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**Total Debt is So Much More  
Than Just Sovereign Debt.**

***Contingent Liabilities in  
Armenia, Belarus, Kyrgyz  
Republic, and Tajikistan***

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This Working Paper has been prepared based on statistics as of 01 August 2021. Macroeconomic indicators for forecast calculations are based on the baseline scenario as of August 2021.

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# Table of contents

Abbreviations .....	2
Acknowledgements .....	3
Executive Summary .....	4
1. Introduction .....	9
2. Literature review .....	11
3. Methodology .....	13
4. Global changes: public and private debt .....	16
5. Contingent and direct liabilities .....	24
6. Stress test: contingent liability shock .....	40
7. Conclusion and policy implications .....	46
References .....	49

## Abbreviations

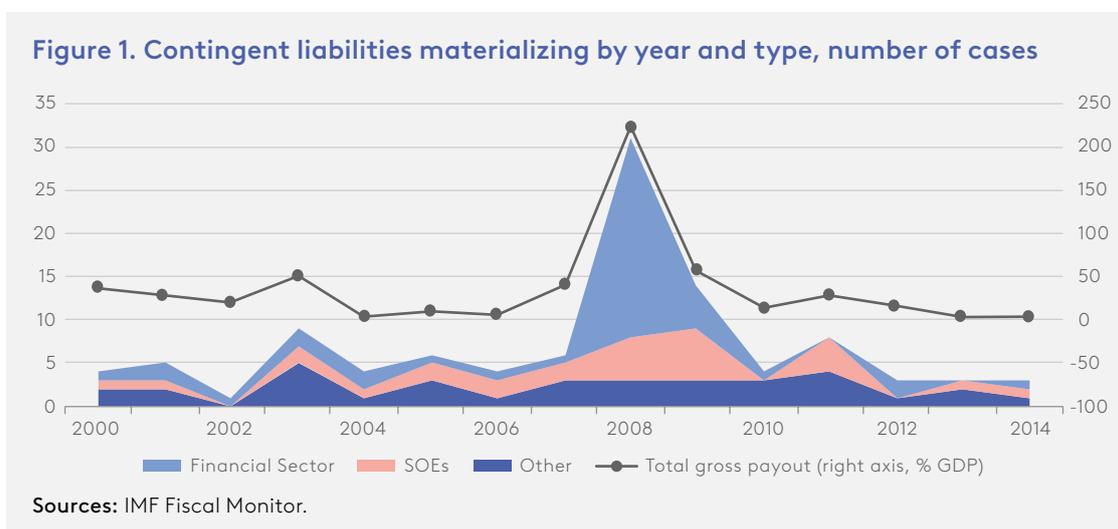
<b>ADB</b>	Asian Development Bank	<b>POCI</b>	purchased or originated credit-impaired
<b>AE</b>	advanced economies	<b>PPP</b>	public-private partnership
<b>AIB</b>	open joint-stock company “Agroinvestbank”	<b>REER</b>	real effective exchange rate
<b>BRI</b>	Belt and Road Initiative	<b>SME</b>	small and medium enterprises
<b>DBB</b>	Development Bank of the Republic of Belarus	<b>SOE</b>	state-owned enterprise
<b>DSA</b>	debt sustainability analysis	<b>SPMD</b>	State Property Management Department at the Republic of Armenia Government
<b>EFSD</b>	Eurasian Fund for Stabilization and Development	<b>SPMF</b>	State Property Management Fund of Kyrgyzstan
<b>EM</b>	emerging markets	<b>TALCO</b>	Tajik Aluminium Company
<b>EMDE</b>	emerging and developing economies	<b>UMIC</b>	upper middle-income countries
<b>GDD</b>	Global Debt Database	<b>WB</b>	World Bank
<b>GDP</b>	gross domestic product		
<b>HIC</b>	high-income countries		
<b>HPP</b>	hydroelectric power plant		
<b>IIF</b>	Institute of International Finance		
<b>IIP</b>	international Investment Position		
<b>JSC</b>	joint-stock company		
<b>LDCs</b>	least developed countries		
<b>LICs</b>	low-income countries		
<b>LMIC</b>	lower middle-income countries		
<b>NBRB</b>	National Bank of the Republic of Belarus		
<b>NFC</b>	non-financial corporate		
<b>NPA</b>	nonperforming asset		
<b>OECD</b>	Organization for Economic Co-operation and Development		
<b>OJSC</b>	open joint-stock company		

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## Executive Summary

A key structural consequence of any economic crisis is the materializing of fiscal and debt risks. The public discourse (in Eurasia and in the world in general) focuses heavily on sovereign debt while the non-sovereign component of debt often remains in shadows. Meanwhile, **companies' bailouts, bank recapitalizations and other effects of macroeconomic shocks lead to materializing of contingent liabilities, which may increase risks to sovereign balance sheets** (Figure 1). Recent experience suggests that anti-crisis measures aimed at economic stabilization may impair governments' capacity to exercise effective fiscal policy, which in turn further triggers economic crises. In order to mitigate these risks, it is critical to identify and manage all the risks that may affect governments' liabilities and jeopardize fiscal and debt sustainability.



**This study aims to contribute to understanding the potential risks and impacts of both explicit and implicit contingent liability shocks on government fiscal and debt positions in the EFSD recipient countries** (Armenia, Belarus, Kyrgyzstan, and Tajikistan). In order to gain a broad picture of their debt obligations, we combine all relevant debt instruments, taking into account interactions between public and private sectors.

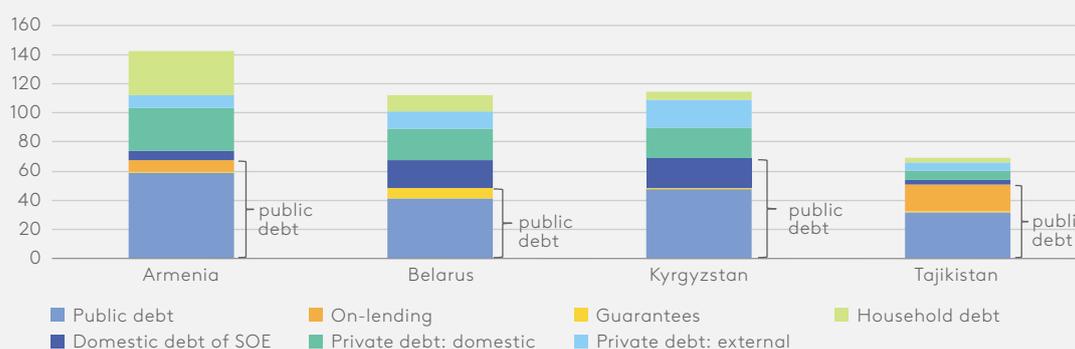
Following this detailed and scrupulous data assessment, we summarize several crucial observations.

**The national governments' involvement (providing state guarantees and supporting important banks and companies) increases countries' fiscal risks. However, this reality is only partially reflected in public finance statistics.** For example, while Belarus's central government debt amounted to around 39%<sup>1</sup> of GDP in 2020, its broadly defined public and publicly guaranteed debt (including

<sup>1</sup> Hereinafter, the EFSD debt estimates may differ from the official data. According to the EFSD approach, the debt level is calculated as the ratio of public liabilities (where foreign-currency debt is converted to local currency using the exchange rate at the end of the period) to GDP in national currency at current prices.

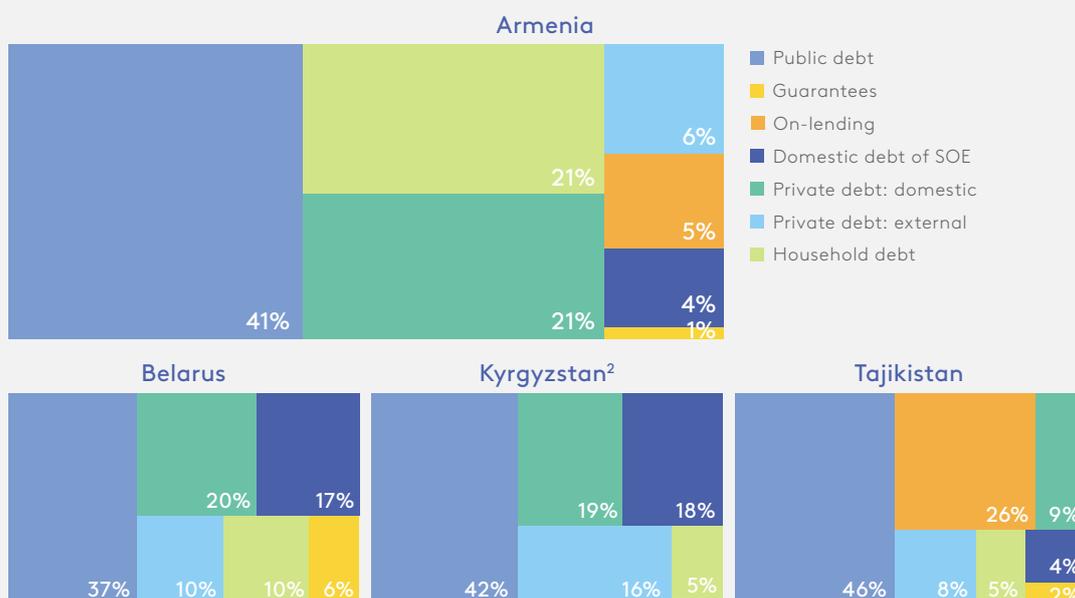
guarantees and local government debt) totaled 48% of GDP. Concurrently, domestic debt liabilities of SOEs were around 19% of GDP in 2020 (Figure 2). Given the government's extensive involvement in SOEs' operations, the deterioration of economic circumstances may have a significant impact on the state of government finances.

**Figure 2. Sovereign debt and private debt of non-financial sector, at the end of 2020, % of GDP**



Sources: Authors' calculations.

**Figure 3. Analytical presentation of the total debt structure, total debt = 100%**



Sources: Authors' calculations.

**On-lending, when a government borrow funds from a nonresident and then on-lend the funds to enterprises, is another factor, which may affect countries' fiscal positions.** Although it is included in public debt stock, its impact on debt flows is rarely considered under risk scenarios. For example,

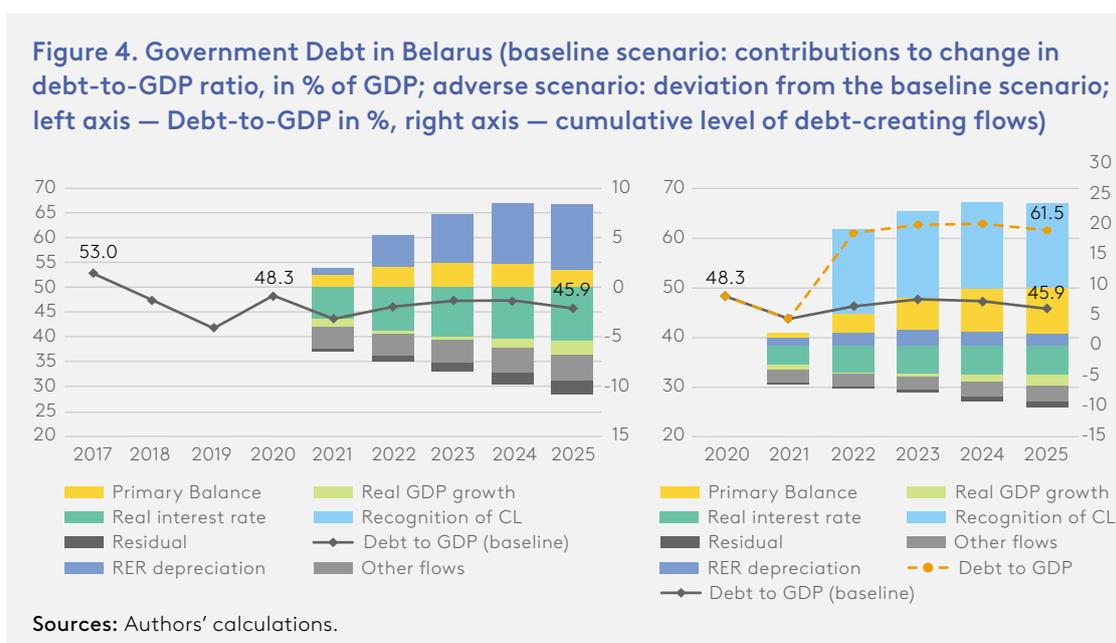
<sup>2</sup> Domestic debt of SOE includes on-lending operations.

on-lent loans in Tajikistan amounted to around one-third of total government debt in 2020 (Figure 2). This implies that if a borrower is unable to service its debt obligations, the country’s solvency risk will increase, as government assets would be impaired.

**Cross-country evidence suggests that countries with market access are at the top of the EFSD private debt ranking.** In contrast, in Tajikistan, companies’ debt obligations are only half of the EFSD average. This relatively low indebtedness of Tajik state-owned companies can be mainly explained by the country’s access to concessional credits, which the government provides as on-lent loans to large and systemically important companies.

A comprehensive analysis of debt instruments and contingent liabilities reveals that **two EFSD recipient countries, Belarus and Tajikistan, are exposed to fiscal risks related to state guarantees and on-lending.** First, both countries have a high degree of government involvement by providing guaranteed and on-lent loans. In addition, their state-owned companies are noted for a relatively weak financial performance and high arrears. Concurrently, their fiscal transparency may need to be further improved.

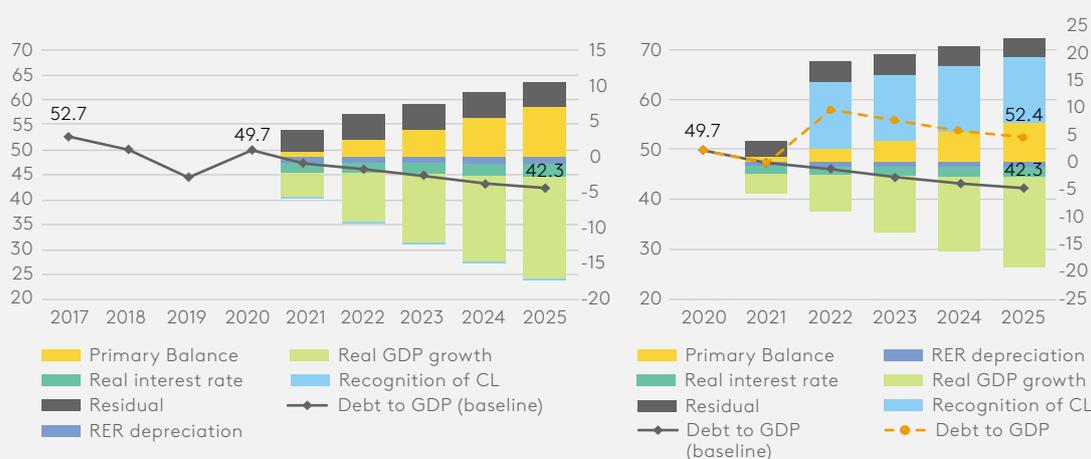
In order to shed light on how the materializing of contingent liabilities may change the financing needs of Belarus and Tajikistan, **we conduct stress-testing of a sizable contingent liability shock.** Assuming that governments are not intended to allow “too big to fall” SOEs to default on their obligations, we focus on private nonguaranteed debt, incorporating our judgement about riskiness of SOE obligations due to the limited available data on their financial performance and uncertainty over the credit agreements. When considering Belarus and Tajikistan, we set the size of shock associated with their contingent liabilities at 14% and 12.1% of GDP, respectively. These assumptions take into account the size of the government sector and its economic performance, as well as the level of its indebtedness.



Our simulation of the contingent liability shock suggests that **it may be a key source of concern for their debt sustainability**. In Belarus, according to the adverse scenario, public debt might increase to almost 61% of GDP in 2022, compared with the projected 46% of GDP in 2022. In the medium run, public debt would remain above 61% of GDP, which is consistent with the general pattern of debt trends in the baseline scenario (Figure 4). An increased debt level is only one side of the problem, however. Another issue is related to financing needs. Our estimates indicate that, in the short run, a contingent liability shock would result in a surge in public financing requirements. Under this pressure, the country's borrowing needs will increase. However, given the limited international support and near closed market access, Belarus may face significant solvency and liquidity risks. By 2025, Belarus's financing needs are expected to decline slightly, however, they are likely to remain a source of vulnerability for debt sustainability, especially given the country's susceptibility to both domestic and external uncertainty and a limitation of funding.

In Tajikistan, contingent liabilities may notably derail the government's debt position; hence, in 2022, the debt-to-GDP ratio may increase to 58% under an adverse scenario (baseline scenario — 46.1%). In the medium run, public debt would moderately decline and, by 2025, it should total 52.4% of GDP (Figure 5). This implies that, over 2023–2025, the country will not be able to reduce its debt obligations to levels similar to those prevailing in 2021. Corresponding estimates for financing needs underline a considerable fiscal burden in the year of the shock. In the long run, they face increased amortization payments and debt-servicing obligations coming due. However, since Tajikistan is a low-income country, it has access to concessional loans, which are expected to become the main financing sources. In line with this assumption, in the medium run, the country's liquidity positions would remain moderate. However, when the grace period ends, the country should be more focused on strengthening its fiscal positions.

