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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 10/57-1

11:15 a.m., June 7, 2010

1. Republic of Tajikistan - First and Second Review Under the Three-Year Arrangement Under the Extended Credit Facility, Request for Waiver of Performance Criteria, and Request for Augmentation of the Arrangement

Documents: EBD/10/22; EBD/10/32; EBS/10/95 and Supplement 1, and Supplement 2

Staff: Schimmelpfennig, MCD; Ghura, SPR

Length: 36 minutes

Executive Board Attendance

J. Lipsky, Acting Chair

Executive Directors	Alternate Executive Directors
	L. Lephoto (AE), Temporary
	T. Nguema-Affane (AF), Temporary
	B. Lischinsky (AG), Temporary
	T. Tira (AU), Temporary
	J. Prader (BE)
	A. Maciá (BR), Temporary
	N. Liu (CC), Temporary
	C. Pérez-Verdía (CE)
	J. Rolle (CO), Temporary
	J. Reynaud (FF), Temporary
	A. Holler (GR), Temporary
	P. Ray (IN), Temporary
	J. Cardoso (IT), Temporary
	H. Yamaoka (JA)
	M. Daïri (MD)
A. S. Shaalan (MI)	K. Ismail (MI), Temporary
	M. Tanasescu (NE), Temporary
	J. Bergo (NO)
	A. Lushin (RU)
	S. Alnefaee (SA), Temporary
	H. Do (ST), Temporary
R. Weber (SZ)	
	E. Meyer (UA), Temporary
A. Gibbs (UK)	

J. Lin, Acting Secretary
F. Jamaludin, Assistant

Also Present

European Department: V. Stepanyan. External Relations Department: O. Stankova. Finance Department: S. Cauchi, C. Hemus. Legal Department: W. Bergthaler, C. Ogada. Middle East and Central Asia Department: A. Abdychiev, M. Ahmed, T. Koranchelian Dit Oranchelian, D. Owen, A. Schimmelpfennig, T. Schneider. Secretary's Department: E. Psalida. Strategy, Policy, and Review Department: Y. Bal Gunduz, D. Ghura. Senior Advisors to Executive Directors: M. Bleinroth (GR), O. Bush (UK), A. Monajemi (MD), M. Peter (SZ), A. Tolstikov (RU). Advisors to Executive Directors: G. Davidsons (NO), G. Drummond (UK), T. Haruki (JA), R. Hills (UK), D. Mevis (be), S. Sagdullayev (SZ).

1. REPUBLIC OF TAJIKISTAN—FIRST AND SECOND REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, REQUEST FOR WAIVER OF PERFORMANCE CRITERIA, AND REQUEST FOR AUGMENTATION OF THE ARRANGEMENT

Mr. Weber and Ms. Tartari submitted the following statement:

On behalf of our Tajik authorities, we thank the staff for the constructive program discussions, their cogent assessment, and candid staff report. The intensive dialogue with the mission provided the authorities with clear and welcome guidance as to the direction of policies and the priority to be given to their implementation. Our authorities concur with the staff's appraisal, including the need to further strengthen the governance of the National Bank of Tajikistan (NBT), step up financial sector reforms, and improve transparency in state owned enterprises (SOEs). In support of their strategy, the authorities ask the Board for approval of this first and second review under the Extended Credit Facility (ECF), and an augmentation of access to 120 percent of quota.

Tajikistan's economic situation remains fragile, while its development needs remain large. The country is also extremely vulnerable to external shocks. Following the adverse impact of food and fuel crisis, Tajikistan in 2009 was severely affected by the global downturn, through a decline of remittances and exports by roughly 30 percent each. In addition, regular disruptions in gas and electricity imports, energy shortages, and continued disruptions in cross-border railway transport with its main trading partner are holding back economic progress. Given frequent natural disasters (particularly flooding, earthquakes, avalanches, and landslides), our Tajik authorities intend to seek support in disaster management as well as financing from the international community. They are grateful to the Fund for providing concessional program financing and policy advice that is complementary to such assistance.

Program Framework

The ECF arrangement serves Tajikistan well as a framework to strengthen macroeconomic stability and advance with structural reforms. The program has also an important catalytic role in mobilizing financing from other official sources, which is particularly critical as the country is facing a financing gap that is higher than previously assessed. Given Tajikistan's external vulnerabilities, the flexible exchange rate has served the country well as a shock absorber and it will allow for the necessary rebuilding of reserves. No direct budget financing is envisaged from the Fund's resources. The

authorities remain committed to fiscal prudence, while safeguarding social and capital expenditures.

Despite the adverse economic environment, the authorities have persevered in successfully implementing the ECF and have adhered to all but two quantitative performance criteria for which waivers are sought. First, unanticipated liquidity shortages in the banking system lead to non-compliance with the performance criteria for net domestic assets (NDA) at end-December 2009. The authorities subsequently agreed with staff to introduce a ceiling on loans by the NBT to better be able to monitor the liquidity provision to banks and meet the NDA target. Second, the accumulation of wage and pensions arrears in 2009 was temporary and regrettable, but these arrears have since been settled and the authorities firmly intend to prevent their recurrence.

The authorities have reached an agreement with staff on the main macroeconomic policies for 2010 as outlined in the MEFP. In the fiscal area, the authorities will continue to maintain discipline and target a fiscal deficit (excluding the externally financed public investment program) of 1 percent of GDP while protecting pro poor spending. Prudent debt management and keeping government debt below the ceiling of 40 percent of GDP remain the focus of their debt management strategy. In the monetary area, the authorities will continue to use reserve money growth as the nominal anchor and rely on a flexible exchange rate regime. An enhanced structural reform process, particularly through improved transparency and governance, will remain the core of the program.

Strengthening the NBT

The authorities seek to bolster the credibility, transparency, and governance of the NBT and to strengthen its capacities in internal audit and financial reporting.¹ They acknowledge the remaining weaknesses in the operations of the NTB in the areas of data systems, transparency, and oversight and intend to address them promptly based on the comprehensive NBT action plan included in the MEFP. The Fund's updated safeguards assessment of the NBT, expected to be finalized shortly, should further support these efforts. Compliance with international practices will be reviewed by the Fund by end-December 2011.

¹ The audited financial statements by the NBT and the reports on the NIR position as of end-June and end-December 2009 have been published on the website of the NBT at <http://nbt.tj/?c=176&id=176&lang=en>.

The authorities, with the Fund's assistance, have developed—and will implement—a sensible recapitalization strategy for the NBT that balances the need to strengthen the NBT's operational instruments with the goal to limit the fiscal costs to the government. In this context, the government has resumed servicing the recapitalization bonds held by the NBT, while the NBT has resumed paying interest on government deposits. In addition, the government will make annual capital injections into the NBT over the coming eight years, starting in 2010. Finally, cotton investors will have to pay principal and interest on their outstanding debt to the NBT starting in June 2010. Regarding the operational instruments, the NBT will continue to fulfill its lender of last resort function in cases of bank distress, restrict its lending to commercial banks and nonbank financial institutions to the NBT's short-term liquidity facility, and refrain from issuing new credits to the private sector.

Structural Reforms

The weakened economic environment has found its expression in a deterioration of banks' asset quality, including on cotton related balance sheet assets, impeding their scope for credit extension. The authorities plan to issue treasury bills amounting to around US\$100 million to shore up banks' asset quality and to refine the regulatory framework including the submission to parliament of a bankruptcy law for credit institutions, which would enable an orderly restructuring and closure of financial institutions in distress. They also envisage submitting an anti-money laundering and counterterrorism financing framework (AML/CFT) law to parliament by end-December 2010. Furthermore, the authorities intend to address the problem of State Owned Enterprise (SOEs) arrears as a matter of priority. A new SOE Supervision Unit will be established and will be fully staffed by end-June 2010. The authorities will publish on the company's website the external audit of the Tajikistan Aluminum Company (Talco) 2006-08 financial statements.

Tajikistan has been facing electricity blackouts for 5-6 months a year during the cold seasons over the last 19 years, which are being exacerbated by disruptions in electricity transit. The authorities thus consider the completion of the Roghun hydropower plant a strategic priority to ensure energy security and promote sustainable development. They are committed to the Memorandum of Understanding signed with the World Bank in March that establishes key principles to achieve a sustainable development of Tajikistan's energy resources and outlines the scope of cooperation with the World Bank. One element in this cooperation is the feasibility study of the Roghun project

initiated by the World Bank, which will include an assessment of its technical and financial dimensions as well as its environmental and social impacts. The authorities look forward to a swift completion of this comprehensive study. The scale of the construction of Roghun is such that financing by an international consortium will eventually have to be sought. The authorities hope that the WB would take the lead in a consortium of potential investors. While the government owns 75 percent of the joint stock company Roghun OJSC, the Tajik authorities have, as of mid-April, suspended the advertisement campaign for the domestic sale of the remaining 25 percent of equity to the public. They do not expect significant equity sales for the remainder of the year. The authorities commit to full transparency and a strong governance structure for the Roghun project, including quarterly financial reporting and annual audits by a reputable international auditing firm.

Mr. Legg and Ms. Tira submitted the following statement:

We thank staff for a comprehensive report and Mr. Weber and Ms. Tartari for the additional input provided through their buff statement.

Tajikistan has been severely affected by the global economic crisis, mainly through a decline in remittances along with a fall in demand for the country's key exports, aluminum, and cotton. Despite the adverse economic environment, program implementation has been on track with the authorities adhering to all but two quantitative performance criteria for which waivers are being sought and corrective measures have been undertaken. Against this background we support completion of the first and second review of economic performance under the ECF and waiver of performance criteria.

The key program objectives for 2010 (largely unchanged from 2009) of maintaining external stability and advancing structural reforms remain appropriate. According to staff assessment, Tajikistan faces an external financing gap in 2010 stemming from the need to rebuild the country's reserve buffer hence the request for augmenting access under the ECF from 90 percent to 120 percent of quota. We recall that the authorities had initially requested assistance of 180 percent, with only 90 percent of quota approved with potential for the Board to revisit the need for additional access. Based on the authorities' positive track record so far and the fact that the economic situation remains fragile amidst a challenging external environment, we are open to supporting the request for augmentation of access to 120 percent of quota if there is a consensus among Directors.

Significant downside risks to the program remain and we broadly agree with staff assessment and recommendations limiting our comments to areas of shared concern.

The safeguard risks for the National Bank of Tajikistan (NBT) remain high and given that this was one area where prior program implementation (from 2007) was severely impaired, we would have expected to see more progress in strengthening the governance and credibility of the NBT. We note that staff has indicated that this will require more time and would appreciate more information from staff on the timelines by which we can expect more significant outcomes in this area.

We share staff concern on the Roghun HPP project and support a complete phasing out of the equity campaign. We note that Tajikistan has a structural energy deficit, but wonder whether the current size of the project is reflective of Tajikistan's total energy needs or is potentially too ambitious and whether other viable options to fill in the current energy deficit are also being explored or not. In this context we join staff in urging the authorities to proceed with care on the Roghun project weighing carefully its potential impact on the overall macroeconomic stability of the country.

