

Tajikistan Business Enabling Environment/ SME Policy Project Press Review - Issue #45

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IFC PRESS REVIEW

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INTERVIEW

L. MOERS: 'RISK OF EXTERNAL DEBT PROBLEMS INCREASED'

The first exclusive interview of Mr. Moers, the IMF Resident Representative in Tajikistan, for the Asia Plus newspaper

1. Soon it will be a year as you stay in Tajikistan. How do you evaluate the economic situation in the republic?

Since the expiration of the last Poverty Reduction and Growth (PRGF) program, in February 2006, the government has been working without an IMF program. This, if you will, 'graduating' from IMF programs is a sign of the progress made. Tajikistan currently does not need IMF financing, and gets large amounts of official financing from other sources. The performance under the last (2003-06) and previous PRGFs (1998-2001) was strong. Specifically, economic growth was higher than expected, associated with a reduction in poverty levels, inflation was brought under control, the somoni was introduced, and fiscal policy was particularly strong, consistently without budget deficits since 2003. What I have observed in the year since I arrived here is largely a continuation of this situation. Of course, that is no reason for complacency. Poverty is still high, the cotton sector debt problem hinders agricultural development, the private investment climate needs further improvements, and the projected external debt accumulation by the government has significantly increased Tajikistan's risk of debt problems in the future. The challenge is to build on the existing basis of macroeconomic stability with further growth-enhancing and poverty-reducing structural reforms.

2. Formerly, IMF representatives recommended Tajikistan not to increase the external debt. Meanwhile, the country intends to implement several large projects requiring significant financial injection. What are the risks of these projects?

It took a lot of effort to bring Tajikistan's government external debt ratio down to sustainable levels. Mostly as a result of debt restructuring operations with Russia and the IMF the external debt-to-GDP ratio was lowered to about 30 percent in 2006. Under the current government plans to implement several large infrastructure projects in the total amount of about US\$ 1 billion, the ratio will increase back to 56 percent in 2009, almost a doubling in three years. Such a rapid pace of debt accumulation significantly increases the risk of future debt problems, particularly as plans for supporting sectoral reforms remain largely unclear. Specifically, the lack of a well-defined electricity regulatory regime, problems with payment discipline on the part of state-owned enterprises, and remaining distortions in the agricultural sector create uncertainty about the economic viability of the projects in question. Moreover, the rapid debt accumulation puts pressures on the budget, as the government has to finance part of the projects itself, which reduces resources available for other priority sectors, in a country where spending on health and education is already among the lowest in the world. The short of it is not that the IMF is principally against government borrowing for potentially useful projects, but, for the reasons mentioned, it judges the risks for the future of the current debt-based, infrastructure-led development strategy as high.

3. Quite recently, there was Development Forum in Dushanbe, where the President of the country Mr. E. Rahmon explicitly said that the international financial organizations do not support Tajikistan on a due level. What are the plans of the IMF concerning further cooperation with Tajikistan after the forum?

In general, increased donor support can only go hand in hand with increased reform efforts. As for the specific case of the IMF, let me remind you that our Executive Board approved debt relief for Tajikistan under the MDRI in January 2006, on all debt outstanding at 1 January, 2005, a total amount of almost US\$ 100 million. Moreover, the nature of IMF financing is different from official development assistance from international donors in the sense that our money is only lent in the case of a clear need from the perspective of the balance of payments, in the most extreme case when a country can no longer pay for its imports. As explained, it is a sign of the progress made that Tajikistan currently does not need this sort of financing. Let me stress, though, that the current absence of an IMF program in Tajikistan does not imply the absence of policy dialogue, surveillance, and technical assistance, which are all continuing. Hardly a month goes by when I am not receiving a team from headquarters to provide technical assistance, or sending government officials for courses at our training centers in Washington and Vienna. My boss, IMF Mission Chief for Tajikistan Carlos Pinerua, and the rest of our team from headquarters will also still be coming here regularly, and our relations with government officials remain extremely cordial. Finally, if the need arises, the IMF will also again consider financial assistance for Tajikistan.

4. How stable is the macroeconomic situation in the country in your opinion? Are there prerequisites in Tajikistan for economic crisis or financial instability?

