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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/8

3:00 p.m., January 26, 2000

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

E. Aninat, Acting Chairman

Executive Directors	**Alternate Executive Directors**
	A.S. Alosaimi
	K. Kpetigo, Temporary
	J.A. Chelsky, Temporary
	M.J. Fernández, Temporary
R.F. Cippà	W. Szczuka
	C.-P. Schollmeier, Temporary
	M. Pérez dos Santos, Temporary
	C.A.E. Sdralevich, Temporary
	R. Djaafara, Temporary
	R.P. Watal, Temporary
W. Kiekens	
	I. Steinbuka, Temporary
	P.A. Brukoff, Temporary
	S. Le Gal, Temporary
	M.R. Shojaeddini, Temporary
	J.A.K. Munthali, Temporary
	E. Kornitch, Temporary
	H. Hagan, Temporary
	V. Dhanpaul, Temporary
	M.E. Kandil, Temporary
	I.-K. Cho, Temporary
	Tong Y., Temporary
	Y.G. Yakusha
	K. Harada, Temporary

A.S. Linde, Acting Secretary
N.M. Hairfield, Assistant

Also Present

IBRD: K. Ogawa, Europe and Central Asia Regional Office. European II Department: J. Odling-Smee, Director; G. Bélanger, Deputy Director; E. Jafarov, L. Hansen, T. O. Saavalainen, J.-Y. Wang. External Relations Department: K.L. White. Fiscal Affairs Department: D.F. Jacobs. Policy Development and Review Department: B.B. Bakker, C. Brachet, R.K.W. Powell. Secretary's Department: P. Gotur. Office of the Managing Director: J.A.P. Clément, S. Tiwari. Assistants to Executive Directors: I.C. Ioannou, J. Schaad, S. Sharipova.

1. REPUBLIC OF TAJIKISTAN—1999 ARTICLE IV CONSULTATION; AND POVERTY REDUCTION AND GROWTH FACILITY—SECOND ANNUAL ARRANGEMENT—REVIEW, MODIFICATION, AND WAIVER OF PERFORMANCE CRITERIA

Mr. Cippà and Ms. Sharipova submitted the following statement:

With great symbolism, the year 1999—the 1100th anniversary of the Saminid state, which gave rise to the formation of the Tajik nation—brought a genuine breakthrough in the implementation of the 1997 peace agreement. The Military Protocol was implemented with over 6,200 ex-fighters having been registered and nearly 2,500 integrated into the Tajik Army. In late summer, mutual understanding prevailed over the deadlock on the integration of the United Tajik Opposition (UTO) into the government and the law enforcement agencies. As required under the Peace Agreement, the 30 percent representation of UTO on the ministerial level was completed with appointments of the heads of the Customs, Ministry of Emergency Situations, and the National Oil Company.

The country's constitution was amended in a referendum held on September 26 to allow the free establishment of political parties, including religious ones. The referendum revealed strong support in favor of a secular state as did the November 6 presidential elections, in which President Rakhmonov was re-elected with a large majority of votes.

Despite significant differences in political views and priorities, both the leadership of the country and its formal opposition have been displaying strong willingness to solve differences through dispute settlements, rather than resorting to armed struggle. The final building block of the Peace Agreement will be in place with parliamentary elections in February.

The major progress in the peace process enabled our Tajik authorities to focus on much needed reforms. Despite a very difficult external environment, Tajikistan has made significant strides toward a market economy during the second-year PRGF program. Setting up the institutional and legal framework of a market economy has advanced. Although some reforms moved more slowly than desired, there was remarkable progress in many areas. For example, in the politically sensitive land reform, 45 percent of arable land is now in private hands. Furthermore, small scale enterprise privatization is now virtually complete.

Difficulties in financing the 1999 cotton crop contributed to an economic slowdown in 1999, but GDP growth remained robust. While GDP, spurred by the end of hostilities, grew by 5.3 percent in 1998, it increased 3.7 percent in 1999. In 1998 there was a large cotton-related capital inflow, whereas external financing of the cotton harvest was not possible in 1999. As a result, the use of fertilizers was reduced, which in turn resulted in lower cotton yields, and the grain harvest was also less abundant than the year before.

Macroeconomic performance weakened in summer, but has recovered since. Inflation peaked in July-August, but thereafter the general price level has declined, resulting in 12-month inflation of 31 percent in December. To a great extent, the sudden rise in the price index was a result of temporary supply disturbances and the sharp depreciation of the exchange rate. However, policy slippages also contributed to these developments, as evidenced by the non-observance of some performance criteria in June and September.

Conscious of the urgency of restoring monetary stability and in response to the growing financial imbalances last summer, our authorities implemented strong corrective actions. A short-term policy agenda was formulated with the Fund staff to bring the program back on track and fiscal and monetary policies were tightened.

As to fiscal policy, combined tax collection by the State Tax and State Customs Committees has exceeded the program target and there are now no budgetary wage or pension benefit arrears. Despite pressure from would-be creditors, the authorities have refrained from extending government guarantees. Also, the fiscal deficit for 1999 as a whole was consistent with the program target. Earlier in the year, the National Bank's (NBT) net credit to the government and net domestic assets exceeded the program ceiling and net international reserves declined, but in both these areas the situation greatly improved toward the end of the year.

Our authorities realize that the fiscal adjustment made so far will need to be continued in 2000. They are resolved to keeping monetary policy tight to strengthen the balance of payments and reduce inflation. On the exchange rate policy, the NBT will refrain from intervening in the market except for smoothing the temporary fluctuations in the exchange rate and only to ensure the achievement of the targeted foreign reserve level.

Further, to stay continually abreast of developments and to help prevent short-term slippages such as they occurred last summer, an Economic Monitoring Group was established. This group, comprising key economic decision makers of the country, reports regularly to the President. The Fund resident representative is also part of it as an observer.

Our authorities are fully aware that, in addition to these efforts, sustainability in program implementation will require further progress in strengthening institutional capacity. In this sense the President, on October 22, 1999, issued a decree, centralizing fiscal management in the Ministry of Finance and ordering the closure of all non-bank enterprise accounts at the NBT. Further, the decree explicitly outrules directed NBT lending.

As to the introduction of VAT, tax identification numbers were assigned to large-scale enterprises, as scheduled. Our authorities are grateful for the Fund's technical assistance in this area, which made this progress possible. They are also grateful for assistance in many other important areas, such as in computerization of the tax administration and for setting up a treasury system. A fully operational treasury system will be in place before the end of this year.

Progress in structural reform was uneven. Operational restructuring of the major banks slowed down and large-scale enterprise privatization, in particular of cotton ginneries, ran into difficulties. Despite persistent efforts to privatize the ginneries, our authorities continue to struggle with weak payment collection. For this reason, ginneries have been put up for re-sale repeatedly and the related structural benchmark for end-September could not be met. The President has now set up a high-level working group to analyze the roots of the problem in depth. The working group is expected to review privatization legislation and regulation and submit proposals for improvement.

Despite progress in economic transition and in handling the post-conflict situation, poverty remains pervasive. Our authorities are committed to start preparing a Poverty Reduction Strategy Paper (PRSP) to improve the social safety net and employment opportunities. They count on the assistance of World Bank and Fund staff and other international supporters to develop appropriate policies. An interim PRSP is expected to be completed by end-May 2000 so that the principles of an efficient poverty reduction strategy can be introduced in the context of the prospective third annual PRGF arrangement. A full-fledged PRSP would be completed in early 2001.

To conclude, the situation in Tajikistan is objectively difficult. As explained in the excellent staff report, not all performance criteria could be met. However, there is no doubt about the strong commitment of our authorities to keep the program on track, as evidenced by the introduction of strong corrective measures since September and the implementation of several prior actions, which are described in the Supplementary Memorandum of Economic Policies. We share the staff's opinion that the authorities' efforts fully deserve the continuation of the Fund's financial support. Accordingly, we urge the Board to grant the requested waivers and to support the completion of the first and second review of the second annual arrangement under the PRGF.

Given the constraints in institutional capacity, further intensive technical assistance is highly welcome in several areas, including fiscal management, monetary operations, and the improvement of the legal system. My authorities will continue to closely cooperate with Fund staff and would like to take this opportunity to reiterate their appreciation for the very valuable advise that has been provided during the past difficult years. They are also thankful for now being able to count on the extensive experience of a resident representative in Dushanbe.

In the spirit of transparency and accountability, my authorities are eager to make their policies known to the interested public. They would thus be grateful if the Fund would make the Supplementary Memorandum of Economic Policies available on its internet website.

