Eurasian Development Bank

EURASIAN FUND FOR STABILIZATION AND DEVELOPMENT WORKING PAPER
WP/19/1

2019

The Eurasian Fund for Stabilization and Development: A Regional Financing Arrangement and Its Place in the Global Financial Safety Net

E. Vinokurov, A. Efimov, A. Levenkov

Keywords: Eurasian Fund for Stabilization and Development, regional financing arrangement, Global Financial Safety Net, global financial architecture, financial crisis, Eurasia, former Soviet Union, global shocks, regional shocks, macroeconomic stability, fiscal sustainability, debt sustainability, sustainable development, development assistance.

JEL codes: F32, F33, F34, G01, H87.

Authors' contact information:
Evgeny Vinokurov, Chief Economist: vinokurov_ey@eabr.org
Alexander Efimov, Expert, Portfolio Planning Unit: efimov_aa@eabr.org
Artem Levenkov, Economist, Chief Economist Group: levenkov_as@eabr.org.

The electronic version of this document is available at https://efsd.eabr.org/en/analytics/

EFSD Working Papers reflect the Fund's research on global, regional, and country economic trends, economic modelling, macroeconomic analysis, sectoral analysis, global financial architecture, and other issues. This Working Paper was prepared by the staff of the Project Unit of the Eurasian Fund for Stabilization and Development in the Eurasian Development Bank. The conclusions and interpretation of the facts in the Working Paper do not necessarily reflect the official position of the EDB, the EFSD Expert Council, the EFSD Council, or the EFSD member states.

TABLE OF CONTENTS

ABBREVIATIONS

AIIB – Asian Infrastructure Investment Bank

ADB – Asian Development Bank

AMF – Arab Monetary Fund

AMRO – ASEAN+3 Macroeconomic Research Office

ASEAN – Association of Southeast Asian Nations

BSA – central bank bilateral swap arrangement

BRICS CRA – BRICS Contingent Reserve Arrangement

CMIM – Chiang-Mai Initiative Multilateralisation

EAEU – Eurasian Economic Union

ECB – European Central Bank

EDB – Eurasian Development Bank

EFSD – Eurasian Fund for Stabilization and Development

ESM – European Stability Mechanism

FLAR – Latin American Reserve Fund (Fondo Latinoamericano de Reservas)

G-20 – Group of Twenty (Group of 20)

GFSN – Global Financial Safety Net

HPP – hydropower plant

IFI – international financial institution

IMF – International Monetary Fund

RA – Republic of Armenia

RB – Republic of Belarus

RF – Russian Federation

RFA– regional financing arrangement

RK – Republic of Kazakhstan

KR – Kyrgyz Republic

RT – Republic of Tajikistan

WB – World Bank

MESSAGE FROM THE MANAGING DIRECTOR

Dear Colleagues!

I would like to present this Working Paper on “The Eurasian Fund for Stabilization and Development: A Regional Financing Arrangement and Its Place in the Global Financial Safety Net.” This starts a series of working papers which will become the main format for the Fund’s public research.

The Eurasian Fund for Stabilization and Development celebrates its 10th anniversary this year. Since its establishment in 2009, the Fund has gained extensive experience in providing loans for financial support to the Fund’s member states for the implementation of anti-crisis and stabilization programmes, as well as investment loans for major infrastructure projects. With our aid, member countries reduce macroeconomic imbalances and build the foundations for long-term economic growth.

The Fund was established in 2009 to overcome the negative effects of the global financial crisis of 2008 and to ensure the economic sustainability of the member states. Studies by various international financial institutions show that substantial risks to debt sustainability have accumulated on the part of both sovereign borrowers and private institutions. In our view, the period of relative calm in the global economy is now coming to an end. Signs of an approaching new global cyclical recession are multiplying, which poses a serious challenge for the member states. The EFSD is charged to respond adequately.

The Fund, as a reliable partner of its member states, intends to increase its own operational efficiency, expand the scope of its macroeconomic expertise, and strengthen the dialogue with its member states. The effectiveness of the EFSD’s work depends on the depth of its understanding and analysis of the national economies and needs of the member states. For this reason, we intend a substantial expansion of our own research expertise.

The Fund attaches great significance to maintaining close relationships with international financial institutions. We are currently planning to host in 2020 the next Regional Financing Arrangements` Research Seminar and welcome staff of the European Stability Mechanism, the Latin American Reserve Fund, the Arab Monetary Fund, and AMRO in Moscow. We are inviting leading experts and speakers from academia, IFIs and public authorities to take part in it.

We look to the future with optimism and believe that the efforts made at all layers of the Global Financial Safety Net over the past years will turn out to be justified.

Andrey Shirokov,

Acting Managing Director of the Eurasian Fund for Stabilization and Development

EXECUTIVE SUMMARY

The Global Financial Safety Net (GFSN) has grown significantly over the decade since the global financial crisis. At the same time, the role of regional financing arrangements (RFAs) has increased significantly due to their responsiveness, flexibility, and in-depth understanding of the regional context. New RFAs enhanced the GFSN by US $1.1 trillion, and improved its coverage in 43 countries.

The EFSD has a crucial role in maintaining the macroeconomic stability of its borrowing countries. In mid-2019, the EFSD lending capacity was US $5407.5 million or 6.4% of the aggregate GDP of the borrowing countries. This was equivalent to 83.5% of their normal access to IMF resources. In 2010–2018, the EFSD disbursed about 20% of the total funding received from all international financial institutions (IFIs) by borrowing countries. Net flows from the EFSD and the World Bank are comparable and equivalent to 0.28% and 0.27% of the aggregate GDP of the abovementioned countries for 2010–2017 respectively.

The EFSD was among the newly established RFAs after the global financial crisis. Unlike others the EFSD has an extended mandate to support both macrostabilization and development goals. This is because of the strong interconnectedness of macrostabilization and specifics of the long-term development objectives of the countries of the post-Soviet space. The latter include the significant deterioration of the production base, along with the continuing deterioration in the quality of infrastructure.

The establishment of the Fund in 2009 was an important and necessary step in the development of the region's financial architecture. Ten relatively calm years have passed, and **risks of macroeconomic destabilization are growing again.** The probability of negative shocks, especially in world trade and in the low rates of economic growth in large economies, has increased dramatically.

The first two layers of the GFSN (international reserves and central bank bilateral swap arrangements) are generally insufficient for the EFSD recipient countries to effectively withstand severe shocks. In 2010–2018 the international reserves of Armenia, Belarus, the Kyrgyz Republic, and Tajikistan averaged 2.4 months of imports of goods and services. If necessary, the Fund's resources, corresponding to an additional 1.1 months of imports, can boost the reserve positions of these countries.

As a result, shareholders decided to strengthen the EFSD. This includes leveraging the EFSD`s institutional capacity, as well as enhancing its dialogue with shareholders, improving the quality of macroeconomic expertise, and developing the Fund as an active participant in the GFSN.

Collaboration within the GFSN enhances its effectiveness. The Fund attaches great importance to maintaining close relationships within the GFSN and with IFIs. Dialogue about strengthening the GFSN and improving the effectiveness of its individual elements is important both at the level of RFA-IMF relations and within the community of RFAs.

1. INTRODUCTION: THE GLOBAL FINANCIAL SAFETY NET

The global financial crisis of 2008 showed the need to strengthen multilateral cooperation and create a more coherent and effective Global Financial Safety Net (GFSN; see **Box 1)**.

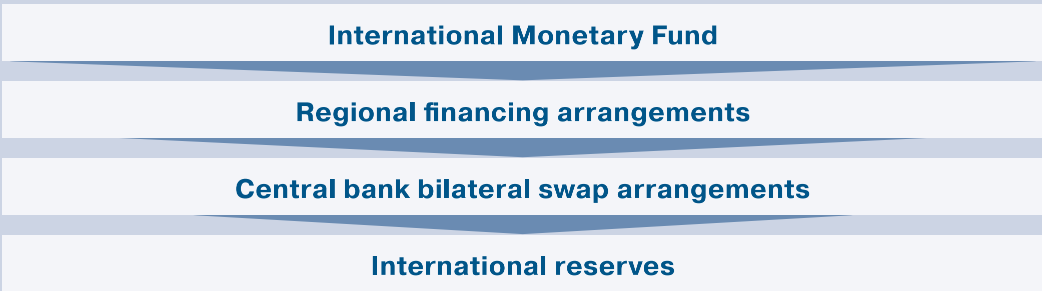
Box 1. What Are the Global Financial Safety Net and Regional Financing Arrangements?

The GFSN is defined as the set of financial resources and institutional arrangements that provide a backstop during a financial or economic crisis. The safety net is a form of insurance against financial crises (following Hawkins et al., 2014:2; Scheubel and Stracca, 2016).

The GFSN has three main objectives: (i) to provide insurance for countries against a crisis; (ii) to supply financing when crises hit; and (iii) to incentivize sound macroeconomic policies. (IMF, 2016).

The GFSN comprises international reserves, central bank bilateral swap arrangements (BSAs), regional financing arrangements (RFAs), and the IMF (Figure 1).

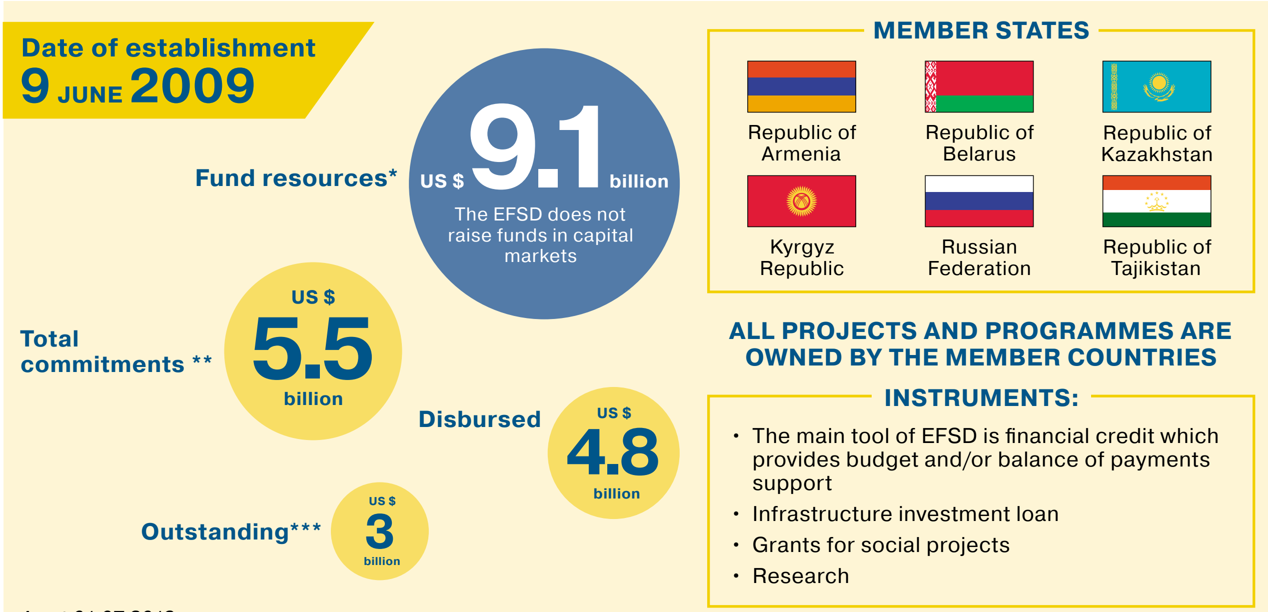
Figure 1. Layers of the GFSN



RFA is broadly defined as a financing mechanism by which a group of countries in a region pledges financial support to members that are experiencing, or might experience, a liquidity shortage or balance of payments difficulties (IMF, 2013). One of the potential advantages of an RFA compared to the IMF may be a faster decision-making process in view of the availability of relevant expertise, as well as direct proximity to its member countries. The financial resources with which RFAs provide liquidity can come from member countries' contributions – in the form of paid-in resourses or financial commitments – or are borrowed from financial markets (Cheng and Lennkh, 2018a). The total resources of all RFAs are currently about US $1.3 trillion, which exceeds the resources of the IMF (about US $1 trillion for 2019, according to the IMF website). RFA activities are generally managed by collegial bodies consisting of representatives of the ministries of finance and/or central banks of the member states.

The EFSD is an integral part of the GFSN and a key mechanism for maintaining macroeconomic stability in its region of operations. The Fund was established on June 9, 2009 by six states (Armenia, Belarus, Kazakhstan, the Kyrgyz Republic, Russia, and Tajikistan) in order to overcome the negative effects of the global financial crisis on the national economies (Figure 2).

Figure 2. EFSD Highlights



As at 01.07.2019.

*Notes: * (a) contributions to the Fund; (b) proceeds from placement of temporarily idle Fund resources; (c) revenues from the resources provided by the Fund on a refundable basis; (g) donations; (d) other income; ** all financial commitments ever approved by the Fund`s Council minus cancellations *** disbursed minus debt repayments.*

The GFSN as a whole and the RFAs in particular have not received sufficient attention in the international academic literature. Within the GFSN, they are shadowed by the analysis of their “elder brother” (the IMF). This is partly due to an underestimation of the significance of RFAs for small economies (Fritz and Muelich, 2019). Small economies, as a rule, do not have access to BSAs, and their own reserves are too small to successfully deal with a crisis without external assistance.