We note that the authorities' priority in respect of SOEs remains to restore financial health and to fight tax evasion. In respect of the aluminum sector, staff has noted that a large share of profits generated in the aluminum production are shifted offshore and thus not taxed in Tajikistan. Given that aluminum production is relatively energy intensive, we would be interested to learn of the outcomes from the recently completed audit on the aluminum smelter Talco and whether there are recommendations towards increasing the public sector's share of the profits from this industry, which could potentially assist, among other areas, Tajikistan's energy strategy. Further information from staff would be appreciated.

We note that the health of the banking sector has weakened substantially through the deterioration of asset quality and profitability. As such we are encouraged by the authorities taking steps to support banks and safeguard financial stability through addressing gaps in the commercial banks laws and assisting with problematic banks. However, given that part of the deterioration resulted from directed loans, we agree with staff that limiting government intervention with bank's lending decision is crucial along with further decisive actions to repair bank balance sheets.

With these comments we wish the authorities all the best.

Mr. Shaalan and Mr. Ismail submitted the following statement:

Tajikistan has managed economic challenges relatively well in 2009. Economic conditions have stabilized since the approval of the program, with the exchange rate depreciation supporting the recovery in remittances and exports and helping to narrow the current account deficit and to build up reserves. Structural reforms in the agricultural sector allowed for greater diversification, which contributed to the recovery of real GDP growth in 2009 and bodes well for the near-term outlook. In spite of performance being broadly consistent with program objectives, two performance criteria were missed related to arrears and the ceiling on Net Domestic Assets (NDA). We support the completion of the reviews and the request for waivers given that the authorities have responded by promptly clearing the wage arrears and that the breach of the NDA ceiling appears to have been unavoidable as the central bank had to respond to liquidity shortages in the banking system.

We thank Mr. Weber and Ms. Tartari for their informative buff statement and the staff for a clear and concise paper with which we broadly agree. In the following we limit our intervention to fiscal policy, the financing of the Roghun Hydropower Project, financial sector vulnerabilities, and the proposed augmentation of the level of access under the Extended Credit Facility.

On fiscal policy, we broadly share staff's assessment that the fiscal deficit target is appropriate, and that maintaining spending related to social services is crucial given the high level of poverty. Similarly, it seems unwise to restrain expenditure on infrastructure maintenance as a means of achieving the deficit target as this may have adverse long-term consequences on growth. Rather, further efforts to mobilize revenues would help protect these expenditures while maintaining a sustainable fiscal framework. Given that VAT on imports account for a third of total tax revenues, we would welcome staff's views on proposed measures to boost alternative revenue sources.

Regarding the financing of the Roghun Hydropower Project, we welcome the authorities' cessation of coercive methods, tantamount to one-off taxation, to mobilize resources for the project, and advice them not to repeat such actions in the future. The project funding, which is on nonconcessional terms, is expected to account for 7 percent of GDP. Accordingly, a cautious risk assessment with international technical assistance will be important as the project progresses. We would welcome clarification of whether the World

Bank is closely involved in providing such technical assistance for the project given its important macroeconomic implications.

Regarding the financial sector, vulnerabilities have risen with the rapid increase in nonperforming loans while provisioning for NPLs remains low. Previous directed lending, with relaxed lending standards, to the cotton sector have resulted in much of the deterioration in the quality of bank assets. The slowdown in economic activity was the other key contributing factor, as is the case in other countries. Moving forward, the authorities need to have a plan to repair banks' balance sheets, while refraining from interference in banks' lending decisions. In this connection, we welcome the authorities' initiative aimed at debt resolution for the cotton-related loans.

Regarding the proposed augmentation of the access level, the authorities and many Directors had considered the access level insufficient at the time of the program's approval. As a compromise, there was an emerging agreement that at the time of the first review, the Board may consider raising the access level by up to double the amount if staff finds such augmentation as needed. While remittances and exports are recovering, reserves remain very low at about 1 month of imports despite the authorities' saving most of the SDR allocation. Even after the proposed augmentation, reserves are expected to rise to only 1.8 months of imports by 2015 and staff notes that the proposed augmentation "does not materially affect debt sustainability." In this connection, we would welcome staff's elaboration of whether a higher level of access was considered given the low level of reserves and if so, the reasons staff decided for lower augmentation. We support the request for augmentation of the Extended Credit Facility (ECF) and would have supported a higher level of access.

Mr. Sadun and Mr. Cardoso submitted the following statement:

We thank staff for their well-written report. We also thank Mr. Weber and Ms. Tartari for their insightful buff statement.

The global economic crisis has exacerbated some structural weaknesses of Tajikistan, including significant domestic rigidities. The most pressing external shock was associated with the external downturn, namely in Russia, causing a worrisome decline in remittances inflows, which has negatively impacted the livelihoods of the most vulnerable social groups, since remittances are their primary source of income, and has pressured Tajikistan's external position, forcing a significant adjustment in 2009. We note with optimism that remittances have started to rebound.

We agree with staff on the authorities' satisfactory performance during 2009 under the program supported by an ECF arrangement. We also note that the first review was delayed and combined with the second review, and we can go along with the justification presented by staff.

We note the request of two waivers. Although regrettable, they have not jeopardized the program. Given the corrective actions, we can support the authorities' request for the two waivers.

The authorities have requested for the augmentation of access under the ECF from 90 percent of quota to 120 percent of quota (SDR 104.4 million, about US\$162 million). On this issue, while recognizing Tajikistan's low level of international reserves, and domestic and external vulnerabilities, we are somewhat worried with the high risk of debt distress.

Notwithstanding the high risk of debt distress, we take note of staff's analysis on the country's capacity to repay the Fund, namely that outstanding purchases would be manageable in absolute terms, and the debt service to the Fund would remain below 1 percent of exports of goods and nonfactor services over the projected period. Additionally, we also note that Tajikistan has an established record of timely servicing its obligations to the Fund.

However, staff should have also equally emphasized (i) the recent past problems of Tajikistan with noncomplying disbursements and breaches of obligations under Article VIII, Section 5 (the furnishing of information) of the IMF Articles of Agreement; and (ii) the false statements, two years ago, to an external audit firm. Tajikistan's misreporting cases have been extensively discussed at the Board. Moreover, it should be noted that Tajikistan has been granted MDRI debt relief based on false information.

Notwithstanding these misgivings, we can go along, with reservations, with the authorities' request for augmentation of access under the ECF. However, we urge staff to carefully and continuously monitor the authorities' compliance with the Fund's rules and procedures.

We understand the importance and priority attached by the Tajik authorities to achieve energy independence, but we are stunned by the coercive equity campaign to finance the Roghun project. This campaign revealed also adverse social and macroeconomic implications, and did not address the project's foreign exchange needs. We would appreciate staff's elaboration on this issue.

We concur with staff that any final decision on the project should be based on the outcome of the techno-economic, social, and environmental assessments, which should take into account the regional implications of the project. In case these assessments favor a decision to go forward with the project, we support the involvement of the World Bank in establishing an international consortium to finance the Roghun project. Given the external debt position, how does staff intend to treat their contracting new debt?

To conclude, we are concerned with the lack of transparency of activities of key public entities like Barki Tojik (electricity company), and especially with Talco (aluminum smelter). We regret that Talco (claiming cost issues) has not hired one of the big four companies to conduct the audit, as agreed upon the approval of the Fund-supported program (structural benchmark for 2009). Given the recent past failure in Tajikistan of a recent auditing operation, contacting a well-known and reputable audit firm would have given more credibility to Talco's audit.

We also note that the field work for Talco's audit has been completed, but that the audit reports have not been published yet. The staff mentioned that these reports are expected to be published shortly. Can staff indicate what can be understood by shortly? Would it not have been wise to schedule the Board discussion after the publication of the audit reports? If the audit reports were already known, and the audit assessment was negative, would the staff's proposal be the same? What would differ?

The Talco Management Company is referred to in the staff's report as Talco's main provider of inputs and the exclusive purchaser of its output. What justifies the existence of the Talco Management Company? Is this the only activity of this company? If not, what other activities is this company operating? Why is this company not integrated in the Budget? How does staff intend to cope with the lower tax revenue due to the offshore activities of this company?

Mr. Virmani and Mr. Patra submitted the following statement:

We thank staff for a well-written report and Mr. Weber and Ms. Tartari for their helpful buff statement. The pre-crisis momentum of growth is gradually returning to Tajikistan after the sharp deterioration brought on by the global crisis. The authorities appear to be resolute in directing macroeconomic policies towards the goals supported by the Fund

program, despite initial setbacks and structural constraints in the form of high levels of poverty, acute energy deficit and resource gaps.

The Program

As staff points out, the authorities have settled the wage/pension arrears that led to the non-observance of the relevant performance criterion, and that the slippage on account of the NDA ceiling appears to have been due to unforeseen liquidity requirements in the banking sector. Accordingly, we can support the authorities' request for waiver of non-observance of these performance criteria in 2009 leading to the completion of the first and second reviews under the ECF. In view of the larger financing gap faced by the authorities, mainly on account of the objective of increasing the reserves to imports cover, we endorse staff's recommendation and also support the authorities' request for augmentation of access to 120 percent of quota for the 2010 program.

Macroeconomic Outlook

We note that macroeconomic performance is integrally linked to remittance inflows with reportedly one out of every ten Tajiks working abroad. The pick-up in growth in the first quarter of 2010 is associated with an increase of 5-6 percent in inward money transfers. What are the prospects of incentivizing remittances through diaspora bonds, special remittance facility arrangements with overseas banks that economize on costs and maximize speed of transfer, exchange houses in main host countries, and the like? Technical assistance could be drawn from the World Bank for this purpose, if required.

The recent efforts of the authorities to diversify the agricultural sector away from cotton are commendable. What is the progress made in farmland restructuring and land reforms which holds the key to unlocking the impulses of growth in the sector?

Improving the energy output assumes critical importance and accordingly we welcome the commitment of the authorities to the Roghun project. Resource constraints are obviously acute and we hope that with the augmented 2010 Fund program, donor financing will flow in again. We would like to be informed about the progress made in assessments on techno-economic, social and environmental viability of the project that are being made with the support of the World Bank.

Monetary and Financial Policies

While reserve money operates as a nominal anchor for monetary policy, we are concerned that fluctuations in liquidity conditions can impart instability to the monetary base and to the money multiplier. In this context, liquidity management assumes importance. The authorities could move towards setting up a repo facility with the NBT with a view to modulating liquidity rather than one-off auctions. Collateral used in the repo needs to be of the highest quality, including treasury paper, certificates of deposits and even central bank bills. The purposes of the facility could be to continuously flush liquidity in and out of the system, create conditions for the orderly evolution of interest rates and also eventually for the development of various segments of financial markets. In this context, the establishment of payment and settlement/clearing mechanisms is also critical. We look forward to staff's responses.

We agree with staff's proposal to deal head on with loan delinquencies and capital requirements. What is the impact of the resolution of cotton sector debt on the former? What are the avenues for infusing capital into the banking sector?

Structural Reforms

We are encouraged by the steps being taken to improve financial reporting and auditing in the NBT and state-owned enterprises, although we are mindful of staff's assessment that progress is slow and safeguard risks remain high. We also note that some progress is underway in implementing structural reforms, particularly in the cotton and energy sectors, but more ground needs to be covered in these areas expeditiously to impart resilience to the economy. We wish the authorities well in their endeavour.

