INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A

PROPOSED GRANT IN THE AMOUNT OF SDR 7 MILLION

(US$10 MILLION EQUIVALENT)

TO

THE REPUBLIC OF TAJIKISTAN

FOR A

PROGRAMMATIC DEVELOPMENT POLICY GRANT

May 9, 2006
REPUBLIC OF TAJIKISTAN

Government Fiscal Year: January-December

Currency Equivalents

(Exchange Rate Effective as of May 9, 2006)

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<th>Currency Unit</th>
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Weights and Measures: Metric System

ABBREVIATIONS AND ACRONYMS

BEEPS Business Environment Enterprise Performance Survey
CFAA Country Financial Accountability Assessment
CIS Commonwealth of Independent States
DFID Department for International Development (U.K.)
GDP Gross domestic product
IDA International Development Association
IFC International Finance Corporation
IMF International Monetary Fund
MDGs Millennium Development Goals
MIGA Multilateral Investment Guarantee Agency
NBT National Bank of Tajikistan
NDS National Development Strategy
NSED National Strategy for Education Development
PDPG Programmatic Development Policy Credit
PPIAF The Public-Private Infrastructure Advisory Facility
PRGF Poverty Reduction and Growth Facility
PRSP Poverty reduction strategy paper
SAC Structural Adjustment Credit

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REPUBLIC OF TAJIKISTAN

Programmatic Development Policy Grant Summary

Borrower
Republic of Tajikistan

Implementing Agency
Government of Tajikistan

Amount
US$10 million in IDA grant

Terms
To be provided on a grant basis, not subject to repayment

Tranching
US$10.0 million in IDA grant will be disbursed in a single tranche following effectiveness.

Description
The proposed Programmatic Development Policy Grant is the first programmatic operation of the Bank in Tajikistan to support the government’s reform program outlined in the PRSP. The operation will support a strategic set policy reforms in private sector development, public sector management and social service delivery. The operation will also provide continuity of the reform initiated by the Bank’s previous adjustment operations (SAC 1 and 2). Policy measures supported by this operation have a strong cross cutting emphasis on improving governance.

The proposed program is divided into two pillars with the following components:

Pillar 1. Promoting Private Sector Development
- Component 1: Maintain macroeconomic stability;
- Component 2: Improve investment climate through reform of licensing and inspections, increasing transparency of the privatization process and promoting market competition; and
- Component 3: Reform regulatory frameworks through separating policy making and regulation function in key strategic sectors (i.e. aviation, cotton and energy).

Pillar 2. Improve Public Sector Management and Public Service Delivery:
- Component 1: Public sector management reform through restructuring of core public institutions, reforms of civil service management and wage system, strengthening the medium-term expenditure framework; and
- Component 2: Improving social service delivery in health and education.
**Benefits**  The proposed operation would provide the Tajik government with financial support to cover some of the expenditures associated with the implementation of a medium-term reform program. Major benefits of the overall reform program would be:

- Greater overall medium term growth as a result of higher private investment spurred by an improved investment climate.
- Improved public sector performance.
- Improved governance.
- Improved delivery of health and education services.

**Risks**  The implementation of the proposed reform program faces four major risks related to: (a) weak government implementation capacity, (b) weak public financial management systems, (c) Tajikistan’s complex political economy coupled with the presidential elections scheduled for November 2006, and (d) the vulnerability of the economy to external shocks. The program contains a number of measures to mitigate these.

**Operation ID Number**  P074889
INTERNATIONAL DEVELOPMENT ASSOCIATION
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1. COUNTRY CONTEXT

1. Tajikistan is a small economy in Central Asia with 6.7 million inhabitants and a per capita income of US$310. The economy, which has been growing on average at 10 percent during 2001-04, depends heavily on exports of cotton, aluminum and hydroelectricity, and on growing remittances of migrants to Russia conservatively estimated at 16 percent of GDP. Poverty although declining steadily remains very high. In 2003 the headcount was 64 percent using purchasing power parity poverty line of US$2.15. However, social indicators have continued to worsen, reflecting deteriorating public service delivery and weak governance. Tajikistan is the only country in ECA region unlikely to achieve most of its Millennium Development Goals (MDGs).¹

2. After independence from the USSR in 1991, Tajikistan suffered a prolonged civil war through mid 1997, when it was resolved with a peace accord. A long period of political stabilization and consolidation followed. It was not until 2005 that parliamentary elections returned Tajikistan’s first non-coalition government since the end of the hostilities and the United Nations graduated Tajikistan from post-conflict status.

3. Notwithstanding this gradual political transition, Tajikistan managed to quickly stabilize the economy by 2000 and undertake exchange rate, price and trade liberalization, financial sector reform, and privatization of lands and small enterprises. Economic growth accelerated to 10.2 percent in 2001 and has averaged 7 percent through 2005. However, this growth reflects recovery in capacity utilization primarily in agricultural, favorable world prices of cotton and aluminum, strong growth in Russia and other trading partners, and increasing remittances from Tajik migrants, mainly in Russia.

4. The extended political consolidation did, however, complicate key elements of the economic transition agenda. As such, Tajikistan has made little progress in the transforming its public sector from a central planning and state production apparatus into an instrument for encouraging private investment in human, social, and physical capital. Largely unreformed Soviet era structures and a poorly paid civil servants marred by years of politicization have left the country with low indicators of government effectiveness and regulatory quality even compared with other Central Asian states and members of the CIS.² Remnants of central planning remain in key industries, notably in the cotton sector.

5. As such, the government has not been very effective in translating the recent strong growth performance into better fundamentals for long term growth and improved social

² World Bank Institute Governance Research Indicator Country Snapshot (GCRIS) indicators.
welfare. Investment rates, including foreign direct investment (FDI), continue to be historically low. Public investment averaged 6 percent of GDP during 2000–04, constrained by fiscal exigencies. Private investment averaged a low 5 percent during the same period, due to unfinished structural reforms and an extremely weak investment climate. Since independence, the key social indicators (primary and secondary school enrollment rates, infant mortality, maternal mortality ratio, total fertility rate, incidence of tuberculosis, and child malnutrition) have been declining. Combined with relatively high population growth rate, the serious implication is that Tajikistan is facing a depreciation of its human capital.

6. While earlier efforts to accelerate structural reforms were plagued by the post-war environment, the combination of sustained macroeconomic stability and economic growth and the recent political consolidation have created the space for more fundamental reform. Concerned about the current vulnerability of Tajikistan’s economy to a change in external conditions, the government has outlined a comprehensive program of structural and institutional reform aimed at sustaining growth and reducing poverty. This program, which is being incorporated in the upcoming second PRSP, centers on (a) reform public sector management; (b) development of private sector and attracting investments; and (c) development of human potential.

7. The proposed operation will support reforms aimed at promoting private sector development and improving the delivery of public services. In the private sector, the proposed reforms will improve investment climate through reforming of the licensing and inspections regime, the legal, institutional and regulatory framework in key strategic sectors (aviation, cotton, and energy) and improve transparency of the privatization process. In the public sector, the operation will focus on improving the quality of public administration, civil service management, public financial management, and the efficiency and equity of social service delivery. Policy actions in private sector development and public administration will address the cross cutting governance issues that are critical for sustaining growth and reducing poverty in Tajikistan. Further details of the program are presented in chapter 3 and the policy matrix (annex 2).

A. Recent Macroeconomic Developments

8. The government’s pursuit of sound macroeconomic management successfully stabilized the economy during 2002–05. Through tight monetary policy and strong fiscal discipline, Tajikistan has been able to reduce inflation from 30–40 percent during 1998–2001 to below 10 percent since 2004. The overall fiscal balance (excluding externally-financed investment) has been in surplus since 2003, achieved through improved revenue mobilization and a reduction in interest payments on external public debt. Revenues have increased from 14 percent of GDP in 2000 to an estimated 20 percent of GDP in 2005. In addition, Tajikistan benefited from several successful debt restructuring and reduction agreements reached with key bilateral creditors, notably with the Russian Federation, Pakistan and through the Multilateral Debt Relief Initiative with the International Monetary Fund. External debt stood at 42 percent of GDP in 2005, down from 124 percent in 2000.

9. Tajikistan benefited from an improvement in terms of trade and burgeoning remittances. Tajikistan enjoyed a sustained improvement in the current account balance from -6.4 percent of GDP in 2000 to -1.3 percent in 2003 on account of rising prices and volumes of key exports, aluminum and cotton. However, in 2004, it increased sharply to -4.0 percent of GDP on account of higher oil import prices, and weakening cotton prices and production. In 2005, the current account balance declined moderately to -3.4 percent of GDP, although the volume of reserves has increased in line with IMF program targets. The unexpectedly strong performance
of imports (fueled by growth in remittance growth) has kept the stock of reserves in relation to import cover at about two months of imports of goods and services during the last few years.  

10. **Over the short to medium term, Tajikistan’s macroeconomic prospects are positive, although growth is expected to slow somewhat.** Growth slowed in 2005 due to weak export prices for cotton and aluminum and higher import oil prices. However, the start of a large-scale Russian-financed hydroelectric power project, expansion in aluminum processing capacity to service continued high world demand, recovery in cotton production following a recent drought, and buoyant inflows of remittances should support growth of 4–6 percent during the next few years. Inflation is expected to remain subdued with continued tight monetary policy, although some pressures on consumer prices may result from increases in world oil prices and proposed electricity tariff adjustments. The government plans to maintain an overall fiscal surplus of 0.5 percent of GDP during 2006–10, excluding the externally-financed public investment program.

**Table 1: Medium-term macroeconomic outlook**

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<tr>
<td><strong>Gross Domestic Product, US$ million</strong></td>
<td>955</td>
<td>1033</td>
<td>1197</td>
<td>1556</td>
<td>2073</td>
<td>2311</td>
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<td><strong>Real GDP Growth, percent</strong></td>
<td>8</td>
<td>10</td>
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<td>10</td>
<td>11</td>
<td>7</td>
<td>6</td>
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<tr>
<td><strong>Real Per Capita GDP growth, percent</strong></td>
<td>6</td>
<td>8</td>
<td>7</td>
<td>8</td>
<td>8</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td><strong>Per Capita GDP, US$</strong></td>
<td>154</td>
<td>164</td>
<td>186</td>
<td>237</td>
<td>309</td>
<td>338</td>
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<tr>
<td><strong>Annual Inflation, percent</strong></td>
<td>33</td>
<td>39</td>
<td>12</td>
<td>16</td>
<td>7</td>
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<td>5</td>
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<td><strong>Current Account Balance</strong></td>
<td>-59</td>
<td>-52</td>
<td>-43</td>
<td>-20</td>
<td>-83</td>
<td>-79</td>
<td>-147</td>
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<tr>
<td><strong>Exports of Goods and Non-factor Services</strong></td>
<td>850</td>
<td>735</td>
<td>799</td>
<td>985</td>
<td>1211</td>
<td>1246</td>
<td>1658</td>
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<tr>
<td><strong>Imports of Goods and Non-factor Services</strong></td>
<td>868</td>
<td>847</td>
<td>929</td>
<td>1142</td>
<td>1451</td>
<td>1683</td>
<td>2294</td>
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<tr>
<td><strong>Net Income</strong></td>
<td>-80</td>
<td>-51</td>
<td>-57</td>
<td>-90</td>
<td>-78</td>
<td>-75</td>
<td>-79</td>
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<td><strong>Net Transfers</strong></td>
<td>39</td>
<td>111</td>
<td>144</td>
<td>228</td>
<td>236</td>
<td>432</td>
<td>568</td>
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<tr>
<td><strong>Net Foreign Direct Investment</strong></td>
<td>24</td>
<td>10</td>
<td>36</td>
<td>32</td>
<td>272</td>
<td>55</td>
<td>88</td>
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<tr>
<td><strong>Current Account Balance</strong></td>
<td>-6</td>
<td>-5</td>
<td>-4</td>
<td>-1</td>
<td>-4</td>
<td>-3</td>
<td>-5</td>
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<tr>
<td><strong>Overall Revenues and Grants</strong></td>
<td>14</td>
<td>15</td>
<td>17</td>
<td>17</td>
<td>18</td>
<td>20</td>
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<tr>
<td><strong>Total Expenditures and Net Lending</strong></td>
<td>19</td>
<td>18</td>
<td>19</td>
<td>20</td>
<td>23</td>
<td>24</td>
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<td><strong>of which: Externally funded public investment program</strong></td>
<td>4</td>
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<td>3</td>
<td>3</td>
<td>3</td>
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<tr>
<td><strong>Fiscal Balance (incl. externally funded public investment program)</strong></td>
<td>-6</td>
<td>-3</td>
<td>-2</td>
<td>-2</td>
<td>-3</td>
<td>-4</td>
<td></td>
</tr>
<tr>
<td><strong>Fiscal Balance (excl externally funded public investment program)</strong></td>
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<td>-1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
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<tr>
<td><strong>External Debt</strong></td>
<td>128</td>
<td>98</td>
<td>84</td>
<td>66</td>
<td>42</td>
<td>39</td>
<td>36</td>
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<td><strong>Debt Service Due, in percent of Export Goods and Non-factor Services</strong></td>
<td>5</td>
<td>14</td>
<td>13</td>
<td>11</td>
<td>28</td>
<td>7</td>
<td>5</td>
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<td><strong>Exchange Rate</strong></td>
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**Note:**

1. 2006–10 weighted averages.

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3 International reserves net of remittance-induced imports are estimated at about 4 months of imports of goods and services.
3. Including grants.

Source: World Bank staff calculations.

11. The external account, despite signs of weakening, is expected to remain quite stable over the medium term. The current account deficit is projected to increase from 3.4 percent of GDP in 2005 to 4.8 percent of GDP during 2006–10, assuming weaker prices of aluminum and cotton, and continued strong demand for imports associated with the investment projects in infrastructure and hydroelectricity.

12. The risk of debt distress is moderate. A recent external debt sustainability analysis conducted jointly with the IMF (annex 8) suggests that all the indicators of external debt burden will remain below relevant thresholds under the baseline scenario but that some indicators worsen over time. Given the high concessionality of external public and publicly guaranteed debt, debt service payments remain low in 2006 at 14.3 percent of revenues and 5.8 percent of exports. Implementing the Multilateral Debt Relief Initiative for IMF debt (as of end 2004) in January 2006 would decrease net present value of debt-to-revenues ratio from 129 percent in 2004 to 114 percent in 2006, and further reduce the risk of debt distress. Sensitivity analyses suggest that several indicators would breach their thresholds in 2007 if the economy were affected by a combined shock to GDP and exports growth, and FDI inflows.

13. However, a structural transformation of the economy is still needed to broaden the sources of economic growth and reduce the vulnerabilities to external shocks. Despite some recent diversification of exports, Tajikistan’s economy remains heavily dependent on a few key commodities and key trading partners. It is therefore vulnerable to shifts in world demand for and prices of cotton and aluminum, or a slowdown in the Russian and CIS economies. Any deterioration in these could widen both the external current account and fiscal deficits, and dampen growth. However, the external current account is financed primarily by donor inflows and remittances. Both are expected to be reasonably stable over the medium term, as donor inflows are expected to continue and Russian immigration policy with respect to Tajikistan is not expected to change.

B. Structural Reform and Challenges

14. Sustaining long term economic growth in Tajikistan will require accelerating export growth and diversification of the domestic economy, by stimulating investment, improving productivity and strengthening competitiveness. Tajikistan has considerable potential to increase its output and exports of agricultural products and of hydroelectricity. In agriculture, productivity remains low hindered by lack of clear land use rights and inefficiencies in the supply of inputs and credit. For hydroelectricity, the regulatory framework currently creates a disincentive for investment. Tajikistan also has good prospects for increasing production of nontradables to meet rising domestic demand for consumer services. Broader diversification, however, will require strengthening a very weak business environment, improving the skills and education of the workforce and improving utility services in key areas.

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4 Average GDP growth of 6.5 percent, export growth of 7.9 percent and an average current account balance of 4.3 percent of GDP during 2006-10, as well as the maintenance of fiscal prudence and tight monetary policy under a new PRGF program.

5 Tajikistan is an active member of the Central Asia Regional Economic Cooperation and benefits from multilateral and bilateral regional programs in energy, trade, and transport.
15. **Under reform programs supported by the World Bank and the IMF since 1997, Tajikistan has made reasonable progress on trade and exchange rate liberalization, privatization, and banking reform.** Tajikistan has a very open trade regime with few tariff lines and an average tariff of around 7 percent—the highest degree of trade openness among low-income members of the CIS. The exchange rate is market-driven through a managed float with interventions limited to smoothing operations. The banking sector has gradually been strengthened through restructuring of its five biggest banks, closure of weak banks, and improved supervision and prudential ratios. Privatization of small enterprises has been completed, while divestiture of medium and large enterprises is ongoing. More than half of state and collective farms have been dismantled and land certificates issued to private farmers.

16. **In addition, the investment climate has improved over the last few years, albeit from an extremely low level.** The number of firms in Tajikistan indicating problems for doing business in most of the key areas of the investment climate has declined, according to the joint World Bank-EBRD Business Environment and Enterprise Performance Survey (BEEPS) conducted in 2002 to 2005. The notable exceptions are in access to land, business licensing and permits, skills and education of the workforce, and labor regulations. The notable exceptions are in access to land, business licensing and permits, skills and education of the workforce, and labor regulations. In addition, Tajikistan compares favorably with other CIS countries with fewer firms reporting each key issue as a problem for doing business, with the notable exceptions of business licensing and permits and electricity supply.

17. **However, Tajikistan faces challenges in completing the transition agenda and addressing underlying governance issues.** The state remains intricately involved in a wide range of commercial and productive activities, which continues to hinder the development of competitive markets. Formal financial intermediation remains very low and the accumulated cotton farm debt is also impeding the efficient allocation of resources for productive activity. Finally, the delivery of public services, including social and economic services, remains inadequate for long term growth and poverty reduction.

18. **The state’s involvement continues to impede the achievement of a satisfactory investment climate and hinder diversification.** This problem ranges from the remnants of central planning in cotton production and restrictions on the use of land rights, to the convolution of regulatory and commercial functions in the aviation and electricity sectors, to the continued preferential treatment—in terms of access to inputs, energy, finance, or in some cases the maintenance of dominant market power—of state-owned enterprises and vested interests with close links to the state. Similarly, a lack of transparency surrounding the privatization process has dampened investor interest in the remaining entities. As a result, in 2004 the private sector produced only 30 percent of GDP.

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7 The comparison of BEEPS results for Tajikistan with those of other countries is fraught with problems, as the private sector remains small and established firms are often those that have overcome most obstacles. Notably absent in these measurement are the perceptions of potential investors and entrepreneurs who have not been able to start firms.
19. Continued state control of the key utility and transport sector—air and rail—is associated with low quality and high cost services. The electricity sector is plagued by the typical problems of noncommercial tariffs, weak finances, and low investment and maintenance, resulting in severe supply shortages. The aviation sector is dominated by the national flag carrier that also controls policy, regulation, and airport operations, resulting some of the lowest airlift capacity and highest prices in Central Asia.

20. The Tajikistan Aluminum Plant—the country’s largest enterprise by far, accounting for 5 percent of Tajikistan's GDP in 2005—has improved its performance in recent years. The company, 100 percent owned by the state and a focus of the Bank-supported Second Structural Adjustment Credit, has improved its operational and financial performance steadily in recent years. The firm has not accumulated arrears in its payments for electricity since the Second Structural Adjustment Credit, and its profitability has steadily improved, profits amounted to
about US$20 million dollars in 2005. The company is Tajikistan’s largest single taxpayer, paying about US$30 million in taxes in 2005, up from about US$18.5 paid in 2004. The main reason for the improved performance is the change of management that took place in December 2004. The previous manager was removed from his post and criminal charges brought against him by the government. The government realizes that the company to provide maximum benefits to the country needs to operate according to a modern corporate governance structure. It requested the World Bank in April 2006 to assist with identifying an internationally reputable aluminum firm that can work with the Tajikistan Aluminum Plant to modernize its operations.

21. **An outstanding problem of cotton farm debt overhang is also impeding the efficient allocation of resources.** To compensate for the shallow financial sector and the collapse of input supply chains, cotton ginneries supply credit to farmers in the form of inputs in kind, which farmers are meant to repay through deductions in the sales proceeds when they deliver their cotton to the gin. This leaves farmers vulnerable to exploitation by ginneries, which can overcharge for inputs and for services provided after the cotton is delivered, such as ginning. This burden, together with the effects of a recent drought and the downturn in cotton prices, has left farmers with a substantial debt roughly estimated at 5–10 percent of GDP and which is now hindering further investments to raise productivity and output.

22. **The financial sector remains very shallow with bank deposits low but growing.** In turn, credit to the private sector stand at around 5.6 percent of GDP. As a consequence, small and medium enterprises have limited access to formal credit necessary for start-up operations or expansion. Larger enterprises with access to the banking system face high transaction costs. High real interest rates of around 15 percent reflect the tight monetary policy, a slow recovery in public confidence in the banking system following earlier currency conversion and devaluation, and high spreads of 9.3 percent. The latter include both the remaining inefficiencies in the banking system and a relatively high risk premium on credit to the private sector. The IMF and the World Bank are planning to conduct the Financial Sector Assessment Program in 2006 to identify key areas for strengthening of financial intermediation.

23. **Delays in the reform of the public sector have limited Tajikistan’s ability to translate the recent growth into improved social welfare.** The public sector is still unable to deliver adequate social services—health and education—for maintaining and developing the human capital of Tajikistan’s population. Social indicators, especially in education, have continued the post-independence decline until just recently. For example, in 2004 basic school attendance did not decline for first year since independence. Economic services such as business registration and regulation continue to be marred by Soviet-era bureaucracy and create opportunities for corruption. In general, the low quality of public services is linked to inappropriate organizational structures, weak institutional capacity, poor incentives, and inadequate and inefficient use of resources.