Mr. Cippà, extending his remarks, said that the Tajik authorities had new information regarding Tajikistan's external debt service. When the authorities had submitted the supplementary memorandum of economic policies on December 1999, they had not been aware of any further obligations to the Commodity Credit Corporation before January 2000. That belief, however, turned out to be based on insufficient information, as external arrears had inadvertently been incurred in 1999. The authorities had explained that the conditions of the Commodity Credit Corporation dating to 1992 and 1993 had not been sufficiently clear on payment deadlines. The corporation's payment schedules and notification of quarterly payments had not arrived in time at the Ministry of Finance because it had been inadvertently sent to the Tajik embassy in Moscow. The authorities had arranged for the settlement of those arrears as soon as they had been made aware of them. To prevent a recurrence of such external arrears in the future, the authorities had established direct contact with the Commodity Credit Corporation through the ministry of finance's external department. Thus, the Board was asked to grant the necessary waiver.

Mr. Shojaeddini made the following statement:

We thank the staff for the well-written reports, especially their analytical approach in presenting the recent economic developments, and Mr. Cippà and Ms. Sharipova for their lucid and helpful statement. The external environment facing Tajikistan during 1999 has been very difficult. Continued terms of trade deterioration and the large reversal of private capital flows severely impacted the economy. The exchange rate depreciated further, inflation soared after price stabilization in 1998, and real GDP growth turned out to be lower than expected. Under these circumstances, strong policy measures were needed to restore economic stability. However, it was in September 1999, after missing some targets in the first and second quarter of the program, that the authorities responded resolutely by implementing tighter fiscal and monetary policies, in order to bring the program back on track. As indicated in the Supplementary Memorandum of Economic Policies (SMEP), their decisive actions have helped strengthen the country's capacity to implement the program on a sustained basis. In this respect, we particularly welcome the establishment of the Economic Program Monitoring Group, which promises to significantly improve early detection of any slippages and provide adequate policy guidance for addressing them. The authorities deserve continued Fund assistance in meeting their economic challenges. We broadly agree with the staff appraisal and support the proposed decision. We encourage the authorities to strengthen their efforts in the fiscal area, in order to pave the way for further assistance under the HIPC Initiative.

We commend the authorities' determination in bringing the level of international reserves close to the original program target for end-December 1999, despite the delays in disbursements from the Fund and the World Bank. Further increase in NIR to eight weeks of imports by end-April 2000 will require tighter-than-envisaged fiscal and monetary policies. However, as the staff point out, the contractionary effect on the economy may prove excessive if the reserve targets are to be met in case of an export revenue shortfall—either owing to lower volume of cotton export, or lower-than-envisaged international market prices. We wonder if it would not be more appropriate to include an adjuster for NIR floors to reduce the risks to economic activity and to better guide the authorities in their policy implementation. The staff may wish to comment.

We welcome the authorities' strong commitment to control spending and enhance revenue collection. The actions and measures specified in paragraph 12 of the SMEP are bold and should help the authorities meet their objectives. It is unfortunate that, in view of spending pressures owing to debt service payments in 2000, capital expenditures are to be reduced substantially. While we commend the authorities for according high priority in cash expenditure to external debt service, wages, and social safety net, we urge them to continue their efforts in improving fiscal institutions and increasing the efficiency of public services. In this respect, we welcome the reform in the Social Security System and the establishment of the full Treasury System in 2000.

Monetary conditions need to be tightened to curtail inflation. Moreover, under a flexible exchange rate regime, with international reserve build-up and a large external debt, the authorities need to strictly adhere to their monetary and credit targets. In the process of meeting the program's monetary targets, financial pressures on the cotton sector will increase. The assurance given by the country's largest cotton export agent and the CSFB—that they would provide new financing in case cotton sector debt repayment proceeded as scheduled—is welcome. Nonetheless, the authorities should remain vigilant against the risk of adverse international price developments and lower-than-expected harvest and exports.

With respect to the financial sector, we wish to underline the importance of bank restructuring and prudential regulation and supervision. In this regard, we urge the authorities to continue with their restructuring program based on recommendations received from the auditors and in consultation with the Fund staff. It is important that the authorities take a strong stance vis-à-vis the large banks in order to demonstrate their seriousness with financial reforms.

Tajikistan has performed well with respect to privatization benchmarks despite the fact that the country that has only recently emerged from domestic conflicts and that it is beset with many structural weaknesses. However, given the administrative weaknesses, caution should be exerted with regard to the large-scale privatization program. As to the ginneries, the authorities should work out a realistic plan with the help of the World Bank to collect full payment by the time of the next review.

Finally, we look forward to a rapid finalization of the authorities' interim PRSP that could provide a framework for policies to reduce poverty and improve social indicators.

Mr. Kiekens made the following statement:

The staff rightly observes that with an estimated per capita income of $330 in 1997, Tajikistan ranks among the poorest countries in the world. According to a poverty survey conducted with technical assistance from the World Bank in 1999, 80 percent of the population lives below the poverty line. Nearly one citizen in six is classified as extremely poor or destitute. The staff provides useful additional documentation on poverty in Tajikistan in pp. 22-23 of the RED paper.

As in so many other poor countries, civil war and poor economic management are the main causes of this dire situation. The cessation of hostilities was therefore a first necessary step toward reversing this trend, and maintaining the peace will be essential. Peace is best secured when it is followed by economic recovery, macroeconomic stability, and sustainable growth. All this requires a strong commitment to adjustment and reform.

The failure to meet half of the program's performance criteria so soon after the Board's approval of the second annual arrangement under the ESAF-supported program and during the approach of the presidential elections is therefore especially disappointing. The fiscal and monetary expansion in July and August 1999, and the rise in the world prices of oil and flour, which are among Tajikistan's major imports, has considerably increased inflation. Bringing the program back on track will require strict adherence to tight fiscal and monetary policies.

Fiscal adjustment should mainly come from improved revenue collection. Revenues now amount to only 12 percent of GDP. The tax and customs administrations must be strengthened, the VAT should be fully implemented, and payment-in-kind of taxes should be permanently eliminated. Spending cannot be cut much further, because the need for public investments in health, education, and the social safety net are all essential for growth. But there is certainly room for making public expenditures more efficient. The authorities' efforts to centralize fiscal management within the Ministry of Finance will be an important step towards this goal. The authorities must avoid wage arrears. This is essential for restoring the public's confidence in the state. It will strengthen popular support for the stabilization and reform efforts.

Tajikistan needs to finance its cotton crop. I would appreciate it if the staff could clarify under what conditions Tajikistan could obtain external private sector financing without exceeding its ability to repay.

In the structural reform area, the authorities should speed up the privatization of medium- and large-scale enterprises. We therefore agree with the authorities' intention not to use arbitrary coefficients in setting the auction starting prices. Transparent auctions should provide the best prices that the authorities can achieve. The government should also focus on enforcing the internal security. Without improving the security, it will be difficult for Tajikistan to attract significant investment from abroad, consequently the government will not be able to achieve its privatization targets.

Tajikistan's heavy external debt burden and severely depressed output represent an extremely difficult economic situation requiring concessional financing. It is of the first importance for Tajikistan to normalize its relations with its creditors. I urge the authorities to fulfill their commitments by timely servicing their official external debt. This is a cornerstone of program credibility.

At the beginning of my statement I observed that Tajikistan is among the poorest countries in the world, facing a high and probably unsustainable external public debt.

The staff observes that the net present value of the country's external public debt amounts to 443 percent of fiscal revenues, well above the 250 percent HIPC Initiative threshold. The staff is right that this high ratio of debt to fiscal revenues ratio is a result of the low revenue to GDP ratio. However, even if fiscal revenues rose to 15 percent of GDP--the minimum required to reach the fiscal definition of sustainability under the HIPC Initiative—the ratio of NPV debt to fiscal revenue would still be 372. This shows that Tajikistan probably qualifies for relief of about one-third of its external public debt.

The staff further observes that the NPV of debt to export receipts is only 83 percent, well below the 150 percent threshold before debt is considered unsustainable using the export criterion. However, the staff's analysis of Tajikistan's capacity to service its debt with export receipts provides an approximate and in fact unsatisfactory answer. Suffice it to observe that Tajikistan not only exports $123 million worth of electricity, but also needs to import $136 million worth of electricity. More than 40 percent of the country's exports amounting to about 30 percent of its GDP is aluminum. However, this requires expensive inputs including of $120 million worth of alumina, and a considerable input of imported electricity. If we ignore Tajikistan's barter cross-border trade in electricity and consider its aluminum exports only in terms of the value added, the country's debt-to-export ratio would approach the unsustainability threshold of the HIPC

Initiative. As I have observed on many other occasions, it is not a country's gross exports but its ability to save more than it invests that enables a country to service its external debt.