Mr. Gibbs and Ms. Drummond submitted the following statement:

We thank staff for a clear and frank paper, and Mr Weber for his helpful buff statement.

The risks to this program remain high, not least given the authorities' troubled track record in their relations with the Fund. We are to some extent reassured by the adequate performance thus far, and can therefore support the completion of the first and second review, and the augmentation of access to 120 percent of quota.

We note that several of the problems that adversely affected the Tajik economy in 2009 persist, namely the Roghun project and the informal Uzbekistan trade embargo. Both can only be resolved through the continuation of political and diplomatic efforts, and we urge the authorities to take all possible steps in this regard.

We find the coercion around the domestic financing of the Roghun project unacceptable. We are disturbed at the adverse social and macroeconomic implications, including its effect on poverty. The authorities have committed to halt the active campaign, but we underscore that we would find it difficult to support the ECF were it to be reintroduced in the future.

Given three-quarters of trade flows through Uzbekistan, Tajikistan could face long term negative impacts through falling imports of essential goods, commodities and foodstuffs should the embargo persist. We might expect domestic prices to increase, especially fuel (noting that petrol prices have gone up 15 percent in recent days), and revenues to be affected as customs receipts decline. Can staff expand on the risks to the program from the continued intermittent disruptions in rail traffic through Uzbekistan?

We note positive growth rates in 2009, and the cautiously optimistic outlook for 2010, including real GDP growth of around 4-5 percent. However, recent World Bank diagnostics suggest that recent growth has been largely jobless. This underscores the need to further strengthen social safety nets. We welcome the authorities' intention to increase the social sector financing floor from 9 to 9.5 percent of GDP. Can staff comment as to why this commitment was not made a benchmark under the program?

The updated safeguard assessment confirms that safeguard risks remain high. We therefore urge the authorities to swiftly implement the outstanding policy recommendations and reforms to address the considerable weaknesses that remain in key functions at the NBT.

We stress the continued need for the authorities' to demonstrate real commitment to SOE reform. We note with concern the delays to the TALCO onshore audit, and are disappointed that greater commitment to transparency has not been demonstrated. We trust that future audits, especially for the TALCO offshore operations, will proceed in a timelier manner. Donors will continue to look for real commitment to improving transparency and fiscal discipline in the SOE sector in making funding decisions.

Finally, staff rightly highlights the risks to the financial sector flowing from past directed lending. We agree that there is an urgent need to establish a clear plan, and to identify the sources of NBT and commercial bank recapitalization in order to avoid a liquidity crisis later in 2010. Is the staff planning on offering technical assistance to this end?

Mr. Alazzaz submitted the following statement:

I thank staff for a well written report and Mr. Weber and Ms. Tartari for their helpful buff statement. Tajikistan performed rather well under the program for 2009. Economic growth is estimated to have exceeded 3 percent. All but two of the quantitative performance criteria under the program have been met, and progress has been made on structural reforms. The arrears accumulated during 2009 were settled by year-end, and additional safeguards had been placed to allow the National Bank of Tajikistan to better monitor liquidity. I can therefore support the completion of the first and second reviews, as well as the request for waivers. The request for an augmentation of resources under the arrangement is also justified given the need to boost reserves further.

On the fiscal side, the target for the deficit (excluding the externally financed public investment program, PIP) of 0.5 percent of GDP has been observed. The program for 2010 envisages a modest increase in the deficit to 1 percent of GDP, which is justifiable in view of the need for a further increase in social expenditure. However, the constraints on certain types of spending, such as maintenance, to achieve the above deficit target, are unsustainable. It is therefore important that efforts to raise revenues over the medium-term be strengthened. The medium-term fiscal program should also maintain a careful balance between social and capital spending, with the two being viewed as complementary.

It is understandable that the authorities accord priority to boosting energy production, since Tajikistan has a structural energy deficit that is expected to widen over the medium-term. However, I agree with staff that the equity campaign initiated by the government in January 2010 to raise financing for the Roghun Hydropower Project (HPP) from the population and domestic corporates, has had adverse social and macroeconomic consequences, and did not address the project's foreign exchange needs. The authorities' intention to ask the World Bank to lead an international consortium to finance the project assuming a positive outcome of the ongoing feasibility study is welcome.

On structural reforms, the continued deterioration in the assets of the banking system is worrisome, and will seriously affect future credit growth if not tackled decisively. I welcome the steps being taken to strengthen Tajikistan's financial sector with a view to reinvigorating private sector credit growth, as detailed in paragraph 15 of the Memorandum of Economic and Financial Policies (MEFP). Reforms in the state-owned enterprise sector to put the enterprises on a sound financial footing, as well as reforms in lending practices to the agricultural sector, are also important steps to help foster long-term growth.

With these comments, I wish the authorities continued success.

Mr. Pérez-Verdía submitted the following statement:

We thank the staff for their comprehensive report and advisory note, and Messrs. Weber and Tartari for a concise and helpful buff statement. Based on the authorities' successful implementation of their 2009 program and the need to further reduce remaining vulnerabilities, we support their request for the completion of the first and second review and the augmentation of access to 120 percent of quota. We also support the request for two performance criteria waivers related to the accumulation of wage and pension arrears (now settled) and the higher than programmed NDA growth (temporary and unforeseen).

Tajikistan's significant dependence on external remittances, equivalent to an estimated 46 percent of GDP in 2008, left the country in a vulnerable position to face the global economic slowdown. The reduced demand for its main exports, cotton and aluminum, worsened the outlook of a deep and protracted shock to current account. The outcome for 2009 was not as severe as initially expected, both in terms of growth and external accounts, in part aided by the flexibility of the exchange rate system, although the economy remains vulnerable to terms of trade, shocks and the stability of foreign flows—both remittances, and project loans and grant. In this respect, we encourage the authorities to continue the reforms that allow resources to be allocated to their most productive uses.

We welcome the authorities' intentions to target a constrained fiscal balance, not including PIP, while paying special attention to social spending. However, we concur with staff that the costing of the pension and health insurance laws should be carried out prior to them coming into effect. We look forward to future updates on tax administration advances, including the implementation of the Treasury Single Account system. We agree with staff in

their recommendation that all income generated from onshore activities in aluminum production be subject to domestic taxation. In this respect, and given the importance of certainty and transparency on Telco's activities, we would have preferred for the audit of its financial accounts to be carried out by one of the big four international firms, as stated in the authorities' letter of intent. We would appreciate further comments from staff on this matter.

Transparency and governance of the central bank form a cornerstone to the authorities' program, as stressed by Messrs. Weber and Tartari. Maintaining a fruitful dialogue with staff in preparing the parliamentary review of the NBT law is strongly embraced. We also welcome the resolve to find an appropriate solution to the cotton debt problem. Could staff further clarify if the debt resolution strategy of 2009 damages NBT's capital, especially since the central bank guaranteed a large part of the loans intermediated by cotton investors?

The staff's analysis points to increasing vulnerabilities in the banking sector, including sharp increases in NPLs related to losses in the agriculture sector and the affected repayment capacity of foreign currency borrowers. Diligent action by authorities to address these problems via regulation, including capitalization plans, is important. We also agree that interference with banks' lending decisions should be avoided.

With these remarks we wish the authorities success in achieving the goals stated in their program.

Mr. Majoro submitted the following statement:

We thank staff for their report and Mr. Weber and Ms. Tartari for their informative buff statement. We commend the authorities for the successful implementation of the program despite the challenges they were facing. Given that corrective action has been taken, we can support the request for waiver of missed performance criteria and the completion of the first and second ECF review. We also support augmentation of the arrangement to 120 percent of quota in light of the low level of reserves.

We note that while the authorities met their fiscal deficit target, arrears on wages and pensions rose temporarily. Could staff elaborate on the reasons behind these arrears and indicate whether the target would still have been met without the arrears? The authorities' aspiration to balance social and capital expenditures is appropriate. However we concur with staff that this should be done in a sustainable manner without risking the degradation of public

infrastructure. We also welcome the authorities' efforts to address the energy deficit. Nevertheless we would urge them to carefully assess the projects they wish to implement in order to minimize costs associated with the project.

The growing deterioration in financial sector conditions is worrisome. We therefore encourage the authorities to step up their efforts to turn the sector around. Tightening prudential regulations and supervision will be essential in this regard. It is imperative to ensure that banks are well capitalized, adequately provisioned for non-performing loans and limit exposure to individual borrowers or sectors to avoid situations such as the current problem of high exposure to the cotton sector. We note that the banking sector's deposit base is dominated by public sector entities and wonder why government deposits are not placed with the central bank. We encourage the banks to diversify their deposit base by putting in place measures to attract private sector deposits. Development of more private sectors-led lending mechanism for agriculture and limiting government intervention in lending decisions would also be helpful.

Improving central bank governance is vital for effective policy implementation and oversight. We therefore, welcome the authorities' efforts to improve governance of the National Bank of Tajikistan (NBT). In this regard, we urge the authorities to fast track the implementation of recommendations of the safeguards assessment, strengthen controls at the NBT, reduce the current high risks and strengthen the credibility of the central bank. We note the authorities plan to review the NBT law by the end of the year. The staff's comment on how this is envisaged to enhance governance of NBT would be appreciated.

With these remarks, we wish the authorities well in their future endeavors.

Mr. Prader and Mr. Mevis submitted the following statement:

We thank the staff for their candid report and Mr. Weber and Ms. Tartari for their insightful buff statement. We support the completion of the First and Second Review under the Extended Credit Facility arrangement with Tajikistan.

While we can agree to the augmentation of the program in light of the low level of international reserves, we note that the Fund is by far the largest contributor to the closure of the financing gap. In effect, the Fund provides more than half the necessary amount in 2010. We would have preferred a

more even distribution. These concerns are increased as the update to the safeguards assessment shows that safeguard risks are high.

After a severe hit due to a sharp fall in remittances and a marked deterioration in the external environment which harmed the Tajik export industries, the outlook is improving. The risks remain on the downside as the global economy remains fragile. Nevertheless, we welcome the good performance of the agricultural sector after liberalization which led to a diversification of output and fostered growth.

We commend the authorities for tackling the debt of the cotton sector through a comprehensive debt resolution strategy. However, in this context, many risks remain, in particular for the National Bank of Tajikistan (NBT) and the banking sector which are holding the debt. We urge the authorities to remain extremely cautious and maintain their commitment to a sustainable and sound resolution of this issue. With regard to the issuance of US\$100 million in treasury bills to finance part of the debt resolution, we note the staff's concern that the terms are not in line with market prices. Could the staff elaborate on the effect of these treasury bills on banks' balance sheets?

The focus of the program on governance and strengthening institutions is well placed. We commend the authorities on the advances made over the past year. Going forward, the most pressing issue is strengthening the independence of the NBT. In this context, the quarterly internal audits are welcome and we look forward to the implementation of the recapitalization strategy for the NBT and the passage of the revised NBT law in parliament by the end of the year. In addition, we welcome the reforms in the revenue administration and public financial management. We encourage the authorities to review the widespread use of tax exemptions and welcome the establishment of an interministerial commission. The external audits and close monitoring of SOEs by the Ministry of Finance are encouraging. We urge the authorities to clarify the issue of the tax treatment of income from aluminum.

