

## I. INTRODUCTION

1. **This Country Partnership Strategy (CPS) presents the World Bank Group's (WBG's) strategy for Tajikistan during the period FY10-13.** The CPS is anchored in the government's own national development priorities as expressed in the National Development Strategy (NDS) and Third Poverty Reduction Strategy (PRS III). To increase the effectiveness of the Bank Group program in ensuring sustainable growth and poverty alleviation through fostering private sector growth, the CPS has been prepared jointly by the World Bank (WB) and International Finance Corporation (IFC). The strategy has also benefited from the Bank Group's participation in the ongoing development of a Joint Country Partnership Strategy (JCPS) for coordinated donor support to Tajikistan. It was originally proposed that the CPS would be prepared jointly with several other donors, but after an initial draft and subsequent consultation, JCPS partners decided to focus first on the development of an aid coordination strategy, completed in October 2009. The Bank will work with these partners to align the CPS with the PRS III within the JCPS framework.

2. **The focus of the proposed CPS builds on the lessons learned in implementing the Bank's previous CPS for FY06-09 (Annex 2).** The objectives of the CPS are two-fold: (i) *reducing the negative impact of the crisis on poverty and vulnerability*; and (ii) *paving the way for post-crisis recovery and sustained development*. These two objectives have a common purpose in meeting short-term challenges and supporting a governance agenda to help build credibility and capacity for achieving medium to long term economic growth. Efforts to improve core governance will be mainstreamed across the CPS program in the context of Tajikistan's Country Governance and Anti Corruption (CGAC) strategy (Annex 4). Progress toward expected CPS outcomes will be monitored through a realistic, measurable results framework (Annex 1), and outer-year programming will be defined through a mid-stream CPS Progress Report (CPS PR) in order to maintain program flexibility in an uncertain environment.

## II. COUNTRY CONTEXT

### A. Geography, Population and Politics

3. **Tajikistan is small, land-locked, and 93 percent mountainous, making it one of the least accessible countries in the world.** It is situated 2,000 km away from the nearest port, and high mountains separate it from the Kyrgyz Republic in the northeast, China in the east, and Uzbekistan in the west and north. Its 1,400 km-long southern border is shared with Afghanistan, and the country is separated from Pakistan in the south by the narrow Wakhan corridor. Tajikistan's remoteness, existence of regional physical barriers together with deteriorating Soviet-style transport infrastructure networks and weak governance and regulatory policy frameworks, poses significant barriers to international trade, connectivity and investment.

4. **Tajikistan is vulnerable to natural disasters, external economic conditions and is the poorest country in the Europe and Central Asia (ECA) region.** It is regularly affected by natural disasters such as floods, mudflows, landslides, avalanches, earthquakes, droughts and epidemics due to its geography, topography and climate. Heavy rains in the Spring 2009 claimed

human lives, destroyed villages and arable land. The country is also dependent on key commodity exports; aluminum, cotton, and labor (measured through remittances) accounted for 51.8 percent of GDP in 2008.<sup>1</sup> Severe limitations in employment opportunities in Tajikistan have led a large number of workers (up to 40 percent of the working population) to seek better job prospects overseas—largely in Russia. The resulting dependence on remittances increases vulnerability in the economy and among the Tajik population. Tajikistan's gross national income (GNI) per capita (Atlas method) was estimated at US\$560 in 2008. Its population of 7.3 million is young and growing rapidly, at 2 percent per year during 2000-07. A 2009 Poverty Assessment Update indicated that households with three or more children account for 53 percent of the total population, and 62 percent of the poor population.

**5. The country has been relatively stable since 1997, but decision-making remains centralized and political accountability is limited.** The presidency is the dominant political institution at the national level. President Rahmon, who was elected to a second seven-year term in 2006, is acknowledged for restoring stability after the civil conflict and presiding over a period of strong economic growth. The President's party (People Democratic Party) won 72 percent of the votes in the most recent Parliamentary elections held in February 2010. Political control remains concentrated in the center, and the scope for opposition parties to challenge the government's mandate is limited. The past decade of political stability has provided some breathing space for the government to begin making the difficult transition from a command and control system to a modern government based on democratic principles.

**6. Tajikistan faces diverse and complex geo-political forces.** The country is seen by China, Russia, the European Union (EU) and the United States (US) as an important gatekeeper for peace and stability in Central Asia. China's interests in the region are based on strengthening commercial advantages and maintaining security in border areas. Russia has a long-standing history of involvement in Central Asia and considers maintaining its presence in the area to be strategically important. The EU and the US are interested in preventing the spread of religious extremism, stifling drug trafficking, and countering geo-political threats in the region. Accordingly, the deteriorating security situation in Afghanistan and Pakistan is of increasing concern to Tajikistan and its allies.

