PROGRAM IMPACT ASSESSMENT

A. Introduction

1. This program impact assessment summarizes expected results of reforms. The proposed program Financial Sector and Fiscal Management Program aims to support the government's efforts to accelerate sustainable private sector growth by creating a more stable financial system, enhancing access to financial services, and improving fiscal management. The program is consistent with the Asian Development Bank (ADB) country partnership strategy for Tajikistan, 2016–2020, that is also closely aligned with the goals of the National Development Strategy of the Republic of Tajikistan for the Period up to 2030 (NDS 2030). The country partnership strategy focuses on supporting the government to achieve sustained and inclusive growth that is less susceptible to external shocks and creates employment. The program is also consistent with ADB's Strategy 2030 and its focus on strengthening governance and institutional capacity through supporting public management reforms and financial sustainability, improving service delivery, strengthening capacity and standards, and accelerating progress in gender equality.

B. Reform Areas and Effects of the Program

2. The program has implemented reforms that improved the efficiency of public and private resources to support the main objective of the NDS 2030 being to improve the standard of living of the population by transitioning to an economy dominated by industry. The reform areas supported under the program are: (i) raising banking sector stability to increase public confidence; (ii) expanding financial sector development to enhance access to finance; and (iii) improving fiscal management to accelerate sustainable private sector growth. The effects are to raise overall confidence in the financial sector and to strengthen the framework for its development that combined with improvements in fiscal management will contribute to a higher level of private investment.

C. Impact Analysis

3. **Impact of reform area 1: Banking sector stability enhanced.** Reform area 1: enhanced banking sector stability and improved public confidence in the financial sector. This was accomplished through: (i) support of the Individuals Deposit Insurance Fund (IDIF) to fund payouts to depositors in the event of insolvency of an insured financial institution; (ii) improving the ability of the National Bank of Tajikistan (NBT) to monitor and manage financial stability and banking sector soundness; and (iii) increasing the capacity of NBT to measure and manage credit risks in financial institutions. Weak banking system performance has lowered public confidence in the financial sector has encouraged households to keep savings outside of the financial system. This structure has major negative implications that limit financial sector development and its capacity to support economic growth and poverty reduction. The transmission channel for the effect of reforms is that enhanced stability of the banking sector builds public confidence, increases financial intermediation capacity allowing the public and entrepreneurs to obtain affordable credit that can be used to expand and grow their businesses. Better access to finance is recognized as effective mechanism for private investment, job creation and poverty reduction.

4. **IDIF's ability to fund payouts to depositors in the event of insolvency of an insured financial institution strengthened.** Specifically, the government adopted a resolution providing back-up funding to the IDIF in the case where it needs financing to support any shortfall in its reserves required to payout claims of insured depositors of a failed bank. The IDIF adopted a resolution which indicates steps to address the current capital reserve deficit by making participation in the insurance scheme mandatory by all banks and raising gradually the coverage amount for insured deposits. These reforms will directly support increased public confidence in the banking system, resulting in increased deposit-taking in banks. Through the back-up funding arrangement for the IDIF directly around 35,000 depositors in the two large state-owned banks, Agroinvestbank and Tojiksodirotbank, that currently cannot access their accounts will be paid-off based on their insured deposits. In addition, with a more stable banking sector, poor and vulnerable households in remote areas of the country will have better access to affordable finance.

5. **Ability of NBT to monitor and manage financial stability and banking sector soundness improved.** The NBT issued a regulation requiring improvements to the operational risk management of banks. The Law on Banking was amended to impose expanded fit-and-proper requirements, help ensure the professional competence and reliability of bank management, supervisory board members, and audit committee members, and provide for better control of conflicts of interest. The NBT also expanded the stress testing framework for financial stability improving macroprudential surveillance and analysis. To enhance the banking sector's soundness and ability to manage risks and volatile economic conditions, the NBT adopted a plan

will better align regulatory capital requirements with Basel II. Directly, these reforms result in improved risk management and governance among banks. Banks will be better managed and more sound. Improved NBT surveillance and oversight of the banking system will help mitigate the likelihood of a bank insolvency in the future and the potential that fiscal resources are needed to rehabilitate the banking system. These reforms will also have the indirect effect of raising the public's confidence in the financial sector.

6. **Capacity of NBT to measure and manage credit risks in financial institutions, including lending to state owned enterprises (SOEs) improved.** To better mitigate the banking sector's credit exposures and high-level of lending to SOEs, the NBT developed a comprehensive template for banks to accurately report credit exposures. Further, the NBT expanded financial reporting requirements for banks by new data to be collected that incorporates information needed under International Financial Reporting Standards (IFRS). These reforms directly impact improved quality of financial reporting by banks and better clarity over credit exposures with SOEs. The improved ability of NBT to monitor these risks in the banking system results in better control of and reduction in loan concentrations to SOEs. The economy of Tajikistan is dominated by state-owned enterprises where SOEs account for more than 40% of total value added and are present in 21 out of 28 sectors. Directly, reducing the banking sector's exposure to SOEs will help reduce the current high level of nonperforming loans primarily caused by exposure to SOEs and free-up the resources of banks to channel funds to more productive sectors of the economy. The cost of lending will decline and access to credit will improve, particularly for poor and vulnerable households in remote areas of the country and women. This in turn will support increased private investment that with accelerate industrialization, increase in labor productivity will boost disposable income.

