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MIDDLE EAST AND CENTRAL ASIA DEPARTMENT

Rethinking Fiscal Policy and Frameworks in the Caucasus and Central Asia

Prepared by Masud Al Taj, Nazim Belhocine,
Alejandro Hajdenberg, Iva Petrova,
Carlos Segura Santana, Shuyu Wang, and
Tongli Zhang

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Contents

Executive Summary	v
Abbreviations	vi
1. Introduction: Why Fiscal Frameworks Matter in the Caucasus and Central Asia (CCA)	1
2. Fiscal Institutions and the State of Play in the CCA	3
A. Historical and Institutional Legacies.....	3
B. Fiscal Institutions and the Role of the State	4
C. Medium-Term Frameworks and Fiscal Rules	6
D. Automatic Stabilizers: Structural Features	9
E. Fiscal Risk Management: Institutional Practices	10
3. Fiscal Policy Effectiveness in the CCA: Stabilization, Growth, and Sustainability	12
A. The Stabilization Function of Fiscal Policy	12
B. Automatic Stabilizers and Discretionary Fiscal Policy	13
C. Fiscal Rules and Stabilization.....	14
D. Fiscal Policy and Economic Growth	16
E. Fiscal Sustainability and Risk Exposure.....	17
4. Reform Priorities: Strengthening Fiscal Frameworks in the CCA	24
A. Recalibrating Fiscal Rules to Support Stabilization.....	24
B. Anchoring Policy in Credible MTFs.....	25
C. Strengthening Automatic Stabilizers	25
D. Enhancing Fiscal Risk Management and Building Buffers	26
Annex 1. Fiscal Rules in the Caucasus and Central Asia: Targets and Outcomes	29
Annex 2. Fiscal Policy Stance and Automatic Stabilizers	30
References	31
BOXES	
Box 1. COVID-19 and Fiscal Rules.....	8
Box 2. Realism of Fiscal Frameworks in Armenia and Georgia, 2013-23.....	19
Box 3. Climate Change Fiscal Costs and Tax Policy	27
FIGURES	
Figure 1. Open Budget Index and Government Effectiveness, 1996-2024	4
Figure 2. SOE Footprint in the CCA Countries.....	5
Figure 3. CCA: PEFA Scores—Selected Indicators	5
Figure 4. Characteristics of Fiscal Rules in the CCA Compared with Other Regions	8
Figure 5. State Spending and Coverage of Social Assistance	10
Figure 6. Good Practices and Steps for Managing Fiscal Risks	11
Figure 7. Fiscal Stabilization Coefficients and Their Statistical Significance	13

Figure 8. Countercyclicality of Fiscal Policy across Different Periods	13
Figure 9. Fiscal Stabilization Tools and Volatility of Economic Activity	14
Figure 10. Fiscal Rule Strength and Fiscal Stabilization	15
Figure 11. Fiscal Rules' Stabilization Functions in CCA Compared with CEE	15
Figure 12. CCA Countries' Spending Needs to Support Long-Term Growth	16
Figure 13. Public Debt	17
Figure 14. Contributions to Changes in Public Debt Ratios	17
Figure 15. CCA: Budget Year Forecast Errors of Macro-Fiscal Indicators, 2016-23	18
Figure 16. CCA: Medium-Term Forecast Error Distributions of Macro-Fiscal Indicators, 2010-23	21
Figure 17. Macroeconomic Volatility and Fiscal Indicators in the CCA Region	22
Figure 18. Total PPP Investments in the CCA, 1990-2023	22
Figure 19. Dependency Ratios	23
Box Figure 2.1. Fiscal Forecast Errors in Armenia and Georgia	20
Box Figure 3.1. Adaptation Costs	27
Box Figure 3.2. Explicit and Implicit Energy Subsidies	28

TABLES

Table 1. Length of Central Planning Regimes	3
Table 2. Length of Central Planning and Quality of Fiscal Institutions	4
Table 3. Fiscal Rules in the Caucasus and Central Asia	7
Table 4. CCA Statutory Personal Income Tax Regimes	9
Box Table 1.1. Fiscal Rules during COVID-19	8
Annex Table 1.1. Fiscal Rule Targets, Outcomes, and Recent Reforms in the Caucasus and Central Asia	29

Executive Summary

Following independence in the early 1990s, fiscal policy has played a central role in supporting economic and structural transition in the Caucasus and Central Asia (CCA), including through the establishment of modern tax systems, the restructuring of public expenditures, and the creation of new fiscal institutions. Although countries in the region started from broadly similar macro-fiscal conditions, their reform trajectories have diverged markedly, reflecting differences in institutional development, exposure to shocks, and policy choices. Despite substantial progress in some countries, the shift toward market-based resource allocation remains uneven across the region, reflected in the continued large footprint of public budgets and state-owned enterprises in parts of the CCA and the private sector's still-limited role as an engine of growth and job creation. These structural factors, combined with high output and revenue volatility and persistent institutional legacies of central planning, continue to shape the operating environment for fiscal policy across the region.

Over time, fiscal policy in the CCA has pursued multiple—sometimes competing—objectives, including growth promotion, employment, crisis response, and consolidation. However, automatic stabilizers remain relatively weak, contributing to a greater reliance on discretionary measures that can be procyclical or slow to implement. At the same time, significant spending needs persist in priority sectors—such as social protection, health, education, and infrastructure—whereas public investment management, fiscal reporting, and broader public financial management practices remain uneven across the region. These gaps limit fiscal policy's ability to support long-term growth and to respond effectively when external conditions deteriorate, particularly in economies with already narrow fiscal space and high exposure to external shocks. The experience of central and eastern European countries highlights the role that stronger institutions can play in enabling credible and countercyclical fiscal policy.

This paper evaluates the fiscal frameworks in the CCA and finds significant scope to strengthen fiscal policy along its stabilization, allocation, and sustainability dimensions. Priorities include enhancing automatic stabilizers through reforms to personal income taxation and social protection systems; refining fiscal rules to better accommodate cyclical conditions and strengthen enforcement; and anchoring fiscal planning in credible medium-term expenditure and fiscal frameworks underpinned by realistic macro-fiscal projections. Reinforcing fiscal risk management—including risks associated with state-owned enterprises, public-private partnerships, financial sector vulnerabilities, and climate-related shocks—will also be increasingly important for safeguarding fiscal space. Improvements in transparency, specifically on fiscal reporting and the coverage of quasi-fiscal activities would strengthen accountability and help policymakers better assess underlying fiscal positions, supporting more effective prioritization and resource allocation.

The successful implementation of these reforms would require sustained political commitment, coordinated capacity development, and sustained engagement with international partners. By modernizing fiscal institutions and grounding policy in transparent, forward-looking frameworks, CCA countries can strengthen the countercyclical role of fiscal policy, support private sector development and job creation, and enhance resilience to future shocks. Taken together, these reforms would help the region sustain higher, more inclusive growth and make progress further on its economic transition path.

Abbreviations

AE	advanced economy
CCA	Caucasus and Central Asia
CEE	Central and Eastern Europe
EMEU	Emerging Eastern Europe
LICs	low-income countries
MTEF	medium-term expenditure framework
MTFF	medium-term fiscal framework
OE	oil exporters
OI	oil importers
OLS	ordinary least squares
PISA	Programme for International Student Assessment
PPP	public-private partnership
SOE	state-owned enterprise
TIMSS	Trends in International Mathematics and Science Study

1. Introduction: Why Fiscal Frameworks Matter in the Caucasus and Central Asia (CCA)

Since gaining independence in the early 1990s, countries in the CCA have relied on fiscal policy to support economic and structural transition, including through the development of new tax systems, fiscal institutions, and public spending frameworks. Although they began from broadly similar macro-fiscal starting points, reform trajectories have diverged markedly over the subsequent three decades (IMF 2014). Although some countries have made substantial progress toward market-based systems and modern fiscal institutions, the transition remains uneven across the region. In parts of the CCA, the state continues to play a large role in economic activity through public budgets and state-owned enterprises (SOEs), whereas the private sector's contribution as an engine of growth and job creation remains constrained.

Fiscal policy in the CCA operates in an environment characterized by high output and revenue volatility, reflecting exposure to commodity price fluctuations, remittance cycles, and external financial conditions. These dynamics vary across the region, particularly between oil-exporting economies—where fiscal revenues are closely tied to commodity cycles—and oil-importing economies that rely more heavily on conventional tax revenues and external financing. These sources of macroeconomic volatility have been amplified by repeated external shocks over the past two decades, including the global financial crisis, large commodity price swings, the COVID-19 pandemic, and, more recently, heightened geopolitical tensions. Persistent institutional legacies of central planning further shape fiscal policymaking, influencing budget processes, expenditure prioritization, and the design and enforcement of fiscal frameworks.

Against this backdrop, fiscal policy in the CCA has been tasked with pursuing multiple—and sometimes competing—objectives. Governments have sought to support economic growth and development, respond to shocks, and safeguard fiscal sustainability, often under tight financing constraints. At the same time, significant spending needs persist in priority areas such as social protection, health, education, and infrastructure, placing additional pressure on public finances. In several countries, limited fiscal space and elevated exposure to external shocks have heightened the importance of credible fiscal frameworks to anchor policy decisions and manage trade-offs over the cycle.

A key challenge for the region has been the effective use of fiscal policy as a countercyclical stabilization tool. Automatic stabilizers in the CCA tend to be relatively weak, increasing reliance on discretionary measures that can be procyclical, slow to deploy, or difficult to reverse. Cross-country experience, including that of Central and Eastern European (CEE) peers, underscores the role that stronger fiscal institutions and well-designed frameworks can play in enabling timely, predictable, and countercyclical fiscal responses while preserving fiscal discipline.¹

¹ Throughout this paper, countries of the Caucasus and Central Asia (CCA) refer to Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. Oil exporters refer to Azerbaijan, Kazakhstan, and Turkmenistan, whereas oil importers are the remaining CCA countries. The group of low-income countries in the CCA are Kyrgyz Republic, Tajikistan, and Uzbekistan. Central and Eastern European countries include Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia. A limited subset of Central and Eastern European countries was selected as an aspirational comparator group, chosen for their relevance as benchmarks for convergence in terms of institutional quality, fiscal frameworks, and economic development. The Baltic countries (Estonia, Latvia, and Lithuania) are shown separately in some descriptive comparisons.

This paper examines how fiscal policy and fiscal frameworks in the CCA have performed in this demanding environment and assesses the scope for strengthening their stabilization, allocation, and sustainability functions (Gigineishvili and others 2023). It takes stock of the region's fiscal institutions and outcomes, analyzes the effectiveness of fiscal policy in smoothing cycles and supporting growth, and identifies reform priorities aimed at enhancing resilience, supporting private sector-led development, and advancing the region's long-standing economic transition.

2. Fiscal Institutions and the State of Play in the CCA

This section takes stock of the fiscal institutions, policy frameworks, and structural features that shape fiscal policy in the CCA. It documents the region's institutional legacy, compares current practices with those in CEE, and provides a factual overview of fiscal rules, medium-term frameworks, automatic stabilizers, and fiscal risk management arrangements. The analysis highlights considerable cross-country heterogeneity, while identifying common institutional characteristics that continue to influence fiscal policy outcomes across the region.

A. Historical and Institutional Legacies

Fiscal institutions in the CCA have been shaped by a pervasive legacy of central planning. Most CCA economies were subject to Soviet central planning from the late 1920s until the early 1990s. Some parallels exist with peer CEE countries, where central planning was introduced later and ended somewhat earlier, followed by a more rapid transition to market-based systems. This difference in historical experience has had lasting implications for governance structures, budget institutions, and the role of the state in economic decision making (Table 1).

Table 1. Length of Central Planning Regimes

Country Groupings	Duration of Soviet Rule	Number of Years
CCA	1928-91	64
CEE (excl. Baltic countries)	1947-89	43
Baltic countries	1940-41 and 1944-90	49

Source: Berengaut and Elborgh-Woytek (2006).

Note: CCA = Caucasus and Central Asia; CEE = Central and Eastern Europe.

Institutional and historical factors have further shaped fiscal institutions across the region. Cross-country indicators of government effectiveness point to persistent differences in institutional capacity between the CCA and comparator regions, consistent with differences in the evolution of public sector institutions. In most CEE and Baltic countries, the prospect of European Union accession provided an external anchor that accelerated reforms in budgetary governance and fiscal oversight. By contrast, CCA countries have relied primarily on domestic reform momentum, contributing to more gradual and uneven institutional convergence. These differences are consistent with the broader institutional legacy of central planning in the region. The regression results reported in Table 2 suggest a negative association between the duration of central planning and subsequent government effectiveness. Given the limited number of observations, these results should be interpreted with caution and viewed as indicative correlations rather than evidence of a causal relationship.

Table 2. Length of Central Planning and Quality of Fiscal Institutions

Variable	Coefficient	Std. Error	t-Statistic	Probability
Constant	3.0646	0.584	5.246	0.000
Years of central planning	-0.0563	0.011	-5.174	0.000
R^2	0.612		F -statistic	26.77
Adjusted R^2	0.589		Prob (F -statistic)	7.63E-05
Log likelihood	-11.296		Durbin-Watson	1.514

Dependent variable: average government effectiveness (1996–2023)
Method: least squares
Included observations: 19
White heteroskedasticity-consistent standard errors and covariance

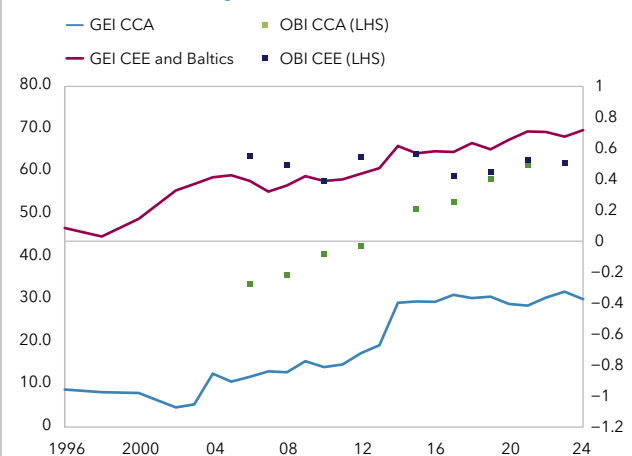
Source: World Bank; and IMF staff estimates.