These numbers show that the sustainability of Tajikistan's external public debt is questionable to say the least. This raises two specific questions. First, how do Tajikistan's chances of qualifying for assistance under the HIPC Initiative affect its ability to obtain new money from public and private creditors? I observe that the staff assesses the balance-of-payments outlook positively, inter alia because official disbursements are expected to increase sharply. And second, can we be sure that Tajikistan will be able to repay the Fund? I regret that the staff's assessment in paragraph 42 only looks at the size of the debt service payments to the Fund as a basis for concluding that "repayments to the Fund will remain modest relative to export revenue and [that] Tajikistan is expected to meet its future obligations in a timely manner."

Mr. Chairman, the proposal before us is to give a loan to Tajikistan, but I wonder whether in the end it will not turn out to be a grant.

Mr. Le Gal made the following statement:

At the outset, I would like to say that I was glad to read in Mr. Cippà's and Ms. Sharipova's preliminary statement as well as in the report that the peace process is proceeding on schedule and that parliamentary elections, the last building block of the peace agreement, will be held in February. I hope that these developments will help the Tajik authorities to focus on economic management and the fight against poverty.

In 1999, the performance of the program has certainly been affected by external shocks, but weak policies were also part of the picture and this is something that Tajikistan cannot afford any longer.

I share the staff's recommendations and I would like to insist on three structural issues: the role of the Central Bank, budget implementation and privatizations in the cotton sector. I also have a comment on the EU-Tajikistan relationship.

I fully support the staff's call in paragraph 52 for strengthening the independence of the Central Bank. An independent Central Bank with a clear mandate would be more legitimate and in a better position to collect the overdue loans and to enforce a strict implementation of the decree prohibiting directed credits. This is critical not only to fight inflation, but also to confront the nonpayment problems and poor governance of public resources.

Similarly, a resolute implementation of the agreed budget will be critical. In this regard, I welcome the fact that wage and pension arrears have been cleared and I urge the authorities to avoid any - even temporary -

budgetary arrears. In this sense, the completion of the prior actions, particularly the virtually balanced budget in Q4 99 and the submission of the Large Taxpayer Inspectorate law to Parliament, is encouraging. I also associate myself with what Mr. Kiekens said about revenue collection, which actually needs to be increased.

I note that the two continuous structural performance criteria (on directed credit and government arrears) have been breached during last year. While it is reassuring that they are now fulfilled, I urge the authorities to respect them from now on as they are the conditions for good quality and sustainable economic growth.

Turning to the privatization of cotton ginneries, I would like to hear a little bit more about the irregularities the staff refer to in paragraph 55. Transparent and market-based economic discipline is not the only way to attract international financial support, but also the way to make privatization actually work and help strengthen growth.

Having said that, I have one comment about the presentation of financial relations between the EU and Tajikistan. Actually, the expected increase in financial assistance from the EU, which is a multilateral creditor, cannot and should not be seen as a rescheduling, as the title of Box 2 might suggest.

With these comments, I support the proposed decision.

Ms. Kornitch made the following statement:

Over the last year the economic performance of Tajikistan has been seriously compromised by the external crisis. Terms of trade have deteriorated further and there have been serious problems with the external private financing of the cotton sector. Owing to domestic policy slippages the authorities were unable to address promptly the difficulties related to the external shock, and the program went off track last summer. GDP growth has slowed down, national currency has depreciated considerably and inflation has reinforced. Considerable weakening of the balance of payments position has resulted in a substantial loss of the international reserves.

Since that time, the authorities have undertaken efforts to bring the program back on track. Thus, fiscal and monetary policies were tightened and inflation was brought under control. A number of prior actions were implemented to strengthen fiscal and monetary stances and push forward structural reform agenda. However, much needs to be done to fully restore macroeconomic stability and strengthen the external position of the country. We welcome the establishment of the Economic Monitoring Group and believe that it will provide necessary guidance to deal with the problems that persist in the economy. The inclusion of the Fund resident representative in this group as an observer will facilitate the collaboration between the authorities and the Fund.

Now let me make some particular comments on the main policy issues.

The developments on the fiscal front in the first half of the year were not satisfactory. Even given some improvements in tax collection, the authorities were able to keep the deficit at an acceptable level only through accumulating wage and pension arrears, which is highly regrettable. The situation deteriorated further in August, when the tax collection weakened, and the nation's anniversary celebration put additional pressure on the budget. The authorities have undertaken a number of appropriate measures in order to tighten fiscal policy. The results are commendable: tax collection has exceeded the program target and budgetary arrears were eliminated. Further efforts are needed to reinforce fiscal discipline and to strengthen fiscal institutions. Centralization of the fiscal management and consolidation of all budget transactions (including extrabudgetary activity of the budgetary organizations) will contribute to strengthening control over expenditures.

The main objectives of the monetary policy are to reduce inflation and to improve the balance of payments position. Besides measures directed toward tightening the monetary stance, the authorities should intensify their efforts to improve the banking system condition. The central bank should be provided with more independence in determining credit policy to prevent government intervention in credit allocation. Banking restructuring process should be accelerated and measures to improve transparency and discipline in the financial sector should be undertaken without delay.

The authorities should maintain flexible exchange rate regime. The NBT's interventions should be used only to smooth temporary short-term fluctuations or to increase the level of reserves as required in the program. We also share the staff's concern about a large spread between the deposit auction and cash market rates. More clarification from the staff would be appreciated on the issue of informal restrictions and moral suasion in determining the exchange rate.

External debt issue is another area of concern. Major debt indicators are not encouraging. The debt service ratio is projected to increase in the coming years. While Tajikistan has made a noticeable progress in negotiations with its creditors, several discussions have not been finalized. We urge the authorities to intensify their efforts to reach debt rescheduling agreements with the remaining creditors. Given extremely heavy external debt burden, the authorities should try to avoid nonconcessional external borrowing, and their commitment to resist pressures for providing government guarantees on such credits is commendable.

The recent instance of the accumulation of external arrears vis-a-vis to the United States, of which we have been informed this morning, is highly regrettable. As the authorities have cleared these arrears early this year and have taken necessary corrective measures to ensure regular debt service payments, we support the granting of a waiver of non-observance of the performance criterion on external arrears and believe that no similar problems will occur in the future.

In the structural reform area the efforts should be accelerated further. Despite some progress that has already been achieved in some key areas, the irregularities in implementing necessary measures, especially in privatization process, continue to be a matter of concern.

With these remarks we support the proposed decision and wish the authorities every success.

Mr. Alosaimi made the following statement

I am heartened by the improvement that Mr. Cippa and Ms. Sharipova report on the prospects for lasting peace in Tajikistan. Meanwhile, however, the economy is facing increasing difficulties. Growth was down and inflation increased last year, owing to terms of trade losses and policy slippages. Against this background, the authorities' evident proactive stance on adjustment and resolve is welcome. I broadly agree with the staff appraisal.

I share the consensus on the need to restore macroeconomic stability. The authorities deserve credit for the sizeable fiscal correction that led to a near achievement of the targeted budget balance in the final quarter of 1999. The increase in revenue collection and the improved management of spending are welcome. Prospects of further fiscal improvements are reassuring. I welcome the authorities' commitment to avoid domestic bank financing of the budget, shift taxes from production to consumption, and further reform public expenditures.

The fiscal strengthening late last year was accompanied by a tightening of monetary policy. This has helped to both reduce inflation and restore the authorities' policy credibility. A well-functioning intermediation process is critical for market-led growth. I urge a speed-up in the financial sector reform and restructuring, aggressive collection of overdue bank loans, and effective implementation of the prohibition of directed credits from the central bank. Maintaining a tight policy stance is critical for achieving the international reserve target.

I recognize the authorities' need to accelerate the privatization process. This is inseparable from the broader problems of the country's transition to a market economy, where timely honoring of contracts is critical. I agree with Mr. Cippà and Ms. Sharipova on the importance of intensive technical assistance in key areas, including fiscal and monetary management, and the improvement of the legal system. Given the significant progress already made in the transition to a market economy, and in view of the country's difficult circumstances, Tajikistan's adjustment and reform efforts deserve continued international support. I therefore support the decision to grant the requested waiver to complete the first and the second reviews under the PRGF arrangement and look forward to the authorities' interim PRSP.

With these remarks, I wish the authorities further success.