I do not see the prerequisites for economic crisis or financial instability in Tajikistan. From what I have already said, it must be clear that we judge the current macroeconomic situation in the country as quite stable, and the main risks for the future in our view lie in the projected rapid debt accumulation. These risks could be minimized if the government puts in place concomitant sectoral reforms, an appropriate debt management strategy, including a prudent absolute limit for the debt-to-GDP ratio, continues borrowing only on concessional terms, and has projects independently vetted.

5. How developed is the Tajik banking system today?

Progress has definitely been made in the operations of the Tajik banking system. Let me mention some of the achievements that I see as the more important. First of all, the banking system has been consolidated, eliminating unprofitable banks by tightening prudential regulations. Also, at the end of 2005, the Tajik banking system was legally opened up to foreign competition, and recently there seems an increased activity from both foreign banks and the government on this point. Finally, bank balance sheets, and asset and deposit ratios are increasing. Nevertheless, the banking system remains small, and its operations are not as transparent as desired. I think the main challenge is to channel more of the large remittances inflow (around US\$ 1 billion last year) into the banking system and from there into the private sector.

6. Time after time some experts expressed their opinion that tight monetary policy does not promote development of the real economy in the country. What do you think of this?

First of all, the recent monetary policy in Tajikistan cannot be credibly characterized as 'tight', as both the NBT re-financing rate and the rates offered on NBT bills have been below the inflation rate for quite some time, and NBT reserve requirements have been stable. If anything, monetary policy was relatively loose over the last year, which we think contributed somewhat to the increase of inflation, to 12.5 percent at end-2006, although this was mostly caused by failed harvests and higher energy prices, which are factors beyond the NBT's control. So far this year, inflation has actually been coming down, and we project a rate of about 9 percent at end-2007. Frankly, among some,

I think there is a fundamental misunderstanding about the role of monetary policy, and what a central bank thus can and cannot achieve. Monetary policy should only be geared to keeping inflation low and stable, which in turn is good for economic growth. It is true that bank lending rates in Tajikistan are high, but this is not caused by 'tight' monetary policy, but mainly by problems in the business environment, which make banks ask for large premiums over their deposit rates. In such a situation, pumping more money into the economy by the central bank would only lead to more inflation and exchange rate depreciation. We are happy the NBT understands this.

7. Some Tajik scholars repeatedly expressed the thought that the IMF's influence hinders development of our economy. What is your position regarding this issue?

Ultimately, what economic policy to pursue is always a government's own choice, and, as explained, in Tajikistan the government has been operating without an IMF program since February 2006. Also, we try to limit our advice to the IMF's core mandate, which is macroeconomics, and we thus do not operate in all areas. All I can say is that experience from different countries has shown that essential macroeconomic problems are often remarkably similar, even though this should and does not preclude the adaptation to the specific context of a certain country of advice on policy instruments to address these problems. Recently, I read somewhere that the IMF 'had insisted on limiting Tajikistan's growth rate to only 5-6 percent'. Apart from the fact that I had never heard about this, this view fails to see that growth is an outcome, influenced by policies, not a variable that you can set to anything you like. There is no escaping further economic reforms if we want to stimulate economic growth.

8. What can you say about the (foreign) investment climate in Tajikistan?

First of all, the IMF is not a specialist in this area, which, on the donor side, is led by the IFC and World Bank. However, the way I read the recent IFC report on this issue is that, on the one hand, positive steps have been undertaken regarding the business environment (e.g., new law on inspections, on licensing, improvement in the access to finance), but, on the other hand, there is still ample room for improvement. What matters most of all is the proper and uniform implementation of the laws. If we look at the latest World Bank's 'Doing Business Indicators', Tajikistan ranks 172 out of 175 countries for 'Protecting Investors'. In that sense, the reluctance to invest in Tajikistan should not be surprising, either by foreign or by domestic private investors. Yet, in case of further improvements the opportunities are enormous. In 2005, net private capital flows to developing countries were US\$ 491 billion. Such amounts dwarf any financing that governments can give, but it has to be understood there is a worldwide competition for these funds influenced by the quality of a country's investment climate. This is the main reason why for example Armenia gets more than double the amount of net FDI inflow of Tajikistan (5 vs. 2 percent of GDP).

