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FOR AGENDA

EBS/93/113

CONFIDENTIAL

July 12, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Kazakhstan - Use of Fund Resources - Request for Purchase Under the Systemic Transformation Facility (STF)

Attached for consideration by the Executive Directors is a paper on a request expected to be received from Kazakhstan for a first purchase under the systemic transformation facility in an amount equivalent to SDR 61.875 million. A draft decision appears on page 15.

This subject is tentatively scheduled for discussion on Friday, July 23, 1993.

Mr. Kapur (ext. 38732) or Mr. Geadah (ext. 38830) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

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INTERNATIONAL MONETARY FUND

KAZAKHSTAN

Use of Fund Resources--Request to Purchase Under the Systemic Transformation Facility (STF)

Prepared by European II Department

(In Consultation with Other Departments)

Approved by John Odling-Smee and Mark Allen

July 9, 1993

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I. Introduction

In the attached letter, the Government of Kazakhstan and the National Bank indicate their intention to shortly request a purchase from the Fund under the Structural Transformation Facility (STF) in the amount of SDR 61.875 million (25 percent of quota), in support of a twelve-month economic program starting July 1993 which is laid out in the accompanying Statement of Systemic and Macroeconomic Policies (Appendix I); a second purchase, of the same amount, is expected to be requested when the conditions for it under the STF are met. Discussions on the STF program were held in Almaty during May 7-24, 1993. The Kazakh representatives included Mr. Sembayev, First Deputy Prime Minister; Mr. Izteleuov, Minister of the Economy; Mr. Tadjiyakov, First Deputy Chairman of the National Bank of Kazakhstan (NBK); and Mr. Sobolev, First Deputy Minister of Finance; the staff also met with President Nazarbayev. 1/

Substantial progress was achieved earlier this year in discussions between the Government of Kazakhstan and the staff on a comprehensive macroeconomic stabilization and structural reform program which could be supported by an upper credit tranche stand-by arrangement with the Fund. Many of the policy measures discussed have already been implemented and the Government expects that the few outstanding issues, notably the key issue of effective monetary arrangements and policies, will be resolved in the coming months to enable the finalization of a program for an upper credit tranche stand-by arrangement before the end of the year. To provide a transition to such an arrangement, the authorities intend to request access to the use of Fund resources under the STF.

The World Bank has prepared several lending operations to Kazakhstan for the next twelve months. Following Fund approval of the first STF purchase, the Bank intends to proceed with an import rehabilitation credit of US$180 million in August/September. In addition, a technical assistance loan of US$38 million will be presented to the Bank's Board in July. The Bank is also in the process of preparing lending operations covering the energy sector, urban transport rehabilitation, as well as privatization, enterprise, and financial sector reform.

The first Article IV consultation with Kazakhstan was concluded on April 23, 1993 (EBM/93/61). Executive Directors commended Kazakhstan on its reform efforts, particularly measures to contain the large macroeconomic imbalances and the initiation of substantive structural and institutional reforms. They also encouraged the Government to proceed with the implementation of a broad-based stabilization program and acceleration of systemic reforms so as to achieve the economic and financial stability

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1/ The staff team comprised Mr. Kapur, Mr. Geadah (both EUR II), Mr. Maret (FAD), Mr. Allum (PDR), Mr. Cartiglia (EP-EUR II), and Mrs. Selishev (Assistant-EUR II). Mr. Sol-Perez, the Fund's resident representative in Almaty, participated in the discussions.

needed to unlock Kazakhstan's growth potential. The authorities were advised to accord top priority to a rapid and substantial lowering of inflation, for which they were encouraged to seek monetary independence for Kazakhstan. While it was generally recognized that Kazakhstan's problems could be best dealt with in the context of a comprehensive package of policies supported by an upper credit tranche stand-by arrangement, it was considered an early candidate for the use of resources under the STF.

Appendix II contains an assessment of Kazakhstan's eligibility to draw under the STF. The Fund's relations with Kazakhstan, including a description of technical assistance activities, are summarized in Appendix III; the World Bank's relations with Kazakhstan are described in Appendix IV.

II. Recent Developments 1/

While some signs of improvement are apparent, overall conditions remained difficult in the first months of 1993 and were worse than had been anticipated at the beginning of the year. During January-May, real GDP is estimated to have fallen by around 15 percent relative to the corresponding period in 1992, although there are signs that the decline may be slowing. The number of registered unemployed has remained low (around 40,000 at the beginning of May), but the authorities estimate that actual unemployment amounted to more than 200,000 people--around 3 percent of the labor force. In addition, it is estimated that about 110,000 workers are currently on forced leave or part-time arrangements.

As in the rest of the ruble area, inflation was very high in the first quarter but began to decelerate thereafter. In the January-March period, the monthly rate of consumer price inflation was around 32 percent, and wholesale inflation is estimated to have been slightly higher (Chart 1 and Table 1). However, consumer price increases slowed in April to a monthly rate of 21 percent and further to 16 percent in May. Following a more than doubling in prices of petroleum imported from Russia, administered prices were raised so that energy products continue not to be subsidized through the budget on a net basis. The monthly minimum wage was raised from rub 2,500 to rub 4,500 in April (compared to rub 9,000 in Russia) and average wages rose 19 percent to rub 24,000 over the previous month. Despite these nominal increases, real wages are estimated to have already declined by almost 20 percent relative to the beginning of this year.

A tight fiscal stance has been a key element of the Government's economic policies in 1993. With inflation only partially under the control of domestic policies, the authorities have focused on strengthening public finances and on minimizing domestic bank financing of the budget. Data on

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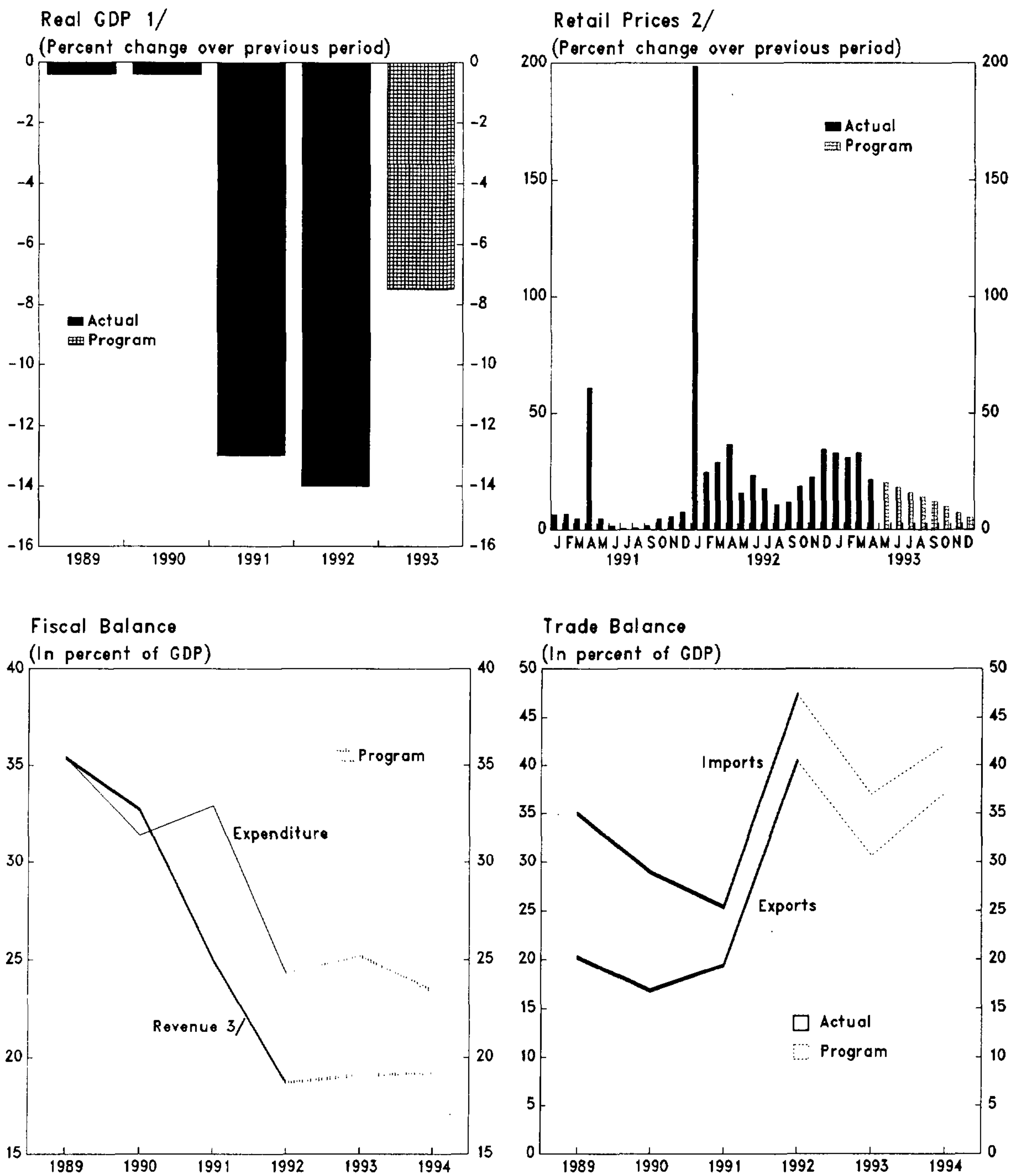
1/ Developments through early 1993 were described in detail in the Staff Report (SM/93/60, 3/23/93, and Supplement 1, 4/16/93) and Background Paper for the 1993 Article IV consultation (SM/93/73, 4/9/93).

Chart 1

KAZAKHSTAN

SELECTED ECONOMIC INDICATORS, 1989-94



Source: Data provided by the authorities; and staff estimates.

1/ Assumes growth of real GDP equals growth of National Income Produced.
2/ Based on Retail Price Index for 1991 and Consumer Price Index for 1992.
3/ Including grants.

the fiscal outcome for the first quarter of 1993 show a small surplus, and there are preliminary indications that this situation continued through May; revenues were relatively buoyant and expenditures were tightly controlled through sequestration and implementation of a cash management system. As higher-than-expected price increases (largely due to higher energy prices) and a more depreciated exchange rate invalidated the budget's underlying assumptions, the Government adopted a revised budget in May which maintained its commitment to a restrictive fiscal policy. The revised budget introduced a gasoline tax (equal to the difference between the regulated retail price and a notional cost-plus-margin price); a local tax for the development of public transportation levied on the wage bill of enterprises at varying rates; and a customs tariff as well as excise taxes on imports from non-CIS countries. Expenditure allocations included provisions for the increase of the minimum wage and pension as of April 1 and a more realistic evaluation of the costs of certain subsidies. The revised budget also reflected the creation of the Fund for Price Regulation which provides for a social safety net to selected groups of the population and subsidies to the agricultural sector (mainly wheat) to offset the large increases in energy prices; the operations of this fund are financed by the revenues from the gasoline tax and balanced with a view to avoiding any net subsidies from the budget.

Monetary and credit developments were dominated by rapid rates of expansion during the first five months of the year, accompanied by the re-emergence of a severe cash shortage and payments arrears in late-April and May as ruble note deliveries from the Central Bank of Russia (CBR) were interrupted. Interstate payments arrears also rose sharply, with Russian enterprise arrears to Kazakh exporters estimated to have risen from rub 150 billion to rub 227 billion during the first quarter, while Kazakh enterprise arrears to Russia declined slightly to rub 66 billion. The shortage of currency led to the emergence of domestic payments arrears, mainly for salaries and pensions as of May 1, and an increase in the premium on cash. 1/ The CBR suspended the extension of credit on its correspondent account with the NBK in May, pending further discussions on Kazakhstan's participation in ruble area monetary arrangements and the Russian Government's decision to extend only interstate credits to other FSU governments; earlier in the year, the NBK was the only ruble area central bank with an unlimited line of credit with the CBR. Negotiations subsequently commenced between Russia and Kazakhstan on the settlement of the correspondent account balances outstanding as of the end of 1992. 2/ In these discussions, Kazakhstan recognized its 1992 debt at an amount of

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1/ Informal information indicates that the premium on cash increased from about 25 percent in December 1992 to about 30-35 percent in May 1993, compared to about 10 percent in Russia.

2/ Russia proposed the conversion of correspondent account balances into an interstate credit on terms that included an interest rate of LIBOR+2, five year maturity, US$5 million guarantee deposit, and indexation of principal on the basis of the U.S. dollar exchange rate as of end-1992.

rub 246.7 billion partially offset by rub 78 billion in net arrears owed by Russian to Kazakh enterprises; no agreement was reached regarding the debt resulting from correspondent account balances in 1993. The final agreement, including an accord on the terms of repayment, is expected by October 1.

