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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 20/4-3

11:15 a.m., January 13, 2020

3. Republic of Tajikistan—2019 Article IV Consultation

Documents: SM/19/289 and Correction 1; and Supplement 1; and Supplement 2; SM/19/290; and Correction 1

Staff: Khandelwal, MCD; Christopherson Puh, Zakharova, SPR

Length: 41 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	O. Odonye (AE), Temporary
	E. Ondo Bile (AF), Temporary
	D. Vogel (AG), Temporary
	N. Heo (AP)
	A. Maciá (BR), Temporary
Z. Jin (CC)	
	E. Cartagena Guardado (CE), Temporary
	A. McKiernan (CO)
	S. Benk (EC)
	P. Rozan (FF)
	K. Merk (GR)
	B.Singh (IN), Temporary
	L. Cerami (IT), Temporary
	K. Chikada (JA)
	C. Sassanpour (MD), Temporary
	P. Al-Riffai (MI), Temporary
	V. Rashkovan (NE)
	K. Karjanlahti (NO), Temporary
	S. Potapov (RU), Temporary
	R. Alkhareif (SA)
	K.Tan (ST)
P. Inderbinen (SZ)	
	O. Haydon (UK), Temporary
	P. Pollard (US), Temporary

C. McDonald, Acting Secretary
S. Maxwell, Summing Up Officer
D. Jiang, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present

Legal Department: R. Berkhout, C. Blair, K. Kao, N. Rendak. Middle East and Central Asia Department: M. AL Riyami, J. Azour, J. Kahkonen, P. Khandelwal, S. Mirzayev, F. Talishli. Monetary and Capital Markets Department: A. Naseer. Strategy, Policy, and Review Department: J. Yepez Albornoz, D. Zakharova. World Bank Group: S. Djumena, S. Mahajan.

Executive Director: A. Mozhin (RU). Alternate Executive Director: L. Palei (RU), F. Sylla (AF), P. Trabinski (SZ). Senior Advisors to Executive Directors: P. Braeuer (GR), G. Heim (SZ). Advisors to Executive Directors: S. Belhaj (MD), X. Cai (CC), D. Crane (US), U. Latu (ST), P. Mooney (CO), H. Mori (JA), A. Zaborovskiy (EC).

3. REPUBLIC OF TAJIKISTAN—2019 ARTICLE IV CONSULTATION

Mr. Inderbinen submitted the following statement:

On behalf of the Tajik authorities, we thank staff for the well-crafted papers. The authorities are grateful for the consistent support and advice that they have benefited from in the course of the Article IV cycle. They thank the MCD mission team, as well as the various TA missions and the Resident Representative in Dushanbe. Engagement with the Fund is a critical and highly valued contribution to the authorities' ongoing efforts to maintain economic and financial stability and to implement important structural reforms under challenging economic and geopolitical circumstances. Tajikistan is a land-locked country with a mountainous terrain and a limited economic base; it is classified as a fragile state in the Fund's LIDC grouping.

Economic developments and outlook

While tapering off to an estimated 5.5 percent in 2019, economic growth has been consistently robust over the past years. Real GDP has grown at an average of close to 7.5 percent over the last two decades. As highlighted in the staff report, this has enabled substantial inroads into poverty incidence and has allowed for critical capital expenditure. The authorities have responded to the recent strains on the external position and the financial sector by allowing for some currency depreciation and by stepping up financial sector supervision. Inflation is within the target range of the NBT; foreign reserve coverage is adequate; and public debt, despite the rapid increase over the past decade, has recently declined as a share of GDP.

The authorities are confident that continued public sector investment, and the implementation of industrial policies and structural reforms in line with their National Development Strategy will allow for continued robust growth going forward. The authorities' economic outlook is thus more optimistic than that offered by staff. This said, the authorities agree that stability and growth would benefit from reforms to increase resilience to economic shocks, further improve the business environment, and strengthen economic governance more broadly.

Fiscal policy

Given shortfalls in revenue, the authorities have taken steps to contain the fiscal deficit for 2019 at 3.75 percent of GDP. In order to maintain current outlays, such as transfers to households and social expenditure, capital expenditure was cut back. This includes reduced expenditure on infrastructure. While total revenue has declined for the reasons given in the report, it should be noted that the effect of import duty exemptions for farm and fishery products is not substantial, due to the small share of this revenue item in the state budget.

The authorities are grateful for staff's suggestions on how to broaden the tax base and make the tax system more equitable. A high-level working group has been established, and the authorities have requested FAD TA to this end. The authorities will continue their engagement with staff on options to strengthen the fiscal policy framework and to increase debt management capacity. Important efforts are underway to stem the losses of the large SOEs and to improve governance of the sector, as laid out in the Selected Issues paper and touched on below. The authorities are also committed to carefully prioritize capital outlays. This will allow for the critical infrastructure projects, including the Roghun hydro-electric station, to proceed as planned. These projects are central to Tajikistan's development strategy, and they will be of significant benefit to the Central Asian region more broadly.

Monetary policy

In accordance with the authorities' Monetary and Currency Policy Strategy, the NBT is taking steps in preparation of a phased transition to inflation targeting. In line with the Fund's advice, the NBT has introduced new instruments to establish an interest rate corridor and has improved forecasting capacity. Further work is underway to improve the transmission mechanism and develop the interbank market. The authorities are encouraged by the correlation that has recently emerged between the refinancing rate and interbank short-term rates. In addition, the NBT has stepped up its communication efforts, both through the media and round tables with market participants.

The authorities differ from staff's assessment of views by market participants on external payment delays and informal guidance by NBT on FX rates. Such reports do not correspond to what commercial banks communicate to NBT, nor do they match the data disposable to the central bank. Given the country's external position and the role of remittances, the Tajik foreign exchange market is characterized by seasonal fluctuations, and relations between supply and demand for foreign currency can change significantly over a given year.

The authorities are currently revising the directive on the use of foreign exchange conversions that is relevant to the MCPs identified by staff, and they are taking the staff's proposals into consideration. More generally, it is important to underline that the two MCPs as listed in the footnote to page 11 and the Informational Annex arise due to the absence of mechanisms to avoid potential deviations between market and official rates. The practice of determining MCPs based on potentiality is to be discontinued in the course of the ongoing review of the Fund's MCP policy.

Financial sector

The authorities are well aware of the benefits of increased financial sector stability. They are continuing their efforts to implement the recommendations of the 2015 FSAP. The NBT has set up a Financial Stability Department to monitor systemic risk, and an inter-agency Financial Stability Council has been established. AQRs have been performed, action plans to reduce NPLs in the banking system have been adopted, and legislation has been passed to increase the resolution powers of the NBT.

The authorities acknowledge that further work is needed to limit concentration risks in banks, address related-party lending, and improve the governance of financial institutions. They are availing themselves of technical assistance by the World Bank and the EBRD. The authorities are continuing to work on bringing the issues around the two insolvent banks to closure. They are currently conducting an asset evaluation and intend to liquidate the banks thereafter.

The loss of correspondent banking relationships is an ongoing concern of the authorities. As documented in the report, CBRs have decreased substantially over the last years. The authorities are well aware that an effective AML/CFT regime is a necessary, albeit not sufficient, condition to maintain a healthy level of CBRs. They are thus committed to implement the recommendations of the recent assessment against the FATF standard by the Eurasian Group.

Structural reforms

The authorities are cognizant of the need for continued efforts to improve the business environment and the investment climate. They intend to build on recent achievements to facilitate private sector activity, including access to credit, which are reflected in improved scores in the World

Bank's 2020 Doing Business indicators, particularly for starting a business and obtaining credit.

Tajikistan has inherited an array of state-owned enterprises from the former centrally planned system. As is well documented in staff's Selected Issues paper, smaller entities were privatized in the early 1990s, and important efforts are underway to reform the large SOEs. Past measures include the establishment of an SOE monitoring unit in the finance ministry, inclusion of a fiscal risks statement in the state budget, and the development of a risk management strategy. More recent steps are the drafting of new legislation to improve accountability and transparency of the sector, and the establishment of a Risk Coordination Council. Ensuring financial viability of Barki Tojik, the energy company, will be key. To this end, significant hikes in electricity tariffs have been set in train; a decree has been issued to unbundle the activities of the company, and arrears to suppliers and banks will be cleared with World Bank and ADB assistance.

The authorities valued the exchange with staff on governance under the Framework for Enhanced Fund Engagement. Staff has provided useful suggestions for areas that further steps might focus on. The authorities' efforts to improve governance will continue to be guided by their National Anti-Corruption Strategy. They saw merit in staff's suggestions on how implementation of the strategy could be improved, and on how the strategy could be strengthened, including by closer alignment with the UNCAC.

Mr. Psalidopoulos and Ms. Cerami submitted the following statement:

We thank Mr. Inderbinen for his informative buff and staff for a comprehensive set of papers. We welcome Tajikistan's strong economic growth and remarkable poverty reduction; however, we concur with staff's assessment that the current growth model based on public investment may not be sustainable in the medium-term. A larger and more competitive private-sector, supported by a sound financial sector, as well as greater exchange rate flexibility are needed to ensure higher and more inclusive growth and strengthen macroeconomic resilience. We offer the following comments for emphasis.

Further efforts are needed to strengthen the monetary framework. The central bank has been successful in steering monetary aggregates to keep inflation within its target range, while taking important steps towards an inflation targeting (IT) framework. However, further reforms are needed for a successful transition to IT, most notably greater independence of the central bank and a more flexible exchange rate. We are concerned about the weak financial position of the central bank, that has persisted since the safeguard assessment was completed in 2009, and urge the authorities to recapitalize the central bank and gradually end all its quasi fiscal activities. We take note of the clarifications about the central bank's formal guidance on foreign exchange rates provided by the buff and welcome the authorities' openness to reviewing the directive on the use of foreign exchange conversions, that gives rise to multiple currency practices (MCPs) based on current Fund's policy on MCPs. In this regard, we see merit in staff's call for improving the transparency and the functioning of the foreign exchange market, thus limiting deviations between market and official rates.

Bolder action is required to restore confidence in the banking sector and support sound credit growth. Despite some progress in strengthening bank regulation and supervision and developing a macroprudential policy framework in line with FSAP recommendations, the financial sector has not fully recovered from the 2015-16 crisis. We agree with staff that liquidating the insolvent banks and reimbursing insured depositors would be key to restore confidence. Furthermore, reducing non-performing loans and strengthening credit risk management and bank governance would be critical to support the efficient allocation of credit, while further enhancements and strong enforcement of the AML/CFT framework would improve financial integrity and help to preserve the remaining correspondent banking relationships.

The large State-Owned Enterprise (SOE) sector should be urgently reformed to safeguard fiscal sustainability. We welcome the envisaged reforms of the state-owned energy company aimed at improving efficiency, addressing arrears, and increasing tariffs up to full cost recovery. The reforms should be broadened to target other large SOEs, whose borrowing plans, although not guaranteed by the government, pose significant fiscal risks through contingent liabilities. Equally important will be increasing the transparency and oversight of large public investment projects, such as the construction of the Roghun dam. Uncertainty over construction costs and power purchase agreements for exports are another source of significant fiscal risks, which call for building buffers through spending restraint and measures to broaden the tax base. While a well calibrated fiscal consolidation is needed to mitigate the high risk of external and public debt distress, it will also be important to maintain adequate social spending throughout the process. With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Benk and Mr. Zaborovskiy submitted the following statement:

We thank staff for the well-written papers and Mr. Inderbinen for his insightful buff statement. Tajikistan's economy is recovering but the economic growth needs to be sustained on the backdrop of downside risks. We positively note that staff and the authorities broadly agree that comprehensive reforms are required to strengthen prospects for sustainable and inclusive economic development. While we broadly share the thrust of the staff appraisal, we would have preferred a more nuanced and holistic description of the proposed adjustment scenario in the papers, since the right sequencing and pace of reforms are critical for the overall success of economic rebalancing.

