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ABBREVIATION AND ACRONYMS

AAA	Analytical and Advisory Activities	MOET	Ministry of Economy and Trade
IDA	International Development Association	MOF	Ministry of Finance
ACU	Aid Coordination Unit	MSRD	Ministry of State Revenues and Duties
ADB	Asian Development Bank	MTBF	Medium-Term Budget Framework
BC	Budget Commission	NBT	National Bank of Tajikistan
CAS	Country Assistance Strategy	PEIR	Public Expenditure and Institutional Review
CEM	Country Economic Memorandum	PEP	Private Enterprise Partnership
CFAA	Country Financial Accountability Assessment	PHC	Primary Health Care
CIS	Commonwealth of Independent States	PIP	Public Investment Program
CPIA	Country Policy and Institutional Assessment	PPP	Purchasing Power Parity
CSIP	Centralized State Investment Program	PRGF	Poverty Reduction Growth Facility
EBRD	European Bank for Reconstruction and Development	PRSP	Poverty Reduction Strategy Paper
ECA	Europe and Central Asia Region	PSD	Private Sector Development
ECSPE	Poverty Reduction and Economic Management Unit, Europe and Central Asia Region	PWG	Presidential Working Group
ESAF	Enhanced Structural Adjustment Facility	RRS	Regions of Republican Subordination
ESW	Economic and Sector Works	SAC1	First Structural Adjustment Credit
EU	European Union	SAC2	Second Structural Adjustment Credit
FSU	Former Soviet Union	SEDP	Socio Economic Development Program
GBAO	Gorno Badakhsan Autonomous Oblast	SFCC	State Financial Control Committee
GDP	Gross Domestic Product	SLC	State Land Committee
GOT	Government of Tajikistan	SMEs	Small and Medium Enterprises
GTZ	Gesellschaft fur Technische Zusammenarbeit	SOEs	State-Owned Enterprises
HIPC	Heavily Indebted Poor Countries	SPC	State Property Committee
IAS	International Accounting Standards	TADAZ	Aluminum Plant
IBTA2	Second Institution Building Technical Assistance	TJS	Tajik Somoni
IFC	International Finance Corporation	UNDP	United Nations Development Program
IMF	International Monetary Fund	USAID	United States Agency for International Development
I-PRSP	Interim Poverty Reduction Strategy Paper	USD	US Dollar
JSA	Joint Staff Assessment	VAT	Value Added Tax
MIGA	Multilateral Investment Guarantee Agency	WB	World Bank
MLSP	Ministry of Labor and Social Protection	WTO	World Trade Organization

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TAJIKISTAN

PUBLIC EXPENDITURE AND INSTITUTIONAL REVIEW

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EXECUTIVE SUMMARY

BACKGROUND

1. *Tajikistan has faced unprecedented challenges in the past decade.* The country gained independence in 1991 as one of the poorest in the former Soviet Union (FSU) and immediately faced severe shocks, including the loss of large fiscal transfers from the center, a sharp deterioration in its terms of trade, and severe natural disasters in three consecutive years. Most importantly, a civil war erupted in 1992 that took 50,000 lives and severely damaged the country's infrastructure. This conflict also paralyzed the processes of economic reform and social transformation. The combined effect of these events was a severe contraction in real GDP between 1991 and 1996—about 60 percent on a cumulative basis leading to a rapid increase in poverty. By 1999, about 80 percent of Tajik people lived below the poverty line and with an estimated per capita GDP of US\$180 Tajikistan was one of the poorest countries in the world.

2. *The legacy of the civil war includes a complex political economy that constrains the overall governance and institutional development process.* A peace accord was signed in late 1997 with the United Tajik opposition that was implemented by March 2000 following general elections. Since then, Tajikistan has established a functioning parliament, with the participation of the opposition, and a stable government that has worked hard to establish the key institutions of a democratic system and market economy. This double transition is still very much underway. The situation today is characterized by political interests that benefit from the status-quo and continue to seek rent-seeking opportunities; public finance and administration systems that are still largely based on the old Soviet model and lack capacity; extremely low average wages in the public sector (around US\$10 a month) that fuel corruption; and highly centralized policy-making and implementing structures that reduce incentives and accountability at lower levels of government.

3. *Important progress has been made with basic economic reforms, but severe institutional and capacity deficiencies remain.* Since 1997 there has been considerable progress with first generation reforms (e.g., liberalization of trade and prices, privatization of small and medium scale enterprises, and some reforms of collective farms). Most recently, institutional reforms, particularly in the public expenditure management area, have been getting increased attention. Initial reforms in this phase included the establishment of a national treasury, a new public finance law, and the establishment of a budget audit agency. The government has enacted much of the basic legislation of a market economy, but progress with enforcement has been slow.

4. *Macroeconomic stability has largely been achieved, GDP growth has been strong and poverty has declined; but the economic base remains narrow, there is a large burden of external debt and the overall fiscal situation is weak.* The economy has

rebounded strongly since the late 1990s. Annual real GDP growth averaged over 9 percent in 2000-2003; raising per capita GDP to \$236 in 2003. However, much of this growth reflects increasing international cotton prices. Living standards survey data show that the consumption poverty rate declined by about 20 percentage points to 60 percent in 2003. General government spending (including the Public Investment Program or PIP) fell from 67 percent of GDP in 1992 to a low of 14 percent in 2000 as expenditures were slashed across-the-board. It has since recovered to about 20 percent of GDP (2003), in large part due to increased donor funding of public investment. In 2003, the overall fiscal balance registered a surplus of 0.6 percent of GDP (excluding the PIP) and an overall deficit of 2.4 percent of GDP (including the PIP). Overall, though, the fiscal situation remains precarious due to a continued large burden of external debt and very sizable quasi-fiscal deficits. At end-2003, the total external debt stock was an estimated 73 percent of GDP. Debt service requirements are expected to absorb about 23 percent of government revenues over the next 3-4 years and there is very little flexibility for public expenditure policy though reductions in external debt service obligations following a series of bilateral debt workouts have eased the situation somewhat. In 2001-2002, external debt service absorbed 40 percent of government revenues. The estimated quasi-fiscal deficit in the energy sector (gas, electricity and heating) reached about 23 percent of GDP in 2003. Most of this quasi-fiscal deficit is in the electricity sector (20 percent of GDP), and reflect low tariffs, poor collection discipline and large technical losses. These factors have encouraged wide-spread electricity over-consumption and the accumulation of arrears by large enterprises such as the aluminum conglomerate TADAZ.

5. *Despite the robust growth and reduction in extreme poverty, the standard of living for many has not materially improved and there is ample evidence that the delivery of public services in social sectors and infrastructure is still deteriorating.* Enrolment in basic education declined throughout the 1990s to about 88 percent of the school-age population in 2000 compared to 94 percent in 1989 and it appears that this trend is continuing. Health expenditures declined steeply in the 1990s, from around 5-6 percent of GDP to about 1 percent GDP in 2002, or below US\$2 per capita—among the lowest levels of spending in the world. The sharp decline in spending by the government has shifted the burden of health spending on to households, leading many households to delay accessing medical care. Access to transport, telecommunications, and safe water, particularly by the poor has also declined.

6. *Tajikistan enjoys very strong donor support for its poverty reduction strategy.* While the post September 11 events in Afghanistan initially led to security concerns, ensuing events did not affect Tajikistan negatively. In fact, regional security issues have raised Tajikistan's international profile and there is now increased donor awareness of Tajikistan and its development needs. Tajikistan presented its PRSP and the associated public investment program (PIP) to the donor community in Consultative Group (CG) meetings in May 2003. Donors welcomed the PRSP and pledged about US\$900 million over a three-year period to support it. However, donors also noted that the PRSP program was too broad and urged the government to prioritize its reform agenda and PIP. Particular attention was suggested for governance and institutional reforms in general, and for service delivery, especially in education and health. In the event, donor

disbursements for the PIP have been very slow; suggesting that there are severe absorptive and public expenditure management problems that need to be addressed urgently.

7. *The country circumstances described above indicate the critical role of public expenditures in Tajikistan's economic and social development well into the medium term.* Key elements of the implied reform agenda include: strengthening the quality and sustainability of fiscal adjustment; enhancing the efficiency and cost-effectiveness of public service delivery; improving the quality and accountability of the public administration; careful coordination of priority policy objectives with actual spending, notably investments in human and infrastructure capital; and mobilizing highly concessional donor resources and using them efficiently and timely. This is a daunting agenda, and a fundamental requirement of any public sector reform strategy in Tajikistan is that it needs to be fully cognizant of the existing administrative capacity weakness and other institutional and political economy constraints.

8. *Reforms in Tajikistan need to be designed, sequenced and supported in a way that allows for progressive implementation over the next several years.* This Public Expenditure and Institutional Review (PEIR) is part of a package of analytical and advisory service products aimed at assisting the government and Tajikistan's other development partners to develop a medium- to long-term strategy for public sector reform to support the government's poverty reduction objectives. Specifically, the PEIR seeks to contribute to the development of such a reform strategy by examining four cross-cutting areas for public expenditure management system: (i) policy formulation and organization of the government, including public administration and human resource issues; (ii) the budget development and management process; (iii) intergovernmental issues and local government reforms; and (iv) public investment program planning and process. Other key pieces of this package, whose main findings and recommendations are integrated into the PEIR, include the recently completed Country Procurement Assessment Review, Country Financial Accountability Assessment, Education Sector Review, Social Expenditures Review and Health Sector Financing Study.

A. Strategic Policy Formulation And Policy Management

9. *The alignment of the policy formulation process and organizational structure of the government in line with its new role in the economy has been slow.* Tajikistan retains a system of government structure and public administration with many features of the former Soviet model. The system is dominated by the Presidential Administration (PA) with small ministries managing large numbers of subordinated bodies, including state owned enterprises, and a broad network of subordinated sector units at Oblast and Rayon level. The roles and functions of the PA and line ministries have many overlapping areas and the lines of authority are not clear. Line ministries are largely unreformed and they continue to operate on a command economy basis doing what they have been doing before focusing on control functions rather than policy development in line with national priorities in a market economy context.

10. ***The fragmentation of policy formulation and implementation structures results in parallel resource allocation mechanisms, hindering the development of strategic priorities and their institutionalization into a public expenditure framework.*** At present Tajikistan has two major development programs, and four different associated policy development structures, and corresponding resource allocation mechanisms. The MOET prepares the 15 year Social and Economic Development Plan (SEDP) which is a central plan based process that is updated every year. The SEDP is a high-growth-oriented, infrastructure-dominated multi-billion dollar investment plan that is out of line with the macroeconomic framework. The SEDP is the basis for the budget and the PIP but it is not linked to PRSP which is largely prepared by the PA. Most line ministries consider the PRSP a document for donors funding of the PIP. These inconsistencies affect Tajikistan's ability to raise donor funds which is needed for growth and poverty reduction. Donor disbursements for the PIP to date are only 20 percent of committed amount at May 2003 CG meetings.

11. ***The current system contrasts with the demands of a market based economic system, which requires the separation of state structures from economic activity.*** Policy management in a market economy requires that the state sets the rules of the game and supervises their effective application, but does not intervene directly in the economy. The government entity responsible for privatization and management of state property is the State Property Committee (SPC). Despite its functional responsibilities to manage state property, does not control the majority of state-owned enterprises. These are controlled either by the President, such as TADAZ, or by line ministries which control sizable state-owned assets. The ministries' vested interest in the enterprises is one of the major impediments to their quick and transparent privatization. The governance of these enterprises are extremely poor with little accountability.

12. ***Civil service and wage reforms have been delayed until now and a reform strategy is urgently needed.*** Civil service legislation, enacted in 1998, has been largely ineffective, and most of the necessary secondary legislation has still not been adopted. Civil service management structures remain weak. The pay and benefits system in the administration is inadequate, too complex, and non-transparent. Some 800 top appointments are handled by the Personnel Policy Office in the PA while the remainder of civil service appointments are still handled mainly by the ministries. The Agency for State Services has still not taken over the majority of functions more than two years after its creation. The system of expenditure planning for personnel and other administrative expenditures is highly incremental rather than need-based. A review of the personnel expenditure planning system is not on the political agenda at the current time, which severely limits the scope for deeper reforms of the system.

Short- and Medium-Term Measures:

- ⌚ First, and foremost, the organization of the government needs a formal priority setting structure. A State Resource Management and Policy Committee should be set-up immediately to consolidate the existing parallel resource allocation mechanisms, PIP, PRSP, SEDP, and budget.

- ⌚ Put in place effective reform management structures at the President's Administration, headed by a plenipotentiary with a clear mandate, supported by a professional secretariat.
- ⌚ Create an effective civil service register, containing data on all civil servants and their profile, and establish and monitor their actual number. In parallel, create similar databases for the core public sector, in particular health, education and other major spending areas.
- ⌚ Assess the current legal frameworks for civil and public service management and, based on an analysis of strengths and weaknesses, design a concept for an amended legal framework.
- ⌚ Agree and implement a diagnostic study of one selected pilot ministry at all levels, and create a reform plan to streamline the organization and management of the ministry and all its subordinated organizations.
- ⌚ Conduct a full assessment of the wage system and design a reform plan to phase out allowances and supplements and put in place a transparent wage system that reflects job requirements rather than subjective factors.
- ⌚ Enhance key processes, such as Government agenda management, monitoring the implementation of Government decisions, by amending relevant regulations and putting in place training programs.
- ⌚ Ensure that fiduciary management continues to move towards international standards as this affects donor disbursements.

Longer-Term Measures:

- ⌚ Design a comprehensive reform strategy, based on a proper diagnostic of the actual size and capacity of the civil and public service.
- ⌚ Design and implement the second phase of restructuring of the President's Administration, with the aim to allow the institution to focus on core tasks, including strategic advice to the President on policy issues and managing cross cutting reform areas such as Public Administration Reform, Poverty Reduction and Local Government Reforms.
- ⌚ Full implementation of new legislation on the Civil Service and related employment for other state sectors.
- ⌚ Strengthening the role of the State Services Administration and develop the Institute for Civil Service training as a key advisory and professional development institution. Link career progression to professional development.
- ⌚ Bring all top level appointments in the civil and public service under the civil service law and the State Services Agency.
- ⌚ Reform the public sector wage system and develop a transparent wage system based on the equal pay for equal work principle.
- ⌚ Raise public sector wages to a level that would reflect up to 4.5% of GDP, over an 8-10 year period, in the context of an overall administrative restructuring plan and linked to the PRSP.
- ⌚ Implement a phased sector-by-sector program to reorganize ministerial structures, including central-Oblast-Rayon relations, and reduce staff levels to a level at which competitive wages can be paid.

- ⌚ Put in place a rudimentary strategic planning system to ensure that scarce public resources are spent on policies that contribute effectively to economic growth and poverty reduction.
- ⌚ Empower SPC to appoint managers of all public enterprises and establish boards for large enterprises, such as TADAZ, Vostokredmet, Tajik Air, Tajik Gas, and Tajik Rail.

B. Budget Management and Execution

13. *In addition to adjusting to the loss of large budgetary transfers from the center at independence, Tajikistan also faced the task of reforming its budgetary system.* As budgeting was subordinate to central planning, the inherited budget process was merely the financial reflection of production plans, rather than an instrument of resource allocation and policy choices. This separation of policy making and planning from budgeting meant that no domestic institutional mechanisms existed to make the necessary choices on what activities could be financed. The authorities' initial reaction to the loss of transfers was to attempt to maintain existing institutional structures and finance previous activities which resulted in a situation in which resources were insufficient to cover current costs or maintenance, or even pay subsistence salaries. More fundamentally, continued delays with the adoption of a financial framework that could take resource constraints, including external debt, into account over a medium term, meant that the budget process was not in line with the macro- framework, nor there were mechanisms to link policy, planning, and the budget which resulted in inconsistencies between the PRSP and the budget as discussed in section I above.

14. *Since 2002 important budget reforms were introduced.* The government has adopted new tools and procedures for formulation, execution and evaluation of the budget, including a new Public Finance Law, a new national Treasury, and a State Financial Control Office (SFCC) to audit the budget in 2002. However, much of the philosophy and practice of the Soviet system still persist and it has been difficult to change the pervasive view that the existing system is adequate but it simply lacks resources. Despite reform efforts the existing system is not yet a vehicle for translating priorities into a well formulated budget and continues to be de-linked from the PRSP. Norm-based budgeting continues and the incremental nature of costing is a major constraint for intra-sectoral efficiency. Budget preparation and execution have major deficiencies leading to poor budget execution results. Budget coverage and presentation is not conducive for transparency and accountability. Internal and external audit mechanisms are evolving and the activities of the SFCC is an inadequate check and balance within the public sector accountability framework. There is a need for a pragmatic reform strategy to ensure that the budgetary process is the main operational instrument for: (i) linking priorities with budget (ii) efficient delivery of public services and (iii) facilitating transparency and accountability.

Short- and Medium-Term Measures:

- ⌚ Clarify which development program guides the budget development process and ensure that there is one set of strategic objectives.
- ⌚ Ensure that strategic priorities are set by the State Resource Management Policy Committee and this is communicated to all ministries in a budget framework paper which should guide the budgetary process to link policy and budgeting.
- ⌚ Move per-capita budgeting in the education and health sectors based on the newly developed sector strategies which also have medium-term costing plans.
- ⌚ Improve resource envelope estimation framework by centralizing this function at the Ministry of Finance with inputs from MOET and the National Bank.
- ⌚ Improve revenue predictability to reduce the large deviations between the allocations in the annual budget law and actual budgetary outcomes and establish a cash management department within the Treasury and improve commitment control.
- ⌚ Set budget ceilings at the beginning of the budget process.
- ⌚ Estimate revenues and revenues separately and not together. Revenues should be estimated at the beginning of the budgetary process not at the end with expenditures.
- ⌚ Review the implications of double accountability of spending units to both local governments and line ministries and develop an action plan to improve accountability .
- ⌚ Budget preparation calendar is too short and this does not give enough time to the Parliament to review and discuss it and it should start no later than March 1.
- ⌚ Present the budget to the Parliament before approval by all levels of government, and by line ministries, and by functional expenditure areas. The approval of the budget law by functional categories means that in practice the allocations of funds to ministries takes place after the budget is approved which is not in line with standards of accountability.
- ⌚ Make all budget documentation and budget execution reports in their entirety available to the public to improve transparency.

Longer-Term Measures:

- ⌚ Develop a timeline to move away from norm based budgeting to more output oriented budgeting. This could be done by developing agency/programmatic based budgeting in tandem with the restructuring of sectoral ministries
- ⌚ Require estimates of future recurrent costs of public investments in education and health sectors for the preparation of 2006 budget and develop a timeline for other ministries for including these in the budget.
- ⌚ Improve the legal framework for internal audit framework and develop an internal audit function within the MOF.
- ⌚ Improve the external audit framework by improving the transparency of SFCC's reporting to the Parliament and the President and have SFCC sent the entire audit report to the Parliament rather than the summary and make this publicly available.
- ⌚ Amend the Public Finance Law and require the Parliament to approve the annual report on budget execution by the SFCC.

- ⌚ Further develop the MTBF that was distributed at the May 2003 CG meetings further and base the budget on this framework.
- ⌚ Reorganize the MOF and consolidate its four different departments that prepare and monitors the budget into one and eliminate its non-core tasks including the construction company and schools under it.

C. Public Investment Planning and Process

15. ***Public capital expenditures are highly fragmented and not guided by a single development strategy.*** While attempts to improve Tajikistan's public investment planning and process have gathered pace in 2003, the fragmentation of public investment funds continue and this undermines the overall management of public expenditures. The extent of fragmentation is a source of concern as this situation has been negatively affecting the quality of the PIP process and its alignment with the macroeconomic framework. Besides combining both budget and off-budget elements such as the externally funded PIP, even the on-budget components are financially fragmented. As shown in this chapter the *institutional fragmentation* of the process is the primary reason for this outcome. Different organizational units in the Government, the MOET, and the MOF are responsible for the PIP, domestic capital investment, and other capital expenditures. A more fundamental problem, however, is that there is no single strategy guiding the PIP planning and process and it is not clear whether the PIP is driven by the SEDP or the PRSP. This situation makes it difficult for the government to communicate its priorities to donors which in the past have contributed to low donor disbursements.

16. ***Main investment windows are:*** (a) the donor funded PIP which is off budget, the major source of public capital expenditure financing in Tajikistan combining credits and grants provided by donor community which is off budget; (b) the Centralized State Investment Program (CSIP), which is a major source of financing *non*-PIP projects from the central and local governments' budgets. While there are two other windows these are small and the PIP and the CISOP accounting for 97 percent of overall public investment envelope (2003). Total public investment in 2003 was estimated at 7.1 percent of GDP almost equally split between the PIP¹ and CSIP (3.9 and 3.2 percent of GDP respectively). Compared to 2000 (4.2 percent of GDP) this means a sharp increase in the total public investment envelope basically due to increasing share of externally funded PIP.

17. ***PIP budgeting and implementation has been ad hoc and there have been important process gaps.*** For instance, PIP implementation reports have been produced on a need-to-do-basis rather than regular practice (mostly prepared by a foreign consultant during preparation of the next PIP); (d) constraints set up recently on external borrowings reflect fiscal constraints (to co-finance) and absorptive capacity, grants co-financing is neglected while they may also require additional budget financing; (e) financial control and monitoring of the use of counterpart funds are weak and there is a classification issue (counterpart funds are classified as "other current expenses"); (f) recent PIP financing

¹ Including counterpart funding and off-budget PIP financing.

priority shift towards infrastructure mismatches with donor priorities and may cause low donor disbursements². This is not in line with the PRSP and indicative of lack of priority setting mechanisms and deficiencies in the overall policy formulation process as noted earlier.

18. *CSIP is on budget and but lacks transparency and is not in line with PRSP.*

While CSIP is a part of existing budget process, its financing priorities conflict with PRSP. CSIP is the only public investment envelope fully integrated into the current budget process. The followings may describe key issues typical for CSIP: (a) there is no formalized methodology for project selection and screening, few criterion used for that: political, technical and financial and in many cases based on sole Government decision; (b) CSIP prioritization does not fit with PRSP as one-third of it is spent for construction / reconstruction of government administrative buildings which is very difficult to qualify as poverty reduction targeted investment; (c) cash management affect CSIP implementation and expenditure arrears continue to be a problem; (d) CSIP is split into “core” (high priority) and “non-core” programs and subject to revision during fiscal year depending on resource availability which may cause under-financing for “non-core” ones; (e) financial monitoring and control are weak, the effectiveness of technical audits is questionable.

Short- and Medium-Term Measures:

- ⌚ Make public capital expenditure envelope, including PIP, consistent with MTBF and debt strategy.
- ⌚ Establish a multi-year rolling ceiling for new commitments to be made under investment credits.
- ⌚ Present CSIP as a part of the broadly defined PIP, which, in turn, should be aligned with the streamlined PRSP.
- ⌚ Reduce the number of investment projects included in PIP and CSIP.
- ⌚ Increase budget coverage to include foreign financed PIP.
- ⌚ Develop and apply methodological guidelines for the estimation of expected disbursement under ongoing PIP projects.
- ⌚ Perform a functional review of the ACU, the MOET (PITAPU and SRPD) and the MOF (PIMU) aiming at revealing overlaps and duplication and assessing the quality of their performance with respect to PIP and CSIP.
- ⌚ Develop a methodology for PIP (and CSIP) projects evaluation and selection, including economic analysis and risks assessment.
- ⌚ Make accounting and reporting on PIP projects (foreign financed and co-financed by the government) consistent with GFS and budget classifications.
- ⌚ Review the project reporting requirements under PIP and CSIP, eliminate excessive and duplicative reporting.

² Donor community tend to be willing to invest in human development and social protection arguing that they are priority areas which would promise poverty reduction and sustainable development in longer term.

Longer-Term Measures:

- ⌚ Increase budget co-financing of foreign financed PIP through the respective reduction of internal budget investment under CSIP.
- ⌚ Seek possibilities for substituting a part of credit financing for grant financing.
- ⌚ Develop and apply the same policies, principles, and criteria to both PIP and CSIP.
- ⌚ Make the broadly defined PIP an investment part of sector/ministry envelopes.
- ⌚ Increase budget and PIP coverage to include all foreign financed grants.
- ⌚ Integrate PIP with the rest of the budget by presenting it the same functional, economic, and ministerial classification.
- ⌚ Require that reasonable estimates of future recurrent costs are provided for all investment projects to be included in PIP and CSIP.
- ⌚ Merge MOET units currently responsible for PIP and CSIP.
- ⌚ Develop streamlined template for project reporting; unify reporting requirements for PIP and CSIP projects.

D. Central-Sub-National Relations

19. *Tajikistan is a highly centralized state with sub-national units of administration play a major role in the provision of public services but subject to a complex budgeting process.* The fiscal relationship between the central and sub-national units of administration is defined by a highly complex annual budgeting process. There are four major drawbacks to the existing system: (i) First, the predominant item of spending—the wage bill—does not reflect any systematic evaluation of staffing priorities or wage policies but simply the physical norms and the allocation of wages largely reflects the accretion of staffable facilities in each jurisdiction. During a decade in which government revenues have declined radically, one might expect an equally radical reallocation of staff. This has not occurred. Instead, the Government has reduced the real wages of all staff rather than making cuts in specific positions; (ii) Second, in protecting the wage component of the budget, the system provides insufficient funding for the materials and supplies required to make personnel effective; (iii) Third, because funding for non-wage budget items is determined through negotiations, its distribution tends to reflect the relative bargaining power of different jurisdictions, rather than any objective measure of need; (iv) Finally, the system used to project revenues encourages strategic behavior among the central and sub-national units of administration: jurisdictions with projected budget surpluses are required to contribute a share of their revenues to the central budget an activity in which the central government typically emerges the loser.

20. *Two budgetary reform options could be considered.* The first option would be to centralize the budget process, reducing the influence of oblast, rayon, and town chairmen in favor of the line ministries. Under such a scenario, most local taxes would be assigned to the Republic budget. Funds would instead be allocated among line ministries according to sectoral budget priorities set by the Government. Sub-national units of administration might play a role in budget execution but would have no role in budget formulation. The second approach would be to shift additional budget authority to the

sub-national level. Under this approach, most local taxes would again be assigned to the Republic budget and the existing position-based system for estimating wages would be eliminated. But funding for functions assigned to sub-national administrations would be allocated among oblasts, rayons, and cities on the basis of block grants. Local administrations would have de-jure authority to reallocate funds among sectors and economic categories of expenditure according to their perceptions of local priorities. While the second approach could improve the efficiency of government spending by shifting budgetary authority to levels of government more responsive to local needs, whether this would occur under the existing structure of sub-national authority is not clear.

21. ***A more modest alternative would be to introduce more direct forms of accountability at a smaller unit of administration—the jamoats, for example.*** Jamoats are currently administrative appendages of their respective rayons. They have few functions beyond the disbursement of salaries and the maintenance of civil registries. Jamoat chairmen are appointed by their respective rayon executives. The government is now considering legislation which would provide for directly elected jamoat councils. These councils would in turn elect a chairman from among their members. As an experiment in local accountability, this has much to recommend it. Whether it would have a significant impact on the quality of governance in Tajikistan will depend, in part, on the scale of responsibilities that are decentralized in tandem. The current draft of the legislation would leave jamoat functions largely unchanged. Given the technical and managerial limitations of many jamoats, this is prudent but the experimenting with the idea is worth the effort given the needs

22. ***Developing a strategy to scale-up resources going to Jamoats can attract additional donor resources and support the government's PRSP at the community levels.*** The government is already considering ways of scaling-up programs that could be implemented at the community level, or the Community Linked Development (CLD) projects. While a number of donors are already implementing similar projects, resource flows under these projects are not large enough, given the needs, and furthermore sustainability of some of these projects could be an issue. Scaling-up CLD projects initially with donor funds and after developing capacity, annual transfer of funds from the budget would go a long way for sustaining projects at the jamoat and/or local government level. At present most jamoats are financially and institutionally weak, so the challenges of building capacity and downward accountability will be large and long-term. However, if developed and implemented such a scheme would be a powerful instrument of reaching to poor communities and demonstrate the benefits of foreign assistance and deliver the much needed key public services as well increase donor disbursements.

Short- and Medium-Term Measures:

- ⌚ Devise new formula for financing subnational administrations, eliminating facilities-based calculations of expenditure needs and gap-filling calculation of subventions; replacing with formula- based bloc grants, with possible earmarking for key sectors

- ⌚ Define respective management responsibilities of line ministries and subnational administrations in key sectors (e.g., education, health), particularly with reference to determinants of the wage bill (changes in authorized positions, salary levels)
- ⌚ Revise legislation and budget procedures to allow all receipts from regulated taxes to be credited to the Republic budget while guaranteeing sub-national administrations the level of subventions provided in the annual budget.
- ⌚ Retain local authority to set rates and retain revenues of at least one significant regulated tax (consistent with overall reform in tax structure).
- ⌚ Enact legislation authorizing election of jamoat chairmen (either directly or indirectly by directly-elected jamoat councils) and devise transparent, formula-driven mechanism for financing current jamoat responsibilities.
- ⌚ Develop pilot programs for scaling-up CLD activities.

Longer-Term Measures:

- ⌚ Implement new formula for financing sub-national administrations.
- ⌚ Implement new division of central, sub-national management responsibilities.
- ⌚ Implement changes in legislation, budget procedures governing the center-local tax transfer arrangements between the central and local budgets.
- ⌚ Conduct elections for chairmen, councils and implement new financing mechanism.

Consider additional functions that might be decentralized in jamoats in the future

STRATEGIC CONTEXT AND MACROECONOMIC SETTING

INITIAL CONDITIONS AND THE REFORM PROCESS

The transition process has brought unprecedented challenges to Tajikistan. The country gained independence in 1991 as one of the poorest in the former Soviet Union (FSU) and immediately faced severe shocks, including the loss of large transfers from the centers, sharp deterioration of terms of trade, and natural disasters three years in a row. More importantly, the eruption of the civil conflict in 1992 took 50, 000 lives and destroyed much of the country's inherited infrastructure. This conflict also paralyzed the reform process. The combined effect of these events had been a severe contraction in GDP between 1991 and 1996—about 60 percent on a cumulative basis. A peace accord was signed in late 1997 with the United Tajik opposition and this was fully implemented by March 2000 following general elections. Since then Tajikistan has a functioning parliament, with the participation of the opposition, and a stable government that has been in the process of establishing the key institutions of a democratic system and a market-based economy. This double transition is still very much underway.

The aftermath of the civil war has produced a complex political economy which affects overall governance and institutional development process. While the country has been stable since 1997, the governance situation remains complicated as the achievement of stability and ending the civil war necessitated the accommodation of demands of various disparate groups. These now represent *political* interest that benefit from the status-quo and continue to seek rent-seeking opportunities. The public finance and administration systems are still largely based on the old Soviet model and lack capacity and with average wages in the public sector being at around US\$10 a month, corruption is rampant. Although economic management is assigned to the Cabinet of Ministers, the Presidential Administration exerts significant influence on policy setting and is the decisive body on key issues. All sub-national appointments are made by political appointees of the President and even the lowest level of local bodies are administrative units of the central government. As a result, the policy making and implementing structures continue to be highly centralized.

During the past few years, the political focus has been shifting from peace-building to sustainable economic development. Since the end of civil war in late 1997 there has been considerable progress with first generation reforms and macro stability was maintained. In 2002 the government issued its Poverty Reduction Strategy Paper (PRSP) which represents a new development strategy for Tajikistan and since then institutional reforms, particularly in the public expenditure management area, have been getting increased attention. Initial reforms included the establishment of a national treasury, a new public finance law, and the establishment of a budget audit agency. As part of other institutional reforms the government has also enacted the basic legislation of a market economy though progress with reforming institutions to enforce the law has been slow.

While it is clear that many of the needed reforms are medium to long term in nature and require careful planning and sufficient funding for capacity building, there is the realization that without steady progress in institutional reforms PRSP targets and Millennium Development Goals (MDGs) will not be attained and that public expenditure reforms would need to be the key element in that process as noted in the PRSP progress report (PRSP-PR) issued in March 2004.

A. Reform Outcomes: Economic Growth, Poverty Reduction, and Public Service Delivery

A.1. Sources of Growth

Economic growth steadily gained pace during the post-war period. Underpinned by the peace accord, the combination of macroeconomic stability and first generation reforms has led to the resumption of growth in **1997**. Initial growth originated from rapid productivity gains, accounting for half of the 10 percent growth by 2000. Privatization of farms, including cotton-ginneries in 2000-01 led to increased private farm yields, up two to three times those of public farms. Privatization of small-scale enterprises in the industrial sector helped to increase output through the utilization of existing capacity. In 2002 higher aluminum and cotton production and their export to foreign markets drove growth. In that year workers remittances registered a rapid increase and reached almost 8 percent of GDP and this added to the growth momentum. In 2003, sources of growth were more diversified as traditional exports, aluminum and cotton, showed modest expansion, while services, non-aluminum manufacturing and non-cotton agriculture accounted for about half of the growth. The rest came from workers remittances, which may have been as much as 30 percent in 2003, and this boosted consumption and hence growth in 2003. Between 1997 and 2003 average growth rate of real GDP was about 8 percent per annum, bringing the cumulative growth rate to over 40 percent in that period.

A.2. Poverty Reduction

Growth performance translated into poverty reduction. According to the initial results of the Poverty Assessment Update (PAU, 2004) based on Tajikistan Living Standards Survey (TSL) 2003³, the preliminary conclusions on consumption poverty are as follows. First, it appears that the rate of poverty has declined sharply in recent years as shown in table 1. Comparing the results of the TLSS 2003 with the TLSS 1999, using \$2.15 PPP as the poverty line, it appears that the rate of poverty dropped from 65 percent to 57 percent (a decline of 13 percent)⁴. Using the State Statistical Agency's poverty line, it appears that the poverty rate dropped from 83 percent to 68 percent (a decline of

³ The TLSS 2003 was a representative national survey, with a sample of 4,160 households. There was oversampling of GBAO and Dushanbe, and a total of 208 population points selected for the survey. There were three types of questionnaires: household questionnaire with 13 modules; community questionnaire; and female questionnaire.

⁴ However, the results of TLSS 2003 are sensitive to the choice of the PPP (using the average of the World Bank and the OECD PPP calculations, the poverty rate would be 62 percent in 2003 instead of 57 percent).

18 percent)⁵. And using the Government's and Rational Nutritional Norm approach, the poverty rate apparently dropped from 90 percent to 83 percent (a decline of 8 percent). The difference in the rates of poverty decline between these three methodologies is not too disparate, suggesting that there has indeed been a reduction in the absolute poverty rate over the four year period by between 8-18 percent, depending on the methodology used.

It also seems that severe poverty has declined more than more moderate poverty. However, despite the apparent improvement in the overall poverty situation, the TLSS 2003 results suggest that over four-fifths of the population still have a total per capita consumption level that is less than the "rational norm". Another finding of the TLSS suggests that proportion of the population above the highest poverty line has increased significantly, that the proportion of the population at the bottom of the spectrum has not decreased much, and that those just slightly above the most severe poverty line has been reduced. These developments suggest that economic growth has been and will benefit the poor. While these are very positive developments, despite rapid economic growth, the level of output is still substantially below pre-independence levels and with an estimated per capita GDP of US\$207 (2003) Tajikistan is still the poorest country in the FSU and one of the poorest in the world. Therefore, it is critical to sustain growth if Tajikistan is to reach its declared PRSP goals.

Table 1. Comparison of Poverty Rates in 1999 and 2003

Poverty Line	1999 TLSS		2003 TLSS		Poverty Rate Decline
	Tajik Ruble	Poverty Rate	Somoni	Poverty Rate	
PPP \$2.15/day (i)	15,111	65.4%	41.72	56.6%	13.5%
State Statistical Agency Poverty Line (ii)	20,000	82.6%	49.55	67.5%	18.3%
Rational Nutrition Norm (iii)	27,400	90.3%	67.53	83.1%	8%

Source: TLSS 1999 and TLSS 2003.

A.3. Public Service Delivery

However, the delivery of public services in social sectors and infrastructure are still deteriorating suggesting that long-run growth potential is at risk. The PAU results show that the situation is still worsening in the social sectors. Enrolment in basic

⁵ However, the results of TLSS 2003 are sensitive to the choice of the PPP (using the average of the World Bank and the OECD PPP calculations, the poverty rate would be 62 percent in 2003 instead of 57 percent).

education declined throughout the 1990s to about 88 percent of the school-age population in 2000 compared to 94 percent in 1989 and it appears that this trend is continuing. Health expenditure declined steeply in the 1990s, from around 5-6% of its GDP to about 1 percent GDP in 2002, or below US\$2 per capita, among the lowest level in the world. The sharp decline in spending by the government has shifted the burden of health spending on the households, leading many households to delay accessing medical care. Access to transport, telecommunications, and safe water, particularly by the poor has also declined. The government is in the process of developing reform programs in these sectors and the Bank has very recently completed sector reviews in education and health which provide options for reforms.

The findings of these two sector reviews have important public finance dimensions. The implications of these studies need to be considered in the context of deepening public expenditure reforms, both at the central and local government levels. One option would be to give more power to local communities and start developing their capacity to absorb donor funding of projects in education and health sectors which would be in line with the government's PRSP objectives. There are new proposals to improve governance at the local level and empowering communities would be an important step for dealing with social service delivery issues and problems. These issues are discussed in more detail later in this chapter and in Chapter 5.

B. Government's Poverty Reduction Strategy and Implementation Challenges

B.1. Poverty Reduction Strategy and Implementation Progress

Tajikistan's PRSP and a Joint Staff Assessment (JSA) were endorsed by the IDA and IMF Boards in December 2002. As noted in the JSA, the PRSP represents an acceptable initial strategy that provides a broad framework for poverty reduction. The PRSP lays out quantitative poverty alleviation targets and presents a comprehensive reform agenda for sectoral and cross-cutting structural reforms. The PRSP attaches particular importance to education, health, and social protection and targets are set for spending increases in each sub-sector which in part are related to the MDGs. The structural reform agenda of the PRSP is ambitious and one key objective is to tackle the long process of institution rebuilding. Public sector reform and improving governance figure prominently in the PRSP. These would be achieved by initiating a civil service reform, improving the legal and regulatory framework for private sector, and restructuring line ministries in line with their new role in a market economy. Reform of public finances to improve transparency and accountability and restructuring of public finance management processes are important cross-cutting themes of the PRSP.

C. Key Issues

PRSP implementation experience to date has been reviewed in the PRSP-PR and its JSA were endorsed by the Bank's Board in June 2004. The JSA, like the PRSP-PR, welcomes the reduction of poverty, but it draws attention to continuing declines of standards and access issues in the social sectors. Strong economic growth performance is noted and attention is drawn to institutional weaknesses which are hindering policy

implementation. In this connection, the JSA emphasizes that re-prioritizing the externally funded PIP and raises concerns about health and education spending. While the JSA expresses general satisfaction with the authorities macroeconomic management, delays in structural reforms are noted, including the deficiencies in farm privatization process, delays with the privatization of medium and large enterprises, and energy sector reforms. Issues related to governance are highlighted and constraints to business environment are noted. The JSA makes the point that these issue are not clearly emphasized in the report and indicates that more determined government efforts would be needed. Taking into account the issues raised in the JSA, and experience with the implementation of structural reforms, four central issues could be identified that are related to public expenditure reforms:

- (i.) *Priority Setting and the Status of the PRSP*
- (ii.) *Policy Formulation Structure: The Role of the State and Capacity Constraints*
- (iii.) *Public Expenditure Framework*
- (iv.) *Governance Issues*

C.1. Priority Setting and the Status of the PRSP

The institutionalization of the PRSP has been slow and its status in the policy formulation process needs to be reaffirmed. While the government has adopted the PRSP in 2002 as the new development strategy, it has been difficult to mainstream the PRSP objectives into overall policy formulation and public resource allocation framework. While the President has indicated his commitment to the PRSP, a number of key ministries and agencies consider PRSP as a document for external use which secures financing for the PIP. With respect to the budgetary planning and the public investment program (PIP), the tendency to follow the guidance of national and regional development programs which are central plan based are still strong. For example, it is the Social and Economic Development Plan (SEDP) that guides the budget process. The PIP is still very much related to the SEDP although the 2004-06 PIP has for the first time pays serious attention to the PRSP. However, there is still serious disconnect among the PRSP, PIP, and the budget. This situation has not been conducive for priority setting and as a result, funding of PRSP programs for which donors have pledged about US\$900 million during May 2003 Consultative Group (CG) meetings, have been far below of expectations to date.

C.2. Policy Formulation Structures: The Role of the State and Capacity Constraints

The overall structure and organization of the government and its associated policy formulation processes have many features of the old Soviet model and capacity of key agencies is low. Although a new system of governance has been defined by the 1999 Constitution and some policy reforms have been implemented, Tajikistan's policy formulation process has serious deficiencies in the organizational structure and management. Policy making is fragmented and this results in parallel resource allocation mechanisms in addition to the PRSP. Deficiencies in this area are not only undermining the implementation of the PRSP but daily functioning of the government. The existing

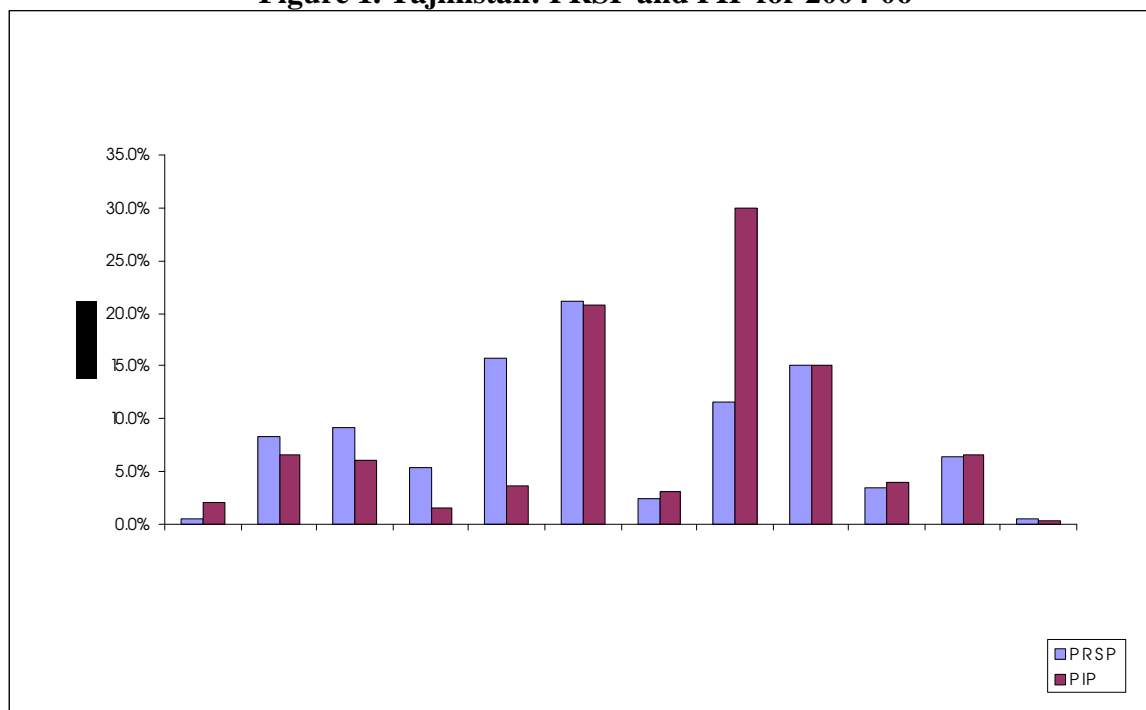
structure does not provide the incentives for line ministries to prioritize as their programs are based on inputs, or obtaining funds from the budget or donors, and not on outputs, more specifically the delivery of public services. The concept of the role of the State is evolving and the government is still involved extensively in market and production of commercial goods and services which is not in line with its role in a market economy context. Apart from these issues the capacity at the key government institutions is low. The departure of many qualified civil servants during the civil war and the difficulty of attracting new talent with the current civil service wage scale means the recovery of key public policy institutions is likely to remain very slow.

C.3. Public Expenditure Framework

While higher levels of donor funding is needed for PRSP, the country is facing serious absorptive capacity constraints and can not effectively use committed funds. As discussed in Chapter 2 public spending per capita is at very low levels and possibilities for inter-sectoral allocation of resources is very limited. This in turn implies that existing resources must be augmented with donor funding in the short term as tax revenues are not projected to increase beyond 18 percent during the next few years. While this is so, turning commitments into disbursements have been particularly challenging. For example, in 2003 the World Bank disbursed only 10 percent of its yearly allocation and other donor data suggests the same which are indicative of serious capacity constraints, both financial and human. However, it is not clear if this is well understood. For example, the 2001-2003 PIP called for investments of US\$688 million over a three year period and expected this to be funded by donors. In its recent efforts to scale down the PRSP envelope, the government has reduced the PIP to \$361 million over the next three years, which represents a reduction of nearly 47 percent. However, this new envelope is still unrealistic in light of the past PIP disbursement profile that averaged only \$30 million annually suggesting that a credible prioritization of PRSP and its associated PIP are needed.

Developing priorities consistent with the macroeconomic framework and absorptive capacities is one of the key challenges. The implementation of a credible poverty reduction program requires having a basic financial framework that takes resource constraints, including external debt, into account: this is the first step of the prioritization process. At present there is no formal structure and process that has the mandate for setting priorities and analyzing trade-offs involved in deciding about programs and resource constraints, and linking policies to the budget process. While an embryonic Medium-Term Budget Framework (MTBF) was prepared for the May 2003 CG meetings, this was never adopted and hence the 2004-2006 PIP continues to be beyond the institutional and financial means of the government. For example, while the debt financed PIP is limited to 3 percent of GDP, there is no limit or a target for grant funded programs. In practice, absorbing new grants would be constrained by counterpart funds and recurrent costs of capital investments which should be factored into the budget. However, this is mostly not done and absorptive capacity of the budget at the macroeconomic level is not fully taken into account. This has implications for the PRGF program and undermines donor perceptions of the policy management process.

Figure 1. Tajikistan: PRSP and PIP for 2004-06



Linking priorities and policies with the budgetary and PIP process has been difficult

The PRSP-PR notes that “despite continuing structural reforms in the budget management, budget allocations still reflect a planned economy system”. It is further indicated that PRSP priorities have not been explicitly communicated to the MOF, other line ministries, and local governments which then results in inconsistencies between among the PRSP, PIP, and the budget as noted earlier. Apart from the policy issue the budgetary process itself is still central plan based which is based on norms and is incremental in nature. The view that the existing (old) system was functioning in a satisfactory way is still pervasive and a significant portion of policymakers consider that shortage of funds is the problem, not the budgetary process. For the PIP, the allocations emphasizes energy and transport (figure2). The transport and energy sectors account for about 45 percent of total resources⁶, while those allocated to the social sectors account for about 11 percent. By contrast, transport and energy account for 26.6 percent in the PRSP, while social sectors account for about 42 percent. The lower amount of resources allocated to the social sectors in the PIP are envisaged to be financed by the relatively large share of technical assistance grant support⁷. Similarly, the higher level of resources for energy and transport in the PIP (45 percent) are offset by the small share of technical assistance.

⁶ This reflects the government’s desire to integrate the Sogd region in central Tajikistan with the Khatlon region through transport and energy networks. The transport link includes the construction of the Anzob Tunnel, while the energy link includes the construction of electric transmission lines from Rogun hydropower complex to Sogd region.

⁷ The technical assistance program includes 83 projects and is estimated at US\$90 million.