The purpose of the present work is to eliminate gaps in understanding of the dynamics of the EFSD development and its role in the financial architecture of the region and the GFSN. To do this, we must first provide the global expert community with a detailed picture of the Fund’s activities, its role in the region, and the dynamics of its development. Second, we must show the role of the Fund as a reliable and responsible partner of the shareholder countries and as an important element of the GFSN in the region of operations. To do this, we will review the EFSD’s specific tasks and its distinctive features in comparison with other RFAs.

The document comprises six sections. For a better understanding of the distinctive features of the region and the corresponding challenges and conditions of the Fund’s work, the second section presents an overview of the Fund’s member states with their specific socio-economic characteristics and an analysis of their interests with respect to the EFSD. Section 3 provides an analysis of the main stages of establishing the Fund and the current profound changes in its activities. Then the role and place of the Fund in the GFSN are described (Section 4) and its operating activities are analysed (Section 5). The last section focuses on the development of a network of international partnerships (Section 6). The three Annexes provide information about the Fund’s programmes (Annex 1), corporate governance and the decision-making system (Annex 2), and the development of macroeconomic expertise, its macroeconomic models and public research (Annex 3).

1. GLOBAL AND REGIONAL ECONOMIC TRENDS, REGIONAL INTERCONNECTIONS, AND INTERESTS OF THE MEMBER STATES

The economies of the EFSD region of operations have a considerable number of distinctive structural features. Of particular concern is that dependence on commodity exports (for Russia and Kazakhstan – oil, gas, metals, fertilizers, grain; for the Kyrgyz Republic – gold; for Belarus – potassium) leads to a strong dependence on commodity prices and increased macroeconomic risks when there is strong price volatility. Another important factor is the predominant weight of Russia in the regional economy (in terms of GDP, population, trade and investment flows, labour market, etc.), which leaves its mark on all regional economic development (Table 1).

Table 1. Indicators of the Socio-Economic Development of EFSD Member Countries, 2018

		Armenia	Belarus	Kazakhstan	Kyrgyz Republic	Russia	Tajikistan
GDP	Nominal GDP, US $ billion	12.4	59.7	170.5	8.1	1 647.5	7.5
	GDP at purchasing-power parity, US $ billion	30.7	190.8	507.6	24.3	4 179.6	30.6
	Nominal GDP per capita, US $	4 188.1	6 020.0	9 977.4	1 254.1	10 950.5	807.1
	GDP growth rate, average for 2010–2018, %	4.1	1.9	4.5	4.1	1.9	7.0
Population, million		2.9	9.4	18.4	6.4	146.9	8.9
Foreign trade turnover, US $ billion		7.4	72.1	93.5	6.7	693.1	4.2

Source: IMF, WB, national statistical offices, EFSD calculations.

The economies of the Fund's member countries are affected by a number of (i) global, (ii) regional, and (iii) national economic trends:

(i) The countries of the Fund, considering the relative size of their economies, demonstrate a high degree of dependence on global economic trends: global economic growth, the state of foreign trade.

Since the end of 2018, economic growth forecasts from leading organizations have begun to be adjusted downward (IMF World Economic Outlook, 2019). Among the international agencies that are changing their forecasts in that way is the WTO: Its assessment of the growth of international trade in 2019 was reduced quite sharply, from 3.7% to 2.6%; the WB lowered its January forecast for global economic growth in 2019 by 0.3 percentage points (to 2.6%) due to sluggish economic trends (World Bank, 2019), and according to Morgan Stanley analysts, trade disagreements between China and the United States could lead to a recession in the global economy in 2020.

It is quite likely that medium-term consensus forecasts significantly underestimate the risks of a cyclical downturn in the global economy in the coming years. Growth is becoming less balanced and may have already peaked in some leading economies. The authors see a significant probability of a relatively mild but long (L-shaped) cyclical slowdown of the global economy. A change in the phase of the world economic cycle may lead to a significant slowdown in the economic development of the Fund's borrowing countries, both directly and indirectly through the economies of Russia and Kazakhstan.

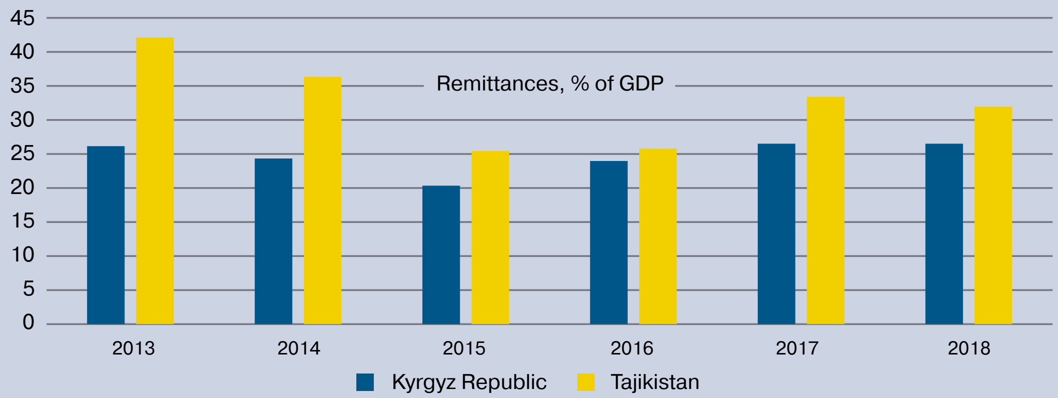
(ii) In addition to global factors, the economic condition of the Fund is affected by such a major regional factor as the substantial dependence of the national economies of the Fund's member states on the dynamics of the Russian economy.

The enormous weight of Russia in the EFSD region of operations – in terms of both GDP and population – presents countries with certain challenges and at the same time creates a number of opportunities. The impact, both positive and negative, is exerted through a number of transmission channels, including trade flows, flows of direct and portfolio investments, the credit channel, inflation, interest rates, remittances of migrant workers, and economic expectations.

If the Russian economy grows, its growth spills over beyond the country's borders. Conversely, if the Russian economy falls, the shock for the region's small economies can be painful, as has happened more than once. That is what occurred in 2015, when a slight reduction in Russian GDP (although accompanied by a sharp devaluation of the rouble) caused a sharp drop in remittances of migrant workers, and this in turn immediately led to budgetary problems in Tajikistan and the Kyrgyz Republic **(Box 2).**

Box 2. Example of a Transmission Channel of Remittances and a Regional Shock

In Tajikistan and the Kyrgyz Republic, a significant share of GDP (about 30%) is remittances of migrant workers. In 2015, their decline relative to 2014 in nominal terms amounted to almost US $470 million in the Kyrgyz Republic (equivalent to 7% of GDP) and about US $1.4 billion in Tajikistan (equivalent to 18% of GDP). The Kyrgyz Republic regained the pre-crisis volume of remittances only in 2017, while Tajikistan has not yet surpassed the previous figures. Because remittances play a key role in maintaining effective demand, their decline slowed the pace of economic growth. To solve this problem, the Kyrgyz Republic and Tajikistan introduced a stimulatory fiscal policy, which resulted in the growth of the budget deficit in the Kyrgyz Republic from 3.6% to 6.9% of GDP, and in Tajikistan from 0.6% to 9.8% of GDP.



Source: national banks and statistical agencies of the Kyrgyz Republic and Tajikistan, calculations of the EFSD.

The relatively calm state of global economy and the rise in commodity prices led to GDP growth in 2017 and 2018, returning to positive territory in all countries of the region. At the same time, in the medium term the heterogeneity and significant volatility of economic growth in the region can be clearly observed. Even in a favourable global economic environment, the majority of the Fund's countries demonstrate a quite high volatility of growth rates. Looking at comparable regions of the world, it exceeds ASEAN and is comparable to the MERCOSUR countries (see Figures 3, 4, 5).

Figure 3. GDP Growth Rates (2010–2018, %), EFSD Region of Operations

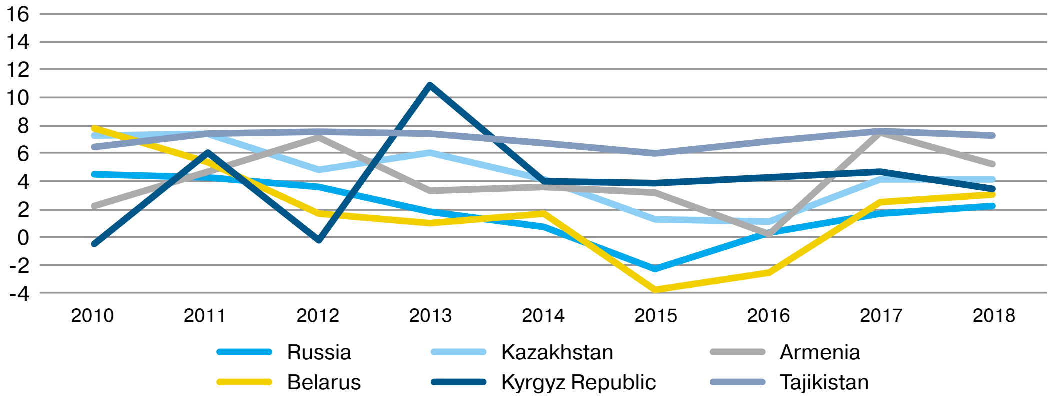


Figure 4. GDP Growth Rates (2010–2018, %), MERCOSUR

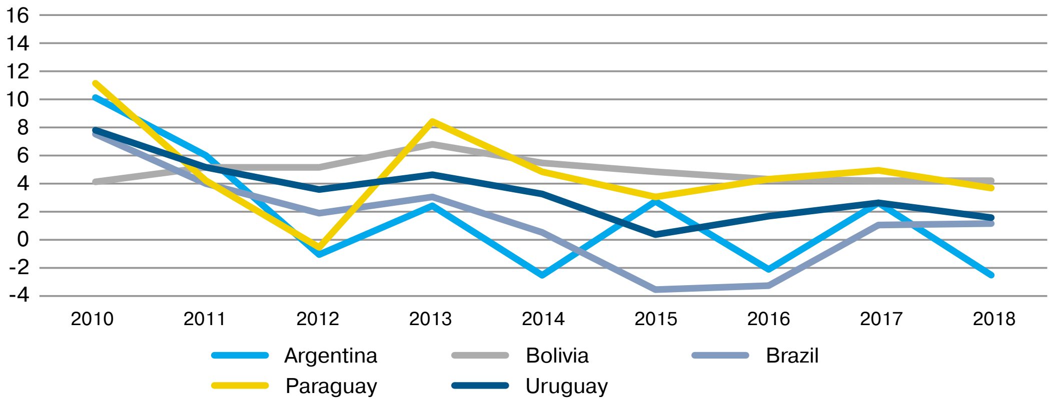
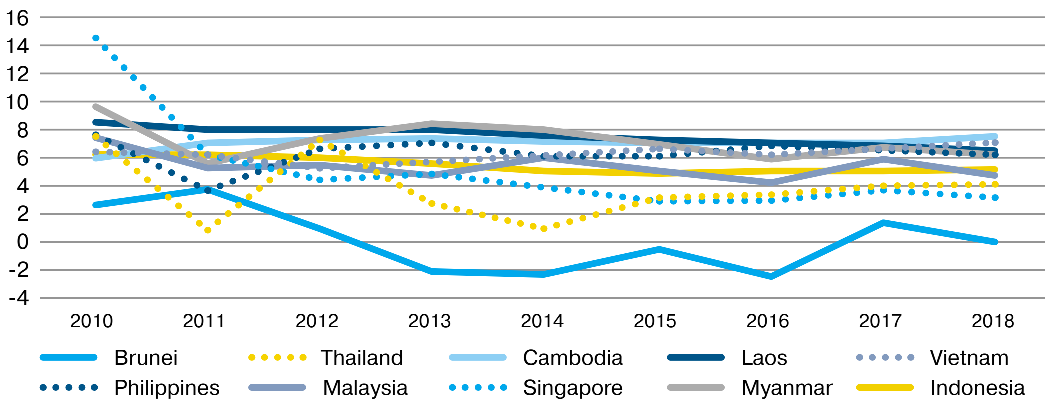


Figure 5. GDP Growth Rates (2010–2018, %), ASEAN



Source: WB data.

(iii) The countries of the region share a common economic and political past. Their economies are closely intertwined, with a multitude of technological connections. This interdependence gradually declines as equipment is modernized and markets diversify (the process is frequently painful and costly). Nevertheless, in practice, there continue to exist thousands of unique productive, technological, and infrastructural connections in engineering, agriculture, light industry, export logistics, etc.