**Figure 5. Government Debt in Tajikistan (baseline scenario: contributions to change in debt-to-GDP ratio, in % of GDP; adverse scenario: deviation from the baseline scenario; left axis — Debt-to-GDP in %, right axis — cumulative level of debt-creating flows)**



Sources: Authors' calculations.

All in all, **contingent liability risks have remained heightened for some EFSD economies, which increases those countries' need for comprehensive fiscal strategies.** In this context, they may need to be focused on a number of factors that will contribute to strengthening the countries' public finance management.

The **policy conclusions** stemming from our analysis are as follows:

First, it is important to remember that **countries' debt is much more than just sovereign debt.** Thus, it is recommended to **focus on a broader scope of countries' finance sectors, including both direct and indirect factors.** The first step in this procedure should include monitoring of balance sheets of state-owned companies and banks through their regular reporting. This implies a need for analysis of quasi-fiscal operations and their effects on both entities' financial results and companies' interactions with the budget — including the terms and conditions — should also be disclosed. For example, while Belarus reports the stock of state guarantees, it does not disclose terms of guarantee agreements, which may lead to speculation about the country's fiscal sustainability and performance of its SOEs. Hence, this uncertainty may result in a higher risk premium and worse borrowing conditions.

Second, it is recommended to systematically conduct a comprehensive risk analysis, **including risks from on-lending, guarantees and state-owned companies, with particular focus on loss-making companies and banks.** This analysis should indicate the probability of contingent liability risks materializing and their potential fiscal impact. We emphasize the importance of public corporations' performance for debt sustainability, and this type of assessment can be considered as a foundation for effective risk management. Based on these estimates, governments may adopt a number of measures that minimize uncertainty and mitigate potential risks, or they may reserve some funds in the event of SOEs experiencing a crisis. The complete risk analysis implies not only investigation of the debt stock but also a study of gross financing needs and borrowings.

Third, **transparency is key in the broader scope of debt. Complete and clear information on different sources of contingent liabilities may strengthen credibility and benefit the credit rating.** This would be reflected in a reduced risk premium and borrowing costs. On the domestic side, this may increase the effectiveness of fiscal policy, and specifically in debt management. Apart from that, high-quality forecasts with stress-testing will contribute to widening room for maneuver in the management of budget funds. It is noteworthy that, in the short run, the decision to increase transparency may diminish countries' credit ratings. However, in the long run, this is usually reversed, and countries may attract additional financing on better credit terms.

# 1. Introduction

One of the key consequences of any economic crisis is the materializing of fiscal and debt risks. Companies' bailouts, bank recapitalizations and other effects of macroeconomic shocks lead to materializing of contingent liabilities, which may increase risks to sovereign balance sheets. Recent experience suggests that expansionary fiscal policy may impair governments' capacity to exercise effective fiscal policy, which in turn may further trigger economic crises. In order to mitigate these risks, it is critical to carefully identify and manage all the risks that may affect governments' liabilities and jeopardize fiscal and debt sustainability.

This study aims to contribute to the understanding of potential risks and impacts of both explicit and implicit contingent liability shocks on government fiscal and debt positions. In particular, this paper includes analysis of debt trends and government financing needs. In this context, the study also considers private obligations and the risk they may expose to the government's balance sheet. Special attention is paid to the importance of state-owned enterprises and their role in countries' debt positions.

In the EFSD recipient countries, specifically the materializing of contingent liabilities may constitute a significant risk to sovereign finances and contribute to debt growth. Volatile economic growth and a persistent fiscal deficit in some EFSD countries leads to a corresponding increase in the debt-to-GDP ratio. Concurrently, undiversified exports and low competitiveness of both their private and state companies motivate the EFSD governments to provide generous support through subsidies, tax exemptions, guarantees and loans. All these factors render sovereign fiscal positions more fragile to economic shocks. Hence, initiatives are required to manage these risks, including an assessment of their sources and implementation of stress-test analysis of countries' capacity to deal with contingent liability shock.

In this study, we intend to shed light on debt positions of the EFSD recipient countries by analyzing their sovereign debt positions with a focus on contingent liabilities' risks. In addition to a general overview, we illustrate the difference between the EFSD recipient countries and their peer countries with a focus on their debt response to the recent macroeconomic shock. By identifying countries' fiscal positions in 2020, we apply a contingent liability stress test to determine their impact on the countries' solvency and the level of debt. In this analysis, we focus on Belarus and Tajikistan, two EFSD member states, due to their high degree of government involvement and overall exposure to fiscal and debt risks.

Motivated by the growing significance of debt sustainability and the necessity to mitigate contingent liability risks, this study emphasizes the importance of monitoring not only public debt, but also state guarantees, obligations of state-owned enterprises, and other factors that may directly or indirectly affect government liabilities. We embed risk management — such as stress tests — in the assessment of debt sustainability, which can contribute to the development of policy responses in the face of contingent liability risks.

The structure of the paper is as follows. Section 2 provides a literature review. Section 3 contains a discussion of methodology and data-related issues. Section 4 shows general patterns in debt portfolios in both advanced and emerging economies, with some focus on the EFSD recipient countries. Section 5 discusses the impact of both direct and contingent liabilities on countries' economic performance and debt positions. Section 6 provides assessments of contingent liabilities' shocks on debt indicators of the EFSD economies with a high degree of government involvement. The concluding Section 7 summarizes the key arguments and develops a set of policy recommendations going forward.

## 2. Literature review

A wide range of studies of international organizations exists that investigate key policy measures aimed at mitigating debt risks and developing new mechanisms for providing finance (WB, 2019a). Together with microeconomic and financial recipes, they identify the role which macroeconomic policy may play in favor of strengthening debt sustainability.

The 2020 crisis notably increased the amount of studies devoted to the problem of raising debt and countries' capacity to mitigate fiscal risks. Kose et al. (2020) presented a comprehensive analysis of different episodes of debt surges in the 1970s-2000s. The study emphasized that around 50% of those debt build ups resulted in economic crises. The OECD (2021) focused on consequences of the COVID-19 crisis and highlighted the importance of coordination between monetary and fiscal policy authorities in order to reduce the public debt burden.

Apart from general debt management based on prudent fiscal policy, some studies emphasized the importance of solving financial difficulties in state-owned enterprises. Baum et al. (2020) presented an in-depth analysis of tackling fiscal risks from SOEs and identified the channels through which these companies impacted budget costs and generated contingent liabilities. Another channel of contingent liabilities consisted of the inability of a borrower to service state guarantees or on-lent loans. A study of guarantees for SOE borrowings by Prats and Moskovits (IADB, 2020) confirmed that state guarantees were the main risk to efficient management of the government balance sheet.

According to a number of studies, the materializing of contingent liabilities, which are often called "hidden deficits", has remained expensive and may push public financing needs into unsustainable territory. A variety of studies sheds light on the high contribution of contingent liabilities to the sovereign debt increase in EMDE and in advanced economies: Towe (1991), Weber (2012), Polackova-Brixl et al. (2002), and Mulas-Granados et al. (2016). Bova et al. (2016) emphasized that, in advanced economies, credit risks were primarily associated with the financial industry, while in EMDE, materializing contingent liabilities painted a relatively mixed picture. In that respect, the consequences of materialized contingent liabilities — including SOE support, subnational government bailouts and others — amounted to around 12–15% of GDP during 1990–2014. They also found that different types of materializing of contingent liabilities correlated with each other, specifically, SOE, subnational and PPP contingent liabilities are all highly linked to fiscal risks from the financial sector.

One of the key issues that most studies faced is the limited transparent data available, such as published state guarantee agreements and contracts with SOEs (IMF, 2016). In addition, the analysis of fiscal risks also requires comprehensive and regular data on public companies' financial statements. Otherwise, weak accounting may result in biased estimates. Most of the studies about contingent liability risks discussed the performance and governance of SOEs (Bower, 2017), and how fiscal risks from SOEs can be mitigated (OECD, 2018). Empirical studies have developed only in countries with implemented monitoring and risk assessment tools (IMF, 2016). These analyses are usually based on the assessment of the expected loss function, taking into account the swap default spreads (Benno Ferrarini, 2018) or other relevant indicators developed by officials (Bachmair and Bogoev, 2018). Apart

from these approaches, the World Bank (Razlog et al., 2020) has developed a toolkit that enables us to forecast cash flows for state guarantees under a variety of macroeconomic scenarios. In turn, the IMF (Baum et al., 2020) has introduced a risk management tool that provides quantitative estimates of potential fiscal costs from SOEs and state guarantees.

While most of the papers tend to provide a general approach to the analysis of fiscal costs from contingent liabilities, and various case studies on countries' measures to eliminate these risks, the purpose of our study is to investigate the role of contingent liabilities (both implicit and explicit) in the debt positions of the EFSD recipient countries and estimate debt sustainability under a contingent liability shock. This task requires a comprehensive review of possible sources of shocks and estimates of their potential level. For these purposes, we used a DSA model (IMF, 2018b), which enables us to simulate debt positions and conduct stress-testing. This tool serves several functions: the assessment and forecasting of countries' debt levels under the baseline scenario, and of debt positions under a contingent liability shock. This approach has been used in a variety of studies and policy papers. In fact, using the DSA model, the IMF and the World Bank have regularly applied contingent liability shocks to countries dependent on the performance of SOEs (Chow, 2015).

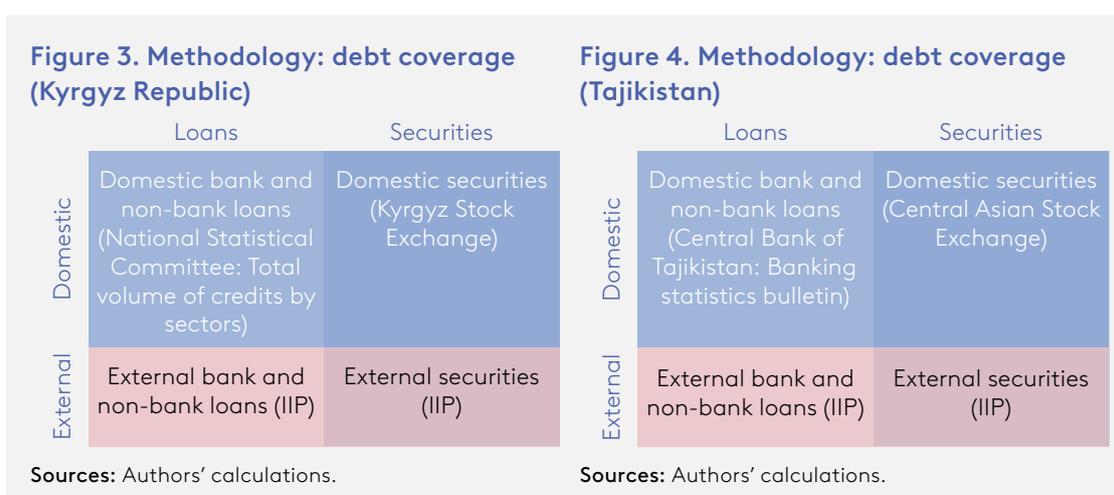
All in all, while the problem of contingent liabilities and their impact on the government balance sheet has been widely discussed, approaches to their analysis are limited, especially for the most vulnerable emerging and developing countries. A lack of transparent microeconomic data on SOE financial indicators has usually forced international organizations to apply a relatively narrow framework for their assessment. It is usually based on average changes in SOEs' obligations to the government during economic crises.



For Belarus, we use debt data from a financial survey, which covers not only domestic debt loans, but also non-bank loans (including non-banking credit and financial institutions, insurance companies, currency and stock exchange, etc.) (Figure 1). Compared with those of the other EFSD recipient countries, these data are relatively exhaustive. The financial survey also includes information on public corporations' debt obligations, which enables us to calculate the footprint of state-related companies, at least on the domestic credit market.

Armenia is also relatively transparent, but compared with Belarus its survey of commercial banks and credit organizations covers only loans and does not include securities (Figure 2). However, one of its strong points is the availability of data on on-lent loans. At the end of 2020, Armenian on-lending operations totaled 8% of GDP, which is a significant figure, reflecting potential risk to the country's financing needs. The annual reports of the Department of State Property Management were used as a source of information on SOEs obligations. For securities, data are collected from Armenia Securities Exchange.

The dataset for LICs (low-income countries) has limited data and covers a short history. A wide range of international institutes usually consider only domestic banks' claims on the nonfinancial sector. However, as the IIP data are available for Tajikistan and the Kyrgyz Republic, we also include them in our analysis. The main hurdle we face in the calculation of their private debt is the differing sector coverage of domestic loans. While for Tajikistan we have relatively comprehensive data, which include household debt, mortgages, leases, overdrafts and even obligations of state-owned companies, in the Kyrgyz data the nonfinancial sectors cover loans to some industries, mortgages and consumer loans. Assuming that household debt primarily consists of mortgages and consumer loans, we classify these categories as household obligations (Figure 3, 4). Data on outstanding amounts of debt securities were collected for Kyrgyz Republic from Kyrgyz Stock Exchange. However, the volume of corporate bonds issued by non-financial companies is extremely small and represented by several companies. The bond market in Tajikistan is represented entirely by securities of financial companies.



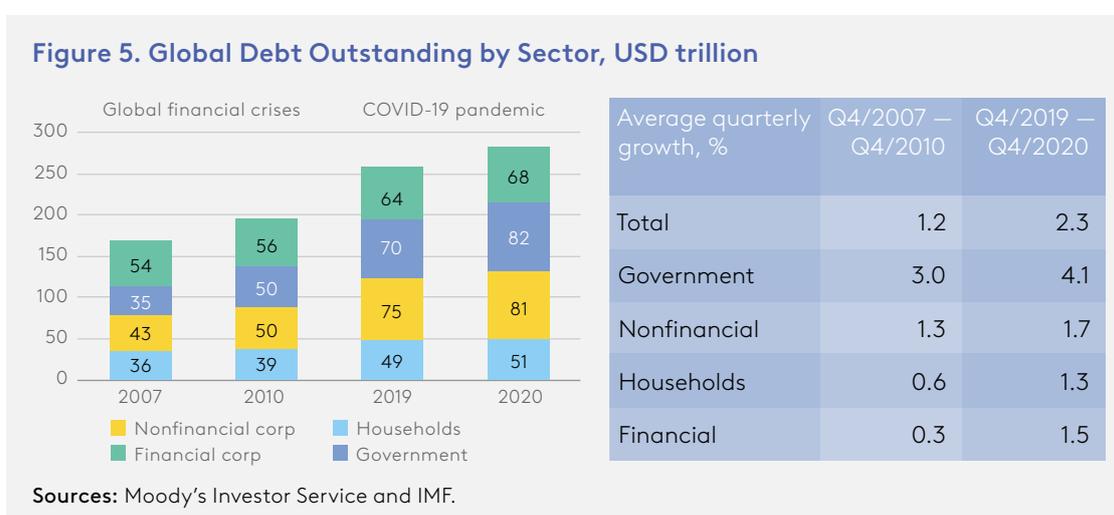
All in all, we have obtained relatively comparable data; however, a comprehensive study may require taking into account some specific features of the EFSD countries' data. In fact, Belarus's nonfinancial debt covers all debt instruments, including repurchase agreements, which results in some gap with other EFSD recipient countries.

In respect of public debt statistics, we highlight that they are more transparent and are primarily taken from data of ministries of finance. These data include series on the debt portfolios and their main components. They are also complemented with series on state guarantees and on-lent loans.

The compilation of private and public debt series results in a comprehensive picture of the EFSD countries' total obligations. Its main purpose is an assessment of both explicit and implicit fiscal risks for separate countries and the EFSD region.

## 4. Global changes: public and private debt

Over the past year, global debt has increased to more than \$ 281.5 trillion, driven by an upsurge in government spending and a decline in revenues amid the coronavirus outbreak. The rescue packages to support economies were significantly larger in 2020 than during the financial crisis of 2008, while the negative shock to most economic indicators was more severe (Figure. 5). In fact, back in 2008, global debt increased by around 10 p.p. of GDP, while in 2020 this rise surpassed 34 p.p. As a result, the global debt-to-GDP ratio soared to over 355%, which is an all-time high.