Exports appear to have been depressed in early 1993, in part by delays in establishing revised export quota and licensing arrangements. Exports to non-FSU countries in the first four months of 1993 totalled only US$355 million (less than a quarter of the previous year's total) while exports to FSU countries were also somewhat lower than expected. 1/ Pressures intensified on the availability of foreign exchange, largely as exporters avoided the repatriation of earnings, and this began to be reflected in an increasing divergence between the exchange rates quoted on the Almaty auction compared with the Moscow interbank rate (Chart 2); in May, the thin local foreign exchange market was also perturbed by the inflow of significant ruble amounts from Kyrgyzstan in the aftermath of that country's introduction of its own currency. Balance of payments financing during early 1993 continued to be provided through correspondent account credits from Russia, and very little foreign financing was disbursed, in part linked to delays in the closing of some major foreign investment agreements.

III. The Program for July 1993-June 1994

The authorities' Statement of Systemic and Macroeconomic Policies describes the objectives and actions that will underpin a wide-ranging program of reforms over the next twelve months. Since Kazakhstan will remain in the ruble area in the immediate future, financial policies will be heavily influenced by developments in other ruble area states, notably Russia; the targets of the program, as well as the underlying policies, will be reinforced in the coming months to coincide with either a move to monetary independence by Kazakhstan or intensified stabilization efforts by Russia, in the context of an upper credit tranche stand-by arrangement, and more effective ruble area monetary arrangements.

1. Objectives

The program aims to contain the decline in output to around 8 percent during 1993. It is expected that the initial results of the stabilization effort and the inflow of foreign financing will have beneficial effects on economic activity. A key objective is to reduce the monthly rate of inflation to around 5 percent by the end of the year, in line with the target agreed with Russia under its STF program. The program also aims to strengthen the balance of payments and significantly increase the level of

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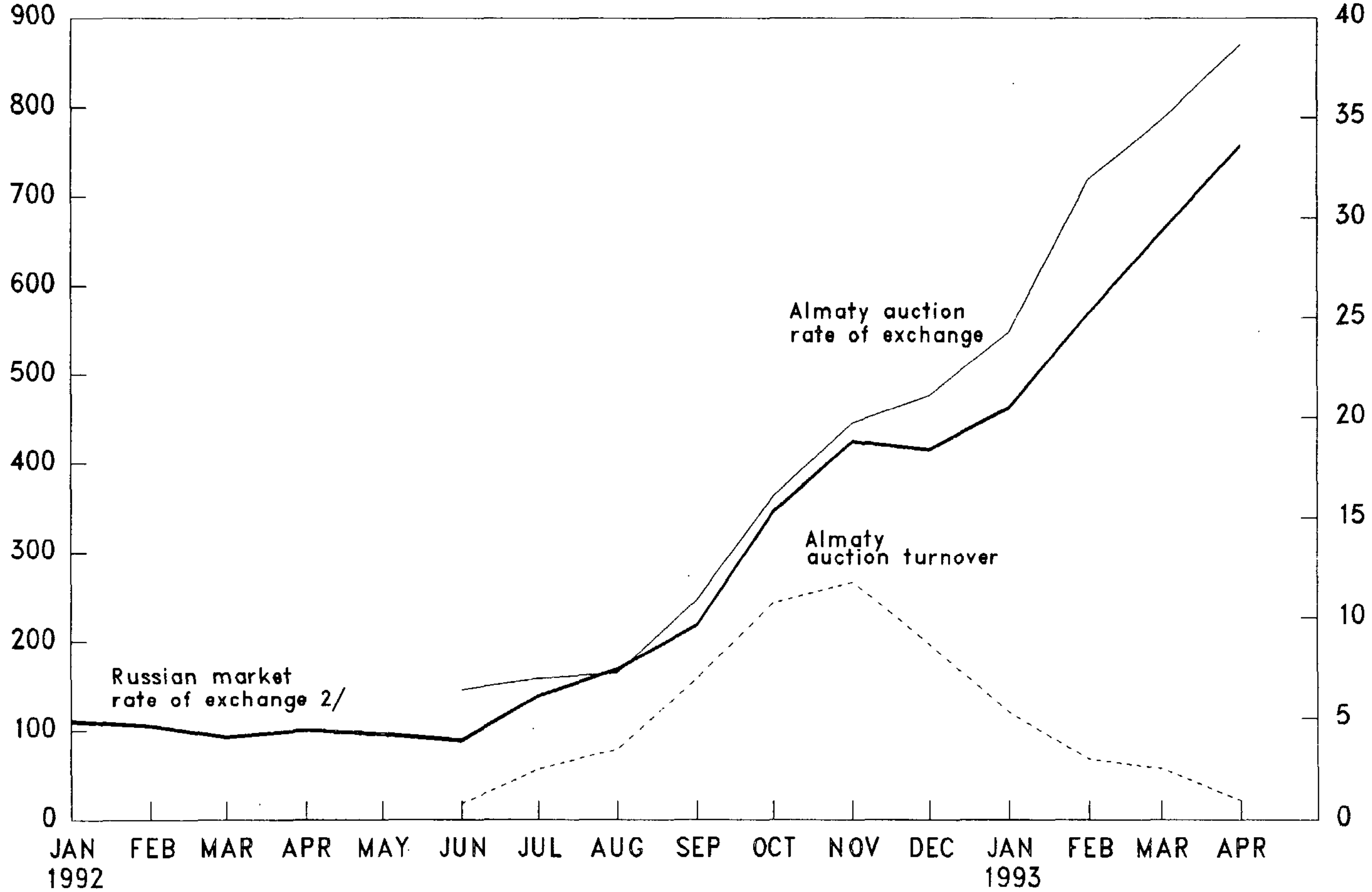
1/ The pricing aspects of the bilateral trade agreement with Russia, which had been concluded in February 1993 (see p.56, SM/93/73, 4/9/93), did not operate as anticipated in large part as the Russian authorities were unable to enforce the agreements on export prices for petroleum products.

Chart 2

KAZAKHSTAN

EXCHANGE RATE DEVELOPMENTS 1/

(January 1992-April 1993)



Source: Data provided by the authorities.

1/ Russian market and Almaty auction rates of exchange measured on left axis in rubles per dollar. Almaty auction turnover measured on right axis in millions of US dollars.

2/ Equivalent to the Kazakhstan official rate of exchange since July, 1992.

international reserves by the end of the year. On the structural side, the planned reforms seek to reinforce the role of market prices, reduce the role of the state in economic activity through implementation of a comprehensive privatization program (adopted in March 1993) and phasing out of direct controls and subsidies, promote efficiency in enterprises, liberalize trade, and provide a supportive environment for domestic and foreign investment.

2. Macroeconomic policies

The program's macroeconomic objectives are to be achieved through the implementation of tight financial policies, coupled with increased access to foreign financing. The fiscal deficit is targeted at 6 percent of GDP in 1993--and domestic bank financing of the budget is to be contained to around 4 percent of GDP--to be reinforced by a prudent incomes policy, with nominal wages adjusted in line with consumer prices so as to keep real wages broadly constant; staff estimates suggest that, in the absence of policy actions foreseen in the program, the deficit could reach 9-10 percent of GDP in 1993. 1/ In order to lend support to efforts to reduce inflation, the National Bank has targeted an increase in its total credit to banks and to the Government that is in line with the expansion foreseen by the Central Bank of Russia. Simultaneously, increasing reliance will be placed on market mechanisms to allocate credit and determine interest rates through a substantial rise in the proportion of credit that is auctioned to banks. The program assumes total external financing (including some correspondent account credit or interstate credits) of about US$560 million during 1993, and US$470 million during 1994; the non-ruble financing, roughly half of the total, will help to attain a significant increase in the level of net official reserves, albeit to only the equivalent of around two weeks of imports, by the end of this year.

a. Government finances

The Policy Statement describes further amendments to the budget aimed at ensuring that the deficit targets are achieved in 1993. 2/ The policy measures include ones that do not require parliamentary approval (e.g. on subsidies and transfers) and will be taken during July-September, as well as tax measures that will be sent to Parliament in the context of a third revision of the budget law during its October session. Revenues and grants are targeted at rub 3,310 billion, or 19 percent of GDP, and expenditures at

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1/ Financing of the remainder of the budget deficit is based on identified external assistance of rub 246 billion plus rub 125 billion included in the balance of payments financing gap for 1993.

2/ Compared with the revised budget, the fiscal program targets reflect the updated macroeconomic projections for 1993, in particular the exchange rate, inflation, and GDP; the yield of some taxes has been lowered; expenditures have been made consistent with the income and subsidies policies envisaged for the rest of 1993; and the expected foreign financing and debt service have been fully reflected.

rub 4,532 billion, or 25 percent of GDP (Table 2). 1/ The Government plans to implement a uniform import tariff, extend the value-added tax (VAT) to imports from non-CIS countries, and impose excise taxes on selected imports from non-CIS countries, in particular cars and luxury goods. These measures are being reinforced by a strengthening of the tax and customs administrations, in line with the recommendations of Fund technical assistance. In order to centralize financial resources in the budget, the Government has suspended implementation of the legislation on free economic zones which allowed selected regional governments to appropriate all tax revenue within their territory. Current expenditure will be reduced in relation to GDP by nearly 3 percentage points relative to the revised budget reflecting a prudent wage policy, lower outlays on goods and services, and a more narrowly targeted social safety net. The minimum wage and pensions are to be adjusted to the real levels of the first quarter of 1993 through an increase in October 1993. The authorities intend to review the subsidies on food and fodder and to replace these and other generalized subsidies by targeted subsidies and/or income transfers before the end of the year; a Fund technical assistance mission on the social safety net is scheduled in the near future. Capital spending will be limited to 5 percent of GDP, corresponding essentially to the earmarked revenue of the investment fund and the fund for replenishment of natural resources, and the transfer of foreign grants to the Tengiz oil company. If Parliament does not approve the proposed tax measures, the Government intends to compensate by cutting expenditures further.

Although there is an unusually high level of uncertainty regarding the future, for 1994 the authorities are targeting a reduction of the deficit to at most 4 percent of GDP, in order to limit domestic bank financing below 2.5 percent of GDP. The achievement of this target will rely, inter alia, on a further reform and streamlining of the tax system, in particular a reduction of exemptions and a reform of taxes on natural resources, the continuation of a prudent wage policy, and a reduction of the ratio-to-GDP of transfers and subsidies. Moreover, by late-1994 the conduct of fiscal policy will be strengthened through the establishment of a Treasury, based on technical assistance provided by the Fund.

b. Money and credit

The authorities intend to cooperate with other states in the ruble area to lower inflation through tight credit policies, higher interest rates, and increased recourse to market-based allocative mechanisms. To that end, the NBK aims to sharply reduce the rates of monetary expansion in the third and

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1/ The budget assumes that Kazakhstan will adopt the "zero option" according to which it would relinquish to Russia its claims to the external assets of the FSU against its share of the external debt obligations of the FSU. The Government intends to seek Parliamentary confirmation of the "zero option" as soon as it receives information that it has asked from Russia on the external assets of the FSU.

fourth quarters of the year. The envisaged deceleration in the growth rate of broad money is consistent with the targeted reduction in inflation and with the rates foreseen in the STF program with Russia. This objective will be achieved by limits on the central bank's net domestic assets; thus, the growth in the NBK's net domestic assets relative to base money is expected to decline sharply from a high of 143 percent in the first quarter of 1993 to 23 percent in the fourth quarter of the year (Chart 3 and Table 3). 1/ The tightening of credit conditions and the concurrent increase in interest rates is expected to be reflected in a moderate rise in velocity during the remainder of the year, with the expansion in broad money remaining below that of base money. However, the projections for credit from the banking system--and consequently for broad money--are subject to considerable uncertainties with regard to the credit multiplier. The quarterly targets for the NBK's net domestic assets, as well as for its components, are contained in paragraph 27 and Table 1 of the Policy Statement and will be kept under continuous review on the basis of developments in the ruble area, particularly in Russia.

Quantitative ceilings on credit from the National Bank are to be accompanied by the enhanced use of market-based instruments to conduct monetary policy. The NBK has already moved away from the extension of loans at interest rates below its official refinance rate, with all subsidies being now reflected in the government budget. Except for a two-year, rub 400 billion loan for replenishment of working capital of state enterprises at 25 percent, virtually all NBK credits are at its official refinance rate. 2/ During the first quarter of 1993, the NBK's average interest rate on its lending was around 50 percent, compared to 21 percent in the second half of 1992. The NBK has also maintained its monthly credit auction and it increased the amounts auctioned, although they were still small relative to the total volume of its lending activity. Auction interest rates rose from 160 percent per annum for three month maturities, and 131 percent per annum for six month maturities, in April to 185 percent and 170 percent, respectively, in June. Interest rates should become the main instrument to allocate credit as the volume of credit auctioned by the National Bank increases sharply in the second half of this year, and further in early 1994, together with the introduction of a government securities market, as reflected in paragraph 28 of the Policy Statement. The credit

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1/ Net domestic assets of the NBK and CBR are not directly comparable. CBR monetary accounts classify correspondent accounts with FSU central banks with domestic assets, whereas these accounts are included with net foreign assets in the NBK presentation.

