

**EURASIAN FUND FOR STABILIZATION  
AND DEVELOPMENT WORKING PAPER  
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**Achieving Stabilization and  
Development Objectives in a Single  
Agenda: The Experience of the  
Eurasian Fund for Stabilization  
and Development**

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# ABBREVIATIONS

**ADB** – Asian Development Bank

**AMRO** – ASEAN+3 Macroeconomic Research Office

**BRICS CRA** – BRICS Contingent Reserve Arrangement

**CMIM** – Chiang Mai Initiative Multilateralization

**EAEU** – Eurasian Economic Union

**ECB** – European Central Bank

**EDB** – Eurasian Development Bank

**EFSD** – Eurasian Fund for Stabilization and Development

**EFSF** – European Financial Stability Facility

**ESM** – European Stabilization Mechanism

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

**GFSN** – Global Financial Safety Net

**HPP** – hydropower plant

**IFI** – international financial institution

**IMF** – International Monetary Fund

**LDCs** – least developed countries

**LICs** – low-income countries

**MDBs** – multilateral development banks

**MFA** – EU's Macro-Financial Assistance program

**MoF** – Ministry of Finance

**MOU** – memorandum of understanding

**NBRB** – National Bank of the Republic of Belarus

**NBT** – National Bank of Tajikistan

**RFA** – regional financing arrangement

**SOE** – state-owned enterprise

**USAID** – US Agency for International Development

**WB** – World Bank

# 1. INTRODUCTION

The last decade has seen a vast expansion of existing and the establishment of new regional financing arrangements (RFAs), whose share in the global financial safety net (GFSN) has significantly increased (IMF 2017). While each RFA provides financial assistance to member countries in a specific way, the principal goal of RFAs is seen as safeguarding financial and macroeconomic stability in the regions and countries they cover. The majority of RFAs have striven towards this goal, providing financial support to their member countries for stabilization purposes, largely related to crisis prevention, resolution, and management (RFA 2018). However, the experience of the Eurasian Fund for Stabilization and Development<sup>1</sup> (EFSD, the Fund) – one of the recently created RFAs – has raised important questions about the additional role an RFA could play for low income (LICs) or less-developed countries (LDCs) as a development institution.

The Fund was established in 2009 as the “EURASEC Anti-Crisis Fund”<sup>2</sup> with the principal goal of helping member countries deal with consequences of the global financial crisis. In this regards, the Fund was no different from other RFAs. Yet, the role of the Fund in the region has evolved over time. During the first few years of operations financial support to member countries was extended exclusively for stabilization purposes, including BoP or budget support. In 2014, the first two agreements were signed for investment projects in the Kyrgyz Republic. In 2015, along with the liquidation of EURASEC (as the Eurasian Economic Union became functional) and in order to better reflect its strategic goals, the Fund was renamed the Eurasian Fund for Stabilization and Development. With time, infrastructure investment and grant programs started to play an increasing role in the Fund’s operations (for more on EFSD’s history see Vinokurov, Efimov and Levenkov, 2019).

The EFSD’s expanding line of activities might have sent a mixed signal regarding the Fund’s agenda in the region. It appears that the IMF and other RFAs continued to consider the EFSD as an integral part of the GFSN with the principal goal to support financial stability in the region, providing financial resources and expertise for crisis prevention, resolution and management. On the other hand, development partners like the World Bank (WB) and the Asian Development Bank (ADB) collaborate with the Fund as a policy-based lender which largely pursues a developmental agenda by providing support to governments in creating conditions for sustainable development, including conditional budget support, as well as investment in infrastructure and human capital.

With time, the Fund’s mandate has become more apparent, and other RFAs have recognized its uniqueness (RFA Joint Staff, 2018). Moreover, agreement was reached among a group of RFAs during the 3<sup>rd</sup> High level RFA Dialogue that the EFSD’s experience might be a thought-provoking case for RFAs and other regional facilities<sup>3</sup>. Even though other RFAs do not have a development mandate, the EFSD’s operational model inspires the RFAs to reflect on their collaboration with their regional development

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<sup>1</sup> <https://efsd.eabr.org/en/>

<sup>2</sup> The Fund is not a legal entity; thus its management has been entrusted to the Eurasian Development Bank. <https://eabr.org/en/>

<sup>3</sup> In October 2018 the heads of regional financing arrangements agreed to advance cooperation among RFAs by organizing six joint workstreams, each to be led by one of the RFAs. The following workstreams were identified: macroeconomic surveillance, communication strategies, lending toolkits and policies, training and capacity building, technical assistance, and achieving stabilization and development objectives. The RFAs discussed and approved the concepts of the respective workstreams at the 3<sup>rd</sup> RFA Research Seminar in May 2019.

banks. This experience could be particularly appreciated by RFAs which provide support to LDCs and LICs facing longer-term structural and institutional challenges.

To share its experience, the EFSD committed to preparing this working paper. Motivation for this paper is twofold. First, the paper is a welcome opportunity to update the community of RFAs, the IMF and development partners on the evolution of the EFSD's operations in the region, including Armenia, Belarus, the Kyrgyz Republic and Tajikistan, in the context of the dual mandate. This should help with better positioning the Fund within the GFSN, and improve collaboration with development partners in the future. Second, the paper should inform the ongoing discussion about the potential role RFAs play in the global and regional developmental agenda. Through a prism of the Fund's experience we will discuss key lessons of tackling development challenges faced by recipient countries, together with stabilization objectives, which are more typical for RFAs. Specifically, we will try to answer the following principal questions:

- *Is there a trade-off between development and stabilization objectives when an RFA provides support to lower income or less developed countries?*
- *How to build an effective dialogue with authorities of a country which faces critical institutional and structural barriers to long-term growth, and remains extremely vulnerable to shocks?*
- *How to achieve effective collaboration with other partners and donors in coordinating developmental agenda for common recipient countries?*

This paper is organized in the following way. The next section defines key concepts and terms. Section 3 presents a brief summary of the EFSD's operations, including their evolution and structure. Section 4 focuses on defining stabilization and development objectives in policy-based operations, infrastructure investment and grants. Section 5 describes collaboration with development partners and other lenders in the region. Section 6 reviews experience of other RFAs in combining stabilization and development objectives. Section 7 summarizes key lessons learned from the EFSD's experience, followed by a conclusion.

## 2. TERMS AND DEFINITIONS

To clarify the terminology we use in this paper, policy-based lending refers to the budget or BoP support development banks provide to its member countries, often in conjunction with structural reforms and institutional development programs. The community of “crisis fighters”, i.e., the IMF and other RFAs may use macroeconomic stabilization loans or credit lines to denote the same type of financial support.

Given that in literature the terms “stabilization” and “stabilization policies” may have several definitions, for the purpose of this paper we define the term “stabilization” as policy actions aimed at restoring macroeconomic and financial stability in a country facing or going through a crisis, or dealing with its consequences. Such policy actions largely involve macroeconomic policy adjustments which take place in the short-term and should have either an immediate or relatively prompt impact on macroeconomic balances and financial markets. Development policies, on the other hand, are expected to have a longer-term impact on countries and consist of a wider spectrum than stabilization policies. There is a common understanding among MDBs and RFAs that such policies are largely related to institutional and structural transformations required for the long-term sustainable development of a country.

To avoid confusion, we also define the two main instruments which the EFSD uses for its operations. The first is a “financial credit” – a policy-based loan extended to member states for BoP or budget support<sup>4</sup>. The second is an “investment loan”, primarily extended to member states to support infrastructure projects. Both instruments are provided on highly concessional terms, depending on the per capita income in the country.

There is one important nuance to the term “development objectives”, which should be helpful to consider in the context of policy-based lending (i.e. stabilization loans/financial credits). This relates to the fact that conditionality and/or prior actions included in stabilization programs may contain not only macroeconomic adjustments but also measures which are designed to exercise a longer-term developmental impact (for example, energy tariff policy, taxation, business regulation, etc.). Thus, for the purpose of this paper we intend to look into two types of “trade-off” for stabilization and development objectives: (1) within policy-based lending; and (2) between policy-based lending and infrastructure investment, or investment in the development of human capital.

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<sup>4</sup> <https://efsd.eabr.org/en/about/instruments/>

### 3. EVOLUTION OF EFSD OPERATIONS IN MEMBER COUNTRIES

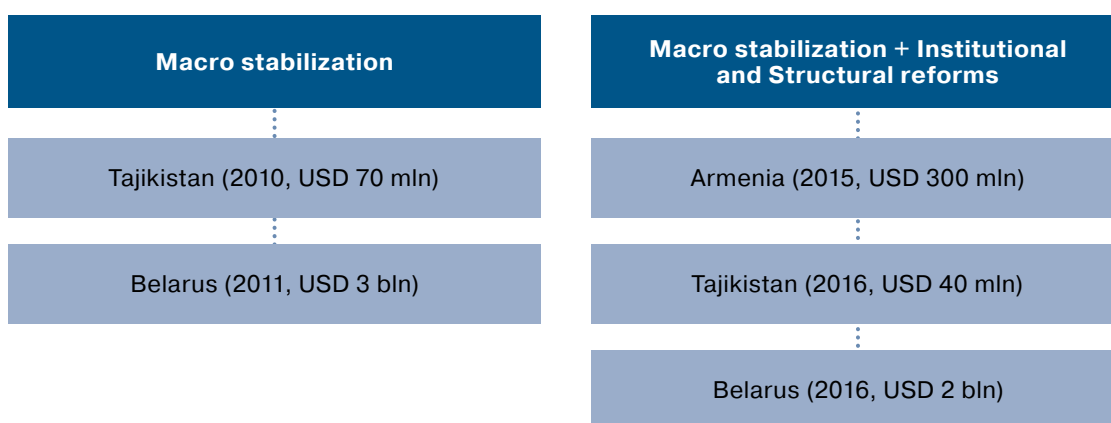
Despite the fact that the EFSD was founded as an anti-crisis fund helping member countries to mitigate the impact of the global financial crisis, the EFSD members entrusted the Fund with a broader mission, which apart from stabilization also includes development and integration objectives. This triple mission has an important underpinning. After the dissolution of the Soviet Union, the EFSD’s potential borrowers had to undergo a difficult transition. The collapsed industrial base, deteriorated physical and social infrastructure and weakened trade links greatly constrained economic growth. The first-generation reforms, undertaken by governments of the EFSD’s borrowing countries, were not enough to create the necessary conditions for stable economic growth. As a result, the land-locked economies have remained extremely vulnerable to external shocks and have been vastly dependent on donors’ support. In order to improve conditions for long-term sustainable and inclusive growth, urgent structural and institutional transformations were needed. The EFSD was thought of as a mechanism helping member countries to navigate this bumpy transition to reach a more sustainable state of development.