Growth-friendly fiscal consolidation underpinned by public financial management reforms is warranted to put debt on a sustainable trajectory. We agree with staff's recommendations on fiscal and debt policies to confront risks of debt distress. However, more attention is warranted to the fiscal target and quality of the adjustment. In the 2017 Article IV report staff recommended "an operational fiscal anchor of a medium-term primary deficit below 1½ percent of GDP" and in the current report "a deficit target of 2 percent of GDP in 2020 and 1½ percent of GDP in 2021". Could staff elaborate more on the operational fiscal target to capture all debt-creating flows? We encourage the authorities to advance their debt management strategy to better mitigate fiscal risks from large infrastructure projects and SOEs. Fiscally sustainable and effective public investments in infrastructure and human capital are of utmost importance given Tajikistan's developmental challenges. In this regard, creating an appropriate fiscal space and increasing public investment efficiency should be a priority. We also welcome the analysis and recommendations on broadening the tax base and optimizing tax expenditures.

Strengthening the monetary policy framework should go hand-in-hand with greater exchange rate flexibility. We welcome the central bank's plan to continue moving towards the inflation targeting regime (IT). However, the appropriate conditions should be in place to successfully carry out this transition and we broadly agree with staff's recommendations in this area, including the central bank's greater independence and interbank market development. While a market-determined exchange rate remains the core pillar of the IT framework, we would like staff to elaborate more on the recommended timing of further FX market liberalization to align it with the transition to the IT, capacity development and possible technical assistance.

We emphasize that the monetary policy stance should be appropriate to contain inflationary pressures.

Cleaning up the financial system from non-viable banks and strengthening bank regulation and supervision will help rebuild depositor confidence. The progress made in addressing vulnerabilities in the financial system is encouraging but more decisive and better-sequenced measures are needed. We encourage the authorities to accelerate their efforts in addressing related-party lending, weak governance in banks, and the high level of non-performing loans. Building on the IMF Technical Assistance on bank resolution and liquidation and shifting to risk-based and forward-looking bank oversight is critical for revitalizing the banking system. We also positively note staff’s assessment that the combined effects of currency depreciation on banks’ balance sheets are manageable owing to their strong initial capital position.

Restructuring the loss-making state-owned enterprises (SOEs) and broadening reforms aimed at the private sector development are critical to sustain economic growth. We welcome staff’s analysis and recommendations presented in the excellent Selected Issues Paper on the fiscal risks stemming from the SOEs and reforms in Tajikistan. Since the state-owned energy company remains the biggest loss-maker, the multi-faceted approach, combining sectoral reforms, tariffs increase, cost-cutting, and a stronger social-safety net, should be implemented to improve the energy sector’s efficiency and contain fiscal risks while protecting the poor from energy tariff hikes. We welcome the authorities’ efforts to address these long-standing issues and encourage them to continue with structural reforms, including the state-owned sector in general, and energy industry restructuring in particular.

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

Mr. Jin submitted the following statement:

We thank staff for the comprehensive set of reports, and Mr. Inderbinen for the useful buff statement. Economic activity remained strong supported by positive performance in the agriculture, industry, and services sectors. To ensure growth is sustainable in the longer term, steadfast reform efforts are needed to strengthen the banking sector, enhance fiscal management, and raise the efficiency of state-owned enterprises (SOEs). We welcome the authorities’ commitment to continuing with the reforms and broadly agree with the thrust of staff’s appraisal.

Fiscal consolidation would be necessary to safeguard fiscal and debt sustainability, and allow room to tackle shocks. Measures are needed on both the revenue and expenditure side. To mobilize more domestic revenue, we agree with staff that the authorities should broaden the tax base and phase out those tax incentives that are inefficient. On the spending side, we see merits on the infrastructure-led development strategy. Meanwhile, strong public finance, investment, and debt management are essential for ensuring that resources are efficiently targeted at high-priority projects and debt remains sustainable. We encourage staff to continue to closely engage with the authorities to provide technical assistance as necessary to support efforts in the above areas.

The monetary policy framework and transmission mechanisms should be further enhanced over time. Like staff, we welcome the steps taken by the authorities so far to introduce standing facilities and monetary instruments, develop liquidity forecasting capacity, and foster money market activity. Building on these efforts, we encourage the authorities to allow greater exchange rate flexibility and pursue efforts to strengthen monetary policy transmission. This requires a careful and well-managed approach, and may take time to become effective.

The financial sector needs to be strengthened in order for it to properly fulfill its function in supporting economic development. We welcome the agreement between staff and authorities on the key areas that need to be tackled, including rebuilding deposit confidence, improving access, and addressing weak governance in banks, and look forward to further progress going forward. We note that the authorities considered that banks would be liquidated after completion of an ongoing asset evaluation - when is this evaluation expected to be completed and what is the expected timeline for completing the liquidation of the two insolvent banks? We also welcome the ongoing steps to strengthen the bank regulatory and supervisory framework, which is essential for effective implementation of macroprudential policies.

On the structural front, there is room to raise the efficiency of the SOE sector and a need to improve the business environment to support private-sector led growth. We welcome the authorities' ongoing efforts to reform SOEs. As some of the SOEs also carry important social functions, we encourage the authorities to also be mindful of the potential social impact of these reforms and ensure that the poor and vulnerable remain adequately protected in the process through well-targeted social assistance. Meanwhile, actions to address weaknesses and tackle corruption would help boost market confidence and investment. Finally, better data and statistics would help facilitate more effective policymaking, and we look forward to more progress in this regard.

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

Mr. Chikada, Mr. Heo, Mr. Tan, Mr. David, Ms. Latu and Ms. Mori submitted the following joint statement:

We thank staff for the informative set of reports and Mr. Inderbinen for the helpful buff statement. Tajikistan has made important progress in generating economic growth, reducing poverty, improving the business environment, and strengthening the monetary and financial supervisory frameworks. To build on this, further efforts are warranted to protect macroeconomic stability particularly in view of the considerable downside risks to the macroeconomic outlook. We broadly agree with staff's appraisal and offer the following comments for emphasis.

Fiscal consolidation should stem the rising fiscal and external imbalances and enhance debt sustainability. We strongly encourage the authorities to proceed with broadening the tax base, prioritizing capital expenditure and improving efficiency of public investments while enhancing the measures to protect the poor and vulnerable. These are particularly important in light of the downside risks from the anticipated further external borrowing for the Roghun dam construction and likely cost overruns of the large infrastructure projects, and other significant risks from SOE losses. The need to recapitalize the central bank and bail out the remaining insolvent banks present additional fiscal risks. We support the measures to strengthen the fiscal framework and transparency. These include the development of a comprehensive debt management strategy to incorporate both public and SOE debt, and upgrading debt recording and reporting practices. Recording of SOEs' non-government guaranteed debt is essential too, given its rising trend. In this context, can staff comment on any plans to improve the debt recording and reporting practices, in line with the DSA criteria?

Accelerating the SOE reform efforts is vital for mitigating fiscal and financial sector risks. The SOE sector is systematically important with large arrears to the government, domestic banks and other creditors while being inefficient and loss-making. This calls for stepped-up efforts on the reform agenda to enhance the SOEs' governance and financial viability. We welcome the reform progress but agree with staff that more needs to be done. This includes the implementation of the Strategy to Manage Fiscal Risks emanating from SOEs, the passing of the new SOE law and continued reform of BT. Improving SOE data quality and coverage is equally important to gauging a complete and accurate picture of the SOEs' financial health and facilitating better monitoring of the associated fiscal risks. Drawing from the international experience with SOEs' reforms (Annex 1 Selected Issues Paper), what would be important lessons for Tajikistan's SOE reform efforts? Given the significant risks posed by the SOE sector and the resource constraints such as the staffing and capacity issues at the SOE Monitoring Department, is there scope for reviving the privatization program?

Enhancing financial sector soundness would support economic development and inclusive growth. We strongly encourage the authorities to continue with the recovery efforts from the 2016-17 financial sector crisis to boost depositor confidence and facilitate better access to deposits and loans. With the differing views on the liquidation of the two large insolvent banks, can staff comment on the associated risks of proceeding with the liquidation as recommended given that the Individuals Deposit Insurance Fund (IDIF) lacks sufficient back-up funding mechanism for larger payouts and the weak fiscal position to support the liquidity and post-liquidation solvency of IDIF? Will the depositors be fully insured, and if not in particular, what could be possible ramifications of the liquidation to financial stability? Based on the authorities' and staff's estimates and bank resolution laws, is there scope for capital injection or another alternative (practical) way to solve this problem apart from liquidation? Decisive steps towards strengthening of bank regulation and supervision including the NPL resolution initiatives and addressing weaknesses in bank governance and credit risk management should continue. We welcome the developments in building a robust macroprudential framework. From the analysis in Annex V and in consideration of data availability, can staff comment on whether the macroprudential toolkit in place or that is being developed is adequately robust to prevent possible future financial upturn that may be followed by another financial crisis?

It is crucial to continue taking firm steps towards addressing the structural constraints to effective monetary policy transmission. Inflation is rising and the external position is at risk with the FX shortages and the international reserves expected to decline over the medium term below the recommended thresholds. Ensuring a strong, financially viable and independent central bank to formulate and implement appropriate monetary policy to effectively address these imbalances is therefore crucial. We take positive note of the reforms to strengthen the monetary policy framework and agree that more needs to be done to strengthen the monetary transmission and thereby enable the central bank to better achieve its mandate. We also support allowing greater exchange rate flexibility to facilitate external adjustment and limiting FX interventions to smoothing excessive exchange rate volatility.

We encourage the authorities to press on with the structural reform agenda to support inclusive and sustainable growth. Labor market reforms would help address the high unemployment rate and low female and youth worker participation rate. Addressing the governance weaknesses in core economic institutions to reduce vulnerabilities to corruption is vital to boosting prospects for private sector-led growth. This would foster confidence and encourage sustainable domestic and foreign direct investment.

Ms. Pollard and Ms. Crane submitted the following statement:

We thank staff for the papers and Mr. Inderbinen for the helpful buff statement. We welcome this chance to discuss Tajikistan, as the last Board discussion took place more than two years ago. In the interim, Tajikistan has made progress in a few reform areas, notably in reducing the cost of doing business and facilitating trade. However, policy adjustments are needed to re-establish macroeconomic sustainability, and a large structural reform agenda remains. We encourage the authorities to take a more prudent approach to public investment, permit a more market-based exchange rate and address remaining issues from the two insolvent banks. We also call on the authorities to strengthen governance through better implementation of the anti-corruption framework and improving governance in core economic institutions. These efforts could be complemented by increased transparency, and in that spirit, we encourage the authorities to consent to publication of the Article IV documents. We concur with the thrust of the staff appraisal and would like to highlight several points.

Fiscal and Debt Sustainability. Tajikistan's large public investments have supported moderate growth but at significant costs. High government spending and limited exchange rate flexibility have led to large fiscal and external deficits and put public debt on an unsustainable path. We welcome the authorities' intention to better prioritize capital spending and avoid non-concessional debt. The high degree of inefficiency in Tajikistan's public infrastructure projects relative to its peers is also troubling. Reducing debt risks and establishing a comprehensive debt management strategy (DMS) that incorporates state-owned enterprise (SOE) debt should be top priorities going into 2020. Have the authorities requested technical assistance to help develop a more comprehensive DMS?

We are particularly concerned with the high degree of external borrowing by SOEs and the lack of proper central government oversight and transparency. We strongly support efforts to improve the monitoring, recording, and publication of all external SOE debt. We welcome the SIP on fiscal risks from SOEs and the discussion in the DSA of non-guaranteed SOE debt in the stress scenarios; we agree that this debt could pose large fiscal risks. Can staff comment on the terms of the recent TALCO and Tajiktransgaz loans, including whether they meet the threshold for “concessional” debt?

Exchange Rate. We agree with staff that exchange rate overvaluation along with barriers to access foreign exchange risks hurting economic activity and incentivizing capital outflows. We urge the authorities to remove exchange restrictions and multiple currency practices, as recommended by staff.

Financial Sector. Significant reforms are needed to strengthen the governance of banks so that they can play their role in supporting economic activity and private sector development. We encourage the authorities to take more decisive action to liquidate the insolvent banks and make payouts to insured depositors. Further efforts are also needed to strengthen the framework for AML/CFT.

