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**Document
of the EurAsEC Anti-Crisis Fund
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Eurasian Development Bank
Resources Manager of the EurAsEC Anti-Crisis Fund

IMPLEMENTATION COMPLETION REPORT

Financial credit to Tajikistan from the EurAsEC Anti-Crisis Fund
In the amount equivalent US\$ 70 million

November 2012

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Republic of Tajikistan
Financial year: 1 January 1- 31 December

NATIONAL CURRENCY EXCHANGE RATE
as of November 21, 2012

Currency	Somoni
1 Euro	6.1454
1 US\$	4.7641
1 Russian Ruble	0.1519

Weights and measures: Metric system

Abbreviations

ACF	EurAsEC Anti-Crisis Fund
ADB	Asian Development Bank
CIS	Commonwealth of Independent States
DFID	Department for International Development, UK
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EDB	Eurasian Development Bank
EDB ACFD	ACF Department of the Eurasian Development Bank
EU	European Union
EurAsEC	Eurasian Economic Community
FC	financial credit
GDP	gross domestic product
GNI	gross national income
IDA	International Development Association
IFO	international financial organization
HPP	Hydroelectric Power Plant
IMF	International Monetary Fund
MDG	Millennium Development Goals
MoF	Ministry of Finance
NBT	National Bank of Tajikistan
PFM	public finance management
PIP	Public Investment Program
PRSP	Poverty Reduction Strategy Paper
RF	Russian Federation
RT	Republic of Tajikistan
SEPD	Social and Economic Policy Division
SOE	state-owned enterprise
STA	single treasury account
TJS	Somoni
UN	United Nations Organization
UNICEF	United Nations Children's Fund
US\$	US dollar
USAID	United States Agency for International Development
WB	World Bank
WHO	World Health Organization

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FINANCIAL CREDIT TO THE REPUBLIC OF TAJIKISTAN FROM THE EURASEC ANTI-CRISIS FUND

KEY CREDIT PARAMETERS, APPROVED BY THE ACF COUNCIL

Recipient	Republic of Tajikistan
Implementing Agency	Ministry of Finance of the Republic of Tajikistan
Credit Size and Main Terms	Amount: US \$70 million; Interest rate: fixed, 1% per annum; Spread over interest base: none; Front-end fee: none; Maturity, including grace period: 20 years; Grace period: 5 years; Co-financing by the recipient: none
Type of Operation	Financial (stabilization) credit
Areas of Support	<ul style="list-style-type: none"> • support budget spending on social sectors (education, health, social protection); • Strengthen public finance management
Key Performance Indicators	<p>State Budget for 2010 ensures the financing of:</p> <ol style="list-style-type: none"> 1. Public health – in the amount of at least 6,1% of total budget expenditures, excluding the Public Investment Program (PIP); 2. Public education – in the amount of at least 17,1% of total budget expenditures (excluding PIP); 3. Social protection – in the amount of at least 16,8% of total budget expenditures (excluding PIP); <p>Tax legislation is enhanced to strengthen tax compliance; Legislative framework for the implementation of internal audit mechanisms in public sector is established; Public access to information on State Budget is improved; Foundation is laid to enhance the capacity and motivation of public servants through salary increases in pilot ministries.</p>
Objective	Maintain budget financing of social sectors, to protect the access of population, especially the poor, to education, health and social protection. This objective will be achieved through strengthening public finance management systems and improvement of the potential of civil servants to implement reforms..
Risks and Risk Mitigation	Risks: (a) weak economic basis and high vulnerability to external shocks; and (b) weak capacity of public administration. To mitigate these risks over medium-term, the EurAsEC Anti-Crisis Fund will support measures that cushion these risks through improvements to business climate and building the capacity of the Government to implement reforms.

Key Findings and Recommendations

1. ***The Agreement on the provision of a financial credit in the amount of US\$ 70 million from the ACF resources between the EDB and Tajikistan was signed on July 24, 2010 in Dushanbe.*** That was based on the decision of the ACF Council meeting, which took place on June 18, 2010 and approved the Appraisal of the Resources' Manager of the EusAsEC Anti-Crisis Fund (hereinafter - the Manager) on Tajikistan's request for the financial credit. The loan was disbursed in one tranche shortly thereafter. Owing to the more favourable than expected economic and fiscal situation, the MoF of Tajikistan used only US\$ 61.5 million of loan proceeds in 2010 fiscal year, while meeting the targets for social sector financing in a satisfactory manner. In 2011, the ACF Council considered and approved the extension of this credit in order to complete the utilization of its resources. The relevant Supplementary Agreement was signed on July 4, 2011.
2. ***The key objective of the financial credit, according to the Credit Agreement dated July 24, 2010, is to maintain social spending share at least at 2009 actual level.*** Besides, the Matrix of Reforms (Attachment 3 of the Report) supported by the ACF financial credit included a range of measures aimed at improving the quality of public finance management, achievement of which was an effectiveness condition for the Credit Agreement. These conditions covered the improvement of tax administration and expansion of the tax base; strengthening control over the use of public funds by developing internal and external audit and improving accessibility of budget information for the civil society; and strengthening incentives for civil servants to implement these reforms by reforming the system of civil service wages.
3. ***In general, the key objective of the credit was achieved – during the period of 2010-2011, the share of social spending in total budget expenditures, excluding the PIP, exceeded the levels set out in the program.*** While the average nominal rate of growth of budget expenditures, excluding PIP and special resources, was at the level of 17% in 2010 and 30% in 2011, spending on social sectors increased by 19% and 26% correspondingly. That enabled an increase of their share in budget spending from 43.6% in 2009 to 44.4% in 2010, but in 2011 their share went down to 43.1%. The most significant rate of growth was observed for the healthcare sector, which led to increase of this sector's share in GDP from 1.4% in 2009 to 1.7% in 2011. Share of expenditures social protection and social welfare in GDP increased only slightly from 3.5% to 3.6%, and the share of expenditures on education dropped from 4.1% to 3.9%.
4. ***The PFM reforms have also progressed to a certain extent over 2011-2012, despite the fact that no further credit agreements were signed between the ACF and Tajikistan.*** Mainly, the reforms supported by the development partners have advanced. The effect of implementing other measures supported by the credit was ambiguous and mainly depended on the degree of international community involvement in supporting the reforms. Besides, some of the reforms supported with the credit, including development of internal and external audit, are of a long-term nature, and the time elapsed since the signing of the ACF Loan Agreement has been too short to see tangible results. Last, but not least, success of PFM reforms depended on reforms in other related sectors. Without the latter, the impact of PFM reforms agreed upon under the ACF Credit Agreement can be lost.
5. ***The targeted use of the credit proceeds has been confirmed by an independent auditor approved by the Manager.*** However, the Manager notes that the MoF was not fully committed to meeting its obligations under the Credit Agreement. While all the procedures related to the administration (required financial reporting and credit servicing) were performed accurately and in a timely manner, there were difficulties with the provision of analytical information. In particular, the Manager had not received the MoF's final report on credit execution by the time of the ACF Council meeting on 7 December 2012.
6. ***According to the reported data currently available to the Manager, all conditions on the share of social spending in total budget expenditures have been met.*** However, according to the independent auditor, the condition related to financing of the social protection and social insurance has not been met. The independent auditor noted in his conclusion that the share of spending to finance this sector was below the targeted level (16.8% of total budget expenditures) by 1 percentage point in 2010 and 0.8 percentage points – in 2011.

7. ***Results achieved in the area of increasing spending on social sectors and reforms in the area of PFM appear to the Manager as quite sustainable in the medium-term.*** According to the Manager's opinion, the sustainability is based on the commitment of Tajikistan's executive authorities to implement the decisions of the President and the Government, as well as on long-term plans of development partners to continue supporting these reforms as the basis for partnership with the country. However, the Manager noted that progress in PFM reforms will likely be slow due to public sector's institutional and staff constraints. From this standpoint, capacity building and improving incentives for the civil service to strengthen public administration remain the key conditions for the success of reforms.

8. ***The success of the Government's efforts to maintain and raise social sector financing to the levels targeted by the Government will, to a large extent, depend on the efficiency of fiscal policies implemented.*** The share of tax revenues in GDP is significantly lower in Tajikistan compared to other countries of the region, including peer countries with comparable GDP per capita. It is primarily due to the complex tax regime, which is lacking in transparency and not conducive to business development, as well as weak tax administration, which results in high tax arrears. The new version of the Tax Code, expected to enter into force in 2013, aims at reducing the number of taxes and simplifying their administration. According to experts' assessment, the new tax regime will result in a certain decline in tax revenues in the short run, but in the medium-term perspective the more favourable tax regime is expected to strengthen investment climate and increase tax revenues. Thus, it will be critical for Tajikistan to ensure both proper functioning of the new tax system and to provide sufficient resources to support the revenue base for the interim period to protect priority spending, including on the social sectors.

9. ***Financing of the social sectors can be raised not only by means of increasing total revenues, but also by redistributing expenditures within the budget.*** In the state budget of Tajikistan, capital expenditures were around 45% of total expenditures in 2011, which was quite atypical for budget systems of transition economies. Over the last decade, the share of the capital budget in GDP had more than doubled— from 5% in 2001 to 12.8% in 2011, while current expenditures increased by only 2.3 percentage point over the same period – from 13.1% to 15.4% of GDP. Against the background of limited domestic resources, it is a factor of crowding out current expenditures. Proper prioritization of budget expenditures will contribute to faster growth of social spending. Measures to streamline all expenditures, in their turn, should be based on the results of reviewing their efficiency, and budget-financed investment projects should be a particular focus of attention. Prioritization and certain consolidation of budget expenditures will become particularly relevant already in the short-term perspective against the background of the expected drop in revenues on adoption of the new Tax Code.

10. ***More vigorous implementation of reforms aimed at optimizing of internal financial flows in the social sectors, improved quality of the services provided and expanded access for the population to services of these sectors also contribute to more efficient utilization of resources.*** The reforms implemented over the last decade in the area of education and health financing have so far demonstrated ambiguous results, often being limited to pilot projects, particularly in healthcare. The social protection system also needs radical improvements through its better targeting and coverage of the vulnerable groups.