Although *de jure* any member country could ask for support from the EFSD, the goal that the EFSD members had in mind was to provide funding to the most vulnerable economies whose internal capacity to deal with crises was frail, including limited access to financial markets and insufficient reserve buffers. Therefore, informally the EFSD members were split into two groups: two donor countries – Kazakhstan and Russia (upper middle income economies in 2009) – and four recipient countries – Armenia, the Kyrgyz Republic and Tajikistan (low-income), and Belarus (middle-income).

During the first few years of operation, the stabilization agenda prevailed. The first financial credit was extended to Tajikistan in 2010, with the main goal to cover the fiscal gap and avoid a budget crisis, which could have escalated due to unforeseen expenditures needed to deal with the landslide. In 2011, the EFSD provided the expedient support to Belarus, helping to mitigate the impact of the BoP crisis and restore macroeconomic stability.

The role of the EFSD has evolved over time. The later programs, supported by EFSD financial credits, apart from key stabilization targets (mostly monetary and fiscal) also included a wide range of measures and reforms, targeting longer-term development objectives (Figure 1). This was in a great part related to key structural and institutional constraints, which amplify macroeconomic imbalances and make countries vulnerable to shocks (see Box 1).

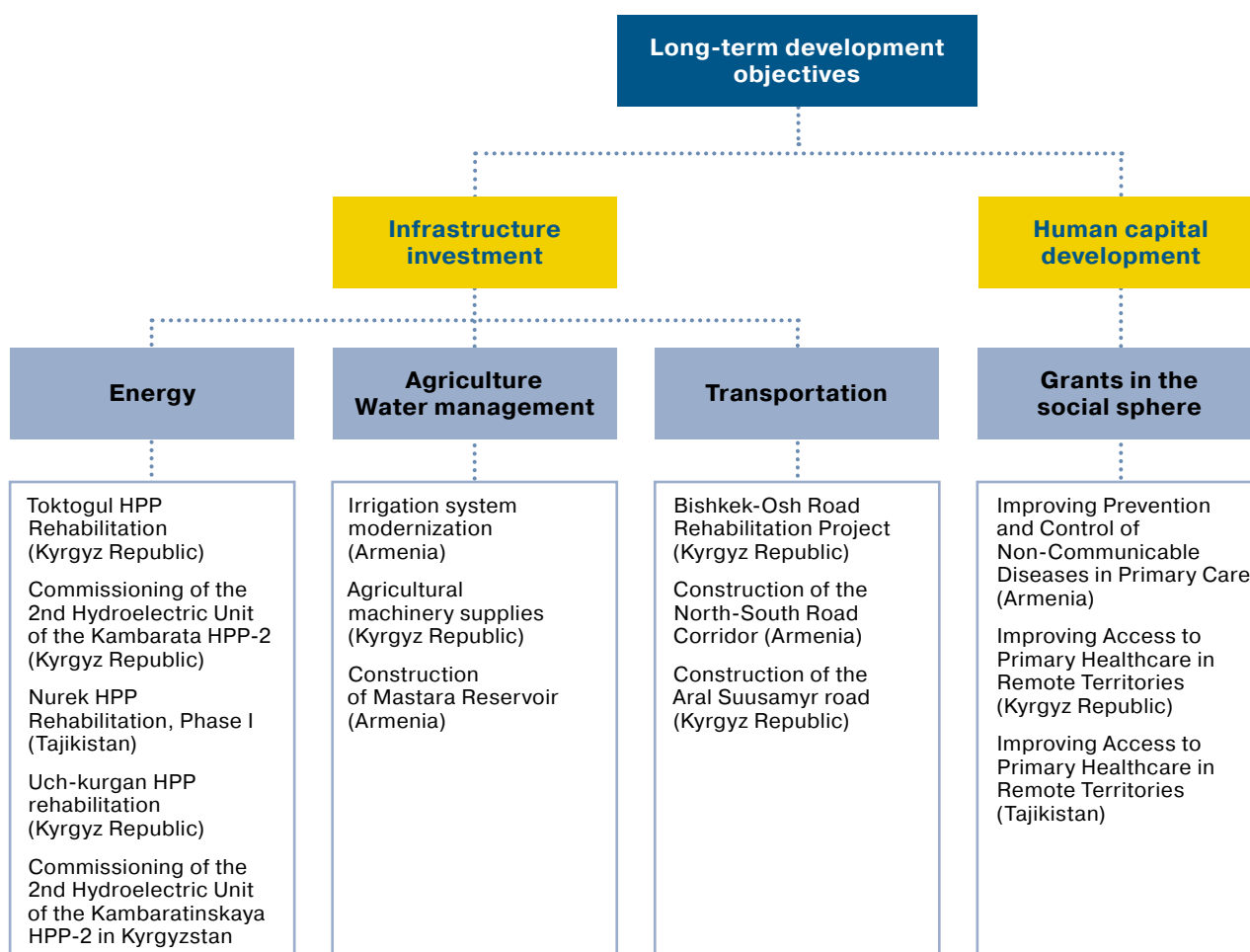
**Figure 1: Approved financial credits by countries and objectives**





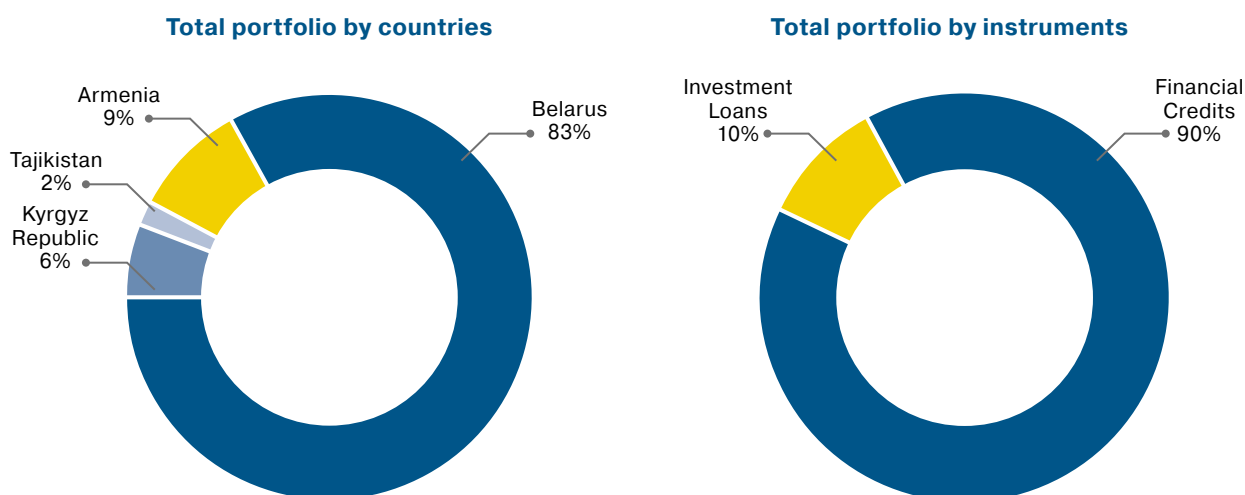
However, as we show in the section on the experience of other RFAs below, the inclusion of development objectives in programs supported by EFSD financial credits is not a unique feature distinguishing the EFSD from other RFAs. A truly unique aspect of the EFSD's operations is, however, the financing extended to member countries to fill in infrastructure gaps, which have become especially acute after a prolonged period of poor maintenance and insufficient investment in key infrastructure, including roads, energy and water management. By 2019, the EFSD's pipeline had included ten infrastructure projects, for seven of which agreements had been signed (Figure 2). All projects are implemented in relatively poor economies (Armenia, the Kyrgyz Republic and Tajikistan), where global development partners are very active, including the WB and ADB. Hence, the EFSD has had an opportunity to leverage its investment operations, relying on their experience and expertise. In 2016, the EFSD started to implement grant programs in the social sphere for least developed economies. This is also a unique activity for an RFA.

**Figure 2: Division of EFSD's investment and grant operations by key objectives**



The current structure of the EFSD's portfolio is shown in Figure 3. The distribution of the portfolio displays a high concentration on a single borrower, which is mainly the result of large-scale BoP and budget support extended to Belarus, the largest economy among recipient countries. The investment portfolio, although accounting for a small share (10%), has considerably more projects in the pipeline than the portfolio of financial credits.

