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Republic of Tajikistan: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

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March 31, 2009

His Excellency
Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431

Dear Mr. Strauss-Kahn:

I would like to express my gratitude to the International Monetary Fund (IMF) for its support of our economic reforms at this critical moment for our economy. I am delighted to inform you that we have successfully concluded a Staff Monitored Program (SMP), covering the period June 1–December 31, 2008. The SMP framework has helped us maintain macroeconomic stability in a difficult external environment. In addition, we have started to address the weaknesses exposed by the recent episode of misreporting, and we repaid all noncomplying disbursements to the Fund.

It is our great concern that the external environment is adversely affecting Tajikistan's economy in 2009. The slowdown in Russia and Kazakhstan, has lead to a dramatic fall in remittances inflow, while cotton and aluminum exports are being negatively affected by a drop in demand and international prices. As a result, Tajikistan is experiencing severe fiscal and external financing constraints, emerging stress in the banking system, and economic activity is sluggish at best.

Against this background, during a February 5–18, 2009 mission we entered into discussions with IMF staff on a new program that could be supported under the Poverty Reduction and Growth Facility (PRGF). I am pleased to inform you that we have reached understandings with staff on a three-year program (April 1, 2009 to March 31, 2012). The program builds on the foundation laid down by the SMP, and establishes a macroeconomic framework that will support our efforts at economic stabilization and implementation of structural reforms. In particular, the PRGF will help us address the problems faced by Tajikistan in the context of the current global economic downturn. With the level of international reserves at a very critical level, we require external assistance to build a more resilient and self-sustaining economic structure, as well as reinforce our balance of payments position. Hence, at the core of this PRGF program are measures aimed at safeguarding external and fiscal stability while supporting growth and poverty reduction. The program thus includes a set of prior actions, quantitative performance criteria, indicative targets, and structural benchmarks (outlined in the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical

Memorandum of Understanding (TMU), to enable us to monitor progress in implementing our reform agenda. We hereby kindly request the approval by the Executive Board of a three-year PRGF program with access of 90 percent of Tajikistan's quota covering the period April 1, 2009–March 31, 2012. However, we would have preferred higher access.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures and in advance of any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We intend to remain in close consultation with Fund staff and provide timely information necessary for monitoring economic developments and implementation of policies under the PRGF. In addition, the Government stands ready to take any further measures that might be required to ensure that the overall objectives of the program are attained.

In line with our commitment to transparency, we hereby request that the staff report, this letter of intent, and the attached MEFP and TMU (including all annexes), as well as all other PRGF-related documents, be published on the IMF website.

Your Excellency, please accept my assurances of my highest consideration,

/s/

Emomali Rakhmon
President of the Republic of Tajikistan

Table 1. Tajikistan: Quantitative Performance Criteria under the 2009 Poverty Reduction and Growth Facility

(In millions of somoni, unless otherwise indicated)

	2008	2009			
	<u>End-Dec.</u> Est.	<u>End-March</u> Proj.	<u>End-June</u> PC	<u>End-Sept.</u> IT	<u>End-Dec.</u> PC
<i>Quantitative Performance Criteria (PC):</i>					
1. Ceiling on cumulative flow of net domestic assets of the NBT 1/ 2/	...	194	244	304	313
2. Floor on cumulative flow of total net international reserves (in millions of U.S. dollars) 1/ 2/	...	-41	-51	-26	-26
3. Zero-ceiling on new lending from the NBT to private sector (continuous quantitative performance criterion) 2/	...	0	0	0	0
4. Floor on cumulative overall fiscal balance of the general government excluding foreign-financed Public Investment Program and related grants 2/	...	-86	16	-86	-106
5. Ceiling on general government wage and pension arrears (continuous quantitative performance criterion)	...	0	0	0	0
6. Ceiling on contracting or guaranteeing of any non-concessional external debt (continuous quantitative performance criterion)	...	0	0	0	0
7. Ceiling on disbursements of concessional external financing (in millions of U.S. dollars) 2/	...	70	147	258	349
8. New external payments arrears (continuous quantitative performance criterion)	...	0	0	0	0
<i>Indicative Targets (IT):</i>					
1. Floor on tax collection 2/	...	854	1,719	2,632	3,627
2. Floor on social and poverty-related expenditure 2/	...	386	801	1,307	1,866
<i>Memorandum items:</i>					
Net domestic assets of the NBT (in billions of somoni) 1/ 2/	1,342	1,536	1,586	1,646	1,655
Net international reserves (in millions of U.S. dollars) 2/	181	140	130	155	155
Required reserve rate in percent as of 12/31/2008					
Deposits in somoni	9
Deposits in foreign exchange	11
Settlement of external guarantees (in U. S. dollars million)	...	6	5	5	5

1/ At program exchange rates - end-December 2008 rates.

2/ Cumulative from January 1 of the year.

