

## **SECTOR ASSESSMENT (SUMMARY): FINANCE SECTOR AND PUBLIC FINANCIAL MANAGEMENT**

### **Sector Road Map**

#### **1. Sector Performance, Problems, and Opportunities**

1. **Financial sector performance.** As of 30 June 2020, Tajikistan had 73 credit institutions: 17 commercial banks (1 fully state-owned, 2 majority state-owned, 8 domestic private, and 6 majority foreign-owned); 1 Islamic bank; and 55 microfinance organizations (20 microcredit deposit and 6 microcredit organizations, and 29 microcredit funds).<sup>1</sup> Banking sector accounts for about 85% of total financial assets, while the six largest banks account for about 70.0% of total bank assets, and foreign-owned banks for 9.6%. Three of the largest banks are state-owned, including the two banks that were left insolvent by the 2015 financial crisis and recapitalized by the government, and jointly accounted for close to 43% of total bank assets as of 30 June 2020.

2. Tajikistan lags behind its regional peers in financial sector penetration. Since it gained independence in 1991, Tajikistan has sought to transition from a centralized to a market-based financial system, and adopted modern standards, especially in banking sector. Financial sector remains shallow, however, with high dollarization<sup>2</sup> and low intermediation. The sector is small in absolute terms, with total assets of credit institutions (\$2.26 billion) accounting for 28% of gross domestic product (GDP) at the end of 2019, which is smaller than that of the country's peers and neighbors. The financial system is inefficient. It registered large losses in 2014 and 2016 as measured by returns to assets or equity, partly because of the high credit risks that arose from loan concentration, insider lending, and lending to related parties in the major banks, often with insufficient collateral and dubious bank governance conditions, but also because of the system's high cost structure given its small scale. These factors have resulted in a high interest rate spread that dampens the volume of intermediation. The average weighted interest rate on loans in national currency was 22.5% for the first 7 months of 2020.<sup>3</sup> Burdened with heavy losses and a backlog of nonperforming loans (NPLs) and diminishing remittances from the Russian Federation (down from \$3.7 billion in 2013 to \$2.2 billion in 2015), banking sector endured a financial crisis in 2015. The authorities intervened at the end of 2016 to liquidate two small banks and inject public funds into the two largest banks. The deposit insurance fund was used to compensate 1,750 depositors in the two small banks.<sup>4</sup> A good-practice bank resolution system is essential to raise public confidence in banking system.

3. **Banking sector.** Banking sector has been facing significant challenges since 2015. The fundamental problems of banks, including long-standing weakness in governance and lending to related parties, were aggravated by the significant currency depreciation (from TJS6.3 per US dollar on 30 June 2015 to TJS10.3 on 30 June 2018). Overdue loans and NPLs, mostly concentrated in the two insolvent banks, decreased to about 30% by the end of June 2020 from 48% in 2016 (footnote 1). NPLs officially reached about \$286 million as of 30 June 2020.

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<sup>1</sup> National Bank of Tajikistan. 2020. *Review of the Financial System of The Republic of Tajikistan in the Second Quarter of 2020*. Dushanbe.

<sup>2</sup> As of the end of June 2020, 50.95% of loans and 47.90% of banks' liabilities were in foreign currency.

<sup>3</sup> [National Bank of Tajikistan](#) (accessed 18 September 2020).

<sup>4</sup> As of 1 January 2020, the maximum amount of insurance coverage for savings in the national currency was TJS29,000, and for savings in foreign currency TJS20,300. Only savings of individuals are covered by the Individuals Deposit Insurance Fund.