**Figure 3: Distribution of the EFSD's portfolio (as of 30.06.2019)**



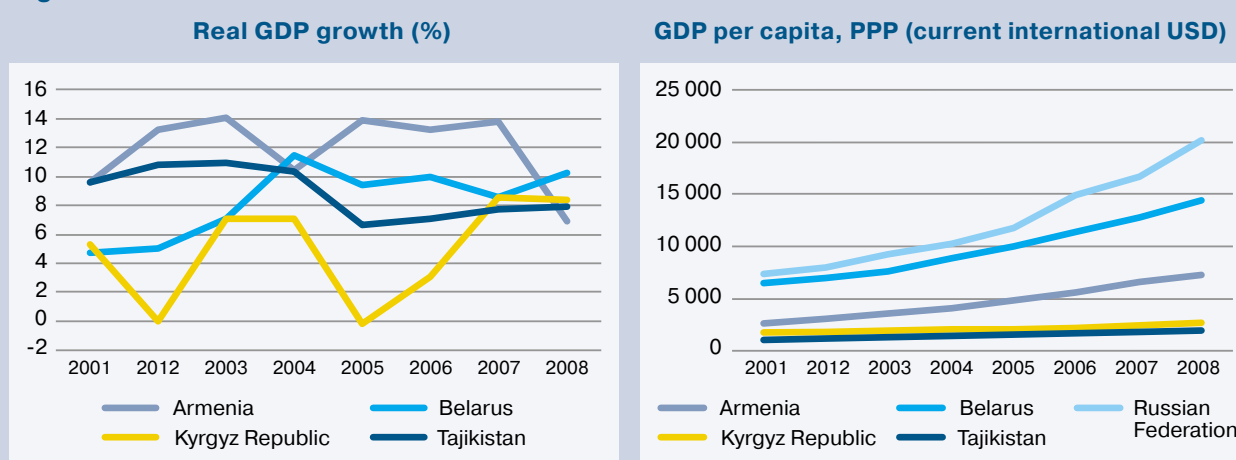
**Source:** the EFSD calculations

Although the expanding role of the Fund created new opportunities to make a broader developmental impact, particularly in the low-income economies of Central Asia, it also brought new challenges, given the Fund's limited internal capacity and expertise. Policy-based lending has become more complex, requiring a more systematic approach to country surveillance, diagnostics and program design. The absence of partnership strategies with borrowing countries made it particularly challenging to shape an effective dialogue with the authorities on fundamental reforms, as well as to ensure essential coordination with other development partners. Moreover, investment operations and grants also required a completely different set of expertise and knowledge, which the Fund had to build from scratch, in the meantime largely relying on support from global development partners like the World Bank and the Asian Development Bank. We discuss these challenges in more detail in the section on lessons learned.

### **Box 1: Social and economic conditions in the EFSD's borrowing countries**

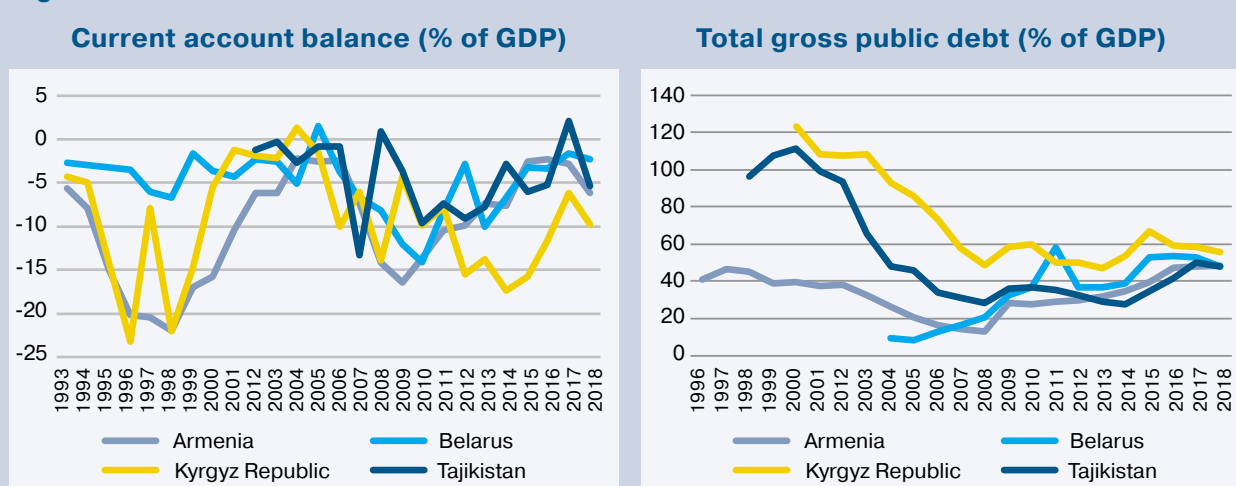
During the 1990s, EFSD member countries experienced severe hardships during economic transition, characterized by skyrocketing inflation, huge current account and fiscal deficits, a fall in real incomes and a rise in poverty. In the 2000s, the favorable external environment supported economic recovery in the region, largely driven by growing exports of commodities including oil and gas, ferrous and non-ferrous metals, precious metals, etc. However, growth in 2001–2008 displayed high volatility, resulting in a continuing divergence in per capita GDP between the EFSD's potential borrowers and donors (Figure 4)

**Figure 4.**



Source: WB

**Figure 5.**



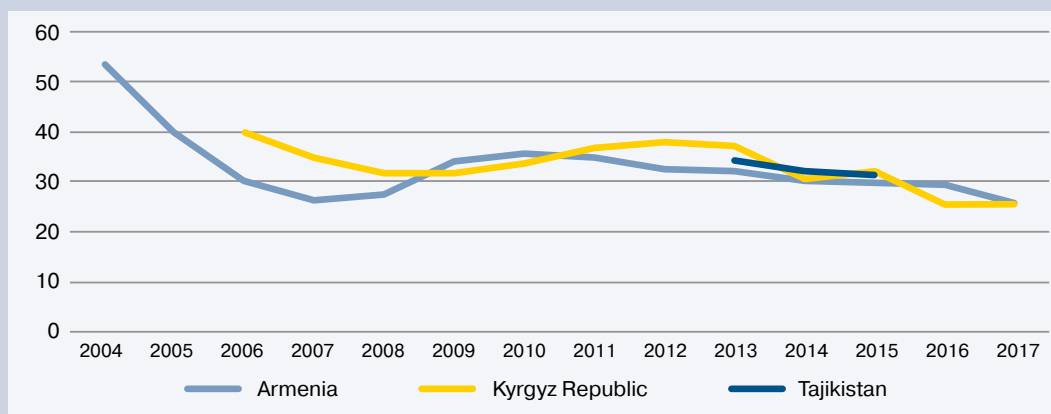
Source: WB data, EFSD calculations

The slow and uneven recovery from the global financial crisis of 2008–2009 highlighted structural and institutional weaknesses of EFSD member states. The observed bumpy recovery also reflects a high dependence on Russia, which was additionally hit by a fall in oil prices and sanctions in 2014–2015. While coping with the consequences of the crisis, most of EFSD’s borrowers accumulated macroeconomic imbalances, which amplified their vulnerabilities to external shocks (Figure 5).

Despite some improvements in the quality of macroeconomic management after the 2008 global financial crisis, EFSD’s potential borrowers share similar macroeconomic challenges, including significant growth volatility, a high debt level, chronic current account and fiscal deficits, and a low level of reserves. Moreover, the economies continued to face severe constraints, which could be attributed to weak micro-foundations for long-term stable growth, including: (1) dominance of the government sector and an underdeveloped private sector; (2) a high share of informal activities; (3) high regulatory barriers; (4) undeveloped banking and financial sectors; (5) distortions on the labor market; and (6) run-down infrastructure.

The low quality of economic growth during the last decade is reflected in poverty data. It appears that despite the success in poverty reduction reached by all countries before the global financial crisis of 2008, the poverty level has remained rather sticky since. In fact, in the low-income economies, which have demonstrated the highest growth rates in the regions, the poverty level has remained above 25% (Figure 6).

**Figure 6. Poverty level (national definition,% of population)**



Source: CEIC

## 4. DEFINING STABILIZATION AND DEVELOPMENT OBJECTIVES IN THE EFSD'S OPERATIONS

### 4.1. Overview of policy-based operations

Although, the principal goal of a typical RFA (within the GFSN) is seen as stabilization (i.e. to provide funding for crisis prevention, resolution and management), it seems logical to combine stabilization and development objectives in the contexts of LICs and LDCs. As we emphasized above, EFSD's potential borrowers face critical structural imbalances and institutional constraints, which appear to have become binding for attaining sustainable and inclusive growth. Similar constraints are also identified by the WB in strategic country diagnostics (WB, 2017–18). This suggests that “fixing” macro imbalances is likely to have only a temporary positive impact on the economic development of these countries, which are likely to remain vulnerable to shocks if critical structural and institutional barriers are not properly addressed. This was a common understanding among the EFSD member states. As a result, development objectives have become an integral part of the EFSD's policy-based operations, executed through financial credits. Consequently, the later programs, supported by the EFSD's financial credits, tend to be more concentrated on structural and institutional reforms and measures.

Defining such dual agenda requires a specific approach to dialogue with potential borrowers as well as coordination with other donors and development partners. The EFSD's regulations require a government applying for a financial credit to submit a reform program, the implementation of which would contribute to addressing the challenges undermining macroeconomic stability. To ensure ownership over programs, they ought to be designed by the authorities. The Fund's team conducts pre-program diagnostic missions and consultations with the authorities on program design. The EFSD may also provide advice or technical support at the program design stage. It has also proved very useful to coordinate with other development partners on the priority areas of reforms to have better complementarity and avoid facility-shopping. An overview of the latest programs supported by the EFSD's financial credits in Armenia, Belarus and Tajikistan, and their main outcomes, are presented in Annex 1.

There are several important factors that affect the dialogue with potential borrowers and design of a program. In case a country has an ongoing IMF program and an agreed macroeconomic framework, the reform matrix is more concentrated on the development agenda (for example, the latest program in Armenia). The main direction of reforms, supported by other development partners (WB, ADB), is also taken into account. In addition, the dialogue could be complicated by low political commitment to reforms. In some countries, such low commitment is due to frequent changes in government. As a result, authorities tend to prioritize measures and reforms which could deliver visible and measurable short-term outcomes. Our experience shows that the easier part has been to negotiate a macroeconomic framework and necessary macroeconomic adjustments, which are expected to restore macroeconomic stability and reduce vulnerability of a country to external shocks. The most challenging part has been to reach an agreement on structural and institutional measures and/or reforms which are expected to have a longer-term positive impact, both on macroeconomic trends and the micro-foundation for growth. A summary of key measures and reforms agreed in three programs supported by EFSD financial credits is presented in table 1.