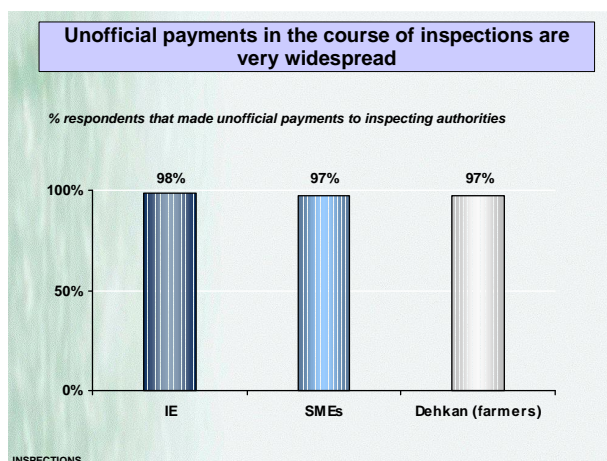
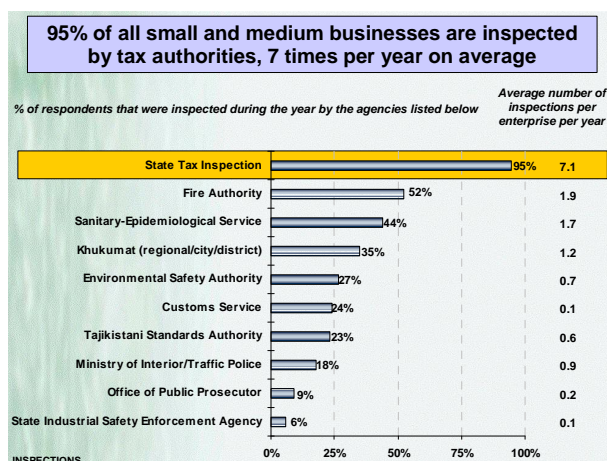
There is too much emphasis on centralized investments without sufficient attention to investments and public service provision that could be undertaken by local communities. Tajikistan's overall public expenditure management framework is still very much center driven. While local governments now play a major role in the delivery of most key of key public services, their budgets are determined through a negotiation process largely controlled by the MOF, and their allocations have been very low compared to the responsibilities assigned to them. Public expenditures received and spent by local governments are at 5 percent of GDP out of a total of 15 percent for Tajikistan and this is low by international standards. Furthermore, local governments have limited revenue-raising powers and the annual budget cycles without a medium term financial framework does not provide a reasonable estimate of funds that are likely to be available and local budgets are subject to considerable amount of certainty. However, there are new reform proposals which aim at delegating more powers to local governments and communities and with these changes it maybe be possible to support local investments. While a number of donors are implementing community driven development projects (CDD), resources provided under these schemes are small given the needs and with local government reforms gaining momentum a strategy that has the potential to scale-up resource flows to local communities would be a very valuable instrument to attract higher levels of donor funding and augment the centralized PIP.

C.4. Governance Issues

Poor governance and corruption undermine policy implementation and the image of the country. Effective governance is one of the four pillars of Tajikistan's PRSP and this has been the most challenging area for the government. The collapse of the FSU not only resulted in the loss of large budgetary transfers but left behind a large public sector with very low wages. The eruption of civil war that intermittently lasted almost 5 years between 1992-97 was a severe blow to the country's overall governance structure which destroyed much of the inherited accountability mechanisms. Furthermore, the fact that ending the civil conflict necessitated the accommodation of the demands of various disparate groups which now represent the status-quo means that improving governance would be a slow process. These difficulties were exacerbated by the regional conflict in Afghanistan starting in late 2001 which worsened the drug trafficking situation adding another dimension to existing problems. In short, the circumstances, both domestically and regional have made the implementation of governance related measures difficult for Tajikistan. Legislation enacted for market institutions since 1991 could not be implemented until 1998 due to civil conflict and capacity to administer these laws are limited. Judicial reforms are in early stages and enforcement of contracts is problematic. The fact that the old system is based on controls and orders rather than incentive based performance results in highly centralized implementation processes which undermines transparency.

Figure 2.

Figure 3.



Deficiencies related to institutional framework encourage rent-seeking and the development of public accountability systems are at early stages. Lack of accountability in the public sector is a problem and this leads to arbitrariness within the entire system of governance. Public accountability framework is still developing and some of the basic laws in this area have only been enacted in 2001. As the PRSP-PR notes that “Transparency and accountability are not embraced priorities yet”. Taken together, these deficiencies encourage corruption and affect perceptions of the society at large as well as the international investors and Tajikistan is ranked 124th out of 133 countries by Transparency International’s Corruption Perceptions Index at the end of 2003. The business environment and investment climate are currently unfavorable for both domestic and foreign investment due to heavy government regulations (excessive inspections and licensing requirements) and ad-hoc interventions that lead to corruption as shown in a recent IFC survey (figure X). The business sector is confronted by the high costs of doing business, such as high tax rates, contradictory legal and regulatory provisions or lack thereof and weak enforcement of laws and this is undermining SME growth, one of the key vehicles to reduce poverty.

Weak fiduciary management, based on recent World Bank assessments⁸, is affecting governance. Fiduciary management encompasses procurement, financial management, and disbursement⁹. Weak fiduciary management is characterized by poor functioning of the public accountability system, lack of transparency at all levels of government, weak control and limited supervisory checks and balances, and rare cases of sanctioning. The accountability framework does not provide significant control to prevent misuse of public funds. This is further complicated by capacity constraints in human and technological

⁸ The World Bank, CPAR (2003) and CFAA (2003). The two studies focus on the review and assessment of the adequacy and transparency of the budget implementation process, including procurement and review of the monitoring, reporting and audit systems for public financial flows.

⁹ It provides assurance that donors’ funds are used for the intended purposes specified in the loans, credits, and grants. For budget transfers, fiduciary management largely depends on the country’s rules on public financial management, including budget and treasury management, procurement, reporting, audit, and accountability. For projects, however, fiduciary management depends on the financial management capacity of the PIU. Specific donors’ rules on procurement are applied to almost all transactions, periodic financial reporting, and auditing of project accounts.

resources that undermine ongoing reform of the public financial management system. Consequently, public funds face high risks, which weaken the quality and credibility of governance and this undermines donor confidence. The environment for conducting public procurement is risky. In terms of project implementation, tender for bidding lacks transparency and openness. Frequent staff changes in the Project Implementation Units (PIU) and large salary discrepancies among PIU and government staff create conflict and tend to slow project implementation. Competition for contracts under donor-financed projects is compromised because the supply of contractors and consultants is inadequate, and because the political and security situation hinder suppliers' participation in bidding. This situation affects both donor disbursements and efficient management of public funds as well as public service delivery.

FOCUS OF THE REPORT

The review of issues discussed in the previous section suggest that there are three cross-cutting issues: (i) implementation of the PRSP requires affective policy formulation to deal with the fragmented nature of policy making and to consolidate the various parallel resource allocation mechanisms through public expenditure reforms so as to ensure that resource use reflects scarcity and priorities; (ii) prioritization is critical for attracting higher levels of donor funding but institutional capacity to do so for appropriate policy design and implementation is low which means that there is a need for medium-term strategy and (iii) public expenditure management (PEM) reforms should be one of the key instruments to improve governance and reduce corruption, and with due consideration of reform options at the local government and community level for improved service delivery, particularly in the areas of education, health, and infrastructure.

Therefore, the PEIR focuses on these three issues for which the Government has requested assistance. The Government is attaching a great deal of importance for the development and implementation of a public expenditure reform program to obtain higher levels of donor funding for operationalizing its PRSP. While the internalization and re-orientation of government programs towards the PRSP process has been progressing slowly, the process nature of the such changes need to be recognized and in the absence of experience other than central planning, the tendency to revert to old ways of doing business must be considered normal. It is also being increasingly recognized that even if increased donor funding do not materialize, the existing system needs to be modernized so as to improve public service delivery. Given these objectives the PEIR aims for (i) providing a diagnosis of deficiencies in the policy formulation process and public expenditure framework; (ii) developing policy proposals that could be implementable in the short-term to attract more donor funding; and (iii) outlining a roadmap and policy proposals for more difficult reform areas, such as public administration reforms that require a longer time to implement.

Given the capacity constraints, it is important to have a medium-term and well sequenced approach to public expenditure and institutional reforms. The strategy adopted in this report is two-fold: First, review the existing public expenditure system rigorously and inform the government about key deficiencies and present the set of policy

proposals to address these. Second, develop the key elements for a set of reforms for education and health on an MTBF basis to attract higher levels of donor funding. The Bank and other donors have recently of view and these should be integrated to the public expenditure framework. While full implementation of such programs will take time it is important to start work in these two critical sectors which intensified their efforts in these sectors and with the government's strong support feasible sector strategies have been developed. Preliminary medium-term financial plans for these strategies have also been developed and the government is considering adopting these. These strategies phase-in major changes, both from sector development and public expenditure management points are important for long-run growth.

The PEIR recognizes the capacity constraints explicitly and for this reason key policy areas are coupled with a TA program or an IDF grant. As noted already capacity constraints are a major bottleneck for mainstreaming PRSP objectives and programs into the broader policy and resource management framework. For some areas, such as the budget reforms, there has been a Bank credit funded TA program that lasted for about 3.5 years and this has come to an end in March 2004. In order to keep the momentum going the PEIR team has obtained funding from donors to build on work that supported the development of a MTBF and to further build capacity in this area. For the PIP process, the PEIR team has worked in close collaboration with the AsDB and USAID and supported the development of the 2004-06 PIP. As the PEIR makes additional policy recommendations and proposes a number of changes to improve the current PIP planning, new funding and training to implement these has been obtained from a donor. In order to support a more effective policy formulation process, a Leadership Training Program has been developed with the support of WBI and LICUS group and the first of a series of planned meetings were held in May 2004 with the participation of seasoned reformers.

Specifically, the PEIR reviews and develops a reform agenda in the three most important areas of the current public expenditure management system: (i) policy formulation and organization of the government, including public administration and human resource issues; (ii) budget development and management process; (iii) intergovernmental issues and local government reforms; (iv) public investment program planning and process. The aim is to facilitate the alignment of public expenditures rigorously with the priorities emerging from the PRSP and provide the basis for the development of a MTBF in line with available resources and at the same time contribute to capacity building. How should the Government think about its resource envelope given the debt problem and low tax revenue generation capacity? What instruments, policies, and processes are needed in the short and medium terms to ensure that Tajikistan has the appropriate resources to implement its PRSP and maintain macroeconomic stability at the same time are the key questions this first PEIR attempts to provide answers to assist the Government in this reform process. On the institutional side, the focus is on possible policy structures and processes to deal with the fragmentation of policy making and parallel resource allocation mechanisms and on options to reform public administration and wage reform. These questions are also relevant for local government reforms and reforms related to the role of communities which could play a significant role in the mobilization and allocation of resources from the international donor community and the

PEIR offers some reform options in this area to operationalize the current Country Strategy Assistance (CAS).

The PEIR has benefited from the existing and ongoing sector work. The PEIR drew from work related to public expenditure management component of Institution Building and Technical Assistance Credit (IBTA2 which has components for budget reforms and expenditure management and public administration reforms. This operation has been under implementation for about three years and there is a large body of material that the PEIR team reviewed and integrated into the PEIR. In addition, the PEIR benefited from Education Sector Review (ESR, December 2003), Social Expenditures Review (SER, May 2003) and Health Sector Financing Study (HSFS, January 2004). The PEIR also benefited from the Utility Reform Study for the quasi-fiscal deficits (QFD) issue. Furthermore, considering the importance of fiduciary issues in the reform process, the PEIR has been prepared in parallel with the Country Financial Accountability Assessment (CFAA) and Country Procurement Assessment Review (CPAR) and the recommendations of these report have been integrated into the PEIR as appropriate.

MACROECONOMIC FRAMEWORK

A. Macroeconomic Stability and Policy Performance

Macroeconomic stabilization has been largely satisfactory, aided mainly by strengthened budgetary discipline. Tight fiscal policy has been a key instrument in reducing inflation and stabilizing the exchange rate. The overall fiscal deficit (including PIP) fell to 2.4 percent of GDP by the end of 2002 and to 2.1 percent in 2003 when the primary deficit was nearly in balance in both years. Inflation declined to an average of 12 percent in 2002 (from 88 percent in 1997) despite of uneven performance prior to 2001 and increased up to 16 percent in 2003. However, there are recent signs that inflationary pressures are increasing reflecting monetary policy weaknesses. After the conversion of the Tajik ruble to the Somoni in 2000, the currency substantially depreciated but stabilized soon afterwards. The real exchange rate appreciated slightly 2 percent during 2003. These, combined with ongoing structural reforms, have fostered strong economic growth, thereby, increasing employment.

Monetary policy management remains weak. The monetary sector suffers from an under-developed financial system, weakness in institutional capacity, and lack of independence of the National Bank of Tajikistan and at 16 percent inflation remained high in 2003. The mechanisms for implementing monetary instruments are limited to the purchase and sale of treasury bills and certificates of deposits in a shallow financial market. Weakness in institutional capacity of the Central Bank makes liquidity control more difficult and thereby hinders the effectiveness of monetary policy in controlling inflation. These deficiencies are compounded by the Central Bank's inability to resist political pressure for direct credits to state-owned enterprises and the cotton sector. These weaknesses were illustrated by two episodes in 2000 and 2002. In 2000, the net domestic asset target set under the IMF program was unmet because the Central Bank issued direct credit to the cotton sector. This combined with other external factors drove up inflation sharply by 61 percent at end 2000. Secondly, inflation surged to 14.5 percent

at the end of 2002, partly because the Central Bank did not sterilize its foreign exchange interventions and continued to issue direct credit. In 2003 unsterilized foreign exchange purchases led to the expansion of growth money and together with the increases in staples this kept inflation rate higher than programmed under the PRGF. NBT started to tighten the monetary policy in early 2004 strictly controlling the reserve money ; it yielded declining inflation – 2.1 percent for 7 months of 2004.

The country's external position has been unfavorable since the end of the conflict, but recently there have been signs of improvement. The financial crisis actually improved the current account deficit, falling sharply in 1998 from 8.3 percent of GDP to 3.4 percent in 1999, largely due to strong export growth of aluminum and electricity. However, the external deficit worsened during the following years because of the declines in international prices of cotton and aluminum, two consecutive droughts (affecting electricity, wheat production and energy imports), and greater import demand encouraged by increased workers' remittances. But by 2002, the deficit shrank to 2.7 percent of GDP, due in large part to strong exports, increased humanitarian assistance and increased workers' remittances. International reserves, which by end-1997 were equivalent to 0.6 months of imports of goods and services, had by end-2002 accumulated to reach 1.8 months of imports. In 2003, the current account deficit was about 2.9 percent of GDP, lower than the projected 5 percent due to the strong growth, as a result of higher than expected workers remittances. However, strong import growth at about 20 percent in 2003 is a source of concern.

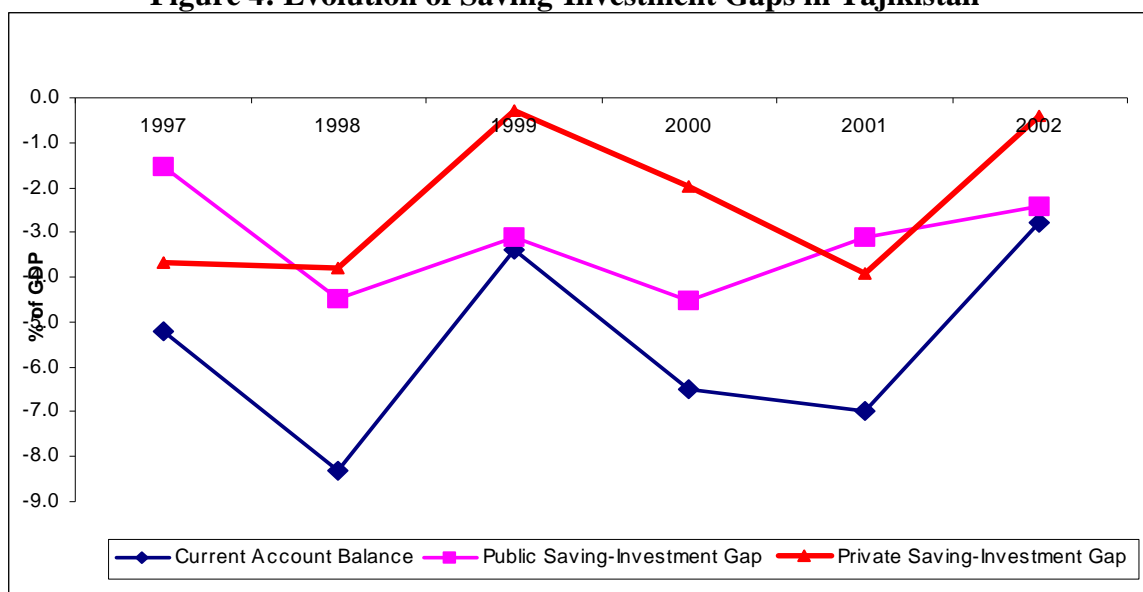
Table 2.

Tajikistan : Key Macroeconomic Indicators, 1997-2002

	1997	1998	1999	2000	2001	2002
GDP Growth	1.7	5.3	3.7	8.3	10.2	9.1
GDP	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	32.0	25.1	25.4	27.0	26.5	22.0
Industry	22.0	20.1	21.7	23.9	22.4	18.7
Trade	20.9	22.6	20.1	18.5	19.3	19.4
Others	25.1	32.2	32.9	30.6	31.8	39.9
Prices						
CPI Inflation						
Average	88.0	43.2	27.5	32.9	38.6	12.2
End-of-period	163.6	2.7	30.1	60.6	12.5	14.5
Nominal Exchange Rate (Somoni/US\$)				47%	32%	17%
Average	563.6	0.8	1.2	1.8	2.4	2.8
End-of-period			1.4	2.2	2.5	3.0
Real Exchange Rate (May 1995=100, + appreciation)	232.0	238.0	187.0	160.9	167.4	
Terms of Trade	109.0	102.2	95.6	92.3	83.3	76.3
Exports (1993=100)	157.0	139.0	130.0	143.0	130.0	
Imports (1993=100)	144.0	136.0	136.0	155.0	156.0	
<i>(Percent of GDP)</i>						
General Government Finance						
Total Revenues	13.7	11.7	13.5	13.6	15.2	16.7
of which Taxes	13.3	11.3	12.8	12.9	14.1	14.7
Total Expenditures	17.0	15.8	16.6	18.2	18.4	19.2
of which: Interest	0.8	0.7	0.6	0.4	1.5	1.9
Public Investment (including PIP)	0.6	2.8	3.4	6.6	5.1	5.4
Primary Balance	-2.6	-3.4	-2.5	-4.2	-1.7	-0.6
Overall Fiscal Deficit (incl. PIP)	3.3	4.2	3.1	4.6	3.2	2.4
Debt Service						
Total Public Debt Stock						
Money						
Broad Money	8.6	6.9	6.8	8.3	7.9	5.8
Velocity	18.9	21.1	22.4	12.1	12.6	12.2
External Sector						
Export GNFS	69.0	48.2	64.2	81.1	61.5	58.5
Import GNFS	74.4	57.3	65.7	85.2	73.6	71.6
Current Account Deficit	5.2	8.3	3.4	6.5	7.1	2.1
Direct Foreign Investment	1.6	1.9	1.9	2.4	0.8	1.8
Stock of International Reserves (months of Imports)	0.6	1.5	1.7	2.1	1.9	1.8
Total External Debt (Mill.US\$)	1065.3	1249.1	1281.5	1041.8	1086.0	
External Debt Service						
Memorandum items:						
GDP (in million of US\$)	1120.5	1320.1	1086.6	991.0	1055.5	1197.0
GDP per capita (US\$)	186.2	215.5	176.5	160.6	169.6	170.0

The saving-investment gap appears to have improved recently. The improved macroeconomic environment contributed to increased saving and investment¹⁰. During the last few years, the level of public savings improved, reflecting a decline in the overall public sector deficit as a result of strengthened fiscal discipline. The government national accounts statistics indicate that increased income contributed to increased gross saving associated with fixed assets and an increase in the stock of tangible working assets during 2001-02. However, if the quasi-fiscal activities in the energy sector is taken into account, the situation will change drastically as discussed in the next section.

Figure 4: Evolution of Saving-Investment Gaps in Tajikistan



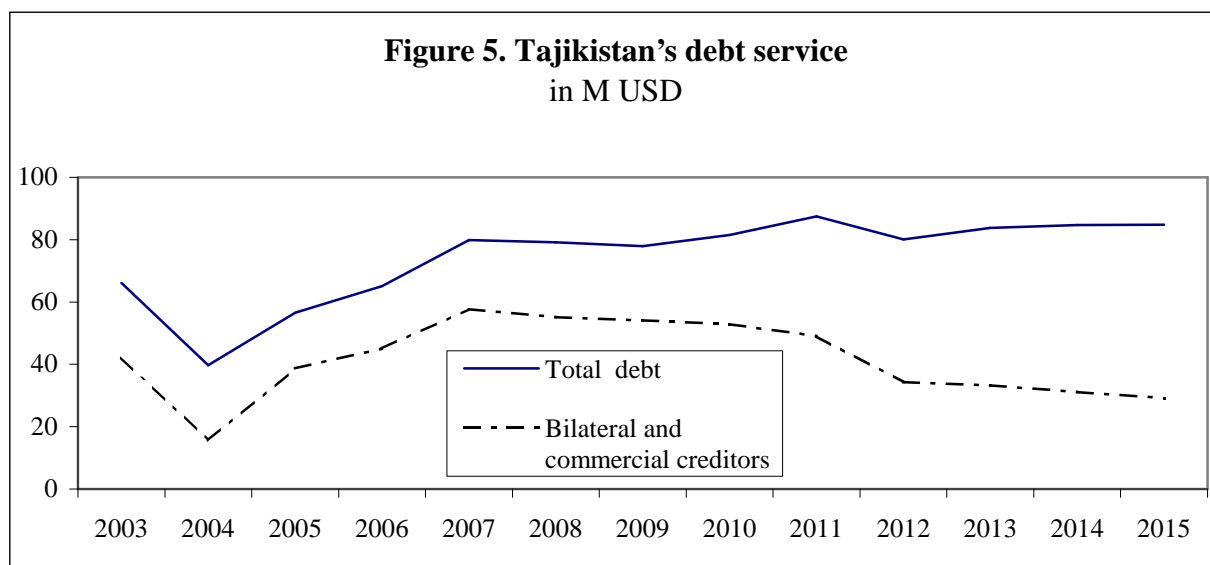
B. External Debt and Vulnerabilities

Tajikistan's external debt continues to be fiscally unsustainable. Starting with no external debt at independence Tajikistan has accumulated a large debt stock, which currently stands at about US\$1 billion, of which US\$982 million (81 percent of GDP) is public or publicly guaranteed debt. The nominal debt stock amounted US\$775 million in NPV terms at end-2003. End-2003 nominal stock of debt represented 66 percent of GDP against 81 percent of GDP as of end 2002. The NPV of debt represented 142 percent of exports¹¹ and 320 percent of government revenues at end 2003 which is an improvement compared to 2002 at 167 percent and 351 percent respectively. This has been due to strong GDP and revenue growth and bilateral debt rescheduling agreements reached with

¹⁰ Because national accounts data is unreliable, the analysis of savings and investment is used as a proxy for reviewing the saving and investment trends. The current account deficit implies the size of the national saving-investment gap. The private saving-investment gap is derived based on the current account deficit and the public sector saving-investment gap.

¹¹ Exports net of alumina imports and electricity exports.

main bilateral creditors, including Russia and Uzbekistan. Debt rescheduling arrangements allowed reducing cash outflow by US\$ 85 mln in 2003. However, with the expiration of grace periods on these debts Tajikistan will face with the hump in debt service during the next ten years, with debt service absorbing around 23 percent of government revenues from 2003 to 2008 with implications for the implementation of the PRSP and for the determination of the overall resource envelope within policy choices have to be made.



Tajikistan's external debt profile is highly vulnerable foreign currency earnings from exports of aluminum, electricity and cotton, and susceptible to growth slowdown. This dependency is the most critical given that its revenue to GDP ratio is the lowest among CIS countries. Tajikistan's external debt is mostly denominated in US\$ and SDRs. Its debt service is estimated at 11 percent of exports of goods and services from 2003 to 2008. Tajikistan has a narrow export base, comprised of aluminum, electricity and cotton, which accounted for 85 percent of exports in 2002¹². Both aluminum and cotton export earnings are vulnerable to price volatility. Energy trade balance was negative in 2002, Tajikistan imported \$82 million and exported \$67million and similar magnitudes were recorded in 2003. It should also be noted that Tajikistan imported \$178 million of alumina in order to produce and export \$399 million of aluminum in 2002 and prices of both have been volatile and this was one of the key reasons for the large current account deficits in 2001 at 6.7 percent of GDP. As noted strong growth was the main factor for improved debt indicators in 2003 contributing to higher revenues as well, and a slowdown would worsen the debt service profile presented above significantly. Hence, Tajikistan is exposed to vulnerabilities related to terms of trade and growth and the stability the country enjoyed in the past few years cannot be taken for granted.

¹² When exports are net of alumina imports and electricity exports, aluminum and cotton still represent 75 percent of exports.

Box 1: Managing Tajikistan's Dependency on Aluminum and Cotton

The 2000-2002 price swing for both cotton and aluminum was not as extreme as the booms of the 1990s but was fairly typical of short-term price behavior. These large term-of-trade shocks put considerable demands on Tajikistan's macroeconomic management capabilities.

The right policy response to term-of-trade shock depends on the nature of the shock. A permanent improvement in the terms of trade should lead to higher spending, an appreciation of the real exchange rate, and a move of investment and labor to the non-tradable sector.¹ A temporary improvement should lead to higher savings, a stable exchange rate, and requires resources to remain in the tradable sector. Fiscal policy can help in adjusting to terms-of-trade shock. Because Tajikistan will remain dependent on aluminum and cotton for years to come, Government should give priority to developing adequate policies and institutions to mitigate the detrimental effects of price booms and busts. Experience from other countries in managing booms shows that the following policies promise to maximize the beneficial effects of commodity booms:

- *Do not overspend or over-commit.* Government should not commit to long-term spending that will be unsustainable when a boom fizzles. Commitments to generous entitlements or long-term projects on the basis of boom-level revenues are hard to reverse. Budgetary procedures may impede the rapid adjustment of expenditures or, under pressure of declining revenues, may cut into desirable expenditures, while less-efficient but well-protected once are unaffected. For this reason, Tajikistan could reconsider their procedures for budget adjustment during the year.
- *Invest in diversification.* Tajikistan could promote economic diversification by using incremental revenues to invest in infrastructure, agro-business, and services which in turn require skilled labor and education.
- *Consider a revenue stabilization fund.* By saving revenues in boom years and depositing them at the central bank, Government could iron out expenditure fluctuations, while sterilizing the foreign exchange inflows in boom years. Chile, which depends on copper, albeit far less than Tajikistan, has successfully implemented such scheme.
- *Hedge.* Hedging can reduce the impact of price fluctuations on the economy and the budget. Aluminum futures, swaps, and options are actively traded in several commodity markets around the world, and could be used by Government to hedge against aluminum and cotton related revenue risk over the budget year. However, Tajikistan only has access to a limited range of instruments, due to its limited creditworthiness. Moreover, since hedging is an insurance against price risk, it comes at a cost, and requires sophisticated administration and dealing.
- *Avoid price stabilization funds.* International agreements (buffer stocks, export quotas, price stabilization funds) do not work. They are unlikely to keep prices high or stable in the long run. Agreements that have been set up in the past have only been successful in the short run.

¹Typical non-tradable sectors are construction and utilities.

C. Fiscal Performance and Policy

The general government budget position has steadily improved. In 1998, a year after peace had returned, the general government fiscal deficit (including the PIP) registered 3.8 percent of GDP; by 2002, it had fallen to 2.4 percent. Over the same period, the primary fiscal deficit fell from 3.4 percent of GDP to 0.6 percent. In 2003 overall fiscal balance registered a surplus of 0.6 percent of GDP (excluding PIP) and a deficit of 2.4 percent of GDP (PIP included). These results are commendable, and were largely the result of a well maintained fiscal discipline. In fact, Tajikistan's successful macroeconomic performance owes much to the efforts realized in the fiscal area. However, the overall deficit of 2.4 percent should be viewed with a caution given the debt issue. Fiscal adjustment relied on reductions in expenditures, improved expenditure management, and increased revenue. However, it was mainly expenditure reduction that

played the key role in controlling the deficit, especially in the immediate aftermath of the civil war. Revenue enhancement measures only led to increased tax yields in 2000 and these were spent to offset the increased expenditures.

However, the quasi-fiscal deficit of the energy sector (gas, electricity, and heating) is large and could undermine progress in fiscal adjustment. The estimated quasi-fiscal deficit in the combined energy sector (gas, electricity, heating) reached about 23 percent of GDP in 2003. Most of the quasi-fiscal deficit reflects the situation in the electricity (20 percent of GDP) and gas (1.9 percent of GDP) sectors¹³. The causes of the quasi-fiscal deficit include lower tariffs, poor collection rates, and technical losses, all of which encouraged over-consumption and the accumulation of arrears by the large enterprises such as TADAZ. Low collection rates led to under-investment of the sector, and as a result infrastructure deteriorated. Low rates also saddled the energy sector with consumer-owed debt. Arrears with energy suppliers accumulated, which constituted contingency liabilities that undermined the government's sound fiscal practice. Recently, the government has taken steps to control the quasi-fiscal deficit by increasing tariffs to a cost-recovery level and by improving the targeting of energy consumption subsidies to vulnerable groups. However, it is clear that without restructuring the energy sector it will be almost impossible to deal with this situation and this is one of the key challenges facing the Government.

Box 2. Quasi Fiscal Deficit (QFD) for Electricity in Tajikistan

A measure of the impact of a state utility such as Barki Tajik on public finances is the QFD. The intent is to estimate the misallocation of resources arising from non-budgetary entities that undertake activities of a fiscal nature¹⁴. Energy QFDs give rise to over consumption, insufficient investment, production inefficiencies and crowding out of the private sector (as public subsidies may be needed to finance the deficit). With tariffs below the economic levels energy companies are under investing and depleting their capital stock.

The QFD for the electricity sector is caused by (a) pricing energy commodities below their economic costs; and (b) operational inefficiencies.

- The economic cost of electricity is determined by the LRMC of electricity supply to the end consumer. The economic price of tradable commodities such as crude oil and coal is determined by their border price adjusted for any additional transportation and O&M costs, excluding financial costs such as duties, and taxes.
- The operational inefficiency can be split up into: technical losses (losses in the networks) and commercial losses (Unbilled losses and non-payments).¹⁵

Estimates of the QFD for Barki Tojik for 2002 and 2003 are given in Table 10. The figures show a substantial reduction from 2002 to 2003 - of \$125 million. Most of this came from the increase in the average tariff, which more than doubled: from 0.2 to 0.44 US\$/kWh, as well as installation of meters. There was also a fall in the technical and unbilled losses of nearly \$50 million. Non-payments, however, went up by about \$9 million, which is not unexpected when tariffs are raised in percentage terms as much as was the case here.

¹³ International Monetary Fund, "Tajikistan: Recent Economic Development," January 2003.

Table 3. QFD for Electricity Sector in Tajikistan

Source	Amount \$US Mln.	As % of GDP
2002		
Tariff Levels below LRMC	247	
Technical and Unbilled	78	
Losses	<u>7</u>	
Non-payment Losses	332	30
Total		
2003		
Tariff Levels below LRMC	165	
Technical and Unbilled	25	
Losses	<u>16</u>	
Non-payment Losses	<u>207</u>	20
Total		

Source: Barki Tojik and Government of Tajikistan. Note: The LRMC for both years is taken as 2.1 US¢/kWh

While the improvement in the QFD is welcome, the position remains far from satisfactory.

At 20 percent of GDP, the level in 2003 remains unacceptable. Further measures are urgently needed to reduce the QFD and bring it to within manageable proportions.

Expenditures, after a sharp reduction in 2000 to curtail the fiscal deficit and inflation, expenditure have increased. Registering 14.2 percent of GDP, the sharp reduction was achieved through reductions in non-wage current expenditures and subsidies in response to a surge in inflation and the current account deficit in 2000. But two years later, the figure reached 16.8 percent (end 2002) as greater revenue during 2001-02 provided scope for the government to reverse the past expenditure trend. The increases were the result of increases in non-wage current expenditures, transfers to households and interest payments. The ratio of total wage bills to GDP declined (from 3.7 percent in 2000 to 3.2 percent in 2002) despite public employees' wages were raised, respectively, by 25 and 30 percent in 2001 and 2002. This is because of a 5 percent across-the-board reduction in the number of civil service employees. Non-wage current expenditures increased by nearly 1 percent of GDP during 2000-02. Interest payments increased to 1.9 percent of GDP in 2002 (from 0.4 percent in 2000) due to a sharp depreciation of the currency

¹⁴ See, Petri, M. G. Taube and A. Tsyinski, *Energy Sector Quasi-fiscal Activities in the Countries of the Former Soviet Union*, IMF Working Paper, WP/02/60, 2002.

¹⁵ A portion of the technical losses occurs in cases of unmetered supplies which are usually billed on the basis of norms; and the consumers routinely consume more than the norms, which gives rise to unbilled consumption.

during 2000-02. Capital expenditures, financed from budgetary resources and donors, had been increasing since 1997 as a result of rebuilding efforts following the war.

The functional classification of expenditure suggests that social expenditures have slowly increased during 2000-02. Due to the change in the functional classification in 2000, expenditure statistics are comparable only for periods that follow. From a level of 6.4 percent of GDP in 2000, social expenditures (education, health, social protection, housing, and others) have slowly increased to 7.1 percent (2002). The share of social sectors in total expenditure has also risen, reaching 44 percent, reflecting greater efforts to improve the quality of services and outcomes and to tackle poverty. The increase in social expenditures was accompanied by an increase in revenue and a reallocation of resources away from the defense, general administration, and economic sectors to the social sectors. In 2003 there was a slight increase in the share of social sectors (X percent).

Tajikistan's tax revenue ranks the lowest among CIS countries. Its average ratio of tax revenue to GDP for the 1997-2002 period came to 13.2 percent of GDP and ranks at the bottom among CIS countries. While this ratio reached to 15 percent in 2003 is still below the average ratio of 7 CIS countries (19 percent). The reasons for low tax revenues reflect a low degree of monetization, weak tax enforcement, low tax compliance, prevalent tax evasion, and weak governance. After independence, tax revenue fell by over two-thirds (from 35 percent of GDP in 1992 to 11.3 percent in 1998, their lowest level), reflecting a collapse in real GDP and weak tax administration. After 1998, tax revenues began to gradually recover and reached 15 percent of GDP in 2002 (in 2002, GDP was at 69% of its 1992 level). The recent improvement in tax revenue -- especially VAT, sales and excise taxes - is a result of strong economic growth and improved tax and customs administration. VAT payments among CIS countries, which had previously been based on import origin, shifted to the destination principle in 2000. This benefited Tajikistan as it has a net trade deficit with neighboring countries. The excise tax rate was increased (alcohol and tobacco), and taxes on exports of cotton and aluminum were eliminated and replaced with sales taxes in order to reduce vulnerability to export price fluctuations. The income tax rate structure was simplified and the tax base was broadened. Tax administration was strengthened through the establishment of a Large Taxpayer Unit. In 2002, the customs duty rate was unified to a single rate of 5 percent, thereby increasing the effective rate of VAT on imports from 2.4 percent to 5.2 percent; similarly, import duties were increased from 2.7 percent to 3 percent.

However, the main revenue sources are dependent on a few indirect taxes. The revenue from these two taxes (VAT and sales tax on cotton and aluminum) combined exceeded 40 percent of total revenue, equivalent to about 5 percent of GDP (2003). Due to a low excise tax rate and under-reporting of the production of excisable goods, excise tax collection is insignificant and amounts to less than 1 percent of GDP. By contrast, direct taxes (including income, enterprise profit, and property taxes) have produced low yields and accounted for only 20 percent of total revenue due to a narrow tax base, under-reporting of income, weak enforcement, and poor valuation system of real estate property. The current system is still characterized by excessive tax payment, which

weakens tax compliance and encourages tax evasion given the weak tax administration in Tajikistan (Box 1.3.).

Box 3. Tajikistan's Tax Burden

Honest taxpayers in Tajikistan are faced with heavy tax burdens due to the high number of tax obligations, cascading and double taxation, and relatively high nominal tax rates.

There are a total of 17 taxes being collected in Tajikistan based on income, consumption and international trade transactions. Of the total, 14 are collected by the central government and 3 are collected by local governments. A legal entity in Tajikistan pays several taxes, including enterprise profit tax, enterprise property tax, payroll tax (employer's contribution to the Social Protection Fund), excise taxes, import duties, VAT (or simplified tax), road user taxes, and retail sales tax. Enterprises also pay administrative fees as ministries have recently increased the number of license fees. The excessive taxes and administrative fees have created serious problems to business activity and have hindered the development of new enterprises. Similarly, an individual pays about 5 different taxes (personal income (patent) tax, payroll tax, property tax, etc).

The tax system is cascading as several taxes are imposed on the same tax base. For example, consumption is a tax base for VAT (20 percent), road user tax (3 percent), and retail sales tax (with up to 5 percent tax rate). The wage bill is taxed twice, once by public transportation tax (surtax on social fee) and again by income and payroll tax (social fee) paid by employers.

Nominal tax rates in Tajikistan are high. For example, an enterprise pays profit tax at 30 percent, VAT tax at 20 percent (before profit tax), and payroll tax at 25 percent on wage bills. Total taxes for enterprises amount to over 55 percent.

Because of the high tax burden, tax compliance is low as evidenced by widespread tax evasion through under-reporting of income and profit, under-valuation of imports, and smuggling. The degree of tax evasion could be implicitly measured by the size of an informal economy estimated between 30-70 percent of the official economy. Illegal activities, especially drug trafficking along the border between Tajikistan and Afghanistan and unrecorded income, contribute to the large size of the informal economy. The official estimate of shadow activities in the National Account Statistics is about 25 percent.

The Government's deficit financing strategy has been a heavy reliance on external sources. Despite improvement of public savings, Tajikistan's financing strategy has been to rely mainly on external debt, which led to a substantial increase in the public external debt, and an increasingly burdensome debt service obligation. Deficit financing from domestic resources has been limited as the Central Bank's net credit to the Government declined to control inflation, and it is estimated that domestic debt would be around [5 percent of GDP], against 81 percent for public and publicly guaranteed external debt. Tajikistan's foreign direct investment remains low at about 2 percent of GDP, the second lowest among the CIS-7 countries due to unfavorable business environments and investment climate. Privatization receipts have remained insignificant as the privatization process for medium and large enterprises has just recently been initiated.

Despite increased concessional borrowing from multilateral creditors, less-concessional bilateral debt is large. From 1990 to 1996, Tajikistan's debt was exclusively bilateral, while multilateral creditors represented 36 percent of the debt outstanding as of end 2002. However, the financial flows from multilateral creditors and has recently increased would representing nearly almost 100 percent of gross disbursements and this trend likely continues in the coming years as the Government's debt strategy is to rely on concessional borrowing.. This shift in the external debt structure of Tajikistan is positive, as the term of multilateral debt is usually highly

concessional compared to those of bilateral and commercial debt (Table 1.4.). Nevertheless, bilateral and commercial debt still represent two third of external debt. Tajikistan has undertaken a debt rescheduling strategy and has signed bilateral debt agreements with its main bilateral creditors, including Russia and Uzbekistan. The grace period of such agreements is usually equal or less than five years, with an amortization period of 10 to 15 years, at an interest rate of 2.8%. If such conditions are concessional, grace period have expired or are about to expire and repayments will be concentrated in a relatively short period of time. Once the grace period ends, Tajik's debt service burden will peak in 2006-07 as shown in Figure below. A coordinated bilateral debt restructuring strategy will be difficult to implement, as none of the Paris Club creditors represent one third of the debt stock.

Table 4. Tajikistan - Government, public and publicly guaranteed external debt

Debt structure and Average concessionality

In %

	1995	2002	Average concessionality ^{1/}
Multilateral debt	0%	36%	70%
Bilateral and commercial debt	100%	64%	38%

Staff estimates

1/ Government debt only. State enterprises debt is even less concessional than government debt, but data reliability was not sufficient to provide an average grant element.

SUSTAINABILITY OF GROWTH

Economic growth has had a significant impact on poverty as noted earlier which underlines the fundamental role of growth for the PRSP process. However, economic growth cannot be taken for granted and must be sustained over a period of time to reduce poverty and improve general welfare for the citizens of Tajikistan. While Tajikistan has been able to maintain economic stability and economic growth there are two sets of factors that are likely to affect the sustainability of growth in Tajikistan. The first is set is related to macroeconomic management, and, structural reforms, and external debt. The second is related to institutional reforms, which are discussed below.

A. Macroeconomic Management, Structural Reforms, and External Debt

A.1 Economic Growth and External Shocks

Sources of growth have shifted but risks have increased. Initially driven by productivity gains through increased capacity utilization and farm yields which led to higher exports for aluminum and cotton, growth in the past to years have become more diversified. Non-traditional exports and services have expanded and at the same time same worker's remittances have rapidly increased. While it is too early to determine the contribution of remittances to growth, the fact that such capital inflows were about 30 percent of GDP in 2003, suggests that the economy is vulnerable to a reduction in or sudden stop of inflow

of worker's remittances. Other vulnerabilities, beyond the control of the government, include TOT shocks and the government needs to have a strategy to deal with this issue. Some of the available options are indicated in box 1. A sudden movement in the exchange rate would also affect economic stability and hence growth this requires a good monetary and fiscal management which could be facilitated by having a PRGF program.

A.2 Deepening Structural Reforms

Despite progress with first generation reforms, a comprehensive structural reform agenda remains to be implemented, and these are important to further exploit productivity gains. Although a multi-faceted program to reform the economy is underway, much needs to be done in the areas of privatization, legislative/regulatory framework, financial sector, business/investment climate, and the public sector. Designed to foster the development of the private sector, the privatization of medium and large enterprises has yet to be accelerated to reallocate existing resources into productive uses. Further, reforms are required in the financial sector, which is fragile and under-developed. Currently, the private sector has very limited access to credit to help rejuvenate their enterprises. Privatization of farm land needs to be pursued but with much more attention to the governance of the process. With slightly over half of the agricultural land privatized, Tajikistan's agricultural sector can easily add 3-4 percent to growth per annum if reforms are carried out in a transparent and efficient manner. The size of the private sector at 50 percent of GDP remains one of the lowest in the FSU and this suggests that Tajikistan has still a lot to gain from privatization.

A.3 External Debt Management

Unless efficiently managed Tajikistan's external debt will undermine growth. Further borrowing to finance the PIP will complicate debt management and hamper growth. If externally financed PIP respect the current ceiling of 3 percent of GDP set in the PRGF supported program debt service would absorb 23 percent of budget revenues in the few years ahead. If externally financed PIP rises to 9 percent of GDP, with GDP growth unchanged, debt to GDP ratio would stabilize upwards at around 100 percent of GDP. The impact on debt service to government revenues may seem painless in the first ten years if external debt remains concessional with long grace period. However, debt services would almost absorb about 30 percent of government revenues in 2015 after a ten-year grace period expires. Figures 1.6. and 1.7. below illustrate the impact of both scenarios.

Figure 6.

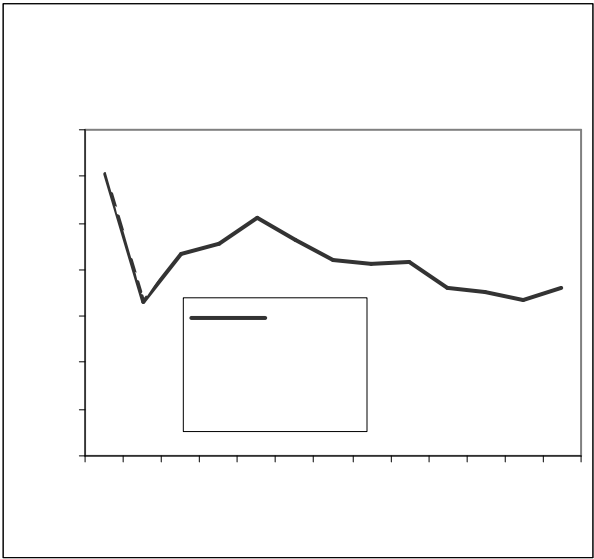
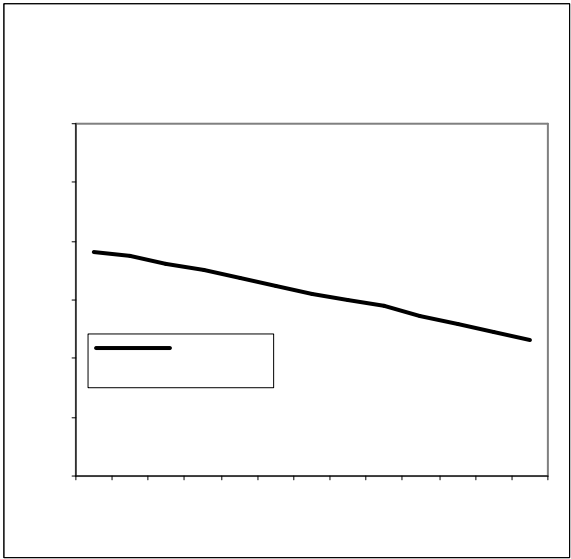
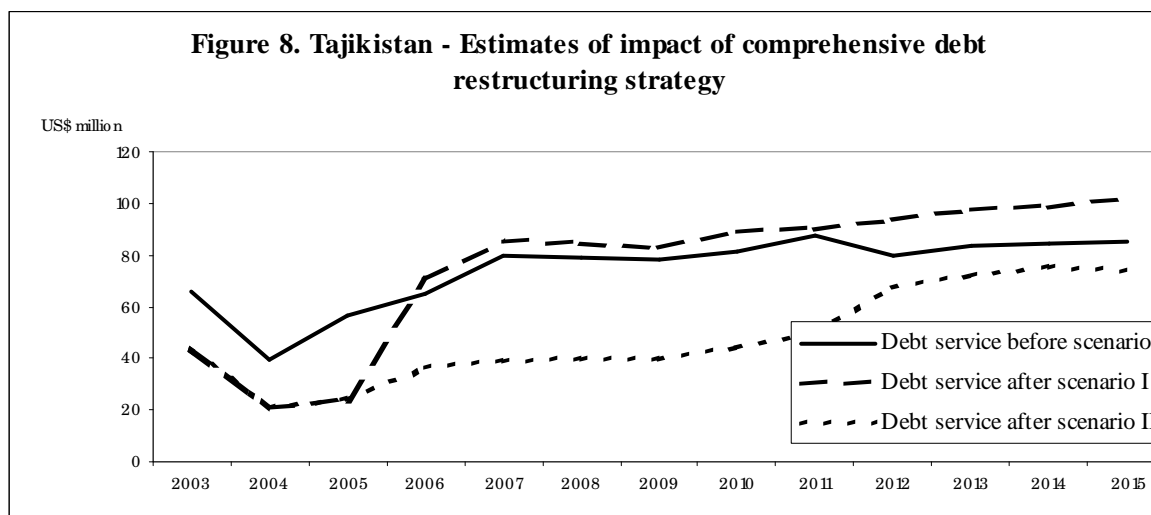


Figure 7.



concessional terms. Applying the “Kyrgyz terms” for Tajikistan, the debt sustainability outlook will improve and fiscal sustainability would ease as debt service requirements will be lowered over the medium and long term. Figure 1.8. below shows the impact of a flow scenario (scenario I), and a flow followed by a concessional stock of debt operation (scenario II). Debt service to government revenues would average 19 percent under Scenario I and 12 percent under Scenario II, compared to 23 percent under the base case scenario.