C. Political Economy and Governance

24. **The legacy of the civil war in Tajikistan includes a complex political economy that has constrained private sector and social development.** In the initial years, the main priority of the government was to consolidate peace, and to ensure that a balance of power between different political factions was maintained. Little progress was made to undertake the fundamental reforms of other members of the former Soviet Union to redefine the role of the state from central planner

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8 The company has been preparing financial statements according to international accounting standards since 2002.
and operator of productive activities to that of policy maker, regulator, and facilitator of private
sector investment.

25. **The weaknesses and lack of ethical standards in public sector management directly affects the public sector management and service delivery.** The inability of government structures to prioritize policies and effectively deliver public services has resulted in disjointed development policies that neither promote economic growth nor enhance the welfare of population. The ineffective use of scarce resources in health and education affect the nation’s human capital and directly impedes the ability of Tajikistan to meet MDG goals.

26. **Early efforts to undertake public service reform were plagued by the use of the state sector as a tool for appeasement of the various political factions.** Attempts at reform were also stymied by collapsing public sector real wages, weak capacity, and the politicization of key positions and functions. Moreover, the delay in adapting Soviet-era practices to the emerging market economy left enormous space for the emergence of state capture and administrative corruption.

27. **Tajikistan compares poorly with other countries of the region on accountability and control of corruption.** Indicators of government effectiveness and regulatory quality in Tajikistan remain very weak, even compared to other Central Asian states and members of the CIS, according to the Governance Research Indicator Country Snapshot (GRICS) of the World Bank Institute. Poor performance in these areas impedes private sector development and public sector performance. The government recognizes the need to strengthen governance both to attract private sector investment for growth and to improve the delivery of public services.

28. **More recently, however, the combination of sustained economic growth and political consolidation are creating the space for more fundamental reform.** Growth of the enterprise sector over time, although still with strong links to the state, has reduced the use of the state sector as a tool for appeasement. In addition, more technically and professionally qualified managers and senior officials in the public sector have gradually emerged. Improvements in revenue collections have been setting the stage for improvements in public sector wages needed to support a better quality cadre of civil servants. And in Tajikistan—as across the region—the demands of the electorate are shifting toward better delivery of public goods and services, improvement of the business climate and, not least, a reduction in corruption.

29. **This gradual evolution of the political system has culminated in a recent re-orientation of the government from consolidation of political power to improved implementation of the political directorate’s policy agenda.** This shift has led to an increased focus on the establishment of clear and stable rules of the game, a more professional civil service, and more effective procedures and processes. Clearly, in some areas where the complex interaction of vested interests and the state remain, it is expected the government will proceed quite tentatively. But the new focus is clearly an opportunity for development partners to help Tajikistan to catch up on its extensive agenda of unfinished structural and institutional reforms, including reform of civil service and public administration.

30. **Tajikistan has made substantial progress in the past few years in public financial management.** Although, the June 2004 Country Financial Accountability Assessment (CFAA), the 2003 Country Procurement Assessment Report, and the 2005 Public Expenditure and Institution Review concluded that Tajikistan was a high risk environment for public funds, Tajikistan has made considerable progress since then in improving public financial management. These efforts have resulted in Tajikistan achieving 8 of the required 16 HIPC indicators of public
financial management, putting Tajikistan in the top quintile of HIPC countries as noted in the recent February 2006 IMF Staff Report and IMF assessment of public expenditure management under the Multilateral Debt Relief Initiative. For details, see fiduciary aspects in chapter 4 section F.

31. **Tajikistan is making progress on other aspects of governance.** The GRICS indicators demonstrate that the country made substantial progress in several areas between 2000–04. Its rating for government effectiveness improved by 100 percent, for political stability by 50 percent, and for regulatory quality by 25 percent. Data from the BEEP also shows that Tajikistan has made significant improvement in governance, and classifies Tajikistan as a “gradual improver” on governance issues. Although Tajikistan remains a high-risk environment, the signs of improvement suggest that the government is serious about reform, and will continue to implement measures to improve governance.

32. **Aside from reform of public financial management, reducing corruption will require reducing the role of the state in the enterprise sector.** State involvement in productive enterprises has resulted in waste, appropriation of public funds for private gain, and inefficient and outmoded industries. A reduced role of the state in productive enterprises combined with a sound regulatory framework and adequate enforcement capacity would free public resources for investment and delivery of public services and would improve the allocation of resources across the economy. The government recognizes this, and is implementing many actions that will over time reduce the role of the state in productive enterprises. Even where the state retains a role, reforms to separate policymaking from operations will lead to much more commercially-oriented operations.
2. **TAJIKISTAN’S POVERTY REDUCTION STRATEGY**

33. **Tajikistan was the first CIS country to prepare a Poverty Reduction Strategy (PRSP) in 2002, covering 2002–05.** The PRSP aimed to increase real incomes, achieve a fair distribution of the benefits of growth, and to ensure a rise in the living standards of the poorest. It focused on four pillars: (a) encouraging equitable, labor-intensive economic growth, with an emphasis on exports; (b) supporting the efficient and fair provision of basic social services; (c) targeting support to the poorest groups of the population; and (d) improving governance and security. The key weaknesses of the PRSP were its lack of prioritization and detailed costing of proposed actions.

34. **Over the last three years, the government implemented key elements of the PRSP, namely, prudent macroeconomic management policy, increasing budget allocations to the social sectors and initiation of important reform in the delivery of social services.** Public spending on health care increased from 5.7 percent of total government expenditures in 2004 to 7.4 percent in 2005. Similarly, public spending on education increased from 2.3 percent in 2003 to 3.5 percent of GDP in 2005. The government approved a health financing reform strategy in 2005 that envisages increased allocations to primary health care and the introduction of per capita funding and fees for services. A basic benefits package was introduced in 2005, although this was later suspended because of problems with pricing of paid services. It is currently being revised for re-introduction under this operation. The use of per capita-based, as opposed to input norm-based, allocations in the education sector is being piloted in five districts as a first step toward increasing efficiency and reducing inter-regional inequities.

35. **The government recognizes that more must be done to implement other elements of the strategy.** This includes improving the business climate, investing in infrastructure (telecommunications, rural and regional roads, energy systems, and water facilities), promoting agricultural productivity, and strengthening governance.

36. **The government is now preparing a long term vision for the achievement of the MDGs, the National Development Strategy (NDS) for 2006-15.** In collaboration with its development partners, the government has identified medium and long-term development priorities for the achievement of the MDGs: (a) reform of public sector management; (b) development of private sector and attracting investments; and (c) development of human potential.

37. **The NDS will form the basis for the upcoming second PRSP to cover 2006-09.** The new PRSP will be underpinned by a medium-term budget framework, and is expected to integrate all existing medium and long-term policy documents and to better prioritize and consolidate the development programs.

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9 The development of the NDS is being overseen by a coordination council established by presidential decree. The council is supported by 12 sector working groups: (1) macroeconomic policy; (2) public administration reform; (3) infrastructure, communications and industry; (4) integration into the world economy; (5) private sector development; (6) food security and agriculture; (7) education and science; (8) health; (9) water supply and sanitation; (10) social protection; (11) environmental protection; and (12) gender equality.
3. THE DEVELOPMENT POLICY PROGRAM

38. This section summarizes the key elements of the government’s medium-term program consistent with the PRSP to address glaring weaknesses in the private sector environment and public sector performance. Taken together, these reforms appear well suited to address the urgent need to diversify the economy, restructure public sector institutions, and improve overall governance. The programmatic series of three development policy operations described in this document is designed to broadly support this medium-term agenda.

A. Pillar 1: Promoting Private Sector Development

39. To sustain the recent high level of economic growth, Tajikistan will need to continue to promote private sector development through maintaining macroeconomic stability, improving investment climate, and improving regulatory framework in key strategic sectors (aviation, cotton, and electricity) over the medium and long term. These will stimulate private investment necessary to sustain a higher level of economic growth and reduce poverty.

(i) Maintaining macroeconomic stability

40. The government has pursued sound macroeconomic management since the end of the civil war in late 1997, as demonstrated by the successful completion of two IMF programs. The main challenge will be to maintain this stability in an economy that is vulnerable to external shocks due to the very narrow export base. In the medium term, however, the external prospects appear stable, with strong world demand projected for both cotton and aluminum. Remittances are also expected to continue to grow as the Russian economy benefits from high oil and gas prices. Over the medium term, the government has targeted a fiscal deficit (excluding externally financed public investment) of 0.5 percent of GDP, the maintenance of single digit inflation through conservative monetary policy, and a gradual accumulation of international reserves. Additional resources generated by ongoing tax reform (supported by the IMF), additional savings from debt service relief and from public sector reform will allow for an increase in social sector spending and a gradual increase in public sector wage levels, in line with the projected inflation targets. Regarding debt levels, the government intends to maintain its current moratorium on non-concessional debt and maintain externally financed public investment program at the current levels of around 4 percent of GDP, the latter in part because of absorptive capacities. As noted above (paragraph 12), the risks of debt distress remain moderate.

(ii) Improving the investment climate

41. To sustain economic growth over the medium and long-term, Tajikistan will need to further diversify the economy. Realizing the potential, however, will require significant improvements to the private investment climate. Currently, the private sector in Tajikistan must cope with an unclear and overly cumbersome regulatory and institutional framework that stifles competition, increases the cost and risk of doing business, and discourages innovation and risk taking.

42. To address these issues, the government is streamlining and simplifying the business licensing and inspections regimes, and strengthening the legal and institutional framework for promoting competition, and increasing the transparency of the privatization process.
Reform of Business Licensing and Inspections

43. **Licensing.** The current licensing regime in Tajikistan significantly restricts market entry, breeds corruption, and discourages private investment. **New businesses face numerous difficulties in obtaining licenses.** These include the lack of comprehensive and reliable information on the application process and criteria for approval, the need for multiple licenses, long processing times, and high cost of licenses (including unofficial payments).\(^9\) Until recently, there were 32 types and 1,000 subtypes of business activities that require licenses in Tajikistan which were covered in 43 laws and 41 normative acts. The need for annual renewals and the arbitrary suspension of licenses create additional uncertainties surrounding this process and encourage businesses to make unofficial payments.\(^10\)

44. **The 2005 Business Environment Enterprise Performance Survey (BEEPS) data indicates that the process of securing business licenses and permits has not improved since 2002.** However, the number of businesses citing a problem with informal payments for business licenses declined.\(^11\) About 38 percent of businesses surveyed in Tajikistan cited business licensing as a problem compared with about 33 percent for the members of the CIS and 31 percent for countries of the Europe and Central Asia Region.

45. **In 2005 the government adopted a new licensing law that reduced the number of activities subject to licensing from some 1,500 to about 113, updated application processing requirements, and harmonized licensing fees.** It also adopted a regulatory framework to implement and administer the law. Implementation of this new legal and regulatory framework is being supported by technical assistance from International Finance Corporation Private Enterprise Partnership, Foreign Investment Advisory Service (IFC-FIAS) and the Multilateral Investment Guarantee Agency (MIGA). However, some of the 113 activities include several subcategories which continue collectively to pose significant barriers to entry. The government intends to amend the current licensing law to further reduce the number of activities and streamline the procedures and amend the administrative violation procedures code to ensure compliance with the amended licensing law. To ensure successful implementation, the government will develop and implement a public communication strategy that comprises (a) a public awareness campaign, (b) training of public officials on the new requirements under the law, and (c) periodic surveys of businesses on progress in implementation.

46. **Inspections.** Currently, the inspection regime in Tajikistan is an uncertain and nontransparent process that can often result in arbitrary suspension or closure of business. Tajikistan’s businesses are subject on average to 12 inspections per year, with each lasting an average of 2.6 hours.\(^13\) Firms are inspected for a single issue by multiple agencies. Multiple inspections by a single agency are also common. Although the share of firms indicating that bribes are frequent fell between 2002 and 2005, Tajikistan continues to rank below average on this indicator among CIS countries. For the state to adequately protect the health and safety of its citizens, while maintaining a level playing field for investors, inspections of enterprises must be conducted in an objective, rules-based manner in accordance with the intended purpose.

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10 Over 50 percent of respondents in the 2003 IFC Private Enterprise Partnership small and medium enterprise survey cited lack of information as a problem. The lack of information was most acute in agriculture as 83 percent of respondents cited this problem.

11 Over 33 percent of those obtaining licenses made unofficial payments. Unofficial payments to acquire a license in the construction sector, characterized by large contracts, are the highest.

12 Supported by the World Bank and European Bank for Reconstruction and Development.

13 BEEPS 2005.
Table 2: BEEPS Inspections

<table>
<thead>
<tr>
<th></th>
<th>Number of inspections in previous 12 months</th>
<th>Average duration of inspections (hrs)</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Tajikistan</td>
<td>CIS</td>
</tr>
<tr>
<td>Tax Inspectorate</td>
<td>3.1</td>
<td>3.1</td>
</tr>
<tr>
<td>Fire &amp; Building Safety</td>
<td>3.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Sanitation/ Epidemiology</td>
<td>1.8</td>
<td>2.3</td>
</tr>
<tr>
<td>Environmental</td>
<td>1.3</td>
<td>0.8</td>
</tr>
<tr>
<td>Labor and Social Security</td>
<td>1.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Municipal Police</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Customs Agency</td>
<td>0.3</td>
<td>0.8</td>
</tr>
<tr>
<td></td>
<td>11.7</td>
<td>10.7</td>
</tr>
</tbody>
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47. The government aims to reduce the frequency, duration, and arbitrariness of inspections. To both monitor the process and curtail arbitrary inspections, the government introduced in 2001 an Inspection Registration Book in which firms and inspectors were to record their visits. However, not all businesses were issued a registration book, and the inspectors continued to intimidate them into not recording their visits. The government intends to establish new rules and procedures for inspections through a new law on inspections and amendments to the tax code regarding inspections (the amendments are necessary because tax inspections constitute more than 50 percent of total inspection activities). In parallel, the government will amend the administrative violation procedures code to increase compliance with the new law on inspections. During the next few years, this will be followed by the adoption of new regulations to implement the law, amendments of other laws governing inspections to ensure compliance with the new law, training of staff in inspecting agencies, and a program to publicize the law, regulations and new procedures among businesses. In addition, reforms will seek to further reduce inspections by moving from a system of 100 percent inspections to selective risk-based inspections. Technical assistance for revising and publicizing the new regulations and procedures is to be provided through IFC-Private Enterprise Partnership and the proposed Bank-supported Public Sector Reform Project.

Improve Transparency in Privatization Process and Market Competition

48. Privatization. While small enterprises were completely privatized in 2001, medium and large enterprises are still being privatized based on the Strategic Privatization Plan for 2003–07. This plan aims to (a) privatize 446 medium-to-large enterprises through auctions, (b) privatize 102 large enterprises through tenders, and (c) restructure, introduce private participation, or privatize the remaining 37 strategic infrastructure and other enterprises. Those in the first and second groups are expected to be privatized by 2007. Almost half of medium and large enterprises (about 271) were divested during 2004–05 through auctions and tenders. Another 150 are scheduled for divestiture during 2006, and 79 are planned for 2007. Restructuring plans will be prepared for the third group during 2005–06, and implementation will start in 2007.

49. To stimulate lagging demand, the government is committed to assuring potential investors and the public of the fairness of the privatization process. With the assistance of the World Bank, a set of regulations for conducting privatization transactions in an effective and transparent manner were adopted in 2004 under the Second Structural Adjustment Credit. To strengthen the transparency of the process, the government will conduct annual random compliance audits of privatization transactions to verify that regulations have been followed. The

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14 IFC-Private Enterprise Project and the Swiss Economic Corporation Organization have provided financial support to enable the government to increase the coverage of the Inspection Registration Books distributed to enterprises (from 40 percent to 80 percent). The IFC-Private Enterprise Project survey of small and medium size enterprises will monitor compliance with the regulations and procedures.
outcomes of these audits will be published annually, including information on progress in implementing earlier recommendations. For 2006, the government has randomly chosen seven transactions completed in 2004 to be audited by an independent international auditor, and will address the deficiencies identified by the compliance review. To increase investor awareness and create greater demand for assets being divested, the government will undertake a publicity campaign and disclose in national newspapers details of past privatization transactions and upcoming asset sales.

50. To attract private sector participation in strategic enterprises, the restructuring plans for individual strategic enterprises need to be improved. The State Privatization Committee is currently assisting sector ministries and entities developing restructuring plans for strategic enterprises under category (c) of the Strategic Privatization Plan. These include the TADAZ aluminum smelter, Tajik State Airline Company, Barki Tojik (electricity distribution company), Tajik Railways, and Tajiktelecom, and other large industrial enterprises. However, early reviews of some of the drafts reveal that they still need to be placed in the context of a sector policy, strategy, and regulatory framework. The draft plans also need to provide stronger justification for their call for new capital investment and to include measures to improve basic accounting and information management. In this context, the government, with assistance from the World Bank under the Public-Private Infrastructure Assistance Facility (PPIAF), intends to strengthen the capacity of the State Privatization Committee to ensure that the plans are economically feasible and consistent with the government’s broader objectives and sector policies. The revised restructuring plans for these enterprises are expected to be approved by the government in 2007, while implementation of the approved restructuring plans will be initiated in subsequent years.

51. Competition. To promote free and fair competition in the market place, the government will adopt amendments to the competition and anti-monopoly laws adopted in 1998. In most post conflict and transition countries, vested interests emerge and consolidate market position and prevent entry and force exit, thereby undermining competition. Tajikistan is no exception. Although the development of adequate protection for competition is a long-term process, early intervention is critical, as it becomes increasingly difficult over time for the government to rein in dominant market players and vested interests.

52. Since 1998, the government has enacted a competition and anti-monopoly law, set up an anti-monopoly agency and promulgated various regulations to administer the law. However, the laws fell far short of international standards. For example, the law did not provide the anti-monopoly agency with adequate enforcement powers, while providing too much right of intervention in the absence of violations. Over time, the anti-monopoly agency also assumed an enterprise support function that diluted its institutional focus and created a significant conflict. In addition, the law assigned responsibilities for the pricing of natural monopoly services to the anti-monopoly agency. In the majority of cases these natural monopolies are infrastructure enterprises that need to be subject to a much broader regulatory framework than just price regulation.

53. The government, with support from a Japanese PHRD grant, has sought to address these issues by preparing amendments to the competition law. It has transferred the enterprise support function to the Ministry of Economy and Trade. The anti-monopoly agency does continue to be involved in pricing issues for natural monopolies, but the government intends to remove this activity from the agency as the infrastructure regulatory frameworks in the country develop. This will be addressed more fully when the regulations for the amended law are prepared. Currently the European Union is providing technical assistance to strengthen institutional capacity of the anti-monopoly agency.
(iii) Regulatory reform in key strategic sectors

a. Aviation

54. **Improved air links are crucial to integrate Tajikistan into the global economy.** Tajikistan is landlocked and the distance to the nearest port is 2,000 kilometers. Tajikistan is separated from the Kyrgyz Republic and China by high mountains. Its long border with Afghanistan creates problems with security and drug trafficking. The movement of people and goods across the border with Uzbekistan is tightly controlled and results in high costs of transportation. Political disruptions in the region could affect the road and rail transit and curtail exports. Strong air links are thus critical to long-term growth and poverty reduction in Tajikistan.

55. **Tajikistan is the only country in the former Soviet Union which is not served by any major international airlines.** Currently, air access to the outside world is controlled by the national airline, Tajik State Airline, which is also responsible for aviation policy, regulation, and airport operations. The Tajik State Airline in 2004 carried 64 percent of international air traffic. It is the sole carrier to destinations outside Russia, which accounts for 10 percent of the market. Most of the remaining traffic is served by Russian carriers to various cities in Russia, other than Moscow. Currently, the company has a fleet of 30 aircraft inherited from the Soviet Republic, most of which are becoming obsolete. The current aviation policy is restrictive in terms of market access (number and types of routes that are operated), market capture (capacity allowances limited by frequency of trips and type of aircraft), and market competition (number of designated carriers per route).

56. **Air travel to and from Tajikistan remains expensive by regional comparison.** Airfares between Moscow and Dushanbe are around one-third more expensive than for comparable routes to other Central Asian destinations. Ticket distribution systems are poor and informal payments to obtain tickets are not uncommon. The burden of high prices and limited ticket availability imposes significant costs on migrant workers, roughly estimated at 7 percent of their annual net income.

57. **The government recognizes the need to reform the aviation sector to reduce the cost and increase the convenience of air travel.** With assistance from the World Bank, the government has conducted a comprehensive review of the aviation sector and developed a reform strategy. The key elements of the strategy are (a) regulatory and institutional reform, (b) gradual expansion of services and introduction of competition, and (c) restructuring of the Tajik State Airline. The first step involves removing the policy function from the Department of Civil Aviation, which will be responsible solely for technical regulation. In parallel, the government will carry out the legal and operational separation of the airline, the airport, and air traffic control services, to ensure that the costs and profits of the various operations are transparent. The first steps will include a financial audit of the separate accounts and a comprehensive analysis of the cost structure of the company’s three business entities (airline, airport, and air traffic control). A realistic timetable for separation of actual operations will be developed together with five-year business plans to strengthen capacity and financial viability of each separate entity. The latter will include revision of the structure of fees and charges for airports and air traffic control and marketing strategies.

