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CONFIDENTIAL

December 18, 1997

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Tajikistan—Staff Report for the 1997 Article IV Consultation and Use of Fund Resources—Request for Emergency Post-Conflict Assistance**

The attached supplement to the staff report for the 1997 Article IV consultation with the Republic of Tajikistan and its request for use of Fund resources for emergency post-conflict assistance (EBS/97/224, 12/5/97), has been prepared on the basis of additional information.

Mr. Saavalainen (ext. 38825) or Mr. Wakeman-Linn (ext. 34145) is available to answer technical or factual questions relating to this paper prior to the Board discussion scheduled for tomorrow, Friday, December 19, 1997.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Bank for Reconstruction and Development (EBRD), the European Commission (EC), and the Organisation for Economic Cooperation and Development (OECD), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF TAJIKISTAN

Staff Report for the 1997 Article IV Consultation and Use of Fund Resources—Request for Emergency Post-Conflict Assistance—Supplementary Information

Prepared by European II and Policy Development and Review Departments

Approved by John Odling-Smee and Susan Schadler

December 18, 1997

This supplement provides information on economic developments since the Staff Report (EBS/97/224) was issued on December 5, 1997, including on the implementation of the agreed prior actions for the program.

I. Recent Macroeconomic Developments

1. During the first two months of the program, financial developments have been well in line with the agreed policy targets. At end-November, credit expansion was less than programmed, with the stock of net domestic assets of the National Bank of Tajikistan (NBT) about 6 percent below the program limit. At the same time, the NBT's foreign reserve position was almost US$6 million better than envisioned in the program, as stronger than anticipated receipts from cotton exports enabled a faster pace of repayment of the earlier loan for the cotton sector. As a result, reserve money was slightly above the indicative target. Fiscal policy has been somewhat tighter than programmed, with preliminary reports indicating a modest budget surplus (0.3 percent of estimated quarterly GDP) during October and November, in part due to strong collections of sales taxes. Indeed, the end-December performance target on the minimum collection of sales tax revenues has reportedly already been exceeded.

2. Inflation has continued to decline; average monthly inflation in October-November was 3 percent, down from more than 15 percent in the period from July through September. The exchange rate has been stable for approximately three months, at roughly TR 750 per U.S. dollar.

II. Prior Actions

3. The status of the prior actions under the program is as follows. Parliament passed the 1998 state budget on December 12. This budget is consistent with the program, with one

minor exception. In consultation with the staff, the authorities added TR 1.5 billion (about 0.1 percent of GDP) in expenditures, in order to finance wage increases for teachers beyond those envisioned in the program. The budget instructs the government to find revenue to pay for this increased expenditure, and gives the government the authority to increase tax revenue to do so. The Prime Minister has confirmed to the staff that the government will work with the staff to reach agreement on revenue measures sufficient to cover this expenditure.

4. Consistent with the program, the 1998 budget unifies import duties at 5 percent with minimum exemptions, eliminates most VAT exemptions, and unifies excise tax rates on comparable imported and domestic products (see EBS/97/224). Enterprise profit tax rates have been unified at 30 percent, while taxation of small businesses has been simplified with the adoption of a 10 percent turnover tax.[1]

5. The remaining prior actions called for collecting 40 percent of the US$7.6 million in foreign exchange loans extended by the Ministry of Finance, and ensuring a positive real refinance rate. As of now, US$2.7 million of the foreign exchange loans have been collected, or about 35 percent of the total; the authorities anticipate collecting the remaining 5 percent in the next few days. Regarding the refinance rate, the current rate of 6 percent per month implies a positive real rate of more than 35 percent on an annual basis, based on the actual October-November inflation and programmed December-January inflation. The NBT has asked for bids from banks for the first credit auction, which is expected to be completed in the next few days, and have reaffirmed their commitment to keep the refinance rate at least 0.5 percent per month above the auction rate.

III. Other Reforms

6. Based on progress to date, it appears that all structural benchmarks for end-December 1997 are likely to be observed: (i) The NBT is organizing the first credit auction. (ii) The NBT Board is reviewing a draft decision increasing the minimum capital requirement for new banks to the Tajik ruble equivalent of US$1,000,000 effective January 1, 1998. The decision also increases the requirement for existing banks to US$500,000 on April 1, 1998, and US$1,000,000 on January 1, 1999. (iii) The authorities have informed the staff that the Large Taxpayer Unit has been established consistent with FAD recommendations. Unfortunately, recent security developments have led to a temporary suspension of UN approval for missions to Dushanbe, thereby delaying an FAD tax policy and tax administration mission to review, inter alia, implementation of this measure.

7. Progress has also been made in other policy areas. Importantly, the authorities have contacted all creditors from whom they are currently requesting a rescheduling of external

[1]The staff report (EBS/97/224) had stated that the turnover tax rate would be 8 percent. However, discussions between the staff and the authorities had focussed on a rate between 7 and 10 percent, and the 10 percent rate is consistent with the program objectives.

debt obligations, with a view to completing bilateral discussions following the creditors meeting held recently in Hong Kong.

8. One aspect of policy implementation which is of some concern is privatization, particularly of small scale enterprises, where progress has failed to accelerate as anticipated. In October-November, only about 100 small-scale enterprises were privatized. Aggressive action in this area will be needed, so as to avoid any delays in meeting the program target of 1200 privatized small-scale enterprises by end-March 1998. On large scale privatization, while the first share auction is expected to be announced in the next few days, it is anticipated that only about 100 medium- and large-scale enterprises will be converted to joint stock companies by end-December, compared to the program target of 200.

IV. World Bank Post Conflict Assistance

9. As envisaged in EBS/97/224, on December 16, 1997 the World Bank Board approved a US$10 million post conflict assistance credit for Tajikistan. This credit is to assist the Tajik authorities in covering costs related to the peace process, as well as in reducing arrears on compensation payments to the population. On January 29, 1998, the Bank Board is scheduled to consider a second US$10 million post-conflict assistance credit, designed to support reconstruction of roads, schools and clinics in some of the areas most affected by the conflict, as well as to assist in the recovery of the agriculture sector.

V. Staff Appraisal

10. The satisfactory implementation of the prior actions and early progress with respect to the end-December structural benchmarks, as well as the strong performance with regard to the financial targets under the program, is encouraging and shows a strong commitment by the authorities to the program. The staff, however, urges the authorities to strengthen their efforts to bring the privatization process back on track. Assessment of progress in this area will form a part of the program review, on the basis of which the Board could consider the request for a second post conflict credit purchase in March 1998. Overall, the staff continues to be of the view that the authorities' commitment to economic reform deserves the support of the Fund.