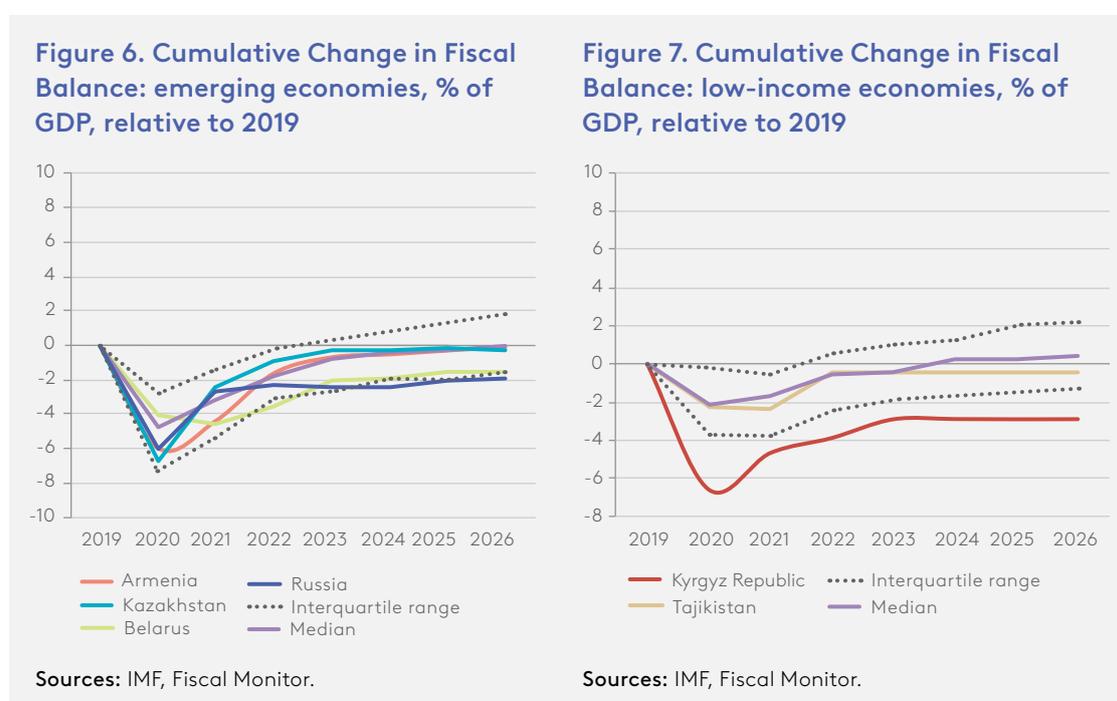
The countries' contribution to the world's debt accumulation varies significantly. Advanced economies (AE) have become the main drivers of the debt mountain, accounting for around 87% of the increment. However, in 1Q2021 their debt slightly declined, while debt in emerging economies has continued to rise. Indirectly, this reflects the fact that emerging and developing countries are under more severe pressure than mature markets. In AE, the decline in the debt-to-GDP ratio is primarily explained by a contraction in obligations of the financial sector. Other sectors – non-financial organizations and households – have also slightly reduced their level of obligations. However, public debt remains the main driver of debt growth across advanced economies. Furthermore, since its share accounts for one-third of countries' obligations, its role seems the most important for countries' debt positions.

### Public Debt

In 2020, AE public debt reached 130.4% of GDP, while in emerging countries it was significantly less, around 63.5% of GDP, which partially reflected limitations to the fiscal space. (Over the last year, AE median public debt surged by more than 20%, but in emerging countries this increase was only 11%).

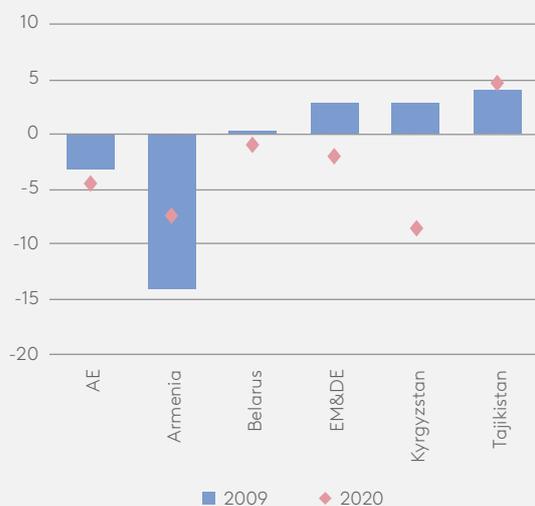
Lower fiscal capacity together with economic activity below pre-crisis levels has made emerging economies more vulnerable to debt distress compared with mature markets. Although their ratio of debt to GDP was notably less than in developed countries, there were a number of factors which increased risks to EM profitability and rendered their performance more fragile. A surge in fiscal deficits coupled with the contraction in output was among the main reasons. The average fiscal deficit in EM jumped to around 10% of GDP in 2020, which was almost twice as large as in 2019 (Figure 6). Low-income countries also implemented significant fiscal actions in 2020, and this boosted the government deficit to 5.5% of GDP (Figure 7).

Since the government response of EFSD recipient countries to the COVID-19 crisis was also notable — according to conservative IMF estimates, between 1.4% of GDP (Belarus) and 6.1% of GDP (Kyrgyz Republic) (IMF, 2021) — it contributed to average growth in their fiscal deficit by almost 5% of GDP.



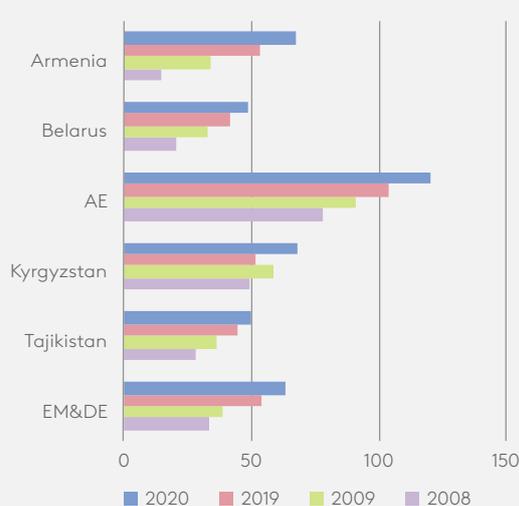
Compared with the global financial crisis, the fiscal response to diminished economic activity in 2020 was stronger. This can be explained by the size of economic contraction (Figure 8). In addition, there was a surge in spending in some countries on the underdeveloped healthcare system. Back in the period of the financial crisis, the contraction in mature economies was limited to 3.3% of GDP, while in emerging economies GDP increased by 2.8%. The EFSD recipient countries experienced an average 1.4% decline in GDP in 2009 vs 2.1% in 2020. Against this backdrop, public debt in the EFSD recipient countries increased by an average 8.4 p.p. of GDP in 2020 (Figure 9), which interrupted countries' debt stabilization in the period of 2017–2019. In line with changes in outstanding debt, countries faced alterations both in (1) the size and (2) the pace of gross financing needs (these consist of debt servicing, the primary balance and short-term obligations). In 2020, EFSD recipient countries' financing needs increased by 4.2 p.p. of GDP, which was nearly twice the impact of the 2008 financial crisis. Furthermore, about half of these needs were due to a weakening of the countries' fiscal positions.

**Figure 8. Real GDP: 2008 GFC vs COVID-19 crisis, %**



Sources: IMF, ministries of finance, authors' calculations.

**Figure 9. Public debt to GDP: 2008 GFC vs COVID-19 crisis, % of GDP**

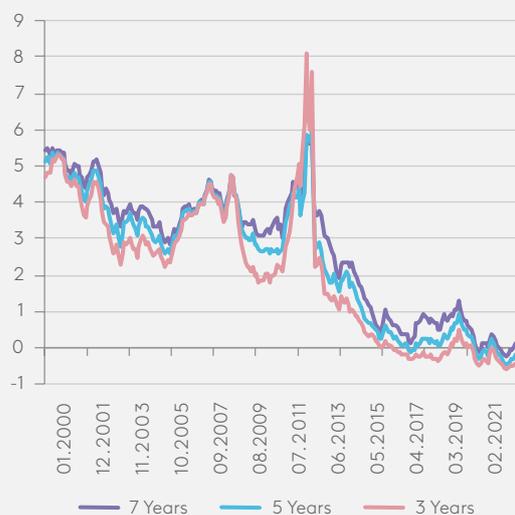


Sources: IMF, ministries of finance, authors' calculations.

Elevated liquidity needs resulted in an adjustment of borrowing strategies in a number of economies. In developed countries, a notable share of government spending has been financed by short-term obligations. In OECD countries, short-term public debt instruments increased from 10.5% of GDP in 2019 to 13.9% of GDP at the end of 2020. This resulted in a decline in the average debt maturity to 7.7 years, vs around 8 years in 2019. In the debt portfolio of the EFSD recipient countries, the share of short-term liabilities has also increased. However, since the EFSD countries are usually focused on keeping some fiscal room for manoeuvre, they try to rely less on short-term borrowings. Hence, their share in the total public debt portfolio has remained less than 1% of GDP. Low-income countries are even more cautious about near-term financing risks. Hence, they rely on long-term financing with a grace period of around 5 years. For example, according to the Debt Strategy of the Kyrgyz Republic, one of the government's aims has remained increasing the maturity of public securities in the period of 2021–2023 (The Ministry of Finance of the Kyrgyz Republic, 2020).

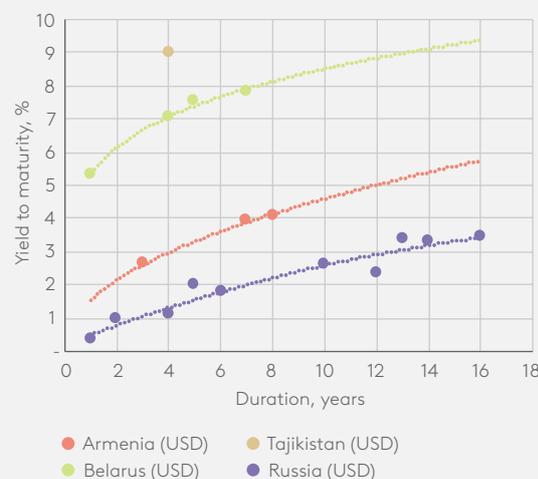
Another common pattern for a number of advanced and emerging economies is related to changes in borrowing conditions. Despite growing government funding needs, most advanced and emerging countries enjoyed relatively favorable borrowing conditions in 2020. In advanced and emerging economies, financing costs have continued to decrease, which has made expansionary fiscal policy less expensive in these countries. Although the first pandemic shock increased EU 7-year and 5-year government bond yields by 0.16 bps (to 0.37% and 0.22%, respectively), since May they have shifted down and in August, they moved into negative territory (Figure 10). The issuance of government debt at a low interest rate was supported by an accommodative monetary policy against the backdrop of investors' high demand for safe assets. These factors enabled a reduction in borrowing costs despite an increased supply of government securities.

**Figure 10. EU government bond yields, euro, %**



Sources: CEIC Data.

**Figure 11. EFSD government eurobond yields, %**



Sources: Bloomberg.

As a result of stimulus policies in mature countries, the global low-rate environment has also reduced financing pressures on EFSD sovereign issuers. In 2020, Belarus successfully attracted resources from international markets. It issued Eurobonds worth \$500 mln with a 6.1% yield and \$750 mln with a 6.378% yield. Despite economic disruption, the yield on 11-year Eurobonds was lower than the 7.625% yield on 10-year Eurobonds raising \$600 mln in 2018. In order to finance an increased budget deficit, at the beginning of 2021 Armenia also issued 10-year Eurobonds at an annual yield of 3.875%. This Eurobond issuance was a successful match of growing interest in risky assets from foreign investors and the growing borrowing needs of the government. As a result, despite a number of adverse economic and political factors, the cost of borrowing was lower than in 2019, when Armenia issued similar bonds with a 4.2% yield (Figure 11).

Although in 2020 global financing conditions remained supportive, pandemic-related spending increased and revenue losses made debt servicing a greater burden for many countries, especially for countries with market access. In contrast, LICs have a limited share of marketable debt and their debt positions are less correlated with market confidence. In developing economies, there are a number of other factors which may make it possible to raise debt without materially jeopardizing the country's debt position. The share of marketable debt in Tajikistan and the Kyrgyz Republic has remained around 6–10% of GDP and, in the medium run countries intend to limit it, shifting more to concessional loans.

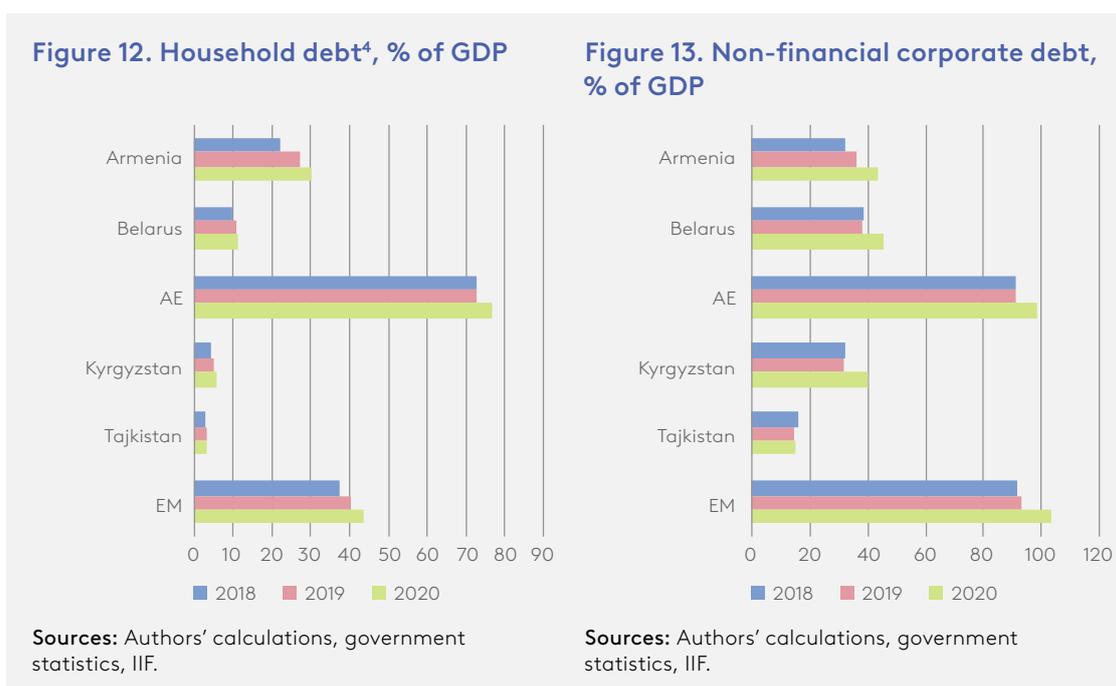
In the EFSD recipient countries with market access, the share of marketable debt is notably higher. At the end of 2020, it reached 15% of GDP in Belarus and 24% in Armenia<sup>3</sup>. While interest rates are low, countries can provide fiscal support through additional borrowing, but after the financial environment

<sup>3</sup> Marketable debt includes securities denominated in foreign currency and treasury securities, with the exception of savings bonds.

changes, the focus should be on strengthening budget positions. Timing is important — especially for countries with a high share of marketable instruments. Furthermore, countries’ public debt and fiscal positions may be exposed to risk from private debt, which in a less favorable environment may cause a materializing of contingent liabilities and weaken the government’s balance sheets.

### Private Debt

The pandemic crisis has notably increased companies’ and households’ borrowing needs. In advanced economies, private sector debt increased from 164% of GDP in 2019 to 175% in 2020. The non-financial corporate (NFC) sector was the main driver behind this debt buildup. In mature economies, growing NFC obligations partially reflected the impact of government anti-crisis measures, including loan guarantees, business rates relief, etc. Households have also built up debt obligations. Across mature markets, they reached 76.8% of GDP at the end of 2020 (Figures 12, 13). The main reasons for the growing household debt are (1) government measures focused on mortgage holidays, and (2) the resilience of residential real estate markets to the pandemic (IIF, 2021). Across the OECD countries, government financial support for homebuyers and homeowners through grants, loans and mortgage guarantees was in the range of 0.03–0.9% of GDP across OECD countries.



Most emerging markets have followed a similar pattern, however, since their government support was in general below the AE level — 5% of GDP in emerging countries vs 19% of GDP in mature economies — the EM private non-financial sector was more cautious about raising additional financing. In 2020, their debt obligations increased to 103.5% of GDP, compared to 93.1% in 2019. In emerging markets,

<sup>4</sup> Estimates in accordance with the IMF approach (Mbaye et al., 2020).

borrowings in foreign currency have been relatively stable, as national currency depreciation has reduced the private sector's incentives for raising FX financing. At the end of 2020, this figure for EM totaled \$8.6 trillion, vs \$8.3 trillion in 2019. Across low-income countries, debt accumulation has been limited, which can be explained by their weak fiscal positions and, hence, limited government support for the private sector.