Mr. Sdralevich made the following statement:

Let me express at the outset our appreciation for the work of the staff in this difficult program, as well as for the authorities' efforts, especially valuable in the aftermath of the civil war.

However, we regret that the program has gone off-track partly because of insufficient efforts on the part of the authorities in the run-up to the presidential elections.

It is unfortunate that it is not yet possible to evaluate fully the effects of the corrective measures taken by the authorities. A more thorough assessment of overall program performance will have to be conducted in the next review. We would appreciate at any rate a brief update on the economic and policy situation from the staff.

It is particularly important at this time to avoid further slippages in occasion of the upcoming parliamentary elections. In the longer run, however, the country must address its fundamental problems.

First of all, as Mr. Milleron has forcefully remarked, Tajikistan suffers from widespread and deep poverty, the reduction of which must be an overriding objective for the authorities. We therefore welcome the steps toward the preparation of the Poverty Reduction Strategy Paper.

The elimination of poverty relies on solid economic performance, and this leads me to the second point. Privatizations and structural reform can go a long way to improving productivity and to making the main sectors attractive to foreign capital inflows. We believe that this can be a determining factor to overcome the external financing and investment constraints. It is thus essential that the privatization process in the cotton sector be brought to completion.

Third, as it has been previously noted by the Board, the economic structure inherited from the past is far from optimal given the to excessive specialization and vulnerability to external shocks. We urge the authorities to work towards a fully flexible exchange rate regime to dampen fluctuations in the terms of trade.

Fourth, the banking sector reform must be carried on to address the exceptional degree of demagnetization of the economy as well as barter and arrears. A reasonably efficient financial sector can mobilize savings for the seasonal financing of the agricultural sector and could be conducive in the future to some degree of diversification of the economy.

Lastly, we encourage the authorities to proceed in the rationalization of the public administration and in particular of the fiscal administration. In this regard, we would like to know from the staff how the centralization of fiscal management in the Ministry of Finance is proceeding.

With these remarks we support the waiver requests and the review completion and wish the authorities success in their difficult endeavors.

Ms. Perez Dos Santos made the following statement

The success of the Fund program is vital in light of Tajikistan's extremely difficult situation. It is hoped that the program can restore a basic level of confidence to allow for sustainable growth in this country, after so many years of decline and civil conflict. We regret the nonobservance of the performance criteria, however. We take note of the authorities' commitment to bring the program back on track, and welcome the introduction of corrective measures since September 1999. The authorities must maintain the momentum of adjustment in order to regain credibility and public confidence. We therefore support the authorities' request for a waiver and the completion of the first and second reviews under the second year PRGF arrangement.

The return of economic growth, and especially the marked decrease in inflation, are remarkable. The external policy has been broadly liberal. The fact that the 1997 peace agreement has held thus far leads us to be cautiously optimistic about the country's political stability. On the other hand, Tajikistan remains at an early stage of transition, and the ability of the state to collect taxes continues to be weak. In addition, international reserves have declined to an alarming level, considering the debt payment obligations in the near future.

We concur with the staff that the only way to avoid a debt crisis is through the adoption of a strict adjustment program. The success of the program depends on the restoration of confidence and the return of flight capital. While this may make the country more vulnerable, we see no alternative.

The fiscal deficit target for 2000 seems ambitious and will prove difficult to meet, given the slow improvements in tax collection. We assume that it will not be monetized, as it should be covered by multilateral and bilateral financing inflows, as well as domestic borrowing and privatization receipts. In 1999, budget revenue amounted to only 12.6 percent of GDP. It is regrettable to see how the lack of revenue limits the government's ability to allocate adequate resources to repair infrastructure, promote an environment which attracts foreign investment, and provide a social safety net.

Export revenues might benefit from the positive effects of large scale privatization, including the successful sale of majority shares in most of the country's cotton ginning plants. The reform of the cotton sector will reap important benefits in terms of improved tax collection and export earnings. Bearing in mind that less than one third of recorded GDP is generated in the private sector, we urge the authorities to press for the privatization of medium and large state-owned enterprises.

It is encouraging that the major state owned banks are in the process of being restructured and recapitalized in a bid to attract foreign investors. We commend the new prudential regulations and the increased minimum capital requirements, and urge the authorities to crack down further on failing banks. This will signal a firm commitment to financial reforms. At the same time, the government should be vigilant in reducing payment arrears and barter trade, as well as liquidating loss-making enterprises.

We welcome the legislation aimed at combating economic crime and corruption in Tajikistan. About 80 percent of the population is estimated to be below the poverty level, and GDP per head is less than in all of the other former Soviet republics. Thus, the government's announcement of salary increases for state employees in 2000 is welcome. The authorities' commitment to start preparing an interim poverty reduction strategy paper to improve the social safety net and employment opportunities is also appropriate.

We wish the authorities success in their challenging economic endeavors.

Ms. Kandil made the following statement

Tajikistan has faced considerable difficulties associated in part with external shocks and compounded by weak domestic policy performance, resulting in a sharp deterioration in economic conditions and missed performance criteria. While we are encouraged by the recent signs of improvement in macroeconomic performance to put the program back on track, we encourage the authorities to adopt a medium-term strategy to address the deep-rooted problems on a sustained basis. The impact of the Russian crisis, the continuing deterioration in the terms of trade, and the substantial outflow of private capital in 1999 have revealed Tajikistan's vulnerability to external shocks, resulting in a significant depreciation of the nominal exchange rate. Policy measures must be geared toward restoring an adequate level of international reserves, in view of the country's high debt service obligations and the projected risk of lower exports in the coming years.

We welcome the authorities' plan to tighten monetary policy, while pursuing an aggressive collection of overdue loans from the cotton sector, banks, and other domestic borrowers. Equally important is the central bank's commitment to a flexible exchange rate policy in order to strengthen the balance of payments and reduce inflation, which is now expected to be significantly higher in 1999 than envisaged under the program. By end-August 1999, the fiscal deficit had already exceeded the level set for end-September, as tax collection weakened and spending pressures increased, owing to the presidential election and the completion of several capital projects. The short-term policy response centered around measures for a tighter fiscal stance. Nonetheless, a more durable program to strengthen public finances, with supporting institution reforms, remains necessary.

We welcome the authorities' commitment to strictly enforce the presidential decree centralizing fiscal management within the Ministry of Finance and establishing an audit mechanism for all extrabudgetary foreign exchange accounts. Tax revenue is conservatively projected at 12.2 percent of GDP. As many speakers have already noted, revenue-enhancing measures are necessary in order to cope with the projected increase in social expenditures. In this respect, we welcome the government's plan to strengthen tax and customs administration, with a view to achieving greater transparency and efficiency. Tajikistan's stabilization record highlights the country's structural weaknesses, particularly in the financial sector. We urge the authorities to ensure that banks comply with prudential regulation.

We welcome specific measures aimed at privatizing medium- and large-scale enterprises. Delays in that area have hampered Tajikistan's ability to secure timely disbursement from the World Bank, and may endanger other needed financial support from the international community. We are encouraged by Tajikistan's track record of corrective actions in the latter part of 1999, and wish the authorities success in maintaining a sustainable pace of reform.

How does the staff view the planned cuts in capital expenditures in the budget in 2000, in light of the concerns about its effects on the economy's ability to sustain long term growth?

Mr. Chelsky made the following statement

Let me thank Mr. Cippà and Ms. Sharipova for a useful preliminary statement. I particularly appreciate the political context in which they situate the reform efforts. It is well reflected in the range of participants in the consultation mission.

I am troubled by certain aspects of the decision, as well as by the fact that I seem to be the only one who has a problem with it. Given the nature of the slippages and the challenges ahead, I would have thought that a rephasing of program disbursements would be more appropriate. Given the prevalence of problems with fiscal management and the transparency shortcomings of privatization directly related to implementation capacity, it would seem appropriate to take the missed disbursements and rephase them so as to backload them. At the same time, the authorities could take advantage of fairly aggressive technical assistance to help improve their institutional capacity. I do not know if the authorities are particularly well served if we do not phase disbursements, when institutional capacity appears to be such a constraint to effective implementation.

I also find troubling the staff's assertion that there is no room for further policy slippages. Usually, there is somewhat of a buffer in programs. Particularly where implementation capacity is so weak, it seems overly optimistic to have a program that has no room for further slippages. The strategy especially relies on the recovery of overdue loans by the central bank from the cotton sector, quasi-fiscal borrowers, and banks, which is perhaps an unrealistic expectation.