Introduction: Key Features of the Republic of Tajikistan

1. ***Tajikistan is a small (6.7 million people) and the poorest CIS country (per capita GNI was US\$ 870 in 2011).*** The country's economy was badly affected by the civil war (1991-1997) and, in spite of the quite fast recovery in the post-war period, it remains poorly diversified and vulnerable to internal, and particularly external shocks, as it heavily depends on remittances from labour migrants, cotton and aluminium exports, and energy sector stability. Further diversification of the economy and development of its export potential are impeded by insufficient development of the private sector and infrastructure, its relative unattractiveness as investment destination, and weak financial sector.

2. ***Low base, favourable external factors, and reforms contributed to high rates of economic growth in the post-war period.*** Implementation of a program of structural reforms aimed at reducing the role of the state in the economy and stimulating private investments, as well as maintaining quite tight monetary and fiscal policies had a positive effect on economic stabilization and ensured sustainable economic growth averaging around 9% in 2001-2011. Favourable development global economic developments, including stable demand for labour of Tajik migrants, and high prices of key exports also contributed to that. Owing to these factors and strengthened international support, the Government has succeeded to significantly reduce and to maintain at an acceptable level its external debt, rather efficiently managed the current account, and raised the share of budget expenditures in the GDP.

3. ***The country's poverty rate remains high, despite achievements in reducing it.*** Close to half of the country's population (45%) belonged to the category of poor in 2011¹, although the share of poor people has gone down by more than a third over the past ten years (it stood at 72% in 2003). High rates of economic growth and significant remittance inflows from Tajik labour migrants in particular, which amounted to practically half of the GDP in the pre-crisis years, were the key factors of poverty reduction. Unlike other countries in the region, where poverty is mainly concentrated in rural areas, poverty in Tajikistan is spread rather evenly over rural and urban areas.

4. ***Efforts of the Government in the area of strengthening public administration and increasing budget spending have improved access of the population to education and healthcare services.*** The school enrolment rate for children under 14 has increased from 88% in 2007 to 95% in 2009. Improved maternity care has contributed to a significant drop in the infant mortality (from 75 per 1,000 live births in 2000 to 34 – in 2010). Child mortality has also gone down – from 93 to 68 per 1,000 live births.

5. ***However, achieving the Millennium Development Goals (MDG) by 2015 remains problematic for Tajikistan.*** The situation with mortality rate, where the gap between the actual rate and the MDG is particularly big, is of special concern. Tuberculosis, malaria, and HIV/AIDS morbidity rates are growing, use of contraceptives and awareness of the HIV/AIDS prevention remain limited. There was a serious poliomyelitis outbreak in recent years. In 2011, the share of rural population with access to drinking water was about 60% (the 2015 MDG is 74%). These gaps arise due to limited financial, institutional, and human resources of the country.

6. ***In spite of the significant increase in public spending on social sectors, it is still far from the level of the early 1990s, and remains among the lowest in the region.*** Over the last decade, budget financing of the social sectors has nearly doubled – from 5.2% of GDP in 2001 to 9.2% of GDP² in 2011. However, Tajikistan's expenditures on education (3.9% of GDP) and health (1.7% of GDP) remain among the lowest in the region. The Poverty Reduction Strategy Paper of the Republic of Tajikistan for 2010-2012 and the relevant medium-term sectoral strategies state that in order to ensure adequate financing of the population's needs for relevant services, budget expenditures on education should be raised in the medium-term up to 6-7% of GDP, and those on health –to 4.4% of GDP.³ This suggests that at the moment these sectors are significantly underfinanced.

7. ***Tajikistan's low revenue base remains a constraint for faster growth of social spending.*** The level of tax revenues to GDP is significantly lower in the country compared to other countries of the region, including those with comparable level of GDP per capita. It is primarily due to complex tax regime, which is lacking in transparency and not conducive to business development, as well as weak tax

¹ According to the RT Ministry of Economic Development, the poverty rate is calculated using the international poverty threshold of US\$ 2.15 at the purchasing power parity (PPP).

² Excluding the Public Investment Program (PIP).

³ According to the *Public Health Strategy*, this level is to be achieved by 2020.

administration, which results in high arrears. In *Doing Business 2012*, Tajikistan ranked 168th among 182 countries by such indicator as taxation, and there have been no improvements in this respect over the last few years. The new version of the Tax Code, to come into force in 2013, aims at reducing the number of taxes and simplifying their administration. According to experts' assessment, the new tax regime will lead to a certain decline in tax revenues in the short run, but the more favourable tax regime is expected to improve the investment climate and increase tax revenues in the medium-term perspective.

8. ***Another constraint for social spending growth is the steady growth of capital expenditures, which currently account for about half of the state budget, which is extremely unusual for budget systems of transition economies.*** Implementation of the Government's plans to strengthen the energy security and improve the infrastructure has caused a significant increase of the investment component of the budget. Capital spending of the state budget has more than doubled over the last decade – from 5% of GDP in 2001 to 12.8% of GDP in 2011. It is partially explained by the launch in 2007 of large investment projects in the energy and road sectors, financed with loans from the Chinese government⁴. But the level of government financing of the investment portfolio is also growing steadily. Since 2005, domestic capital expenditures of the budget have increased from 4.9% to 7.9% of GDP that is mainly related to reconstruction of the Roghun HPP. Against the background of limited domestic resources, these trends serve as a factor of crowding out current expenditures thus constraining growth of social sectors.

9. ***Over the past decade, current expenditures grew at a significantly lower rate.*** In 2011, current expenditures accounted for 15.4% of GDP that is only 2.3 percentage points above the 2001 level, and their share in total expenditures went down from 63% on average in 2001-2007 to 54% in 2011. These resources are distributed practically evenly between three big expenditure items– wages, procurement of goods and services, and current transfers. At the same time, spending on maintenance and recurrent repair are less than 6% of total state budget expenditures (1.6% of GDP). This appears to be extremely insufficient compared to massive on capital investments and raises the issue of sustainability of these capital investments in the medium- and long-term perspective.

⁴ By 2011, a significant part of these loans was disbursed, and the share of capital spending in the budget went down noticeably in 2012.

Credit Objectives and Conditionality

Social and Economic Situation in Tajikistan at Credit Preparation Stage

10. ***Global financial crisis of 2009 impacted the economic situation in Tajikistan through a sharp drop of energy prices and a decline in external demand for exports.*** The drop in oil prices, which resulted in the decline of Russia's GDP by 7.8% and Ruble depreciation by 28%, led to a drop in remittances to Tajikistan by 30% compared to the previous year – from US\$ 2.3 billion (46% of GDP) to US\$ 1.6 billion (33% of GDP). On the other hand, the drop in oil prices also contributed to a decline in import prices, while the decline in remittances reduced demand for imports. Against the background of Somoni depreciation by 21%, this had improved the trade balance despite lower exports⁵.

11. ***The outcomes for 2009 proved to be significantly better than initially expected, although problems in the financial sector deteriorated further.*** Against the background of low world commodity prices, inflation slowed down to 5% compared to 12% in 2008. GDP growth remained positive at 3.4% against 9% during the previous seven years that was primarily related to growth of non-cotton agricultural sectors. The Government undertook a number of anti-crisis measures, including the reduction of VAT rate and devalued the national currency in order to improve competitiveness of the economy. Writing off “cotton debts” of US\$ 550 million and the Somoni depreciation – weakened the balance sheets of NBT and commercial banks, since the share of foreign exchange-denominated loans in their portfolio was at 60%. According to the IMF estimates, the share of non-performing loans doubled within one year, reaching 20% of the loan portfolio by the end of 2009. Thus, the already low capacity of the banking system to provide loans to the weakened economy shrank even further.

12. ***A number of adjustments were also made in 2009 budget to mitigate the impact of the crisis.*** Budget expenditures to finance social sectors increased, including the anti-crisis social programs to promote employment of the population. Compared to 2008, budget expenditures on these sectors increased from 7.6% of GDP to 9% of GDP. At the same time, expenditures on other, lower priority budget items, including capital spending against the PIP, were reduced. Grant assistance from development partners more than doubled, reaching 2.2% of GDP. However, total budget revenues went down by 2.5 percentage points. It was mainly due to a shortfall in VAT owing to reduced imports, duties on which constitute one third of tax revenues, as well as lower VAT rate, which was brought down from 20 to 18% in the second half of the year. As a result, the budget deficit (excluding the PIP) reached 3.1% of GDP⁶ (against a surplus experienced since the beginning of the 2000s).

13. ***At the beginning of 2010, the fiscal position remained highly unsustainable despite the steady recovery of the economy.*** It was mainly due to the disruption of railway links with Uzbekistan. Lower imports caused a shortfall in tax revenues of 20% for four months against the approved budget. The actual budget deficit in 1st quarter of 2010 (excluding the PIP) was at the level of 4.5% of GDP. Quasi-fiscal risks related to the weakness of the banking system and state-owned enterprises, which had significant tax arrears, also remained serious. Lack of certainty in revenue collection and increased expenditure commitments—*inter alia*, in connection with implementation of Anti-Crisis Program measures—were the primary factors for the Government of Tajikistan to request a budget support from credit from the EurAsEC Anti-Crisis Fund (ACF).

Key Targets and Reforms Supported with the ACF Credit

14. ***In March, 2010, the Government of Tajikistan requested a financial (stabilization) credit from the ACF (hereinafter referred to as the Credit) of US\$ 90 million⁷.*** The requested amount was substantiated by the lack of funds in the 2010 state budget to implement the Anti-Crisis (Stabilization)

⁵ Exports of goods went down by 13% as a result of lower prices and demand for aluminum and cotton.

⁶ All budget indicators are calculated based on the reports from the RT MoF. According to the IMF data, the RT budget deficit (excluding PIP) was 0.5% of GDP in 2009. The difference between these indicators is due to adjustments made by IMF experts based on additional primary data that shows that budget reports are, at the very least, inaccurate.