2/ As in Russia, quoted interest rates in Kazakhstan are in nominal terms and do not reflect the compounding of interest; given monthly payments, the effective NBK quoted refinance rate of 110 percent at present would be 186 percent per annum. The NBK auction market rates in June, which were nominally 170 percent for six month maturities and 185 for three month maturities, would amount to 390 percent and 459 percent on an effective basis.

auctions will be held bi-weekly during the third quarter of 1993 and weekly beginning in 1994. Remaining directed credits would be based on the National Bank's official refinance rate; this rate was raised substantially on July 5, 1993 (with retroactive effect from July 1) from 65 percent to 110 percent, narrowing the gap with the CBR's refinance rate. The authorities have committed themselves to increasing the NBK refinance rate to 140 percent by July 22, and again in August to match further increases in the CBR's refinance rate. As of July 1, the deposit rates of the Savings Bank were raised by 20 percentage points to a range of 35-90 percent; these rates will also be increased further in early-August. Moreover, the Savings Bank's lending rates are now at the same level as the NBK's auction market rates.

c. Balance of payments and the capacity to repay

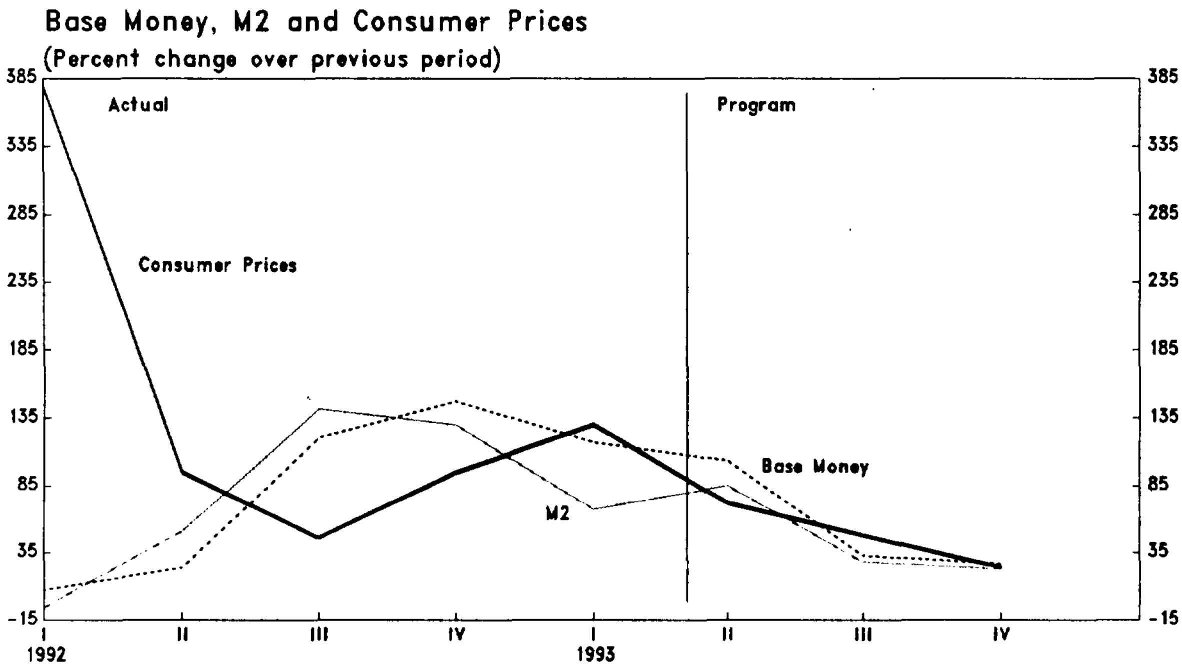
Balance of payments projections for 1993 and 1994 agreed with the authorities in March 1/ have been revised in the light of new data and to reflect the policies foreseen in the program. The most significant changes have been in respect of the near-term prospects for non-FSU trade and foreign direct investment. For 1993, the growth of exports to non-FSU markets have been constrained by domestic production and shipping problems. While the impact of the quota system will be eased under the program, exports to non-FSU markets are now anticipated to increase by 23 percent (in dollar terms) in 1993, compared to an earlier projection of 38 percent. For 1994, rates of export growth are largely unchanged from earlier projections.

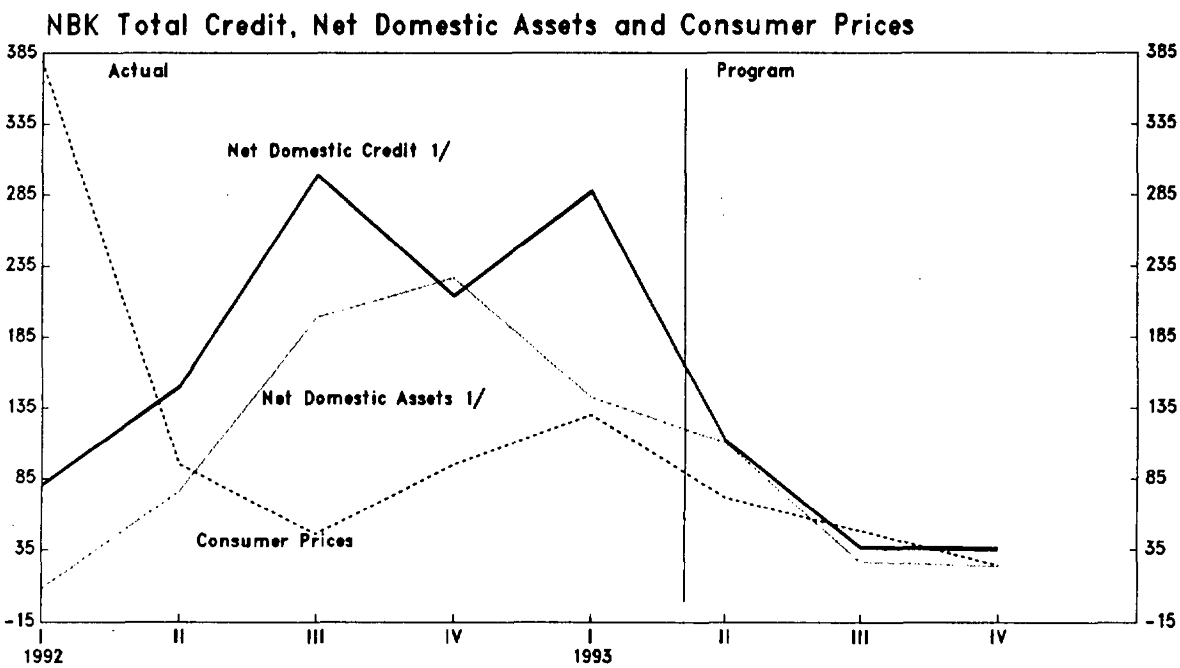
Foreign interest in joint ventures and other direct investments remains strong, but processing and administration is proving slow, and some anticipated disbursements have been delayed. For 1993, foreign currency receipts associated with direct investments are anticipated to total US$320 million, compared to an earlier projection of US$520 million; for 1994, the shortfall is considerably smaller (Table 4). Lower levels of foreign investment will have a direct counterpart in lower imports; it is also expected that reduced export earnings will be reflected in lower imports and, to some extent, in a lower than previously anticipated build-up of reserves.

As a result, for 1993, the estimated financing need is little changed, although the gap has been partly closed through the receipt of correspondent account credits during the first few months of the year. The financing gap during the second semester of 1993 is estimated at around US$325 million. For the first semester of 1994, Kazakhstan's financing gap is provisionally estimated at US$200 million, out of a possible full-year financing need of around US$465 million. Taken together, the financing need for the 1993-94 program period is provisionally estimated at around US$525 million. At the

1/ The balance of payments projections are summarized on pp. 19 and 21-23 and Tables 4 and 5 of SM/93/60, (3/23/93).

Chart 3
KAZAKHSTAN
MONEY, CREDIT AND INFLATION, 1992-93





Source: Data provided by the authorities; and staff estimates.

1/ Percent change in relation to beginning period base money.

meeting of the Consultative Group for Kazakhstan on December 14, 1992, in Paris, the Government requested external financing from bilateral donors and international institutions. Financing amounts provisionally identified for 1993-94 total US$420-440 million. This includes US$180 million in the form of a World Bank import rehabilitation credit; an equivalent amount of cofinancing from Japan; and up to US$60-80 million in the form of additional import credits and balance of payments financing from other sources, including the European Community. Additional financing could be forthcoming in the form of interstate credits provided by Russia. In collaboration with the World Bank, as a follow-up to the Consultative Group meeting held in Paris on December 14, 1992, a meeting of creditors and donors has been convened in July in Washington to seek confirmation of financing amounts.

The program aims to strengthen the international reserves position. Net official international reserves (including gold) are targeted to increase by US$179 million between April 1, 1993 and the end of the year. In light of uncertainties regarding the rate of acquisition of domestically produced gold and the nature and timing of foreign financing, the reserves target would be reviewed, in consultation with the Fund staff, by end-September 1993. 1/2/

On exchange arrangements, the authorities intend to remain in the ruble area for the immediate future, during which period the official exchange rate will remain set at the rate determined by the CBR on the basis of the auctions at the Moscow Interbank Currency Exchange. As a precaution in case financial policies and monetary arrangements in the ruble area fail to demonstrate that price stability will be attained relatively rapidly, plans have been prepared for a separate currency, which could be adopted in the context of a stand-by arrangement with the Fund later in the year.

As regards the medium-term prospects, the additional information available for the early months of 1993 and the specific policy measures adopted under the program would not warrant significant changes to the balance of payments outlook beyond 1994, and the medium-term projections

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1/ The program does not include a ceiling on new external credits contracted or guaranteed by the Government, although this will feature in the stand-by arrangement. The Government is committed to a prudent approach toward the acceptance of new debt obligations. Thus, to assist in monitoring the accumulation of new external liabilities, improved reporting arrangements have been implemented (Policy Statement, paragraph 21).

2/ While the program does not include general requirements regarding the elimination of existing arrears and the non-accumulation of new arrears, these would be incorporated in the stand-by arrangement. The authorities intend to resolve by July 31, 1993, Kazakhstan's position in respect of the "zero-option" (on the basis of information requested from Russia) and to negotiate with other FSU states the mutual elimination of interstate payments arrears.

agreed with the authorities in March remain broadly valid. 1/ Although there are considerable uncertainties regarding future developments, and any projections beyond 1994 must be considered as purely illustrative, the implementation of tight financial policies and comprehensive structural reforms should lead to higher levels of foreign investment, and substantial improvements in the external position coupled with a recovery in growth; on the other hand, significant delays in removing the structural impediments to modernization of the economy and continuing financial instability would result in large and unsustainable external financing gaps.

Assuming that both purchases are made under the STF, and excluding any financing under a successor stand-by arrangement, Kazakhstan's obligations to the Fund would rise to 25 percent of Fund quota by the end of 1993 and 50 percent by mid-1994 (Table 5). On this basis, obligations to the Fund would be equivalent to around 8 percent of gross international reserves (including gold) at end-1993, and to around 11 percent by mid-1994. Fund repurchases would commence only in 1998, and charges and repurchases would remain low in relation to exports and to total external debt. This outlook would change to the extent that purchases under a stand-by arrangement were to commence in late-1993.

3. Systemic policies

As described in paragraphs 5-21 of the Policy Statement, the Government has adopted a wide range of structural policies in the areas of further price and trade liberalization, privatization and enterprise reform, financial sector restructuring, rehabilitation of the petroleum sector, and legal and institutional reforms (Table 6). Moreover, as described in paragraphs 31-36 of the Policy Statement, the Government is taking specific steps to improve the quality of economic and financial statistics and has begun to reinforce the institutional structures to strengthen the design and monitoring of reform policies.

a. Trade and exchange liberalization

A core component of the program is the further liberalization of trading arrangements, notably in the area of export licenses and quotas. Export quotas are currently imposed on a range of mineral and agricultural raw materials and a very limited number of processed goods. 2/ The Government intends to move by September 1, 1993, in parallel with Russia, to ease these restrictions by reducing the number of products subject to quotas and by increasing the size of remaining quotas by at least 20 percent. Moreover, quotas will be eliminated as the trade situation improves and output stabilizes, or earlier in line with similar moves by other CIS

1/ See pages 21-23 and Table 5, SM/93/54 (3/23/93).
2/ In late-January 1993, the list of quotas comprised 29 products exported to non-FSU markets and, as of March 1993, 59 products exported to FSU markets.

trading partners. Licensing requirements would also be eased, with a view to eliminating the remaining restrictive elements of current arrangements (including the restriction of the validity of licenses to the current calendar year, which has the impact of delaying exports in the early weeks of the new year).