4. Small and medium-sized enterprises (SMEs) are important engines of growth, jobs, and social cohesion. However, access to finance, especially for SMEs, is hampered by high interest rates and collateral requirements. The banking sector is small and inefficient and exposed to weak asset quality, mainly concentrated in two failed state-owned banks.<sup>5</sup> The share of outstanding loans to state-owned enterprises (SOEs), many of which have financial difficulties, increased from 15% in 2012 to 27% in the first half of 2020 and represents 49% of all foreign-currency loans.<sup>6</sup> Adding the loans made to SOEs by nonbanking institutions, outstanding loans to SOEs became 33%, and 51% of all foreign currency loans.<sup>7</sup> Directed lending to SOEs, which is not sufficiently monitored by the government, has crowded out private borrowing and investment and increased the share of NPLs and overall financial systemic risks and instability, fueling borrowing cost. The Individuals Deposit Insurance Fund (IDIF) provides coverage up to about \$2,900 per person but does not have sufficient financing resources. In case of liquidation of the two large insolvent state-owned banks, IDIF will not have sufficient reserves to compensate secured depositors.

5. **Insurance.** Of the 18 insurance companies, including 1 mutual insurance society, 2 are state-owned and 16 privately owned. The two state-owned insurance companies have a big share in the market for mandatory nonlife insurance products. Supervision of insurance was transferred from the Ministry of Finance to the National Bank of Tajikistan (NBT) in 2017. Since then, the NBT has taken some tangible positive steps. For instance, it now has seven full-time employees supervising insurance and plans to add two more. In March 2020, the government adopted a resolution increasing the minimum capital requirements for insurance companies, bringing them closer to the average level required by peer countries in the region. Despite these promising signs of progress, insurance is underdeveloped by international standards, with gross written premiums of only 0.34% of GDP in 2018.<sup>8</sup> Individuals and businesses are, consequently, underserved. Among the reasons why the market remains small is the population's skepticism toward insurance, lack of knowledge about insurance, and high poverty levels; and the underdeveloped insurance market infrastructure and lack of tax incentives (footnote 8).

6. **Capital markets.** The government has invested considerable time and effort into regulatory and policy measures to develop the government securities market. A robust, commercially attractive government securities market, secondary trading in government securities, and the introduction of longer-term benchmark securities are prerequisites to developing capital markets and government securities as an important source of government borrowing. The government securities market, however, remains underdeveloped. Primary instruments on the domestic government securities market are exceedingly short-term discounted treasury bills (*veksels*). They are priced at 0.99% and purchased only by the IDIF, which is required to invest its funds in treasury bills; the yield is unattractive to domestic and foreign investors. The absence of attractive, longer-term, market-rate government securities prevents the development of money market instruments and borrowing by private legal entities. One issuer is listed on the Dushanbe-based Central Asian Stock Exchange, which was established in 2015.<sup>9</sup> The NBT auctions deposit certificates to commercial banks using the Thomson Reuters platform.

7. **Public financial management system.** Countries with strong, transparent, accountable public financial management (PFM) systems can ensure that funding is available for their strategic priorities. Such countries deliver services more effectively and equitably and regulate markets more efficiently and fairly. The government has been working on improving PFM since 2009. It

<sup>5</sup> European Bank for Reconstruction and Development. 2020. *Tajikistan Diagnostic*. London.

<sup>6</sup> National Bank of Tajikistan. 2020. *Banking Statistics Bulletin*. August. Dushanbe.

<sup>7</sup> National Bank of Tajikistan. 2018–2020. *Banking Statistics Bulletin*. Dushanbe.

<sup>8</sup> Rating-Agentur Expert RA. 2019. [Central Asia: Industry Research—Insurance](#). Frankfurt. 1 November.

<sup>9</sup> [Central Asian Stock Exchange](#).

made good progress until the financial crisis of 2015, strengthening annual and medium-term planning and budgeting, financial control, treasury management, accounting, PFM information systems, internal and external auditing, and monitoring of SOEs. In 2017, the Public Expenditure and Financial Accountability assessed PFM to document its progress and to form a basis for agreeing to recommendations for further improvements. The assessment indicated steady and gradual improvement of most indicators compared with the previous assessment, mainly in comprehensiveness of annual budget information, predictability and control in budget execution, financial data integrity, and external scrutiny and audit. Some areas that need significant improvement are related to fiscal transparency, medium-term expenditure budgeting, public investment management, accounting standards, and fiscal risk of SOEs. Plans for improving these areas and all aspects of PFM are in the government's Public Financial Management Reform Strategy 2019–2030.