**Table 1. Selected measures from policy matrices of recent EFSD financial credits**

Measures/ purpose	Armenia	Belarus	Tajikistan
<b>I. Macroeconomic stabilization</b>			
<b>International reserves sustainability</b>		Gross international reserves floor Net international reserves floor	
<b>Monetary aggregates</b>		Ceiling for net domestic assets Ceiling for reserve money Maximum broad money growth	Liquidity ceiling Reserve money ceiling
<b>Exchange rate policy</b>		No multiple exchange rate practices Introduction of a two-way continuous auction mechanism for forex trading	No multiple exchange rate practices
<b>Refinancing rate policy</b>		Refinancing rate level conducive to stabilization (inflation target, CAB, exchange rate and international reserves stability)	
<b>Fiscal stability and budget credibility</b>	Budget deficit ceiling (in accordance with the IMF's program requirements)	Extended budget balance floor Wages growth limitation	Budget deficit ceiling No budget arrears for salaries and pensions Social expenditures floor
<b>Public debt sustainability</b>		New public debt ceilings Public debt to GDP ratio ceiling	No new non-concessional debt New public borrowings ceiling No arrears for public debt repayments Improved access of public to debt information
<b>II. Development objectives</b>			
<b>Markets liberalization</b>		De-regulation of consumer prices Increasing cost-recovery level for residential utility/transport tariffs Phasing out directed lending (provided at discounted rates) Lifting restrictions on the forex market	
<b>Banking sector sustainability</b>	Improved prudential monitoring (introduction of Basel principles) Reduction of loans/deposits dollarization Improved trust of population in the banking system (deposits guarantee legislation)	Support of the pre-privatization process for state banks	Strengthened prudential monitoring Disclosure of main shareholders of the banks, affiliation and possible conflicts of interest

Measures/ purpose	Armenia	Belarus	Tajikistan
<b>Improved public resources management</b>	<ul style="list-style-type: none"> <li>Introduction of a new Tax Code</li> <li>Improved public procurement legislation (expansion of electronic trading, elimination of conflicts of interest)</li> <li>Introduction of modern accounting standards for public institutions</li> <li>Improved budgeting in the transport sector</li> <li>Improved efficiency of social expenditures (introduction of one-stop-shop approach, widening access to online services)</li> </ul>	<ul style="list-style-type: none"> <li>Improved management of SOEs, based on better estimation of the quasi-fiscal risks generated by them</li> <li>Introduction of international accounting standards</li> </ul>	<ul style="list-style-type: none"> <li>Optimization of the tax exemptions system <sup>1</sup></li> <li>Improved management of SOEs, based on better estimation of the quasi-fiscal risks generated by them <sup>2</sup></li> <li>Automatization of the budget processes</li> </ul>
<b>SOE reform</b>		<ul style="list-style-type: none"> <li>Adoption of a comprehensive strategy for SOE sector reform<sup>5</sup></li> <li>Commercialization of the SOEs (elimination of direct production targets, introduction of corporate principles, optimization of staffing in parallel with strengthened social protection of the unemployed)</li> <li>Facilitation of the privatization process through improved legislation<sup>6</sup></li> </ul>	<ul style="list-style-type: none"> <li>Introduction of independent audit of state enterprises</li> </ul>
<b>Improved sustainability of the energy sector</b>	<ul style="list-style-type: none"> <li>Strengthening of financial sustainability of the sector through improved regulations/ methodologies (production forecasts, loss estimations, tariffs)</li> <li>Improving competitiveness through opening the market</li> </ul>		<ul style="list-style-type: none"> <li>Optimization of the BarkiTojik's balance sheet</li> <li>Energy tariffs methodology</li> </ul>
<b>Private sector development</b>	<ul style="list-style-type: none"> <li>Improved legislation to foster an investment climate</li> <li>Simplification of regulatory procedures for doing business (connection to electricity, construction, access to loans, reduction of the tax burden)</li> </ul>	<ul style="list-style-type: none"> <li>Creating an enabling environment for private sector development through improved legislation</li> <li>Introduction of RIA requirements</li> <li>Establishment of the Business Ombudsmen institute</li> </ul>	

The embedded problem with implementation is reflected in the fact that three out of five programs supported by EFSD financial credits were completed without disbursement of the concluding tranche. Implementation problems may be divided into three types: (1) program design and timeline; (2) government capacity and commitment to reforms; and (3) frequent exemption from key measures and reforms or postponing their implementation to later tranches. We discuss these and other implementation challenges in the section on lessons learned below.

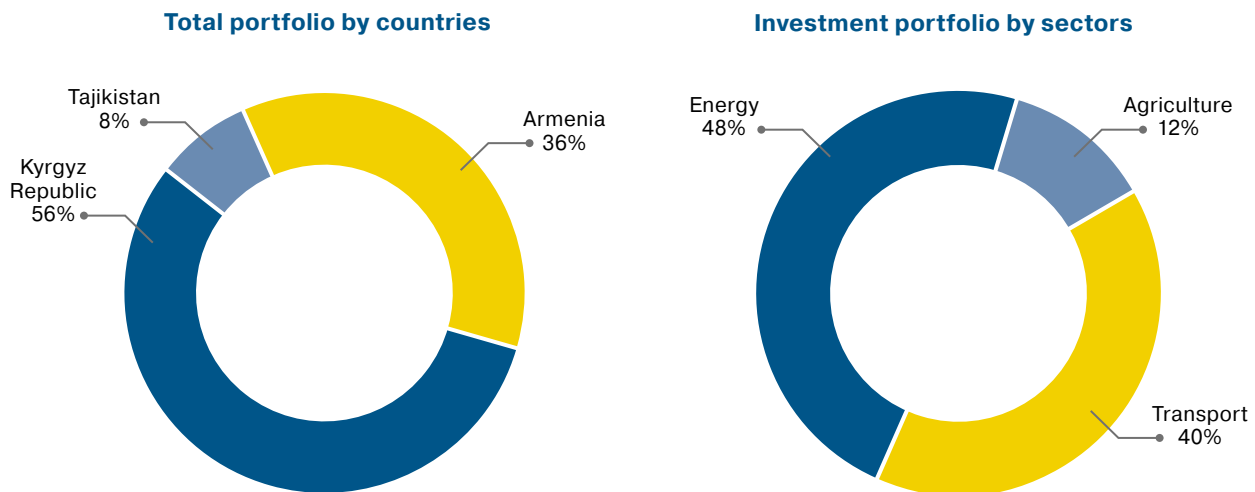
<sup>5</sup> Not met

<sup>6</sup> Met partially

## 4.2. Overview of infrastructure lending and grant programs.

A large infrastructure gap is a common feature of EFSD member countries. The key constraints include uneven (within countries) and unstable access to electricity and water, as well as poor connectivity both within countries and with the main trading partners. Closing this gap has become one of the main goals stipulated in all countries' medium and long-term development strategies and programs. However, given hard budget constraints and a lack of expertise in infrastructure projects, the internal capacity of the EFSD's borrowers to close these gaps is extremely limited. Thus, they have been heavily reliant on donors' support. In fact, some development partners have conducted thorough studies of problems with access to energy, connectivity and water management, and have included development projects in these areas in their partnership strategies with EFSD member states. For example, the ADB has been very active in the construction of roads in the Kyrgyz Republic and Armenia. Both the WB and ADB provide support for rehabilitation of energy generation and building of energy transmission capacity in countries of Central Asia. In order to fulfill its developmental objectives, the EFSD too has become an important player in addressing infrastructure challenges of its member states. The Kyrgyz Republic is the largest recipient of the EFSD's infrastructure lending, accounting for 56% of the EFSD's total investment portfolio. Among sectors, energy generation accounts for almost a half of the total investment portfolio, followed by the transport sector (Figure 7).

**Figure 7: Distribution of the EFSD's infrastructure investment (as of 30.06.2019)**



Source: the EFSD

The EFSD's infrastructure projects are relatively "young". Most of them are at the initial stages of implementation. Although their social and economic effects are still to materialize, their estimated potential effects are significant. Below we highlight examples of infrastructure projects which are expected to exercise notable longer-term effects both at the country and regional levels (Box 2).



## Box 2: Anticipated impact from the EFSD's investment credit operations

**Development of the energy sector in the Kyrgyz Republic.** In 2015, the EFSD Council approved funding of USD 100 million for the second phase of the Toktogul HPP Rehabilitation<sup>7</sup>. In 2016, the Council approved funding of USD 110 million for modernization of Kambarata HPP-2<sup>8</sup>, and in 2019 the Council approved the preliminary application from the Kyrgyz Republic for renovation of Uch-Kurgan HPP costing USD 45 million. Successful implementation of these projects is expected to have the following integral effects:

- Improved energy security, including better reliability of the national energy system and more stable access to electricity in winter times;
- Increased export potential;
- Improved efficiency of water management in the basin of the Aral Sea.

**Development of road infrastructure in Armenia.** The construction of 32 km of the North-South Road Corridor in Armenia is the single-largest infrastructure project of the EFSD. The Fund's Council approved USD 150 million for this project in 2014<sup>9</sup>. The project has strategic importance for this land-locked country, stretched across mountainous and remote areas. It is expected to have the following main direct and indirect social and economic effects:

- Improved connectivity, which is expected to reduce shipping costs and promote foreign and domestic trade, as well as investment;
- Creation of new jobs in the construction industry, with multiplication effects for other sectors;
- Increased business activity due to the development of small roadside businesses;
- Improved labor mobility.

