

INTERNATIONAL DEVELOPMENT ASSOCIATION
AND
INTERNATIONAL MONETARY FUND

REPUBLIC OF TAJIKISTAN

**Joint Staff Advisory Note on the
Poverty Reduction Strategy for 2007–2009**

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

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I. OVERVIEW

1. **The Government of the Republic of Tajikistan in April 2007 formally approved its Second Poverty Reduction Strategy (PRS 2) for 2007–2009.** Building on the first PRS for 2002–05, the PRS 2 presents the first three-year plan to operationalize the country's long-term development vision laid out in the National Development Strategy (NDS) for 2006–2015. The PRS 2 reflects lessons learned during the implementation of the first PRS. These include strengthening the monitoring and evaluation framework, improving the approach for prioritizing and sequencing interventions, and enhancing coordination of development partner support. The PRS 2 also incorporates key elements of its predecessor, emphasizing prudent macroeconomic management and allocating an increasing share of the budget to the social sectors, while improving the effectiveness of spending.

2. **The PRS 2 presents a comprehensive medium-term program to implement the strategic directions of the NDS: (a) improvement of public administration, (b) promotion of sustained economic growth, and (c) development of human potential.** The overarching PRS 2 objective is to promote sustainable improvements in the living standards of the population, particularly of vulnerable groups. The PRS 2 is organized around three blocks, in line with its key strategic directions: (a) a functional block, covering public administration reform, macroeconomics, investment climate, private sector, regional cooperation and global economic integration; (b) a production block, covering food security, agriculture, infrastructure, energy and industry; and (c) a social block, covering health, education, water and sanitation, housing, and social welfare. The PRS 2 also recognizes several cross-cutting issues, including institutional reforms, demographic change, environmental management, and gender equality.

3. **The PRS 2 addresses the key recommendations of the Joint Staff Advisory Note of the second progress report of the first PRS, dated January 2006.** First, it describes the measures being taken to accelerate structural reforms, including securing land rights and enhancing the business environment. Second, it discusses the actions to improve public sector governance and public sector management, especially through reform of the public administration. However, it would benefit from a much more detailed discussion of steps being taken to reduce corruption. Third, the PRS 2 presents a clear process for costing and prioritizing the PRS 2 and introducing a medium-term budget framework to underpin the strategy. However, more needs to be done to ensure that program costing is realistic and that budget allocations reflect PRS 2 priorities. Fourth, it provides a comprehensive description of how poverty analysis and monitoring will be strengthened over time. A more complete poverty analysis will have to await the collection of better data, as described below.

II. POVERTY ANALYSIS

4. **The PRS 2 provides an incomplete picture on the dynamics and dimensions of poverty in Tajikistan, due to weaknesses in data.** According to the 2003 living standards measurement survey—the most recent such survey conducted in Tajikistan—poverty declined from 83 percent in 1999 to 64 percent in 2003. Extreme poverty was cut by one-half from 36 percent in 1999 to 18 percent in 2003. The decline in poverty was uneven between regions, ranging from a 12 percent drop in poverty in Dushanbe to a 26 percent drop in the Region of Republican Subordination. While more recent survey data are not available, strong economic growth, coupled with high migration and the consequent inflow of remittances to households is likely to have reduced poverty further from 2003 levels. A more detailed analysis and discussion of these issues would strengthen the policy basis for future efforts to reduce poverty. In this regard, the staffs welcome the living standards survey to be completed in 2007, which will provide more insight into the recent poverty dynamics and information needed to analyze important issues, such as food security, functioning of labor markets, the impact of migration on household incomes, access of various income groups to health and education services, and the potential impact on poverty of external price shocks.