Table 2. Tajikistan: Prior Actions and Structural Benchmarks for 2009

	Date	Rationale	Status
<i>Prior Actions</i>			
Adopt a comprehensive and time-bound action plan to address all issues and recommendations raised in the report on the special audit of the National Bank of Tajikistan.	20 days prior to Executive Board meeting	Enhance central bank governance	
Publish the executive summary of the report on the findings of the special audit of the National Bank of Tajikistan for at least six months.	5 days prior to Executive Board meeting	Transparency	
Complete external audit of the National Bank of Tajikistan's net international reserves position as of December 31, 2008 and share the audit report with Fund staff.	5 days prior to Executive Board meeting	Provide assurances to Fund	
Appoint an external auditor to conduct the audit of the National Bank of Tajikistan's financial statements in accordance with international standards (ISAs) for the fiscal year ending April 30, 2009.	5 days prior to Executive Board meeting	Enhance central bank governance	
Submit to Parliament amendments to National Bank of Tajikistan and Commercial Banking Laws to (i) appoint the NBT chairperson and his/her deputies for fixed terms that do not coincide with the electoral cycle, and outline the reasons for their dismissal explicitly in the law; (ii) require official identification and disclosure of beneficial owners of companies registered with the Agency for Securities in the ministry of finance and other authorized entities, including financial institutions; (iii) clarify the provisions covering conflicts of interest for the National Bank of Tajikistan management and staff, and require them to disclose their personal holdings in financial institutions and excuse themselves from official decisions affecting those institutions.	5 days prior to Executive Board meeting	Enhance central bank governance	

Table 2 (continued). Tajikistan: Prior Actions and Structural Benchmarks for 2009

	Date	Rationale	Status
<i>Structural Benchmarks</i>			
National Bank of Tajikistan will issue a circular that defines the terms of liquidity provision, including a maximum maturity of three months and acceptable collateral.	end-June	Strengthen effectiveness of monetary policy implementation	
Close down the cotton debt department at the National Bank of Tajikistan.	end-June	Eliminate non-core functions	
Establish a working group between the government and the National Bank of Tajikistan to develop a strategy to recapitalize the National Bank of Tajikistan.	end-June	Strengthen central bank's ability to conduct monetary policy and independence	
Adopt a strategy to resolve the cotton debt problem.	end-June	Remove risk to macroeconomic stability, raise growth potential	
Publish semi-annual external debt reports on the website of the ministry of finance.	end-June	Transparency	
Publish the audited financial statements together with the audit report for fiscal year 2009 of the National Bank of Tajikistan on the NBT's external website.	end-December	Transparency	
Conduct quarterly internal audits of the National Bank of Tajikistan's financial statement to be discussed by the National Bank of Tajikistan's Board.	end-December	Enhance central bank governance	
State-owned enterprises reporting to the monitoring unit at the ministry of finance to submit their financial performance plans for 2010 for approval together with a corporate intent statement.	end-December	Address contingent liability	
Talco's financial accounts for 2006 through 2008 will be audited by a reputable international audit firm (one of the big four), and the audit reports will be published on the company's website.	end-December	Transparency	

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES (MEFP) FOR 2009-12**March 31, 2009****I. INTRODUCTION**

1. This memorandum outlines the economic and financial policies of the Government of Tajikistan for 2009–12. Our program aims at maintaining macroeconomic stability, enhancing economic growth, and reducing poverty in the face of the ongoing global crisis that will take a heavy toll on Tajikistan. These policies are also intended to form the basis for a new three-year IMF-supported program under the Poverty Reduction and Growth Facility (PRGF) and, we hope, will unlock further donor support.

2. Tajikistan will be severely affected by the global crisis in 2009. The main transmission channels are an expected dramatic decline in remittances and a decline in the demand and price for our traditional exports aluminum and cotton. As a result, Tajikistan is suffering a significant weakening of its external position, and we expect real GDP growth to temporarily slow in 2009 below our target of 7 percent or more which we aim to achieve again by the end of the program period.

3. In this environment, our program focuses on safeguarding the macroeconomic stability achieved under the Staff Monitored Program (SMP) in 2008, accelerating structural reforms, supporting the poor and vulnerable segments of society, and enhancing the role of the private sector in the economy. The policy framework for the proposed arrangement will build on the measures that we implemented during the SMP, and draw, in particular, on the findings and recommendations of the recently completed special audit of the National Bank of Tajikistan (NBT), the 2007–08 Financial Sector Assessment Program (FSAP), and ongoing technical assistance in the fiscal area.

4. We have reached understandings with IMF staff on a set of prior actions, quantitative performance criteria, indicative targets, and structural benchmarks for 2009. Macroeconomic policies described in this memorandum are in line with our Poverty Reduction Strategy (PRS, 2007–09), and our National Development Strategy (NDS, 2006–15), and will provide an anchor for our new PRS (2010–12), for which we have recently started preparations with assistance from donors.

II. MACROECONOMIC POLICES FOR 2009 AND BEYOND

5. Macroeconomic policies in 2009 will be primarily geared toward maintaining external stability. In line with currency movements of some of our main trading partners, the somoni has already depreciated by 9 percent against the U.S. dollar year-to-date. We expect this trend to continue, and believe that it will facilitate external adjustment by strengthening our export

competitiveness and shifting demand toward domestic producers. Fiscal policy will be in a position to modestly support activity given expected donor support to the budget. We believe that this policy mix will help us achieve a real GDP growth of 2-3 percent in 2009, which will mainly come from the noncotton agriculture sector and public investment in infrastructure. Still, given the expected decline in remittances, real per-capita income is likely to contract for the first time in many years, and we will step up social spending to alleviate the economic impact of the crisis.