B. Fiscal Institutions and the Role of the State

CCA countries have made notable progress in strengthening fiscal governance over the past decade. Improvements are visible in several dimensions of budget transparency and oversight, including more comprehensive budget documentation, expanded public access to fiscal information, and strengthened audit and parliamentary scrutiny. Indicators such as government effectiveness and the Open Budget Index show gradual convergence toward CEE levels for the median CCA country, albeit from a lower base (Figure 1).

Despite these advances, the role of the state in the economy remains sizable in parts of the region. Public budgets and SOEs continue to account for a significant share of economic activity, particularly in infrastructure, energy, transport, and finance (Figure 2). In some countries, governments have maintained a proactive role in directing investment and employment through public entities, reflecting both developmental objectives and perceived weaknesses in market mechanisms. In several cases, SOEs continue to operate under multiple and sometimes conflicting mandates, complicating performance assessment and blurring the boundary between commercial activity and public policy objective, particularly where ownership and policy functions are not clearly separated. This institutional complexity has, in practice, made it more difficult to assess SOE performance and to contain quasi-fiscal activities.

Figure 1. Open Budget Index and Government Effectiveness, 1996–2024
(Median OBI, average GEI)



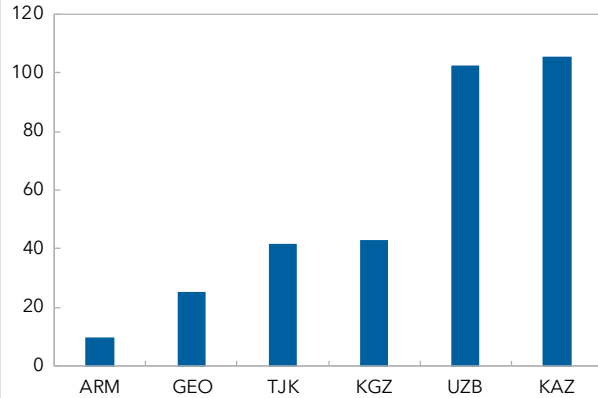
Sources: Open Budget Initiative; World Bank; and IMF staff estimates.

Note: OBI for Baltic countries not available. CCA = Caucasus and Central Asia; CEE = Central and Eastern Europe; GEI = government effectiveness index; OBI = open budget index.

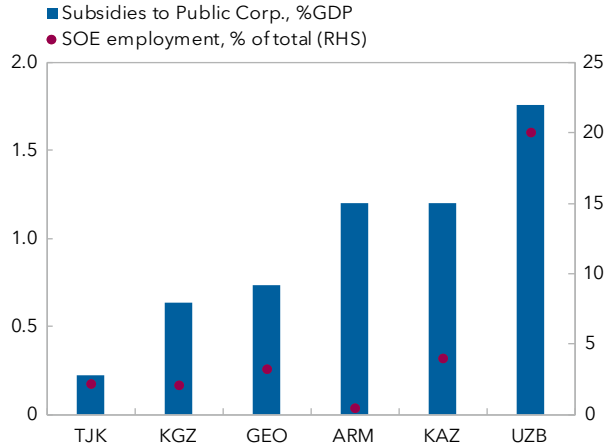
Figure 2. SOE Footprint in the CCA Countries

1. SOE Assets

(2019 or latest available, percent of GDP)



2. SOE Subsidies and Employment



Sources: EBRD 2024; GFS database; IMF 2019; national authorities; and IMF staff estimates.

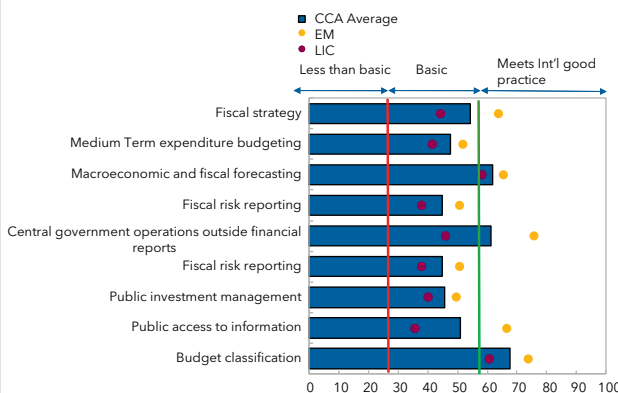
Note: ARM = Armenia; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan; CCA = Caucasus and Central Asia; SOE = state-owned enterprise.

The scale and governance of the SOE sector vary considerably across countries, reflecting differences in institutional oversight and reporting practices (Ramirez Rigo and others 2021). In several cases, SOEs remain dominant in key sectors and are characterized by weak governance, limited financial transparency, and significant quasi-fiscal activities. These features can distort competition and generate fiscal risks through contingent liabilities and recurrent demands for budgetary support. By contrast, Armenia and Georgia have made progress in improving SOE reporting and oversight, although challenges remain even in these cases.

Public financial management (PFM) practices also display significant heterogeneity. Public expenditure and financial accountability assessments indicate that, on average, PFM systems in the CCA lag behind those of emerging market peers, particularly in medium-term budgeting, public investment management, and fiscal reporting coverage (Figure 3). Although Georgia—and to a lesser extent Armenia—has achieved relatively strong scores across several PFM dimensions, most other countries meet only basic standards, highlighting persistent gaps in planning, prioritization, and execution.

Figure 3. CCA: PEFA Scores—Selected Indicators¹

1. PFM Performance



2. Armenia

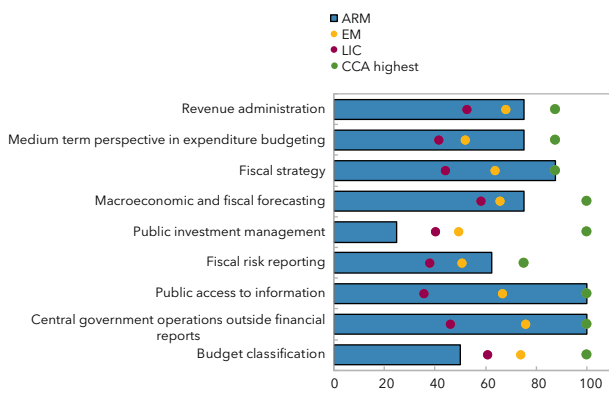
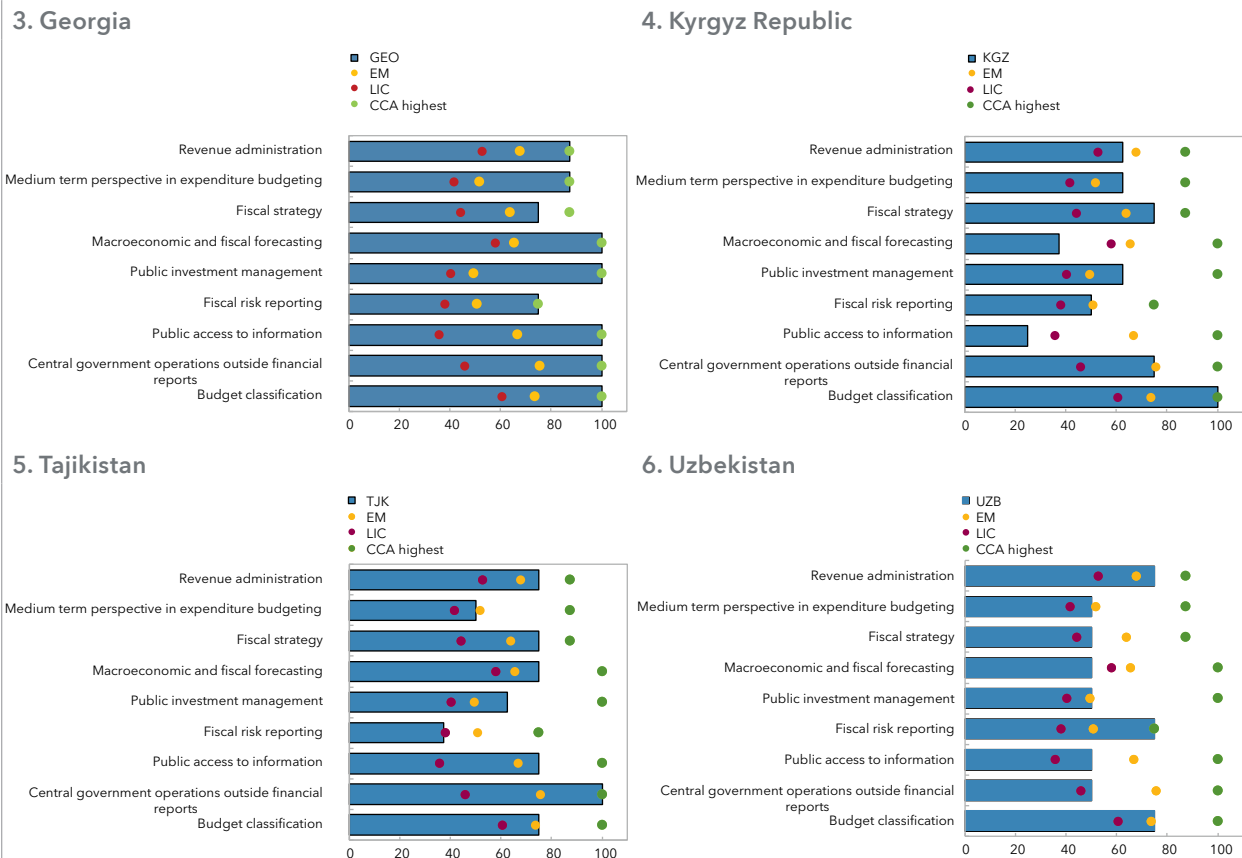


Figure 3. CCA: PEFA Scores—Selected Indicators¹ (continued)

Sources: PEFA reports; and IMF staff calculations.

Note: ARM = Armenia; GEO = Georgia; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan; CCA = Caucasus and Central Asia; EM = emerging market; LIC = low-income country; PEFA = public expenditure and financial accountability; PFM = public financial management.

¹ PEFA indices for each fiscal dimension are translated into numerical scores and then converted into a 0–100 scale and averaged across LICs, EMs, and CCA countries. A score below 35 indicates noncompliance with best practice, a score in the range of 35–65 indicates basic compliance, and a score above 65 indicates full compliance.

C. Medium-Term Frameworks and Fiscal Rules

Medium-term fiscal and expenditure frameworks (MTFF and MTEF) are intended to bridge the gap between annual budgets and longer-term fiscal objectives (IMF 2023; Currstine, Duran, Harris 2024; World Bank 2023).² By setting multiyear projections and expenditure paths consistent with macroeconomic conditions and debt sustainability, MTEFs provide a structure for managing fiscal trade-offs over time. In principle, they help anchor annual budget decisions in a medium-term perspective, reduce procyclicality, improve expenditure prioritization, and enhance the credibility of fiscal policy. Well-functioning MTEFs also support the effective operation of fiscal rules by translating numerical targets into operational guidance for line ministries and policymakers.

MTFFs and MTEFs are formally in place in most CCA countries, but their design and institutional integration vary widely. In many cases, MTFFs or MTEFs are prepared alongside the annual budget and cover a three-year horizon, providing projections for revenues, expenditures, and fiscal balances. However, these frameworks

² A medium-term fiscal framework sets multiyear aggregate fiscal objectives and constraints consistent with macroeconomic conditions and sustainability, and a medium-term expenditure framework translates these top-down targets into medium-term expenditure ceilings and budget allocations across sectors and programs.

are often indicative rather than binding, and their role in guiding annual budget decisions remains limited. Multiyear expenditure ceilings are not consistently enforced, and links between medium-term plans and sectoral or program budgeting are often weak. Although some countries—such as Armenia and Georgia—have made progress in integrating medium-term projections into the budget process, in several others, MTFs function primarily as planning tools with limited operational relevance.

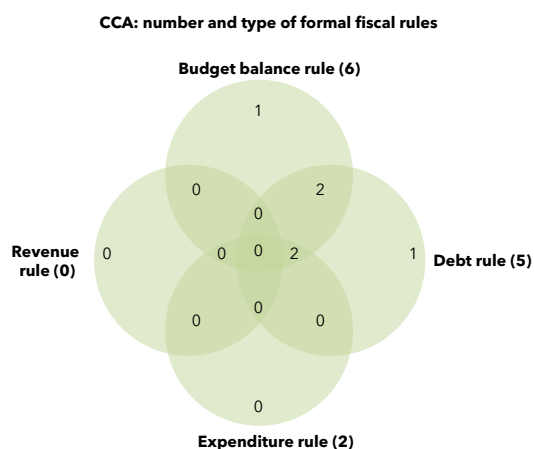
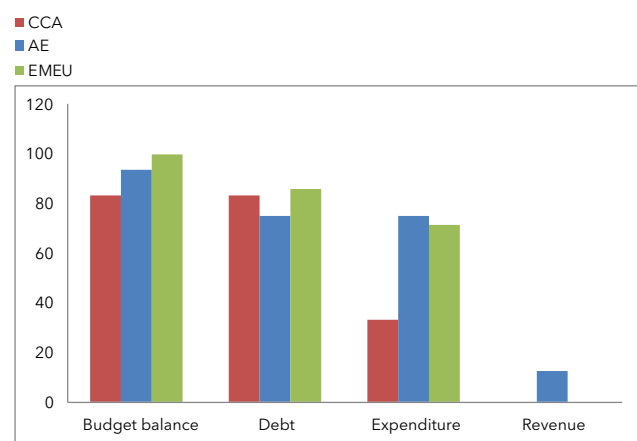
Most CCA countries have adopted numerical fiscal rules aimed at anchoring fiscal discipline and sustainability. These rules are typically embedded in primary legislation or, in some cases, constitutional provisions and most commonly take the form of limits on public debt and fiscal balances (Table 3). Several countries complement these anchors with expenditure growth ceilings or resource-based rules in commodity-exporting economies. A more detailed overview of fiscal rule targets, recent outcomes, and design changes across countries is provided in Annex 1.

