons to expect major interruptions in gold production or even suspension of operations.*

10. **We welcome the Kyrgyz authorities' efforts to combat the climate change.** About a quarter of total water resources in the Central Asia originate in the Kyrgyz Republic, with substantial part of freshwater stored in its glaciers. We note the authorities' strong concerns about the potential loss of glaciers and the associated large impact on the regional ecosystem. The fragility of the environment and the history of dangerous accidents call for close and continuous cooperation between the authorities and investors operating in Kyrgyzstan.

With these comments, we wish the Kyrgyz authorities every success in their future endeavors.