6. Given the external pressures, we will let the exchange rate depreciate in line with market trends. The exchange rate will be the main instrument to bring about external adjustment, and we expect to see most of the required depreciation to take place in the first half of the year. The National Bank of Tajikistan (NBT) will only seek to dampen volatility, and we expect to keep net international reserves at \$155 million at end-December 2009, broadly the current level, and despite significant external pressures. To contain inflationary pressures from the depreciation of the somoni, we target reserve money growth of 12 percent in 2009, though we already see shortages in somoni and U.S. dollar liquidity in the system, and expect these to increase during the course of the year.

7. After achieving consecutive years of fiscal surplus (excluding the externally financed public investment program, PIP), we will allow for a modest overall deficit (excl. PIP) in 2009. The 2009 budget targeted an overall deficit (excluding PIP) of ½ percent of GDP, and we believe that this remains the appropriate fiscal stance. However, compared to budget projections, we now expect a shortfall in revenues and grants of 3 percent of GDP, and additional spending on account of the expected depreciation of the somoni. Moreover, we need to allow for additional social spending on direct and indirect transfers of around 1 percent of GDP compared to 2008 to alleviate the immediate impact of the global crisis on the population. We are working closely with the World Bank in this area, and expect to raise social- and poverty-related spending to 9 percent of GDP in 2009. To achieve our deficit target, we have therefore identified expenditure cuts of 1½ percent of GDP in current spending (goods and services, subsidies and other current transfers), and of 2½ percent of GDP in capital spending. If revenues or external donor support exceed our conservative projections, we will consider moving ahead with some of the delayed capital projects. At the same time, we will closely monitor external developments and stand ready to tighten fiscal policies, in close consultation with IMF staff, if exchange rate movements alone are insufficient to maintain external balance. We remain committed to an open trade regime, and will refrain from increasing tariff or nontariff trade barriers.

8. Tajikistan's banking sector is affected by the global crisis through indirect channels. The expected exchange rate depreciation could lead to a deterioration in loan quality since debtors with U.S. dollar denominated loans do not necessarily have foreign exchange income. Moreover, depositors could seek to convert somoni deposits into U.S. dollars or withdraw

from the banking system completely. We are therefore developing contingency plans in close cooperation with IMF staff that would help us manage any stress that could emerge in the banking system.

9. In light of the tense external financing outlook, we have set up a joint crisis working group at the deputy level between the NBT and ministry of finance. The working group has developed a monthly foreign exchange cash plan for official flows that will assist us in meeting our external obligations in a timely manner. The plan will be updated on a bi-weekly basis, and the working group will monitor developments in the external and financial sector closely to anticipate potential vulnerabilities early on and take appropriate policy responses. The working group will liaise closely with the IMF's resident representative.

10. Looking beyond 2009, we hope that a more favorable external environment will pave the way toward a resumption of growth. But even in this case, we expect to see a further depreciation of Tajikistan's real effective exchange rate that will help return the current account deficit toward a more sustainable level. We also intend to significantly strengthen our international reserves position, and target a reserve coverage of three months of imports by 2014. In the fiscal area, we will continue to balance spending needs in the social area and infrastructure projects, while broadly aiming for overall fiscal balance (excluding PIP).

III. STRUCTURAL REFORMS

11. Structural reforms will seek to strengthen key institutions in the economic sphere, and lay the foundation for sustained economic growth over the medium-term. In particular, the program will address governance issues at the NBT and major state-owned enterprises (SOEs). We will also push ahead with ongoing reforms in revenue administration and public financial management. With assistance from the World Bank, we will continue with the reforms in the health and education sectors, in order to meet the Millennium Development Goals. Our reform agenda also includes steps to stimulate private investment, diversify our export and production base, and raise productivity, including by addressing issues in the agricultural and energy sectors.

A. Monetary and Financial Sector Reforms

12. The special audit of the NBT has revealed governance deficiencies at the NBT, and serious issues at Kredit Invest, and cotton investors. As indicated earlier, we will publish the executive summary of the special audit report on the NBT's website, for at least six months, within one week after receiving the signed report from the Ernst & Young (prior action). As a next step, we will then adopt a comprehensive and time-bound action plan to address all issues and recommendations raised in the report, to be agreed with IMF staff (prior action). This action plan will include (i) an external audit of the NBT's net international reserves position as of December 31, 2008 (prior action); (ii) appointing an audit firm to conduct the

external audit of the NBT's financial statements for the fiscal year ending April 30, 2009 in accordance with international standards on auditing (prior action); (iii) publishing the audited financial statements together with the audit report for fiscal year 2009 prepared by the external auditors (benchmark); (iv) strengthening the internal audit function at the NBT and conducting quarterly internal audits that will be discussed by the NBT's board (benchmark); (v) closing down the cotton debt department at the NBT (benchmark); and (vi) cleaning up the NBT's balance sheet. We will share the report of the special audit of the NBT with the appropriate law enforcement agencies who will assess whether there have been any legal wrongdoings and act accordingly.

13. We will also complete the outstanding SMP measure of submitting to Parliament a set of amendments to the NBT and Commercial Banking Laws, as agreed at the time of the first assessment of the SMP (prior action). These amendments go beyond the commitments made under the SMP. Specifically, the amendments, which we have prepared with assistance from the World Bank, include:

- Changes to the terms of appointment and removal of board members: The NBT Chairperson and his/her deputies will be appointed for fixed terms, which will not coincide with the electoral cycle. Moreover, the reasons for their dismissal will be clearly defined in the law.
- Provisions for conflict of interest: We will introduce clear provisions for what constitutes conflict of interest behavior and introduce sanctions to be applied in the case of violations.
- Disclosure of beneficial ownership: We will introduce requirements for the identification and disclosure of beneficial ownership in financial institutions, after the ministry of finance already introduced similar requirements for all companies registered with its Agency for Securities.

