

## International Monetary Fund

[Republic of Tajikistan](#)  
and the IMF

### **Republic of Tajikistan:** Letter of Intent

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## Republic of Tajikistan—Letter of Intent

January 12, 2006

Mr. Rodrigo de Rato  
Managing Director  
International Monetary Fund  
700 19<sup>th</sup> Street  
Washington, D.C. 20431

Dear Mr. de Rato,

During November 8–16, 2005, the Government of Tajikistan held discussions with Fund staff for the sixth and final review under the Poverty Reduction and Growth Facility (PRGF). We also took this opportunity to discuss with Fund staff the results of the Ex Post Assessment of Longer-term Program Engagement (EPA) with Tajikistan.

I am pleased to report that during the past year we have made further progress in strengthening macroeconomic stability and alleviating poverty. Our economy continues to expand at a robust pace benefiting the population in general, with GDP growth projected to reach 7–8 percent in 2005. Inflation, after increasing early in 2005, has since fallen to more moderate levels and is projected to reach 7 percent for the year as a whole. Finally, the external current account deficit contracted relative to 2004, as continued strong growth in remittances more than offset the impact of a deterioration in our terms of trade. Our macroeconomic policy efforts have been anchored by a strong fiscal stance, with the 2005 fiscal position broadly in balance as a result of a strong revenue performance and expenditure restraint.

We have observed all quantitative and structural performance criteria, as well as all indicative targets, for end-September 2005 (Table 1). In line with our commitments in the June 6, 2005 Memorandum of Economic and Financial Policies, we have completed the implementation of all of the outstanding structural benchmarks for 2005 (Table 2). Specifically, a cash management unit was established at the ministry of finance; the Banking Law was amended to open the banking sector to foreign participation; and the National Bank of Tajikistan has recovered SM 10 million in credit to the private sector. In addition to these measures, we have used our budget resources to recapitalize the state savings bank, Amonatbank, to guarantee it meets the minimum capital requirements as of January 1, 2006.

Based on this performance and our commitment to pursue prudent macroeconomic policies in 2006 as outlined below, we hereby request the completion of the sixth review under the PRGF arrangement and the disbursement of the related last tranche in the amount of SDR 9.8 million. Moreover, we would like to reiterate our interest in starting discussions in March 2006 on a successor Fund arrangement. We believe such an arrangement will allow us to safeguard the macroeconomic achievements of the previous two arrangements, and

provide a framework for implementing the outstanding structural reform agenda, including in the areas identified in the EPA. In this connection, we are in the process of completing a National Development Strategy for the period through 2015, which will serve as the basis for preparing our new Poverty Reduction Strategy Paper. In addition, we would like to express our appreciation to the international community for allowing Tajikistan to benefit from the Multilateral Debt Relief Initiative. In this regard, in the coming months, we will be discussing with Fund and World Bank staff possible strategies on how to best allocate the freed resources in support of our poverty reduction efforts.

The Government believes that the economic policies outlined below are appropriate to preserve macroeconomic stability in 2006 and set the basis for economic growth in the medium term. However, if warranted, the government, in consultation with Fund staff, will take any further measures that may become appropriate for this purpose. We will provide Fund staff with the information required for monitoring economic developments and progress in program implementation. In this regard, in line with our commitment to transparency, we hereby request that the staff report, the EPA background paper, and this letter of intent be published in full on the IMF website.

### **Our program for 2006**

The macroeconomic outlook for 2006 is favorable, albeit not without risks. Strong economic growth in the region, a favorable outlook for aluminum and cotton export prices, and prospects for significant investment in our hydroelectricity sector should support growth in GDP of about 8 percent. At the same time, prudent fiscal and monetary policies will buttress exchange rate stability and limit CPI inflation to below 7 percent, despite uncertainty about energy prices (including on the price of gas imports from Uzbekistan) and potential upward pressures on nontraded goods prices coming from rising incomes, especially from remittances. We are also projecting the external current account deficit to widen to about 4.5 percent of GDP in 2006, as the growth in remittances is expected to slow down and FDI-related imports to grow. We will aim at keeping gross international reserves at about the current level of 2 months of imports.