8. **Medium-term expenditure framework.** The government aims to roll out its medium-term expenditure framework (MTEF), which has been in partial operation for some years but needs to be improved in several ways. Projects and plans competing for funds need to be appraised and selected considering output and outcome performance indicators, including program budgeting and gender-responsive budgeting techniques and budgeting for the long-term cost effects of capital investments. Reconciliations between the MTEF and the annual budget for revenue and expenditure and semiannual reviews of budgeting performance need to be improved.

9. **Public Sector Accounting Standards.** In June 2020, the government adopted a revised road map to implement public sector financial reporting standards. It sets out the schedule for adopting the 23 remaining Tajikistan Public Sector Accounting Standards (TPSAS), based on full accrual international public sector accounting standards (IPSAS), in 2021–2025. The first 14 are being embedded in the public sector. The road map is an essential component of the public sector accounting reform strategy, which provides clear direction, and realistic milestones for the phased adoption of new financial reporting standards. In the new road map, the Ministry of Finance envisages that all public sector bodies, including SOEs, will apply the TPSAS standards until SOEs develop the capacity to adopt international financial reporting standards (IFRS). The government is working on the next strategy for managing fiscal risks in 2021–2024 with technical assistance from the World Bank. Most of the government's attention is focused on 14 of the largest enterprises where the state is the sole shareholder. Two of the largest SOEs, Barki Tojik and TALCO, have accounted for large operating losses and increased indebtedness in recent years.

10. **Tax and fiscal sector.** The severe impact of the COVID-19 pandemic has rendered Tajikistan even more fiscally vulnerable to external shocks. The pandemic's immediate impacts are observed in weak remittances, trade, tourism, labor mobility, investments, and tax revenue. The pandemic is projected to reduce tax revenue and expand the fiscal deficit to 7.7% of GDP. Unforeseen health-care costs of the pandemic and the problematic banking sector pose other salient fiscal risks that might lead to increasing the expenditure–GDP ratio way above 29.4% forecast for 2020 and 29.9% for 2021. Fiscal deterioration is reflected in the estimated rise of public debt to 50% of GDP in 2020 and total external debt to 39% in 2021.

## 2. Government's Sector Strategy

11. The National Development Strategy of the Republic of Tajikistan for the Period up 2030 (NDS 2030) aims to ensure a steadily growing, competitive country that provides decent living standards and equal opportunities for everyone to realize their potential on the basis of equality, justice, and respect for human dignity. NDS 2030 identifies and recognizes a number of problems hindering financial sector, including (i) the inefficient use of internal capacity to mobilize domestic

savings and transform them into loans and investments, (ii) the low level of capitalization of financial institutions, (iii) the limited diversification of financial products and channels, and (iv) the high price of financial services. The recently approved Tajikistan Public Financial Management Reform Strategy 2019–2030 is to determine the overall direction of PFM reforms, underpinned by the four-pronged objective to ensure (i) fiscal discipline, (ii) allocative efficiency, (iii) operational efficiency, and (iv) transparency and accountability of public resources.