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15 Istanbul, Munich, Almaty, Bishkek, Sharjah, and Delhi.
16 A Chinese carrier also operates flights once a week from Urumchi, China.
58. **To provide time for the Tajik State Air company time to modernize and improve its competitive position, the government will allocate in a phased manner new and additional route rights over a period of three years.** The government has already licensed two new international carriers to provide services to Dushanbe, a Russian airline (from Moscow) and in January 2006 a Turkish airline (from Istanbul). The government will expand market access during 2006 and 2007 by allowing at least one new international carrier to start regular flights to and from Dushanbe during the next two years.

b. **Cotton**

59. **Tajikistan’s agriculture is dominated by a cotton sector that suffers from substantial domestic inefficiencies and inequities.** Today, the Tajik cotton sector, traditionally, the engine of Tajik agriculture, is facing significant challenges. The sector is impeding rather than enhancing growth in agricultural production and rural poverty reduction. Its contribution to export earnings and tax revenue is below potential. The cotton sector’s crucial role in the Tajik economy derives not only from its contribution to agricultural output (60 percent), export earnings (15 percent), and tax revenue (35 percent), but also its support to the welfare of rural population (75 percent) and uses of irrigated and arable land (55 percent of irrigated arable land). Growth, however, is slow relative to other agriculture subsectors, yields are currently around half of their pre-independence levels, and rural poverty is highest in cotton growing areas.

60. **Growth and efficiency of the cotton sector are constrained by restrictive land tenure rights, oligopolistic processing and marketing structure, underdeveloped financial services, and distortionary pricing and contracting regulations.** There are a number of underlying causes of the low rural incomes, productivity and investment in the sector. The most fundamental is a land tenure system which provides farmers with only usage rights that cannot be transferred; in some cases a collective ownership system require farmers to produce specific crops, such as cotton. Farmers are thus unable to use the land as collateral to finance inputs, and rely heavily on advance credit arrangements from ginneries and exporters. The second main cause is lack of competition along the marketing chain. There is one main buyer of Tajik cotton exports, who has strong relations with local input suppliers. Little competition exists in ginning. Finally, a number of pricing and contracting regulations that are intended to protect the farmers in fact serve to reinforce the accumulation of rents between the ginning and export stages, leaving farmers to lose due to low farm-gate prices based on the export of ungraded cotton and often with inferior but overpriced inputs.

61. **Recognizing the challenges, the government finalized a Cotton Sector Reform Strategy in early 2005.** The first part of the strategy proposes immediate measures to resolve the current farm debt overhang (5–10 percent of GDP). These efforts are being supported by the World Bank under an ongoing cotton sector project, the Asian Development Bank, DFID, and other donors. The strategy proposes to (a) revise the pricing and contracting systems, (b) encourage alternative sources of financing for agriculture, (c) abandon the practice of local authorities of setting cotton production targets, and (d) create the necessary framework for increasing and encouraging competition in input markets.

62. **To support the implementation of the strategy, the proposed program will assist the government in revising the cotton pricing and introducing the universal cotton grading standards.** The revision of cotton pricing rules will allow farmers to register contracts based on negotiated rather than only regulated prices, which are not based on production contracts with input creditors, and with futures, rather than only spot, prices. The introduction of the universal cotton grading system is expected to increase the price that Tajik cotton can fetch in the world
market and allow contracts for baled cotton to be based on FOB, and not CIF prices. The latter restriction currently discourages the downstream processing of cotton in Tajikistan because local processors are currently forced to pay for freight costs as if they were purchasing on the world market. Further actions to provide incentives to farmers to boost cotton quality by strengthening the link between farm prices and the cotton that farmers deliver to ginneries are under study.

c. Electricity

63. **Tajikistan has vast underexploited hydroelectricity potential.** The electricity sector currently accounts for about 5 percent of GDP, and electricity is the most important input for the two key export commodities: aluminum and processed cotton. Tajikistan possesses vast amounts of hydroelectric resources of which it currently utilizes only about 5 percent. Developing this resource would allow export of electricity to countries within and outside of Central Asia.

64. **Yet the country suffers from unreliable power supply and severe seasonal power shortages.** Although, the proportion of firms citing provision of electricity as a problem in Tajikistan has declined between 2005 and 2002, according to the BEEPS, Tajikistan’s power supply is reported as the most unreliable of all the CIS countries, with an average of 250 hours of outages per year.17

65. **These shortages reflect years of underinvestment and poor financial management and operation of the state-owned electricity company, Barki-Tajik.** The government invested little in the electricity infrastructure in the years following independence, due to the civil war and limited fiscal resources. As a result, physical infrastructure has deteriorated significantly. The utility generates large commercial losses, partly due to the legacy of supplying energy without meters, and partly due to the lack of commercial orientation. The problem is exacerbated by the very low tariffs, currently US$0.06 per kilowatt hour which are not sufficient to cover the maintenance, let alone capital costs and contribute to demand that well exceeds supply. Moreover, the country’s largest industrial consumer of electricity, the state-owned Tajikistan Aluminum Company, is a chronic defaulter on its payments for electricity. The government recognizes that the situation not sustainable, and in the last three years, has started to address the issues. Measures to increase the proportion of costs paid by consumers of energy services were implemented in 2003, beginning by withdrawing subsidies granted to privileged groups and increasing gas and electricity tariffs. As a result, the quasi-fiscal deficit induced by the energy sector declined to about 13 percent of GDP as of end 2005 from about 30 percent in 2001.

66. **The government recognizes that much more needs to be done to promote efficiency and reliability of service delivery.** Accordingly, the authorities have recently completed a review of the energy sector with assistance from the Bank, and have formulated a comprehensive strategy for developing the sector (electricity, gas, and heat) over the medium term. The strategy is based on a two-track approach. The first track focuses on the domestic energy market and comprises policy reforms and investments aimed at upgrading operating conditions and improving the financial viability of the service providers. Policy reforms include implementing a medium-term tariff policy, coupled with a social protection policy, covering both the electricity and gas sectors. It also includes institutional reforms to improve the transparency and efficiency of operations, to facilitate electricity trade, and create the foundation for increasing private sector participation in the sector. Priority investments include an energy loss reduction program in the electricity and gas sectors, an energy efficiency and demand side management program, and, over the medium term, a gas and electricity network rehabilitation program. The second track focuses on

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17 Measured by the average number of outages per year (38.2) multiplied by the length of outages.
increasing electricity exports, first using existing seasonal surpluses in the summer, and, second, developing newer hydroelectric capacities for export to countries like Afghanistan, China, Iran, Pakistan and Russia. The country already exports electricity seasonally to Afghanistan and Russia. The government intends to develop the newer hydro capacities with foreign investors, possibly from Russia and Iran, who have made some investment commitments.

67. **The government has already begun to implement the energy strategy.** In the summer 2005, the government doubled the summer electricity tariffs by equating them to the winter tariffs. In early 2006, it raised the tariff by 70 percent for residences consuming more than 250 kilowatt hours per month. Financial and technical assistance has been mobilized with support from the Bank and the Swiss government to reduce commercial losses in the electricity and gas sectors. Barki Tajik has been separated from the Ministry of Energy as a prelude to further restructuring. An independent assessment of the proposed social protection schemes and available options has just been completed.

68. **Financing for investments in hydro are being mobilized.** An outcome of the debt to equity swap with the Russia, Tajikistan has secured investment commitments from Russian investors to complete the Sangtuda hydroelectric project, which will produce electricity for export to South Asia. The international financial institutions, led by the Bank, are advising and facilitating the creation of a regional electricity market between Central Asia in general and Tajikistan in particular, and South Asia, especially Afghanistan and Pakistan. Plans are being prepared to build the necessary transmission lines for such electricity exports. These projects are to be built, owned, and operated on a public private partnership basis. On the basis of these schemes, about 1,000 gigawatt hours of electricity could be exported from Tajikistan to Afghanistan as early as 2007/08, and roughly 5,000 gigawatt hours could be exported to Pakistan after the Sangtuda project is built.

69. **The proposed operation will support several policy actions over the medium term.** These include (a) restructuring of the electricity sector by separating the policy making from commercial operations (Barki Tajik), (b) implementing a schedule for electricity tariff adjustments for 2007–10 to gradually move toward cost recovery levels, and (c) implementing a social protection measure for the vulnerable groups to ensure access to a basic level of service.

B. **Pillar 2: Public Sector Reform and Improving Public Service Delivery**

70. **The government is now committed to implementing reforms of the public sector to address the governance issues highlighted in chapter 1.** The government adopted a comprehensive public sector reform strategy in March 2006. The strategy includes restructuring of government institutions, civil service reform including wage reform, local public administration, and public financial management. In addition, the government has begun implementing sector wide reforms in health and education to improve access and quality of public delivery. The medium term reform program is described in more detail below.

(i) **Public sector management reform**

71. **Tajikistan retains a government structure and system of public administration with many features of the former Soviet model.** The system is dominated by the presidential administration, and a large number of small ministries and subordinated bodies, including large state-owned enterprises, and a broad network of subordinated sector units at the oblast and rayon levels. Roles and functions are not clear, duplication is extensive, and the lines separating the state and private sectors are often blurred. Ministerial agencies at the local level are subject to
dual subordination, as they are required to report to their corresponding central ministries and to local government administration. As a result, the delineation of powers is unclear, which hinders the effectiveness of the state agencies at the local level. The institutional fragmentation and complexity also severely impede budget planning and in particular translation of strategic policy objectives into budget allocation decisions. The lack of progress in reorganization and reallocation of functions may be due in part to vested interests that fear losing from the reforms.

72. **The government is currently addressing the above problems by reforming its system of public management.** The government adopted on March 13, 2006 an overarching Public Administration Reform Strategy that provides the basis for the rationalizing and improving the management of the public sector. The strategy has a long-term time frame and short and medium-term action plans. It takes a broad approach to institutional reform, addressing institutional reorganization, budget management, regulatory management, and human resource management, and proposes measures to strengthen accountability and transparency in public sector management. The Bank through its forthcoming Public Sector Reform Project and Public Financial Management Reform Project will support the implementation, and monitoring and evaluation of the public administration reform strategy. The proposed operation will support selected measures to rationalize core public administration structures, reform the civil service management and wage system, and improve public financial management, specifically the medium term expenditure framework (MTEF).

a. **Rationalization of Core Public Administration Structures**

73. **The government will review functions to identify and eliminate duplication and fragmentation of responsibilities.** The review and the restructuring of individual agencies over time should create a more transparent and efficient public administration. As a first step, the government has prepared and submitted to the Bank reform plans for the Civil Service Agency, Ministry of Finance, and Ministry of Labor and Social Protection, with the aim of realigning their organization and management.

74. **The government intends to complete the rationalization of government organization over the medium term.** In 2007, the government plans to complete a horizontal functional review of the central and local government agencies to reduce levels of duplication and fragmentation in the allocation of functions. The government will adopt a resolution to (a) clearly allocate responsibilities for budget preparation and execution, (b) clearly assign to one institution the responsibility for private sector development policy issues, and (c) rationalize structures for public investment planning. The government in 2008 will adopt a time-bound plan for restructuring of all central ministries and pilot hukumats over the medium term, in line with the objectives of the public administration reform strategy. Reforms of the structures of the Civil Service Agency, Ministry of Finance, and Ministry of Labor and Social Protection will be supported by the World Bank-supported Public Sector Reform Project.

b. **Civil Service Reform**

75. **As with most former Soviet republics, civil service reform has been difficult and challenging in Tajikistan.** The civil service laws passed since independence have not been effective in clarifying the separation of elected officials, political appointees and career civil servants, leading to an unclear salary differentiation mechanism for civil servants. The post-
independence period saw a dramatic decline in public sector real wages in Tajikistan, which eventually led to an erosion of the corps of qualified personnel, widespread administrative corruption, and the development of an accepted, but largely unregulated, system of formal and informal payments for public services.¹⁹ Wage levels remain extremely low even after of two rounds of across the board wage increases of an average 40 percent in both 2004 and 2005. The government did manage to reduce the size of the civil service from 20,000 to approximately 16,000 staff at the central and local levels, and draw a clear distinction between core civil service positions and contractual and support staff. The first stage of the civil service reform does not envisage any retrenchment of civil servants.

76. Wage reform. Tajikistan’s civil service wage system suffers from a lack of transparency, and is highly compressed. The wage structure for civil servants comprises base salaries, monthly regular supplements, allowances, bonuses, and extra-budgetary payments. The number of supplements and allowances is large and their total makes up 75 percent or more of total net pay, a very low compression ratio that discourages officials from seeking a civil service career or aspiring to take on functions with higher-level responsibilities. This problem has been aggravated by the introduction of the qualification rank supplement, which is calculated as a fraction of the minimum wage, and thus poses serious fiscal risks in its current form. Further, the wage levels remain extremely low, even when recognizing that base pay levels generally constitute no more than 25–30 percent of real earnings. The low wage levels encourage staff providing core public services to charge additional fees for their services.

77. International experience suggests that successful wage system reform should be carried out in a phased manner. For example, the government of Serbia implemented the decompression of the pay system through gradual and phased increases of salaries of government employees, starting with the increase of wages of top officials and gradually stretching the system to benefit officials at the level of head of department and eventually head of unit.²⁰ This process was followed with similar success in the former Yugoslav Republic of Macedonia, Montenegro and Russia.²¹

78. In addition to the overall Public Administration Reform Strategy, the government intends to adopt a specific strategy to reform public sector wage policy. Since 2004 the government has been developing a new transparent and predictable civil service wage system, aimed at linking rewards to performance and at creating improved career and earnings prospects for public officers. The introduction of the new wage system in November 2005 on a pilot basis constitutes a significant step toward building a professional civil service, although full implementation is expected to take an additional four or five years. The new wage system to be piloted in the first year of the proposed program will (a) integrate all bonuses and allowances, (b) decouple the calculation of the incremental wage for qualification ranks from the minimum wage, (c) introduce in a phased manner decompression of wages to better reward those that hold positions of higher complexity and responsibility, and (d) change the status of technical staff in

¹⁹ The practice of fees for services was formalized by a constitutional amendment in 2003 but it is not well regulated.

²⁰ The new levels of base salaries for elected, appointed officials and civil servants were established as of December 2004. Civil servants’ base salaries are planned to be increased in four phases from December 2004 till October 2005. In addition, the government intends to target a special group of civil servants that are considered essential; those civil servants whose job descriptions include work on legal drafting and harmonization are benefiting more during this transition phase.

the ministries to contract staff. The government plans to roll out the new wage system to all central ministries on April 1, 2006.

79. **The government intends to implement additional wage reforms over the medium term.** The government is planning to introduce on January 1, 2007 the second step in decompression that specifies a 1:4 decompression ratio between specialist and deputy minister. It is expected to introduce on January 1, 2008 a new central wage model (based on categories, bands and steps, and integrating a years of service component) and the third step in decompression, which specifies a 1:4 decompression ratio between specialist and head of department. Finally, it plans to implement on January 1, 2009 the monetization of benefits and nonwage bill spending on salaries.

80. **Civil service management.** In 1998, parliament enacted a new civil service law. However the law does not provide for a clear separation of elected officials, political appointees, and career civil servants. In addition, the job classification scheme is too general, consisting of only four legislated categories and a subjectively applied system of qualification ranks within them. Also the lack of a clear delineation of the civil service makes it impossible to define a policy to address the problem of low civil service wages and related risks of corruption.

81. **International experience shows the importance of having a well-developed central management agency for the civil service.** Russia, which so far has not established a core civil service agency, has faced significant delays in the implementation of its civil service reform program. However, states that have invested in developing core management structures for the civil service, including Armenia, Slovakia and Kazakhstan, have performed consistently better in international reviews and assessments and are models in the region.

82. **A revised civil service law is currently under discussion in the Tajik parliament which addresses many of these weaknesses, including provisions to clearly separate political from civil service appointments and to reform the wage system.** Subsidiary regulations need to be developed and the capacity of the civil service department to monitor the implementation of this legal framework needs to be strengthened. Established in 2001, the civil service department is now almost fully staffed. However, the department still requires significant strengthening. A restructuring plan prepared for the agency in 2005, which aims to strengthen its power and capacity is being considered by the government.

83. **The government has also adopted new regulations on competitive recruitment and strengthened the civil service register—a key tool for merit-based management of human resources.** Competitive recruitment practices, although successfully piloted in 2005, require further development, as do management tools such as the civil service register. Adoption of secondary legislation will enable implementation of the new job classification and wage grid in all government institutions and implementation of merit-based recruitment and promotion. Merit-based criteria for senior management positions will be developed and adopted. To ensure effective human resource management, the government intends to introduce a computerized civil service register and link to the payroll system that will be supported by the Public Sector Reform Project.

c. **Public Financial Management Reform**

84. **Tajikistan’s prudent fiscal policy has facilitated macroeconomic stability for growth, but has not been accompanied by the commensurate quality of public financial management.** Analytical work of the Bank’s 2004 Public Expenditure and Institution Review and the 2004
CFAA showed weak linkages between budget allocations and medium-term policies and priorities presented in the PRSP and other government development strategies. Deviations between the approved budgets and the realized budget have also been significant. The CFAA further highlighted deficiencies in public financial management. The government has started to address the weaknesses identified in these studies. It established a budget committee in 2003, which has improved the budget process, providing greater scope for sectoral participation. To improve capacity for internal and external audit, the State Financial Control Committee, established under the Second Structural Adjustment Credit, is currently undertaking a capacity building exercise through a twinning arrangement with the U.K. National Audit Office, which will assist in developing the legal framework and methodology in the move towards international standards. The Bank-supported Public Reform Project will support further work in this area. In addition, the government has recently enacted a modern procurement law. A grant from the Bank’s Institutional Development Fund is supporting implementation of the new law.

85. Over the last few years the government has made some progress in implementing budget reforms. Some of these include strengthening budget preparation, presentation and management systems, including the establishment of a budget management information system (the Tajik budget system), the adoption of the 14-sector Government Financial Statistics 1986 classification, the preparation of the program-based budgets at the level of key budget organizations, and enhanced ability to monitor budget execution in a more comprehensive manner. A multiyear budget was introduced and a cash management unit was recently established. All sector strategies were integrated into a single document—the NDS that serves as a basis for the government medium-term strategy that will be aligned with the government budget. The government has also adopted a multiyear perspective in fiscal planning, expenditure policy, and budgeting by establishing a budget commission that will play an important role in ensuring the budget reflects policy priorities.

86. However, past attempts to introduce an MTEF have not been successful. The institutional and legislative framework on which an MTEF could be built is lacking. Further, the government analytical and technical capacity is weak. As a result, a macroeconomic framework both for policy development and budget formulation is often unrealistic, and resource ceilings for sectors are not well communicated to line ministries.

87. The government is committed to deepen public financial management reform. This is expected to further improve consistency between the budget and government policy priorities, improve transparency and accountability of public financial management, and increase the efficiency of public spending in priority areas. Donors (European Union, DFID, World Bank, Asian Development Bank, and IMF) intend to support strengthening of budget management and an MTEF to improve predictability of the budget and ensure priority and efficiency of public spending. The government will adopt an action plan to implement the MTEF. It plans to adopt a budget strategy paper during 2007–08 that highlights key priority areas and defines resource envelopes for sectors. It will then develop the strategies for key sectors consistent with the MTEF. Over the medium term, the government plans to modernize treasury management, accounting, and auditing with the support of the development partners. The government is working with the Bank in preparing two new projects (Public Sector Reform Project and Public Financial Management Modernization Project) to further strengthen the country’s public financial management system.

According to the IMF assessment of Tajikistan’s public financial management system, priorities are to improve organizational budget classification, introduce a rule-based system for intergovernmental relations, address aggregate fiscal risks, and strengthen the link between policies and budgeting.
(ii) Public service delivery

a. Primary Health Care

88. **Health outcomes and the quality of health care services have been deteriorating in Tajikistan since independence in 1991.** For instance, Tajikistan’s infant mortality rate is around 90, its under-5 mortality rate is around 120 both per 1000 live births, and the tuberculosis incidence is around 70 cases per 100,000 inhabitants. These indicators are among the poorest in countries of the region. Tajikistan has one of the lowest levels of public spending in health (around 1 percent of GDP in 2005) among CIS countries of similar income levels. Under funding is a key contributor to poor outcomes and quality. In addition, Tajikistan’s health system also suffers from a number of structural weaknesses common to post-Soviet and transition economies, including an under-emphasis on primary health care, an excessively large hospital network, poorly paid health workers, and the insidious prevalence of informal payments for services.

89. **In May 2005, the government adopted a national health financing strategy, based in part on an earlier health policy note prepared by the World Bank.** The strategy aims to improve fiscal sustainability, transparency, and accountability in the health sector. Its key elements are to:

- **Reallocate resources toward primary care, including targeting upcoming wage increases in the health sector to primary health care workers.** Combined with greater primary health care worker accountability, this is expected to stem the current out-migration of primary health care workers, reduce informal payments, and improve service delivery.

- **Implement a basic benefits package that includes free primary care and co-payments for hospital care.** The basic benefits package is expected to increase resources, formalize co-payments and paid services, regulate out-of-pocket payments, and increase accountability for the use of private resources in hospitals. In addition, the hospital budget will be defined on the basis of public and private sector contributions, and hospitals will be expected to allocate increased income for the financing for wages, performance bonuses, and other variable inputs.

- **Introduce a financing mechanism that is more transparent and is based on a needs-based formula calculated on the basis of population at rayon level.** The implementation of this reform is expected to address historical patterns of inequity under the former input-based financing system and improve allocation of limited resources.