In the past, taxes have been imposed in convertible currencies on non-CIS exports with a view to financing official import needs. As a move toward a more rational tax system, such taxes will be payable in domestic currency as of December 31 (or earlier in the context of a stand-by arrangement with the Fund), and official imports will be financed by purchases of foreign exchange from the NBK. At the same time, in light of this additional demand on NBK foreign exchange holdings, and the need to build official reserves, the rate of foreign currency surrender will be temporarily increased; despite this move, the retention of foreign currency by enterprises will increase compared with the present situation.

b. Price liberalization

As part of the move to market prices, the Government has significantly raised the administered prices of the very limited number of goods and services that still remain regulated 1/, and intends to continue preventing their erosion in real terms during the rest of the year. In particular, the regulated prices of bread, flour, and fodder will be raised again later in the year to coincide with the new harvest. Future increases in the import cost of energy products will be passed-through in full into domestic prices, with a move to world prices envisaged by early 1994.

c. Privatization and financial sector reform

The authorities aim to offer all trade, distribution, and trucking networks for sale during 1993-94, and to privatize 30 percent of the assets of non-agricultural medium and large enterprises by March 1994. The Government also plans to offer for sale at least ten large or special enterprises on a case by case basis by the same date. Preparation to implement the privatization program is proceeding with technical assistance from several institutions--including the World Bank, the EEC, USAID, and the EBRD. Progress is being made on the design of a system for the distribution of coupons and on the registration of companies for the corporatization program. An important auction of small enterprises will be held in July, and a large tobacco company has been chosen to be offered in the first competitive sale open to international investors.

As part of financial sector reform, the Government has embarked on strengthening the institutional capacities of the central bank for the

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1/ Bread, flour (partially), baby food, imported medicines, fodder, housing rents and utility tariffs (both targeted according to income level), and public transportation fares.

conduct of monetary policies, improving banking supervision, and initiating a broad program of structural changes to the banking system. The legal foundations of the NBK have been strengthened through adoption of new statutes, and new banking and foreign exchange laws were approved by Parliament in April, as indicated in paragraph 14 of the Policy Statement. This has been accompanied by an overhaul of the instruments of bank supervision, and a tightening of commercial bank capital requirements and licensing procedures; specific measures were introduced to increase the flexibility of the commercial banking system, as noted in paragraph 15 of the Policy Statement. During the next twelve months, comprehensive external audits of the National Bank and the major commercial banks will be carried out with technical assistance from the Fund, the World Bank, and some donor countries.

IV. Staff Appraisal

During the past nine months, significant progress has been achieved toward the formulation and implementation of a comprehensive economic program which could be supported by an upper credit tranche stand-by arrangement with the Fund later in 1993. Many of the policies envisaged in the context of a program for such a stand-by arrangement have already been implemented. During 1992 and early 1993, progress was made in containing macroeconomic imbalances, notably in restraining the size of the fiscal deficit by improving tax collection, cutting expenditures, and following a cash-management system; subsidies and transfers were reduced or eliminated for a wide range of products; and the social safety net has been more carefully targeted. Important steps were also taken to strengthen and modernize the banking system as well as the central bank's legal basis and instruments for the conduct of monetary policies. Systemic reforms included a wide-ranging liberalization of prices, the reduction of direct state intervention in the economy, the establishment of a legal and institutional framework for political and economic decision-making, and the start of a comprehensive and ambitious privatization program.

As the staff has noted in the context of the recent Article IV consultation, given the absence of credible and effective arrangements for conducting coordinated monetary policy in the ruble area, the balance of arguments continues to be in favor of Kazakhstan proceeding firmly to *monetary independence*. For now, the main outstanding issue for agreement on a program to be supported by a stand-by arrangement relates to the inability of the Kazakh authorities to lower inflation and stabilize the exchange rate without a separate currency or reasonable certainty, at this time, that low inflation rates will in fact be attained in the ruble area. The authorities have made it clear that the key barrier preventing an immediate move to monetary independence is the unique political relationship with Russia rather than economic factors; time is needed to prepare the ground, both domestically and elsewhere, for such a move. To support the extensive reforms underway, the Kazakh authorities will shortly request the use of Fund resources under the STF, as a transitional phase to a stand-by arrangement later this year. The staff believes that Kazakhstan's problems would best be handled in the context of an upper credit tranche arrangement with the Fund and that the policies to be adopted under the Government's program go a long way toward this goal.

The principal objectives of the present program are to contain the decline in real GDP, substantially lower the inflation rate by the end of the year, and strengthen the balance of payments and external reserve positions. On the structural side, key measures include initiation of the implementation of the privatization of state assets, specific timetables for the phasing out of direct controls and subsidies as well as for the further adjustment of prices to market levels, a plan of action for financial sector reforms, and further steps toward trade and exchange liberalization. The major differences between the policies to be supported by use of the STF and those under discussion for a stand-by arrangement revolve around the issue of monetary independence and the implications that this would have for faster stabilization in terms of the macroeconomic targets.

The authorities' commitment to the program targets, combined with the strengthened institutional capacities of the Government and the National Bank, should enable the successful implementation of the policies outlined in the Policy Statement. However, it must be recognized that achievement of one of the program's key objectives, notably the targeted reduction in inflation, is partially outside the control of domestic policies and depends on developments in Russia as long as Kazakhstan remains in the ruble area. Nevertheless, full implementation of the program would still promote stabilization and structural change in Kazakhstan, thus providing for the intended transition to an upper tranche stand-by program. The fiscal deficit, and its need for domestic bank financing, is to be contained to levels consistent with Kazakhstan's efforts to contribute to lowering inflation in the ruble area; in this context, it is crucial that the authorities proceed determinedly with the intended reductions in subsidies and transfers and the extension of the coverage of the VAT, excise taxes, and import tariffs. The National Bank's credit policies, notably the substantial deceleration in the growth in base money, should significantly help in lowering inflation; this will be aided by the increased role of market interest rates in the allocation of resources, especially through the planned increase in the volume of credit passed through the auctions. In this context, it is vital that the National Bank continue to move its refinance rate--which is still significantly negative in real terms--closer to market levels, but at least in tandem with that of the Central Bank of Russia. Later in the year, the rationalization of surrender requirements, combined with the abolition of payments in foreign currency for export taxes, should create a more transparent foreign exchange system with a greater incentive for the repatriation of export earnings and the build-up of the official international reserve position. The program's target for external reserves is particularly important should Kazakhstan introduce its own currency, especially given the present low import coverage ratio. The commitment to a progressive elimination of trade restrictions will contribute over time to an improvement in the balance of payments position;

in this regard, the staff urges the authorities to proceed with the elimination of export quotas as fast as feasible.

There are other risks to the attainment of the program's objectives. Monetary and credit policies are not entirely independent of developments in Russia and, at least at the moment, it is clear that ruble area monetary arrangements are not operating in the way a normal currency union should function. In the circumstances, and unless ruble area arrangements rapidly improve along with the reinforcement of the recent moves to monetary stability in Russia, the staff would urge the authorities to proceed quickly with monetary independence, for which the successful implementation of other policies foreseen in the STF program would be crucially important. In any case, the staff believes that a sharp tightening of credit policies is necessary regardless of whether Kazakhstan stays in the ruble area or introduces a separate currency. On the fiscal stance, in October, Parliament may not approve the tax measures that are necessary and pressures are likely to continue, if not intensify, to relax the wage stance and increase the subsidies on credit--notably to the agricultural sector--as interest rates rise. Although the authorities have indicated their intention to compensate by reducing expenditures, this may prove difficult in terms of the nature and pace of adjustment. On the structural side, even though the authorities are strongly committed to moving ahead rapidly, the primary risk involves delays in implementation that could be caused by insufficient institutional capacity, particularly with regard to the privatization program.

The staff believes that the broad-based policy package prepared by the Kazakh authorities addresses virtually all the critical issues facing the economy. It will need to be vigorously implemented--and further reinforced (notably with regard to monetary policies) in the context of a move to an upper credit tranche program--if Kazakhstan is to deal with its pressing problems of declining output and a high inflation rate. Both the macroeconomic stabilization efforts as well as the ongoing structural reforms need to be urgently supported by external financial assistance if they are to be successful. The provision of Fund support through the STF will allow the World Bank and some bilateral donors to move forward with much-needed financing for critical imports; it would be important for other donors to also move rapidly with their financial and technical support.

Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

Request for purchase under the Systemic Transformation Facility

1. The Fund has received a request by the Government of Kazakhstan for a purchase equivalent to SDR 61.875 million under the Decision on the Systemic Transformation Facility (Decision No. 10348-(93/61) STF, adopted April 23, 1993).

2. The Fund approves the purchase in accordance with the request.

Table 1. Kazakhstan: Selected Economic Indicators, 1990-94

(Percentage change over same period one year earlier, unless otherwise specified)

	1990	1991	1992 Est.	1993 Program	1994 Program
Nominal GDP (in billions of rubles)	51	94	1,593	17,285	35,698
Real GDP	-0.4	-13.0	-14.0	-7.5	1.0
Exchange rate (rubles per US$1)					
Period average	0.6	1.75	222	967	1,503
Retail prices					
End-of-period	...	147.0	2,567.0	625.0	30.0
Period average	4.2	91.0	1,381.0	926.0	104.0
Minimum wage (end-period; rub per month)	...	342	900	10,000	15,500
Percent change	...	...	163.0	1,011	55
Domestic petroleum prices (excluding transport costs)					
End-of-period	...	70	8,400	92,000	169,349
As percent of international prices 1/	...	44.0	20.0	65	100
Revenues and grants (in percent of GDP)	32.7	25.0	18.7	19.1	19.2
Expenditures (in percent of GDP)	31.4	32.9	24.3	25.2	23.4
Budgetary fiscal balance (deficit (-);					
(in percent of GDP) 2/	1.3	-7.9	-5.6	-6.0	-4.2
(excluding grants)	-8.7	-12.3	-6.9	-7.0	-5.6
Cash fiscal balance (deficit (-);					
in percent of GDP 2/	1.3	-7.9	-2.3	-6.1	-4.2
NBK net domestic assets 3/	...	579	1,007	632	...
NBK liabilities	...	579	615	638	...
Current account balance					
(in millions of US$)	-2,370	-1,300	-2,080	-1,150	-1,220
(in percent of GDP)	(-2.8)	(-2.5)	(-9.9)	(-6.4)	(-5.1)
Trade account balance					
(in millions of US$)	-9,790	-3,160	-1,670	-1,070	-1,190
(in percent of GDP)	(-11.3)	(-6.0)	(-6.9)	(-6.1)	(-4.9)
Financing gap (in millions of US$)	--	--	--	325	465

Sources: Goskomstat, Ministry of Economy, National State Bank of Kazakhstan, and Fund staff estimates.

1/ International prices entering the calculation were converted into domestic currency using the exchange rates shown above.

2/ Differs from the budgetary fiscal balance concept by the change in arrears.

3/ In relation to liabilities of the NBK at the beginning of the period; there was a change in the methodology used in constructing the monetary accounts series starting in 1991.

Table 2. Kazakhstan: Government Finances, 1990-94

	1990	1991	1992 Est.	1993 Program	1994 Program
			(In billions of rubles)		
Total revenue and grants	17	23	298	3,310	6,838
Direct taxes	4	10	92	882	1,774
Of which:					
Corporate income tax	(...)	(7)	(62)	(600)	(1,207)
Indirect taxes	7	8	169	1,990	4,331
Of which:					
Turnover tax/VAT 1/	(...)	(4)	(72)	(804)	(1,702)
Taxes on international trade	(...)	(--)	(29)	(209)	(237)
Nontax revenue	--	2	16	254	238
Other revenue	...	--	1	2	5
Grants	5	4	21	181	489
Total expenditure	16	31	387	4,352	8,342
Current expenditure	...	...	306	3,451	...
Wage bill	(...)	(...)	(39)	(589)	(...)
Goods and services	(...)	(...)	(173)	(1,925)	(...)
Subsidies	(...)	(...)	(18)	(206)	(...)
Transfers	(...)	(...)	(44)	(674)	(...)
Interest payments	(...)	(...)	(33)	(57)	(...)
Capital expenditure	...	...	81	901	...
Overall balance (commitment basis, including grants	1	-7	-89	-1,043	-1,504
Financing					
External	--	--	19	371	556
Domestic	-1	7	18	681	948
Arrears	--	--	52	-10	--
Residual gap	--	--	--	--	--
Memorandum item					
Primary deficit	...	...	-56	-986	...
			(In percent of GDP)		
Overall balance, including grants	1.4	-7.9	-5.6	-6.0	-4.2
Revenue (excluding grants)	22.7	20.5	17.4	18.1	17.8
Grants	10.0	4.5	1.3	1.0	1.4
Total expenditure	31.4	32.9	24.3	25.2	23.4
Current expenditure	...	...	19.2	20.0	...
Capital expenditure	...	...	5.1	5.2	...
Primary deficit	...	...	-3.5	-5.7	...