In the EFSD recipient countries, debt obligations of the private sector are in general lower than in their peer countries. Apart from that, the 2020 crisis did not create incentives that would have encouraged EFSD companies and households to increase their borrowings. According to our estimates, the debt of EFSD companies<sup>5</sup> and households has increased from 44% in 2019 to 51% in 2020 (Figures 12, 13). However, Armenian and Kyrgyz corporations recorded the most sizable increase in their debt-to-GDP ratio, which primarily reflected a roughly 8% decline in GDP in 2020. Tajik companies have the lowest debt burden among EFSD recipient countries. At the end of 2020, it amounted to 15% of GDP, consistent with its 2019 level. Relatively low borrowings of Tajik companies can be explained by three factors. First, the largest SOEs have access to on-lending from the Tajik government, which accounted for at least 18% of GDP in 2019. Second, Tajik companies are in general small-sized and mainly consist of individual entrepreneurs in the agriculture and trade sectors. This implies that companies tend to develop using their own resources. Third, the interest rates on loans are significantly higher than in other EFSD countries – in 2020, they stood at 24% for somoni-denominated loans and 13.4% for FX-denominated loans. Thus, their access to affordable borrowing is constrained.

The EFSD households have also faced limits in smoothing their consumption by increasing borrowing. Hence, under increased uncertainty their debt level has remained roughly 13% of GDP. The lowest debt burdens are seen in the low-income EFSD countries, the Kyrgyz Republic and Tajikistan. At the end of 2020, they totaled around 5.8% and 3.4% of GDP, respectively. The most indebted country across EFSD recipient members is Armenia, although its private sector debt ratio is notably lower than the average level of other emerging markets.

In line with the economic deterioration, EFSD non-financial companies faced difficult financial conditions, which contributed to the growth of non-performing and overdue loans. In Armenia, the share of non-performing loans in the total amount increased from 5.5% in 2019 to 6.6% in 2020. The Kyrgyz private sector has also fallen further into arrears; its overdue debt increased to 10.5% vs 8.0% in 2019. Belarus and Tajikistan, according to official data, reduced its private sector overdue loans: from 3.9% to 2.9% in Belarus and from 19.1% to 16.2 in Tajikistan. However, these improvements may be associated with debt restructuring, rather than with stronger borrowers' performance. For example, despite the decrease in Belarus overdue loans, the volume of non-performing assets (NPA) of Belarus banks increased by 26.8%, where around 76% of NPA are owned by state-owned banks, servicing primarily SOEs.

Given that, we conclude that amid current economic uncertainty the debt positions of the EFSD private lenders remain fragile. Weak economic recovery, sizable private sector losses and solvency problems

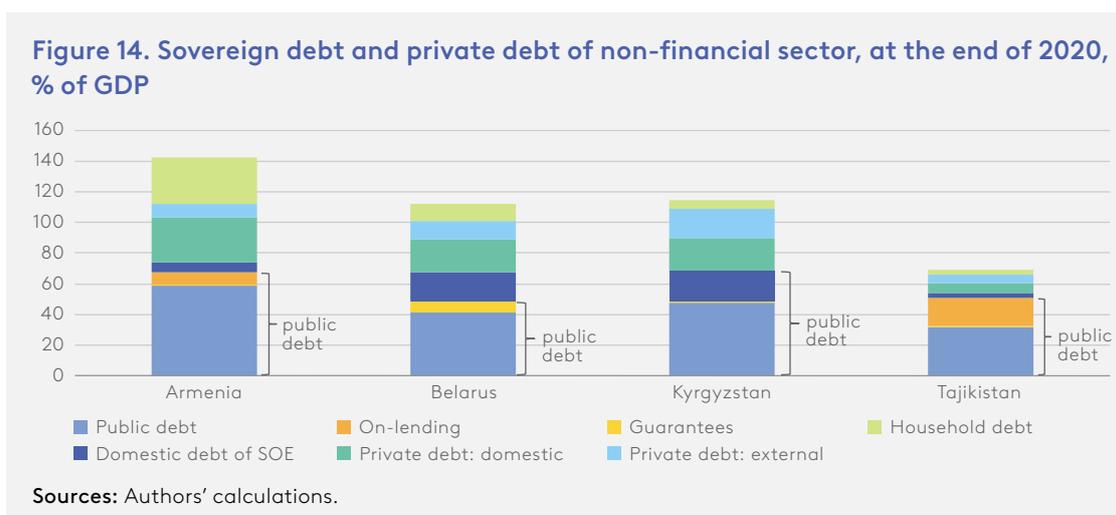
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<sup>5</sup> Excluding on-lending.

may lead to further issues with servicing debt obligations, which may require governments to provide additional support. In these circumstances, the materialization of any contingent liabilities could become a substantial burden for both fiscal and public debt positions.

### EFSD recipient countries' total debt

Given existing interactions between private and public sectors, we combined all relevant debt instruments in order to gain a broad picture of the EFSD recipient countries' debt obligations. This compilation revealed a few important factors. The EFSD governments are significantly engaged in their countries' financial and economic activities. These governments provide state guarantees and support the most important companies and banks. The combination of these factors increases countries' fiscal risks, however, only part of them are reflected in public finance statistics. For example, while Belarus's central government debt amounted to around 39% of GDP in 2020, its broadly defined public and publicly guaranteed debt – including guarantees and local government debt – totaled 48% of GDP. Concurrently, domestic debt liabilities of SOEs were around 19% of GDP in 2020 (Figure 14). Given the government's extensive involvement in SOE operations, the deterioration of economic circumstances may have a significant impact on the state of government accounts.



On-lending is another threat to countries' fiscal positions. Although on-lent loans are included in public debt stock, their impact on debt flows is rarely considered under risk scenarios – despite the fact that they may have a severe impact on countries' solvency. For example, on-lent loans in Tajikistan amounted to around one-third of total government debt in 2020. If a borrower is unable to service its debt obligations, this impairs government assets and increases public financing needs. The effect on the state balance sheet depends on the beneficiaries' credit quality. However, it is noteworthy that a sizable share of on-lent loans and guarantees is usually provided to loss-making state companies and banks. Hence, it increases the necessity to track the repayment performance of these companies and conduct regular risk analysis.

Against this backdrop, we can also point to the fact that the EFSD countries' debt story has been dominated by the public sector. Private sector indebtedness has remained dependent on the general macroeconomic environment and countries' level of market development. Cross-country evidence suggests that countries with market access are at the top of the EFSD private debt ranking. In contrast, private debt obligations in Tajikistan are only half of the EFSD average. This relatively low indebtedness of Tajik companies can be mainly explained by the country's access to concessional credits, which the government provides as on-lent loans to large and systemically important companies.

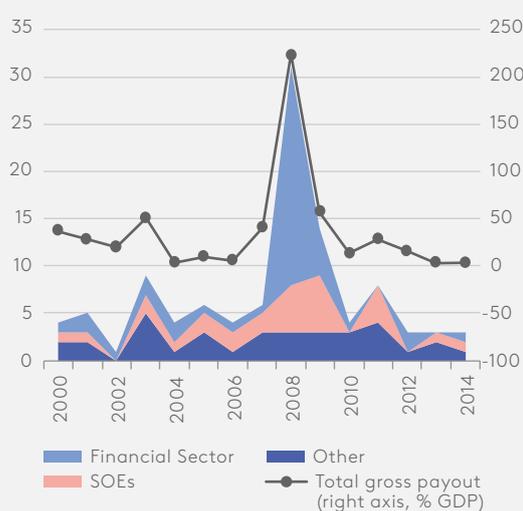
All in all, the current state of private and public sector indebtedness drives the necessity to reduce government influence in the EFSD region and to make it more transparent. This transition to a more competitive environment may notably reduce countries' fiscal risks and improve their credit ratings. Thus, it can be the first step to attracting investments and ensuring sustainable development of the EFSD region.

## 5. Contingent and direct liabilities

Given the specifics of the EFSD economies – which are marked by a high degree of government involvement – we consider not only public debt, but also contingent liabilities arising from government support to state banks and companies. These data are usually less transparent, but they may reflect significant risks to debt and fiscal positions. We investigate two types of contingent liabilities: explicit and implicit ones. Explicit contingent liabilities consists of state-guaranteed debt, while implicit ones include SOE debt not guaranteed by the government. In addition, we take into account on-lending operations, which may directly affect the countries’ fiscal balance sheets.

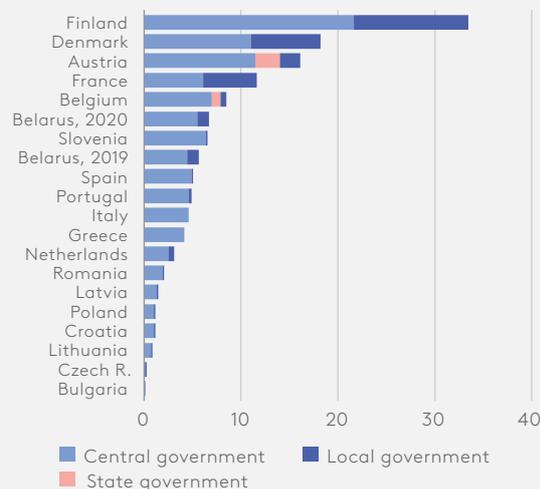
We consider the analysis of these liabilities as an important step in an assessment of fiscal and debt risks, since countries which have a limited fiscal space can easily face an economic crisis and further budget restrictions. Bova et al. indicated that, over 1990–2016, contingent liabilities related to the activity of SOEs and public-private partnerships amounted to around 20% of the total number of materialized contingent liabilities (Figure 15). Accompanied by financial sector shocks, they may lead to 1/5 of unexpected debt growth. According to Lee and Bachmair (2019), credit guarantees and guarantees in PPPs are considered to be the most notable source of contingent liabilities in a wide range of countries.

**Figure 15. Contingent Liabilities Materializing by Year and Type, number of cases**



Sources: IMF Fiscal Monitor.

**Figure 16. Government guarantees, 2020, % of GDP**



Sources: Eurostat.

Nevertheless, a wide range of both developed and emerging countries has continued to provide state guarantees as a type of government support, especially during the crisis. Across the EU countries, the average amount of state guarantees amounted to around 7% of GDP, where Finland was a leading country (Figure 16). It provided the greatest share of a country's GDP, which in 2020 exceeded 30% of GDP, followed by Denmark and Austria. However, statistics for Finland also include the guarantees provided by its financial public corporations. In general, governments may provide different types of debt guarantees. Some of them issue state guarantees for commercial loans of SMEs, while others are aimed at providing support to SOEs. A variety of emerging economies, such as African and Latin American countries, tend to provide guarantees to state-related companies. Prats and Moskovits (IADB, 2020) indicated that the average guarantee-to-GDP ratio in 2012–2017 totaled around 4%. In some countries, this figure exceeded 10%, including South Africa and Tunisia. However, in an attempt to support systemically important companies, governments may face severe fiscal challenges.

### Direct and explicit contingent liabilities

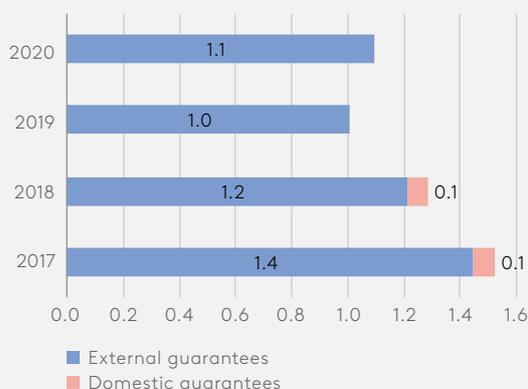
Among the EFSD member states, Belarus and Tajikistan are countries which actively support their companies and usually protect them from competition. One of the forms of this support consists of state guarantees, which provide a lower cost of capital to the countries' systemically important companies. During the COVID-19 crisis, the pressure of loan guarantees on government fiscal positions has notably increased, which may lead to sovereign contingent liabilities.

In Belarus, state guaranteed debt increased to 7% of GDP in 2020, accounting for 14% of total public and publicly guaranteed debt. Thus, it cancelled out the progress of 2015–2019, when debt guaranteed by the government declined from 14% of GDP to 5.6%. In Kyrgyz Republic and Tajikistan, credit risks primarily arise from the government's on-lending operations. Since these risks may similarly impair state finances, we also consider them as a possible liability for the government. In Tajikistan, they exceeded 18% of GDP in 2019, in Kyrgyz Republic — 20% in 2020, in both countries on-lending operations are mainly concentrated in the energy sector. In the Kyrgyz Republic, the government does not provide direct guarantees, in Armenia and Tajikistan the amount of guarantees is insignificant — around 1% of GDP.

### Armenia

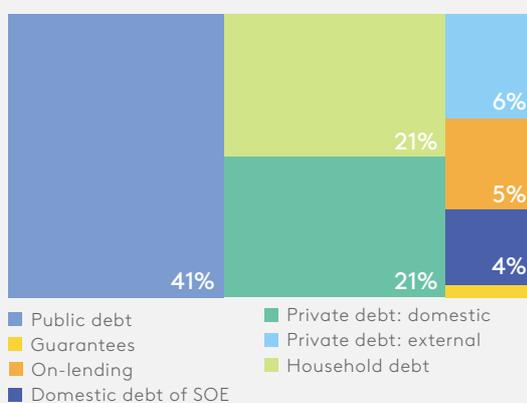
In Armenia, the total stock of state guarantees amounted to around 1% of GDP. In 2020, due to deterioration in economic activity, it slightly increased to 1.1% of GDP (Figure 17). However, over the past 4 years the stock of state guarantees has not exceeded the 1.5% of GDP level and has remained relatively sustainable. Hence, we do not expect a severe threat from these explicit debt indicators to the country's fiscal positions. Apart from that, Armenia boasts sound fiscal transparency, which is another important aspect promoting debt sustainability. The Armenian ministry of finance has regularly reported data on outstanding guarantees in its monthly and annual surveys.

**Figure 17. Armenia's state guarantees, % of GDP**



Sources: Authors' calculations.

**Figure 18. Armenia: sovereign debt and private debt of the non-financial sector, end of 2020**



Sources: Authors' calculations.

The Armenian government has primarily issued guarantees for external loans of the CBA, which are focused on development programs. In 2020, these guarantees constituted around 93% of the total. The only other guarantee consisted of an external loan to Nork-Marash Medical Center. The regulation of guarantees is stipulated in the Budget System Law, which limits the amount of guarantees provided in the given year to 10% of the government's tax revenues collected in the previous year (Budget System Law, 1997). The procedure for issuing state guarantees is also highly regulated in Armenia.

While the situation with guarantees does not seem fragile, on-lending is the focus of current concerns over fiscal risks. First, they are relatively high. In 2020, their share accounted for around 5% of total sovereign and private debt obligations (Figure 18). Furthermore, on-lent loans rose from 6.6% of GDP in 2019 to 7.5% in 2020. This implies that they may increase risk to the government's financial assets, which depend on borrowers' ability to service debt. Second, the main beneficiaries of these loans are state energy companies, which have provided essential services but remained loss-making and dependent on fiscal support. In order to bail out these companies, the Armenian government has primarily attracted external borrowings, which it has provided through Project Implementation Units (Hambardzumyan, 2020). Finally, while on-lending stock is relatively transparent and reported on a monthly basis, we have less data on their flows, which are disclosed in separate surveys or decrees. However, this information is essential as it determines a country's financing and potential borrowing needs.

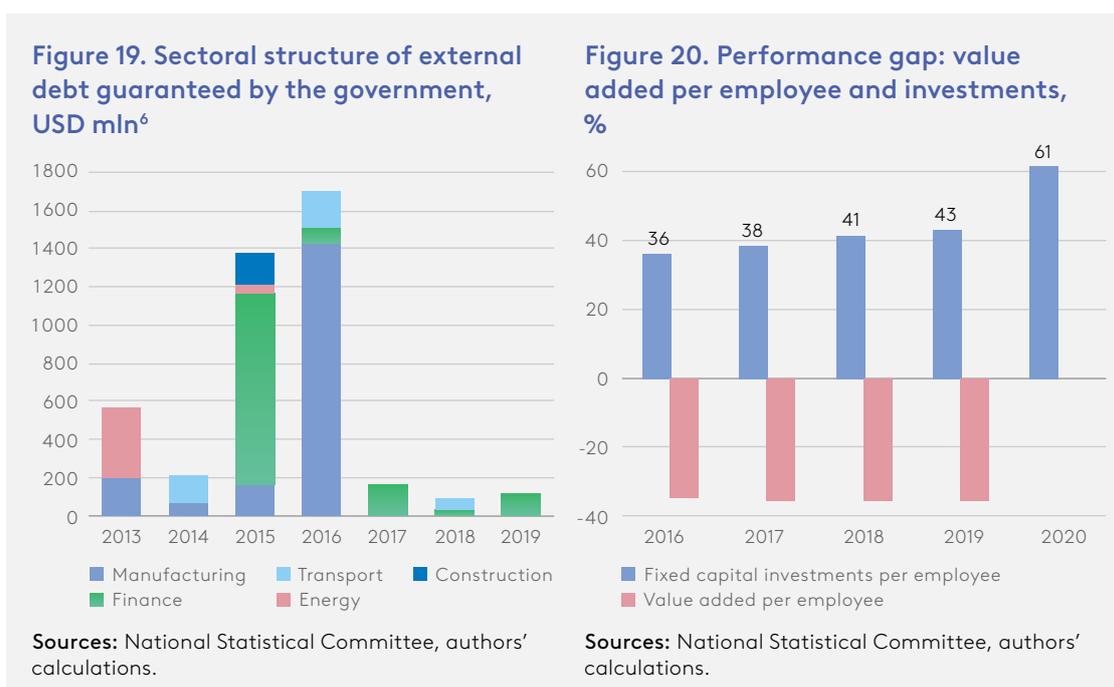
## Belarus

In respect of Belarus, we note that the government has issued a significant amount of guarantees. Cross-country evidence suggests that this figure is consistent with the average 7% of GDP in European countries (Figure 16). However, apart from guarantees, the Belarus government provides a wide range of other support instruments, such as capital injections, subsidies, etc. Part of them are provided through the state banks, which accumulate more than two-thirds of the country's banking system assets. Thus, the existing economic system is marked by a high degree of government involvement, but due to limited transparency and accounting it is complicated to calculate total government assistance, including state guarantees.

