

INTERNATIONAL DEVELOPMENT ASSOCIATION
AND
INTERNATIONAL MONETARY FUND

REPUBLIC OF TAJIKISTAN

**Joint Staff Advisory Note
On the Poverty Reduction Strategy Paper Progress Report**

Prepared by the Staffs of the International Development Association (IDA)
and the International Monetary Fund (IMF)

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I. OVERVIEW

1. The Tajik authorities have been implementing their Poverty Reduction Strategy (PRS) since late 2002. The Poverty Reduction Strategy Paper (PRSP) was presented to the Boards of IDA and the IMF in November 2002. The first PRSP Annual Progress Report and the accompanying Joint Staff Assessment (JSA) were presented to the Boards in July 2004. The JSA stressed the importance of maintaining prudent macroeconomic management and accelerating structural reforms. The JSA also underscored the need to put fiscal targets into a broader medium-term expenditure framework with detailed costs of social and sectoral programs, to prioritize expenditures, to improve governance, and to broaden consultations with stakeholders.
2. The authorities' second Annual Progress Report ("report") reviews the implementation of the PRS in 2004. This Joint Staff Advisory Note (JSAN) comments on the second Annual Progress Report, discusses the implementation of the PRS to date, reports on how issues raised in the previous JSAs were addressed, and provides advice on how to further strengthen the implementation of the PRS.
3. **The report provides evidence of strong economic performance.** In the second year of implementing their PRS, the government continued to pursue a prudent macroeconomic management strategy, improved budget transparency, and broadened the participation of stakeholders. The government also launched important reforms in social areas, particularly in the health care and education sectors, thereby strengthening the basis for sustained poverty reduction. The report presents the most recent assessment of poverty conditions based on several surveys and provides a candid assessment of progress achieved so far. It also highlights many critical issues that have yet to be addressed, including accelerating structural reforms, improving public sector governance (especially in the area of public administration),

strengthening the process of costing and prioritizing the programs presented in the PRSP, and improving poverty monitoring and analysis.

II. POVERTY DIAGNOSIS

4. **The report presents a comprehensive assessment of the nature and dynamics of poverty from various sources and perspectives and recognizes the challenges ahead for continued progress in reducing the number of people living in poverty.** Tajikistan's strong economic growth in recent years has contributed to a significant reduction of the proportion of the population living below the poverty line of \$2.15 per day (using 2000 purchasing power parity exchange rate) from 81 percent in 1999 to 64 percent in 2003. However, improvements have not been evenly distributed across regions, with cotton growing regions (Gorno Badakhshan and Khatlon) making the least progress.

5. **The report fully acknowledges that the poor quality, reliability, and timeliness of statistics for monitoring progress in poverty reduction are due to the lack of capacity to collect and analyze data and to weak coordination between state agencies.** The staffs are in accord with the report that the quality of statistics is poor, especially social statistics. For example, the education statistics on student enrollment and attendance are unreliable, thus hindering the performance assessment of the education system, given the lack of standard instruments to monitor learning outcomes. Furthermore, official health indicators, such as infant and maternal mortality, fail to account for unregistered births. Given the important role of statistics in monitoring and evaluating progress in poverty reduction, the staffs suggest that the authorities strengthen the capacity of the State Statistical Committee and line ministries to collect and analyze statistics.

III. PRIORITY PUBLIC ACTIONS

A. Macroeconomic Policies and Sustainable Growth

6. **The staffs of IDA and the IMF concur with the report that macroeconomic policies and performance have been strong.** Strong GDP growth (exceeding 10 percent) and declining inflation in 2004 were supported by favorable international prices of cotton and aluminum, increased inflows of remittances, and prudent macroeconomic management. This reflected continued strong fiscal and monetary policies:

- The authorities have maintained a prudent fiscal stance. They managed to increase tax revenues (relative to GDP) while continuing to pursue cautious expenditure policies. The new tax and customs code, drafted in 2004, has since been enacted. This simplified tax regime provides a more transparent basis to administer taxes and improve taxpayers' rights. However, the report acknowledges that while the external public debt was recently successfully reduced, further debt reduction will be needed to ensure fiscal sustainability. In this regard, the staffs suggest that the authorities continue improving debt management capacity.