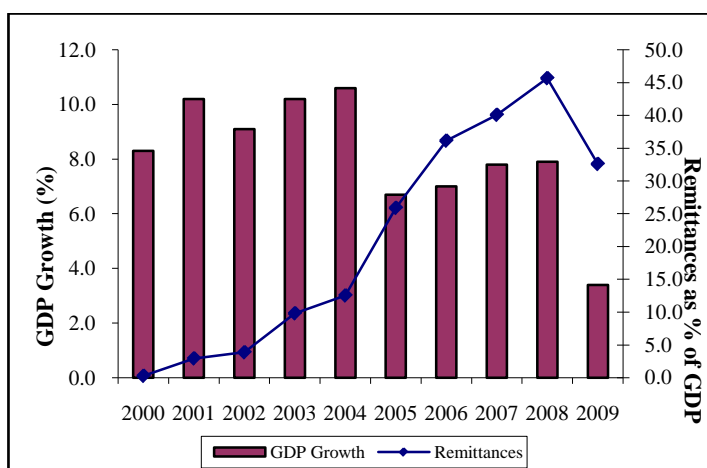
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<sup>1</sup> Government of Tajikistan, State Statistical Committee.

## B. Recent Economic Developments

7. **Soon after the civil war, peace and political stability were restored, and the economy began to register robust growth.** The economy grew at an average of 8.6 percent per year during 2000-2008. This growth was driven mainly by restoration of fiscal discipline and macroeconomic stability which stimulated a recovery of consumption, production and investment facilitated by implementation of some structural reforms to liberalize the economy following the end of conflict, and a favorable external environment.

Figure 1: Tajikistan – GDP growth and Remittances



World prices for cotton and aluminum—Tajikistan’s main export commodities—soared. Rapid growth in Russia and other trading partners boosted demand for Tajik labor. The resulting growth in remittances fuelled a consumption boom in Tajikistan, which helped to support buoyant growth in real GDP during the 2000s. Inflation steadily declined reaching a single digit during 2004-05. The country has also received considerable multilateral financing over these years to finance its basic needs (Figure 1).

8. **Tajikistan has taken steps to improve business environment and delivery of basic services.** The new laws on business inspections and licensing have been adopted and under implementation. The Government has made good progress with the reform of the aviation sector by liberalizing air access, thus enhancing competition and increasing passenger turnover during the past few years. The Tajik Airlines has also been restructured, as a result, new independent companies have been established to transport passengers, operate airports and control air traffic. To improve delivery of basic services, the government has gradually increased social spending for health, education and social protection and implemented per capita financing in health and education on a pilot basis with further scale-up at the national level. The public sector pay system has become more transparent and the government intends to deepen the reforms in this area.

9. **Despite the ongoing structural reform implementation, progress has been slow and uneven.** Macroeconomic management, especially fiscal policy was strengthened under the previous PRGF when fiscal deficits were reduced substantially and domestic financing of the budget was completely eliminated. Reforms of the sectors that represent sources of future growth (agriculture, energy, private and financial sector development, and transport) have been undertaken. Until recently, government’s continued intervention in agricultural production and markets restricted the freedom of farmers to grow whatever crops that were most profitable, and a burdensome cotton farm debt financing schemes have constrained growth in the agriculture. Recently the government with the help of donors has resolved the longstanding cotton debts issue and written off large parts of these debts. This is an important step towards greater farm

freedom and agricultural productivity in the country. Financially nonviable and poorly regulated state-owned enterprises (SOEs) in the energy sector failed to secure a reliable supply of electricity throughout the country, especially in the winter. Quality of business enabling environment has witnessed some improvement due to reforms in legislation to simplify business regulations and entry. This has earned the country a place among the top ten reformers and improved its ranking in the Doing Business Report 2010. There is a need to deepen reforms to improve the business climate and reduce the cost of doing business and minimize risks to investors.

**10. Macroeconomic performance weakened in the mid 2000s due to an increase in external public debt, the quasi-fiscal activities of the central bank and external shocks.** Tajikistan's external debt position has weakened due to increased external borrowing from bilateral creditors (particularly China) to finance large infrastructure projects, although external public debt remains sustainable. The fiscal balance (including the public investment program, PIP) widened to 5.5 percent of GDP in 2008. The quasi-fiscal deficit in the energy sector, though declining, remained high at 10 percent of GDP in 2008. The quasi-fiscal activities of the central bank revealed that the country's central bank, the National Bank of Tajikistan (NBT), had pledged foreign exchange reserves as guarantees for foreign credits to a non-bank financial institution for cotton financing without reporting these activities to the International Monetary Fund (IMF) as required under the Poverty Reduction and Growth Facility (PRGF) for 2002-2006. These developments coincided with supply side shocks that hit the country during the period 2007-2008 through a steep rise in global fuel and food prices, and eroded the macroeconomic indicators. The NBT's international reserves fell below the equivalent of two weeks of imports; the money supply nearly doubled, fueled by expansionary monetary policy and annual average inflation accelerated to 20 percent in 2008. Trade and current account deficits and public debt rose sharply.