Mr. Beblawi and Ms. Al-Riffai submitted the following statement:

We thank staff for their comprehensive reports and Mr. Inderbinen for his candid buff statement. Tajikistan continues on a strong growth momentum, accompanied by moderate inflation. Reforms by the authorities rightly aim to achieve fiscal consolidation, greater financial stability, a stronger external position, and stronger governance, and improve the business climate.

Fiscal consolidation is best served by relying on domestic resource mobilization, as well as expenditure rationalization. Despite strides in tax reforms, which resulted in higher tax revenues as a share of GDP in 2014, tax revenues have since fallen due to tax exemptions and weak tax compliance. We see merit in advancing tax administration reform and broadening the tax base so as to improve revenue performance. To that end, we are reassured that the authorities have established a high-level working group to prepare a new tax code and look forward to IMF technical assistance in this area. We see a need to prioritize and improve the efficiency of public investment to create fiscal space for important infrastructure projects. Furthermore, to protect vulnerable groups, it will be necessary to increase targeted social assistance. Can staff comment on the efficacy of the social safety net? We see merit in avoiding non-concessional borrowing so as not to exacerbate the existing debt vulnerabilities. We concur with staff that strengthening the macro-fiscal capacity in the Ministry of Finance would better support fiscal analysis and policy-making.

The National Bank of Tajikistan (NBT) has made progress in strengthening regulation and supervision and developing the macroprudential framework and toolkit. Nonetheless, more efforts are needed to restore public confidence and mitigate risks in the banking sector. We thank staff for their analysis in Annex V, which highlights the link between the build-up of systemic risk and financial cycles in Tajikistan's banking sector. Staff emphasizes that a more robust macroprudential framework can help mitigate the upswings in the financial cycle; thus, reducing the need for large and disruptive corrections. To that end, we welcome the NBT's efforts aimed at developing the macroprudential framework and the establishment of a Financial Stability Department and an Inter-Agency Financial Stability Council. Further strengthening of the supervisory and regulatory capacity, as well as improving the quality and availability of data, would allow the macroprudential framework to operate efficiently. We are pleased to note that the authorities are proceeding with strengthening the AML/CFT regime to improve its financial integrity and stability and help in mitigating pressure on CBRs. To that end, we welcome Fund support in strengthening risk-based AML/CFT supervision of financial institutions. Mr. Inderbinen notes in the buff statement that an effective AML/CFT regime is a necessary, but not sufficient, condition to address a loss of CBRs. We would appreciate staff's comments on what other challenges underlie the loss of CBRs in Tajikistan.

We take note of Tajikistan's significant infrastructure needs. However, high and inefficient public investment and loss-making SOEs, a legacy of a previously centrally planned system, have been contributing to higher debt vulnerabilities, costly bank bail-outs, and a pressing need for foreign exchange. Since SOEs currently pose significant fiscal and financial sector risks, we see merit in advancing improvements in oversight, transparency (including the publication of audited IFRS-compliant financial statements for all economically significant SOEs), and performance of SOEs to help mitigate these risks. We commend the authorities for their ongoing reforms for Barki Tojik (BT), the state-owned energy company which alone accounts for over 80 percent of SOE losses. We welcome the unbundling of its operation and BT's improved financial viability, as a result of higher electricity tariffs, which we hope is accompanied by improved operational efficiency. We would appreciate staff's clarification on whether the authorities plan to rely on PPP's in the energy sector, specifically, and in other public investment projects in general.

Mr. Mozhin and Mr. Potapov submitted the following statement:

We thank staff for a set of comprehensive reports and Mr. Inderbinen for his insightful buff statement. Since the previous Article IV consultation economic developments in Tajikistan have been broadly favorable despite the challenging domestic and global environment. Economic activity has been strong, with the growth rates at around 7.2 percent in 2017-18. The financial sector is recovering from the 2015-16 crisis. Reserve coverage under the Fund's various metrics is adequate. At the same time, the country's external position is expected to deteriorate due to surging imports for capital-intensive projects and falling export proceeds. The outlook is also clouded by rising contingent liabilities and remaining weaknesses in the banking sector. We agree with staff and the authorities that further reforms are needed to strengthen macroeconomic stability and growth prospects.

On the analysis of risks facing the Tajik economy, staff could have shed more light on potential shocks stemming from still heavy dollarization and possible strengthening of the U.S. dollar. In a dollarized economy of Tajikistan, the U.S. dollar strengthening is likely to automatically increase the debt-to-GDP ratio and weaken the banks' balance sheets, as it was observed in 2015-16. The delay in the authorities' response to these external shocks contributed to higher balance of payments pressures and loss of foreign exchange reserves. We have also emphasized on prior occasions that it is important not to confuse the effects of the strengthening of the U.S. dollar with other external factors, including the size of remittances in terms of the national currency and/or as a share of GDP. Could staff elaborate on the recent trends of remittances' flows into Tajikistan, including their average real value in national currency terms? Could staff also comment on the key measures to reduce dollarization in Tajikistan?

The fiscal situation is challenging. Although the level of public debt is expected to decline from 50 percent of GDP in 2017 to 45 percent of GDP in 2019, the country's risk of debt distress remains high, especially in the context of spending pressures to support the construction of the Rogun. Under these circumstances, the authorities would be well advised to consider staff's recommendations on fiscal consolidation, including the recommendation to expand the tax base and reduce tax exemptions. The authorities also need to enhance the fiscal framework and reduce fiscal risks and quasi-fiscal deficits stemming from SOEs operations. Borrowing by SOEs should be carefully monitored and included within the government's overall medium-term debt envelope and strategy. Could staff elaborate on any best practices to record non-guaranteed borrowing by SOEs? Could staff also comment on their growth assumptions, which the authorities consider to be too conservative?

The external sector assessment in Tajikistan shows that the external position remains vulnerable with overvalued currency and high current account deficit. While these estimates are subject to high uncertainty, we support staff's recommendations to move to a more flexible exchange rate regime, which could also be instrumental in accumulating additional foreign exchange reserves. In this context, we agree with staff that further improvements in the monetary policy framework and the FX market need to be advanced.

We note the disagreement between staff and the authorities on the reasons behind the shortage of foreign currency in the market and grievances of some banks about the delays in obtaining FX by their customers. As Mr. Inderbinen pointed out in his buff statement, the Tajik foreign exchange market is characterized by seasonal fluctuations, and the balance between supply and demand for foreign currency can change significantly over a given year. In this context, we would appreciate staff's additional comments on their findings described in paragraphs 22-23 of the report, as well as on possible next steps in addressing this sensitive for the authorities on this issue. Did staff consider the possibility of providing specific TA to examine in greater detail the underlying issues for the FX shortage?

Except for two problem banks, the financial sector continues its path of recovery from the banking crisis, with positive improvements in the quality of the credit portfolio. The share of NPLs has declined from 36.5 percent in 2017 to 31.5 percent by September 2019, while profitability has improved. Could staff elaborate on their recommendation to liquidate the two insolvent banks and related consequences for the IDIF and financial stability?

Implementation of structural reforms is critical for strengthening private sector development, promoting diversification, and improving the business environment. Over the recent years, the authorities have made important progress in some areas, as reflected in the World Bank's Doing Business ranking. At the same time, Tajikistan's export basket remains narrow and concentrated in metallic minerals, leaving the country highly vulnerable to fluctuations in international commodity prices. We support the authorities' and staff's views on the need for further improvements in other key areas, including government efficiency and governance.

We wish the Tajik authorities all the best in their reform efforts.

Mr. Mojarrad and Mr. Ahmed submitted the following statement:

We thank staff for a well-written set of papers and Mr. Inderbinen for his informative buff statement. We are in broad agreement with the thrust of the staff appraisal.

Recent economic developments have been mixed. Economic activity has remained strong on the back of firm capital spending and household consumption, while the inflation rate has been kept in the NBT target range. On the other hand, the current account surplus in 2017 turned to a deficit of 5 percent of GDP in 2018, with weakness continuing in 2019; and total public guaranteed and unguaranteed debt has climbed steeply, with risk of debt stress remaining elevated.

We agree with the staff assessment that Tajikistan's growth model based on public investment and inward remittances may not be sustainable in the longer run. While noting that the authorities find staff's growth projections on the conservative side given the expected high levels of public investment and the strength of their industrial policies, we are encouraged that they agree with staff on the necessity of comprehensive reforms to strengthen the prospects for inclusive and sustainable growth.

Given the underlying debt dynamics, we find the staff's recommended deficit target of 1 ½ percent of GDP in the medium term feasible. And to that end, we welcome the authorities' intentions to mobilize tax revenues with IMF TA, and prioritize current expenditure and limit capital spending to the most critical projects. Public investment in Tajikistan in relation to GDP is one of highest among its peer group. Prudent project selection and efficient implementation and monitoring should have high priority. At the same time, we welcome the authorities' commitment to strengthen the fiscal framework and fiscal transparency, and to manage the fiscal risks of SOEs, including their unguaranteed debt. While the authorities consider staff's DSA assessment as unduly negative, we welcome their recognition of the need to continue attracting concessional financing and their agreement that non-concessional borrowing would further weaken already-stretched debt sustainability.

Greater exchange rate flexibility would reduce external sector vulnerabilities and help build stronger buffers against external shocks. While we appreciate the authorities' concerns about the impact of exchange rate depreciation on inflation and on uncovered FX balances, we support the view that greater exchange rate flexibility now would help avoid a sharper and potentially more disruptive adjustment later. We appreciate staff comments on the dollarization trend in the economy and the NBT efforts to bolster the role of somoni.

We welcome the authorities' efforts to strengthen the monetary framework and improve the monetary policy transmission mechanism. There are a number of important prerequisites for an inflation targeting framework, most notably, a market-based exchange rate, a robust and efficient banking system, and central bank policy independence and operational autonomy. High credit risk and operational inefficiencies have contributed to abnormally high interest rate spreads, underscoring the need to rebuild depositor confidence and increase financial access. The recent increase in bank loans is encouraging and is indeed essential for supporting private sector activity. Also critical to public confidence will be a timely liquidation of the two formerly systemic insolvent banks and payout of insured depositors. With that in mind, we urge the authorities to expedite the implementation of the April 2019 IMF TA recommendations on bank resolution and liquidation. Progress in strengthening bank regulations and supervision is encouraging, but should be stepped up. We also welcome the authorities' commitment to further strengthen the AML/CFT regime to augment financial integrity and stability.

We urge the authorities to build on the progress already made in improving the business environment and press ahead with structural reforms, in close consultation with the private sector. Finally, we support staff recommendations for improving statistics—in terms of accuracy, timeliness and coverage—and urge the authorities to draw on Fund TA.

With these remarks, we wish the authorities all the success.

Mr. Lopetegui and Mr. Vogel submitted the following statement:

We thank staff for the reports and Mr. Inderbinen for his helpful buff statement.

Tajikistan's robust growth rates achieved in recent years and those projected for the future constitute a platform for the country to address its substantial challenges and risks. Among them, we observe fiscal and external imbalances, as well as vulnerabilities in the financial system and obstacles to growth related to structural issues. Regarding growth, staff rightly underscores that the country's growth model of reliance on public investment and remittances is not sustainable.

Although the debt-to-GDP ratio does not seem to be relatively high, looking at the complex outlook for external and domestic risks, the staff report timely recommend undertaking a fiscal consolidation process which would help to maintain fiscal and debt sustainability. We agree with staff that the process should protect the poor and vulnerable, while focusing on public investment, which seems to be elevated and not entirely efficient. We are encouraged by the authorities' intentions to strengthen the fiscal framework and transparency.

Tajikistan's current exchange rate system seems to constitute a distortionary factor for the country's economy. We note from the staff report that the lack of exchange rate flexibility is contributing to real appreciation, while putting pressure on international reserves, thus exacerbating external imbalances. Clearly, greater exchange rate flexibility would help Tajikistan to better absorb shocks.