Sources: Kazakh authorities and staff estimates.

1/ The VAT was introduced on January 1, 1992 to replace the turnover tax.

Table 3. Kazakhstan: Summary Monetary Accounts, 1991-93

(In billions of rubles, unless otherwise indicated)

		1992				1993			
	1991	I	II	III	IV	I	II	III	IV
National bank									
Net foreign assets	15	14	-11	-57	-161	-243	-292	-205	-141
Net international reserves	--	--	--	--	61	85	118	204	268
Other	15	14	-11	-57	-222	-328	-410	-410	-410
Net domestic assets	30	33	70	186	480	935	1,700	2,069	2,498
Credit to Government (net) 1/	14	9	-3	-8	-5	-92	25	200	628
Credit to banks	31	72	155	337	617	1,613	2,265	2,620	2,864
Credit to the economy	--	1	8	22	18	61	91	91	91
Other items (net)	-14	-48	-90	-163	-144	-650	-681	-842	-1,085
Liabilities	45	48	59	129	319	692	1,408	1,864	2,357
Currency outside NBK	14	21	32	73	156	278	572	905	1,305
Reserves	4	6	10	23	46	88	250	290	320
Excess reserves	23	15	8	16	73	237	416	483	534
Other deposits	3	6	9	17	45	89	170	186	198
Banking system									
Net foreign assets	15	15	-11	-33	-202	-211	-206	-156	-69
Net domestic assets	71	66	132	328	879	1,342	2,293	2,818	3,316
Credit to Government (net) 1/	7	1	-13	-20	-26	-128	4	177	607
Credit to the economy	58	113	274	587	1,027	2,102	3,340	3,967	4,447
Other items (net)	3	-50	-133	-245	-124	-655	-1,052	-1,326	-1,737
Liabilities	87	81	122	294	676	1,131	2,087	2,662	3,247
Currency in circulation	14	20	31	72	155	277	572	905	1,305
Deposits	73	61	90	222	522	854	1,515	1,757	1,942
National bank		(In percent change in relation to beginning period Base Money)							
Net foreign assets		--	-53	-78	-80	-26	-7	6	3
Net international reserves		--	--	--	47	8	5	6	3
Net domestic assets		7	76	199	227	143	111	26	23
Domestic credit		80	150	299	215	288	112	37	36
Net credit to Government		-12	-24	-11	-2	-24	18	12	23
Credit to banks		92	174	310	217	312	94	25	13
Base money		7	23	120	147	117	104	32	26
Banking system		(In percent change in relation to beginning period M2)							
Net foreign assets		-1	-31	-19	-57	-1	--	2	3
Net domestic assets		-6	81	160	187	68	84	25	19
Domestic credit		56	184	252	146	147	120	38	34
Net credit to Government		-7	-15	-5	-3	-12	11	8	16
Credit to the economy		63	199	257	150	159	109	30	18
Broad Money		-6	50	141	130	67	85	28	22

Source: National Bank of Kazakhstan, and Fund staff estimates.

1/ Includes public organizations and funds; projected change in 1993 differs from budget accounts by valuation changes in the Stabilization Fund accounts.

Table 4. Kazakhstan: Balance of Payments, 1990-94

	Non-FSU balance					FSU balance 1/					Consolidated balance				
	1990	1991	1992	1993	1994	1990	1991	1992	1993	1994	1990	1991	1992	1993	1994
	(In millions of U.S. dollars)					(In billions of rubles)					(In millions of U.S. dollars)				
Current account balance	-990	-1,470	-290	-470	-690	-1	--	-185	-619	-784	-2,370	-1,300	-2,080	-1,150	-1,220
Trade balance	-590	-1,140	-30	-450	-710	-5	-4	-170	-568	-720	-9,790	-3,160	-1,670	-1,070	-1,190
Total exports, of which	1,900	780	1,490	1,840	2,170	8	17	324	3,423	10,000	15,130	10,210	7,370	5,080	8,820
Crude petroleum	50	40	480	700	1,070	...	...	34	568	2,543	...	...	890	1,220	2,760
Total imports	-2,490	-1,910	-1,520	-2,290	-2,870	-13	-20	-494	-3,991	-10,719	-24,920	-13,370	-9,040	-6,190	-10,010
Services and transfers, of which	-390	-330	-260	-20	10	4	4	-15	-51	-65	7,420	1,860	-410	-80	-30
Interest 2/ 3/	-140	-140	-180	-20	-50	--	--	--	...	...	-140	-140	-180	-20	-50
Capital account balance	-260	30	-110	590	940	...	...	...	...	...	-260	30	-110	590	940
Amortization obligations 2/ 3/	-690	-450	-440	-30	-130	...	...	...	...	...	-690	-450	-440	-30	-130
Financial credits	420	480	230	300	450	...	...	...	...	...	420	480	230	300	450
Foreign direct investment	--	--	100	320	620	...	...	...	...	...	--	--	100	320	620
Errors and omissions	...	...	40	--	--	...	...	116	68	--	...	...	350	110	--
Overall balance	...	...	-360	110	250	...	...	-70	-551	-784	...	...	-1,840	-450	-280
Financing	...	...	360	-110	-250	...	...	70	551	784	...	...	1,840	450	280
Reserves (-increase) 4/	...	...	-250	-110	-190	...	...	--	--	--	...	...	-250	-110	-190
Arrears reduction (-) 2/	...	...	340	--	--	...	...	-169	--	--	...	...	370	--	--
Debt deferral	...	...	270	--	--	...	...	--	--	--	...	...	270	--	--
Correspondent account credits						...	...	238	147	...	...	...	1,440	230	...
Financing gap	...	...	--	-10	-60	...	...	--	404	784	...	...	--	330	470
	(In percent of GDP, unless otherwise stated)														
Memorandum items:															
Current account balance 5/	-1.1	-2.8	1.7	-2.8	-2.9	-1.7	2.8	-11.6	-3.6	-2.2	-2.8	-2.5	-9.9	-6.4	-5.1
Trade account balance 5/	-0.7	-2.2	3.8	-2.8	-2.9	-10.7	-3.8	-10.7	-3.3	-2.0	-11.3	6.0	-6.9	-6.1	-4.9

Sources: Kazakh authorities and staff estimates.

1/ Includes all transactions with countries of the FSU, including those denominated in currencies other than the ruble.
2/ Kazakhstan's liabilities for the debts of the former U.S.S.R. are assumed eliminated under the "zero option", effectively back-dated to January 1, 1993.
3/ Interest and amortization on all credits used to close the financing gap recorded in non-FSU balance.
4/ Excludes changes in monetary gold holdings.
5/ Non-FSU figures based on ruble annual totals, converted from quarterly dollar figures using quarterly exchange rates. The sign of the ruble totals may differ from that measured in dollars, reflecting this conversion procedure.

Table 5. Kazakhstan: Indicators of Fund Credit, 1993-99 1/

	1993	1994	1995	1996	1997	1998	1999
				(In percent)			
Outstanding Fund credit relative to:							
Quota	25.0	50.0	50.0	50.0	50.0	43.7	35.4
Exports 2/	1.7	2.0	1.8	1.7	1.6	1.3	1.0
Reserves 3/	8.2	11.3	9.0	7.5	6.4	4.9	3.5
Total external debt 4/	10.9	10.8	9.3	8.7	8.1	6.6	5.0
Fund charges and repurchases relative to:							
Quota	0.4	2.6	2.9	2.7	2.7	8.9	10.5
Exports 2/	0.0	0.1	0.1	0.1	0.1	0.3	0.3
Reserves 3/	0.1	0.6	0.5	0.4	0.4	1.0	1.0
Total external debt 4/	0.2	0.6	0.5	0.5	0.4	1.3	1.5
				(In millions of U.S. dollars)			
Memorandum items:							
Fund purchases	87	87	--	--	--	--	--
Fund repurchases	--	--	--	--	--	22	29
Total liabilities to the Fund	87	173	173	173	173	152	123
Fund charges	1	9	10	10	10	9	8
SDR/US$ exchange rate	1.4	1.4	1.4	1.4	1.4	1.4	1.4

Source: Fund staff estimates.

1/ Assuming purchases of SDR 61.875 million under the STF in July 1993 and January 1994.
2/ Exports to both FSU and non-FSU markets.
3/ Gross international reserves (including gold).
4/ Assuming agreement on the "zero-option".

Table 6. Kazakhstan: Major Structural Reforms, January 1992-June 1993

Area	Actions
Price System	- Liberalization of prices of most goods and services - Elimination of compulsory state orders - Substantial increases in remaining administered prices
Foreign Trade	- Elimination of quantitative import restrictions - Reduction in the coverage of export licensing and quota arrangements - Reduction in the coverage of interstate bilateral trade arrangements - Elimination of state orders for exports
Exchange System	- Adoption of a unified official exchange rate - Current account convertibility for residents - Introduction of foreign exchange auctions with participation by commercial banks - Adoption of a new foreign exchange law
Fiscal Operations	- Strengthening the design and implementation of budgetary policies - Introduction of VAT and excise taxes - Reform of corporate and individual income taxes - Implementation of a cash management system
Privatization	- Adoption of a comprehensive and detailed privatization plan - Corporatization of many state enterprises - Progress in privatization of housing and small-scale enterprises - Legal recognition of only two forms of property: state and private
Financial System	- Adoption of new NBK Statutes and commercial banking law - Introduction of credit auctions at the NBK - Abolition of limits on households' deposits with commercial banks - Strengthening of prudential bank supervision - Abolition of limits on margins between cost of funds and lending rates for commercial banks

Table 6 (Cont.). Kazakhstan: Major Structural Reforms, July 1993-June 1994

Area	Actions
Price System	- Administered prices adjusted to avoid their erosion in real terms - Increase price of subsidized product to reduce budgetary impact - Future increases in import costs of energy products to be passed-through in full into domestic prices - Domestic prices of energy products reach world levels by early 1994
Foreign Trade	- Reduction in number of products subject to export quotas, and increase in scale of remaining quotas by at least 20 percent before September 1993 - Ease export licensing requirements
Exchange System	- Export taxes payable in domestic currency by July 1993 - Adjust export surrender requirements - Select an internationally recognized firm to audit the foreign exchange transactions of the key hard currency earners by October 1993; audit completed by March 1994
Fiscal Operations	- Plan for the creation of a Treasury prepared by end-1993 - Develop the Customs Committee into a full-fledged customs administration - Strengthen tax administration - All enterprises subject to hard budget constraints, with all financial support included in the budget - Proceeds from sales of state assets placed under budgetary control - Subsidies to agriculture limited to the explicit provisions made in the revised 1993 budget - Introduce a 15 percent import tariff on non-CIS imports - VAT coverage extended to non-CIS imports
Privatization	- All trade, distribution, and trucking networks offered for sale during 1993-94 - Complete distribution of investment coupons by end-1993

Table 6 (Concluded). Kazakhstan: Major Structural Reforms, July 1993-June 1994

Area	Actions
	- Convert medium and large enterprises into joint-stock companies by March 1994 - Privatize 30 percent of the assets of non-agricultural medium and large enterprises by March 1994 - Offer for sale at least 10 very large and/or special enterprises by March 1994; finalize plans to privatize 10 more enterprises by March 1995 - Initiate medium term structural reforms of state enterprises not to be privatized
Financial System	- Increase the proportion of new credit auctioned by the NBK, from 20 percent in the third quarter of 1993 to 50 percent in the second quarter of 1994 - Revise banks' minimum capital requirements by end-1993 - No credit at preferential interest rates will be extended by the NBK from January 1994 - Settlement of Savings Bank frozen assets issue and solution to the Soviet domestic loan of 1990 by end-1993 - Approval of a new liberal foreign direct investment law by end-1993

July 5, 1993

Dear Mr. Camdessus:

As you know, we have been engaged in intensive discussions with the Fund staff on a broad-based program of macroeconomic stabilization and systemic reforms that could be supported by the use of Fund resources. These negotiations are at an advanced stage and we hope to resolve the remaining outstanding issues, mainly related to monetary independence, in the next few months. At that time, the Government of Kazakhstan intends to request a stand-by arrangement with the Fund. In the interim, and to provide a smooth transition to the stand-by arrangement, we request that the Fund support Kazakhstan's reform efforts through the new Systemic Transformation Facility (STF).