Table 3. Fiscal Rules in the Caucasus and Central Asia

Country	Does the Country Have Fiscal Rules?	Type of Rule			
		Public Debt	Fiscal Balance	Expenditure	Revenue
Armenia	Y	Y	Y	Y	N
Azerbaijan	Y	Y	Y	N	N
Georgia	Y	Y	Y	N	N
Kazakhstan	Y	Y	Y	Y	N
Turkmenistan	Y	N	Y	N	N
Uzbekistan	Y	Y	N	N	N
Kyrgyz Republic	N	–	–	–	–
Tajikistan	N	–	–	–	–

Sources: National authorities; and publicly available legislation.
Note: Y = yes; N = no; "–" = not applicable.

The design and coverage of fiscal rules vary widely (Figure 4). Armenia, Georgia, and Kazakhstan operate relatively comprehensive frameworks that combine debt and balance rules with supporting procedural elements, whereas other countries rely on simpler constraints with more limited institutional backing. During the COVID-19 pandemic, fiscal rules were suspended or relaxed in most CCA countries, either through the formal activation of escape clauses or de facto deviations (Box 1). This episode underscored both the role of rules in anchoring expectations and the importance of well-specified flexibility under extreme shocks.

Figure 4. Characteristics of Fiscal Rules in the CCA Compared with Other Regions**1. Fiscal Rules****2. Taxonomy of Fiscal Rules by Region***(Percent of countries with formal fiscal rules)*

Sources: Fiscal Affairs Department's fiscal rules database; national legislation; and IMF staff estimates. See Alonso and others (2025). The data set contains 32 AEs, 7 EMEU economies, and 6 CCA economies.

Note: AE = advanced economy; CCA = Caucasus and Central Asia; EMEU = Emerging Eastern Europe.

Box 1. COVID-19 and Fiscal Rules

Fiscal rules across the region were suspended during the COVID-19 pandemic. The pandemic resulted in an economic slowdown and fiscal revenue shortfalls in most countries of the Caucasus and Central Asia. Complying with fiscal rules would have required extraordinary procyclical adjustment, whereas the suspension of fiscal rules allowed for countercyclical fiscal policy. In Armenia, Azerbaijan, and Georgia, fiscal rules were suspended by invoking escape clauses. These clauses allowed for the temporary suspension of rules under adverse shocks. In Kazakhstan, rules were suspended de facto, but not de jure. Turkmenistan complied with its fiscal rule, as its accounting practices allowed domestic financing and privatization proceeds to count as revenues, providing an unusual degree of flexibility in a fiscal rule, albeit inconsistent with international fiscal reporting standards. Uzbekistan did not have fiscal rules at the time.

In some cases, sovereign wealth funds helped smooth the fiscal shock. This was the case in Azerbaijan and Kazakhstan. Azerbaijan withdrew 1 percent of GDP more than the original budget plans from the State Oil Fund in 2020, whereas Kazakhstan withdrew almost 3 percent of GDP more in 2020 and 2 percent more than originally envisaged in 2021 from its National Fund. Although Uzbekistan has a Fund for Reconstruction and Development, it is not authorized to finance the budget. Armenia resorted to its stabilization deposit account, drawing around 0.8 percent of GDP, mostly in 2020.

Box Table 1.1. Fiscal Rules during COVID-19.

Country	Rules Suspended during COVID-19	Restoration of Rule In	Introduced New Rules
Armenia	Y	2021	N
Azerbaijan	Y	2022	Y
Georgia	Y	2023	N
Kazakhstan	Y	2024	Y
Kyrgyz Republic	N	-	Y
Tajikistan	-	-	N

Country	Rules Suspended during COVID-19	Restoration of Rule In	Introduced New Rules
Turkmenistan	N	-	N
Uzbekistan	-	-	Y

Sources: National authorities; and publicly available legislation.
Note: Y = yes; N = no; "-" = not applicable.

Most countries in the region have reinstated existing fiscal rules or introduced new ones. After invoking the escape clause for a second year in 2021 to allow increased COVID-19-related spending, Armenia's fiscal rules were reinstated with the 2022 budget. In Georgia, compliance with the debt rule was achieved already in 2021, and the fiscal balance rule was reinstated by the 2023 budget, in line with the three-year hiatus prescribed by the escape clause. Kazakhstan reinstated the rules in 2024, with a one-year delay relative to the original plans. Azerbaijan, Kazakhstan, and Uzbekistan adopted new rules. In 2022, Azerbaijan revised its rules, putting in place a medium-term target on the non-oil primary balance as a share of non-oil GDP and a cap on the public-debt-to-GDP ratio. Kazakhstan introduced an oil reference price to cap the transfers from the National Fund of the Republic of Kazakhstan (NFRK) to the government and a cap on the growth of central government spending. Uzbekistan set a cap on public debt in 2023.

D. Automatic Stabilizers: Structural Features

Automatic stabilizers in the CCA are generally limited in size and responsiveness compared with those in CEE and advanced economies. On the revenue side, most countries rely on flat personal income tax systems, which reduce the cyclical sensitivity of revenues to income fluctuations (Table 4). Only a small number of CCA economies—such as Azerbaijan and Tajikistan—have introduced progressive elements into their income tax structures.

Table 4. CCA Statutory Personal Income Tax Regimes¹

(As of February 2025, or latest observation)

Country	Type of Tax Regimes	Year of Flat-Rate Adoption (Repeal)	Initial (Latest) Flat Tax Rate
ARM	Flat	2020	23% (20%)
AZE	Progressive	2006 (2018)	12% (14% and 25%)
GEO	Flat	2005	12% (20%)
KAZ	Flat	2007	10%
KGZ	Flat	2006	10%
TJK	Progressive	2006 (2012)	13% (12% and 18%)
TKM	Flat	2004	10%
UZB	Flat	2019	12%

Sources: KPMG; PWC; and IMF staff calculations.

Note: ARM = Armenia; AZE = Azerbaijan; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan; CCA = Caucasus and Central Asia.

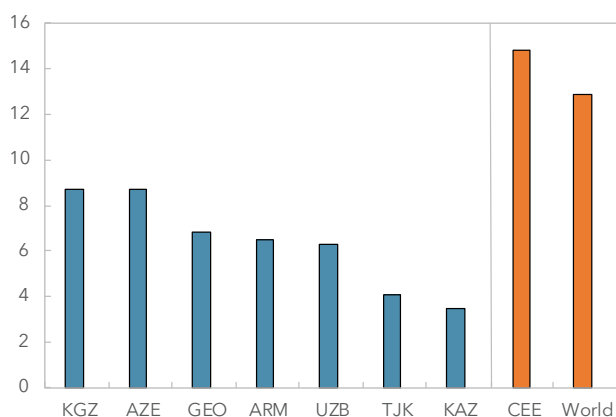
¹ Figures do not account for special personal income tax provisions.

From the expenditure perspective, social protection systems tend to be relatively small and weakly targeted. Spending on unemployment benefits and income-tested transfers is low by international standards, and coverage of vulnerable groups remains uneven (Figure 5). Despite recent expansions, the automatic stabilizing impact of social assistance programs remains modest, given their relatively small scale, limiting their contribution to countercyclical fiscal policy.

Figure 5. State Spending and Coverage of Social Assistance

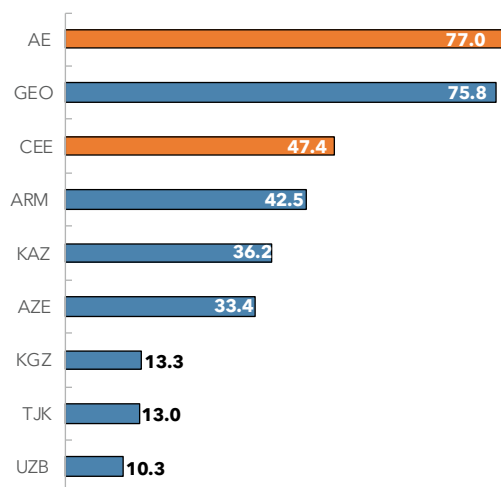
1. Social Protection Spending

(Percent of GDP, 2022 or latest available)



2. Coverage of Social Assistance Programs

(Percent of population in the poorest quintile, 2022)



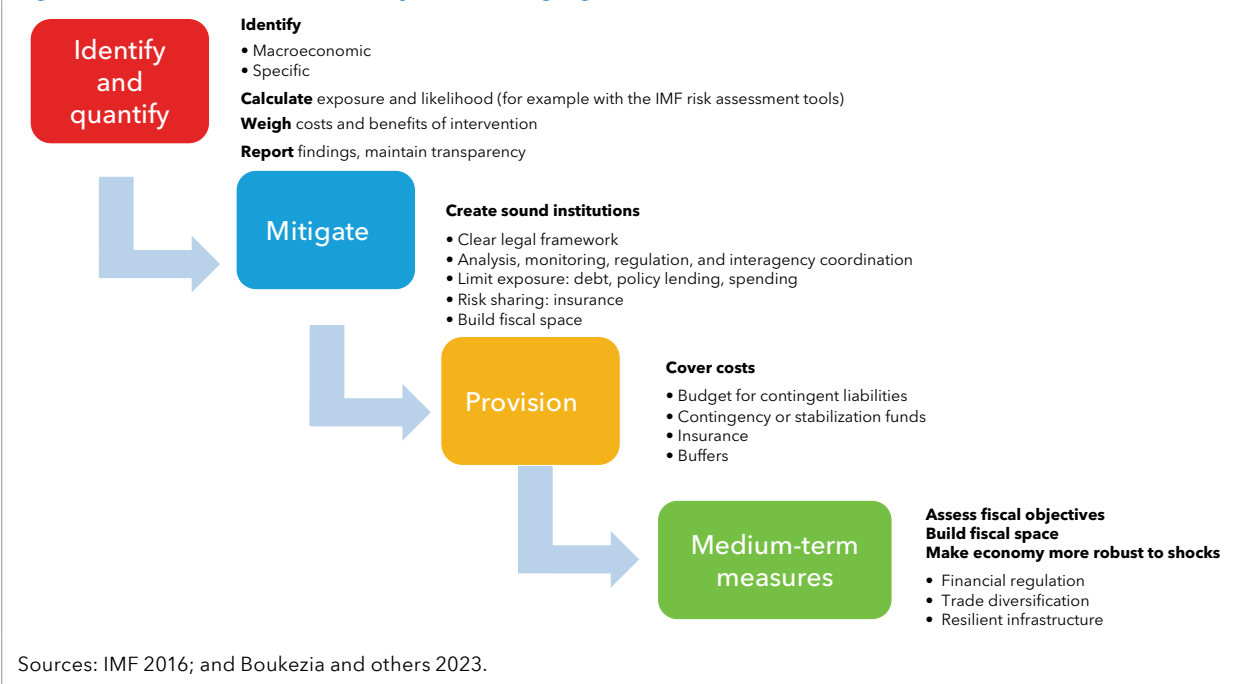
Sources: ASPIRE; ILO; World Bank; and IMF staff estimates.

Note: ARM = Armenia; AZE = Azerbaijan; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan; AE = advanced economy; CEE = Central and Eastern Europe.

These structural features help explain why fiscal stabilization in the CCA relies heavily on discretionary measures. In environments characterized by high output volatility, limited automatic stabilizers not only increase the importance of timely discretionary responses but also raise the risk of procyclicality and mistiming of implementation.

E. Fiscal Risk Management: Institutional Practices

Institutional arrangements for identifying and managing fiscal risks have strengthened across the CCA, but practices remain uneven. Most countries now publish fiscal risk statements or include dedicated risk analyses in budget documentation, covering macroeconomic shocks, SOEs, public-private partnerships (PPPs), financial sector exposures, and long-term pressures such as demographics and climate change—including risks stemming from guarantees, on-lending arrangements, and extra-budgetary entities (Figure 6).

Figure 6. Good Practices and Steps for Managing Fiscal Risks

Dedicated fiscal risk units have been established in some countries, such as Armenia, Georgia, and the Kyrgyz Republic, whereas in others, responsibility is distributed across macro-fiscal, budget, or debt management departments. Coverage and analytical depth vary significantly. More comprehensive approaches are observed where reporting frameworks are well developed and coordination across institutions is stronger, as in Armenia and Georgia.

Despite this progress, challenges remain in quantifying risks, integrating them into fiscal planning, and linking risk analysis to decision making. In several cases, quasi-fiscal activities and off-budget operations are not fully captured in fiscal reports, complicating assessments of the underlying fiscal position and exposure to shocks. These limitations underscore the importance of continued efforts to strengthen fiscal transparency and risk disclosure across the region.

3. Fiscal Policy Effectiveness in the CCA: Stabilization, Growth, and Sustainability

This section evaluates how fiscal policy has performed in the CCA with respect to its core macroeconomic functions: smoothing business cycles, supporting economic growth, and maintaining fiscal sustainability. It draws on cross-country empirical analysis and comparative evidence with CEE countries to assess outcomes over time and across different economic conditions. The results not only highlight progress in some areas but also reveal persistent weaknesses—particularly in the stabilization function—that are closely linked to the institutional features documented in Section 2. The analysis examines fiscal stabilization outcomes and channels, the role of fiscal rules, growth implications, and fiscal sustainability and risk exposure.