We welcome the authorities' focus on addressing the structural energy deficit and upgrading the energy infrastructure. In the past, difficulties in power supply have severely affected the export industries—aluminum in particular. Nevertheless, we strongly agree with the staff that the authorities should quickly bring the coercive equity program to a halt. This *de facto* tax leads to a significant fiscal contraction and could affect the macroeconomic outlook and have negative social consequences. Rather, we urge the authorities to await the outcome of the technical assessments of the project and on the basis of these results, intensify the search for foreign investors.

This could be done as proposed in the staff report through a consortium led by the World Bank.

The authorities need to upgrade supervision and address the issues weakening the banking sector. The tightening of prudential norms and increased supervision are welcome in this respect. Also, the collaboration with the World Bank on the revision of the commercial bank law is useful. Nevertheless, the episode of directed loans to the cotton sector and the resulting problems with banks' asset quality has shown that government intervention should be limited to regulation and supervision.

Mr. Rutayisire submitted the following statement:

We thank staff for a well-written paper, and Mr. Weber and Ms. Tartari for their informative buff statement.

Tajikistan's economic activity slowed down in 2009, with a real GDP growth of 3 percent in 2009 down from 8 percent in 2008, due to a combination of several shocks, including the global economic slowdown and the decline in remittances. Inflation rate significantly decelerated to 5.0 percent in 2009 from 11.8 percent in 2008, owing to declining international commodity prices and lower domestic demand. Despite the difficult circumstances, performance under the ECF has been broadly satisfactory with all but two performance criteria at end-2009 met, and notable progress made in the implementation of structural reforms. In light of the remedial actions taken, we support the authorities' request for waivers for missed performance criteria.

Recent developments on the external front, notably the rebound in remittances and exports in the first quarter of 2010, are very encouraging and bode well for economic growth this year, which is projected at 4-5 percent. Going forward, the authorities are encouraged to maintain the reform momentum, in order to make further inroads towards macroeconomic and financial stability. In this regard, we welcome their continued commitment to their ECF-supported program. We agree with the view that, in light of the low level of reserves and given the uncertainty in the external environment, additional donor support will be needed to bring reserves to a level sufficient to withstand unexpected shocks. In this respect, we support the authorities' request for an augmentation under the ECF.

In the fiscal sector, we note the authorities' intention to maintain supportive policies through increases in the minimum pension and in wages in

social sectors, which will result in a widening of the fiscal deficit. Given the permanent nature of such measures, we would like staff to indicate why they have been preferred to, for example, transfers through well-defined and targeted social programs. We welcome the progress made in the tax administration and public financial management reforms and look forward to further progress in the implementation of the 2005 Tax Code and Treasury Single Account (TSA), the finalization of the pension and health insurance laws, as well as the rationalization of tax exemption policies.

On the monetary front, we welcome the authorities' commitment to a prudent policy that will ensure adequate liquidity in the banking system and achieve the NDA targets set out in the program. We also welcome their indication that they will continue to limit interventions in the foreign exchange market for volatility smoothing purposes. We note that reforms of the central bank are progressing, with notably the development, with Fund's assistance, of a recapitalization strategy of NBT, the publication of financial statements and audits, and the strengthening of liquidity management tools. We agree that much remains to be done, and welcome the authorities' intention to pursue the reforms, taking into account the recent Fund's safeguard assessments.

In the financial sector, we note the weakening of financial indicators, in particular the high level of NPLs in the banking system and low provisioning ratios by banks. We support the authorities' ongoing efforts to strengthen the regulatory and prudential framework, with notably the submission to the Parliament of a bankruptcy law for credit institutions. We also welcome their actions to improve banks' asset quality. A successful resolution of the cotton debt issue will be helpful in that regard.

On structural issues, we welcome the progress made in the restructuring of public enterprises, with a view to increase transparency and strengthen their financial health. Regarding the electricity sector, we welcome the gradual increase in electricity tariffs to achieve cost recovery and improve the financial situation of the electricity company. We understand the strategic importance of the Roghun hydropower project in achieving energy security and thereby in supporting economic development. In this regard, we welcome the authorities' decision to review, with World Bank assistance, their financing strategy of the project, as indicated in Mr. Weber and Ms. Tartari's statement.

With these remarks, we support the completion of the first and second review under the ECF and wish the Tajik authorities success in their endeavors.

Mr. Stein and Ms. Holler submitted the following statement:

We thank staff for an insightful report and Mr. Weber and Ms. Tartari for their helpful buff statement. It is comforting to note that Tajikistan's growth momentum has started to rebound in the second half of 2009, and that projections on most of the country's macroeconomic fundamentals have improved vis-à-vis their outlook at the time of the authorities' request for financial assistance one year ago. We especially welcome that reserve growth (in absolute terms) is significantly stronger than expected at the onset of the arrangement. Despite this development, the success of the Fund-supported program continues to be subject to substantial risks—recently added by tensions in the financial sector and the worsening of the medium-term external debt outlook. While reserve augmentation has accelerated over the course of 2009, their absolute level is still precariously low, following their fraudulent misallocation under the former NBT's management in 2004-07.

Given the major concerns waived by this chair in consenting to the arrangement and the credit of trust extended to the authorities against the backdrop of their weak track record, we would have hoped for a stronger program implementation. Set against this standard and considering the significant delays in program implementation (with two out of four structural benchmarks for the second review not fulfilled and the other two met only with delays) and the request for waivers for non-observance of two performance criteria, we do not concur with staff's assessment that the performance under the program was "satisfactory." Moreover, it is disappointing to learn that progress in the crucial area of strengthening governance at the NBT and SOEs has been slower than envisaged. On NBT governance, we urge the authorities to speed up progress on the initial steps taken thus far and, aided by Fund technical assistance, forcefully address the still high risks identified in the safeguards assessment update. The staff's comments on possible technical assistance are welcome.

Our unease with the proposed decision is further fuelled by serious concerns about the widespread use of coercion that reportedly characterized the sale of equity in the Roghun Financing Campaign. We appreciate the frank discussion of this matter in the staff report. We welcome that the authorities agreed to stop the campaign. However, the campaign has, in our opinion, been detrimental to the program due to its effects on the already fragile financial

situation in many commercial banks and SOEs and even more so with respect to its consequences on economic growth and social indicators. We are deeply worried by the World Bank estimations, according to which poverty could rise temporarily by two percentage points as a result of the campaign and regard this outcome as critically contravening the social- and poverty-related objectives of the program.

We are concerned that the medium-term debt outlook has deteriorated substantially. External debt is now projected to exceed the 2009 program's ceiling of 40 percent of GDP by 2012. With the accumulation of all these concerns, we cannot support the completion of the first and second review and the request for an augmentation, and wish to be recorded as abstaining.

Mr. Rediker and Mr. Meyer submitted the following statement:

The global crisis impacted Tajikistan's economy, primarily through sharp reductions in remittances, which fell by 31 percent in 2009 reducing real GDP growth to 3 percent. The external environment is improving—the Russian economy is recovering while global demand for exports has rebounded—but Tajikistan still faces major challenges. Unfortunately, weak public sector transparency, financing of the Roghun dam, and increased credit risk in the banking sector jeopardizes Tajikistan's economic outlook and efforts to reduce poverty.

We opposed this program when presented last year, given concerns with program design and questions about Tajik commitment to accountability, transparency, and reform measures. While there has been some progress under the ECF, notably in agreeing to resolve cotton sector debt and in beginning to reform the NBT, performance has been modest at best, as indicated by the request for two waivers. Ongoing delays with the audits of state-owned enterprises, and the authorities' push to raise private financing for Roghun in an unsustainable fashion, raises questions about the adequacy of the current program and the government's commitments to comprehensive reform. Recognizing that there has been some progress, but also reflecting our continued unease with performance, transparency and accountability, we ask to be recorded as abstaining on the decision, including on the augmentation of the facility.

Fiscal Policy

Fiscal policy implementation continues to be a challenge, as reflected in the increase in pension and wage arrears last year. We are pleased to see

these have been corrected and urge the authorities to redouble their efforts at both expenditure control and improved tax administration. More importantly, we continue to see strong merit in the Tajik authorities producing consolidated accounts, including SOEs. While there has been some progress in auditing and accountability of SOEs and we recognize this is a precursor to producing consolidated accounts, much remains to be done. Audits for state-owned Barqi Tojik and Talco have both been delayed and have yet to be published. We welcome the commitment highlighted by Mr. Weber and Ms. Tartari to publish the Talco audits. This is critical to shedding light on these firms' financial activities and the use of public funds. It also sets important precedents for the operations of other state-controlled enterprises, such as the Roghun dam. We urge the authorities to move forward expeditiously in completing these audits and to making them public. Going forward, we also urge that the Tajik authorities and the Fund staff consider setting consolidated budget targets that also include SOEs. The introduction of a single treasury account in 2011 will be an important step to regaining control over public funds and expenditures.

While we recognize that the development of hydropower is critical to Tajikistan's long-term growth prospects, the implementation of the Roghun project raises immediate concerns. These reflect the strong tactics used to raise domestic funding and the detrimental impact this has on growth and poverty reduction. We fully support the staff's recommendations and take note, as reflected in Mr. Weber's and Ms. Tartari's buff, that the authorities do not anticipate significant additional equity sales for the rest of this year. Going forward, we urge the authorities to cease the domestic share subscription campaign; to work closely with the MDBs in assessing the project and in identifying suitable financing; and to ensure that private subscriptions to date are properly registered and treated as true investments.

Monetary Policy and Financial Sector

The flexible exchange rate has served Tajikistan well as a buffer to external shocks. We are pleased to see progress in reforming the NBT, particularly the closure of the cotton department whose operations led to major losses in reserves. We take note of the ambitious reform program for the NBT and urge the authorities to continue to stay on target with implementation in order to begin to restore credibility. There is rising concern with the stability of the financial sector, given the increase in NPLs to 20 percent of total loans. The concentration in the three largest banks is of particular note given their connections. The authorities will need to focus on enhanced supervision and monitoring of banks and to develop contingency

measures, including plans for dealing with resolution and/or recapitalization, in the event banking sector difficulties increase. The structural benchmark on submitting a bankruptcy law for credit institutions to parliament is an important step in this process.

Mr. Hockin and Mr. Rolle submitted the following statement:

We thank the staff for a very helpful set of papers and Mr. Weber and Ms. Tartari for their buff statement. Since we concur with the staff's appraisal, the scope of our remarks will be limited.

We can agree to the completion of the first and second reviews under the Extended Credit Facility (ECF) for Tajikistan, and to the request for waivers for the two structural benchmarks on the audits of the central bank and the state owned aluminum smelter (Talco). Nevertheless, it is regrettable that capacity constraints have slowed progress on comprehensive strengthening of the internal audit systems within the central bank. In respect of Talco, however, we do not appreciate the full significance of the deviation caused by the use of an external auditor that was not one of the big-four international firms. Rather, it would appear to have been an overly stringent program condition. The staff's comments would be appreciated.