**11. To restore macroeconomic stability and the credibility of the NBT and the government, the authorities agreed with the IMF on an economic stabilization program in April 2008.** The Staff Monitored Program (SMP) aimed to rebuild foreign reserves and strengthen governance of the NBT.<sup>2</sup> The government has succeeded in achieving all targets under the IMF SMP. Macroeconomic performance improved in the second half of 2008. The economy grew by a respectable 8 percent despite reduced agricultural (cotton) and industrial output resulting from drought, electricity shortages and decline in the world demand and prices for key export commodities, such as aluminum and cotton. Although the spike in global food and fuel prices in early 2008 exacerbated inflation (which reached 26 percent in June 2008), it subsequently receded to 12 percent by end-December 2008 reflecting relatively effective monetary policy and decline in the global commodity prices. The current account deficit declined to 7.7 percent of GDP as a result of strong remittances inflows (47 percent of GDP), enabling the NBT to accumulate international reserves equivalent to 1.1 months of imports (end-2008). The overall fiscal balance (excluding externally-financed investment) remained in surplus (at 1.4

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<sup>2</sup> The Staff Monitored Program (SMP) measures included the implementation of a special audit of the National Bank of Tajikistan (NBT), strengthening the autonomy and governance of the NBT through the passage of appropriate amendments to the central bank law, and strengthening governance and monitoring of the largest state-owned enterprises (SOEs), including through tenders for external audits of the two largest SOEs (Barki Tajik and Talco) by reputable international firms.

percent of GDP) owing to strict expenditure control combined with buoyant revenues (amounting to 22.1 percent of GDP) reflecting the high nominal GDP and strong import growth. The overall fiscal deficit (including externally-financed investment) slightly declined to 5.5 percent of GDP (down from 6.1 percent 2007) reflecting disbursements of concessional external financing for public investment projects. The stock of public debt declined to 28.9 percent of GDP due to prudent debt policy and strict control on non-concessional borrowing (Table 1).

**12. The government adopted an anti-crisis action plan and agreed with the International Monetary Fund (IMF) on the new Extended Credit Facility (ECF) to reduce the impact of the crisis.** The anti-crisis action plan aims to protect critical social spending (e.g., education, health, social protection), support improved efficiency and quality of public services through targeted increases in public sector wages, and expand employment opportunities through social programs such as a cash-for-work scheme and measures to facilitate entrepreneurship. The government also plans to continue implementing its civil service reform program with the objective of improving the efficiency and the quality of public service delivery. The successful completion of the SMP in April 2009 has paved the way for a new ECF for 2009-2012.<sup>3</sup> The ECF's macroeconomic priorities include: (i) maintaining a modest fiscal deficit, excluding the PIP; (ii) facilitating external adjustment through the exchange rate depreciation; (iii) strengthening monetary policy and banking supervision frameworks; and (iv) building up foreign currency reserves. The ECF's structural reform priorities include: (i) strengthening governance of the NBT; (ii) improving the operational and financial management of large SOEs; and (iii) adopting a strategy to resolve cotton sector debt. Over the course of the program, the IMF is expected to lend US\$116 million, of which about US\$40 million was released in May 2009 after approval of the ECF. An additional US\$40 million is expected to be disbursed in May 2010 upon completion of the first and second reviews. To achieve the overall fiscal deficit target, the authorities are deferring domestically-financed capital spending, continuing only with the highest priority projects.

**13. The global economic crisis has weakened economic performance.** Output growth fell to 3.4 percent in 2009 (although higher than the original forecast of 2 percent) mainly driven by buoyant non-cotton agricultural output. However, a significant reduction in remittances inflows (by 31 percent) caused real per-capita disposable income to contract for the first time in many years. Inflation receded substantially to 5 percent by end-2009. The current account deficit declined to 7.3 percent of GDP due to lowered trade deficit (from 53 percent in 2008 to 39 percent of GDP in 2009). This was driven by lowered prices of imported fuel and food, reduced domestic demand, and by a currency depreciation that increased export competitiveness. As a result, the level of international reserves fell to equivalent of 1.4 months of imports in 2009. Due to slow economic activities and the anti-crisis fiscal measures (lowered VAT and income taxes) to stimulate private sector development, tax revenue fell by 1.1 percent of GDP (from 18.7 percent in 2008 to 17.6 percent in 2009). Budget support from development partners (WB, ADB, and EC) amounting to US\$74 million helped offsetting the impact of revenue shortfall, thus enabling the government to increase social expenditure under the anti-crisis action plan. The overall fiscal balance (excluding externally-financed investment) registered a deficit of 0.5 percent of GDP in 2009 and the overall fiscal deficit (including externally-financed investment)

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<sup>3</sup> The Extended Credit Facility (ECF) replaced the Poverty Reduction and Growth Facility following the entry into force of the IMF Executive Board's decision of July 2009.

slightly declined to 5.4 percent of GDP in 2009. The stock of public debt increased to 33.5 percent of GDP in 2009 (Table 1).