⁷ Letter of the RT Minister of Finance # 2-1(b)-4/454 dated March 16, 2010.

Program measures⁸ covering the expansion of social spending in order to mitigate the impact of the global crisis.

15. ***The Request was considered and assessed by the Manager in accordance with the requirements of the ACF policies and procedures***⁹. In particular, the Manager performed appraisal of the Request from the point of view of its consistency with the objectives of the ACF activities, directions for provision of financing, the procedure and terms for ACF resource provision, priority and efficiency of financing, quality of the Request, and other aspects. Governments of other ACF member states and key IFIs confirmed that the Applicant had no outstanding external debt service arrears.

16. ***During the appraisal, the Manager concluded that the Request was consistent with the Fund's objectives and recommended the following to the ACF Council:***

- Based on Tajikistan's limit in ACF (US\$ 170.26 million), the analysis of budget needs for 2010 and the medium-term perspective, and taking into account the prospects of investment cooperation of Tajikistan with the ACF, *to set the credit size at US\$ 70 million;*
- Taking into account the severity of the problem with underfinanced social sectors (education, healthcare, and social protection) in the country and the risk of further cuts in their financing in crisis years, *to set out maintaining levels of social spending at least at 2009 actual level as the key objective of the financial credit;*
- In the interests of long-term sustainability and improved efficiency of the budget system in general, *to support with the requested credit a range of reforms in the area of public finance management (PFM) and civil service capacity-building.* These reforms are components of the Public Finance Management Strategy for 2009-2018 and of the Public Administration System Reform Strategy for 2005-2015¹⁰.
- In the framework of medium-term cooperation with Tajikistan, to present these reforms in the context of their development over the medium-term period as a basis for potential follow-up financial credits.

17. ***When identifying the reforms to be supported with the Credit, the Manager took into account the current institutional capacity of RT ministries and agencies.*** The Matrix included only those reforms, which were close to completion and implemented with foreign technical assistance:

- Improving budget revenues by taking measures aimed at strengthening tax administration and expanding tax base;
- Improving efficiency of budget resource use through developing internal and external audit and better access of the civil society to budget information;
- Reforming the system of civil service wages (raising wages, which is critical due to their very low level; streamlining the wage structure in the civil service as a whole; and making wages consistent with the work functions performed).

18. ***Implementation of the first-year reforms was a precondition for credit disbursement.*** The status of reform implementation on the date of the Agreement's effectiveness is presented in the List of Prior Conditions below. A complete list of medium-term reforms in the form of the Matrix approved by the ACF Council is found at Annex 3 to this report.

⁸ Approved by Resolution of the RT Government # 231 dated April 29, 2009.

⁹ Including the Treaty establishing the EurAsEC Anti-Crisis Fund, the Statute of the EurAsEC Anti-crisis Fund, and the Regulation on the use of ACF funds for Providing Financial Credits.

¹⁰ Approved by the President of Tajikistan on March 20, 2009 and March 15, 2005, correspondingly.

List of Preconditions for the Effectiveness of the ACF Credit

Effectiveness Conditions for the 2010 FC Agreement	Implementation Status at Effectiveness	Comments of the Manager
Approved budget for the health sector is at least 6.1% of total state budget expenditures in 2010 (excluding the PIP budget).	Under Law <i>On the State Budget of the Republic of Tajikistan for 2010</i> # 561 dated November 14, 2009, the approved health sector budget (including the PIP and special resources) was TJS 403.9 million, including budget funds in the amount of TJS 330.6 million (6.5% of total state budget resources).	According to the information on state budget execution for January-June 2010 provided by the MoF, there were delays in execution of health sector financing (the revised half-year plan execution was at 88.8%).
Approved budget for the education sector is at least 17.1% of total state budget expenditures in 2010 (excluding the PIP budget).	Under Law <i>On the State Budget of the Republic of Tajikistan for 2010</i> # 561 dated November 14, 2009, the approved education sector budget (including the PIP and special resources) was TJS 1,068.3 million, including budget funds in the amount of TJS 901.1 million (17.8% of total state budget resources).	According to the information on state budget execution for January-June 2010 provided by the MoF, there were delays in execution of education sector financing (the revised half-year plan execution was at 87.8%).
Approved budget for the social protection sector is at least 16.8% of total state budget expenditures in 2010 (excluding the PIP budget).	Under Law <i>On the State Budget of the Republic of Tajikistan for 2010</i> # 561 dated November 14, 2009, the approved social protection sector budget (including the PIP and special resources) was TJS 1,061.8 million, including budget funds in the amount of TJS 1,008.6 million (20.0% of total state budget resources).	According to the information on state budget execution for January-June 2010 provided by the MoF, there were significant delays in execution of education financing (the revised half-year plan execution was at 84.5%).
Changes to the tax laws concerning the indisputable collection of tax arrears.	By RT Law # 493 dated March 26, 2009 <i>On Amendments to the Tax Code of the Republic of Tajikistan</i> , Articles 92 and 94 of the Tax Code concerning indisputable collection of tax arrears were amended.	In spite of amendments to the Tax Code aimed at simplifying extra-judicial collection of tax arrears of economic entities, those arrears grew steadily—at least in 2010. According to the Manager's experts, it is explained by a range of factors, including: (1) insufficiently clear description of the extra-judicial mechanism of tax arrears collection in the Tax Code and (2) systemic problems in tax administration and state-owned enterprise management (taking into account that the largest non-payers are, as a rule, state-owned enterprises).
Publication of a full list of tax exemptions for enterprises/goods.	The Tax Committee website published the Tax Code with a list of existing tax exemptions.	Inefficient tax legislation, including large number of tax exemptions, is seen by the Government as one of the key problems weakening budget revenues. Thus, the Government initiated efforts to revise tax exemptions with the purpose of subsequent elimination of at least some of them. In particular, this intention is reflected in the Conceptual Framework of Post-Crisis Measures for 2010 approved by a resolution of the Government of Tajikistan. To revise and estimate the cost of tax exemptions, a working group was created with the task of completing the effort and publishing the list of exemptions by end-2010. In its Memorandum of Economic and Financial Policies for 2009-2012 agreed with the IMF, the Government committed itself to include this list and estimated cost of such exemptions into the budget for 2011 as a first step to implement more ambitious reform of the system of tax exemptions.
Government approval of the draft Law <i>On External Audit</i> .	The draft Law <i>On External Audit</i> was endorsed by the Government and submitted for the consideration of the Parliament of Tajikistan.	In the medium-term, establishment of external audit institutions will have a positive effect on improving the efficiency of utilization of public

Effectiveness Conditions for the 2010 FC Agreement	Implementation Status at Effectiveness	Comments of the Manager
		resources.
Adoption by the Parliament of the Laws <i>On Internal Audit in the Public Sector</i> and <i>On Financial Management and Internal Control in the Public Sector</i> .	Law <i>On Internal Audit in the Public Sector</i> # 631 was adopted by the Parliament and signed by the President on July 21, 2010. Law <i>On Financial Management and Internal Control in the Public Sector</i> # 626 was adopted by the Parliament and signed by the President on July 21, 2010.	Introduction of internal financial control and audit in the public sector in Tajikistan is supported by the European Commission. By now, the MoF has established the Division for Centralized Harmonization of Financial Management, Control, and Internal Audit; internal audit departments have been established at the Ministries of Labour and Social Protection, Education, Healthcare, and Agriculture; training for internal auditors has been conducted. After the laws were adopted, steps have been taken to develop guidelines and regulations. International experience shows that strengthening internal control and audit requires certain time and political commitment. Besides, an important factor for strengthening the demand for the services of internal audit is the presence of strong and independent external audit.
Publication on the MOF's official website, at least, of the <i>Law On State Budget for 2010</i> and the Treasury report on budget execution for January-March of 2010.	Both documents were posted on the MoF's website.	The design and structure of the MoF's website need certain improvement and systematization of documents posted on it, to make access of users to required information easier. Besides, information and documents need to be updated faster.
Adoption by the Government of a resolution approving the new wage grid for civil service and piloting it for 5 government agencies.	Paragraph 39 of the Government Resolution # 203 dated May 3, 2010 sets 2010 as the start year for the transition to the new wage grid for civil service wages.	For the past three years, the Government has been developing the regulatory and legal framework for the new civil service wage structure with the World Bank assistance. . This Financial Credit supports the reforms which aim to introduce a new wage grid for civil service, which envisages raising the average level of wages, linking them better with the work performed, and unifying wage structure in all government agencies, which will help control the overall wage bill and improve the accuracy of its calculation. Improvements in the quality and capacity of the civil service are expected to be achieved in the medium-term perspective, provided that a number of other civil service reforms are implemented simultaneously, including improvements in human resource management, increased responsibility for quality of public services provided, streamlining civil service functions, etc. Due to unfavourable situation with budget revenues, the Government has repeatedly postponed the start of piloting the new wage grid in 2010, but this pilot project is expected to be launched in Q4 2010.

19. ***The Agreement on the provision of a financial credit in the amount of US\$ 70 million from the ACF resources between the EDB and Tajikistan was signed on July 24, 2010 in Dushanbe.*** That was based on the decision of the ACF Council meeting, which took place on June 18, 2010¹¹ and approved the Conclusion of the Manager on Tajikistan's request for the financial credit. Owing to the more favourable than expected economic and fiscal situation, the MoF of Tajikistan used only US\$ 61.5 million of the loan proceeds in the 2010 fiscal year, while meeting the targets for social sector financing in a satisfactory manner¹².

20. ***In 2011, the ACF Council considered and approved extension of the credit for the period of complete resource utilization.*** On the Borrower's request, on June 4, 2011 the ACF Council approved the decision to grant Tajikistan a possibility to utilize the remaining US\$ 8.5 million of the financial credit until the end of 2011. The relevant Supplementary Agreement was signed on July 4, 2011.