We concur that Tajikistan still has significant external vulnerabilities and needs to continue to build up its international reserves. In this regard, we remain supportive of the authorities' reform agenda and the overarching importance of the poverty reduction strategy (PRS 3). In light of the continued challenge posed by depressed remittance inflows, softness (albeit stabilized) in export earnings and sizeable financing needs for public sector investments, the augmentation of the size of the ECF is therefore agreeable. Did the exclusion from the definition of international reserves of gold that does not meet "London good delivery standard" also contribute to the revised accumulation target for 2010?

On fiscal policy, the authorities have recognized the importance of improving revenue yields. However, collections were adversely affected by the 2009 reduction in the VAT rate. Is any consideration being given to reversing this decision?

We urge the authorities to allow market forces to operate more freely in respect of domestic financing activities. Given what the staff describes as an effective taxation exercise to raise capital for the Roghun hydropower project (RHPP), we would favor some rollback of the fund raising. That is,

allowing households to voluntarily readjust their holdings to ensure that basic consumption needs are not being undermined. This provides even stronger justification for accelerating international investor participation in the project, since Tajikistan's energy deficit still needs to be addressed. We join the staff in also advising the authorities to attach more marketable terms to the planned Treasury bill issue to resolve cotton sector bad debts. This would include use of instruments of a longer maturity as opposed to a mandatory rollover provision.

In the financial sector, urgent strengthening of prudential regulations and enforcement, and fortification of the bank resolution framework are appropriate, given the impaired state of balance sheets. The high levels of NPLs underscore the strategic importance of tightening lending standards, boosting capital and strengthening loan loss provisions. As a contingency, we urge the authorities to obtain comprehensive assessments of the potential fiscal costs posed by these weaknesses.

Mr. Lushin and Mr. Tolstikov submitted the following statement:

We thank staff for the well-written report and Mr. Weber and Ms. Tartari for their helpful buff statement.

Tajikistan was strongly hit in 2009 by the reduction in remittances and lower external demand for its main export products. The authorities have mitigated the impact of the external shock by increasing social spending and allowing the exchange rate to depreciate. As the external environment is improving and remittances inflows are recovering, Tajikistan's economy is returning to stronger growth rates.

The ECF arrangement has served Tajikistan well in these difficult circumstances, helping the authorities to maintain macroeconomic stability and keeping on with structural reforms. The performance under the program has been broadly satisfactory. Although two quantitative performance criteria were missed, this had no significant macroeconomic impact. Taking into account the corrective actions taken, we support the request for waivers.

Given the extremely low level of international reserves, which at the end of 2009 amounted to only about 1.1 months of next year's imports, there is a need for substantial additional external financing. We support the authorities' request for the augmentation of access under the ECF from 90 percent of quota to 120 percent of quota and we welcome additional

financing provided by the international community. As we broadly agree with the staff appraisal, we will limit our comments to a few structural issues.

The program is rightly focused on structural reforms to strengthen governance at the NBT and the SOEs. However, progress in both areas is not fully satisfactory.

We are concerned by the conclusions of the safeguard assessment that safeguard risks remain high and restoring credibility of the central bank will require more time. We welcome the development of the elaborate NBT Reform Action Plan (MEFP, Table 1) and urge the authorities to fully implement it.

Given Tajikistan's financing gap and limited fiscal resources, it is regrettable that a large share of profits generated in the aluminum production is shifted offshore and is not taxed in Tajikistan. Therefore, it is disappointing that the structural benchmark for the audit of Talco's financial accounts was not fulfilled in time and the conclusions of this audit are not available before the Board discussion. The publication of the full audit report may shed more light on the tax evasion problem and provide additional incentives for mitigating actions. It is, therefore, important that a tender for an external audit of Talco Management Company's 2008 and 2009 financial statements by a reputable international audit firm be announced without delays. As operations of Talco and Talco Management Company are closely interrelated, we wonder why the tender for audit of Talco's 2009 financial statements was not included into this structural benchmark.

The establishment of the SOE monitoring unit in the Ministry of Finance is a welcome development. It is also important to attract qualified staff to this unit and secure political support for this work.

The Roghun hydropower station is regarded by the authorities as a high priority project, given its potential to address the structural energy deficit and achieve energy independence. However, its hasty implementation created regional tensions and was also marked by coercive methods of fundraising. Therefore, we support the curtailing of the Roghun equity financing campaign. We also welcome the World Bank's leading role in conducting a systemic techno-economic, social, and environmental impact assessment. The feasibility study carried out by international experts will make the discussion of the impact of this project more informed and may also ease some regional concerns.

Finally, we welcome the ongoing reforms in the agricultural sector that allowed farmers to shift from cotton to food production. The diversification may not only improve the economic and social conditions in the rural areas, but also alleviate the pressures from the loss-making cotton enterprises on the financial and fiscal systems.

Mr. He and Ms. Liu Naji submitted the following statement:

We thank staff for the well-focused report and Mr. Weber and Ms. Tartari for their helpful buff statement.

With the drastic decline in remittance and trade, despite supportive policies, the global crisis hit the country severely when it was on its way to cope with large development needs and push forward structural reforms. The outlook is challenging.

Facing all the adverse factors, we commend the authorities' success in broadly implementing the ECF. We support the completion of the first and second review of the three-year arrangement under the ECF. Given the country's need to build NIR and address domestic and external vulnerabilities, we also support the augmentation of access from 90 percent to 120 percent of quota. At this critical moment, Fund support, which will catalyze other donors' support, is vital for the country to embark on a sustainable growth path.

It is understandable that achieving energy independence, raising social expenditures, and strengthening governance in the NBT and SOEs are top on the authorities' plan list. We consider more time is needed to address the challenges surrounding the SOEs. For example, progress in SOE reform depends on the capacity of the private sector to absorb the shedding of labor and to fund privatization. It also depends on the development of new institutions to facilitate orderly competition.

We note that the authorities have suspended the 25 percent of equity domestic sale campaign of the Roghun HPP and do not expect significant sales for the remainder of the year. As staff rightly points out, the campaign may have adverse macroeconomic implications, such as purchases by banks could undermine the already weak financial health; likewise, purchases by SOEs could increase their contingent fiscal liabilities. However, given the urgent need for the construction of the project, can staff elaborate on alternative options available?

The banking sector remains vulnerable. We agree with staff that it should be addressed urgently. It is noteworthy that banks' asset quality and profitability deterioration is mostly linked with the weakened cotton sector through directed lending in the past. In this regard, we see a strong case for the authorities to play a responsive role in the repair process. As mentioned in Mr. Weber and Ms. Tartari's buff statement, issuing treasury bills might be an appropriate choice. On the other hand, the NBT is expected to step up its enforcement of prudential standards to safeguard the financial sector. In this light, reform at the NBT is pivotal. We welcome the authorities' efforts to bolster the NBT's credibility, transparency, and governance. We especially commend the authorities' sensible recapitalization strategy, with Fund assistance, for the NBT to strengthen its operational instruments.

We wish the authorities success in their endeavors.

Mr. Bakker and Mr. Tanasescu submitted the following statement:

We support the conclusion of the First and Second Review under the ECF, Request for Waiver of Performance Criteria, and Request for Augmentation of the Arrangement. We thank Mr. Weber and Ms. Tartari for their informative statement.

Tajikistan's economic situation remains fragile, and it is extremely vulnerable to external shocks. Remittances, the largest source of inflows, have contracted sharply, while low prices and weak external demand for traditional exports will further deteriorate the current account position and require significant external financing. The situation is further complicated by considerable structural and investment bottlenecks. Continued success of the program will require strong ownership by the authorities.

We broadly agree with the thrust of the staff appraisal, and we will, therefore, focus our comments on a few points for emphasis.

Fiscal Policy

We agree with staff that the authorities' fiscal stance is appropriate. Given rising social spending to support the poor, the prioritization of government spending is a step in the right direction. Nevertheless, a decline in revenues as a percentage of GDP is worrisome, and despite efforts to enhance revenue administration, we urge the authorities to improve the tax collection and strengthen tax administration. The staff's comments on measures taken by the authorities to increase revenues are welcome.

Regarding the financing of the Roghun Hydropower Project, we welcome the authorities' cessation of corrective methods, and we support a complete phasing out of the equity campaign. We understand the government's priority to achieve energy independence, but like staff, we consider that the equity campaign has adverse social and macroeconomic implications. While the authorities' energy strategy is mainly centered on the Roghun HP, we consider that alternative solutions should be taken in consideration. We concur with staff that any final decision on the project should be carefully analyzed, and the implication of the World Bank in the project is desirable, also in view of the need to pay attention to social, macroeconomic, and debt sustainability.

Financial Sector

We note that the banking sector has weakened dramatically because of deteriorating asset quality and profitability. The vulnerabilities in the system should be addressed urgently. At the same time, given the high dollarization of the banking system, currency pressures, and economic slowdown, increased credit and liquidity risks should not be neglected. We are encouraged by the authorities taking measures to support banks and safeguard financial stability, but more decisive actions are needed, including addressing weaknesses in the supervisory framework, and in particular, to strictly enforce prudential rules without any exception.

Structural Reforms

We note that progress in structural area has been slower than hoped, and we consider that accelerating structural reforms are crucial to create stable growth and reduce poverty in Tajikistan. In this context, strengthening the key functions of the NBT and creating a more independent central bank are important steps to restore the NBT's credibility. Increasing transparency and improving governance of the NBT will make the NBT's Board and the internal audit function more effective and improve investors' perceptions. At the same time, we welcome the authorities' decision to adopt a recapitalization strategy for the NBT, which will seek to minimize fiscal costs, and to review the central bank law by the end of the year.

Restoring financial health of SOEs is very important to further consolidate the public finances. In this context, we welcome the authorities' priority to monitor more closely the SOEs by the finance ministry and to strengthen the fiscal control of those companies, in particular in the aluminum

sector, which are shifting their profits offshore in order to avoid taxes in Tajikistan.

The staff's comments would be appreciated.

Mr. Bergo and Mr. Davidsons submitted the following statement:

This program review shows mixed performance with regrettably slow progress in important areas like addressing safeguard risks and governance reforms at the NBT. Considering that there is progress on most of issues, and the prior actions have been completed, we can, if with some hesitation, support completion of the first and second review and the augmentation of the level of access. Recovery in Russia and the consequent resumption of the remittances flows has improved the economic outlook for Tajikistan. We broadly concur with staff's assessment and limit our comments to the following comments.

While we may agree with staff that overall performance has been satisfactory, it is disappointing that some of the transparency benchmarks have not been met. We supported the program noting that the program's structural benchmarks would be key for assessment of the program performance. Regarding the structural benchmark on Talco audit, as other Directors, we wonder about the reasons for; i) the delays of publishing Talco 2006-2008 financial statements; and ii) for not hiring one of the big four. About the former, we note from Mr. Weber and Ms. Tartari's helpful buff statement that the authorities are committed to publish the statements. The latter seems not to be a significant breach but is slightly odd considering the benchmark's explicit wording. Could staff comment? Given the administrative capacity constraints we may understand the delays in initiating NBT quarterly audits.