Box 2 of the staff report is a good and timely reminder regarding the cost that financial inefficiencies and distortions often entail to the country and its population, particularly its most vulnerable sectors. As noted in that Box, the interest rate spreads in Tajikistan are among the highest in the world, which among other things, is related to high nonperforming loans. The report provides helpful recommendations aimed at addressing the above-referred distortions in the system, while encouraging the authorities to continue reinforcing bank regulation and supervision.

On structural issues, addressing governance problems and control of corruption, as well as reforms to state-owned enterprises, particularly to Barki Tojik, will allow the country to attract private investment, encourage growth, and further reduce the still high—although declining—poverty rate.

With these comments, we wish Tajikistan and its people every success in their future endeavors.

Mr. Sigurgeirsson and Ms. Karjanlahti submitted the following statement:

We thank staff for a well-focused and detailed set of reports and Mr. Inderbinen for the informative buff statement. While, reported growth has remained solid, the current growth model in Tajikistan is challenging which is evident from the accumulation of imbalances, the weak external position and high risk of debt distress. To rebalance, the authorities will need to embark on a broad set of reforms ranging from increased exchange rate flexibility, modernizing the monetary framework, fiscal consolidation, reining in SOE-related risks, continuing to build resilience in the financial sector, and enhancing the business environment. A Fund program could be beneficial to support the authorities in this endeavor. We are in broad agreement with staff's appraisal but would like to offer the following remarks on monetary, fiscal and financial stability.

Addressing the external imbalances through monetary and exchange rate reforms is critical. Large current account and fiscal deficits have spurred debt accumulation and combined with limited exchange rate flexibility led to real appreciation and fx-shortages. We agree with staff that allowing for more exchange rate flexibility and removing fx-restrictions will support adjustment, help to build buffers, and pave way for more balanced growth. We commend the authorities for the efforts taken in strengthening the monetary framework and encourage continuing the modernization of the NBT by increasing its independence, capital and financial position, and operational efficiency.

Fiscal consolidation will be integral to rebalance the economy and mitigate risk related to high debt. The very large public sector investment has supported growth and significant poverty reduction. However, it has also led to inefficiencies in spending and excessive debt. Consolidation of the fiscal deficit is needed but should be targeted to allow for increased support for the poor and vulnerable while ensuring prioritization of capital investments. Further, the erosion of tax revenues is concerning. Broadening the tax base, including by removing inefficient tax incentives, remains key for improved fiscal balance. Efforts to improve the efficiency, transparency, and governance of the very large SOE sector should be enhanced both to limit fiscal risks and improve the dynamism of the economy. We encourage the authorities to continue reforming Barki Tojik and highlight the importance of measures to mitigate the impact of energy tariff increases on the poor and vulnerable.

Reforms in the financial sector are needed to rebuild confidence. The legacies of the financial crises have led to elevated credit risks and NPLs, which continue to hamper credit growth. Rapid liquidation of the two insolvent banks, together with increasing incentives for NPL resolution by removing tax incentives, would improve the credibility of the banking sector, help reduce high spreads and restore credit flow to the economy. These efforts should be supported by strengthening the governance of the banking sector together with continued focus on improving bank regulation and supervision.

We agree with staff and the authorities on the importance on enhancing the AML/CFT framework.

The reform needs in Tajikistan are large and we encourage Fund TA to support the priority reforms. While there were several references to TA advice in the staff report it would be useful to get an overview. Could staff provide a list of a TA activities provided for Tajikistan and how these support the reform priorities identified in the previous and this year's AIV report?

Ms. Levonian, Ms. McKiernan and Mr. Mooney submitted the following statement:

We thank staff for their report and Mr. Inderbinen for his informative buff statement. The Republic of Tajikistan continues to experience strong economic growth accompanied by moderate inflation, while the poverty rate continues to decline. However, numerous challenges remain, including the unsustainability of the growth model's reliance on public investment and remittances, the narrow tax base, and the fragile banking sector. We agree with the thrust of staff's assessment and offer the following points for emphasis.

We support staff's view that reforms should be introduced to broaden the tax base and achieve fiscal consolidation, and that the tax system should be made equitable and practicable. We welcome the recommendations contained in the Selected Issues Paper to make tax incentives more transparent and nondiscretionary, in tandem with the establishment of a robust reporting system for firms benefiting from tax incentives. We agree that some recent increases in spending on goods and services should be reversed in order to expand targeted social assistance programs. We positively note the authorities' commitment to carefully prioritize capital outlays, which will allow for the critical infrastructure projects, including the Roghun hydro-electric station, to proceed as planned.

In relation to the banking sector, we agree with staff that rebuilding depositor confidence and improving access to finance is critical to support inclusive growth. In addition, further efforts to strengthen bank regulation and supervision are also needed. Staff recommend the prompt liquidation of two insolvent banks to trigger payouts to insured depositors by the IDIF. Are staff confident that the IDIF has the ability to carry this out in a swift and efficient manner, given the Fund TA provided to date in this area? We positively note the ongoing efforts to construct a robust macroprudential framework, which requires further improvements in data collection to enhance functionality. In relation to AML/CFT, we welcome the authorities' intention, as outlined in the buff, to implement the recommendations of the recent assessment of FATF standards implementation in Tajikistan by the Eurasian Group. This will be important in the maintenance of a healthy level of CBRs.

We encourage the authorities to continue the implementation of reforms pertaining to the State-Owned Enterprises sector, particularly in relation to Barki Tojik (BT). We welcome the technical assistance (TA) provided by the Fund in this area and encourage the authorities to remain committed in this regard, as this unprofitable sector continues to stifle economic growth, as illustrated in the Selected Issues Paper. We note that Tajikistan's WB Doing Business indicators have improved considerably in 2019 and encourage the authorities to introduce further measures in this space to encourage SME growth and reduce Tajikistan's reliance on public investment and remittances to facilitate economic growth. We commend the authorities for the ongoing reduction in the poverty rate. However, we note the very low female labor force participation rate as outlined in Table 8 of the report and encourage authorities to devise and implement policies to address this gap. We agree with staff that authorities should address ongoing weaknesses pertaining to corruption, including bringing the legal framework in line with the UN Convention Against Corruption.

Mr. Merk, Mr. Rashkovan, Mr. Braeuer and Mr. Jost submitted the following joint statement:

We would like to thank Mr. Inderbinen for his informative statement and staff for their well drafted set of reports. We take note that reported economic activity has been strong, inflation has picked up and the monetary framework is being strengthened. However, we are concerned about existing and developing fiscal risks, including those linked to contingent liabilities. We therefore welcome that the reports, in particular the SIP, provide a deeper insight into SOEs in Tajikistan. More ambitious SOE reforms will be needed to create a dynamic economy. More broadly, governance challenges remain important and should be addressed by the authorities as a matter of priority. We broadly agree with staff recommendations and would like to add a few points for emphasis.

Fiscal developments are of concern, in particular given the existing downside risks. Staff's assessment that the fiscal deficit is likely to exceed 4 percent of GDP and the finding that risks to debt sustainability are high, remains problematic. Large infrastructure projects are significantly increasing debt levels and could potentially crowd out growth-enhancing expenditures and further weaken external debt service capacity. We broadly agree with staff's recommendations aimed at addressing imbalances, in particular relating to fiscal consolidation and strengthening the fiscal framework, both at level of general government and of SOEs. Also, as staff, we believe that increasing the efficiency of public spending is of the essence. More generally, we believe it is important that the quality and efficiency of public investment needs to be adequate – not the level alone.

We appreciate that the report looks in greater detail into financial risks linked to SOEs and PPPs. We found the explanations provided in the SIP to be most useful. As the SIP lays out, the SOE sector plays an important role in the Tajik economy, employing 24 percent of the labor force and accounting for around 17 percent of GDP. The report illustrates that further reform in this sector will be vital going forward. In particular, we fully agree with staff that greater oversight and transparency of SOEs are necessary to help mitigate fiscal risks. We concur with staff that improving accounting, auditing, data availability and capacity constraints will be of the essence to address existing challenges.

While we appreciate staff efforts in the context of SOEs, we take note that the DSA does not seem to fully cover SOE related fiscal risks, as indicated in the table of page 8 regarding the scope of the DSA. In general, we strongly encourage staff to extent the DSA to include SOE debt in the DSA perimeter. In this case, we take note of staff's explanations that the Ministry of Finance does not record non-guaranteed debt of SOEs. We understand that situation renders staff's task difficult. While the SIP reflects ways of improving the situation, we would be interested in hearing staff's view on what actions should be taken first to improve the situation for next year's assessment? We appreciate staff's candor and explanations on what the DSA does not include (i.e. non-guaranteed liabilities of SOEs, contingent liabilities linked to the potential liquidation of two large and troubled financial institutions as well as guarantees triggered from any existing PPP agreements). We are, however, concerned that these omissions might lead to an underestimation of downside risks. We can therefore retrace staff's choice to use a value of 10 percent of GDP for the shock for SOE debt in the DSA stress test. At the same time, we would like to seek staff comments on as to why the shock for PPP was set at 1.73 percent of PPP stock instead of the default value of 35 percent.

More broadly, we encourage the authorities to more consistently follow up on IMF recommendations, in particular when it comes to the financial sector and the fiscal framework. In this context, we appreciate staff's table summarizing main recommendations and an assessment of the authorities' implementation thereof. Here, and while welcoming progress, we urge the authorities to increase their efforts to reform the banking sector and strengthen bank regulation and supervision. We fully support staffs call for improvements in statistics and data availability.

Finally, we welcome the authorities' efforts to improve the business environment, as laid out in Mr. Inderbinen's statement. We believe that efforts remain warranted and governance and corruption challenges need to be addressed as a matter of priority. We are concerned about the highlighted governance weaknesses in core economic institutions and believe that weaknesses in banks' and SOE governance is problematic from both an equity and economic attractiveness perspective.

Mr. Rozan and Mr. Sode submitted the following statement:

We thank staff for a comprehensive report as well as Mr. Inderbinen for his insightful buff statement. The country has registered strong economic growth over the last two years. However, its economic model, still largely relies on remittances and public spending. Public debt vulnerabilities, fiscal risks, inflationary pressures and rising external imbalances call for a more restrictive policy-mix, a flexibilization of the exchange rate and a more conducive business environment. While these policy adjustments are necessary, attention should be paid to cushioning their impact on the most vulnerable part of the population. Important governance issues must also be addressed to set track for inclusive growth. We broadly agree with the report and would like to make the following comments for emphasis:

Public debt is still on an unsustainable path. The DSA is quite similar to the 2017 DSA and shows that current policies are not likely to address existing vulnerabilities. Fiscal consolidation and a sound debt management strategy are necessary to address this challenge. We encourage the authorities to avoid new non concessional borrowing. Amongst large investment projects, the Roghun dam project is a key source of risk. While it is expected to produce positive development impacts, its potential cost for public finance is substantial, while the economic returns are uncertain. Staff has identified several weaknesses such has uncertainty on construction costs and power purchase agreement which merits the greatest attention. Could staff provide further analysis on expected effects on the country's macroeconomic trajectory?

The overvaluation of the real exchange rate and the existence of multiple currency practices must be addressed orderly. Indeed, the FX rate is excessively regulated, and the real appreciation of the currency is costly. The recommendation of the staff to increase flexibility is warranted and should facilitate external adjustment. However, adverse social impacts may arise, further degrading economic conditions of poor households. The analysis done on the impact of exchange rate flexibilization on the banking system was particularly interesting. Could staff elaborate on the expected socio-economic impact of FX restrictions removal and other proposed measures?

Financial sector still faces important issues: reforms have progressed, but the authorities still have headroom for further improvements. Since the 2015-2016 crisis, banks' health has improved but there were still more than 30 percent non-performing loans in September 2019 which hampers financing of the private sector. In order to improve trust, it is necessary to swiftly address the case of AIB and TSB in accordance with global good practice, in particular to promptly trigger payouts to insured depositors. The AML/CFT regime needs to be strengthened.