### **Fiscal policy**

In the 2006 budget, we will limit the fiscal deficit to 0.5 percent of GDP. We project tax revenues to increase to 16.4 percent of GDP in 2006 (compared to 16 percent of GDP in 2005). To allow us to reach this revenue goal, we have included in the Budget Law a provision to establish a 4 percent processing tax on aluminum exports, replacing the current 3 percent sales tax. We have also eliminated some tax exemptions. Furthermore, in order to increase the efficiency of our tax administration efforts and limit fraud, we have amended the Tax Code to raise the VAT threshold to \$60 thousand. Finally, we will continue to implement the reform program along the lines of the recommendations made by the recent technical assistance mission from the International Monetary Fund.

The lion's share of the budgeted increase in fiscal expenditures is linked to a necessary adjustment in public sector wages. We feel that it is of the utmost importance to continue to increase spending on wages in the budget sector to ensure competitiveness of remuneration in civil service and basic public services, including health care, education, and national security. The wage increase envisaged in 2006 will bring the wage bill to 4.5 percent of GDP and allow us to (a) meet the requirements of a rapidly growing school-age population; (b) support the health sector's financing reforms (including to retain skilled staff); (c) raise compensation for law enforcement bodies and border guards; and (d) finance the cost of decompressing wages in the pilot ministries, where reforms are being supported by the World Bank. To offset some of the increase in the wage bill, we are planning to cut expenditures on certain discretionary items, such as new purchases of automobiles and equipment. Capital expenditures (including those financed from external sources) are set to stay about constant relative to GDP.

We remain committed to strengthening our public expenditure management system, along the lines of the technical assistance recommendations received from the Fund. In particular, once the cash management unit is fully functional early in 2006, the next task will be to consolidate all treasury accounts into a single account. We are also committed to improving the treasury's expenditure commitment control system. We will be seeking external financial support to allow us to extend these reforms to the local treasuries as soon as possible.

### **Monetary and exchange rate policy**

Our indicative monetary program for 2006 envisages growth in reserve money of 18 percent. We will focus policies on achieving the program's reserve money targets—the key monetary anchor—and limit unscheduled foreign exchange interventions to smoothing operations only. Furthermore, the National Bank of Tajikistan will continue its loan recovery efforts and refrain from making new loans to the private sector and commercial banks.

We recognize that the effectiveness of monetary policy remains constrained by a lack of appropriate monetary policy instruments. We have asked Fund staff to provide technical assistance in this area, including in developing a strategy to recapitalize the central bank, designing an appropriate mutual settlements agreement between the central bank and the ministry of finance, and in developing a securities market.

### **Structural policies**

In the structural area, we will press ahead with the implementation of reforms already underway. Specifically, we will continue to reform the civil service, education and health sectors, including through the adoption of a comprehensive public administration strategy, the submission of amendments to the Civil Service Law, the completion of restructuring plans for pilot public institutions, the redesigning of the per-capita funding system in education, and the introduction of a new wage grid for employees in primary health care. Furthermore, we will work with the World Bank in developing an appropriate framework for the development of the energy sector, to be supported by the design of a better focused social

compensation system. We will also take further steps to strengthen external debt management and enhance our efforts to foster transparency and governance, including by upgrading the quality and dissemination practices of our national statistics. In this regard, we have recently appointed a national Special Data Dissemination Standard (SDDS) coordinator and plan to subscribe to the SDDS as soon as feasible. Finally, we will continue to seek a permanent solution to the cotton debt problem, as this issue remains an area of vulnerability for our economic program.

Please accept, Your Excellency, the assurances of my highest consideration.