For example, a crucial role is played by the common "1520" railways (so called because of their track gauge in millimetres), common to all the republics of the former Soviet Union without exception, as well as Finland. Meanwhile, the 1435 mm gauge is used in most EU countries and China. Historically, for the enormous land area of Northern and Central Eurasia, railways have been essential, much more than in other regions and countries, due to the lack of alternatives (sea transport can be used only to a limited extent, and rivers flow only meridionally).

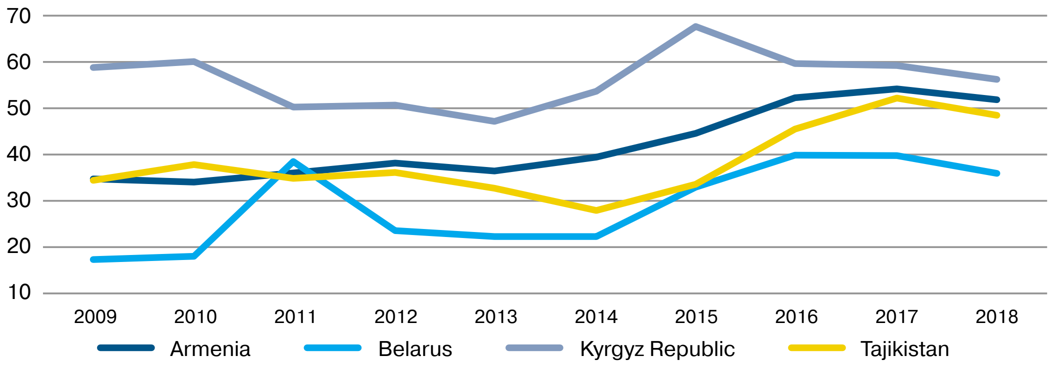
Furthermore, member states are currently participating in the Belt and Road Initiative based on the railway system: investments in railway transport, increased containerization, progress in multimodal transport, realization of the potential for a China-EU route through countries of the EAEU, and construction of high-speed highways. (Vinokurov, 2018). The Belt and Road Initiative should in the future have a noticeable and generally positive impact on the economies of the EFSD member countries, through large investments in infrastructure, logistics, etc., new production niches, and integration in value chains. However, the Belt and Road Initiative has unavoidable limitations and risks. For example, land transit traffic is currently developing through Kazakhstan, Russia, and Belarus, but without affecting other countries that are not along the shortest transit routes (Vinokurov and Tsukarev, 2018). In turn, major investment projects that rely on the incursion of debt raise serious concerns about deteriorating debt sustainability.

There are also close technological ties in the electric power industry. Even during the breakup of the 1990s and 2000s, considerable energy trading volumes existed, largely due to the layout of the preserved Soviet generating facilities. For example, the historically inexpensive coal-fired power plants of the Ekibastuz Basin in northern Kazakhstan partially operate in adjoining regions of Russia. Similarly, power plants on the Volga export energy to the energy-deficient territory of western Kazakhstan. Capital investments in generation and distribution systems are so large that complete autonomy would be difficult to achieve even if desired. Moreover, true energy security, especially for medium-sized power systems, lies in industrial and economic integration with neighbouring states. This helps balance the national power system and serves as an "insurance policy" against emergencies and peak loads. Starting in 2018, work has been under way to restore the Unified Energy System of Central Asia. In 2018, thanks to efforts to organize cross-border electrical connections, Tajikistan, for the first time since 2009, exported about 3 billion kWh to Uzbekistan and Afghanistan. Thus, the prospects are gradually opening up for more efficient and coordinated development of the region's hydropower complex, including water use, sustainable agriculture, and hydropower potential.

These trends create new opportunities for the Fund's member countries, but they also generate potential risks. Under conditions of the unstable growth of the world economy and increased volatility of the global financial markets, the main guideline for the Fund's member countries should be to steer a course towards sustainable development, which means realization of the potential for economic growth while at the same time strengthening the foundations of macroeconomic stability.

One of the key factors is the overall debt burden, both public and private debt. Public debt is low in the largest economies among the Fund's member countries, Russia and Kazakhstan. As at the beginning of 2019, the public debt in these countries was 14.6% and 25.8% of GDP, respectively. Periods of unfavourable external and domestic market conditions, including weak external demand and declining prices for export goods, devaluation of national currencies along with the Russian rouble, as well as a loose fiscal policy, led to an increase in the public debt of the recipient countries of the Fund: Armenia, Belarus, the Kyrgyz Republic, and Tajikistan, in 2009–2018. In Armenia and the Kyrgyz Republic, the public debt to GDP has already exceeded the 50% threshold, reaching 51.4% and 56%, respectively, and in Tajikistan it reached 47.9% (Figure 6).

Figure 6. Public Debt, % of GDP



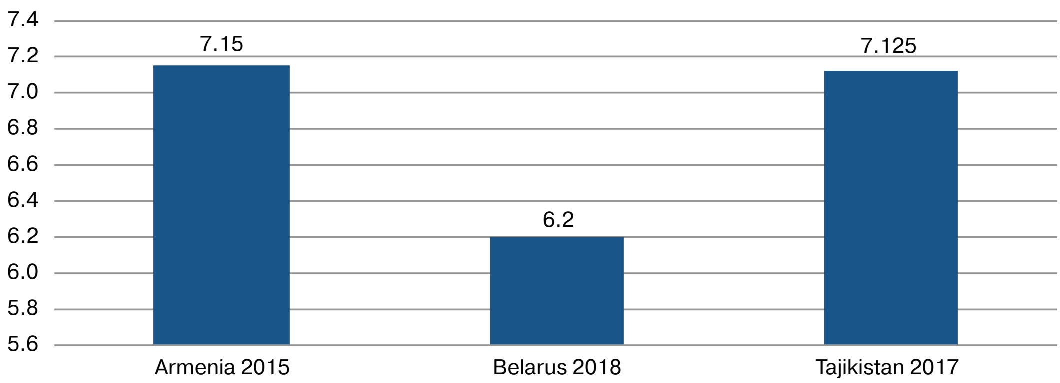
Source: data from the statistical offices of the respective states.

This level of debt is not necessarily a problem: Its structure should be further considered. The significant portion of "cheap" debt from donor organizations in the total public debt reduces the risks.

However, an analysis of the debt dynamics in Armenia, Belarus, the Kyrgyz Republic, and Tajikistan over the past decade points to a number of problems that may have negative consequences for debt sustainability and the economy as a whole. First, there was an increase in the share of less concessional loans and therefore of the cost of debt service in the medium term, which could potentially exert pressure on macroeconomic stability. Second, the large accumulated debt, especially its FX component, reduces the fiscal space, which makes it difficult to implement countercyclical measures. Most of the national debt of the four EFSD countries under consideration consists of foreign currency borrowing. At the end of 2018, foreign exchange liabilities amounted to 85% of the public debt of the Kyrgyz Republic, 81% of that of Belarus, 80% of that of Tajikistan, and 78% of that of Armenia. Third, quasi-fiscal operations in order to support state-owned enterprises lead to an increase in contingent liabilities and the risk of their realization, especially in economies with a significant state role, such as Belarus and Tajikistan (Kurmanaliyeva and Rudakovsky, 2018).

Impairment of debt sustainability can be especially acute in situations of changing investor sentiment and stricter conditions for financing and access to capital markets. These countries' access to global capital markets remains limited, and the cost of borrowing is high (Figure 7).

Figure 7. Interest Rates of 10–12-Year Eurobonds

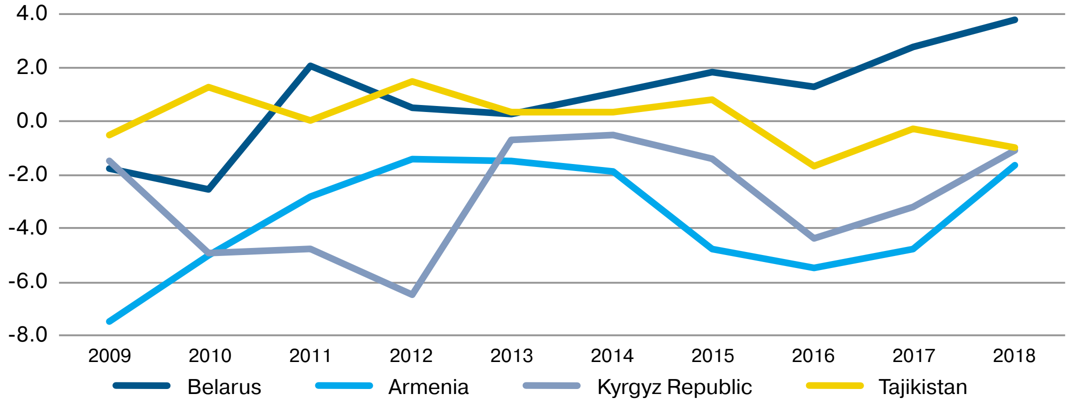


Source: Prospects for the issue of Eurobonds.

Thus, the debt has reached relatively high levels, the possibility of further borrowing is in question for some countries, and the risks of problems associated with refinancing are growing.

Another significant factor affecting macroeconomic stability in the EFSD region is the state of public finances. Mainly it was the high budget deficits of these countries, combined with distinctive features of their fiscal policy, that led to an increase in debt (Figure 8).

Figure 8. Budget Balance, % of GDP



Source: data from the statistical offices of the respective states.

Member states used significant fiscal stimuli to overcome the economic contraction of 2015–2017. All the countries under consideration except Belarus experienced a budget deficit in 2015–2018. Here we should take into account the notable level of quasi-fiscal operations in the individual countries. Only in recent years countries have begun to introduce fiscal rules (except Armenia, which introduced fiscal rules in 2008 with it modification in 2017), including regulating the debt burden in order to limit budget deficits and new borrowings.

Given the trends and risks described above, the main interests of the borrowing countries – Armenia, Belarus, the Kyrgyz Republic, and Tajikistan – with regard to the EFSD are as follows:

- Countries that borrow from the Fund may need support to respond to emerging global and regional threats. Under these conditions, the demand from these countries for the Fund's lending facilities will grow. Since the Fund's main instrument is now and will continue to be budget support loans, obtaining them is the main concern of these countries. These programmes usually include two types of measures and recommendations: (i) stabilization (anti-crisis) measures to support the macroeconomic, fiscal, debt, and financial sustainability of the national economies; (ii) structural and institutional measures and/or reforms that should have a longer-term effect in ensuring sustainable economic growth. Particular attention should be paid to measures and reforms that can have both effects: short-term stabilization and long-term effects for economic growth (Ulatov, Pisareva, Levenkov, 2019).
- Low interest rates on loans (compared to market financing) make it possible to reduce the burden on public finances, to improve credit metrics, and to preserve the ability to finance social spending.
- The Fund's investment loans are a source of long-term and concessional financing for the development of basic infrastructure. There is a great need for such financial resources, since the overwhelming majority of such projects in countries with lower than average budget revenues cannot meet the conditions of commercial lending, and budget funds are strictly limited. Frequently these projects are so capital-intensive (HPPs, roads, etc.) that they require syndication of concessional resources from various donors. In this regard, the Fund's readiness and ability in principle to participate in the co-financing, according to the standards of leading IFIs, is of great importance.

- In the future, it may be of considerable interest to the member countries of the Fund to receive grants from the EFSD for social projects, as well as qualified technical assistance.