14. Once the above measures are in place, we will take steps to restore the financial health of the NBT. At present, the NBT's weak balance sheet limits its effectiveness in implementing monetary policy. Moreover, the absence of marketable government securities leaves the NBT mainly with its own certificates of deposits as instruments of monetary policy. Therefore, we will establish a working group between the government and the NBT to develop a strategy to recapitalize the NBT (benchmark), and steer the program for the issuance of government securities (with Swiss and IMF support). The strategy will include a memorandum of understanding that will guide NBT–ministry of finance relations, such as appropriate remuneration of deposits and holdings of government securities. The strategy will be agreed with IMF staff, and we request its technical assistance for this purpose.

15. We recognize the high importance of completing a safeguards assessment of the NBT by the first review of the PRGF. To that end, we will authorize our prospective external auditors to hold discussions directly with IMF staff and to provide IMF staff with all information requested in the context of the safeguards assessment. We further commit to instructing the NBT to receive a safeguards mission from the IMF and to provide that mission with all necessary cooperation and information required to complete the assessment by the first review.

16. In its monetary policy operations, the NBT will continue to refrain from issuing new credits to the private sector, except for liquidity purposes or in cases of bank distress or failure (lender of last resort). Specifically, we will restrict all lending to commercial banks, credit unions, credit associations, and microfinance organizations to short-term liquidity loans with a maturity of up to three months, and we will not extend any loans to domestic nonbank financial institutions or any other domestic entity other than the general government. In this context, the NBT will issue a circular that defines the terms of liquidity provision, to be agreed with IMF staff (benchmark). We intend to introduce a statutory overnight credit facility that can provide liquidity to qualifying banks in a prompt and effective manner, subject to appropriate safeguards. We will also introduce a statutory seven-day deposit facility.

17. The NBT will continue to closely monitor potential vulnerabilities in the banking system, not least in light of the possible impact of the global crisis. Supervisors will pay close attention to banks' loan classification, including through on-site visits, and will monitor the financial soundness indicators collected in the Uniform Bank Performance Reports. In order to decrease banks' vulnerability to exchange rate changes, NBT will start applying higher capital charges to foreign-currency denominated loans to unhedged borrowers. Furthermore, prudential rules will be strictly enforced, without any exception, including on exposure limits and reserve requirements. As is the case for all other commercial banks, we will now also require the state savings bank (Amonat) to have an annual independent audit of its financial statement. Moreover, all banks will be required to publish their annual audit reports with the auditors' opinion on their website. We are also working with the World Bank and the IMF to establish an appropriate anti-money laundering and counter-terrorism financing framework (AML/CFT), and intend to submit an AML/CFT law to parliament in 2010.

B. Reforms in the Fiscal Area

18. With assistance from the World Bank, we will continue with our reforms of the civil service, health care, and education sectors. In this connection, we continue to work with the World Bank on the ultimate goal of adopting a competitive and affordable civil service wage system. On health financing reform, we will continue with our strategy of allocating

resources in an asymmetric fashion favoring primary health care. On education, we will continue with the implementation of our per capita funding pilot system.

19. An efficient, equitable, and simple tax system can help stimulate innovation, investment, and growth. In 2005, we have revamped Tajikistan's tax code, and work is ongoing to further strengthen the tax system. We will continue to draft and ratify the remaining regulations for the Tax Code, prepare and disseminate all relevant information to taxpayers, and introduce new operational procedures and forms. To take stock of the fiscal impact of existing tax exemptions, we will include a report that assesses the costs and benefits of existing tax exemptions during 2009 and 2010 in the 2010 budget.

20. There is a need to strengthen the functioning of the value-added tax (VAT) system. In particular, tax compliance procedures are excessively cumbersome, and there are problems with the refund system. As such, we intend to (i) streamline the VAT exemptions for imports, while making all VAT payments on imported fixed assets refundable; (ii) streamline the VAT refund system for exports; and (iii) request technical assistance to assess weaknesses in the existing VAT refund system and take remedial steps. In this regard, we have already developed a software that will allow us to verify refund claims.

21. We will also continue with our strategy of strengthening the capacity of the revenue authorities by (i) introducing one-stop-shop facilities in the 68 tax inspectorates, including in Dushanbe; (ii) enhancing the large tax payers inspectorate; (iii) establishing model tax inspectorates in major centers; (iv) accelerating IT systems development and business process reengineering; and (v) enhancing human resource management. We will seek donor assistance for these reforms.

22. Tax arrears remain a problem, and are concentrated in a few large SOEs. In this regard, we have recently raised the penalty for tax arrears to 29 percent per annum (0.08 percent per day—not compounded—from 0.05 percent per day). We will ensure that all government entities will stay current on its payments to Barki Tajik. More generally, since tax arrears are linked to a complicated web of cross-arrears, we will adopt a strategy to settle these starting with the 2010 budget, and, going forward, to ensure that there is no renewed build-up of tax arrears. The work of the SOE supervision unit in the ministry of finance (below) will provide a basis for this strategy. We will also automatically link the penalty rate to a market based lending rate, with a quarterly reset.