**Table 1: Tajikistan Economic Indicators**

Item	Actual		2008	Estimate	2010	Projection		
	2006	2007		2009		2011	2012	2013
<b>Income and Growth</b>								
GDP per capita (US\$ current)	398	514	696	661	714	773	829	900
GDP growth (% constant prices)	7.0	7.8	7.9	3.4	4.0	5.0	5.0	5.0
<b>Savings and investment</b>								
Investment	13.7	22.9	21.3	18.8	19.4	21.7	21.0	19.2
Gross National Savings	10.9	14.3	13.6	11.5	11.4	12.9	11.9	9.9
<b>Money and Inflation (annual % change)</b>								
Consumer Price Index (period average)	10.0	13.2	20.4	6.5	7.0	8.3	6.7	5.5
Broad Money (growth in percent over 12 months)	63.4	78.8	6.0	34.5	17.4	19.2	19.5	19.5
<b>Government Finance (% of GDP)</b>								
Revenues and Grants	23.6	22.5	22.1	23.3	26.6	25.2	22.7	22.6
Expenditure and Net Lending	21.9	28.6	27.6	28.8	29.1	30.2	28.5	27.3
Overall Fiscal Surplus (Deficit)*	1.7	-6.1	-5.5	-5.4	-2.4	-5.0	-5.9	-4.7
<b>Balance of Payments</b>								
Merchandise Trade Balance (% of GDP)	-35.1	-45.1	-53.0	-38.7	-39.8	-39.5	-39.5	-39.0
Current Account Balance (% of GDP)	-2.8	-8.6	-7.7	-7.3	-8.0	-8.8	-9.1	-9.3
Merchandise Export (\$) Growth (annual % change)	1.2	16.9	12.8	-5.5	7.2	10.0	12.5	10.2
Merchandise Import (\$) Growth (annual % change)	38.0	57.9	45.0	-23.7	10.8	9.8	10.3	10.5
<b>External Payments Indicators</b>								
Gross Official Reserves (\$ million)	111	107	193	347	457	537	607	677
(months of merchandise imports of goods and services)	1.0	0.4	1.1	1.4	1.7	1.7	1.8	1.8
Total PPG External Debt (% of GDP)	32.9	33.7	28.9	33.5	35.3	37.3	38.3	37.1
<b>Memorandum Items</b>								
GDP (current prices, million somoni)	9,272	12,780	17,609	20,623	24,665	29,394	34,568	40,289
Exchange rate (somon/US\$, period average)	3.29	3.44	3.43	4.14	4.48	4.83	5.19	5.45
Population (million)	7.06	7.22	7.37	7.54	7.70	7.87	8.04	8.22

GDP = Gross Domestic Product; PPG = Public and Publicly Guaranteed

\* including Public Investment Program and Grants

*Sources:* IMF (IFS Online; Article IV Staff Report, March 2010; Staff Reports: March 2010, BoP file; IMF and Bank staff calculations.

14. **However, the somoni depreciation is expected to add stress on the banking system.** The recently stress tests carried by IMF staff indicated that banks are vulnerable to a large depreciation of the somoni because debtors with U.S. dollar-denominated loans (about 60 percent of outstanding loans) do not necessarily have foreign exchange income. To help limit the risk of a banking crisis in Tajikistan, the authorities are strengthening the regulatory requirements and intensifying supervision. The priorities are to improve the liquidity position of the banks and to curb the impairment of their assets. With the support of the World Bank and the IMF, the NBT is also drawing up contingency plans for tackling a banking crisis, so that it is not caught unprepared should one materialize.

15. **Under the ECF program, a sound fiscal and monetary program has been agreed for 2010.** The economy is expected to grow by 4 percent in 2010 due to a slow recovery of the global economy. The overall fiscal deficit (excluding the Public Investment Program) is projected to increase from 0.5 percent of GDP in 2009 to 1 percent of GDP in 2010. However, this target and the associated ECF performance criteria for domestic borrowing will be challenging due to a slowly increase in domestic revenue arising from lowered tax rates associated with anti-crisis fiscal measures, a weaker demand for imports and domestic

production. With non-discretionary expenditure on wages and salaries, interest payments, and transfers and subsidies already accounting for 65.8 percent of total budget expenditure in 2010, further spending cuts will have to come from operations and maintenance activities, if additional donor support is not available. The authorities have opted to defer some domestically financed capital spending, but given the ECF target for an overall fiscal deficit, there remains a fiscal gap between available resources and essential spending needs that is expected to be financed through budget support grants from donors.