- **Implement systematic and strict monitoring of the basic benefits package and paid service by the Ministry of Health.** This will ensure adherence to operational guidelines aimed at improving accountability of health care workers and allocation of resources.

90. **The government has already increased public spending on health care in Tajikistan from 0.9 percent of GDP in 2004 to 1.3 percent in 2005.** The expected increases in wage and salaries from the sector financing reform will be accompanied by the gradual reform of the wage and job classification system in the health sector over the next three to four years.

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23. A simulation exercise for the 2006 hospital budgets showed that applying the new basic benefits package, should be able increase the resources available to the hospital sector by 53 percent over their current public budgets.
91. **Implementation of health care reforms has begun on a pilot scale.** The basic benefits package was rolled out nationwide in August 2005. However, negative feedback from health workers and patients because of misuse and inefficient use of fee revenues prompted a temporary suspension. The government is now introducing a unified methodology for computing fees for paid services and co-payments, developing guidelines on the use of additional revenues by hospitals, and strengthening the monitoring system.

92. **The proposed operation will support reform of primary health care through reallocation of the increases in the wage bill in favor of primary health care over the medium-term.** The operation will also support complementary reform measures including the reintroduction of basic benefits package, introduction of a new job classification and wage grid system for primary health care workers, and separation of funding flows and accountability mechanisms between primary and secondary care. Once these reforms are initiated, the proposed operation will support the introduction of per capita allocations in primary health care.

93. **The proposed operation complements other projects in the health sector.** The World Bank-financed community and basic health project (Board approval was December 2005), and projects supported by other donors (USAID-financed Zdrav++ Project, Swiss-financed Sino Project, Asian Development Bank-financed Health Sector Reform Project) will provide the necessary support for capacity building, monitoring, and implementation of the reforms supported through the proposed operation.

b. **Education**

94. **Education outcomes in Tajikistan have declined steadily from independence, as demonstrated by falling enrollment and completion rates.** In 2004, for the first time since independence, the basic school attendance rate did not fall, remaining at 88 percent. Education infrastructure has not been maintained—one quarter of the schools does not have heating system and over a third do not adequate sanitation. Teachers are poorly paid, learning materials are inadequate and inappropriate, and curriculum and teaching methods are outdated.

95. **Public spending on education in Tajikistan remains comparatively low at only 3.5 percent of GDP in 2005.** This was 20 percent of the 1992 share. The wage bill at 80 percent of total education spending is crowding out investment in school facilities, teaching and learning materials, and operating costs. The norm-based allocation of funding to local governments has encouraged an inefficient allocation of resources.

96. **Under the implementation of the first PRSP (2002–05), the government increased resources allocated for education from 2.3 percent of GDP in 2000 to 3.5 percent in 2005.** Teachers’ salaries were raised on an average by 25 percent in September 2004 and by another 65 percent in January 1, 2005. More recently, the government adopted a National Strategy for Education Development for 2006–15, and has initiated reform of education financing.

97. **In 2005 and 2006, a system of per capita allocations was implemented in the schools in five pilot rayons.** However, a recent review of implementation found two shortfalls: (a) only the

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24 Input-based norms such as the number of teachers required for the curriculum at each grade and the number of non-teaching staff required for each school encourage the inflation of enrolment numbers, inefficient formation of classroom groups and use of shifts as a mechanism to increase teacher payments.

25 The latter increase was also meant to finance an increase in the teaching load from 14 to 16 hours per week.
very limited non-wage resources were actually allocated on a per capita basis; and (b) the flexibility to use resources at the school level is limited by the budget law. The government now plans to allocate the full package of wage and non-wage resources to schools in pilot rayons, and increase their authority to hire non-teaching staff on a contract basis and to allocate their own budgets against the individual line items. In the medium term, the government intends to adopt new regulations to strengthen accountability and financial management at the school level and rollout the per capita financing in phases. The rollout of per capita financing is expected to improve the efficiency of resource use and reduce regional disparities in education attainment. These policy actions will be supported by the proposed operation.

98. **Other measures envisaged under the National Strategy for Education Development that will be supported by the proposed operation include reform of the wage system, (including defining teaching loads as close as possible to a full time equivalent) and introduction of a new remuneration and promotion system that compensates education workers based on level of responsibility, qualifications and performance.** The government will also complete a school mapping for the whole country in 2007, with financial assistance from the Fast Track Initiative Trust Fund. This map will serve as a basis for a rationalization plan for school infrastructure to be implemented starting in 2008.
4. PROPOSED OPERATION

A. Description of the Operation

Operation description

99. **Programmatic Approach.** *This is the first of the three programmatic development policy operations consistent with the Country Partnership Strategy (Country Partnership Strategy) finalized in July 2005.* The full details of the PDPG1 policy actions as well as the tentative policy actions for PDPG2 and PDPG3 are specified in the policy matrix and the government’s Letter Development Policy which are attached as annex 1 and 2 to this document. The policy actions for PDPG3 (to a lesser extent those for PDPG2) are as yet preliminary and will be more firmly articulated as preparation of the follow-on programs proceeds once much of the ongoing analytical work is completed, and the policy dialogue matures. Furthermore, Tajikistan’s vulnerability to external shocks may require an adjustment in the medium-term policy agenda in response to changing environments.

Objectives and themes

100. **Development objectives.** The development objectives of the proposed PDPG are to improve the environment for private sector development, and to improve overall functioning of the public sector and the delivery of key public services. The proposed program is aligned with the first two pillars of Tajikistan’s PRSP.

101. **Themes of the operation:** To achieve both objectives, the program requires maintenance of macroeconomic stability. To promote private sector development, the program will support regulatory and institutional reforms in key strategic sectors (i.e. aviation, cotton and energy), improve investment climate and transparency of the privatization process. To improve overall functioning of the public sector and delivery of public services, the program will support public sector reforms aimed at improving public sector management, the efficiency and effectiveness of public spending. The program will also support reforms in education and health sector policies to improve access, quality, and equity of services. The table below lists the core policy actions agreed with the government for PDPG1 and PDPG2.
## Table 3: Core policy actions under Programmatic Development Policy Operation 1 and 2

<table>
<thead>
<tr>
<th>Area</th>
<th>PDPG1 Core Prior Actions</th>
<th>PDPG2 Core Prior Actions</th>
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<tbody>
<tr>
<td><strong>PILLAR 1: PROMOTING PRIVATE SECTOR DEVELOPMENT</strong></td>
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| Reform of business licensing and inspections | • Submit to parliament amendments to the current licensing law to reduce entry barriers satisfactory to IDA.  
  • Submit to parliament a law to reduce the scope of inspections and increase accountability of inspection officers and submit amendments to the tax code regulating the activities of tax inspectors satisfactory to IDA.  
  • Adopt the necessary measures to ensure the implementation of the amended licensing law, including: (a) public awareness campaign, and (b) training of public officials on the new requirements under the law.  
  • Introduce changes and amendments into current legislation to ensure compliance with the law on licensing. | |
| Aviation | • Adopt a government resolution to remove policy making function from Department of Civil Aviation and assign to another governmental agency by end 2006;  
  • Adopt a government resolution to establish a timetable by end 2006 for the legal and operational separation of the airline, airport, and air traffic control management by 2008; and  
  • Allow at least one new international carrier to start regular flights to and from the city of Dushanbe.  
  • Progress acceptable to IDA achieved with liberalization of air regime. | |
| Cotton | • Adopt a government resolution to introduce the Universal Cotton Grading System.  
  • Amend the existing regulations to ensure compatibility with new international cotton grading standards and cotton pricing system satisfactory to IDA. | |
| **PILLAR 2: PUBLIC SECTOR REFORM AND IMPROVING PUBLIC SERVICE DELIVERY** | | |
| Public administration reform | • Adopt a public sector reform strategy satisfactory to IDA.  
  • Implement first set of short-term measures as specified in strategy matrix. | |
| Civil service reform | • Adopt a presidential decree for the core wage system reform satisfactory to IDA  
  • Agree on a second phase in decompression of wages for 2007.  
  • Implement the second phase in wage decompression as agreed with IDA. | |
| Improved public service delivery: Health | • Adopt presidential decree that assigns greater share of wage bill increases in health to primary care in 2006.  
  • Adopt a presidential decree that expands the primary health care share of wage increases in health in 2007 as agreed with IDA. | |

### B. Linkages

**Link to Country Partnership Strategy**

102. *The proposed three Programmatic Development Policy operations based on the medium-term program described in this document form the backbone of the Country Partnership Strategy lending program for fiscal 2006–09.* The new Country Partnership Strategy, discussed by the Board on July 26, 2005, focuses on maintaining growth in the short term and building a foundation for growth in the future. Developed in close consultation with the government, it focuses on three strategic objectives: (a) improve business opportunities in rural and urban areas, (b) enhance the quality of health and education, (c) improve the delivery of energy services and exploit the country’s hydropower potential. Due to limited IDA resources...
and taking into consideration the Bank’s comparative advantages, the Bank’s assistance to Tajikistan will be highly selective.

103. **To achieve the objectives of Country Partnership Strategy, the proposed operation will support a selective cross-cutting reform program.** To improve business opportunities in rural and urban areas, the operation will support reforms aimed at streamlining licensing and inspection regimes, ensuring greater transparency of the privatization process, promoting market competition, and improving transport. The operation will contribute to enhancing quality of education and health by supporting the reform of the budget allocation mechanism (per capita allocation), and the other reforms planned for these sectors. The operation will also support energy sector reforms aimed at improving the delivery of energy services and increasing the supply of electricity exports. These reforms will complement the Bank’s ongoing and planned investment projects in public administration, education, health, agriculture, and energy. The policy matrix included in the annex 2 shows how each of the proposed reform programs is linked to the objectives of the Country Partnership Strategy.

**Relationship with analytical work and other Bank operations**

104. **The proposed reforms are based on extensive Bank analytic and advisory activities carried out during the past two years.** A public expenditure and institutional review, a country procurement assessment report, a country financial accountability assessment, a public and civil service wage note, and a remittances note have informed the public sector reform program. A trade diagnostic, an investment climate assessment, an aviation sector note, an energy utility reform review, the Central Asia Regional Electricity Export Potential Study, and an Agricultural Development Strategy have highlighted key reforms required to attract private sector investment. A poverty assessment update has deepened understanding of poverty and its dynamics, and is important for the design of policy reforms that effectively reduce poverty. Annex 3 shows the linkage between Bank’s analytical and advisory work and the reform actions of the proposed operation.

105. **The proposed operation supports policy reforms that are critical to the success of ongoing and planned investment and technical assistance operations.** The proposed operation will support adoption of policies critical for reform of the public administration; capacity to implement the reforms will be the focus of a Bank-financed Public Sector Reform Technical Assistance Project. Similarly, the program supports policy reforms in the education, health, agriculture, and energy sectors—all areas of recent or forthcoming Bank-supported projects. Reforms to improve the investment climate and to redefine the role of the state in the economy will complement support of the IFC and MIGA to promote private sector development. Annex 3 shows the links between PDPG policy actions and other investment operations.

**Collaboration with the IMF and other donors**

106. **The Programmatic Development Policy Grant and the new IMF’s PRGF complement each other.** The Bank takes the lead and provides background to the IMF program in private sector development and privatization, enterprise reforms, farm productivity, and regulatory reforms (see details in annex 4). The Bank and the Fund share responsibility in public sector management, budget planning and execution, financial sector reforms, and utilities’ reform. The Fund and the Bank cooperate on fiscal policies and reduction of quasi-fiscal deficits, which requires close cooperation with the Bank’s programs for health, education and infrastructure. The Fund also leads in tax reform, and in revenue and expenditure management. In these areas the
Bank takes into account the Fund policy recommendations and ensures consistency between them and its own measures. In addition, there is close coordination between the Bank and the Fund concerning the public sector reform agenda. The Fund and the government agreed on a policy matrix in February 2005, which includes the broad agenda of the public administration reform component of the proposed operation.

107. **Coordination with other donor programs. The Bank is also coordinating closely with other development partners in Tajikistan.** The proposed operation is expected to complement programs of the European Union, Asian Development Bank, and DFID in specific areas. For instance, the Bank is supporting the development of a new competition policy, which the European Union will help to implement through capacity building. The Asian Development Bank will support the implementation of the new cotton grading system. The Bank is supporting the development of policies to improve the management of the transportation system; the Asian Development Bank, the Islamic Development Bank, the Kuwaiti and Saudi Funds will support the construction of infrastructure. In addition, the proposed operation introduces policy measures that would improve access to Tajikistan, while the European Bank for Reconstruction and Development (with restructured programs based on discussions with the Bank) will finance and support their implementation. The Swiss government and the Japan Bank for International Cooperation have both expressed an interest in co-financing the proposed operation, and will be partners in monitoring implementation of the prior actions. For details see annex 3.

C. **Lessons Learned**

108. **The design of the proposed operation reflects several lessons from implementation of the previous CAS in Tajikistan, other operations in Tajikistan, and policy-based loans in other countries. These include:**

- **Government ownership of the reform program is essential for success.** Extensive experience demonstrates that government ownership of the reform program is the single most important criterion for success. Insufficient government commitment to the reform program delayed the implementation of the second Structural Adjustment Grant by 1½ years, affecting the implementation and effectiveness of the CAS. The medium-term reform program of the proposed series of programmatic operation has been designed in close collaboration with key relevant ministries and the Executive Office of the President Administration.

- **Focus on a limited set of key reforms.** The proposed Grant supports deep reforms in a few selected areas. The program includes only the critical actions that the government believes that it can realistically implement at this time, backed by sector-specific projects, capacity-building, and communication campaigns. These are the reforms that the government is already committed to and has been carrying out. The proposed operation contains ten core prior actions (see table 3) that are critical to the achievement of development objectives of the Grant.

- **Build capacity for implementation of the reform agenda.** Passage of legislation and adoption of strategies have often had little impact in Tajikistan, because of lack of institutional capacity to implement reforms. The proposed operation is accompanied by a Public Administration Technical Assistance Project that focuses on building capacity of the public administration for implementation.
• **Build effective partnerships with the IMF and other donors in designing the proposed Grant.** The Bank has consulted with the IMF, the Asian Development Bank, the European Commission, and the major bilateral donors in Tajikistan to ensure that the prior actions of all policy-based operations are harmonized to the extent possible and that the program benefits fully from the analytical work and knowledge of others.

• **Offer a series of annual single tranche budget support operations, rather than multi-tranche operations.** Single-tranche operations, which are approved only after the government has implemented agreed reforms, require both the government and the Bank to be realistic about what is possible, and then to agree on a program of completed actions that is acceptable to both sides. The proposed program is a single tranche operation to be followed by two additional single-tranche Programmatic Development Policy Grants, each of which furthers the reforms supported by the previous operation. This approach allows the government and the Bank to adapt the medium-term program as new information becomes available and feasible options for realizing the intended development goals change. It also ensures that the flow of funds is predictable and that the technical assistance required to implement and sustain reforms is available.

D. **Poverty and Social Impact**

109. **Poverty and social impact of this operation is likely to be positive.** In the short term, the proposed reforms in health and education are likely to result in improved access and quality of services to the poor. Similarly the impact of the revised energy tariffs will include special provisions to avoid negative impacts on the poor with a subsidized rate for the vulnerable population. Similarly, reforms in the aviation sector will improve access and reduce cost of transport for low-income migrants. In the medium term, reforms proposed in public administration reform strategy should yield benefits through improved public sector management. The planned reforms do not envisage further retrenchment of personnel in the short-term; however, if implementation of the medium-term measures were to result in the need for adjustment in the size of public employment a PSIA would be undertaken to facilitate the adoption of mitigation measures for vulnerable population.

110. **Poverty and social impact analyses have recently been carried out to ensure that the government and the development partners understand the potential impact of policy reforms on specific groups.** The studies include an assessment of the potential impact of changes in energy tariff policy, and a study investigating the impact of changes in policies affecting the cotton sector. These studies have informed the design of the reform program in several ways. For example, the study of energy tariff policy, completed in April 2005, recommended that the government adopt a three-band tariff structure that will allow the poor to pay subsidized rates for energy, while ensuring full-cost recovery for the energy sector through imposition of higher tariffs on the better off. The government has now designed a new tariff structure consistent with this letter of development strategy for the energy sector that will be implemented gradually starting in 2007 and is expected to be completed in 2010.

111. **A poverty and social impact analysis for the cotton sector, completed in June 2004, estimated that cotton yields would increase from the current 1.9 tons per hectare to 2.8 tons per hectare, if all the necessary reforms were carried out.** This would translate to almost US$100

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million in additional revenue from cotton sales. The study proposed focusing in the medium term on reforming contracting, pricing, and standards, which would benefit local farmers and farm workers. This study also notes that such reforms will be easier to implement than resolving farm debt or pursuing land reform.

112. **Additional planned poverty and social impact analyses include:**

- Impact of adopting a new cotton pricing scheme and international cotton grading standards on rural welfare;
- Impact of the proposed introduction of higher energy tariff, for 2007-10 on employment opportunities and income level of aluminum workers;
- Impact of the reform in per capita allocation on the quality of primary education for the poor; and
- Impact of the introduction of the basic benefits package for primary health care on the poor.

113. **In general, reforms supported by the proposed operation are expected to stimulate economic growth and reduce poverty.** For example, cotton farmers are expected to benefit from the improvements introduced under the proposed program. Resource allocation within the energy sector and across the economy is expected to improve through cost recovery tariff reform. The private sector will benefit from the aviation sector reforms as they will reduce the cost of transportation, stimulate investment and improve profitability of enterprises. In addition, it is expected to improve consumers’ welfare and promote the free movement of labor. The poor will be assured of access to affordable and quality primary health care through the implementation of the basic benefits package. Similarly, the population will have better quality education through reform of the per capital allocation.

114. **The proposed operation is closely aligned with the PRSP objectives.** The measures supported under the program are intended to increase access to quality social services by the poor. Rural and remote schools will continue to receive input-based funding until their special needs arising from small class sizes can be addressed through the per capita funding scheme. The shift of resources to primary health care will improve access to basic services by the poor. Increasing wages of primary health care providers should help to reduce and gradually eliminate informal payments of patients to service providers, further improving access of the poor.

115. **Improved governance is important to reduce poverty and access of public services by the poor.** Improved management and incentive systems in the state administration aim to reduce the capture of policy processes by special interests. This is achieved by gradually improving civil servants’ earnings and the development of improved internal accountability mechanisms in the administration. It thus creates the conditions for the policy process to become more transparent and accessible, which will benefit those who have limited access to decision-making processes.

E. **Implementation, Monitoring, and Evaluation**

116. **Amount and tranching.** The proposed operation is the first of three programmatic single-tranche operations. The proposed operation would be provided in IDA grants in the amount of US$10 million. Funds would be available upon effectiveness, expected in September 2006. The

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Swiss government and the Japan Bank of International Cooperation have expressed an interest in co-financing the medium-term program.

117. **Executing agency.** The State Advisor for Economic Policy will be responsible for overall implementation of the reform program, for reporting progress, and for coordinating actions among the other agencies and ministries involved. The Office of the Prime Minister will provide overall guidance and oversight. The Presidential Administration will be responsible for implementing the public sector reforms. The line ministries involved (energy, education, health, agriculture, and transportation) are accountable for implementing the sectoral reforms specified in the reform program. The State Property Committee will be responsible for implementing the privatization program. The National Bank of Tajikistan (NBT) will monitor the macro stability measures. The Ministry of Economy and Trade, and the Ministry of Finance will be responsible for reforms of licensing, regulation, and the privatization process. The Ministry of Agriculture will monitor the cotton sector reforms, while the Ministry of Energy and the Prime Minister’s Office will be responsible for the energy sector reforms. The Borrower will open an account at the National Bank of Tajikistan against submission by the Borrower of a simplified withdrawal application.

118. **Monitoring and evaluation.** Bank staff will continuously monitor implementation of the reforms specified in the program matrix of the proposed Grant and the subsequent Grants. Monitoring will focus on the indicators specified in the program matrix. A status report on the first reform program will be presented in the documentation for the second. Bank staff will focus on the outcomes of the reforms through its regular monitoring of Tajikistan’s PRSP. Country capacity for monitoring will be strengthened through the ongoing Statistical Capacity Building Project. For instance, a living standards measurement survey (LSMS) is to be conducted in 2007–08 supported by the Bank-supported Statistical Capacity Building Project, which will help in assessing the impact of many of the proposed reforms on the population as a whole and on different socio-economic groups. A quality enhancement review for this project was carried out in December 2005 and the revised program document reflects the recommendations made. An implementation completion report will be issued within six month following the closing date of the medium-term program.

F. **Fiduciary Aspects**

119. **Country Financial Accountability Assessment.** The June 2004 CFAA concluded that the risk to public funds was high in Tajikistan, because of: (a) poor systems of public accountability and weak mechanisms for public sector transparency; (b) weak internal control systems and internal audit function; (c) weak institutional capacity to implement some of the budget reforms being undertaken; (d) fragmented budgets and poor cash management, (e) lack of transparency in state-owned enterprises, and (f) weak capacity with the legislative bodies to provide effective oversight over the working of the government. Tajikistan has made substantial progress since then in various aspects of the public financial management. For example, the organic budget system has been thoroughly revised, the budget classification system has been changed, the treasury system has been modernized by introducing automation, a treasury single account has been established, quarterly budget execution reports are now routinely prepared, and external audits have become more timely. The government is also strengthening the capacity of key accountability institutions in the country. For example, with a grant from the Bank’s Institutional Development Fund, the Supreme Audit Institution of Tajikistan has entered into a twinning arrangement with the U.K.’s National Audit Office to strengthen the skills of staff of the Supreme Audit Institution of Tajikistan and to introduce modern auditing processes. In addition, through another grant of the Institutional Development Fund, Tajikistan has enacted a modern
public procurement law. These efforts have resulted in Tajikistan achieving 8 of the required 16 HIPC indicators of public financial management, putting Tajikistan in the top quintile of HIPC countries as noted in the recent February 2006 IMF Staff Report and IMF assessment of public expenditure management under the Multilateral Debt Relief Initiative. However, the adoption of good policies is not enough to improve performance. Capacity to implement the policies also needs to be developed. The government is working with the Bank in preparing two new projects—the Public Sector Reform Project and the Public Financial Management Modernization Project—aimed at strengthening capacities to implement improved systems of public financial management systems. Fiduciary risk will need to be monitored closely on a continuous basis.