7. **Impact of reform area 2: Enabling environment for financial sector development improved.** Reform area 2: (i) strengthened the scope for development of the financial sector; (ii) expanded competitiveness of Islamic finance and the growth potential of the insurance industry; and (iii) enhanced the liquidity and efficiency of the government securities market. Overall development of the financial sector is hindered the lack of a formal strategy that will allow the government to better identify, prioritize, and sequence critical reforms required to expand private investment. The last sector strategy for Tajikistan covered only the banking sector for the period of 2010–2015.

8. **Framework supporting financial sector development improved.** The government took steps to strengthen development of the finance sector, increase competition, support insurance industry growth, expand Islamic finance, augment literacy and gender inclusiveness, and support financial consumer protection. Specifically, the government improved the framework supporting financial sector development by creating an intergovernmental working group to prepare a medium-term financial sector development strategy. Among other elements, the strategy considers access to finance by women, Fintech development and enhancing financial consumer protection. The working group composition is broad to include delegates from the Ministry of Finance (MOF), IDIF, NBT and other relevant stakeholders, with at least 30% women members. The strategy and road map will include trackable target indicators. To ensure stability of the insurance sector and removing barriers hindering development and expanding Islamic finance, the government increased the minimum statutory capital requirement for insurance and reinsurance companies and the NBT extended regulation of Islamic credit institutions, including their minimum capital and other prudential requirements.

9. These reforms will directly enhance the insurance sector's risk reserve buffers that allow the sector to grow and offer a wider range of products. Clarity of the permissible activities of Islamic credit organizations leading to greater turnover and development of Islamic banking and wider contribution to improved financial access. Due to improved regulation which allows remote personal authentication, the public will intensively use digital financial products and e-money. Creation of a medium-term financial sector development strategy will provide better guidance for growth of the sector, leading to (among other things) enhanced women's access to finance, increased application of fintech, and improved consumer protection.

10. **Market for government securities enhanced.** Through adoption of expanded issuance, improved auction processes and utilization of market pricing. To expand the government securities market, MOF: (i) submitted a draft resolution to the Parliament to improve the process of issuing and circulating government securities; and (ii) approved an action plan for modernizing the government securities auction process, which includes pilot issuance of securities at market rates and at tenors longer than 91 days. A more liquid and efficient government securities markets will aid in creating a benchmark yield curve that will facilitate issuance of private securities expanding funding options for businesses.

11. **Impact of reform area 3: Fiscal management strengthened.** Reform area 3 strengthened fiscal management. This was accomplished through: (i) public financial management (PFM) reforms implemented in line with the Mid-term Program Development of the Republic of Tajikistan for 2016–2020 and the Tajikistan Public Financial Management Reform Strategy 2019–2030 (PFMRS 2030), including effective roll out of the medium-term expenditure framework (MTEF), ensuring gender responsive budgeting and analysis, and improving budget transparency; (ii) public sector accounting standards improved; (iii) SOE financial reporting standards and MOF monitoring and reporting of fiscal risks of SOEs improved; and (iv) increased transparency and efficiency in tax policy regarding finance sector products and services. Weak PFM has reduced the efficiency of public investment for high quality key economic infrastructure and public services necessary for crowd-in private investment. The transmission channel for the effect of reforms is that improves the transparency in existing budget process, increases readiness for effective roll out of the MTEF to improve efficiency in budget process, improves public sector accounting standards and SOE financial reporting standards to better managing fiscal risks, public expenditures and debt exposure. A PFM system is an essential aspect of the institutional framework for an effective state. Countries with strong, transparent, accountable PFM systems are able to ensure that funding is available for their strategic priorities. They deliver services more effectively and equitably and regulate markets more efficiently and fairly. This in turn contributes towards stronger governance, higher growth, poverty reduction, greater gender equality and social inclusiveness, and is a necessary condition for most development outcomes.

12. **PFM reforms implemented** in line with the Mid-term Program Development of the Republic of Tajikistan for 2016–2020 and the PFMRS 2030, including effective roll out of the MTEF, ensuring gender responsive budgeting and analysis, and improving budget transparency. Although a three-year medium MTEF is operational in Tajikistan which links between the longer term strategic plans of sectors and the government’s annual budgets, there are a number of weaknesses that contribute to reducing its effectiveness.[1] A number of problems are concerned with the methods used for deciding which investments and activities should be included in the plans of budget organizations and how they should be monitored and evaluated. There should be semiannual reviews of budget performance to establish the effectiveness of existing budget plans. Capital investments should be appraised using criteria which take into account their effect on recurrent costs as well as their capital costs. Another group of problems is concerned with weak reconciliation between the various plans that are used. To address these concerns, the MOF approved: (i) guidelines to improve the quality and expand the coverage of budgetary and financial resources published on official website, and to develop and publicly disclose a comprehensive mid-year review of state budget execution; and (ii) analysis to revise the methodology for MTEF preparation, incorporating gender responsive budgeting, consistent with the sector plans and improved analysis of capital investment expenditure. Directly, these reforms improve budget transparency and ensure budgets reflect government's social and economic priorities. It also provides foundation for effectively roll out the MTEF and ensure gender responsive budgeting and analysis.