Public spending could better benefit to growth through better transparency, equity and efficiency. The fight against corruption and the promotion of the rule of law are essential to create a more business friendly environment. The 2013-2020 anti-corruption strategy provided a clear framework but has suffered from a lack of implementation. What were the most promising areas of the strategy and what impedes its effective implementation?

We invite the authorities to follow staff recommendation on improving the information system and supervision of SOEs borrowing and to consider SOEs' debt and fiscal risks for prudent budgetary planning. Debt level of SOEs such as Barki Tojik, Tadjikstransgaz and TALCO, among others, clearly demonstrates the risk emanating from bad SOE debt management. We are particularly concerned with the high degree of external borrowing by SOEs.

We welcome the demand of the authorities regarding TA of the Fund for fiscal architecture. The selected issues paper highlights that corporate tax system suffers from a flawed design, with high effective tax rate compared to regional rates and a complex tax administration. Tax exemption and incentives are vulnerable to abuse and the expected results on key sector development could benefit from a better assessment. Besides, tax incentives seem to have resulted in the erosion of the tax base.

Mr. Villar and Mr. Cartagena Guardado submitted the following statement:

We thank staff for a candid and well-informed Article IV report and Selected Issues paper that reflect the main developments, policies and challenges facing the Tajik economy. We also thank Mr. Inderbinen for his buff statement. We mostly agree with the thrust of the staff appraisal and want to emphasize a few points.

Strong economic growth and challenges ahead. Tajikistan has enjoyed strong rates of economic growth over the last two decades with an average of 7.5 percent. It has also reduced poverty by almost 50 percentual points over 17 years, and inflation remains within targets. The country faces challenges in the fiscal and financial sectors that need to be tackled promptly, as well as deterioration of its current account. Prudent macroeconomic policies are fundamental to reduce the high risk of debt distress reported in the debt sustainability analysis. We will welcome further comments regarding the reforms and industrial policies contained in the National Development Strategy and their stage of implementation.

Further reforms are essential to improve the soundness of the banking sector. We welcome the authorities' efforts to strengthen regulatory and supervisory capabilities and the banks resolution framework. The measures that authorities are implementing to control the high levels of NPLs and related lending go in the right direction. However, more needs to be done in the short run. If not controlled promptly, NPLs can impose important costs on the economy in the near future, as in previous experiences presented in Annex V of the report, and on the soundness of the banking system. The authority's actions to strengthen the banking law and macroprudential regulations with IMF's assistance are urgent and will help the country be better prepared for the challenges ahead.

Strengthening the oversight and transparency of the state-owned enterprises (SOEs) is needed. We welcome the measures being taken by the authorities to improve oversight and governance of the SOEs, as well as the creation of the Coordination Council and the revised SOEs Law. The risks and vulnerabilities for debt sustainability arising from SOEs, mainly from the energy enterprise that concentrates a large part of the losses, pose important contingencies for the fiscal stance and financial stability, and call for prompt actions. While staff recommendations to monitor, to improve corporate governance, and to pass the reformed SOEs' law according to best practices go in the right direction, we are of the opinion that a much deeper and comprehensive reform is needed to find a permanent solution.

We welcome the authorities' efforts to contain the fiscal deficit, as referred in the buff. As noted in the staff report, Tajikistan's fiscal stance has been on an expansionary path, as revenues as proportion of GDP have reduced and expenditures increased. We welcome the last actions being implemented by the authorities to restore the path of fiscal consolidation, especially considering the high contingencies and fiscal exposure derived from the SOEs and the financial system. We agree with staff that reforms to broaden the tax base are necessary and welcome the authorities' commitment to prepare the new tax code with IMF assistance, as well as the measures to strengthen the fiscal framework and transparency.

Strengthening Statistics. We encourage the authorities to continue taking advantage of the technical assistance provided by the IMF to strengthen the national account and fiscal statistics. This will be highly valued by international investors and international organizations, while also being a fundamental tool for the authorities' policy making and macroeconomic surveillance.

Mr. Bhalla and Mr. Singh submitted the following statement:

We thank the staff for an analytical set of papers and Mr. Inderbinen for his insightful buff statement.

It is encouraging to note that strong growth performance of Tajikistan over the past two decades has made substantial dent on poverty. However, given the lack of space in both the fiscal and monetary policy front, macroeconomic policies would need to proceed with caution so that the downside risks do not materialize and affect economic progress. In order to contain twin deficits, Tajikistan needs to diversify the economy, pursue fiscal consolidation (to ensure debt sustainability) and allow greater exchange rate flexibility (to enable the economy to absorb external shocks). Given a reasonably high tax-GDP ratio and given the limits to tax capacity in a developing economy, whether staff would like to lay specific emphasis on expenditure prioritization to achieve fiscal consolidation rather than reliance on tax revenues.

Growth trajectory is expected to slowdown in 2019 and further in the medium-term, which may affect the pace of reduction of poverty levels. Policy efforts to enhance productivity in agriculture and industry and provision of better education and health facilities would help in improving growth and reducing poverty. The buff states that the authorities' economic outlook is more optimistic than that offered by the staff. The SR mentions that GDP growth in H1 of 2019 was over 7 percent (page 5 of SR), while the projection for the full year is 5.5 percent (page 28 of SR), does it imply that there would be a sudden loss of speed in H2? If so, we would like the staff to elaborate on the factors that may cause sharper slowdown, given that there hasn't been a significant change in the macroeconomic environment between H1 and H2.

The biggest challenge to growth emerges from the financial sector weaknesses. As weaker financial sector constraints monetary transmissions and chokes off credit and GDP growth, we support the staff suggestions for reforms to restore public confidence in banks by reducing NPLs, improving bank governance, and reducing concentrated exposures to loss-making state-owned enterprises (SOEs). Enhancing the legislative framework to strengthen the financial sector should form an important element of policy efforts. In this regard, it's encouraging to note that the authorities are availing technical assistance from the World Bank and EBRD and are continuing to work on bringing the issues around the two insolvent banks to closure. Going forward, keeping in view the banking distress episodes, there may be scope for greater reliance on macroprudential policies to mitigate risks.

On the external front, the staff assessment indicates an overvaluation of the real effective exchange rate (REER). We agree with the assessment that the REER misalignment highlights the need for a combination of greater nominal exchange rate flexibility. While cross-border remittances have been an important support for the current account of the country, there has been a significant slowdown on remittance inflows after 2013. As the same time correspondent banking relationships have decreased substantially over the last years. We would like to know whether staff has done some analysis to understand the impact of loss in correspondent banking relationships on remittance inflows to Tajikistan.

We wish the authorities all the best in their future endeavors and hope that Tajikistan will soon catch-up with its past growth trajectory.

Mr. Sylla and Mr. Ondo Bile submitted the following statement:

We thank staff for the comprehensive reports and Mr. Inderbinen for his helpful buff statement.

We welcome Tajikistan's continued strong growth momentum in 2019. We note, however, that the country's fiscal and external deficits remain large and that inflation has risen in recent months. External public debt has also increased due among other to infrastructure projects financing and SOEs borrowing. We also note important downside risks to Tajikistan's outlook. Against this background, we encourage the authorities to undertake bold reforms and implement sound policies to pursue fiscal consolidation and strengthen the monetary policy framework in order to preserve macroeconomic stability. In addition, we also urge them to decisively address the issue of the two large banks that remain insolvent.

Fiscal consolidation should continue to further reduce the fiscal deficit and contain the rising public debt. Fiscal measures implemented in 2019 are welcome and we encourage the authorities to broaden the tax base and eliminate tax incentives assessed as being non-efficient. We see merit in the establishment of a high-level working group to prepare a new tax code and support the authorities request for a Fund's technical assistance in this area. Further efforts are also needed to better prioritize and increase the efficiency of public investments. Regarding the SOEs, we share the view that there is a need to closely monitor risks to debt sustainability stemming from accelerated borrowing.

Further efforts are needed to enhance the monetary policy framework. We welcome the measures taken by the authorities to improve monetary policy transmission including streamlining of open market operations and development of the domestic debt market. However, an effective transition to inflation targeting requires notably the strengthening of the financial position of National Bank of Tajikistan (NBT) and enhancing its independence.

Promoting financial sector's stability is crucial. The authorities have taken measures to strengthen banking sector supervision and put in place a macroprudential framework. Nevertheless, additional efforts are required to accelerate the restructuring of banks' balance sheets. Regarding the two non-insolvent banks, we take positive note from Mr. Inderbinen buff statement that the authorities intend to liquidate the two insolvent banks after finalizing the ongoing asset evaluation. We share the concern expressed by Mr. Inderbinen on the impact on the financial sector of the loss of correspondent banking relationships and encourage the Fund to assist the authorities to establish an effective AML/CFT framework.

Structural reforms should be continued to improve the business environment and unleash Tajikistan growth potential. In this regard, we welcome progress recently achieved by Tajikistan in the World Bank doing business indicators. We also note steps taken by the authorities to improve accountability and transparency of SOEs. Moreover, we welcome the important measures underway to address the financial viability of the energy company, Barki Tojik.

The Acting Chair (Mr. Zhang) made the following statement:

As staff reported and also highlighted in your grays, the country has experienced strong economic growth, but the outlook is challenging with the external and domestic downside risks. To move forward, particularly in terms of sustaining macroeconomic stability and facilitating inclusive growth, there are challenges, particularly in terms of the need for further fiscal consolidation and containing fiscal risks from large infrastructure projects and state-owned enterprises (SOEs), among others. These are challenges already highlighted in your grays, and I am sure we will discuss more in today's discussion.

Mr. Inderbinen made the following statement:

I will make a full statement at the end of the meeting, but I just wanted to indicate that the authorities are actively considering publication of the document. There are requests for modification of the staff report that are outstanding, and these relate in particular to Paragraphs 22 and 23 of SM/19/289 on the exchange rate policy. We will continue to engage with staff on these requests, and we hope to find a satisfactory outcome in due course.

The staff representative from the Middle East and Central Asia Department (Ms. Khandelwal), in response to questions and comments from Executive Directors, made the following statement:[1]

We have circulated written responses to the questions, and I will take this opportunity to emphasize three issues. The first is on the growth outlook. We mentioned the significant reforms in Tajikistan in recent years, especially on banking supervision and regulation, the monetary policy framework, and the business environment. The authorities' policies in the National Development Strategy include the high level of public investment and industrialization policies. However, there are considerable challenges to private sector growth, including the weak macro environment, which requires fiscal and external adjustment, the large but unprofitable SOE sector, the small financial sector, and the landlocked nature of Tajikistan. Private sector

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

investment remains low. Staff's growth projections reflect these challenges. Growth is projected to moderate from 5.5 percent in 2019 to 4 percent over the medium term as external and public debt vulnerabilities continue to rise.

Turning to the next issue, I would like to talk about fiscal risks where we have seen that the construction of Roghun dam is over 50 percent of GDP and is tying up fiscal resources, and the authorities have been borrowing to finance the dam. Even with concessional borrowing, the government debt is on the rise. If there were cost overruns or difficulties in marketing electricity exports, the fiscal situation would deteriorate further. When you look at the SOEs, this financial situation becomes worse. Of course, Barki Tojik reforms are very welcome, but they still need time for completion, and there are further measures needed to address losses and arrears. At the same time, you have sizeable SOE projects that are being financed by commercial non-guaranteed debt, which also then increase public debt vulnerabilities. So if you have any slippages in Barki Tojik (BT) reforms, or SOE projects, that would further aggravate debt vulnerabilities.

On the other hand, it is worth looking at how these investments are affecting the economy. They create appreciation pressures, which leads to a loss of external private sector competitiveness. Then restoring competitiveness means that you need a nominal currency depreciation, which proposes challenges for the monetary policy framework, public debt dynamics, and financial sector stability.

We agree that Tajikistan needs investment in infrastructure. That said, fiscal policy needs to support monetary policy, financial sector health, and private-sector development. Public investment needs careful prioritization and improvements in efficiency to mitigate these effects.