5. **Addressing the factors that underlie rising income inequality is vital to ensure that the benefits of growth are widely shared.** Most of Tajikistan's poor people live in rural areas, where incomes have stagnated or fallen since independence, due to an incomplete transition to a more market-oriented agricultural sector. The PRS 2, while noting the need to address rising inequality, does not elaborate on the measures that will be pursued to do so. Such measures would include those aimed at improving the rural economy, including removing barriers that prevent access to credit, land, and other productive resources, strengthening agricultural research and extension services, improving access to public services targeting vulnerable groups, and enhancing labor market flexibility. Focusing public spending on services targeting the poor—including education, health, and basic infrastructural services—are critical to address non-income aspects of poverty. Measures to maximize the benefits of labor migration and remittances for development are also important, as are actions to address child poverty, child labor, and social risks to children related to labor migration of the household head.

III. MACROECONOMIC POLICY FRAMEWORK AND PRS 2 FINANCING

6. **The staffs welcome strong economic growth of the past five years**, supported by prudent macroeconomic management. Real GDP growth averaged about 9 percent during 2002–06 and is expected to remain robust in 2007, at about 7.5 percent, driven by remittance-financed demand in the services and construction sectors. Moreover, the benign external environment, including large workers’ remittances, has led to higher consumption levels and helped to keep the somoni stable. Fiscal performance has strengthened, with the overall fiscal surplus (excluding externally-financed public investment program (PIP)), reaching 0.4 percent of GDP in 2006, aided by expenditure restraint and a surge in tax revenues, mainly from VAT on imports. The improved fiscal position, together with the debt reduction through the Multilateral Debt Relief Initiative and from Russia, helped reduce external public debt to about 30 percent of GDP in 2006. However, inflation, after being on a downward trend, accelerated significantly and reached 12.5 percent in 2006, well above the PRS 2 target inflation rate of 6–7 percent. The inflation rate is expected to remain in double digits in 2007 partly due to the recent increases in world grain and energy prices. The staffs encourage the government to focus on controlling inflation through prudent fiscal and monetary policies.

7. **Continued prudent macroeconomic management and further deepening of structural reforms are needed to maintain high growth rates.** The PRS 2 recognizes that maintaining macroeconomic stability, successfully implementing structural reforms to attract private sector investment, enhancing the efficiency of the public sector, strengthening the financial system, including banking supervision, and addressing long-standing infrastructure needs are necessary to maintain growth. However, more could be done to reduce the high costs of doing business that result from corruption, the weak judiciary, and excessive regulatory activities. More could also be done to deepen reforms of the agricultural sector, accelerate liberalization of the aviation sector, and improve governance by establishing an independent audit function. The staffs therefore urge the government to accelerate reforms in these areas that will provide substantial benefits for the Tajik economy. Moreover, the country’s development strategy involves a rapid accumulation of external debt over the next three to four years. As a result, the external debt-to-GDP ratio is expected to reach 55 percent by end-2009. Staffs believe that such an accumulation of debt has the potential to destabilize the gains from macroeconomic stabilization of recent years.

8. **The current debt-based development approach could have adverse consequences for debt sustainability, and a well-defined debt management strategy is urgently needed.** This strategy should impose cautious limits on the accumulation of new debt—which should be contracted only on concessional terms—and accompanied by appropriate vetting mechanisms to assess the economic benefits of proposed projects. In this regard, any proposed strategy for resolving the issue of cotton debt must be crafted taking into account the external debt situation. With regard to fiscal policy, the PRS 2 targets an overall budget deficit, excluding the PIP, of about 1 percent of GDP. The authorities are projecting a smaller fiscal deficit than staff, but they are premising their revenue projections on overoptimistic nominal income growth projections and uncertain expected improvements in tax administration. It will be essential to maintain a prudent

fiscal stance with expenditures based on realistic revenue projections and limited recourse to central bank financing. In this respect, substantial fiscal resources could be generated by enhancing the efficiency and transparency of the operations of state-owned enterprises, particularly that of the Tajik Aluminum Company. More also needs to be done to control the quasi-fiscal deficit related to the energy sector projected at 9 percent of GDP in 2006, by persevering with raising electricity tariffs, reducing the technical losses of Barki Tajik, and improving collection of tariffs.