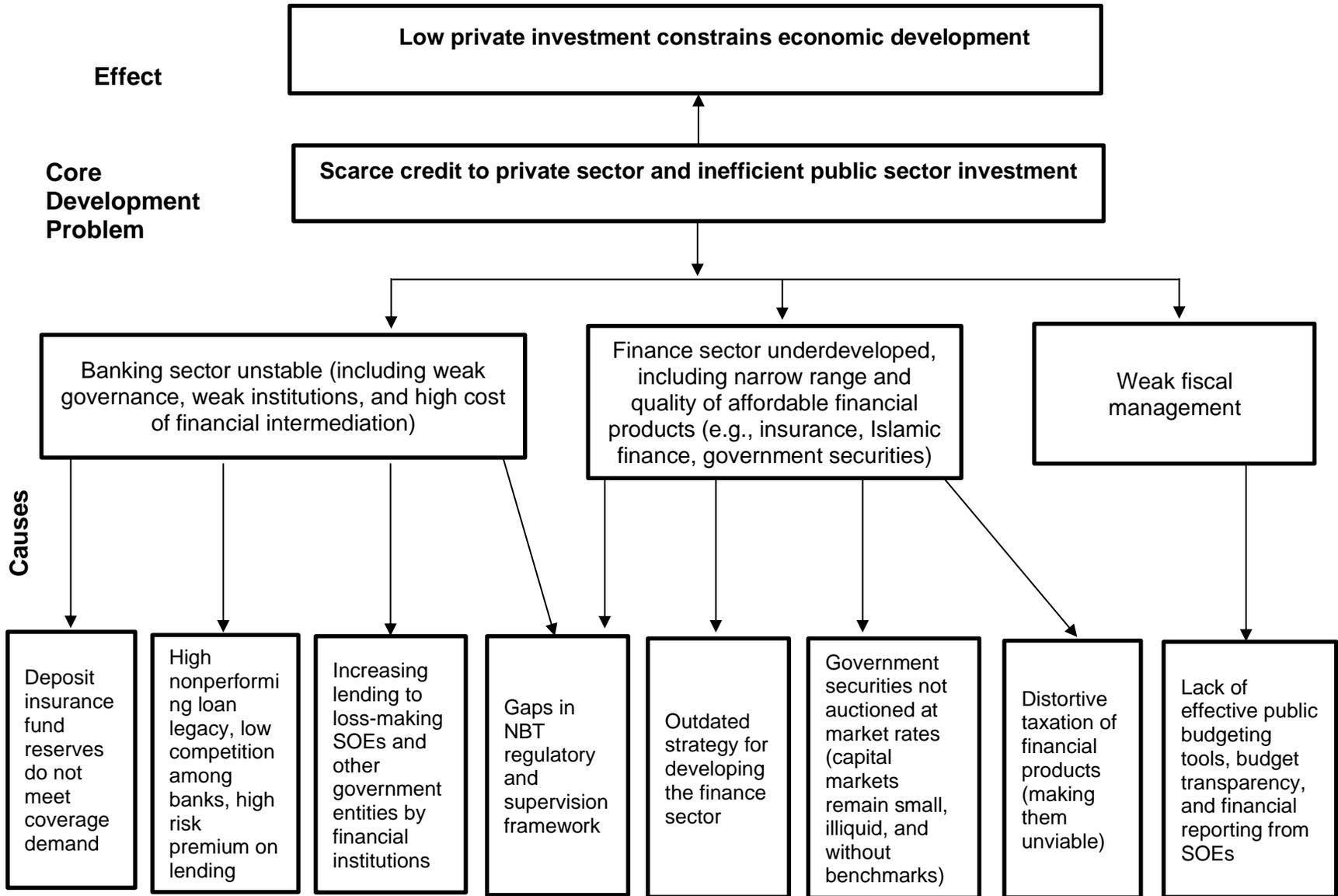
### **3. Asian Development Bank Sector Experience and Assistance Program**

12. The Asian Development Bank (ADB) is well prepared to design and implement the program, given its experience with policy-based financing in Tajikistan and in similar policy areas in the region. The program builds on successful reforms initiated and accomplished under ADB Investment Climate Reforms Program subprograms 1 and 2 for improving private investment.<sup>10</sup> ADB's experience and strong relationship with the government is important in identifying and implementing critical reforms. Strong value addition is demonstrated through (i) identifying binding constraints; international good practices; and possible policy, legal, and institutional solutions; (ii) conducting policy dialogue and generating knowledge products such as diagnostic studies; (iii) having long-standing experience in designing and implementing TA and policy-based financing in support of reforms to increase private investment, economic diversification, and inclusive growth; and (iv) coordinating with other development partners to avoid duplication of support and to ensure consistency of key policy messages. Developing and implementing reforms in the program would have been difficult and costly without ADB's analytical, technical, and financial support.

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<sup>10</sup> ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Grant to the Republic of Tajikistan for the Investment Climate Reforms Program (Subprogram 1)*. Manila; ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan and Grant to the Republic of Tajikistan for the Investment Climate Reforms Program (Subprogram 2)*. Manila.

**PROBLEM TREE**



NBT = National Bank of Tajikistan  
 SOE = state-owned enterprise