The Government of Kazakhstan has been undertaking a wide range of policy actions, as regards both structural and institutional reforms as well as macroeconomic stabilization, during 1992 and early 1993. We believe that a great deal of progress has been achieved, but much remains to be done. On the basis of the policies in the attached Policy Statement, we intend to request two purchases from the International Monetary Fund under the Systemic Transformation Facility (STF) in the aggregate amount of SDR 123.75 million (50 percent of quota). It is intended that the first purchase under the STF would be for SDR 61.875 million and would be made on the date on which the Fund confirms the eligibility and qualification of Kazakhstan to use this facility.

As indicated, we will seek to reach understandings as soon as possible with the Fund staff on a comprehensive adjustment program that could be supported by the Fund under a stand-by arrangement in the upper credit tranches. We intend to request a second purchase of SDR 61.875 million as soon as the conditions under the STF are met.

Yours sincerely,

D. K. Sembayev
First Deputy Prime Minister
Government of Kazakhstan

G. Bainazarov
Chairman
National Bank of Kazakhstan

Attachment

Mr. Michel Camdessus
The Managing Director
International Monetary Fund
Washington, D.C. 20431

GOVERNMENT OF KAZAKHSTAN

Statement of Systemic and Macroeconomic Policies

July 1993-June 1994

1. The Government of Kazakhstan has been in the process of adopting a comprehensive program of economic and structural reforms aimed at limiting the decline in output and trade, modernizing the institutional and economic structures, and moving as rapidly as possible to an open and efficient market-based economy. Within these broad objectives, the program aims at creating the necessary conditions for sustainable growth in the medium term, through a rapid stabilization of the macroeconomic situation and an acceleration of the process of systemic change that began in 1992. The Government and the IMF staff have been involved in an intensive policy dialogue on the elements of the program that could be supported by an upper-credit tranche stand-by arrangement with the Fund. At this stage, only a few issues remain outstanding, and many of the policy measures envisaged under the program have already been implemented this year. The Government also expects to reach understandings with the Fund as soon as possible on a comprehensive program that could be supported by an upper credit tranche stand-by arrangement. In support of the 12-month program described below, the Government will request shortly a first purchase under the Structural Transformation Facility, in an amount of SDR 61.875 million, equivalent to 25 percent of Kazakhstan's quota in the Fund. The Government intends to request a second purchase in the same amount when the conditions for it under the STF are met.

2. The elimination of central planning, the breakdown of traditional trading arrangements among FSU states and with the CMEA countries, and the start of transition to a market economy have all adversely affected Kazakhstan's trade accounts, notably export earnings, and output. Calculations show a substantial decline in exports between 1990 and 1992--equivalent to about US$0.8 billion (twice Kazakhstan's Fund quota)--the bulk of which resulted from a shift in generalized state trading at non-market prices to increasingly liberalized and multilateral trade. Despite a virtual doubling of exports to non-FSU countries in 1992, sales remained below levels achieved in 1990 and earlier years; in addition, the value of exports to FSU states, in U.S. dollar terms, has fallen steadily since 1990.

I. Program Objectives

3. The program's broad macroeconomic objectives for 1993-94 are to contain the overall decline in output, reduce inflation, and strengthen the balance of payments and official external reserve positions. On the structural side, the program will seek to reinforce the role of market prices as an allocative mechanism, reduce the role of the state in economic activity through initiation of a well planned privatization program and progressive elimination of direct controls and subsidies, promote efficiency in enterprises, and provide a supportive environment for domestic and foreign

investment. As the pace of reforms depends on strengthening the Government's institutional capabilities, the program's initial focus will be on the creation and strengthening of institutions necessary for the conduct of economic policies in the new liberalized environment. These moves will enhance the Government's ability to successfully implement a strong program of structural change and macroeconomic stabilization.

4. The key macroeconomic objectives for 1993 are to contain the overall decline in output to 7-8 percent; reduce inflation, in conjunction with other major states in the ruble area, to a 5 percent monthly rate by the end of the year; strengthen the balance of payments position; and build-up the official external reserve position. Policies during 1994 will seek to consolidate and improve on these gains. The Government expects that these objectives, backed by its firm commitment to implement the wide-ranging and mutually supportive policies described below, will receive the necessary support from the Fund. It is also seeking financial and technical support for its economic reforms from the World Bank and other international agencies, as well as from bilateral donors and creditors. In this regard, the Government expects that a Consultative Group meeting will be convened shortly with a view to securing the necessary financial support from donors.

II. Systemic Reforms

Price liberalization

5. Following a fairly comprehensive price liberalization, the prices of a very limited number of goods and services remain administered and subsidized. 1/ The prices of these products, however, are being monitored and will be raised so as to avoid their erosion in real terms over time. The Government will review the list of administered prices by end-1993 and the prices of subsidized products will be raised in order to reduce the budgetary impact.

6. The Government recognizes that energy prices should be fully liberalized to ensure the most appropriate rate of extraction, production and utilization of these valuable exhaustible resources. It is thus the Government's intention to move to world pricing for its petroleum exports from January 1, 1994, and no measures will be adopted in the domestic markets to limit the price of any energy product at below world market levels. Prior to this date, Kazakhstan is willing to negotiate with its FSU trading partners a phased adjustment of its energy export prices toward world levels, providing that prices are not reduced in real terms. Increases in the import cost of energy products will be passed-through in full into domestic retail prices.

1/ Bread, flour (partially), baby food, imported medicines, fodder, housing rents and utility tariffs (both targeted according to income levels), and public transportation fares.

Privatization and state orders

7. The Government's privatization program was approved in April 1993. It provides for a broad-based corporatization program, protection for private property and entrepreneurship, an operating framework for holding companies and investment funds, a coupons/privatization accounts scheme, and bankruptcy procedures and corporate management for state enterprises.

8. The privatization program for 1993-95 consists of three components. The first component involves the auction of small-scale enterprises for cash or housing vouchers. All trade, distribution, and trucking networks will be offered for sale during 1993-94. The second component consists of the mass privatization of medium and large enterprises. To this end, these enterprises will be converted into joint stock companies by March 1994; the distribution of investment coupons is expected to be completed by end-1993. The Government intends to use this mechanism to privatize 30 percent of the assets of the non-agricultural medium and large enterprises by March 1994 and at least 70 percent by March 1995. The third component of the program consists of the case-by-case privatization of very large enterprises and conglomerates and special enterprises. The Government plans to offer for sale at least 10 large and/or special enterprises on a case by case basis before March 1994 and at the same time finalize plans for privatization of at least an additional 10 enterprises before March 1995. It is in the area of implementation of the privatization program that institution building is urgently needed and the Government is making a major effort, with the assistance of the World Bank, to move rapidly in that direction in the coming months. For a few sectors where early privatization is either impractical or undesirable, such as defense industries and railways, the Government will embark on medium-term structural reforms to improve their efficiency. Nevertheless, all enterprises will begin to be subjected to a hard budget constraint with financial support fully and transparently reflected in the budget.

9. Proceeds from sales of state assets (net of fees) will be brought under budgetary control, as contained in the legislation adopted by the Parliament in conjunction with the 1993 budget. Privatization proceeds will be used for financing of the military conversion program, the restructuring of the enterprises remaining under government ownership, the financial restructuring or liquidation of insolvent enterprises, and of the financial sector as well as partial repayment of domestic debt.

10. A strong and flexible market system requires enterprises to be able to choose with whom they conduct business--both within and outside Kazakhstan. For this reason, the system of compulsory state orders (Goszakaz) governing the distribution of production was abolished in December 1992. The successor state purchasing system is viewed as a transitional stage on the path to a liberal, market-oriented state procurement structure. It is being implemented so as not to restrict enterprises' rights to establish independent trading links (in the civilian sector) and to market products at freely negotiated prices.

11. The Government believes strongly in the economic and social importance of the agricultural sector to Kazakhstan's economy, and is aware of the fundamental importance of private ownership in order to provide the appropriate economic incentives for its development. Parliament amended the existing legislation and passed new laws in early-1993 establishing only two forms of property--state and private--and abolished the concept of collective property. Private sector activities in storage, marketing, agro-processing, exports as well as imports of foodstuffs and inputs will be strongly encouraged. Agricultural subsidies will be limited to the explicit provisions made in the revised 1993 budget.

Structural reform of Government finances

12. The Government believes that a strengthening of the tax and customs administrations is necessary to anchor the present tax policies and to achieve their full revenue potential. The merger of the Tax Inspectorate and the Customs Committee with the Ministry of Finance in November 1992 will be complemented by further structural measures in 1993. The reorganization of the tax inspectorate along functional lines and the design of a pilot data processing program will be initiated in one district of Almaty before October 1, 1993. The design of a taxpayer identification number and a taxpayer register will be completed by the same date, and implemented at the Almaty district level during the year. The Customs Committee will be developed into a full-fledged customs administration to match its new mandate and broadened responsibilities; specific plans for 1993 include the recruitment and training of customs officers and the establishment of a number of border posts with Russia and China.

13. The conduct of fiscal policy has been reinforced by strengthening of budgetary procedures and expenditure control in 1993. The monthly cash management system adopted by the General Government since January 1992 has been maintained. Substantial progress has also been made in expanding the budgetary coverage and in improving the transparency of the General Government's operations. In the Ministry of Finance a plan of action will be prepared by the end of the year for the creation of a Treasury--with technical assistance from the Fund--to supervise all cash transactions and manage all government debt.

The banking system

14. The Government and the National Bank of Kazakhstan (NBK) are conscious of the importance of a modern banking system for the effective conduct of monetary policy and for an efficient allocation of capital in the economy. To this end, Parliament approved in April 1993 the NBK statutes, the law on banking activities, and foreign currency law. The NBK statutes strengthened the central bank's independence from government, and provided it with the legal foundation to ensure the stability of the currency of Kazakhstan, to conduct monetary and credit policies, and to regulate and supervise the banking system. The new commercial banking law sets out the principles for the establishment and functioning of the banking system of Kazakhstan, and the legal basis for banking transactions. The revised foreign currency law,

which will need to be supported by detailed regulations, establishes a liberal framework governing foreign currency transactions and, along with a specific provision in the NBK statutes, allows for the introduction of a national currency.

15. Additional measures have already been implemented to increase the flexibility of the commercial banking system. Transactions between commercial banks within the ruble area are limited only by the amounts available on their correspondent accounts. Regulations limiting commercial banks' household deposits to an amount equivalent to their capital were rescinded in 1992. Furthermore, not later than July 1, 1993, deposit and lending interest rates of the Savings Bank will be raised closer to market levels. The interest rate paid by the Government on its new borrowing from the NBK, to finance the budget deficit, will be increased closer to market levels from the beginning of 1994, to serve as a basis for the creation of a government securities market.

16. The reform of the financial system and the institutional strengthening of the NBK has been accompanied by an overhaul of the instruments of bank supervision. Commercial banks' licensing procedures have been tightened, both by raising substantially the minimum capital requirements and by introducing a more rigorous assessment of applications. The minimum capital requirement will be kept under review, and revised by end-1993 on the basis of developments in inflation and in the banking system, particularly nonperforming loans. Furthermore, the NBK will lay the groundwork for the control of commercial bank credit and payment risks. On-site and off-site examination of banks is being improved, and plans are underway to audit the NBK and the largest commercial banks. To bolster confidence in the financial system, the settlement of the Savings Bank's frozen assets and a solution to the Soviet domestic loan of 1990 will be found before the end of the year in time for inclusion in the 1994 budget.

Exchange and payments system

17. The Government has already introduced a number of exchange system reforms. In July 1992, Kazakhstan adopted a unified official exchange rate (pegged to the freely floating exchange rate as determined by the Central Bank of Russia based on the Moscow Interbank Currency Exchange). In 1992, all official foreign exchange and gold holdings were brought under the management of the NBK. In April 1993, a foreign exchange law was approved by Parliament which establishes the basis for the regulation of current international transactions. We expect that Parliament will approve a new, liberal foreign direct investment law before the end of the year.

18. Despite these reform measures, the foreign exchange market remains illiquid. In large part, this reflects the impact of the unstable macroeconomic environment, with ruble interest rates which are substantially lower than inflation. The Government expects that appropriate demand management and incomes policies, together with financial liberalization, will help improve the liquidity of the exchange market. Supplementary measures will also be adopted. In order to strengthen the central bank's

reserves position, the Government will introduce by end-December 1993, or earlier in the context of a stand-by arrangement with the Fund, regulations temporarily increasing the overall surrender requirement (excluding export taxes), while substantially reducing exemptions to repatriation and surrender of export earnings. At the same time, the export tax will be made payable in domestic currency. In order to ensure that all foreign exchange receipts are appropriately surrendered and accounted for, the Government will select by October 1, 1993 an internationally recognized firm to audit the foreign exchange transactions of the key foreign exchange earners. The audits will be completed by March 1, 1994. Foreign export proceeds surrendered to the NBK are being purchased at the market rate of exchange and those surrendered to the banking system will be purchased at the rate of exchange determined on the Almaty auction.