We share the staff's concerns regarding the Roghun Hydropower Project. We are astonished to read that the authorities rose funding through coercion and find it unacceptable. The way the fund raising preceded raises concerns about the prospects of repeating the Sangtuda I HPP scenario, described in Box 1. The staff rightly points out that the authorities have rushed to implement the project without a due assessment of social and macroeconomic implications. We note from Mr. Weber's and Ms. Tartari's buff statement that the authorities have suspended the advertisement campaign for the domestic sale of the equity to the public. As we understand from the buff statement, the Tajik authorities are well aware that they would have to attract an international consortium at further stages of the project. Therefore,

we are slightly puzzled about the reasons for this urgency, as it would seem rather difficult to start to implement the project without a major shareholder. Do authorities plan to start the project and sign new contracts before the feasibility study initiated by the World Bank? Given concerns about those issues, we find the 2010 structural benchmarks increasing transparency of the Roghun HPP project as appropriate and we will closely follow the authorities' performance in meeting the benchmarks.

We are concerned about the rise of contingent liabilities stemming from the banking sector. The sharp increase of NPLs in the banking sector and the fact that the deposit increase is mainly due to government deposits raises concerns about the possible fiscal costs stemming from the banking sector. The staff points towards risks of declining credit growth.

Finally, we support the authorities' efforts aiming at developing a private sector-led financing mechanism for the agriculture sector. We can also observe progress with NBT governance reforms, though much remains. We commend the Tajik authorities for the way the NBT involvement in cotton industry financing was resolved and for adopting the NBT recapitalization strategy.

Mr. Daïri and Mr. Monajemi submitted the following statement:

We thank staff for the well-written papers and Mr. Weber and Ms. Tartari for their informative statement.

Higher social spending, with financial support from the international community, together with exchange rate flexibility allowed the authorities to alleviate the severe impact of the global crisis and to stimulate the economy. Nonetheless, the rate of growth decelerated significantly in 2009 which, together with the fall in remittances, resulted in a sharp decline in disposable per-capita income. Even though prospects for 2010 are promising, as remittances and exports have started to recover, there are significant downside risks, mostly related to sporadic disruptions in rail traffic through Uzbekistan, uncertainty about the pace of revenue reforms, vulnerabilities in the banking sector, and weak institutional capacity.

Performance under the ECF arrangement was broadly satisfactory. The authorities are committed to the key 2010 program objectives of maintaining external stability, ensuring fiscal sustainability, and meeting the country's large social and infrastructure needs, in line with their Third Poverty Reduction Strategy for 2010-12. Therefore, we support the authorities' request

for waivers, completion of the first and the second reviews, and augmentation of access. However, like Mr. Shaalan and Mr. Ismail, we would have supported larger access, given Tajikistan's very low level of reserves, even after the proposed augmentation.

We concur with the authorities' supportive fiscal policy in 2010, aimed at a small widening of the overall fiscal deficit, compared to 2009, notwithstanding the projected decline in grants. This will be achieved through a modest increase in revenue and a broadly unchanged level of expenditure as a ratio to GDP, although the composition of expenditure will be changed toward increased social spending. As underscored by staff, the increase in wages in the social sectors and the minimum pension would improve the quality of social services and provide a direct benefit to low-income groups. However, we are concerned about the decline in infrastructure spending. We also agree with staff that the equity campaign for the financing of Roghun Hydropower project exerts a countercyclical impact and more than offsets the intended fiscal stimulus. We welcome the authorities' agreement to phase out the equity campaign, in view of its adverse social and macroeconomic implications, and their intention to seek financing of the project through an international consortium under the leadership of the World Bank.

The flexible exchange rate regime has facilitated adjustment to exogenous shocks and reduced external vulnerabilities. We are pleased to note that the National Bank of Tajikistan (NBT) will continue building international reserves, while maintaining the flexible exchange rate regime. It is also encouraging that interventions in the foreign exchange market will continue to be limited to smoothing excess volatility. The sharp rise in nonperforming loans, the decline in profitability, and the significant slowdown in credit growth are cause for concern. Even though the authorities' actions in tightening prudential norms and stepping up supervision have reduced the risk that this poses to the financial sector, vigilance is required in view of the remaining vulnerabilities indicated in Box 2. We welcome the authorities' efforts in revamping the NBT law in line with best international practices, strengthening governance of the central bank, adopting a strategy for its recapitalization with Fund TA, addressing gaps in the commercial banks law, and establishing an appropriate AML/CFT framework. We also welcome the ongoing strengthening of liquidity management tools.

In addition to NBT governance reform, the structural reform agenda will focus on improving revenue and expenditure management, and reforming SOEs and reducing the related fiscal risks. Adoption of remaining regulations for implementation of the 2005 Tax Code, and strengthening administrative

capacity will be key for enhancing revenue. We would welcome staff clarification on the tax treatment of profits from aluminum production, which are to a large extent “shifted offshore and not taxed in Tajikistan,” and how Tajikistan compares with other countries in this regard. The envisaged implementation of the full Treasury Single Account (TSA) system would enhance fiscal monitoring and transparency. We welcome ongoing reforms of the civil service and the health and education sectors, as well as the authorities’ indication that the pension and universal health insurance reforms will be costed and their poverty and social impact assessed before the related laws come into effect. Elimination of SOE arrears and implementation of the action plan for the cotton sector would enhance overall efficiency and reduce vulnerabilities, including for the financial system.

The debt sustainability analysis update indicates that Tajikistan would remain at high risk of debt distress. However, we note that the DSA does not take into account workers’ remittances which, if included, would significantly improve the debt situation, in view of their exceptionally large size. We believe that the DSA framework should be revisited as soon as possible to include remittances and eliminate this unacceptable discrimination against remittance-dependent countries. The staff may wish to comment

With these remarks, we wish the authorities success in their endeavors.

Mr. Yamaoka and Mr. Haruki submitted the following statement:

We thank the staff for their informative paper and Mr. Weber and Mr. Tartari for their helpful statement. We can go along with the completion of the First and Second Review under the Extended Credit Facility (ECF), and support the authorities’ request for augmentation of the arrangement, although we regret that the structural reforms, in particular those regarding the governance of the National Bank of Tajikistan (NBT), are delayed.

Commitment to the Program and Structural Reforms

We regret that a mid-2009 temporary accumulation of wage and pension arrears led to the nonobservance of a performance criterion. As a remedial action to this nonobservance, the pension arrears were settled at the end of 2009, and a small remainder of the wage arrears was settled in April 2010. Although we acknowledge the authorities’ efforts to settle this problem, this nonobservance may bring about doubts about the authorities’ commitment to the ECF program. If such nonobservance of a performance criterion were to be repeated, it would be hard for the authorities to maintain

credibility within the international community regarding their ability to follow through with decisive policies. In this context, we encourage the authorities to strive to demonstrate their strong commitment to the program.

Moreover, we are concerned about the delays in carrying out structural reforms, in particular those related to the governance of the NBT. The staff report illustrates significant weaknesses in NBT governance, such as fragmented accounting of financial information and weak internal audit mechanisms that fail to cover certain core operations. Especially, we share the staff's concern regarding the NBT's plan to hire an external firm to provide assistance with internal auditing activities within the NBT's International Relations Department; this plan would carry the highest operational and financial risk. We welcome the staff's update on whether the NBT will modify their original plan or not.

In addition to the NBT, Roghun financing campaign, which rendered share purchases a de facto, one-off tax evidenced a lack of governance at this public entity. Such lack of transparency in public sector policies makes it difficult to attract capital inflows from overseas investors, as they would worry about institutional uncertainty and the possibility of a de facto taxation without due-process. Who purchased the Roghun shares? Did the banking sector also bear the burden of this purchase? How are the purchased shares evaluated in terms of accounting? (There can be a significant underestimation of risks if these shares are evaluated at the purchased price. Indeed, the fact that the government had to carry out a coercive campaign implies that the actual value of these shares may be lower than the purchase price. Additionally, the liquidity of these shares would be substantially reduced if there are any constraints on their disposal.) We would welcome the staff's comment.

Taking into account Tajikistan's large current deficit, around 7 percent of GDP, in 2010, the authorities need to make an effort to accelerate their structural reforms, in particular regarding the transparency of the public sector's policies, so as to gain credibility from both international markets and capital inflows.

Financial Sector

We are also concerned about the current high levels of non-performing loans (NPLs), as their ratio is as high as around 20 percent. Banks are strongly required to make an appropriate evaluation of their toxic assets, to ensure sufficient provisioning, in line with their expected losses (EL), and to separate

toxic assets from their balance sheets. Moreover, if necessary, the authorities should be ready to implement capital injections to banks. To this end, the authorities must ensure an appropriate supervision of the financial sector.

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

Mr. Fayolle submitted the following statement:

We thank the staff for a well written and candid assessment and Mr. Weber and Ms. Tartari for their informative buff statement.

We support the reviews of the ECF and the request for augmentation but we would like to express our disappointment regarding the implementation of the program. Little progress has been made since the ECF approval, a year ago, two quantitative performance criteria were missed, and while we recognize the potential short-term issues underlying this, we also wonder whether these are due to more structural issues in the banking sector and in the resolution of public arrears. We also acknowledge the mixed progress and delays on the structural reforms front.

Fiscal Policy

While we realize that the overall fiscal deficit for 2009 was consistent with the program target, we wonder whether the authorities are following a consistent approach. For example, we would like to know how the 2 percent reduction in the VAT rate, the increase in wages and social expenditures, and pension arrears clearance were financed.

Under these circumstances, the additional financing gap and the request for augmentation come as a surprise. Moreover, the government is presently financing the cotton debt by issuing around US\$100 million in treasury bills. We take, however, due note that staff indicated that the terms of the above-mentioned issuance are not in line with market prices. We would appreciate it if staff could comment on whether all financing options to fill the financing gap were discussed? Furthermore on the cotton debt, we note that around US\$550 million of the debt incurred by farms will be written off and an additional debt of US\$154 million will be repaid to the NBT. Could staff also elaborate on the means to accomplish this?

The Roghun Hydropower Project could potentially have significant macroeconomic impact. We are somewhat astonished by the estimated impact

on poverty of the equity campaign and more broadly on economic growth. While it is undeniable that the country severely needs infrastructures, we believe that other ways to finance such a project could have been preferable. Moreover, the issue of debt sustainability of the project, given that the debt of the country is still qualified as under distress, is a concern. Figure 1 of the DSA is very illustrative of the distress situation, since most of the scenarios are flirting with thresholds.

Monetary Policy and Financial Sector

While we are pleased to see that the authorities are committed to the flexible exchange rate, the reserves remain at a very low level. Since staff's CGER analysis is not included in the report, it provides no information on the development of exchange rates. Furthermore, except for financial sector issues, there is no reference to the conduct of monetary policy, apart from the report's assessment that the central bank seems to pursue a quantitative approach. We would appreciate more discussions on these issues in future reports.

Financial sector pressures are mounting. It is difficult, in our view, to enhance best practices in the financial sector when the NBT's lack of controls over financial reporting is characterized by a complete absence of any oversight bodies, a restricted access to basic data, limited operational integrity and a lack of transparency that remain causes for concern. Therefore, staff's recommendation that the "NBT needs to step up its enforcement of such standards and require [commercial] banks to prepare credible strategies to repair their balance sheets" seems a very challenging task. We hope that the monitoring of the implementation of the safeguard assessment's recommendations will be as serious in Tajikistan as it is in other regions.