Nevertheless, we are willing to, with hesitancy, support the decision. It is commendable that the authorities continue to resist pressure for government guarantees on external commercial loans. At least one of the countries in this constituency did not resist that pressure in the past and has been paying for it for some time, so there are a lot of lessons to be learned. My sense is also that Tajikistan's remedial actions were undertaken in such way that the fiscal slippages were not related to the presidential election. If that is the case, it is something that needs to be acknowledged and rewarded. Nevertheless, if we find ourselves in a similar situation in the future with significant slippages, instead of making all disbursements, we should consider looking at phasing, which is more consistent with implementation capacity. That does not reflect a concern with the authorities' commitment, but with their ability.

The staff representative from the European II Department said that the irregularities in the privatization process were related mainly to the pricing mechanism and the transparency of the system. For example, the last two ginnery auctions had been conducted with the commitment that no reserve price would be set. Nevertheless, the prices had been set by the authorities to levels, which, according to many specialists, were higher than the true value of at least some of those ginneries. Some potential foreign investors had also been discouraged by the fact that many bids for the ginneries and large and medium size enterprises had been rejected without full explanations, as well as because of irregularities in the bidding process. On the EU loan, it should not be considered a rescheduling, but rather a new loan for macroeconomic assistance, which should not have been included in the staff report's box on debt rescheduling.

The interest rate spread between the deposit market and the cash market was a result of informal restrictions and moral suasion, although the staff and the technical assistance missions had not been able to detect any formal restrictions, the staff representative noted. There could be some informal mechanism that had contributed to the high spread, and restricted the availability of central bank cash to the banks that had been participating in the deposit market. There were also some indications that the tax authorities and power ministries had been actively collecting information about the financial situation of the participants in the deposit market, which had driven some participants to operate in the cash market. That had increased demand for cash and caused the spread to rise.

The staff could not prove whether there was any moral suasion in determining the exchange rate, the staff representative continued. The fact that the country was small, with few participants, had allowed the participants and central bank to discuss the exchange rate in an informal way. However, it had been difficult to be specific. The next Monetary and Exchange Affairs Department (MAE) mission at the beginning of March 2000 would again review the exchange rate mechanism, as well as the credit auction market, where a similar informal phenomenon might exist.

Strengthening the Ministry of Finance and its role in fiscal planning was dependent on progress in establishing the treasury system, the staff representative remarked. The Memorandum of Economic Policies included the specific steps taken recently to improve the execution of the budget. There had been a change in the finance ministry, including a new Minister of Finance, and further concrete steps in that area would be discussed in the February mission.

The decline in capital expenditures in the 2000 budget was a result of two issues, the staff representative reported. First, the program had gone off track in the middle of 1999 because of high capital expenditures related to the country's anniversary celebrations. The decline therefore represented a return to a more normal level. Second, those numbers did not reflect the increase in investment related to additional foreign financing. A consultative group meeting had been planned for the fall, and there was some possibility that project financing would increase public investment, although that had not been reflected in numbers.

On the current economic situation, inflation had been negative, about 5 percent in November-December 1999 cumulatively, the staff representative said. On cotton exports, there had been some problems in January owing to the cold weather, which had halted shipments, but those had reportedly recovered. The central bank data so far indicated that the program targets for end-January 1999 were feasible.

The availability of foreign financing in the coming years was expected to improve as the political risk declined, although the economic risks including due to a high debt burden were becoming more pronounced, the staff representative remarked. Given the uncertain prospect, the major financing so far had come from the World Bank and the Fund. The high debt burden had been known for some time, but debt service burden was increasing. The completion of the peace process could help foreign financing, and the staff was looking into the willingness of foreigners to refinance next year's cotton harvest. The staff had decided to first address the fiscal revenue issue prior to the next round of debt rescheduling, because there seemed to be room for improvement. Some debt relief had taken place in the previous round. For example, debt to Russia had been reduced to half of what it had been three years ago.

The staff representative from the Policy Development and Review Department said that the debt data included in Table 46 of the background paper did not reflect the full use of traditional debt relief mechanisms, i.e. those available on Naples terms. Therefore, the numbers were not comparable with those for countries which had already made use of such mechanisms. If necessary, Tajikistan could approach its bilateral creditors for debt relief of the type that they had received from Russia. Those, however, were not members of the Paris Club at the moment: if, after the full use of traditional, Paris Club-type, debt relief mechanisms, the country's debt was judged to be unsustainable, nothing a priori could prevent access to the HIPC Initiative from being considered, assuming that the necessary criteria had been met. The Fund was extending a loan to Tajikistan, but it was the case that, under the HIPC Initiative framework, outstanding debt to official creditors, at a possible future decision point, would noticeably be eligible for relief under the HIPC Initiative. In the meantime, the environment remained difficult, and the lending community would have to exercise prudence in defining the terms of any future financial support to the country.

On whether other creditors might be concerned over extending concessional assistance to Tajikistan because they might run the risk of being "caught" by the HIPC Initiative, the staff representative remarked that that was the general proposition for all HIPC Initiative countries. The international community was certainly aware that, to a degree, the HIPC Initiative could raise some moral hazards in terms of countries' access to concessional lending by official creditors. This was why the focus had to remain on the underlying policies that were being supported by multilateral and bilateral lenders.

Mr. Kiekens made the following statement

> It is obvious that the HIPC Initiative raises enormous moral hazard problems. As long as it is not crystal clear whether Tajikistan will apply for the Initiative, any well-informed creditor will be reluctant to give it new credit. Thus, it is urgent that all HIPC Initiative countries make it clear whether they plan to apply, in order to establish normal relations with new creditors. This may not come up soon for Tajikistan, so there will be a period during which it will be difficult for the country to find new credit. A second moral hazard problem is that the more fiscal revenues Tajikistan raises, the lower the debt relief will be. It will be hard for us to convince the Tajik authorities to increase fiscal revenues when that will mean they have smaller debt relief from the Fund and the other bilateral or multilateral creditors. Third, there are few creditors that can give Tajikistan debt relief. The only meaningful creditors are the Fund and the World Bank. It remains to be seen whether the application of the Naples terms could bring Tajikistan closer to sustainable debt. It would be useful to make some calculations to see where Tajikistan would come out, allowing new creditors to know what they are doing when they extend credit or grants. Finally, it would be good to know if the external viability of Tajikistan is as projected by the staff. Currently, 40 percent of Tajikistan's exports are aluminum, which is expected to increase to 45 percent next year. I wonder whether this is realistic, given the slump in aluminum prices, the inefficiency of the aluminum plants, and the extreme high energy consumption of aluminum production in Tajikistan. External

> reports make clear that the factories in Tajikistan are highly damaging to the environment, which raises the danger that this major export production will fall apart or cease to be available, which in turn raises the question of debt sustainability. The projections are highly speculative.

Mr. Chelsky considered referring to the moral hazard in Tajikistan as an enormous problem an overstatement. It was clear that the private sector was not eager to lend money to the country. Even if it was, Tajikistan might not necessarily need commercial financing but short term trade financing, for instance in the cotton sector. That kind of lending would be drawn in and paid back over a time frame when there was little possibility of reaching a decision point, particularly as Tajikistan had not taken full advantage of existing mechanisms.

The disincentive to raise revenue should not be given too much credence either, Mr. Chelsky continued. It would be unrealistic to think that the authorities' only objective in economic policy was maximizing debt relief. The type of reforms necessary to raise the revenue ratio were ongoing ones that would reverberate through the entire economic framework. The authorities' sole objective might not be debt relief, which would seem inconsistent with the responsible approach that they had taken. The reason for the minimum threshold on fiscal criteria, nonetheless, was to make sure that it did not generate such a disincentive.

Mr. Yakusha said that Mr. Chelsky might not be entirely correct with respect to the character of cotton financing. Given the country's political and economic risks, was it feasible to finance the cotton production without recourse to external financing of inputs guaranteed by the government, which in turn would increase the public debt and all of the already questionable ratios?

The staff representative from the European II Department said that cotton financing did involve prefinancing. The inputs at the time of the planting season, including fertilizers and fuel, were financed, but thereafter the cotton harvest was collateralized against that loan. The loan would be repaid when the shipment left the country, and the balance in the credit risk would thus drop.

Mrs. Fernandez made the following statement:

> Last July, at the time of the approval of the authorities' request for the Second Annual Arrangement under the now denominated PRGF, this chair commended the authorities for their efforts to overcome the severe economic consequences derived from: (i) a long civil conflict; (ii) a difficult peace process; and (iii) two hard external shocks—the fall in world commodity prices and the financial crisis in Russia—that had dramatically widened the country's fiscal and current account disequilibria and lowered its international reserves to poor levels. To support these efforts and start restoring the basis for a sustainable economic growth, we recognized the merits of the authorities and the staff's hard work to design a comprehensive and well balanced

macroeconomic program, whose successful completion was going to require from the authorities a strong commitment.