IMF safeguards assessment. The IMF’s most recent safeguards assessment, conducted in June 2003, noted several weaknesses at the NBT, including a qualified audit opinion by an international firm on the financial statements for fiscal 2002 that included audit observations with respect to guarantees issued and loans made to commercial banks, nonpublishing of annual financial statements, weak internal audit capacity at NBT, and infrequent and inaccurate periodic financial statements. It recommended several measures to address the weaknesses, mainly in the areas of financial accounting and reporting and auditing. The latest available IMF Article IV consultation report, completed in April 2005, concluded that the NBT was implementing the recommendations made in the safeguards assessment. The external internal audit of the NBT was completed for 2003 and 2004 and the one for 2005 is underway. However, details on progress made in implementing various recommendations, including results of audits for the latest two years, are not yet publicly available. Accordingly, the team recommends opening a dedicated foreign currency deposit account and a dedicated local currency deposit account at the NBT, in the name of the Ministry of Finance, to receive funds under the proposed operation. The government and the Bank discussed the arrangements for utilization of the proceeds of this foreign currency and the Tajikistan delegation conveyed the intention of the government to directly utilize the foreign currency proceeds deposited into the foreign currency deposit account for foreign currency debt servicing (already included in the fiscal 2006 annual budget), thereby obviating the need to convert the foreign currency into local currency. The Ministry of Finance will submit quarterly reports, providing details of utilization of the proceeds of the grant, until proceeds have been fully utilized. The final statement on the utilization of the proceeds of the foreign currency and local currency deposit accounts will be subject to an audit under terms of reference acceptable to the Bank and by an audit firm acceptable to the Bank.

G. Disbursement and Auditing

121. Disbursement. The Borrower is the Republic of Tajikistan. The proceeds of the Grant will be disbursed upon effectiveness of the Development Financing Agreement. The Borrower will open and maintain a separate foreign currency deposit account in (US dollars) at the NBT, as part of the general foreign currency reserves of the government. The proceeds of the Grant will be deposited by the Association into such dedicated foreign currency deposit account. The IDA “negative list” restrictions, agreed during negotiations and specified in the Development Financing Agreement, will apply to the use of grant proceeds. If after depositing funds in the deposit accounts, the proceeds of the grant are used for ineligible purposes as defined in the Development Financing Agreement, the Bank will require the Borrower to either: (a) return that amount to the account for use for eligible purposes, or (b) refund the amount directly to the Bank.

122. Reporting and auditing arrangements. Through the Ministry of Finance, the Republic of Tajikistan will (a) report on a quarterly basis to IDA the amount received into the deposit accounts at the NBT, (b) provide confirmation of the amounts withdrawn and/or transferred from
the deposit accounts, including bank account numbers, date and names of beneficiaries, (c) ensure that the proceeds of the Grant are not used for ineligible expenditures defined in the IDA “negative list” as agreed during negotiations and specified in the Development Financing Agreement. The deposit accounts and the transactions from this account to the ultimate beneficiaries’ accounts will be independently audited in accordance with terms of reference to be agreed with IDA.

H. Environmental Aspects

123. The conclusion of an environmental screening of the proposed reforms, undertaken as per the requirements of OP 8.60, is that the reforms are largely benign from an environmental point of view. Details of the analysis for each reform area follow.

- **Maintaining macroeconomic stability.** Macroeconomic stability is necessary for economic growth and poverty reduction, which may indirectly generate environmental benefits by encouraging the adoption of modern technologies which use resources more efficiently than those they replace.

- **Reforming licensing and inspections.** Reform of licensing will facilitate business entry and growth and reduce costs for businesses. This will result in uncertain environmental impacts, depending on the sectors that attract new investment, and the availability and cost-effectiveness of new technology. However, the extent to which the reforms attract businesses into the formal sector may be positive for the environment, since formal businesses are more likely to comply with environmental policies. Reform of the inspection law will increase the accountability of inspectors and reduce the opportunity for rent seeking. This in turn will increase the effectiveness of the inspection process to detect violations in health, safety, environmental, tax, and other laws, which will have a positive impact on the environment.

- **Improving transparency of the privatization process and market competition.** Increasing the transparency and accountability of the privatization process will likely have a positive impact on the environment, because this transparency is likely to include disclosure of a firm’s environmental liabilities for past contamination and current environmental performance. The government with the support of the PPIAF is preparing restructuring plans for several large industrial plants. These plans will incorporate measures to address past and ongoing pollution with oversight from the State Committee on Environment Protection and Forestry. Amending the competition and natural monopolies laws to increase competition among enterprises will have uncertain impacts on the environment. The cross-country evidence suggests that over time, competition leads to more efficient resource use, and thus reduces environmental impact of a unit of output. However, competition could also lead to negative environmental impacts if it encourages firms to use cheaper, but environmentally-damaging technologies. The net effect in Tajikistan is likely to benign.

- **Aviation sector reform.** The proposed operation seeks to improve efficiency and enhance competition in aviation. Although increased competition is expected to raise the number of flights between Tajikistan and other countries, this is expected to lead to adoption of more fuel-efficient, less noisy aircraft by the Tajik State Airline, with an overall benign impact on the environment. The operation does not support investment in airports, which
is being supported by other development partners with oversight of the State Committee on Environment Protection and Forestry.

- **Cotton sector reform.** The proposed operation aims to introduce a universal cotton grading system that will increase the confidence of potential end users of the quality of Tajikistan cotton being purchased. This will maximize the sales price and stimulate demand from end users for premium cotton. This will have only indirect, if any, impacts on the environment. An increase in demand for premium cotton could stimulate new production, or it could encourage farmers to substitute higher-grade cotton for lower grade. An increase in cotton production will not necessarily have a negative impact on the environment, depending on the environmental impact of the crop relative to alternative land use. In any case, ongoing Bank projects, including the Rural Infrastructure Project, the Community Agriculture and Watershed Management Project, the Land Cadastre Project, and the Farghana Valley Development Project are closely monitoring the potential environmental impacts of projects supporting agricultural and natural resources management. The proposed Bank-supported Cotton Sector Recovery And Poverty Reduction Project and a project supported by the Asian Development Bank will strengthen capacity of the government to address environmental issues arising from reforms of the cotton sector.

- **Energy sector reform.** The proposed operation will support separation of policymaking from commercial operations and restructuring of tariffs to promote cost recovery, while ensuring that the poor have access to a minimal level of service at affordable rates. These measures are expected to promote efficiency, which will have a positive impact on the environment. Without mitigating measures, reforming the tariff structure may have had a negative impact on the poor, according to the poverty and social impact analysis, which may have increased pressure on forests for fuelwood. However, this will be mitigated through provision of subsidies to low-income electricity consumers. The proposed operation does not support any investment operation for constructing new dams. Environmental impacts of future energy investments will be carried out under the projects that support them.

- **Reforming public sector management.** The operation will support implementation of reforms of public sector management aimed at improving the efficiency and effectiveness of the public service and the delivery of health and education services. These reforms are not expected to have any impact on the environment. Improvements in public administration that encompasses environmental agencies may improve the efficiency and accountability of these agencies.

124. *As a newly independent country emerging from a civil war, neither awareness of environmental issues nor institutional capacity to address them are well developed in Tajikistan. This is now changing.* Tajikistan’s PRSP recognizes water pollution, soil degradation, water pollution, deforestation, and biodiversity conservation as environmental priorities and proposes a range of measures to address them. Tajikistan is an active party to several United Nations conventions and has prepared a National Strategy for Combating Desertification (2002), and a National Biodiversity Conservation Action Plan (2003). The country has also adopted environmental laws and regulations, including a requirement that environmental impact assessments are conducted for all new construction. The borrower also imposes fees and fines on all major polluters. The country established the State Committee on Environment Protection and Forestry in January 2004, merging the Ministry for Environment Protection and the Committee on Forestry. The new entity conducts its activity in accordance
with the law on environment protection and other legal documents, such as the water code, land code, and others. It has over 600 employees throughout the country to monitor and enforce compliance with the country’s environmental laws and regulations.

125. **Gaps in capacity is being strengthened through a number of Bank-supported projects.** The government is strengthening its the capacity to assess and mitigate environmental impacts of economic activities through training and hands-on experience. The Bank, through four ongoing rural development projects, is strengthening the local line departments by supporting the upgrading of their national and local level analytical laboratories and training their staff with internationally-recruited environmental and natural resource protection specialists. The Bank is also assisted the government in holding conferences and workshops on natural resource and environmental management and in disseminating their proceedings to the public. Additional measures to strengthen the government’s institutional capacity for environmental management will be addressed through the Bank’s country program and programs of other development partners. A country environmental assessment that examines the institutional framework and capacity of the country to address its environmental challenges may be undertaken during the next phases of the program.

I. **Risks and Risk Mitigation**

126. **Successful implementation of the medium-term reform program faces risks, for which mitigation measures have been identified. Specific risks include:**

- **Weak implementation capacity.** Capacity in Tajikistan to implement a complex reform program is weak. Development partners are helping to strengthen capacity in several ways. A Japanese Policy and Human Resources Development Grant is helping to build capacity through support for design and sequencing of reforms, analytical work, and intergovernmental coordination. The Bank will help to strengthen capacity of central government operations through the Public Sector Reform Technical Assistance Project. It will strengthen capacity of the sector ministries and government agencies involved in the program through ongoing and planned projects. Other development partners are working with the Bank to ensure that capacity building initiatives are well coordinated and meet the needs of the government.

- **Weak public financial management systems.** The public financial management system is characterized by poor internal controls, lack of transparency, high level of corruption, low capacity, poor cash management and budget execution, all of which undermine efforts to enforce fiscal discipline. During implementation, fiduciary risks will be mitigated by: (a) creating a dedicated foreign currency account into which Bank funds will be disbursed; (b) regular reporting on the use of funds disbursed; and (c) requiring an independent audit on the use of funds provided under the proposed operation. In addition, the following actions will be required in order to realize longer term progress in public financial management: (a) commitment by the authorities to implement key recommendations of the CFAA, the Country Procurement Assessment Report and other IMF reports; (b) satisfactory implementation of the grants from the Bank’s Institutional Development Fund supporting public sector reform program of the government; (c) satisfactory implementation of the Public Sector Reform Project, which will soon be negotiated, and the proposed Public Financial Management Modernization Project, currently under preparation. Progress in strengthening the public financial management will be assessed through the IMF fiscal transparency Reports on Observance of Standards
and Codes to be carried out in fiscal 2006, and a fiduciary update to be conducted by the Bank in fiscal 2008.

- **Complex political economy coupled with the presidential elections.** Tajikistan has been independent from the former Soviet Union for slightly over ten years and is still recovering from a devastating civil war. Its institutions are very weak and vulnerable to capture by special interests. Stakeholders who benefit from the current institutional arrangements are likely to resist reforms that will leave them worse off. Moreover, the resistance of vested interests is likely to increase in the run-up to the presidential elections scheduled for November 2006. The president and the ruling party, however, have are much stronger than the opposition, and the election is not expected to result in significant changes in government or in policy that would threaten the momentum of the public sector reform program. The Bank will address risks posed by the upcoming election by improving and expanding its efforts at communications, emphasizing the costs of continuing with the economic status quo, the long-term benefits of reforms, and opportunities for accelerating growth through greater private sector involvement in infrastructure. Better dissemination of the findings of Bank-supported analytical work will be an important vehicle of this enhanced communications effort, but it will also involve proactive efforts, with assistance from the external affairs units in the country office and in headquarters. The Bank will regularly monitor progress and actively engage in dialogue to help government and with the opposition. It will continue to coordinate closely with other development partners to monitor political developments and provide a common response to political developments.

- **External factors.** Tajikistan is exceptionally vulnerable to shifts in the external environment, due to its small internal market, its landlocked position, and its dependency on a small number of commodity exports, limited number of transport routes, and workers’ remittances for income and for foreign exchange. Deteriorating terms of trade would negatively affect rural incomes and Tajikistan’s balance of trade. Political or economic instability in neighboring countries also poses a significant risk to Tajikistan; as such instability could lead to closures of borders or trade disruption. Apart from pursuing suitable economic policies to diversify its exports, as an active member of the Central Asia Regional Economic Cooperation, Tajikistan is addressing some of these trade and transportation issues through regional cooperation efforts.
THE PRESIDENT OF THE PREPUBLIC OF TAJIKISTAN

Dushanbe No. 23.1/1-1 28 March 2006

H.E. Mr. Paul WOLFOWITZ
President
The World Bank
1818 H Street, N.W.
Washington, DC 20433

Excellency,

Please allow me to express my gratitude to you and in the name of you the World Bank for the support being provided to the government of the Republic of Tajikistan in the reforms.

The objective of this Letter of Development Policy (LDP) is to outline recent developments in Tajikistan’s economic and social situation and the related prospects over the next three years. This LDP is based on National Development Strategy (NDS) and the recently approved Public Administration Reform Strategy (Public Administration Reform Strategy) that the Government intends to implement. NDS represents follow-up actions under the on-going Poverty Reduction Strategy Paper (PRSP) with longer term time horizon. The recently approved PAR covers medium and longer term actions to reform public administration in order to improve the quality of public service delivery.

As you know, the World Bank’s Country Assistance Strategy (CAS) for Tajikistan covering FY 2006-2009 includes a program of lending aimed at supporting the different areas of Tajik Government’s program aimed at achieving its goals of promoting growth, reform public sector and improve the quality of public services delivery.

With respect to the economic program of the government, we would like to highlight some of the results achieved in recent years. According to experts’ evaluation, Tajikistan has been one of the fast-growing economies in ECA with average five year growth rate of 10 percent (2000-04). This high growth rate reflects the progress achieved during initial stage of structural adjustment reforms, balanced macroeconomic policy, as well as economic rebound after the civil war, favorable external factors, and strong inflows of migrants workers’ remittances.

In 2004, real GDP growth reached the highest level in Central Asia (10.6 percent). Economic growth achieved during recent years effected a significant decrease of poverty level in the country. Consequently, the poverty rate (using a PPP of USD2.15 per capita per day) significantly fell by 18 percent (from 82 percent in 1999 to 64 percent in 2003).
The tightening of Tajikistan’s monetary policy stance since late 2003 brought to significant reduction of inflation: from 16.4 percent in 2003 to 7.9 percent in 2004. At the same time it is necessary to note that measures on increasing tariffs for electricity in order to reach cost-recovery, as well as increase on world oil prices, due to increase in cost; as a result inflation had increased to 8.5 percent during last 12 month. National currency depreciated by about 5 percent through end-July 2005, but has been stable since then.

Despite those achievements, we fully understand that Tajikistan may face major challenges ahead. Our country remains vulnerable to external shocks and is still the poorest country in the CIS with an estimated per capita GDP of $310 in 2005. This vulnerability is due to the fact that about three-forth of total export earnings remain concentrated on aluminum, cotton and electricity and the remittances from abroad are the key trade deficit financing source and hence current account balance stabilization. Besides, the Tajik economy depends on oil imports whose prices tend to further increase in recent years. These factors pose significant risk to maintain sustainability of high economic growth rate over the long-term. To mitigate such risks, the government intends to deepen structural reforms in all sectors to unlash their full potential to sustain high economic growth rate and accelerate poverty reduction following the adoption of the Public Administration Reform Strategy and the gradual improvement in capacity in the government to implement key reforms.

We are ready to implement important policy measures that will be realized in areas that pertain to the Programmatic Development Policy Grant (PDPG).

I. SUSTAINING ECONOMIC GROWTH

Government attaches high importance to the growth agenda. In recent years growth performance has been strong, while in 2005 it slowed down mostly due to both external (world market prices for cotton, aluminum, and oil) and internal (in particular due to low cotton productivity, onerous regulatory environment for private sector development) factors. We understand that key reforms in this area should focus on: (i) improving investment climate; (ii) improving productivity of enterprises and agribusiness; (iii) increasing the efficiency in energy sector; and (iv) improving trade and transport.

Currently, Government discusses the new triennial program with the IMF and will follow all agreements that will be achieved in the negotiations and Government’s macroeconomic policy will be consistent with them.

Investment Climate

Improved investment climate is considered to be a major target in private sector development policy of the government. Further actions in this area include streamlining and minimization of government intervention into business operations and reducing barriers to entry into the market. We acknowledge that those are major constraints for private sector development. The government has established a working group to prepare a new Law on Inspections and amend existing Tax Code as well as amending licensing
law. Those amendments and new law are being discussed in the Majlisi Oli (Parliament) for final adoption.

We are also pleased for fruitful collaboration under the World Bank Technical Assistance on a communication strategy to publicize future asset sales as well as past privatized objects to build support for the privatization program and complete a compliance review of a set of randomly selected privatized objects for 2004. The State Committee on Administration of the State Property has been publishing information on asset sales for previous periods and future assets. The compliance review is expected to be produced by April 2006. The government of Tajikistan will pursue policy actions to enforce transparency and accountability rules in privatization process.

Our further steps toward improving investment climate include as follows:

* Licensing and Inspections:*

  - adoption of regulatory documents of inspections, as well as amendments into current regulations of licensing selected types of activity. These regulations shall be maximum clear and exclude any possibility for double-interpretation, as well as maximally facilitate the processes. Besides, Government shall amend relevant clauses in the legislation of Administrative violations that stipulate administrative measures against those public officers, which fail to observe new requirements for licensing and inspections. In future we will thoroughly monitor the legislative execution practice of newly adopted legislation in the area of activities inspection and licensing for their proper and efficient execution.

* Private sector development*

  - The government has recently developed a pledge law for movable property and with donor support is setting up a registry for such pledged assets in the Ministry of Justice. This will improve the investment climate by facilitating secured lending where collateral is movable. The government has also recently drafted an investment law to provide clarity to and facilitate investors, in particular foreign investors.
  - In order to achieve sustainable development, the government intends to develop and implement private sector development strategy. However, further donor assistance and input is needed before this strategy can be finalized and implementation can begin.
  - Also, the government, with donor support is working towards developing a policy on property rights including for intellectual property.

* Privatization.*

  - Government shall continue the current course for transparency and accountability of the process. The specific steps in this area are as follows: (i) amendments to current regulations promoting remedial actions to deficiencies explored during
random compliance review of privatized objects; (ii) Conduction of new random compliance review of privatized objects for 2005 and adoption of necessary actions; (iii) strengthening advertisement campaign and broad communication of the public on previous and future auctions; and (iv) adoption and implementation of individual restructuring plans of Large State Enterprises. We also plan a program on privatization of unfinished legacy which implementation will allow to their exploitation and provide efficient utilization by the private sector with creation of employment and sustaining growth.

Enterprise Productivity and Agribusiness

Improved competition rules and increasing productivity in agribusiness are expected to create a healthy competitive environment in local market and ensure sustainability of growth in medium and longer term. The government has prepared new version of Law “On Competition and limitation of monopolistic activity at commodity markets”, which is to be submitted to the Majlisi Namoyandagon Majlisi Oli of the Republic of Tajikistan for approval in April 2006. Further, the government intends to develop clear regulatory mechanism for execution of new Law. We also intend to amend Law of the Republic of Tajikistan “On Natural Monopolies” and provide its implementation mechanism.

On agribusiness, the government has adopted Farm Debt Resolution Strategy which considers necessary actions to increase productivity and ensure fair distribution of export sales revenue in cotton subsector. The Ministry of Economy and Trade, Ministry of Agriculture and Agency for Antimonopoly Policy and Entrepreneurial Support have redrafted cotton pricing regulation towards increased flexibility and increased competition. Government has also to adopt a decree on moving to international cotton standards; a joint venture will be established with an internationally recognized cotton grading company with compulsory grading and weight certification in next two years. We will plant 40 hectares for High Yielding Varieties (HYVs) of cotton under World Bank Land Registration and Cadastre System (LRCS) project funds. Overall, those actions are to contribute to increasing productivity in cotton subsector through increasing competition in the sale as well as fair income distribution in the subsector.

Energy Sector Reform

Energy is considered one of the important sources of future growth for the country. In January 2006 the government has signed Memorandum of Understanding with international financial institutions on future development strategy as well as new tariff policy and social protection mechanism. The government will continue actions to restructure the sector, including separation of policy making and commercial operations, and develop a new tariff policy and social protection mechanism by end of 2006. In this regard the Presidential Decree on separation of Open Joint Stock Holding Company “Barqi Tojik” from Ministry of Energy has been signed in March 2006. On the latter, gradual energy tariffs increase will be exercised during 2007-2010 until they reach cost recovery level of 2.1 cent per kWh. Respectively, there will be measures adopted for social protection of vulnerable population from electricity tariff increases.
Trade and Transportation

Government had taken initial steps to reform aviation sector. The Department of Civil Aviation was set up in 2001. We understand that follow up actions are needed to separate policy making and technical regulation responsibilities. It is expected that by the end of 2006 policy making functions will be separated from the Department of Civil Aviation to another state agency. Also, State Unitary Aviation Enterprise “Tojikiston” (Tajik State Airline) restructuring plan is under preparation considering legal separation of the operations of the airport, airline and air traffic control by end 2008.