Key Results of the Credit Utilization

Social and Economic Development of the Republic of Tajikistan in 2010-2011

21. ***The factors contributing to the quite fast recovery of economic growth in the aftermath of the 2009 crisis included renewed inflow of remittances of labour migrants, favourable prices for exported goods¹³, as well as growing volumes of public investment.*** The GDP growth was 6.5% in 2010 against 3.9% in 2009, and in 2011 it reached 7.5%. The key source of growth was the service sector stimulated by the renewed inflow of labour migrants' remittances in the aftermath of the global crisis¹⁴. Remittances amounted to about US\$ 2.4 billion in 2010 (41% of GDP) and US\$ 3 billion (45% of GDP) in 2011. Most of the remittances, as well as increase in monetary incomes of the population due to increased average economy-wide wages¹⁵ were used for domestic consumption¹⁶. Stabilization in the supply of energy, generation of which grew by 5% in 2010, had a positive multiplication effect for other industrial sectors. Positive developments were observed both in mining and processing industries.

22. ***Fixed capital investments grew by 11.5% in 2010 and by 5% in 2011.*** That was mainly related to the resumption of reconstruction works on the Rogun HPP and the recovery of remittances. In January-July 2012 investments in the energy sector continued growing and increased by 15% compared to the same period of 2011, while investments in other sectors dropped by 38%.

23. ***Economic growth and some improvement in tax administration strengthened the country's budget position.*** The actual budget revenues in 2011 were 6 percentage points above their level in 2009, reaching 25.8% of GDP, while taxes increased from 15.7% of GDP to 19.6% of GDP. The buoyancy ratios of taxes have improved. While in the pre-crisis period 1% of GDP growth generated tax growth of 1.2%, the buoyancy ratios in 2010-2011 were correspondingly 1.9% and 1.5%. Since the structure of the economy and tax rates did not change during that period, it can be assumed that the tax administration improved somewhat in the post-crisis period.

24. ***In 2010-2011, there were no significant changes in Tajikistan's budget expenditures compared to 2009.*** In 2011, the level of general expenditures was 0.9 percentage points above the level of the 2009 crisis year, and reached 28.5% of GDP. There were no particular changes in the expenditure composition: over 40% of total expenditures were used for capital construction, but in 2011 this share went up to 45% (against 44% in 2009 and 41% in 2010). The share of own resources of the Government in capital expenditures financing was already above 62%. Against the background of unchanged expenditures, the budget deficit (excluding the PIP) went down in 2010 to 0.4% of GDP, and there was a surplus of 0.4% of GDP in 2011. Transition to a budget surplus allowed stopping the depletion of government deposits that were used to finance budget deficits in previous years. According to IMF staff, the level of such deposits

¹¹ The complete text of the Conclusion of the Manager on the request of the Republic of Tajikistan for the ACF credit is available on the ACF website at: http://acf.eabr.org/media/img/rus/project/zy_tjk.pdf.

¹² According to the reports currently available to the Manager, all the conditions on the share of social spending in total budget expenditures have been met.

¹³ In 2010, the cotton and aluminum prices grew on average by 29 and 78%, correspondingly.

¹⁴ Under the influence of renewed growth in the Russian Federation on average by 4.3% in 2010-2011.

¹⁵ In nominal terms, wages increased in 2010 by nearly 23.2%, in 2011– by 25.8%. Real wages growth was 15.8% in 2010 and 16.4% in 2011.

¹⁶ The retail turnover grew by 9.5% in 2010 and by 8.9% in 2011.

went down from 30% of annual revenues in 2008 to 11% in 2011.

25. ***The pattern of inflation in Tajikistan in 2010-2011 was largely determined by the level of prices in international markets.*** As a result of growth in international prices for important food items such as wheat, sugar, and vegetable oil, as well as owing to seasonal pick up in prices for fruits, vegetables, meat, and dairy products, price growth accelerated in the second half of 2010, which led to the inflation at 9.8% for the full year¹⁷. Besides, due to the rise in international oil prices and changes in the terms of trade in fuel and lubricants, domestic prices for petroleum, oil, and lubricants increased by more than 30% in 2010. This impacted the level of prices of many types of goods and products. The same factors also determined the level of prices in 2011, when inflation was 9.3%. Stabilization of world prices for food and energy by the end of 2011 had a direct effect on 2012 prices. Consumer price index was 102.9% for the first seven months of the year, while food prices grew by only 1.4%. However, the current resumption of food price growth owing to droughts in many regions of the world give grounds to expect that inflation will pick up in the second half of 2012.

26. ***Monetary policies of the National Bank of Tajikistan during the past period were quite tight, but their efficiency was limited by weak financial markets, low level of monetization of the economy¹⁸, high rate of dollarization, and continued directed lending.*** Against the background of high risks in the banking system, efforts of the NBT to bring down monetary inflation had varying success. The increase of refinancing rates in October 2010 and March 2011 was accompanied by a slow-down of monetary inflation to 3-5%. But funding banks resulted in acceleration of 12-month broad money growth beyond 50% after March 2011. By mid-year, inflation went back to the 7% level.

27. ***The external position of Tajikistan somewhat deteriorated in 2011 owing to a sharp drop in export volumes.*** The current account surplus of 2.1% of GDP registered in 2010 was replaced with a deficit of 2.3% of GDP. Export of goods and services declined by half compared to 2010, constituting 8.1% of GDP due to a drop in sales of both cotton and aluminium. Growth in imports due to higher food and energy prices was offset to some degree by cuts in the volumes of fuel imports from Russia after it hiked fuel prices, as well as higher labour migrants' remittances, which increased by 34%. As a result, Somoni exchange rate vis-à-vis US dollar remained quite stable during 2011 that enabled the NBT to somewhat replenish its international reserves by the end of 2011.

28. ***Risks to the country's debt sustainability persist, especially in the light of limited domestic resources, depletion of government deposits, and frequent external shocks.*** Despite certain decline in the government debt burden from 34% of GDP in 2009 to 32% of GDP at end-2011, as well as highly concessional nature of government external debt, the IMF and WB assess the risk of losing the sustainability of the government's debt position as high. The IFIs see lowering export revenues and growing trade imbalance as the key sources of risks to debt sustainability. Remittances play the role of the debt burden stabilizer; thus, they should be seen as one of the key determinants of economic development for the medium-term perspective. On the other hand, remittances are highly vulnerable to external shocks and this creates high risks. From this standpoint, more prudent debt policies and development of own diversified economic base is a more preferred option for the country's development.

Performance under the Program

29. ***The Credit Agreement sets out maintaining social spending at least at the 2009 actual levels as the key objective of the financial credit.*** Besides, the Matrix of Reforms supported by the ACF financial credit included a range of measures aimed at improving the quality of public finance management, and their implementation was an effectiveness condition for the Credit Agreement. These conditions covered improvement of tax administration and expansion of the tax base; strengthening control over the use of public funds by developing internal and external audit and improving accessibility of budget information for the civil society; and strengthening incentives for civil servants to implement these reforms by raising their wages.

30. ***In general, the key objective of the credit was achieved – over the period of 2010-2011, the share of social spending in total budget expenditures, excluding the PIP, exceeded the floors set out in the program.*** As to PFM reforms supported with the credit, there was also some progress in 2011-2012,

¹⁷ Of which for food stuffs – by 13.4%, non-food – by 5.5%, and for services – by 4%.

¹⁸ The ratio of broad money to GDP was 21% in December 2010.

even in the absence of follow-up credit agreements between Tajikistan and the ACF. Progress was mainly observed in the part of reforms supported by the donor community.

31. ***Social sector spending increased during the credit program years by 0.2 percentage points (from 9% of GDP in 2009 to 9.2% of GDP in 2011).*** However, growth of spending by sectors was uneven. While the average nominal rate of growth of budget financing, excluding the PIP and special resources, was at the level of 17% in 2010 and 30% in 2011, spending on social sectors correspondingly increased by 19% and 26%. The most significant rate of growth was that for the healthcare sector financing, while spending on education and social protection grew at a more moderate rate. As a result, the share of expenditures on healthcare in GDP increased by 0.3 percentage points, that of expenditures on social protection and social welfare – by 0.1 percentage points, and the share of expenditures on education dropped by 0.2 percentage points.

32. ***In spite of the increase of social sector financing, its level is still far from the Government's goals.*** The Poverty Reduction Strategy Paper of the Republic of Tajikistan for 2010-2012 and the relevant medium-term sectoral strategies state that to ensure adequate financing of the needs of the population for relevant services, budget expenditures on education should be raised in the medium-term perspective to 6-7% of GDP, and those on health –to 4.4% of GDP¹⁹. This suggests that at the moment these sectors are significantly underfinanced.

33. ***Progress in reforming the system of social sector financing, which could promote more efficient utilization of available resources, was not as fast as planned.*** The substance of healthcare reforms is to redirect financial flows from the tertiary (specialized centres) and secondary (hospitals) levels to the primary one (outpatient clinics and public healthcare), and to introduce new systems of output-based financing. In the framework of these reforms, a number of innovations have been introduced over the last decade, including transition to per capita financing at the primary level, implementation of formal co-payments by patients for diagnostic services, as well as introduction of the concept of a guaranteed service package. But in many instances these elements are just tested in pilot regions, and have no significant influence on the efficiency of resource utilization. Besides, higher financing of this sector is mainly related to the increase in wages to employees of this sector, while its facilities remain at an unsatisfactory level, which negatively impacts the quality of services provided.

34. ***In the education sector, the implementation of structural reform is somewhat faster.*** In 2010, all schools in the country switched to per capita financing that—according to statistics—increased efficiency of resource utilization owing to a link between the financing envelope and the number of students, optimized student-teacher ratio, and some unification of school financing in different regions. The new system of financing generated reduction in the share of wage-related expenditures in the sector, freeing some resources to finance the training process, although in rural areas wage-related expenditures are still very high, exceeding 85% of total spending²⁰. However, there are still many problems in the sector, which are related to insufficient qualification of teachers, especially in rural areas, unsatisfactory condition of school buildings, and poor facilities.