This being said, we emphasized that we found it comprehensible than in the wake of a severe deterioration of the external environment the chances of setbacks in a program implementation could make necessary the introduction of adjustments in the program targets; however, when the lack of compliance was owing to domestic policy slippages, that is more difficult to understand.

Today, these same observations have to be repeated. It is most regrettable that soon after this Second Annual Arrangement had been approved, the hit of external factors, but also domestic policy slippages from the program's fiscal and monetary targets, had made the program go markedly off track, making it impossible to proceed with its first and second reviews.

As stated by the staff, the authorities have reacted decisively to bring the program back on track undertaking most needed corrective measures and accomplishing (or being well on the way to accomplish) most prior actions that had been established to enable the completion of the pending reviews. It is on this basis and on the authorities' expressed commitment to enhance the incipient stability gains that have already been attained by the fiscal and monetary tightening implemented since September, that we share the view that the Tajik authorities deserve the continued support of the Fund.

As I agree with the thrust of the staff appraisal, I will just limit myself to a few brief comments for emphasis.

With regards to fiscal policy, I am glad to note the fact that the practically balanced budget registered in the fourth quarter had been achieved through an improvement in revenue collection, a step forward that the authorities are correctly committed to continue pursuing through the strengthening of the tax and customs administration, the implementation of the Large Taxpayers Directorate, and the VAT reforms. Moreover, taking into consideration the country's high external debt burden, I would like to encourage the authorities to keep reinforcing their efforts to enhance tax accrual so as to be able to surmount a low 12 percent in terms of GDP that might impede a possible eligibility for the HIPC Initiative.

The process of fiscal consolidation that will have to continue this year will need to rely not only on tax revenues, but also in the privatization proceeds. In this respect, and notwithstanding the progress already made by the authorities in the privatization agenda, the fact that the ginnery privatization process is advancing at a slower pace than expected poses an important problem. Taking into account the constraints already imposed on the spending side, it is of the utmost importance that the authorities, in full collaboration with the World Bank, find a way to collect full payment of all ginneries included in the program, thus accomplishing as soon as possible one prior action that is still to be attained.

With respect to expenditure, I most welcome the authorities' determination and steps already undertaken to improve fiscal institutions and governance; to rationalize the wage bill; and, in light of the high level of poverty, to increase expenditure in the social safety net. More precisely, with regards to poverty alleviation I am glad to learn that the authorities intend to have an Interim PRSP in May. In the same vein, like Mr. Shojaeddini, I find it unfortunate that capital spending had to be reduced substantially, but hope that the decisive implementation of the program may lead to start establishing the basis for the most needed credibility in the economy's potential.

In relation to the structural reform agenda, I will just refer myself to the bank restructuring to stress the importance of continuing the process of liquidation of those non-viable banks, and making those which are viable to comply with prudential regulations. Besides, making banks pay their overdue loans is something that has to be fully undertaken as it constitutes a key element of the tight monetary program.

Finally, Mr. Chairman, I would like encourage the authorities to strictly comply with the economic program leaving no room for slippages, as it will be the only way to succeed in the difficult route towards internal and external viability.

With these remarks, this chair supports the completion of the first and second review of the Second Annual PRGF and the request waiver of performance criteria, on the understanding that the actions already undertaken will ensure the regular service of external debt; and wishes the Tajik authorities all the best in their endeavors.

Mr. Schollmeier made the following statement:

Tajikistan has been facing a challenging economic situation in 1999. The already difficult external environment has been worsened by a weak policy performance, contributing to an acceleration of inflation and a further depreciation and finally lead to the non-observance of performance-criteria for end-June and end-September.

We can go along with the staff's analysis and recommendations. I will confine my remarks to a few important points:

First, fiscal consolidation is one of the key issues to support price stability and to enhance confidence in the exchange rate. As total public debt—around 75 percent of GDP—as well as debt service is already on the high side, fiscal consolidation measures are of utmost importance. Compared to other countries, tax revenue in relation to GDP (12 percent) is low and even in the revised program for 2000 (Tab 3) tax revenue remains at nearly the same level. The collection of indirect taxes is still low. However, with the new tax code, Tajikistan has already started to improve its tax system. We welcome the agreed measures to improve the efficiency of fiscal administration.

Secondly, we encourage the authorities to strengthen the independence of the central bank in order to prevent undue government influence in monetary policy. It would appear advisable to anchor the independence of the central bank in a more comprehensive way rather than through isolated decrees. The development and refinement of tools for monetary policy seem necessary to improve efficiency of the central bank.

Thirdly, although substantial progress in privatization has been achieved, payments for the privatization have not been completed. Irregularities and a lack of transparency have affected the sale of large entities. This problem should be tackled as soon as possible to strongly demonstrate the commitment to market-based reforms and restoring confidence of international investors.

Fourthly, macroeconomic stabilization, supported by the PRGF-program, should enable the country to improve the standard of living over the medium term. According to the EBRD Transition Report, income per capita in Tajikistan is one of the lowest in the CIS. Better growth perspectives are of utmost importance in order to improve standards of living and to strengthen the social security system.

Let me turn now to the final point: Regrettably, it was not possible to fulfill all prior actions. However, as the deviations are small and—at least partly of a technical nature—and as the authorities have taken decisive steps to return to the adjustment path, we can support the requested waiver and the completion of the first and second reviews under the second-year PRGF-arrangement. We trust that the authorities are well aware of the demanding and urgent task of strong policy implementation. Given the difficult economic situation, there is no room for any further policy slippages.

Ms. Brukoff made the following statement:

The staff's continued efforts in this challenging environment are commendable. Likewise, the continued progress by the authorities toward implementation of the 1997 Peace Agreement has been impressive. As this chair supports the proposed decision and request for waiver of performance criteria, and as most of the points we raised during our discussion last July remain valid, I will be brief.

The authorities' moves to tighten fiscal and monetary policy in the fourth quarter of 1999 were welcome after weak policy performance during early- to mid-1999. While we recognize the importance that Tajikistan attached to last year's anniversary observance, this episode points to the continued need for more rigorous prioritization of expenditures given the country's limited resources and high level of poverty.

Clearly, the track record of maintaining a tight fiscal stance during the fourth quarter of last year will now have to be extended into ongoing strong policy implementation in 2000 and beyond, particularly in light of the country's high public debt burden.

In this context, we regret the government's recent failure to make a payment to the U.S. Commodity Credit Corporation on time. We hope that the newly created debt management system in the Ministry of Finance will begin to systematize the government's tracking of its external obligations, and urge the authorities to stay current on their debt service payments to both official and private creditors.

Finally, I would like to associate myself with the comments made by Mr. Chelsky with regard to the need for efforts aimed at strengthening institutional capacity.

Mr. Munthali made the following statement:

We concur that the Tajik authorities experienced serious difficulties in implementing their economic adjustment and reform program, as evidenced non-observance of a number of quantitative performance criteria and structural benchmarks for end-June and end-September test dates. In part, this reflected the continued deterioration in the terms of trade and the withdrawal of private capital in support of the cotton sector which in turn severely constrained economic activity. Being in the midst of an election year, pressure on the budget intensified, resulting in weakening of fiscal performance.

However, we commend the authorities for recognizing the need for firmer and sustained corrective action to bring the program back on track and to ensure early restoration of macroeconomic stability as key for the country's long-term growth. Mr. Chairman, we are in broad agreement with the staff appraisal and can support the proposed decision, including the request for waivers. We believe that there are firm indications that the measures taken as prior actions as outlined in the supplements have brought the process of economic adjustment back on its course.

As a general remark, we commend the authorities and the staff for including certain important features that reflect the peculiar circumstances in Tajikistan. For example, there is a strong input of technical assistance in key areas, recognizing the apparent weakness in institutional capacity which has been highlighted by many previous speakers including Mr. Chelsky. In our view, the particular areas in which this assistance has been provided would enhance the prospects for success of the program. We would, therefore, support the authorities' desire for sustained Fund technical support, especially in their efforts to strengthen fiscal revenues. Another pertinent example where the program has been formulated to take into account local conditions is the inclusion in the 2000 budget of a special compensation scheme for the poor segments of the population to protect them from the prospective increase in electricity tariffs. This kind of accommodation, although only temporary, would strengthen the hand of authorities in mustering the necessary political consensus for continued economic adjustment and reform.