A. The Stabilization Function of Fiscal Policy

Countercyclical fiscal policy plays a central role in reducing macroeconomic volatility by moderating fluctuations in output, employment, and income. In principle, fiscal policy should tighten during economic expansions and loosen during downturns, thereby working in coordination with monetary policy and mitigating the amplification of shocks. Prior to the global financial crisis, macroeconomic stabilization was widely viewed as the primary responsibility of monetary policy, with fiscal policy playing a supporting role through automatic stabilizers. The experience of large and repeated shocks over the past 15 years, however, has renewed attention to the stabilizing role of fiscal policy—particularly in emerging market and developing economies where monetary transmission may be weaker.

To assess the degree of fiscal stabilization in the CCA, this paper employs a standard empirical framework used in the fiscal cyclicity literature (Jalles and others 2023). The analysis estimates fiscal reaction functions that relate changes in the overall fiscal balance to economic activity, allowing for a decomposition between automatic stabilizers and discretionary fiscal policy. The estimation is conducted using panel regressions over the period 1998–2024 and compares results for the CCA with those for CEE countries. Alternative estimation techniques—including ordinary least squares, generalized method of moments, and two-stage least squares—are used to address potential endogeneity concerns, with full technical details and robustness checks reported in Annex 2:

$$b_{ct} = a_c + \lambda_t + \beta \Delta y_{ct} + \varepsilon_{ct}$$

where b_{ct} is the overall fiscal balance in percent of GDP in country c at time t ; Δy_{ct} is GDP growth; a_c and λ_t are country and time fixed effects; and ε_{ct} is a white noise disturbance term. The variable of interest is β , the fiscal cyclicity coefficient that captures the degree of fiscal policy stabilization.

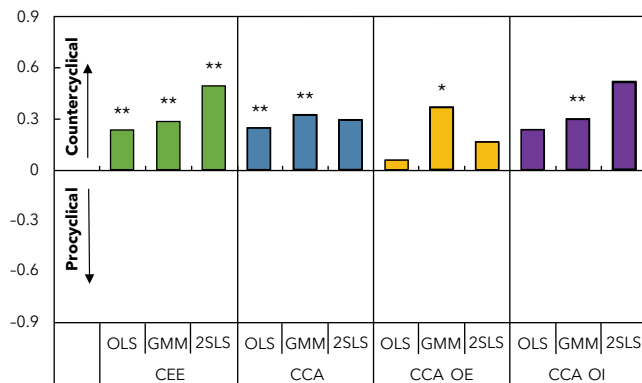
The results indicate that fiscal policy in the CCA has exhibited some countercyclical behavior on average, but with weaker and less robust responses than in CEE countries (Figure 7). Although the overall fiscal balance in the CCA tends to improve during economic expansions and deteriorate during downturns, the estimated degree of countercyclicality is smaller and sensitive to the estimation method. In contrast, CEE countries display stronger and more consistent countercyclical responses across specifications, suggesting more effective use of fiscal policy to smooth the cycle.

Differences across time and country groups are also notable. Fiscal countercyclicality in the CCA is stronger during noncrisis periods than during episodes of acute stress (Figure 8). During crises, fiscal responses tend to be more muted, reflecting financing constraints, implementation delays, and limited fiscal space

in some countries. Additional heterogeneity emerges across country groups. When the sample is split between oil-importing and oil-exporting CCA countries, important differences emerge. Oil-importing economies display stabilization patterns broadly similar to those observed in CEE countries, whereas oil-exporting economies exhibit weaker and less consistent countercyclical responses. This suggests that structural factors—particularly revenue volatility associated with commodity dependence—help explain differences in fiscal responses across countries in the region.

Figure 7. Fiscal Stabilization Coefficients and Their Statistical Significance

(1998–2024, * $p < .05$; ** $p < .01$)



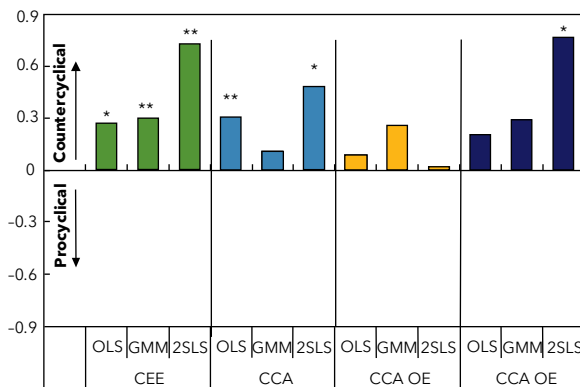
Source: IMF staff estimates.

Note: CCA = Caucasus and Central Asia; CEE = Central and Eastern Europe; GMM = generalized method of moments; OE = oil exporters; OI = oil importers; OLS = ordinary least squares; 2SLS = two-step least squares.

Figure 8. Countercyclicity of Fiscal Policy across Different Periods

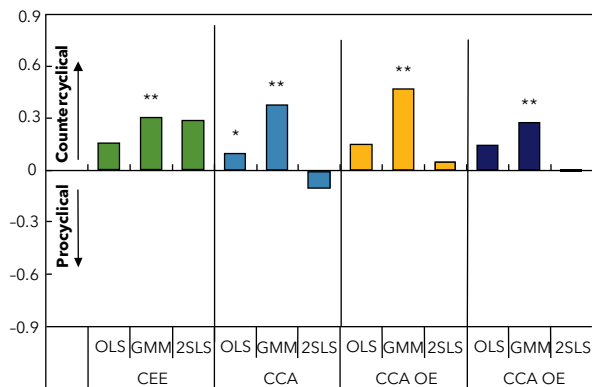
1. Fiscal Stabilization Coefficients during Noncrisis Periods

(1998–2006, 2010–19, 2022–24, * $p < .05$; ** $p < .01$)



2. Fiscal Stabilization Coefficients during Crisis Periods

(2007–09, 2020–21, * $p < .05$; ** $p < .01$)

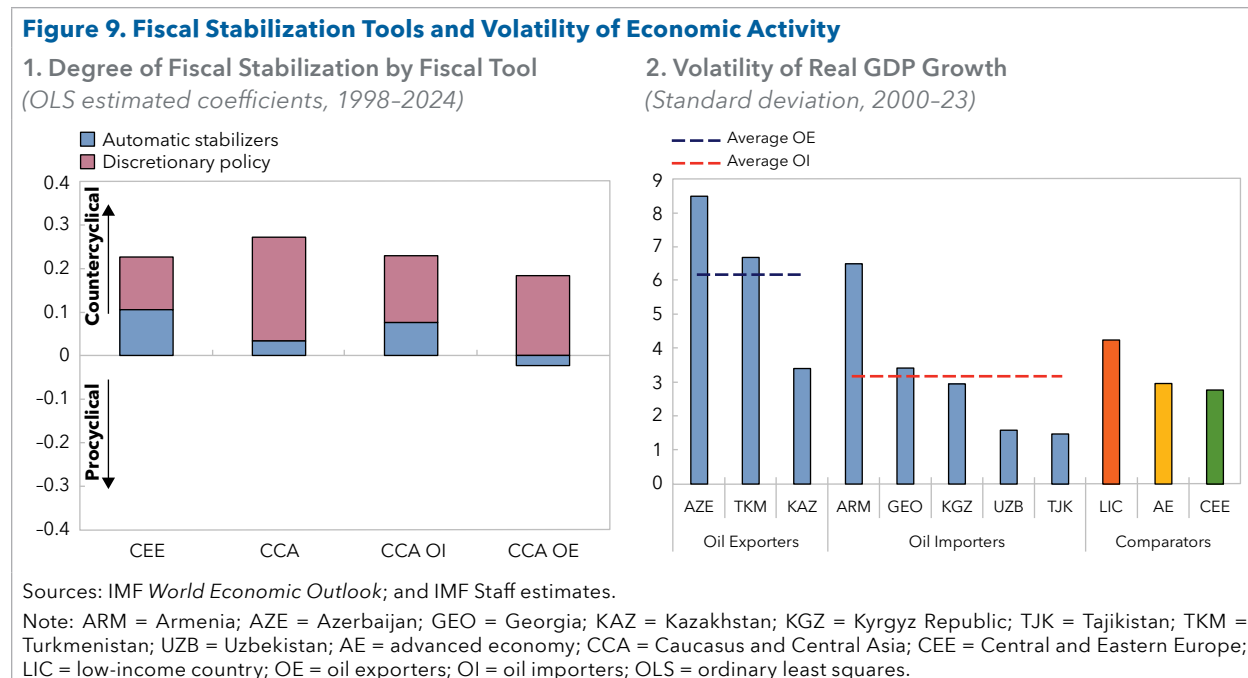


Source: IMF Staff estimates.

Note: CCA = Caucasus and Central Asia; CEE = Central and Eastern Europe; GMM = generalized method of moments; OE = oil exporters; OI = oil importers; OLS = ordinary least squares; 2SLS = two-step least squares.

B. Automatic Stabilizers and Discretionary Fiscal Policy

A key finding of the analysis is that fiscal stabilization in the CCA relies disproportionately on discretionary measures rather than automatic stabilizers. Decomposing fiscal responses shows that the contribution of automatic stabilizers to countercyclicity is significantly weaker in the CCA than in CEE countries (Figure 9). By contrast, discretionary fiscal policy accounts for a larger share of observed stabilization, particularly during downturns.



This reliance on discretionary measures reflects the structural features described in Section 2. Flat personal income tax systems, limited progressivity, and relatively small social protection programs reduce the automatic responsiveness of revenues and expenditures to changes in economic activity. As a result, fiscal policy adjustments in the CCA often require ad hoc policy decisions, which may be delayed by administrative, political, or financing constraints.

The effectiveness of discretionary fiscal policy is further complicated by forecasting challenges. Evidence from budget and macro-fiscal projections indicates a tendency to overestimate negative output gaps and underestimate positive gaps, partly because of optimistic assumptions about potential growth. This bias can lead to procyclical fiscal impulses, with expansionary policies implemented during upswings and insufficient adjustment during recoveries. Together, weak automatic stabilizers and forecasting biases limit the capacity of fiscal policy to act as a reliable countercyclical tool.

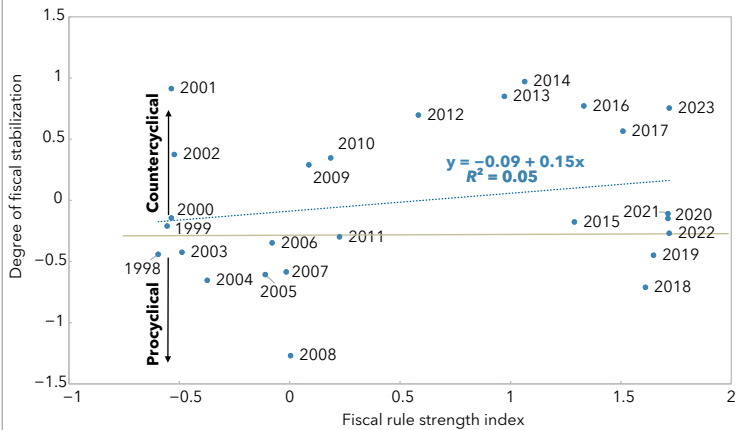
C. Fiscal Rules and Stabilization

Fiscal rules influence fiscal stabilization outcomes by shaping policy space and incentives over the economic cycle (Kopits and Symansky 1998; Eyraud and others 2018; Heinemann and others 2018). When well designed and credibly enforced, rules can help restrain procyclical fiscal expansion during upswings, preserve buffers, and enable a more supportive fiscal stance during downturns. Conversely, rules that are overly rigid, weakly enforced, or poorly integrated with medium-term fiscal frameworks may amplify procyclicality or be circumvented through discretionary measures. In practice, differences in enforcement capacity and political commitment help explain why similar rule designs yield different stabilization outcomes across countries.

Empirical evidence points to a modest positive association between the strength of fiscal rule frameworks and the degree of fiscal countercyclicality achieved over the cycle (Figure 10). Countries with clearer legal anchors, broader coverage, and stronger enforcement mechanisms—including transparent monitoring arrangements and institutional oversight of rule compliance—tend to exhibit more countercyclical fiscal responses, although outcomes also depend on broader institutional capacity and policy implementation. In

many countries, such oversight functions are performed by fiscal councils or parliamentary budget institutions that monitor compliance with fiscal rules and assess fiscal policy developments. In the CCA region, however, such institutions remain limited, with monitoring of fiscal rules typically conducted within the executive branch. These patterns are consistent with the differences in stabilization performance observed between CCA countries and peers (Figure 11). Causality is difficult to establish, though, and rule adoption itself may reflect broader institutional strength.

Figure 10. Fiscal Rule Strength and Fiscal Stabilization¹
Country-year observations



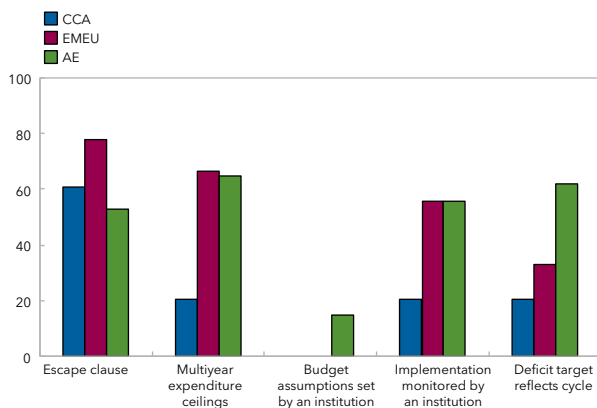
Sources: Fiscal Affairs Department’s fiscal rules database; national legislation; and IMF staff estimates.

Note: CCA = Caucasus and Central Asia; CEE = Central and Eastern Europe.