- The implementation of monetary policy has also been strengthened through stronger coordination between the ministry of finance and the central bank. Nevertheless, the staffs recommend that the authorities broaden the range of monetary policy instruments to establish a stronger foundation for market oriented monetary policy, including through the introduction of marketable securities. The report also notes that confidence in the banking system remains low. The staffs believe that more should be done to address this problem, including by strengthening the supervision of banks and removing restrictions on the entry of foreign banks.

7. **The report highlights risks to growth and poverty reduction resulting from Tajikistan's vulnerability to external shocks.** The staffs agree with the analysis and look forward to greater consideration in the forthcoming PRSP of growth-oriented policies, such as provision of basic infrastructure and public services and improving the business environment, especially for small- and medium-sized enterprises. This should be complemented by continued improvements in public expenditure management and governance, especially civil service reform, improved investment climate and accelerating implementation of structural reforms as highlighted below.

B. Public Expenditure Management

8. **The report underlines improvements in budget management.** These have been achieved through the adoption of a new budget classification system, and the introduction of a computerized budget system for budget preparation and execution. The staffs welcome these improvements but underscore that continued implementation of these measures is a must for improving transparency and budget execution. In this regard, the staffs advise that the government strengthen cash management, modernize the treasury system by integrating central and local treasury offices, and further improve fiscal transparency by publicly disseminating the budget.

9. **The report argues that the establishment of a Budget Commission will enhance control of revenues and expenditures.** The staffs maintain, however, that the Budget Commission only represents an initial step towards improving the link between the budget and government policy priorities. Further effort is necessary to ensure the efficiency of resource allocation towards priority sectors. This would require the unification of all budgets, including all donor-funded public investment programs, the realistic costing of both new and ongoing programs, and the adoption of a medium-term expenditure framework. Such a framework should also include an analysis of external and fiscal sustainability. The progress report should also have provided more guidance on the key parameters of budgetary policy and a macroeconomic framework for the period beyond 2006.

C. Social Sectors

10. **The report notes the poor quality of and limited access to education services despite progress in education reforms.** The reforms include reducing teaching loads, revising the curriculum, increasing teacher salaries and reducing the numbers of education

workers. The staffs concur with the report that education standards are declining, as evidenced by a drop in secondary school attendance rates across regions, and widening disparities between boys and girls in attending school and completing basic education. Looking ahead, the staffs encourage the authorities to deepen the reforms to improve quality and access to education services for both boys and girls. Careful steps should be taken to evaluate the performance of per capita financing in pilot schools before adopting this system nationwide. In this regard, the staffs suggest that the authorities review the current per capita formula, the teaching load system, and the compensation system for teachers and other staff. Further, the emergence of numerous unfilled vacancies, in the staffs' view, is likely due to mismatched skills resulting from the vocational and technical education system that produces graduates with narrow specialization and low capacity to adapt to new demands. The staffs recommend that the authorities identify an affordable and effective solution to eliminate mismatched skills in the labor market by promoting a private sector role in providing training and motivating employers to invest in their employees.

11. The staffs concur with the report's diagnosis of the health sector and advise the authorities to focus on reforming the primary health care system. Poor health outcomes in Tajikistan, including an emergence of malaria and HIV/AIDS and other infectious diseases, reflect the demand for more primary care services. The government recently introduced a basic minimum health package and approved a health financing reform strategy that envisages increased allocations to primary health care, and the introduction of per capita funding and fees for services. In view of limited resources, the staffs advise the government to reallocate resources from hospital to primary health care, introduce a proper job classification system for primary care staff, and relate wage levels to the classification system.