It is necessary to emphasize that the Fund is of interest not only to borrowing countries, but also to donor countries (currently, these are Russia and Kazakhstan). They are united by several strategic interests, and the Fund is one of the key instruments for achieving these:

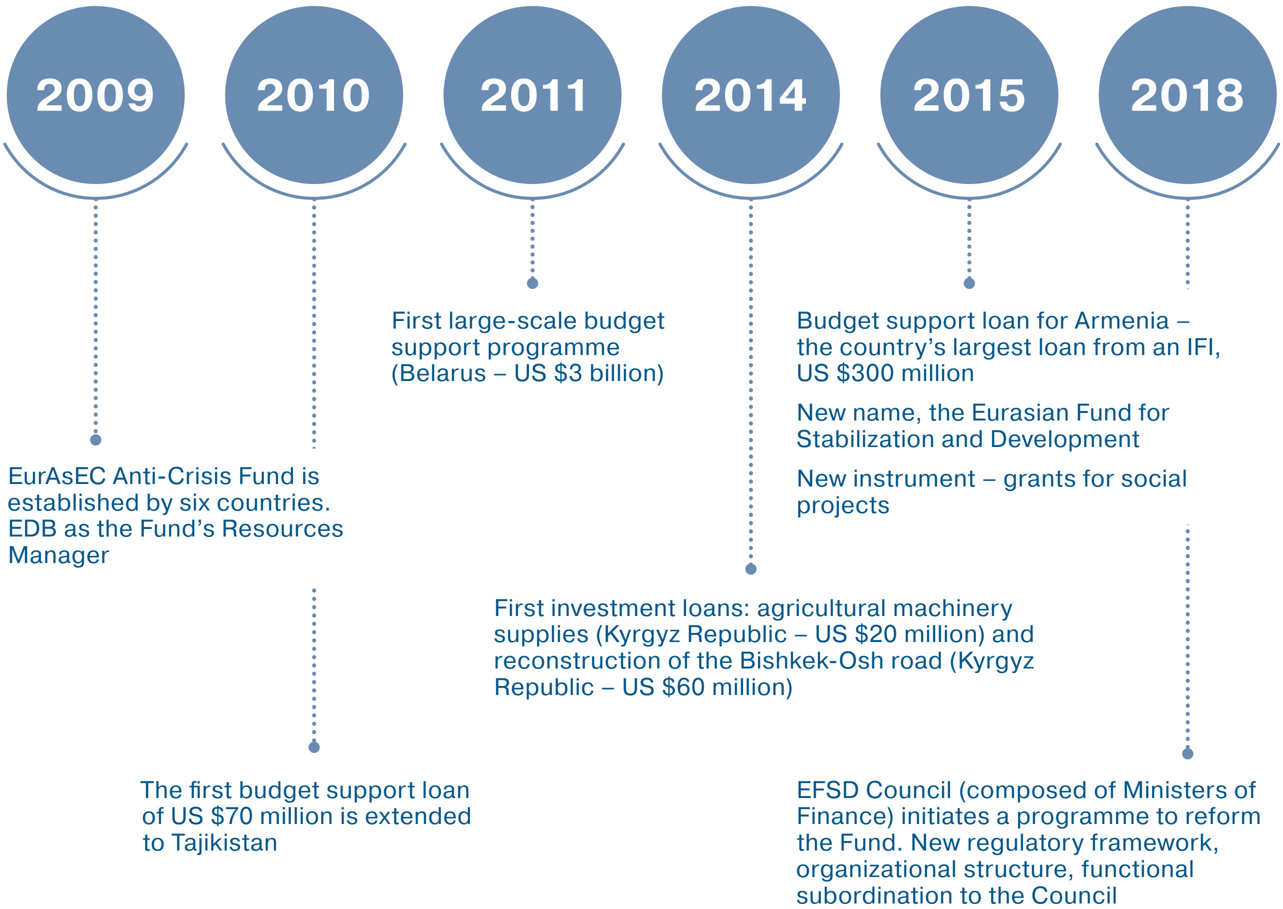
- Both countries are extremely interested in the sustainable economic development of the entire post-Soviet region and Central Asia in particular. Prosperity of the borrowing countries is the best insurance against instability, uncontrolled migration, and the growth of radicalism in the Central Asian region.
- By promoting the development of borrowing countries, donor countries increase the potential for mutual trade and investment.
- The Fund is a reliable and conservative way to use capital and fulfill international commitments to provide development assistance to donor countries.

3. ESTABLISHMENT OF THE FUND AND DIRECTIONS OF ITS FURTHER DEVELOPMENT

The Fund was established at a difficult time for the global economy and was a response to the challenges faced by its member countries.

The timeliness and speed of decision making in the establishment of the Fund are worth noting. The founding states were able to quickly create an effective RFA. The main stages of the Fund's development are shown in Figure 9.

Figure 9. Main Stages of the EFSD's Establishment from 2009 to 2019



In August 2010, the Fund Council approved a loan of US $70 million to the Republic of Tajikistan. Its main purpose was to support budget financing of the country's social sectors amid declining revenues. Budget support was subsequently extended to Armenia, Tajikistan, and Belarus (twice). These support programmes were aimed at achieving macroeconomic stability and creating conditions for the borrower countries to embark upon a sustainable growth trajectory, through improving economic policies and putting into effect the necessary structural transformations.

The development of investment financing was a new milestone in the history of the Fund. In 2014, the EFSD Council approved the first investment loan. Among the Fund's investment projects were construction of the North-South Road Corridor in Armenia, rehabilitation of the Toktogul HPP, and commissioning of the second hydraulic unit of the Kambarata HPP-2 in the Kyrgyz Republic, the rehabilitation of the Nurek HPP in Tajikistan, etc. (see the section "EFSD Operational Activities").

In 2015, a new grant instrument was developed to support projects in such social areas as health care, education, good governance, social security and protection, including food security.

Analysis of the international experience of the evolution of international organizations, including financial ones, indicates that they can be given new tasks and functions over time, up to and including dramatic changes in their official mandate (Vinokurov and Libman, 2017). In the case of the EFSD, in 2014–2015 the mandate was supplemented by a new function for lending to major, systemically important infrastructure projects. However, the Fund's principal function remained lending to support the budget and the balance of payments. At present, the EFSD is the only RFA that has a dual mandate aimed at both macrostabilization and development financing, due to its members' desire to comprehensively accomplish long-term development tasks.

The Fund supports many of the Sustainable Development Goals adopted at the UN Summit in September 2015. Goal 1: No poverty; Goal 3: Good health and well-being; Goal 7: Affordable and clean energy; Goal 8: Decent work and economic growth; Goal 9: Industry, innovation, and infrastructure; Goal 10: Reduced inequality; Goal 17: Partnerships for sustainable development.

Time has shown that the EFSD has the potential for development and is in demand in the region of operations. In recent years, there has been a notable increase in the risk of negative shocks. To be able effectively to counter them, the Fund Council initiated administrative transformations of the EFSD. These changes are aimed at institutional development of the Fund through improving the quality of interactions with shareholders and development partners; improving the effectiveness of operations; defining priorities; building up industrial and sectoral expertise; and development of EFSD research activities.

The effectiveness of the EFSD's work depends on the depth of its understanding and analysis of the national economies and needs of the member states. Without adequate understanding of the micro- and macroeconomics of the borrowing countries, it is impossible to design a realistic and useful country programme under the auspices of a budget support loan. In turn, without an understanding of trade ties and commercial arteries within a country, the distinctive functioning of various sectors of a particular country, serious errors can be made when financing large infrastructure projects. The research function is an independent instrument in the activities of a modern IFI. This makes it necessary for the Fund to build up its own research capacity to improve the quality of its lending, its public research in the Fund's area of specialization, and its further provision of technical assistance to member states in the research domain (Annex 3).

In 2018, implementation of administrative transformations began **(Box 3).**

Box 3. The EFSD Project Unit in the EDB Structure

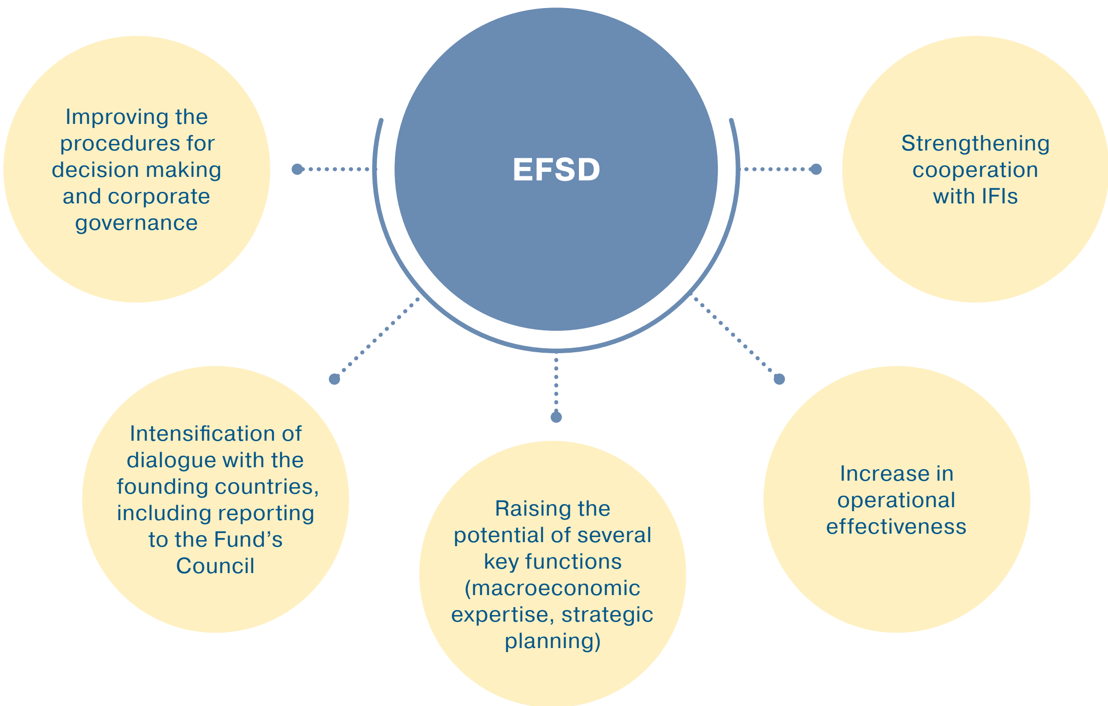
The EFSD Project Unit was reformed in 2018, absorbing the previously existing project groups on financial and investment loans, as well as the division of Project Support and Planning; the staffing table was expanded; dialogue with the founding countries about the Fund's strategic priorities and the quality of its portfolio was significantly intensified, as well as work to improve existing and create new internal regulatory documents.

The EFSD Project Unit relies on the EDB, in its role as the Fund Manager, for a significant portion of its key functions. Notable among these are financial transactions, treasury operations, legal support, HR management, compliance monitoring, risk management, accounting, and auditing.

It should be noted that the model of the EFSD's activity is fundamentally different from that of the EDB. While the EDB works with corporate clients and finances commercial projects, the EFSD works exclusively with sovereign states and finances non-commercial projects. The Fund's model also differs in its fundamental goals. The Fund's ultimate goal is to prevent financial/economic crises in the participating states and, if crises occurs, to minimise their negative consequences for the national economies.

By the end of 2019, the medium-term EFSD Development Strategy is expected to be finalized; it will include key areas of focus for transformation of the Fund (Figure 10), and will combine the accumulated experience of the Fund and best practices of existing IFIs.

Figure 10. Some Objectives of the EFSD Administrative Reform



4. THE EFSD'S PLACE AND ROLE IN THE GLOBAL FINANCIAL SAFETY NET

The GFSN has grown considerably over the decade since the global financial crisis of 2008–2009. The data shows that an impressive amount of short-term liquidity has been available through the GFSN – US $12.8 trillion, which is about 15% of world GDP (Kring and Gallagher, 2019). An additional US $6 trillion is available for financing development through various mechanisms, including all the development banks. A clear trend of the last two decades is that 63% of the growth in short-term liquidity and more than 90% of the growth in capital available for financing development has come from emerging economies. More than three-quarters of this capital, however, is at the national level (international reserves, BSAs, and national development banks). Less than a quarter of the available capital is concentrated at the levels of BSAs, RFAs, and the IMF.

The IMF traditionally plays a leading role in the GFSN, having the task of ensuring the stability of the international monetary and financial system and providing foreign exchange liquidity in the event of temporary difficulties in financing balance of payments deficits.

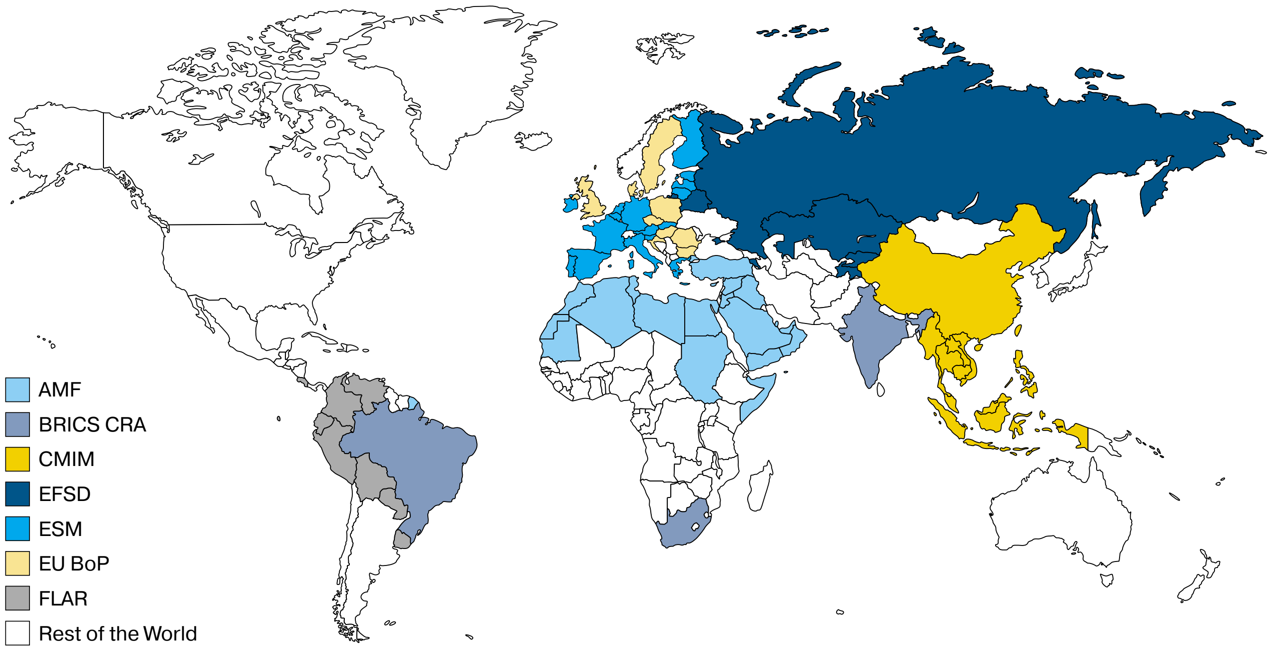
Each of the other layers of the GFSN is important in its own way in overcoming and preventing financial crises.