19. The NBK will introduce by July 31, 1993 revised foreign exchange regulations, based on the new foreign exchange law. In the event that the Government introduces a separate currency, a unified exchange system with a single, freely floating market-determined exchange rate will be maintained. During the period of the program, the Government will not impose or intensify restrictions on payments and transfers for current international transactions, introduce or modify any multiple currency practices, conclude bilateral payments agreements that are inconsistent with the Fund's Articles of Agreement, and impose or intensify any import restrictions for balance of payments purposes.

Trade arrangements

20. In parallel with the liberalization of the exchange system, the Government has implemented a number of measures to liberalize trading arrangements. As noted above, the Goszakaz system, which allocated a proportion of domestic output to FSU and non-FSU export markets, was abolished in December 1992. The coverage of export licensing and quota procedures was narrowed substantially in February 1993; in a parallel move, the coverage of the most important interstate bilateral trading arrangements, notably with Russia, was substantially reduced. Procedures for obtaining licenses have also been simplified for 1993; steps will be taken to grant licenses on the basis of tenders to render the system more transparent. Nevertheless, while considerable progress toward a market-oriented trading system has been achieved, the Government intends to move further. Thus, by September 1, 1993, the Government will reduce the total number of products subject to quotas and will increase remaining quotas by an amount not less than 20 percent, in line with similar moves in Russia. These quotas will be eliminated as the trade situation improves and domestic output stabilizes, or earlier in line with similar moves by other CIS trading partners. Licenses will not be required with a view to maintaining the domestic supply of products, or to ensuring favorable internal prices, and restrictions limiting export licenses to producer enterprises and state trading organizations will be abolished and the licenses will be granted for a twelve-month period.

External debt management

21. Mechanisms for coordinating and monitoring foreign credits contracted and guaranteed by the public sector are being improved. Responsibility for monitoring outstanding credits has been assigned to the Ministry of Finance which will provide the Government with monthly statements, starting July 1, 1993, summarizing the external debt position; the Ministry of the Economy is responsible for policies regarding the undertaking of new external debt and will provide the Government with quarterly forecasts of the prospective debt burden implied by future credits, in consultation with the Ministry of Finance and the National Bank. As agreed at the CIS heads of state summit in Moscow on May 14-15, the Government has conducted negotiations with a view to establishing its debt service obligations and the settlement of interstate arrears. In these discussions, Kazakhstan recognized its 1992 debt, as reflected in the balance on the National Bank's correspondent account with the Central Bank of Russia, in the amount of rub 246.7 billion; this amount may be adjusted in the near future in favor of Kazakhstan on the basis of the balance of arrears between enterprises in Kazakhstan and Russia. The final agreement is expected to be reached before October 1, 1993. However, no agreement was reached regarding the debt resulting from the balances on the NBK's correspondent account with the CBR for the period January-April 1993, i.e. prior to the suspension of transactions on this account by the CBR; the settlement of this debt will be the subject of further discussions between Kazakhstan and Russia. The Government intends to clarify, no later than July 31, 1993, its intentions with respect to its agreed debt service obligations in respect of the debts of the former U.S.S.R on the basis of information requested from Russia on the assets and liabilities of the FSU.

III. Macroeconomic Policies and the Social Safety Net

22. The immediate priorities are to contain the fiscal deficit, pursue a restrained incomes policy, implement a cost-effective and carefully targeted social safety net and a restrictive monetary policy. As a precaution in case financial policies and monetary arrangements in the ruble area fail to restore price stability, the Government will continue preparations for the introduction of a national currency.

Budgetary policy

23. The budget law approved by Parliament in January 1993 targeted a deficit of rub 183 billion, then under 4 percent of GDP, equivalent to a deficit of rub 198 billion (5 percent of GDP) on a cash basis and based on the Fund's definition. However, as the macroeconomic assumptions of the budget were invalidated by developments--notably a sharp increase in energy prices--shortly thereafter, a revised budget was adopted by the Executive Committee of Parliament in May. Additional revenue and expenditure measures will be taken, some now and others by October; the key assumptions regarding inflation and the exchange rate have been updated. The overall deficit is targeted at rub 1,043 billion, or around 6 percent of GDP in 1993; domestic

bank financing of the deficit is projected at no more than rub 665.8 billion, or 4 percent of GDP.

24. A levy on gasoline was introduced and several revenue measures will be taken in the near future. Before end-July, excise taxes on selected non-CIS imports will also be levied, a uniform import tariff of 15 percent will be introduced on non-CIS imports by October, with exemptions limited to basic food items and medicines, and the coverage of the Value Added Tax (VAT) will be extended to imports from non-CIS countries. In order to centralize financial resources in the budget, for 1993 the Government has suspended the implementation of the legislation on Free Economic Zones that allowed selected regional governments to appropriate all tax revenue within their territory. The tax on exports to non-CIS countries will be made payable in domestic currency no later than end-December 1993; this tax will be superseded by legislation limited to the taxation of natural resources to be prepared in the context of the 1994 budget.

25. The 1993 program calls for the implementation of a tight expenditure program based on a prudent wage policy, while strengthening the social safety net. It is expected that the minimum wage will need to be adjusted to rub 10,000 in the fourth quarter of 1993 in line with the expected increase in retail prices. The Government's wage bill in 1993 should be limited to rub 590 billion, or 3.4 percent of GDP. The program also calls for the strict limitation of all budgetary transfers and subsidies (including the social safety net) to rub 880 billion, or 5.1 percent of GDP. Consumer subsidies will remain limited to bread, flour (partially), imported medicines, baby food, and fodder with price adjustments to cap their amount at 1.2 percent of GDP.

26. Although the details and the quarterly targets for the 1994 budget deficit will be set in the context of the review of the program and the discussions on the budget, we intend to limit the overall deficit and its domestic bank financing in 1994 to at most 4 percent and 2.5 percent of GDP, respectively. The achievement of the target deficit will rely on a further reform and streamlining of the tax system, in particular a reduction of exemptions, and the reform of taxes on natural resources. The Government also intends to maintain a prudent wage policy and reduce the ratio-to-GDP of transfers and subsidies. Explicit budgetary allocations for virtually all previously implicit interest subsidies have been already included in the 1993 budget. Finally, the Government will progressively eliminate its direct lending activities, and further develop market instruments for non-bank financing with technical assistance from the Fund.

Monetary and credit policy

27. Consistent with the Government's stabilization program, the National Bank will cooperate with other members of the ruble area to stabilize the ruble. In particular, it will target the growth in its net domestic assets to no higher than that of the Central Bank of Russia (CBR). As of April 14, 1993, the CBR has frozen the credit operations through the correspondent accounts with Kazakhstan; in mid-May the Russian Government proposed that

the correspondent account advances be handled through interstate credits. Although no formal agreement has been reached between Russia and Kazakhstan, discussions are continuing on the possibility of finalizing an interstate credit of around rub 150 billion in the near future. On the basis of current projections, the stock of net domestic assets of the NBK will be limited to no more than rub 2,069 billion by end-September, and to rub 2,498 billion by end-December 1993. These targets will be mainly achieved by limiting the amounts of credit provided by the central bank to commercial banks; net credit to the Government from the central bank will also be limited as indicated in Table 1. In order to align its policies with the CBR as long as Kazakhstan remains in the ruble area, the NBK will substantially raise its refinance rate by July 5, 1993 in line with that prevailing in Russia and maintain this linkage.

28. The NBK intends to discontinue the practice of using the refinance mechanism to allocate credit on a sectoral basis, and to make interest rates the main instrument to allocate credit. Significant measures have already been taken in this area. Credit auctions were resumed in January 1993 and have been held monthly, while preparations are underway for the introduction of a Government securities market. The NBK will conduct bi-weekly auctions during the third quarter of 1993, and will increase their frequency to weekly as of the beginning of 1994. The proportion of new credit (except to the Government) that is auctioned will also be expanded so that an average of 20 percent of NBK credit is auctioned during the third and fourth quarters of 1993, 35 percent during the first quarter of 1994, and 50 percent during the second quarter of 1994. The present reserve requirements for commercial banks and the compulsory deposits on correspondent accounts with the NBK will be maintained during 1993. The refinance mechanism will be used for meeting short-term liquidity needs, and not as a primary source of credit to banks; the maximum maturity of refinance credits will be reduced, and the practice of rollover of refinance credits eliminated in the first half of 1994. Beginning January 1, 1994, the NBK will no longer provide credit at preferential interest rates and all subsidies will be limited to those provided through the budget.

The balance of payments

29. Kazakhstan's balance of payments position remained weak in early 1993. Exports to non-FSU markets fell while those to FSU states were also weaker than anticipated. External financing continued to be provided, in large part, through correspondent account credits until May when Russia placed a moratorium on new financing under this system. On the basis of current projections, and assuming Kazakhstan's agreement on the zero option with Russia, the financing gap for 1993 is projected to be around US$330 million, before receipts of new credits from multilateral institutions and bilateral donors and creditors and any financing provided through interstate credits from Russia; preliminary estimates for 1994 indicate a financing gap of around US$470 million, with approximately US$200 million falling in the first half of the year. These estimates for 1994 will need to be carefully reviewed, and possibly revised, by the end of this year in the light of developments, notably within the ruble area.

30. As of April 1, 1993, net official foreign reserves (including gold) of the NBK were the equivalent of about US$139 million, representing approximately two weeks of estimated imports. In line with the overall balance of payments situation and the need to strengthen the external asset position and ensure the availability of foreign exchange, the NBK will increase its stock of net official international reserves (including gold holdings valued at US$350 per ounce) to US$225 million by September 30, 1993 and US$318 million by December 31, 1993. These targets will be adjusted for shortfalls or excesses of external financing from the program assumptions, as indicated in Table 1.

IV. Statistical Issues

31. The Government intends to improve the quality and reporting of fiscal statistics. First, it has issued administrative regulations and procedures to monitor and control all external financing operations of the public sector. Second, the control and monitoring of capital expenditure will be enhanced by identifying separately all financial lending and repayments transactions. Third, a quarterly economic classification of budgetary expenditures will be established at each level of government and consolidated within four weeks of the end of each quarter. Moreover, a quarterly consolidation of the operations of State budget with the extra-budgetary funds, the Pension Fund, the Social Insurance Fund, and the State Fund for the Promotion of Employment and Migration will be introduced in order to develop an overall view of the operations of the General Government which is not limited to the State budget.

32. Significant progress has been made in adapting the NBK's accounting system to the Fund's money and banking statistics methodology. Further refinement awaits the introduction of a new plan of accounts for the NBK by early 1994, which will classify statistics on the basis of residency and economic sectors and will identify the NBK's gold and foreign exchange holdings. The reporting requirements of commercial banks will also be revised, and adapted to the NBK's requirements for banking supervision, foreign exchange controls and exchange market monitoring, and statistical and monetary policy purposes.

33. The Government recognizes the urgent need to improve the monitoring of the balance of payments. Responsibility for compiling balance of payments statistics has been assigned to Goskomstat, and an action plan, developed during 1992 with the technical assistance of the Fund, is being implemented. Goskomstat will report quarterly to the Ministry of Economy and Ministry of Finance on progress in implementing the plan, including on its success in collecting the necessary information from enterprises and government ministries and agencies.

34. The revision of production and price statistics awaits the pending revision of the United Nations System of National Accounts due in 1993. Suitable technical assistance has been requested so that Goskomstat might start the necessary preparatory work in the second half of 1993. A revised

consumer price index with national coverage was introduced in 1993; the revision of the wholesale price index has also begun.

V. Program Review and Monitoring

35. The Government has delegated to the National Council on Economic Transformation the task of coordination and monitoring of progress in implementation of the wide range of structural and systemic reforms described above. The Council, with the assistance of the Ministry of the Economy, Ministry of Finance and the National Bank will prepare a set of economic, financial, and structural indicators to report on a monthly basis the status of program implementation to the Cabinet of Ministers.

36. The implementation of the measures stated in this statement will necessitate an intensive program of technical assistance that the Government hopes will be offered by international financial institutions and other governments. To ensure the optimal implementation of the program, a technical assistance coordination unit has been set up in the Ministry of Economy to define technical assistance priorities that clearly fit into the overall economic policy of the Government and coordinate with the international entities that are providing the assistance.

37. For purposes of monitoring implementation of the program, the quantitative targets, through end-1993, and structural benchmarks are contained in the attached Table 1; quarterly quantitative targets for the first half of 1994 will be established, in consultation with Fund staff, before the end of 1993. The Government will remain in close consultation with the Fund staff, and will provide the Fund with such information as it requests for monitoring the progress in program implementation. Monetary and external developments, notably progress toward reduction of inflation, as well as the implementation of the privatization plans and preparation for the 1994 budget will be the subject of particular attention. In view of the considerable uncertainties regarding developments in the ruble area, program targets will be kept under continuous review, in particular with regard to inflation as well as monetary and credit growth rates, and the policies of the CBR.