/s/

Emomali Rakhmonov

Table 1. Tajikistan: Quantitative Performance Criteria and Indicative Targets for the Third Annual Program  
Under the PRGF Arrangement, October 2004–December 2005

(In millions of somoni, unless otherwise indicated)

	2004 Actual 1/	End-Jun. 2/		Actual 1/	End-Sept.		End-Dec. 2/ (EBS/05/105)
		(EBS/05/38)	Adjusted		(EBS/05/105)	Actual	
<i>Performance Criteria:</i>							
1. Ceiling on net domestic assets of the NBT 3/	73	82	64	32	101	41	90
2. Ceiling on net credit of the banking system to general government 3/	-218	-196	-214	-281	-169	-255	-178
3. Floor on the cumulative overall fiscal balance of the general government (excluding foreign-financed public investment program) 4/	17	5	10	77	-27	56	20
4. Ceiling on general government wage, and nonworking pensioners' pension arrears 5/	0	0	...	0	0	0	0
5. Floor on tax collection of the ministry of state revenues and duties 4/	250	798	...	826	1,070	1,126	290
6. Floor on total net international reserves (in millions of U.S. dollars) 3/	67	58	64	74	59	78	71
7a. Ceiling on the contracting or guaranteeing of short-term nonconcessional external debt with original maturity of up to and including one year 6/	0	0	...	0	0	0	0
7b. Ceiling on the contracting or guaranteeing of medium and long-term nonconcessional external debt with original maturity of more than one year 6/	0	0	...	0	0	0	0
8. New external payments arrears 5/	0	0	...	0	0	0	0
<i>Indicative targets:</i>							
Ceiling on reserve money 2/	278	257	257	257	278	277	305
New arrears of budget entities and key state-owned enterprises to Naftrason, Barqui Tajik, and Tajikgas	24	0	...	0	0	0	0
<i>Memorandum item:</i>							
Cumulative disbursement of program loans and grants (in millions of U.S. dollars) 7/	0	0	6	6	6	...	6

Sources: Tajik authorities; and Fund staff estimates.

1/ Calculated using the 2005 program exchange rates.

2/ Indicative targets.

3/ On a cash basis, the ceiling will be adjusted for the deviation of actual program loans and grants disbursements compared to the projections. Adjustment for grants is with effect from end-June 2005.

4/ For March–September 2005, the targets are cumulative from October 1, 2004.

5/ A continuous performance criterion.

6/ By the government, NBT or any other agency acting on behalf of the government as defined in the Technical Memorandum of Understanding.

7/ Program loans and grants for March–September 2005 are cumulative from end-October 2004.

**Table 2. Tajikistan: Structural Performance Under the Third Annual Program Under the PRGF Arrangement, January–September 2005**

Measure	Status as of December 29, 2005
<b><i>Continuous structural performance criteria</i></b>	
Prohibit the NBT from issuing directed credits.	Observed
Prohibit the NBT from making expenditures not related to its core business.	Observed
Implement quarterly adjustments of all utility tariffs, equivalent to the depreciation in the nominal exchange rate in the previous quarter.	Observed
<b><i>Structural benchmarks</i></b>	
<b>For end-June 2005</b>	
Reduce NBT's claims on the private sector by SM 10 million from October 2004 to June 2005 through collateral sales or other loan recoveries.	Not observed
Remove the regulatory limits on foreign capital in the banking system and the requirement for a Tajik citizen to head commercial banks in the Banking Law.	Observed
Expand the register of the Large Taxpayer Inspectorate (LTI) to cover at least 60 percent of total tax collections.	Observed
Develop and continuously update a database at the NBT for monitoring private sector external debt (starting with cotton sector debt).	Observed
<b>For end-September 2005</b>	
Make operational a cash management unit in the ministry of finance and strengthen communication links between local branches of the central treasury with the headquarters to enhance fiscal management, cash control and forecasting.	Observed