Mr. Weber made the following statement:

The Fund's relationship with Tajikistan has not been smooth in the past years, mainly due to an incident of serious misreporting, and for that reason allow me to spend a bit of time in my introduction. At the last Board discussion in April 2009, during which the present arrangement was approved, we informed the Board that the Tajik authorities completed its audit of the National Bank of Tajikistan conducted by Ernst & Young London and that they had repaid all non complying disbursements to the Fund. The change at the helm of the Central Bank took place before the Board agreed to the program.

Now, with Tajikistan's track record and its commitments being doubted by several directors, conditionality on governance and transparency, particularly regarding the NBT and the major state owned enterprises, has remained part and parcel of the current ECF arrangement, and Tajikistan has complied fully. The audit of the National Bank's financial statements and audited reports of the NIR position have been concluded and published. The Fund's updated safeguards assessment of the National Bank's operations is about to be completed, and the same principles of transparency and publicity will apply to Talco and the Roghun joint stock company.

On the Roghun hydropower project, several colleagues commented on the staff's appraisal that the financing campaign has been coercive. On behalf of my Tajik authorities I would like to clarify that elements of coercion have indeed been observed. But a more nuanced picture should have been painted, as such practices—which mostly occurred on the district level or lower—seem to implement a campaign to an extent that the government did not support or endorse. Most importantly, however, there is now a solid understanding about the joint process led by the World Bank to, first, thoroughly assess from all angles the Roghun hydropower project; and then, assuming technical, economic, social and environmental feasibility, to seek financing from an international consortium for the construction of the Roghun plant. This project is but one example of the necessary and necessarily close cooperation of the Fund's mission with multilateral development banks and bilateral donors.

The Fund arrangement serves as an anchor not only for strengthening macro stability, but also as a framework for the cooperation and the financial support of these other official creditors and donors. I would like to stress that Tajikistan is a landlocked, low income country and remains highly vulnerable to external economic shocks such as swings in remittances and exports. Program performance is also likely to be impacted by continued disruptions in electricity supply and cross border railway transport with its main trading partner as well as recurring natural disasters that are taking a heavy toll on vital infrastructure and that regularly claim many lives. Among these disasters, the most recent large mudslide in the south is estimated to have caused damages of more than \$600 million.

On account of the specific vulnerability of Tajikistan to external shocks and the need to shore up its reserves, my Tajik authorities ask the Board for the completion of this combined review as well as augmentation of the program to 120 percent of quota. On the latter point, this would amount to less than double asked for by authorities in April 2009, which several colleagues would have found desirable and acceptable. We hope that our buff

statement has provided sufficient information and assurances to colleagues for this request to be granted.

The staff representative from the Middle East and Central Asia Department (Mr. Schimmelpfennig), in response to questions and comments from Executive Directors, made the following statement:

As many Directors noted, the authorities have made some important progress under the program so far, and economic developments were better than we had projected a year ago. At the same time, some reforms are lagging; and in particular the Roghun equity campaign ran counter to key program objectives. On balance, I hope that the program has made a difference for the better and will continue to make a difference.

Take, for example, the Roghun equity campaign. An important reason for the authorities to initiate the equity sales was the feeling that they were not supported by the international community in their development strategy. There are good and valid reasons why international support was slower than hoped for by the authorities. But to me, a take away from this is that we can influence the authorities' policy choices if we stay engaged and seem to be helping them to achieve their goals. This is the reason why the staff proposes to proceed with the program. One concrete achievement of remaining engaged is that the authorities have agreed to de facto phase out this equity campaign. They have committed to good governance principles with regard to the construction, including external audits, and they are now paying better attention to the project's macroeconomic implications.

Let me now turn to specific questions. I will first address issues pertaining to the level of access. The proposed access level balances the need to swiftly build national reserves, the constraints imposed by already high debt levels, and Tajikistan's ability to accumulate reserves by improving its balance paid position over time. Access of 120 percent of quota also corresponds to the new norm for a country such as Tajikistan.

Then more specifically on the Roghun hydropower project, there is a consensus that Tajikistan has a large hydropower potential that is not fully exploited, yet. The authorities are working on a number of projects in parallel, with Roghun being by far the largest. The Roghun project was conceived as a key element of the Central Asia energy grid and is also a key element of the hydropower chain involving Russia. Once the World Bank financed feasibility study becomes available—hopefully in early 2011—we will have a better understanding of the project's merits. The World Bank is working very closely

with the authorities on this project, and according to a memorandum of understanding between the authorities and the Bank, the government is only carrying out reconstruction work on the Roghun site to rebuild facilities to their 1992 status just before mudslides seriously damaged the existing structures. This does not interfere with the feasibility study, and major construction work is being delayed until this study is finalized.

At that time, the staff advised that the authorities should finance the Roghun project on concessional terms based on the current cost estimates that the debt sustainability analysis shows that assuming that there is a positive growth dividend, this would be viable. The preferred financing strategy involves the formation of an international consortium under World Bank leadership. This is also what the authorities would like to pursue. It would ensure the lower cost of funds and ensure proper governance standards during the construction process. The equity campaign does not yield the foreign exchange needed for the project. However, based on our understanding, the authorities have sufficient resources to carry out the work that is planned through the end of 2011, which gives sufficient time for the completion of the study and also for forming that international consortium.

Regarding the equity campaign, no comprehensive information is available on who purchased the shares. For the banks, the staff has advised that the NBT issue guidance on the fair market valuation of the Roghun shares. While the NBT has yet to provide these, it would give us a good idea of the impact on banks' balance sheets. The impact on households and growth arises mainly from the fact that households' purchases of Roghun shares reduces their disposable income and hence their consumption and welfare.

Turning to governance at the Central Bank and the safeguards assessment, the slow progress on improving governance that many directors noticed is to some extent a capacity problem. De facto, many of the key reforms are managed by the same few people at the NBT who have to handle this in addition to their regular work. Also, such reforms are politically and inherently difficult. Nonetheless, we believe that there is ownership at the top level of the leadership of the NBT. Indeed, Table 1 of the MEFP outlines a comprehensive and timely strategy for moving forward with the government's reforms. This includes, for example, seeking the assistance of an external auditor for core internal audit functions. The contract for this was signed as a prior action.

Also, the review of Tajikistan's Central Bank law, which is not on par with best practices, follows up on the FSAP. The FSAP had identified a

number of reform areas to enhance governance. The most important ones were taken up under the 2008 Staff-Monitored Program, and the remaining ones should now be addressed under the overall NBT law on which the staff will be providing technical assistance.

On the cotton sector's debt resolution and its impact on NBT and commercial banks' balance sheets, the cotton debt resolution is the main factor behind the need for recapitalization. The NBT is sitting on non performing loans of around \$450 million that are being written off as part of this resolution. For commercial banks, the cotton debt resolution replaces about \$113 million of non performing assets with government securities. Given the below market interest rates, banks still take a loss compared to the nominal value of these cotton sector loans. However, given that the loans were not collectible in the first place, their resolution and these Treasury bills on balance strengthen banks' balance sheets.

The NBT has also issued repayment schedules to cotton investors for debts to the tune of \$154 million. Investors are expected to start repaying as of this month under the program as part of the recapitalization strategy. In terms of the capital injection needs for commercial banks, we believe that these should come from existing or new shareholders because the government has limited fiscal space, and also the NBT lacks the financial means to become a shareholder.

On monetary policy and other financial sector issues, the exclusion of non London gold delivery standard gold from net international reserves (NIR) did not directly impact the accumulation target for 2010, partly because of the limits of absolute accumulation during the normal course of business, but also because the excluded gold is still part of net foreign assets. So the NBT has the opportunity, at a cost, to bring this gold up to London gold delivery standards, and thus it would then be counted in the NIR. The revisions to the NIR target as compared to last year mainly reflect our updated risk assessment of reserve accumulation needs.

There was a question on whether something can be done to enhance remittances. We think that the transfers have already been facilitated by strengthening official financial channels such as money transfer bureaus. We do not see this as a priority area for reform at present. Diaspora bonds could be issued, but they would have to be issued in hard currency at market interest rates, and such financing would not be a viable option for Tajikistan given the constraints imposed by already high debt levels.

Setting up the repo facility and establishing payment settlement tier mechanisms are important reform areas, and the authorities are working with regional technical assistance advisors financed by SECO to establish secondary markets including by starting a program of regular Treasury issuance. These issuances commenced last year and we will monitor progress closely. More Treasury bills will be issued in the context of the cotton debt resolution and the NBT recapitalization, and their circulation will mark an important step towards having collateral interbank transactions as well as setting a risk free interest rate as a benchmark.

In addition, the World Bank is assisting the authorities with legislation that would facilitate bank resolution. Fund staff is in ongoing dialogue with the authorities on the state of the financial sector, but no specific TA requests have been made so far.

The central government, just to clarify, has its deposits exclusively with the Central Bank, but there are some local government enterprises that also use commercial banks. With the introduction of the treasury single account, government deposit should also be further concentrated at the Central Bank.

Turning then to fiscal issues, the authorities are keenly aware of the need to strengthen revenue collection. Their efforts are focused on improving tax compliance and reducing tax arrears, and FAD is currently fielding their second tax administration mission to Tajikistan this year. The staff has also proposed to review the tax system as a whole to address existing inefficiencies and raise the revenue yield over time. One part of strengthening revenue collection would be the onshoring of the aluminum profits.

The authorities, however, are not considering a reversal of the VAT rate cut effective in 2009. They feel that the previous rate was too high compared to neighboring countries and prohibitive to the private sector. In 2009 the rate cut was financed by stronger-than-projected revenue performance in the second half of the year.

The social spending commitment in nominal terms is included in the program as an indicative target, and hence the staff did not propose an additional benchmark for this. In 2009 the social spending increases were included in the original program financing package, the same as for 2010. Part of the budget increase comes from wage and pension increases because the level of pensions at \$170 per year and wages at \$820 per year in Tajikistan are

among the lowest in the world and remain low even after the planned increase of the program.

The World Bank supported civil service reforms that envisage wage increases to be able to attract qualified workers and improve social service delivery. Still, despite the authorities' commitment in these areas, pension arrears rose last year because contributions to the pension fund fell short of pension obligations. These arrears were cleared through temporary transfers from the defined component of the pension fund, and this transfer is to be reversed once a grant to support pension reforms is disbursed. Wage arrears arose in one district, not at the central government level, due to financing bottlenecks. And for program purposes, these arrears were treated as financing, and thus the reported fiscal deficit under the program is not affected by these problems.

Coming then to the audit, Talco has explained to us that the delays in finalizing and publishing the audit were due to a newly introduced legal requirement to revalue fixed assets. This was issued late last year. The company has now done this revaluation and expects that the auditors will soon be able to complete their reports.