23. We are pursuing steps to further enhance public financial management. We have already set up a cash management unit that has strengthened expenditure controls. We will now develop and promulgate instructions on commitment controls, and continue the preparatory work toward introducing a single treasury account. To enhance transparency of the budget and facilitate the political debate over spending priorities, we will include

appropriations according to administrative classification in the annual budget law, starting with the 2010 law.

24. We have taken strides to improve our debt management capacity and strategy. In 2008, we adopted an external debt strategy that sets a ceiling on the external debt-to-GDP-ratio of 40 percent. This is an upper limit, and we aim to keep external debt below the ceiling, as we carefully scrutinize external borrowing plans and the economic impact of new investment projects. In this regard, we will continue to refrain from contracting nonconcessional debt and settle any external payment obligations of the general government or the NBT in a timely fashion. We will continue to strengthen our debt data management framework, including by completing an inventory of government domestic debt and government-guaranteed debt of SOEs, and by publishing this report together with a report on government and government-guaranteed external debt in the 2010 budget documents. We will also publish semi-annual external debt reports on the website of the ministry of finance (benchmark). In addition, the NBT will finalize the monitoring system of private external debt, publish these data on the NBT website on a semi-annual basis, and share them with the ministry of finance on a monthly basis.

C. State-Owned Enterprise, Agriculture, and Data

State-Owned Enterprises

25. The SOE supervision unit of the ten largest SOEs that we established within the ministry of finance last year will start working fully this year, and we are requesting IMF technical assistance to expedite the process.¹ The unit should focus on putting SOEs on a sound financial footing, improving their tax compliance, and eliminating quasi-fiscal deficits. To this end, the unit will require SOEs to submit their financial performance plans for 2010 for approval together with a corporate intent statement (benchmark). An important step in this direction will also be the publication of an annual report on the financial health of SOEs on the ministry of finance website. Supporting this, the ministry of finance will also publish the 2008 annual audit reports of the SOEs that report to the unit on its website.

26. Our efforts will particularly focus on Tajikistan Aluminum Company (Talco) and Barki Tajik, the two largest SOEs. Talco's financial accounts for 2006 through 2008 will be audited by a reputable international audit firm (one of the big four); the audit reports will be published on the company's website (benchmark). We will continue with the schedule of tariff adjustments agreed with the World Bank, in order to achieve cost recovery by end-2010, while the government will improve the social mitigation mechanism to ensure that the

¹ These SOEs are Talco, Tajik Rail, Tajik Air, Barki Tajik, Tajikgas, Oil Gas and Coal, Vostokredmet, Tajikcement, Amonatbank, and Tajiktelecom.

most vulnerable segments of the population have access to a basic minimum of energy services. Barki Tajik's 2007 and 2008 financial audit reports will be published on the company's website.

27. Following last year's order by the minister of finance requiring disclosure of beneficial ownership of all companies registered with the ministry's Agency for Securities, we will finalize the database of beneficial ownership of all companies listed with the Agency, and publish it on the ministry's website.

Agriculture

28. Based on the work of the government consultant, we will adopt an action plan to resolve the cotton debt problem, which holds back growth in the agricultural sector (benchmark). The action plan will include (i) steps to address the problem of farmers' outstanding debt to investors; (ii) maximum recovery of debt from investors to Kredit Invest, including by seizing pledged collateral, with a view to minimizing the financial impact on the NBT which guaranteed most of this debt; (iii) outline of a plan to move to a private-sector led financing mechanism (considering a similar design as the European Bank For Reconstruction and Development's Tajik Agricultural Finance Facility); and (iv) due attention to the social context. We are working closely with the World Bank and the Asian Development Bank in this area. A precondition for having a private-sector led financing mechanism will be the ability to use land-use rights as collateral.

29. In the meantime, we will implement modifications to the temporary financing scheme that we introduced in 2008. Starting in 2009, the budget resources made available to commercial banks for onlending will no longer be restricted to cotton farmers, but will be available to the whole agricultural sector. Banks will have complete freedom in loan allocation, and farmers will have complete freedom in their crop choice.

Data

30. Regarding data issues, we plan to strengthen our national accounts and price statistics, for which our national statistics agency is requesting IMF technical assistance.

IV. PROGRAM MONITORING

31. We will monitor progress in implementing the program through quantitative performance criteria and indicative targets, as well as prior actions, and structural benchmarks set for June 2009 and December 2009. These are listed in the tables attached to the letter of intent. The technical memorandum of understanding which is also attached to this letter defines the quantitative targets of the program and their adjustors, and specifies reporting requirements. The planned reforms related to the special audit of the NBT will be

the main focus for discussion for the first review under the proposed arrangement. In this regard, the completion of the first review under the PRGF arrangement—which is envisaged for September 2009—will require observance of the quantitative performance criteria for end-June 2009, and completion of the second review—which is envisaged for March 2010—will require observance of the quantitative performance criteria for end-December 2009. The first review will focus on reforms at the NBT, including the follow-up on the recommendations from the special audit and steps to strengthen the NBT's liquidity management framework, and resolution of cotton debt issues. The second review will maintain focus on reforms at the NBT and, in addition, concentrate on reforms in the area of SOEs. At the time of the first review, we will also set additional quantitative performance criteria and benchmarks for 2010.