9. **Additional measures may be needed to ensure the full implementation of prudent macroeconomic policies.** In particular, against the background of rising inflationary pressures, the staffs recommend that efforts be undertaken to ensure the operational independence of the National Bank of Tajikistan (NBT), including ending the practice of providing directed subsidized credit to specific sectors of the economy and enforcing the legal reserve requirements and prudential ratios. Moreover, the balance sheet of the central bank needs to be strengthened, including through the securitization of the government obligations on the NBT's balance sheet and its recapitalization.

10. **The staffs concur with the plans of the government to introduce a medium-term budget framework (MTBF).** The MTBF should be consistent with the macroeconomic framework underlying the PRS 2, including its broad fiscal objectives, instruments, and assumptions. The MTBF should also include details about the government's plans to allocate more resources to programs targeting the poor and to promote growth, disaggregated into capital expenditures and recurrent expenditures. Actions in the area of budget classification, including a mechanism to monitor poverty reducing expenditure, are also needed. The staffs are also in accord with the measures to strengthen tax and custom administration to generate funds for investment and service delivery. The staffs welcome the opportunity to assist the government in designing its fiscal strategy.

11. **The PRS 2 would benefit from a more complete analysis of the financing requirements and how they are expected to be met.** In this regard it is suggested that the financing framework be improved by providing more detailed coverage of the projected annual financing for both the PIP and other government expenditures broken down by financing source (for example, domestic revenue, domestic borrowing, external borrowing, external partner assistance, foreign direct investment, or other source). Presenting the information in this way will help ensure that the PRS 2 is realistic. Moreover, since not all priority expenditure can be financed by available concessional resources, the staffs recommend to prioritize expenditure and to build in contingency measures, should such financing fall short of expectations.

IV. EQUITY AND POVERTY REDUCTION

A. Institutional environment and governance

12. **The staffs welcome the frank discussion in the PRS 2 of governance problems in the public administration.** The PRS 2 addresses key governance issues, such as (a) corruption at all levels of government; (b) weak public procurement and financial

management systems; (c) heavy involvement of the state in economic activity, which hinders private sector development; (d) complex and untransparent business regulation; and (e) weak protection of property rights. However, capacity and political constraints mean that significantly improving governance will take time and require prioritization and sequencing of reforms. The staffs recommend that the government initially focus on ensuring proper and transparent planning and execution of the annual budget. They also advise empowering one agency that has strong political support to manage the public administration reform agenda.

13. **The staffs agree that poor management of state enterprises results in weak governance and corruption.** Restructuring and modernizing the enterprises will help. Additional measures to improve the functioning of the public enterprises include promoting private sector participation in their management, developing expenditure management and audit systems to effectively monitor and supervise public enterprises, and establishing transparent corporate governance structures.

14. **More needs to be done to improve governance and strengthen transparency and accountability across the public sector.** The PRS 2 is silent on the measures to be taken to improve transparency in public procurement and public financial management systems. The staffs urge the government to elaborate a comprehensive public financial management strategy to underpin a future reform program in this area.

B. Economic growth

15. **The recognition of the importance of private sector development to stimulate growth and poverty reduction is welcome.** The authorities are working on enhancing Tajikistan's investment climate through a range of measures, including through eliminating unnecessary licenses and inspections, cutting the number of mandatory standards and easing certification procedures, strengthening property rights, and improving infrastructural services. However, in spite of those efforts, Tajikistan still ranks only 153 of 178 countries in the Doing Business 2008 of the World Bank/International Finance Corporation. Sustained effort to improve the overall climate for investment is needed if Tajikistan is to attract the private investment expected to finance the PRS 2. The staffs caution the authorities against trying to select specific industries for public investment or for special support. Not only will this require public resources that are needed for delivery of basic services directed at the poor, but this may encourage investment in areas in which Tajikistan has no comparative advantage.