Government of Tajikistan has decided that Tajik State Airline will collaborate with international financial institutions to mobilize resources to develop a competitiveness strategy under gradual liberalization of air policy. Tajikistan will continue gradual move to open air policy. Since May 2005, a China Southern Airlines started operating on Dushanbe-Urumchi-Beijing route; Turkish Airlines has been operating on Dushanbe-Istanbul route since end-January 2006.

To improve the access to the country, the government decided further simplifying the visa regime. Letter of invitation-free visa regime will be established with OECD countries; we will adopt new rules for issuing visas for citizens of OECD countries upon arrival in the country. To facilitate domestic trade the government has issued a decree to reduce internal checkpoints of traffic police.

The government has also significantly liberalized the internal visa regime to reduce transaction costs for business and to increase flexibility in labor markets. We are also actively pursuing a program of reforms to enable WTO accession and significant progress has been made in this effort. In particular, the government has reformed its custom administration procedures and revised the customs code, to make the country more compliant with the Kyoto protocol.

II. IMPROVING PUBLIC SECTOR PERFORMANCE AND THE QUALITY OF SERVICE DELIVERY

Tajikistan has been moving to a market economy and needs to establish adequate public institutions to improve the quality of public services that is one of the three strategic priorities the government has set out in the context of the National Development Strategy. In this regard, high priority is attached to: (i) the implementation of the Public Administration Reform Strategy (Public Administration Reform Strategy); (ii) resource allocation by strengthening the link between mid-term and long-term Government programs and budget planning; (iii) improving the efficiency in budget resource allocation in the education sector; and (iv) improving primary health care (primary health care) service by increasing transparency and increasing wages. We see the importance of immediate actions in Civil Service Pay reform, strengthening horizontal civil service management and amending the “Law on Civil Service”.

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Public Administration Reform Strategy (Public Administration Reform Strategy)

Following President’s address to the parliament in April 2005, the comprehensive public administration strategy was developed, which was adopted on 15 March 2006. We are grateful to the WB and USAID/Urban Institute for technical and advisory support in developing the PAR Strategy.

Government has taken some initial actions on selected key aspects of public administration and civil service reform:

(i) A Presidential decree was issued in November 2005 envisaging the introduction of new civil servants wage system in five pilot ministries and agencies. According to new system, all benefits and supplements, except qualification rank increment and years of service, were integrated into a single base pay with moderate decompression of salaries and de-coupling the increment for qualification rank from the minimum wage has been revised; gradual separation of auxiliary staff from civil servants and regulations on funding their salaries is being addressed;
(ii) Civil Servant Register has been created and ready for computerization;
(iii) The Civil Service Department has been strengthened, and we begin the implementation of Plan for reinforcing the Civil Service Department;
(iv) Amendments to Civil Service Law have been prepared. They will provide the legal basis for wage system reform, the introduction of merit principles in civil service recruitment, the establishment of legal base for incentive funds, based on transparent criteria, and the formal separation of career civil servants and political appointees;
(v) The Restructuring plans of five pilot agencies (Ministry for State Revenues and Duties, Ministry of Finances, Ministry of Economy and Trade, Ministry of Labor and Social Protection of Population, and Civil Service Department) have been prepared and submitted to the government that intends to approve these plans by end of April 2006.

All the above actions will be completed before Programmatic Development Policy Grant negotiation.

Strategic policies and resource allocation framework

Under forthcoming DFID and European Union TA programs, the government will develop a framework to ensure linkage between strategic policies and resource allocation framework. By May 2006, the government of Tajikistan will adopt MTBF implementation action plan. The joint program of the World Bank, DFID and European Union will support us to implement MTBF during next two years. The government in its turn does all the necessary for fully implement MTBF.

Resource allocation in the education sector
The government has completed the process of designing an Education Sector Strategy, which is to be followed by a specific strategy on Education Financing. Per Capita Funding was introduced on a pilot basis in five rayons in 2005. It is expected that all issues related to the design and scale up nationwide will be developed in 2006.

Government’s policy actions in this area include the development of a strategy to address structural impediments to the roll out of per capita funding based on expert review. Further action stipulate more flexibility in resource allocation in pilot rayons by moving support staff to the ‘goods and services’ component of the budget and allocation all non-wage resources as a package to the schools. These reforms will be accompanied with measures on strengthening financial management and accountability at school administration level, as well as the review and reform of the stavka system to ensure that teacher loads are closer to full time equivalent, the design of a new remuneration and promotion system that rewards performance and is more aligned with responsibility and qualification levels, a complete mapping of schools and a plan for rationalization of resource allocation and utilization in education.

Health Care

In 2004 the government has adopted the Health Financing strategy, which sets out the objective to allocate Government resources to strategic objectives of the sector. The key objectives of the Strategy are: (i) establishment of an institutional structure of a single-payer for health care, (ii) pooling of sources of public funds for free health care, (iii) development and implementation of new provider payment mechanisms; (iv) regulation of informal payments in the health system and introduction of formal co-payments; (iv) increasing health personnel salaries; (v) reorganization of the system of health services delivery; (vi) improving equity of resource allocation. In order to meet the goals of the strategy, as well as to guarantee access by the vulnerable population to basic health services and legalized Paid Services for Secondary care, the government initiated in summer 2005 the Basic Benefit Package (basic benefits package). However, due to design flaws, the system was suspended in October 2005.

Government intends to renew paid medical services step by step as follows:

(i) in 2006 categorize medical facilities and positions (jobs), separate financing flows of primary health care and hospital level and based on this to develop and introduce new wage system for primary health care personnel;

(ii) In 2007 based on experience of one region to implement paid services and in parallel approve the action of revised basic benefits package;

(iii) In 2008 to introduce paid services and reintroduce basic benefits package at national level.

Besides, the government currently plans to implement asymmetrical wage bill increase for primary health care as follows: 60:40 in 2006, 80:20 in 2007, and maximum level of asymmetrical allocation of wage bill increase for primary health care effective from 2008.
Further steps of Government in this sphere will be accompanied with implementation of financial management and accountability measures on level of medical facilities, both primary and secondary, improving criteria for resource allocation (per capita funding in health) as well as complete rationalization of medical facilities.

**Conclusion**

As the above indicates, the government of Tajikistan is strongly committed to undertaking necessary reforms actions to promote economic growth and improve service delivery. In this context, the support of the World Bank would be important to support government’s reform agenda through approval of the Programmatic Development Policy Grant is a very important element.

Please accept Your Excellency the assurances of my highest consideration.

Emomali Rahmonov
## Annex 2: Policy Matrix

**REPUBLIC OF TAJIKISTAN**  
**PROGRAMMATIC DEVELOPMENT POLICY GRANT (PDPG)**  
**POLICY MATRIX**

<table>
<thead>
<tr>
<th>Medium-term Objectives</th>
<th>Policy Actions</th>
<th>Outcomes (Monitoring Indicators)</th>
<th>CAS goals to which PDPG is contributing (and related Bank Group operations)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SUSTAINING ECONOMIC GROWTH THROUGH</strong></td>
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<tr>
<td><strong>A PILLAR I: PROMOTING PRIVATE SECTOR DEVELOPMENT</strong></td>
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<tr>
<td>(i). Maintaining Macroeconomic Stability</td>
<td></td>
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<tr>
<td>(ii). Improving of Investment Climate</td>
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</tbody>
</table>
| (a) Reform of Business Licensing and Inspections  
*Paragraph 45,46* | Submit to parliament amendments to the current licensing law satisfactory to IDA to reduce entry barriers. | 1. Adopt the necessary measures to ensure the implementation of the amended licensing law, including: (a) public awareness campaign (including publication and public dissemination through mass media); and (b) training of public officials on the new requirements under the law (incl. training program by Civil Service Department).  
2. Submit to parliament amendments to all laws to ensure compliance with the law on licensing.  
Government of Tajikistan to adopt amendments to secondary legislation on licensing. | Review and research implementation progress to ensure compliance with the law on licensing.  
- Cost of doing business improved, as monitored by indicators agreed with IDA.  
- Reduction in the percentage of firms reporting un-official payments for obtaining of business licenses and permits, as measured by indicators satisfactory to IDA.  
- The average number of inspections of fire and safety declines from 3 per firm in 2005 (BEEPS) as measured by indicators satisfactory to IDA.  
28 The baseline data and sources for some of the indicators will be further refined during PDPG2 preparation. | Improve business opportunities in rural and urban supported by PDPG (FY07–08), PPIAF program, IFC PEP, IFC small and medium size enterprises Project, and MIGA Foreign Investment Advisory Service Doing Business Survey (2007)  
Public Sector Reform Project (FY07) and IFC Small and Medium Size Enterprise Project. |
| | Submit to parliament a law to reduce the scope of inspections and increase accountability of inspection officers and submit amendments to the tax code regulating the activities of tax inspectors satisfactory to IDA. | 1. Issue new by-law and regulations (at inspecting agency level) for the new law on inspections  
2. Submit to parliament amendments to current legislation and regulatory acts covering inspections to ensure compliance with the law on | Review and research implementation progress to ensure compliance with the law on inspections.  
28 The baseline data and sources for some of the indicators will be further refined during PDPG2 preparation. | |

*Note: PDPG 1 (triggers are bolded) PDPG 2 (tentative triggers) PDPG 3*
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<tbody>
<tr>
<td>(b) Improving Transparency of the Privatization Process and Enhancing Competition</td>
<td>PDPG 1 (triggers are bolded)</td>
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<tr>
<td></td>
<td>PDPG 2 (tentative triggers)</td>
<td></td>
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<td></td>
<td>PDPG 3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paragraph 48, 49, 52</td>
<td>inspections.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Disclose detailed information on all asset sales in 2004.29</td>
<td>1. Disclose detailed information on all asset sales in 2005.</td>
<td>Disclose detailed information on all asset sales in 2006.</td>
<td>Privatization process is more transparent (information on asset sales is readily available on the internet and the media).</td>
</tr>
<tr>
<td>2. Adopt a communication strategy that adequately advertises future asset sales.</td>
<td>2. Implement the communication strategy.</td>
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<tr>
<td></td>
<td>2. Adopt and implement remedial measures to address the deficiencies identified by the 2004 compliance review.</td>
<td>2. Adopt and implement remedial measures to address the deficiencies identified by the 2005 compliance review.</td>
<td></td>
</tr>
<tr>
<td>Submit to parliament amendments to the current competition law satisfactory to IDA to better protect against practices undermining competition.</td>
<td>1. Revise implementing regulations to ensure compliance with the amended competition law.</td>
<td>Identify measures for the effective compliance with the amended law regulating natural monopoly activities.</td>
<td>Competition among enterprises rises, as measured by indicators satisfactory to IDA.</td>
</tr>
<tr>
<td>(iii). Regulatory Reform in Key Strategic Sectors</td>
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<tr>
<td>(a) Aviation</td>
<td>1. Adopt a government decision to remove policy making function from Department of Civil Aviation and assign to another governmental agency by end 2006.</td>
<td>1. By end-Dec-2006, issue and implement government decree on separation of policy making and technical regulation activities in civil aviation acceptable to IDA</td>
<td>Allow, at least one international airline to operate to Tajikistan every year for next two years.</td>
</tr>
<tr>
<td>Paragraph 55, 56</td>
<td>2. Develop a business strategy (with timetable) of the Tajikistan State Airline Company.</td>
<td>2. Develop a business strategy (with timetable) of the Tajikistan State Airline Company.</td>
<td>Allow, at least one international airline to operate to Tajikistan every year for next two years.</td>
</tr>
<tr>
<td></td>
<td>3. Adopt government decree on separation of airlines, airport and air traffic control management by</td>
<td>3. Develop a business strategy (with timetable) of the Tajikistan State Airline Company.</td>
<td>Access to Tajikistan by air increases as measured by indicators satisfactory to IDA. (Baseline number of flights from 3,500 year, and available seats per year from 400,000 in 2004 (Tajik Air records).</td>
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<tr>
<td></td>
<td>by end 2006.</td>
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</tr>
<tr>
<td></td>
<td>1. By end-Dec-2006, issue and implement government decree on separation of policy making and technical regulation activities in civil aviation acceptable to IDA</td>
<td>Implementation underway for the legal and operational separation of the airline, airport and air traffic control management.</td>
<td>Improve business opportunities in rural and urban areas supported by PDPG (FY07–08).</td>
</tr>
<tr>
<td></td>
<td>2. Develop a business strategy (with timetable) of the Tajikistan State Airline Company.</td>
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<tr>
<td></td>
<td>3. Develop a business strategy (with timetable) of the Tajikistan State Airline Company.</td>
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</table>

29 Including the number of tenders submitted the identity of the final buyer, and the final purchase price for each asset.
<table>
<thead>
<tr>
<th>Medium-term Objectives</th>
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<th>Outcomes (Monitoring Indicators)</th>
<th>CAS goals to which PDPG is contributing (and related Bank Group operations)</th>
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<tr>
<td></td>
<td>PDPG 1 (triggers are bolded)</td>
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<td></td>
<td>PDPG 2 (tentative triggers)</td>
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<td>PDPG 3</td>
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<tr>
<td>2008.</td>
<td>IDA.</td>
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<tr>
<td>3. Allow at least one new international carrier to start regular flights to and from the city of Dushanbe.</td>
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<tr>
<td></td>
<td>1. Adopt a government resolution to introduce the universal cotton grading system.</td>
<td></td>
<td>• At least one international cotton grading company providing universal cotton grading services (as assessed by the number of quality certificates (one per bale) issued and the percentage of the total covered: year 1: 15–25% of production, year 2: 40–60% of production year 3: 90–100% of production.</td>
</tr>
<tr>
<td></td>
<td>2. Adopt an inter-ministerial resolution to increase market competition in the cotton sector.</td>
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<tr>
<td></td>
<td>1. Accreditation of at least one internationally recognized cotton grading company to provide universal cotton grading services.</td>
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<tr>
<td></td>
<td>2. Amend the existing technical regulations to ensure compatibility with new international cotton grading standards and cotton pricing system satisfactory to IDA.</td>
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<td></td>
<td>3. Publish widely the revised cotton pricing system.</td>
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<tr>
<td>(b) Cotton Paragraph 59–61</td>
<td>1. Issue a government decision to introduce mandatory grading and weight certification by the Tajikistan office of standards and weights.</td>
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<td></td>
<td>2. Publish widely the revised cotton pricing system and grade mechanisms adopted by the government in every gin, on every local government office bulletin board, with pamphlets through news media.</td>
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<tr>
<td></td>
<td>Continue implementing the Energy Sector Development Strategy, especially 1. Adopt government decree on the separation of policy making and commercial operations, by end-Dec-2006; 2. Adopt government decree on energy the tariff adjustments (up to full cost recovery level) in line with the agreed schedule (2007-2010).</td>
<td></td>
<td>• Financial viability of Barki-Tajik and Tajik Gas increases (increase in the ratio of customer payments in total costs from 54 percent in 2004).</td>
</tr>
<tr>
<td></td>
<td>Continue implementing the Energy Sector Development Strategy.</td>
<td></td>
<td>• Efficiency of energy sector improves (operating losses fall from 28% in 2004).</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Improve service delivery to business and industry, (measured by reduced number days of outage a year in Dushanbe and GBAO from 32 in 2004).</td>
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<tr>
<td></td>
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<td></td>
<td>Improve the delivery of energy services and exploit the country’s hydropower potential supported by: Energy Loss Reduction Project</td>
</tr>
<tr>
<td>(c) Energy Paragraph 66, 67</td>
<td>Adopt and initiate implementation of the Energy Sector Development Strategy satisfactory to IDA that includes the following key elements: ▪ A restructuring plan for the electricity sector to separate policy-making from commercial operations (Barki Tajik); ▪ A schedule for electricity tariff adjustments for 2007-2010 to gradually move toward cost recovery levels; and ▪ A social protection measure for the vulnerable groups to ensure access to a basic minimum amount of energy.</td>
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<td>---------------------------------------------------------------------</td>
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<tr>
<td>B PILLAR II: PUBLIC SECTOR REFORM AND IMPROVING PUBLIC SERVICE DELIVERY</td>
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<tr>
<td>(i) REFORMING PUBLIC SECTOR MANAGEMENT</td>
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<tr>
<td>Public Sector Reform Strategy Paragraph 71</td>
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</tbody>
</table>
| 1. **Adopt a public sector reform strategy satisfactory to IDA.**  
2. Assign responsibility for management and monitoring of the implementation of the Strategy to a dedicated structure within the Executive Office of the President. | 1. Implement first set of short-term measures as specified in strategy matrix.  
2. Launch the implementation of the second set of priority measures in the strategy matrix, as announced on an annual basis. | 1. Implement second set of short-term measures as specified in strategy matrix.  
2. Evaluate implementation of the first set of the short-term measures.  
3. Launch the implementation of the third set of priority measures in the strategy matrix, as announced on an annual basis. | Quality of governance in Tajikistan improves compared to the baseline indicator on monitoring the development of the governance system to be established under the Public Sector Reform Project in early 2007. (baseline governance cluster CPIA rating) | Public Sector Reform Project (FY07) |

(a) Rationalization of Core Public Administration Structures

Paragraph 72

| Adopt reform plans by pilot ministries satisfactory to IDA and start their implementation. | 1. Complete the horizontal functional review and submit proposals and recommendations for consideration by the government, including on: (a) the allocation of responsibilities for budget preparation and execution, (b) assignment to one institution of the responsibility for private sector development policy issues, and (c) rationalize structures for investment planning.  
2. Adoption of a new structure of central ministries and agencies and a time bound restructuring plan for implementation of the results of the review. | 1. Implement the restructuring plans for at least 8 central ministries | Horizontal reallocation of functions and reform of at least 8 central institutions completed (as indicated by the annual report of the Department of Economic Reforms and Investment on implementation of the public sector reform strategy.) | Public Sector Reform Project (FY07) |

(b) Civil Service Reform

Wage Reform Paragraph 75, 77

<table>
<thead>
<tr>
<th><strong>Adopt a presidential decree for the core wage system reform satisfactory to IDA.</strong></th>
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<tbody>
<tr>
<td>Adopt government decree on the implementation of the second phase in wage decompression as agreed with</td>
</tr>
</tbody>
</table>

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30 The wage reform will (a) integrate all bonuses and allowances in a new wage system (October 1, 2005 for pilots and April 1, 2006 for all ministries); (b) decouple the calculation of the increment for qualification rank from the minimum wage; (c) introduce a phased decompression of wages to better reward those
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<td><strong>PDPG 3</strong></td>
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</tbody>
</table>
3. Agree on a medium-term plan for completing wage reform. | IDA. | integrating Years of Service component) by January 1, 2008;  
2. Implement the third phase in decompression satisfactory to IDA; and  
3. Monetize benefits and non-wage bill spending on salaries by January 1, 2009. | competitive and fair improves (A baseline value will be established in early 2007 through public official survey supported by the Public Sector Reform project.)  
• Remuneration of civil servants better matches complexity and responsibility of job (wage spread between classes of civil servants attains the decompression ratios:  
  • 2007: 1:4 between specialist and deputy minister  
  • 2008: 1:4 between specialist and head of department).  
• Efficiency of civil service improves, as compared to the baseline to be established under the monitoring system of the Public Administration Reform Project to be established in early 2007  
• Functions and responsibility of civil service positions and corresponding wage systems clearly defined | |
| **Civil Service Management**  
*Paragraph 79, 81, 82* | Submit to parliament amendments to the Civil Service Law to separate political from administrative positions, establish the legal basis for the reformed wage system, and provide justification for pilot wage reform activities from December 1, 2005.  
1. Adopt secondary legislation to implement new job classification and wage grid in all government institutions; and  
2. Adopt secondary legislation on merit-based recruitment and promotion. | Adopt merit-based criteria for senior management positions defined as part of secondary legislation. | Public Sector Reform Project (FY07) |

that hold positions of higher complexity and responsibility, starting with pilot ministries on October 1, 2005, with roll-out to other central ministries in spring 2006; (d) changes the status of technical staff in the ministries to contract workers (move under the goods and services item).  

31 The target ratio is agreed between the government and IDA, but is understood to be subject to the revenue performance of the government.
<table>
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<td>PDPG 1 (triggers are bolded)</td>
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<td>PDPG 3</td>
<td>(as indicated by data on newly clarified political and administrative positions and wages).</td>
</tr>
</tbody>
</table>

Establish a comprehensive civil service register ready for computerization. | Introduce a computerized civil service register | Further review and strengthen the civil service register computerization and link to payroll system | Civil service uses a fully functional civil service database system that links to payroll system. |

(c) Public Financial Management Reform

**Medium-term budget framework**

Paragraph 83, 84

1. Develop and adopt a medium-term budget framework implementation action plan acceptable to IDA;
2. Launch a public expenditure tracking study covering health and education sectors.
3. Improve the quality of budget monitoring reports.
4. Disseminate the results of the public expenditure tracking studies and take action to improve resource flow in health education.

1. Implement the medium-term budget framework action plan
2. Government to approve a budget strategy paper for the 2008–10 that contains sector policy priorities and resource ceilings for the sectors.
3. Improve the quality of budget monitoring reports.
4. Disseminate the results of the public expenditure tracking studies and take action to improve resource flow in health education.

1. Approve a budget strategy paper for 2009–11 that includes an analysis of key cross cutting issues and at least one sector strategy.
2. Launch a public expenditure tracking study covering social protection.