TECHNICAL MEMORANDUM OF UNDERSTANDING

March 31, 2009

I. INTRODUCTION

1. This memorandum defines the quantitative performance criteria and the indicative targets and relative adjusters, and establishes the content and frequency of the data to be provided to IMF staff for the program monitoring relating to the program supported under the Poverty Reduction Growth Facility (PRGF) under the request in the authorities' Letter of Intent dated March 31, 2009.

II. QUANTITATIVE PERFORMANCE CRITERIA

A. Definitions and Concepts

2. **Test dates.** Quantitative performance criteria are set semi-annually starting June 30, 2009 through December 31, 2011, and are to be met at the end of each period unless otherwise specified.
3. **National Bank of Tajikistan (NBT).** The NBT is the central bank of the country responsible for the formulation and implementation of monetary policy. For the purpose of the program, NBT includes all its central and regional offices.
4. **General government.** For the purpose of the program, "general government" includes the republican government, local (including municipal) governments, and all extra-budgetary funds at all levels of general government, including the Agency of Social Protection and Pensions. It excludes all other agencies not specifically listed, including but not limited to Barki Tajik and Talco.
5. **Foreign-financed PIP and related grants.** The foreign financed PIP is a program of investments in infrastructure and social sectors agreed by the general government of Tajikistan and its donors (including but not limited to international financial organizations). The program is fully financed by related grants and loans, and does not involve any additional financing commitment from the general government of Tajikistan. Related grants are grants provided by the donors financing the PIP for financing of projects included in the PIP.
6. **Domestic arrears** are defined as the general government expenditure that have not been paid after coming due as determined in the State Budget of the Republic of Tajikistan and other government documents regulating the execution of the Budget.

7. **External arrears** are defined as overdue payments (principal or interest) on external debt contracted, guaranteed, or converted into interstate debt by the general government of Tajikistan or the NBT.
8. **Concessional and nonconcessional debt.** Concessional debt is defined as debt with a grant element equivalent of 35 percent or more. The grant element is calculated using the commercial interest reference rates (CIRRs) plus a margin, which will be taken as those for December 31, 2008. For debts of an original maturity of 15 years or more, the average CIRR over the last 10 years will be used, while the average of CIRRs of the preceding six-month period will be used to assess the concessionality of debts with original maturities of less than 15 years. To the 10-year and 6-month averages of CIRRs, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–29 years; and 1.25 percent for 30 and more years. In general, the grant element is calculated as value of the loan minus present discounted value of future payments over the loan value (multiplied by 100). Present discounted value is sum of all future discounted payments (both amortization and interest), where the discount rate corresponds to the CIRR mentioned above. Nonconcessional debt is defined as debt without a grant element or with a grant element of less than 35 percent. The debt refers also to commitments contracted or guaranteed and for which value has not been received. The grant element is calculated using the CIRRs plus a margin, which will be taken as those for December 31, 2008 until revised in the program. The calculation is performed by the authorities and verified by the IMF based on the data provided by the authorities.
9. **Valuation changes.** For program monitoring, U.S. dollar-denominated components of the general government's and the NBT's balance sheets will be valued at the program exchange rate (SM 3.452 = \$1.00; official exchange rate as of December 31, 2008). Other foreign currency denominated items will be valued at the respective cross rates between the program exchange rate of the U.S. dollar and current official exchange rates of the U.S. dollar against those currencies as of December 31, 2008. The SDR components will be valued at the program SDR exchange rate SDR 1 = \$1.524 (December 31, 2008). Official gold holdings shall be valued at \$865 per troy ounce (December 31, 2008).

B. Quantitative Performance Criteria and Indicative Targets

Quantitative Performance Criterion 1: Ceiling on a cumulative flow of net domestic assets of the NBT for the year.

10. **Definition.** For the purpose of the program, net domestic assets (NDA) of the NBT are defined as reserve money minus net foreign assets of the NBT. The cumulative flow of NDA for the year is defined as a difference between end-of-period balances for a period under evaluation and the preceding end-of-the year balance, unless otherwise specified. Reserve money (RM) is composed of currency in circulation (CC), required reserves (RR),

other bank reserves (OBR), and deposits of nongovernmental nonbanks with the NBT (DNGNB). The value of the net foreign assets of the NBT is calculated as the difference between NBT's claims on nonresidents and its liabilities to nonresidents. The NBT's NDA comprise the following assets and liabilities: net credit to the general government, net claims on banks, credit to the economy, and other items net (OIN). OIN includes the foreign exchange revaluation and capital accounts of the NBT.

11. **Adjustor for changes in reserve requirement ratio.** The ceiling on a cumulative flow of NDA of the NBT for the year will be adjusted upwards (downward) when the required reserve rates (rr) on deposits in local and/or foreign currency (DB) are increased (decreased), resulting in a corresponding increase (decrease) of reserve money (RM).

NDA before RR change: $NDA = RM - NFA$

$RM = CC + RR + OBR + DNGNB$ where:

$RR = rr * DB$

DB – deposit base

rr – required reserve rate

Define: drr – change of required reserve rate.

DB – deposit base used for calculation of required reserves

$drr * DB$ – amount of upward (if $drr > 0$) or downward (if $drr < 0$) adjustment in RM

NDA after RR change $NDA = RM (+/-) drr DB - NFA$.

12. **Adjustor for settlement of external guarantees different from projections.** The ceiling on change in net domestic assets of the NBT will be adjusted by the difference of the actual settlement of external guarantees from the projected settlement of external guarantees under the program. The external guarantees extended by the NBT are the guarantees provided in favor of foreign financial and nonfinancial institutions to secure credit lines for Kredit Invest, cotton investors, and their suppliers. When the NBT settles a guarantee on behalf of these parties, the NBT books a domestic claim on these parties.