International reserves are a country's own resources, which can be used without any conditions or repayment obligations and are considered a means of self-insurance. The volume of international reserves began to grow very rapidly after the Asian financial crisis; since the beginning of the 1990s, emerging markets have doubled their reserves in percent of GDP (IMF, 2016). In fact, the international reserves of individual countries are the largest component of the GFSN. Total gold and foreign currency reserves rose from US $6.5 trillion in 2005 to just under US $11.6 trillion in the first quarter of 2019, according to COFER data (Currency Composition of Foreign Exchange Reserves). Thus, the existence of a significant buffer in the form of international reserves, combined with responsible macroeconomic policies, is an important indicator of a country's stability in the face of a crisis.

BSAs are the next layer of the GFSN. These are agreements between central banks that allow a recipient central bank to receive financing in foreign currency from another central bank for a fee. BSAs were used extensively during the global financial crisis between central banks that were issuers of reserve currencies and central banks of other advanced economies and several emerging-market economies.

Increased interconnections among countries have led to an accelerated spread of systemic risks and reduced the effectiveness of countries' internal protective mechanisms (IMF, 2013). Thus, the importance of the third layer of the GFSN increased. During the decade after the global crisis, the regional component of the GFSN increased due to the "new" RFAs by US $1.1 trillion, and coverage expanded to 43 countries. The RFA "family" currently includes eight arrangements: the Arab Monetary Fund (AMF), the BRICS Contingent Reserve Arrangement (BRICS CRA), the Chiang-Mai Initiative Multilateralisation (CMIM), the Eurasian Fund for Stabilization and Development (EFSD), the EU Balance of Payments Facility (EU BoP), the European Financial Stabilisation Mechanism, the European Stability Mechanism (ESM), and the Latin American Reserve Fund (FLAR). The international community has noted the uneven coverage of the GFSN (RFA Joint Staff, 2018). This pertains especially to the countries of Latin America and Sub-Saharan Africa (Figure 11).

Figure 11. Geographic Coverage by Various RFAs



Source: RFA Joint Staff (2018).

However, when this choice exists, the question arises: how to choose the optimal variant? In the framework of the Global Network as a whole, and the use of RFAs in particular, there is both complementarity and competitiveness (see especially Henning, 2019). In the academic literature and practical deliberations by representatives of the IFIs, there is a lively discussion of the pluses and minuses of the current state of affairs. Relative consensus has been achieved on three points. First: The heterogeneity and diversity within the GFSN is an established fact: New levels and elements appear and develop. Second: In the current state of affairs, there are advantages, associated with de-monopolization and increasing liquidity (Grabel, 2019), as well as disadvantages (non-optimal competition, non-optimal or non-existing mechanisms for cooperation). It can be said that alternative sources of resource supply have emerged in the GFSN, which, generally speaking, is good for borrowing countries, but this may reduce the overall efficiency of the use of financial resources. Third, there is a need to design and introduce various mechanisms for cooperation, coordination of positions, and operations at various layers of the GFSN, with the aim of improving its effectiveness (G-20 Eminent Persons Group).International practice shows that RFAs are usually created in response to crises. The FLAR in Latin America and the AMF in North Africa and the Middle East were founded in response to the volatility of capital flows and the debt crises of the 1970s and 1980s, respectively. The Chiang-Mai Initiative (CMI), an agreement to provide bilateral swap lines, was founded in response to the need for countries in the East Asia region to have their own RFA after the Asian crisis of 1997–98.

The Arab Monetary Fund, which was one of the first RFAs, has provided about US $10 billion in loans to its member states since its inception. Approximately 60% of the committed funds accounted for balance of payments support programmes (AMF, 2018). In recent years, the focus has shifted towards loan programmes for support of structural reforms. As for the FLAR, it plays a large anti-crisis role in its region. Currently, it is operating loan programmes in Venezuela and Costa Rica to the sum of US $1.485 billion.

After the 2008–2009 global financial crisis, the development of the RFA "family" received a new impetus. The reason was not only the financial crisis, but also the lack of progress in reforming the Bretton Woods institutions and strengthening the voice of the emerging economies in them. In 2009, the EFSD was established (at that time it was called the EURASEC Anti-Crisis Fund). In 2010, the Chiang-Mai Initiative (a network of BSAs) was reformatted into the Chiang-Mai Initiative Multilateralisation (CMIM). And, most importantly, in 2010 the European Financial Stability Facility was created, the successor of which in 2012 became the European Stability Mechanism, with enormous resources at its disposal. In 2014, the BRICS Contingent Reserve Arrangement (BRICS CRA) was formed (Table 2).

Table 2. RFAs Established or Institutionalized After 2008

	EFSD	EFSM and ESM	BRICS CRA	CMIM
Year founded	**2009**	**2010 and 2012**	**2014**	**2010**
Members	6 (Armenia, Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan)	19 (Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, Spain)	5 (Brazil, Russia, India, China, South Africa)	13 (Brunei, Cambodia, China, Indonesia, Japan, Korea, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam)
Volume, billions USD	9.1	786.45	100	240
Size, % of members' aggregate GDP, 2018	0.5%	5.8%	0.5%	1%
Borrowing on capital markets	No	Yes	No	No
Average amount issued in 2010–2018 to each state borrower, % of 2018 GDP	3%	29%	–	–
Average amount issued in 2010–2018 per capita of each borrowing country in 2018	190	7254	–	–
Members represented by	Ministries of Finance	Ministries of Finance	Ministries of Finance and central banks	Ministries of Finance and central banks
Types of financing	Loans, financial support, investment loans, grants	Primary: loans to support macroeconomic reform programmes and indirect recapitalization of banks	Swap lines	Preventive and to overcome the crisis
Pre-qualification conditions	No	No	No	Yes

Sources: ESM, AMRO websites, WB data, World Economic Outlook data, EFSD.

RFAs differ with respect to their purpose and set-up, their surveillance capacity and the conditions under which they disburse financing. Some agreements provide lending instruments that are suitable for solving various financial problems, such as those of the ESM, FLAR, and AMF. Other agreements involve establishment of BSAs when a member country stands in need of foreign currency. In the first case, foreign exchange reserves usually serve as a source of financing, and in the second, funds from the state budget, in some cases with the attraction of funds borrowed from the capital market. The majority of RFAs require countries to meet certain macroeconomic conditions for obtaining financial support, at least in cases where the amount exceeds a predetermined limit. The lending capacities of RFAs also differ substantially. (ECB, 2016).

The increased importance of BSAs and RFAs has enabled countries to choose among sources of financing. That became a cause for concern for the international community, since the borrower faced a complex choice between the terms of financing from different sources (ESM, 2016). In 2011, the Group of 20 agreed on general principles of interaction between the IMF and RFAs, with the objective of directing their efforts in a single direction, while preserving a balance between the consistency of approaches and the flexibility of the institutions.

Since 2016, RFAs have held annual high-level meetings to coordinate the work of the GFSN. In 2017, this goal was reflected in the Hamburg Action Plan of the Group of 20, as part of an initiative to strengthen the GFSN.

In 2017, an IMF strategic document identified six operational principles (independence, compliance with the mandate and technical expertise, early and ongoing cooperation, consistency, evenhandedness, and adherence to the Fund's preferred creditor status) and three role distribution formats (formalized, lead agency model, interconnected programmes) for working with RFAs (IMF 2017).

In turn, RFAs have developed a collaborative approach that offers a certain level of formalization of relations with the IMF in such areas as institutional capacity building, information sharing, and training. RFAs generally supported the IMF's approach, which can be considered the starting point in the creation of a regulatory framework for a system of interaction between the RFAs and the IMF (RFA Joint Staff, 2018).

The metaphor of a fire brigade is a useful one to describe the activities of the IMF and the RFAs. It is no coincidence that one of the most frequently cited articles in discussions on the GFSN is that of (Orszag and Stiglitz, 2002), about how to determine the optimal size of a fire brigade by mathematical analysis. There are a number of parallels here. The main thing, of course, is that it does not pay for every individual house to have its own fire brigade. In addition, fire spreads from house to house, which is an analogue of market contagion, when a crisis is passed from country to country (for example, the 1997 currency crisis in Southeast Asia; in the context of the EFSD, it is primarily the shock waves extending from Russia to smaller economies of the region) (Scheubel and Stracca, 2016). And, to develop the metaphor, fire prevention (in our case, encouraging states to maintain sound macroeconomic, fiscal, and debt policies) is much more effective than extinguishing fires (pouring in liquidity during a financial crisis).

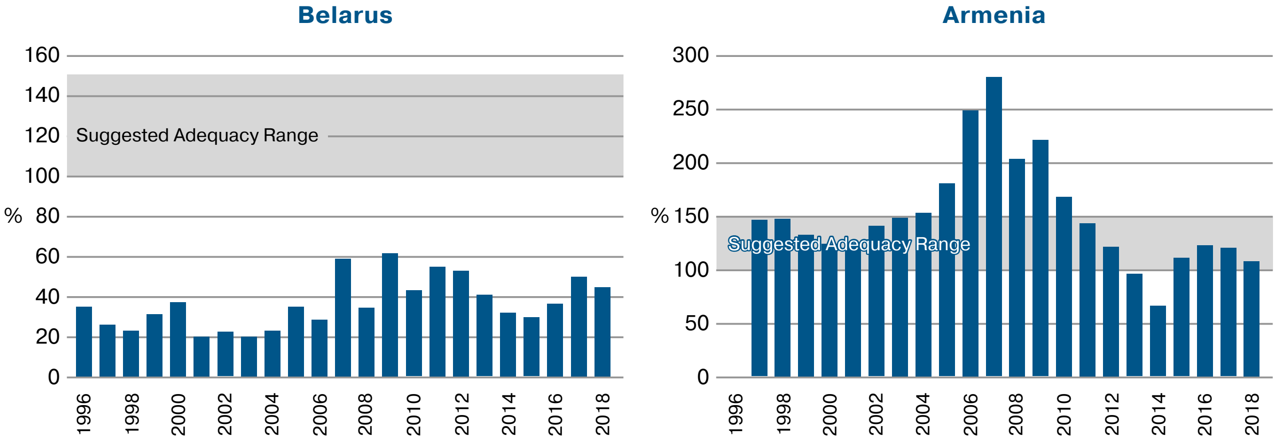
Following this metaphor, the EFSD is "Eurasia's fire brigade," and its ultimate goal and the most important criterion of the effectiveness of its work is not the effective extinguishing of fires, but their absence. The EFSD is unique among all other RFAs in its integrated approach, which involves macrostabilization and financing development. This is due both to the specifics of the long-term development objectives of the countries of the post-Soviet space and the deep interconnection of stabilization and development issues in the Fund's region of operations (Ulatov, Pisareva, Levenkov, 2019).

After the 2008 global financial crisis, two RFAs were most intensively used to prevent regional instability: the ESM during the sovereign debt crisis in the Eurozone, and the EFSD. In 2018, the size of the EFSD compared to the combined GDPs of the recipients of funds reached 10%, whereas for the ESM this figure was 34%. Furthermore, the accumulated funds disbursed to the borrowing countries was an average of 3% of their GDPs, while for the ESM the figure was 29%.

The establishment of the Fund in 2009 was an important and necessary step in the development of the region's financial architecture. The international reserves of the four countries that borrowed from the Fund in 2010–2018 averaged 2.4 months of imports of goods and services. This is insufficient to effectively withstand crisis shocks. If necessary, the Fund's resources, corresponding to an additional

1.1 months of imports, can boost the reserve position of these countries. For example, Belarus and Tajikistan have small international reserves. Armenia's international reserves at different periods of time also turned out to be lower than the IMF's ARA metrics (Figure 12); the economy of the Kyrgyz Republic, in turn, is dependent on the size of remittances (see also Box 2 in Section 2).

Figure 12. Reserve Adequacy (ARA Metric)



Source: IMF data.

Note: The ARA metric is a combined metric of the adequacy of reserves based on the IMF's formalized model. It characterizes the adequacy of reserves for various indicators, including coverage of imports and broad money etc. See the link[1] for more information.

Coverage of the second layer of the GFSN in the form of BSAs is also limited in the borrower states, and the terms for their allocation are not always transparent. For example, the volume of BSAs in yuan from the Chinese People's Bank is equivalent to US $1 billion for Belarus, US $150 million for Armenia, and US $450 million for Tajikistan (McDowell, 2019). BSAs are used primarily to support trade between countries.

All of this signifies the great importance of the third layer of the GFSN, which is the EFSD for the region of its operations. In mid-2019, the Fund's ability to extinguish and prevent "fires" amounted to US $5.4 billion (6.4% of the aggregate GDP of the four borrowing countries).[2] This is equivalent to 83.5% of the total access of these countries to IMF resources conditions under normal access,[3] or 1.1 months of their imports of goods and services in 2018.