B. Institutional Reforms and Growth Links: The Broader Agenda

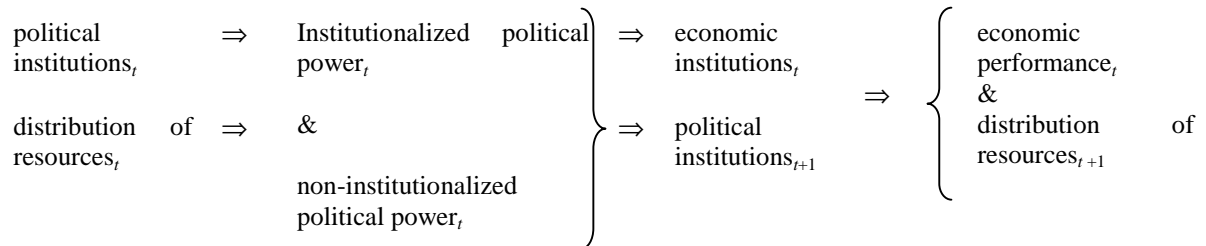
International experience shows that sustaining economic growth is much more difficult than starting it and that sustained growth depends on institutional reforms. Institutional reforms need to be seen from a broad perspective of governance affecting the entire economic system and hence economic growth¹⁶. Public expenditure reforms and other policy reforms proposed in this report are very much part of this process of institution building. As shown by the experience eastern European countries, the full effectiveness of first generation reforms, such as, privatization, and financial sector reforms depends on parallel institutional reforms, such as legal and judiciary, property rights, and rule of law. The concept of institutions is evolving in Tajikistan and sometimes it is confused with development and capacity building of government agencies, such as the MOF. Box 1 clarifies this concept and the links between economic growth and institutions are discussed.

¹⁶ In his discussion of the role of institutions Rodrik makes this point and notes that igniting growth and sustaining are different enterprises. “Growth Strategies” forthcoming in the Handbook of Economic Growth, 2004.

Box 4.

One widely accepted definition is that “Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction”.¹⁷ Institutions condition the incentives individuals face, from investing in physical and human capital to deciding whether to engage in rent-seeking or productive activities. For example, without property rights people will not have the incentives to invest in business or educate themselves as it is the property rights and enforceable contracts that enable them to keep their earnings. Experience has also shown that there are a variety of institutional arrangements and there is no simple or universal way to transform first-order economic principles, such as protection of property rights, competition, sound fiscal and monetary policy, into unique policy packages. This process tends to be context specific and is heavily influenced by a given country’s political institutions, and other mechanisms which resolve conflict of interest among various groups, and ultimately by political power. In addition to determining growth potential economic institutions have an impact on other important factors, including the distribution of resources in the future. Hence, economic institutions influence the size of the pie, the national income, as well as the division of pie among different groups and persons in a given country.

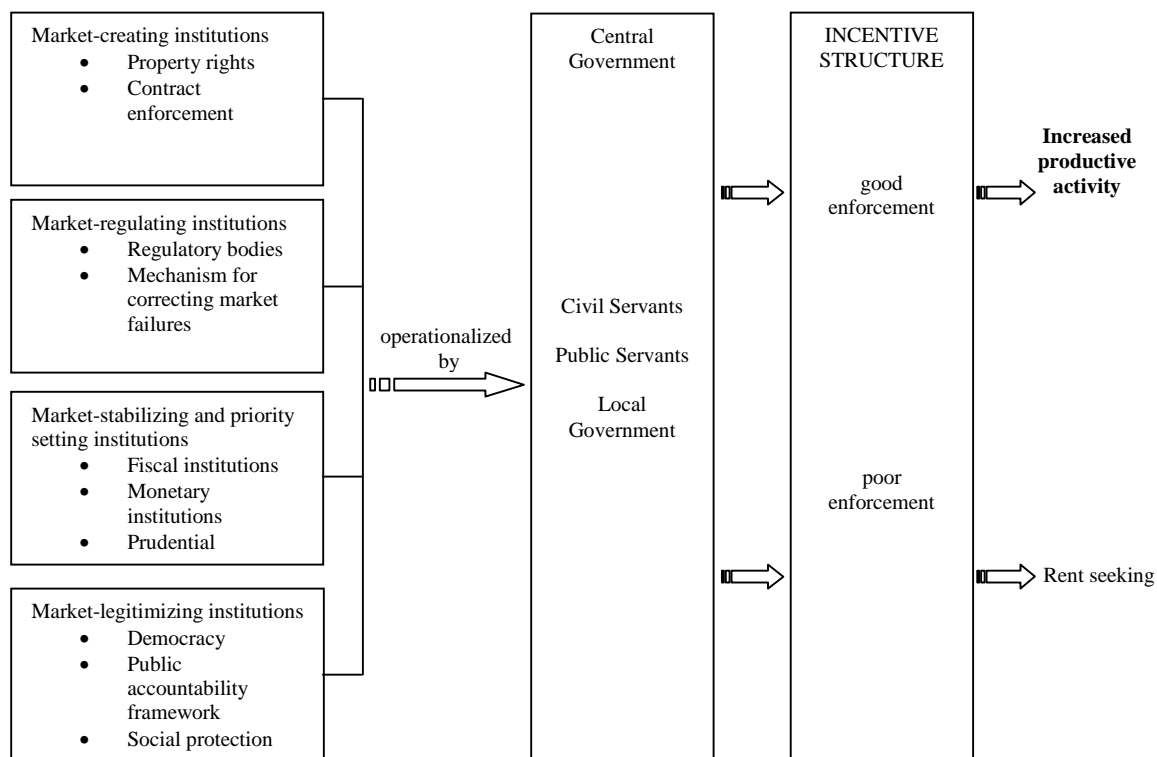
The nature of the use of political power is a key because this determines political institutions which in turn determines economic institutions. The particular issue here is that, as shown by history and economic research, individuals in power can not commit not to use it in their best interests. This commitment problem in turn leads to inseparability between efficiency and distribution” because individuals who gain cannot make compensatory transfers or side-payments to offset the distributional consequences of a particular set of economic institutions which they created¹⁸. Many countries dealt with this problem in the course of their development process and established various forms of political institutions ranging from democracy to dictatorship, or autocracy. Modern democracies, for example established constitutions which sets out certain political institutions and constraints on political elite, which are fundamental rules of the game and institutionalized legal arrangements, or institutionalized power. However, even if they are not assigned power by political institutions, certain groups may possess power, such as the regional interests in Tajikistan. This type of power could be called power that is not institutionalized which depends on their ability to organize themselves and the economic resources they have. In a schematic form institutional development and growth links is as follows:



Tajikistan has made a start in laying the foundations of market institutions and much of its economic performance over the long term will depend on developing these effectively. Turning to specific market -sustaining economic and political institutions - which are likely emerge out of the interactive process described above over time - the following taxonomy could guide the discussion and give an account how far Tajikistan has come along these dimensions of institutional development.

¹⁷ Douglas North, *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press, 1990.

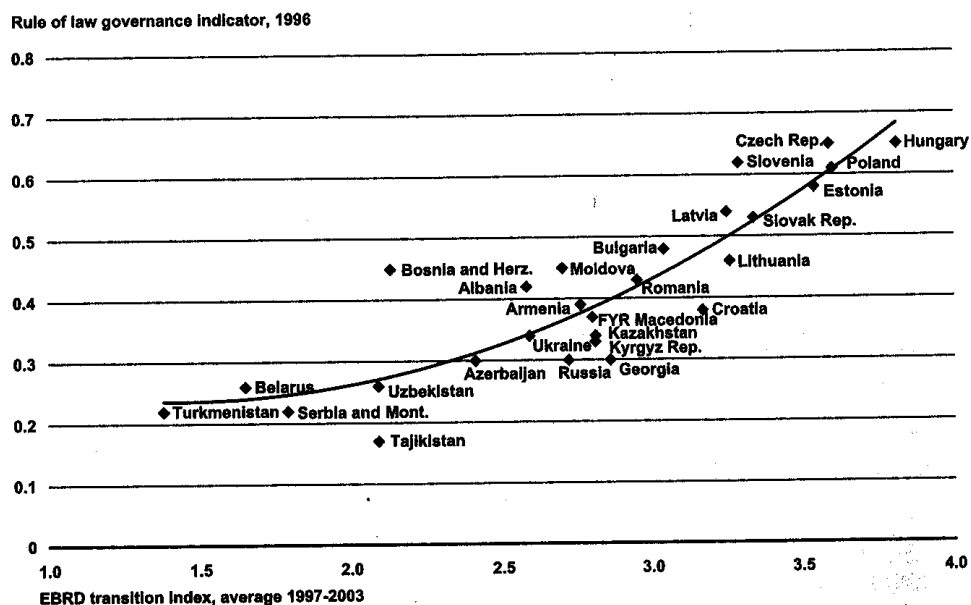
¹⁸ See the discussion in Acemoglu et al, “Institutions as the Fundamental Cause of Long-Run Growth”, NBER working Paper 10481, May 2004.



Property rights, Contract Enforcement, and Rule of Law. In Tajikistan, basic laws guaranteeing property rights and private ownership has been enacted. However, the land belongs to the State and this is specified in the Constitution. This is not unusual in Central Asia and property ownership is increasing and transfer of immovable assets, such as apartments, upon mutually agreed upon sale has not been problematic. However, contract enforcement and trust in the legal system has been difficult to achieve. Surveys have consistently shown that the private sector has been subject to excessive inspections, harassment, and a very high percentage of surveyed had to pay bribes as shown in figure X. Another finding of the survey shows that only 6 percent of respondents appealed against the wrongful actions on the part of the inspectors suggesting there is a lack of trust in the system. Another issue is that there have been a number of cases here court orders were not respected and court judgments were ignored and this is a source of concern and indicative of difficulties lying ahead. A particularly difficult issue has been the degree of discretion exercised by the line ministries and some other key agencies in interpreting or sometimes not paying attention to existing laws and regulations of the government. During the implementation of farm and enterprise privatization programs not all procedures were followed and in some cases they were simply ignored. Deficiencies in this area affect new business creation, encourage informal sector activities, and undermine the incentives for higher level of private investments, including FDI.

Figure 9.

Rule of law and progress in transition

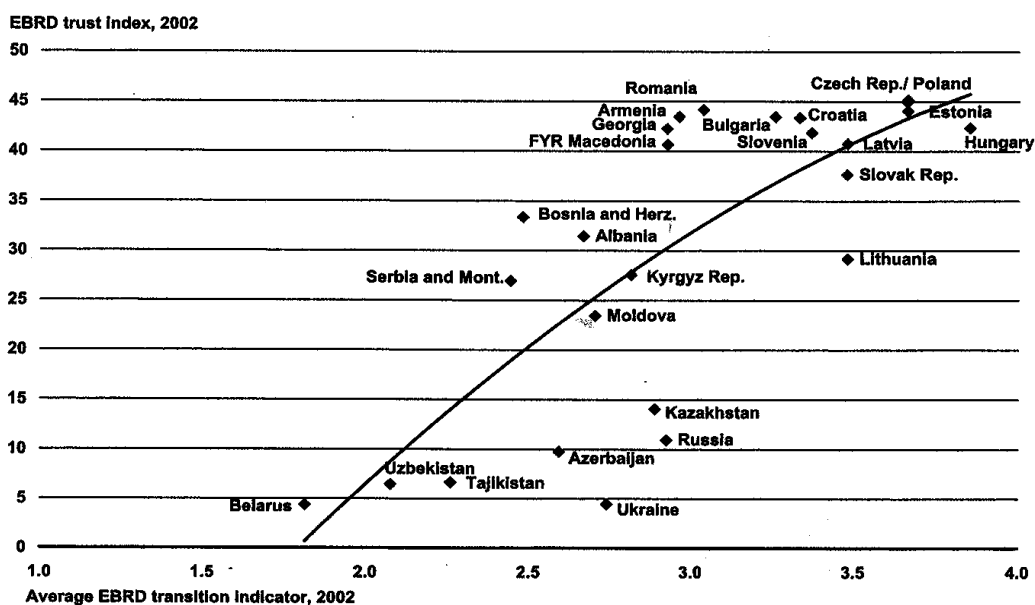


Sources: EBRD and World Bank.

Note: The rule of law governance indicator measures perceptions of the effectiveness of the judiciary, the enforceability of contracts and the incidence of crime. In the chart, 0 represents the lowest and 1 the highest level of rule of law.

Figure 10.

Trust in the business environment and progress in transition



Source: Business Environment and Enterprise Performance Survey (2002).

Note: The trust score represents the country's average proportion of firms demanding advance payment for sales. This score has then been inverted so that low trust countries appear at the bottom of the y-axis and high trust countries appear at the top of the y-axis.

Regulatory bodies and market failure correction mechanisms. Tajikistan's experience with regulatory bodies and measures to deal with market failures is very new. Regulatory bodies are important and are necessary to deal with abuse of market power and other market failures but their development is no simple task, even for developed market economies, and the situation in Tajikistan is exacerbated by lack of capacity. Newly created agencies such as the Anti-Monopoly and Entrepreneurship Support Agency (AMESP) are still in the process of learning regularly processes and issues and its interventions have been control oriented and not incentive based regulation. The Government Standards Agency (GSA) is another new agency and it has a broad mandate to set standards. Its operations have not been transparent and somewhat intrusive. Another issue is that most regulatory agencies do not have clear understanding of the role of State in a market economy context and they confuse public and private interest. For example, a Civil Aviation Regulatory Department has been created to establish an even playing field for encouraging competition but this department has not function as expected. Another issue is that some of the line ministries still issue regulations that are in conflict with the regulatory frameworks issued by regulatory bodies and this is a major problem.

Monetary Institutions and Market Confidence: It has been repeatedly shown that countries that maintained monetary and fiscal stability grew faster than others. The independence of central banks is a key element of financial stability and this is important for both macroeconomic management and trust in the banking system. Tajikistan has made progress in this area and the National Bank of Tajikistan (NBT) reports to parliament though there have been instances where the NBT issued directed credit to certain sectors. Perhaps more importantly, the fact that there have been three different currencies in the past decade and many people lost money when the government changed its currency(ies), trust in the banking system is low. Freezing or imposing penalties on deposits without a court order has also had a negative impact on deposit growth and despite tax code changes tax authorities continued to interfere with individual and commercial accounts. However, this situation is expected to improve with the planned revisions to the tax code though implementation will be the key. Banking supervision system have been slow and the NBT has been slow to withdraw licenses for banks that do not satisfy prudential norms in part due to political pressures. Legislation that would support the expansion of banking sector, such as collateral law, secured transactions law, mortgage and creditors' rights are still evolving.

Fiscal Framework and Institutions: As discussed in detail in this report, fiscal framework and fiscal governance structures are being reformed and this process has been particularly demanding for Tajikistan. The government's role and functions, and responsibilities in the overall fiscal framework have been defined only recently with the enactment of the Law on State Finance in 2002. The existing framework and workings of the system does not yet operate on the basis of accountability. While fiscal reporting has improved, what is reported is too condensed and full budget execution reports are not publicly available. Fiduciary management at the local government level is particularly weak and public funds are at risk. The government has delegated budget preparation and budget policy to MOF and this has not been conducive to priority setting and political decisions have more than usual impact on the allocation of public funds.

Market-legitimizing institutions: the Parliament, accountability, and social protection issues. Tajikistan has a functional Parliament with the participation of the opposition. A new parliamentary elections are scheduled in February 2005. While these are positive developments, the government is facing serious challenges as regionalism exerts a significant influence on the political dynamic and this constraints the pace of reforms. The oversight role of the Parliament to scrutinize the executive and the government is evolving and public accountability frameworks are at their early stages of development. The President still holds legislative powers and exerts considerable influence over the judiciary which is not independent. The roles and responsibilities of the executive office and the cabinet of ministers is blurred. Social protection system which is particularly necessary during the transition period has been suffering from shortages of resources though the government has been paying increased attention to it during the past two years.

C. A Summing-Up

Developing a reform agenda for institutional reforms is key for growth and attraction of higher levels of donor funding and public service delivery. While it is well recognized that Tajikistan is in the process of creating a market economy and a modern state at the same time, and that development of market institutions outlined above will take time, the country can not afford to delay institutional reforms. The effectiveness of Tajikistan's first generation reforms depends on deepening institutional reforms and this is important to sustain growth and reduce poverty. This report focuses on the public expenditure management and proposes a set of policy and institutional reforms that aims to contribute to the articulation of priorities in the short run and developing fiscal institutions in the medium-term. The reform proposals are sequenced and feasible and in most cases they come with capacity building programs.

CHAPTER II: PUBLIC EXPENDITURE TRENDS

INTRODUCTION

2.1 Successful public expenditure management is firmly anchored in outputs and outcomes that enable the Government to achieve the objectives articulated in the national strategy. An assessment of public expenditure management is generally made at three levels: aggregate fiscal discipline, allocative efficiency, and technical efficiency. This chapter will focus on the last two levels to examine the efficiency of public spending at an aggregate level of government as well as at sectoral levels, with an emphasis on the social sectors that absorb more than one-half of government spending. The allocative efficiency across sectors and within sectoral programs will be noted and the technical efficiency will be assessed based on the impact of outputs and outcomes on the poor and poverty. The underlying intention is to identify the areas where scope for improving efficiency of public spending remains feasible.

2.2 The chapter is organized into three sections. The first section describes scope of the government being reviewed. Section Two analyzes recent trends in public expenditure based on both economic and functional classification. The final section examines public expenditure in priority sectors: education, health, and social protection.

2.3 This chapter reviews the public expenditure of the general government excluding state-owned enterprises. The general government budget encompasses the budgets of republic governments (central government budget and the budgets of state targeted funds), local government budgets, social protection funds, and the public investment program (PIP). The republican budget covers expenditures of administrative bodies under management of the state, the legislative and judiciary bodies (Parliament and Justice). Local government budgets include four tiers of administrative and territorial units: regions (oblasts), districts (rayons), villages, and community administrations (jamoats).¹⁹ The social protection budget is an extra-budgetary item that accumulates funds for social protection purposes, namely pension and social insurance. Finally, the public investment program covers capital expenditures financed by the central government budget and by donors through loans, credits, and grants.

2.4 The Republican budget accounts for over 65 percent of total general government expenditure. The republican government is responsible for broad expenditure functions.²⁰ The state targeted funds are used only for the purposes determined by

¹⁹ The Oblast level includes the City of Dushanbe, Khatlon, Sugd and the autonomous oblast of Gorno-Badakhshan; the district level includes cities and Rayons under the oblasts, four districts in Dushanbe city as well as 13 rayons directly under the republican budget, and the village and community level in rural areas (including the *jamoats* and local councils composed of several villages).

²⁰ These include elections and referendum, judiciary, defense, subsidies for transport, scientific research, finance, social compensation, relief from natural disasters, public investment, servicing public debt, statistics, higher and specialized education, and support of local authorities.

legislation and in accordance with the budget of specified funds. There are only two state targeted funds in Tajikistan, namely a contingency fund²¹ and a President's Reserve Fund²², both of which are disclosed in the budget and reported in the annual execution report to Parliament. The expenditure of the republican budget is financed by tax revenues, grants, and domestic and foreign borrowing.

Table 1

Tajikistan: Public Expenditure by Level of Government			
	2000	2001	2002
<i>% of Total</i>			
Total General Government Expenditures	100.0	100.0	100.0
State Budget	89.9	89.1	89.0
Republican	64.7	63.2	65.0
Local	25.2	26.0	24.1
Social Protection Fund	10.1	10.9	11.0
<i>% of GDP</i>			
Total General Government Expenditures	14.5	15.1	16.2
State Budget	13.0	13.5	14.4
Republican	9.4	9.5	10.5
Local	3.6	3.9	3.9
Social Protection Fund	1.5	1.6	1.8
<i>Per capita</i>			
Total General Government Expenditures	42.4	61.0	85.1
State Budget	38.2	54.4	75.8
Republican	27.5	38.5	55.3
Local	10.7	15.8	20.5
Social Protection Fund	4.3	6.6	9.3

2.5 Local government expenditures make up about one-fourth of total expenditure (4 percent of GDP or about one-fourth of total expenditure) distributed among oblasts, rayons, and jamoats. The local authorities independently develop, approve, and execute the local government budgets. They are responsible for provisioning of social services (general education, health, housing, and local infrastructures) to the local population, construction and maintenance of local roads, and the development of housing and municipality facility (including sewage and waste management, transport services). The expenditure on social services (education, health, and housing services) accounts for about 70 percent of total local government expenditures. The bulk of local government expenditure is devoted to salaries, wages, and employers' benefits, while capital expenditure directed towards repair and maintenance of existing facilities and other infrastructure is negligible. Rayons, which provide social services, absorb most of this expenditure, while oblasts perform an administrative and supervisory role. Jamoats and mahallas receive minimum budgetary funds to operate and they rely mostly on voluntary community efforts.

²¹ The Government determines the size of the Contingency Fund, its distribution and use. The contingencies fund is used to overcome the consequences of natural disasters, epidemics and other unforeseen circumstances that are not provided in the annual budget.

²² The revenue of the President's Reserve Fund is established at 2 percent of state revenues and its spending is authorized by order of the President.

2.6 In reality local governments have very limited capability to meet the above responsibilities assigned to them. First, they have little flexibility in using budgetary resources as several expenditure items, such as wages, stipends and transfers to the population, are protected. Discretionary spending granted to the local executive bodies is exercised at the chairperson's discretion. Secondly, local governments' finances are at the central government's mercy. When revenue of oblasts exceed expenditures,²³ they need to transfer the surplus to the central government. The oblasts, whose local tax revenue is insufficient to cover the expenditures necessary for provision of social services, are dependent on the central government's subsidies and transfers. When resources are not available, the central government will reduce subsidies to local governments, thus affecting the quality and quantity of public service deliveries. Finally, the central government is reluctant to entrust local governments in policy decision making on resource allocation. Their decision making is limited to only construction and maintenance in local communities.

2.7 Social Protection Fund accounts for 10 percent of total expenditure. The Social Protection Fund was established in 1996 and took over the Pension Fund, Social Insurance Fund and Employment Fund. Two components of the Social Protection Fund (SPF) include pensions that absorb the bulk of social protection expenditure, and social assistance including transfers and subsidies to vulnerable groups. The Ministry of Labor and Social Protection and the Population Social Protection Fund are responsible for the implementation of the government social protection policy. Although the amount of social insurance benefits (received by about 10 percent of the population) is too low (on average 10 Somoni per month), it is still appreciated by beneficiaries who receive it²⁴. The provision of other social services and care for invalids, the elderly and people with special needs (the disabled, psychiatric patients)²⁵ is shared between the Ministry of Labor and Social Protection (MOLSP) and the Ministry of Health. The SPF's expenditure is financed by the collection of contributions to the social fund by employers (25 percent) and employees (1 percent). By law, the SPF cannot register a deficit as there is no transfer from the state budget to cover the deficit.

2.8 Capital expenditures are financed by multiple budget and off-budget windows. The donor financed Public Investment Program (PIP) combines credits and grants and, when required, government's counter-part funding (on-budget)²⁶. The centralized State Investment Program (CSIP) is financed by the central and local governments' budgets. Repairs and maintenance and small capital expenditures are financed by the regular budgets of line agencies. Special funds are financed off-budget and earned by line agencies themselves. Investment of state-owned enterprises (SOEs) is financed

²³ These include Sugd Oblast, Dushanbe City and Tursunzade

²⁴ Health Care Systems in Transition – Tajikistan, The European Observatory On Health Care Systems, 2000.

²⁵ For the most part, care is institutionally based, not community-based. Families bear the burden of caring for their dependent family members as well. Hospitals are also used for long-term care. MoLSP has eight homes for disabled adults, and about 50 homes for children; the homes are in disrepair and lack operating funds.

²⁶ Alexander Morozov and Utkir Umarov, Trends and Sustainability of Public Capital Expenditures.

by off-budgets, except for SOEs' credit lines and/or investment grants that are financed by the state budget.²⁷ Finally, local governments sometimes co-finance capital construction projects. The net accumulation of goods for reserves is another minor capital expenditure window.²⁸ The PIP and CSIP represent major sources of funding of capital expenditure

2.9 The Public Investment Program (PIP) is a rolling three-year planning tool for public investment financed externally by bilateral and multilateral donors.

Currently, the PIP is prepared by the Aid Coordination Unit that reports to the Executive Office of the President and is prepared outside the budget cycle. Since 1997, Tajikistan has had three PIPs for the 1998-2000, 2001-03, and 2004-06 periods. The Government uses the PIP to solicit financial support for public investment in various sectors at the consultative meetings of donors. In the past, donors' pledges were not fully disbursed due to several factors (limited implementation capacity, inadequate counterpart funds required by donors, and weak fiduciary management). The average disbursement of PIP is estimated at about 3 percent of GDP, the level at which the limit on PIP disbursement is established by the IMF under the current PRGF program to ensure Tajikistan's long-term external debt sustainability.

RECENT TRENDS IN PUBLIC EXPENDITURES

2.10 Tajikistan's public sector ranks the second smallest in CIS-7 countries, after Georgia. As the country with the lowest per capita income and most narrow revenue base in the CIS, Tajikistan is faced with a low level of expenditure. The average general government expenditure for the 1995-2002 period stood at 20 percent of GDP, compared to an average of 27 percent for the CIS-7, and 18 percent for Georgia over the same period. Public expenditure has steadily increased about 5 percent (from 14 percent in 2000 to 20 percent of GDP in 2003), surpassing Georgia whose expenditure has gradually declined.

²⁷ Although such SOEs are not a part of the general government sector, they should be considered as a part of the broader *public* sector.

²⁸ The Law on State Finance of the Republic of Tajikistan misclassifies lending to legal entities from the state budget as capital expenditure. However, it cannot be considered as capital expenditure and should be shown under the "Net Lending" category of economic classification of state expenditures.

Table 2

Total Public Expenditure in CIS-7
(Percent of GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
CIS-7	38.2	22.8	24.8	25.1	28.7	25.4	24.3	27.6	27.4
Armenia	27.0	22.8	24.8	25.1	28.7	25.4	24.3	22.7	25.3
Azerbaijan	22.5	20.4	20.8	23.8	23.6	20.8	18.6	27.6	30.0
Georgia	12.7	20.0	20.4	20.7	20.2	18.9	19.0	18.8	
Kyrgyz Republic	38.3	29.8	29.3	33.5	32.0	28.1	26.1	28.5	27.4
Moldova	46.2	43.9	50.0	42.9	35.0	34.6	30.3	33.1	33.5
Tajikistan	38.2	19.0	17.0	15.8	16.6	14.2	18.4	19.2	20.9
Uzbekistan	47.3	48.6	41.8	43.7	41.1	39.3	36.9	36.6	

2.11 Public expenditure excluding the PIP sharply declined after independence and reached the lowest level in 2000. The loss in revenue associated with independence, adverse external shocks, and the civil war, all contributed to a sharp decline in expenditures. It fell from 67 percent of GDP in 1992 until it reached the bottom of 14 percent in 2000. To contain the fiscal deficit and inflation, and deal with a heavy debt service obligation, expenditure reduction was instituted across the board, which significantly affected social sectors (education, health, and social protection), infrastructure, and general administrative services. This, coupled with slow progress with reform, led to funding shortfalls for the social sectors. This caused deterioration in the quality of social services, increased informal payments, and reduced access to services among the poor. Inadequate funding for repair and maintenance deteriorated physical infrastructure, and thereby limited economic opportunities (the poor quality and high cost of transport inhibited trade both domestically and internationally) and lowered living standards. A reduction in general administrative services resulted in a low level of public employees' salaries and an accumulation of salary arrears.

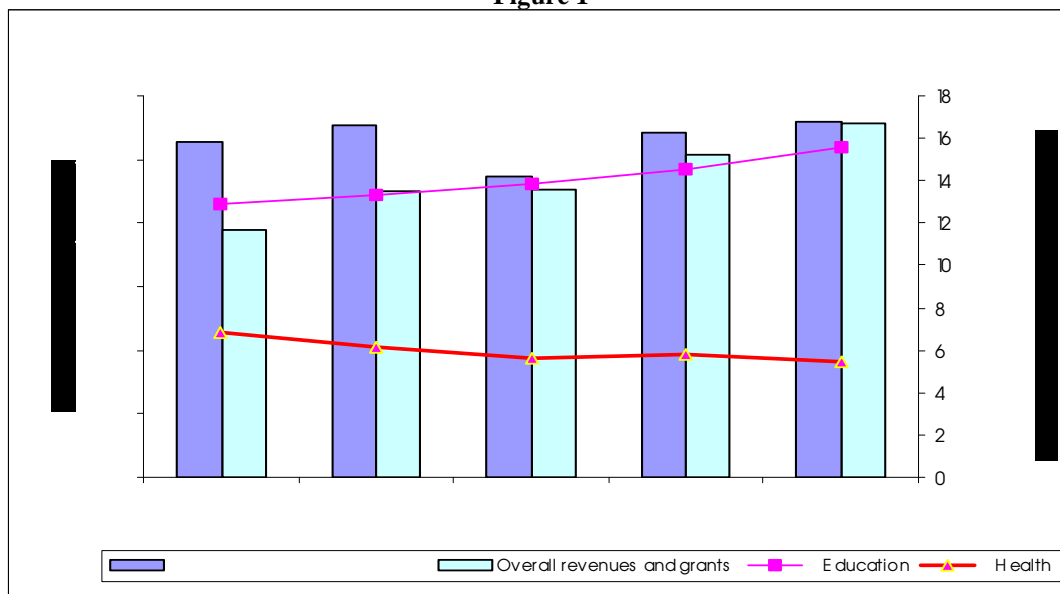
Table 3
Tajikistan : Public Expenditure

	2000	2001	2002
Total Expenditure incld. PIP (% of GDP)	18.2	18.4	19.2
Total Expenditure excld. PIP (% of GDP)	14.2	16.3	16.8
Debt Service (% of GDP)	0.6	3.5	2.4
Total Expenditure excld. debt services and PIP (% of GDP)	13.6	12.8	14.4
Total Expenditure (inclcd. PIP)per capita (US\$)	29.2	31.2	36.5
Total Expenditure inclcd. PIP at 1997 Prices	135.5	137.4	170.0

2.12 Public expenditure subsequently recovered during 2000-2002, benefiting from improved tax collection and saving from debt service payments associated with debt restructuring with bilateral creditors. The cessation of the civil war combined with the resumption of economic growth and an improved tax administration contributed to a significant increase in tax revenues (from 14.2 percent in 2000 to 16.8 percent of GDP in 2002). Moreover, the restructuring of external debt with bilateral creditors (Russia, Uzbekistan, China and Iran) in 2001 and 2002 generated savings from debt

service payments. These provided scope for the Government to increase social expenditures, especially in subsequent years. Despite the increase in total expenditure, the current level of expenditure remains at 25 percent of the 1992 level (measured as a ratio to GDP per capita expenditure).

Figure 1



2.14 Financing of public capital expenditures is highly centralized. The republican budget finances about 97 of total capital expenditure (including PIP); the remaining is financed by local budgets and state-owned enterprises, mostly natural monopolies. The change in the PIP component and PIP counterpart funding over 2000-2003 accounted for the overall increase in the public capital expenditure envelope. By contrast, the share of domestic public investment and other public capital expenditures has declined somewhat. As a result, since 2002 the PIP with its budget counterpart accounted for more than 50 percent of the total public capital expenditure envelope.

2.15 The aggravation of the existing debt service problem and the threat to macroeconomic stability prompted the IMF to impose a ceiling for external borrowing to 3 percent of GDP or about US\$30 million per annum (for new commitments under the new IMF PRGF for 2004-2006). The present level of public capital expenditures appears to be consistent with the country's growth rate and fiscal balance. However, the analysis of public debt sustainability³⁰ suggests that Tajikistan needs to be cautious in financing the PIP with external credit. In addition, the current public investment program implies future increases in public expenditures to finance the recurrent costs of ongoing public investment projects. Finally, the recent trend in public capital expenditure is worrisome: it increased from 4.2 percent of GDP in 2000 to 7.1 percent of GDP (2003 estimate), while GDP growth decelerated from 8.3 percent to 6.0 percent and the fiscal deficit (including PIP) increased from 0.6 percent to 1.9 percent of GDP over the same period. This trend indicates a serious fiscal sustainability problem as well as a possible crowding out of private investment and a low (or much delayed) return on public investment.

2.16 Public capital expenditure is extremely fragmented, which seems typical for many, if not, all CIS countries. The budget process for projects funded externally under the PIP is done outside the budget process. Implementation of the PIP represents a quasi-fiscal activity³¹, thus making it more difficult to enforce, implement and monitor. Besides, public investment financed by the state budget is also fragmented both financially and institutionally within the Ministry of Economy and Trade and the Ministry of Finance. As the budgets for the counterpart funding of the PIP, domestic capital investment and other capital expenditures are responsible by different organizations, weakness in coordination among different budgets of the capital expenditure envelope is inevitable. This leads to probable inconsistency between the different components of the capital budget and the fiscal aggregate and sector strategies. Addressing this weakness, the Government has decided to integrate all projects fully and partially funded from the budget (including the PIP) to be

³⁰ Based on the assumptions of continued strong real growth, fiscal consolidation and declining inflation, the sustainability of public debt, after worsening in 2005-2009, will remain a concern in the medium term as the ratio of PV to revenue is projected to fall below 250 percent only in 2006.

³¹ Except for the provision of counterpart funding for PIP projects if required by donors.

prepared together with the current budget under the same annual budget cycle and process in 2004.

A. Functional Composition of Expenditure

2.17 The analysis of expenditures will cover the 2000-02 period because of limited availability of functional expenditure statistics. The current system of functional classification was introduced in 1999³² based on a classification consistent with the Government Financial Statistics (GFS). However, the functional classification of expenditures only begins from 2000 onwards and excludes capital expenditure financed by external sources, which accounts for about 3 percent of GDP. As a result, spending of the sectors by function, especially agriculture, infrastructure, and social sectors, will exclude capital expenditures financed by external sources.

2.18 An increase in general government expenditures was linked to an increase in social expenditure and other non-classified expenditure. During 2000-02, the social sectors registered a significant increase in expenditure (measured as a ratio to GDP, in US\$ per capita, and in real terms). Spending on non-classified expenditure increased due to an increase in interest payments. It is noted that these increases were financed by increased tax revenue as well as a reduction in expenditures on defense spending (from 2.4 percent of GDP in 2000 to 2.0 percent in 2002) and on economic sectors (agriculture, transport and telecommunication, and energy) associated with the elimination of subsidies to state-owned enterprises (Table 5).

Table 5

Functional Expenditure excluding PIP
(% of GDP)

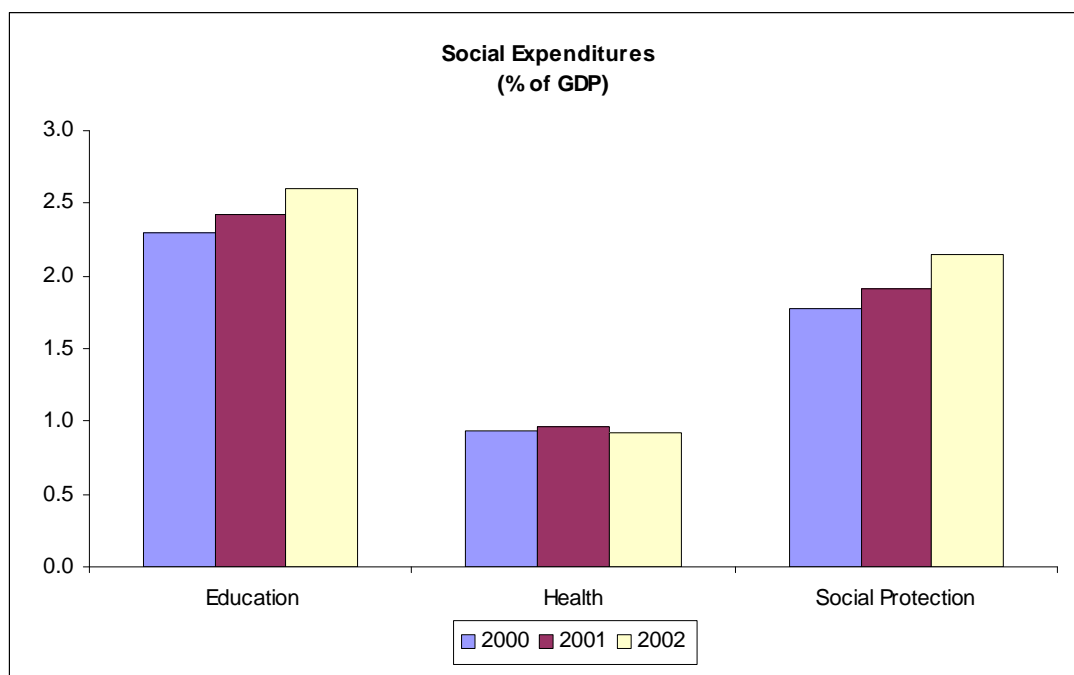
Functions	2000	2001	2002
Total (% of GDP)	14.5	15.1	16.1
General Public Services	2.8	2.4	2.8
Defense and Security	2.4	2.2	2.1
Social Sectors	5.0	5.3	5.5
Education	2.3	2.4	2.6
Health	0.9	1.0	0.9
Social Protection	1.8	1.9	2.1
Housing and Recreation	1.4	1.5	1.5
Economic Services	2.1	2.2	1.9
Fuel and Energy	0.2	0.3	0.1
Agriculture	0.5	0.4	0.5
Mining and Construction	0.2	0.1	0.2
Transport and Communication	1.1	1.3	1.0
Others	0.1	0.2	0.1
Other non-classified expenditure	0.7	1.5	2.3

³² The current system covers all of the day-to-day operations of the government. In addition, the government makes its budget recommendations to the Parliament based on the current functional classification system.

2.19 The education and social protection sectors comprise the majority of social expenditure. Education and social protection expenditures make up about two-thirds of social expenditures (education, health, and social protection) and account for about 30 percent of total public expenditure. The concern over a decline in education outcomes and increased poverty has recently prompted the Government to reallocate additional resources gained from improved tax collection and debt restructuring to the education and social protection sectors. The increase in social spending during 2000-03 was mostly allocated to social protection, while education spending increased slightly during this period. The share of health expenditure, however, declined.

2.20 Health expenditure is the lowest among the social expenditures. Since independence, health spending has declined significantly from 6 percent of GDP in 1992 to less than 1 percent in 2002. Health spending per capita was under 2 US dollars in 2002, compared to a per capita expenditure of US\$5 for education and US\$4 for social protection. The decline in public spending on health has been accompanied by an increase in patients' out-of-pocket payments. The World Bank's report on Health Care Financing found that private out-of-pocket payments accounted for 71 percent of total health care funds in 2003. Tajikistan's public spending on health is about the same as the CIS average (1.4 percent of GDP for 1995-2002).

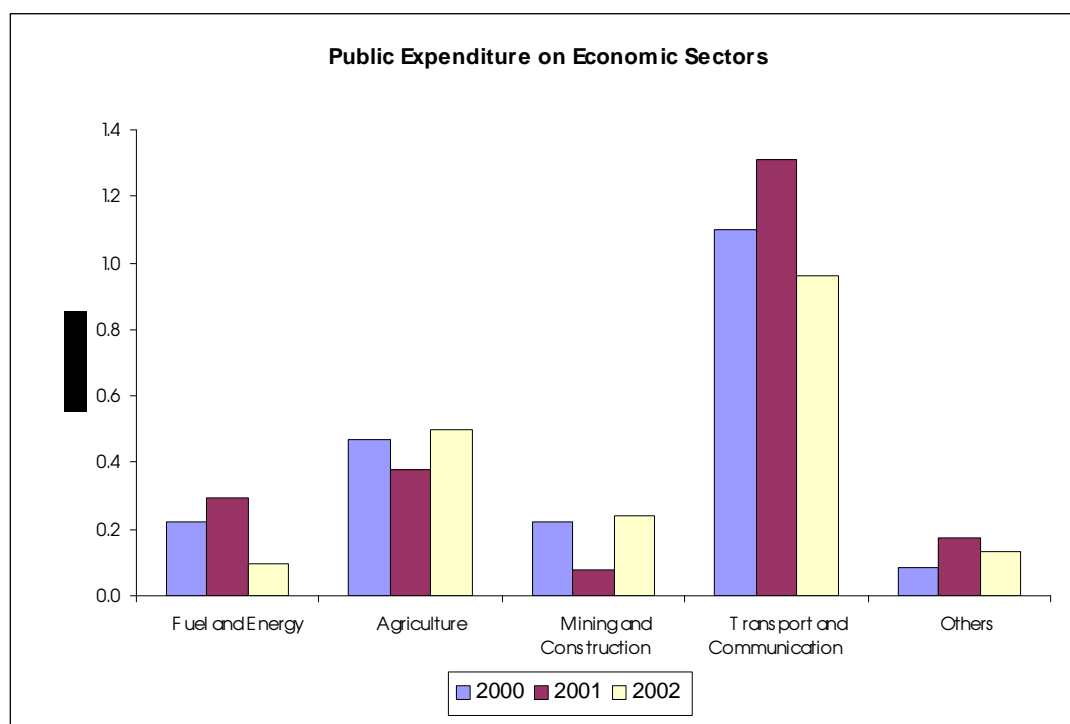
Figure 2



2.21 Spending on economic sectors remained low and continued to decline despite its role in fostering long-term economic growth. Expenditure on economic sectors (agriculture, transport and telecommunication, sewage and water, etc) declined from 2.1 percent of GDP in 2000 to 1.9 percent in 2002, which was due to less spending in

the transport and telecommunication sectors, especially energy. The expenditure on transport and communication accounted for one-half of total economic expenditure. The externally financed public investment projects, especially in the agriculture and transport sectors, estimated at about 1 percent of GDP in 2002 (US\$12 million). The share of public investment under the PIP for both sectors accounted for about 40 percent of total PIP in 2001, although it substantially declined to about 23 percent in 2002. The functional review of the ministries of Agriculture, Transport and Communication carried out by the World Bank (IBTA II project)³³ found that both ministries have still retained production and commercial activities that are inappropriate for the role of the government in a market economy. Limiting the role of the ministries to policy development and regulatory framework for the sectors and leaving production and commercial operations to the private sector could free up resources to other priority functions.

Figure 3



1. 2.22 *An analysis of functional expenditure suggests that the scope for inter-sectoral allocation of resources financed by the state budget is quite limited.*

Tajikistan's public expenditure on social sectors (education, health, and social protection) is already below CIS averages and international standards. Despite the history of civil conflict and instability in neighboring countries (Uzbekistan and Afghanistan), the level of spending on defense, public order and domestic security is considered low. Spending on defense and domestic security averaged 1.9 percent of GDP for 2000-02, and is currently below the CIS average (3.1 percent) and the international standards (4 percent).

³³ SMEC Report on Functional Review, 2002..

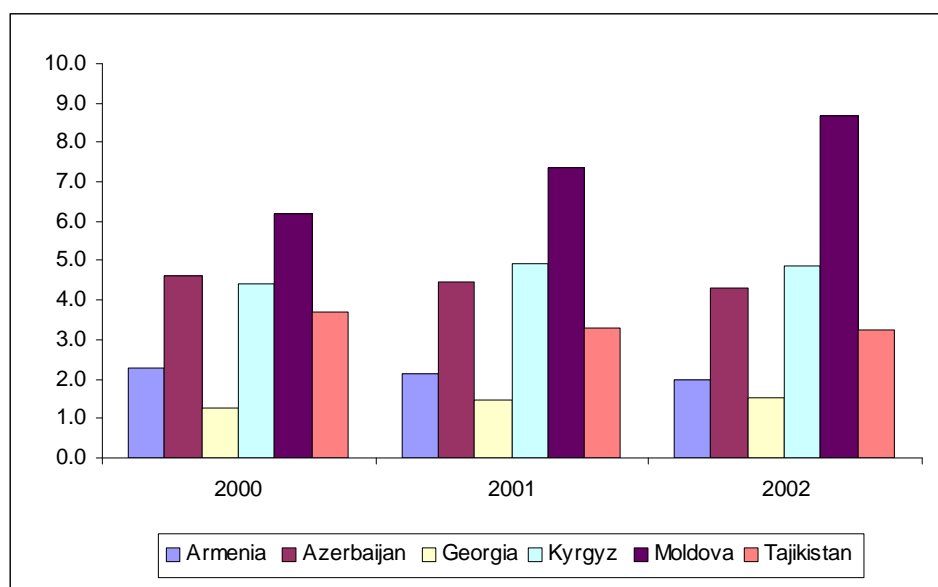
Expenditure on general public services (2.7 percent of GDP for 2000-2002) is slightly above the CIS level of 2.4 percent and could be considered for resource reallocation to other priority sectors. Despite this limited scope, the Government has taken the initiative to reallocate resources financed by external sources. The 2003-06 PIP suggests that the Government has given priority to infrastructure as evidenced from the inter-sector reallocation of PIP resources toward the infrastructure sector.

B. Economic Classification of Expenditures

2.23 Non-interest Current Expenditure. Current expenditure (excluding interest payments) accounts for nearly 80 percent of total general government expenditures excluding the PIP. Non-interest current expenditure increased slightly from 11 percent of GDP in 2000 to 11.4 percent in 2002 due to an increase in purchases of other goods and services and transfers to households. Wages and salaries declined despite an increase in public sector salaries. The increase in non-interest current expenditure was made possible by improved revenue performance and saving from debt restructuring.

2.24 Tajikistan's average wage bill for the 2000-02 (3.4 percent of GDP) was slightly below the CIS-6 average (3.9 percent). The size of the wage bill ranks the third lowest, surpassing Georgia and Armenia. It is considered to be relatively small, compared to the average of 4.5 percent of GDP in low income countries and 7.7 percent of GDP in EU accession countries

Figure 4
Wage Bills in 6 CIS countries
(Percent of GDP)



2.25 The public sector wage bill does not appear to crowd out other recurrent expenditures. The average wage in the public sector over the 2000-2002 period is low, about one-half of the wage level in the non-agriculture sector (about US\$8 per month)³⁴. The wage bill accounts for about one-fifth of total expenditure, excluding the PIP. The public sector wage bill has declined slightly from 3.6 percent of GDP in 2000 to 3.4 percent in 2002; however, it remained below the average for transition economies (4 percent of GDP). The wage bill in real terms has increased significantly between 2002 and 2003 due to an increase in nominal wages (by 40 percent in 2002 and 20 percent in 2003) and lowered inflation. Increases in the public sector wage were undertaken in order to address its declining trend and low wage level. However, the increase was carried out only after an across the board retrenchment of public sector employees (including teachers and medical staff) by 20,080 (about 4.3 percent) during the first ten months of 2003. In light of rapid growth and the increase in energy tariffs, the Government also plans to increase the public sector wage by 28 percent in 2004.