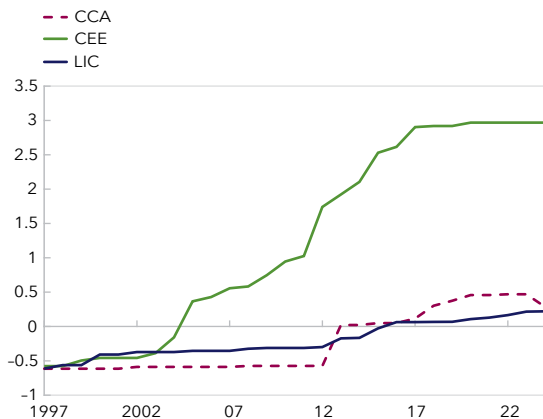
¹ The composite index is a summary measure of fiscal rules’ characteristics as described in Alonso and others (2025). Fiscal stabilization is a coefficient measuring the response of fiscal policy to economic cycles.

Figure 11. Fiscal Rules’ Stabilization Functions in CCA Compared with CEE

1. Characteristics of Fiscal Rules by Region
(Percent of countries with formal fiscal rules)



2. Fiscal Rule Strength Index¹
(Standardized fiscal rule strength index)



Sources: Fiscal Affairs Department’s fiscal rules database; survey of the IMF country teams; and IMF staff estimates. See Alonso and others (2025). The data set contains 34 AEs, 9 EMEU economies, and 5 CCA economies.

Note: AE = advanced economy; CCA = Caucasus and Central Asia; CEE = Central and Eastern Europe; EMEU = Emerging Eastern Europe; LIC = low-income country.

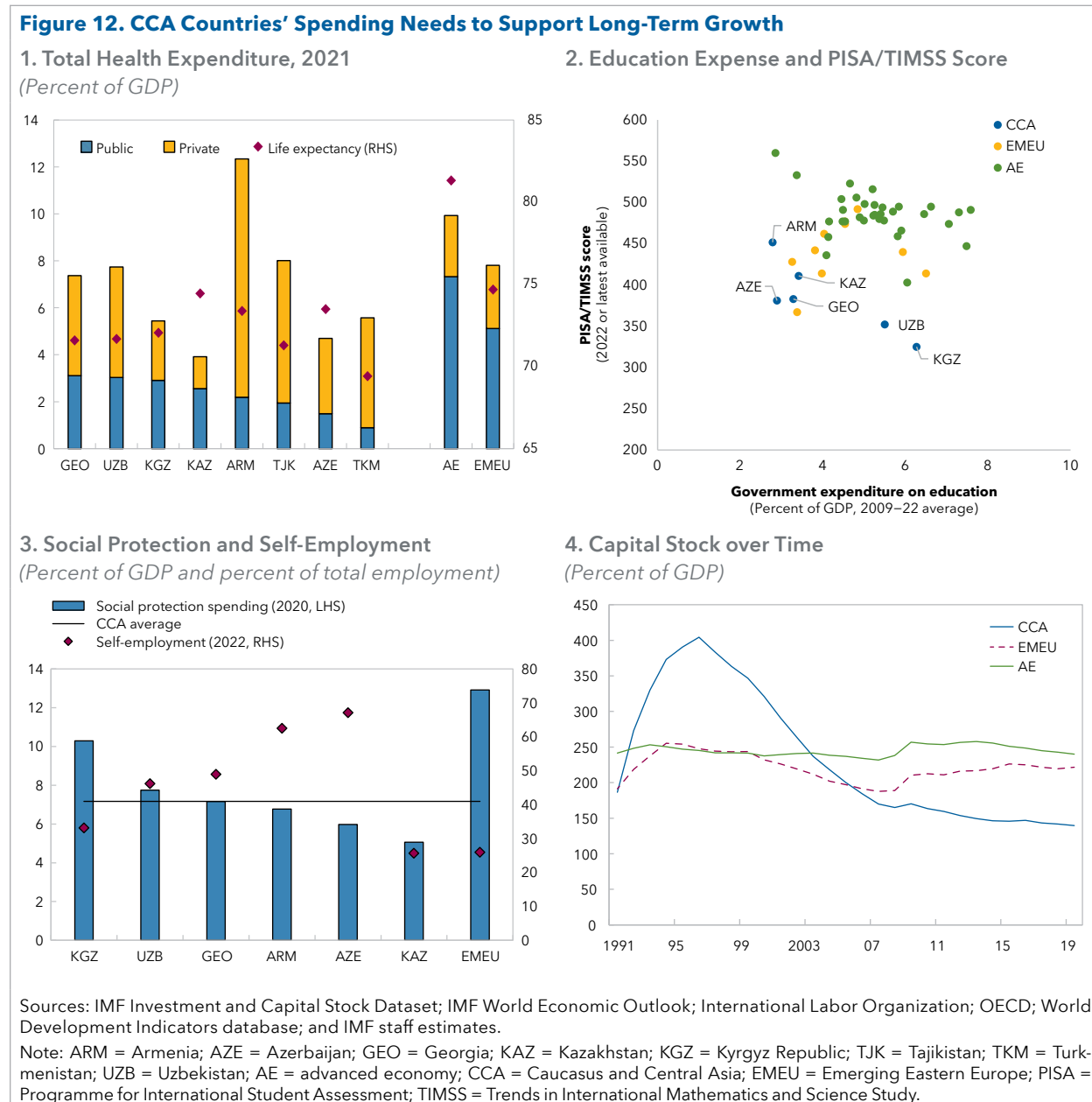
¹ The index combines a set of subindices for each type of rule (debt, budget balance, expenditure, and revenue rules) based on the following key characteristics: number of fiscal rules, coverage, legal basis, formal enforcement, supporting procedure, and flexibility. It is standardized around the full-sample mean; negative values indicate below-average fiscal rule strength.

At the same time, the effectiveness of fiscal rules depends critically on their interaction with medium-term fiscal frameworks and institutional capacity. In the absence of credible medium-term expenditure planning, fiscal rules are more easily bypassed or suspended, reducing their stabilizing role. As a result, the adoption of fiscal rules alone has not been sufficient to ensure countercyclical fiscal policy in several CCA countries.

D. Fiscal Policy and Economic Growth

Beyond stabilization, fiscal policy in the CCA has played an important role in supporting economic growth and development. Governments have used public spending, investment programs, and state involvement in key sectors to address infrastructure gaps, expand access to public services, and promote employment. These efforts have contributed to improvements in living standards and resilience in some countries, particularly during periods of favorable external conditions.

At the same time, despite robust growth in the past three years, sustaining strong medium-term growth will remain challenging because of structural constraints and limitations in the efficiency and composition of public spending. While fiscal policy has supported economic activity and development objectives, longer-term growth prospects continue to depend on improvements in productivity, private-sector development, and the quality of public investment.



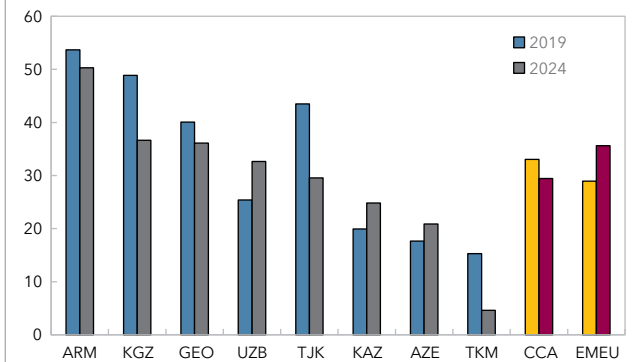
One key reason for this is that high public investment and development spending have not always translated into commensurate productivity gains. Weak public investment management, inefficiencies in SOEs, and limited crowding-in of private investment have reduced the growth payoff of fiscal expansion in several cases. These findings underscore the importance of the quality, not just the scale, of fiscal intervention in shaping long-term growth outcomes (Figure 12).

E. Fiscal Sustainability and Risk Exposure

Fiscal sustainability has remained broadly preserved in the CCA, with public debt levels generally moderate by international standards, though this aggregate picture masks substantial heterogeneity across countries and over time. Although average debt ratios remain below those observed in many emerging market peers, several oil-importing economies record debt levels close to or above 50 percent of GDP—comparable to emerging Europe—reflecting rising debt ratios and the erosion of fiscal buffers (Figure 13). In contrast, oil-exporting countries generally maintain lower debt levels, benefiting from past commodity windfalls and the accumulation of assets in stabilization or savings funds. These differences underscore the importance of country-specific initial conditions in assessing fiscal sustainability.

Recent debt dynamics have reflected a combination of macroeconomic and fiscal factors. Strong nominal GDP growth, elevated inflation, and—in some cases—exchange rate appreciation have supported declining debt ratios in recent years. Looking ahead, these tailwinds are expected to weaken as growth moderates, and inflation normalizes. As a result, stabilizing or reducing debt ratios will increasingly depend on primary fiscal balances and disciplined expenditure management, particularly in countries with limited fiscal space (Figure 14).

Figure 13. Public Debt
(Percent of GDP)

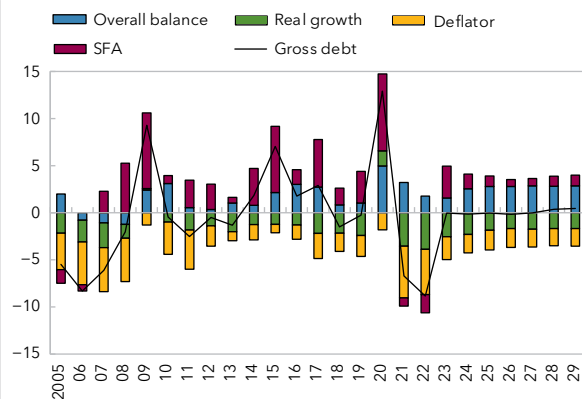


Sources: IMF *World Economic Outlook*; and IMF staff estimates.
Note: ARM = Armenia; AZE = Azerbaijan; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan; CCA = Caucasus and Central Asia; EMEU = Emerging Eastern Europe.

Figure 14. Contributions to Changes in Public Debt Ratios

Debt is projected to stabilize in oil-importing countries. . . .

1. Annual Change in Public Debt, Energy Importers
(Percentage points of GDP)



. . . while rising moderately on average in oil-exporting countries.

2. Annual Change in Public Debt, Energy Exporters
(Percentage points of GDP)

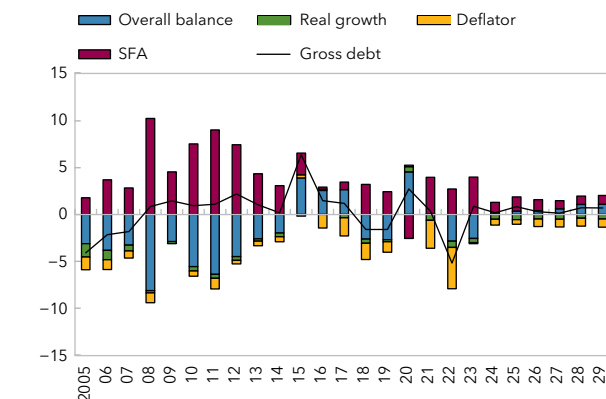
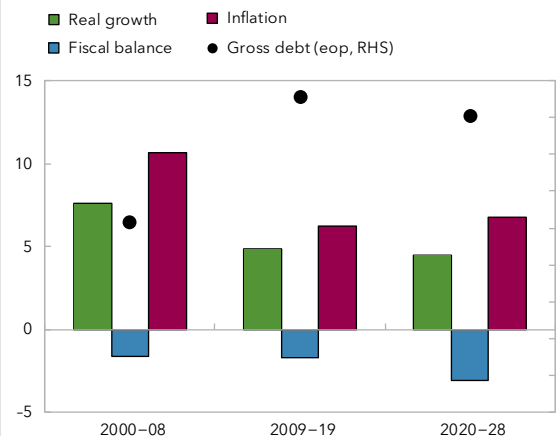


Figure 14. Contributions to Changes in Public Debt Ratios (continued)

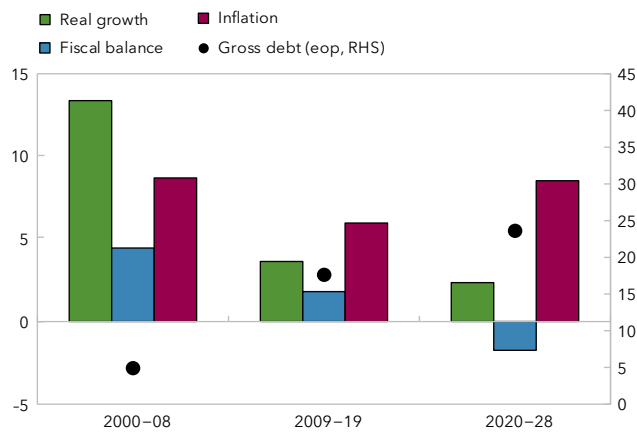
Declines in growth and fiscal balances underlie these trends. . . .

. . . and are more pronounced in oil-exporting countries.

3. Key Drivers of Public Debt, Energy Importers
(Percentage points of GDP, period average)



4. Key Drivers of Public Debt, Energy Exporters
(Percentage points of GDP, period average)



Sources: IMF World Economic Outlook, April 2023; and IMF staff calculations.

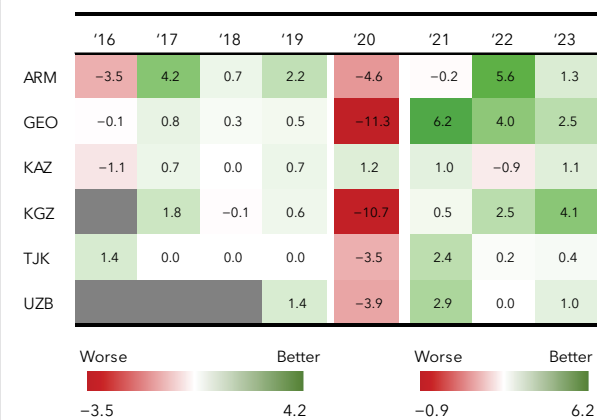
Note: SFA = stock-flow adjustments, including exchange rate revaluations.