Apart from infrastructure challenges, the EFSD's potential borrowers face another set of common long-term challenges related to the development of human capital. Uneven and insufficient access to education and healthcare is a serious impediment to economic and social mobility in most EFSD borrowing countries. Other shared problems are the relatively low participation of women in economic activities and inadequate systems of social protection. All these factors have negative implications for longer-term economic potential, inclusiveness of growth and tackling poverty, which remains at stubbornly high levels despite the reported robust economic growth in recent years (see Figure 6 in Box 1). Recognizing the importance of addressing human capital challenges, in 2015 the EFSD members approved spending up to 10 percent of the Fund's profits on grants to support national programs in education, healthcare, governance and social protection<sup>10</sup>. Since then, the EFSD has conducted two

<sup>7</sup> <https://efsd.eabr.org/en/projects/toktogul-hpp-rehabilitation-in-kyrgyz-republic/>

<sup>8</sup> <https://efsd.eabr.org/en/projects/commissioning-of-the-2nd-hydroelectric-unit-of-the-kambaratinskaya-hpp-2-in-kyrgyzstan/>

<sup>9</sup> <https://efsd.eabr.org/en/projects/construction-of-the-north-south-road-corridor-in-armenia/>

<sup>10</sup> <https://efsd.eabr.org/en/grants/>

rounds of grant contests. The first round was completed in 2017, and the following three grants were awarded:

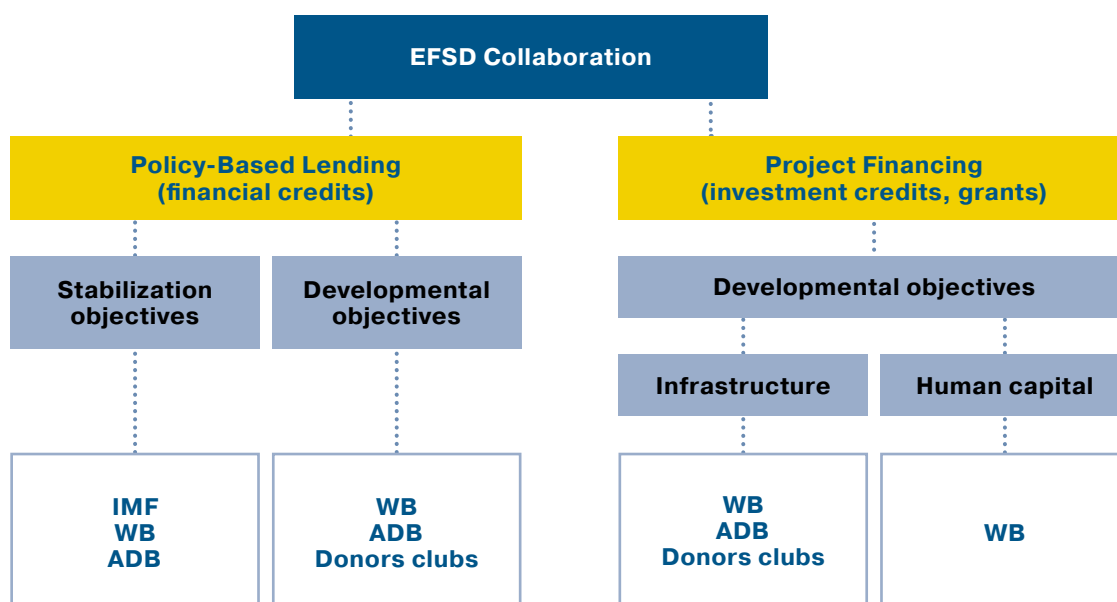
- Armenia, USD 1 million – *“Improving Prevention and Control of Non-Communicable Diseases in Primary Healthcare”*.
- Kyrgyz Republic, USD 2 million – *“Improving Access to Primary Healthcare in Remote Territories”*.
- Tajikistan, USD 2 million – *“Improving Access to Primary Healthcare in Remote Territories”*.

As we noted above, the implementation of infrastructure projects and grant programs requires a specific set of expertise, including in project design and monitoring, procurement and safeguards. The EFSD has lacked this expertise and faced limited internal capacity in terms of human resources. Besides, policies and procedures of the EDB (the Fund’s manager) are based on commercial practice and, in most cases, could not be applied to the EFSD projects. Thus, collaboration with other donors, who have established themselves as experienced development partners in the EFSD’s member states, has been crucial for the successful implementation of the EFSD’s projects, particularly in infrastructure.

## 5. COLLABORATION WITH DEVELOPMENT PARTNERS AND OTHER LENDERS IN THE REGION

Channels of collaboration between the EFSD and other lenders and development partners in the region have diverged with time, as the EFSD has expanded its line of instruments. Currently, there are two main focus areas of collaboration – policy-based lending and project financing (Figure 8).

**Figure 8: Channels of EFSD's collaboration with other lenders in the region**



The modality of collaboration depends on objectives and the type of instruments. In policy-based lending collaboration is typically found in bilateral consultations, which take place either during the EFSD missions to member states or via video conferences, organized on an ad hoc basis on specific issues. It should be noted that the EFSD does not have statutory requirements to reach an agreement on its macroeconomic framework with the IMF or other donors. However, the EFSD tries to maintain constructive dialogue with them to ensure a coordinated approach to key measures and reforms, and to minimize facility shopping and moral hazard risks. Currently, the main counterparts for collaboration in policy-based lending include the IMF, WB and ADB.

The modality of coordination for stabilization objectives depends on the IMF program in a country. For example, in Armenia, where the IMF had an active program, the EFSD has relied broadly on the IMF's assessment of the macroeconomic framework, while in Belarus and Tajikistan which did not have an IMF program, the macroeconomic framework and stabilization measures in policy matrixes were developed by the EFSD and agreed with the authorities, including key macroeconomic benchmarks (see Table 1). However, to minimize potential conflict in macroeconomic policy advice in countries without an IMF program, the EFSD takes into account the IMF's assessment of macroeconomic risks and vulnerabilities

provided in Article IV reports (if available), as well as the WB and ADB assessments presented in their country macroeconomic diagnostics.

The WB and ADB are the key counterparts in collaboration on the development agenda pursued within policy-based lending. Constructive dialogue with the WB and ADB helps to fill in the knowledge gap and reach maximum complementarity in supporting important and politically difficult structural and institutional reforms. Both the WB and ADB have conducted detailed country diagnostics of the EFSD members' economies and have medium-term strategic partnership frameworks with each country, while the EFSD's analytical capacity to assess the needs of its member states in structural and institutional reforms is still limited. Good examples include energy sector reform in Armenia and utility tariffs reform in Belarus. Collaboration on the development agenda also helps identify country needs for technical assistance. For example, to support WB and government efforts in reforming the tax system in Armenia, the EFSD financed a consultant who drafted laws and sub-legislation to ensure full enactment of the Tax Code.

Last but not least is collaboration with global development partners in project financing. The WB and ADB have significantly larger capacity than the EFSD in designing, implementing and monitoring infrastructure projects. Among other items, this capacity includes accumulated global knowledge and best practices in procurement, financial management and safeguards. The EFSD has capitalized on these practices and procedures, and used them for the majority of its infrastructure projects. Besides, a number of projects enjoy parallel financing from the EFSD, WB and ADB. This type of financing allows counterparts to leverage the overall financing capacity for the project, which is constrained by quotas and limits for each institution. At the same time, the EFSD has an opportunity to rely on the expertise of global development partners during project implementation<sup>11</sup>, which in turn allows the EFSD to build internal capacity through learning-by-doing. The EFSD also relies on the expertise of experienced partners in its institutional development. For example, the recently approved procurement policy and procedures underwent a thorough peer-review process by the WB and ADB. A similar approach will be applied to the development of the EFSD's safeguarding policy and standards.

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<sup>11</sup> To ensure successful implementation of the Construction of North-South Road Corridor in Armenia project the EFSD and ADB signed an MOU stipulating technical support that the ADB was expected to provide during project implementation.

## 6. EXPERIENCE OF OTHER RFAs

To shed light on the experience of other RFAs in addressing the dilemma between stabilization and developmental objectives, we asked our colleagues from the ESM, the European Commission, FLAR, CMIM, AMRO, and BRICS CRA to fill in a questionnaire (see Annex 2) designed to address the three main questions posed in the introduction to this working paper. This survey was also expected to help with understanding whether the existing capacity of RFAs – as one of the main layers in the GFSN – is sufficient to consider financing developmental needs of their member countries in addition to fulfilling their principal goal of supporting macroeconomic and financial stability.

Generally, the survey confirmed that each RFA provides support to its member in a specific way, depending on the mandate and mission (see Boxes 3–5). While some RFAs, like the ESM and EFSD, offer loans or credit lines with an adjustment program which contains measures and reforms that the beneficiary member state commits to implementation, others, like FLAR, do not have conditionality. However, there are common features, which are worth emphasizing:

- All RFAs consider the amount of currently available funds adequate to fulfill the task of supporting macroeconomic and financial stability in their respective regions;
- None of the surveyed RFAs has infrastructure investments in its portfolio aligned with its strategy and mission;
- The IMF is the key counterpart for all RFAs. All RFAs are working on improving coordination and collaboration with the IMF.

The survey confirmed our understanding that there is a fine line between stabilization and development objectives that could be targeted in programs supported by RFAs within policy-based lending. Some measures, included in policy matrices, could have both stabilization and development impact either in the short or longer-term. It also appears that demand from member states for longer-term structural transformation has increased, which entails the growing role of development and structural reform policy objectives in the RFAs agenda. The IMF 2018 review of conditionality also indicates an increase in structural reforms in its most recent programs compared to the previous review period. The key issues and challenges when implementing policy measures highlighted by the ESM square with ours and suggest a need to improve coordination with global and regional development partners, who, among other expertise, have accumulated knowledge and best practice in impact assessment and in the development of medium-term strategic frameworks.

The survey also revealed that the EFSD is the only RFA that provides funds for infrastructure and human capital development. In this respect, most RFAs raised concerns regarding their ability to provide effective support through infrastructure project financing. This is not only related to the capacity constraints in specific knowledge and expertise required for infrastructure lending, but primarily to the scope of RFAs' operations defined in their founding documents. Besides, some RFAs pointed to the need for a clear division of tasks in the global financial architecture, in which the task for development financing appears to be more relevant for MDBs.