Last but not least, I would like to talk about the recommendation to liquidate two insolvent banks, Agroinvestbank (AIB) and Tojiksodirotbank (TSB), where we have seen repeated episodes of bank bailouts in Tajikistan since 2000. Most recently AIB was recapitalized in 2012 and also in 2016. The 2016 bailout of AIB and TSB left the existing bank management in place. It is three years down the road, and the banks are not viable or solvent, and deposit withdrawal restrictions remain in place. Because of this history that we have seen, the financial sector lacks the confidence of the public. Deposits and private sector credit are much smaller than in other countries, and interest rates are among the highest in the world. This has an adverse impact on prospects for private sector growth. In this regard, staff consider that reimbursing the insured depositors of AIB and TSB is important to restore confidence in the system. The banks are already going through a voluntary self-liquidation. They are not making new loans or taking deposits. Existing depositors are not able to withdraw their money. Statutory liquidation would put the authorities in charge of the process, and it will allow the payout of all insured depositors. It will ensure a more transparent deposit of assets and address moral hazard. That said, asset disposal may take some time. Staff also recommends putting in place a temporary fiscal backstop to ensure market confidence, and having it in place early means that the authorities may not have to use it or are likely not to have to use it. The Fund has provided expertise on bank liquidation.

Mr. Alkhareif made the following statement:

I would like to start by thanking staff for the excellent set of reports and Mr. Inderbinen for the insightful buff statement and helpful remarks which conveys the authorities' willingness to publish the report after cooperation with staff on certain issues. We have not issued a gray statement, but we would like to take this opportunity to commend the authorities for the strong economic performance, which not only has been strong but has been inclusive. We note the poverty rate has declined from over 80 percent to less than 30 percent in 2017. This is very encouraging.

As rightly mentioned by staff, there remain a lot of challenges. Unemployment remains high, and the Human Development Index (HDI) still has room to improve. Moreover, fiscal and external imbalances have widened, and the financial sector faces many weaknesses. In this context, we welcome the mention in Mr. Inderbinen's buff statement that the authorities are aware of these issues and are carrying out structural reforms and prudent policies in line with their national development strategies to improve growth and enhance its resilience.

On fiscal policies, we welcome efforts to maintain adequate social spending despite the decline in revenues. I see the mission chief's statement that capital expenditure (capex) has declined, and we think it is already at a high level. We see the usefulness to shift spending from capex to social spending as appropriate in the case of Tajikistan.

Improving spending efficiency and domestic revenue mobilization will be important going forward to strengthen the fiscal position. We note that staff have provided technical assistance in the fiscal area, and we encourage further efforts to help the authorities broaden the tax base and enhance the institutional capabilities in this area.

Strengthening the fiscal framework and enhancing fiscal transparency will be important, and we take note of the authorities' efforts to improve debt management capacity in the Ministry of Finance. Financial stability is very important, and we are encouraged by the authorities' efforts in enhancing financial stability. Particularly the establishment of the Financial Stability Department is important. We also take note of the interagency National Financial Stability Council, which will help the government arrange different procedures to ensure macro-stability for the whole economy.

We note staff recommendation on further improving the exchange rate flexibility. At the same time, we note the authorities' concern about the possible impact on inflation and social welfare, and we encourage staff to take this into consideration in future recommendations.

We note the concern also on the loss of correspondent banking relationships, and we encourage the authorities to continue their efforts and strengthen the anti-money laundering and counter terrorist financing (AML/CFT) framework. We welcome their commitment to implement the recommendations of the recent assessment of Financial Action Task Force (FATF) standards by the Eurasian Group.

Finally, we welcome the emphasis on improving statistics. We think this will help the government implement sound policies and improve the decision-making process. The quarterly GDP publication will be important to help assess timely policy recommendations. Also, improving the debt statistics and the government finance statistics (GFS) in line with the IMF standards would be important going forward. With these remarks, we wish the authorities every continued success.

Mr. Jin made the following statement:

First, economic growth of Tajikistan has been consistently robust over the past years. Real GDP has grown at an average of close to 7.5 percent over the last two decades and has allowed for critical capital expenditure, which is critical for a landlocked country like Tajikistan. We commend the authorities for their efforts to conduct continued public sector investment and the implementation of industrial policies and the structural reforms that will contribute to a sustained and robust growth going forward.

Second, fiscal prudence and consolidation would be necessary to safeguard fiscal and debt sustainability, and measures are needed on both the revenue and the expenditure side. On one hand, the authorities should broaden the tax base to mobilize more domestic revenue. On the other hand, we see merit in the infrastructure-led development strategy. We take positive note that the authorities are committed to carefully prioritize capital outlays and the focus on critical infrastructure projects, which are central to Tajikistan's development strategy and beneficial to the central Asian region. That said, we encourage staff to continue to closely engage with the authorities to provide technical assistance on public finance and the debt management. With these remarks, we wish the authorities every success in their policy endeavors.

Ms. Pollard made the following statement:

Strengthening debt management will require progress on SOE governance. In the answer to our question on the terms of borrowing by two large SOEs, TALCO aluminum plant and Tajiktransgaz, staff said they do not have any information on these contracts but that the authorities assert that the borrowing is commercial and non-guaranteed. Although that sounds good, we would like to have more information on this. These two companies are in the process of undertaking new borrowing totaling about 10 percent of GDP, so fiscal risks from contingent liabilities could be quite significant. Therefore, we think there should be more transparency about the terms of the contracts and urge the authorities to take up staff advice to strengthen financial reporting of the SOEs and to include SOE borrowing plans within the medium-term envelope of government borrowing. I would like to echo Mr. Jin's comments on the need of providing TA on debt management and fiscal in general.

On the exchange rate, we note Mr. Inderbinen's point that multiple currency practices (MCPs) stemming from the exchange restrictions are based on potential deviations and might not be considered MCPs under the proposed policy change. However, even if this is the case, we think the exchange restrictions combined with the currency over-valuation are not serving Tajikistan well. As staff points out, they risk hampering economic activity and incentivizing capital outflows. Instead, we think the authorities could develop tools to smooth seasonal fluctuations as warranted while still allowing two-way flexibility of the exchange rate. We encourage the authorities to continue engaging with Fund staff on policy and capacity development in this area.

Finally, we urge the authorities to publish the staff report as an important demonstration of transparency and would appreciate an update on whether the authorities have consented to do so.

Mr. Cartagena made the following statement:

We welcome the authorities' efforts to strengthen the regulatory and supervisory capabilities and the bank resolution framework. However, we consider more needs to be done to protect the soundness of the banking system. The authorities' actions to strengthen the bank law and macroprudential regulation with IMF assistance are urgent and will help the country be better prepared for the challenges ahead. We welcome the measures being taken by the authorities to improve oversight and governance of the SOEs, as well as the creation of the Coordination Council.

The recent vulnerabilities for debt sustainability was important contingencies for the fiscal stance and financial stability and call for prompt actions. We are of the opinion that a much deeper and comprehensive reform is needed to find a permanent solution.

We also welcome the action being implemented by the authorities to restore the path of fiscal consolidation. We agree with the staff that reforms to broaden the tax base are necessary and welcome the authorities' commitment to prepare the new tax code with IMF assistance.

Finally, we encourage the authorities to continue taking advantage of technical assistance provided by the IMF to strengthen the national accounts and fiscal statistics.

Mr. Sassanpour made the following statement:

We have issued a gray statement, and let me again commend the authorities for high and very inclusive growth of the past few years, as was mentioned by Mr. Alkhareif, which is evident in the sharp reduction in poverty rates.

The high level of public investment has certainly contributed to robust growth but also adding to debt. The high rates of investment are expected to continue going forward in the region of 13-14 percent, which is adding to debt, but the impact on growth seems to be less certain. We definitely welcome the rebalancing of part of the capital spending with social protection, which is quite prudent.

The staff mentioned, and Mr. Jin also backed it up, that he is encouraged by the authorities' intention to prioritize capital spending going forward. I would like to seek staff views as to the efficiency and prioritization over the medium term. Currently maybe two or three bulky projects are accounting for most of the public investment, but it is not clear to me going forward what would be the nature of these public investment projects and to what extent it could be supporting growth and maybe even crowding out private investment. Any elaboration on that front would be highly appreciated.

Mr. Mozhin made the following statement:

Over the last two decades the Tajik economy has demonstrated strong growth performance, with growth rates at an average of close to 7.5 percent. The poverty rate has declined from over 80 percent in 2000 to near 29 percent in 2017. Despite these positive developments, substantial challenges and risks remain. The authorities are well aware of the need to strengthen the fiscal and external positions, improve SOE governance, modernize the monetary framework, promote financial sector stability, and enhance the business environment.

We would like to commend the authorities for their commitment to the reform agenda and their efforts to improve business climate. According to the 2020 WB Doing Business, Tajikistan was among the 10 economies that improved the most in their ease of doing business score. We believe that further progress on this front would help advance structural reform priorities and strengthen the overall governance.

Staff have rightly emphasized that the lack of exchange rate flexibility is contributing to real appreciation, while putting pressure on international reserves, thus exacerbating external imbalances. Clearly, greater exchange rate flexibility would help Tajikistan to better absorb shocks.

In our gray statement we highlighted the risks associated with still heavy dollarization of the Tajik economy. As suggested by many studies, dollarization can lead to lower monetary policy and fiscal policy effectiveness, heightened financial stability risks, as well as lower financial depth and the banking sector efficiency. Many countries in the region have embarked on ambitious de-dollarization strategies, and we encourage the authorities and staff to examine the most successful policy efforts in the future discussions. We agree that strengthening economic institutions and particularly monetary policy frameworks that enhance the credibility of monetary policy in the face of external shocks would be a critical step to reduce dollarization.

Regarding the issue of publication, we would certainly encourage the authorities to make every effort to publish the report. However, we also see the point they made, as explained by Mr. Inderbinen, that the language in paragraphs 22 and 23 could be market sensitive because it very clearly implies the need to devalue, and that, of course, can have immediate market implications. In that respect, I wonder whether the authorities and staff could see how they can address this in an effort still to make the report public. With these remarks we wish the authorities all the success.

Mr. Rashkovan made the following statement:

We issued a joint gray and appreciate the authorities' commitment to further implement reforms, particularly when it comes to those linked to the financial sector, fiscal framework and governance. We believe the governance challenges remain important for foreign investment and the business climate, and in that sense we are encouraged by the explanation given by Mr. Inderbinen in his statement.

We very much welcome that staff went to great lengths to analyze the SOE sector in Tajikistan, particularly given its structural importance to the economy. The explanation provided in the selected papers give a comprehensive overview of the challenges that remain to be addressed in the SOE sector, notably when it comes to efficiency, governance, and potential adverse impact on public finances. We think that these may serve as an example for other Article IV reports.

This chair firmly believes that contingent liabilities need to be taken into account by staff when assessing the fiscal risks that the government is exposed to, and we appreciate staff explanation as to why SOEs' liabilities were not fully included in the Debt Sustainability Analysis (DSA) and encourage staff and the authorities to work towards extending the DSA perimeter to the extent possible in the next Article IV exercise. In this sense, we support the recommendation of staff regarding the SOE sector, including that aimed at increasing financial transparency oversight and data availability. We hope also the authorities will decide to publish the report. With these remarks I would like to wish the authorities the best in their efforts.

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

There was one question on the efficiency and prioritization of public investment. The information that is in the staff report shows that the infrastructure quality does not reflect the magnitude of public investment spending in Tajikistan, reflecting the inefficiencies in that process. In our view, greater prioritization of capital spending is needed, not least to ensure fiscal and debt sustainability over the medium term. There is a World Bank Public Expenditure Review that is expected in the next few months, and hopefully that effort will shed more light on the efforts for the authorities of what more is needed for them to prioritize public spending and to improve its efficiency.

Mr. Inderbinen made the following concluding statement:

I think there is a lot of acknowledgement in Directors' statements of the achievements in terms of growth and poverty reduction over the past years and also the policy response to the external and financial stress that was experienced more recently. I am also grateful that many chairs recognize the significant economic and geopolitical challenges that the country faces. As we noted in the buff statement that we circulated ahead of the meeting, Tajikistan is a low-income country with per capita GDP not much over 800 U.S. dollars, as can be seen from Table 1 of the staff report, and the country is listed as a fragile state in the Fund's LIDC grouping.