Persistent expenditure overruns point to a deficit bias in fiscal policy that poses risks to sustainability. Although budget year projections for growth and revenues do not exhibit a systematic optimism bias, deviations from planned expenditures have been frequent and, in many cases, substantial (Figure 15). Medium-term projections tend to be more optimistic, contributing to repeated slippages relative to fiscal targets and complicating the operation of fiscal rules. These patterns indicate weaknesses in expenditure control, medium-term planning, and enforcement mechanisms, which undermine the credibility of fiscal frameworks and limit their effectiveness in anchoring expectations, including through frequent supplementary budgets or in-year reallocations, often approved late in the fiscal year (Box 2). This diagnosis is consistent with findings in other emerging market economies (IMF 2019, 2022a).

Figure 15. CCA: Budget Year Forecast Errors of Macro-Fiscal Indicators, 2016-23¹

(Percent of GDP)

1. Actual Real GDP Growth Minus Forecast



2. Actual Minus Budgeted Revenues

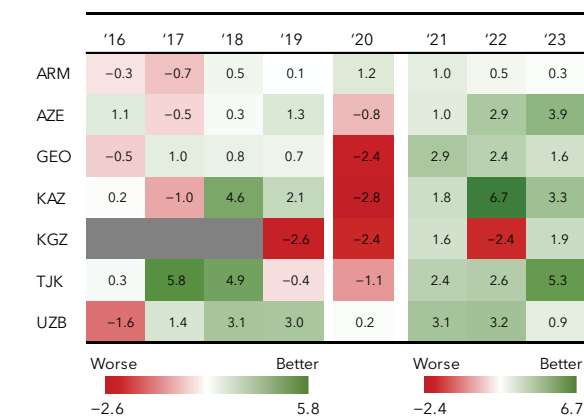
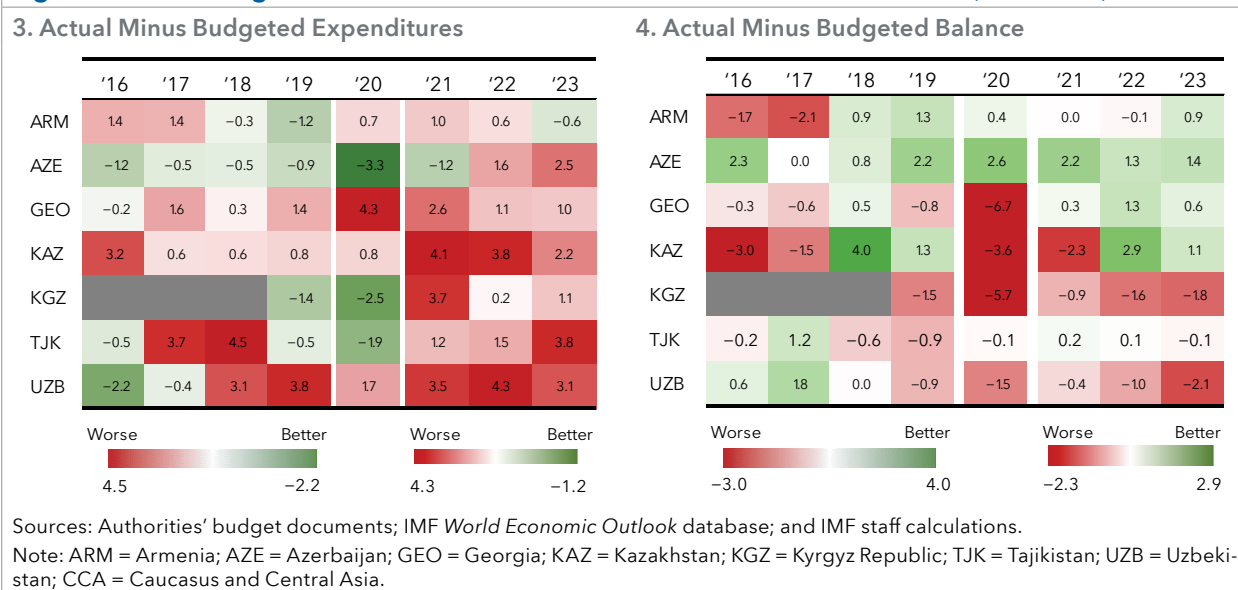


Figure 15. CCA: Budget Year Forecast Errors of Macro-Fiscal Indicators, 2016-23 (continued)

Box 2. Realism of Fiscal Frameworks in Armenia and Georgia, 2013-23

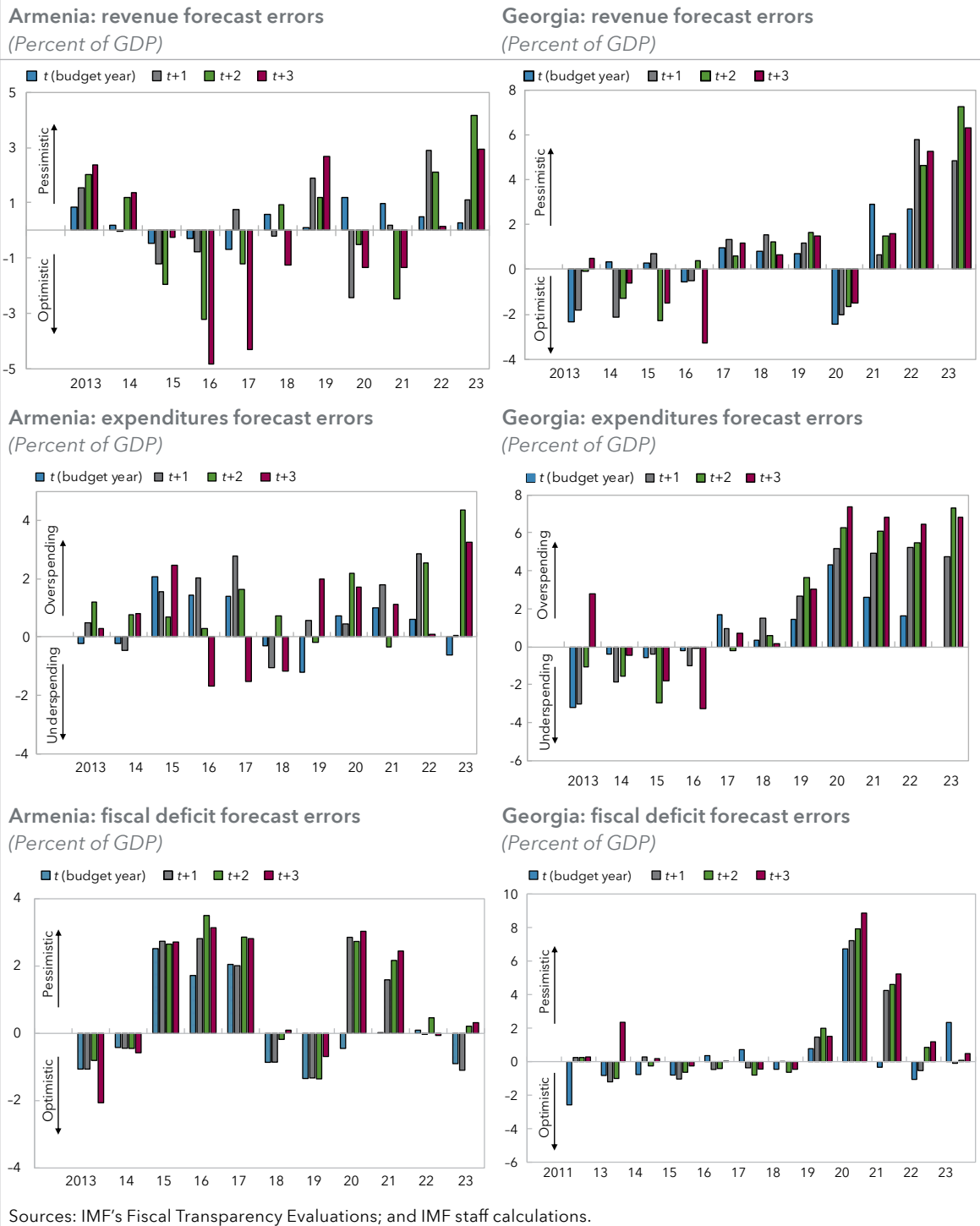
The International Monetary Fund's Fiscal Transparency Evaluation assessed Armenia and Georgia to be in the advanced category of fiscal transparency. This box takes a long view by analyzing the realism of their fiscal forecasts since 2013.

Fiscal revenues have overall overperformed relative to forecasts since 2018. Despite higher growth projections, budget year revenue forecasts were overall conservative in Armenia except during 2015-17. However, the three-year forward projections were optimistic overall during 2015-21 by an average of 1.5 percent of GDP. Budget year projections in Georgia were overall conservative, underperforming only in 2013, 2016, and 2020. Meanwhile, three-year forward revenue projections overperformed for most of the period since 2013, underperforming primarily during 2014-16 and in 2020 by an average of 1.7 percent of GDP.

There is a clear tendency to exceed expenditure ceilings. During 2013-23, budget years in Armenia experienced overspending by an average of 0.4 percent of GDP, increasing to 0.7 percent of GDP for the three-year forecasts. Expenditure overruns in Georgia reached on average 0.7 percent of GDP for the budget year projections, rising to 2.5 percent of GDP for three-year ahead projections. They also consistently exceeded projections during 2017-23, with a wide margin in the later years.

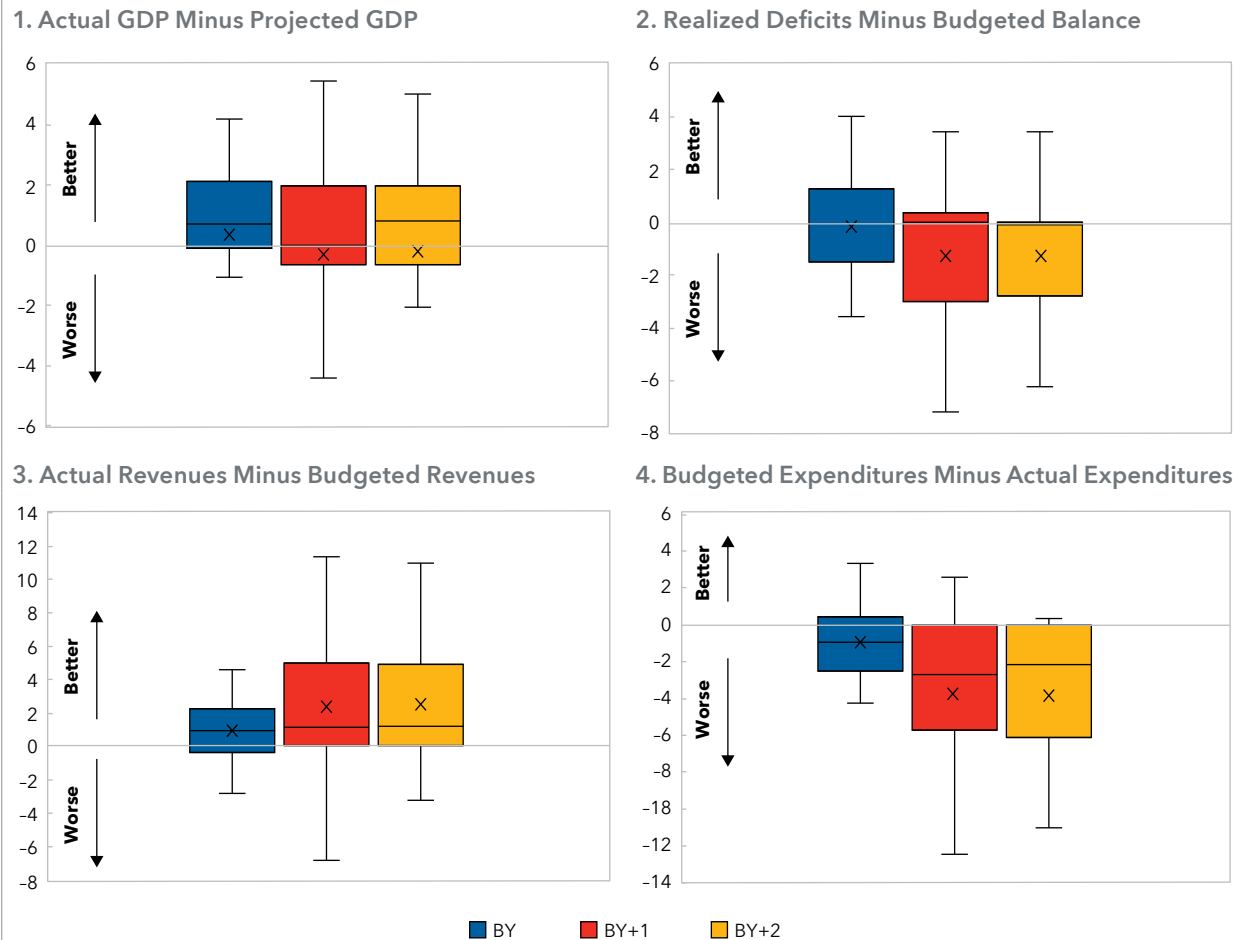
The optimism of expenditure forecasts in the medium term exceeded on average conservative revenue projections, leading to optimistic deficit bias. Budget year projections were on average optimistic by 0.3 percentage point of GDP in Georgia, whereas neutral in Armenia. Deficit overruns in the medium term averaged 1.0 percentage point of GDP in Armenia and 1.7 percentage points of GDP in Georgia during 2013-23. These forecast biases remained high during the recent period for both countries.

Box Figure 2.1. Fiscal Forecast Errors in Armenia and Georgia



These patterns point to the central role of weak medium-term fiscal frameworks in shaping fiscal outcomes. In many CCA countries, MTEFs and MTEFs do not provide binding constraints on annual budget decisions. Optimistic fiscal projections, the absence of enforceable multiyear expenditure ceilings, and limited accountability for deviations weaken the credibility of medium-term plans and reduce their effectiveness as fiscal anchors. As a result, fiscal rules are more easily circumvented, discretionary adjustments dominate, and consolidation or stabilization efforts tend to be delayed or reversed, as reflected in the distribution of forecast errors for key macro-fiscal aggregates (Figure 16).