For the time being, we do not think that delays in completing the audit were sufficient grounds for holding up the review, as the program covers a wide range of reform areas and the authorities have made progress in many of these. Going forward, the staff will continue to follow up and seek to ensure that this is done before the next review. Once the findings of the audit report become available, they will also inform the agenda in coming reviews. Hiring a "Big Four" auditing firm for this audit provides ex ante assurances for certain audit quality based on the internal controls of these firms. In the event, the choice of a so-called second tier firm resulted from a tender process and was based on cost considerations. Once the staff has had a chance to analyze the audit report, we should be in a position to assess whether this has affected the audit quality.

Turning to the profit of aluminum production: these profits are not taxed in Tajikistan because they mainly accrue to an offshore tolling partner called Talco Management. The choice to register this tolling partner offshore was partly driven by ongoing legal suits and was intended to protect Talco and its assets from these suits. Onshoring is ultimately a political decision given that Talco Management is partly owned by the government and would help to ensure that all profits that are generated from aluminum production in Tajikistan are adequately taxed. In this regard, the prospective audit of Talco

Management to which the authorities have committed under the program should make its financial flows more transparent.

With regard to economic outlook and risks, risks to the program from the rail disruptions are three fold. First, economic activity could be adversely affected if key inputs do not arrive in time—or do not arrive at all—and exporters cannot deliver on contracts. Second, shortages could also push up prices and thus fuel inflation. And third, dampened activity and lower-than-projected imports and exports would lower revenue collection and thus require additional spending cuts to stave off deficit targets. However, so far we have not seen a severe impact on the real economy, though customs collection has suffered somewhat in the first quarter.

Finally, on structural reforms, with the help of the World Bank, a new land registration law was adopted, and steps are being made to establish land use rights. Also, the legislation to protect and strengthen land use and ownership rights has been drafted. The authorities are engaged with several IFIs, including the EBRD, the IFC and the ADB in developing private sector-based agricultural lending.

The staff representative from the Strategy, Policy, and Review Department (Mr. Ghura), in response to comments and questions from Executive Directors, made the following statement:

There was a question on remittances and how they are treated in the DSA. Remittances in Tajikistan's DSA were treated in line with the new debt sustainability framework that was approved by the Executive Board in August 2009. In the new DSF, a new favorable rating can be envisaged based on two conditions that need to be satisfied together.

First, remittances should represent a reliable source of foreign exchange, which is the case for Tajikistan. These remittances should not exhibit very large volatility or structural decline in the recent past. The second condition is that breaches in the thresholds under the baseline without remittances—whether under the baseline or under stress tests—should not be protracted. In the case of Tajikistan, the breach under the scenario of no remittances is actually protracted, and this is why the risk classification still remains at a “high risk of debt distress.”

Having said this, we recognize that remittances play a critical role in Tajikistan's foreign exchange inflows, and certainly we should take this into account in policy choices.

Mr. Daïri encouraged the management to look into the issue of remittances again for all countries to see how the DSA framework could be reviewed or revisited to have a more equitable treatment of that important source of revenue for many countries.

Mr. Yamaoka made the following statement:

We have a bit of concern about the institutional aspects of such financing. The staff mentioned the lack of information at this juncture, so we hope that the staff could provide an explanation by the next review. For example, the staff indicated that there was a lack of information in terms of equity financing, which means that the government does not keep any list of shareholders. It is unbelievable. There are also accounting issues here. If the shareholders do not have any claim and there is no dividend payment, the value of the equity should be evaluated at zero. So we hope the staff will provide more information on this issue by the next review.

On governance issues, in principle, the shareholders should have the power to eliminate bad managers, because otherwise there might be substantial agency problems and substantial inefficiency in terms of the governance of such projects. For example, bad managers make bad decisions while receiving huge amounts of payments and living in a gorgeous house with a gorgeous girl. There are a couple of frameworks to prevent such bad management, but the easiest way is to make the compensation of bad managers linked to the dividend payments; for example, no dividend payments mean no payment to the managers. There are also a couple of other ways such as the external audit. Another important method is to disclose the payment to the managers and facilitate or maintain the transparency of the balance sheet and the income statement of such a project.

So we hope that the staff will provide further information on issues such as the accounting of equities and the corporate governance of programs by the next review.

The staff representative from the Middle East and Central Asia Department (Mr. Schimmelpfennig) responded that the staff would provide an update at the next review. With regard to composition, the government itself had information on the shareholders. Though not all shareholders had been registered, yet. Some of the small shareholders still needed to be registered, and that was part of the commitment that the authorities had made under the program. The authorities however felt that for confidentiality purposes they could not share the composition of the shareholders with anybody, including the staff.

The Acting Chair (Mr. Lipsky) asked for clarification on whether the authorities had committed to complete the roll of shareholders but had not committed to transparency on that the roll.

The staff representative from the Middle East and Central Asia Department (Mr. Schimmelpfennig) responded that the authorities had not committed to sharing the information on individual shareholders.

Mr. Weber made the following concluding statement:

My Tajik authorities are very grateful to the Fund for an intensive and constructive policy dialogue in the context of implementing the ECF arrangement. As we just learned, there are many difficult structural reforms that are still pending.

My authorities are aware that much remains to be done on this front, such as improving the business climate, removing rigidities in the agricultural sector, further enhancing transparency and accountability in the NBT and state owned enterprises. They are fully committed to the measures outlined given the economic and financial policies.

Executive Directors' support and constructive comments and questions will be duly transmitted to my authorities.

The Acting Chair (Mr. Lipsky) made the following summing up:

Executive Directors broadly agreed with the thrust of the staff appraisal. They observed that Tajikistan's growth momentum started to rebound from the second half of 2009, and with improving remittances and exports, the outlook for 2010 is positive. They stressed, however, that risks related to the uncertain external environment and policy implementation remain.

Directors considered the authorities' macroeconomic policies for 2010 generally appropriate. Given the uncertainties around the strength of the recovery, Directors agreed with the need for continued supportive fiscal policy in 2010. In this context, they also stressed the need to further build up international reserves.

Directors acknowledged the importance that the authorities attach to developing hydropower potential to address Tajikistan's structural energy deficit. They called for the cessation of financing the Roghun hydropower

project through equity sales, noting with concern the coercive elements in this approach and its adverse social and economic effects. They encouraged the authorities to work closely with the World Bank on the ongoing feasibility study and to form an international consortium to finance the project once the study is completed, taking into account Tajikistan's debt constraints.

Directors cautioned the authorities to carefully balance social and capital spending needs. While recognizing the need for developing hydropower as part of the growth strategy, they emphasized the importance of critical social expenditures, including on education and health. In this context, Directors encouraged the authorities to continue their efforts to improve tax administration and appropriately tax the profits generated by the aluminum production, including those that are shifted offshore through the tolling arrangement.

Directors welcomed the initial steps in the resolution of the cotton debt problem and recapitalization of the National Bank of Tajikistan (NBT). They encouraged the authorities to move quickly with the next steps, including compensating commercial banks for the government mandated cotton debt write-off and implementing the NBT's recapitalization strategy. Directors also stressed the importance of addressing the remaining serious weaknesses in governance identified by the safeguards assessment of the NBT.

Directors encouraged the authorities to make further progress in reforming state-owned enterprises. They also noted the importance of regular audits and the timely publication of audited financial statements.

The Executive Board took the following decision, with two abstentions from Messrs. Rediker (UA) and Stein (GR):

Republic of Tajikistan—First and Second Review Under the Three-Year Arrangement Under the Extended Credit Facility, Request for Waiver of Performance Criteria, and Request for Augmentation of the Arrangement

1. The Republic of Tajikistan has consulted with the Fund in accordance with paragraph 4.A(b) of the arrangement for the Republic of Tajikistan under the Extended Credit Facility of the Poverty Reduction and Growth Trust, as set forth in EBS/09/43, 3/31/2009 (the "Arrangement"), to review program implementation.
2. The letter from the President of the Republic of Tajikistan, dated May 20, 2010 (the "May 2010 Letter"), together with its attached Memorandum of Economic and Financial Policies (the "May 2010 MEFP")

and Technical Memorandum of Understanding (the “May 2010 TMU”) and the letter from the Chairman of the National Bank of the Republic of Tajikistan, dated June 4, 2010, shall be attached to the Arrangement, and the letter of the President of the Republic of Tajikistan dated March 31, 2009 shall be read as further supplemented and modified by the May 2010 Letter.

3. Accordingly, the Arrangement shall be amended as follows:

a. In paragraph 1(a) of the Arrangement, “SDR 78.3 million” shall be replaced by “SDR104.4 million.”

b. In paragraph 1(b) of the Arrangement, “SDR 65.26 million” shall be replaced by “SDR 78.31 million.”

c. New paragraphs 2(d) and 2(e) of the Arrangement shall be inserted to read as follows:

“(d) the fourth disbursement, in an amount equivalent to SDR 13.045 million, will be available on or after September 15, 2010, at the request of the Republic of Tajikistan and subject to paragraphs 4 and 5 below;

(e) the fifth disbursement, in an amount equivalent to SDR 13.045 million, will be available on or after March 15, 2011, at the request of the Republic of Tajikistan and subject to paragraphs 4 and 5 below.”

d. A new paragraph 4.B of the Arrangement shall be inserted to read as follows:

“B. the fourth and fifth disbursements under this arrangement specified in paragraphs 2(d) and 2(e) above:

(a) if the Managing Director of the Trustee finds that with respect to the fourth disbursement, the data as of June 30, 2010, and with respect to the fifth disbursement, the data as of December 31, 2010 indicate that:

(i) the ceiling on the cumulative flow of net domestic assets of the NBT, or

(ii) the floor on the cumulative flow of total net international reserves, or

(iii) the floor on cumulative overall fiscal balance of the general government excluding foreign-financed Public Investment Program and related grants, or

(iv) the ceiling on the disbursements of concessional external financing,

as set out in Table 3 of the May 2010 Letter and further specified in the May 2010 TMU, was not observed; or

(b) until the Trustee has determined that, with respect to the fourth disbursement, the third program review, and with respect to the fifth disbursement, the fourth program review, referred to in paragraph 26 of the May 2010 Letter, has been completed.”

e. In paragraph 5(a) through (d) of the Arrangement, “Table 1 of the Letter” shall be replaced by “Table 3 of the May 2010 Letter” and “TMU” shall be replaced by “May 2010 TMU.”

4. The Fund decides that the first and second reviews contemplated in paragraph 4.A(b) of the Arrangement are completed, and that the Republic of Tajikistan may request the disbursements of the second loan referred to in paragraph 2(b) of the Arrangement and the third loan referred to in paragraph 2(c) of the Arrangement, respectively, notwithstanding the nonobservance of (i) the end-December 2009 performance criterion on the ceiling on the cumulative flow of net domestic assets of the NBT, as set out in paragraph 4.A(a)(i) of the Arrangement, and (ii) the continuous performance criterion on arrears on wages and pensions of the general government, as set out in paragraph 5(b) of the Arrangement, on the condition that the information provided by the Republic of Tajikistan on the performance under these two criteria and on the implementation of the measures specified as prior actions in Table 4 of the May 2010 Letter is accurate. (EBS/10/95, Sup. 2, 6/4/10)

Decision No. 14645-(10/57), adopted
June 7, 2010

APPROVAL: July 19, 2010

SIDDHARTH TIWARI
Secretary