### **C. Medium-term Outlook and Debt Sustainability**

16. **Tajikistan’s economic prospects are expected to improve over the medium-term, although much depends on the positive confluence of external and domestic factors.** The protracted recession that is currently affecting Russia is expected to begin unwinding by the end of 2010, allowing gradual recovery in Tajikistan. A recovery in demand and trade would support Tajikistan’s exports and employment opportunities (migrant and domestic). At home, successful implementation of the government’s anti-crisis action plan and the ECF—as well as good progress on structural reforms to reduce supply constraints—is expected to contribute to an economic rebound. Increased availability of employment opportunities through facilitating and attracting investment would also help address poverty and food security concerns. Economic recovery would depend in part on the timing, extent and focus of donor support.

17. **Output is expected to recover slowly over the medium-term.** The IMF is projecting an upturn in domestic output of 4 percent in 2010 and 5 percent on average during 2011-2013, though substantial downside risks persist. This is supported by the implementation of structural reforms aimed at removing the most pressing barriers to expansion of productive capacity in agriculture, energy and the private sector as well as increased remittances and investment due to rebounding regional growth. Prudent management of monetary and fiscal policy is expected to keep inflation to single digits and domestic and external balances at sustainable levels. Given a high population growth rate, a small positive growth will not be sufficient to reduce poverty. Growth will need to accelerate to pre-crisis rates to ensure that gains in poverty reduction are not be eroded. Debt sustainability is likely be further challenged by the absorption of cotton sector debt and the associated need to recapitalize the NBT.

18. **Tajikistan can grow and recover over the medium-term only if it addresses the key binding constraint to growth and utilizes its hydropower potential.** A Country Economic Memorandum (CEM) prepared in 2009 found that growth is constrained by a low level of private investment. Medium to long term growth can be achieved through hydropower production, agriculture, small and medium businesses, infrastructure, and labor migration. Raising private investment requires that the government: (a) improve the investment climate and protect property rights in order to attract investment from abroad and thereby meet the large capital expenditure requirements of large investment projects, (b) shift resource away from cotton to food crops and fodder crops for livestock through the removal of restrictions on the “freedom to farm”, the liberalization of land use and agricultural input and output markets, and carefully planned support services for farmers and livestock producers, and (c) alleviate key bottlenecks such as unreliable power supply through institutional and governance reforms to improve generation and distribution systems in the energy sector and increasing tariffs to cost recovery levels. These

actions would be facilitated by efforts to strengthen governance, transparency, and accountability in Tajikistan.

19. **Debt sustainability remains at risk.** In recent years, the government has borrowed increasingly from bilateral creditors, mainly to finance infrastructure projects that aim to support economic growth over the medium-term. Most of the debt stock growth in 2008 resulted from the disbursement of loans from China (over 5 percent of GDP) to finance roads and energy projects (power transmission lines). Though the ratio of private and public sector external debt to GDP improved from 53.6 percent in 2005 to 47.3 percent in 2008,<sup>4</sup> the joint IMF-WB debt sustainability analysis (DSA) conducted in February 2009 shows that Tajikistan’s risk of debt distress remains high; this is also confirmed by a recent DAS update.<sup>5</sup> The deterioration of macroeconomic indicators such as growth and export demand is likely to cause the net present value of debt-to-GDP and debt service-to-exports indicators to breach policy thresholds. Alternative scenarios and stress tests indicate that debt sustainability is vulnerable to adverse macroeconomic shocks such as lower GDP, declining export growth, real exchange rate depreciation, non-concessional borrowing and even an additional debt on concessional terms. This underscores the need for the government to exercise extreme caution in incurring new debt, to carefully vet large-scale investment projects, and to ensure efficient utilization of external resources. Sound macroeconomic policies and acceleration of structural reforms would also be essential to maintain debt sustainability by enhancing growth potential and safeguarding external stability.

#### D. Poverty and Social Developments

20. **Strong growth driven by remittances contributed to impressive progress on poverty reduction in Tajikistan.** According to the 2007 Tajikistan Living Standards Survey (TLSS), and using the poverty line of US\$2.15 per day in Purchasing Power Parity (PPP), the poverty headcount declined from 64 percent in 2003 to 41 percent<sup>6</sup> in 2007. In absolute terms, about 1.35 million Tajiks (of which 1 million

**Table 2: Poverty Headcount, 2003-2007**

(Poverty line: PPP US\$ 2.15)			
	Poverty Headcount (%)	Number of Poor	Population
2003 (actual)			
National	63.5	4,233,341	6,667,510
Urban	59.1	1,066,293	1,804,290
Rural	65.1	3,167,048	4,863,220
2007 (actual)			
National	40.9	2,886,561	7,061,249
Urban	40.3	747,778	1,856,865
Rural	41.1	2,138,783	5,204,564

Source: World Bank estimates based on the 2003 and 2007 TLSS.