Figure 16. CCA: Medium-Term Forecast Error Distributions of Macro-Fiscal Indicators, 2010-23
(Percent of GDP)

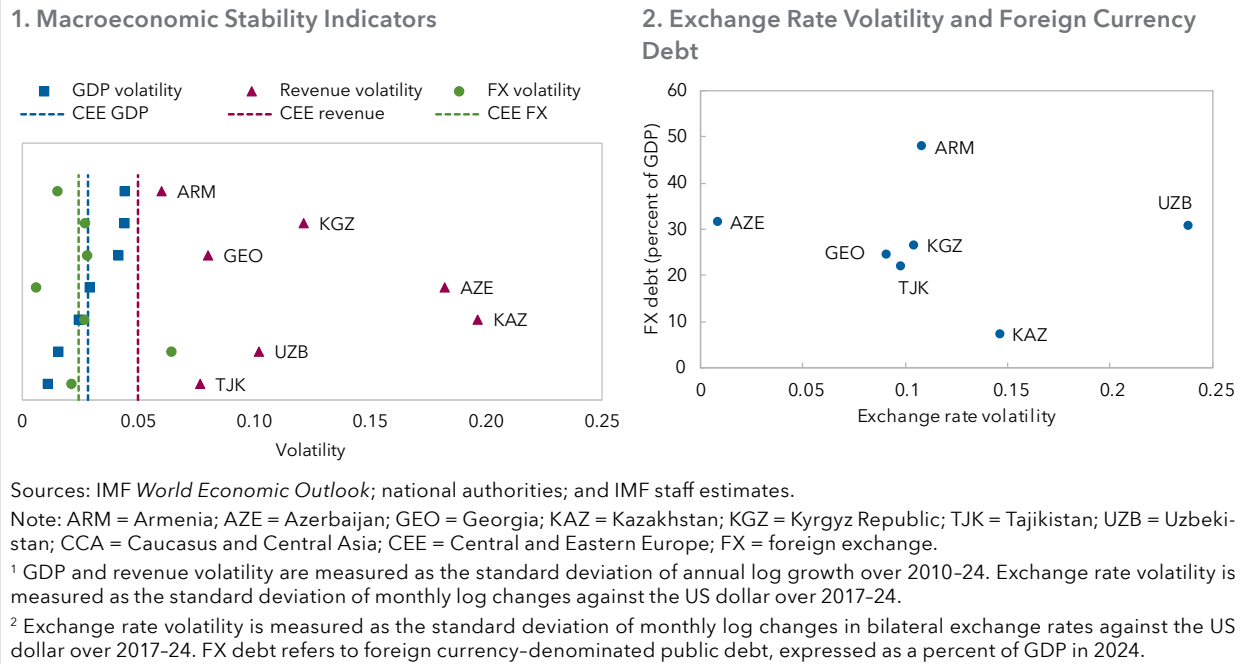


Sources: Authorities' budget documents; Fiscal Affairs Department's Fiscal Risk Assessment Tool; and IMF staff calculations.

Note: Only Armenia, Georgia, and Kazakhstan have BY + 1 and BY + 2 projections. Negative values denote overestimation/optimism. BY = budget year; CCA = Caucasus and Central Asia.

Macroeconomic volatility further amplifies fiscal risks in the CCA. Over the past 15 years, the region has been repeatedly affected by large external shocks, including the global financial crisis, sharp commodity price swings, the COVID-19 pandemic, and heightened geopolitical tensions. These shocks have been associated with pronounced fluctuations in output, revenues, remittances, and exchange rates. Volatility of nominal GDP and government revenues has generally been higher in the CCA than in peer regions, reflecting heavy reliance on commodities and external inflows, as well as relatively shallow financial markets. In addition, in several countries, a significant share of public debt is denominated in foreign currency, increasing exposure to exchange rate movements and amplifying the fiscal impact of currency fluctuations. In some cases—Azerbaijan and Kazakhstan—substantial sovereign assets mitigate these balance sheet risks (Figure 17).

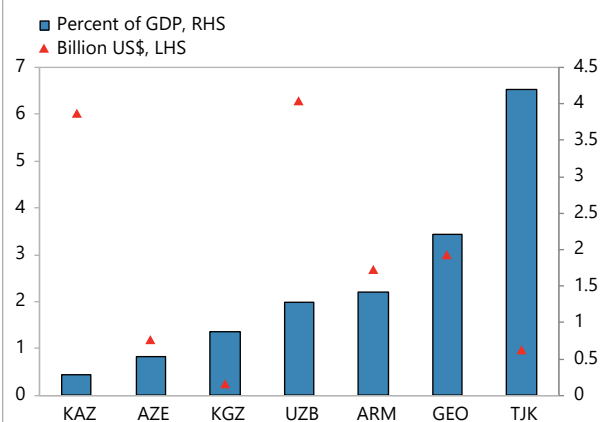
Figure 17. Macroeconomic Volatility and Fiscal Indicators in the CCA Region



Beyond macroeconomic shocks, contingent liabilities represent an important source of fiscal risk in the CCA. PPPs have expanded rapidly in several countries as governments seek to address infrastructure gaps and attract private capital, but they also entail risks related to cost overruns, contract renegotiations, and demand shortfalls (Figure 18). Government guarantees and on-lending arrangements constitute an additional channel through which fiscal risks can accumulate. Such instruments are often used to support investment by SOEs or priority sectors, but are not always subject to systematic ex ante risk assessment or pricing, and may be only partially reflected in fiscal reporting. When economic conditions deteriorate, these contingent obligations can materialize quickly, placing pressure on public finances and eroding fiscal buffers.

SOEs constitute another major channel of fiscal risk. In many CCA countries, SOEs continue to play a dominant role in key sectors, including energy, transport, and finance. Weak governance, quasi-fiscal activities, and limited financial transparency have contributed to recurrent losses and the accumulation of liabilities that ultimately fall on the public sector. During periods of economic stress, governments have often been required to provide financial support to SOEs through transfers, guarantees, on-lending, or debt restructuring, increasing pressure on public finances.

Figure 18. Total PPP Investments in the CCA, 1990–2023



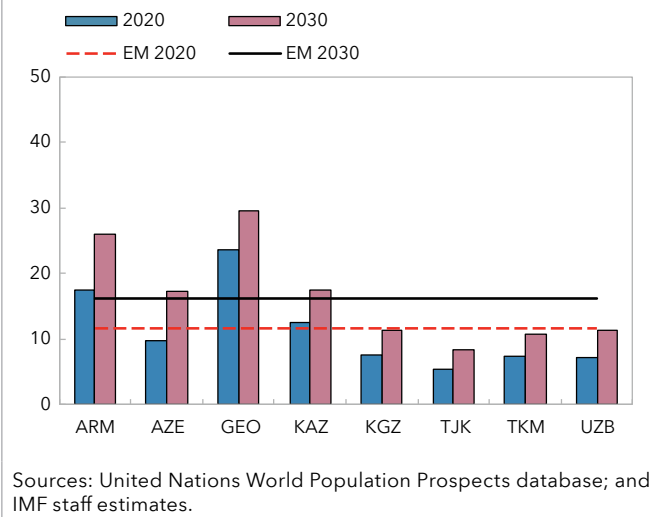
Sources: Private Participation in Infrastructure (PPI)—World Bank Group; and IMF staff estimates.
 Note: ARM = Armenia; AZE = Azerbaijan; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan; CCA = Caucasus and Central Asia; PPP = public-private partnership.

The financial sector also poses contingent fiscal risks. Episodes of banking sector distress in the region have, in the past, required significant state intervention, with sizable fiscal costs. High levels of dollarization, concentrated banking systems, and the large footprint of state-owned banks in some countries heighten exposure to shocks. Although capital and liquidity buffers have generally improved and supervisory frameworks have been strengthened, progress has been uneven across the region, and legal and resolution frameworks have yet to be tested under severe stress in several cases.

Long-term demographic trends add to sustainability concerns. Population aging is projected to intensify across the CCA, particularly in countries such as Armenia and Azerbaijan, increasing pressures on pension systems, health care spending, and long-term care (Figure 19). Although these trends unfold gradually, international experience suggests that delayed policy responses can result in significant fiscal costs over time, especially when long-term projections rely on optimistic assumptions regarding productivity growth or migration.

Climate-related risks further compound fiscal vulnerabilities. CCA countries are increasingly exposed to both acute climate-related shocks—such as floods, droughts, and extreme temperatures—and longer-term structural challenges associated with climate change. These risks can generate substantial fiscal costs through emergency spending, infrastructure damage, and adaptation needs, while also affecting growth and revenue bases. For hydrocarbon exporters, the global energy transition introduces additional long-term fiscal risks related to a possible decline in demand for fossil fuels.

Figure 19. Dependency Ratios
(Percent, 65+/15–64)



4. Reform Priorities: Strengthening Fiscal Frameworks in the CCA

Building on the analysis of fiscal policy effectiveness and the assessment of existing institutions, this section outlines key reform priorities to strengthen fiscal frameworks in the CCA. The focus is on enhancing the stabilization, allocation, and sustainability functions of fiscal policy, while recognizing differences in institutional capacity and economic structures across countries. Although reform needs vary, the recommendations discussed in the following sections highlight common principles and practical steps that can help align fiscal frameworks more closely with macroeconomic objectives and development priorities.

A. Recalibrating Fiscal Rules to Support Stabilization

Reform efforts on fiscal rules should focus on strengthening their design, enforcement, and operational relevance to better support countercyclical fiscal policy while preserving sustainability. Although fiscal policy in the CCA has exhibited some countercyclical features, the empirical analysis in Section 3 shows that stabilization responses remain weaker and less robust than in comparator regions and rely heavily on discretionary measures. In the CCA context, the objective is not to expand the number of numerical constraints but to ensure that existing frameworks provide clear guidance for fiscal policy over the cycle and are sufficiently flexible to accommodate large and frequent shocks.

Greater attention to the operational design of fiscal rules would improve their stabilizing properties. In environments characterized by high revenue volatility, particularly in commodity-dependent economies, expenditure-based rules can provide a more stable and easier-to-monitor and easier-to-communicate anchor for fiscal policy than balance-based targets. In practice, expenditure ceilings should be calibrated in a manner consistent with medium-term debt objectives and projected revenue paths, for example, by setting expenditure growth limits that stabilize or gradually reduce the debt ratio over time. In commodity-exporting economies, expenditure ceilings should also ensure that public spending does not rise and fall with volatile commodity revenues. This is often achieved by saving windfall revenues in stabilization or sovereign wealth funds and drawing on them when commodity prices decline. Where balance rules are retained, greater attention should be paid to their cyclical properties, including through the use of well-defined correction mechanisms that allow temporary deviations during downturns while ensuring a credible return to the rule over time.

Recent crisis episodes highlight the importance of embedding flexibility within rule frameworks without eroding their credibility. Clearly specified escape clauses—anchored in objective triggers, transparent activation procedures, and predefined correction paths—can help reconcile stabilization needs with fiscal discipline during exceptional shocks. Experience during recent crises underscores the importance of embedding such clauses within a robust institutional framework to avoid ad hoc suspensions that weaken confidence in the rule.

More effective enforcement and monitoring arrangements would further enhance the credibility and effectiveness of fiscal rules. Simplifying and streamlining rule frameworks, clarifying the hierarchy among multiple constraints, and strengthening independent oversight can improve transparency and accountability. In this regard, fiscal councils or similar institutions can play an important role by monitoring compliance, assessing macro-fiscal assumptions, and communicating deviations from the framework to the public. Together, these measures would enhance the stabilizing role of fiscal rules and reduce reliance on discretionary adjustments.

B. Anchoring Policy in Credible MTFFs

Strengthening MTFFs and MTEFs should focus on making them more binding, transparent, and operational in guiding annual budget decisions. In the CCA context, priority reforms include anchoring medium-term plans in realistic macro-fiscal projections, enforcing multiyear expenditure ceilings, and strengthening accountability for deviations between approved plans and budget outcomes.

One area where reforms could have particularly high payoff is the introduction and enforcement of binding multiyear expenditure ceilings that are firmly anchored in macro-fiscal projections and debt sustainability considerations. Rolling expenditure ceilings can help discipline annual budget decisions, protect priority spending during downturns, and reduce procyclicality, provided they are supported by strong top-down budget processes and clear accountability for line ministries.

The effectiveness of medium-term frameworks also depends on the realism and transparency of macro-fiscal projections. This includes strengthening forecasting methodologies, increasing transparency around underlying assumptions, and subjecting projections to greater scrutiny, either internally or through independent review. Clear procedures for addressing deviations between plans and outcomes—such as corrective actions or explanations in budget documentation—can further enhance accountability and confidence in the framework.

Closer integration of medium-term frameworks with annual budget preparation would help ensure that medium-term objectives meaningfully guide fiscal decisions. MTFFs and MTEFs should guide, rather than merely accompany, annual budget preparation, with medium-term objectives clearly reflected in budget ceilings, sectoral allocations, and investment planning. Improved integration would enhance policy coherence, strengthen the credibility of fiscal commitments, and support more effective implementation of both fiscal rules and stabilization objectives.

C. Strengthening Automatic Stabilizers

Reforms to automatic stabilizers can enhance the timeliness, predictability, and equity of fiscal responses to economic fluctuations, while limiting reliance on discretionary measures (Baunsgaard and Symansky 2009). In the CCA context, reforms should focus on enhancing the cyclical responsiveness of both revenue and expenditure instruments, without necessarily increasing the overall size of government.