Quantitative Performance Criterion 2: Floor on a cumulative flow for the year of total net international reserves (in millions of U.S. dollars).

13. **Definition.** Total net international reserves of the NBT are defined as the difference between total gross international reserves of the NBT and total reserve liabilities of the NBT. Total gross international reserves of the NBT are defined to include NBT's holdings of

monetary gold, SDRs, convertible currencies in cash or in nonresident financial institutions that are readily available and any reserve position at the IMF. Also included are holdings of foreign currency-denominated securities issued by governments or central banks of OECD member states. Excluded are changes in the level of gross foreign reserves that arise from revaluation of gold, capital subscriptions in foreign financial institutions, nonliquid assets of the NBT, convertible currency denominated claims on domestic banks and other residents, assets in nonconvertible currencies, foreign assets pledged as collateral or otherwise encumbered and the net forward position, if any (defined as the difference between the face value of foreign currency denominated NBT off balance sheet claims on nonresidents and foreign currency obligations to both residents and nonresidents). Reserve liabilities of the NBT are defined as liabilities outstanding to the IMF and liabilities of the NBT to nonresidents with an original maturity of up to and including one year. A cumulative flow for the year of total net international reserves (in millions of U.S. dollars) is defined as a difference between the end-of-period balances for the period under evaluation and the preceding end-of-the year balance, unless otherwise specified.

14. **Adjustor for settlement of external guarantees different from projections.** The floor under net international reserves will be adjusted by the negative difference of the actual settlement of external guarantees from the projected settlement of external guarantees under the program. The external guarantees extended by the NBT are the guarantees provided in favor of foreign financial and nonfinancial institutions to secure credit lines for Kredit Invest, cotton investors, and their suppliers.

Quantitative Performance Criterion 3: Zero ceiling on new lending and guarantees from the NBT to private sector (continuous quantitative performance criterion).

15. **Definition.** New lending from the NBT to the private sector is defined as loans extended by the NBT to domestic commercial banks, credit unions, credit associations, and microfinance organizations with a maturity of more than three months, and loans extended by the NBT to other domestic nonbank financial institutions or any other domestic entity other than the general government. Short-term liquidity loans to domestic commercial banks, credit unions, credit associations, and microfinance organizations with a maturity of up to three months are not included under this definition. Guarantees are defined as any guarantee extended by the NBT of principal or debt service payment for debt issued or contracted by private sector entities.

16. **Adjustor for settlement of external guarantees different from projections.** The ceiling on new lending from the NBT to the private sector will be adjusted by the difference of the actual settlement of outstanding existing external guarantees from the projected settlement of external guarantees under the program. The external guarantees extended by the NBT were the guarantees provided in favor of foreign financial and nonfinancial institutions to secure credit lines for Kredit Invest, cotton investors, and their suppliers. When the NBT

settles a guarantee on behalf of these parties, the NBT books a domestic claim on these parties.

Quantitative Performance Criterion 4: Floor on the cumulative overall fiscal balance of the general government excluding foreign-financed PIP and related grants.

17. **Definition.** The overall fiscal balance of the general government is defined from below the line on a cash basis as the negative sum of:

- *change in net claims on the general government of the NBT:* net claims on the general government of the NBT is defined as the sum of the change in stocks of the NBT's net claims on the general government, which include all deposits of the general government with the NBT, counterpart deposits (which reflect balance of payment and/or general budget support from international financial institutions and other donors), NBT loans and advances to the general government, NBT holdings of government securities, bank restructuring costs, and the privatization account (where proceeds from the privatization of state property are held);
- *the change in net claims on the general government of the rest of the domestic banking system:* net claims on the general government of the rest of the domestic banking system are defined to include the net position of the general government with respect to other domestic commercial bank assets (loans, overdrafts, cash advances, holdings of treasury bills or other securities) and liabilities (deposits, etc.).
- *the change in net claims on the general government of domestic nonbank institutions and households:* net claims on the general government of domestic nonbank institutions and households are defined as treasury bills, bonds or other government securities held by nonbank institutions and households (including nonresidents and nonresident financial institutions), plus any other liabilities of the general government to domestic nonbank institutions or households.
- *the change in net foreign liabilities of the general government:* net foreign liabilities of the general government are defined as government debt to foreign sovereigns, and foreign financial and nonfinancial institutions. For this purpose, net foreign liabilities exclude liabilities that arose in the context of the externally financed PIP.

- *gross proceeds from the privatization of state property*: gross proceeds from the privatization of state property are defined as all receipts originating from the sale of the general government property.
- *the change in gross arrears of the general government*: gross arrears refer to domestic or external arrears.

All changes will be calculated as the difference between end-of-period stocks, net of any valuation changes resulting from currency movements.

Quantitative Performance Criterion 5: Ceiling on general government wage and pension arrears (continuous quantitative performance criterion).

18. **Definition.** Arrears on general government and pensioners' pensions are defined as any shortfall in monthly disbursements of wages and pensions. These payments are defined as overdue if they have come due at the end of the month and remain unpaid thereafter. To allow monitoring of the above defined arrears the government will provide data on actual wage payments as part of the monthly budget execution statements submitted to the IMF staff. The Agency on Social Protection and Pensions will provide quarterly reports and statements of their operations.