Motivated by this fact, we collected and examined guarantees issued by the Belarus government in 2013–2020. This analysis is based on separate data from decrees of the Council of Ministers, but information has remained opaque, with undisclosed terms and conditions for some of the guarantee agreements. Our dataset spans a total of 109 guarantees — 26 for external loans and 83 for domestic loans. The identified dataset represents almost 90% of total annual guarantees for external debt issued in 2013–2020.

According to our estimates, in 2013–2020 the government provided guarantees in an amount around 3.2% of GDP annually. In 2013, state guarantees reached a peak, amounting to 5.7% of GDP. However, since 2016 state guarantees to GDP have plunged, due to the government’s focus on strengthening its fiscal position.

By considering Belarus’s state guarantees in order of the fiscal risk they pose, we first focus on external agreements. Over the last 8 years, the annual volume of guarantees issued by the government for external loans amounted to 1.1% of GDP. In 2016, it increased to 3.5% of GDP. However, the Belarus government did not provide any guarantees for external loans in 2020, while guarantees for domestic borrowings increased. At the end of 2020, the share of external guarantees was around 44% of the total.



In general, state guarantees oblige the government to assume debt obligations in the event of borrower default. In Belarus, they have been provided primarily to public corporations from a variety of economic sectors, ranging from manufacturing (55%) to transport (7%) and energy (11%). This highlights a specific feature of Belarus: while in most emerging economies state guarantees have a heavy presence in natural monopoly sectors such as energy and transportation, Belarus has notable exposure to

<sup>6</sup> In the financial sector, the maximum amount of the credit line in 2015 is specified. Moreover, the financial sector is not always the ultimate beneficiary, providing credit lines to small and medium-sized enterprises from various sectors of the economy.

manufacturing (Figure 19). In addition, state guarantees are provided to Belarussian banks in order to finance SMEs. This implies that a public corporation’s presence in Belarus goes beyond those industries where government ownership is explained by economic rationale. As a result, this reduces market competition and efficiency.

Over 2013–2019, a sizable part of external state guarantees was provided to the real sector for the implementation of projects which stimulate investment activity in public corporations. In fact, a comparison of investment activity between the private and public sectors confirms that public companies, despite active government support, have remained less efficient in their allocation of labor and capital. In 2016–2020, the public sector made higher investments per employee, but its value added per worker was 35% lower than in private companies (Figure 20).

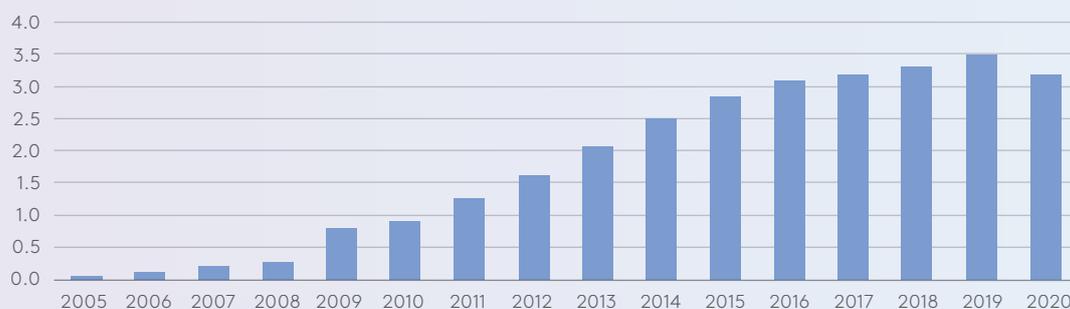
Low productivity of the main beneficiaries of guarantees may limit diversity in external credit resources. It is partially reflected in the structure of Belarus state guarantees for external loans. In 2020, the majority of external guarantees were attached to loans from China – almost 90%. Another 3.5% were for the Eurasian Development Bank. The relatively high level of external guarantees in 2015–2016 was primarily due to loans and credit lines attracted from China.

### Box 1. Belarus’s Public and Publicly Guaranteed Debt to China

Since 2005, Belarus has raised funds for infrastructure and other development projects through loans provided by China. In 2008–2015, China’s economic presence in Belarus steadily grew, due to the attractiveness of Chinese loans, provided at a competitive or lower-than-market interest rate and for a longer term. By the end of 2020, China had become one of the main lenders to Belarus, accounting for over 18% of Belarus external debt.

One of the key features of the Chinese lending strategy – credits tied to projects of their own companies and under state guarantees of the borrower – was also pertinent to Belarus. In 2009, the share of these loans in the Belarus debt portfolio was around 1.3% of GDP, and they amounted to \$785 mln. By 2013, the amount had increased to \$2.0 bln (Figure 21). Over that period, Chinese Exim Bank issued several credit lines to Belarus at a 6-month LIBOR interest rate of 2–4.75%, which were cheaper than the Eurobonds issued in 2010 at 8.75%.

**Figure 21. Public and publicly-guaranteed debt to Chinese banks, USD billion**



Sources: NBRB.

In 2015, Belarus received two credit lines from China: a commercial one worth \$4 bln, and another \$3 bln at a concessionary interest rate of 2% with maturity of up to 15 years. Around \$1.0 bln was directed to the development of SMEs. However, since that period, Belarus has faced issues with debt repayment. Several Belarusian companies, including cement, cardboard, cellulose, and potash factories, have required government interventions, which were provided through on-lent loans and external state guarantees.

In total over 2005–2019, the government assumed obligations of at least 5 companies covering more than 30 enterprises. Furthermore, according to Rudy (2020), Belarus has completed a limited number of successful projects with China (one of the bright spots being the Belgee automobile factory, financed by government external loans). Since 2017, there has been a downward trend in the provision of state guarantees for Chinese loans. A new wave of Belarus-China cooperation started in 2019, when China provided a \$500 mln loan to the Belarus government and Belarusian Railway signed loan contract with Exim Bank under guarantees from Belarusbank.

Interbank borrowing is another important aspect of the use of state guarantees and financial cooperation between countries. Over the past 10 years, state guarantees granted for the largest state-owned banks – Belarusbank and the DBB – have accounted for around 30% of the total amount of external debt guaranteed by the government. The main issue with this lending is that both banks have remained involved in quasi-fiscal operations, especially focused on the support of the low-profit agricultural industry.

In respect of the Chinese–Belarusian partnership, it is noteworthy that the location of Belarus is relatively attractive for China – it opens convenient, albeit not the most important trade access to European countries. Given that, a significant part of Chinese funding has been allocated to transport infrastructure – as part of the Belt and Road Initiative (BRI). Guarantees for the transport industry are mainly for Belarusian Railway, which has received more than \$330<sup>7</sup> mln from China.

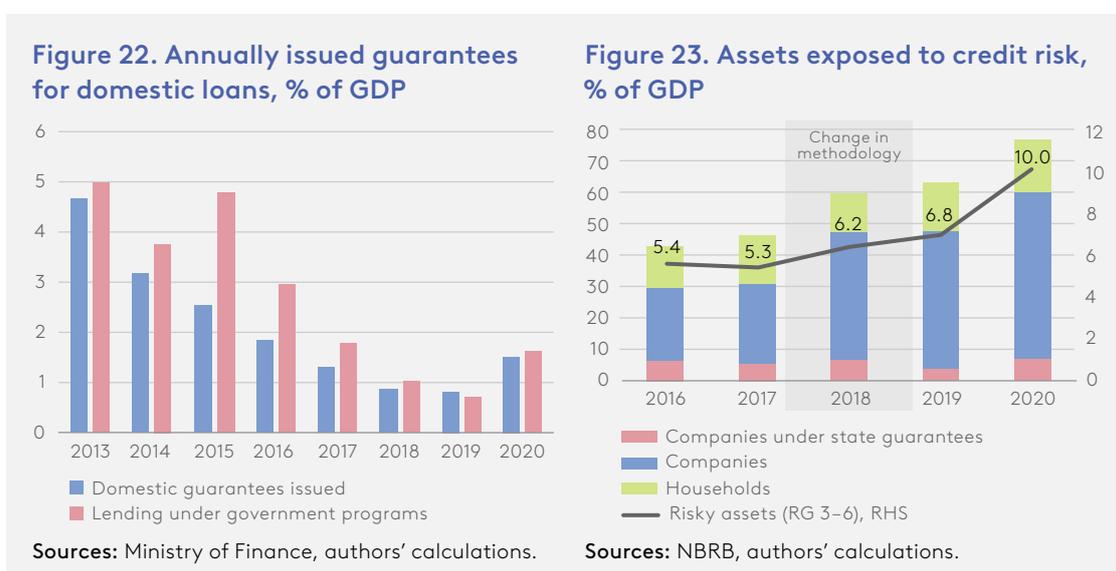
Since the Belarusian banking system is marked by significant involvement of the government, some state-owned banks have not only provided loans to SOEs, but have also issued guarantees on external loans. Among these banks are Belarusbank, Belagroprombank, Belinvestbank and the Development Bank (DBB). The DBB is a special institute, established in 2011 to increase transparency in directed lending (Ehrke etc, 2014). However, the current guarantee scheme without centralized authority seems relatively complicated and leads to unclear macroeconomic control over guarantees. In fact, in 2020, while the government issued only domestic guarantees, Belarusbank and other state-banks provided \$200 mln in guarantees for external loans. Concurrently, the government has provided sizable financial support to state banks involved in quasi-fiscal operations. The existing scheme, where the guarantor can be different institutes, makes the guarantee issuance process less transparent.

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<sup>7</sup> Excluding \$70 mln under the guarantee of JSC Belarusbank in 2020.

According to our estimates, at the end of 1H2021 the outstanding amount of guarantees provided by state-owned banks for external loans reached almost \$0.3 bln<sup>8</sup>. In some areas, loan agreements have been issued not only under state guarantees, but also under guarantees of state-owned bank, such as JSC Belarusbank. For example, some new loans were issued under state-owned banks' guarantees instead of the government. In particular, since 2019, Belarusian Railway has switched to a new scheme for attracting loans from China.

Guarantees for domestic loans are another instrument enabling the Belarusian government to facilitate investments in certain projects or entities. Over the past 8 years, the average size of annually issued guarantees for domestic loans has reached 2.1% of GDP. Until 2020, the government had moderately reduced the amount of provided guarantees. However, the spread of COVID-19 and the deterioration of economic activity interrupted the declining trajectory of recent years, and in 2020 state guarantees for domestic loans increased to 1.5% of GDP, compared to 0.8% of GDP in 2019 (Figure 22).



One of the key issues of these state guarantees is their high concentration in the agriculture sector and industrial production. Over 2013–2020, more than 2/3 of government guarantees were provided for the development of these sectors. In 2014, the government issued guarantees of BYR600 bln (BYN60 mln after the currency reform) to Belagroservice for a machinery leasing program to support agricultural producers. In 2018, state guarantees were provided for the debt rollover of Minsk Tractor Works, a major producer of agricultural machinery. Although these initiatives were focused on enhancing the efficiency of agro-industrial production, they proved to be extremely expensive, given the capacity of the economy and its fiscal space. However, they did not improve the efficiency of these companies. According to the NBRB, the riskiest lending is in financing agriculture and manufacturing (NBRB, 2021). In 2020, the share of non-performing assets in agriculture amounted to 12.9% of total loans, and 9.3% in manufacturing – for the total economy this figure is around 6.67% (NBRB, 2021).

<sup>8</sup> Payment guarantees with an initial validity period of less than 1 year are not taken into account. Excluding DBB.

Since banks are among the key participants of the guarantee schemes — especially state-owned banks — the contingent liability risk can also be estimated based on analysis of their performance. Our assessment suggests that, at the end of 2020, outstanding guarantees for domestic debt amounted to 3.9% of GDP. As the banking sector is highly concentrated and the majority of assets and loans belong to state-owned banks, a significant share of state guarantees is also accumulated in public banks, primarily in the DBB and Belarusbank. High dependency on the government makes these banks relatively exposed to macroeconomic crises and results in contingent liabilities for the government. For example, in 2011 a large number of contingent liabilities materialized as some Belarusian state-owned banks required a recapitalization. This amounted to around BYN1.5 bln (adjusted for the currency reform).

In 2020, the pandemic shock also had a severe impact on the country's banking system and its sustainability. At the end of 2020, the share of risky assets (related to risky groups from problem (Group 3) to non-performing assets (Groups 5–6) increased to 10% of GDP, compared to around 7% in 2019 (Figure 23). In line with that, the NBRB emphasized that a number of SOEs faced a significant issue with debt repayment (Kalechic, 2021). In 2020, these problem loans of public corporations totaled 14% of GDP. As a result, the Belarus government had to bail out its financial sector. A wide range of instruments was developed for these purposes. The Belarus government conducted a recapitalization amounting to BYN1 bln for Belarusbank, which has remained the country's largest lender and accounts for almost 50% of total bank lending. During the 2020 crisis, Belarusbank became the main implementer of government programs, and its increase in lending accounted for around 70% of total growth. Concurrently, the loan portfolio of Belarusbank weakened in 2020: the share of credit-impaired financial assets (POCI<sup>9</sup>) and assets with identified signs of default (ECL, transferred to Stage 3) rose from 2% of GDP in 2019 to almost 3% in 2020, while assets with a significant credit risk reached 5.4% of GDP (2019–4.5%). The Belarus government also injected capital into other troubled and financially distressed banks. In line with that, the on-lending debt of Belagroprombank and Belinvestbank was restructured and prolonged to 2028. Going forward, growing economic uncertainty amid an unfavorable external environment may increase the vulnerability of state-owned banks, which would trigger the materialization of fiscal risks.

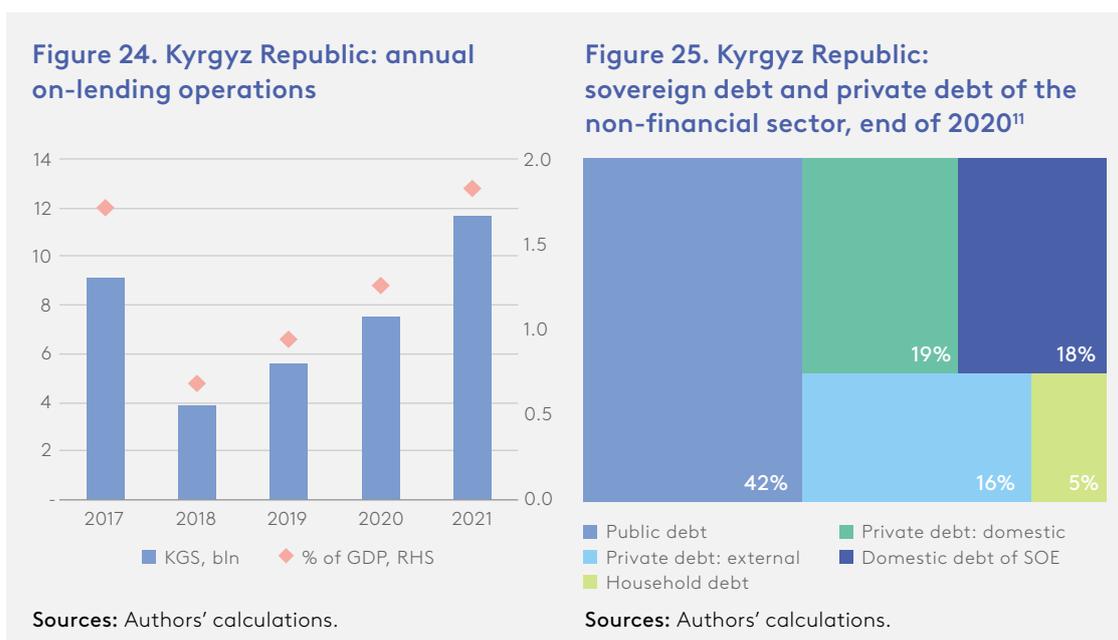
### The Kyrgyz Republic

In the Kyrgyz Republic, the government does not provide direct guarantees. However, the government has established the State Guarantee Fund for this purpose, aimed at improving the access of SMEs to financial resources. State guarantees provided by this Fund have amounted to around 0.3% of GDP annually, and have focused on trade and agricultural enterprises. In general, these companies have had the capacity to meet their obligations and we do not expect that this may give rise to contingent liabilities. Nevertheless, the Kyrgyz government's balance sheet may be exposed to fiscal risks through on-lending operations. In general, debt risks from government on-lending and state guarantees are different. If borrowers do not repay, then, in the case of guarantees, public obligations would increase. However, in the case of on-lending, public debt remains unchanged. For the Kyrgyz Republic, it means

<sup>9</sup> Stage 3 — Impaired or default, POCL — purchased or originated credit impaired.

that if borrowers fail, the country would not face rapid growth in its public debt-to-GDP ratio, but its financing needs may notably increase. If the country has limited fiscal space, this would lead to new borrowings and result in feedback loops to public debt. In the Kyrgyz Republic, on-lending is one of the key channels of government support to SOEs and the development of public-private partnerships. According to Kyrgyz budget data, the annual amount of on-lending operations amounted to around 1.1% of GDP in 2017–2020 (Figure 24). These loans are primarily provided by bilateral and multilateral creditors on concessional terms, but in the currency of the original loan agreements between the Kyrgyz Republic and creditors.