13. **Public sector accounting standards improved.** To improve public sector accounting standards, MOF adopted a roadmap for implementation of financial reporting standards of the public sector of Tajikistan for 2020–2025, including (i) introduction of the remaining Tajikistan public sector accounting standards (TPSAS) based on full accruals basis of the International Public Sector Accounting Standards (IPSAS), (ii) generating public sector financial statements on an accrual basis, (iii) updating IFRS related regulations, and (iv) improving the methodology for generating reports on fiscal risks associated with the activities of large SOEs. The roadmap sets out the schedule for the adoption of the 23 remaining TPSAS, based on full accruals IPSAS over the period 2021–2025. The first 14 TPSAS have been introduced and are currently being embedded across the public sector. Among the new standards were ones based on IPSAS 12 "Inventories" and IPSAS 17 "Fixed Assets" in which accounting staff have been instructed to conduct inventories according to the new methodology. The roadmap is an essential component of the public sector accounting reform strategy in Tajikistan that it provides a clear direction of travel and, in terms of the planned phased adoption of new financial reporting standards based on IPSAS, a realistic set of milestones.

14. **SOE financial reporting standards and MOF monitoring and reporting of fiscal risks of SOEs improved.** In accordance with Presidential Decree No. 755 (2016), the Department for Supervision of Large SOEs in the MOF is required to report annually to the government on the fiscal risk in accordance with IFRS. It is recognized by the government that while the current reports do identify the potential impact of fiscal risk materializing, more should be done to prescribe measures to mitigate such risks. To strengthen oversight and accountability of SOEs, the government adopted (i) updated financial reporting requirements for large SOEs in accordance with IFRS for improved financial management and reporting, (ii) a new regulation on

[1] PEFA. 2017. *Public Expenditure and Financial Accountability (PEFA) Assessment Final Report*. Washington D.C.

the creation of a supervisory board in each large SOE to oversee overall financial performance, and (iii) guidelines for assessing fiscal risks for the government. Improved reporting systems allow the government to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards. Better financial disclosure by SOEs, leading to changes that would ultimately result in lower fiscal risks to the government of resulting from the activities of SOEs.

15. **Tax code clarified for banking, insurance and Islamic finance clarified.** To support financial sector development through ensuring transparency and efficiency in tax policy, regulatory framework and administration: (i) the government drafted a new Tax Code, including clarification of taxation of voluntary insurance premiums, provisions related to Islamic finance and treatment of loan loss reserves' provisions as an expense, and (ii) the Parliament ratified the Exchange of Information framework within tax authorities in Commonwealth of Independent States. The government adopted the resolution to improve the procedure of provision of tax and customs benefits through introduction of cost-benefit analysis framework for assessing the effectiveness of tax incentives and definition of the authorized state body for the provision of tax and customs incentives. Revisions to the tax code will directly improve financial intermediation needed to support access to finance and reduce the likelihood of market-distorting tax and customs incentives that have impaired financial sector development. The exchange of information framework helps ensuring that governments in member countries cooperate in good faith and make information available to their peers to aid tax administration and enforcement. It will improve transparency in tax administration as well as eliminate tax avoidance and evasions. Improved process of tax and customs benefits will ensure transparency and efficiency of the mechanism for provision of tax and customs incentives.

C. Sustainability of the Reform

16. Country ownership and political traction for these reforms help ensure that the policy actions adopted are fully implemented, functional, and impactful in the long run. ADB is providing policy advisory support for financial sector development and promoting private investment, incorporating lessons learned and extensive experience with policy-based financing in Tajikistan and in similar policy areas in the region. Lessons from ADB's previous engagement in Investment Climate Reforms Program in the region highlight three main risks to sustainability of reform projects: (i) lack of political traction outside the key leading ministry; (ii) low capacity of local authorities; and (iii) high rotation of civil servants and weak institutional memory. The program was designed in a way that mitigates these risks as much as possible.

17. First, the reform program will be implemented by four key counterparts: MOF, NBT, IDIF, and the Tax Committee. This will ensure that traction is built across all key stakeholders involved in the process of economic reform in the Republic of Tajikistan. The political economy setting is also currently favorable as all relevant ministries and agencies consider financial sector development as a key priority for the short and medium term. Second, the program, including the transaction technical assistance program, includes capacity development activities whenever relevant, to ensure government counterparts are capable of delivering on the policy actions agreed in the design and monitoring framework. Thirdly, policy actions in this program are more dependent on systems and structures than on specific individuals. This helps mitigate the risk of loss of traction due to rotation of civil servants. The focus on approval of programs, policies, and regulations which can be easily institutionalized helps contribute to the sustainability of the program in the long term.