### Box 3. EU Commission/ESM Experience

The European RFAs consist of different and complementary facilities, designed for different challenges and targeting different “recipients”.

- The European Stability Mechanism (ESM) is intended to support exclusively Eurozone Member States. The ESM is an International Financial Institution (IFI) with paid-in capital from Eurozone Member States which borrows funds on the market (maximum lending capacity: 500 billion euros).
- The Balance of Payments Facility (BoP) is intended for non-Eurozone Member States that face serious balance of payments difficulties. Funds are borrowed by the European Commission and are lent on to the beneficiary member states (maximum capacity: 50 billion euros).
- The EU’s Macro-Financial Assistance program (MFA) is designed to address exceptional external financing needs of countries that are geographically, economically and politically close to the EU. Its prime objective is to restore macroeconomic and financial stability in third countries, while encouraging macroeconomic adjustment and structural reforms. Georgia and Jordan are the MFA’s most recent recipients.
- There is finally the European Financial Stabilization Mechanism (EFSM) with a total lending capacity of €60 billion. It covers all member states of the EU. But with the development of the ESM, the EFSM is expected to be used in exceptional circumstances, and most likely for the non-euro area EU member states only.

#### ESM programs

The ESM, together with its predecessor, the European Financial Stability Facility, provided financial assistance programs to five Eurozone countries (Ireland, Portugal, Greece, Spain and Cyprus) between 2011 and 2018. The scope to include policy measures targeting structural and institutional constraints depends very much on the need of the country requesting ESM assistance. In the case of Greece for instance, structural reforms were a cornerstone of the country’s efforts to return to growth and restore sustainability. The ESM evaluation report<sup>12</sup>, which examined the relevance, effectiveness and efficiency of EFSF and ESM financial assistance in Ireland, Portugal, Spain, Cyprus and Greece (EFSF program up to its initial expiry in December 2014), drew a number of lessons for the ESM’s operations in the future. For instance, the ESM should focus on program credibility and support ownership. Conditionality should give priority to macro-critical conditionality in program design. The design of short-term and long-term measures should reflect realistic expectations. For instance, short-term measures need to focus on closing financing gaps and maintaining financial stability, while measures addressing long-term fiscal sustainability, competitiveness and other structural issues should be phased in from the outset of the program, but may take beyond the program period to bear fruit.

#### ESM coordination with IFIs

The design of the Eurozone programs resulted from close cooperation between the European Commission, the ECB, the IMF, and the ESM. The IMF co-financed with the EFSF and ESM in four program countries (Ireland, Portugal, Greece and Cyprus).

#### Adequacy of resources and capacity

The evaluation report concluded that the financing envelopes were sufficient to implement the program strategies. There were also implicit contingency buffers that were built into the assistance programs.

#### Policy-based lending vs. infrastructure investment

The ESM does not provide lending for infrastructure needs, human capital development, or other development needs.

<sup>12</sup> <https://www.esm.europa.eu/content/evaluation-report-efsesm-programmes>

## Box 4. The FLAR Experience

### FLAR program

FLAR does not have an economic program design. To apply for a Balance of Payments Support loan with FLAR, the Governor of the requesting central bank presents an explanation to FLAR's Executive President of the monetary, loan, exchange, tax and foreign trade policy measures that the corresponding national authorities have adopted and intend to adopt to correct or mitigate the imbalance in their country's balance of payments.

FLAR analyzes the economic measures presented by the central bank. Then, the Executive President presents a report to the Board of Directors. Based on this report, the Board of Directors studies and decides whether to approve the loan.

In cases of liquidity or contingency (i.e. short-term) loans, approval rests with the Executive President.

### Adequacy of resources and capacity

FLAR's current resources are capable of addressing 70% of the maximum simultaneous demand from its member countries. For example, FLAR can cover simultaneous demand from all of its countries with small economies plus one country with a big economy. Historical FLAR loan demand has shown that not all member countries ask for loans at the same time. In that sense, FLAR's resources are adequate under the current lending size parameters.

However, FLAR has begun to redesign its processes for the creation of added value for its member countries and its processes for attracting human talent, aimed at adjusting its organizational structure in all its areas to expand its membership to all of Latin America. For this purpose, FLAR has engaged external consultants and advisors, and it also exchanges experiences with other international bodies.

### Policy-based lending vs. infrastructure investment

FLAR specializes in addressing balance of payments needs. FLAR sees problems in seeking to fulfill a dual mandate. The institution points out that there should be a clear division of responsibilities in global financial architecture.

FLAR has provided value to its member countries as a form of external liquidity insurance. It believes that the value it represents would be diminished if the purpose of the loans was modified.

## Box 5. The CMIM/AMRO Experience

### CMIM program

The CMIM was established in 2010 and has not been requested as of yet due in part to the fact that there have been no episodes of financial volatility serious enough for the members to access the CMIM during this period. Nevertheless, the process of drafting the CMIM program and conditionality, including consultation with third parties, differs depending on whether the CMIM arrangement requested is the IMF De-Linked Portion or IMF Linked Portion. In both cases, the borrower will be responsible for writing and suggesting the economic program and conditionality with the support of AMRO if necessary and the CMIM governing body reviews it and decides whether to approve it.

### CMIM coordination with IFIs

The CMIM together with AMRO as a surveillance unit under the CMIM are actively engaged in partnership with other related agencies to enhance their own research and organizational capacity. For example, AMRO has developed joint capacity building activities with the IMF. The two institutions signed an MOU in October 2017 which allows for the exchange of views and information sharing on their common membership, staff exchange, and capacity building through joint activities.

### **Adequacy of resources and capacity**

The CMIM financing resources, which currently stand at USD 240 billion, are sizable when compared to other RFAs, especially the non-European ones. Also, the maximum arrangement (or the swap quota) available to each CMIM member is generally comparable to the IMF resources available to those countries, except for the cases of China, Japan, Korea and LIDC members. As to the size of staffing, it will be adjusted in line with demand for quality surveillance and the CMIM support function.

### **Policy-based lending vs. infrastructure investment**

The CMIM's objective is to provide liquidity support in response to short-term liquidity difficulties and/or balance of payments difficulties. Thus, providing lending solely for infrastructure needs, human capital development or other development needs would be beyond the CMIM's mandate. However, the CMIM members have started to discuss whether it is desirable to make the CMIM financing facilities more flexible.



## 7. LESSONS LEARNED FROM THE EFSD'S EXPERIENCE

Before giving answers to the three principal questions of this paper, we would like to summarize key lessons drawn from the EFSD experience in the context of the dual mandate. It should be emphasized that most stabilization measures and benchmarks in the programs supported by EFSD financial credits have been met, particularly by those countries where key counterparts have better capacity and are less politically engaged. In part, this reflects the completion of first-generation reforms, which has allowed the authorities to improve the quality of macroeconomic management. Strong commitment to reforms from countries' authorities and greater complementarity with reforms, supported by other donors and development partners, are the other two factors that have contributed to effective program implementation. Box 6 summarizes a few interesting cases of successful implementation of program measures supported by EFSD financial credits.

### Box 6: EFSD financial credits – what worked

**Belarus (stabilization measures):** So far, macro-stabilization efforts of the National Bank and the Ministry of Finance have been remarkably positive. The success was supported by several factors, including (i) strong new management of the NBRB and the MoF; (ii) transition of the NBRB to inflation targeting; (iii) budget constraints related to shrinking of oil subsidies from Russia and limited access to external financial markets.

**Belarus (development measures):** Implementation of a package of market liberalization measures was the most successful example. All agreed measures were implemented on time. The key success factors were: (i) commitment of the authorities, above all from the EAEU; (ii) the pace of reform was agreed at the initial stage; (iii) pressure from IFIs.

**Armenia:** The package of agreed reforms was implemented either anticipatory or on time. During the mid-term review, the policy matrix was supplemented by new measures, which were also implemented on time. The success factors: (i) strong commitment of the authorities (all measures were envisaged by the different types of program/strategy); (ii) most measures were evolutionary in nature, and their implementation didn't require building additional capacity/consensus; (iii) some key measures were supported by other donors, either in the form of policy advice/prior actions for credit disbursement (the Tax Code's introduction – an IMF program requirement, and recommendations of the WB and other donors) or as technical assistance (digitalization of geological documents – USAID; construction of one-stop-shop social security centers – WB).

The main problems were with implementation of the second-generation structural and institutional reforms and measures<sup>13</sup>, addressing longer-term development challenges. In most cases, the implementation failure was related to low political commitment and lack of ownership on part of the authorities, as well as due to insufficient implementation capacity, which is a common feature for LICs and LDCs. Another important factor was the lack of EFSD expertise and the absence of systemic country diagnostics at the micro level, which is crucial for the design of programs. Box 7 discusses several cases of reforms that were not implemented.

<sup>13</sup> We define second-generation reforms as the set of measures needed to enable a country to attain high-quality sustainable growth.

### Box 7: EFSD financial credits – what did not work

**Belarus:** The reforms aimed at improvement of the SOEs' management, envisaged by the policy matrix, were not implemented within the stipulated scope and time frame. The key failure factors: (i) reforms included in the matrix were not agreed with top-level politicians, either by the government or by the EFSD – later, the President rejected the government's proposals on SOE sector reform as premature; (ii) in an environment of unfinished discussions about the reform agenda and the EFSD's lack of capacity/knowledge about the specifics of some reforms, some key measures were formulated overly broadly, which gave the government too much flexibility in interpreting the conditionality status.

**Tajikistan:** The key measure in the policy matrix requiring recommendations to be elaborated on the removal of ineffective tax benefits was not implemented, despite the provision of technical assistance from the EFSD (hiring a local consultant to conduct a tax benefits system assessment). Main reasons of failure: the government's lack of commitment to the reform and lack of knowledge of the Fund of the technical aspects of the functioning of the system of tax benefits in the country (it was assumed that the government had all the data to assess the effectiveness of benefits, whereas the country lacked a system of accounting for benefits). However, numerous discussions on this topic, including within the framework of EFSD monitoring missions, and concern of other donors considering the overly generous and opaque benefits system to be an obstacle for fiscal sustainability, strengthened the understanding of the authorities about the importance of the problem and stimulated them to move forward with some measures to optimize the system.