9. What is your assessment of the Government's efforts in combating corruption, and how to fight it?

Corruption is never inevitable, but simply a matter of incentives. In particular, if legislation and regulations leave a lot of room for discretion, and wages are low, unofficial payments may be too tempting. This does not just apply to Tajikistan, but anywhere. What could thus certainly help to fight corruption is simplification of legal and regulatory requirements, accompanied by higher wages for public servants. However, the latter has to go hand in hand with broader civil service reform, and be done in a budgetary responsible manner. We are currently definitely seeing increased attention to combating corruption, but I find it is too early to judge the results, for example of the new State Financial Control and Anti-Corruption Committee.

10. Does corruption exist in the IMF and the World Bank? What do you think about the scandal connected with Mr. Wolfowitz, President of the World Bank? Could this happen in the IMF?

You will understand that I am not a big fan of such hypothetical questions, but let me say that I think that the checks and balances are in place to make this risk negligible. I will give you some examples from the IMF, since that is the organization that I work for. When I got hired by the IMF in 2000, I had to swear that none of my immediate relatives was already employed by it, otherwise I could not have been hired. More generally, there is an extensive official IMF code of conduct to which every staff member is required to subscribe. As part of that code, for example, I have to disclose every year any financial or business interest that I or my immediate family members have that might be in actual or apparent conflict with my IMF duties. About the case of Mr. Wolfowitz I will only say that one has to respect his decision to resign as President of the World Bank. What is important is to look forward, and maintain the focus on the vital task of promoting economic development.

11. The President of the country urged international organizations to assist in writing off the cotton sector debt. Now a specific strategy to write off the debt for farmers is being worked out. What is your attitude towards this initiative?

As I explained, the IMF's core area is macroeconomics, and we have no particular expertise in agriculture, an area in which the World Bank and Asian Development Bank are taking the lead among donors. However, the cotton debt is one of the main problems currently facing the Tajik economy, in particular as agriculture affects the main source of livelihood of well over 60 per cent of the population, and thus has important implications for poverty. So debt

resolution definitely needs to take place somehow, and rather sooner than later. Nevertheless, note that it is private debt, not government debt to any international organization. I do not understand why private investors who ran into debt need to be bailed out by either international organizations or the government, particularly since, while this debt was built up, cotton exports have earned more than US\$ 900 million (I looked up the NBT balance of payments data since 2000). Moreover, agricultural experts tell me that the debt must be significantly lower than the latest estimate of some \$ 400 million, even though so far nobody has been able to come up with the 'real' number. This is the first task in order to get to any form of debt resolution. More broadly, the top priority should be to put the agricultural sector on sustainable footing, and the President's signing in March of 'Decree 111', which includes a 'Road Map' of measures that need to be implemented, was a good start of this process.

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Biographical information from Asia Plus: Luc Moers was born on December 21, 1967 in The Netherlands. He works in the IMF since 2000. He has mainly worked on transition and developing countries (in particular Estonia, Senegal, Yemen, and Bangladesh), and low-income country policy issues in general. He has PhD. His thesis is entitled 'Institutions, economic performance, and transition'. He is working as the IMF Resident Representative in Tajikistan since July 2006. Married. Has two month old daughter. In his spare time, he most enjoys hiking in the great mountainous scenery of Tajikistan and having tea with the sheperds there.

PATENT + SOCIAL TAX = RICH BUDGET

DUSHANBE, July 5, "Tojikiston" - In Dushanbe, the State Tax Committee of Tajikistan, IFC and the International Monetary Fund last week hosted a conference on "Tax Administration Development During the Independence Period of the Republic of Tajikistan."

It was noted at the conference, that Tax Committee is ready to consider suggestions from entrepreneurs and other interested parties to improve tax administration. Bakhtiyor Sultonov, Deputy Chairman of the State Tax Committee of Tajikistan noted: "Tajikistan's tax system has to contribute to the achievement of aims such as increasing tax collection, promotion and development of small and medium entrepreneurship (SME), and attracting foreign and domestic investment to develop industrial potential and create new jobs".