We may assume that in the event of a relatively mild regional shock, the EFSD can be effective on its own. This conclusion is supported by IMF calculations about RFAs overall (IMF, 2017). In the case of global shocks, similar in strength and coverage to the 2008 crisis, the Fund's support can become part of an effective response to crisis events for its borrowing countries, in cooperation with the IMF and other elements of the GFSN.

---

[1] https://www.imf.org/external/np/pp/eng/2016/060316.pdf

[2] The total amount of funds remaining to be paid on promissory notes issued in the initial contributions to the Fund, and temporarily idle resources, net of outstanding commitments under the signed loan and grant agreements.

[3] For example, as part of agreements for stand-by loans and extended arrangements. Extraordinary access mechanisms used during the European debt crisis are much larger and can exceed 1,000% of the country's quota at the IMF.

EFSD instruments combine features of IMF and WB products, in order to adequately reflect the needs of the Fund's member states (Table 3). This is possible because unlike global IFIs, the EFSD is a regional player, and of its six member states, four are recipients of funds. Over time, the programmes supported by the EFSD are becoming more comprehensive, and, as a result, longer-lasting, and conditionality is of an ex-post character. The EFSD programmes, like those of the IMF, imply indicative and obligatory conditions. That is critical to the successful implementation of the programme.

Table 3. Comparison of IMF, EFSD, and WB Instruments

	IMF	EFSD	WB
Support of the balance of payments/structural reforms	Emphasis is on support of the balance of payments	Support of the balance of payments and structural reforms	Emphasis is on support of structural reforms
Non-financial instruments	Yes	No	Yes
Duration of programmes	Emphasis on short-term programmes	Short-term programmes	Medium-term programmes and ex-ante
Conditionality	Ex-post and ex-ante; recently the emphasis has shifted to ex-ante	Ex-post	Ex-post and ex-ante
Project financing	No	Yes	Yes

Source: EFSD Project Unit.

The partnership between the IMF and the EFSD functions through informal consultations on macroeconomic policy and reforms that were supported by EFSD programmes. To avoid repetitive or contradictory macroeconomic recommendations, the EFSD has concentrated on structural reforms if there was an active IMF programme (such as the programme in Armenia in 2015–2017). Considering that the IMF is increasingly involved in issues of structural transformation, the EFSD also consults with it on this matter. It should also be noted that in the context of structural reform measures, a dialogue is maintained with development institutions such as the WB and the ADB, to harmonize possible measures and reforms that have been supported by EFSD loans.

5. OPERATING ACTIVITIES

By mid-2019, the Fund's portfolio comprised 15 projects with accumulated financial commitments of US $5475 million[4], of which 90% were loans for budget support (Figure 13).

Budget support loans disbursed by the EFSD helped to eliminate the deficit of external financing of the member states, which corresponds to the general trends of the international financial architecture, whereby the role of RFAs has increased significantly over the past ten years.

The portfolio structure corresponds to the principal task of the EFSD: maintaining the macroeconomic stability of the member states. The predominance of budget support loans in the portfolio is due to two large loans to Belarus with a total value of US $4.56 billion (Figure 14).

Figure 13. Portfolio Structure

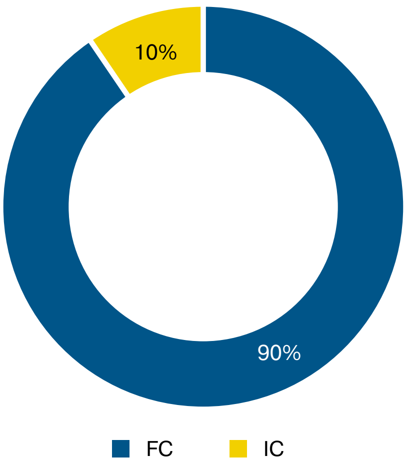
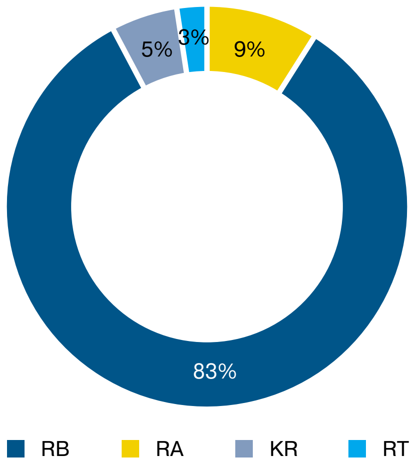


Figure 14. Portfolio Geography



Note: financial liabilities approved by the EFSD Council by the cumulative as at mid-2019; FC ('financial credits') – budget support and BoP support loans; IL – investment loans; RA – Republic of Armenia, RB – Republic of Belarus, KR – Kyrgyz Republic, RT – Republic of Tajikistan.

Source: EFSD Project Unit calculations

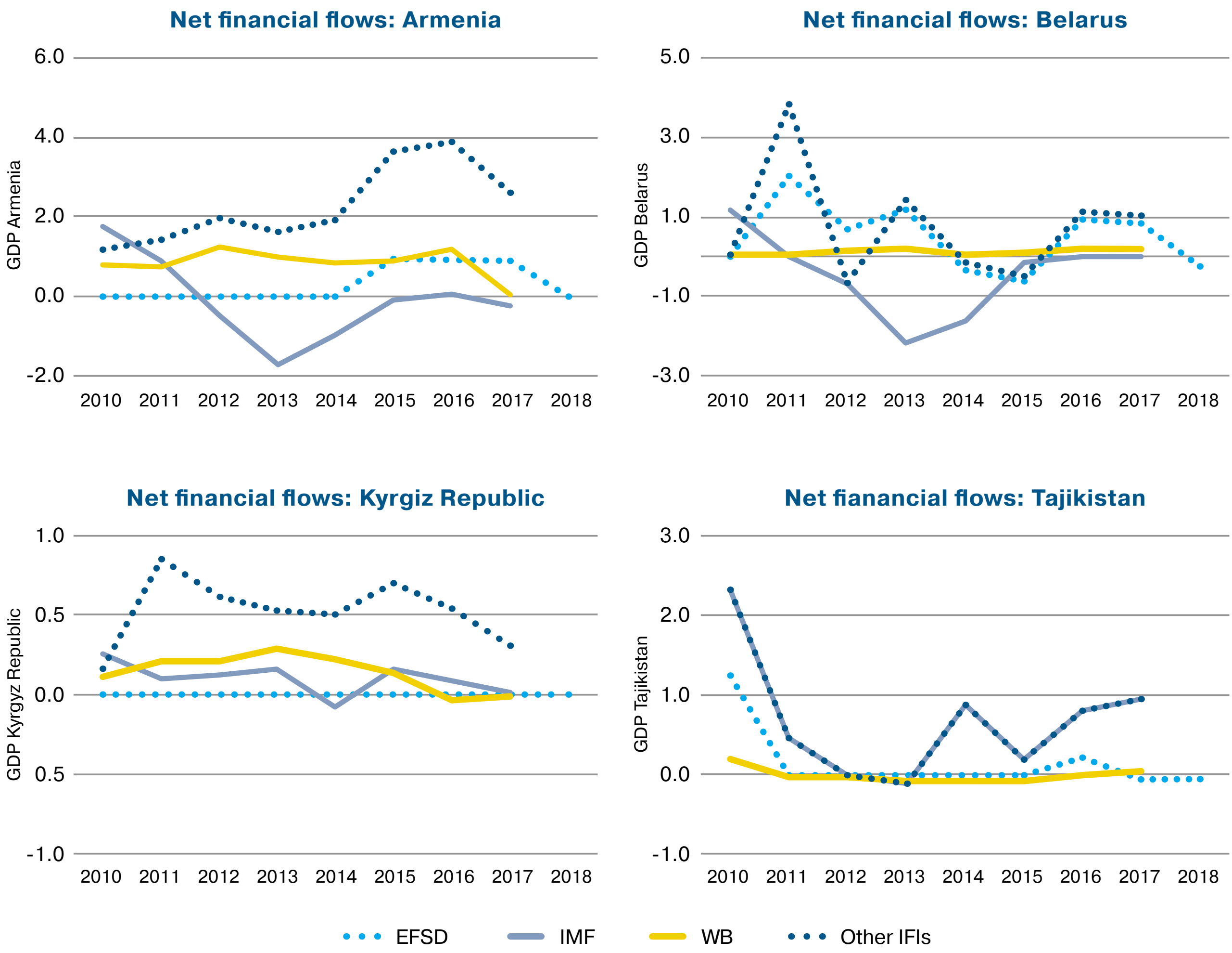
The objectives of providing budget support loans to maintain macroeconomic stability (support for the balance of payments and the budget) and to ensure sustainable development (support for structural and institutional transformations).

An important condition for a loan is a guarantee that measures included in the funded programme will achieve macroeconomic stability and improve the business climate of the borrowing state, and ensure long-term development as well as fiscal and debt sustainability.

[4] The total amount is made up of commitments for all financial credits, investment loans and grants approved by the EFSD Council, including undisbursed amounts and closed projects, net of debt repayments of previous periods.

The EFSD has made a material contribution to the external financing of the four recipient states. During 2010–2018, the Fund provided about one fifth of all the funding they received from all IFIs, on a net basis (Figure 15). The net flows from the EFSD to these four countries are comparable to the WB's financing (0.28% of the total GDP of the four borrowing countries from the EFSD and and 0.27% from the WB for 2010–2017).[5]

Figure 15. Net Flows



Note: according to OECD DAC methodology net financial flows are disbursements minus principal repayments relation to GDP.

Source: EFSD Project Unit calculations on WB data.

Programmes in Belarus dominated in EFSD budget support **(Box 5)**, which since the beginning of the Fund's activity has attracted funding in the amount of 7.7% of GDP, or US $461 per capita. In Armenia (**Box 5)** and Tajikistan, these figures were several times lower. No budget support loans were provided to the Kyrgyz Republic.

[5] Data from the WB and other IFIs are available through 2017.

Box 5. Budget Support Loans to the Republic of Belarus and Republic of Armenia (see Annex 1)

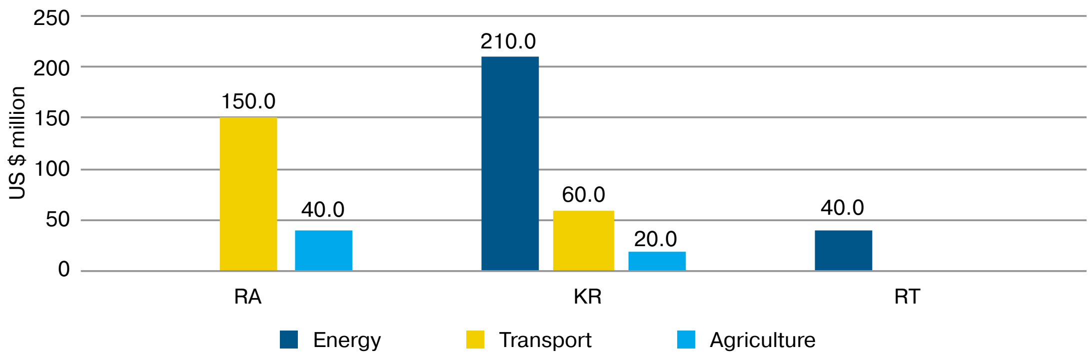
In 2011, a chronically high current account deficit in the context of an unbalanced policy of stimulating domestic demand led to depletion of the international reserves of the country, which provoked a FX crisis. The EFSD Council approved US $3 billion financial assistance to the country in six tranches for a Reform Programme coordinated with the country's authorities. The Reform Programme was primarily aimed at ensuring macroeconomic stability amid remaining imbalances and structural constraints through tightening monetary and fiscal policies and pursuing a more flexible exchange-rate policy.

In 2016, the recession in Belarus led to a reduction in budget revenues and international reserves. The Fund Council decided to provide a second round of financial aid to the country for budget support in the amount of US $2 billion in seven tranches during 2016–2019, subject to implementation of the relevant measures of the Reform Programme. The programme's measures can be divided into two sections, one concentrated on macroeconomic stabilization, and the other on structural reforms to increase the efficiency and competitiveness of the Belarusian economy. One of the main results of the programme was a significant strengthening of macroeconomic stability.

In 2015, the regional crisis had a negative impact on the revenue part of the Armenian budget. At the same time, the need grew to increase budget spending in order to stimulate the economy and to support socially vulnerable strata of the population. The EFSD provided the country with US $300 million to bridge the fiscal gap in the medium term. The Reform Programme, supported by the EFSD loan, was aimed at increasing the country's ability to withstand external shocks through more efficient management of public finances, improving the business climate, and strengthening the banking sector. In order to achieve the stated objectives, the Government of Armenia and the EFSD agreed on a matrix of measures, the fulfilment of which was the condition for release of the loan funds in three equal tranches in 2015–2017.