12. The staffs share the report's concern about the inadequacy of funding for education and health care. The levels of public expenditure for education and health care in Tajikistan (2.7 percent and 1 percent of GDP in 2004, respectively) are very low relative to international standards. The low levels of expenditure, combined with continued structural weaknesses in the education and health systems, pose a significant challenge in achieving the MDGs. According to the World Bank report,¹ Tajikistan is unlikely to meet the global MDGs on education and health, especially the MDG on HIV/AIDS and other diseases. The staffs, therefore, support the authorities' view on the need to allocate additional resources to the sectors, within an appropriate macro-fiscal policy framework. The staffs would have also welcomed, more explicit links in the report between the overall poverty reduction strategy and progress in achieving MDGs.

¹ The World Bank, Millennium Development Goals: Progress and Prospects in Europe and Central Asia region, 2005.

D. Private Sector Development, Infrastructure, and Agriculture

13. **The report notes that private sector development faces several challenges due to a difficult business environment and lack of transparency.** The staffs agree that excessive requirements for businesses (registration, licensing, permits, inspections, standardization, and certification) hinder new entries and competition because they increase the cost of doing business and promote rent seeking activities. Consequently, private investment is deterred and job growth is sluggish, thus putting additional pressure on public service provision as well as emigration. The staffs urge the authorities to create an investor-friendly business environment by reducing the number and the types of businesses subject to licensing and reducing the frequency of inspections. In parallel, the authorities are encouraged to further deepen financial sector reform to improve access to financing for the private sector, especially small- and medium-sized enterprises.

14. **The staffs concur with the report on progress made in the privatization of medium-sized and large enterprises.** The number of privatized assets cited in the report is consistent with the target set out in the strategic privatization strategy for medium and large enterprises. However, the staffs caution that challenges remain in improving transparency of the privatization process and restructuring of strategic enterprises. The authorities' intention to undertake a random audit of privatization transactions will improve transparency of the privatization process. Successfully addressing the problems in governance and the business environment will encourage reputable foreign investors to bid for assets, especially related to the large strategic enterprises. Towards this end, the staffs urge the authorities to place high priority on initiating the reform of the aviation sector to bring down the costs and increase the frequency of flights to Tajikistan. This will increase the attractiveness of the country to tourists and foreign investors, and thereby stimulate economic growth.

15. **The report highlights the importance of rehabilitating and constructing infrastructure.** Rehabilitating and constructing the telecommunication network, rural and regional roads, energy systems, water systems (irrigation and drinking water), and school and health facilities are important to promote growth and reduce poverty. As acknowledged in the report, potential sources of domestic and foreign financing of these projects are insufficient. Therefore, the staffs suggest that these projects be better prioritized by carefully conducting cost-benefit analyses and taking into consideration Tajikistan's medium-term fiscal and external sustainability.

16. **The report emphasizes that low agricultural productivity and high farm debt are limiting the contribution of agriculture to the economy, but does not analyze the underlying causes.** According to the report, land reform (farm restructuring and privatization) has progressed relatively well. However, productivity growth and rural incomes remain low due to limited access to agricultural inputs (including modern technology), underdeveloped markets, and the burden of farm debt. In the staffs' view, low agricultural income is caused, in part, by the inefficiency of the chosen approach to farm privatization, based on collective land tenure. The Poverty and Social Impact Analysis (PSIA) supported by the World Bank indicates that a different approach, which would allow

individual households the right to own land, would be more transparent and fair, and would thus lead to higher productivity. In this context, the staffs advise the authorities to focus attention on the design and implementation of measures to further reduce poverty in the cotton regions. Such measures should aim at promoting competition in cotton marketing and improving cotton yields. In particular, revising the farm privatization process would ensure transparency and equality. The staffs also welcome the steps recently taken by the government to identify a mechanism to resolve the debt problem without resorting to government guarantees.

E. Public Sector Reform and Governance

17. **The report fully recognizes the need for broad reform of the public sector.** The low quality of public services is linked to poor institutional capacity, the existence of a centrally-planned management system, and provision of insufficient resources. The staffs agree with the diagnosis in the report and are encouraged that the authorities have established a high level presidential working group to develop a comprehensive and coherent strategy for reforming the public administration, as recommended in the JSA of the first PRSP progress report. The staffs recommend that the authorities continue their efforts in this area by focusing on the rationalization of core economic and social functions of the state administration, reforming the system of public service delivery (addressing problems related to dual subordination of service delivery units), modernizing the civil service management system, and implementing a transparent and merit-based wage system.