Overall, the following important lessons in the context of policy-based lending might be of interest to other RFAs and development partners:

- To avoid implementation problems due to capacity constraints, close collaboration with other donors (in terms of analytical and technical support at both the design and implementation stages) is crucial.
- Better results are observed in reforms supported by multilateral agreements and/or international ratings.
- In the case of weak or absent commitment to critical and politically sensitive reforms, sometimes it could be worth considering piecemeal measures as a compromise. It appears that the partial implementation of critical measures could stimulate the implementation of more comprehensive reforms.
- The risk for an RFA being perceived as a provider for facility shopping is high; this might have negative implications for the dialogue with a potential borrower. In this regards, trade-offs between the softening of budget constraints and commitment to reforms should be taken into account.

The implementation of infrastructure projects and grants faces issues and constraints similar to those faced by policy-based lending, including insufficient capacity and lack of expertise, both on the part of the EFSD and the borrower. In addition, infrastructure projects face serious risk of poor governance and low efficiency of public investment.

Another set of lessons involves the EFSD's ability to balance internal resources and achieve synergies between policy-based and infrastructure lending. The most important ones are:

- Provided that financial resources are adequate to address the dual mandate (this is the case for the EFSD), an RFA, working in a relatively small number of countries, may avoid conflict in internal procedures required for policy-based and infrastructure lending.

- A substantial investment in the development of internal procedures and human resources is required to make sure that all processes are streamlined and avoid conflict.
- Infrastructure lending has allowed the EFSD to stay engaged with countries' authorities and other donors in times when program-based lending is not provided.
- The dual agenda allows the positioning of the EFSD as a longer-term partner rather than as a lender of last resort. We believe that this is especially important for constructing effective dialogue with the authorities in LICs and LDCs.

## 8. CONCLUSION

To conclude, we provide answers to the three main questions which could serve as a basis for further discussion both among RFAs and with other development partners.

**Question 1:** *Is there a trade-off between development and stabilization objectives when an RFA provides support to low income or less developed countries?*

The experience of the EFSD and other RFAs suggests that the role of an RFA could be different, depending on the state of development and specific needs of countries in the region. We agree that RFAs should continue to fulfill their principal goal of macro and financial stability safeguards. Yet, as in the case of the EFSD member states, the developmental objectives could be equally important. First, because the majority of potential recipients of stabilization support have implemented first-generation reforms and improved quality of macroeconomic management. Second, the ongoing dialogue between the IMF and RFAs on improving collaboration already addresses many issues and problems for policy-based lending, targeting macro stabilization. Besides, the amount of available resources appears to be adequate for potential threats for BoP and debt sustainability in the EFSD member states, at least in the medium-term.

The dual mandate that the EFSD has been pursuing arose from an understanding that without structural and institutional transformation, as well as infrastructure and human capital development, economic growth in EFSD member states is likely to be excessively volatile and less inclusive, while external vulnerability is unlikely to diminish. At the same time, the countries' internal capacity to finance development needs is scarce, while a single donor's resources to meet these needs and willingness to accept long-term risks are limited.

For other RFAs, even if they do not have a mandate to provide infrastructure and other types of development projects, they generally have structural objectives embedded in their adjustment programs. At the 4<sup>th</sup> High-level RFA Dialog, many RFA leaders pointed out that macro-stabilization and structural objectives in general can be designed to reinforce each other. Short-term stabilization objectives should ideally create time and policy space for implementation of longer-term structural reforms. The latter will ultimately promote economic growth and bring longer-term sustainability.

There is another important nuance which should be considered in answering the first question. It relates to the ability of an RFA with *ex post* conditionality to minimize moral hazard and facility-shopping risks. While in some countries this problem could be partly solved by introducing *ex ante* conditionality (for example, by making policy-based lending conditional to the IMF program in a country), in many countries which have faced challenges of second-generation reforms, particular highly-indebted ones, such an approach could be unsuccessful. If a country considers the IMF and an RFA as lenders of last resort, *ex ante* conditionality based on stabilization benchmarks is not sufficient to avoid moral hazard risk (Scheubel and Stracca, 2016). To do so, structural and institutional benchmarks need to complement short- and medium-term macroeconomic adjustments required by a program. For example, this strategy is reflected in the recent IMF program in Armenia, where structural benchmarks are at least as important as macroeconomic targets<sup>14</sup>.

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<sup>14</sup> <https://www.imf.org/en/Publications/CR/Issues/2019/06/05/Republic-of-Armenia-2019-Article-IV-Consultation-and-Request-for-a-Stand-By-Arrangement-46968>

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Thus, the simple answer to Q1 (which we would like to propose for further discussion) is that in principle there should not be any *trade-off* between stabilization and development objectives in the context of LDCs and LICs. An RFA could be an effective contributor to both the stabilization and development agendas in its respective region, provided it has sufficient resources, both financial and human.

**Question 2:** *How to build an effective dialogue with authorities of a country which faces critical institutional and structural barriers to long-term growth, and remains extremely vulnerable to shocks?*

Our experience suggests that targeting longer-term strategic development goals requires a more strategic approach. We believe that the modality of partnerships that global development partners pursue with their members could serve as best practice for building an effective dialogue with authorities. For example, strategic partnership frameworks or road-maps of reforms might become an essential tool for successful achievement of medium-term developmental objectives. Such a framework would ensure better coordination of key reforms and projects with authorities and main donors. This will also help improve a country's ownership of and commitment to reforms. The framework will also allow improved synergy in achieving stabilization and development objectives.

Another important aspect, which should be carefully considered, is building expertise and capacity in areas that present the most interest to the authorities. Our experience suggests that the authorities value technical assistance and support from donors, and are more willing to hold an ongoing dialogue on sensitive issues and problems with those donors and development partners who have expertise in those areas, even without the agreed reform program.

**Question 3:** *How to achieve effective collaboration with other partners and donors in coordinating developmental agenda for common recipient countries?*

At the very least, an RFA which takes on developmental objectives should carefully study the expertise and knowledge accumulated by other development partners, found in systemic diagnostics and fundamental research. In addition, the above-mentioned partnership frameworks or road-maps should serve as a fundamental basis for coordinating the developmental agenda with partners in a common recipient country. Besides, a young RFA could rely on global development partners in building its human resources expertise and technical capacity.

Given that recent IMF programs include more structural benchmarks, improving synergy in the development agenda may also require a joint coordination effort between the IMF, RFAs and MDBs. This is especially important for success in politically-sensitive reforms.

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# ANNEX 1. OVERVIEW OF THE LATEST PROGRAMS SUPPORTED BY EFSD FINANCIAL CREDITS

## Armenia

The regional crisis at end-2014 negatively affected the Armenian economy and led to a deterioration in external and internal balances which forced the government to seek resources from the EFSD to support the budget. As Armenia was following an IMF program at that time, we relied on the IMF assessment of the adequacy of the macroeconomic framework, concentrating mainly on structural (institutional) reforms. The ultimate long-term goal of these reforms was to strengthen the country's resilience to external shocks through (i) broadening the economic growth base and tax potential; (ii) improving the efficiency of public resource management; and (iii) strengthening banking sector sustainability. This approach (as well as the list of measures) was suggested by the Armenian authorities and supported by the Fund and other donors.

The objective of broadening the growth base was supposed to be met through facilitating the entry of local and foreign investors to markets (the simplification of regulatory requirements, increasing transparency of and access to information important for starting a business, the introduction of an on-line tax declaration system, improving investment legislation), coupled with improved financial sustainability of the energy sector (improving tariff policy and increasing competitiveness). While it will take more time before the impact of these reforms on economic growth materializes in full, some indicators are already pointing to their early success: Armenia's ranking in *Doing business* has improved, all overdue debts in the energy sector have been repaid and a new ambitious program of sector development has been approved and is under implementation.

To improve the efficiency of public resources management, the program envisaged measures, the implementation of which had an impact on both the revenue side (through the adoption of a first Tax Code in the history of the country) and the expenditure side (improved value for money as a result of improved public procurement legislation; more strategic budgeting process in the selected sectors; and the introduction of international accounting standards). While results of the new Tax Code's introduction are already vivid (the growth rate of taxes in 2018 compared to 2017 was 8%), the impact of improvements in public expenditure is yet to be estimated.

The measures implemented in the banking sector had the ultimate objective of improving the sustainability of the banks through decreasing their dollarization level (the introduction of corresponding macro prudential norms by the CB) and increased population's trust in the banks (as a result of amendments to legislation to enhance deposits protection). By the end of the program, the dollarization level of loans had declined by 4 p.p. as a share of GDP (from 65.7% to 61.7%) but that of deposits had increased by 8 p.p. (from 38.7% to 47%). Further dedollarization will promote a more flexible exchange rate policy, which will have a positive effect on resilience to external shocks and improve competitiveness of the country.

## Belarus

The Belarus authorities requested the EFSD's second financial credit of USD 2 bln in March 2015 in a situation of economic recession due to deteriorating terms of trade and after trying stimulative economic policies, which the authorities had resumed in 2014 to support growth, but which resulted in widening both domestic and external imbalances. While external factors (the terms of trade

and decreased demand) had a more direct and short-term effect, the excessive role of the state in economic management, especially given the large size of the public sector, had a longer-term effect on growth. Based on this understanding, the EFSD's opinion was that the ultimate objective of economic stabilization was not possible to achieve without solving the structural constraints of the Belarusian economy. The lessons learned from the previous EFSD and IMF stabilization programs in 2009–2011, which showed the rapid disappearance of the results of macro stabilization after the end of the programs as a consequence of the resumption of the stimulative policy of the state through the support of a significant public sector, were also taken into account. The Belarus authorities also admitted the need for de-regulation of the economy to be carried out in a gradual mode. Based on this mutual understanding, it was agreed that the program to be supported by the credit would consist of two pillars – macroeconomic stabilization and structural reforms. Whereas the stabilization part of the program was agreed upon fairly quickly, the discussion of the depth and speed of the structural reforms took quite some time. Finally, the policy matrix approved by the Fund Council reflected some kind of compromise between the readiness of Belarus for reforms and the original recommendations of the EFSD.