35. ***In the sector of social protection and social insurance of the population, reforms to improve efficiency of the state support are yet at the very early stage.*** The package of social protection programs currently in place in the country is characterized by an extremely insignificant financing envelope (under 1% of GDP) and low efficiency, due to poor targeting under the programs²¹. Since January 2011, a pilot project has been implemented in two districts of Tajikistan with the assistance of the WB and the EU, with the key objective to test a new program of social protection based on a better income testing methodology. If this pilot is expanded to cover the whole country, higher financing will most likely be required for this subsector because of the increase in the number of program participants.

36. ***The effect of implementing other measures supported by the ACF credit was ambiguous*** and mainly depended on the degree of international community involvement in supporting the reforms. Besides, some of the reforms supported with the credit, including development of internal and external audit, are of long-term nature, and the period of time up to now has been too short to see tangible results. The last, but not the least factor determining the success of the measures taken is implementation of

¹⁹ According to the *Public Health Strategy*, this level is to be achieved by 2020.

²⁰ In urban areas, the situation is somewhat better with the share of wage-related expenditures at the level of about 60% of total current expenditures.

²¹ According to the WB's estimates, only 23% of social assistance reached the poorest 20% of the population in 2009.

reforms or lack thereof in other related sectors, non-reforming of which diminishes the efficiency of the ACF-supported measures.

37. ***The impact of provision in the Tax Code on extrajudicial collection of tax arrears on the tax revenue pattern is difficult to assess as there are no relevant statistical data available.*** The total amount of tax arrears tended to increase, at least, during 2009-2010, and the situation began to improve only in 2011. Judging by the information available to the Manager, the level of arrears went down from TJS 688 million at the beginning of 2011 to TJS 544 million at the year end.²² Most of these arrears were generated by large state-owned enterprises, including *Barki Tajik* and *Talco*, and, *inter alia*, is explained by significant receivables of these, as well as other SOEs. The high level of inter-enterprise arrears is a result of a whole range of factors, including the low quality of state-owned property management, poor payment discipline, and distorted pricing, especially in the energy sector, that prevents enterprises from covering their costs in full. In this situation, the effect of the amendments to the Tax Code adopted in March 2009 in the part of indisputable collection of tax arrears appears to the Manager to be positive, but quite limited. The minimum range of measures required for more efficient application of this provision of the Tax Code includes capacity building for the Tax service and implementation of wide-scale reforms in the management of state-owned property.

38. ***Besides, the Tajikistan's tax system itself needs radical reforms, as the current tax regime is complex, lacking in transparency, and thus not conducive to business development.*** In the “*Doing Business 2012*” survey, Tajikistan ranked 168th among 182 countries by such indicator as taxation, and there have been no improvements in this respect over the last few years. The current Tax Code includes a significant number of taxes (about 20), most of which are nuisance taxes, contributing to the revenue only in a minor way, but increasing the taxpayers’ costs²³ and weakening the administration capacity of the Tax Service. About 70% of all tax revenues of the budget are generated by three types of taxes: VAT, personal income tax, and social contributions.

39. ***On the other hand, the Tax Code provides for a large number of tax exemptions for different categories of goods and taxpayers that also weakens the country's tax base significantly***²⁴. According to the agreement with the IMF, the Government committed itself to implement certain measures to systemize all the exemptions and to estimate their cost by end-2010. This initiative was also supported by the ACF Manager, since this would improve the transparency of country's tax system and create the basis for further steps to eliminate at least some of the tax exemptions. By the time the credit was disbursed, the MoF made the first step in this direction by posting on its website the list of Tax Code articles containing information about tax exemptions, but no complete list of tax exemptions and not full estimate of their cost have been prepared so far. In 2011, the Government, supported by a number of development partners, started drafting of a new version of the Tax Code and considered the continuation of the assessment of the current exemptions to be unnecessary.

40. ***The Credit Agreement also provided for a number of reforms to strengthen control over the use of budget resources.*** RT fiduciary institutions have insufficient capacity, which constrains efficient use of public funds. Hence, the Agreement supported efforts to create a legislative framework for internal and external audit development. Besides, to improve access of the population to budget information and expand participation of the civil society in control over the use of budget resources, the Manager proposed a condition that budget documents, including laws on the budget and reports on its execution, should be posted on the MoF's website.

41. ***Introduction of internal audit functions in public sector was fixed in the Law on Internal Audit in the Public Sector adopted in July 2010.*** To implement provisions of that Law, the Government, supported by the European Commission, took a number of steps to lay the foundation for and to further develop internal audit. In particular, the MoF has established the Division of Centralized Harmonization of Financial Management, Control, and Internal Audit; internal audit functions have been introduced at six government agencies²⁵; a range of guidelines have been prepared; training for internal auditors have

²² This represents 15.5% and 9.3% of tax revenues in 2010 and 2011, correspondingly.

²³ According to *Doing Business 2012*, an average taxpayer in Tajikistan makes 69 payments per year, while the average number of such payments for the region of Europe and Central Asia is 37.

²⁴ Besides, the annual Law on the State Budget contains a list of additional exemptions for certain types of goods and services.

²⁵ Ministries of Labor and Social Protection, Education, Healthcare, Agriculture, Transport and Communication, and the Tax Committee.

been arranged; and the practice of preparing internal auditors' reports summarizing the results of their work at government agencies has been introduced.

42. ***It is now difficult to speak about the efficiency of this reform, inter alia, due to the short period that elapsed since its implementation, and due to poor development of external audit, which should generate the demand for efficient management of public funds by budget organizations.*** International experience shows that strengthening internal control and audit requires a certain period of time and political commitment. Besides, an important factor for improving demand for internal audit services is the presence of strong and independent external audit. Although the *Law on the Audit Chamber* (supreme audit body) was adopted in the middle of 2011, that institution had not started its operations as of August 2012. Moreover, the State Agency for Financial Control and Combating Corruption of Tajikistan still operates, comprising the functions of both external and internal audit, and often duplicating the work performed by internal audit divisions of government agencies. Reports of these internal audit divisions are now submitted to that Agency, and not to the Division of Centralized Harmonization of Financial Management of the MoF that definitely is not conducive to improved understanding of the role and functions of internal audit in the public sector.

43. ***The role of the civil society in control over public funds, at least for now, cannot be called significant either.*** Several factors contribute to that, including quite limited access of citizens to budget information, and poor financial education of the population limiting their ability to adequately interpret available information. In the framework of the Reform Program supported with the ACF credit, the MoF undertook to publish a range of budget documents, including laws on the budget and reports on its execution, on a quarterly basis. This information is published, albeit with significant delays, but its format and degree of dissemination need to be improved. Besides, in the absence of active training of the civil society on budget issues, especially at the local level, as well as with no clear mechanisms in place to make executive authorities accountable to citizens for their performance, one can hardly expect tangible results from these measures.

44. ***One of the key constraints for promoting reforms in the country is the poor capacity of the civil service of Tajikistan.*** In the process of Credit Agreement implementation, a new wage setting mechanism was introduced at five pilot ministries. This mechanism improves the system's transparency by consolidating numerous top-up payments into basic wages, and raises the level of pay for junior civil servants to make civil service more attractive for them. In 2012, this mechanism was expanded to cover all central government agencies. Combined with other reforms under implementation by the Government in the area of public administration, this is expected to improve the quality and capacity of the civil service to promote reforms in the medium-term perspective. However, the Manager notes that raising wages is just one element of the civil service reform and that more comprehensive and proactive reform implementation in this sector is required to improve the quality and efficiency of civil servants' work.

Assessment of Manager's and Borrower's Performance

45. ***Interaction of the Manager and the Borrower in monitoring of the Credit Agreement implementation was based on the rights and responsibilities of the respective parties set out by the EDB and ACF statutory documents, as well as by the Credit Agreement.*** The following instruments were used for monitoring purposes:

- Visits of the Manager to the country for consultations with the Government, National Bank, international and bilateral donor organizations;
- Formal requests for economic, fiscal, and monetary data from relevant Tajik authorities;
- Regular reporting by the MoF on the credit's implementation;
- Exchange of correspondence on current issues and operational activities;
- Discussions on the progress in the implementation of the Credit Agreement in meetings of the Council of Experts and the ACF Council.

46. ***Under the regulations of the EDB²⁶, other EDB subdivisions, besides the EDB ACFD, participated in financial credit preparation and implementation monitoring,*** including:

²⁶ Including *EDB Regulation on Preparation and Provision of EurAsEC ACF Financial Credits* approved by the EDB Management Board on September 14, 2010.

- Credit and Investment Department (CID), whose main functions include monitoring of the borrower's program implementation and compliance with commitments under the agreement, assessment of efficiency of financial credit disbursement (jointly with the EDB ACFD), as well as other administrative support to the agreement and project profiling as needed;
- Operations Department (OD), which performed the function of recording and accounting of the borrower's debt to the Fund;
- Legal Department (LD), which provided legal support to credit preparation and implementation activities, including drafting agreements and amendments to them;
- Security and Compliance Control Department (SCCD), which was also responsible for monitoring of the progress of Program implementation and, if needed, notifying the Bank's concerned units involved of potential risks;
- the Treasury, which disbursed credit proceeds to the borrower's account.

47. ***On the side of Tajikistan, overall coordination of the project activities was performed by the MoF represented by the Deputy Minister of Finance and the Head of Directorate for Budget Planning of External Policy Activities and Intergovernmental Fiscal Relations, who was also a member of the ACF's Council of Experts.*** Besides, relevant subdivisions of the MoF, including the State Budget General Directorate, Tax Policy General Directorate, Accounting Methodology, Reporting, and Audit Directorate, and Directorate of the Budget of State Authorities and Public Administration Bodies, as well as, although to a significantly lesser degree, line ministries, including the Ministries of Education, Healthcare, and Social Protection, were involved in program implementation and monitoring.

48. ***Participation of the offices of the President and Prime Minister in the Program coordination and monitoring, envisaged at the stage of project preparation, was minimal.*** In particular, the Executive Office of the President was expected to perform the functions of overall program monitoring and assessment, while the Prime Minister's Office – the functions of overall management and control. The actual participation of these offices in the Program implementation was limited to a few strategic meetings of the Manager with their representatives at the early stage of project preparation. It can be partially explained by the fact that, after the effectiveness conditions for the credit disbursement had been met in 2010, no high-level discussions of the Program development in the medium-term perspective took place, due to the absence of Tajikistan's requests for further ACF credits.