Table 6
Government Expenditure by Economic Classification
Percent of GDP

	2000	2001	2002
Total Expenditures including Lending minus Repayment	14.5	15.1	16.2
General expenditures	14.4	15.0	16.2
Current expenditures	11.3	12.3	12.7
Non-interest Current Expenditure	11.0	11.7	11.4
Expenditures for goods and services	8.2	8.9	8.4
Wage and Salary	3.6	3.5	3.4
Other Goods and Services	4.6	5.4	5.0
Expenses for stationery, purchase of textbooks and visual aids	0.3	0.3	0.3
Subsidies and Other Transfers	2.8	2.8	3.0
Interest Payments	0.4	0.6	1.3
Capital expenditures	3.1	2.7	3.5
Lending minus repayment amount	0.1	0.1	0.1

Source: Ministry of Finance, Republic of Tajikistan

2.26 Non-wage Current Expenditure. Non-wage current expenditures include expenditure for goods and services related to operations and maintenance, travel, goods and supplies, and utilities and energy. These expenditures are important as they provide necessary equipment, training and material supplies to public employees to perform their duties effectively, and they provide repair and maintenance necessary to improve the performance of physical capital and infrastructure. Non-wage expenditures stabilized at slightly above 5 percent of GDP during 2001-02. Repair and maintenance financed by the state budget (accounting for about 1.6 percent of GDP in 2002) is not sufficient to cover minimum maintenance of physical infrastructure that remains in poor condition due to the civil war and ongoing deferred maintenance.

³⁴ IMF, Staff Report on the second review of the PRGF, January 2004.

2.27 Subsidies and Transfers. Subsidies and transfers accounted for 3 percent of GDP in 2002. Subsidies have declined as the Government's role in provisioning of goods has gradually diminished to provide scope for development of private sector activities in a market economy. However, transfers to households (including pensions, benefit and allowances, compensation for energy consumption and natural disasters) have increased. Pension benefits accounted for about 78 percent of total transfers to households, equivalent to about 2 percent of GDP in 2002.

2.28 Public Debt Service. Debt service (interest and amortization payments) absorbed more than 30 percent of the central government revenue in 2002. The recent debt rescheduling with bilateral creditors (Russia and Uzbekistan) has provided short-term cash flow relief on principal repayment; however, interest payment has increased during the 2000-02 period. This has provided more scope for financing of expenditure, notably on social sectors. During 2005-06, debt service is estimated to absorb substantial resources from the budget (about 20 percent), and thus limit the availability of discretionary spending that could be used to alleviate poverty. A comprehensive debt strategy and aggressive revenue enhancement measures are needed to increase resource availability for poverty reduction. The strategy should encompass seeking debt restructuring with major bilateral creditors (especially with Russia³⁵) under concessional terms to provide significant cash flow relief over the medium-term, refraining from contracting external debt on commercial terms, strengthening debt management, and developing a domestic debt market

2.29 The review of expenditures by economic classification indicates that there is scope to improve the efficiency of public spending. However, a thorough review of sector programs will be necessary to identify possible areas of improvement. For example, the Government's role in a market economy should be limited to activities that are considered as public goods. Other production and commercial activities could be operated by the private sector. A functional review will provide scope for further reducing the number of public sector employees, and savings can be used to increase the public sector wage. The review of the social sectors will help uncover inefficiencies in public spending.

C. Sectoral Components of Capital Expenditures

2.30 The PIP represents the largest component of the public capital expenditure envelope in Tajikistan and it has a diversified sectoral structure (see Table 7). The two recent PIPs (2001-2003 and 2004-2006) cover 13 sectors of the economy.

³⁵ The debt sustainability analysis was conducted for the CIS-7 Study. A hypothetical restructuring of Tajikistan's debt to Russia improves debt sustainability. Rescheduling of debt service to Russia on more concessional terms (a reduction of the interest rate from 4 percent to 2.8 percent is consistent with the interest paid to most other creditors, with a six-year grace period through 2009 and the repayment of debt by 2021) reduces the actual and projected PV of debt. While the PV of debt-to-revenue ratio will decline modestly, the impact on debt service payments is significant: under the restructuring scenario, during 2004-2009 debt service will average 8 percent of export earnings and 16 percent of fiscal revenue, compared with 10 and 20 percent, respectively, without the restructuring.

Table 7
Sectoral Allocation of PIP, 2001-2006,
(in percent)

Sectors	Actual		Estimate	Plan (PIP for 2004-2006)		
	2001	2002	2003	2004	2005	2006
Economic Management	0.0	0.0	0.0	0.4	2.0	5.0
Agriculture	23.1	15.1	8.0	7.1	8.7	17.9
Irrigation and Rural Water Supply	2.6	16.0	10.0	9.4	12.5	10.1
Water Supply and Sewerage	1.3	1.1	4.5	6.8	9.3	3.2
Energy	0.1	8.2	30.3	24.9	37.8	29.8
Transport	17.4	8.8	30.3	21.5	12.9	6.5
Communications	0.0	0.0	4.8	7.4	1.3	1.4
Education	11.6	17.5	3.7	4.5	5.1	9.9
Health	8.6	1.8	1.4	1.9	0.9	1.6
Social Security and Labor	6.7	26.3	7.0	2.8	4.2	4.7
Environment	0.6	0.3	0.0	0.2	0.4	0.5
Private Sector Development	0.0	0.0	0.0	2.5	3.7	3.8
Multisector and Other	27.9	4.8	0.0	10.7	1.1	5.6
TOTAL	100	100	100	100	100	100

Source: PIPs 1998-2000, 2001-2003 and 2004-2006

2.31 The Government has recently shifted its priority from the social sectors (education, health and social security), which dominated the 2001-2003 PIP, to the infrastructure sector (energy, transports, and irrigation) for the 2004-06 PIP. The sectoral allocation of the PIP currently favors the infrastructure sector (energy, transport, irrigation) over the social sectors (Table 8). The energy sector ranks the first for four out of six PIP years; transport ranks the second over four years; irrigation ranks the third over 5 years; and finally agriculture has always been in the list of top 5 for each of six PIP years. The 2004-2006 PIP gives high priority to the energy, transport (road rehabilitation), and rural infrastructure (approximately two-thirds of the Program). The social sectors, by contrast, appear to have low priority based on their shares in the PIP over the 2001-2006 period. The shift in priority seems to be problematic in light of deteriorating social indicators in Tajikistan and the PRSP priorities

Table 8. Resource Allocation Across Top 5 Recipient Sectors: PIP vs. CSIP Priorities

	1999	2000	2001	2002	2003	2004	2005	2006	
Externally Funded Public Investment Program (PIP)	Funds absorbed by Top 5 Sectors, %	97.9	84.1	88.6	83.7	85.6	73.9	81.2	74.2
	Funds absorbed by a leading sector, %	39.8	28.5	27.9	26.3	30.3	24.9	37.8	29.8
	Transport	Transport	Multisector and Other	Social Security and Labor	Energy	Energy	Energy	Energy	
	Multisector and Other	Multisector and Other	Agriculture	Education and Science	Transport	Transport	Transport	Agriculture	
	Social Security and Labor	Agriculture	Transport	Irrigation and Rural Water Supply	Irrigation and Rural Water Supply	Multisector and Other	Irrigation and Rural Water Supply	Irrigation and Rural Water Supply	
	Health	Health	Education and Science	Agriculture	Agriculture	Irrigation and Rural Water Supply	Water Supply and Sewerage	Education and Science	
	Education and Science	Social Security and Labor	Health	Transport	Social Security and Labor	Communications	Agriculture	Transport	
Domestic Budget Funded Centralized Capital Program (CSIP)	Funds absorbed by Top 5 Sectors, %	83	81	92	88	81			
	Funds absorbed by a leading sector, %	29	32	44	33	34			
	Transport	Transport	Transport	Construction (Government)	Construction (Government)				
	Water Supply and Sewerage	Construction (Government)	Construction (Government)	Transport	Transport				
	Construction (Government)	Energy	Energy	Energy	Energy				
	Irrigation and Rural Water Supply	Water Supply and Sewerage	Defense and Security	Defense and Security	Multisector and Other				
	Education and Science	Education and Science	Irrigation and Rural Water Supply	Irrigation and Rural Water Supply	Defense and Security				

2.32 *The allocation of resources for capital expenditure financed by the CSIP is highly concentrated in three sectors: construction of administrative buildings, transport sector, and energy sector accounting for 70 percent of domestic budget capital expenditures during 1999-2003.* Investment for government administrative buildings accounted for about one-third of total public capital expenditure financed by the CSIP. Education was the only social sector in the list of top five recipients of resources allocated from the CSIP during the 1999-2000 period. Since then, social sectors were not represented in the list of Government priorities under the CSIP.

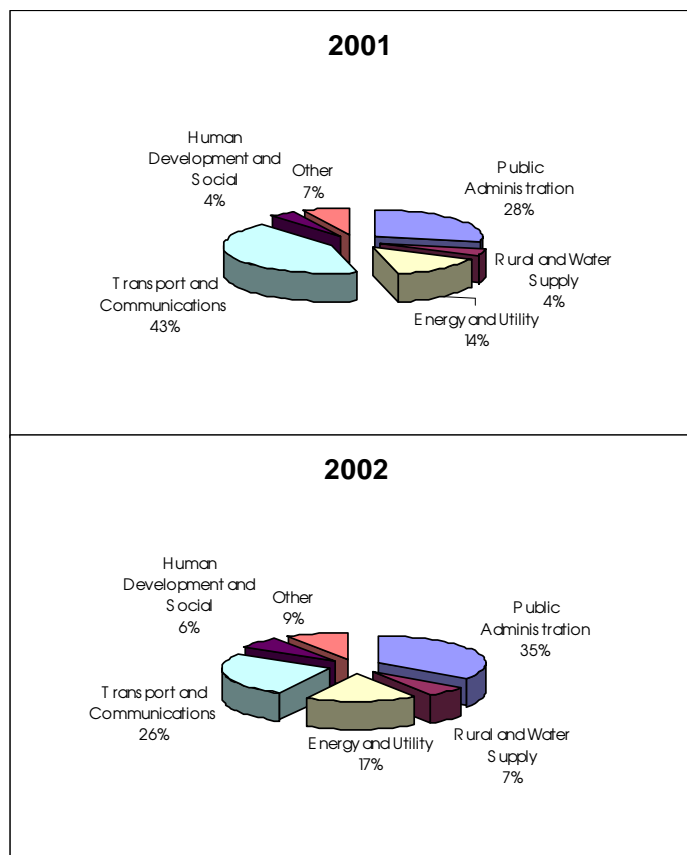
2. 2.33 *However, the picture looks a little different after accounting for the disbursement gaps (planned versus actual disbursement) in various sectors (see Table 9).* The Energy and Communications sectors were the most severely underfinanced by donors and the budget in both 2001 and 2002. The social sectors (education, social security, and labor) ‘suffered’ relatively less than others; however, this could have been attributed to differences in project cycles across sectors, rather than to a coherent policy of the Government and/or donors.

Table 9
PIP: Discrepancy between Program Targets and Actual Disbursement, 2001-2002
(in percent)

Sectors	2001		2002	
	Donors	Budget	Donors	Budget
Agriculture	(55.5)	(93.4)	(77.8)	(92.9)
Irrigation and Rural Water Supply	(83.4)	(82.1)	(28.4)	(39.8)
Water Supply and Sewerage	(91.6)	(98.7)	(95.8)	(84.5)
Energy	(100.0)	(100.0)	(90.6)	(97.8)
Transport	(89.1)	(81.3)	(93.0)	(93.9)
Communications	(100.0)	(100.0)	(100.0)	(100.0)
Education	(77.4)	(67.8)	(33.1)	(47.9)
Health	(84.5)	(98.0)	(96.3)	(99.5)
Social Security and Labor	(59.8)	(79.5)	(39.6)	(37.4)
Environment	(97.0)	(98.0)	(76.7)	0.0
Private Sector Development	(100.0)	0.0	(100.0)	0.0
Multisector and Other	96.1	43.1	(66.5)	227.7
AVERAGE	(80.2)	(88.9)	(79.6)	(86.3)

Source: PIP 2001-2003, PIP 2004-2006

Chart 2. CSIP Structure, 2001-2002, percent



2.34 Capital expenditure financed by the Centralized State Investment Program (CSIP) is not targeted to the poverty related sectors. More of the public ‘owned’ resources were allocated to physical infrastructure, leaving capital expenditure in the social sectors to be financed by donors under the PIP. Capital expenditure for the transport and communication, public administration, and energy and utility sectors dominated the CSIP in both 2001 and 2002. The social sectors are under-invested, accounting for only 4 percent in 2001 and 6 percent in 2002. Given that the 2003-2006 PIP gives high priority to the infrastructure sectors, the financing of capital expenditure for the social sectors required to achieve the MDGs may be compromised.

REVIEW OF PUBLIC EXPENDITURES IN PRIORITY SECTORS

A. Education³⁶

2.35 Access to education is the right guaranteed by the Constitution. Article 41 of the 1994 Constitution (amended in July 2003) states that every person has the right to education³⁷, and basic general education is compulsory. The state guarantees access to free basic general education (grade 1-9) in the state educational establishments. It also guarantees free education for students in the upper secondary education (grade 10-11), professional, vocational and higher education in the state educational establishments. Most students are in public educational institutions and nearly 90 percent of total students in Tajikistan are in general education (including primary, basic, general, gymnasium, lyceum, and special education). Despite the constitutional amendments, there remains scope for policy changes, especially policy on free education for students in secondary vocational and technical and higher education, policy on private education, and education subsidies targeting poor students. The Ministry of Education is currently drafting a new law on education that aims at reforming the education sector to reverse the declining education trend and improve outcomes. However, the scope of reform will depend on the new education law that is currently being drafted.

2.36 Planning for public education financing is still based on norms. Budget allocation is based on input-based norms; for example, the number of teachers required for the curriculum at each grade and the number of non-teaching staff in each school. Budgetary funds are allocated by line items, such as salaries, textbooks, building utilities, food, and building maintenance. Reallocation of expenditure across line items is rigid and some expenditure, such as salaries, books, and utilities, are protected from budget cuts. A new system of education financing based on a per student basis³⁸ was introduced for budget year 2003. However, the Ministry, oblasts and rayons are not ready for this

³⁶ This section summarizes the analysis from various World Bank reports, including Education Sector Review (2002), Social Expenditure Review (2002) and Poverty Assessment (1999).

³⁷ Tajikistan’s education system is organized into four levels: pre-schools, general education, professional and specialized secondary education (vocational and technical training), and higher education. General education includes primary (grades 1-4), secondary (grades 5-9), and upper secondary (grades 10-11).

³⁸ Tajikistan, 2002.

change due to lack of capacity to implement necessary changes required for a strategic budget planning based on sector policy.

A.1 Expenditure Trends in the Education Sector

2.37 The Ministry of Education is responsible for overall education policy with involvement from other public institutions. Provision of education is the responsibility of both the republican and local governments. The republican budget finances specialized secondary and higher education through the budgets of the Ministry of Education and Ministry of Labor and Social Protection. Local governments (rayons) are responsible for the provision of pre-school and general education services financed by local government budgets through resource transfers from oblasts to rayons. About 80 percent of total education expenditure (2002) is allocated to local governments, of which 96 percent of local government spending on education was spent on general education

2.38 Education spending slowly recovered after the 1997 civil war but remains low. Spending in 2002 reached 2.6 percent of GDP (about one-fifth of the 1992 level), accounting for about 16 percent of total expenditure. Spending on education represents the largest share of social sector expenditure (46 percent); however, it remains the second lowest among CIS-7 countries, after Georgia. This level is also below the OECD average (4 percent).

Table 10
CIS7 Public Spending on Education
% of GDP

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
CIS-7				4.3	3.0	4.1	3.3	3.4	3.3	3.5	3.7	
Armenia			1.4	2.8	2.3	2.2	2.3	2.5	3.0	2.7	3.1	
Azerbaijan				4.5	3.7	4.1	3.3	4.2	3.8	3.5	3.7	3.6
Georgia				0.9	1.9	2.5	2.3	2.1	2.2	2.5	2.2	
Kyrgyz		4.2	6.1	5.7	4.4	4.2	4.2	3.4	3.3	3.5	4.5	
Moldova						9.7	7.1	5.3	5.1	5.4	5.2	5.6
Tajikistan	11.2	8.8	8.7	4.1	2.1	2.1	2.2	2.1	2.3	2.5	2.6	2.8
Uzbekistan				7.4	7.4	7.1	7.6	7.5	6.7	6.5	6.3	

2.39 Due to insufficient public spending on education, households have been making out-of-pocket payments for education. Private payment for education is roughly equivalent to public spending on education (2.1 percent of GDP in 1999) and accounts for about 2.4 percent of household spending. The Household Budget Survey data indicated that private households spend a greater share of their education payments for higher education, in urban areas, and for boys (79 Somoni in 1999). Payments go for tuition (only for post-general education) and uniforms. Recently, both formal and informal fees have been introduced in basic education, including contribution to schools and payments for extra courses. Fees are used to pay teachers' salaries and operations and maintenance.

A.2 Resource Allocation in the Education Sector

2.40 The allocation of education expenditure among primary, secondary, and tertiary levels conforms to international standards. Tajikistan's total spending on primary education (2002) is above the OECD average of 70 percent (Table 12). Republican and local governments have slowly increased resources for primary education, and at the local government level, spending accounted for 90 percent of total education spending. The republican government has also increased spending on primary education by reallocating resources away from higher education (from 46 percent in 1999 to 27 percent in 2002) due to limited budgetary resources. However, public spending on vocational and technical education financed by the republican budget has remained high (about 19 percent of total).

Table 11
Education spending by source and level of education, 1999-2002
% of Total Education Expenditure

	1999			2000			2001			2002		
	Republ ican	Local	Total	Republ ican	Local	Total	Republ ican	Local	Total	Republ ican	Local	Total
Pre-school education	0	7	6	0	8	7	0	7	6	0	6	5
Primary and Secondary education - general programs	13	87	75	13	88	76	13	89	75	18	90	77
Secondary education - vocational and technical	18	0	3	23	0	4	18	0	3	19	0	3
Secondary education affairs and services not elsewhere classified	0	0	0	0	0	0	0	0	0	0	0	0
Higher education affairs and services	46	0	7	37	0	6	27	0	5	27	0	5
Education services not definable by level	4	0	1	3	0	1	2	0	1	2	0	1
Applied research and experimental development related to the Education sector	0	0	0	1	0	0	1	0	0	1	0	0
Education affairs and services not elsewhere classified	18	5	7	23	4	7	39	4	10	34	3	9
Total:	100	100	100	100	100	100	100	100	100	100	100	100

Source: Ministry of Finance

2.41 The wage bill for the education sector crowds out non-wage current expenditures, especially at the local government level. Total wages and social contribution for teachers and non-teaching staff accounts for nearly three-fourths of overall education expenditure, compared to the OECD average of 74 percent³⁹. Local governments, however, spend more than 80 percent of their education expenditures on wages and social contribution (Table xx). The high wage bills are attributed to the large number of teachers (especially ghost teachers, estimated at about 5-10 percent of teacher's labor force) and contract teachers who substituted for those migrating out of town. However, teachers' salaries remain below the overall average wage. This has led to informal payments from parents and a diversion from carrying out other income generating activities.

2.42 Non-wage current expenditure in the education sector is spent mostly on housing and food. Despite a declining trend in food expenditure in the education sector, the level of food spending (about 5 percent in 2002) is considered high by international

³⁹ OECD countries on average spend 80 percent of their recurrent budget on salaries in general education, equivalent to 74 percent of total spending once capital spending is also included.

standards. Given that non-wage current expenditure accounts for about 15 percent of total education spending, there are very little resources left for other pro-poor expenditures to improve the learning outcomes of students. These expenditures include stipends, textbooks and visual aids, scholarships, training of teachers, equipment, and repair and maintenance of schools. The World Bank estimated that only 30 percent of students in general education have textbooks, and that there are virtually no textbooks available for higher education. Moreover, the textbooks available are considered inadequate to the curriculum⁴⁰. Additionally, textbooks in minority languages are not available as required by law.

2.43 Education infrastructure⁴¹ has not been maintained and inadequate budgetary funds have limited new capital investment. The lack of repair and maintenance combined with heavy use over time⁴² have deteriorated school physical infrastructure.⁴³ The supply of basic utility services (heat, water, and sanitation facilities) is inadequate. The World Bank's survey of 1,845 schools found that 26 percent of schools do not have heating systems, 24 percent do not have water pipes, and 35 percent do not have sanitation systems. Missing window glasses in many of these schools makes it impossible to heat during winter. A lack of heat in the winter has contributed to a reduction in attendance in rural areas. There is an urgent need for the Government to conduct a comprehensive survey of education infrastructure to assess and identify rehabilitation needs and to further consolidation of education infrastructure.

Table 12
Education spending by economic classification, actual, 1999-2002
Percent of Total

	1999			2000			2001			2002		
	Republ ican	Local	Total	Republ ican	Local	Total	Republ ican	Local	Total	Republ ican	Local	Total
Salary and social pension fund	38	80	73	40	80	74	53	85	80	34	82	73
Goods and services:	39	15	19	42	12	17	40	10	15	36	12	16
Housing and communal amenity	2	6	5	2	4	4	1	4	3	1	3	3
Stipends and scholarships	9	0	2	8	0	2	6	0	1	5	0	1
Food	4	8	7	16	5	7	11	4	6	9	4	5
Textbooks and other visual aids	4	0	1	3	0	0	3	0	0	2	0	0
Maintenance and current repair	10	1	2	6	1	2	5	1	2	9	4	5
Equipment	9	1	2	6	1	2	14	0	2	10	1	2
Transfers												
Subsidies												
Capital investments and repair	22	3	6	8	0	1	4	1	2	6	1	2
Interest payment												
Other expenditures	1	2	2	11	8	8	3	4	3	24	5	9
Total:	100	100	100	100	100	100	100	100	100	100	100	100

1. Source: Ministry of Finance

⁴⁰ The current curriculum requires an average of 8 textbooks per primary school student and 16 textbooks per lower secondary student.

⁴¹ Tajikistan's State Statistic Committee estimated that in 2001 there were 3,695 general education school houses Tajikistan, of which 85 percent are located in rural areas. There were about 3,400 institutions for basic education.

⁴² According to the World Bank's Review of Education Sector, about 80 percent of institutions in basic education operate in two or more shifts.

⁴³ Buildings and school outfitting, including desks, tables, chalk boards, and other essential education equipment.

2.44 Investment in education is relatively low and is mostly financed by donors. The capital expenditure on education under the last two PIPs (1998-2000 and 2001-2003) accounted for 11.6 and 17.5 percent, respectively, of the total program. The 2004-06 PIP plans to allocate less than 10 percent to the education sector. The proposed activities focus on rehabilitation of physical infrastructure, provisions of textbooks, and teachers' training. However, recurrent expenditures accompanying capital investment are completely excluded from the PIP due to the twin budget planning for current and capital expenditure. The State budget only allocates insignificant amounts for repair and maintenance.

Table 13
Public Education Spending, 2000-2001
Somoni per student

	2000	2001
Pre-school	64	75
General education	22	30
Specialized secondary	59	83
University degree	49	59

2.45 Public spending per student at the pre-school, specialized secondary, and higher education levels remains significantly above those of the general education and international averages. Spending per student for these education levels are approximately 2.5 to 3.0 times what is spent per student for general education. The international averages for upper secondary spending tends to be about one-half that of primary education; for higher education, spending is about two times that of primary education, and for preschool spending it is about the same as primary education. This suggests further scope to lower per student spending.

2.46 The allocation of public expenditure for education across the regions is uneven. Public spending on education per capita is the lowest in the most populous oblast – Khatlon -- where more than one-third of the population lives, compared to the national average. By contrast, per capita public spending on education is the highest in GBAO. This is due to the relative sizes of the two oblasts. Schools in GBAO, the largest oblast, spread out in several villages and rayons with the low density of population; education spent per student thus tends to be higher than for a smaller oblast with high population density.

Table 14
Public Spending on General Education by Region, 2000-2001
(Somoni per student)

	2000	2001	2002	2003 Jan-Sept
Dushanbe	16.1	26.2	39.3	50.7
GBAO	37.1	56.2	85.8	110.6
RRS	22.0	30.6	40.2	49.1
Sugd	22.4	30.5	37.4	48.8
Khatlon	18.3	26.1	32.0	39.4
Average	20.9	29.5	37.9	47.7

2.47 Public spending on upper secondary and higher education is biased against poor households. Preliminary analysis of benefit incidence of public education expenditure for the upper secondary and higher education shows that students from higher expenditure quintiles benefit more from public education spending than their counterparts from lower quintiles. For instance, the share of public expenditure on education allocated to the richest expenditure quintile doubled that of poor students in 1999 and it increased to 3 times that of the poorest quintile in 2003 due to an increase in attendance rate of the richest quintile in 2003. This comes at the expense of the poorest household quintile whose share of public education expenditure fallen to 11 percent in 2003 (from 19.6 percent in 1999) as well as the attendance rate. It is noted that the poorest household quintile benefited from public expenditure on education at the general education level as much as the richest household quintile in both years.

Table 15
Benefit Incidence of Public Spending on Education

Expenditure Quintile	Benefit Incidence of Public Spending				Attendance Rate			
	General Education		Upper Secondary and Higher Education		General Education		Upper Secondary and Higher Education	
	1999	2003	1999	2003	1999	2003	1999	2003
1	20.8	19.6	13.6	10.7	86.6	84.4	13.6	11.2
2	18.7	20.5	15.1	15.2	88.2	89.3	13.1	14.6
3	21.1	20.4	21.3	15.5	92.6	88.1	20.7	15.6
4	20.0	20.3	22.1	22.6	92.7	88.8	19.7	21.0
5	19.4	19.2	27.9	36.0	92.4	88.9	23.1	30.1
Total	100.0	100.0	100.0	100.0	90.4	87.9	18.1	19.0

Source: WB staff estimates based on TSLS 1999 and 2003.

2.48 Inadequate public funding has affected both the supply and demand for education. On the supply side, the state at both central and local levels faces fiscal constraints and weak management capacity that lead to poorly maintained physical infrastructure, inadequate training of teachers, outdated and irrelevant curricula, a shortage of materials, and an exodus of qualified teachers associated with a reduction in the real wage. On the demand side, limited financing for education has led the Government to find alternative sources of revenue. Some cost recovery measures have already been introduced formally and/or informally at all levels of education. In higher education, students are increasingly paying the costs of their education. The Government has also been promoting the financing of students' education by employers. The situation has led to an increase in the cost of education, thereby limiting accessibility to education among the poor.

2.49 Education outcomes have declined. Enrolment rates have fallen and non-attendance and drop-out rates, particularly among girls, have increased. Despite unreliable estimates from various sources, there is agreement that the enrolment of the school-age population for basic education has fallen substantially (from 94.3 percent in

1989 to 77 percent [2002 PRSP] and 61.1 percent [2002 Human Development Report].⁴⁴ Although the Government cited that the enrollment rate has increased in 2003 (79 percent)⁴⁵, it is much lower than the level achieved prior to independence. Limited access to basic education is cited as a major cause of the decline. Interestingly, children in rural areas seem more likely to attend school (attendance is lower in Dushanbe than in the rest of the country). Evidently, drop-outs and non-attendance are increasing in the basic secondary school grades. The survey on Monitoring Learning Achievement (MLA)⁴⁶ noted that non attendance rate at primary schools was 13.7 percent of surveyed children while the non attendance ratio for 5th to 9th graders was 74.6 percent. Girls are at greater risk than boys for not attending school regularly or dropping out from schools before completing 9 years of compulsory education. The increasing trend of girl dropout is confirmed by the survey in which over half of parents (57 percent) ‘absolutely agree’ that it is more important to educate boys than girls.

2.50 The education sector is at a crossroads. The education system across all age groups and grade levels faces a major challenge ahead. The state, civil society and community, and the family as the primary caregiver to children, are not able to ensure children’s access to education and development opportunities. Moreover, many children in poor families are under-nourished and some are forced to drop out from schools to work. The effects of the civil war and extreme poverty has led to further homelessness and abandoned children, who have no parent or community involvement. The Government needs to adopt a comprehensive reform agenda to address the bottlenecks in the education sector.

2.51 There remains scope to improve allocative efficiency by improving the targeting of education spending. The overall allocation of expenditure to general education is reasonable by international standards. Spending on general education is consistent with the spending on primary and secondary education in OECD countries. Thus, improving efficiency through reallocating resources from vocational and higher education toward general education will be limited. Within the education programs, the analysis of expenditure incidence shows that efficiency could be further improved by efficient targeting to ensure that the poorest benefit from education expenditure

2.52 Technical efficiency can be improved. Although technical efficiency of the education infrastructure seems good (e.g., school buildings have two or three shifts), scope for improvement remains. First, rationalization of non-wage current expenditures could improve technical efficiency. Secondly, reallocation of wages to non-wage expenditures could improve technical efficiency at the local government level. Finally, raising the student-teacher ratio (implying a reduction in the number of teachers and non-teaching staff) would require additional policy changes to rationalize resource utilization in the education sector.

⁴⁴ PRSP 2002, page 11 (Table 1) and UNDP, HDR 2001-2002, Basic Facts.

⁴⁵ Republic of Tajikistan, PRSP Progress Report (February 2003).

⁴⁶ Monitoring Learning Achievement in Primary School in Tajikistan and Problems of Non-Attendance, Ministry of Education, UNESCO and UNICEF, 2002.

2.53 *Additionally, the Government needs to review education fee policies and the role of the private sector in education provisioning.* In the medium term, it is unlikely that public resources would increase substantially to cover education financing as stipulated by the constitution. Limited revenue raising capacity and the debt service burden will continue to restrain the availability of resources necessary to finance public education expenditure. Improved efficiency of education spending is merely a necessary condition but one not sufficient to provide the resources that could arrest the decline in education outcomes. Rich households benefit from public spending on specialized secondary and higher education as this provides a high rate of return to students in terms of future income. Fees for both specialized secondary and higher education, therefore, should reflect the rate of return on education and the ability of rich households to pay. Public provision of education should concentrate on primary education that has a maximum impact on economic growth and poverty. Specialized secondary and higher education could be provided by the private sector.

2.54 *The Government is committed to accelerate reform in the education sector.* A working group on education reform chaired by the Prime Minister has been set up to formulate a detailed reform strategy and prepare a fully-costed plan for education reform by the end of March, 2004. One of the structural benchmarks agreed under the second review of the PRGF is a reduction in the number of education employees by 5 percent to be implemented by the Government by end July 2004. The savings will be used to finance an increase in teachers' salaries on a merit basis.

B. Health

2.55 *The 1994 Constitution guarantees access to health care services for the population free of charge at the point of service.* However, the quality of health care has been deteriorating since independence (1991), and limited public resources have led to under-funded health care services. Private out of pocket payments have increased and become pervasive at all levels. Recognizing the need to match public commitment with available resources, the Constitution, as amended in 2003, modified the provision of free health care services. It authorizes the Ministry of Health to develop a Program of State Guarantee that provides minimum benefits free of charge and to identify additional services that are to be paid by patients partially or fully.

2.56 *Health care management and provision are the responsibility of both the central and local governments.* Public health care delivery ranges from the national down to the village level. The Ministry of Health is responsible for policy formulation, coordination, and management of the national-level health care services. Local authorities (oblasts and rayons) are responsible for most social services and manage regional-level health facilities, such as large hospitals and polyclinics, but account to the Ministry of Health on professional matters. Primary care in rural areas is delivered through nurses' posts and small clinics and rural hospitals.

2.57 Budget planning and allocation in the health sector does not provide an incentive system to improve the efficiency of health care delivery. The Ministry of Finance is responsible for budget planning and financial allocation for the health sector with limited inputs from the Ministry of Health. Prior to 2002, planning and allocation of budgetary resource among regions and medical institutions in the health sector were based on capacity-based norms including the number of medical beds, staff, etc. Because cost savings are not retained in the sector, the Ministry of Health has little incentive to improve efficiency of the health system. In 2002 the health budgetary fund was allocated according to the per-capita based methodology developed by the Ministry of Finance and the Ministry of Health.

B.1 Trends in Public Spending on Health Care

2.58 Since independence, public health spending has fallen both as a share of health spending in GDP and in terms of US\$ per capita. Although it has slowly increased during the 2000-2002 period, health spending in 2002 was only about one-third the 1995 level (3.1 percent of GDP). However, this increase is too small to have significant impacts on health care resource allocation and it is not consistent with GDP growth⁴⁷.

Table 16

Tajikistan: Health Spending in the State Budget in 2000-2002

		2000	2001	2002
Percent of GDP	Social expenditure	4.75	5.27	5.94
	Of which health	0.95	0.96	1.14
US\$ Per Capita	Social expenditure	6.37	8.83	10.38
	Of which health	1.27	1.61	2.00
Share in Total Expenditure	Social expenditure	33.98	36.03	42.10
	Of which health	6.76	6.58	8.10

Source: Ministry of Finance

2.59 Among CIS-7 countries, Tajikistan has the lowest level of public spending on health, with the exception of Georgia. Public spending on health dropped noticeably in 1995 and has remained roughly constant at about 1 percent of GDP. Such a low level of public financing is not even sufficient to cover basic needs. Health services have been sustained by the additional resources of the private sector and donors.

⁴⁷ Republic of Tajikistan Poverty Assessment, 2003

Table 17
CIS7 Public Spending on Health
% of GDP

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
CIS-7				2.4	1.4	1.6	1.4	1.4	0.9	1.1	1.2	
Armenia			0.7	1.8	1.4	1.2	1.4	1.4	0.9	1.3	1.5	
Azerbaijan				2.1	1.4	1.6	0.9	1.0	0.9	0.8	0.9	0.9
Georgia				0.7	1.0	0.9	0.9	0.6	0.6	0.9	0.9	
Kyrgyz		2.6	3.5	3.4	3.0	3.3	2.9	2.7	2.0	1.8	2.1	
Moldova						5.7	4.0	2.8	3.0	3.0	3.3	3.1
Tajikistan	5.7	5.4	6.4	2.8	1.3	1.3	1.1	1.0	0.9	1.0	0.9	1.0
Uzbekistan				3.6	3.7	3.3	3.2	2.9	2.6	2.5	2.4	

2.60 Financing for national health care relies on both domestic and external sources. Two sources of domestic financing for national health include the government budget and out-of-pocket payments. The TSLS reports that the government's share of financing for total health care costs has declined substantially from 26 percent of total national health spending in 1999 to 16 percent in 2003, while the share of households' payments is estimated to increased from 68 percent in 1999 to 71 percent in 2003. The remaining costs are financed by international agencies, which provides aid for drugs and medical supplies and it has doubled in 2003.

Table 18
Sources of Funding of the National Health Care System in Tajikistan
(% of Total)

Sources	1999 TSLS	2003 TSLS
State Budget	25.9	16.0
Republican	6.1	3.3
Local	9.8	12.3
Private out-of-pocket payments	67.8	70.6
Donors	6.3	13.3
Total	100.0	100.0

Source: Cheryl Cashin, Tajikistan Health Sector Note on Health Financing, 2003

2 2.61 Domestic sources of financing for health care services include line ministries (other than the Ministry of Health), state-owned enterprises and private payments. Line ministries (including the Ministries of Internal Affairs and of Security) and Tajik Air provide health care services to their employees from own budgets, and these expenditures are excluded from the government's health expenditure. Some large factories and enterprises also provide health services (for example, 477 polyclinics located in enterprises that are financed by their own operation costs and supplemented by local administrations). There is no health insurance scheme at present. The TSLS suggested that out of pocket payments in the health sector constitute two-thirds of all health spending in 1999. In 2003, private household out-of-pocket payments accounted

for 71 percent of total financing of the health care industry, compared to 16 percent by the government budget and 13 percent by donors.

Within the health services financed by the state budget, local governments absorb about 80 percent of the total public health expenditure. The level of health spending by local governments has been relatively stable over 1998-2002, accounting for about 80 percent of total health expenditure. The finance departments of the oblasts (hukomats) are responsible for managing these budgets. The republican budget finances the remaining health services (about 19-20 percent), which includes general and specialized hospitals, as well as the apparatus of the Ministry of Health and some other specialized medical agencies.

Table 19
Health Expenditure by level of Government in 1998-2002

	1998	1999	2000	2001	2002
State budget (millions of Somoni)	11.9	14.0	16.8	24.4	30.6
Republican as percentage of total	19.1%	23.4%	18.5%	18.9%	20.6%
Local as percentage of total	80.9%	76.6%	80.9%	81.1%	79.4%

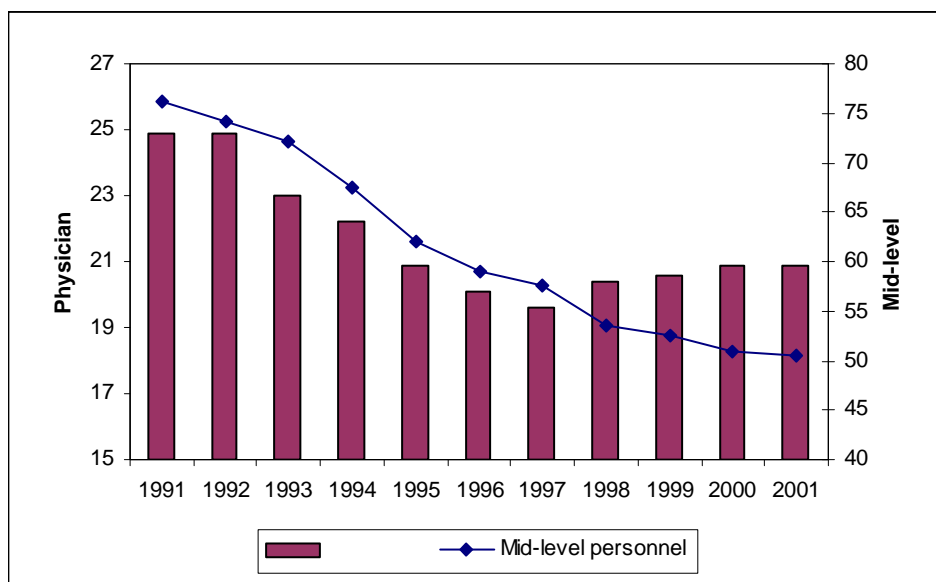
Source: Ministry of Finance

B.2 Resource Allocation in the Health Sector

2.25 2.62 Inputs for health care provision have declined and consequently the quality of care has been declined. The number of physicians and mid-level health personnel per 10,000 persons fell, respectively, by 16 and 34 percent during 1991-2001. Low salaries make it difficult not only to retain but also to attract health staff with appropriate skills. The loss of health workers is acute in the mid-level workers, especially nurses. The number of hospital beds has fallen as the utilization rate has declined, with less than 60 percent occupancy in 1997⁴⁸. The government decision to reduce the number of hospital beds by 30 percent in 1993 has brought the number of beds per population. Hospital bed occupancy fell from 75 percent in 1997 (WHO Health For All database) to 55 percent in 2002, in line with that of the EU. Finally, health infrastructure is badly maintained due to under investment and lack of proper repair.

⁴⁸ *ibid.*,

Figure 6
Number of Health Personnel
(per 10,000 Populations)



2.63 The budgeting based on input norms (physicians and beds) leads to inequitable distribution of resources across regions that is biased towards large cities. The hospital system inherited from the Soviet time remains fragmented and needs to be restructure to improve efficiency. Delays in restructuring of the health care system combined with the norm based budgeting leads to budget allocation that favors such regions as GBAO and Dushanbe, with the highest number of physicians and hospital beds⁴⁹. GBAO has the highest level of health spending per capita, followed by Dushanbe. By contrast, Khatlon, the poorest region and most populated, receives the lowest public resources for health care service provision, as reflected by its per capita health spending data.

⁴⁹ Dushanbe had 77 physicians per 10,000 persons in 2000, almost four times the national average, while Khatlon and RRS regions had 11 physicians per 10,000 (11 in 2000). Dushanbe and GBAO had 99 and 97 beds per 10,000 population, respectively in 2000, while Khatlon and RRS had 55 and 51 beds per 10,000 population, respectively.

Table 20
Public Spending on Health by Oblasts

	2000	2001	2002
<i>Somoni per capita</i>			
Dushanbe	3.49	4.94	6.16.
Khatlon	1.6	2.46	3.27.
GBAO	5.3	7.01	8.66.
RRS	1.62	2.18	2.68.
Sugd	2.64	3.62	3.9.
<i>Percent of Total</i>			
Dushanbe	39.6	41.3	48.4
Khatlon	69.3	78.3	97.6
GBAO	22.1	21.2	24.1
RRS	43.9	43.2	50.1
Sugd	100.0	100.0	100.0

2.64 *Although public expenditure on health has gradually shifted towards basic health services, the bulk of spending is allocated to hospital services, especially at the local government level.* At the state level, the reduction in expenditure on general hospital services (2002) reflects the reallocation of resource towards polyclinics, medical, dental, paramedical practitioners and other health services. At the local level, health care provision is in favor of general hospital service, which absorbs about three-fourths of health spending, but this declined significantly in 2002. By contrast, the republican expenditure on general hospital services increased at the expense of a reduction in spending on health oversight and management.

Table 21

Tajikistan: Health expenditures by types of services
Percent of Total

Health Expenditure	1999			2000			2001			2002		
	State	Republ	Local	State	Republ	Local	State	Republ	Local	State	Republ	Local
General hospital services	68	31	79	72	54	77	69	48	74	65	44	71
Specialized Hospitals and Centers Services												
Medical and maternity center services												
Rehabilitation centers and nursing services												
Hospital affairs and services not elsewhere classified												
Polyclinics, and medical, dental, paramedical practitioners	8	3	9	10	3	12	11	2	13	13	1	16
Public health affairs and services	6	4	6	6	4	7	4	2	5	5	3	6
Organizations involved in medicines supply	0	0	0	0	0	0	3	0	3	0	0	0
Applied research and experimental development related to the health and medical sector	0	0	0	0	0	0	0	3	0	1	4	0
Other Health Affairs and Services*	19	62	6	11	39	5	12	45	5	16	48	8
Total:	100	100	100	100	100	100	100	100	100	100	100	100

* This includes: Health oversight and management, and Health affairs and services not elsewhere classified

Source: Ministry of Finance.

2 2.65 *Wage and social contribution have begun to crowd out other expenditures in the health sector, especially at the local government level.* The share of salaries and social fund contribution in total health expenditure in the state

and local government budgets increased significantly between 1999 and 2002 (Table 22). They crowded out purchases of goods and services, especially the pro-poor spending. In particular, public spending on drugs in the Republican budget has declined substantially from 30 percent of total expenditure in 1999 to 11 percent in 2002. The decline in public spending on drugs is likely compensated by an increase in the private out-of-pocket payments and donor contributions.

2.66 Repair and maintenance of health infrastructure are inadequate. The deterioration and theft of equipment and supplies and the destruction of health posts and other health infrastructures during the civil unrest in the 1990s considerably deteriorated the extensive network of primary health system developed during Soviet times.⁵⁰ The share of expenditure for repair and maintenance in total health expenditure increased; however, it remains inadequate for proper repair and maintenance, especially at the local level.

Table 22

Health Expenditure by Economic Classification, actual, 1999-2002 (in somoni)
Percent of Total

Health Expenditure	1999			2000			2001			2002		
	Republ		Local	Republ		Local	Republ		Local	Republ		Local
	State	ican		State	ican		State	ican		State	ican	
Wages and salaries and Contribution to SPF	24	11	28	30	15	33	33	16	36	37	20	42
Total Goods and services	65	66	65	63	64	63	57	53	58	53	46	54
Economic expenditures	19	5	23	5	1	6	4	1	5	3	1	4
Business trips	2	5	1	1	3	1	1	4	1	1	3	1
Small value equipment	3	4	3	5	9	4	5	9	5	4	6	4
Maintenance and repair	7	10	6	11	18	9	10	13	10	10	11	10
Food	18	11	21	18	13	19	15	9	16	13	8	14
Medicines and dressing materials	16	30	11	12	14	12	12	12	11	11	11	12
Utilities (Electricity, gas, water)	0	0	0	5	2	6	6	1	7	5	1	6
Fuel for motor vehicles	0	0	0	2	3	2	2	2	2	2	2	2
Other	1	0	1	3	2	3	1	1	1	1	2	1
Capital Expenditure	11	24	7	7	21	4	10	31	5	10	34	3
of which: New construction	7	18	4	6	16	3	5	20	2	6	27	1
Transports	4	6	3	1	2	0	1	3	0	1	3	1
Total:	100	100	100	100	100	100	100	100	100	100	100	100

Source: Ministry of Finance

B.3 Assessment of the Health Sector

2.67 Tajikistan's health outcomes have been the poorest compared to the other FSU countries⁵¹. Table 23 shows that Tajikistan has the worst indicators when it comes to the probability of dying for children under the age of five, while its life expectancy indicator is comparable with the other FSU countries. The mortality and morbidity rates are high and infectious diseases have emerged. The 2000 MICS estimated IMR at 89.9 per 1,000 live births and under-5 mortality at 126. The maternal mortality rate is high. Hemorrhage is the leading cause of maternal death at 37.5 percent. Malaria morbidity

⁵⁰ Facilities description is summarized from "Health Care Systems in Transition – Tajikistan", The European Observatory On Health Care Systems, 2000

⁵¹ Detailed explanation on the measurement can be found in the World Health Report, 2000.

and Tuberculosis are also rising. Based on indirect indicators, the WHO estimates that the current tuberculosis morbidity rate in Tajikistan is most likely 127.3 per 100,000.

Table 23
Performance of Health Care System in 2000

	GDP per capita, 2000 (constant 1995 US\$)	Public Health Expenditure, 1998 (% of GDP)	Overall Health Performance 1997	Health Performance Index, 1997	Probability of dying - under age 5		Life expectancy at birth	
					Male	Female	Male	Female
Kazakhstan	1,512	1.6	0.752	0.598	80	60	58	68.4
Kyrgyzstan	885	3.7	0.455	0.598	70	58	60	68.8
Tajikistan	386	0.4	0.428	0.551	85	82	60.4	64.7
Turkmenistan	1,377	3.4	0.443	0.513	59	52	60	64.9
Uzbekistan	485	3.3	0.599	0.681	69	57	62.1	68
Russian Fed	2,455	3.9	0.544	0.606	23	17	59.4	72

Note: GDP data is from World Bank SIMA data base. Public health expenditure data is obtained from UNICEF MONEE. Overall health performance and health performance index data⁵² is from World Health Report (2000).

2.68 A shortfall in public funding of health services has increased out-of-pocket payments and increased inequality in health utilization among the poor. Patients' out-of-pocket payments have increased and become more common in health care provision. Out-of-pocket payments by individuals for outpatient care and hospital care have become widespread and increased in magnitude as more individuals at all expenditure quintiles made payments for health care services, often informally. Over 80 percent of the poorest quintile seeking outpatient care made payments out of their pockets.⁵³ The amount of payments for health care services has also increased significantly during the two surveys. The average out-of-pocket payments made by the poorest quintile for outpatient care and hospital care have increased, respectively, by six times and three times between 1999 and 2003.⁵⁴ This limits access of the poor to the utilization of health care service that is presumably provided to the citizen free of charge based on the Constitution.

2 2.69 Based on the health utilization and health expenditure, the spending patterns show that a larger share of the government budget benefits the higher income groups than the lowest income groups due to the higher utilization rate, especially inpatient services, by the higher income groups. The Government

⁵² The performance index of health system measures how efficient the health systems translate expenditure into health as measured by disability-adjusted life expectancy (DALE), defined as the ratio between achieved levels of health and the levels of health that could be achieved by the most efficient health system (DALE) ranges from 0 [least] to 1 [most] efficient system). Overall performance relates overall health system achievement to health system expenditure.

⁵³ The TSLS for 2003.

⁵⁴ Cheryl Cashin, Policy Note on Tajikistan's Health Financing, p. 25.

contribution is extremely limited, especially for outpatient services - and most of the payments are out-of-pocket. There is very little social protection or risk pooling in a situation where households are making most of the payments directly out of pocket.