We have only a few specific comments for emphasis. First, on fiscal policy we agree with the need to bring government expenditure under strict control and ensuring a balanced budget. However, we would like to know if the staff has information as to whether or not it became necessary to cut spending on construction, transportation, agribusiness and other capital programs in order to meet the balanced budget requirement in the fourth quarter of 1999. The point we would like to make here is that such expenditure cuts would be unfortunate, given that these outlays may be important in securing future growth prospects as emphasized some previous speakers. Second, tax revenue in relation to GDP, estimated at 12.2 percent in the 2000 budget remains low and despite the prospective improvement in performance amounting to 0.4 percent resulting from the measures being implemented. Perhaps the staff could elaborate on the reduced yield in sales taxes that would offset the projected increase.

Third, we commend the staff for working closely with the staff of the World Bank in areas of poverty reduction and the related reforms of the social safety net. In particular, we note that the staff were involved in the poverty survey analysis. As such exercises are likely to take place with greater frequency, we were curious to know what was nature of the staff involvement in this particular instance, given that the staff normally focuses on macroeconomic issues and analysis.

Finally, we note that Tajikistan's external debt is high relative to its fiscal revenue even if efforts were to be stepped up to achieve a revenue to GDP ratio of 15 percent. Under these circumstances, I wonder whether or not the proposed further rescheduling would bring external debt servicing within a range that would free substantial government resources for a more effective program for poverty reduction. Like others, we would urge the authorities to proceed with the preparation of the PRSP.

Mr. Yakusha made the following statement

I thank the staff for the candid and comprehensive report. One of its important features is that external shocks are to be blamed, at least partly, for the deterioration of economic conditions in Tajikistan. Policy slippages also played a role, but the staff was absolutely correct to have favored a rapid rather than gradual return to macroeconomic stability. At the same time, the staff may have not adequately addressed potential remedies to the causes of Tajikistan' deterioration in the terms of trade, and I am not entirely confident that everything has been done to limit the country's exposure. As opposed to back-loading, this could be a case for compensatory financing augmentation, to the extent that the initial program assumptions were not in place, which we learned early in the process. The full cooperation of the authorities was necessary; adjustment was secured only with some delay. But we feel that the program from the beginning was not realistic, with inflated prices for imports and unfavorable prices for exports.

We would like to note the authorities' willingness to cut expenditures in case revenues do not materialize, as we are not optimistic about projections for cotton sales taxes in 2000. However, those expenditure cuts need to be exercised in an orderly manner, not just through arrears.

The staff representative from the European II Department said that the uncertainties related to the external sector, in particular the cotton tax revenues and the viability of the balance of payments, were a good example of the difficulty of forecasting in a country with two major export commodities with huge variations in prices. Preliminary information on the overall production of aluminum exports for 1999 showed that revenue was more than $300 million, compared with the $280 million forecast. That was because prices during the previous four or five months, increased from $1,000 per ton to $1,650 per ton. The same could happen at some point for cotton, which had continuously declined in price. In the previous two weeks, cotton prices had risen from 45 cents per pound to 51 cents per pound, although it was uncertain whether that increase would continue.

Mr. Shojaeddini asked the staff whether it would be more appropriate to include an adjustor for the NIR floor.

The staff representative from the European II Department explained that there was already one adjustor for unforeseen shortfalls of net external financing for the central bank's NDA and NIR. Adding more adjustors would make it harder for the authorities to understand what the target was. If there were an adjustor for the export revenue shortfall, given the price volatility of the major export products, it would be difficult to determine whether the shock would be temporary or permanent, which would require a different treatment. As there was a quarterly review process, manual steering was better than automatic steering.

Mr. Cippà made the following concluding statement:

On behalf of my Tajik authorities I would like to express the sincere gratitude to my colleges for today's interesting discussion, for your understanding of the situation in which they are called to deliver and for your support. Let me also thank Mr. Saavalainen for the detailed answers to your questions.

At the least, we can say that Tajikistan is implementing its reform program in a very difficult environment. But despite that, substantial economic growth as well as relatively moderate inflation had been maintained. There is also no doubt that significant strides toward a market economy were further made during the second year of the PRGF program. Although some reforms moved more slowly than desired, there was remarkable progress in many areas, as some of you have pointed out. And what matters most, the commitment of my Tajik authorities remains as strong as ever.

My authorities are very conscious of the fact that much remains to be done, and that the recent gains in macroeconomic stability need to be preserved to ensure sustainability in the economic development. In particular, they are resolved to keep up the strong effort to strengthen fiscal discipline also for the year 2000 and to keep monetary policy tight, so as to strengthen the balance of payments and further reduce inflation. An adequate monitoring of monetary and fiscal policies is essential to avoid slippages like the ones that occurred last summer. That is the reason why they recently established an Economic Program Monitoring Group with the participation of the Fund resident representative as an observer. My authorities also realize the importance of further strengthening the institutional capacity for the reform effort that eventually will translate into macroeconomic accomplishments.

Before concluding, three short observations:

The prior action concerning privatization of ginneries was missed again, although not because of the lack of effort on the part of my authorities. As stated in the preliminary supplement, in view of the authorities' recent efforts and the difficulties in collecting full payments from local investors, the World Bank has agreed to extend the closing date of the SAC and thereby the relevant conditionality for the collection of full payments for privatized ginneries. To address this situation, the President has now set up a high level working group to analyze the roots of the problem in depth. My authorities will review privatization legislation and regulations and submit proposals for possible improvement. At the same time, doubts remain about the realism of the conditions that were set in this matter. I believe it is time for the World Bank and the Fund to revisit this important issue with an open mind, and if required to draw the necessary conclusions.

The second observation is just to stress a point raised by many of you, i.e. that, despite progress in economic transition and in handling the post-conflict situation, poverty remains pervasive. My authorities welcome the new focus of Fund's activity and the increased importance attached to poverty reduction. They are committed to start preparing a Poverty Reduction Strategy Paper to improve the social safety net and employment opportunities. In this endeavor in defining the framework and developing the appropriate policies, they count on the assistance of the World Bank, the Fund and other international supporter.

And third, on a point raised by Mr. Kiekens, I think that the possibility of Tajikistan to receive debt relief through the HIPC Initiative should be seriously analyzed. I take note of the answers by Messrs. Saavalainen and Brachet, and I broadly share their assessment. Mr. Chairman, you rightly emphasized that the HIPC Initiative issue is a process. But this also means that during this process, things can evolve, and, as said by the staff, many risks about future developments in Tajikistan remain. The bottom line is that Tajikistan is a poor and increasingly indebted country. Therefore, it is important that the Fund keeps an open mind as regards to a possible participation in the future of Tajikistan to the HIPC Initiative, and this very much in line with the great flexibility that we have shown in applying this initiative to other countries.

Let me conclude by thanking again management and the Executive board for continuously granting the financial support to reforms in Tajikistan and for the very valuable technical assistance. I thank management for positively responding to my authorities request for a resident representative. This can only improve the already excellent cooperation existing between my authorities and the staff, a cooperation that has been formed over the years and that is largely the result of the professionalism and competence of Mr. Saavalainen and his team.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They noted that the difficult external environment—in particular the deterioration of the terms of trade and a large reversal of private capital inflows associated with the cotton sector's financing—had placed a severe constraint on domestic economic activity in 1999. In addition, significant slippages in policy implementation had weakened Tajikistan's macroeconomic performance. As a result, inflation had accelerated and economic growth slowed. Directors concurred, however, that the authorities deserved credit for having taken strong corrective actions to bring the program back on track. Tight fiscal and monetary policies implemented as last September had restored price stability, strengthened the balance of payments, and improved confidence in the economy. Directors also welcomed the major progress in the peace process, which had facilitated the strengthening of economic policies and reforms.

Directors stressed that the policy adjustment needed to be continued in the period ahead to ensure macroeconomic stability and further strengthen the external position. They supported the envisaged reduction of the fiscal deficit in 2000 and urged the authorities to maintain the recent strong performance in revenue collection by fully implementing the VAT reform and further improving tax and customs administration. Public expenditure reform was also seen as essential to achieving the fiscal adjustment goal. In this context, pointing to the high level of poverty, Directors welcomed the recent poverty survey and the authorities' intention to amend the social safety net accordingly, as well as their early commitment to developing a strategy for sustained poverty reduction. Directors viewed the deficit overrun of the summer of 1999 as clear proof that fiscal institutions, especially the Ministry of Finance and the treasury system, needed to be strengthened to improve expenditure control and enhance transparency in fiscal operations. They stressed the importance of avoiding the buildup of public domestic arrears, which could also help strengthen confidence in government policies.