Investment loans are provided to EFSD member states that are carrying out interstate investment projects which stimulate integration among member states – for example, in energy and infrastructure – and also large national investment projects. A mandatory condition for investment financing from the EFSD is the impossibility of attracting market financing for the project in full, on terms that are reasonable for the needs of the project and at an acceptable level of risk. Two sectors, transport and energy, account for almost 90% of the cost of investment loans in the Fund's portfolio (Figure 16).

Figure 16. Investment Loans by Country



Note: Financial liabilities are cumulative as at mid-2019.

Source: EFSD Project Unit calculations.

EFSD involvement in infrastructure financing has a certain internal logic, which we illustrate with the example of the Kyrgyz Republic. Most IFIs, having started work in the region in the 1990s, prefer to approach the situation from a "clean slate." The EFSD, however, was established by the states of the region, which look at the situation from the inside and share a common history. In Soviet times, the Kyrgyz Republic was an industrial-agrarian economy with powerful scientific, technical, and educational potential. It was closely connected with its neighbours by railways, the common Central Asian energy system, water flow regulation, and thousands of production chains. Deindustrialization and the rupture of connections in the 1990s-2000s turned the country into practically an agrarian economy. Basic energy and transport infrastructure deteriorated. Therefore, the first and principal challenge is the creation of the prerequisites for economic growth. The EFSD's first investment project in the country was the financing of supplies of agricultural machinery in order to increase returns on production in rural areas. The second project, participation in reconstruction of the Bishkek-Osh road, was associated with the collapse of Soviet transport connections. Historically, the southern and northern districts of the Kyrgyz Republic were connected through Uzbekistan. A good new road between the capital and Osh is currently necessary for the country's economic integrity. The third and fourth projects were the rehabilitation of hydropower: the Toktogul and Kambarata HPPs. At the current stage of development and with current profitability, money should be invested specifically in rehabilitation, not in the construction of new HPPs.

A number of projects are being implemented with the participation of IFIs, such as co-financing, with the ADB, of rehabilitation of the Toktogul HPP in the Kyrgyz Republic (**Box 6)** and construction of the North-South Road Corridor in Armenia (**Box 7)**.

Box 6. Rehabilitation of the Toktogul HPP

In 2015, the EFSD Council approved financing for the second phase of the project for rehabilitation of the Toktogul HPP, in the amount of US $100 million. The ADB provides US $110 million in co-financing. The project will comprehensively modernize the hydropower plant, with the following results: increased reliability and stability of the power supply and a greater supply of electricity to the population; increased energy security and sustainability of the country's energy system; growth of the Kyrgyz Republic's export potential through export of surplus electricity to other EFSD members; an improved balance of payments; and a decrease in the severity of winter electricity shortages.

Box 7. North-South Road Corridor

In 2015, the EFSD Council approved the signing of an agreement on the financing of a project to build a North-South Road Corridor. The project involves reconstruction of the transport corridor in the context of the comprehensive investment project for "Construction of the North-South Road Corridor." The North-South Road Corridor connects Central Asia and India with Iran, Georgia, Russia, and Europe. Crossing Armenia from south to north (Meghri-Kapan-Goris-Yerevan-Ashtarak-Gyumri-Bavra), the corridor from the south joins the Georgian road leading to the Black Sea ports of Poti and Batumi and on to Russia, the CIS countries, and the European Union. The North-South Road Corridor is also part of the AH 82 international road linking the Central Asian countries. The integrated project will improve Europe-Caucasus-Asia communication at the point where Western Asia joins Eastern Europe.

Grants are a new type of financing for the Fund, intended for countries with a relatively low per capita income among the Fund's member states. The EFSD is prepared to provide up to a tenth of its net profit to support national projects in such social sectors as health care, education, social security (including food security), and the efficiency of public service.

6. DEVELOPMENT OF A NETWORK OF INTERNATIONAL PARTNERSHIPS

Developing and strengthening partnerships with IFIs has been a strategic goal of the EFSD since its establishment.

The cooperation priorities for the Fund are:

(i) Active participation of the EFSD as a member of the GFSN in strengthening and developing a network of partnerships on the global level (IMF, WB), regional level (RFAs), and country level (donor clubs). The Fund works with “donor clubs” in three member states: the Kyrgyz Republic (Development Partners Coordination Council), Tajikistan (Donor Coordination Council), and Armenia (Donors coordination). EFSD representatives participate in high-level conferences of RFAs and the IMF, as well as in RFA Research Seminars. Such conferences and events are an important platform for the development and strengthening of the GFSN.

(ii) Opening of new project opportunities, such as parallel and contractual co-financing with other IFIs. International cooperation with a number of organizations is already substantive and material (Figure 17). First of all, there is co-financing of development projects with the ADB in the Kyrgyz Republic (Toktogul HPP, Uch-Kurgan HPP, Bishkek-Osh road) and Armenia (North-South Road Corridor), and with the WB in Tajikistan (Nurek HPP) and also Armenia (modernization of the irrigation system). The Asian Infrastructure Investment Bank (AIIB) is also a partner in the Nurek HPP project.

(iii) Development of the EFSD’s potential and the quality of its macroeconomic expertise through regular consultations during country missions, dialogue among macro- and sectoral economists, mutual training programmes and internships, as well as the preparation of joint research papers.

(iv) Coordination of actions in the Fund’s member countries, including joint implementation of programmes and projects. Partnership with the IMF is especially important for the EFSD, considering that IMF programmes and criteria have a significant overlap with the Fund’s priorities and principles regarding budget support loans. Partnerships with the WB and the ADB are no less important for the EFSD, primarily through joint infrastructure projects.

(v) The use of best practices to harmonize standards and environmental and social responsibility policies with the regulations of leading IFIs.

Figure 17. Investment Loans: Fruitful Cooperation with the ADB and WB

- The Fund follows IFI policies & procedures on disbursement, social and environmental safeguards, and financial management)
- ADB: productive cooperation in Kyrgyzstan (Toktogul HPP, Uch-Kurgan HPP, Bishkek-Osh road) and Armenia (North-South Road Corridor)
- WB: productive cooperation in Tajikistan (Nurek HPP) and Armenia (irrigation system modernization)

The priorities in the EFSD's international cooperation will be enshrined in the medium-term strategy of the Fund, which is currently under development.

REFERENCES

AMF (2018) Annual report. Abu Dhabi, U.A.E. Available at https://www.amf.org.ae/sites/default/files/econ/annual%20reports/%5Blanguage%5D/Annual%20Report%202018.pdf

ECB (2016) The Layers of the Global Financial Safety Net: Taking Stock. *Economic Bulletin,* 5.

EFSD (2009) *Polozhenie ob Antikrizisnom fonde Evraziiskogo ekonomicheskogo soobshchestva [Statute of the Anti-Crisis Fund of the Eurasian Economic Community]* Available at: https://efsd.eabr.org/upload/iblock/66b/66b99846f3b694924dc600972e4fab31.pdf

ESM (2016) *The Global Financial Safety Net through the Prism of G20 Summits*. ESM: Luxembourg.

Fritz, B., Muehlich L. (2019) Regional Financial Arrangements in the Global Financial Safety Net: The Arab Monetary Fund and the Eurasian Fund for Stabilization and Development. *Development and Change,* 50(1): 96–121.

G-20 Eminent Persons Group (2018) *EPG Report on Global Financial Governance.* Available at: https://www.globalfinancialgovernance.org/assets/pdf/G20EPG-Full%20Report.pdf

Grabel, I. (2019) Continuity, Discontinuity and Incoherence in the Bretton Woods Order: A Hirschmanian Reading. *Development and Change,* 50(1): 46–71.

Hawkins, A. J., Rahman, and T. Williamson (2014) Is the Global Financial Safety Net at a Tipping Point to Fragmentation? *Economic Roundup 2014,* Issue 1. Canberra: The Treasury, Australian Government. Available at: https://treasury.gov.au/publication/economic-roundup-issue-1–2014/economic-roundup-issue-1/is-the-global-financial-safety-net-at-a-tipping-point-to-fragmentation/

Henning, C.R. (2019) Regime Complexity and the Institutions of Crisis and Development Finance. *Development and Change*, 50(1): 24–45.

IMF (2013) *Stocktaking the Fund`s Engagement with Regional Financing Arrangements*. IMF: Washington D. C.

IMF (2016) *Adequacy of the Global Financial Safety Net*. IMF Policy Paper. March.

IMF (2017) *Collaboration Between Regional Financing Arrangements and the IMF – Background Paper*. IMF Policy Paper.

IMF (2019) *World Economic Outlook. Growth Slowdown, Precarious Recovery.* April 2019. IMF: Washinton D. C. Available at: https://www.imf.org/en/Publications/WEO/Issues/2019/03/28/world-economic-outlook-april-2019

Kring, W., Gallaher, K. (2019) Strengthening the Foundations? Alternative Institutions for Finance and Development. *Development and Change,* 50(1): 3–23.

Kurmanalieva, E. and Rudakovsky, Ya.S (2018) *Spetsial'nyj doklad. Kratkii obzor gosudarstvennogo dolga Armenii, Belarusi, Kyrgyzstana, Tajikistana [Special report. A brief survey of the public debt of Armenia, Belarus, Kyrgyzstan, Tajikistan].* EDB: Moscow. Available at: https://efsd.eabr.org/upload/iblock/5f6/SPECIAL-REPORT_RU_08_2018-_1_.pdf

McDowell, D (2019) The (ineffective) financial statecraft of China`s bilateral swap agreements. *Development and Change.* Available at: https://onlinelibrary.wiley.com/doi/10.1111/dech.12474

Orszag, P. and Stiglitz, J. (2002) *Optimal fire departments: Evaluating public policy in the face of externalities*, The Brookings Institution Working Paper, No 4.

RFA Joint Staff (2018) *IMF-RFA Collaboration: Motives, State of Play, and Way Forward.* A joint RFA staff proposal (ESM, AMF, AMRO, EFSD, EC, FLAR). October.

Scheubel, B. and Stracca, L. (2016) *What do we know about the global financial safety net? Rationale, data and possible evolution*. European Central Bank Occasional Paper Series #177, September.

Ulatov S., Pisareva N., Levenkov A. (2019, forthcoming) *Achieving Stabilization and Development Objectives in a Single Agenda*. Working Paper no. 2. EFSD: Moscow.

Vinokurov E. (2018) *Introduction to the Eurasian Economic Union.* London and New York: Palgrave Macmillan.

Vinokurov E. (2019, forthcoming) *The Belt and Road Initiative: A Russian Perspective*. In: Kohli, H., Linn, J., Zucker L. (eds.) China's Belt and Road Initiative: Potential Transformation of Central Asia and the South Caucasus. Sage.

Vinokurov, E. and Libman, A. (2017) *Re-Evaluating Regional Organizations: Behind the Smokescreen of Official Mandates.* Basingtoke and New York: Palgrave Macmillan.

Vinokurov, E. and Tsukarev, T. (2018) The Silk Road Initiative and the Interests of Transit Countries: An Economic Assessment of Transport Corridors. *Area Development and Policy*, 3: 1: 93–113.

World Bank (2019) *Global Economic Prospects*. World Bank: Washington D. C. January. Available at: https://www.worldbank.org/en/publication/global-economic-prospects

ANNEX 1. COUNTRY PROGRAMMES

First programme of the Republic of Belarus, 2011–2013

Major achievements of the programme were empowerment of the independence of the National bank of the Republic of Belarus and introduction of monetary policy-related constraints to its activities. Of particular note, the updated legal framework prohibited the National bank of the Republic of Belarus from roles not typical for monetary authorities, including lending to the economy and participation in commercial entities and other businesses.

The Programme eliminated the multiplicity of exchange rates and laid the foundations for transition to a flexible exchange rate regime.

Although direct lending continued, awareness increased of the ineffectiveness of this kind of investment, leading subsequently to the decision to gradually reduce this type of lending. Starting in 2020, it is planned that new financing through direct lending will be completely stopped.

At the end of 2012, amid a deterioration in the foreign economic environment, the national authorities again returned to the active use of non-market measures to stimulate consumption and maintain the population's purchasing power. These included another extension of price controls, direct lending, and excess of wage growth over productivity growth. This led to another build-up of external and internal imbalances, and the EFSD Council decided to end the Programme without disbursement of the last (sixth) tranche of US $440 million.

Second programme of the Republic of Belarus, 2016–2019

One of the main results of the programme was a significant strengthening of macroeconomic stability:

- The authorities' restrained monetary and fiscal policies contributed to an unprecedentedly low level of inflation: As at the end of 2018, twelve-month inflation was 5.6%, compared to 12% at the end of 2015 (that is, before the start of the programme), which laid the foundation for transition to a policy of inflation targeting.
- Compared to 2015, when the general government balance (excluding the Development Bank) showed a surplus amounting to 0.5% of GDP, in 2018 the surplus was 5.1% of GDP, which is being directed to repay the external debt.
- The reduction in direct lending had a positive effect by reducing compensations from the state budget to banks and businesses.
- The increased cost recovery for household utility tariffs reduced the need to finance subsidies to enterprises and producers of these services, and introduction of a system of subsidies for vulnerable groups improved the targeting of those who require a social safety net.
- In 2018, there was a significant reduction of budget support to state-owned enterprises in replenishing their statutory funds and to execute guarantees for foreign borrowing.
- Reform of state-owned enterprises began, with a focus on market financing methods.
- The current account deficit was significantly lower compared to the period of the first loan, a process aided by both the reforms mentioned above and the increased exchange-rate flexibility.