Many chairs have noted the risks to the fiscal position both due to the high need for capital expenditure and the large SOE sector. The achievements in SOE reform are very well outlined in the selected issues paper, as are the remaining challenges. As explained in the buff statement, the authorities are implementing important and difficult reforms to ensure viability of the energy sector, and they are well aware of the need to further improve data and monitoring of the SOE sector more broadly.

On infrastructure, hydro energy is a critical element of Tajikistan's National Development Strategy and one that taps a key resource that the country has, and the provision of clean energy will benefit the central Asian as well as the south Asian regions. It is important to note in this context that Barki Tojik (BT), the proprietor of the electricity grid, already has power purchase agreements with Afghanistan, the Kyrgyz Republic, and Uzbekistan, which provide for the sale of energy generated by the Roghun project.

There was also much encouragement by Directors to continue with financial sector reform, and the authorities are building on the achievements to date, and they are partnering with the World Bank and the European Bank for Reconstruction and Development (EBRD) to limit related party lending and strengthen governance of financial institutions.

Efforts are also underway for a phased transition to inflation targeting. The NBT has introduced new instruments and strengthened capacity, as we outlined in the buff. There are some differences that prevail on the multiple currency practices and exchange rate restrictions identified in the report, but it is important to note here that the authorities are very much open for further discussions with staff on this.

On structural reforms, efforts are in train to further improve the business environment and the investment climate, and the recent advancement in the World Bank's Doing Business Indicators is encouraging, as also mentioned by Mr. Mozhin this morning. In fact, if one takes the 2020 vintage of the Doing Business Indicators, Tajikistan ranks among the top five reformers, according to these metrics.

This said, the authorities are aware of the need for further progress, including on SOE reform, including on the AML/CFT framework, and including on governance more broadly. With this, Mr. Chairman, I would like again to thank colleagues for their comments, and I would also like to express the gratitude both of the Tajik authorities and my own to Ms. Khandelwal and her excellent team, both here at the headquarters and in Dushanbe, for the hard work for the benefit of the Republic of Tajikistan. Thank you very much.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the solid growth performance, poverty reduction, and improvements to bank supervision and regulation, as well as progress in further developing the monetary and macroprudential frameworks. Noting that continued large external and fiscal deficits create a challenging macroeconomic outlook over the medium term, Directors emphasized the importance of protecting macroeconomic stability and supporting sustainable growth. They encouraged further fiscal consolidation, greater exchange rate flexibility, measures to strengthen the financial sector, and structural reforms to improve the business environment and governance framework.

Directors encouraged fiscal consolidation measures to put debt on a downward trend, including broadening the tax base and gradually phasing out tax incentives. On public investment, they called for greater prioritization and improvements in efficiency to create fiscal space for important infrastructure projects. Targeted social assistance should be stepped up to protect vulnerable groups. Directors urged the authorities to avoid non-concessional borrowing and implement a comprehensive debt management strategy, with IMF technical assistance, to manage risks from large infrastructure projects and

SOEs. Fiscal risks from the largest SOEs should be further mitigated through passage of the SOE law in line with IMF recommendations.

Directors emphasized the need for greater exchange rate flexibility to facilitate adjustment to shocks, help preserve external buffers, and support growth. Removing the exchange restriction and improving the transparency and functioning of the FX market should also be priorities, with due attention to dollarization and inflation considerations. Directors encouraged further efforts to strengthen the monetary policy framework and transmission. They considered that the National Bank of Tajikistan's (NBT) planned transition to inflation targeting remains an appropriate medium-term goal and would be supported by enhancements to exchange rate flexibility and the NBT's financial position and independence. As inflationary pressures have risen in recent months, Directors considered that tighter monetary policy might be needed to mitigate possible second-round effects.

Directors emphasized that, despite the reduction in NPLs and improved profitability of banks, more is needed to restore financial stability and boost confidence in the banking sector. In this regard, an important priority to be considered is the liquidation of two formerly-systemic insolvent banks and payout of insured depositors. Directors also highlighted the importance of continued efforts to strengthen bank governance and supervision, and implementation of AML/CFT policies to mitigate pressures on correspondent banking relationships and boost financial integrity.

Directors encouraged sustained and strong implementation of structural reforms to improve the business environment and foster higher and more job-rich growth in the medium term. They underscored the importance of undertaking measures to improve the governance of core economic institutions and SOEs and to enhance the rule of law and anti-corruption policies to boost investment and inclusive growth. Improvements in the quality and timeliness of economic data would strengthen economic analysis and policy making.

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

The Acting Chair (Mr. Zhang) made the following statement:

The Republic of Tajikistan is an Article VIII member and maintains one exchange restriction and two multiple currency practices subject to Fund approval under Article VIII. Staff is not recommending approval of these restrictions, and therefore no decision is proposed.

APPROVAL: May 26, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Could staff also comment on their growth assumptions, which the authorities consider to be too conservative? The SR mentions that GDP growth in H1 of 2019 was over 7 percent (page 5 of SR), while the projection for the full year is 5.5 percent (page 28 of SR), does it imply that there would be a sudden loss of speed in H2? If so, we would like the staff to elaborate on the factors that may cause sharper slowdown, given that there hasn't been a significant change in the macroeconomic environment between H1 and H2.***

- Staff's growth projection for 2019 is 5½ percent, and this moderates to 4 percent over the medium term.
- Staff considers that there are weaknesses in national accounts statistics. In the absence of alternative data sources, we rely on historical data from the authorities. However, growth projections are based on staff's assessment of underlying growth drivers. In 2019, growth is expected to have been supported by the expansionary fiscal stance, while the subdued global environment and weaknesses in the external position (including remittances) and the financial sector (as reflected in the slow credit recovery) are likely to have weighed on growth. Our full year projections reflect these underlying dynamics.
- Over the medium term, growth projections reflect staff's assessment of the growth outlook under current policies, and the reliance on public investment and remittances as drivers of growth is not seen as sustainable. Looking ahead, domestic factors including limited exchange rate flexibility and gaps in the implementation of reforms to the monetary policy framework, the financial sector, and the business environment are expected to weigh on growth and result in continued large fiscal and external deficits. In staff's view, more policy efforts are needed to address macroeconomic imbalances and structural constraints to private sector led growth.

2. ***Amongst large investment projects, the Roghun dam project is a key source of risk. While it is expected to produce positive development impacts, its potential cost for public finance is substantial, while the economic returns are uncertain. Staff has identified several weaknesses such has uncertainty on construction costs and power purchase agreement which merits the greatest attention. Could staff provide further analysis on expected effects on the country's macroeconomic trajectory?***

- Staff baseline projections include projected Roghun construction costs and energy exports assuming that power purchase agreements will materialize. Therefore, an increase in construction costs would deteriorate the fiscal outlook and increase borrowing needs and aggravate debt vulnerabilities. Further, if the energy export tariffs or quantities turn out to be lower than expected, that would make the fiscal and external positions more challenging. To the extent that these shocks squeeze out other growth enhancing spending, this will have an adverse impact on longer-term growth prospects.

3. We will welcome further comments regarding the reforms and industrial policies contained in the National Development Strategy and their stage of implementation.

- Tajikistan's National Development Strategy 2016–30 is supported by a medium-term development program (MTDS) targets for 2016-2020. The NDS focuses on enhancing energy and food security, communications, and productive employment. The construction of the Roghun Hydropower Project ("HPP") is the centerpiece of this development masterplan (Annex III) and will help tap into Tajikistan's natural resources. The authorities are working to improve the monetary policy framework, the financial sector, and the business environment. Tax exemptions are being granted to businesses as this is considered a key constraint to doing business.

Fiscal Policy and SOEs

4. Could staff elaborate more on the operational fiscal target to capture all debt-creating flows? Previous AIV recommended an operational fiscal anchor of a medium-term primary deficit below 1½ percent of GDP" and in the current report "a deficit target of 2 percent of GDP in 2020 and 1½ percent of GDP in 2021.

- The staff continues to work with the authorities to capture debt-creating flows in the overall fiscal balance and improving fiscal statistics. In this regard, the authorities have started providing data to staff on Roghun expenditures and fiscal financing from gold sales. The passage of the SOE law will further advance efforts to publish audited financial statements for SOEs and help improve information in this area.
- The current deficit target as explained in the staff report helps put deficit on a downward path and rebuild fiscal space. The fiscal anchor, which aims to put debt on a downward path and reduce the risk of debt distress, is identical to the fiscal anchor in 2017. That said, underlying projections in the macro-framework have changed.

5. Given a reasonably high tax-GDP ratio and given the limits to tax capacity in a developing economy, whether staff would like to lay specific emphasis on expenditure prioritization to achieve fiscal consolidation rather than reliance on tax revenues?

- The recommended consolidation does emphasize expenditure prioritization to achieve fiscal consolidation—the text table in the staff report shows 1.5 percent of GDP in expenditure savings as opposed to 0.8 percent of GDP in revenue measures. Capital expenditures are large and staff see significant scope for prioritization and improve efficiency. That said, staff calls for tax reforms as current tax revenues have seen a large decline which should be reversed.

6. Can staff comment on the efficacy of the social safety net?

- The social benefits in Tajikistan are dominated by generalized transfers to households. The WB is assisting authorities with the TSA program which provides benefits to the extreme poor. Efficiency of TSA program is limited as registration of recipients is incomplete (40 of 68 districts based on H12019 data) and benefits have not been indexed to inflation nor differentiated by family characteristics. It is envisaged that the registration will be expanded to all the remaining districts and the benefits will be indexed and increased to improve social protection.

7. Drawing from the international experience with SOEs' reforms (Annex 1 Selected Issues Paper), what would be important lessons for Tajikistan's SOE reform efforts? Given the significant risks posed by the SOE sector and the resource constraints such as the staffing and capacity issues at the SOE Monitoring Department, is there scope for reviving the privatization program?

- As noted in Annex 1 of the SIP, many developing countries have introduced reforms to improve SOEs' performance by establishing better institutional frameworks for managing them such as allowing SOE management more autonomy in their business operations and strengthening ex post monitoring and incentive mechanisms. Privatization or some degree of private investor participation can help introduce accountability. These reforms require political commitment and determined efforts over time.
- Staff consider that, given the large number of SOEs in Tajikistan, and their weak financial performance, there is a need for ambitious reforms. For SOEs that do not meet a public policy goal, privatization (conducted transparently, with appropriate market regulation) should be considered.

8. While the SIP (on SOEs) reflects ways of improving the SOE monitoring situation, we would be interested in hearing staff's view on what actions should be taken first to improve the situation for next year's assessment? Could staff elaborate on any best practices to record non-guaranteed borrowing by SOEs?

- To effectively record, monitor, and report public debt on a consistent basis requires a strong governance framework, effective organizational structure, adequate staff capacity, and a functional recording system. Recording, monitoring, and reporting of public debt also depend critically on robust data collection and the use of a secure debt recording system. To effectively report upon public debt, reliable and comprehensive data recording and monitoring is necessary.

- Adequate recording of non-guaranteed SOE debt should form part of a robust oversight framework for monitoring SOE performance. In particular, a legal and regulatory mandate to monitor the debt of all public issuers (including SOEs, with or without a sovereign guarantee), and other contingent liabilities should be established, and responsibilities for doing so should be clearly delegated to a specific agency. Also, SOEs could be required to obtain approval (from the Ministry of Finance, for example) before borrowing. Finally, entities that are permitted to borrow should submit annual borrowing programs as well as quarterly reports on actual borrowing.
- In the near-term, passage of the SOE law would help with improving the availability of financial information.

9. We would appreciate staff's clarification on whether the authorities plan to rely on PPP's in the energy sector, specifically, and in other public investment projects in general.

- Staff are not aware of any plan for the authorities to rely on PPPs in the energy sector or general government investment projects. PPPs contracted previously cover mostly the energy sector.

10. Can staff comment on the terms of the recent TALCO and Tajiktransgaz loans, including whether they meet the threshold for "concessional" debt?