Directors observed that the prudent monetary policy stance and maintenance of a flexible exchange rate had preserved Tajikistan's external competitiveness and facilitated the adjustment of the balance of payments in 1999. The continuation of a tight credit policy, including timely loan recovery, would help enhance the credibility of stabilization policies and contribute to the required strengthening of financial discipline in the banking system. To prevent the reoccurrence of quasi-fiscal operations, however, it remained imperative to increase further the independence of the central bank. In this connection, Directors welcomed the abolition of directed lending by the central bank.

Directors stressed the importance of maintaining a liberal trade and exchange system in order to ensure a competitive domestic market structure. They welcomed the authorities' application for WTO membership. Directors noted the progress made recently in debt rescheduling negotiations but, in view of Tajikistan's heavy debt-service obligations, they urged the authorities to be persistent in their efforts to regularize all remaining debts with bilateral creditors. The government should continue avoiding guarantees on nonconcessional external loans. Directors also observed that the recent involvement of private creditors in the cotton sector's debt restructuring had played a positive role in Tajikistan's adjustment to recent external shocks.

Regarding structural reforms, Directors welcomed the progress in land reform and small-scale privatization. However, the privatization of cotton ginneries and larger enterprises continue to be hampered by weak payment collection. To quicken the pace of reform in this area, Directors not only stressed the importance of increasing transparency in the privatization process, but also called for a thorough overhaul of the cotton sector's development strategy in order to ensure a fully liberalized and competitive market environment.

In other structural areas, Directors underscored the critical importance of a sound banking system in mobilizing domestic savings for sustained economic growth. They urged the authorities to press ahead with bank restructuring, while strictly enforcing the central bank's prudential regulations. Directors encouraged the authorities to improve the business climate in Tajikistan by reducing administrative interference in private sector activity.

Directors noted that Tajikistan's statistical database remained weak, and encouraged the authorities to make further improvement by devoting the necessary resources and seeking international technical assistance.

It is expected that the next Article IV consultation with the Republic of Tajikistan will be held on the standard 12-month cycle.

The Executive Board took the following decision:

1. The Republic of Tajikistan has consulted with the Fund in accordance with paragraph 2(g) of the second annual arrangement under the Poverty Reduction and Growth Facility (then Enhanced Structural Adjustment Facility) (EBS/99/105, Sup. 3) and paragraph 2 of the letter of June 17, 1999, from the President of the Republic of Tajikistan, and paragraph 44 of the Memorandum of Economic Policies for 1999-2000 (the "Memorandum") attached to the letter of June 17, 1999 from the President of the Republic of Tajikistan.

2. The letter dated December 30, 1999, from the President of the Republic of Tajikistan and its annexed Supplementary Memorandum of Economic Policies, and the letter dated January 22, 2000, shall be attached to the second annual arrangement for the Republic of Tajikistan under the Poverty Reduction and Growth Facility, and the letter of June 17, 1999, together with its attached Memorandum, shall be read as supplemented and modified by the letter of December 30, 1999, and its annexed Supplementary Memorandum of Economic Policies, and by the letter of January 22, 2000.

3. Accordingly, the second annual arrangement under the Poverty Reduction and Growth Facility for the Republic of Tajikistan shall be modified in the following manner:

a. Paragraph 1(d) shall be modified to read as follows:

"(d) the fourth loan, in an amount equivalent to SDR 6.66 million, will be available on March 15, 2000, at the request of the Republic of Tajikistan, subject to paragraph 2 below, and"

b. Paragraph 1(e) shall be modified to read as follows:

"(e) the fifth loan, in an amount equivalent to SDR 3.36 million, will be available on June 15, 2000, at the request of the Republic of Tajikistan, subject to paragraph 2 below."

c. Paragraph 2(a) shall be modified to read as follows:

"(a) If the Managing Director of the Fund finds that, with respect to the second loan, the date as of end-June 1999 and, with respect to the third loan, the data as of end-September 1999 and, with respect to the fourth loan, the data as of end-January 2000, and with respect to the fifth loan, the data as of end-April 2000, indicate that:"

4. The performance criteria set out in paragraphs 2(a)(i) through 2(a)(viii), of the second annual arrangement under the Poverty Reduction and Growth Facility for the Republic of Tajikistan for end-January 2000 and end-April 2000 shall be as specified in Annex 1 to the Supplementary Memorandum of Economic Policies attached to the letter of December 30, 1999, from the President of the Republic of Tajikistan.

5. The Fund determines that the first and second reviews contemplated in paragraph 2(f) of the second annual arrangement under the Poverty Reduction and Growth Facility for the Republic of Tajikistan are completed, and that the Republic of Tajikistan may request disbursement of the second and third loans specified in paragraphs 1(b) and 1(c) of the same arrangement, notwithstanding the nonobservance as of end-June 1999 of the performance criteria specified in paragraphs 2(a)(i), 2(a)(ii), 2(c), 2(d), and 2(e)(v) of the second annual arrangement, the nonobservance as of end-September 1999 of the performance criteria specified in paragraphs 2(a)(i), 2(a)(ii), 2(a)(iii), 2(a)(iv), and 2(d) of the second annual arrangement, and the nonobservance of the performance criterion specified in paragraph 2(e)(v) of the second annual arrangement for the Republic of Tajikistan (EBS/00/2, Sup. 2, 1/24/00).

Decision No. 12126-(00/8), adopted
January 26, 2000

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions was adopted by the Executive Board without meeting in the period between EBM/00/7 (1/24/00) and EBM/00/8 (1/26/00).

2. BENIN, BURKINA FASO, CÔTE D'IVOIRE, GUINEA-BISSAU, MALI, NIGER, SENEGAL, AND TOGO—REPRESENTATIVE RATE FOR CFA FRANC

1. The Fund finds, after consultation with the authorities of Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo, that the representative exchange rate for the CFA franc, under Rule O-2, paragraph (b)(ii), against the U.S. dollar, is the rate obtained on the basis of the relationship between the CFA franc and the euro, and the representative rate for the euro.

2. Banque Centrale des Etats de l'Afrique de l'Ouest, Dakar will immediately inform the Fund of any change in the representative rate. (EBD/00/5, 1/14/00)

Decision No. 12127-(00/8) G/S, adopted
January 24, 2000

3. CAMEROON, CENTRAL AFRICAN REPUBLIC, CHAD, REPUBLIC OF CONGO, EQUATORIAL GUINEA, AND GABON—REPRESENTATIVE RATE FOR CFA FRANC

1. The Fund finds, after consultation with the authorities of Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon, that the representative exchange rate for the CFA franc of these numbers, under Rule O-2, paragraph (b)(ii), against the U.S. dollar, is the rate obtained on the basis of the relationship between the CFA franc and euro, and the representative rate for the euro.

2. Banque des Etats de l'Afrique Centrale, Yaounde, Cameroon will immediately inform the Fund of any change in the representative rate. (EBD/00/5, 1/14/00)

Decision No. 12128-(00/8) G/S, adopted
January 24, 2000

4. COMOROS—REPRESENTATIVE RATE FOR CFA FRANC

1. The Fund finds, after consultation with the authorities of Comoros, that the representative exchange rate for the SFA franc, under Rule O-2, paragraph (b)(ii), against the U.S. dollar, is the rate obtained on the basis of the relationship between the CFA franc and the euro, and the representative rate for the euro.

2. Banque Centrale des Comoros will immediately inform the Fund of any change in the representative rate. (EBD/00/5, 1/14/00)

Decision No. 12129-(00/8) G/S, adopted
January 24, 2000

5. TUNISIA—REPRESENTATIVE RATE FOR TUNISIAN DINAR

1. The Fund finds, after consultation with the authorities of Tunisia, that the representative exchange rate for the Tunisian dinar, under Rule O-2(b)(i), against the U.S. dollar, is the average interbank market rate as ascertained and reported by the Banque Centrale de Tunisie.

2. The Banque Centrale de Tunisie will immediately inform the Fund of any change in the representative rate. (EBD/00/5, 1/14/00)

Decision No. 12130-(00/8) G/S, adopted
January 24, 2000

6. EXECUTIVE DIRECTORS' OFFICES—STAFFING

The Executive Board approves the recommendation by the Committee on Executive Board Administrative Matters to amend the staffing entitlements for offices of Executive Directors as set forth in EBAM/00/12 (1/19/00).

Adopted January 24, 2000

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 98/101 and 99/11 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by an Assistant to an Executive Director as set forth in EBAM/00/13 (1/21/00) is approved.

APPROVAL: May 4, 2001

SHAILENDRA J. ANJARIA
Secretary