16. **The staffs would appreciate a greater focus on the financial sector and are looking forward to discussing the findings from the recent joint World Bank-IMF Financial Sector Assessment Program.** Financial intermediation and access to finance are low in Tajikistan. The staffs welcome the opportunity to work with the government in strengthening the financial sector through the implementation of the recommendations of the Financial Sector Assessment Program. The staffs are looking forward to further discussing with the government the report and its recommendations.

17. **The staffs support efforts to promote rural development.** The emphasis in the PRS 2 on essential elements for rural development—securing access to land-use rights for small farmers, promoting equal access to land by both men and women, enhancing agricultural research and training, and strengthening financial service providers—is welcome. The staffs urge the authorities to develop a cotton debt resolution strategy in consultation with all relevant parties to facilitate a private resolution to the debt overhang and ensure that public funds are not used to bail out private interests. The authorities should also take measures to minimize the risk of recurrence of this problem—and stimulate rural development in general—by addressing its underlying causes, including land use rights, competition among investors, and inappropriate interventions by government authorities.

18. **Greater focus on the energy sector is timely.** Harnessing Tajikistan’s significant hydropower potential is expected to increase exports and to encourage investment in energy-intensive industries. Reforming the management of Barki Tajik and ensuring the transparency and accountability of operations are critical. As noted in the PRS 2, developing new hydropower facilities are also important. However, the staffs advise the government to carefully evaluate the technical and financial viability of proposed projects to ensure that they generate the expected return on investment.

C. Human development

19. **The staffs welcome the government’s plans to both increase expenditures on education and to improve their effectiveness with the aim of attaining the education Millennium Development Goals (MDGs).** Tajikistan can achieve universal primary education if the government increases public expenditures in education from 4 percent of GDP in 2005 to an average of 4.2 percent of GDP during 2008–10, and improves the effectiveness of expenditures. The planned adoption of per capita financing of education to give schools more choice of how to use resources, the reform of the teacher load (*stavka*) system, and the introduction of the medium-term budget framework for education will help to improve the impact of available resources. However, more needs to be done to ensure access to both primary and secondary school for girls and for children from poor and vulnerable groups. Greater effort also has to be made to improve the quality of education at all levels by enhancing pre-service and in-service training, revising the curriculum, and reforming remuneration packages for teachers.

20. **The increased attention to improving health services is a positive development.** The staffs agree with the authorities’ plans to focus spending on primary health services, an area that has suffered from inadequate funding in the past. They also encourage the government to increase the overall public allocation for health from the 2007 figure of 1.6 percent, which is among the lowest in the region. A strong focus on the outcomes of the spending will also help accelerate progress towards reaching the health MDGs. This will require institutional reforms and further implementation of the government’s health finance strategy, in addition to investment in health physical infrastructure. A comprehensive sector reform strategy would also help clarify and facilitate the implementation of needed reforms.

21. **Improving effectiveness and efficiency of the social welfare system is critical to ensuring that vulnerable groups are adequately protected.** The staffs welcome the emphasis in the PRS 2 on improving the targeting of social benefits. This will require a thorough assessment of the current allocation mechanisms, more effective integration of the existing programs, including those designed to limit the impact of energy price increases on the poor, and careful design of benefits packages. The staffs and other development partners are ready to work with the government in designing and implementing a better integrated and more effective social protection system.

V. PARTICIPATION, MONITORING AND EVALUATION, AND RISKS TO IMPLEMENTATION

22. **The process of preparing the NDS and the PRS 2 has been highly participatory.** Sector working groups comprising government officials, civil society organizations, the private sector, academia, and development partners drafted the NDS. These sector working groups have presented their drafts to a broad range of stakeholders through public forums and regional meetings. Given their strong representation in the NDS drafting process, the nonstate actors played a somewhat lesser role in drafting of the PRS 2 compared with their role in formulating the first PRS.