2.70 The estimated cost of health care for both inpatient and outpatient services in 2003 indicates that the burden of health care cost is borne by the private, especially for drugs. The shares of private payment for inpatient and outpatient services are, respectively, 52 and 96 percent of total drug costs. It should be noted that this estimation does not make any adjustments for the difference in unit costs of services used by the rich and poor due to a lack of data on intensity of services. It's likely that the difference would be even greater if this adjustment could be made. Also, these expenditures do not necessarily reflect the total cost of admission or visit as the patients and their families also make contributions in-kind and by labor (e.g., feeding, bathing, even injecting), not adequately captured in the data above.

Table 24
Unit Cost of Health Care by Level of Services and by Financing Sources in 2003

Service Category	Total Unit Spending	Government	Private	Donors
Inpatient (per admission)	129.54	41.09	54.28	34.16
by medical services	87.18	35.44	32.27	19.47
by drugs	42.36	5.65	22.01	14.69
Outpatient (per consultation or visit)	5.15	0.17	4.61	0.37
by medical services	0.96	0.13	0.58	0.24
by drugs	4.19	0.04	4.03	0.13

Source: 2003 TSLs.

2.71 The forgoing review reveals that the efficiency of public expenditure on health could be further improved through reallocation towards preventive care and through rationalization. The functional review of health spending shows that efficient resource allocation could be improved at the local government level. This could be achieved through reallocation of public resources from general hospital services that are oriented to curative and in-patient services towards preventive health care and outpatient service that is considered to be cost effective.

2.72 The rationalization of health infrastructure could generate additional resources to improve the health care services that benefit the poor. The allocation of non-wage current expenditure among repair and maintenance of health infrastructure and medical equipment could be rationalized to improve spending efficiency and increase equity across geographical areas. Similar to other CIS countries, Tajikistan has excess capacity of health infrastructure inherited from Soviet times. A complete system of health care, including primary care, hospitals, specialty dispensaries and SES, exists in parallel at rayon, city and oblast levels. The duplication of service delivery should be rationalized through downsizing or closures of the existing health infrastructure. The Government has recently adopted the health reform strategy that focuses on reforming of the Soviet

primary care which comprises several levels of medical facilities (ranging from medical houses to rural hospitals) into family health centers.

2.73 *The current budget formulation procedures need to be changed to improve intra-sectoral resource allocation among programs within the health sector.* The budget formulation should be based on outputs (activities and services) instead of the input-based norms to provide incentives for the local governments to initiate saving measures. The Government has recently introduced output-based budgeting (health expenditure per capita) for the budget formation of primary health care facilities in 2002, however, the formula developed is inadequate (Box 1). The Ministry of Health recognizes the issue and the formula will be revised under the health care financing strategy plan. It is important that the Government gradually introduces the per capita budget formula for allocating the entire health care budget.

Box 1: Population based Budget Formation for the Health Sector

The Ministry of Finance has recently initiated a new formula for allocation of budgetary resources to the education and health sectors for the 2002-2004 Budget. The new formula based on activity and population rather than input based budgeting (hospital beds, physicians) and is currently limited to budget formation of primary health care facilities. This represents a change in primary health provider payments. The per capita allocation of public spending on health for a local budget (oblast, municipality, or rayon) is determined by three factors the health budget, the size of population, and the average share of primary health care budget.

Per capita budget =(Local health budget/local population)*Average share of primary health care.

However, there are challenges for estimating the per capita budget using the above formula. First, the local health care budget only excludes capital expenditures, the costs of free and subsidized medicines provided as benefits to protected individuals. Secondly, the local budget health care is difficult to estimate due to a lack of accounting system to separate budget for primary care. Finally, off-budget expenditures, namely barter utility payments for health care services and in-kind expenditures provided by community members (volunteer labor for performing outreach and other service for local health facilities) are difficult to properly estimate.

Source: Cheryl Cashin, *Tajikistan Health Sector Note: Health Financing Report*, January 2004.

2.342.74 *Additionally, greater autonomy of the local governments should be allowed together with rationalization of health infrastructure and the introduction of per capita based budgeting.* Both reforms will shift resources to primary health care and the per capita allocation implicitly implies that savings from rationalization will be retained within the health sector. It is necessary to accompany the reforms by granting greater autonomy to local public administration to provide incentives for public health administrators to drive the restructuring. The local governments should be able to make independent decisions as regards to reallocation of resources across budget line items and personnel management (recruitment, hiring, etc) in order to improve internal efficiency and to meet priority needs in health care delivery.

3 2.75 *In parallel with rationalization of hospital infrastructure, additional sources of revenue need to be identified to improve health care services.* The available budgetary resource is likely to be insufficient over the medium-term due to the

heavy debt service burden and low revenue collection. Over the short and medium-term, formalization and rationalization of patients' out-of-pocket payments by introducing co-payments with appropriate exemption system will provide additional resources to improve the quality of health care services. Donor financing of health care services should be directed and coordinated to ensure effective uses of external assistance.

C. Social Protection

2.76 *Tajikistan's social protection system that was inherited from the Soviet Republic has remained unchanged since independence.*⁵⁵ The system still provides a wide range of benefits and privileges that are eligible to broad categories of citizens. According to Article 39 of the Constitution, every person is guaranteed social security in old age, in the event of sickness and disability, loss of ability to work, or loss of a guardian or other instances prescribed by law. As budgetary resources become very limited, the country can no longer afford such a system that is complicated, non-transparent, poorly targeted, and outdated due to the underpinning legislative framework. There is an urgent need to reform the current system to ensure that the social safety net is available to protect the most vulnerable groups from further deterioration in incomes and standards of livings.

2.77 *Public expenditure for social protection accounted for about 2 percent of GDP in 2002.* This represented nearly one-third of social sector expenditures, the second after education. Available statistics show that social protection expenditure declined since independence and reached the lowest level in 2000 (Table 26). However, the trend has reversed in subsequent years, reflecting a central role of social protection as a coping strategy to fight poverty in Tajikistan.

Table 25
Tajikistan: Social Security and Welfare

	1998	1999	2000	2001	2002
Percent of Total Expenditure (excluding PIP)	16.0	11.5	9.8	10.4	11.2
Percent of GDP	2.5	1.9	1.8	1.9	2.1
In 1997 prices (millions of Somoni)	18.2	14.1	13.2	14.3	19.0
US\$ per capita	5.5	3.4	2.9	3.2	4.1
Percent of Social Expenditure	43.5	37.1	35.4	36.0	37.9

Source: Ministry of Finance

2.78 *The formal social protection system includes four components of benefits: pension, unemployment and family benefits, social assistance (cash compensation benefits and non-cash benefits), and social care (institutional care and social services).* Social insurance is only available for beneficiaries who are formally employed and make contributions to the SPF. Pension and cash compensation constitute major benefits for the poor and vulnerable groups. Pension and family benefits are financed by the Social

⁵⁵ Minor changes have been introduced but for one benefit at a time, for example the Cash Compensation Program.

Protection Fund (SPF)⁵⁶, while social assistance and social care are financed by the Republican budget. Pension (old-age, early retirement, disability and survivors) is administered by the republican government while other types of social assistance are managed by both republican and local governments. Military and law enforcement pensions are not subject to insurance arrangements and are paid directly out of the Republican Budget. Unemployment benefits and family benefits (including sickness, maternity, birth and funeral) are guaranteed by the Constitution.

2.79 The SPF is responsible for collecting contributions from employers and employees. The employers pay contribution (payroll tax) of 25 percent⁵⁷ while employees pay 1 percent of their earnings as contribution to the SPF. This one percent is included as the revenue of the SPF, deposited at the National Bank of Tajikistan under Employee Savings Accounts (ESA) and it cannot be used to pay for actual benefits.

Table 26
Revenues and expenditures of SPF

	2000	2001	2002
Expenditures	30.2	54.0	75.0
Pensions	25.4	41.2	58.4
Allowances	1.8		
In-kind benefits		7.6	10.1
Contribution to ESA	1.0	2.0	3.0
Other Subsidies	1.3	1.0	2.0
	0.7	1.5	0.9
Administrative expenses			
Capital Expenditure		0.6	0.6
Revenues			
Employer contributions	27.6	52	72
Employee contributions	1.0	2.0	3.0
Others			

Source: World Bank, *Tajikistan Social Expenditure, 2002*

2.80 The SPF has no formal policy regarding the contribution rate, the level and extent of benefits, and the target groups. The level and types of benefits are determined by law. Pensions are defined benefits in nominal terms according to a standard formula;⁵⁸ however, benefits of new pensioners are determined by a unit in the Ministry of Labor and Social Protection under the authority of local governments. According to the social protection law, the state budget supposedly transfers to the SPF funds to cover non-contributory benefits such as social pensions, but in reality it does not receive any transfers. Social pensions are paid out of contributions.

⁵⁶ Income and expenditure of the SPF must be balanced as it cannot legally run a deficit. Since 2001, the SPF has registered surpluses that were spent on additional benefits to World War II veterans.

⁵⁷ The payroll tax declined from 38 percent to 30 percent in 1998.

⁵⁸ Women may retire after 20 years and men after 25 years on 55%, plus an extra 1% for each year beyond the 20 or 25 years of either the average of the last two years salary or any five years salary.

Table 27
Tajikistan: Social Protection Fund Expenditures 1998-2000

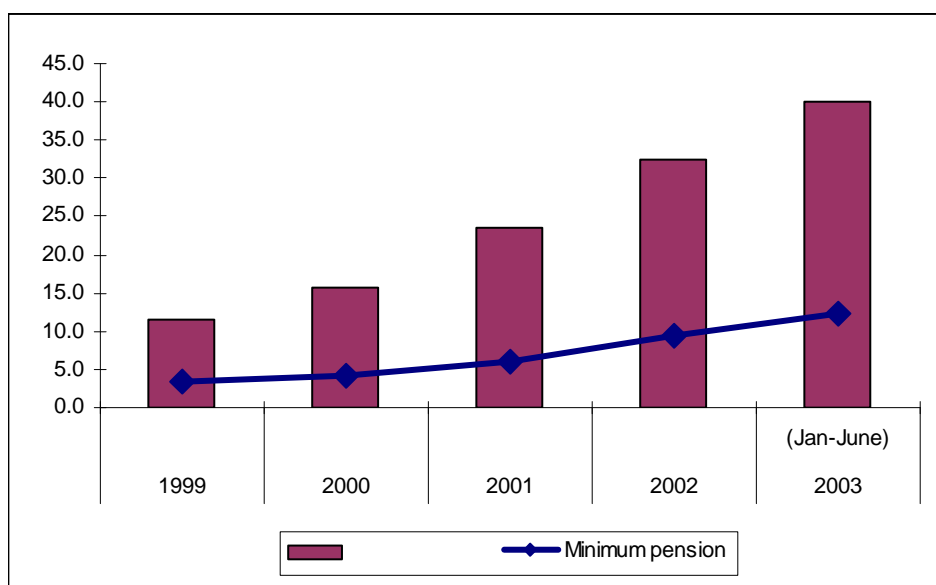
	Total	Pensions	Health improvement	Employment Policy	Benefits	Other
1998	100.0	78.5	2.4	2.4	10.4	6.2
1999	100.0	82.0	2.2	2.2	9.6	4.1
2000	100.0	86.2	1.8	1.7	8.5	1.9
2001	100.0	85.3	1.8	2.5	8.0	2.4
2002	100.0	80.6	1.8	2.1	8.2	7.3

Source: Social Protection Fund

- 2 2.81** *Pension accounts for about 80 percent of the SPF. The old-age pension benefit is based on the length of service and average earnings over a specific period of time.* Since July 1, 2003, the retirement age is currently 63 years for men and 58 years for women. There are about over half a million pensioners that receive old-age pensions. A full size pension is about 55 percent of average earnings over the last two years, and it is subject to an upper limit and a lower limit.⁵⁹ The average pension received by an individual was very low (only 10 Somoni per month in 2002, equivalent to US\$3). Disability pension, paid to disables regardless of work-related or general injury, is paid to three different categories (disables deemed incapable of working, disables having limited capacity to work, and disables capable of working). The average disability pension is slightly higher than the old-age pension. Survivor pensions are paid to dependent family members who lost insured breadwinners, including children up to 18 years, parents, and spouses of pension age, close relatives care for children under 18 years, and grandparents. The pension entitlement is equivalent to 50 percent of a deceased's earning subjected to upper and lower limits. Early retirement pensions are not typical in Tajikistan. Privileged pensions, including military service, physical conditions that prevent working, and special merit pensions for those that serve the nation in a special way, are relatively generous. The average pension was 19.3 in 2001. There are more than 4,000 persons eligible for special pensions. Social pensions, paid to disables and elderly not entitled to social insurance and poor children, are independent of recipients' income. The payment ranges between 30-100 percent of the minimum pension.

⁵⁹ An upper limit equals 30 times the minimum pension (5 Somoni in 2002) or 75 percent of covered earnings (90 percent for state employees). A lower limit equals social pensions (2.5 Somoni in 2002).

Figure 5
Average wage and Pensions
(in Somoni)



Source: PRSP Progress Report, February 2004

2.82 Non-pension benefits, including unemployment and family benefits, account for only 20 percent of total expenditure of the SPF and are paid directly by enterprises that in turn offset them against social tax contributions. It is likely that the non-pension benefits are under-estimated as the SPF does not know the exact number of recipients of these benefits. Unemployment benefits, paid up to six months to a registered unemployed person at the local employment office, are equivalent to 50 percent of average wages over the last two months of employment. The statistics indicate that the number of beneficiaries receiving unemployment benefits has declined while the benefit per month doubled in 2001. Family benefits include sickness, maternity, child care, birth, and funeral benefits (the latter is paid by both the Ministry of Labor and Social Protection and by the Social Protection Fund). It is a lump-sum payment equivalent to 20 times the minimum pension, paid upon the death of an insured person or dependents.

Table 28
Social Insurance (Pensions, Unemployment, and Family Benefits)
2000-2001

	2000			2001		
	Number of Recipients	Average Payment per month	Total Payments per month (Mill. of Somoni)	Number of Recipients	Average Payment per month	Total Payments per month (Mill. of Somoni)
Pensions	559,437	4.06	2.269	556,113	6.01	3.343
Old age	366,109	4.19	1.534	357,657	6.24	2.231
Disability	70,157	5.05	0.354	76,068	7.53	0.573
Survivor	67,098	4.22	0.283	60,047	7.01	0.421
Special	4,543	6.2	0.028	4,092	8.25	0.034
Merit	4,072	15.87	0.065	4,276	19.31	0.083
Social	56,069	1.73	0.097	62,335	1.9	0.119
Unemployment Benefits	20,284	7.1	0.144	16,062	12	0.194
Family Benefits						
Maternity		1.03	0.112		2.0	0.145
Child care		1.0	0.105		1.5	0.256
Birth Grant						
Funeral						
By MoLSP	16,862	60.0	1.012	15,309	60.0	0.919
By SPF		9.7	0.608		18.5	1.105

Source : Ministry of Labor and Social Protection

3 2.83 Social assistance includes cash compensation benefits targeted to vulnerable groups classified as likely poor. There are two cash compensation programs targeting two types of beneficiaries, the children and the poor consumers of energy. The cash compensation program for children was first introduced in 1996 to replace the existing system of child allowances. A universal bread subsidy provides cash transfers to limited members of the four target groups, including: (a) families with per capita income of less than two times the level of the minimum wage (TR 4,000); the benefit is then payable for each child under the age of 8; (b) families with children under age 16 who have lost one or both parents and who are receiving survivor pensions; (c) disabled (regardless of employment status) and non-working pensioners with pensions below the minimum pension level of TR 2,000; and (d) students in vocational, specialized secondary and higher education regardless of any scholarships received. The level of monetary benefits provided by the CCP and the number of beneficiaries are limited. The amount of the benefit is established at 500 Tajik Ruble per eligible person per month in 1998. Only 17 percent of the total population was eligible to benefit, while only 5 percent of the total population received the CCP.⁶⁰

2.84 The new cash compensation program was piloted in 2001 and fully implemented nationwide in January 2002. The program targets the 20 percent poorest children (6-15 years) attending schools and is financed by local budgets. The program aims to prevent children from dropping out of school and to provide incentives for children not attending school to return to schools. The benefit is administered by a

⁶⁰ The World Bank, Tajikistan Poverty Assessment (2000).

school commission (teachers, parents, local representatives) responsible for identifying the poorest children and allocating the cash benefit (equivalent to 24 Somoni per year paid in four installments). Only three children maximum in a family can receive a benefit. The payment mechanism is implemented by school committees to ensure transparency and accountability. The CCP covered only 292,500 school children in 2002 and in 2003.⁶¹

2.85 The Government also introduced a cash allowance to compensate for utility tariff increases (electricity and gas). The state budget allocated 12 million Somoni in 2003 and 20 million Somoni in 2004 to compensate for utility tariff increases that targeted at families whose income is below average wage in a district or town. The amount of compensation paid to each beneficiary is calculated and the payment mechanism is administered by a government commission comprising local authorities and community representatives. The compensation payments do not necessarily reach the neediest poor due to complex administrative procedures related to the identification of beneficiaries. The Government has established Working Groups to streamline the identification procedures of the submission of applications.

2.86 The “Law on Social Protection” requires that the government allocate resources for rehabilitation of institutions that provide non-cash social assistance to the disabled, elderly and war veterans, including treatment at sanatoria, free public transport, free or subsidized housing and telephone. Sanatorium treatment is provided to war veterans and the disabled. Their eligible benefits include 18-day free treatments every two years and priority is given to sick and referred persons. War veterans who do not want the treatment are entitled to cash compensation payments (about 19 Somoni in 2000). Finally, the Government also provides a boarding house for war and labor veterans.

2.87 Social care provisions are provided by both the Ministry of Labor and Social Protection (MoLSP) and Ministry of Education (MoEd). Currently, there are 12 social care facilities. Nine institutions subordinated to the MoLSP are financed by the Republican Budget. Six houses for invalids and elderly adults and three houses for disabled children; three sanatoria; one rehabilitation clinic; and a vocational school for disabled young adults subordinated to MoLSP. There is social assistance financed by local budgets. For example, “home help services” are provided by local social protection offices to help the elderly and disabled with daily hygiene and other basic activities. “Territorial social service centers” in larger cities serve food for poor pensioners, and temporary housing before moving to an institution.

⁶¹ PRSP Progress Report, February 2004.

Table 29
Social Care under MoLSP

	# of institution s	# of Places	# of inhabitant s 2000	# of inhabitant s 2001
Boarding Houses for Elderly and Disabled	6	820	589	635
General	4	460	301	331
Special (mentally handicapped adults)	2	360	297	305
Boarding houses for children	3	160	108	116
Mentally handicapped	1	100	69	74
Physically handicapped	2	60	39	42
Sanatoria and Resorts				
Sanatoria	3	170	370	520
Pension home	1	100		

Source: Ministry of Labor and Social Protection

C.1 Effectiveness of the Social Protection System

2.88 *The current social protection is ineffective in terms of coverage, efficiency, and adequacy.* The World Bank's 2000 Poverty Assessment concluded that the coverage of the social protection system is inadequate as fewer people benefit from the system due to a lack of funds and administrative difficulties. The lack of funds led to an accumulation of arrears on social insurance benefits. Benefits provided by the social insurance system are inadequate due the low level of pension benefits that was further eroded by inflation.

2.89 *The pension system is inadequate, unaffordable, and unsustainable.* The size of pension benefits at its absolute level is too low due to the low level of wages. In 2002, the minimum pension was established at 5 Somoni and the maximum pension was 70 Somoni. The system is not affordable for all of society as the eligibility criteria is too generous while the contribution (replacement) is falling, thus resulting in a small size of pension. Financing is not sustainable from the financial point of view as collections have been poor due to lack of enforcement, limited administrative capacity and absence of individual contribution records. Moreover, the SPF has used employee contributions to finance non-contributory benefits (such as social pensions) and the Government does not transfer funds to cover these expenditures.

2.90 *Social assistance, specifically cash compensation program for children, is not adequate and poorly targeted.* Although the cash compensation program specifically targets poor children attending schools, it appears to be ineffective. First, the methodology to identify the 20 percent poorest children is questionable as it is not based on poverty criteria. Government regulations have set up a wide range of criteria that are not strictly adhered to by the school commissions. Administrative difficulties make it difficult for beneficiaries to receive the cash compensation payments (child allowances). The targeting efficiency of CCP to the needy groups cannot be assessed due to insufficient data. Very few households receive benefits covered by CCP. Finally, the benefits provided by the SPF and CCP are clearly inadequate, at only 2 Somoni per

month. The payment rate of the CCP is low in all oblasts due to insufficient funds allocated to the CCP and delays in presenting a list of the poorest children.⁶²

2.91 *Although the law grants numerous non cash privileges, beneficiaries rarely receive these benefits in reality.* Non-cash social assistance includes free transport, regular sanatorium treatment, housing and utility subsidies. The targeting methodology, which is based on rights and categorical groups, suggests that the beneficiaries are not necessarily poor. This targeting results in a large number of beneficiaries, thus making it difficult for the Government to afford the entitlements. The houses that provide institutional care do not have capacity to cover the whole country. The limited capacity of sanatoria has resulted in a long waiting list for treatment. Consequently, war veterans only get one treatment every four years instead of every two years as stipulated by law. Moreover, the treatment is out of reach for beneficiaries who can not afford travel expenses. Finally, shortage of budgetary funds to provide institutional care is acute.

2.92 *The social protection system needs to be reformed.* First, the social assistance benefits needs to be streamlined to ensure that the system is affordable within the availability of budgetary resources. A wide range of privileges and entitlements should be reviewed and rationalized. Privileges should ultimately be eliminated. Secondly, the targeting methodology of social assistance should be improved to ensure that the needy poor benefit from social assistance. The targeting criteria should be based on income or poverty rather than categorical groups' criteria and rights. The administrative procedure for implementing the social assistance should be streamlined and simplified. These reforms will reduce the number of benefits and beneficiaries, thereby, increasing the size of social assistance to the level that is considered sufficient.

⁶² Franziska Gassmann, "Social Protection Sector Review -- Formal and Informal Safety Net" Social Development Project, ADB Technical Assistance, Dushanbe September 2002.

Tajikistan: Formal Social Protection System

TYPE OF ASSISTANCE	ELIGIBILITY		ENTITLEMENTS
	General	Specific	
1. Pensions			
1.1 Old age	Employment records	Men: 61 years Women: 56 years	Pensions size depends on average earnings and length of services
1.2 Disability	Employment records	Three categories of disability	50-70% of earnings.
1.3 Survivor	Employment records	Dependent family members unfit for work.	30% of the deceased's earnings
1.4 Early retirement	Privilege	Certain professional	Varies per group.
1.5 Special pensions	Privilege	Certain occupations and merits	Varies per group.
2.1 Unemployment	Employment records	Registered as unemployed	3-6 months; 50-60% of earnings or minimum wage.
2.2 Family benefits			
2.2.1 Sickness	Employment records	Temporary illness or care for sick family members.	60-100% of earning but at least min. wage
2.2.2 Maternity		Before or after giving birth	Minimum wage
2.2.3 Child care		Women taking leave for 18 months	Minimum wage
2.2.4 Birth grant		Lump sum	1-3 times min. wages
2.2.5 Funeral			20 times min. wages
3. Social assistance			
3.1 Social pensions	No other pension rights	Old-age, disability, children w/o breadwinner	50-100% of min. pensions
3.2 Cash compensation program for children	Targeted	Children aged of 6-15 attending school	24 Somoni per year
3.3 Cash compensation program for energy tariff increases	Targeted	20% poorest Energy consumption	24 m. Somoni per year
3.4 Non-cash benefits	Categorized benefit	Disabled, privileged groups	
4. Social Care			
4.1 Institution care	Old age		
	Disability		
4.2 Social services	Home Help		
	Day care		

STRATEGIC POLICY FORMULATION AND HUMAN RESOURCES

INTRODUCTION

The alignment of the policy formulation process and organizational structure of the government in line with its new role in the economy has been one of the slowest reform areas. The formal creation of new governance and policy-making structures under the 1999 constitution has so far left intact much of the extensive network of institutions that served the previous system of governance, both at central and local level. Therefore, under the surface of the new system of governance defined by the Constitution, Tajikistan still retains a system of public administration based on the former Soviet model, characterized by small ministries that manage large numbers of subordinated bodies, including state owned enterprises, and a broad network of subordinated sector units at Oblast and Rayon level. Embryonic self-governing institutions are being developed at the Jamoat level, but their role and functions are as yet to be clearly defined.

Weaknesses in the public administration system have two main features. First, there are serious deficiencies in the organizational structure and management of the system, in particular in the management of the policy process. This prevents the design of effective policies to stimulate growth and development, and make the Government unable to effectively use the significant donor support available to the country. Second, the continued involvement of Government in market and production functions stifles private sector development and diverts resources from areas that are key to achieving sustainable growth and development, such as Education, Health and Social Protection.

The fragmentation of the policy-making and implementation system hinders the effective development and implementation of policies driving growth and competitiveness. Due to weaknesses in the policy management system, the Government has faced significant problems with the prioritization of development goals, which are pursued under a variety of different programs. This is putting a serious strain on the potential for economic growth. Furthermore, weaknesses in the management of policy implementation have led to a gradual deterioration of the quality of health and education services, which raises questions about the medium to long term competitiveness of the country.

The current system contrasts with the demands of a market based economic system, which requires the separation of state structures from economic activity. Policy management in a market economy requires that the state sets the rules of the game and supervises their effective application, but does not intervene directly in the economy, except in areas of strategic interest. A command and control based system of public administration is ineffective in social service delivery, as effective social service delivery depends on the ability of local service delivery units to respond to specific local demands and conditions, rather than to implement mechanically central orders.

Since the adoption of the new constitution in 1999 initial steps have been made to bring the system of public administration more in line with the demands of a democratic and

market based system of governance. A first set of reforms in the structure and organization of the policy process has been implemented. The reform of the President's Administration, carried out in 2001-2002, has formally pushed policy-making functions down to the level of the ministries, while reducing both the size and functions of the central administrative machinery. The number of institutions in the central state administration has been reduced, from 86 in 2001 to 64 in 2004, with a further reduction to 40 planned for the next two years. This reduction mainly involves the gradual abolition of institutions that used to directly manage market operations. If the restructuring effort at the core of the Government is to have its intended effect, an equivalent reform of structures and processes in line ministries is needed. Without a serious investment in staff development, in particular by strengthening policy units in the ministries, a formal transfer of responsibility for policy development to line ministries will not have the desired impact.

Civil Service development is hampered by unresolved issues regarding the legal basis for employment conditions in the Civil Service. Civil service legislation, enacted in 1998, has been largely ineffective, and most of the necessary secondary legislation has still not been adopted. Civil service management structures remain weak, and Tajikistan has only recently started to establish the necessary training infrastructure for the public sector. For over 12 years there has been no investment in staff capacity development in the Tajik civil service. The lack of capacity in the Civil Service is one of the main causes of the low quality of policies in Tajikistan. Most civil servants still operate in the 'Soviet mode', when the main functions of civil servants was to exercise control over implementation. For many officials, policy development therefore remains an alien concept.

The size of the Public Sector Wage bill is small relative terms, and remains at under 3% of GDP and the wage system is opaque and inadequate. If anything, especially central level institutions such as core ministries are understaffed. Still, chronic under-investment in areas such as health and education means that increases in wages will have to remain limited in order to create the necessary fiscal space for much needed capital expenditures. Therefore, whereas in principle there would be fiscal space to increase wages, up to around 4.5-5% of GDP as a maximum,⁶³ the more significant increases that are required to bring wages above subsistence level will have to be funded in part through either shedding staff⁶⁴ or through externally funded means. The wage system in the state sector is inadequate even when numerous bonuses and premiums are taken into account. Public sector workers in most instances do not earn a living wage. Staff numbers and salary levels are an issue of constant disagreement between the government and the IMF, which has routinely imposed across the board staff cuts as a conditionality.

⁶³ This is the approximate average among the 6 poorest CIS states. It should be noted that the wage bill as a percentage of GDP is higher in OECD states, and that rates of around 10% are not an exception in other transition states

⁶⁴ As was done in 2003, with the reduction of some 20,080 staff in the health and education sectors, see chapter 2

The following sections address key systemic issues related to four main aspects of public administration: policy management, organizational structures, staffing issues and reform management. The two sections on the policy process include an assessment of policy development and policy implementation structures and review measures taken to date to rationalize structures and processes in order to create effective and open system of governance. The section on civil service development reviews current legislation and practices in place and the ongoing civil service development process, and subsequently focus on the crucial issue of wage policy.

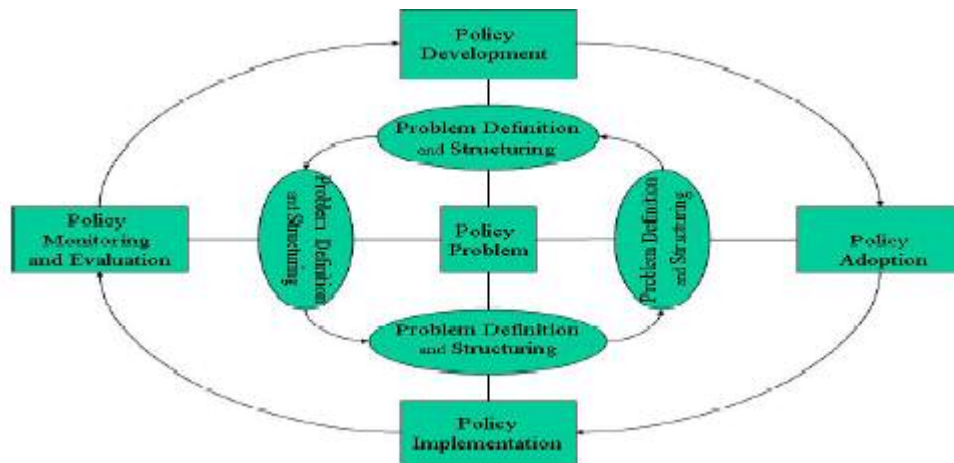
POLICY MANAGEMENT PROCESSES AND STRUCTURES: A CONVOLUTED POLICY PROCESS

A. Policy Management: Conditions For An Effective Process

Ideally, policy management involves both top-down and bottom-up processes. Top-down processes involve the development of overall government strategy, which sets the overall policy framework for the general direction of development in the state. The design of overall development strategies is generally led by the head of state or government, and supported by the Presidential administration or the Prime Minister's office, drawing on inputs from line ministries and society at large. The support structures at the President and Prime Minister's offices should be organized and staffed in a way that facilitates the provision of support on strategic development issues, while matters of sectoral and detailed policy are left to the ministries. A second main function of support structures at the President's and Prime Minister's offices is to effectively manage the Government decision-making process, which involves making sure that sector policies proposed comply with overall Government policy and meet formal requirements, such as compatibility with the Constitution and other legislation, compatibility with the fiscal framework and the state budget as well as possibly other compatibility checks, such as environmental standards, etc..

According to international practice, ministries would have the task to develop specific proposals to achieve overall Government objectives, as well as to address specific problems identified in their respective sectors. Ministries need to have the relevant staffing capacities required to effectively fulfill this function. Usually, ministries would also propose and outline what instruments should be used to achieve policy objectives (legislation, programs, incentive measures etc.). In order for policies to reflect the needs of society, the policy process normally involves institutionalized consultation with outside actors and co-ordination with other ministries, for which the initiating ministry is responsible. Ideally, policy management processes should therefore follow the steps as summarized in Figure 1 and Box 1 below.

Figure 1. Policy Cycle: a simplified model of policy making processes (Source: Public Policy Analysis: An Introduction by W. N. Dunn, p.15-17)



Box 1. Policy Process Stages (Based on Dunn, Public Policy Analysis, 1994)

Policy development: Once an issue has been identified and put on the agenda of the ministry, it is up to civil servants formulate a policy proposals to address the issue. Civil servants will developed alternative options, based on policy analysis and outcomes to be achieved. Information is provided to decision-makers about the benefits and costs of alternatives, the future consequences that have been estimated and possible criteria for making choices. Potential tensions with stakeholders are also identified.

Policy adoption: A concrete policy alternative is chosen and adopted by the management of the ministry and a formal legislative or administrative procedure (depending on the option adopted) is put in place, leading to final adoption by either Parliament or Government (depending on the instrument).

Policy implementation: An adopted policy is carried out by the ministry, or a subordinated body under the ministry, for which financial and human resources are mobilized. The policy is communicated and social, public, economic, technological, and political support is sought. Where possible, different options are tested.

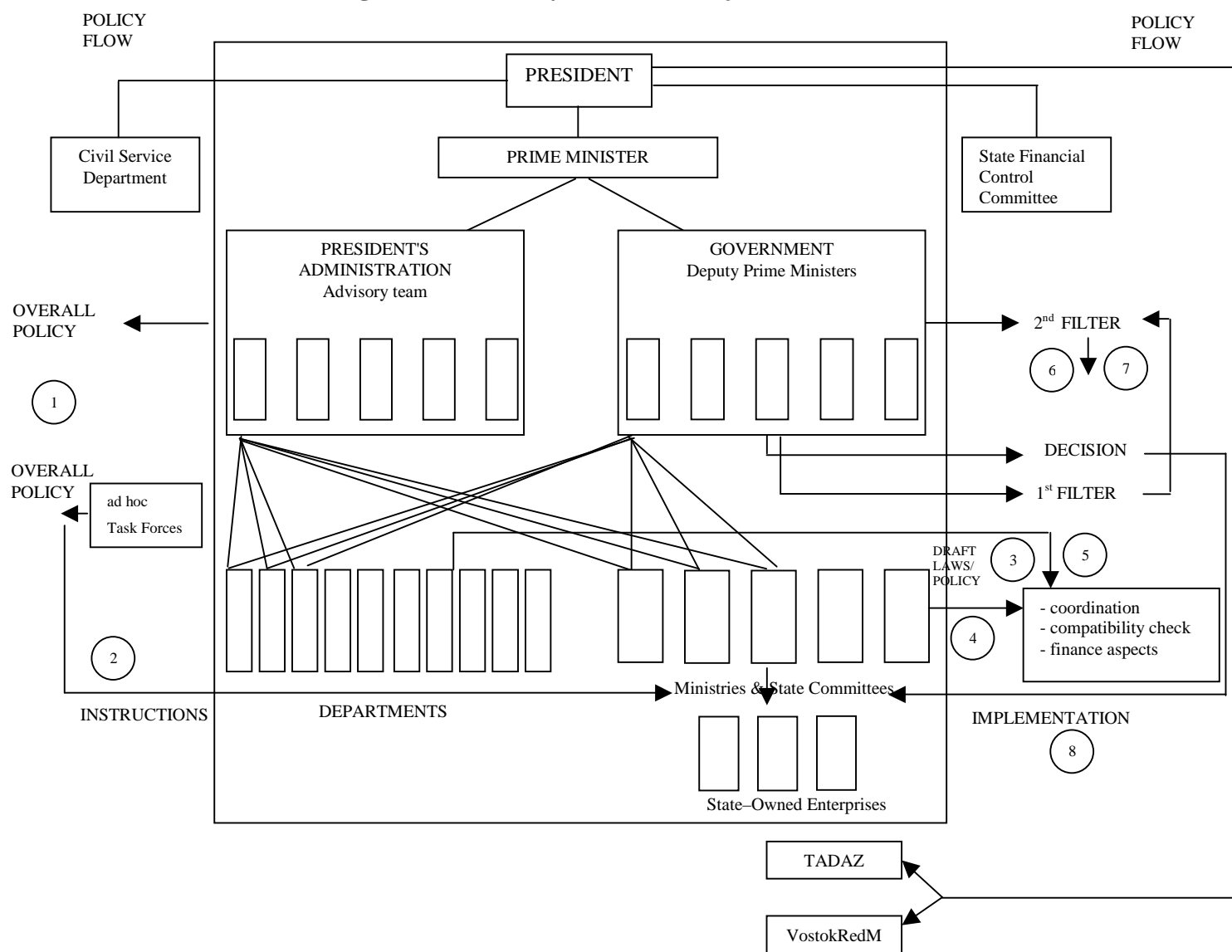
Policy monitoring and evaluation: This involves the assessment of the policy. The process establishes whether the adopted policy it is achieving its objectives. Monitoring reveals information about the consequences of the adopted and implemented policy and helps in achieving better implementation. Evaluation reveals discrepancies between expected and actual performance, thus assisting policymakers in identifying future agenda issues. These processes may lead to adjustments or reformulation of policies.

In the above model, which underlies policy processes in most developed democracies, it is the ministry that is the pivotal institution in the formulation, evaluation and monitoring of government policy. The structure, staff capacity and work program of individual ministries should therefore reflect this. Line ministries should be relatively small organizations, with staff members that are trained in policy design and evaluation. Ministries also are expected to play an important role in policy implementation, either through monitoring and reporting work or by drafting secondary legislation, guidelines and rules. Policy implementation is the responsibility of subordinated bodies, either at central or at local government level, which require different staffing levels and capacities. Issues related to the management of policy implementation are discussed in the next section.

The system of policy formulation and implementation currently in place in Tajikistan is ineffective and too complicated. This is due mainly to overlapping responsibilities

between the President's Administration and the line ministries that prevent the development and application of a clearly structured policy process. In addition, it is important to note that any duplication of functions is highly taxing in the context of Tajikistan, as the available capacities in the administration are very limited due to the lack of opportunities for existing staff to develop the new skills they need to operate in a change political and socio-economic context, and the inadequate incentive structure, which prevents the Government from hiring high quality staff. The main actors and their roles in the policy process in Tajikistan at the current time are set out in figure 2 and analyzed below.

Figure 2. The Policy Process In Tajikistan



A.1 President's Administration and Line Ministries

The President's Administration has two sets of units that play a role in policy management, the Presidential Team of Advisors and the Policy Sector Units. The Presidential Team of Advisors, which consists of five state advisers, eight senior advisers and twelve advisers, leads the development of policy priorities for the President. The advisory team is divided in five groups, dealing with economic policy, legal issues, international affairs, social affairs and personnel policy. The President is the main initiator of policies in Tajikistan, which makes the advisory group the nucleus of the policy-making system. State advisers and advisers are part of the group of some 800 top officials that are appointed through a special procedure, outside the scope of the civil service law and based on the personal trust of the president. Apart from their function in policy initiation, the advisory team also is the final instance to check on policy proposals before they are submitted for discussion in the meeting of the Council of Ministers.

The Sector Units in the President's Administration shadow the policy development work of the state administration and exercise quality control over policy proposals prepared by individual ministries and other institutions. There is one sector unit for each main policy sector, each subordinated to one of the Deputy Prime Ministers. The Deputy Prime Ministers control the access to the Government agenda and can stop any proposals from going forward. In addition to the sector units that monitor substantive matters of policy, there are two additional units that conduct compatibility checks on financial and legal aspects of proposed laws and policies. All policy proposals need to be reviewed by these two units. These units duplicate the work of the Ministries of Finance and Justice, which have units with similar responsibilities. The Sector units have several important functions in the policy process. First of all they have a key role in policy co-ordination. Each sector unit co-ordinates the activities of several ministries and state committees. The responsible sector unit also fulfills additional co-ordination tasks, as it checks policy proposals with other units inside the President's Administration. This duplicates the inter-ministerial coordination process, which is not working adequately.

Sector Units have the right to return policy proposals to the ministries if they are deemed to be of insufficient quality. This is usually decided by the relevant Deputy Prime Minister. The sector units therefore are one of the four quality control 'filters' in place in the President's administration, in addition to the financial and legal reviews conducted by the specialized units in the President's Administration and by the Ministries of Justice and Finance, and the reviews conducted by the Team of Advisors to the President. The role of the sector units and their size have been reduced significantly over the last two years. Whereas in the past the units actually developed much of the draft legislation and policy proposals for the government, this task has now been formally decentralized to the line ministries. The sector units have been reduced in size by about 50%, and some of the staff have been transferred to the line ministries to develop their policy-making capacity.

The line ministries are now formally the main actors in the policy development process. Most ministry regulations have been amended in recent years to reflect their changed role and function. However, in reality ministries lack the expertise and capacities to perform

this function and remain under heavy guidance of the sector units. In addition the restructuring process of ministries, necessary to bring ministerial structures and staff in line with their new role of the ministries, has been very slow, and is in many ministries just at the starting point (see Box 2 below). Moving additional policy-making staff down into the ministries is one possible part of the solution to this problem, as most qualified staff in policy management issues still remains at the President's Administration. However, there are few incentives for staff to move, as the work in ministries does not carry the same prestige as the work in the President's Administration and is not rewarded in the same way. The development of a special scheme or program to develop capacities in line ministries by putting in place special arrangements for staff in key policy positions might be considered and will be discussed in the later section on medium term reform options.

Box 2. The Pros and Cons of placing Sector Units in the Center of Government: the experience of Kyrgyzstan and Slovakia (Source: Re-Building State Structures, Methods and Approaches, UNDP, Bratislava 2001)

The situation described above is not exceptional in the context of Central and East European states. Many states, especially those with Presidential and Semi-Presidential systems, have top-heavy policy-making machineries, with inbuilt duplications of functions between Center of Government institutions. In most instances these structures are either an inheritance of past practice, when duplication of functions was a means to exercise additional control, or a result of complex coalition politics, in which Sector Units serve the function of a control mechanism between the different political forces that make up a coalition.

Kyrgyzstan, like Tajikistan, has a Semi-Presidential system of government, but has separate Offices of the President and Prime Minister. A functional review of the President's Administration and the Prime Minister's Office, carried out in 2000, highlighted both the extent of the duplication of functions between these offices and between these and the line ministries. Key policy sectors had both a ministry, a unit at the Office of the Prime Minister and a unit at the President's Administration. In addition both the President and Prime Minister had teams of advisers. Whereas formally the roles of these units was different, in reality there was a strong overlap of functions. The functional review proposed pushing policy making functions down into the Ministries and retaining only an advisory function for the President and the Prime Minister, allowing them to focus on strategic priorities. The proposals met with strong resistance from the President's Administration and their implementation was deferred, regardless of the clearly identified duplication of functions. However, recently the discussion on the reform of the President's Administration and the Office of the Prime Minister has been re-opened as it is clear that the current system makes effective policy-making almost impossible.

Slovakia also has a Semi-Presidential system of Government, though the role of the President is highly limited. The main focus of the policy process lies with the Prime Minister and the Cabinet of Ministers, supported by the Office of the Government. Under the coalition government that came to power in 1998, a complex institutional arrangement was created at the Office of the Government. Nine sector units were created to support the three Deputy Prime Ministers. Each of these units had both coordination and policy-making tasks, but in reality they were mostly used for coalition parties to control each other (Sector Units subordinated to a Deputy Prime Minister of one party would control a line Ministry headed by a Minister from a different party). In addition each of the Deputy Prime Ministers and the Prime Minister had their own advisory services. A functional review of the Office of the Government, carried out in 2000, highlighted the strain that the system imposed on the policy management system. Deputy Prime Ministers and the sector units subordinated to them engaged in second guessing line ministries on policy proposals, often for political reasons, and thus added an additional layer of control, slowing down the decision-making process.

Following the parliamentary elections in 2002, a reform of the Office of the Government was carried out, effectively abolishing the system of Sector Units and placing full responsibility for policy development with the line ministries. Deputy Prime Ministers were moved out of the Office of the Government and instead were given ministerial portfolios of their own. This reform is widely seen as having contributed significantly to the improved effectiveness of the Slovak policy-making system over the last 1.5 years.

Box 3. functional reviews in Tajikistan: ministries continue to focus on implementation and direct involvement in the economy

A process of functional reviews of line ministries was started in Tajikistan in 2000 under the IBTA II credit. The underlying logic of the reviews was to assist the government in implementing its policy to modernize the system of governance and to bring the structure of the state administration in line with the requirements of a market economy. A set of pilot ministries was selected for review processes, which in each case were conducted over 3-6 month periods by external experts, who worked together with an internal task force set up in each ministry. Recommendations for restructuring were subsequently submitted to the government through the Public Administration Reform Task Force.

The scope of the reviews was limited to the central structures of the selected ministries and their subordinated units at the central government level. Local branches of the ministries were not considered, even though a limited review of some of the Oblast structures was made at a later stage. Furthermore the reviews did not include the sector units in the President's Administration and the President's advisory team. The scope of the reviews was therefore limited and focused mainly on:

- identifying market functions still performed by the ministries
- identifying duplications with other ministries and subordinated central bodies
- reviewing subordination arrangements with central state administration bodies and enterprises in the system of the ministry
- assessing the extent to which structures and functions matched the re-orientation of ministry functions towards policy-making rather than market and service delivery functions

The reviews identified numerous market functions in all ministries reviewed and provided recommendations for their privatization or, in some cases, closure. In addition sectoral ministries also continue to include educational institutions in their system. A large number of duplications in roles and functions were also identified and the ministries reviewed still retained a heavy emphasis on direct service delivery and enterprise management activities. The reviews found that even though formal changes in ministerial structures had been introduced to bring about an orientation towards policy development and monitoring functions, in reality ministries continued to function much like they did before.

The review recommendations remained limited in scope, mainly due to the fact that key institutions in ministerial sectors (the sector units and ministerial units at the oblast and Rayon level) were not included in the reviews. This prevented the review teams from capturing essential issues related to the policy formulation and implementation process and kept the review result at a rather limited and technical level. The exception to this was the review of the Ministry of Finance, which has a much broader remit, though also here the sector units in the President's Administration were not included. The Ministry of Finance review was also by far the most controversial of all the reviews as it made substantive and wide-ranging recommendations, which unfortunately have been ignored thus far. The recommendations focused in particular on the rationalization of subordinated institutions so that the ministry would be able to focus on its core take of designing and monitoring fiscal policy.

In addition to the line ministries and the President's Administration there is a fourth, ad hoc, set of institutions involved in policy development organizational arrangement which are the Specialized Task Forces. The President frequently establishes special task forces to deal with complex policy issues. Two task forces are currently in place that work on issues directly related to administration reform, the Presidential Task Force on Public Administration Reform and the Presidential Task Force on local government issues. These Task Forces are usually chaired by a key minister or by a State Adviser and contain officials from across the administration.

Subordinated units, such as the Oblast and Rayon administrations, remain largely outside the policy debate. Even if it is often argued that they can bring up issues through the ministries, in reality their formal influence appears highly limited, as they are seen mainly as the executive arm of either the President or the ministers. The exclusion of lower level institutions from the policy formulation process is seen as one of the causes why policies in key areas such as education and agriculture have been ineffective. When policies are designed by institutions that are far removed from the reality of implementation, which in Tajikistan is enhanced by poor communication facilities and infrastructure, it is unlikely that they will effectively address real issues on the ground.

The presidential advisory team has a much broader role than is necessary, which impacts negatively the ability of the team to perform its main function, which is to advise the president on overall state policy and, where necessary, review incoming policy proposals in this context. In reality the advisory team is involved in detailed monitoring of policy implementation and also reviews every incoming policy or legislative proposal on substance before it can be submitted to the government. The role of the Sector Units goes well beyond the expected role of units at a core government institution. Policy co-ordination tasks are vested mainly in these units and they also duplicate the work of the ministries on policy development. Even if their role has been reduced in recent years, their remit is still extremely broad. This prevents inter-ministerial discussions from taking place at an earlier point in the policy development process and thus leads to blockages in policy development very late in the formulation process. Ideally, the sector units should be abolished and their staff and competencies moved down into the ministries.