Deviations reduced between:
- Expenditure outturn and original budget.
- Composition of expenditure outturn and the original budget.
- Aggregate revenue outturn and original budget.

Public Sector Reform Project (FY07).
World Bank IDF grant for procurement reform
Public Financial Management Reform Project (FY08)

Procurement Reform

Adopt a new law on procurement. | Amend by-laws in accordance with the new procurement law. | Fully implement procurement law with all relevant procedures amended | Increase the transparency and efficiency of procurement system |

Public Financial Management Reform Project (FY08)

Internal Audit

Adopt a strategy for the development of a public sector internal audit function satisfactory to IDA. The strategy should include (a) staffing and skill requirements; (b) audit approach and methodology; and (c) structural and institutional arrangements.

1. Train initial cadre of internal audit staff.

- Internal control function to strengthen budget execution and monitoring of overall quality of financial management systems improved (as measured by the number of internal audits conducted using revised methodology).
- Managerial accountability and transparency for the...
<table>
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<td><strong>PDPG 3</strong></td>
<td></td>
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<tr>
<td>External Audit</td>
<td></td>
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</tr>
<tr>
<td>1. Developing amendments for updating the law on State Financial Control satisfactory to IDA.</td>
<td>1. Develop and implement the revised methodology for pilot audits.</td>
<td>• Greater independence, transparency, and accountability of the State Financial Control Committee in accordance with international norms.</td>
<td>World Bank IDF grant for the State Financial Control Committee’s Twinning Arrangement.</td>
</tr>
<tr>
<td>2. Develop and adopt an action plan for building capacity of the State Financial Control Committee satisfactory to IDA and implement key recommendations outlined in the action plan.</td>
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<tr>
<td><strong>Public Sector Reform</strong></td>
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<tr>
<td>a. Primary Health Care</td>
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<tr>
<td><strong>Paragraph 88, 89</strong></td>
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</tr>
<tr>
<td>1. Adopt presidential decree that assigns greater share of wage bill increases in health to primary health care in 2006.</td>
<td>1. Adopt a government decree that expands the primary health care share of wage increases in health in 2007 as agreed with IDA.</td>
<td></td>
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<tr>
<td>2. Adopt a government resolution satisfactory to IDA to:</td>
<td>2. Adopt government decree on reintroducing the fully-funded basic benefits package in one oblast in 2007 on a pilot basis and integrate the basic benefits package into the hospital budgets for that oblast (by Nov-2006).</td>
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<tr>
<td>• Lift the suspension on the basic benefits package.</td>
<td>3. Allocate health budget on a per capita basis.</td>
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<tr>
<td>• Task the ministries of health and finance to ensure re-introduction of basic benefit package in</td>
<td>1. Continue expanding the primary health care share of wage increases in health in 2008 as agreed with IDA.</td>
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<td>2. Implement basic benefits package nationwide.</td>
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<td></td>
<td>3. Adopt a government decree specifying the formula for per capita financing in health by</td>
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<tr>
<td></td>
<td>1. Increase utilization of PHC by rural population by 30 percent;</td>
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<tr>
<td></td>
<td>• Resources for primary health care rise (actual non-wage expenditure for primary health care increases from 56 percent in total public health expenditure;</td>
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<td>• Transparency and certainty regarding out-of-pocket payments for health improves as</td>
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<td></td>
<td>• These targets for primary health care wage bill are subject to revenue performance and good progress in implementation of the basic benefits package.</td>
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<td></td>
<td>• From 2008, all wage increases for secondary health care workers should be financed from the basic benefits package co-payments for paid services, and the defined target for wage bill increase allocation is understood between the government and IDA to be subject to the successful implementation of the basic benefits package.</td>
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<td>PDPG 3</td>
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<tr>
<td>3. Issue an interministerial agreement satisfactory to IDA to identify steps for (a) introducing a new job classification and wage grid system for primary health care, and (b) separating funding flows and accountability mechanisms between primary and secondary care.</td>
<td>March 2007.</td>
<td></td>
<td>measured by a reduction in out-of-pocket payments from 77 percent of total public expenditure (WHO Health National Account)</td>
</tr>
</tbody>
</table>
| | | | • Wage bill for primary health care workers rises faster than for other health care workers*:
  2006 60% and 40%
  2007 80% and 20%
  2008 100% and 0%* |
| b. Education | Implement changes to the education per capita allocation system used in the pilot rayons to increase schools’ flexibility and autonomy in managing resource. | Adopt interministerial instruction/order (by Ministry of Finance and Ministry of Education) to:
  1. Design and adopt a new stavka system that ensures that teacher loads are as close as possible to full time equivalent.
  2. Design and adopt a new remuneration and promotion system that compensates education workers based on level of responsibility, qualifications and performance.
  3. Adopt regulations on accountability and financial management at school level. | 1. Implement the per capita system in a phased manner.
  2. Implement the new stavka system that ensure that teacher loads are close to full time.
  3. Implement the new remuneration and promotion system based on performance evaluation. | • Efficiency in resource allocation in general education improves (measured by an increase in the student/teacher ratio from 15.6 in 2001/02 and a reduction in the ratio of wage to nonwage bill in the general education from 90:10.) |
| Paragraph 95, 96 | | | Enhance and preserve the quality of the human capital supported by Education SWAp (FY09). |

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### Annex 3: Link between the Program, AAA and other Bank and Donor Programs

<table>
<thead>
<tr>
<th>Reform Area</th>
<th>AAA</th>
<th>Other Bank Operation</th>
<th>Other Donors</th>
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</thead>
</table>
| **Licensing and Inspections** | Investment Climate Assessment  
IFC small and medium size enterprises survey | PPIAF program  
IFC PEP  
IFC small and medium size enterprises Project  
MIGA Foreign Investment Advisory Service | Swiss  
ADB – (Tax code modernization)  
USAID/Pragma – (Licensing and Registration) |
| **Privatization Program** | Investment Climate Assessment  
Trade Diagnostics Study | PPIAF program | Swiss |
| **Aviation Sector Reform** | Trade Diagnostic Study  
Aviation Study | EBRD Loan | EBRD |
| **Energy Sector Reform** | Trade Diagnostic Study  
Energy Utility Sector review Sector  
Central Asia Regional Electricity Export Potential Study | Energy Loss Reduction Project  
Pamir Private power Project | ADB – (Power Rehabilitation) |
| **Cotton Sector Reform** | Trade Diagnosis Study;  
Aviation Sector Study  
Agricultural Development Strategy  
Poverty Assessment Update  
Tajikistan: Cotton Sector Review | Farm Privatization Support  
Cotton Sector Modernization Project  
Rural Infrastructure Project, Community Agriculture and Watershed Management Project, Land Cadastre project  
Farghana Valley Development Project | ADB  
USAID - Pragma  
Swiss  
DFID  
UNCTAD – (Standards)  
UNFAO – (Land Reform) |
| **Public Administration Reform** | Public Expenditure and Institutional Review  
Public Sector and Civil Service Wage note | Public Sector Reform Project (FY06)  
IDF Grant for Strengthening Civil Service Capacity  
Public Financial Management Reform Project (FY07)  
IDF Public Sector Accountability Institution Building and Technical Assistance II | European Union  
ADB  
DFID  
TACIS – (Public Procurement) |
| **Civil Service and Wage reform** | Country Economic Memorandum: Civil and Public Sector Wage Policy Note | Public Sector Reform Project (FY06) | European Union  
ADB |
| **Social Sector Reform** | Health Sector Policy Note  
Poverty Assessment Update | Community and Basic Health Project  
Education Modernization Project  
Central Asia HIV/AIDS Project  
Fast Track Initiative Trust Fund Social Protection reform Grant  
Second Poverty Alleviation Project | ADB  
Sweden  
Swiss  
European Union  
DFID  
USAID |
Annex 4: Relations with the International Monetary Fund

The Bank's Country Partnership Strategy, endorsed by the Bank's Board of Executive Directors on July 26, 2005, focuses on the following three priorities, which are in line with the country's PRSP:

- To improve business opportunities in rural and urban areas
- To enhance and preserve the quality of the human capital
- To improve energy service delivery and increase electricity exports.

In addition, in each of the above areas, the Bank Group and Government agreed to work to improve government capacity and efficiency, and reduce corruption by giving special emphasis to measures that increase transparency of resource use, reduce discretionary controls, and encourage the participation of users in the provision of services.

Macroeconomic management aims at establishing a stable economic environment through appropriate fiscal, monetary, exchange rate, and sustainable debt policies. In support of these policies, the authorities are tightening payment discipline, especially in the energy sector, hardening budget constraints for state-owned enterprises, and pursuing enterprise and banking privatization and restructuring. Recent improvements in macroeconomic management have supported the current economic recovery. However, to maintain strong growth the authorities will need to accelerate structural reform to support private sector development and investment, and encourage foreign investment.

The IMF has taken the lead in assisting Tajikistan in enhancing macroeconomic stability. The Fund has encouraged the authorities to continue with fiscal consolidation, maintain a restrictive monetary policy, and restructure external debt to enhance debt sustainability.

The World Bank has taken the lead in the policy dialogue on structural issues, including poverty reduction measures, agriculture sector reforms, private sector development, institution building, and governance. A range of instruments is used to conduct the dialogue. Policy based lending and technical assistance is supporting reforms in a number of sectors. The Policy Based Grant currently under preparation will engage the government in the areas of public administration reform, public expenditure management, social service delivery and private sector development.

This broad-based approach is combined with sector projects in health, education, municipal infrastructure, power, agriculture, environment, and poverty alleviation. Over the last two years, the Country Procurement Assessment Review, the Country Financial Accountability Assessment, a Trade Diagnostic Study, an Investment Climate Assessment, a Note on Public Sector Wages and the Public Expenditure and Institutional Review have been finalized in collaboration with the government of Tajikistan. An Aviation Sector Note and a Note on Remittances will be issued soon.
The table below illustrates division of labor between two institutions in specific areas:

<table>
<thead>
<tr>
<th>Area</th>
<th>Specialized Advice from Fund</th>
<th>Specialized Advice from Bank</th>
<th>Key Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Framework/Management</td>
<td>Monetary policy, exchange rate, fiscal, and trade policies, economic statistics</td>
<td>Economic growth, economic statistics</td>
<td><em>IMF</em>: PRGF performance criteria and benchmarks on monetary and fiscal targets.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>Bank</em>: PBC and STATCAP under preparation.</td>
</tr>
<tr>
<td>Budget</td>
<td>Medium-term budget framework, tax and customs policy and administration, and treasury and debt management</td>
<td>Budget management, debt management and statistics, Public Expenditure Review, Country Procurement Assessment</td>
<td><em>IMF</em>: PRGF performance criteria on overall fiscal balance, including PIP. Structural benchmark on treasury development</td>
</tr>
<tr>
<td>Public Sector Reform</td>
<td>Civil service reform, public sector wage policy, administrative restructuring and health and education financing</td>
<td></td>
<td><em>IMF</em>: PRGF</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>Bank</em>: PBC and Rapid Response TA under preparation.</td>
</tr>
<tr>
<td>Social/Poverty</td>
<td>Poverty analysis; reforms in education, health, social protection; support to community driven development</td>
<td></td>
<td><em>IMF</em>: PRGF</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>Bank</em>: PBC, Community Health, Poverty Alleviation 3, Health and Education Sector-Wide Program under preparation. Education Modernization, Poverty Alleviation 2 under implementation.</td>
</tr>
<tr>
<td>Private and Financial Sector Development</td>
<td>Bank supervision; development of the interbank market and increasing competition in the banking sector</td>
<td>Cotton export pricing, developing and implementing the privatization strategy, farm privatization, bank closure and restructuring</td>
<td><em>IMF</em>: PRGF conditions on farm privatization, bank closures, and opening the banking sector to foreign competition.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>Bank</em>: PBC under preparation</td>
</tr>
</tbody>
</table>
# Annex 5: Tajikistan at a Glance

## Poverty and Social

<table>
<thead>
<tr>
<th>Year</th>
<th>Tajikistan</th>
<th>Central Asia</th>
<th>Low-income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GNI per capita (Atlas method, USD)</td>
<td>310</td>
<td>2500</td>
<td>450</td>
</tr>
<tr>
<td>GNI per capita (PPP method, USD)</td>
<td>21</td>
<td>1220</td>
<td>1038</td>
</tr>
</tbody>
</table>

### Average annual growth, 1993-95

- **Population (%)**: 2.9, 6.1, 19
- **Labor force (%)**: 3.3, 0.2, 2.3

### Most recent estimate (latest year available, 1993-95)

- **Poverty (% of population below national poverty line)**: 64, 64, 70
- **Urban population (% of total population)**: 25, 63, 30
- **Life expectancy at birth (years)**: 67, 69, 75
- **Infant mortality (per 1000 live births)**: 96, 31, 62
- **Child malnutrition (% of children under 5)**: 36, 44
- **Access to an improved water source (% of population)**: 56, 51, 75
- **Literate (% of population age 15+)**: 1, 3, 39
- **Gross primary enrollment (% of school-age population)**: 99, 103, 92
- **Male**: 164, 59
- **Female**: 112, 65

## Key Economic Ratios and Long-Term Trends

<table>
<thead>
<tr>
<th>Year</th>
<th>1993</th>
<th>1993-03</th>
<th>2004</th>
<th>2005</th>
<th>2003-07</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (USD billions)</td>
<td>0.02</td>
<td>2.1</td>
<td>2.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross domestic investment/GDP</td>
<td>39.2</td>
<td>18.4</td>
<td>18.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports of goods and services/GDP</td>
<td>51.9</td>
<td>50.4</td>
<td>53.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross domestic saving/GDP</td>
<td>10.5</td>
<td>12</td>
<td>-6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross national saving/GDP</td>
<td>411</td>
<td>164</td>
<td>138</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account balance/GDP</td>
<td>-399</td>
<td>-40</td>
<td>-34</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest payment/GDP</td>
<td>1.4</td>
<td>1.2</td>
<td>1.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total debt/GDP</td>
<td>110.9</td>
<td>140.8</td>
<td>93.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total debt service/GDP</td>
<td>4.7</td>
<td>39.1</td>
<td>7.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of debt/GDP</td>
<td>195.6</td>
<td>38.6</td>
<td>36.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of debt/imports</td>
<td>164.7</td>
<td>73.5</td>
<td>78.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Economic Ratios

- **GDP per capita**: 0.4, 2.7, 2.0
- **Exports of goods and services**: 0.4, 22.9, 2.7

## Structure of the Economy

<table>
<thead>
<tr>
<th>Year</th>
<th>1993</th>
<th>1993-03</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>22.3</td>
<td>21.6</td>
<td>22.0</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>46.5</td>
<td>35.4</td>
<td>31.1</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>32.4</td>
<td>24.3</td>
<td>26.1</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>30.2</td>
<td>43.0</td>
<td>45.0</td>
<td></td>
</tr>
<tr>
<td>Private consumption</td>
<td>12.7</td>
<td>77.4</td>
<td>74.3</td>
<td></td>
</tr>
<tr>
<td>General government consumption</td>
<td>47.3</td>
<td>9.4</td>
<td>11.7</td>
<td></td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>59.1</td>
<td>70.0</td>
<td>57.8</td>
<td></td>
</tr>
</tbody>
</table>

### Growth of Investment and GDP (%)

- **Agriculture**: -7.9, 2.3, 18.1, 9.6
- **Industry**: -1.7, -0.1, 10.2, 10.2
- **Manufacturing**: 12, 110, 115 | |
- **Services**: -11.8, 4.3, 5.0, 7.2
- **Private consumption**: 13.5, -7.3, 6.1
- **General government consumption**: -13.3, -3.0, -0.8
- **Gross domestic investment**: -12.5, -6.9, 9.9
- **Imports of goods and services**: 2.3, -5.3, -0.5

### Growth of Exports and Imports (%)

Note: 2005 data are preliminary estimates.

* The diamonds show key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.
### PRICES and GOVERNMENT FINANCE

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Prices (% change)</th>
<th>Government Finance (% of GDP, excluding current grants)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPI</td>
<td>7.43</td>
<td>7.1</td>
</tr>
<tr>
<td>Implicit GDP deflator</td>
<td>127.8</td>
<td>16.9</td>
</tr>
<tr>
<td>Current revenue</td>
<td>33.3</td>
<td>17.9</td>
</tr>
<tr>
<td>Current budget balance</td>
<td>-15.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Overall surplus/deficit</td>
<td>-20.5</td>
<td>-4.4</td>
</tr>
</tbody>
</table>

### TRADE

<table>
<thead>
<tr>
<th>Year</th>
<th>(US$ millions)</th>
<th>Export and Import Levels (US$ mill.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports (incl.</td>
<td>456</td>
<td>1039</td>
</tr>
<tr>
<td>Aluminium</td>
<td>220</td>
<td>150</td>
</tr>
<tr>
<td>Cotton</td>
<td>117</td>
<td>162</td>
</tr>
<tr>
<td>Manufactures</td>
<td>81</td>
<td>127</td>
</tr>
<tr>
<td>Total imports (incl.</td>
<td>635</td>
<td>1210</td>
</tr>
<tr>
<td>Food</td>
<td>157</td>
<td>175</td>
</tr>
<tr>
<td>Fuel and energy</td>
<td>125</td>
<td>200</td>
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<tr>
<td>Capital goods</td>
<td>34</td>
<td>132</td>
</tr>
<tr>
<td>Export price index (1985=100)</td>
<td>47</td>
<td>101</td>
</tr>
<tr>
<td>Import price index (1985=100)</td>
<td>61</td>
<td>127</td>
</tr>
<tr>
<td>Terms of trade (1985=100)</td>
<td>77</td>
<td>79</td>
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</table>

### BALANCE of PAYMENTS

<table>
<thead>
<tr>
<th>Year</th>
<th>(US$ millions)</th>
<th>Current account balance to GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>470</td>
<td>1211</td>
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<tr>
<td>Imports of goods and services</td>
<td>686</td>
<td>1451</td>
</tr>
<tr>
<td>Resource balance</td>
<td>-215</td>
<td>-241</td>
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<tr>
<td>Net income</td>
<td>16</td>
<td>-79</td>
</tr>
<tr>
<td>Net current transfers</td>
<td>25</td>
<td>236</td>
</tr>
<tr>
<td>Current account balance</td>
<td>237</td>
<td>-83</td>
</tr>
<tr>
<td>Financing items (net)</td>
<td>284</td>
<td>35</td>
</tr>
<tr>
<td>Changes in net reserves</td>
<td>2</td>
<td>54</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
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<tr>
<td>Reserves including gold (US$ millions)</td>
<td>2</td>
<td>189</td>
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<tr>
<td>Conversion rate (1995, local NIS)</td>
<td>1.87E-2</td>
<td>3.0</td>
</tr>
</tbody>
</table>

### EXTERNAL DEBT and RESOURCE FLOWS

<table>
<thead>
<tr>
<th>Year</th>
<th>(US$ millions)</th>
<th>Composition of 2004 debt (US$ mill.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total debt outstanding and disbursed</td>
<td>582</td>
<td>887</td>
</tr>
<tr>
<td>IBRD</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>IDA</td>
<td>0</td>
<td>236</td>
</tr>
<tr>
<td>Total debt service</td>
<td>22</td>
<td>341</td>
</tr>
<tr>
<td>IBRD</td>
<td>8.0</td>
<td>8.0</td>
</tr>
<tr>
<td>IDA</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Composition of net resource flows</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Official grants</td>
<td>11</td>
<td>58</td>
</tr>
<tr>
<td>Official credits</td>
<td>57</td>
<td>-104</td>
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<tr>
<td>Private creditors</td>
<td>56</td>
<td>6</td>
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<tr>
<td>Foreign direct investment</td>
<td>0</td>
<td>272</td>
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<tr>
<td>Portfolio equity</td>
<td>0</td>
<td>0</td>
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<td>World Bank program</td>
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<tr>
<td>Commitments</td>
<td>0</td>
<td>5</td>
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<td>Disbursements</td>
<td>0</td>
<td>56</td>
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<tr>
<td>Principal repayments</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Net flows</td>
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<td>56</td>
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<td>Interest payments</td>
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<tr>
<td>Net transfers</td>
<td>0</td>
<td>50</td>
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## Annex 6: Selected Macroeconomic Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Actual</th>
<th>Estimate</th>
<th>Projection</th>
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</thead>
<tbody>
<tr>
<td>National accounts (as % of GDP)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross domestic product&lt;sup&gt;a&lt;/sup&gt;</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>25.0</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Industry</td>
<td>25.0</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Services</td>
<td>25.0</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Total Consumption</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Gross domestic fixed investment</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Trade balance</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Current account balance</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Net capital inflow</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Change in reserves&lt;sup&gt;c&lt;/sup&gt;</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Balance of Payments (US$ million)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export&lt;sup&gt;d&lt;/sup&gt;</td>
<td>645.7</td>
<td>719.7</td>
<td>794.9</td>
</tr>
<tr>
<td>Merchandise exports</td>
<td>581.6</td>
<td>658.6</td>
<td>732.5</td>
</tr>
<tr>
<td>Services</td>
<td>64.1</td>
<td>64.1</td>
<td>64.1</td>
</tr>
<tr>
<td>Other merchandise exports</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Change in reserves&lt;sup&gt;d&lt;/sup&gt;</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Balance of payments (as % of GDP)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Current account balance</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Change in reserves&lt;sup&gt;d&lt;/sup&gt;</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Public finance (as % of GDP at market prices)</td>
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<tr>
<td>Current revenue and grants</td>
<td>12.0</td>
<td>12.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Current revenue</td>
<td>13.3</td>
<td>13.3</td>
<td>13.3</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>-1.3</td>
<td>-1.3</td>
<td>-1.3</td>
</tr>
<tr>
<td>Capital expenditure (including externally financed FDI)</td>
<td>4.4</td>
<td>4.4</td>
<td>4.4</td>
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<tr>
<td>Foreign financing</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Overall public sector balance (including externally financed FDI)</td>
<td>-2.4</td>
<td>-2.4</td>
<td>-2.4</td>
</tr>
<tr>
<td>Monetary indicators</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M2/GDP</td>
<td>6.6</td>
<td>5.9</td>
<td>7.1</td>
</tr>
<tr>
<td>Growth of M2 (%)</td>
<td>30.5</td>
<td>30.5</td>
<td>30.5</td>
</tr>
<tr>
<td>Private sector credit growth</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total credit growth</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Price indices (1990 = 100)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merchandise export price index</td>
<td>79.2</td>
<td>81.0</td>
<td>83.0</td>
</tr>
<tr>
<td>Merchandise import price index</td>
<td>70.3</td>
<td>72.0</td>
<td>73.0</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Real exchange rate index</td>
<td>112.4</td>
<td>112.4</td>
<td>112.4</td>
</tr>
<tr>
<td>Real interest rate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer price index (as % change)</td>
<td>-4.3</td>
<td>-4.3</td>
<td>-4.3</td>
</tr>
<tr>
<td>GDP deflator (as % change)</td>
<td>-5.8</td>
<td>-5.8</td>
<td>-5.8</td>
</tr>
</tbody>
</table>