Macro stabilization measures were aimed at a reduction of the inflation level and increase in national savings through conducting balanced monetary, foreign exchange, and fiscal policies. The agreed thresholds for monetary indicators were intended to contain the money supply. The conditionality to execute a general budget with a zero balance due to restrained wages growth and reduced budget subsidies and transfers to state enterprises had the objective of optimizing and increasing the efficiency of domestic demand and, along with a more flexible exchange rate policy, mitigating pressure on public debt and the BoP. The reforms implementation had a positive impact on macro indicators, including a visible reduction in inflation, some stabilization of the BoP/ public debt parameters, and growth of international reserves.

The agreed package of structural reforms could be divided into three broad categories: (i) markets liberalization; (ii) SOEs management reform; and (iii) enabling the business environment.

Markets liberalization envisaged easing regulation in all markets through liberalization of consumer prices; increasing the cost-recovery level for residential utility and transport tariffs; the abolishment of direct price setting for dominant enterprises; curtailing directed (or subsidized) lending (i.e. state programs); and lifting restrictions on the forex market. So far, all indicators have demonstrated notable improvements since the beginning of the program in 2016: the share of regulated consumer prices in the consumption basket has decreased by 17 pp to 21%; directed lending as a share of GDP has shrunk by almost half (from 21% to 12%); all restrictions on economic entities in the forex market have been cancelled. Yet, there are some signs that administrative pressure on consumer prices still exists. Also, the full transition to market pricing is hindered by a highly regulated system of state purchasing prices for agricultural products.

It was assumed that the SOE reform would be carried out according to the principles of the Strategy for Improving the Efficiency of Managing State-Owned Organizations, to be elaborated and approved by the authorities by September 2016. That draft Strategy had benefited from recommendations of different development partners active in the country, and envisaged a wide set of reforms, including separation of the functions of the owner and the regulator; the introduction of corporate management principles in SOEs; improving the monitoring system of fiscal risks generated by SOEs; an assessment and optimization of the scale and effectiveness of state support; the introduction of international accounts; and improvement of the legal framework in the management of state property. This document was not, however, supported at the highest political level as premature. The compensatory measures for the following tranches agreed with the authorities in these circumstances were mainly about introducing corporate governance elements into the performance of separate enterprises and had no visible impact on the SOEs' efficiency, because of their fragmentation and lack of comprehensiveness.



The abolishment of production targets for SOEs, which assumes transition to a more market-oriented approach, and the establishment of a department for monitoring and assessing SOEs' quasi-fiscal risks in the MoF, could be mentioned as positive outputs of the program in this direction.

The set of measures aimed at creating a more favorable environment for private sector development envisaged the establishment of the Business Ombudsman institute, the introduction of a regulatory impact assessment instrument for all legal acts, and simplification of regulatory norms for small and medium-sized (private) enterprises. The latter two requirements were met, as many legal and by-law acts adopted in the course of the program have indeed diminished the regulatory burden. The Business Ombudsman institute was not established, however, as the top-level authorities decided that the existing Business Development Council under the President was a sufficient equivalent of the Ombudsman. The preservation of unequal conditions for the development of state and private enterprises because of a continuation of budget support for SOEs, albeit on a smaller scale, and the conservation of the problem of over-employment in SOEs, are among the main obstacles to the more rapid development of the private sector.

## Tajikistan

The 2014 regional crisis had a direct negative impact on the state budget of Tajikistan through a reduction in the volumes of transfers sent by Tajik labor migrants to the home country (on average, constituting about 30–40% of GDP), which caused a decline in imports and customs revenues. The devaluation of the somoni, the Tajik national currency, after some attempts by the National Bank to support its pre-crisis level, resulted in a boost to the public debt level, depletion of the international reserves and a multiplicity of exchange rates. While the Ministry of Finance requested the credit to support budget expenditures, it was quite obvious that the long-term goal of fiscal sustainability lay, in the first place, in expanding the growth base and improving the quality of public financial management. From this point of view, the emphasis of the policy matrix was placed mainly on development reforms, though it also envisaged some elements of stabilization measures (in the absence of an active IMF program in the country).

The focus of the macro stabilization section was on eliminating the multiplicity of exchange rates and conditions (including methodological ones) provoking their appearance. Progress in this area was uneven – due to the monetary authorities' policies, the exchange rate was only unified in 2015–2016, although in April – May 2017 multiplicity was observed again. The thresholds of monetary indicators were set to help reduce inflation, and violation of some of them was reflected in accelerating prices in 2017. Compliance with established ceilings of the budget deficit and new debt borrowings, coupled with a requirement to maintain social expenses at the agreed level, was supposed to ensure more budget discipline and stability in the short term. While requirements for fiscal ceilings were met within the program, Tajikistan has conducted an expansionary budget policy since 2017 with the aim of large-scale public construction.

To address the deteriorating situation in the banking sector because of the non-transparent exchange rate policy and large volumes of high-risk and inefficient directed lending, aggravated by shrunk domestic demand, the policy matrix envisaged conditionalities to improve the quality of the National Bank's prudential monitoring and to improve access of the population to information about banking sector activities (including disclosure of the banks' main shareholders on the bank websites). The measures were implemented only partially and were insufficient to prevent a banking crisis in 2016.

To improve the fiscal stance, the matrix included measures aimed at eliminating ineffective tax exemptions and improving SOEs management. Based on some experts' estimations, tax expenditures in Tajikistan could reach 7–8% of GDP annually, although their efficiency and effectiveness are under question. The intent was that the latter issues would be analyzed by the government with the help of

consultants, and a decision on system optimization would be made based on the results of this analysis. However, as the consultant failed to gather the necessary information, partly due to the absence of an appropriate system for recording and monitoring tax expenditures, the planned assessment was not conducted. The positive effect of this measure is that the authorities are now concerned about the effectiveness of tax incentives and have begun to take a number of steps to create an appropriate system of accounting for tax expenditures. While the government has adopted a strategy for improving the management of quasi-fiscal risks generated by SOEs, which was drafted with the help of foreign consultants, right now it is too early to judge about the effectiveness of the implemented measures.

Given that the largest quasi-fiscal risk was generated by the state energy company Barki Tojik, the matrix envisaged some measures aimed at improving the balance sheet of this company through a revaluation of fixed assets and a write-off of bad debts. Partial implementation of these measures and slow progress in the other areas of the company's restructuring, as well as the absence of improvements in both management of the company and energy tariffs policy, have resulted in a further deterioration in the company's financial state. Recently, the Tajik government approved a new concept for the company's financial rehabilitation, which will take another 6 years and will cost about USD 1.2 billion.

## ANNEX 2. INPUT FROM RFAs FOR THE WORKING PAPER – QUESTIONNAIRE

### RFA programs

**Q1:** Please briefly describe your program’s designs (past or current) in terms of the following policy measures and/or conditionalities:

1. Short-term stabilization, macro-adjustment and macro-prudential;
2. Policy measures or reforms which are expected to exercise a longer-term developmental impact (for example, these could be structural and/or institutional reforms – labor market reforms, judicial reform, land reform, etc.);
3. Policy measures which could have both a short-term and longer-term impact on economic development in a country (for example, this could be a tax reform expected to improve the fiscal position in the short-term and, at the same time, could have a longer-term impact on income distribution and growth).

**Q2:** Do you consider measures and policies which target structural and institutional constraints to growth as an important part of your program? If yes, how you go about negotiating such measures with governments?

**Q3:** Please describe implementation issues that you face:

1. Short-term stabilization measures;
2. Policy measures or reforms targeting longer-term development objectives;
3. Other implementation issues.

**Q4:** Do you consult/coordinate your policy advice (to borrowers) with other IFIs or donors? If yes, please describe the coordination process.

**Q5:** Please list key lessons from your experience with respect to:

1. Key obstacles for program implementation;
2. Feasibility of measures included in programs;
3. Adequacy of internal capacity to design, monitor and implement a successful program.

### Adequacy of resources and capacity

**Q6:** With an understanding that the principal goal of your RFA is to support macroeconomic and financial stability in your member countries, do you consider the amount of available funds adequate to fulfill this task? How do you assess the adequacy of available resources?

**Q7:** Do you consider that your RFA has an appropriate structure and staffing to fulfill the principal task mentioned in Q6?

Q7a. if not, which expertise is lacking?

Q7b. if not, do you outsource some functions to consultants, to other IFIs, etc.?

## **Policy-based lending vs. infrastructure investment**

**Q7:** Does your RFA has an opportunity (i.e. no formal restriction) to provide lending for infrastructure needs, human capital development or other development needs?

Q7a: If yes, do you have such operations in your portfolio? Please describe them.

Q7b: If not, do you think that such operations could add value to your RFA's role and impact in the region?

**Q8:** In principle, do you see any problems (risks) if an RFA, whose principal goal is to safeguard macroeconomic and financial stability, also provides sovereign loans for building infrastructure?



**EFSD** WP/19/1 (RU/EN)

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

The objective of the first working paper is to bridge the gap in understanding the dynamics of EFSD development and its place in the Global Financial Safety Net (GFSN) and the region's financial architecture.



## Eurasian Development Bank

Sergei Ulatov, Natalia Pisareva, Artem Levenkov

Achieving stabilization and development objectives  
in a single agenda: The experience of the Eurasian  
Fund for Stabilization and Development

The **Eurasian Fund for Stabilization and Development (EFSD)** amounting to US\$8.513 billion was established on June 9<sup>th</sup>, 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/>

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