Table 1. Kazakhstan: Quantitative Targets and Structural Benchmarks

Quantitative targets

The National Bank of Kazakhstan's net domestic assets not to exceed rub 1,700 billion by end-June, rub 2,069 billion by end-September 1993, and rub 2,498 billion by end-December 1993 through adjustments in NBK credit to banks. 1/

Net financing from the NBK, commercial banks, and the Savings Bank to the General Government not to exceed rub 124 billion during the period March-June 1993, rub 288 billion during the period March-September 1993, and rub 710 billion during the period March-December 1993 so that the total net flow of bank credit to the government will not exceed rub 666 billion during the year.

NBK holdings of net international reserves (including gold valued at US$350 per ounce) not to be less than US$225 million by end-September 1993, and US$318 million by end-December 1993. 2/ These targets will be adjusted on account of shortfalls in external financing relative to program assumptions by the amount of the shortfalls up to a maximum of US$30 million at end-September and US$50 million at end-December 1993.

Structural benchmarks

Raise NBK refinance rate in line with that prevailing in Russia.	July 5, 1993
Reduce number of products subject to export quotas, and increase remaining quotas by an amount not less than 20 percent.	September 1, 1993
Make tax on exports to non-CIS countries payable in domestic currency, and temporarily increase overall foreign currency surrender requirement.	December 31, 1993
Privatize 30 percent of the assets of the non-agricultural medium and large enterprises.	April 1, 1994
Prepare plan of action for creation of a Treasury in the Ministry of Finance	January 1, 1994

Auction 20 percent of new NBK credit (except to the Government) in the third and fourth quarters of 1993, 35 percent during the first quarter of 1994, and 50 percent during the second quarter of 1994.

1/ Net domestic assets of the NBK are defined as the difference between base money (including currency, required and excess reserves) minus net foreign reserves including the net position of the NBK correspondent account with the Central Bank of Russia (including currency deliveries). Thus defined, the NBK's net domestic assets would comprise: credit to all levels of government minus deposits of the government, credit to domestic banks, credit to domestic enterprises, and all other net assets.

2/ Net international reserves are defined as the difference between the NBK's foreign currency assets and liabilities, plus official holdings of monetary gold, less purchases from the Fund.

Eligibility for the STF

The conditions under which Fund members are eligible for STF financing are provided in paragraph 1 of the STF decision of April 23, 1993. In the case of Kazakhstan, eligibility can be established in light of the sharp fall in total export receipts associated with "the shift from significant reliance on trading at nonmarket prices to multilateral, market-based trade".

Prior to 1992, around 90 percent of Kazakhstan's exports were to the other republics of the former U.S.S.R., and were strongly influenced by central planning arrangements determining the level and direction of export shipments and the prices applicable to such trade. Exports to non-FSU countries were also subject to strong centralized controls. While some exports to non-FSU countries were at market-based prices, Kazakh exporters were commonly compensated in domestically-controlled ruble prices, or at a composite price, reflecting an average of internal and external prices. In the case of other exports, notably those prior to 1991 to former CMEA countries, trade was based on annual bilateral trade agreements with the Soviet Union, and took place in nonmarket prices denominated in transferable rubles.

Controls on export activities have been progressively eliminated since 1990. The CMEA trade and payments system ceased to exist on January 1, 1991, and, within the FSU, the central planning system was progressively dismantled during 1991-92. In late 1992, Kazakhstan abolished the state orders system. Nevertheless, the transition to a fully multilateral, market-based trading system is not yet complete, and trade continues to be adversely affected by deficiencies in the trade and payment system, particularly regarding trade within the FSU.

Exports to both FSU and non-FSU markets have declined significantly since 1990. The precise measurement of the decline is subject to major statistical problems associated with the conversion of trade denominated in rubles or transferable rubles into U.S. dollars. 1/ A particular problem arises on account of the sharp devaluation of the ruble exchange rate, associated with the move from an administratively determined official exchange rate of around 0.6 to the U.S. dollar in 1990 to an (eventually) market-determined exchange rate of around 198 to the U.S. dollar in 1992. When these exchange rates are used to convert ruble-denominated export data into U.S. dollars, the decline in total exports is implausibly large (Table 2, section I). Results have therefore been calculated using an inflation-adjusted exchange rate (Table 2, section II). The results indicate that the absolute and cumulative decline in exports over the period 1990-92 were substantial, and far exceeded the threshold required for a member to be eligible for the STF (i.e. 50 percent of quota, which is equivalent, for Kazakhstan, to around US$175 million).

1/ See "A Fund Facility to Help Members Respond to Systemic Disruptions in Their Trade and Payments Arrangements--Supplementary Information", EBS/93/58, Supplement 1, 4/14/93 (pages 7-8).

Table 2. Kazakhstan: Exports, 1990-92

(In billions of U.S. dollars)

	1990	1991	1992
I. Trade valued at Actual Exchange Rates			
Exports to:			
Non-FSU	1.9	0.8	1.5
FSU	14.4	10.3	1.8
Total	16.3	11.1	3.3
(Change from 1990)	--	(-5.2)	(-13.0)
(Cumulative change from 1990)	--	(-5.2)	(-18.2)
Rubles per U.S. dollar 1/	0.6	1.7	198
II. Trade valued at Inflation-Adjusted Exchange Rate (base 1992)			
Exports to:			
Non-FSU	1.9	0.8	1.5
FSU	2.2	2.0	1.8
Total	4.1	2.8	3.3
(Change from 1990)	--	(-1.3)	(-0.8)
(Cumulative change from 1990)	--	(-1.3)	(-2.1)
Rubles per U.S. dollar 2/	3.8	9.1	198

Sources: CIS Goskomstat, Goskomstat of Kazakhstan, and staff estimates and projections.

1/ Official exchange rate in 1990, commercial rate in 1991, market rate in 1992.

2/ Adjusted for estimated changes in the ruble price of Kazakh exportables and the dollar UVI of industrial countries' non-oil exports.

Kazakhstan - Fund Relations

(As of June 30, 1993)

I. Membership status:

(a) Date of membership: July 15, 1992
(b) Status: Article XIV

II. General Resources Account:

	SDR Million	Percent of Quota
Quota	247.50	100.0
Fund holdings of currency	247.50	100.0
Reserve position in the Fund	0.01	0.0

III. SDR Department:

SDR Million	Percent of Allocation
--	--

IV. Outstanding purchases and loans: None

V. Financial arrangements: None

VI. Projected obligations to the Fund: None

VII. Exchange Rate Arrangements:

The currency of the Republic of Kazakhstan is the Russian ruble. The official exchange rate, which is defined as the value of the ruble against the U.S. dollar as ascertained by the Central Bank of Russia (CBR) on the basis of the Moscow interbank foreign currency exchange, is applied to foreign exchange surrendered to the National Bank of Kazakhstan (NBK), official external debt service payments, purchases of foreign currency from the Republican Hard Currency Fund, and accounting purposes by state enterprises. The NBK publishes the exchange rate of the Russian ruble for 25 currencies and the ECU that are quoted by the CBR on the basis of the international cross rate relationship between the U.S. dollar and the currencies concerned.

A second exchange rate emerges from a weekly auction of foreign exchange at the NBK's Hard Currency Exchange, in which the

NBK and authorized dealers in foreign exchange participate. A single fixed rate is applied to all transactions conducted at each auction, the buying and selling rates being the same.

In addition, a third exchange rate emerges from foreign exchange operations of authorized banks with resident enterprises and individuals. This rate is market-determined, except that the spread between buying and selling rates must not exceed 10 percent.

As of August 14, 1992, Kazakhstan has availed itself of the transitional arrangements under Article XIV. 1/ The Board was notified of the exchange arrangements that Kazakhstan intends to apply in fulfillment of its obligations under Article IV, Section 1, of the Fund's Articles on February 19, 1993 (EBD/93/28).

VIII. Article IV Consultation:

The first Article IV Consultation was completed on April 23, 1993. Kazakhstan is on a 12-month consultation cycle.

IX. Staff visits and policy discussions:

1. December 9-12, 1991: Staff Visit.
2. January 8-22, 1992: Pre-Membership Economic Review.
3. April 13-20, 1992: Exploratory Program Discussions.
4. June 19-July 2, 1992: Use of Fund Resources.
5. September 29-30, 1992: Managing Director's Visit.
6. October 28-November 8, 1992: Use of Fund Resources.
7. November 26-December 2, 1992: Use of Fund Resources.
8. January 29-February 7, 1993: Use of Fund Resources.
9. March 8-17, 1993: Technical Visit.
10. May 7-24, 1993: Use of Fund Resources

XI. Technical Assistance:

The following list summarizes the technical assistance provided by the Fund to Kazakhstan since 1991.

Monetary and Exchange Affairs

1. November 1991: Prediagnostic mission.
2. April 1992: Modernization of the NBK, banking supervision.
3. August 1992: NBK accounting and organization, monetary policy implementation, foreign exchange operations, and payments' system.

1/ The Article IV consultations described in this report also cover the required Article XIV consultations.

4. November 1992: Modernization of the NBK, banking supervision, monetary policy implementation.
5. March 1993: Foreign exchange operations, the payments system, monetary management and securities auctions, commercial bank reporting and legal issues related to central bank and foreign exchange laws.
6. May 1993: Payments system.

Fiscal Affairs

1. November-December 1991: Review of tax system and administration, and social safety net programs.
2. December 1991: Public expenditure management.
3. April-May 1992: Tax administration and VAT implementation.
4. December 1992: Establishment of a Customs Administration.
5. March 1993: Establishment of a Treasury.

Statistics

1. February 1992: Multitopic review and basic training in statistical methodologies.
2. July 1992: Balance of payments.
3. August-September 1992: Balance of payments, Government finance prices and national accounts.
4. November-December 1992: Consumer price index.
5. February-March 1993: Consumer price index and national accounts.

Institute

1. April 1992: Seminar on the interdependence of fiscal, monetary, and BOP policies in a market economy.
2. November 1992: Course on financial programming and policy.

XII. Resident Representative

Mr. Jorge Sol-Perez, Resident Representative, since August 17, 1992.

XIII. Resident Advisor

Mr. Hofstetter has been assigned as General Resident Adviser to the National Bank of Kazakhstan since October 1992. Mr. Larsen was assigned as bank supervisor in March 1993 for a period of one year.

Kazakhstan--Relations with the World Bank Group

Kazakhstan became a member of the IBRD in July 1992. Intensive work has been undertaken by the Bank in the economic, privatization and private sector development, energy, financial and social sector areas.

The primary focus of the Bank's assistance strategy to Kazakhstan is to assist the Government in the ongoing transformation of the economy. In the short term, the Bank's program supports the Government in the design and implementation of the most urgent structural and systemic elements of the reforms and in the formulation of a long-term development strategy. The Bank's medium-term objectives are to continue to support the implementation of structural measures to ensure a vigorous supply response and to undertake financing of sound investments in key sectors. More specifically, Bank activities endeavor to support: (i) establishment of an appropriate legal and institutional framework, including policies which will ensure competition; (ii) privatization including enterprise restructuring and corporatization; (iii) financial sector reform; (iv) targeting and strengthening of the social safety net; (v) sectoral reforms in energy, mining, and agriculture and in infrastructure for restructuring and rehabilitation/expansion of the transport sectors.

Most of the Bank's policy and technical advice and support in 1992 was financed through a Technical Cooperation Agreement between the Bank and the Government. The Bank has been instrumental in the development of the Government's structural reform policies, through technical assistance, the preparation of a Country Economic Memorandum, and the development of a proposed Rehabilitation Loan in close coordination with the IMF. The Bank has had a key role in the development of the Government's privatization strategy. Simultaneously, the Bank has undertaken a review of, and provided policy advice on, the financial sector. In addition to a comprehensive energy sector review, the Bank has provided assistance on petroleum legislation, petroleum taxation, and enterprise rehabilitation in the oil sector. The Bank has also assisted the Government of Kazakhstan with the development of its external assistance strategy and the establishment of an Aid Coordination Unit. The Consultative Group meeting held in Paris on December 14, 1992, was organized and held under the Bank's auspices; a local CG meeting concentrating on technical assistance was held in May 1993.

The Bank lending program is still under development. In addition to the proposed rehabilitation loan, the Bank is currently working on an earlier Technical Assistance Loan which it hopes to begin implementing around midyear. Other projects currently under active consideration include a private sector development operation in support of the privatization program, an urban transport investment operation, and an energy sector technical assistance and investment loan.