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*a. GDP deflator.*
*b. "US$ million."* 
*c. Includes net capital transfers excluding official capital grants.*
*d. Includes use of IMF resources.*
*e. Includes central government.*
*f. "US$ million."* 
*g. An increase in US$ million denotes appreciation.*

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Annex 7: Implementation of Structural Adjustment Credit 2: Policy Areas and Achievements

<table>
<thead>
<tr>
<th>POLICY AREAS</th>
<th>ACTIONS</th>
<th>ACHIEVEMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector management and service delivery</td>
<td>i. Eliminate directed credits and quasi-fiscal operations of the NBT</td>
<td>Relatively substantial improvements were achieved in the area of public sector management within the framework of SAC2. Authorities have taken a number of actions which would enable to push public administration reform agenda further. The law “On the National Bank of Tajikistan” has been amended with a provision prohibiting the issuance of directed credits. In order to better control inspections of private sector entities by state bodies, a Black Book mechanism was introduced that helps monitor the nature and frequency of inspections, although a recent business survey indicates that small and medium-size enterprises continue to be hassled by officials through overly frequent inspections. The laws “On State Financial Control” and “On Public Finance” have come into force in December 2002, thus creating the regulatory basis for the activities of the State Financial Control Committee, the Supreme Audit Institution in Tajikistan. With some support through the IBTA 2 Project, functional reviews of Government ministries were conducted and the Ministries of Health, Education, Agriculture, and Telecommunications were either partially or fully restructured. The Ministry of State Revenues and Duties was established in January 2002 and started modernizing the Customs and the Tax Codes, which have been redrafted with technical assistance from the Asian Development Bank and USAID. The new customs and taxes codes were adopted in November 2004. Also, an internal audit department has been set up within that Ministry in order to increase accountability and to fight corruption.</td>
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<tr>
<td></td>
<td>ii. Establish a supreme budget authority</td>
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<tr>
<td></td>
<td>iii. Reorganize key ministries</td>
<td></td>
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<tr>
<td></td>
<td>iv. Reform the customs administration</td>
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</tr>
<tr>
<td>Budget planning and execution</td>
<td>i. Establish a national Treasury</td>
<td>There have been noticeable improvements of the budget process under SAC2. Individual bank accounts of Ministries have been closed by early 2002 and all transactions are now channeled through a single consolidated account at the Treasury. The law “On State Finances” enacted in December 2002 is a well drafted and modern law on budget processes. However, the full implementation of this law proved slow due to the limited capacity of the Ministry of Finance and line ministries, and the fragmented nature of the budget preparation process. The government developed its first medium-term budget framework (MTBF) for 2002-2004, which links policy, planning and budgeting decisions over the planning and resource management cycle. While this is an important first step, a full and effective integration of the MTBF into the budget process has yet to be achieved. A Budget Commission was set up, but met only twice and was later dissolved since its role had not been clearly defined. On June 30, 2004, GOT issued new decree (No. 294) on (re-) establishment of high-level Budget Commission (BC) chaired by the Prime Minister and consisting of twelve ministries (including line ministries). Unfortunately, the mandate of the Budget Commission remains weak. The Public Investment Program (PIP) is now officially part of the budget process, and counterpart funding is listed as a distinct expenditure item within the State Budget. However, the process linking MTBF, PIP and the State Budget will require significant further improvements.</td>
</tr>
<tr>
<td></td>
<td>ii. Adopt a new Law on Public Finances introducing modern budgetary procedures, improving fiscal management, and developing a MTBF</td>
<td></td>
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<tr>
<td></td>
<td>iii. Integrate the Public Investment Program (PIP) into the budget process</td>
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<tr>
<td></td>
<td>iv. Switch from norm-based costing to activity/population based expenditure allocation in the education and health sectors</td>
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</tbody>
</table>

34 BC management consists of the Prime Minister (Chairman), Minister of Finance (Deputy Chairman) and Economic Reform and Foreign Investment Department of President Administration (Secretary).
<table>
<thead>
<tr>
<th>Financial sector reforms</th>
<th>i. Accelerate financial sector restructuring and close weak banks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ii. Establish new regulatory framework for the establishment of non-bank intermediaries</td>
</tr>
<tr>
<td></td>
<td>iii. Reduce discretionary restrictions on account holder by limiting their access to their own bank accounts conditional on a court authorization only.</td>
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</tbody>
</table>

The main reform objective in the area focused on improvements of banking legal and institutional framework to improve banking and other financial services. While the Agency for Bank Liquidation and Grant Collection (ALCO) was operational, the National Bank of Tajikistan (NBT) has closed down 5 commercial banks not complying with the minimum capital requirements. The assets of these banks were transferred to ALCO. All banks are now required to issue annual audit reports on a regular basis within 120 days following closure of a fiscal year. Four large banks issued/published their audit reports. In order to allow full tax deductibility of loan loss provisions for non-standard loans, to change the basis of the property tax base for banks from net assets to fixed assets (land and buildings), and to preclude tax authorities from freezing accounts without obtaining a prior court order, the Tax Code was amended accordingly during 2001-2002 (see appropriate section of Annex 1 for details). The law “On Collateral” has been amended, replacing the previous 20 percent fee for transferring the ownership of the collateral upon borrower’s default by a simplified schedule based on minimum wages and averaging no more than 3 percent of the value of the claim. The fee was unified for all types of collateral.

<table>
<thead>
<tr>
<th>Private sector development</th>
<th>i. Take measures to improve financial transparency and establish hard budget constraints</th>
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<tbody>
<tr>
<td></td>
<td>ii. Establish an Agency to support the private sector and improve the legal framework for private sector activity</td>
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<tr>
<td></td>
<td>iii. Reduce taxes on the agricultural sector</td>
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</tbody>
</table>

The key public utilities, Tajik Gas\(^{35}\), Tajiktelecom, and Barki Tajik\(^{36}\) have significantly improved collection rates and a large majority of clients are current within 90 days sales equivalent on their payments under threat of disconnection. In late 2001, the government adopted a resolution requiring all budget entities to adequately plan their utility expenditures and not to accumulate utility arrears. After initial delays, the most significant arrears problem, the electricity arrears of the aluminum smelter TADAZ, the largest industrial enterprise in Tajikistan consuming one third of the country’s domestic electricity output, has now been credibly addressed and a pattern of timely payment of electricity bills has been established. In 2002, the Prime Minister approved a time-bound action plan for TADAZ, incorporating measures for financial and operational restructuring, re-capitalization, and technical rehabilitation. In order to implement this action plan, the UK’s Department for International Development has recently agreed to fund outside financial and technical advisors who are expected to take up their work over the next few months. An international independent audit of TADAZ’s 2002 financial statements has been completed and was found to comply with international audit standards (IAS) after an earlier version of the audit had been rejected. The IAS audit of Barki Tojik is scheduled for September 2004 and will be financed by the Asian Development Bank. An audit of Tajik Gas is also hoped to be carried out later this year. To reduce the tax burden in the agricultural sector, the Tax Code was amended to pilot a single farm tax in four districts in August 2002. Manuals on reorganization and privatization of collective and state farms have been published in the mass media and 556 out of 700 state and collective farms have been restructured. However, it is worth pointing out that the extent to which the restructuring of the collective farms has empowered farm workers to improve their incomes varies greatly. Improving the method of farm restructuring and privatization remains a critical challenge for Tajikistan in order to reduce poverty in a country.

\(^{35}\) State—owned Tajik Gas Supply Company

\(^{36}\) State-owned electricity generation and supply company. In 2003 it was integrated into the Ministry of Energy as a department.
where more than half of all domestic employment is in agriculture.

| Privatization, enterprise reforms and farm privatization | i. Accelerate privatization of medium and large enterprises  
ii. Develop a plan to engage the private sector in Tajikistan’s strategic enterprises and adopt a strategy to privatize those enterprises in medium-term  
iii. Take actions towards the improvement of corporate governance in public enterprises  
iv. Upgrade the status of the Land Reform Committee to the equivalent of a ministry, accelerate farm privatization, and enforce procedures that ensure transparency and equitable privatization of farm land | Progress both on farm privatization and enterprise privatization has been made during the SAC2 period. To facilitate farm privatization, the government adopted a resolution in late 2001 reducing the fee for issuance of land use right certificates to USD 6. There have been some reports that local officials add informal payment requests to this official fee, a practice that may not always be easy to control but that needs to be prosecuted vigorously. In order to improve the land-use rights procedure, the budget for the issuing agency has been raised significantly and new technical equipment has been acquired. To date, more than 21,000 land use certificates have been issued to individual farmers and Dehkan farms.\(^{37}\)  
The improvement in court access benefits businesses more widely as the court fee has been lowered to 2 percent of the claim value by Resolution of the government in early 2002. Over 250 medium and large enterprises have been privatized while SAC2 was active. In November 2003, the government adopted a comprehensive and time bound Strategic Plan for the Privatization of Medium and Large Enterprises and the Restructuring of Natural Monopolies and the Largest Enterprises for 2004–2007, covering almost 500 remaining state owned companies. New regulations on the auction and bidding process to implement this plan have been approved by the government in early 2004. Improved bankruptcy and liquidation procedures are being developed that are also required for the implementation of the new privatization strategy. A continued timely and solid implementation of the privatization plan will be critical. |

| Infrastructure reforms | i. Separate regulatory and commercial functions of Tajiktelecom  
ii. Develop a modern telecommunication law that would allow the emergence of a multi-operator industry structure and develop of a privatization plan for Tajiktelecom  
iii. Take steps toward splitting of Tajik Air Company’s organizational structure into three different and separate | The Law “On Telecommunication” was adopted by the parliament on April 10, 2002 and enacted on May 10, 2002. A resolution on the establishment of telecom regulation has been prepared by the Ministry of Communications and was approved by the government in December 2003. Telecommunication sector policy and strategy has been developed. EBRD assistance to: (a) develop a legal framework for separating the regulatory and commercial functions of Tajik Air and Tajik Rail; and (b) develop accounting methodology for separating the revenues and costs of the three divisions of Tajik Air (air company, airports, and flight control services) underway. |

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\(^{37}\) Local appellation of peasant farm.
| business units in order to improve efficiency |  |
Annex 8: Joint IMF-World Bank Debt Sustainability Analysis (Summary)

Tajikistan's risk of debt distress is moderate. Under the baseline scenario, all the external debt burden indicators are below their policy-dependant thresholds, but some of the indicators worsen over time. Several indicators breach their thresholds under various stress tests. Given the high concessionality of the external public and publicly guaranteed debt, debt service payments remain low in terms of revenues and exports, at 14.3 percent and 5.8 percent in 2006, respectively. Implementing the Multilateral Debt Relief Initiative in January 2006, which pertains to Fund debt as of end-2004, would further reduce risk of debt distress and decrease net present value of debt-to-revenues ratio from 128.8 to 113.7 percent.

1. Data and Methodology

This DSA was conducted jointly by Fund and World Bank staff, using the debt sustainability framework for low income countries. It has benefited from Fund and Bank staff consultations with the Ministry of Finance during missions to Dushanbe in September and November 2005, and included reconciliation of the debt data.

Reflecting limited data availability, the DSA focuses on external public and publicly guaranteed debt. Tajikistan has some "disputed" government guaranteed debt from a period prior to 1998, when guarantees were issued in ad hoc manner. This type of debt was not included in the DSA given that terms, conditions, and government repayment obligations were not clear at the time of this analysis. The National Bank of Tajikistan has recently started compiling inventory of external private sector debt not guaranteed by the government. Also, reliable information on domestic public debt is not available, but obtaining it should be a future priority in order to conduct a full debt sustainability analysis. Including information on domestic and "disputed" debt could substantially increase Tajikistan's risk of debt distress.

2. Tajikistan's External Debt Situation at End-2004

Tajikistan's past record points to the authorities' overall strong commitment to meeting their external public and publicly guaranteed debt obligations. Since a large share of loans were providing on a concessional basis, debt service obligations have been manageable. Tajikistan has focused on bilateral negotiations with its main creditors, taking advantage of its strong ties with them.

38 The Low-Income Countries debt sustainability analysis uses (a) the current year exports as denominators or estimating debt-to-exports ratio; (b) the WEO exchange rate projections for estimating debt stocks and debt service; and (c) a 5 percent discount rate.
39 In 1999, the issuance of guarantees was centralized at the Ministry of Finance. The guarantees issued between 1992 and 1998 are estimated to amount to about US48 million.
40 One of the major issues in this area is cotton farm debt.
41 There were several incidences of misreporting on accumulation of external arrears, but the amounts involved were small and stemmed from the authorities' inexperience with external debt management.
42 The 2005 status report on external debt of Tajikistan, prepared by the MOF, provides further information.
Tajikistan's external position has shown a marked improvement from 108 percent of nominal debt-to-GDP ratio at end-2000 to 42 percent at end-2004. This was due to both declines in the level of debt and rapid real GDP growth. The lower level of indebtedness is also the result of improved debt management (such as restrictions on government public and publicly guaranteed non-concessional borrowing) and debt rescheduling, write-offs and debt-asset swaps after successful negotiations with bilateral creditors.

A major breakthrough in Tajikistan's debt consolidation was the debt-asset swap operation of USD242 million with Russia in October 2004. At end-2003, the debt to Russia amounted to USD300 million, carried an interest of 4 percent a year, and constituted almost 30 percent of total external debt. In 2004, a debt write-off of USD13 million was obtained from Pakistan. Following these transactions, the external PPG debt decreased from 66 percent of GDP at end-2003 to 42 percent at end-2004. At the same time, the share of multilateral concessional debt increased from 30 percent of external debt in 2000 to almost 70 percent at end-2004. By end 2004, the debt owed to IDA constituted about 50 percent of the total debt to multilateral creditors.

3. Baseline Scenario

The baseline scenario, developed on a cautious set of assumptions about economic policies and outcomes (Box 1), shows that Tajikistan is at a moderate risk of debt distress. The 2004 World Bank's Country Policy and Institutional Assessment ranks Tajikistan's policies and institutions as those corresponding to a "weak performer." The debt-burden thresholds for countries in this category are (i) net present value of debt-to-exports of goods and services of 100 percent, (ii) net present value of debt-to-GDP of 30 percent, and net present value of debt-to-fiscal revenue of 200 percent. The relevant debt service thresholds are (i) 15 percent of exports of goods and services and (ii) 25 percent of revenues.

All of Tajikistan's external debt burden indicators remain below the policy-dependant thresholds during the projection period under the baseline scenario. The net present value of debt-to-exports of goods and services ratio amounts to 52 percent in 2005, well below the threshold of 100 percent. Following a gradual increase until 2015, due to an assumed accelerated disbursement of public investment project finances, and no new bilateral debt relief agreement, this ratio is projected to decline to 47 percent by 2025. Debt service payments continue to be very manageable, reflecting a rapid repayment of the remaining debt to Russia as well as the fact that all Tajikistan's external public and publicly guaranteed debt has been contracted on concessional terms. However, the net present value of debt-to-GDP ratio converges close to its threshold over the years, underscoring the importance of implementing the relevant structural reforms.
Box 1. Macroeconomic Assumptions

Real GDP grows at about 6 percent until 2010, and at 5 percent between 2011 and 2025. This figure is slightly above its ten-year historical average of 4.2 percent, but well below its five-year (post-Russian crisis) average of 9.7 percent. Growth is driven by exports and expanding nontraditional sectors (services, textile, non-cotton agriculture) as well as continued inflows of remittances.

Exports of goods and services are projected to grow at 6 percent until 2010, when exports of aluminum and cotton, the main export commodities, are low due to declining prices in 2005 and 2006. The authorities have identified sectors other than cotton and aluminum as key for increasing economic diversification, and the forthcoming investment in the energy sector and ongoing structural reforms support this strategy. As the diversification of exports progresses, the export growth increases to 9 percent between 2011 and 2025.

The current account deficit (including official transfers) in terms of GDP is below its ten-year historical average of 5.2 percent by 1.1 percent of GDP between 2005 and 2010, mainly due to a rapid increase of remittances from previously low levels. The current account deficit is projected to gradually decrease further to 2.5 percent of GDP, while the reserve coverage of imports is projected to build up gradually to slightly over 3 months of imports by 2025.

The fiscal stance continues to be appropriately prudent. Due to improved administration, revenues would increase from 18.1 percent of GDP in 2005 to 19.1 in 2010, and further to almost 21 percent by 2025. Expenditures are projected to increase at the same rate, leaving the fiscal deficit unchanged.

Official external loan financing (on concessional terms) is projected to increase from USD105 million in 2006 to USD435 million throughout the projection period (and amount to 4 percent of GDP until 2010 and 4.5 percent thereafter).

External debt indicators relative to government revenues also stay well below the thresholds (Table 2 and Figure 2). The net present value of debt-to-revenue ratio would remain just below 140 percent throughout the projection period, while the associated debt service ratio would exhibit a declining trend (from 14.8 percent in 2005 to 12.3 percent in 2025).

4. Alternative Scenarios and Bound Tests

The historical scenario is based on averages from 1999 to 2004, and thus reflects a period of macroeconomic consolidation, some progress with structural reforms, and debt reduction. 43 Under this scenario, not only all debt burden ratios remain well below the threshold indicators, they also follow a downward trend throughout the projection period. While the conditions of the economy as well as its external environment differ have changed, this scenario illustrates the importance of preserving macroeconomic stability, progress with structural reforms and continued

43 The 1995–98 period has been excluded from historical average scenario due to disruptions associated with civil war and Russian crisis. The average values for the 1999–2004 period are calculated for current account deficit, real GDP growth, GDP deflator in US$, export growth, net transfers and foreign direct investment to GDP ratios.
prudent debt management (negotiations on bilateral and multilateral debt relief as well as keeping restrictions on non-concessional borrowing).

**A relaxation of the authorities' prudent approach to contracting external debt would lead to a substantial deterioration of Tajikistan's external debt indicators.** If new borrowing were to be contracted on less than concessional terms during the projection period, Tajikistan's net present value debt-to-GDP ratio would rise substantially. Specifically, increasing the average interest rate on new disbursement by 2 percentage points would bring the net present value of debt-to-exports ratio to the threshold level of 30 percent in 2011 and to 46 percent by the end of the projection period.

**Bound tests show that adverse macroeconomic shocks would also have a profound negative impact on Tajikistan's external position.** In the event of a combined shock (to real GDP growth, exports growth, FDI inflows), Tajikistan's net present value of debt-to-GDP ratio would rise to 48 percent in 2007, keeping it above the policy-dependent threshold of 30 percent throughout the entire projection period. The same shock would also significantly worsen the public and publicly guaranteed net present value of debt-to-revenues ratio, which would jump up to 260 percent in 2007 and stayed above the threshold of 200 percent until 2022. If FDI were to grow less by one standard deviation in 2006-07, Tajikistan's net present value of debt-to-exports ratio would approach very closely the 100 percent threshold between 2008 and 2012.44

5. **Effects of Multilateral Debt Relief Initiative**

**The Multilateral Debt Relief Initiative debt relief would lower Tajikistan's probability of debt distress in the short and medium term.** In 2006, the relief under the initiative would lower Tajikistan's net present value of debt-to-revenues ratio from 128.8 percent to 113.7 percent, while the debt-to-exports ratio would decrease from 52.3 to 46.2 percent. The debt service-to-exports ratio would decrease from 5.8 percent to 4.5 percent. Regarding the dynamics of net present value of debt-to-GDP ratios, the "MDRI path" would start at lower value in 2006, but converge to the "non-MDRI path" by 2014. Same pattern holds for paths of net present value of debt-to-exports and debt-to-revenues ratios.

VI. **Conclusions**

The main conclusion of the debt sustainability analysis is that Tajikistan's risk of debt distress is moderate.

The results from the alternative scenarios underscore the need for the authorities to maintain sound macroeconomic policies, accelerate structural reforms to achieve higher export growth and enhance output growth. While these measures would reduce Tajikistan's vulnerability to exogenous shocks, staying on sustainable debt path would also require that Tajikistan continues with prudent debt management policies and uses external resources productively.

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44 Since Tajikistan is a small open economy with a high share of exports-to-GDP, the debt-to-revenue indicator is a better measure of debt vulnerabilities.