49. ***Representative offices of international financial institutions and donor countries played an important role in the process of Program monitoring.*** Since many of the reforms supported with the ACF Credit were implemented by government agencies with the assistance of other development partners, the Manager used consultations with the latter as an important source of information on the reform status and key challenges to their implementation. The most active dialogue on the results of credit monitoring was maintained by the Manager with the World Bank working on such areas of reforms as support to social sector financing, reforming healthcare and education financing, and the development of external audit; with the European Commission that supports the development of internal audit and social protection reforms; the Asian Development Bank that supports tax administration reforms; and the International Monetary Fund on issues of macroeconomic stability.

50. ***In general, the level of cooperation between the Manager and the Borrower was satisfactory, but several factors have reduced the efficiency of this cooperation.*** As the financial credit to Tajikistan was the first ACF credit extended at quite an early stage of the Fund's development and activity of the EDB ACFD, many statutory documents regulating relations with borrowers had been prepared in the course of the project implementation. In particular, it caused certain problems with the format of quarterly reports on credit implementation that were supposed to be submitted under the Agreement by the borrower. On the part of the Borrower, coordination of project implementation at the working level was impaired by the resignation in 2011 of MOF staff that served as the member of the Council of Experts. The MoF has not proposed a replacement candidate for this position yet. Established functional responsibilities of the MoF's senior officials did not always allow the Deputy Minister responsible for the Credit to efficiently support its implementation, as some divisions of the ministry were beyond his remit. In particular, the condition set out in the Agreement on external audit of credit proceeds was met with an 8-month delay, *inter alia*, due to the fact that the Deputy Minister supervising the project did not have the power to accelerate the pace of work of the external auditor.

Managing the Risks of Misuse of Credit Proceeds

51. ***In the course of financial credit utilization, the Manager envisaged implementation of a number of measures to ensure proper use of the credit proceeds.*** In its Appraisal of Tajikistan's request for the financial credit the Manager noted a number of problems in Tajikistan's public finance management system, which could impair the efficiency of the credit proceeds' use. In particular, it is related to the poor overall capacity of the civil service, weak internal and external controls, as well as problems with classification and decentralized Treasury operations, with its local divisions still performing work manually²⁷.

52. ***To ensure proper control over the use of credit proceeds, the Credit Agreement envisaged the opening by the Borrower of a special US dollar account with the NBT.*** The full amount of the credit was transferred to that account by the Manager as soon as the Credit Agreement became effective²⁸, and until converted and transferred to the budget, credit proceeds were treated as part of international reserves of the country.

53. ***The Manager monitored the use of credit proceeds on a quarterly basis.*** Under the Agreement, the Borrower submitted quarterly reports to the Manager on the flow of funds in the special account. The reported data show that the credit proceeds were withdrawn from the special account to be converted and transferred to the budget accounts of the Central Treasury on three occasions: on 31 August 2010 – in the amount of US\$ 20 million; on 5 November 2010 – in the amount of US\$ 41.5 million; and on 20 October 2011 – in the amount of US\$ 8.5 million. Besides, the MoF submitted to the Manager quarterly Treasury reports on the execution of state budget by functional classification for monitoring purposes.

54. ***Another instrument to ensure targeted use of credit proceeds is the requirement to conduct an independent audit of their use by the Borrower.*** Under the Agreement, this audit was supposed to be performed in the 1st quarter of 2012—the year following the year of full credit disbursement. The selection process of an independent auditor took a long time, which explains a delay in the launch of the audit. The MoF proposed to the Manager an auditor selected not on a competitive basis, but based on the fact that the firm was already on the list of companies acceptable to the ADB and had already audited several projects of international organizations. Such an approach called for the clearance of the Fund Chairman. The audit started in June and was completed in mid-November 2012 – 4.5 months beyond the deadline established by the approved Terms of Reference. The key findings of the audit are presented below.

55. ***When credit proceeds are provided for general budget support, the depth of control over their targeted use has certain limitations.*** As a rule, it is possible to check only accurate conversion of the proceeds and actual receipt of the converted amount in the Treasury accounts. In many treasury accounting systems, there is no mechanism to track the movement of credit proceeds once they are credited to the Treasury accounts. In case of the ACF credit, the MoF applied certain mechanisms to code the resources in the Treasury system that enabled monitoring the flow of credit proceeds to the final beneficiary.

56. ***According to the Auditor's Conclusion, the financial proceeds of the credit were used in line with the Agreement provisions, i.e. to finance social sectors.*** The auditor also noted that expenditures on social protection and social welfare sector stood at 15.7% of budget expenditures in 2010 and at 16% – in 2011, while the Credit Agreement required that minimal level of these expenditures was 16.8% of total budget expenditures. As mentioned above, the Manager possesses the Treasury reports confirming that this condition has been met by the Borrower.

Sustainability of Achieved Results and Lessons Learned

57. ***The Reform Program supported with the ACF credit was designed based on the medium-term priorities reflected in relevant strategic documents of the Government.*** Besides, taking into account the

²⁷ Treasury system reforms, including automation of its procedures, are being implemented in the framework of the World Bank project. In January 2012, Tajikistan's MoF announced that the Single Treasury Account (STA) had been implemented for institutions financed from the republican budget. Thus, all transit accounts of the institutions in commercial banks were closed and the funds were concentrated in Treasury subaccounts at the NBT.

²⁸ Effectiveness conditions for the Credit Agreement were: (a) submission of the Borrower's legal opinion confirming appropriate enactment of this Agreement by the Borrower; and (b) implementation of all measures in the 2010 ACF Credit Matrix.

insufficiently developed capacity of the Borrower to implement reforms, the Program included mainly those measures, which were implemented with financial support and technical assistance of development partners. This Program covered a three-year period and included those reforms, the implementation of which was seen as preliminary conditions for the disbursement of three originally envisaged ACF credits.

58. ***By now, the Program has not been developed further as Tajikistan has made no new borrowings from the ACF.*** Based on the budget needs for 2011 and 2012 and budget revenue projections, the Government of Tajikistan decided not to borrow from the ACF in these years. Thus, the implementation of the ACF Program conditions was limited to meeting the conditions for the first Credit Agreement.

59. ***Actual reforms were implemented in the framework of working plans of the Government and the action plans of development partners.*** In particular, maintaining social sector spending at the pre-crisis level is a condition for a series of operations of the World Bank and the Asian Development Bank to support the budget. Reforms in these sectors aimed at improved quality of services and more efficient spending are also supported by the EU, World Health Organization (WHO), USAID, and UNICEF. Tax system optimization and building the administrative capacity of tax authorities are supported by the IMF, WB, and ADB. All the above development partners, as well as the UK Department for International Aid (DfID) and the Swiss State Secretariat for Economic Affairs (SECO) are also involved in supporting public finance reforms.

60. ***Continued implementation of PFM reforms seems quite sustainable in the medium-term perspective.*** In the Manager's opinion, this is due to the accountability of Tajikistan's executive authorities for implementing decisions approved by the Government and the President, as well as to long-term plans of development partners to continue support these reforms as the cornerstone of their partnership with the country. However, the Manager notes that progress in PFM reforms will likely be impeded by institutional and staff constraints of Tajikistan's public sector. From this standpoint, capacity building and strengthening incentives for the civil service to improve the quality of public administration remain the key factors for the success of reforms.

61. ***Based on the analysis of the implementation of ACF's financial credit in Tajikistan, the Manager has drawn some conclusions, which should be taken into account while designing further budget support operations to Tajikistan, as well as to other ACF member countries:***

- i. Given the medium- and long-term nature of reforms in the sector of public administration and finance, a budget support loan should also be based on a medium-term reform program²⁹, agreed and formally approved by the Borrower Government and the Manager and provide for either a series of short-term credits, or a multi-year credit disbursed in several tranches. The size of the credit should be determined based on the medium-term projection of a country's borrowing requirements. In this case, the Manager will have an instrument to stimulate implementation of reforms by the agreed dates that will improve the efficiency of the credit use.
- ii. Maintaining the level of financing of certain sectors is most often a required, but not a sufficient condition for improving the quality of services provided by these sectors. To ensure more efficient use of credit proceeds, the credit's conditions should include the implementation of certain reforms in these sectors aimed at streamlining the structure of, and optimizing internal financial flows, ensuring improvements in the quality of services provided, and expanded access of the population to these services. A sector-wide approach in most cases is the best mechanism, which combines budget support and requirements to reform the sector.
- iii. Taking into account the limitations of civil service capacity, technical assistance on reforms becomes one of the key success factors. Coordination between technical assistance activities and development policy operations (budget support) is equally important to ensure that reform conditions stipulated in budget support loans are met on time. Coordination becomes especially important when technical assistance and budget support are provided by different development partners.
- iv. Financing of top priority sectors can be raised not only by increasing the overall volume of revenues (and, as a consequence, expenditures), but also by redistributing expenditures within the budget.

²⁹ The so-called "programmatic approach" providing for implementation of a medium-term reform program supported with a series of development policy lending. The key reform directions are to be consistent with the objectives of the medium-term ACF Country Partnership Strategy.

In the case of Tajikistan, one of the most probable sources for resource redistribution is its capital budget, financing of which takes up practically half of total budget resources. From this standpoint, credit support to measures aimed at streamlining budget expenditures could promote faster growth of social expenditures. In their turn, such streamlining measures should be based on the results of reviewing the efficiency of all types of expenditures, with a particular focus on budget-financed investment projects. Prioritization and certain consolidation of budget expenditures becomes relevant already in the short-term perspective, *inter alia*, due to the adoption of the new Tax Code, which will result in a tax shortfall of over US\$ 178 million³⁰ in 2013 owing to reduction in the number of taxes and tax rates.

³⁰ According to the MoF.