Quantitative Performance Criterion 6: Ceiling on contracting or guaranteeing of any nonconcessional external debt (continuous quantitative performance criterion).

19. **Definition.** The external debt is defined as in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), adopted August 24, 2000; see below) and also includes commitments contracted or guaranteed and for which value has not been received. The debt limits apply to short-, medium-, and long-term debt contracted by the government of Tajikistan, the National Bank of Tajikistan, and any other agency acting on behalf of the government, including but not limited to state-owned banks.

20. **The definition of debt set forth in point No. 9 of the guidelines reads as follows:** “(a) For the purposes of this guideline, the term ‘debt’ will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future points in time; these payments will discharge the principal and/or interest liabilities under the contract. Debts can take a number of forms, the primary ones being as follows: (a) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the

funds and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (b) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (c) leases, i.e., arrangements under which property is provided which the lessee has the right to use one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

21. **External debt limits** apply to the contracting or guaranteeing of new nonconcessional short-term external debt (with an original maturity of up to and including one year), and to the contracting or guaranteeing of new nonconcessional medium- and long-term external debt (with original maturities of more than one year).

22. **Exclusions from the external debt limits.** Loans contracted for debt rescheduling or refinancing if the terms of the new loan are more favorable will be excluded from the debt limits. IMF credit is excluded from the external debt limits. The rollover of the existing guarantees will be excluded from the debt limits. If pledged reserves of the NBT were to be securitized, these amounts will also be excluded from the debt limits. The performance criterion on new nonconcessional short-term external debt will not apply to loans classified as international reserve liabilities of the NBT (liabilities of the NBT to nonresidents with an original maturity of up to and including one year). Normal import-related financing is excluded from the criterion.

23. **Valuation of debt denominated in currencies other than the U.S. dollar.** Debts falling within the external debt limits that are denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at the exchange rate prevailing at the time the contracting or guaranteeing takes place or at the exchange rate stipulated in the contract.

24. **Guarantee of a debt.** For the purposes of the program, the guarantee of a debt arises from any explicit legal obligation of the general government or the NBT or any other agency acting on behalf of the general government to service such a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or indirectly through any other obligation of the general government or the NBT or any other agency acting on behalf of the general government to finance a shortfall incurred by the debtors.

Quantitative Performance Criterion 7: Ceiling on disbursements of concessional external financing.

25. **Definition:** Disbursements of concessional external financing are defined as disbursements of debt with a grant element equivalent of 35 percent or more.

Quantitative Performance Criterion 8. New external payments arrears (continuous quantitative performance criterion).

26. **Definition.** External payments arrears are defined as overdue payments (principal or interest) on external debt contracted, guaranteed, or converted into interstate debt by the general government of Tajikistan or the NBT.

Indicative Target 1: Floor on tax collections.

27. **Definition.** Tax collections are defined to include all taxes (and custom revenues) collected under the general government budget. Regarding internal taxation, the definition excludes any proceeds from loans, or other banking system credits, the issuance of securities, or from the sale of state assets. Custom revenues are defined to include customs duties and other taxes (including VAT) on international trade and transactions.

Indicative Target 2: Floor on social- and poverty-related expenditure.

28. **Definition.** Social- and poverty-related expenditure is defined as the sum of current and capital expenditures in the education, health, and social protection sectors.

III. REPORTING REQUIREMENTS UNDER THE PROGRAM

29. For program monitoring, the following data should be reported to the Middle East and Central Asia Department of the International Monetary Fund via the IMF Resident Representative's office in Dushanbe.

Table 1. Data reporting frequency for program monitoring

Data	Frequency	Lag
1. NBT analytical balance sheet	Weekly	3 working days
2. NBT balance sheet	Monthly	2 weeks
3. Commercial banks' and Kredit Invest balance sheets	Monthly	4 weeks
4. Auction results for NBT certificates and treasury bills	Weekly	1 week
5. Foreign exchange transactions	Weekly	1 week
6. Fiscal revenues, expenditures and financing of budget execution, and extrabudgetary funds	Monthly	4 weeks
7. Reports and statements from the Agency on Social Protection and Pensions	Quarterly	6 weeks
8. Arrears of budget entities and state-owned enterprises	Quarterly	4 weeks
9. Stocks, disbursements, guarantees, new contracts of external debt including terms and disbursement profile	Monthly	4 weeks
10. External arrears arising in respect of obligations incurred directly, guaranteed, or converted into interstate debt by the general government of Tajikistan or the NBT, including penalties or interest charges	Monthly	4 weeks
11. Liquidity loans and loans stemming from fulfillment of the lender-of-last-resort function extended by the NBT to the economic agents in Tajikistan (financial sector, nonfinancial sector, enterprises, individuals, and any other) specifying date of issue, amount of original loan, interest, term, schedule of repayment, currency, and any grace period	Monthly	4 weeks
12. Net and gross international reserves, daily sales and purchases of foreign currency, and daily sales and purchases of foreign currency executed with an intention of influencing the exchange rate of somoni	Daily	1 working day

APPENDIX III. TAJIKISTAN: TENTATIVE WORK PROGRAM

April 2009	Board discussion of Tajikistan's request for PRGF
May 2009	Staff visit to discuss end-March developments
September 2009	Review of end-June performance under the program
March 2010	Review of end-December performance under the program