18. **The staffs are disappointed that progress in improving other aspects of governance remains limited.** Previous JSAs have stressed the importance of improving public sector governance to support private sector development. Notwithstanding some improvements, the staffs are concerned that progress in many areas has been limited. Regarding transparency of public finance, while the government has taken steps to strengthen the financial audits of public enterprises, the State Financial Control Committee still needs to conduct its activities in a more transparent manner. The dissemination of its quarterly audit reports continues to be limited; detailed reports should also be made readily available to the legislatures. In addition, the government continues to intervene in the activities of state enterprises, especially in the energy sector. As noted in the report, the independence of Barki Tajik has not been restored as recommended by the last JSA, leading to further deterioration of energy infrastructure. The staffs underscore the need to accelerate reforms to improve governance because of its contribution to sustainable growth and poverty reduction.

IV. PARTICIPATION AND MONITORING

19. **Since the last Annual Progress Report, the government has made progress in strengthening public participation and monitoring.** During the past year, the authorities have broadened the consultation process to include stakeholders outside the government. An institutional arrangement for participatory monitoring of the implementation of the PRS has been established consisting of the Economic Consultation Group and the regional PRS monitoring centers. Steps were taken to improve dissemination of information to the public

and consultation with stakeholders. Regarding the proposed set of monitoring indicators, the staffs recommend that the authorities include only a small number of monitorable indicators that can be tracked regularly to ensure that implementation of the PRS can be objectively assessed.

20. **The report highlights weak donor coordination due to differences in donors' approaches and priorities.** The staffs concur with the report but note that progress has varied across sectors. In the agriculture sector, donor coordination has been good, as demonstrated by the efforts of the development partners to assist the government in addressing the farm debt. By contrast, donor coordination in the education sector has been weak due to different approaches adopted by both the government and donors towards education reform (e.g. curriculum development, student assessment, etc.). As a practical step forward, the staffs encourage the government and donors to focus on improving the effectiveness of assistance in the education sector.

V. INSTITUTIONAL ARRANGEMENTS AND TIMETABLE FOR THE SECOND PRSP

21. **The report indicates that the government has taken steps to develop a unified National Development Strategy that provides a strategic framework for the next PRSP.** The authorities have recently established the National Coordination Council with responsibility for formulating the Strategy. The Council, comprising government officials from line ministries and agencies as well as donor representatives, is supported by 12 working groups responsible for development of sector strategies. The staffs welcome the new institutional arrangement led by the Coordination Council. However, the staffs advise that the government further clarify the process, institutional arrangement, and timetable for the development of the next PRSP. They suggest that the authorities complete the PRSP by mid-2006.

VI. CONCLUSION

22. **Overall, the implementation of Tajikistan's poverty reduction strategy during 2004 has been good; however, the staffs underscore the need to accelerate reforms in order to sustain a high economic growth rate and further reduce poverty.** Significant poverty reduction was achieved, reflecting prudent macroeconomic policies and strong economic performance, some progress in implementing structural reforms, a favorable external environment, and strong inflows of remittances. The staffs commend the authorities for their effort to address the shortcomings pointed out in the JSA of the first PRSP Progress Report. Nevertheless, the staffs note that there are several critical areas where reform implementation has been limited and delayed, in particular privatization of land, improvement of the business environment and strengthening of governance. Stepping up the implementation of reforms in these areas could unlock Tajikistan's growth potential.

23. The staffs recommend that future APRs as well as the next PRSP include a description of planned policy actions to address the shortcomings and challenges identified in

this report. To be an effective and credible policy framework for poverty reduction, the staffs recommend that the authorities focus on the following priority areas:

- Accelerating structural reforms, especially land privatization and improving business environment;
- Improving public sector governance, especially public sector management;
- Continuing the development of a clear process of costing and prioritizing the PRS and strengthening the medium-term budget framework, which should underpin the next PRSP;
- Strengthening poverty analysis and monitoring.