Since the advisory team and the sector units exercise the main responsibilities in the policy formulation process, the role of the ministries remains limited and out of line with government regulations. Ministries are formally the main actors in policy development, as is general practice in most modern states. However, in reality the role of ministries is often limited to technical drafting of policy proposals, that are subsequently given to the sector units for finalization and co-ordination. In reality therefore, the ministries remain the weakest link in the policy formulation system.

The focus of the work of the ministries remains on implementation issues, and in particular on monitoring the work of subordinated institutions at regional and local level. In addition, ministries in most cases still have large numbers of State Owned Enterprises in their sectors, or at least control large holding companies, controlling markets. Even if these have been transformed into Joint Stock companies, ministries remain heavily involved in directing the management of such companies, distracting their attention from their core task, which is to provide an enabling environment for the private sector, not to manage its operation. Unless the full privatization of such enterprises is completed in the foreseeable future, it is unlikely that the actual role of policy development will become more important in line ministries.

Finally, there is no clearly assigned responsibility for policy evaluation and monitoring of implementation. The responsibility for evaluation of the implementation of policies and programs could either lie with a unit at the Center of Government (most commonly), or could be decentralized and lie with the individual line ministries. However, based on

discussions held and available material, the responsibility for policy evaluation is currently not assigned.

POLICY FORMULATION FOR PRIORITY SETTING

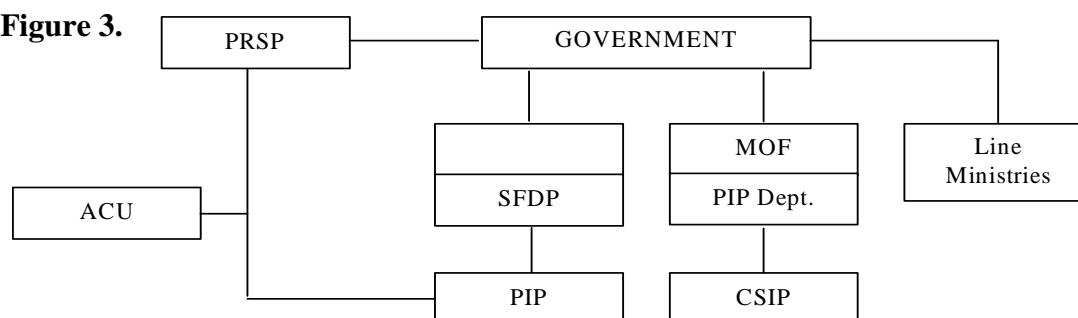
A. Parallel Resource Allocation Mechanisms

A.1 Public Expenditure Management Implications

One good illustration of the problems generated by an ill-structured policy management system is the process of setting conflicting development policy. As indicated in Chapter 1, there are two major development strategies guiding three different parallel resource allocations mechanisms and each are supported by different organizations for the for the design and implementation of development strategy and policy: the SEDP, PRSP, PIP, CSIP, and the budget. The SEDP is developed by MOET and this is a multi year multi year investment program that is energy and infrastructure based (table 1). The SEDP guides the budget and heavily influences the PIP and it is significantly out of line with the macroeconomic framework and does not take into account external debt sustainability issues. This is one of the root causes of difficulties of developing strategic priorities and very much related to the unreformed nature of policy formulation and line ministries operating along command economy lines which leads to parallel resource allocation mechanisms.

The SEDP has no links with the PRSP which is managed by the Presidential Administration. In addition the Aid Coordination Unit functions as a specific coordination mechanism for donor support. Whereas in theory the PIP should reflect the priorities set out in the PRSP, in reality there is little relation between these two strategic documents. Furthermore the Aid Coordination Unit, which is responsible for coordinating the foreign donor input in both, is in reality marginalized, which poses a strong risk of duplication and ineffective use of donor funds. Finally, the budget formulation process basically is run autonomously from the decision-making process under the PRSP and the PIP, even though the MTBF is supposed to take the planned funding and required Government counterpart contributions to these funds into account. The problems in prioritization and the lack of a clear linkage between the budget process and the decision-making process under the PRSP and the PIP are identified as one of the key reasons why disbursement ratios on donor funding are as low as 20% of committed funds in May 2003 CG meetings which has a strong negative impact on economic growth and development.

Figure 3.



Social and Economic Development Plan

Parameters	Units	2000	2005	2010	2015	Growth rate in %			
						2000-2005	2005-2010	2010-2015	2000-2015
Population (end of the year)	thousand	6250	6901	7694	8662	110.4	111.5	112.6	138.6
Labor resources	thousand	3186	3523	3970	4490	110.6	112.7	113.1	140.9
Economically active population	thousand	1794	2160	2617	3291	120.4	121.2	125.8	183.4
Employed	thousand	1745	2107	2554	3220	120.7	121.2	126.1	184.5
Unemployed (real)	thousand	772	684	582	404	88.6	85.1	69.4	52.3
Poverty	thousand	5219	4685	2962	1005	89.8	63.2	33.9	19.3
National income	mln.somoni	1536	2483	4133	7139	161.7	166.5	172.7	464.8
Consumption Fund	mln.somoni	1161	1862	3017	4997	160.4	162.0	165.6	430.4
Accumulation fund	mln.somoni	375	621	1116	2142	165.6	179.7	191.9	571.2
Industry Gross output:									
in current prices	mln.somoni		5238	9910	149990	381.1	189.2	1513.5	10913.1
in prices of 2000	mln.somoni	1374.4	2586	4210	5821	188.2	162.8	138.3	423.5
Agriculture production:									
in current prices	mln.somoni		2369	3763	4412	341.7	158.8	117.2	636.5
in prices of 2000	mln.somoni	693.2	1106.7	1379.8	1551.5	159.7	124.7	112.4	223.8
Retail turnover:									
in current prices	mln.somoni		2400	3654	6468	430	152.3	177	1160
in prices of 2000	mln.somoni	558.2	1181	1550	2460	211.6	131.2	158.7	440.7
Paid Services:									
in current prices	mln.somoni		1400	2415	3612	741.1	172.5	149.7	1912.1
in prices of 2000	mln.somoni	188.9	879	1450	1806	465.3	165	124.6	956.1
Cargo traffic	mln.tons	24.3	41.8	54	73.9	172	129.2	136.9	304.1
Passenger turnover	mln.passengers	157.3	241.5	326	456.4	153.5	135	140	290.1
Inflation rate	%		9.6	7.4	5.8				
GDP:									
in current prices	mln.somoni		5920	10386	18393	327.7	175.4	177.1	1018.0
in prices of 2000	mln.somoni	1806.8	2899	4750	7932	160.4	163.8	167	439.0
Average annual rate of growth	%					9.9	10.4	10.8	10.3
GDP per capita (in prices of 2000)	somoni	292.2	420.1	617.4	915.7	143.8	147	148.4	313.4
Average annual rate of growth	%					7.5	8.1	8.2	7.9
Domestic investments:									
in current prices	mln.somoni		380.5	1319.8	1952.5	458.4	346.9	147.9	2352.4
in prices of 2000	mln.somoni	83	247.6	926.2	1122.1	298.3	374.1	121.2	1351.9
Foreign investments:	\$ mln.	20.1	322	1156.5	1170	1602.0	138.8	101.2	5820.9
External turnover:	\$ mln.	1459.4	1830	2105.4	2254	125.9	115	107.1	154.4
export	\$ mln.	784.3	1020.3	1274	1424	130.1	124.9	111.8	181.6
import	\$ mln.	675.1	809.7	831.4	830	119.9	102.7	99.8	122.9

B. Complex Administrative Structure and Governance of State-Owned Enterprises

According to the SFCC, despite the ongoing privatizations, 583 SOEs remain, with different percentages of Government ownership. About 38 percent have over 200 employees.

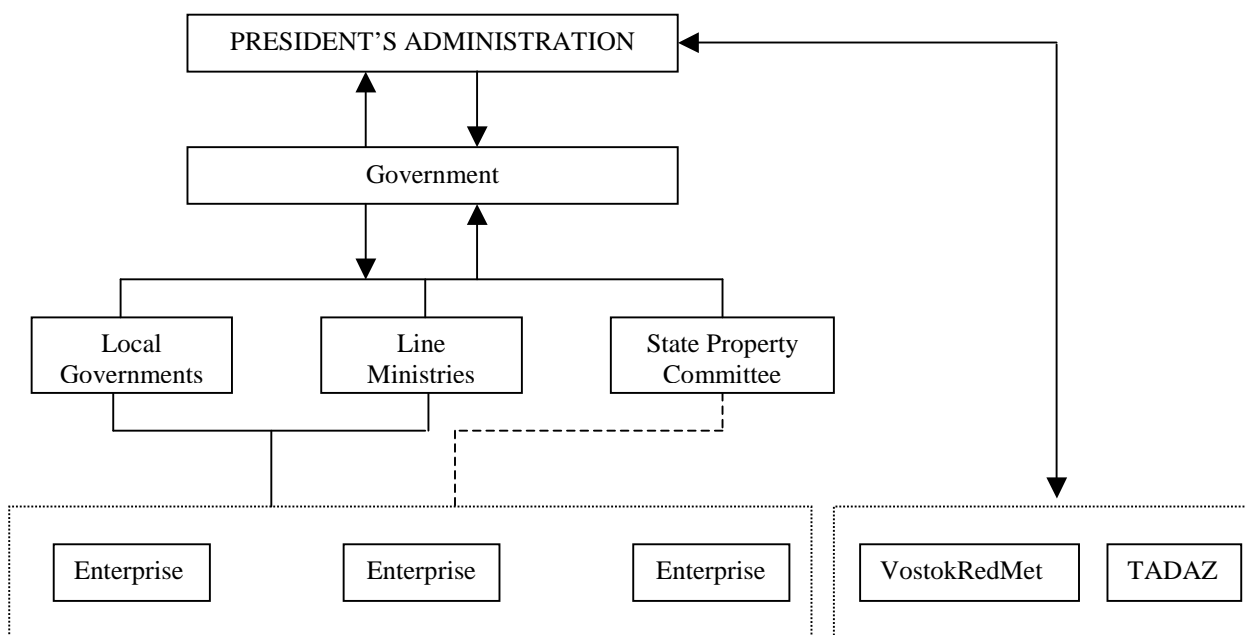
Government ownership	No. of SOEs	%
Under 25 %	58	10
25% - 99%	467	80
100%	58	10
Total	583	100

The SOEs are constituted under charters or closed joint-stock companies. Except for two companies, Tajik Aluminum and Vostok Redmet, all SOEs report directly to their designated line ministries.⁶⁵ Legally, they are autonomous bodies, but the respective ministries appoint directors and key personnel. Thus, in practice, SOEs are quite regulated and experience a high degree of ministry interference. SOEs submit monthly, quarterly and annual data to the ministries on key quantitative indicators. Also, they produce annual accrual-based financial statements, including income and expenditure

⁶⁵ TADAZ and Vostok Redmet report directly to the Office of the President.

accounts and balance sheets, which are subject to the same accounting rules as private sector corporate financial statements. The reports are supplied to the line ministries, the MoF and the State Committee of Statistics. Such information is used primarily for statistical rather than managerial purposes.

Figure 4.



The governance of SOEs is very poor. The government entity responsible for privatization and management of state property in Tajikistan, the State Property Committee (SPC), despite its functional responsibilities to manage state property, can not manage nor control the majority of state-owned enterprises. As noted above, these enterprises are controlled either by the president (the case with the Tajik Aluminum Plant and), by line ministries which control less significant but nonetheless, sizable state-owned assets, such as the National Telecom, Airline, Railway, Electricity System and hundreds of other smaller enterprises and local governments (see chart above). The ministries' vested interest in the enterprises is one of the major impediments to their quick and transparent privatization. In addition, overlapping and/or vague regulations create duplication of roles and responsibilities of the ministries and the SPC with respect to these enterprises. Thus, the Charters of many ministries approved by the GOT gives them controlling functions over the enterprises. At the same time, the law on privatization and the charter of the SPC gives the SPC the powers to exercise the ownership function over all state assets. This is major governance issue and the government needs to clarify the roles and responsibilities of the SPC and line ministries. In any event, all large enterprises should have Boards and should be delinked from ministries.

Box 4. Case Study - Tajik Aluminum Plant – TADAZ

The Company. TADAZ is a 100 percent state-owned-enterprise incorporated in Tajikistan. TADAZ produces aluminum. In 2002, production totaled 307,000 tons with a sales value of around US\$405 million. More than 98 percent is exported to a limited number of customers incorporated overseas, under exclusive contractual agreements. The ownership of these companies is unclear.

TADAZ, which employs about 13,000, is a major player in the economy. It is the largest enterprise and accounts for 35 percent of electric energy consumption, 30 percent-40 percent of exports and a significant share of GDP.

Management structure and corporate governance. The Company is not governed by a Board of Directors or any other type of executive committee. Instead, it is under the sole command of its Director, who reports only to Tajik President at a monthly meeting.

Since SOEs normally report to their respective line ministries, TADAZ's arrangement is an exception. The only other exception involves the Vostok Redmet, a company that produces precious metals.

The company's operations are subject to numerous checks by various Government control bodies. However, the company does not report to Parliament, except during the approval of the State budget when the company's chief accountant provides information and reports to the Budget Commission, upon request.

Financial management. TADAZ maintains its records and prepares its financial statements in the national currency (Somoni) according to the Tajik accounting and tax legislation. It was only in 2000 that the Company first presented financial statements, prepared according to International Accounting Standards (IAS). SAC2 required TADAZ to have an audit of its IAS statements conducted according to International Standards of Audit (ISA). Audit results combined with some estimates about pricing under exclusive contracts suggest that the government may have lost between US\$40-45 million in 2002.

Going concern and related-parties transactions. According to the audit report issued on the financial statements for FY 2002, "the company had an accumulated deficit of US\$529 million and net current liabilities of US\$158 million. In addition, the company is heavily reliant on a single group of companies as a supplier of material, purchaser of finished goods and provider of credit."

The Government should create a unit to monitor SOEs' quarterly financial flows, debt and arrears, as well as financial and other performance targets. In addition, the unit should oversee governance arrangements, including the appointment of Directors and the publication of regular financial information, audited financial statements and company charters. The monitoring unit would focus initially on the largest SOEs.

SYSTEMIC ISSUES: MANAGING POLICY IMPLEMENTATION

Policy implementation is the responsibility of the ministries and their subordinated bodies at central, oblast and Rayon level, though new regulatory management structures are also emerging as an element of market reforms. Most policies are delivered through the subordinated units of line ministries at Rayon level, while Oblast level units mainly fulfill coordination and communication functions. Self-Governing structures do not as yet play a significant role in implementing government policies, as no major functions have been delegated to this level. However, an enhancement of their role is likely in the future, and planned new legislation on Jamoats is expected to constitute an important step in this direction. Capacity building efforts at this level are therefore of special importance.

Service delivery continues organized through a broad network of subordinated bodies, mainly based at Rayon level. Management of service delivery in Tajikistan is plagued by the consequences of the across the board staff cuts imposed by the IMF in recent years, which have significantly reduced the ability of ministries to effectively coordinate service delivery. A number of successive cuts of 5% in overall staff numbers annually have been imposed in order to reduce the public sector wage bill. However, these cuts have been introduced without any underlying reform plans, which means that they have mostly been implemented in a mechanical fashion, by reducing staff numbers with 5% in each individual institution funded from the budget. This method of reducing staff is potentially highly damaging in the context of transition states, which require a re-allocation of resources in the public sector, away from the institutions that used to fulfill market functions, many of which need to be closed down, towards institutions that fulfill policy and regulatory functions. Across the board cuts acts as a substitute for reform and therefore they not only freeze existing systems into place, preventing organizational and structural changes, but also dilute already limited staff capacities in priority areas, and reduces coordination capacities at the central level of administration. Local units providing services to citizens therefore tend to be under-staffed, underfunded and ill-coordinated. The case of the Ministry of Labor and Social Protection, described in Box 4 below, provides a good illustration of the problems posed by organizational fragmentation and piecemeal reform.

Box 5. The Ministry of Labor and Social Protection: an Illustration of Fragmented and Ineffective Service Delivery

The Tajik Ministry of Labor and Social Protection has approximately 388 subordinated units in the Oblasts and Rayons, employing over 9000 staff members, about a 940 of which are civil servants. The central ministry itself has less than 100 staff. The fragmented system as it exists now is not able to handle effectively any of the key issues that arise in the social sphere.

The Ministry of Labor and Social Protection has an extensive networks of local units, some of which are leftovers from the former system and others that provide new types of functions, such as for instance social assistance departments, which provide social worker services to the elderly and invalids. The ministry was created based on the merger of two former ministries and three former state committees and commissions, and has a significantly decreased number of central staff. The ministry seeks to develop an integrated approach to social policy issues, which the leadership of the ministry is pursuing through further structural re-organization.

However, the system of subordinated units has not been rationalized, which leaves numerous units in place that have little or no possibilities to provide service delivery and in addition leads to a disjointed and ineffective approach to social policy at the local level. The consequences for key aspects of service delivery are dramatic. In Kulyob city, for instance, three main units share the very limited social affairs budget; the employment center, the social protection department and the social assistance department. Of these three units, only the social protection department, which handles the processing of pension request and calculates pension rights, is able to deliver the most basic of services, as pensions are generally paid on time.

The Employment Center, which handles the registration of unemployed, the preparation of decisions on the allocation of benefits, the payment of benefits and the development and implementation of re-training programs, is able to pay unemployment benefits only to a fraction of the unemployed and is not in the position to provide any effective re-training programs. The Social Assistance Department at the time of the discussion did not even have premises to work in, and had moved between various buildings 5 times over the last year. The Hukumat has been unwilling to provide office space to the department, even though the department is a structural unit of the Hukumat. There are virtually no funds available to care for the city's 260 single elderly.

The situation is all the more striking if one takes into account that due to excess revenues the Chairman of the Hukumat actually had some 250 000 Somoni, or 16% of the regular budget available as discretionary spending, to be endorsed only by the meeting of the Council. Higher tax revenues (due partly to improved economic performance but mostly due to the low revenue target set for the city) left the city with a large surplus budget, and based on the revenue level collected in 2003 this situation is like to repeat itself. Social welfare issues do not feature among these spending priorities. One of the main reasons why social issues do not feature on the local government agenda is the lack of ability of the fragmented system of local units to effectively formulate common proposals to handle social policy issues. There is no co-ordination body or administrative unit at local level that could develop an integrated view of the social problems of the city and bring social issues to the local policy agenda. Officially this is the task of one of the deputy chairpersons of the Hukumat, but this official needs to cover a wide range of policy issues.

The ministry, in turn, is seen as remote, and the Oblast administration acts as an effective filter to any requests that come from local level, which have to be passed through the Oblast administration of Khatlon Oblast. The presence of this additional, and largely superfluous, level of administration impedes effective communication between delivery units and the ministry and thus prevents the ministry from having a realistic picture of the local situation. Thus, a key policy area is increasingly neglected, due to a lack of ability to formulate coherent policy at local level and the dysfunctional communication system between levels of government.

The system for the appointment of Oblast and Rayon level staff, and the revenue management system further aggravate existing systemic problems. Both issues are discussed in depth in the later sections on the organization and structure of local governments.

In relation to effective policy implementation, the way the dual subordination system of local units of line ministry is currently applied prevents consistent implementation of government policy and distorts funding priorities. Due to the specific features of the appointment process of local state administration staff, and the infrastructure related problems of communication between the central and local level administration, in practice the reporting relations and accountability of the heads of specialized units at local level are mainly towards the Rayon authority, which itself is largely unaccountable. This also means that any reform of service delivery systems will have to focus on the Rayon and Oblast level. Whereas a minister can try to initiate a reform of the system of subordinated unit, the minister fully depends on the cooperation of the local administration in making reform happen. This therefore involves dealing with often entrenched local interest on a Rayon by Rayon basis, which makes reform of service delivery a highly difficult process.

Ongoing work on the new Law on State Administration is expected to help address the problems highlighted above. There are basically two options for reform; either sector units need to be brought under the direct responsibility of the Oblast or Rayon, which would increase the level of deconcentration of power, but not necessarily the level of democratic accountability, and would weaken the central ministries. As an alternative, they would need to return to direct ministerial supervision, which would imply some centralization of power, but possibly bring more consistency in the implementation of state policies.

The emerging system of regulatory management has brought more fragmentation to the policy implementation system. The Government has started the development of a system of regulatory management institutions that will perform licensing, inspection, supervision and market supervision tasks. As a general rule such institutions should be given a high degree of independence to safeguard them from political interference. Oversight of regulatory institutions is often carried out by boards, typically consisting of non-civil servants, which form a professional oversight mechanism over the institution. The institution's direct reporting relations to the ministry would in this case be limited to reporting on the use of state financial resources.

In Tajikistan regulatory management institutions are being established in most policy areas, but they do not reflect principles of good regulatory management. The establishment of regulatory institutions is often driven by conditionality imposed by outside actors, in the context of market reforms. Ministries have responded to these requirements by creating regulatory bodies by ministerial regulation and under direct control of the ministry, which runs contrary to the principle that regulatory institutions should have a high degree of independence. Therefore, whereas the creation of new regulatory institutions is a positive development in principle, as it helps building the foundation for a market economy, the process through which new institutions are being

established creates a serious danger of further institutional fragmentation. In addition the unresolved issues of the public sector wage system (see section on civil service management) constitute a further risk that the new regulatory management systems could be used for the wrong purpose.

Box 6. Licensing Medicines: the Implications of a Centralized Licensing System

One practical example of the potential implications of a centralized decision making system for local service delivery was provided by the Health Policy unit at the Khudjand Hukumat. The right for general practitioners to prescribe certain sedative drugs is extremely restricted, in line with legislation on narcotics, and needs the permission not only from the Ministry of Health in Dushanbe, but also of the Interior Ministry and the State Committee on Narcotics. General practitioners can obtain these licensing only by going physically to Dushanbe. The cost of a return trip to Dushanbe, which over land can be made only in late Spring and Summer, exceeds several monthly salaries of a general practitioner. The central institutions in Dushanbe have thus far refused to grant the permission to either the Oblast authorities or certain hospitals to issue licenses. This means that in many parts of Sugd Oblast small scale operations have to be conducted without the use of sedatives, posing serious risk to the health of patients.

Tajikistan does not have general legislation in places which regulates the creation and abolition of agencies and other institutions subordinated to ministries. In addition some other key laws, such as a general law on licensing, are also not yet adopted. The creation of new institutions in this kind of legal vacuum is potentially dangerous. The experience of other transition states, in particular that of Latvia in the mid 1990s, provides a clear and important example of the potential risks of an overly liberal approach to the creation of new government institutions to regulate an emerging market economy. Latvia had to introduce legislation on agencies to re-regulate the operation of the plethora of new institutions that had emerged from the drive of individual ministries to implement a reform strategy based on New Public Management principles. Other transition states have experienced similar problems.

One part of the solution to the above problem is the creation of an appropriate legal basis which would set out the conditions for the creation of new agencies, and determine their mode of governance, depending on the type of agency being created. This would at best create the legal framework for a proper accountability system, which would have the potential to make the operation of new regulatory bodies more reliable and predictable. However, at the very least it would prevent the creation of a system of market institutions based on unclear rules which would be certain to pose further problems to entrepreneurs. In addition the adoption of framework legislation governing inspection and licensing regimes would set further limits to the discretion of newly created institutions, limiting the scope for abuse of power.

Box 7: The Wild Growth of Licensing: an Effect of Uncontrolled Development of Licensing Institutions

The reports submitted by the Carana corporation, one of the contractors under IBTA II, makes a large number of references to licensing problems and the inappropriate use of licensing requirements. As the number of regulatory agencies increases in Tajikistan, so do the reports of their interference with private sector businesses. Licensing institutions should be tightly monitored to prevent them from becoming instruments to extort funds from businesses and impediments to the development of private businesses. Among the practices listed in the Carana reports are the following:

Private businesses that have bought up real estate and started new operations on these premises often find themselves subject to inappropriate demands from local authorities. The case of a billiard club that was set up in the premises of a former shoe shop was quoted. When the owner of the new business applied for an alcohol license he was told to reconvert the premises to a shoe shop and that no license would be provided unless he did so.

Enterprises are forced to purchase subscriptions to local newspapers and journals, often owned or part owned by local authorities. In case they refuse to purchase these subscriptions, which can come at significant cost, licenses can either be withdrawn, or their next application be refused.

Licensing appears to have become a substitute for direct government control over enterprises and in particular private enterprises suffer from this new form of government intervention. Instead of an instrument to promote public safety and health, licensing has become a tool for more extraction of funds and government interference into the operation of the emerging private sector.

CIVIL SERVICE AND PERSONNEL ISSUES

Reviewing *the Tajik Civil Service System brings out a confusing picture of both the number of civil servants and the definition of who is a civil servant*. Table 2 below summarizes data provided by the Ministry of Finance on staff numbers funded by the budget, subdivided in Civil Servants and auxiliary staff. According to these data, the total number of officials covered by the Civil Service Law is 17,322 officials. However, the numbers provided by the Ministry are contested by other institutions. The Civil Service Agency now includes only some 10,000 positions in the Civil Service registry, though it is argued that the low number this is due to incomplete information provided by the Ministries. However, neither of these numbers appears to be correct. For instance, employees that fall under the Civil Service Law but whose wages are paid from the Social Protection Fund are excluded.⁶⁶ For the Ministry of Labor and Social Protection, for instance, the estimated number of Civil Servants under this calculation would be up to 950, instead of the 225 included in the table provided by the Ministry of Finance. Without clarity on how many Civil Servants there actually are, it is virtually impossible to define a clear approach to Civil Service reform or Development. The development of a proper civil service register with complete data on staffing levels at all budget funded institutions is therefore a first and urgent step in the reform process.

⁶⁶ Under an arrangement put in place following the merger of three Funds (pensions, social welfare and unemployment benefits), the Employment Centers were transferred to the Ministry of Labor and Social Protection, while their staff continues to be paid by the Social Protection Fund. The Ministry of Labor and the Social Protection Fund have made proposals to transfer the responsibility for this staff to the Ministry, and to transfer the units calculating and paying pensions to the Social Protection Fund, thus rationalizing both systems. However, the proposal was blocked by one of the Deputy Prime Ministers

Apart from the basic problem of identifying the actual number of civil servants, there are several structural features in the Civil Service System that hinder the development of a professional, merit-based Civil Service. Without the elimination, or at least the correction of some of these features the civil service is likely to remain a potential brake on economic development. The sections below deal with issues in appointment processes, career management and incentive systems.

Table 2. Public Employees of State-Financed Organizations, 2004

		Service staff	Total	% of total	
				Emp.	Ser.staff
T o t a l	17322	2550,5	19872,5	87,2	12,8
Republican budget					
President and Prime-minister	350	237	587	60	40
Executive Offices, jurisdictional agencies (higher agencies)					
Legislative power	205	167	372	55	45
Judicial power	1193	429	1622	73,5	26,5
Executive power	8098	1295	9393	86	14
including:					
Tribunals and agencies connected to them	777	360,5	1137,5	68,3	31,7
Foreign Affairs agencies	81	9	90	90	10
Conservation of nature agencies and emergency situations agencies	38	14	52	73	27
Financial, tax and customs agencies	4479	512	4991	89,7	10,3
Education and culture agencies	130	20	150	86,6	13,4
Healthcare agencies	51	4	55	92,7	7,3
Labor and social protection agencies	225	30	255	88	12
Agriculture agencies	105	7	112	93,7	6,3
Industry and trade agencies	310	66	376	82,4	17,6
Transportation agencies	104	16	120	86,6	13,4
Various committees, Authorities	1798	256,5	2054,5	87,5	12,5
Others					
<i>Total Republican budget</i>	<i>9846</i>	<i>2128</i>	<i>11974</i>	<i>82,2</i>	<i>17,8</i>
Local budgets	7476	422,5	7898,5	94,6	5,4
State services providing Science Education					

A. Appointment Processes And Career Management

The Civil Service Law, adopted in 1998, has not been implemented, with most of the main secondary legislation still to be drafted. In the absence of a functioning Civil Service Law, appointment and career management processes continue to be based on the notion of the old ‘reserve’ system, which is static and based largely on years of service and political preference, not on performance or merit. In addition, there are several types of reserve systems in operation, which make career moves across levels of government, or between government institutions, relatively difficult.

Some 800 top appointments in the state, which include political appointments, administrative appointments, including the Chairpersons of Hukumats, as well as the top level appointments in strategic State Owned Enterprises, are handled by the Personnel Policy Office in the president’s administration. The Office of Personnel Policy consists of a State Adviser on Personnel Policy, supported by a Senior adviser and several advisers. Individual advisers are assigned to take responsibility for appointments in specific Oblasts. The Office also monitors the work of personnel units in the ministries and of those working in the Oblasts and Rayons and tracks the career path both of top officials and of some 5000 middle management staff to identify potential new talent for top level positions.

Even though some of the responsibilities of the Office are being gradually devolved to the Agency of State Service, top level appointments will continue to be handled by the Office of Personnel Policy. In addition, the Office of Personnel Policy is also likely to continue to support the recruitment and career management process of those officials appointed by the government, which includes the appointment of Deputy Ministers and Heads of Committees under the government. The Deputy Chairpersons of Oblast and Rayon administrations are appointed by the Chairpersons with the agreement of the President. The Office of Personnel Policy will therefore continue to play a pivotal role in civil service management issues, regardless of the creation of the Agency for State Services. Earlier proposals to merge the Office of Personnel Policy with the Agency for State Services were rejected. However, there is no objective reason to keep these two functions separate, and it would therefore be logical if the previous proposals would be reconsidered. A first step in this regard could be to create an oversight structure, like a top level appointments committee, that would oversee all top level appointments below the level of minister. Such a step was recently taken for instance in Ukraine, as a way to build safeguards regarding professional quality into the top level appointment system.

At the current time the remainder of civil service appointments are still handled mainly by the ministries. The Agency for State Services has still not taken over the majority of functions some two years after its creation, even though it is fully staffed, and so far appears to have had little impact on the operation of recruitment and career management systems. The problems with continuity in the top management of the agency has further delayed its institutional development; throughout its existence the position of director has been vacant for all but four months. Other key issues to be addressed, related to the appointment process, are the need to define a clear distinction between political appointees and career officials and between civil servants and technical employees. Even

though the latter distinction is formally made in the Civil Service Law, the actual division of posts between technical and civil service posts is yet to take place in most state institutions.

The Office of Personnel Policy at the President's Administration is in the process of initiating rules and procedures for recruitment by open competition. It is the intent that competitions should eventually be held for all new recruitment processes, except for those in the first and high category. The exact scope and form of the tests is to be decided. However, for competitions to be an effective tool in civil service management, more attractive employment conditions would first need to be defined.

B. Remuneration Issues

Salaries of civil servants, and of public officials in general, remain highly inadequate, and in most cases well below subsistence levels. In part this is due to an over-extended public sector, as reviewed in many sectoral studies, but in part also to the low proportion of public sector wages as a component of GDP, and the also low level of state expenditure as a proportion of GDP.⁶⁷

The relatively high number of staff in the public sector combined with limited budgetary means leads to the salary fund being spread too thinly over a too large group of officials. Table 3 below sets out the average level of base and real pay⁶⁸ in some key positions in the administration.

Table 3. Monthly Wages of Particular Positions in the Ministries
(Ministry of Finance Data)

	Base wage rate		Real wage rate	
	somoni	\$US	somoni	\$US
Minister	65,15	22,46	125,96	43,43
Deputy minister	50,83	17,52	90,70	31,27
Head of the unit	37,43	12,90	66,75	23,01
Chief of the General Board	45,73	15,76	81,55	28,11
Head of the department	45,73	15,76	81,55	28,11
Head of the section	33,73	11,63	60,15	20,73
Main specialist	33,73	11,63	60,15	20,73
Specialist of First category	27,25	9,39	48,60	16,13
Specialist	14,31	4,93	25,52	8,80

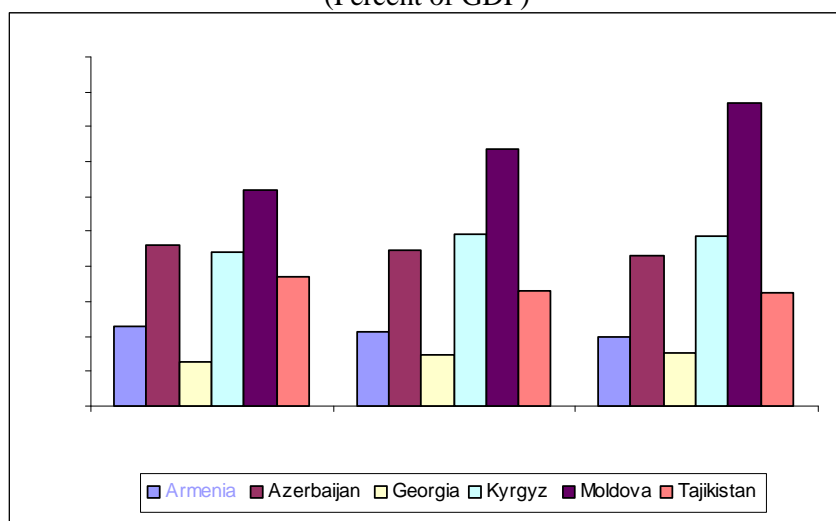
⁶⁷ Based on World Bank studies on the Health, Education and Social sector, conducted in 2002, see chapter 2 for more details

⁶⁸ Not, however, taking into account various ad hoc bonuses

The IMF has continuously pressured the Tajik authorities to reduce staff numbers, and have imposed several general staff cuts in recent years. A 5% reduction was imposed for the fiscal year 2003. In addition some specific staff reductions were mandated in the health and education sector (see chapter 2). General, or across the board cuts tend to have dangerous side effects, as the impact of cuts is relatively larger in institutions of smaller size, in particular in the central line ministries, which already are comparatively understaffed. In addition ministries have showed themselves adept at avoiding staff cuts, for instance by ‘parking’ staff in state owned enterprises, thus shifting the burden of the staff budget outside the formal public service, but not actually reducing its fiscal impact.⁶⁹

Furthermore *the mandated reduction in staff numbers are not offset by equivalent increases in wage levels*, as IMF policies have also emphasized the need to reduce the proportion of the wage bill in terms of GDP. However, the proportion of wages in terms of GDP (local and central government) is already at one of the lowest levels in the ECA region, at around 2.8%, down from 3.8% in 2000. In states at the high end, such as Serbia, Montenegro, Croatia, but also Denmark the proportion of the central government wage bill as a percentage of GDP is over 12%. The OECD average for central government is between 5 and 6%.⁷⁰ The rate is also low in comparison to other CIS states with similar economic conditions (see chart 1 below).

Chart 1. Wage Bills in 6 CIS countries
(Percent of GDP)



An alternative to the current approach of across the board cuts and restrictions on wage growth would be a combination of programmed targeted staff reductions in sectors where over-staffing is an issue and allowing an increase in the proportion of

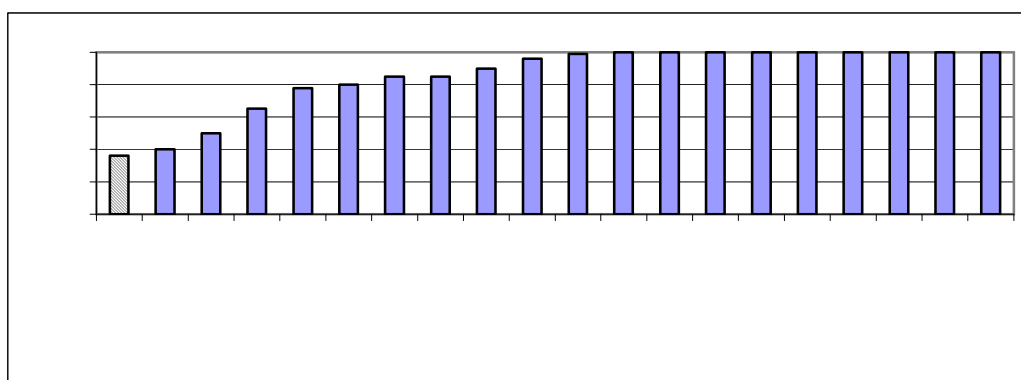
⁶⁹ Practices confirmed during interviews at local government level: officials are formally dismissed, but then are re-hired through municipal enterprises or other semi-state bodies, which are given additional payments for services to government

⁷⁰ It should be noted that the OECD includes several Federal states, which brings the average level down.

public sector wages to GDP to between 4.5 and 5% over a defined time period. This would provide some of the necessary means for wage reform, while at the same time effectively addressing imbalances in public sector employment. However, a strong commitment from the Government would be required to ensure that a sector-by-sector approach to staff reduction is implemented, and transparency in the wage system is enhanced, so that the gradual increase in wages would benefit a streamlined and slimmed down public sector.

In addition to reducing staff levels and increasing budgetary means available for public sector salaries, a comprehensive reform of the pay system is also required. The complexity of the current system, which poses problems of both transparency and equity, is summarized in Box 8 below. The data provided also show that the ratio between base pay and real pay in Tajikistan is very low (see chart 2 below), which poses problems of transparency and predictability.

Chart 2. Base pay to real pay ratio in a comparative perspective (source: Kyrgyzstan PEIR (2003), Tajik data based on information obtained from the Civil Service Agency of Tajikistan)



Box 8. Reforming the pay system: increasing transparency and equity

Wage reform in the public sector is one of the most contentious issues in the current debate on public administration development in Tajikistan. Wages are low and constitute an impediment to the creation of an effective and ethical public sector.

The wage system in the public sector, and in particular in the civil service, is highly complex. The base salary gives little indication of the actual wages paid in the administration. Whereas in OECD states base salaries make up 80-90% of actual pay, in Tajikistan this is around 30-40%, depending on the actual level of bonuses paid. A complex system of bonuses and premiums is in place which includes the following elements:

1. supplement for years of experience, up to 45% of basic pay
2. supplement for academic degree, up to 35% of basic pay
3. general bonus, which is paid four times per year to all staff, consisting of one month salary
4. bonuses given on the occasion of state holidays, one monthly salary, generally paid four times per year to all staff
5. bonus for medical care, 2 monthly salaries, payable to all staff
6. bonus for holidays, 2 monthly salaries, payable to all staff
7. bonus for excellent performance, or for taking on additional duties, 50% of a monthly salary, up to a maximum of two monthly salaries per year, payable only to a small number of staff

Adding up all these supplements, bonuses and premiums leads to a base pay-total pay ratio of 30-40%. The system is unwieldy and lacks transparency, both internally and towards the taxpayer. The existence of this type of system is common practice in many CIS states, and based on the Labor Code provisions that used to be in place in the Soviet-Union.

Addressing the problem of pay levels in Tajikistan requires a complex approach, based on three main pillars:

1. Revenue levels have to be increased to fund pay increases. The current system of revenue target setting has a highly negative impact on revenue collection rates, as local authorities in particular have an interest to set revenue targets as low as possible and the Ministry of Finance does not have adequate data to calculate real revenue potential. Increasing wage levels should be contingent on changes in the revenue targeting and collection system.
2. The size of the public sector needs to be reduced. However, current methods of imposing across the board cuts are ineffective as they keep in place a unbalanced system. An assessment should be made of where staffing levels are excessive and strategies for reducing staff levels in these sectors should be designed. For instance, it is clear that in the education sector staffing levels were until recently up to 35% higher than would be needed relying on data pupil-teacher ratios. If one takes into account non-teaching staff the excess level is even higher. In contrast with this, central ministry and local government core staff levels appear to be lower than would be required, local administrations for instance appear to employ far fewer staff than would be needed to delivery good quality public services.
3. The pay system needs to be rationalized. The percentage of base pay as a part of total pay needs to be gradually increased to 80% in order to make the wage system more transparent and wage cost more predictable. This can only be done over a 4-5 year time period. In addition the IBTA II project has produced proposals on the improvement of the management of the payroll system, which should also be introduced to make the system less prone to abuse.

In addition to overstaffing, the low overall expenditures on public sector wages and the *complexities of the wage system, there are still some other issues that need to be highlighted. There is a need to eliminate the multiple forms of remuneration that continue to exist in the system.* Based on reports of the State Financial Control Committee, ministries retain certain categories of staff that remain outside the official salary scales. This is in part a remnant of the Soviet system, in which salaries of officials in branch ministries were often covered by enterprises subordinated to the ministries, and remained outside the state budget payroll. Even though this system has been abolished and officials are now paid from budget funds, ministries continued the practice of paying officials involved in monitoring state enterprises from 'fees' charged for monitoring services, which were channeled through extra-budgetary funds. The salaries of this category of officials were significantly higher than those of ordinary civil servants. The implementation of the law on the state financial system, which prevents ministries from having extra-budgetary funds, with a small number of exemptions,⁷¹ was supposed to put an end to this practice. However, discussions with the Ministry of Finance and the State Financial Control Committee revealed that there is still a widespread practice of enterprises paying ministries for 'services', often on a cash basis. This allows ministries to retain staff off the books and to pay significant supplements to salaries. The State Financial Control Committee has uncovered such practices on many occasions and

⁷¹ As an example, fees for the production of internal and external passports by the Ministries of Interior and Foreign Affairs respectively

imposed fines on the ministries found at fault. However, the continued appearances of such practices indicates that the fines charged are not a sufficient deterrent to the ministri

The possible solution to this problem is to ensure that the ties between ministries and formerly subordinated enterprises are severed, with privatization being the main option available to the government. However, the privatization program has stalled during the last year and could take several more years to complete, in particular in the area of agriculture. Therefore this is likely to remain an issue for the foreseeable future, unless the reports of the Financial Control Committee are followed up by higher authorities.

C. Expenditure Planning And Execution Of Staffing Budgets

The system of expenditure planning for personnel and other administrative expenditures is highly incremental. As will be discussed in depth in the chapter on the Budget Process, the expenditure planning system is dominated by the Ministry of Finance, which has a special department that plans the salary expenditures for government staff as well as other administrative expenditures. Salary expenditures for teachers and other staff in the education sector are handled by a separate unit. The inputs ministries provide to the budget process are generally not taken into account by the Ministry of Finance, staff numbers are planned incrementally, generally taking into account only mandatory reductions based on IMF conditions. One of the main reasons behind the incremental process of expenditure planning is the low level of acceptability of significant staff reductions in a state that already has a high level of unemployment and high rates of poverty. A review of the personnel expenditure planning system is not on the political agenda at the current time, which severely limits the scope for deeper reforms of the system. Functional reviews, which could have provided the government with an instrument to re-allocate staff resources, have generally not been followed up. One of the cited reasons for this has been the narrow character of the reviews, that focused mainly on the core ministries, where there is relatively little scope for staff reductions and where arguably staff numbers in many ministries would actually need to be increased.

In addition to the problems *caused* by the *incremental* nature of expenditure planning in the area of personnel policy, there are also various problems with the budget execution in this area. Two of such problems deserve further elaboration.

In many institutions posts are kept vacant, which allows other officials to fulfill the tasks that should be performed by the office holder of the vacant post. This practice is used to increase salaries. Officials performing additional duties are entitled to a maximum additional payment of 50% of their monthly salary. The number of vacant posts is estimated at 10-12%. There are several problems with this practice, which is applied widely across the public sector. First, it is an ineffective use of public funds, as the vacant posts obviously are not essential. Second, this practice provides ample opportunities for favoritism, as it is up to the minister to decide what officials are entitled to fulfill the additional duties and obtain additional payments. A fundamental review of posts would certainly identify a large number of redundant posts, but this would be a time consuming and difficult exercise that cannot really be *performed* by outsiders.

Numerous cases of abuse of public funds for paying additional salaries (through maintaining fictitious posts) have been cited by the State Financial Control Committee, which claims this practice is widespread in particular in rural areas. Even though the Treasury department argues that it is difficult to manipulate the system, as 'labor book' and other proof is required for staff to be actually paid, the State Financial Control Committee argues that nevertheless there is a high number of illegal salary payments and widespread abuse of budget funds allocated for business trips and office supplies.

REFORM MANAGEMENT ISSUES: THE LACK OF A CENTRAL ADMINISTRATIVE REFORM MANAGEMENT UNIT

There is as yet no single 'owner' of administrative reform processes, which is one of the key impediments to the implementation of a successful administrative development policy. The Presidential Task Force on public administration reform has thus far not been able to wield enough clout to prevent ministries from circumventing agreed reform decisions. The lack of any follow-up to the functional review reports submitted to the government, and in the case of the Ministry of Finance, the actual rejection of the report and endorsement of a ministerial action plan that contained plans to create a construction company under the ministry, and the lack of follow-up on the payroll reform proposals submitted to the government, shows that the Task Force is not able to effectively bring reform issues to the government agenda. The fact that most reform issues are currently stalled is to a large degree due to the lack of a strong advocate for reform in the system. In addition work on the substance of reform is divided among different Presidential advisers, including the advisory team on personnel policy and the advisory team on economic policy, which further reduces the scope for effective reforms.

More commitment is needed from the government. In a system with strong vested interests against reform, in particular from line ministries bent on retaining their profitable links with institutions and enterprises in their system, a much stronger central function needs to be put in place to push through reform measures. The current arrangement, which puts administrative reform among the responsibilities of the State Adviser on Economic reform, does not ensure sufficient visibility for the administrative reform agenda, while the Presidential Task Force for Public Administration Reform neither has the necessary political clout to get issues on the political agenda, nor is an effective forum for the initiation and monitoring of reform.

ROADMAP FOR REFORM

A. A Complex Reform Agenda: What Needs To Be Done?

The implementation of a comprehensive administrative reform agenda in Tajikistan is a key condition for improved Public Expenditure Management and enhanced private sector development. However, the institutional problems set out in the previous chapters are pervasive and reform management capacity is highly limited. Therefore, institutional reforms have to be phased in carefully and have to be pursued over a long term period if they are to be effective. In first instance, it is crucial to define a roadmap for reform, with

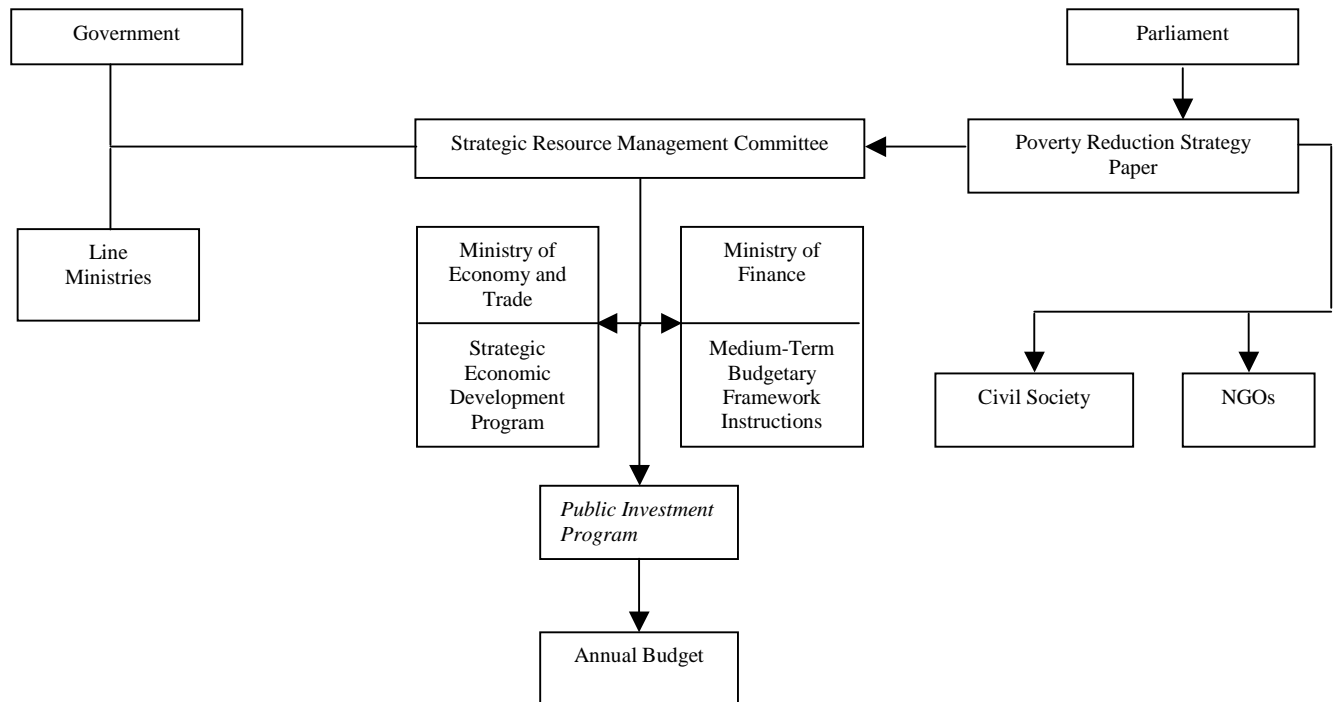
self-contained, feasible steps, that would in the medium to long term address the deep structural problems in the state administration.