<sup>4</sup> Including noticeable improvement in the PPG debt to GDP ratio from 38.8 percent in 2005 to 28.9 percent in 2008.

<sup>5</sup> The recent IMF update of the DSA (April 2010), shows that debt ratios for external debt look significantly better when remittances included into the denominators of the modified debt burden ratios. The vulnerability indicators are substantially lower than previously assessed and remain below their respective thresholds. However, this does not change Tajikistan’s high risk rating, which is based on indicators without accounting for remittances inflows. Debt-to-export ratio significantly exceeds the threshold throughout the projected period, and debt-to-GDP ratio breaches the threshold during 2014-2019, albeit marginally.

<sup>6</sup> This is the expected reduction in poverty between 2003 and 2007 as estimated by the WB using the 2003-2007 economic growth rate (in per capita terms) applied to the 2003 household survey data. Alternatively, based on the absolute poverty line derived from the 2007 TLSS, the poverty headcount declined from 72 percent in 2003 to 54 percent in 2007.

live in rural areas) escaped poverty in recent years, though about 2.9 million remain poor (Table 2). The incidence of extreme poverty<sup>7</sup> declined from 42.1 percent in 2003 to 17.3 percent in 2007, dropping more rapidly in rural areas. The strong growth in remittances between 2003 and 2007 accounts for about half of the observed reduction in poverty.<sup>8</sup> Poverty is mainly a rural phenomenon in Tajikistan, with the rural poor accounting for 75 percent of all poor and 72 percent of the extreme poor (Box 1).

### Box 1: Poverty in Tajikistan

**Poverty in Tajikistan is largely a story of the working poor in the rural sector.** Though employment—especially in non-agriculture sectors—does reduce the risk of poverty, 58 percent of poor people in Tajikistan live in households where the household head is employed. Rural areas account for nearly 80 percent of the working poor, as employment is concentrated in agriculture and related activities. Other characteristics of poor households include three or more children, household heads with limited education, landlessness or ownership of small plots in rural areas, and location at high altitudes.

**Many households in Tajikistan send workers abroad as a poverty-coping strategy.** About 25 percent of households participating in the 2007 TLSS included a migrant worker who was abroad or had returned in the past year. Employment abroad does reduce the risk of poverty, as the total and extreme poverty headcounts (using a cost-of-basic-needs approach) among households with over 20 percent migrant workers were 43 percent and 13 percent, respectively, as compared to 54 percent and 17 percent among households with fewer migrant workers.

**Yet Tajikistan's dependence on remittances is a source of considerable vulnerability.** Scenario analysis based on TLSS data suggests that a 30 percent decline in remittances would increase the national poverty rate by 6 percentage points and inequality by 3 percentage points. This effect would be expected to be stronger in rural areas due to the higher concentration of migrant workers in those areas.

**Non-income dimensions of poverty show limited progress.** Pressure on public service delivery grew significantly after independence due to rapid population growth and reduced public spending. As a result, infrastructure is of poor quality; access to electricity, heating, and safe drinking water is limited; and unofficial payments for services are high and prevalent. The social protection system is rudimentary, dominated by old-age and disability pensions with virtually no social assistance. Together, these factors have constrained access to education and health services, especially for the poorest of the poor in rural areas.

**Food security remains a concern.** Food insecurity is high among the extreme poor and worsens between late winter and early spring. Common coping strategies include reducing the number of meals to two or fewer per day and altering the nature of food consumed. As a result, the poorest quintile of the population consumes fewer than 2,000 calories per person per day on average.

*Source: World Bank. Republic of Tajikistan Poverty Assessment. October 2009.*

21. **The decline in some social indicators has improved.** Social indicators such as school enrollment, infant mortality, and child mortality were poor at the end of the 1990s, as a consequence of the post-independence civil conflict, weak governance and deterioration of public services. As peace and stability took hold, the environment became conducive to the implementation of structural reforms, increased public expenditure, and strengthened social sector management. In time, indicators began to reflect these improvements. School enrollment

<sup>7</sup> Extreme poverty refers to food poverty. It reflects the cost of a typical food basket needed to consume 2,250 calories per person per day with typical needs. The value of this extreme poverty line is equivalent to 89 somoni per month at end-2007 prices.

<sup>8</sup> World Bank. *Republic of Tajikistan Poverty Assessment*. October 2009.

rates increased at all levels of education between 2000 and 2006.<sup>9</sup> The primary completion rate rose from 95 percent in 2000 to 99 percent in 2005. Improved maternal health services, combined with a reduction in poverty, contributed to a significant decline in infant mortality (from 75 per 1,000 live births in 2000 to 56 in 2007). Similarly, child mortality declined from 93 to 68 per 1,000 live births. Gender equality improved, with the ratio of girls to boys enrolled in primary school rising from 93 in 2000 to 95 in 2007.