- Staff has not received the contracts on TALCO and Tajiktransgaz loans or any debt service projections. However, informally, the authorities have suggested this is commercial, non-guaranteed borrowing.

11. We would like to seek staff comments on as to why the shock for PPP was set at 1.73 percent of PPP stock instead of the default value of 35 percent.

- According to the World Bank data, total stock of PPPs in Tajikistan amounts to 4.95 percent of GDP. For the DSA, staff used the default value of 35 percent of PPP stock, which corresponds to the shock size of 1.73 of GDP.

Financial sector

12. With the differing views on the liquidation of the two large insolvent banks, can staff comment on the associated risks of proceeding with the liquidation as recommended given that the Individuals Deposit Insurance Fund (IDIF) lacks

sufficient back-up funding mechanism for larger payouts and the weak fiscal position to support the liquidity and post-liquidation solvency of IDIF? Will the depositors be fully insured, and if not in particular, what could be possible ramifications of the liquidation to financial stability? Based on the authorities' and staff's estimates and bank resolution laws, is there scope for capital injection or another alternative (practical) way to solve this problem apart from liquidation? Could staff elaborate on their recommendation to liquidate the two insolvent banks and related consequences for the IDIF and financial stability? Are staff confident that the IDIF has the ability to carry this out in a swift and efficient manner, given the Fund TA provided to date in this area? We note that the authorities considered that banks would be liquidated after completion of an ongoing asset evaluation - when is this evaluation expected to be completed and what is the expected timeline for completing the liquidation of the two insolvent banks?

- NPLs at both AIB and TSB are near 100 percent of the loan portfolio. As per staff analysis, there is no path for these banks to return to solvency or viability. The two banks are now largely operating as asset management companies in voluntary liquidation (not as banks), and they are no longer systemically important.
- Liquidation is the best policy option. Statutory liquidation will ensure that the government can control the disposal of assets and distribution of proceeds in line with the law. Otherwise, there is continued risk of fraud, nontransparent disposal of assets, and preferential treatment of well-connected creditors.
- Statutory liquidation is needed to trigger the payout of insured depositors. Deposit withdrawal restrictions have been in place for over 3 years. Payout of insured depositors will boost confidence in the financial system. Disposal of bank assets over time can help pay out claims of IDIF, government and/or non-insured depositors over time (who cannot access their deposits at the current time anyway).
- The IDIF only needs an additional 0.1 percent of GDP in funding to be able to meet claims of insured depositors in full. Staff do not recommend paying uninsured depositors with IDIF money. In addition, there is a need for a fiscal backstop to provide liquidity for the IDIF. Putting it in place ahead of time will help reassure people that it is not needed.
- The Fund and other IFIs have provided TA to the NBT and the IDIF to help prepare for the potential liquidation of the 2 banks.
- The authorities have not so far indicated a timeline for the completion of the asset valuation but have indicated their intent to liquidate the banks after the completion of the valuation.

13. From the analysis in Annex V and in consideration of data availability, can staff comment on whether the macroprudential toolkit in place or that is being developed is adequately robust to prevent possible future financial upturn that may be followed by another financial crisis?

- In its drive to reform the financial sector, the NBT has made significant progress in developing its macroprudential framework and toolkit with the help of World Bank technical assistance. But it is still early in the process. The tools that have been deployed in 2017-18 are aimed at mitigating FX risks in banks. Additional challenges pertain due to weak supervisory capacity, which is a prerequisite for effective implementation. Data limitations will need to be addressed before early warning indicators and additional macroprudential tools can be put in place.

14. **W*e would appreciate staff's comments on what other challenges underlie the loss of CBRs in Tajikistan. We would like to know whether staff has done some analysis to understand the impact of loss in correspondent banking relationships on remittance inflows to Tajikistan.***

- The drivers for pressures on correspondent banking relationships for Tajikistan are generally those that are described in the 2017 Board Paper on Recent Trends in Correspondent Banking Relationships—notably correspondent banks' cost-benefit assessment of the profitability and risks of the correspondent banking relationship. The correspondent bank's risk assessment takes into consideration the risks of a specific relationship and the institution's own risk tolerance. These factors operate concurrently, and their relative significance varies case-by-case, also in relation from one (Tajik) respondent bank to another. While Fund support in strengthening risk-based AML/CFT supervision of financial institutions and other improvements to the AML/CFT system will allow authorities to mitigate certain risks, other structural risks, such as geographic closeness to areas of higher-risk (e.g., regions that produce large amounts of illicit drugs) are more difficult to mitigate in any country.
- Staff has analyzed and discussed correspondent banking relationship with the authorities, as part of the mission and also as part of ongoing AML/CFT related technical assistance. Staff has discussed volume, patterns and direction of financial flows and pressures on the correspondent banking relationships and their concentration and has noted that all correspondent banking relationships in USD with banks headquartered in the US have terminated and most Tajik banks experience difficulties in establishing new correspondent banking relationships. However, as far as remittance inflows are concerned, Tajik banks maintain correspondent banking relationships to support operations of payment service providers that mirror remittance inflows corridors, mainly with Russian banks.

Monetary and Exchange Rate Policies

15. We would like staff to elaborate more on the recommended timing of further FX market liberalization to align it with the transition to the IT, capacity development and possible technical assistance.

- The exchange rate misalignment combined with barriers to access FX could hurt economic activity and incentivize capital outflows. Addressing weaknesses (misalignment and barriers) in the near-term is important to support growth and avoid a sharp adjustment over the longer term.
- Greater exchange rate flexibility is needed in the near-term to align the REER of the somoni with fundamentals. Greater flexibility is needed even if there are delays in implementation of IT.
- Staff considers that NBT allowed significant exchange rate flexibility in 2017, but then maintained a stabilized exchange rate for most of 2018-19. Staff recognize that the authorities may not be ready for full flexibility of the exchange rate regime in the near term and are recommending greater flexibility. Exchange rate flexibility is important for smooth transition to IT and its successful implementation, and staff will be able to provide technical assistance to help with FX market liberalization if needed.

16. Could staff elaborate on the expected socio-economic impact of FX restrictions removal and other proposed measures?

- The removal of FX restrictions and greater exchange rate flexibility is likely to result in a depreciation of the exchange rate vis-à-vis the USD and higher inflation. Staff estimates suggest that inflation pass-through is between 20-25 percent. A currency depreciation of about 10 percent would raise prices by around 2-2½ percent.
- Since over 80 percent of the remittances received by the population are denominated in rubles, a depreciation is likely to increase the somoni value of their receipts and can help offset part of the adverse impact.
- Further, with an exchange rate in line with fundamentals, export growth is likely to be supported, promoting domestic employment, private sector activity, and inclusive growth.

17. We appreciate staff comments on the dollarization trend in the economy and the NBT efforts to bolster the role of somoni. Could staff also comment on the key measures to reduce dollarization in Tajikistan?

- Deposit and loan dollarization have been on a decline in Tajikistan, following the spike in the aftermath of the 2015-16 external shocks. The significant drop in FX deposits in the banking sector over the last two years has not been compensated by an equivalent growth in local currency deposits.
- The NBT's strategy includes de-dollarization as one of priorities. The authorities have taken macroprudential measures to mitigate risks on bank balance sheets. These include:

a. Differential reserve requirements on deposits in domestic and foreign currency to discourage deposit dollarization.
b. Higher risk-weights for foreign currency denominated loans (since 2018)
c. A ban on the provision of FX denominated mortgage loans to unhedged borrowers (since 2017).
d. Limits on open FX positions of banks.
e. Differential insurance (covered amount and premiums) by the IDIF for deposits in FX and domestic currency.

- More efforts are still needed. Measures for de-dollarization should include a comprehensive approach with sound macro policies to enhance the credibility of the central bank's monetary and FX policies to keep inflation low and maintain confidence in the currency. In this regard, the authorities' efforts to further develop the monetary framework will help, while exchange rate misalignment and barriers for businesses to access FX are likely to be counter-productive in the long run.

18. We note the disagreement between staff and the authorities on the reasons behind the shortage of foreign currency in the market and grievances of some banks about the delays in obtaining FX by their customers. As Mr. Inderbinen pointed out in his buff statement, the Tajik foreign exchange market is characterized by seasonal fluctuations, and the balance between supply and demand for foreign currency can change significantly over a given year. In this context, we would appreciate staff's additional comments on their findings described in paragraphs 22-23 (MCP) of the report, as well as on possible next steps in addressing sensitivities for the authorities on this issue. Did staff consider the possibility of providing specific TA to examine in greater detail the underlying issues for the FX shortage?

- Market participants reported substantial delays in making external payments, leading to arrears, as well as moral suasion by the NBT to keep exchange rates within a narrow band around the official rate. This moral suasion—as evidenced by such delays and arrears—gives rise to an exchange restriction because it constitutes official action (action by the authorities) that limits access to foreign exchange necessary to make payments/transfers for bona fide current international transactions (see Article VIII, Section 2(a)).
- The seasonal changes in foreign exchange supply and demand (e.g., decreased supply in the first half of 2019 noted by the authorities) in the absence of increased foreign exchange intervention in general should result in changes in the exchange rate during the course of the year reflecting this seasonal gap. The stable exchange rate (except April-July 2018 and August 2019 when the NBT allowed nominal depreciation) in the context of seasonally fluctuating supply and demand suggests that the exchange rate is not being affected by seasonal fluctuations and is not determined solely by market forces.

- Staff's recommendation is that the NBT ensure that market participants can set exchange rates based on market supply and demand, without informal guidance about market rates, in order to allow all bona fide requests for foreign exchange for current international payments and transfer to be met. Allowing seasonal two-way fluctuations in the exchange rate will mitigate one-way speculative pressures against the currency. The NBT's FX interventions could then be geared towards smoothing excessive volatility. Staff stands ready to provide any TA related to the foreign exchange system if the authorities so request.

19. Could staff elaborate on the recent trends of remittances' flows into Tajikistan, including their average real value in national currency terms?

- The somoni-USD exchange rate has been mostly stabilized against the USD in 2018-19 at a time when the USD has strengthened globally. As EM partner currencies have moved, the nominal effective exchange rate and the real effective exchange rate of the somoni has appreciated. This may lead market participants to hold back ruble remittance transfers, in anticipation of a somoni depreciation.
- Using NBT and CBR data, the total amount of remittances (as measured in USD) in 2019H1 was flat. Staff do not have details on the currency composition of remittances. However, deflating the somoni value of remittances by the CPI yields a decrease in their real local currency value by 6 percent y-o-y.

Governance

20. The 2013-2020 anti-corruption strategy provided a clear framework but has suffered from a lack of implementation. What were the most promising areas of the strategy and what impedes its effective implementation?

- The most promising areas of the anti-corruption strategy are the comprehensive coverage of the different aspects of corruption. The strategy covers specific sectors, the public service and issues such as party financing. Each of the different chapters of the strategy also include useful overall objectives. The main impediment to effective implementation lies in the drafting of the strategy's implementation action plan, which could either be more detailed or be better connected to the objectives of the strategy. As drafted, the implementation action plan items also do not allow for easy measurement of progress.

Capacity Development

21. Have the authorities requested technical assistance to help develop a more comprehensive DMS? Could staff comment on any plans to improve the debt recording and reporting practices, in line with the DSA criteria?

- Debt recording and reporting practices remain weak and staff sees this as priority area for capacity building. Authorities concur with the staff on the need for robust debt management and data collection. To this end they are collaborating with SECO to purchase Debt Management and Financial Analysis System (DMFAS). However, achieving a comprehensive, accurate, and timely debt recording system will take significant effort and time. The staff recommend further TA in this area.

22. Could staff provide a list of a TA activities provided for Tajikistan and how these support the reform priorities identified in the previous and this year's AIV report?

- The TA to Tajikistan is closely coordinated with other donors and IFIs and prioritized based on the authorities' interests. The list of TA provided to Tajikistan by the Fund is reported in the Informational Annex. Recent TA has covered many important areas including enhancing macroeconomic statistics, bank resolution, strengthening of monetary policy framework, mitigating fiscal risks from SOEs and the medium-term debt management strategy.