B. Central Government Reform: Developing Policy-Making Capacity And Reforming Incentive Structures

Improving the quality of the policy management system is a crucial element of the reform process. The development of a strategic vision for development and the creation of an investment climate conducive to private sector development in the geographic and historical context of Tajikistan requires innovative strategic thinking and sound policies. As discussed in the chapter on institutional development, the current policy-making system in Tajikistan is not conducive to innovative policy design. The serious problems the Government is facing in setting priorities on economic development under multiple instruments (PRSP, PIP), and the lack of ability to effectively connect development initiatives with the Medium Term Budget Framework are a telling illustration of the lack of policy-making ability at the very core of the Government. As a result, disbursements of donor assistance have fallen as low as 10%, severely affecting development prospects.

Policy fragmentation formulation has major implications for the public expenditure management and donor disbursements and for this reason there is an urgent need to create a high level strategic resource management and policy committee. As institutional development takes time, a relatively small and powerful committee is now needed to consolidate various resource allocation mechanisms and mainstream government's priorities into the broader public expenditure framework. This committee, which could be called State Resource Management and Policy Committee (SRMPC) can and needs to be the administrative and organizational answer to the deficiencies arising from the unreformed nature of the policy making process and structures. Figure 5 below shows the SRMPC scheme and lines of reporting. The staffing of the SRMPC and its core functions are described in Chapter 4.

Figure 5



There are *two* conditions for improved policy management in Tajikistan, one is structural, and relates to the policy process, the other one relates to the need to enhance civil service capacity.

In terms of structure-related conditions, the ambiguity and duplication in the policy management system, combined with its emphasis on control instead of policy design are the key problems. This requires a second stage of reform of the President's Administration, to streamline its functions and organization. The system of State Advisors is in principle conducive to the development of a strategic vision for the country, provided advisors spend their time on developing and testing strategic policy options. An interdisciplinary team, for which the foundations are in place, would be well placed to serve the President in his role of defining a strategic vision for the country. However, instead of this, the advisory team is bogged down in operational matters (senior appointments, drafting decrees etc.) and detailed control of the work of the state administration. Therefore, the President lacks the necessary strategic support to create an overall vision for the development of the state. *Reforming the system of advisers, including releasing them from operational matters and implementation control, and allowing them to focus on their core function of strategic policy design and advice would be a starting point for improved policy management.* The formal as well as the practical role of the advisory team therefore needs to be changed.

The abolition of the current system of Sector Units in the President's Administration and a change in roles of Deputy Prime Ministers constitute further structural conditions for improved policy management. Sector Units, which shadow line ministries

in virtually all policy areas, and Deputy Prime Ministers currently act as a brake on the definition of effective policies. Whereas there is a role for Sector Units in some key cross-cutting policy areas (such as Poverty Reduction and Public Administration Reform), there is no rationale for retaining the current system of Sector Units. As long as these remain in place, and the current role of Deputy Prime Ministers is retained, improvements in policy management cannot be expected.

Organizational reform *measures* are insufficient by themselves. ***The third key problem hindering effective policy management is the lack of policy-making capacity in the line ministries.*** In order to build staff capacity, line ministries need to strengthen the existing policy units, both in terms of number and in terms of quality of staff. However, the current system does not provide the required conditions for the creation of strong policy units in ministries, salaries and benefits remain unattractive. As discussed below, reform of the wage system will take a prolonged period of reform, and more radical short to medium term measures will be required if capacities in policy management are to be enhanced. Proposals for such measures will be outlined in the final section of this PEIR.

C. Reforming Policy Implementation Systems

The review of the management of policy implementation highlights the severe systemic problems in the effective delivery of policies. Outdated and fragmented structures at the Rayon level are largely controlled by the local Hukumats, even if they are formally subordinated to the line ministries. The largely unaccountable Hakims in addition have a large degree of discretion in deciding on priorities in public expenditure, due to the inadequate system of estimating and projecting revenues. This further decreases the ability of Government to effectively delivery social services.

The key issues that hinder the effective delivery of policies are the complexity of the institutional organization at local level and the dual subordination system, which means that any reform of the system of subordinated units requires the consent of both the Heads of the Rayon and the responsible minister. A third issue is the local revenue management system, which is discussed in the chapter on the budget process. Subordinated units at the Rayon level remain unreformed, as illustrated in the case of the Ministry of Labor and Social Protection, reviewed in the diagnostic chapter on institutional reform. This means that state administration organization at the local level largely mirrors the organization of the central administration before this was rationalized. Each line ministry therefore has a plethora of units at local level, which often operate under different funding arrangements. The central ministries, much reduced in size are unable to provide effective coordination.

The only realistic way forward is to conduct a comprehensive, ministry by ministry reform process, looking into ministries and their subordinated structures from the top (Sector Units and President's Advisory Team) to the bottom (Rayon level units), and to adopt a reform plan for the restructuring of each ministry. This would need to be endorsed at central, Oblast, and Rayon level. Taking into consideration the existing capacity constraints, one pilot sector should be selected for an in-depth organizational review. The review would look into structures of the ministry at the different levels of

government, including institutions funded by the ministry (vocational training institutions, etc.), into their management and interrelation, and also would consider what functions could eventually be transferred to the Jamoats, the emerging level of local self-government.

In order to increase incentives for reform, the use of Resource Agreements between the respective line Ministry, the Ministry of Finance and the President's Administration may need to be considered. This would allow a proportion of the funds saved through the reform process to be re-invested in improved employment conditions and in the material budget of the sector. There are successful examples of the use of Resource Agreements available in the region, in particular in Latvia and Kyrgyzstan.

Reforms ***launched*** in one sector could be subsequently used to further reforms in others. Whereas this would constitute a gradual approach and it would take a long time to complete the whole process, in the current context of low capacities and low interest in reform, this would be the only appropriate way forward. An overall program phasing organizational would set out the timeframe for the reform process.

D. Civil Service Development: Frameworks And Incentives

As set out in the analytical part of this PEIR, civil service reform is yet to be started and even the scope of the civil service has not yet been defined, there is no clarity on the actual number of civil servants and no consensus on how narrow or broad the civil service should be. Furthermore, the management structure for the Civil Service remains diluted, with top level appointments management directly by the President's Administration and lower level appointments managed by the line ministries. The State Services Agency (SSA) neither has the authority nor the resources and capacity to harmonize civil service management procedures and processes.

The development of adequate recruitment and career management systems will require the amendment of the current Civil Service Law, and eventually its replacement with a new, more modern law, and the proper implementation of existing provisions on competition and performance evaluation. In addition, the SSA needs to be given the appropriate staffing and authority to monitor the consistent application of rules and procedures, both through changing its statute and enhancing its budget.

The emerging professional development system needs more investment, especially if the recently establish Civil Service Training institute is to become a driver for institutional change. Earmarking a percentage of staff budgets as mandatory expenditure on staff development is a useful and tried and tested method to increase the use of formal training as part of civil service career development, and could also be applied in Tajikistan.

The wage system remains the main bottleneck in the system. Wages are inadequate and the wage system both lacks transparency and equity. Wage reform is the most difficult part of the reform agenda, but also a condition sine-qua-non. Any approach to wage reform would have to address two aspects, the wage level and the wage system.

Reform of the wage system is relatively straightforward and should include the integration of the plethora of allowances (which can define anywhere between 60-70% of actual wages) into base pay, and abolishing all but the essential salary supplements. This would require amendments to the Civil Service Law and the Labor Code. Furthermore the gradual introduction of a performance appraisal system should be started, which could eventually lead to the introduction of a limited performance element in salaries.

Wage levels can only be addressed in the context of an overall reform program. If structural issues in the administration are addressed, there should be scope to increase the level of the public sector wage bill to levels up to 4.5-5% of GDP, and bring them in line with the lower range of transition states. However, this can be achieved only through a phased and gradual process, in synch with the implementation of organizational reform and based on a comprehensive reform of the wage system as proposed above.

E. Reform Management: The Need To Create A Reform Champion

The approach that the government has taken so far is to move a number of initiatives on parallel tracks, without sufficient political ownership. The adoption of the Civil Service Law, the creation of the Agency for State Services and, more recently, the Civil Service Training Institute were supposed to address deficiencies in civil service management, while the reorganization of the central structures of power and subsequently of the ministries, combined with the implementation of the privatization agenda were to bring about fundamental changes in the way the administration functions. However, all these initiatives are handled by different actors. Civil service reform is expected to be managed by the Agency for State Services, which reports to the State Adviser on Personnel Policy, structural reform falls under the responsibility of the State Adviser on Economic Reform and the local government reform agenda is managed by a Presidential Task Force headed by the Minister of Justice. The Presidential Task Force on Public Administration Reform is supposed to play a coordinating role and pull together the work undertaken in all these areas, but the Task Force has rarely met and lacks the necessary clout to drive reforms.

It is clear that the only way in which substantial progress could be made, in the face of the substantial opposition from vested *interests* against any significant reforms, is through the creation of a comprehensive strategic framework that would bring together ongoing initiatives, and set out an integrated agenda of how the various systemic issues facing the Tajik system of public administration can be addressed in the medium term.

The creation of a structure that can draft and monitor the implementation of a strategic framework for reform should be addressed urgently. The current reform management arrangement, under which various elements of the reform process are

covered by different high level officials, is unlikely to bring results. The reform agenda will remain fragmented and lacks leadership. It would therefore be helpful for the government to consider the appointment of a Presidential Plenipotentiary, reporting directly to the President and charged exclusively with administrative reform matters. The Plenipotentiary should be supported by a small high quality secretariat that would assist the Plenipotentiary in developing strategic reform initiative and monitor the activities of the various units involved in the implementation of specific reform measures. Any structural changes in the administration should require the consent of the Plenipotentiary. Only this kind solution could help break some of the elements of the deadlock now in place, provided the plenipotentiary is given the necessary authority by the President.

Balancing long-term reforms with short term measures

As outlined above, comprehensive reforms can only be achieved in a long term process. Sequencing reform implementation is therefore crucial, in particular in the light of the prevailing capacity constraints in the country. It is also important to combine the development of framework laws and concepts with actual reform of structures and management systems. Finally, there is the question of using conventional methods versus more risky and bold approaches.

A number of more conventional reform steps can be designed and implemented in the short to medium term:

- Putting in place effective reform management structures at the President's Administration, headed by a plenipotentiary with a clear mandate, to replace the current fragmented and piecemeal approach to reform;

- Creating an effective civil service register, containing data on all civil servants and their profile, and establish and monitor their actual number. In parallel, create similar databases for the core public sector, in particular health, education and other major spending areas. This is an essential condition for any reform in this area to move forward, and should be done in the next 6 months;

- Designing a holistic reform strategy, based on a proper diagnostic of the actual size and capacity of the civil and public service. Such a diagnostic could be conducted in a 3-4 month period if resources are made available, and could be combined with the work on the creation of the civil service register provided the Government demonstrates its willingness to work on this;

- Designing and implementing the second phase of restructuring the President's Administration to allow the institution to focus on core tasks, including strategic advice to the President on policy issues and managing cross cutting reform areas such as Public Administration Reform, Poverty Reduction and Decentralization. In addition its role would need to involve the management of some key functions in the policy process, such as Government agenda management, monitoring the implementation of Government decisions, and

policy evaluation. The reconsideration of the roles of Sector Units and Deputy Prime Ministers should be part of the remit of the review. Based on experience in the region, this kind of reform process would take between 6 months and one year;

Assess the current legal frameworks for civil and public service management and based on an analysis of strengths and weaknesses design a concept for an amended legal framework, based on sector specific but linked legislation for different parts of the public sector;

Conducting a full assessment of the wage system and designing a reform plan to phase out allowances and supplements and putting in place a transparent wage system that reflects job requirements rather than subjective factors. Based on experience in other states an in-depth diagnostic study could be conducted over a period of 3-4 months, after which the Government would have to consider options for pay system reform;

Agree and implement a diagnostic study of one selected pilot ministry at all levels, possibly the Ministry of Labor and Social Protection, and create a reform plan to streamline the organization and management of the ministry and all its subordinated organizations. This could be pursued over a 4-5 month period. Implementation would take a minimum of 6 months following the decision to move forward on the reform plan.

In a longer term perspective, and in the context of the successful implementation of an overall reform program, the following are key potential targets to be achieved.

Raising public sector wages to a level that makes average public sector wages sufficiently attractive to retain qualified staff, by raising the proportion of wages to GDP up to between 4.5 and 5% over an 8-10 year period, under the condition of full implementation of the adopted reform strategy and action plan;

Implementation of a phased sector-by-sector program to reorganize ministerial structures, including central-Oblast-Rayon relations, and reduce staff levels to a level at which competitive wages can be paid, which means significantly lower than the current estimation of over 375,538 public sector employees (2003). A full and comprehensive restructuring process could take up to 10 years;

Full implementation of new legislation on the Civil Service and related employment for other state sectors, including the development of a modern public sector wage system, built on the principles of transparency and equal pay for equal work. This would also include strengthening the role of the State Services Administration and developing the Institute for Civil Service training as a key advisory and professional development institution. Based

on the experience of other transition states, this would take at least 6-7 years to complete;

Put in place a rudimentary strategic planning system to ensure that scarce public resources are spent on policies that contribute effectively to economic growth and poverty reduction. Based on the experience gained in Lithuania, this would take a minimum of 5-6 years to become fully operational.

F. What Role For The Donor Community

The full implementation an agenda of the type outlined above would take an unconventional approach to donor support. Traditional forms of technical assistance and training have proven to be inadequate to the challenges posed by the development situation in Tajikistan, which combines a number of exceptional conditions that severely limit what can be achieved with traditional development assistance. Continued provision of TA in the traditional sense would therefore produce an almost certain failure of the reform effort.

Based on the discussions in this PEIR, a proposal for a support mechanism for the implementation of institutional and structural reforms has been designed that could potentially assist the Government in overcoming some of the key challenges posed by the lack of financial resources and extremely low human resource capacities in the state. The main elements of such an approach are outlined in section xxx. They include investment into the development of policy capacities in line ministries, through providing budget funding for increased salaries of key staff in policy functions and the implementation of a high level training program for such staff and investment in the training system for public sector staff at all levels.

Government contributions to the system would be phased in over time, and would be raised from (a) increases in revenue to be gained from more effective revenue collection and (b) reforming the system of revenue target setting, (d) saving from reductions in the size of the state administration including efficiency gains from improved management and organization and (d) of additional resources that would become available through the gradual increase of the public sector wage bill to a level of up to 4.5-5% of GDP, provided the reform program remains on track.

BUDGET MANAGEMENT AND EXECUTION

INTRODUCTION

The collapse of FSU necessitated the transformation of Tajikistan's central plan based budgetary structure and processes to a modern public finance system. In addition to adjusting to the loss of large budgetary transfers from the center, Tajikistan also faced the difficult task of reforming its budgetary system following independence. As budgeting was subordinate to central planning, the inherited budget process was merely the financial reflection of the of production plans, rather than an instrument of resource allocation and policy choices. This separation of policy making and planning from budgeting in the Soviet system, like many other aspects of policy formulation as discussed in Chapter 3, meant that no domestic institutional mechanisms existed to make the necessary choices on what activities could be financed. Hence, the reform process required the introduction of policy measures and new processes covering the entire spectrum of public finance management framework with little capacity and familiarity with modern budget management systems on the part of the key policy making bodies.

As a result, the pace of reforms has been slow. Constrained by the lack of capacity and the effects of the civil war, the authorities initial reaction to the loss of transfers was to attempt to maintain existing institutional structures and finance previous activities. This increasingly resulted in a situation in which resources were insufficient to cover current costs or maintenance, or even pay subsistence salaries. The incremental nature of the inherited budgeting process, in which budget requests are based on the previous year's allocation irrespective of whether this was sufficient exacerbated the situation. Insufficient allocations were "locked in" and in fact the system has not been able to finance the normative standards which are in theory the basis of budget planning. More fundamentally, continued delays with the preparation and adoption of the MTBF meant that the budgetary process was not associated with a financial framework that could take resource constraints, including external debt, into account over a medium term, nor there were mechanisms to link policy, planning, and the budget in a consistent manner which results in inconsistencies between the PRSP and the budget as discussed in chapter 3.

Since 2002 important budget reforms were introduced but much remains to be done to implement these and this requires stronger government commitment. The government has introduced new tools and procedures for formulating, execution and evaluating the budget since 2002, including a new Public Finance Law, a new national Treasury, and a State Financial Control Office (SFCC) to audit the budget. While these have led to improvements, much of the philosophy and practice of the Soviet system still persist. In some policy areas the Government's determination and ownership of reforms have not been persistent enough, particularly with the development of the MTBF, and it has been difficult to change the pervasive view that the existing system is adequate but it simply lacks resources. Although it is well understood that institutional reforms take time, and this PEIR takes a medium term approach to these, as argued in the PRSP progress report of March 2004, there is a need to press ahead with public expenditure reforms and move

the budget management system on a realistic and modern basis and make it the key vehicle for public spending in line with priorities set by the government.

ANALYSIS OF THE CURRENT SYSTEM

A. Overview of Institutional Structure and Framework for Evaluation

Efforts to reform the budget process have been underway since 1999. The Constitution gives Parliament the power to approve budgets, taxation and the financing of budget deficits. Parliament has a Budget Committee which is involved in reviewing and meets in open session to evaluate the budget prior to approval. Budget execution is controlled by a Treasury which was established in 1999 that is governed by a Treasury Law from 2001. The law provides for a Single Treasury Account and requires the Treasury to be responsible for the execution of both central and local Government budgets. The government is responsible for elaborating the budget, but in practice this responsibility is delegated to the MOF. The annual budget cycle begins in April when the MOF begins drafting the instructions for preparation of the budget. This is circulated to Ministries and agencies in early June. At the same time the MOET prepares the Social and Economic Development Program (SEDP), which is an update of the five year SEDP, and these provide the basis for the elaboration of the budget. This forecast is submitted to the MOF in August, and in September the PIP, which is also prepared by the MOET, is sent to the MOF for incorporation into the budget. The draft budget goes to the government for review in September and the final budget is submitted to parliament by October 1. The budget law is usually enacted by December.

Required reforms to link policy, planning, and budgeting are now institutional. While Tajikistan's fiscal discipline has improved in recent years as noted in Chapter 1, much remains to be done to ensure that budgetary process and resultant expenditures are linked with strategic priorities and are efficiently utilized. The budgetary discipline has been achieved essentially through a system of cash rationing in both budget preparation and execution and the allocation of budgetary funds is not based on any medium-term financial plan as noted earlier. The incremental nature of the budget and the utilization of norms for distributing resources is a serious constraint for improving allocative efficiency at the budget level. An efficient public finance framework, particularly if the PRSP is to be implementable and fiscal sustainability to be fully factored in the budget process, requires a number of steps with associated processes. In general, there are three sets of considerations in the assessment budgetary processes and these are:

Legal basis of budget preparation process, including documentation, coverage, assignment of expenditures, and requirements of accountability and transparency.

A process for identification of a resource envelope that determines total available resources and establishes the budget constraint.

- A sound budget preparation process that has the potential to prioritize expenditures in line with needs and available resources and to ensure public service delivery.

Using these three points as a framework the following sections analyze the budget preparation process in Tajikistan taking note of achievements as well as shortcomings and emerging issues.

A.1 Legislative Basis of the Budget

The Law of State Finances of the Republic of Tajikistan has been enacted in 2002. This law replaced the previous Budget System Law and it has most of the key elements of a modern budget process.. The main strengths and weaknesses of the Law are summarized below in box 3.1 below.

Box 1.

General government is defined in a way which meets international standards. The budget system consists of two levels: the republican (central government) budget together with the Social Protection fund and local government budgets. There are no extra-budgetary funds and the only major targeted budget fund is the Social Protection Fund.

The Law has a partial list of the types of expenditures which might be made from the Republican and Local Government budgets, but a number of areas including subsidies to most types of economic activity and law enforcement are listed as joint responsibilities

The Law gives authority to the Ministry of Finance to draft the state budget on the basis of the forecast of SEDP for presentation to the Government of Tajikistan. It specifies a number of additional inputs to the budget preparation process including the main directions for fiscal, monetary and exchange rate policy, the public investment program, the plan for public sector development and the programs for public borrowing and guarantees. It does not specify a timetable or which institutions are responsible for drawing up these inputs. In practice the timetable and responsibilities are decided by annual Government decrees and instructions issued by the Ministry of Finance.

The only reference to a medium term approach to budgeting is in Article 35 which makes reference to the submission of medium term indicators for revenues and charges and medium term public investment proposals to the Ministry of Finance, but does not give any significance to these indicators. Indeed the Law does not even appear to require estimates of expenditures beyond the budget year and even there is no definition of the period covered by the medium term indicators.

The Law gives wide formal powers to the Ministry of Finance to take the final budget decisions on the budget as Articles 35 and 38 give it allow it to decide on budget allocations in the case of disputes with budgetary institutions or local governments, and submit these to the Government for consideration. There is no formal procedure for negotiation of budget requests.

The Law provides for changes to the budget during the year either by Government decree or by an application of a budget institution to the Ministry of Finance as long as such changes do not exceed either 20% of the item. In addition any changes of more than 10% of total revenues or expenditures must be approved by an amendment to the Budget Law submitted to Parliament.

While the Law makes no specific references to changes in the local government budgets, the Law on Local Government Finance, Article 17 allows the Chairperson of the Hukumat to spend any excess revenues on any items they wish, subject only to the consent of the local legislative body, without consulting the Ministry of Finance.

The budget documentation provides a broad but not yet complete coverage of fiscal activity. The budget documentation covers the State and republican budget and provides detailed estimates for the budget year, with current year implementation. Additional information on forecasts for the next two years

is also provided. However, quasi-fiscal activities are not covered and the law does not require this.

The budget provides for a contingency fund⁷² and 2 percent of the state budget revenue is provided for a President's Reserve Fund, spent at the discretion of the President. These are both disclosed in the budget and reported in the annual execution report to Parliament.

B. Budget Planning Process: Macroeconomic Framework and Fiscal Sustainability Issues

The process for determining the resource envelope is still central plan based. The resource envelope, or the volume of resources from revenues, domestic and foreign borrowing, and other revenues (such as privatization proceeds) likely to be available consistent with macroeconomic framework and absorption capacity, is the starting point for any system of public resource management: without this estimate within which choices can be made it is impossible to prioritize expenditures. In the case of Tajikistan's the determination of the resource envelope is a fragmented process and it does not fully take into account the requirements of fiscal sustainability, particularly the future implications of a higher level of PIP, and risks arising from changes in the terms of trade which would affect external debt payments. Furthermore, the existing process does not lead to the establishment of a budget constraint, or the resource envelope, which would necessitate the adjustment of expenditures and their prioritization. While at one level this is one of the results of lack of a MTBF, it is also the result of the budgetary process which is analyzed below.

Macroeconomic forecast is the first step for the determination of the resource envelope.

The first step is the estimate of key macroeconomic indicators which will serve as the basis of or input to the fiscal revenue forecast and will also allow an assessment of the capacity of the country to borrow and finance specific levels of a fiscal deficit. In Tajikistan the macroeconomic forecast function (for budgetary purposes) is split between the Ministry of Economy and Trade (MOET) and the Ministry of Finance (MOF)⁷³. Starting in January the MOET begins preparing a consolidated plan and forecast for the national economy, indicating detailed sectoral and regional breakdowns, largely on the basis of the production plans of over 600,000 public and private enterprises from which data is gathered on an individual basis.

The forecast is thus very much a consolidation of detailed plans and forecasts reminiscent of the previous central planning system. It is regarded in the MOET as a plan which the MOF should then finance⁷⁴. The forecast receives inputs from bilateral

⁷² The size of the Contingency Fund; its distribution and use are conducted by the Government.

⁷³ This division was explicit in Article 15 of the 1997 law "On Principles of Budget Structure and Budget Process" which governed the budget process until 2003, and required the MOET to prepare plans and forecasts, as well as sectoral programs as the basis for drafting the expenditure budget. In addition it played a role planning revenues. Under the December 2002, "Law on State Finances" the role of the MOET is no longer explicit, although Article 34 does talk about the budget being prepared on the basis of a forecast of social-economic development.

⁷⁴ This was the role of Gosplan, the MOET's predecessor in the Soviet period. Discussions with officials within and outside the MOET suggest that this view is still widely held today.

meetings with sectoral ministries and from the NBT on inflation and the balance of payments. The forecast is then presented to the Government and the Ministry of Finance in September, at the end of the budget process, implying that either it will have very little impact on the budget, or that numerous ad hoc changes will be made to the budget at the last moment by the MOF. In neither case is this a satisfactory situation. In parallel with the MOET forecast, the MOF develops its own forecast (beginning in April) which is discussed with the IMF, with the involvement of the National Bank, to establish the broad macroeconomic parameters for the budget, and presented to the Government in early June. The draft forecast is also used as an input into the Budget Instructions which are sent out in June. The main parameters used in the issue of the budget instructions are those for GDP growth and inflation for the following three years. Of these only the inflation figures are used for budget preparation, unless the global GDP figure is used as an indicative output measure for enterprises and agencies.

Revenue side of the budget is estimated simultaneously with expenditures and the process does not establish a budget constraint at the start of budget preparation. The macroeconomic forecast feeds in to the revenue part of the budget but also gives guidance on sectoral priorities for expenditure. The budget instructions ask for detailed information on forecasts of taxes and other revenues from which the tax forecasting department of the Ministry of Finance produces a detailed forecast of revenues by types of tax, in conjunction with the sector and enterprise information of the MOET's forecast. This forecast is largely derived from the application of known tax rates to the output and employment volumes of the sector and enterprise plans, which are prepared by the enterprises themselves, and are not subject to audit or verification. They are not then directly linked to underlying macroeconomic dynamics of the Ministry of Finance forecast. After discussion by the Government the forecast is sent to the Ministry of Revenues and other line ministries, for inputs and finalization, in August. What is notable about this process is that the revenue side of the budget is estimated simultaneously with the expenditures. Thus there is no opportunity to have a resource envelope at the beginning of the budget process within in which ceilings are set for ministries and agencies to develop their budgets. If the revenue forecasts developed at the end of the budget process show significant changes in the expected revenues, these will be incorporated on an ad hoc basis to the expenditure side of the budget by the MOF, without inputs from Ministries and agencies.

The way revenue targets are planned and achieved are distortive. The revenue forecasts have the additional role of being plans for tax collection by the Ministry of Revenues (MoR), which will be held responsible for meeting the plan for each individual tax. This dual role for the tax forecasts has implies that there will be incentives built into the process to lower the forecast so as to make the plans easier to fulfill. Local governments which in fact are responsible for tax collection in their areas, also have a strong incentive to minimize the tax forecast since article 17 of the Law on Local Governments allows the Chairperson of the Hukumat to spend any excess revenues on any items they wish, subject only to the consent of the local legislative body, without consulting the Ministry of Finance. It also contributes to a deterioration in the business environment since the MoR is held accountable for achieving the plan on each individual tax on a monthly basis. Thus shortfalls during the year will be met by increased harassment and of

enterprises to fulfill their “plans” for tax payments. Resources are also employed to move taxes from one category to another in order to fulfill the plan. The emphasis on fulfilling plans thus draws resources away from the development of systems to ensure and maximize voluntary compliance, which in the long term is likely to increase revenues and promote private sector development and growth.

The fragmentation of the process is a major constraint. As discussed above, there are four agencies involved in the process and their roles are not clear. While the MOET is responsible to develop the forecasts, final estimations come too late in the process and these are not utilized in the determination of the key budgetary parameters. The fact that the MOET forecast does not have a clearly defined role suggests that there is scope for questioning the utility of the consolidation exercise used to produce the If the MOET is to be involved in this process it needs to change the way it estimates economic growth and revenues and given the lack of capacity the MOET should work much more closely with the MOF, NBT, and Goskomstat in the determination of resource envelope.

B.1 Budget Process and Fiscal Sustainability: The Need for a MTBF

As discussed in chapter 3 budget is one of the one four resource allocation processes in Tajikistan. This fragmentation has implications for the usefulness and functionality of the budget as a tool of macroeconomic management. For Tajikistan this is particularly important as the country is trying to implement a PRSP and suffering from heavy external debt repayments which require a medium-term approach to the determination of the resource envelope. Essentially this is the MTBF which is a process for determining available public resources and allocating these resources in line with government priorities. It seeks to cap spending within the limits of what is affordable and increase predictability of resource flows over the medium term. It is based on the notion that the policy decisions made by government should be disciplined by resource realities over the medium term and that the most effective way for countries to restructure their spending so that policy decisions reflect resource availabilities is by taking a medium term perspective.

Lack of MTBF undermines the capacity of the budget to manage external debt and the fiscal sustainability situation. Although Tajikistan produced a draft MTBF for the period 2003-2005 and this was circulated during the May 2003 CG meetings the MOF chose not to forward to the Government and the budget process is still not based on MTBF. As a result, since the budget is not based on any MTBF, not all the requirements of the PRSP, PIP, and external debt payments are taken into account in the budget formulation process but the budget is expected to provide resources for all three parallel processes. For example, a higher level of PIP means future recurrent costs that must be met from the budgetary sources for which there is no process to factor this in. The same situation applies to externally debt and grant funded PIP or other expenditures. Funding of off-budget PIP projects means that the budget is or would be taking on external debt payment and counterpart commitments for which no provision has been made for. Collectively, these have a number of implications. First, as the formulation of the resource envelope as described above has very limited attention to future debt repayments that could be due to off-budget PIP funding as well as their counterpart fund needs, it is clear that that it lacks

a fiscal sustainability approach to the determination of the overall resource envelope which is the first step of the prioritization process and proper management of foreign debt. Second, as not all counterpart fund needs are factored into the budget, it is also clear that future donor disbursements would be problematic.

C. Budget Preparation Process

The budget preparation process should follow the determination of the resource envelope. The budget preparation process should aim for allocating these resources in line with priorities in the most efficient way. A fundamental test of the effectiveness of any budgetary system is its capacity and success in translating government policy into budgets, expenditure, and ultimately service delivery in line with priorities. The fulfillment of these objectives require a sound budget formulation process whose elements in general are:

- Identification of sectoral strategic priorities and the alignment of the budget with priorities.
- Allocation of initial budget ceilings to ministries and budgetary organizations.
- Preparation of initial budgets.
- Negotiations with Center.
- Agreement on final budgets and submission of the Budget to Parliament for review and approval.
- A budget classification and presentation to facilitate accountability and transparency.

C.1 Identification of sectoral priorities

Currently there is no formal mechanism for the identification of strategic priorities. As noted in Chapter 3, the fragmentation of the overall policy making process has led to parallel and quasi-resource allocation mechanisms and this has undermines the budgetary process. While a Poverty Reduction Strategy Paper (PRSP) has been developed, and is intended to be a strategic planning document to reduce poverty, it has an uncertain status for the budget process. It identifies problems and needs, but it is recognized that there are virtually no resources to include new activities in the budget. The PRSP is “monitored” by unit within the Presidential Administration. The unit maintains a matrix of activities for each sector, and it would appear that some of these activities are added to the responsibilities of sector ministries, and thus may be financed. There is no process whereby PRSP proposals can be developed and trade-offs against other activities considered. In other words PRSP activities will take place through directives issued from the Presidential Administration. Given the incremental nature of the rest of the budgeting process, and the lack of costing of PRSP activities it is unlikely that it has a significant effect on resource allocations across and within ministries

C.2 Allocation of initial budget ceilings

The budget instructions do not set initial budget ceilings. The MOF involvement in budget formulation in Tajikistan begins in April when the State Budget Department drafts the instructions for the preparation of the budget. The instructions give indications of

incremental increases (due to inflation) allowed on items and budgetary organizations by economic classification. Also included are requirements for the budgets to be consistent with the plans / forecasts of *the* MOET's SEDF, and the relevant tax rates for calculating budget revenues from public enterprises. Crucially however, the budget instructions do not contain either ceilings or envelopes for budget formation, nor do they contain any statement on sectoral priorities. Incremental budgeting is explicitly encouraged so as to avoid excessive budget requests as the budget units are asked to take account of actual spending in recent years, as opposed to input norms, which were financed historically. Although it was initially planned that for the 2004 budget ceilings for budget formation would be issued, this has not happened. If in the future ceilings are issued and can be linked to sectoral priorities, this would represent a significant step forward in the Budget Preparation process.

C.3 Preparation of initial budgets

Spending units get involved in the process with the preparation of initial budgets.

Once the budget instructions have been sent out to ministries, agencies and local units the process of preparing budgets begins. In most cases the budget of a sector (see for example the box on budgeting for education) will be split between the Republican (Central Government) and local (Oblast or Rayon) budgets. In one sense the budget is a unitary one in which the distinction between local and central government budgets is somewhat blurred. This is because the budgets are formed by a consolidation of the budgets of the lowest level spending units. Whether the budget of a spending unit is part of a Rayon, Oblast or the Republican Budget will depend on the formal reporting arrangements of that unit. If a unit is part of a Rayon or Oblast budget it will be accountable to both the local administration and the local branch of the line ministry (see the box on budgeting in the education sector) which will be involved in drafting its budget. In addition local administrations will have a finance unit which reports to the MOF and will also be involved in checking the budgets.

The double accountability of spending units to both local governments and the local branches of the line ministry is one of the greatest weaknesses in both the budgeting process and for service delivery and governance at a local level. On the one hand local governments and service delivery units cannot respond to local needs, since inputs will be controlled by the local branch of the line ministry. On the other the line ministry does not have responsibility for the delivery of services at a local level and will therefore simply transmit inadequate resource allocation from the center. In addition the formal responsibilities for the delivery of services, particularly in the areas of Education and Health at a local level far outweigh the resources to provide them. In practice double or multiple accountability at all levels implies no accountability and forces underpaid employees to engage in rent seeking behavior, and the provision of those services which are most likely to generate personal income.

Related to lack of sectoral priorities issue, the budget process itself at the initial budget stage does not provide guidance to ministries and other spending units. At no point in the system is anybody responsible for deciding what services should be provided and what institutions should be supported, since these decisions have been taken through

historical inertia. The budget formation process is largely one of funding the “needs” of existing institutions. Within those needs, the most pressing will be to secure funding for the wage bill, although at levels which are insufficient for subsistence, and therefore require employees to engage in rent seeking behavior in order to survive. At a technical level preparation of budgets is made more difficult by the lack of computers and trained staff. Thus the budget process becomes very much an exercise in cascading up a manual consolidation of budgetary data. Given that budget requests are prepared without ceilings and that there is general underfunding of institutions budget requests forwarded to the MOF are usually substantially beyond available resources and these are subsequently modified by the MOF at the negotiations stage and by large amounts.

Box 2. Tajikistan Education Finance Reform Strategy 2005-2015

The general strategy proposed has six core elements: (i) increasing government funding for the sector, and ensuring that the public funds are utilized well; (ii) increasing the role of local communities in supporting schooling at the local level; (iii) reforming the school curriculum; (iv) increasing the teaching load of teachers, restructuring their work arrangements, and retraining them to teach more students and in different ways; (v) upgrading school facilities; and (vi) reforming the budget system.

The formation of education budgets continues to be based on the norms inherited from the Soviet budgeting process. These norms specify the number of teachers required according to the curriculum in each grade, as well as the number of non-teaching staff per school. This budget formation process based on inputs, combined with rigid regulations requiring teachers to specialize in one subject after grade four or five, has led to an excess number of teachers and inefficiently low student/teacher ratios, declining teachers' salaries, and inequitable geographic allocation of education funding. In addition, because of the infrastructure and staffing norms, education budgets are nearly fully consumed by fixed labor costs, with inadequate resources available for non-labor inputs, such as text books, supplies and maintenance. The unfunded operating costs for schools are increasingly borne by households with children attending school. The increased direct cost of education is in turn becoming a barrier to school attendance for children from poor families, which is reflected in the gradually declining attendance and completion rates for basic education in the region.

Funding for the education sector in Tajikistan is largely generated at the local (city, rayon) level. Some reallocation of resources across geographic areas is carried out through the use of block grants, but typically there is no mechanism to ensure that the reallocation of resources is used for education financing at the local level. Budgets are administered by oblast, city and rayon finance departments rather than education departments, so other budget priorities often displace transfers from the national budget for education. There are two problems with the fragmentation of education financing down to the lowest administrative level. First, because the capability of generating tax revenue, as well as the priority given to education, funding levels vary widely across geographic areas and there are large inequities in the per capita resources available for education. Second, when funding is generated and disbursed at the lowest administrative level, opportunities for restructuring and consolidating schools are greatly reduced. The network of schools in Tajikistan is characterized by a large number of small schools with small class sizes. Consolidation of schools across rayons and cities becomes unlikely, if not impossible, if the funds do not also flow across those administrative borders.

Education reforms and pilot projects will not be sustainable unless the fundamental inefficiencies in education resource allocation are addressed. Three directions of education financing reform should be considered to address the main inefficiencies: (i) the education budget formation should be based on an output measure, such as the number of students (per capita), rather than input norms; (ii) the pooling of education funding at the oblast level is needed to improve equity and allow reorganization and consolidation of the network of schools; and (iii) the funding of schools through per capita budgets needs to be accompanied by the removal of chapter restrictions and staffing norms, as well as by other measures to increase internal management autonomy at the school level. To move forward, there is need for a pilot program to be developed through the rest of Year 2004 so that a new budgeting system could be introduced for the start of the new budget year in 2005.

C.4 Negotiations with the Center

The negotiations process does not usually result in reallocation of resources and it has serious shortcomings. While budget requests are required to be submitted in early July, in practice most spending units submit their requests in September, and then a process of negotiations begins. This process largely consists of the MOF denying requests for funding due to lack of resources and in practice the MOE does not have enough time to consider these in a meaningful way. As a result, the main negotiations are usually not on what policies would be funded, but on what commitments would not be funded, with the emphasis being on the payment of wages and utilities. The MOF is also unable to respond effectively on policy or outcome based negotiations due to the internal organization of the Budget Section which is divided into four separate Departments each reporting to a different deputy minister and this is one of the reasons that there is a rigid process in place that which in turn is not conducive to the emergence of a true negotiations process that requires a full knowledge of the overall budget situation. This is critical for reallocation of resources across the budget and this situation needs to be dealt with as soon as possible.

Negotiations for local government budgets is not transparent and there is no obvious criteria guiding the process. Another element of the negotiations will be the funding arrangements of local governments which will be determined partly by ad hoc tax sharing arrangements, and partly by transfers from higher to lower levels of government to fill in the difference between budgeted revenues and expenditures. For example in 2003 Value Added Tax was assigned to local governments except in Sugd Oblast and Dushanbe City (50% local and 50% to the Republican Budget and Tursunzade 100% to the Republican budget. Other taxes are assigned in different percentages for different localities and are renegotiated from one year to the next. Effectively what the process of negotiations implies is that there is little real independence of local budgets from the Republican Budget, as they are considered simultaneously and interdependently. In practice the decision on the budget allocations will be that of the MOF, often in consultation with the President's office on contentious issues.

C.5 Agreement on final budget and submission to the Parliament

The time period for finalizing the budget is too short. Following the main negotiations on the budget between the MOF and the line ministries and local governments the main parameters of the draft budget are sent to the Presidential Office by 15 October. It is then reviewed, a few final modifications are made to the Draft Budget, and it is sent for formal approval by the government. The Budget is then signed by the President and it must be submitted to Lower House of Parliament (MN) by November 1. In 2002, the major parameters of the Draft Budget for 2003 were submitted to the MN in October, to allow for more detailed discussion. The Parliament has a separate Economy, Budget, Finance and Taxes Committee (Budget Committee) to review the draft budget law. Other sector committees of the MN also discuss areas of specific interest regarding the budget submissions and a summary of all the comments is presented by the Budget Committee at a plenary session of Parliament. During these sessions key officials from the Presidential

Office, MOF and line ministries are invited to appear. The time period is too short to have a meaningful discussion and debate.

The capacity of the Parliamentary budget committee needs strengthening and it should be given more time to review the budget. At present, the Budget Committee includes seven deputies and a small support unit, usually one consultant. The capacity of the committees to conduct a detailed review of the budget submissions is thus limited, as they do not have sufficient specialized staff to research and analyze both the budget proposals or the execution reports. The discussion of the budget in the MN is used as an opportunity to discuss broad economic issues rather than detailed changes to the budget. In the debate on the 2003 budget the main issues considered were the issue of government guarantees, the size of the external debt and existence of interlocking arrears (on taxes and utility payments) between government institutions and public enterprises.

The budget law as approved includes total revenues, expenditure and financing for the State Budget (General Government), but no breakdown by levels of government. For the Republican Budget it also shows revenues by major tax source and how these will be divided by levels of government. In addition it includes a functional (sector) breakdown of expenditure of the Republican Budget, which includes some assignments to specific institutions such as the Parliament, Office of the President and some of the highest courts. Most of the assignments are for general functional categories such as Fuel and Energy Complex, Transport and Infrastructure, overseas business trips, which will not be related to specific institutions. Finally, the Budget Law includes a division of the total Republican budget by broad economic categories. However, the economic breakdown is not shown by either functions or institutions.

The approval process in 2003 included a multi-year budget approach though there is a need for improving the basis and the process for it. In the Resolution approving the Law on the Budget the MN also “approves” the forecast of the State (General Government) Budget for the period 2004-2005. This forecast includes estimates of income and expenditure by broad functional categories for the period 2003-2005, although as noted below, in the expenditures by functional categories all have the same rates of growth in 2004 and 2005, and so do not represent a real attempt at medium term costing of ongoing programs. It also includes forecasts of expected financing on ongoing projects from external loans, and domestic co-financing. Finally it shows breakdowns of the allocation of transfers to local governments presented as a lump sum in the Budget Law and this does not provide sufficient detail and does not identify the funding of specific program(s).

The approval of the budget law mainly by functional categories (and economic classification for the whole budget) raises a serious question of transparency and accountability. This means that in practice the allocation of funds to ministries and other spending units takes place after the approval of the Budget Law, by the Ministry of Finance, with some guidance from the President’s Office. Such an arrangement implies that the MN cannot hold individual institutions accountable for the use of resources, which is a basic principle of sound budgetary practice. It also implies considerable discretion for the MOF in allocating resources following the approval of the budget.

Many of the major decisions on the allocation of resources thus take place after the approval of the budget by the MN and this is a serious short coming of the current process and presentation of the budget for accountability and public service delivery.

C.6 Budget Classification and Presentation

Budget classification has been improving. After January 2000, the classification of fiscal accounts followed a system presented in the Government Financial Statistics (GFS) manual. The 2002 budget was prepared following these classifications, as was its execution report as further discussed below. In addition, data covering the consolidated central and local governments are now reported in the GFS Yearbook. While the Government has been using the 14-sector GFS 1986 functional classifications, these did not anticipate the use of modern financial management systems or of organization-based budgets. Thus, the Government recently developed new improved functional classifications that will, for the first time, automate budget analysis at the level of the budgetary organization. This exercise will involve aligning the coding systems in the Budget and Treasury Departments; once accomplished, the linkage between the two systems will save substantial time, especially in automating the quarterly distribution of finances to budgetary organizations.

D. Budget Execution

D.1 Treasury: Main Functions and Capacities

Following the enactment of Law on Treasury Law in 1999, a national treasury has been established in the same year. The Treasury Department is under the MOF and it is responsible for executing the budget. The Treasury has established a single account after the adoption of the Law in 1999 and all budgetary expenditures and revenues pass through this account. The Department includes the central Treasury serving all ministries and budgetary organizations financed from the republican budget. There are 79 local treasury branches, which finance the local budget. According to the Law on the Treasury, the institution controls republican and local budget execution and prepares budget execution reports. The central Treasury financial management system is automated and based on one used in Kazakhstan. The system has automated access controls and appears to have adequate back-up arrangements. The Treasury, which plans to extend the system to local treasuries in the near future, should review the lessons in other countries in the region where some treasury offices have experienced slow system response times (delays due to poor communications' infrastructure), which resulted in delays in completing transactions.

The Treasury has a difficult time in accurately reporting on budget execution due to a lack of computerization. While the paper-based systems that are used to collect data on budget implementation are easy to use, particularly at the local level, this does not give the Government the quarterly and annual budget execution reports it needs to supervise and monitor the budget plans. Fundamentally, the reporting exercise is time consuming and MOF staff does not have time to analyze reports so as to make financial management decisions. The Treasury records transactions when it receives revenues or makes

payments on behalf of a budgetary institution. However, as noted below, commitments are not completely recorded in the Treasury ledgers. Regional treasury offices maintain manual single-entry ledgers for each budgetary institution. The allocations are recorded against each account and disbursements are allocated against this amount. This manual system has the attraction of being simple but makes analysis and the consolidation process difficult and prone to error. The Treasury collates and consolidates reports received from the regional treasuries. The Law of State Finances requires the MoF to prepare quarterly reports on the State and republican budgets, which are submitted to the Government. Once approved, the Government sends them to Parliament and the media, which publishes the reports no later than two months after the end of the quarter.

D.2 Cash and External Debt Management

Cash management has improved though the current arrangements are too centralized.

The MOF has overall responsibility for cash management. The use of the single treasury accounting system, particularly after 2002, has imposed stronger control over cash at the aggregate level and this contributed to the achievement of financial discipline. However, cash management and or cash needs forecasting systems are still weak and this leads to arbitrary variations in payment dates and inefficient use of resources. The existing system of prioritizing payments is excessively centralized and requires daily decisions on the part of senior officials at the Treasury and MOF, including the Minister. The Law of Treasury contains no provision to regulate the cash flow process or borrowing procedures in the event of a cash shortage, or to invest when cash is abundant. As noted in the CFAA there is a need for a Cash Management Unit within the MOF to improve the predictability of cash releases and communicate cash forecasts to line ministries.

Commitment control management needs improvement. For effective budget execution, Treasury systems need mechanisms to effectively control commitments that can prevent the build-up of excessive expenditure arrears. In Tajikistan, the system of recording commitments is incomplete; employee salaries are not recorded in the system for example. What is recorded is the cash payments but commitments entered by budgetary organizations are not recorded in their entirety. This weakness allows spending units to take on commitments beyond their annual budget appropriations. There is no system to record past arrears in the system and the system needs to be modified to record and recognize them. Recording commitments will be particularly difficult at the local level, where systems are largely manual based. Systematic efforts are needed to record commitments and arrears in the Treasury system. Further developing procedures to record commitments through the automated expenditure controls already embedded in the system is required to improve commitment control and this also suggested by the CFAA. Recent actions in this area includes new provision in 2005 Budget Law which envisages that key budget organizations have no rights to overspend budget allocations for the procurement of goods and services.