**22. Despite this important progress, it is unlikely that Tajikistan will achieve its Millennium Development Goals (MDGs) by 2015.** The indicators related to infant mortality (per 1,000 live births), under-five mortality (per 1,000 live births), and maternal mortality (per 100,000 live births) stand at 56, 68, and 97, compared to the 2015 MDG targets of 25, 30, and 30, respectively. The incidence of tuberculosis (TB) and HIV/AIDS has been increasing, and the use of contraception and knowledge of HIV/AIDS prevention remains limited. The percentage of the rural population with access to safe water stood at 55 percent in 2007, compared to a target of 74 percent by 2015. The reasons for this have much to do with the limited financial, institutional, and human resources available to the country to adequately address its basic social challenges. Social sector expenditure remains lower than those prevailing in other Commonwealth of Independent States (CIS) countries due to budget constraints. Despite efforts to improve its social sector, the quality of education and health services remains below Soviet-era levels. A large proportion of the population still has only limited access to basic services. The social safety net system that was established to protect the vulnerable, including the unemployed, is rudimentary.

## **E. Governance**

**23. Development in Tajikistan depends on improvements in the governance.** The civil war took a heavy toll on Tajikistan's institutional and human capacity. Efforts to rebuild that capacity are impeded by specifics of the country's political economy and limited financial resources to upgrade institutions and retrain workers with outdated technical skills to properly manage the transition to a market economy. Capacity limitations constrain the government's effectiveness in designing and implementing programs to achieve priority development objectives. In addition, the political arrangements between the national and sub-national government that are required to keep peace appear to limit the scope of governance reforms.

**24. The government's effectiveness needs to be increased at both national and sector levels.** During the last CPS period, political interference, weak capacity, and lack of transparent institutional arrangements in Tajikistan contributed to critical domestic policy slippages. Uneven progress has been achieved in: (a) resolving long-standing rural reforms,<sup>10</sup> (b) effectively managing macroeconomic policy, (c) addressing successive energy and food price crises, and (d) inspiring confidence in dealing with the impact of the global economic crisis on the Tajik economy. The disruption in energy supplies during the severe winter of 2008 further highlighted

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<sup>9</sup> According to the TLSS, gross pre-primary enrollment increased from 73 to 91 percent, net primary enrollment from 96 to 97 percent, net secondary enrollment from 71 to 80 percent, and gross tertiary enrollment from 14 to 18 percent.

<sup>10</sup> These rural reforms include land restructuring, resolution of the cotton farm debt, freedom-to-farm initiatives, and reduction of state interventions in cotton production and marketing.

the government's inability to overcome low capacity and weak corporate governance among state-owned energy enterprises (especially Barki Tajik and Tajiktransgaz). Increasingly viewed as having limited capacity to manage crises, the government's effectiveness in managing conventional economic duties is also in question as a result of the misuse of public funds (discovered to have been kept completely off-budget) and the belated admission of misreporting to the IMF in 2007.

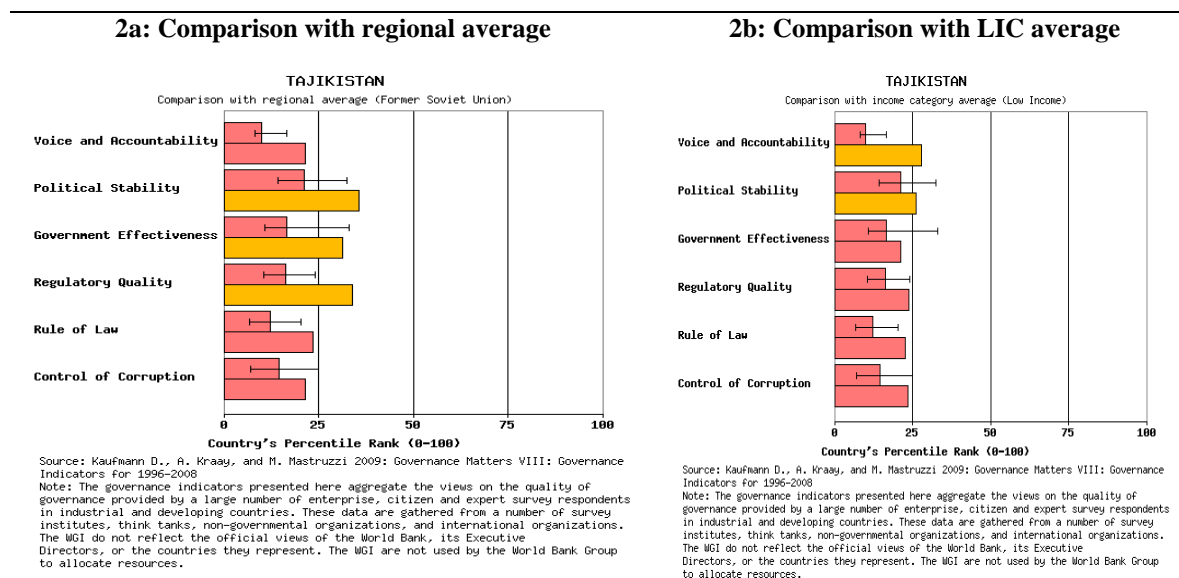
25. **Work is underway to strengthen public financial management (PFM) and public sector performance in Tajikistan.** PFM reforms initiated over the last decade have begun to bear fruit, including the introduction of a partially automated Treasury system, development of a new budget classification system, efforts to strengthen planning and resource allocation in the social sectors, and promulgation of a new procurement law. To strengthen public sector performance more broadly, the government streamlined the structure of central public administration to eliminate excessive fragmentation of institutions, clarify mandates, and strengthen institutional capacity. Civil service reforms have been initiated, including efforts to introduce competitive recruitment and pay linked to job descriptions. A functional review of the administration and delivery of social services has led to the amendment of key legislation and institutional improvements in priority sectors (e.g., streamlining education service delivery and financing, piloting patient fees in health care institutions, introducing policy-based budgeting). Service delivery standards have been designed and institutional changes needed to improve the quality of social services have been initiated.