Based on the results of the business environment survey conducted by IFC in Tajikistan in 2006, Andrea Dall'Olio told that SME taxation is very complicated. Especially for growing businesses. The patent system of taxation, preferred by most individual entrepreneurs, is somewhat complicated due to the necessity to pay social and retail taxes in addition to the patent. Combining of patent with social retail trade tax will significantly simplify SME taxation. 'Simple procedures and transparency can promote the development of trade in the country', noted A. Dall'Olio.

Luc Moers, the Resident Representative of the International Monetary Fund, supported IFC's recommendations in the area of SME taxation, but noted that careful assessment of the impact on tax revenues was needed and require further increasing. "Most of the difficulties we are discussing are caused by confusion about the implementation of the Tax Code, and not by the Code per se. Thus, the top priority should be to develop the required supporting regulations for proper implementation of the existing Code," he noted.

Conference participants made recommendations for included consolidating taxes to simplify process, combining the social and tax registration numbers, tax inspections conducting and increasing the quality of such inspections.

HELP WILL BE PROVIDED TO BUSINESSMEN TO OVERCOME BARRIERS

DUSHANBE, July 5, "Vecherny Dushanbe" - Eurasia Foundation in Central Asia launched the program aimed to create Public Entrepreneurs Protection Center.

The objective of the program financed by Embassy of Kingdom of Netherlands in Kazakhstan is a provision of legal assistance to small and medium entrepreneurs and improvement of regulatory legislation for entrepreneurship in Tajikistan.

Through the strategic legal procedures, the Center will help businessmen to overcome significant barriers during their activities and provide a possibility to protect their rights', said Rahmatillo Zoyirov, Head of the Legal Consortium and Project Manager. "Providing free legal consultancy to businessmen will promote problems' solution in official way," he also noted.

"Experience shows that trial process is effective method of SME rights protection. We appreciate Embassy of Kingdom of Netherlands for their interest and support of direction that promote anticorruption and is very important for Tajik entrepreneurs," said Zarona Ismailova, EFCA Director for Tajikistan. "From our side, we will continue to support entrepreneurship development in the whole Central Asia," she added.

TAX COMMITTEE IS READY TO TAKE INTO ACCOUNT ENTREPRENEURS' OPINIONS

DUSHANBE, July 5, Vecherny Dushanbe - Increasing entrepreneurs' awareness about the current tax code and further improvements were discussed at the conference "Tax Administration Development During the Independence Period of the Republic of Tajikistan" hosted by Tax Committee under the Government of Tajikistan jointly with International Finance Corporation and IMF.

It was noted at the conference, that Tax Committee is ready to consider suggestions from entrepreneurs and other interested parties to improve tax administration. "Tajikistan's tax system has to contribute to the achievement of aims such as increasing tax collection, promotion and development of small and medium entrepreneurship (SME), and attracting foreign and domestic investment to develop industrial potential and create new jobs", said the Deputy Chairman of the State Tax Committee of Tajikistan, Bakhtiyor Sultonov.

IFC's Andrea Dall'Olio told about the current situation in SME taxation based on the results of the business environment survey conducted by IFC in Tajikistan in 2006. According to the conducted survey, tax administration in Tajikistan is still cumbersome, while the overall tax burden is high, especially for growing businesses.

Also the survey revealed that the patent system of taxation, preferred by most individual entrepreneurs, is somewhat complicated due to the necessity to pay social and retail taxes in addition to the patent.

Luc Moers, the Resident Representative of the International Monetary Fund, supported IFC's recommendations in the area of SME taxation, but noted that careful assessment of the impact on tax revenues was needed that require further increasing.

Under the same context, he also stressed that more attention should be given to reducing tax arrears, which have increased in recent years, in particular those of state-owned enterprises.

Moers argued for the concentration of Tax Committee resources where the largest revenue gains could be achieved, while reducing resources allocated to inspectorates generating minimal revenue. "Most of the difficulties we are discussing are caused by confusion about the implementation of the Tax Code, and not by the Code per se. Thus, the top priority should be to develop the required supporting regulations for proper implementation of the existing Code," he noted.

Conference participants made recommendations for included consolidating taxes to simplify process, combining the social and tax registration numbers, conducting awareness campaigns about tax inspections, and increasing the quality of such inspections.

2. News interesting for Business Environment



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With best wishes,
Tajikistan SME Public Relations/Communication Department