Table 1. Tajikistan: Key macroeconomic parameters

	2005	2006	2007	2008	2009	2010	2011
GDP, US\$ million	2311	2811	3712	5135	4982	5642	6523
GDP per capita, US\$	353,5	424,2	551,8	751,0	661,7	810,0	870
GDP real growth, %	6,7	7	7,8	7,9	3,9	6,5	7,4
Export of goods and services, US\$ million	7,1	12,5	19,7	11,9	5	9,8	9,3
Import of goods and services, US\$ million	601	656	767	865	804	913	529
Export of goods and services, % of GDP	1221	1618	2555	3703	2710	3159	3324
Import of goods and services, % of GDP	26,0	23,3	20,7	16,8	16,1	16,2	8,1
Trade balance, % of GDP	52,8	57,6	68,8	72,1	54,4	56,0	51,0
Current account balance, % of GDP	-26,9	-34,9	-45	-52,7	-38,7	-29	-54,8
Labor remittances, % of GDP	-2,8	-2,8	-8,6	-7,6	-5,9	-6,5	-11,8
Budget balance (without PIP), % of GDP	598	1015	1487	2343	1622	2040	0
Budget balance incl. PIP, % of GDP	25,9	36,1	40,1	45,6	32,6	36,2	33,3
Reserve money, % to the previous period	0,2	0,4	1,8	1,9	-3,1	-0,4	0,4
Broad money, % to the previous period	-3,4	-2,3	-5,4	-5,0	-7,8	-3,9	-2,7
Gross reserves, months of import	29,2	49,2	40,3	29,6	39,2	15,8	36,9

Source: RT authorities, ACF staff calculations

Table 2. Fiscal aggregates as percent of GDP, 2001-2011

	(2001-2007)	2008	2009	2010	2011
Total revenue	18,3	22,3	19,8	23,3	25,8
Taxes	15,7	18,6	15,7	18,0	19,6
Non-tax revenue	2,2	2,7	1,9	3,1	4,0
Grants	0,4	1,0	2,2	2,2	2,3
of which PIP grants	...	0,9	0,8	1,5	1,8
Total expenditure	21,2	27,2	27,6	27,2	28,5
Current expenditure	13,4	13,0	14,8	15,8	15,4
Capital expenditure	7,7	13,7	12,1	11,2	12,8
of which PIP	3,7	7,7	5,5	5,0	4,9
Net credits	0,1	0,1	0,5	0,7	2,1
Overall deficit ("+" means surplus)	-2,9	-5,0	-7,8	-3,9	-2,7
Overall deficit ("+" means surplus)	0,6	1,9	-3,1	-0,4	0,4

Source: RT MoF, ACF staff calculations

Table 3. Social sector expenditures

	Credit Agreement	2009	2010	2011
<i>As % of total expenditures (without PIP)</i>				
Education	17,1	20,0	19,9	18,4
Heath care	6,1	6,8	7,2	7,7
Social protection	16,8	16,8	17,3	17,0
<i>As % of GDP</i>				
Education		4,1	4,0	3,9
Heath care		1,4	1,4	1,7
Social protection		3,5	3,5	3,6
<i>Growth rates, in % to the previous year</i>				
Education		138,0	117,1	119,5
Heath care		132,2	123,3	139,9
Social protection		136,7	120,6	127,3
<i>Note: growth rates of total expenditures (without PIP)</i>				
		132,9	117,2	129,8

Source: RT MoF, ACF staff calculations

Table 4. International comparison (taxes w/o social contributions as % of GDP)

	2001	(2002-2006)	2007	2008	2009	2010
Republic of Tajikistan	12,2	13,7	15,9	16,6	13,6	15,7
Kyrgyz Republic	12,4	15,3	18,7	19,1	18,4	20,6
Moldova	...	21,6	25,6	23,8	20,9	26,1
ECA region, average	18,6	20,4	22,3	23,4	21,5	22,5

Source: RT MoF, WB data base

Table 5. Budget expenditures on education - international comparisons

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Republic of Tajikistan										
% of GDP	2,4	2,6	2,4	2,7	3,5	3,4	3,4	3,5	4,1	4,0
% of total expenditures 1/	17	17	15	16	19	19	19	19	20	20
Kyrgyz Republic										
% of GDP	4	4	4	5	5	6	6	6	6	6
% of total expenditures	23	22	22	23	24	25	26	25	21	19
Moldova										
% of GDP	5	5	5	7	7	7	8	8	10	9
% of total expenditures	21	24	24	19	19	20	20	20	21	22
ECA developing countries										
% of GDP	3	3	4	3	4	4	4	4	..	..
% of total expenditures	16	16	15	14	15	14	14	14	..	..

Source: GDF&WDI database

1/ Domestically financed only

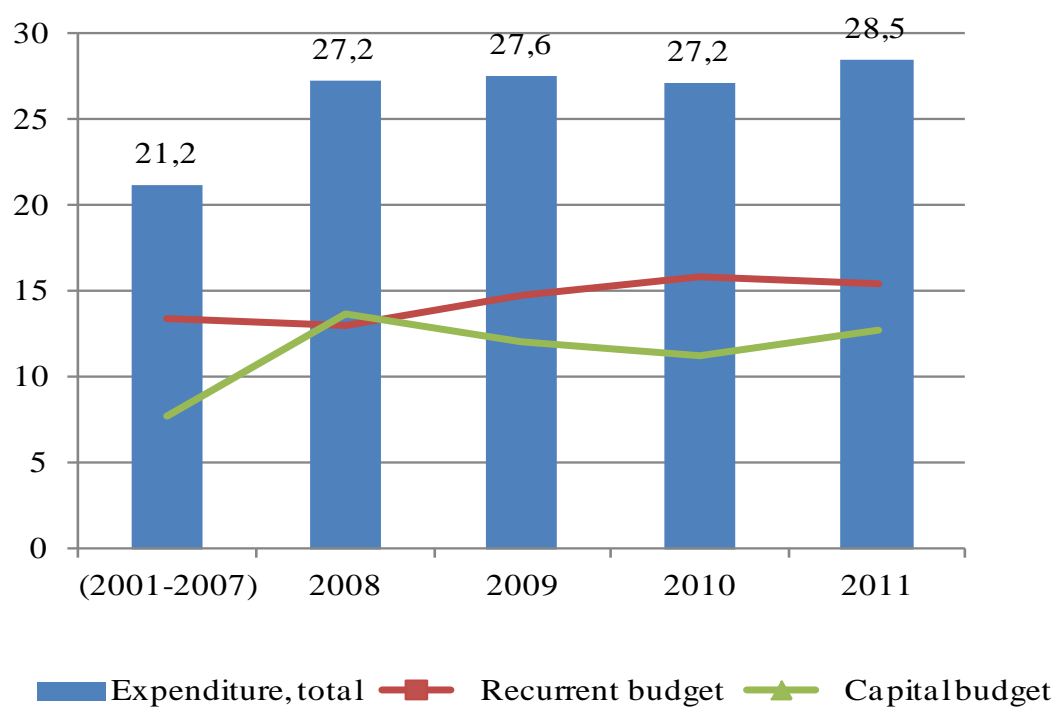
Table 6. Budget expenditures on health - international comparisons

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Republic of Tajikistan										
% of GDP	0,9	0,9	0,9	0,9	1,1	1,1	1,1	1,2	1,4	1,4
% of total expenditures 1/	17	17	15	16	19	19	19	19	20	20
<i>Note: health expenditure per capita (current US\$)</i>	8	9	11	14	17	21	30	43	44	49
Kyrgyz Republic										
% of GDP	2	2	2	2	2	3	3	3	3	..
% of total expenditures 1/	12	11	10	11	12	13	13	12	12	11
<i>Note: health expenditure per capita (current US\$)</i>	15	17	20	24	27	36	49	56	57	53
Moldova										
% of GDP	3	4	4	4	4	5	5	5	6	..
% of total expenditures 1/	11	12	12	12	11	12	12	13	13	13
<i>Note: health expenditure per capita (current US\$)</i>	27	34	42	56	70	101	134	194	191	190
ECA developing countries										
% of GDP	3	4	4	3	4	4	4	4	4	..
% of total expenditures 1/	..	..	11	11	11	11	11	10	10	10
<i>Note: health expenditure per capita (current US\$)</i>	98	118	146	186	236	293	383	451	396	439

Source: GDF&WDI database

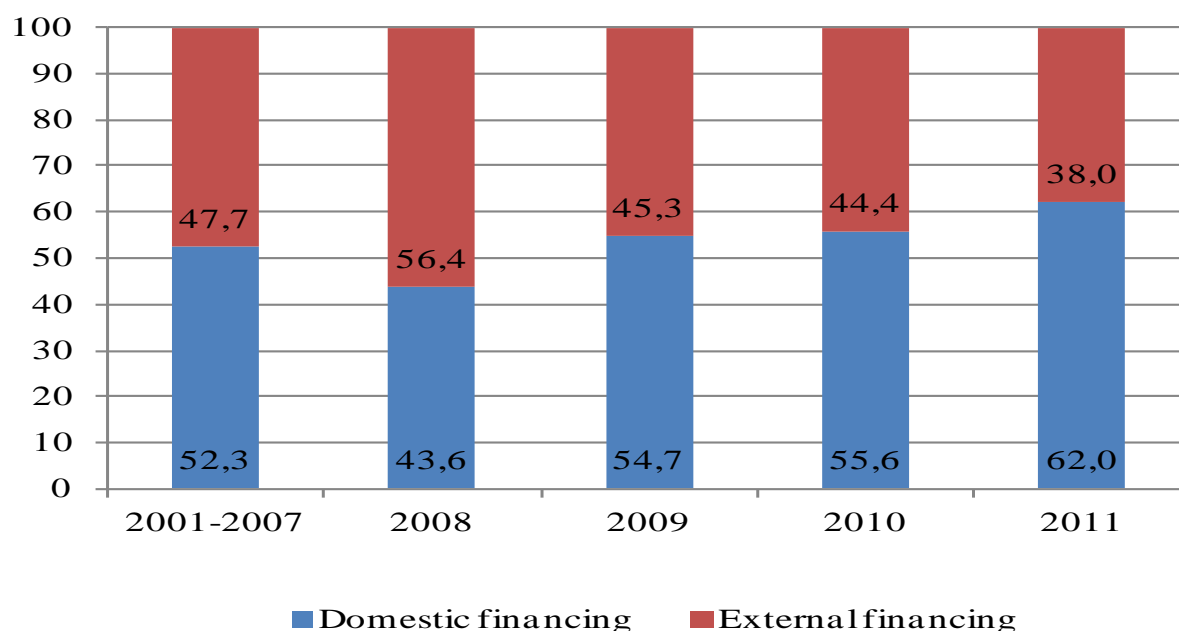
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Chart 1. Budget expenditure structure (as % of GDP)