26. **However, public finance management system needs to be strengthened and transparency and accountability improved to avoid potential risks to public funds.** A 2007 Public Expenditure and Financial Accountability (PEFA) Assessment indicated that the budget process remains fragmented and there are substantial deviations between budget allocations and execution, both in amount and composition. Tracking and control of commitments are not well linked to the procurement function. In March 2007, the government adopted a strategy for improving internal control and established pilot internal audit units in a number of line ministries. Yet internal audit remains weak, focusing more on individual transactions than on systemic issues and effectiveness of public resource use. Development of legal and institutional structures that will support the establishment of an independent external audit institute is ongoing. Accounting does not comply with international standards and is still done manually at all levels except the central treasury, though basic systems of accounting, recording and reporting are in place. There is still no reliable, modern financial management information system to ensure quality and reliability in reporting. In an effort to address these concerns, the government of Tajikistan adopted a comprehensive PFM Reform Strategy for 2009-18 in March 2009 and the Ministry of Finance (MoF) has prepared a more targeted Action Plan for 2009-11.

27. **Cross-country indicators show that tackling governance problems in Tajikistan must become a priority.** Tajikistan has recently improved on the ease of doing business (DB), according to the joint World Bank Group *Doing Business 2010* survey (paragraph 40) and was among the top 10 world reformers. However, the country's ranking remains low at 152<sup>nd</sup> out of 183 countries, as compared to the LIC average of 141. The quality of public administration, as measured in the 2008 Country Policy and Institutional Assessment (CPIA), is stable at 2.5 (out of 6) as compared to the average among IDA borrowers of 2.9. At the same time, the 2008 World Governance Indicators rank Tajikistan in the bottom 15 percent of countries on voice and

accountability, rule of law, and control of corruption, significantly below ECA and LIC averages (Figure 2).

**Figure 2: Governance in Tajikistan, 2008**



Note: Top bar = Tajikistan; Bottom bar = Former Soviet Union

Note: Top bar = Tajikistan; Bottom bar = Low-income countries

Source: Kaufmann, Kraay, and Mastruzzi 2009: Governance Matters VIII: Governance Indicators for 1996-2008.

### III. TAJIKISTAN'S DEVELOPMENT AGENDA AND PRIORITIES

#### A. National Development Agenda

28. **In 2005, Tajikistan adopted the NDS for 2006-2015.** The NDS aims to support the creation of a democratic and prosperous state where the benefits of political and economic development are available to the population as a whole. Key priorities include improving public administration, developing the private sector and attracting investment, and developing human potential.

29. **A follow-up PRS III for 2010-2012 presented a medium-term program to implement the NDS vision, building on the lessons learned under PRS II.** It builds on the overarching objective and strategic building blocks of the PRS II. The PRS III's overarching objective is to promote sustainable improvements in living standards, particularly of vulnerable groups. It maintains the three strategic programming blocks spelled out in the PRS II: (i) a *functional* block on public administration reform, macroeconomics, investment climate, private sector, regional cooperation and global economic integration; (ii) a *production* block on food security, agriculture, infrastructure, energy and industry; and (iii) a *social* block on health, education, water and sanitation, housing, and social welfare. It recognizes several crosscutting issues, including institutional reforms, demographic change, environmental management, and gender equality.