Nevertheless, EFSD Project Unit staff members believe that in order for Belarus to return to the path of long-term sustainable growth, more resolute structural reforms are necessary, aimed at improving the management of state-owned enterprises and the competitiveness of the Belarusian economy.

Programme of the Republic of Armenia, 2015–2017

The main results of the programme are as follows:

- The first Tax Code in the history of the country was adopted. This is a very important result for the institutional development of the country, which significantly improves the tax policy and in the medium term will make it possible to increase the stability of the Armenian budget by increasing tax revenues, and to expand the budget's ability to finance infrastructure projects and the social sector.
- A number of measures were implemented to increase the effectiveness of government spending. Among these, we should mention measures to improve the quality of the public procurement process, measures which make up a significant share of the state budget. The legislation, amended in the context of the project, notably involves an increase in the share of electronic procurement methods, which reduces the direct contact between suppliers and purchasers and increases the transparency of the process. The law also prohibits the simultaneous participation in a tender of suppliers who are related to each other by business or personal interests.
- The methodology for setting electricity tariffs has been improved. Combined with improved management, this helped the distribution network to repay ahead of schedule the US $80 million overdue debt to suppliers accumulated up to 2015. In July 2017, an ambitious reform of the energy sector began, the implementation of which will increase competition in the market, including through opening access for foreign suppliers, and will lead to lower tariffs for consumers. Furthermore, as part of the reform of the energy sector's tariff policy, supported by a financial loan from the EFSD, among other things, the flexibility of tariff setting is increased. For example, if the actual balance of electricity generation deviates from the forecast, the tariff can be revised on a semi-annual basis.
- A number of important measures were implemented to improve the conditions for doing business and to increase the country's investment attractiveness. The latest "Doing Business" report of the WB indicates a noticeable advance in Armenia's rating, from 70.44 points at the beginning of the programme to 75.37 points in 2018.

As a result of implementation of the package of measures agreed upon by the Central Bank of Armenia, the level of dollarization decreased; this contributed to banks' greater resistance to shocks associated with the depreciation of the national currency. In addition, the adoption of a number of amendments to the law "On Guaranteeing the Bank Deposits of Individuals" increased protection of deposits, so that people became more willing to deposit their savings in banks. In turn, the expansion of the banks' deposit base increased their opportunities for lending to the economy.

ANNEX 2. CORPORATE GOVERNANCE AND DECISION MAKING

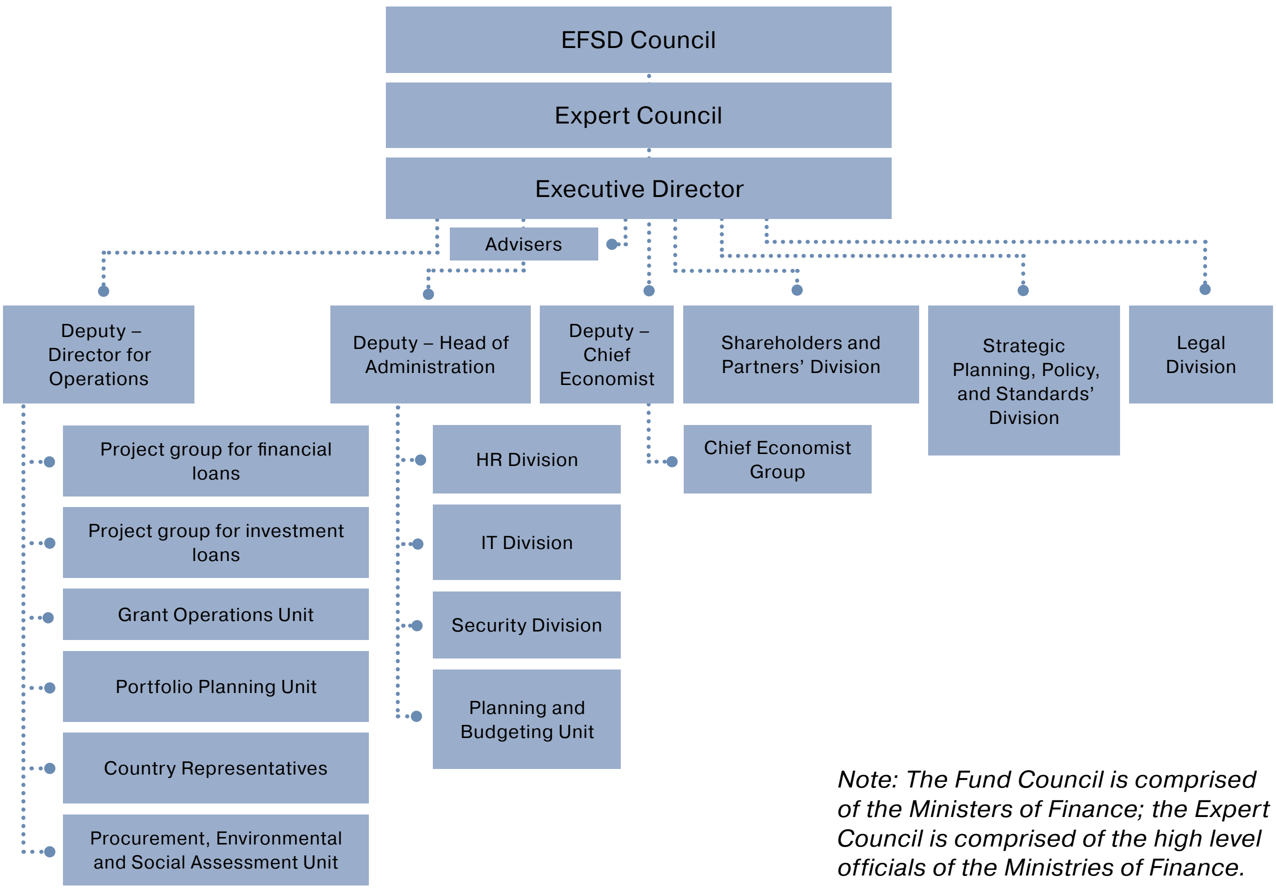
The EFSD is managed by the EFSD Council, comprising the ministers of finance of the member states and chaired by one of the ministers. The Fund Council is the principal decision-making body.

The EFSD Council's decisions are drafted by Expert Council. The Expert Council members are the Ministries of Finance department directors of member states.

When the EFSD was established it did not have an institutional base, so the member states agreed that the Eurasian Development Bank would administer the Fund's resources, and a separate subsection was formed exclusively for the needs of the Fund.

The EFSD Project Unit appraises members` financing requests and monitors the way projects are implemented in close coordination with member states and other IFIs it also acts as the Fund Secretariat (the organizational structure is shown below).

Organizational Structure



Note: The Fund Council is comprised of the Ministers of Finance; the Expert Council is comprised of the high level officials of the Ministries of Finance.

EFSD resources are comprised of member states' contributions to the Fund (Table 4), as well as interest received on loans to member states and treasury operations. Since the Fund`s establishment, total initial contributions and net profit reached US $9.1 billion. The total initial contributions of the member states to the Fund amounted to US $8.513 billion.' Ten percent of the initial contributions were made to the Fund's account in the form of cash, 90% in the form of simple, non-circulating and non-interest-bearing promissory notes of the member states. As at 7 January 2019, partial repayment on the promissory notes amounted to US $2.2 billion.

Table 4. Contributions of Member States

Armenia	$1 million
Belarus	$10 million
Kazakhstan	$1 billion
Kyrgyz Republic	$1 million
Russia	$7.5 billion
Tajikistan	$1 million

Each country has its own access limit, which is set by the EFSD Council for each member state in proportion to the size of its GDP per capita; the limits can be reallocated (transferred from one member state to another).

A decision to allocate a loan from the resources of the Fund is preceded by a process of appraising the application by the EFSD Project Unit, collecting information, and preparing an appraisal.

Decisions to extend financial credits to member states are based on an assessment of:

- the urgency of the state's need for financing and its solvency;
- the country's long-term debt sustainability;
- the borrower's institutional capacity to achieve targets established by the EFSD programmes and projects;
- the quality of public administration and the effectiveness of the country's anti-corruption policy (taking into account evaluations of the WB, IMF, and other IFIs).

The procedure for granting investment loans includes two stages:

- preliminary, at which the project concept and opportunities for development of a technical and economic feasibility study are considered;
- final, at which the decision is made on allocation of the investment loan.

The Fund is guided by the following fundamental principles in lending:

- transparency at all stages of preparation and implementation of programmes and projects;
- full accountability of the use of the Fund's resources (including audit of financial statements by an independent auditing company);
- detailed disclosures of information on the Fund's operations;
- authorship of the project, as well as the leading role in its implementation, always belongs to the recipient of the funds;
- sustainability of the project results.

ANNEX 3. DEVELOPING EXPERTISE AND RESEARCH

In a modern IFI, research is an independent instrument. This makes it necessary for the Fund to build up its own research capacity to improve the quality of its lending, its public research in the Fund's area of specialization, and its further provision of technical assistance to member states. In this regard, the EFSD and its Chief Economist Group work on three interrelated tasks.

The first is setting up the work to analyse the economies of the Fund's member states, regional macroeconomic trends, and to analyse the economies of Russia and Kazakhstan with a focus on their influence on the national economies of other Fund member states. The emphasis will be placed on the distinctive so-called "transmission channels," and there are at least six of them: the trade channel, the investment channel, the inflation channel, the interest-rate channel, remittances of migrant workers and the channel of economic expectations.

The second task is to achieve a state-of-the-art level of macroeconomic modelling, which must be adapted to the specifics of the countries and tasks involved. In 2019, the Fund already has its own set of financial programming models for the four borrowing countries. Financial programming models are the basis of operational work on budget support loans. During 2019, a medium-term forecasting system will be launched for each member state. The third mandatory element will be Debt Sustainability Analysis (DSA), which will then allow the gradual construction of an early warning system for crisis prevention.

THE FUND'S FUTURE MODELS

(1) Financial Programming (FP)	(2) Quarterly Projection Models (QPM)	(3) Debt Sustainability Analysis (DSA)
Financial programming models make it possible to analyse a country's economic and financial development using historical data. With the models, we intend to create a stable, short-to-medium-term forecast that takes into account the principal economic risks and imbalances, as well as government response. Models make it possible to prepare a realistic scenario, reflecting the impact of economic changes, as well as to define future economic goals.	Models of medium-term forecasting are constructed on the principles of general equilibrium, taking into account both external assumptions of economic development and economic interrelations among the EFSD member states. One of the basic principles of the model is optimization of the activities of all economic agents, considering the endogenous monetary policy. This approach allows us to generate a forecast for a horizon of 1–4 years, given the level of inter-country integration.	Models of debt sustainability make it possible to assess the current debt situation in the country and to identify the key imbalances in the economy, given the structural characteristics of each country. In addition, with the models we can evaluate the effect of various stabilization mechanisms and analyse alternative scenarios of economic development for their effect on debt sustainability.

The third task: The EFSD plans to create a high-quality series of publications, including EFSD Working Papers, reports and individual publications, including those based on joint projects with IFIs. The series of Working Papers was launched in 2019: the second will be released shortly (Ulatov, Pisareva, Levenkov, 2019). The Fund's publications will involve, in one way or another, different areas of its activity: the development of budget and balance of payments loans; the specifics of infrastructure financing; and the tasks of international cooperation and strategic planning.

Eurasian Development Bank

E. Vinokurov, A. Efimov, A. Levenkov

The Eurasian Fund for Stabilization and Development: A Regional Financing Arrangement and Its Place in the Global Financial Safety Net

The **Eurasian Fund for Stabilization and Development (EFSD)** amounting to US$8.513 billion was established on June 9th, 2009 by the governments of the Republic of Armenia, the Republic of Belarus, the Republic of Kazakhstan, the Kyrgyz Republic, the Russian Federation, and the Republic of Tajikistan. The objectives of the EFSD are to assist its member countries in overcoming the consequences of the global financial crisis, ensure their economic and financial stability, and foster integration in the region. The EFSD member countries signed the Fund Management Agreement with Eurasian Development Bank giving it the role of the EFSD Resources Manager. More information about the EFSD is available at: https://efsd.eabr.org/en/

EFSD Working Papers are the main format of the Fund's public research. They reflect the Fund's research on global, regional, and country economic trends, economic modelling, macroeconomic analysis, sectoral analysis, global financial architecture, and other issues. EFSD publications are available at https://efsd.eabr.org/en/analytics/

Address:
1-st Zachatievskiy pereulok,
house 3, block 1,
Moscow, 119034, Russian Federation
Tel: +7 (495) 645 04 45
Fax: +7 (495) 645 04 41
Web: https://efsd.eabr.org/en/

Eurasian Development Bank

www.eabr.org