An additional issue may arise with respect to transparency. It is noteworthy that comprehensive information on on-lending is not stipulated in the Kyrgyz budget. What we know from the current budget is that, in 2020, outstanding debt of SOEs totaled around 20% of GDP, or 18% of the country’s obligations (excluding the financial sector), which included the on-lent loans (Figure 25)<sup>10</sup>. SOEs’ financial positions are relatively weak, which may lead to additional liabilities, when the government has to service debt obligations of its public companies. This may increase the country’s financing and borrowing needs. As these risks are relatively high, we recommend considering them in the debt and fiscal management strategy.



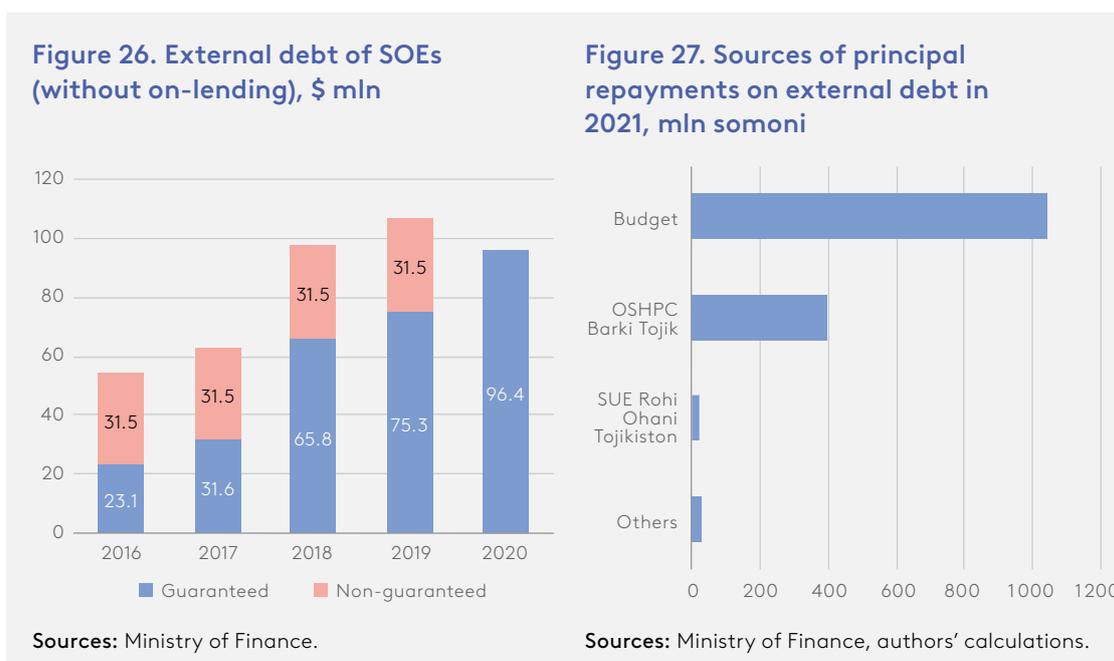
## Tajikistan

Tajikistan is also exposed to fiscal risks due to the government’s on-lending operations. In general, no state guarantee scheme exists in Tajikistan, as the government primarily on-lends loans to SOEs that it

<sup>10</sup> We excluded debt obligations of SOEs from public debt, assuming that primary source are on-lending operations.

<sup>11</sup> Domestic debt of SOEs includes on-lent loans.

raises from international organizations. The substance of this on-lending scheme consists of providing what were initially concessional loans on non-concessional terms to Tajik companies. According to our estimates, this on-lending amounted to roughly 18% of GDP at the end of 2019<sup>12</sup>. By comparing it with state-guaranteed external debt of SOEs, amounting to only 1.3% of GDP (Figure 26), we may conclude that the main mechanism to raise financing for Tajik SOEs is to receive on-lent loans from the government.



Over the last decade, Chinese Exim Bank, the World Bank, Asian Development Bank, KfW Development Bank, Islamic Development Bank and Kuwait Fund have been the main on-lending partners for Tajikistan. Among these international institutes, the role of Exim Bank has remained the most significant. Despite considerable financial support from multilateral and bilateral creditors, the pressure on Tajik public debt has notably increased. This has made the country's fiscal position more vulnerable.

According to our estimates, around 30% of public principal payments depend on SOEs in 2021, i.e. on whether they honor their obligations (Figure 27). It is noteworthy that some of the contingent risks have already materialized in 2021. The largest Tajik banks, Agroinvestbank (AIB) and Tojiksodirobank, were liquidated this year and will not be able to repay all outstanding debt obligations. This will notably increase the government's financing needs. The total sum of these banks' obligations to government is estimated at around 3.9 bln somoni, or 4.6% of GDP. In 2021, of the projected countries' loan repayments, 100 mln somoni was meant to be financed by AIB. However, given the start of the liquidation process of both banks, these obligations will be directly transferred to the government. Hence, there is a question about the availability of financing for them or of the country's capacity to attract it.

<sup>12</sup> Excluding accrued fines and penalties for arrears.

## Implicit contingent liabilities

Implicit contingent liabilities in Belarus, Kyrgyzstan and Tajikistan are primarily defaults of SOEs on nonguaranteed loans. Over the last decade, the portfolios of SOEs has remained large and primarily concentrated in high-impact but vulnerable industries. Furthermore, a number of state-owned companies have had to undertake quasi-fiscal activities, which has made them vulnerable to macroeconomic shocks. Hence, a wide range of governments have faced large fiscal costs when they had to bail out dependent companies. Among the EFSD recipient countries, the most fragile situation is in Belarus and Tajikistan.

Across this subset of the EFSD recipient countries, state-owned companies produce a significant share of GDP. According to our estimates, state-owned enterprises produce about 40% of GDP in Tajikistan and 45% of GDP in Belarus. However, while they are important players in the economies of the EFSD recipient countries, a number of SOEs tend to post a relatively weak performance. Nevertheless, the contingent liability risks – with varying degrees – have remained acute for all EFSD countries. In this chapter, we study SOEs' financial positions in the EFSD recipient countries and analyze their potential impact on the countries' debt stance.

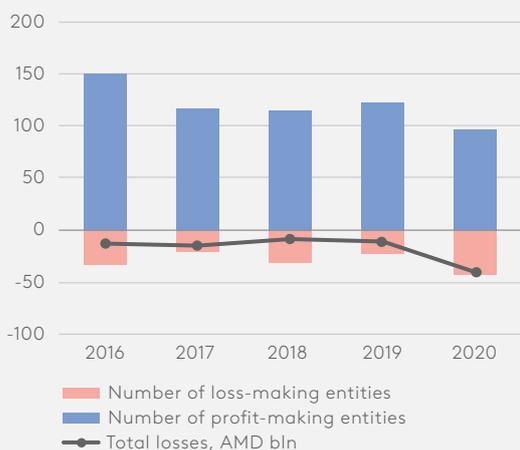
### Armenia

Over the past 5 years, Armenia has focused on developing its private sector, thus, it has persistently reduced the dominance of SOEs. In 2020, the number of public corporations contracted to 153, compared to 207 entities in 2016. The assets of public companies have also declined, from 12.8% of GDP in 2016 to 10.8% in 2019. However, economic disruption increased their assets-to-GDP ratio to 12% in 2020 and partially offset the progress of previous years.

In general, the pandemic crisis has accentuated a number of challenges in public finance management especially related to SOEs. In 2020, Armenia faced a considerable increase in the number of loss-making public companies. Their share surged to 29%, compared to 15% in 2019. In line with that, SOEs' operating losses exceeded AMD 40 bln, which is three times larger than in 2019 and the highest level of the last 5 years (Figure 28). Among the main loss-making entities were energy companies Armenian Nuclear Power Plant, Yerevan Thermal Power Plant and High Voltage Electric Networks, which contributed around 86% to total SOE losses. This high concentration of losses coincided with a considerable accumulation of capital stock in these companies. This implies highly probable government support to these entities, which may increase the country's fiscal risks.

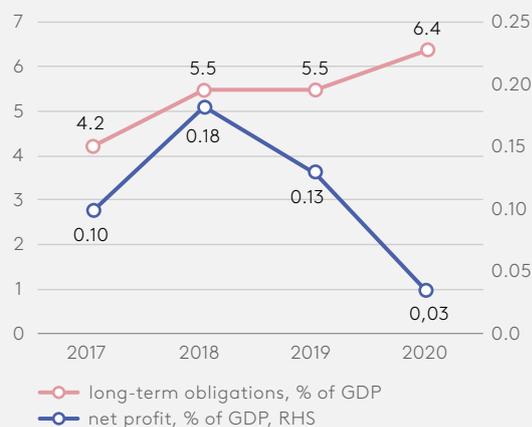
According to SPMD, the total profit of public companies – which were primarily concentrated in the telecommunication sector – amounted to only AMD 2 bln (0.03% of GDP) in 2020, far less than the average of AMD 8.3 bln (0.14% of GDP) in 2017–2019 (Figure 29). In line with the weak financial performance, public companies have continued to increase their debt obligations. By the end of 2020, SOEs' long-term liabilities had increased to AMD 394 bln, or 6.4% of GDP compared to AMD 234 bln or 4.2% of GDP in 2017.

**Figure 28. Operating losses of public companies in Armenia, AMD bln, and number of profit- and loss- making SOEs**



Sources: State Property Management Department.

**Figure 29. SOE financial indicators, % of GDP**



Sources: State Property Management Department.

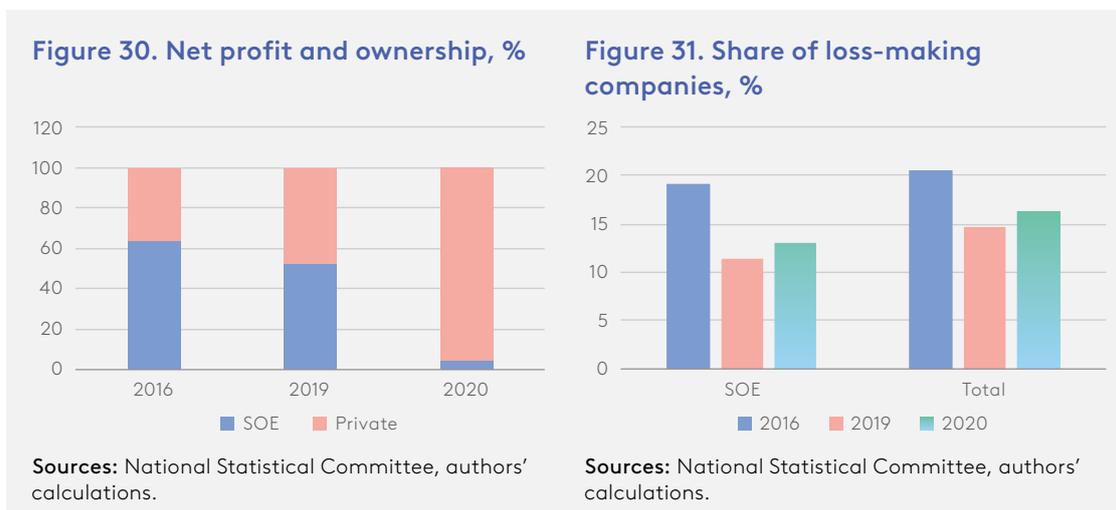
All in all, the Armenian government faced a variety of problems in 2020, which required involvement in its finances and management. Subsidies, equity injections and cheap loans have become the main instruments of Armenian government support, as well as the main factors behind the country's weakening fiscal and debt sustainability. However, this was partially offset by Armenia's progress in increasing its fiscal transparency and financial supervision of its state-owned companies and fiscal risks. These factors rank Armenia highly compared to EFSD peers. In addition, they reduce uncertainty and contribute to better lending conditions.

## Belarus

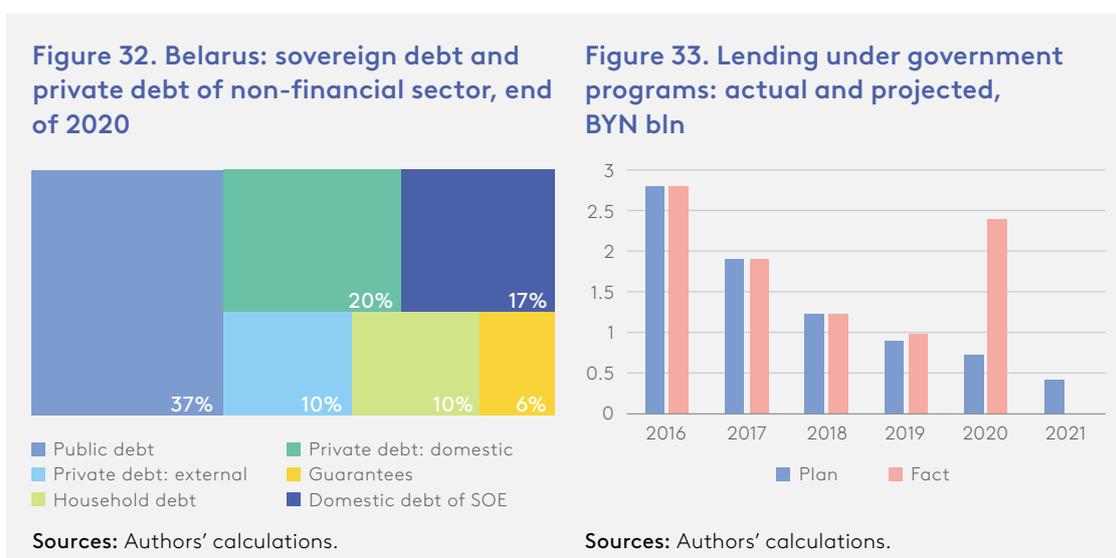
According to official data, the Belarus state sector has produced around 45.5% of total gross value added. Apart from that, it has been responsible for more than 60% of total investment in fixed capital. This high concentration of assets in the SOE sector is accompanied by their notable inefficiency, which may have macroeconomic implications. Their product profitability has remained lower than in private companies. For example, in one of the largest sectors of the economy – manufacturing – the return on sales among private companies averaged about 11%, while among state-owned companies only 7.6%.

The pandemic has worsened the financial state of a number of Belarusian SOEs. Their net profit declined by 95.6% to BYN242.1 mln, which contributed only 4% to the economy's total profit (Figure 30). Similarly, the share of loss-making SOEs also rose, from 11.4% in 2019 to 13.1% in 2020 (Figure 31). However, this low efficiency wasn't perfectly reflected in SOEs' financial indicators. The reason is partially in the way Belarusian SOEs are organized. Most state-owned companies are consolidated into conglomerates, where profitable companies are merged with loss-makers. As a result, large firms prevail across SOEs. For example, an average manufacturing SOE employs 740 staff, while a private enterprise employs

only 18. This structure helps to avoid the collapse of governance (Favaro et al., 2012), but it still implies potentially large fiscal and debt risks. At the end of 2020, the share of SOE debt to domestic banks amounted to around 17% of the country's total obligations (Figure 32). In contrast, in Armenia, this figure was around 4% of total country's obligations.