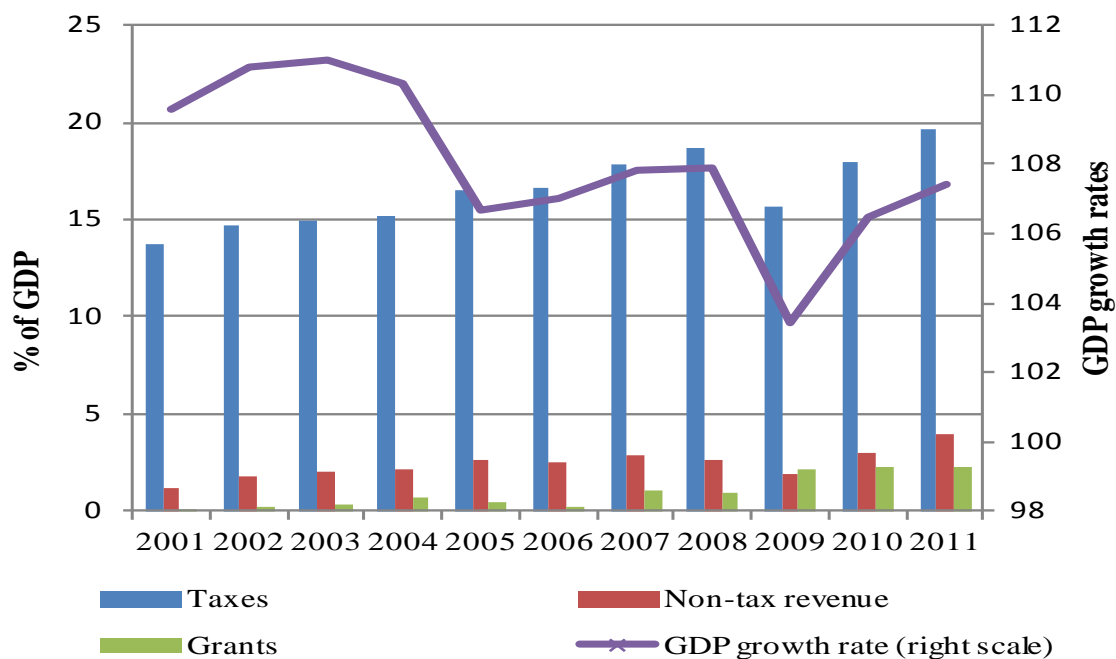
Sources: RT MoF, ACF staff calculations

Chart 2. Structure of capital budget, inc. PIP (as a share of total expenditures)



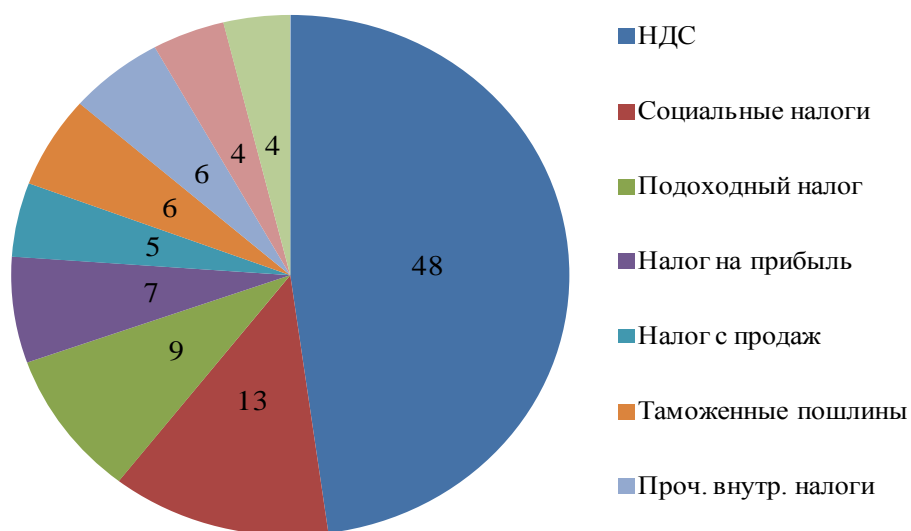
Sources: RT MoF, ACF staff calculations

Chart 3. State budget revenue growth rates



Sources: RT MoF, ACF staff calculations

Chart 4. Taxes structure (for 2005-2011 in average)



Sources: RT MoF, ACF staff calculations

Annex 3. Matrix of Economic Policy Measures

Matrix of reforms to be supported by a series of the ACF financial credits approved by the Credit Agreement

Current situation	Medium term targets	Effectiveness conditions for Credit Agreement for FC -1 (2010)	Indicative measures		Monitoring indicators for FC -1
			For FC – 2 (2011)	For FC-3 (2012)	
<i>Maintenance of social sectors expenditures</i>					
Low levels of financing and low efficiency of the use of available resources in social sectors, which erodes human development and, consequently, becomes a significant obstacle to further development of the country.	Raise levels of sector financing. Carry out reforms aimed at improving the efficiency of sector management.	<p>Approved budget for the health sector is at least 6.1% of total state budget expenditures in 2010 (excluding PIP budget).</p> <p>Approved budget for the education sector is at least 17.1% of total state budget expenditures in 2010 (excluding PIP budget).</p> <p>Approved budget for the social protection sector is at least 16.8% of total state budget expenditures in 2010 (excluding PIP budget).</p>	<p>2010 budget for the health, education and social protection executed at 100% of the originally approved expenditures.</p> <p>Approved budget for the health sector is at least 6.1% of total state budget expenditures in 2011 (excluding PIP budget).</p> <p>Approved budget for the education sector is at least 17.1% of total state budget expenditures in 2011 (excluding PIP budget).</p> <p>Approved budget for the social protection sector is at least 16.8% of total state budget expenditures in 2011 (excluding PIP budget).</p>	<p>2011 budget for the health, education and social protection executed at 100% of the originally approved expenditures.</p> <p>Approved budget for the health sector is at least 6.1% of total state budget expenditures in 2012 (excluding PIP budget).</p> <p>Approved budget for the education sector is at least 17.1% of total state budget expenditures in 2012 (excluding PIP budget).</p> <p>Approved budget for the social protection sector is at least 16.8% of total state budget expenditures in 2012 (excluding PIP budget).</p>	<p>Actual implementation of the health sector budget in 2010 reaches 6.1% of total expenditures (excluding PIP funds);</p> <p>Actual implementation of the education sector budget in 2010 reaches 17.1% of total expenditures (excluding PIP funds);</p> <p>Actual implementation of the social protection sector budget in 2010 reaches 16.8% of total expenditures (excluding PIP funds)</p>
<i>Improvement of the state resources management</i>					
<i>A. Strengthening of the revenue base</i>					

Low revenue base of the budget and imperfect tax administration	Increase budget revenues through better tax administration and the reduction of tax exemptions.	Amendments to the tax laws concerning the indisputable collection of tax debts are introduced. A full list of tax exemptions is published.	Relevant measures of the Tax Reform Strategy planned for this period are implemented. Tax exemptions are eliminated based on the conducted analysis and according to an elaborated action plan.	Relevant measures of the Tax Reform Strategy planned for this period are implemented.	Tax legislation is improved to strengthen the payment discipline.
<i>B. Increase of efficiency of and accountability for the resources utilization</i>					
Institutions that supervise the effectiveness of public resource use are not sufficiently developed, in both the executive and legislative branches of government. As a result, state agencies do not possess the capacity and the monitoring mechanisms for proper use of these resources. Parliament also plays an insufficient role in overseeing the implementation of the budget due to the current institutional and legislative framework	Preparation of legislative framework and creating the capacity for implementing the functions of internal and external audit in the civil service	The Parliament adopts the Laws "On Internal Audit in the Public Sector" and "On Financial Management and Internal Control in the Public Sector"	The Parliament adopts a law on external audit. Activities to set up institutions of external and internal audits started with parallel efforts to build the staff capacity.	Institutions of external and internal audit are set up and fully operational; the capacity building efforts continue.	A legislative basis for introduction of internal audit in public sector exists.
The population has low access to budget information. The public does not have the opportunity to participate in budget preparation and in overseeing its	Increasing the transparency of the budget as a factor in strengthening public sector accountability to the public	Publication of the Law on State Budget for 2010 and the Treasury report on budget execution for January-March of 2010, as a minimum, on the MoF's official website	Publication of the budget execution reports on the MoF's official website. Dissemination of the budget information in mass media based on agreed list of issues,	Dissemination of the budget information in mass media based on agreed list of issues, terms and periodicity.	Access of population to the budget information is improved.

implementation	and more efficient use of budget resources		terms and periodicity.		
<i>C. Strengthening of civil service capacity to promote reforms more effectively</i>					
Low salaries of civil servants is one of the obstacles to attract and retain skilled public servants	Increasing salaries of public servants is a major factor for improving the quality and motivation to work in the civil service	A government's decree approving a new tariff system for civil service wages is issued and piloted in 5 state agencies.	A new tariff system for civil service wages is applied for other state agencies according to an agreed action plan.	A new tariff system for civil service wages is applied for other state agencies according to an agreed action plan.	A basis to improve capacity and motivation of civil servants for more effective implementation of reforms by means of salary increase (on pilot basis) is established.
<i>D. Establishment of more favourable business environment</i>					
There are many obstacles for private sector development, including cumbersome procedures for business and a weak financial market	Development of private sector through implementation of measures aimed at investment climate improvement		To be determined later	To be determined later	