On the revenue side, greater progressivity in personal income taxation can increase the automatic responsiveness of revenues to changes in economic activity. Although flat tax regimes have supported administrative simplicity and compliance in many CCA countries, greater progressivity—through multiple tax brackets, higher marginal rates for top incomes, or targeted earned income tax credits—can strengthen the stabilizing role of the tax system and reduce the need for ad hoc fiscal adjustments during downturns.

On the expenditure side, more robust and better-targeted social protection systems would enhance the automatic support provided to households during downturns. Expanding the coverage, adequacy, and targeting of income-responsive transfers and unemployment benefits can enhance automatic fiscal support to households during economic shocks. Priority reforms include improving social registries, reducing program fragmentation, and strengthening administrative capacity, including through digital delivery mechanisms that allow benefits to scale up automatically when conditions deteriorate (OECD 2023).

D. Enhancing Fiscal Risk Management and Building Buffers

Policy priorities in fiscal risk management can be understood along three complementary dimensions: strengthening the identification and disclosure of fiscal risks—including through more comprehensive fiscal reporting and improved coverage of extra-budgetary entities and quasi-fiscal activities—improving mechanisms to mitigate their likelihood and impact, and building adequate buffers and provisioning to absorb shocks when risks materialize. In the CCA, these priorities are particularly relevant given the wide range of fiscal risks countries face and the need to integrate risk analysis more systematically into fiscal decision making.

Strengthening oversight and governance of SOEs remains central to reducing fiscal risks in the CCA. In many countries, SOEs continue to operate under multiple and sometimes conflicting mandates, complicating performance assessment and blurring the boundary between commercial activity and public policy objectives. Although ministries of finance typically retain formal ownership or oversight responsibilities, monitoring arrangements vary widely, and consolidated information on SOE financial positions is not always produced on a regular or comprehensive basis. These weaknesses have contributed to quasi-fiscal activities and the accumulation of contingent liabilities, which can materialize rapidly during periods of economic stress. Enhancing transparency, clarifying mandates, and strengthening centralized monitoring—supported by more systematic consolidation of SOE financial information—would help contain fiscal risks and improve accountability.

Managing fiscal risks from PPPs also requires continued attention. Although PPPs can help address infrastructure gaps, approval and control frameworks are not always fully integrated with the budget process. In some cases, project appraisal, affordability analysis, and risk-sharing arrangements are conducted primarily at the line-ministry level, with limited centralized scrutiny. This can allow fiscal commitments to accumulate outside headline deficit and debt measures, particularly when projects rely on availability payments, revenue guarantees, or power purchase agreements. Establishing centralized approval processes, applying standardized appraisal and risk-sharing frameworks, and setting quantitative limits on exposure would help ensure that PPPs support development objectives without undermining fiscal sustainability.

The accumulation and prudent management of fiscal buffers are also important for preserving space for countercyclical policy. Although stabilization and savings mechanisms have helped smooth revenue volatility in some commodity-exporting countries, drawdown practices and integration with annual budget processes differ widely across the region. For commodity-exporting countries, well-governed sovereign wealth funds integrated with the budget can help smooth revenue volatility and support intergenerational equity. In this context, adopting a broader public sector balance sheet perspective—including greater attention to net debt rather than gross debt—such as through sovereign asset and liability management frameworks, can help guide fiscal policy by jointly assessing the risks and costs associated with government assets and liabilities. For commodity-importing countries, buffers are more likely to be built through sustained revenue mobilization, improved expenditure efficiency, and prudent debt management.³ Broadening tax bases and reducing exemptions can play an important role in strengthening revenues while supporting growth.

³ The International Monetary Fund's recent estimates of tax revenue potential suggest that, under current tax policy frameworks, tax revenues in CCA countries could be substantially higher if compliance and policy gaps were closed. Using tax gap methodologies applied in the International Monetary Fund's departmental work for the region (see IMF, 2022b, indicative estimates point to potential gains of up to about 75 percent of current revenues in oil-importing economies and around 6 percent in oil-exporting countries, reflecting differences in tax bases, reliance on hydrocarbon revenues, and administrative capacity. These figures should be interpreted as upper-bound estimates rather than policy targets and are sensitive to assumptions regarding compliance, informality, and enforcement.

Over the medium, fiscal risk management frameworks will also need to account more systematically for structural challenges, including demographic pressures and climate-related risks (Gonguet and others 2021). Integrating these risks into fiscal planning, debt sustainability analysis, and budget documentation would help ensure that fiscal policy remains resilient in the face of evolving structural pressures and supports sustainable development over the medium term (Box 3).

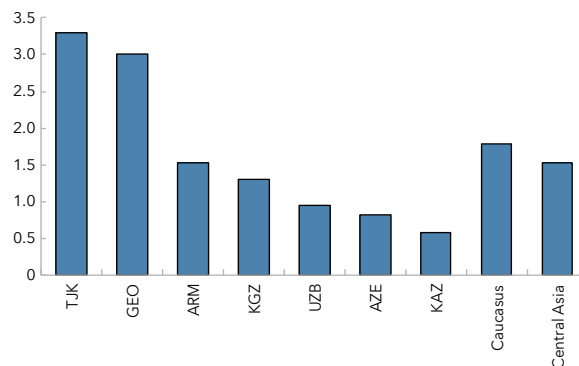
Box 3. Climate Change Fiscal Costs and Tax Policy

Countries in the Caucasus and Central Asia (CCA) face high fiscal costs from climate change, reflecting both acute climate-related shocks and longer-term structural pressures (Harris and others, 2021, 2022). The cost of floods, storms, and sea-level rise in the CCA region is estimated at 1–3 percent of GDP per year (Parry, Black, and Vernon 2021). Climate Risk Country Profiles jointly developed by the World Bank and ADB suggest that the environmental impact of climate change will be severe across the region.¹ Specifically, all CCA countries are expected to experience above-average increases in temperature, alongside reductions in arable land and yields of staple crops (including Armenia, Georgia, Kazakhstan, Tajikistan, and Uzbekistan), and more frequent natural disasters, such as floods and landslides (Armenia, Kyrgyz Republic) and severe droughts (Kazakhstan, Turkmenistan, and Uzbekistan).

Adapting to climate change in the CCA will require identifying and prioritizing investments that reduce vulnerability to the climate risks most prevalent in the region, while yielding benefits under a wide range of future emissions and climate scenarios.² Estimates suggest that such adaptation costs could average around 1.7 percent of GDP (Box Figure 3.1). Fiscal policy can also support mitigation objectives. Carbon taxes are among the most powerful and efficient tools for reducing domestic carbon dioxide emissions (IMF 2019), and the International Monetary Fund’s staff analysis suggests that they could generate substantial revenues in CCA economies (Duenwald and others 2022). For illustrative purposes, a carbon tax of US\$25 per ton could raise more than 1 percent of GDP in additional revenue in most CCA countries. “Feebates”—sliding scales of fees on products and activities with above-average emissions rates that finance rebates for those with below-average emissions rates—offer an alternative market-based approach (IMF 2019). Emissions trading systems can also contribute to mitigation efforts; for example, Kazakhstan’s system now covers about 46 percent of greenhouse gas emissions (ICAP 2022).

Box Figure 3.1. Adaptation Costs

(Percent of GDP, 2020)



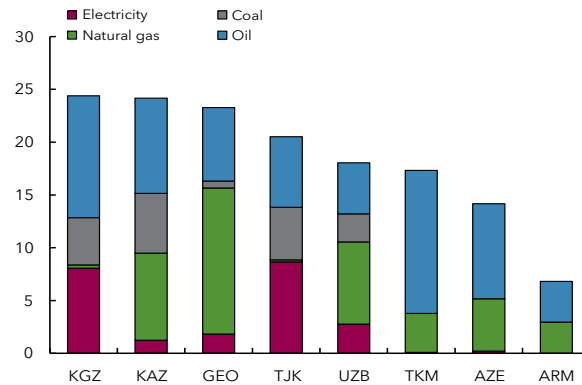
Note: ARM = Armenia; AZE = Azerbaijan; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; UZB = Uzbekistan.

Sources: Parry, Black, and Vernon (2021); IMF, *World Economic Outlook*; and IMF staff estimates.

Energy pricing remains another important dimension of climate-related fiscal policy in the region. In many CCA countries, energy prices are below market levels, generating losses in domestic energy companies and requiring explicit or implicit government support. As a result, CCA countries record some of the highest energy subsidies worldwide (Box Figure 3.2). Reforming these subsidies could promote more efficient energy use and improve resource allocation. Complementary regulatory measures—such as energy-efficiency standards and minimum requirements for renewable energy in power generation—can further support emissions reduction objectives. Some countries may also consider moving beyond subsidy reform toward explicit carbon pricing instruments, which could help align domestic incentives with decarbonization objectives and mitigate potential trade impacts associated with external measures such as the European Union’s Carbon Border Adjustment Mechanism (Abdou and others 2025).

Box Figure 3.2. Explicit and Implicit Energy Subsidies

(Percent of GDP, 2022)



Note: ARM = Armenia; AZE = Azerbaijan; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; TKM = Turkmenistan; UZB = Uzbekistan.

Sources: IMF Fossil Fuels Subsidy data; and IMF *World Economic Outlook*.

¹ See <https://climateknowledgeportal.worldbank.org/country-profiles> for country-specific Climate Risk Country Profiles.

² Heltberg, Siegel, and Jorgensen (2009) discuss a conceptual framework for identifying such “robust” adaptation interventions.

Annex 1. Fiscal Rules in the Caucasus and Central Asia: Targets and Outcomes

Annex Table 1.1. Fiscal Rule Targets, Outcomes, and Recent Reforms in the Caucasus and Central Asia

Country	Targeted Concept	Target	Outcome in 2023	Recent Changes
Armenia	Central government debt	Below 50 percent of GDP	51 percent of GDP	N/A
	Overall fiscal deficit (if public debt exceeds 40 percent of GDP)	Below capital spending	Deficit below capital spending by 3 percent of GDP	
	Current primary expenditure (if government debt exceeds 50 percent of GDP)	Current primary expenditure growth below the average nominal GDP growth for the past seven years	Current primary expenditure marginally exceeded average GDP growth (9.5 percent) in 2023	
Azerbaijan	Public debt	Less than 30 percent of GDP	21.7 percent of GDP	Starting in 2022: medium-term target on the ratio of non-oil primary balance to non-oil GDP. The cap on the public-debt-to-GDP ratio increased from 20 percent to 30 percent in 2023 to reflect expanded coverage.
	Non-oil primary balance of the consolidated budget as a percent of non-oil GDP	Decline to 13 percent in 2029	22.5 percent, 0.1 percentage point lower than in 2022	
Georgia	Deficit of the unified state budget	Below 3 percent of GDP	2.3 percent of GDP	Fiscal rules were reinstated with the 2023 budget.
	General government debt	Below 60 percent of GDP	39.2 percent	
Kazakhstan	Spending of the state budget	Growth below the sum of the average growth of real GDP in the past 10 years and the inflation target	Rule not in effect in 2023	These two new fiscal rules are effective in 2024 (implementation was postponed from 2023).
	Transfers from the National Fund	Oil revenues set according to a cutoff price for oil	Rule not in effect in 2023	
Kyrgyz Republic	State government debt	Below 70 percent of GDP	50 percent of GDP	N/A
Turkmenistan	State budget	Zero	N/A	N/A
Uzbekistan	Public and publicly guaranteed debt	Below 60 percent of GDP, with a trigger at 50 percent	36.3 percent of GDP	A public debt law formalizing a 60 percent limit on public-debt-to-GDP ratio was enacted in 2023.

Sources: IMF Fiscal Rules Dataset, 1985–2024; and IMF staff compilation.
Note: N/A = not applicable.

Annex 2. Fiscal Policy Stance and Automatic Stabilizers

The definition of the variables is as follows. The measure of economic activity (y_{ct}) is real GDP growth, which captures the degree of countercyclicality of the fiscal policy in response to a mix of demand and supply shocks. The real GDP growth indicator is retrieved from the *World Economic Outlook* database. The output gap is calculated using the Hodrick-Prescott filtering methodology. To estimate the cyclicality of fiscal policy (b_{ct}), the paper uses the overall fiscal balance indicator from the *World Economic Outlook* database.

The analysis using the overall fiscal balance estimates the degree to which the fiscal balance responds to the changes in economic activity. We then estimate the discretionary component of the fiscal policy by using cyclically adjusted fiscal balance. Since the cyclically adjusted fiscal balance indicator is not available for all countries of interest in the *World Economic Outlook* database, we calculated it using the Hodrick-Prescott-filtered potential GDP and computing cyclically adjusted revenues and expenditures by assuming the elasticities of revenues and expenditures to GDP as 1 and 0, respectively (Girouard and André 2005; Mourre and others 2014; IMF 2022a).

The cyclically adjusted fiscal balance is obtained as the difference between cyclically adjusted revenues and expenditures (as a percent of GDP). The “automatic stabilizers” component is calculated using the difference between the overall fiscal balance and cyclically adjusted balance as the measure of fiscal balance (b_{ct}) in the regression.

To address potential endogeneity issues, we applied additional estimation techniques, including the generalized method of moments and two-step least squares, using up to two lags of GDP growth rates as instruments for estimating the coefficients of fiscal stance. We assessed the validity of the instruments using the Hansen J-test and difference-in-Hansen test for overidentification. To test for weak instruments, we have used Cragg-Donald Wald F statistic, Stock-Yogo critical values, and Kleibergen-Paap rk Wald F statistic tests in two-step least squares estimations. We conducted the Arellano-Bond tests to assess the first (AR(1)) and second (AR(2)) autocorrelation in the first differenced residuals in the generalized method of moments estimation. The results for instrument validity and autocorrelation tests were generally robust, providing support for the reliability of our estimation. However, the analysis faced challenges because of the limited number of observations, as the regions under study are small and the data are available on an annual frequency only, which may affect the precision of the estimates and the power of the statistical tests.

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