Poorly managed state-owned companies usually struggle to service their debt obligations. It can be proved by SOE significant arrears – at the end of 2020, their share accounted for 78% of total arrears in the economy. Among the main contributors to SOE arrears were the manufacturing and agricultural sectors, which accounted for around 50% and 13.5% of the total arrears (incl. the private sector), respectively.



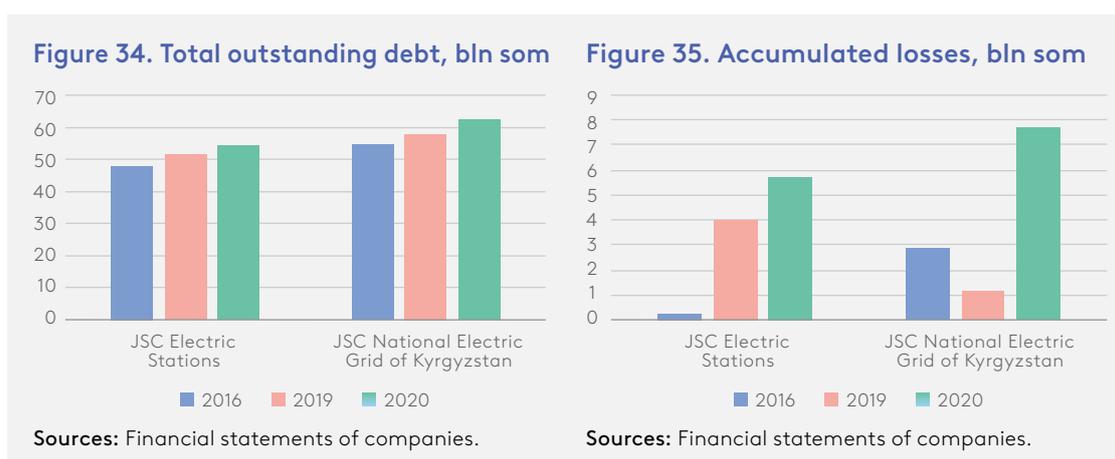
It is noteworthy that, despite consistent financial problems of Belarusian SOEs the government has continued to provide significant support to address the deterioration of their economic performance. In 2020, lending under government programs exceeded their planned level and reached BYN2.4 bln

(Figure 33). (Around 1/3 of the total was directed to Promagroleasing, a state-owned company.) Apart from this type of support, the Belarusian government tends to subsidize and provide capital transfers and injections to SOEs. These measures are, on the one hand, focused on ensuring a business for public companies, but, on the other hand, they increase the fiscal burden.

## Kyrgyz Republic

In the Kyrgyz Republic, the role of private sector activity is higher than in other EFSD countries. In 2019, the share of private companies exceeded 83% of GDP. Nevertheless, despite the limited impact of SOEs on economic output seems limited, and a wide range of issues has remained. First, SOEs are prevalent in strategic sectors, which are economically important. However, over 50% of SOEs are loss-making. Second, almost half of SOE assets are concentrated in the energy sector, which accumulates over 95% of total SOE liabilities. Together, these factors highlight the necessity of regular state bailouts for the most vulnerable public companies.

The main reasons for persistently high losses of energy SOEs are subsidized below-cost tariffs for customers. They lead to growing indebtedness of energy sector SOEs amid their low profitability (at the end of 2020, total debt of the energy sector increased to 20% from 17% of GDP in 2018, and this trend has remained relatively stable). However, despite growing indebtedness, its arrears have remained relatively low (less than 1% of GDP), primarily due to significant debt restructuring. In 2020, the debt of the two largest energy SOEs, OJSC National Electrical Grid of Kyrgyzstan and JSC Electric Stations, was partially rolled over — it amounted to roughly KGS 5.6 bln (Figure 34). According to the State Property Management Fund (SPMF), these two companies have remained the main borrowers among SOEs. In 2020, their outstanding debt exceeded KGS 116 bln, or 19.5% of GDP. Hence, they accounted for more than 95% of total energy sector debt.



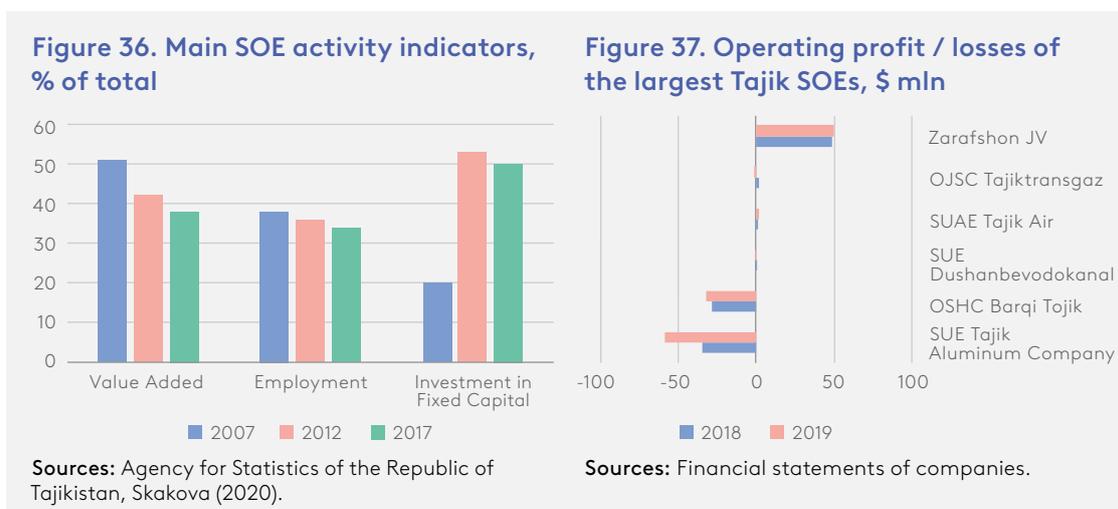
We expect that the gap between efficiency and the performance of energy SOEs cannot be fixed in the short run. As a result, SOEs' requirements for fiscal support are likely to be high. This situation with growing debt of energy SOEs provides clear evidence of the necessity to reform energy companies. Over 2018–2020, the accumulated losses of energy SOEs increased by 2.6 times (Figure 35). Similarly, their total outstanding debt rose by 14%.

Growing obligations of the Kyrgyz SOE sector increase the need for subsidies and equity injections, which under unfavorable economic circumstances may result in higher fiscal risks. However, in the case of the Kyrgyz energy sector, which has constantly required transfers from the government, the only solution can be found in undertaking reforms in energy companies. Otherwise, the Kyrgyz Republic may continue to increase its debt obligations and raise borrowings in order to meet financing needs.

## Tajikistan

Tajikistan is a country with a significant share of the public sector in the country's output. At the end of 2017, there were around 900 public companies, which produced nearly 40% of GDP (EBRD, 2020). In Tajikistan, SOEs are dominant in the energy, banking, infrastructure, and transport sectors. According to the World Bank (2019b), around 70% of the country's industrial output is produced by SOEs. Tajik SOEs are also a significant source of employment – they are responsible for more than 30% of all jobs in the country (Figure 36). Apart from that, SOEs play a dominant role in the investing process and infrastructure development (WB, 2018). However, the financial performance of Tajik SOEs may pose significant fiscal risks. One of the main concerns is related to the high concentration of SOE assets in three companies: Barqi Tajik, TALCO (Tajik Aluminum Company) and Tajik Railways have accumulated over 80% of total SOE assets (EU, 2017). This implies significant risks to the countries' fiscal positions in the event of SOE failures, particularly given the size of these companies and their importance for the economy.

The recent macroeconomic deterioration has notably increased these risks. In 2020, substantial constraints were faced not only by SOEs, but by the entire economy. At the end of 2020, the share of loss-making companies amounted to around 28%. The pressure on SOEs is even more significant, as some state-owned companies carry costly public mandates. According to the ADB (ADB, 2021), 12 of 27 SOEs (the largest SOEs, which are regularly monitored by the Ministry of finance) posted combined losses in 2020 that exceeded 8% of GDP. Hence, loss-making companies may require bailouts and increase the country's borrowing needs. Barqi Tajik and TALCO have remained among the main loss-making SOEs in Tajikistan (Figure 37).



Apart from on-lending of loans which SOEs receive from the government, a number of state-owned companies have direct external obligations, which under adverse macroeconomic circumstances may become implicit contingent liabilities for the government. For example, in 2020 the Tajik government approved a credit agreement for \$545 mln between TALCO, a Tajik loss-making company, and China Machinery Engineering Corporation for the reconstruction of TALCO's production facilities. Sizeable financing totaling \$300 mln was raised by Tajiktransgaz for the construction of a gas pipeline. Although these borrowings do not have a direct or immediate impact on the country's budget, if the given SOEs face financial distress then that will lead to implicit contingent liabilities.



This text analysis emphasizes the importance of “contingent liabilities” in Belarus and Tajikistan, which is a relatively frequent phrase for both countries. For Belarus, “guarantees” and “balance sheet operations” are also among the most common words, while for Tajikistan “SOE”, “guaranteed” and “authorities” are common. For Armenia, the most frequently used phrases refer to the problem of high share of FX debt: “exchange rate”, “REER”. For Kyrgyz Republic, there are no clear patterns in texts. Other highly frequent words, including “government”, “depreciation” and “sustainability”, are relevant for all countries.

By investigating these texts, we conclude that IMF debt analysis has usually pointed to the problem of contingent liabilities from SOEs and state guaranteed loans in Belarus and Tajikistan. This implies that the issue has remained acute for a long period and that the government may need to mitigate contingent liabilities from public companies by improving their financial performance.

These word clouds illustrate commonly used words in clauses that describe debt sustainability in Belarus and Tajikistan. In each chart, the size of each word indicates its frequency; a word that appears large is more frequent. All sets of clauses were obtained from available studies in 2013–2020.

In this section, we consider the impact of SOEs’ economic performance on the EFSD countries’ fiscal and debt positions. We focus only on non-government guaranteed debt, incorporating our judgement about riskiness of SOE obligations — given the limited data on their financial performance and uncertainty over credit agreements. Comparing the baseline scenario with the adverse scenario, we estimate the effect of contingent liabilities on countries’ fiscal and debt performance.

We focused on Belarus and Tajikistan, which are the EFSD member states with relatively high fiscal vulnerability to SOEs’ financial performance. We did not include Armenia in this assessment, as its government has notably reduced the number of public corporations and has remained less involved in the country’s business activity compared to other EFSD countries. Furthermore, its share of public corporation liabilities is around 15% of GDP (Seiwald et al., 2019), compared to Tajikistan with SOE debt around 30% of GDP, and Belarus, where the problem loans of SOEs alone total 14% of GDP. The Kyrgyz Republic was also excluded from the stress test analysis as, according to our estimates, the total effect related to the operation of SOEs would not exceed 2% of GDP.

### Baseline Scenario

In the baseline scenario, we assume moderate economic recovery in the EFSD recipient countries in the medium run. According to our estimates, the average GDP growth of the EFSD region will reach 3.3% of GDP in 2021 and after that it will be around 2.7% of GDP. In the short run, according to government plans, fiscal policy would primarily move from expansionary to contractionary in order to restore balance to the countries’ business cycles. In 2021, the primary deficit in Tajikistan would narrow to

0.9% of GDP. However, it is projected to recover from 2022 to its historical average levels, amounting to around 2% of GDP. In Belarus, in contrast, the government would pursue an expansionary fiscal policy in the short run, but in the medium run it would restrain its expenditures under the pressure of weak economic growth.

In line with these projections, our assessments are that the public debt-to-GDP ratio would decline in both countries by 2024. However, while in Tajikistan public debt would gradually decline over the projection period, in Belarus, after some fall in the debt-to-GDP ratio in 2021–2022, it is expected to increase. All in all, the recovery of the EFSD region would be uneven, especially given the pressure of both external and domestic uncertainty.

**Table. Baseline Scenario: macroeconomic indicators**

	2020	2021	2022	2023	2024	2025
<b>Common trends</b>						
World GDP growth	-3.5	5.7	3.1	3.0	3.0	2.5
Urals Price, \$	41.8	55	57	59	60	60
Russian GDP growth	-3.0	3.3	0.9	0.8	1.0	1.5
<b>Belarus</b>						
Real GDP growth	-0.9	2.1	-0.8	0.6	1.0	1.1
Primary deficit, % GDP	0.0	1.3	0.6	0.2	0.4	0.8
Debt, % GDP	48.3	43.8	46.2	47.4	47.3	45.9
<b>Tajikistan</b>						
Real GDP growth	4.5	7.7	7.2	6.6	6.1	5.5
Primary deficit, % GDP	1.8	0.9	1.5	1.4	1.7	1.6
Debt, % GDP	49.7	47.0	46.1	44.4	43.2	42.3

Sources: Authors' calculations.

### Contingent Liability Shock Scenario

In the scenario of a contingent liability shock, we assume that some SOEs will be incapable of servicing their debt obligations. Thus, governments may need to bail out these companies. The issue can be even more severe given the sheer size of state companies' operations (Baum et al., 2020) and their relatively low efficiency.

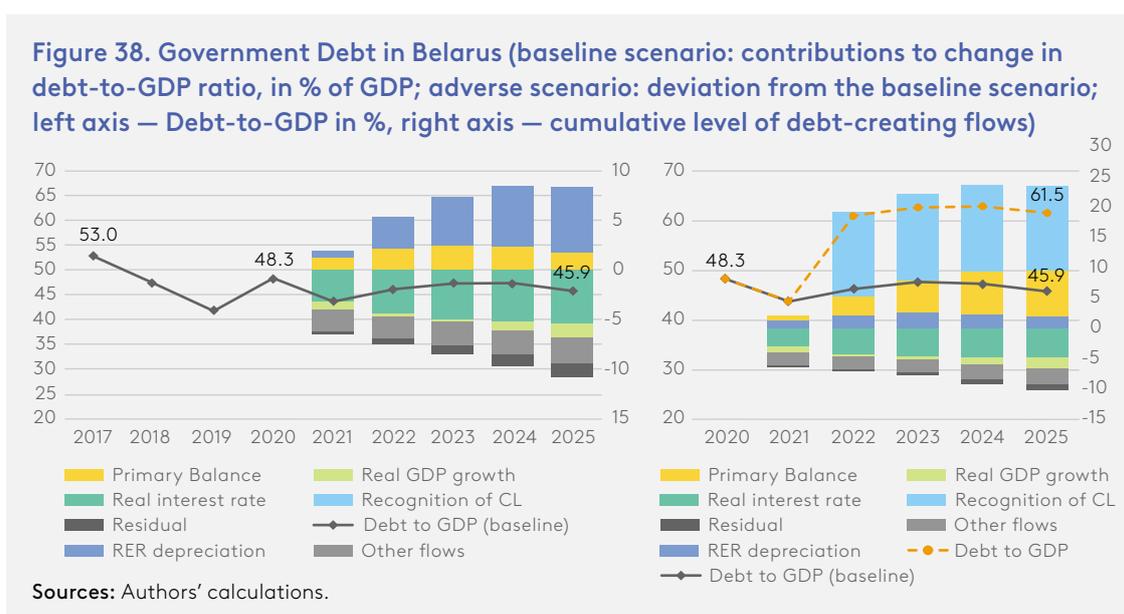
In considering Belarus and Tajikistan, we set the size of shock associated with their contingent liabilities at 14% and 12.1% of GDP, respectively. These assumptions take into account the size of the government sector and its economic performance, as well as the level of its indebtedness.

## Belarus

In 2020, Belarus remained under pressure from both domestic and external factors. Among domestic factors, the main threat was related to loss-making SOEs, which has remained a structural issue for the country. However, the 2020 crisis revealed the sensitivity of the economy to the inefficiency of public corporations. In 2020, the share of loss-making SOEs increased to 13.1%, compared to 11.4% in 2019. Given the existing interlink between Belarus SOEs and state banks, the financial positions of the latter have also become more vulnerable and may require government support. This bailout can be sizable, as the share of state bank assets accounted for 64.6% of the total bank assets. In 2020, increased financing to SOEs resulted in 29% growth of state banks' claims (NBRB, 2021).

In order to estimate the country's contingent liability risk, we consider an adverse scenario with a 14% of GDP shock (Kalechic, 2021), which corresponds to the volume of problem loans of public corporations. The shock is applied to 2022, as the EU sanctions will have a more negative impact on the economy in this period.

By comparing the results obtained from the baseline scenario and stress tests, we estimate that, in 2022, Belarus public debt might increase to almost 61% of GDP in the adverse scenario, compared to a projected 46% of GDP in 2022 (Figure 38). In the medium run, public debt would remain above 61% of GDP, which is consistent with the general pattern of debt trends in the baseline scenario. However, an increased debt level is only one side of the problem. Another issue is related to financing needs. Our estimates indicate that, in the short run, a contingent liability shock would result in a surge in public financing needs. Under this pressure, the country's borrowing needs will increase. However, given the limited international support and near closed market access, Belarus may face significant solvency and liquidity risks. By 2025, Belarus's financing needs are expected to decline slightly, however, they are likely to remain a source of debt sustainability vulnerability, especially given the country's susceptibility to both domestic and external uncertainty and limitations to funding.