23. **The PRS 2 includes a comprehensive results framework to measure progress toward key outcomes and objective, but monitoring arrangements remain weak.** The monitoring framework contains more indicators than the government is likely to be able to track during the next three years, especially given weak capacity to collect and analyze data. Moreover, many of the indicators are poorly specified and lack baseline values. In addition, the data collection instruments for many of the indicators are not specified. The staffs welcome the plans for strengthening capacity of the State Statistical Committee, and the statistics offices of the line ministries, local government entities and others for collecting and analyzing data. The staffs working with other development partners stand prepared to assist the government in developing a more useful framework for monitoring the implementation and outcomes of the PRS 2 and to build capacity within the government for monitoring and evaluation.

24. **Successful implementation of the PRS 2 faces risks.** A deterioration of macroeconomic management poses a major risk to successful implementation of the PRS 2. The government's rapid accumulation of external debt has the potential to destabilize the gains from macroeconomic stabilization of recent years, especially if the debt-financed projects generate lower returns than anticipated. The staffs recommend that the government adopts a debt management strategy to mitigate this risk. Poor governance that prevents effective use of resources and discourages private sector investment is another risk. The staffs urge the government to develop and implement a program of reforms in the public financial management area, particularly with implementing the new law on public procurement and with establishing an independent external audit function. The weak capacity of the government to implement and coordinate a comprehensive program to reduce poverty is a risk. The staffs recommend that the government continue with its efforts to create capacity, including through implementation of its public administration reform strategy. Finally, external shocks present risks. Deteriorating terms of trade, political or economic instability in neighboring countries, or a slowdown in the

Russian economy could adversely affect growth and household incomes in Tajikistan. The staffs advise the government to continue to focus on diversifying exports and on strengthening regional cooperation, including on issues of trade and transportation.

VI. CONCLUSIONS AND ISSUES FOR DISCUSSION

25. **The PRS 2 provides a reasonable assessment of Tajikistan's development challenges and the measures required to improve development outcomes.** However, reforms need to be prioritized to ensure that fast progress towards the MDGs and the PRS 2 targets can be made. A stronger monitoring and evaluation system will enable stakeholders to monitor progress towards targets, providing essential information to improve the design and implementation of policies.

26. **A more realistic financing framework, which identifies the likely sources of finance, will help ensure that the PRS 2 is credible.** Attaining the objectives of PRS 2 requires a strategy to underpin macroeconomic stability and promote shared growth. In this context, introducing a well-defined debt management strategy, maintaining a clear focus on inflation accompanied with measures to restore the operational independence of the NBT, and continuing prudent fiscal policies will safeguard debt sustainability and a stable macroeconomic environment.

27. **In addition, addressing the challenges in improving governance is critical to ensure that resources are used as intended to improve development results.** Improving the investment climate through regulatory reform, strengthening of the financial sector, and enhancing infrastructural services will help attract private sector resources for growth and development.

28. **A continued focus on human capital development through better education and healthcare services will help people reach their full potential.** Improved targeting of social benefits will protect the poorest and most vulnerable.

29. **The staffs recommend that the next progress report includes planned actions to address the shortcomings of the PRS 2. The staffs recommend that the authorities focus on:**

- Strengthening the poverty analysis, including collecting updated information on the dynamics of poverty and inequality.
- Specifying actions to ensure that the benefits of growth are widely shared.
- Providing a more detailed discussion of measures to improve governance, including public procurement and financial management.
- Describing the measures being taken to strengthen the planning and budgeting process to ensure that budget allocations reflect priorities of the PRS 2.
- Further strengthening the discussion of structural reforms, especially measures being taken to improve the business climate and to strengthen property rights.

- Highlighting progress with enhancing education and health services and improving mechanisms to protect vulnerable groups.
- Including a detailed debt sustainability analysis.

30. Do Directors agree with the staffs conclusions for (a) areas in which further analysis or adjustments to the PRS 2 are needed, (b) measures for improving its implementation, (c) implementation risks and measures to address them, especially the risks of a debt-based development approach.