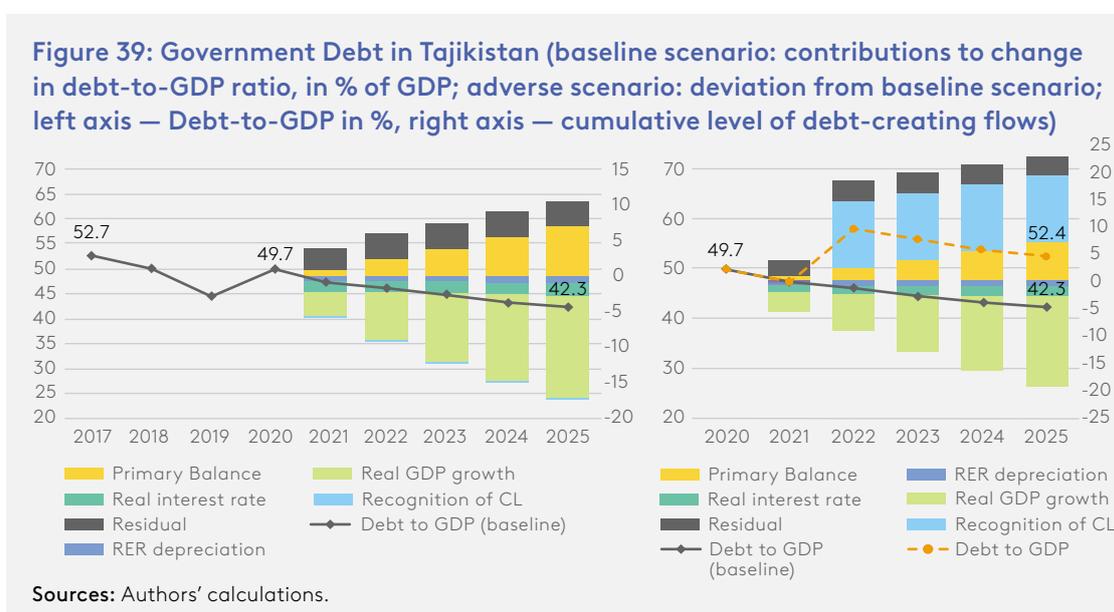


## Tajikistan

In Tajikistan, the risk of contingent liabilities materializing is also significant. According to our estimates, the shock includes the effects of several factors.

- One of the concerns is related to Barqi Tojik’s arrears. At the end of 2020, Barqi Tojik’s outstanding debt to the government exceeded 20%<sup>14</sup> of GDP (CIS Electric Power Council, 2021). Apart from these obligations, Barqi Tojik has received loans from domestic banks and energy suppliers. These energy suppliers are Sangtuda-1 HPP and Sangtuda-2 HPP. At the end of 2020, the cumulative liabilities of Barqi Tojik to these suppliers were around TJS 4 bln, or 4.5% of GDP. Coupled with debt to other suppliers and loans from local banks, this figure may exceed 8% of GDP. The Barqi Tajik debt obligations make the company’s performance fragile; pose significant risks to the banking system and fiscal stance.
- Alongside these liabilities, we believe that the Tajiktransgaz loan agreement with China on the construction of a gas pipeline may also threaten the country’s fiscal position. First, the project is currently stalled and, second, Tajiktransgaz is a state-owned company, which implies that these obligations may be contingent liabilities for the Tajik government. The total debt obligations amount to 4% of GDP.

Combining these risks – which total around 12.1% of GDP – we have conducted a comprehensive stress-test analysis of debt sustainability in Tajikistan.



<sup>14</sup> Including fines.

Our estimates suggest that, in Tajikistan, contingent liabilities may notably derail the government's debt position; hence, in 2022, the debt-to-GDP ratio may increase to 58% under the adverse scenario (Figure 39). In the medium run, public debt should moderately decline and, by 2025, it will total 52% of GDP. This implies that, over 2023–2025, the country will not be able to reduce its debt obligations to levels similar to those prevailing in 2021.

Corresponding estimates for financing needs underline the considerable fiscal burden in the year of the shock. In the long run, the country will be faced with increased amortization payments and debt-servicing obligations coming due. However, since Tajikistan is a low-income country, it has access to concessional loans, which are expected to become the main financing sources. Given this assumption, the country's liquidity position will remain moderate in the medium run. However, when the grace period ends, the country will need to be more focused on strengthening its fiscal position.

All in all, contingent liability risks have remained heightened for both the Belarus and Tajikistan economies. Thus, the countries may need comprehensive fiscal strategies, focused on improving fiscal management, increasing the transparency of fiscal and quasi-fiscal operations, and reducing the footprint of state-owned companies. Since SOE shocks are highly correlated and may have spillover effects on the banking system, the government may need to conduct regular assessments of SOEs' performance and their potential risks.

## 7. Conclusion and policy implications

The strengthening of public finances in the EFSD recipient countries and mitigation of their fiscal risks should be significant steps towards improving those countries' debt sustainability. Before the COVID outbreak, the EFSD countries had made notable progress in attaining long-term debt sustainability. However, diminished economic activity and growing budget deficits have weakened the EFSD countries' debt positions and raised many questions about ensuring sound fiscal accounts. Moreover, under less favorable economic circumstances, the problem of fiscal and debt sustainability is not limited to sovereign debt. The issue of growing private obligations and those of state-owned companies becomes more critical — in a period of crisis, a wide range of countries have had to bail out their systemically important companies and banks, and to manage credit risk from state guarantees.

In an attempt to shed light on the EFSD countries' total debt positions, we compiled private and public debt indicators with a focus on public corporations and banks. Apart from a general view on countries' debt levels, our intent was to compare the EFSD recipient countries in order to determine their fiscal and debt risks. This comparative approach also enables us to identify gaps in the reporting of private and sovereign debt series. We also attempted to present a broad overview of the EFSD countries' budget and debt positions by combining a wide set of debt instruments and covering various sectors. We further studied fragmented data on countries' state guarantees, on-lending and their SOEs' performance, as well as their interactions with budget expenditures, in order to identify the main shortcomings in debt reports and fiscal management. However, this study has a number of limitations. First, it does not collect and assess the financial health of all public companies, partially because such information is not transparent or available. Second, it does not investigate PPP risks in details and the impact of financial sector shocks on EFSD debt sustainability, although these shocks can be significant (given interlinks between public corporations and state banks). As a result, a study of EFSD countries' debt-carrying capacity could be developed further by taking into account balance sheets of their SOEs and financial risks.

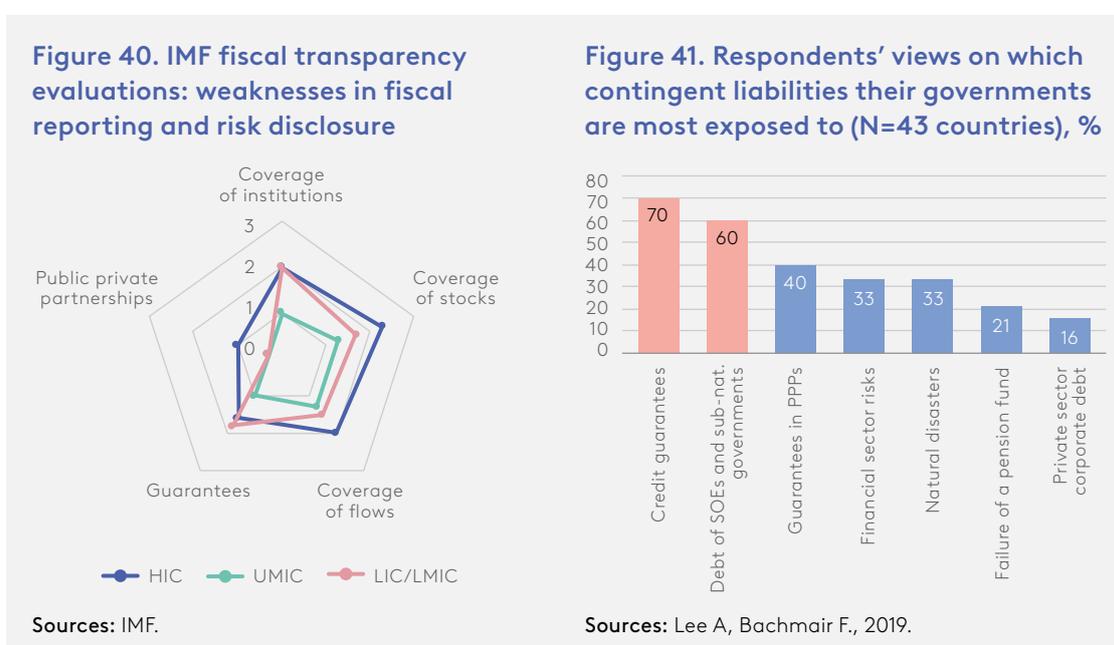
Reviewing our results, it can be concluded that EFSD countries' weaknesses in fiscal risk disclosure are similar to those of their peer countries. According to IMF estimates, only a few countries cover public-private-partnerships' and quasi-fiscal risks (Figure 40). The EFSD recipient countries have also experienced issues in efficient and regular reporting of these data. Concurrently, some EFSD economies incorporate a significant share of on-lent loans, which the government provides to loss-making companies. These data are not transparent either and require risk assessment, especially with a focus on countries' debt flows. Across the EFSD countries, regular and the most comprehensive information on on-lending is posted by Armenia (on a monthly basis), while other EFSD countries provide separate and irregular data outside fiscal and debt statistics. Another channel of EFSD fiscal risks is the financial position of subnational governments.

According to a World Bank (2019a) survey, these risks from on-lending and subnational governments have remained the most severe. A poll of public debt managers from 43 countries suggests that contingent liability risks primarily emanate from state guarantees, SOEs and subnational governments: the share of respondents who perceive state guarantees as the main risk amounted to 70% in 2019, while the share who believe that financial vulnerability of SOEs and subnational governments may

reduce their country's fiscal space was around 60% (Figure 41). The impact of other factors is seen as less dangerous; however, they may also become a source of fiscal costs.

We stress the following policy conclusions:

First, given the potential negative impact of these risks on the EFSD fiscal space, it is important to remember that **countries' debt is much more than just sovereign debt**. Thus, it is recommended to **focus on a broader scope of countries' public finance sectors, including both direct and indirect factors**. The first step in this procedure should include monitoring of financial balance sheets of state-owned companies and banks with their regular reporting. This implies a need for analysis of quasi-fiscal operations and their effects on both entities' financial results and companies' interactions with the budget.



State guarantees and on-lending — including their terms and conditions — should also be disclosed. For example, while Belarus reports the stock of state guarantees, it does not disclose terms of the guarantee agreements, which may lead to speculation about the country's fiscal sustainability and performance of SOEs. Hence, this uncertainty may result in a higher risk premium and worse borrowing conditions.

Second, a number of institutes **recommend conducting a comprehensive risk analysis with a particular focus on loss-making companies and banks**. This analysis should indicate the probability of contingent liability risks materializing and their potential fiscal impact. A complete risk analysis requires research not only of the debt stock but also of gross financing needs and borrowings.

In this study, we also conducted risk analysis that investigates EFSD debt sustainability under a contingent liability shock from SOEs. Our estimates are that, amid contingent liabilities materializing,

public debt may significantly increase. One of the important factors contributing to an accumulation of debt obligations is the inability of some SOEs to honor their payment obligations. This implies notable consequences for countries: for example, a credit rating downgrade and a decline in economic activity. That would significantly increase the countries' debt servicing burden and borrowing needs. The results of this study highlight the importance of public corporations' performance for debt sustainability, and this type of assessment can be considered as a foundation for efficient risk management. Based on these estimates, governments may set a number of measures that will minimize uncertainty and mitigate potential risks, or they may reserve some funds in case of an SOE crisis.

Third, **transparency is key for understanding and efficiently managing external debt. Complete and clear information on different sources of contingent liabilities may strengthen credibility.** Hence, the credit rating may benefit. This would be reflected in a declining risk-premium and borrowing costs. On the domestic side, it may increase the effectiveness of fiscal policy, specifically in debt management. Apart from that, high-quality forecasts with stress-testing will contribute to widening room for maneuver in the management of budget funds. It is noteworthy that, in the short run, the decision to increase transparency may diminish a country's credit ratings. However, in the long run, this is usually reversed by attracting additional financing.

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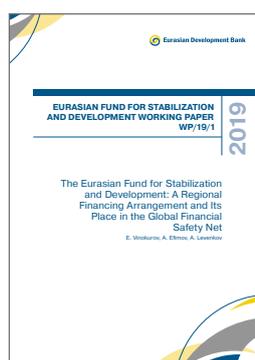
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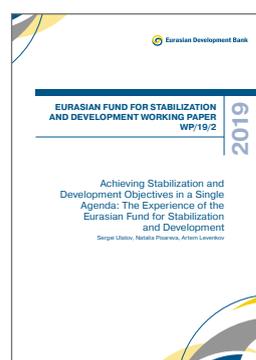
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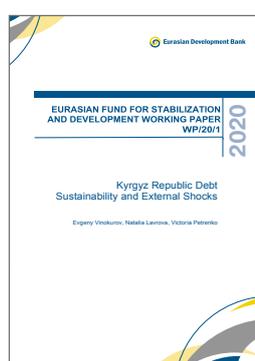
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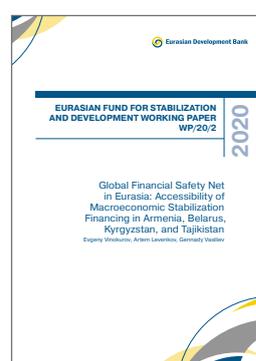
**Working Paper WP/19/1 (RU/EN)**  
**The Eurasian Fund for Stabilization and Development: A Regional Financing Arrangement and Its Place in the Global Financial Safety Net**  
 The objective of the first working paper is to bridge the gap in understanding the dynamics of EFSD development and its place in the Global Financial Safety Net (GFSN) and the region's financial architecture.



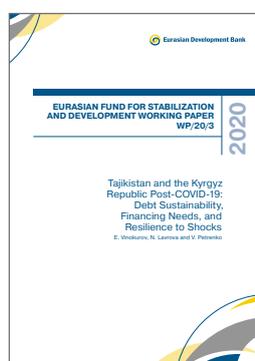
**Working Paper WP/19/1 (EN)**  
**Achieving Stabilization and Development Objectives in a Single Agenda: The Experience of the Eurasian Fund for Stabilization and Development**  
 This working paper analyzes the experience of the EFSD, which suggests that in the context of low-income countries, the RFA's stabilization mandate may benefit from complementing it with developmental agenda.



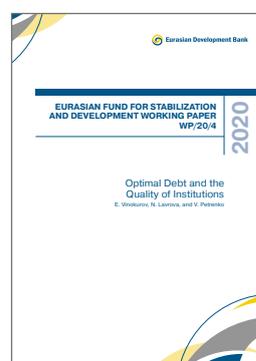
**Working Paper WP/20/1 (RU/EN)**  
**Kyrgyz Republic Debt Sustainability and External Shocks**  
 The document examines the resilience of the Kyrgyz debt under three stress-scenarios: (1) a global recession, (2) a financial crisis, and (3) the combination of a global recession and a financial crisis.



**Working Paper WP/20/2 (RU/EN)**  
**Global Financial Safety Net in Eurasia: Accessibility of Macroeconomic Stabilization Financing in Armenia, Belarus, Kyrgyzstan, and Tajikistan**  
 The document estimates the availability of stabilization financing for Armenia, Belarus, the Kyrgyz Republic, and Tajikistan based on three approaches.



**Working Paper WP/20/3 (RU/EN)**  
**Tajikistan and the Kyrgyz Republic Post-COVID-19: Debt Sustainability, Financing Needs, and Resilience to Shocks**  
 The COVID-19 outbreak has revealed the sensitivity of economies and their debt positions to a wide range of disruptions.



**Working Paper WP/20/4 (RU/EN)**  
**Optimal Debt and the Quality of Institutions**  
 Amid the COVID-19 pandemic policymakers now face the dilemma of whether to stimulate infrastructure development by raising debt, which may reduce future flexibility, or to strengthen their fiscal positions.



**Working Paper WP/21/1 (RU/EN)**  
**Evolution of Tools and Approaches within the Enlarged Global Financial Safety Net in Response to the COVID-19 Crisis**  
 This working paper provides the analysis how the GFSN responded to pandemic on global level and on regional level (in the EFSD countries).



## Eurasian Development Bank

E. Vinokurov, N. Lavrova, D. Taltaev

Total Debt is So Much More Than Just Sovereign Debt.  
Contingent Liabilities in Armenia, Belarus, Kyrgyz Republic, and Tajikistan

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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