External debt management has been weak but there has been good progress since 2003. As there has been no need to contract and hence manage foreign debt under central planning, Tajikistan's inherited public finance management system did not have any expertise in this area. Development of capacity and institution building efforts have

progressed slowly and the system suffers from lack of technical knowledge, insufficient administrative capacity, as well as low salaries. As a result, there has been several instances of misreporting of external debt, which have affected disbursement conditionalities on the PRGF. The Government has acknowledged these problems and improvements were noted in 2002; authorities completed an inventory of government, government-guaranteed and state-enterprise debt and wrote to bi-lateral creditors to confirm its status. Debt inventory updating is now an ongoing process as it should be and much more needs to be done to improve the MoF's debt monitoring, analytical capacity and debt reporting systems. To this end, the MOF has been strengthening its Department of External Debt and is currently receiving technical assistance from the IMF. To increase transparency, the Government began submitting quarterly reports to Parliament on its external debt, including debt service obligations and accumulated arrears. These reports were also incorporated into the Annual Budget Execution Report.

E. Budget Monitoring and Evaluation

E.1 Current Arrangements

Budget monitoring is currently limited to main fiscal aggregates. The MOF monitors the budget at the level of key fiscal aggregates to ensure that targets, particularly the PRGF quantitative fiscal targets supported by the IMF, are attained and maintained. While the focus on key fiscal indicators have been in part due to the lack of a well functioning Treasury system prior to 2003, as discussed in the previous section the MOF has now the capacity to monitor budget execution on a regular, even on a daily basis. The automated budget system developed under the IBTA2 has established a link between the Treasury accounts and the budget system which is now functional. This is a relatively new development and the new system is allowing the MOF and the Government to monitor the budget in a more effective way. Current arrangements for formal monitoring include monthly reports by the Treasury for expenditures and by revenue assessment reports by the Ministry of Revenues and Customs. These are for internal use only and the quality of reporting has improved during the last year although lack of computerization at the local level delays the monitoring process and this is a source of concern as majority of spending for social sectors are at the local level.

E.2 Capacity Development

The capacity of the Government and the MOF to monitor the budget can further be enhanced if the MOF approves the newly designed budget classification structure. As noted in the previous section, the budget reform project supported by IBTA2 has further developed the existing functional budget classification structure by presenting each item in a more detailed way. Each functionally classified item has now more details under it which did not exist before. However, while the MOF has full technical and professional capacity to use this system it did not yet adopt and it is not clear why this is so. It is important that Tajikistan adopts this new FBC as one aspect of the monitoring of the PRSP depends on this new classification structure. In fact, as discussed above, the MOF and hence the Government of Tajikistan has now the technical capacity to monitor expenditures at the program and agency based levels. Hence, once program based and

agency based budgeting is adopted and the MOF has received considerable technical assistance for this purpose, Tajikistan's capacity to monitor expenditures at these levels would be greatly enhanced which would be highly beneficial for the monitoring of the PRSP. Tajikistan can immediately adopt the new FBC and can begin designing the budget on a program and agency basis, at least for the key social sectors, which would facilitate the implementation of the PRSP and accelerate the disbursement of donor funds.

Evaluation of budget capacity needs to be developed. The current budgetary process and organizational arrangements do not permit the analysis and monitoring of the impact of budgetary policies and spending. While such function was not deemed necessary under central planning based budgetary system, the Government and the MOF needs to develop capacity to analyze the achievements of public spending through the budget on outcomes, particularly in the social sectors. The government's capacity to do so critically depends on having the information, and hence a better FBC - and much more so if program and agency based budgets could be implemented. Given that the government's overall development strategy is increasingly being implemented under the PRSP and there is an ongoing capacity building exercise at the PRSP unit, it will be important to support this activity at the budget level. The current system of incremental budgeting does not pay much attention to performance and this is a serious shortcoming. As noted in the PRSP and the first PRSP Progress Report of March 2004, government's efforts will increasingly focus on outcomes and since a large portion of funding for these programs will come from the budget, it is important that budgetary allocations move on a agency basis in the short run which would also facilitate evaluation of results in a given sector given the amount of resources provided by the budget.

PUBLIC ACCOUNTABILITY FRAMEWORK

A. Internal and External Audit: Institutions, the Process, and Disclosure

A.1 Recent Developments

Processes and concepts for both the internal and external audit are in early stages of development. A fundamental element of a modern public finance system is the audit of the use of public funds. This is needed to ensure that public funds are used for intended purposes at least cost, in a transparent manner, and as authorized by the Parliament. Audit is also an instrument of the accountability of the government and the audit process gives an assurance to the Parliament that funds have been used properly. In general, most countries have two types of audit: (i) internal audit, which is a form of internal management control tool of the ministry or any other agency that uses public funds. This type of audit is needed for ensuring compliance with financial regulations and laws and is undertaken to inform and give assurance to the Minister or head of agency- that funds allocated to the agency in question are spent for intended purposes and in the most economical way; and (ii) external audit, on the other hand, is usually prepared independent of the government and the executive and is intended for informing the Parliament of the appropriateness of the execution of the annual budget law as well as the

public for accountability purposes. Hence, external audit has broader governance implications.

The audit system Tajikistan inherited from the FSU has weakened significantly since independence. As discussed in detail in the CFAA, a number of budgetary controls were used during central planning. Checks and reviews within each ministry were essentially internal audits and this was reasonably well developed. There were no external audits in the sense of the concept as described above. However, verifications exercised by the Central Bank and the State banking apparatus, which were in charge of disbursement and transfer of funds, inspections undertaken by the MoF's Directorate of Financial Control and Revision (FCR), as well as the ad hoc financial controls and reviews of accounts by the Party in a way were regarded as external audits and these were effective mechanisms of financial control as well as instruments of the implementation of the central plan. During the transition period, these processes and institutions were substantially weakened and existing internal audit mechanisms simply collapsed. As a result, paying illegal salaries by keeping fictitious posts and improper purchase of office equipment had become commonplace. The weakening of internal controls have exacerbated the corruption situation as informal payments to government employees became a serious problem as IFC 2003 survey has shown.

An external audit institution, the State Financial Control Committee (SFCC) has been established in 2002. This agency was originally created with a Presidential decree in 2001 and a law establishing its legal and organizational basis was enacted by the Parliament in 2002. The creation of the SFCC has been a major step for the development of a public financial accountability framework. While the SFCC's activities and responsibilities are defined by the law it has significant freedom to choose what and how to audit and develops its audit methodologies, standards, and manuals. The Committee's scope of activities is broad and includes supervising and auditing the (1) revenue and expenditure parts of the republican and local budgets, (2) use of State funds and property, (3) use of gold and foreign currency reserves, (4) legitimacy and timeliness of the movement of public resources in State and commercial banks and (5) use of credit resources and external debt. It must also analyze the draft revenue and expenditure parts of the State budget and identified deviations from the indicators of the State budget and SOEs.

A.2 Issues

The SFCC reports to the President by law and it only submits its reports on audits conducted to the Parliament when requested. As discussed in detail in the CFAA, a precondition for an objective and effective audit is the independence of the audit agency. Since the SFCC has been established by and reports to the President - the President appoints and can dismiss SFCC's chairman, approves the regulations, number of staff and their salaries, and is the sole recipient of the SFCC's detailed quarterly reports-the agency can not be considered independent. While this situation is not unique to Tajikistan in the region, a particular weakness of the current arrangement is the lack of transparency. The SFCC prepares summary audits every quarter and following the approval of its Chairman and these are then sent to the President only. The fact that SFCC is only required to

submit its reports on the results of the audits to the (MN) upon request is not sufficient for transparent reporting by international standards. Furthermore, as required by the Law on State Finances, the SFCC should submit its external opinion on the budget execution report prepared by the MOF submit to the President, the government, and the MN. However, in practice this has not been complied with and is a source of concern. Coupled with the fact that there are no specific provisions in the law requiring the Parliament to approve the annual report on budget execution submitted by the SFCC, current activities of the SFCC is an inadequate check and balance within the public sector accountability framework and a weakness for the overall governance situation.

A new institutional framework is evolving for internal audit. The fact that internal controls within many agencies have weakened following independence has been recognized by the government. The government also realizes that developing an effective internal control system will take time and policy measures to achieve this objective are underway. The Financial Control and Revision Unit (FCR) of the MOF was disbanded in 2001 upon the creation of the State Financial Control Committee and following the Treasury Internal Audit Department (IAD). However, as discussed in detail in the CFAA, these bodies do not yet have clearly defined functions and accountabilities and in some cases there is a duplication of their activities. Under the current arrangements the internal audit function is being performed by the IAD and its activities, which involve on-site inspections, focus mainly on assessing compliance with the budget law and determining if funds are misused, for example, funds being allocated to inappropriate purposes. However, the organizational and management structure of IAD is not conducive to enable it to perform its function independently. Hence, its structure needs to be revised according to the guidelines defined in the Treasury Manual.

The legal framework for internal audits and internal controls needs substantial improvement. As noted by the CFAA the current legislation has three major shortcomings. First it does not define and set accountabilities for maintaining the internal control framework. Thus, it needs to identify the role of spending agencies in maintaining adequate financial management systems, including internal controls. Second, apart from the small IAD in the Treasury, the Government has yet to address the role of internal audits in the public sector. With its present governance problems, the most important objective should be to ensure compliance with the financial laws and regulations. This could be achieved if an internal audit function were developed within MoF, with a special cadre and concentration of scarce audit resources. Third, once the IAD's structural issues are resolved, the MoF needs to develop a professional internal audit function for the public sector, using international standards and practices.

BUDGETARY PERFORMANCE

A. Analysis of the Execution of the Budget

A.1 Effectiveness of the budget

The execution of the budget in compliance with the budget law is a key indicator of the credibility and effectiveness of the budget. One of the most important function of any

government budget is to translate policy objectives into budgets and ultimately the delivery of public services such as health and education. This not only requires a well formulated budget in line with policies and priorities but actual budgetary performance in terms of the execution of the budget. In this connection, one frequently used indicator is the variance of the budget which is the difference between the initial budget amounts as approved by the Parliament and the actual spending at the end of fiscal year. A greater variation is indicative of low credibility for the budget and this may result in line ministries and other budgetary organizations putting less effort into the budget preparation process. If deviations are large then it is important to understand their sources as budget deviations could be related to the budget preparation and execution process or outside the budget process so that appropriate measures and new policies could be developed for improving budgetary performance. Using data provided by the MOF such an analysis is carried out for the republican budget for 2002 and 2003 by determining the deviation between the approved budget and actual expenditure. The results are presented in tables 1-4.

There are significant deviations between the approved and actual budget realizations.

Focusing initially in the central government budget (the Republican Budget) first, calculations provided below shows that there were differences between the budgets approved by the Parliament and actual end of fiscal year results for both 2002 and 2003. These differences are sizeable 17.8 percent in 2002 and 25 percent for 2003 and high by international standards. A closer examination of data shows that in both years the total budget envelope was substantially higher and it appears that this would explain a large portion of the variation in both years. In both years general public services receive substantial reallocation, 58 percent and 42 percent respectively, which is indicative of government's priorities. On the one hand, social sectors, education, for example, received only 4 percent in terms of additional resources while health sector received a 32 percent increase in 2003. Social insurance and social security on the other hand received less than the originally budgeted amounts and this is a source of concern. It would appear that at a time when revenues have been growing and budgetary resources were increasing a higher level of expenditures could have been reallocated for social security and social sectors in general. A particularly important issue in this context is the funding of priority activities and support for new policies in the key sectors in line with the PRSP program.

Table 1.

FUNCTIONAL CLASSIFICATION (mln. Somoni)

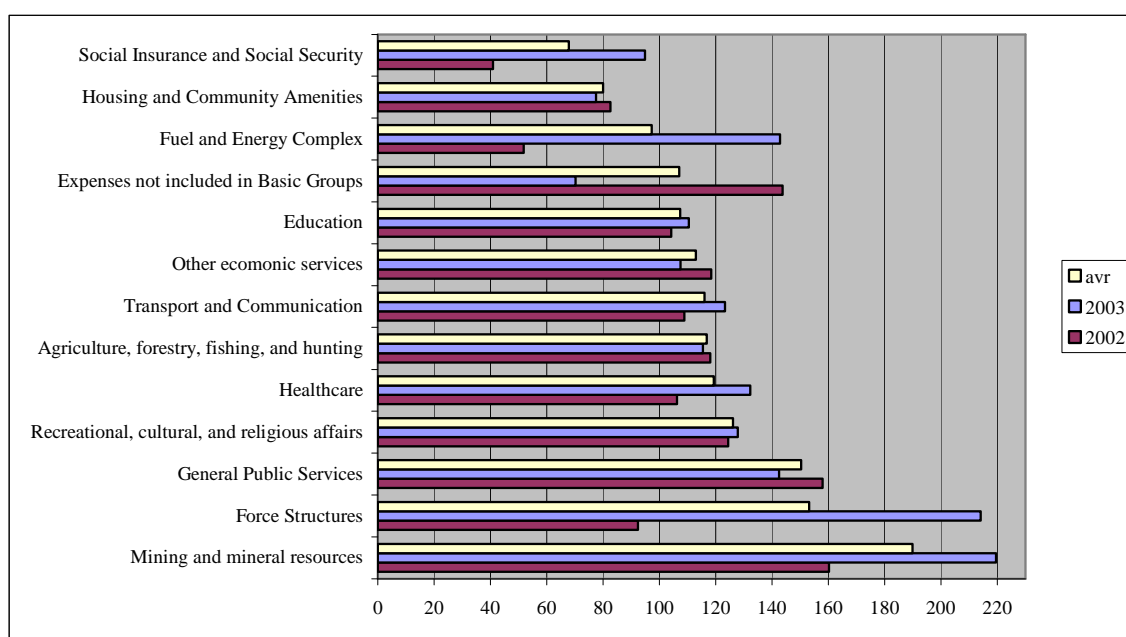
		Planned		Actual		%			Deviation	
		2002	2003	2002	2003	2002	2003	Avr	2002	2003
	Republican Budget	286.5	343.3	352.7	447.4				51.0	85.9
1	General Public Services	47.5	71.6	75.1	102.1	158	142	150.2	27.6	30.4
2-3	Force Structures	72.2	41.2	66.7	88.2	92	214	153.2	-5.5	47.0
4	Education	15.6	18.3	16.2	20.2	104	110	107.4	0.7	1.9
5	Healthcare	5.9	8.1	6.3	10.8	106	132	119.3	0.4	2.6
6	Social Insurance and Social Security	14.1	24.2	5.7	22.9	41	95	67.8	-8.3	-1.3
7	Housing and Community Amenities	3.3	4.6	2.7	3.5	83	78	80.1	-0.6	-1.0
8	Recreational, cultural, and religious affairs	10.2	13.7	12.7	17.6	124	128	126.1	2.5	3.8
9	Fuel and Energy Complex	6.4	6.3	3.3	9.0	52	143	97.3	-3.1	2.7
10	Agriculture, forestry, fishing, and hunting	12.9	18.4	15.2	21.2	118	115	116.7	2.3	17.5
11	Mining and mineral resources	4.7	3.7	7.5	8.2	160	220	189.9	2.8	4.5

12	Transport and Communication	22.1	30.2	24.0	37.3	109	123	116.0	1.9	7.0
13	Other economic services	3.8	3.4	4.4	3.7	118	108	112.9	0.7	0.3
14	Expenses not included in Basic Groups	67.9	99.4	97.5	69.9	144	70	107.0	29.7	-29.6
	Special assets performance			15.2	33.0					

Table 2.

	2001	2002
Total budget deviation	17.80	25.01
Aggregate expenditure deviation	23.12	30.33

Figure 1.



One key reason for this outcome is that a significant proportion of the budget is allocated not during the formal budget process but as a result of intra-year adjustments depending on the actual revenues received. In principle most of this reallocation at a central level takes place by the MOF on the basis of submissions from line ministries and local governments six and nine months into the budget year. Below the results of the reallocations are shown for the State (central government excluding the social protection fund) and the local budgets. Like the Republican budget, it possible to note that much of the reallocation of resources takes place in favor of public administration, and while in aggregate health receives a below average reallocation. It is clear that of this reallocation most takes place at the central level (probably funding hospitals) while at a local level health allocations were actually below original budget, despite and increase in overall incomes. This suggests that there is even less prioritization of the non-budgeted revenues than of budgeted income. Viewed from the perspective of the PRSP and prioritization of expenditures, the results do not show unambiguous support for the implementation of the

PRSP. Furthermore, as the government has not adopted a MTBF it is impossible to determine if reallocations across functional categories, positive or negative, reflect longer term and strategic, or planned, shifts.

Table 3.

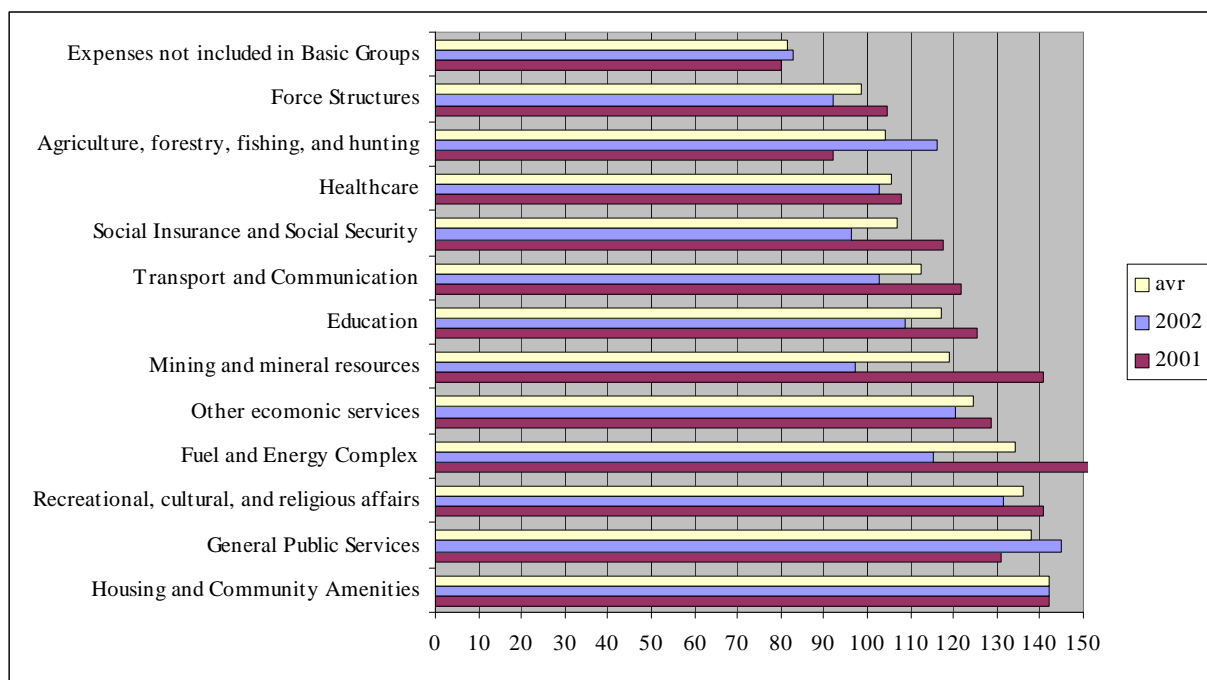
FUNCTIONAL CLASSIFICATION (mln. Somoni)

		Planned		Actual		%			Deviation	
		2001	2002	2001	2002	2001	2002	Avr	2001	2002
	State Budget	330.8	490.2	379.7	543.0				49.0	52.8
1	General Public Services	45.1	64.6	59.2	93.5	131	145	137.9	14.1	28.9
2-3.	Force Structures	53.9	76.5	56.3	70.7	104	92	98.4	2.4	-5.9
4	Education	48.5	79.8	60.9	86.9	126	109	117.2	12.4	7.1
5	Healthcare	22.6	29.8	24.4	30.6	108	103	105.4	1.8	0.8
6	Social Insurance and Social Security	40.8	74.5	48.1	71.7	118	96	107.0	7.3	-2.8
7	Housing and Community Amenities	16.0	22.2	22.7	31.6	142	142	142.2	6.7	9.4
8	Recreational, cultural, and religious affairs	10.6	13.4	14.9	17.6	141	131	136.0	4.3	4.2
9	Fuel and Energy Complex	4.8	2.9	7.4	3.3	153	115	134.3	2.6	0.4
10	Agriculture, forestry, fishing, and hunting	10.3	14.3	9.5	16.6	92	116	104.2	-0.8	2.3
11	Mining and mineral resources	1.4	8.3	1.9	8.1	141	97	119.0	0.6	-0.2
12	Transport and Communication	27.0	31.4	32.9	32.2	122	103	112.3	5.9	0.9
13	Other economic services	3.4	3.7	4.4	4.4	129	120	124.4	1.0	0.7
14	Expenses not included in Basic Groups	29.7	68.8	23.8	57.1	80	83	81.6	-5.9	-11.7
	Special assets performance	16.7		13.3	18.6	80		39.9	-3.4	18.6
	Short-term credits			0.1					0.1	0.0

Table 4.

	2001	2002
Total budget deviation	14.81	10.76
Aggregate expenditure deviation	14.81	10.76

Figure 2.



Local government revenues require further analysis. The data in the tables include a number of inconsistencies, the most important being that the recorded revenues of local governments increase far less than those of central government in 2001. In itself this would be surprising given the nature of tax sharing arrangements, but it is all the more surprising given anecdotal evidence that local governments were receiving between 15 and 20 percent higher revenues than budgeted and are allowed to retain these under the provisions of article 17 of the Law on Local Governments discussed previously. This suggests that local governments may be retaining revenues without them being included in the reporting system. Discussions with the chairmen of selected Hukumats implied that this was indeed the case. The large and varied intra-year budget adjustments taking place across sectors points to the need for prioritization not only in budget preparation, but during budget execution. Given the short time frame in which such decisions need to be made it would be necessary at the budget preparation stage to indicate a contingent prioritization to cover both revenue surpluses and shortfalls within the year.

Table 5.

Item	Local Budgets					
	2001		2002		2001	2002
	Approved plan	Executed	Approved plan	Executed	App/exec	App/exec
Public Administration	10407	12351	15823	18555	18.7	17.3
Defense	1847	1637	2447	2308	-11.4	-5.7
Law and order	1517	1459	1946	1741	-3.8	-10.5
Education	47921	49986	67596	70487	4.3	4.3
Public health	19827	19587	24181	24116	-1.2	-0.3
Social protection and maintenance	5096	2261	8270	6684	-55.6	-19.2
Environment and housing	17278	20401	22134	28675	18.1	29.6
Culture	3667	4436	4082	4906	21.0	20.2
Fuel and Energy sector	0	0	0	0		
Agriculture and forestry	1251	1239	1374	1337	-1.0	-2.7
Mineral extraction and construction	180	50	1928	2057	-72.2	6.7
Transport and communication	10378	12581	9185	8156	21.2	-11.2
Other economic activities and services	21	0	0	0		
Others	3156	4685	3189	3239	48.5	1.6
TOTAL	122546	130673	162159	172262	6.6	6.2

A.2 Main Factors Affecting the Budget Preparation and Performance

The review of budget preparation process and budget performance suggest there are at least five other important reasons for differences between approved budgets and actual outcomes. These are:

Initial agency and sector ceilings

Budget calendar and the inclusiveness of the budget process

Economic growth and revenue estimates

Lack of MTBF and the time horizon.

Investment and recurrent budgets and counterpart fund issues.

Norm based budgeting.

Structure of the Ministry of Finance

Initial budget and sector ceilings are necessary for effective budget preparation and execution. As noted already the budget circular or budget instructions that the MOF issues at the beginning of the budget cycle do not contain any ceilings. The budget instructions require agencies to develop their budgets within specific incremental limits based on previous years' allocations. While this does not promote strategic reallocations between sectors, it does establish a planning ceiling for each program and agency. Further, agencies will not receive approval for budgets that do not follow guidelines. The consequence of this is that budget requests are becoming an operational planning document that force agencies to develop plans to live within the constraints of limited funding based on past years. As there have been no sector strategies agreed within the government, in general line ministries prepare their budgets as in the past and since the previous practice has been one of "adjust as you go" the ministries often ignore previous

years budget allocation and in practice there is no initial budget constraint. The MOF has yet to work through the issue of setting sector ceilings and needs to issue those with the Budget circular or budget instructions. While this is related to the sector strategies and the MTBF issue, and in fact the budget reform project suggested and included in the draft of the budget circular for 2004, the MOF excluded sector strategies which would have contributed to the development of ceilings.

Tajikistan's budget preparation calendar is too short and the budget process is not inclusive. The process begins in earnest with the issuance of budget circular and budget instructions by the MOF which in principle should be issued in April-May. The past two years the MOF issued both of these documents in late June or early July. Agencies submit their budgets in August and then a first draft is prepared. The draft of the budget is very much the work of the MOF based on past year's budget with limited input from agency budget submissions. While discussions with line ministries have revealed that they do not attach the necessary importance for the budget preparation as these are largely ignored by the MOF, the MOF officials draw attention to the fact that these initial submissions are not realistic at all. Furthermore, in part due to time constraints negotiations between the MOF and ministries are short and this undermines the nature and quality of discussions. MOF then assembles the revised budget and submits it to the Government for review and approval. The government considers the budget in the month of October and the Parliament in November/December. The consequence of this procedure is a comparatively short time for a careful review and approval process. While there has been a recommendation for establishing an earlier timeline for the budget preparation process-as the Law does not prevent the MOF from submitting the draft budget to the Parliament earlier - under the budget reform project funded by IBTA2 credit, this was not accepted by the MOF.

Time horizon of the budget and lack of MTBF is one of the key issues. As noted already although Tajikistan has made some progress in developing a multi-year budget and a draft MTBF have been prepared. However, the draft MTBF and associated processes were not adopted by the MOF and the budget preparation process has proceeded independently of the MTBF preparation efforts. The one year horizon of the current budget cycle not only undermines fiscal management in the macroeconomic sense but complicates budget execution by (i) weakening the ability of the MOF and the Government to estimate resources that maybe available; (ii) reducing the incentives of budgetary organizations to manage their resources efficiently as it does not encourage them not pay enough attention to resource constraints; (iii) undermining the accountability of budget organizations; and (iv) not presenting resource availability indicators over a medium-term which is important for the sustainability of government programs. Fundamentally, it should be recognized that the MTBF is a whole of government process, not a technique applied in the MOF, and in the absence of a MTBF it is very difficult to evaluate of the desirability and extent of budgetary deviations as it is not clear whether these are driven by policy shifts in line with priorities or not. While it is understandable that the development of the full MTBF takes time, the draft MTBF circulated during the May 2003 CG meetings could have been used as the basis for having a forward looking three year budgets for agencies which would be major step forward, particularly in the health and education sectors.

The separation of investment and recurrent budget planning is affecting budget execution and leading to counterpart funds shortages. The current budgetary process separates investment and recurrent budget planning process and this is increasingly having an impact on the budget preparation and execution. As discussed earlier in Chapter 2 Tajikistan has a budget funded CSIP and a foreign funded PIP and their preparation process are reviewed in Chapter 5. The planning of recurrent expenditures for both programs are undertaken by the MOF while investment planning takes place in the MOET. Despite recent improvements the process for the preparation of both programs do not take place within a coherent budget policy framework under which both recurrent and investment planning are driven by the same strategic objectives and priorities, such as the PRSP, and actually are properly accounted for in the budget. While the CSIP is more or less in prepared in parallel with the budget, the PIP planning and preparation and budget cycles are different and this is undermining the integrity of the budget. For example, while the government wishes to obtain higher levels of donor funding, beyond the 3 percent limit imposed by the IMF, the recurrent expense implications of investment projects beyond the 3 percent, if that materializes, is not discussed in the PIP nor in the budget documents. This is an issue to be addressed.

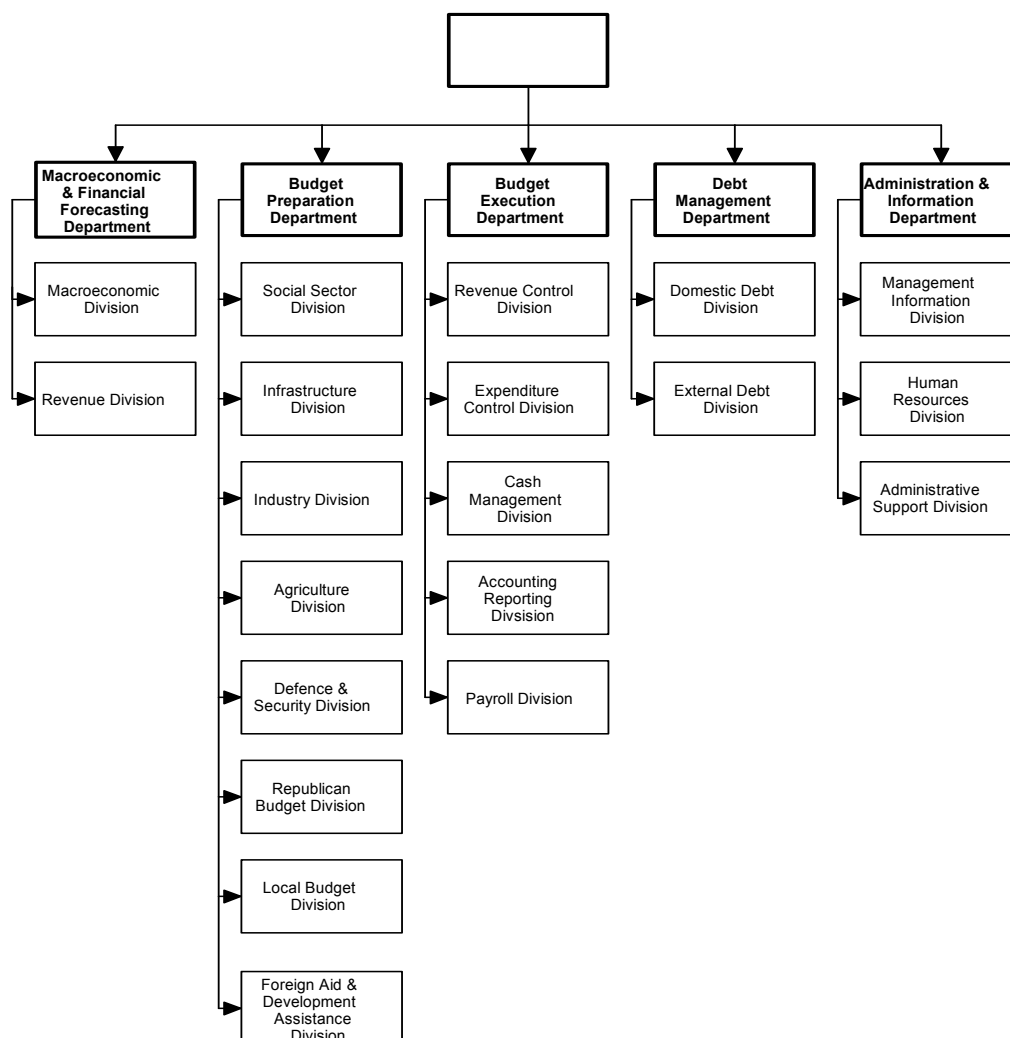
Input-norm orientation of the budget continues but there are signs that this maybe changing in health and education. While norm based budgeting may have been efficient under socialism and programs under it affordable with the large budgetary transfer from the FSU, it is no longer feasible and not the most efficient way of delivering public services as shown by three separate recent reports on education, health, and poverty assessment as well as the government's PRSP progress report of March 2004. Furthermore, norm based budgeting does not facilitate the prioritization of resources as it locks in resources to programs and activities that may no longer be possible to fund nor needed. For example, rationalization of health and education facilities maybe necessary as financing all that were inherited from the FSU is no longer possible. However, there has been some progress under the budget reform program and in 2002 the budget instructions required that the health and education ministries prepare their budgets on a per capita basis, which was extended to all ministries in 2003. Most ministries submitted their budget requests in both years by using the new forms developed by the BRP and the MOF collected this information. While this did not lead to major changes as the submissions were of poor quality in the absence of training and the MOF continued to use norms for preparing the budget most ministries have been exposed to the idea and its merits. A very recent encouraging development has been the development of a preliminary sector strategies for health and education and associated costing proposals based on per capita financing. These efforts are being supported by the Bank and a number of donors and the budgeting process could use these which will greatly improve service delivery in these critical sectors.

Economic growth and revenue estimates need to be improved. The fact that economic growth has steadily increased since 1997 and that this has resulted in higher revenues is a welcome development. However, from the budget credibility and predictability view point what is important is to have reliable revenue estimates and allocate them across expenditures categories so as to minimize variations between the approved and the actual budgetary outcomes. The fact that revenues have been consistently underestimated by

wide margins during the past few years would suggest that the process for such estimations needs to be reviewed. While one interpretation could be that the government has been conservative with these estimations, the review of the growth forecast process as well as forecast of revenues suggests this has not been the case. The government is still very much relying on revenue forecast methods as noted in previous sections and it is important to start moving away from forecasts based on production plans of enterprises. While it is understandable that this is a medium term capacity building issue and immediate improvements could not be expected, it is also important to note that the government has received considerable assistance in this area under IBTA2 since 2001 but some of the basic recommendations of this project were not adopted. Hence, to improve the predictability of budgetary outcomes it is important that the government requests the adoption of forecasting techniques provided under IBTA2.

The organizational structure of the MOF hampers effective budget development and execution. A recent functional review of the Ministry of Finance carried out under the IBTA-2 project noted that not only did the Ministry carry out some functions which would not normally be considered core functions of a MOF, such as preparing policy on precious metals and stones and supervising a secondary school, but one of its core functions, that of Budget preparation was split into four separate departments each reporting to a deputy minister. This structure in itself makes the preparation of a comprehensive budget difficult since each of the departments are likely to be competing for resources rather than providing a comprehensive overview of the whole budget. Although a more conventional structure for the Ministry was proposed (see diagram below), a new structure of the Ministry of Finance was approved in February 2003 in which, many of the characteristics of the old structure, including the division of the budget departments and the supervision of policy on precious stones and metals are retained, but in addition establishes a health improvement center managed by the Ministry and a construction company and printing house subordinate to the Ministry. The new structure does not give a clear mandate to the Ministry to formulate macro-economic policy, which is implicitly left with the Ministry of Economy through the SEDP. The restructuring of the Ministry of Finance has not been in the right direction and in fact is a backward step in terms of establishing a modern public expenditure management system, and illustrates the need for capacity and consensus building at the center of Government as a precondition for the success of technical assistance at all other levels.

Structure of Ministry of Finance Proposed in Functional Review



Lack of capacity and appropriate skills is affecting the budget process adversely and is an issue that needs to be addressed over the medium term. While IBTA-2 had a large component (US\$2.5 million) designed to improve public expenditure management and progress has been made in some areas, capacity in the MOF and other budgetary organizations remains limited and much remains to be done. Capacity building activities that started under BRP financed by the IBTA2 credit needs to be followed. While this TA program produced mixed results overall the impact has been positive and the MOF has been exposed to modern concepts of budget planning and implementation. There is now basic capacity to develop multi-year budgets, an electronic system in place that has the technical capability to develop agency and program based budgets though full transition to such systems will take time and considerable capacity building. MOF staff also obtained training on macroeconomic forecasting and a simple economic model that can exploit the links between GDP growth and money supply, exchange rate and foreign trade exists in the MOF. There is a need to provide training to line ministries and this has not started in earnest. Not only budget units in the line ministries are weak and they play

a minor role in the formulation of the sector budgets, but policy formulating departments are also weak.

THE SOCIAL PROTECTION FUND

The Social Protection Fund is the only targeted fund. It accounted for 15% of General Government expenditure in 2002 and was established in 1996 as a result of a merger of the Pension, Employment and Social Insurance Funds. It is run by a board with representatives from the Trade Unions, public, Ministry of Social Protection as well as the Central Bank and the Savings Bank. Revenue for the Fund comes from a payroll deduction (at a rate of 25% paid by employers and 1% paid by employees).

Table 6. Expenditure of Social Protection Fund 1998-2003, thousands Somoni

Years	Budget Approved	Budget Actual	ACTUAL EXPENDITURES					
			Total	of which				
				Pensions	Health improvement	Employment Policy	Benefits	Other
1998	21015.0	18874.0	19922.4	15646.1	469.6	486.8	2080.7	1239.2
1999	26015.0	24186.1	24440.1	20042.2	546.9	528.3	2339.8	1002.9
2000	30200.0	38124.7	36214.6	31228.7	647.0	601.4	3060.6	676.9
2001	54000.0	56210.8	54844.7	46778.3	1003.2	1362.0	4407.5	1293.7
2002	75000.0	80921.7	81721.0	65900.1	1472.4	1680.0	6686.9	5981.6

The purpose of the fund is to provide pensions (except military and law enforcement pensions which are not subject to insurance arrangements and are paid directly out of the Republican Budget), sickness, unemployment and maternity benefits. The fund is required to balance its income and expenditure and cannot legally run a deficit. As can be seen from Table 1 the vast majority of its expenditure is on pensions. It is notable that the SPF itself does not know the numbers of recipients of maternity and sickness benefits as these are paid directly by enterprises which offset them against social tax contributions. The enterprises are not required to provide a breakdown of the offsets, and only submit the information on total deductions to local units of the SPF. The system implies that it is virtually impossible to monitor the degree to which benefits due are actually paid, and certainly the impact of benefits in alleviating poverty. It also implies that there is considerable scope for underpayment of social tax by enterprises.

However, the Fund has no formal policy development responsibilities. The Fund does not control either the levels or extent of benefits which are determined by law, nor can it determine the contribution levels to the fund. In the case of pensions these are defined benefits in nominal terms according to a standard formula⁷⁵. However, the actual determination of the level of pension of a new pensioner is carried out by local units of the Ministry of Labor and Social Protection which are under the authority of local governments and depends upon the presentation of documentation from previous

⁷⁵ Women may retire after 20 years and men after 25 years on 55%, plus an extra 1% for each year beyond the 20 or 25 years of either the average of the last two years salary or any five years salary.

employers. In addition to being extremely cumbersome the current system is clearly open to rent seeking behavior on the part of officials in the local offices.

The SPF currently has plans to introduce a computerized system, in which current and future pensioners would have card with a microchip storing all the required data. This would allow the centralization of payments processing and the necessary databases within the Fund itself. It would appear however that such a system would only be able address the weaknesses in the current system in the long term, since it would require an extensive computerization at local level and would not solve the problems of those already retired nor of those retiring in the next few years unless it were possible to collect and input accurate data on employment and contribution records of those currently employed in order to be able to assess their pension entitlement.

Its solvency is maintained in the short term by the fact that pension levels are adjusted annually by presidential decree. However, the fund is consulted by the government on the increases in pensions which are consistent with the likely receipts. This would appear to pose the risk that if resources are insufficient, arrears may occur, recipients selected arbitrarily, or that eventually the government would have to make a direct contribution to the Fund. Since 2001 the Fund has reported surpluses, which can be retained and used to pay additional benefits, usually through a government decree. One example of this cited for 2002 was a decree to increase benefits to World War II veterans. Clearly the risk of insolvency of the fund (thus posing a contingent fiscal liability for the government) will increase if nominal reductions in pensions cannot be implemented due to political considerations in the event of a revenue shortfall. There is thus no effective policy process to determine levels of benefits or target populations, or budget allocation process. Resources are earmarked to the Fund, and if and when a surplus appears this is allocated on an ad-hoc basis.

The discussion of the targeting of benefits in order to maximize their socio-economic impact is limited by the Soviet tradition of universal benefits. This points to the need for the establishment of a policy making unit either within the Fund itself, or within the Ministry of Labor and Social Protection, to define feasible goals of Social Protection Policy and necessary strategic choices, given the limited resources available, which might include the abolition or restriction of many benefits in order to concentrate on providing a few well targeted benefits. Eventually, within a well functioning MTBF this policy unit, would, along with other similar ones based in other ministries provide the necessary material to feed into a strategic policy unit located either within the Presidential Administration or as secretariat to the Government. The alternative is that policy will continue to be made on an incremental ad hoc basis and very low poorly targeted benefits will fail to have an impact on the most vulnerable sectors of Tajik society.

TOWARDS A REFORM STRATEGY

The analysis of budgetary planning and execution process suggest that Tajikistan needs a pragmatic and feasible reform strategy to ensure that its budgetary process is the main operational instrument for (i) priority setting and improved service delivery;

(ii) ensuring transparency and accountability; and (iii) supporting macroeconomic stability and growth. The analysis in this chapter shows that Tajikistan is in early stages of budgetary reform and the budget process is not yet a vehicle for priority setting in the overall government policy framework. Lack of capacity is a serious issue and this necessitates a well designed and well sequenced strategic reform management with sufficient technical assistance. Since the findings of PA, ESR, and HSR, show that delivery of public services in social sectors are still declining, and this undermines long-term growth potential, there is also the need to reform the way these sectors are funded. Taken together, the analysis suggests that there are three broad reform areas each having short term elements and policies and medium term strategies which need to be converted into implementable programs.

First, at the strategic level, the government needs to clarify which development program will guide the resource allocation process. Currently, the government has two development programs: (i) the ESDP of the MOET which forms the basis of the key parameters of the budget and PIP; and (ii) the PRSP largely managed by the Office of the President. Both of these programs are being supported by a number of government agencies, such as the ACU, State Economic Advisor, and line ministries. These programs are not consistent with each other and each has different set of strategies and funding needs and it is not clear which one is the priority. Related to this issue is the need to develop sector strategies and elaboration of expected outcomes in a given sector. The ESDP is a long term development plan (15 years) that is updated annually and is reminiscent of central planning and its basis is not clear. Furthermore, there is no prioritization of programs proposed in the ESDP and no costing of programs and investments proposed under it. The PRSP, which has been issued in 2001, on the other hand is declared to be the main policy paper of the government with the explicit aim of poverty reduction, presents a set of priorities, though the costing of programs under it are not realistic and its implementation is constrained by lack of capacity. More fundamentally, it is not clear if the PRSP is actually guiding government policy formulation. In the PRSP progress report issued by the government in March 2004 it is noted that the budget process is not linked to the PRSP and there is no medium term approach programs proposed under the PRSP.

Second, develop a monitorable budget management reform program to align the budgetary process with government priorities with the participation of key ministries and the approval of the government, which could include agency based budgets for education and health on a pilot basis. The review of the process and discussions with key policymakers and line ministries and budgetary organizations suggest that the process and actual budget execution, as well as the delivery of public services which is the ultimate aim of any budget process, needs to be established on a more stable and broad-based consensus of budget policy formulation and process, from estimating the resource base to the submission of the budget to the Parliament. This needs to be at the technical working level and at political levels and at each phase of the budget preparation process. While in principle a well designed MTBF could serve this purpose, the lack of such a process in Tajikistan suggests that the government needs to adopt a medium-term work program to achieve it. As noted already the MOF has already received TA for the development of the MTBF and there is a reasonable basis to further develop it with the

active participation of line ministries as the MTBF is a government-wide process. While the development of the MTBF would take time and require further TA, a more modest and practical way forward would be the adoption of health and education sector strategies developed by the government and with significant donor support. These strategies are now ready and integrating their financial plans into the budget process could be the first steps of agency based budgeting. Developing innovative ways to work with local governments and jamoats and to engage them in the management of public funds could be one of the elements of such program.

Third, strengthen basic budget preparation procedures and improve transparency and accountability framework as well as reporting to the public before giving more autonomy to line ministries and local governments. There are a number of operational improvements that the government and the MOF could introduce easily to better prepare the budget and these would go a long way toward improving public expenditure management. These measures range from initial budget ceilings to timely transfer of resources and to accountability at the Parliament level. These will complement measures suggested under item 2 above and would facilitate the transition to agency based budgeting to increase the accountability of agencies who actually implement the budget in their sectors. As control structures of central planning have gone, there needs to be new mechanisms to ensure that line ministries actually deliver the services they are expected to deliver and undertake investment projects in a least cost manner. This would suggest that they should have reasonable control over in the management of financial resources so that they could be accountable and if the PRSP is to be implemented line ministries and agencies would need to assume more important roles and responsibilities and the budgetary process needs to support this. While this is a medium-term issue, piloting this scheme in the health and education sectors could start as there is now a medium term financing plan based on recently developed strategies and both ministries receive TA in those areas.

A. Elements of a Reform Strategy – Linking Policy and Budget Process

Given the key issues discussed above, a well sequenced reform measures combining short-term and medium term measures are needed. The key issues discussed above could only be addressed by developing and adopting specific policies and measures. It should be stressed that most of the proposals require a process of capacity building and some can only be adopted over a number of years with appropriate technical assistance. In the discussion of policy proposals below these are pointed out. The implementation of policy proposals below require commitment at the highest levels of government to the process. The recommendations are not and cannot be technical solutions to political problems.

A strategic policy making and priority setting body is needed and this body should be established immediately. Given the multiplicity of development of programs and associated processes, and to create an effective demand for reform, the government should establish a formal State Resource Management Policy Commission (SRMPC.) The strategic responsibility of the SRMPC would be (i) the initiation of a reform process to move from input to output based budgeting; (ii) determining priorities and linking

these with the budget allocation decisions and discussing trade-offs which would emerge as a result of supporting a sector instead of another (inter-sectoral trade-off) or supporting a specific program instead of another (intra-sectoral trade-off). The purpose is not to create another level of bureaucracy but to ensure that the SRMPC key government policies and objectives are clarified and decide which document would guide the policy and budget formulation process. In this way the necessary link between budget allocations and national policy could be established. Commission membership would include members of the president's administration, members of Parliament and only the heads of central bodies such as the MOF, MRC, the MOET, and the National Bank. An embryonic version of the SRMPC exists in the form of CG-follow-up committee and this could be converted in a SRMPC with formal responsibilities. Other than the core members, the SRMPC would not have permanent membership. PRSP and ACU should be represented at the SRMPC.

In order to support linking policy and budget allocations the SRMPC should review PRSP, PIP, SEDP and decide on a single financial framework based on available resources. Given the inconsistencies among PRSP, PIP, SEDP, and the budget it is critical that the SRMPC address this problem. This inconsistency is causing a considerable degree of confusion within the government as well as donors and undermine domestic policy formulation as well as donor disbursements. The SRMPC should articulate government priorities in a clear manner and communicate these to all budgetary organizations. The SRMPC should demand a multi-year approach to financing important budget decisions and agency based budgets in the priority areas and ensure that the PIP is integrated into the budget process. These elements are at the heart of the MTBF. While more TA is needed, Tajikistan has some capacity developed under BRP to use the existing draft MTBF and the processes associated with it at the MOF. A simple MTBF with multi year programs and financing plans for health and education could be prepared and over the medium term this practice could be extended to other sectors. This is not only critical to attract higher levels of donor funding but it will also enable the government to improve its public expenditure management framework significantly. Before the beginning of the budget cycle the SRMPC should issue the "Budget Policy Statement" available to the public, and this should become the official document guiding the policy formulation process. The MOF could issue detailed budget instructions shortly afterwards to give sufficient time to Ministries and Local Governments to prepare budgets based on the Budget Policy Statement and the instructions issued by the MOF.

The government should support the development of consultative policy formulation mechanisms which will improve priority setting and budget execution and support the SRMPC. In addition to the creation of the SRMPC line ministries need to be given the formal responsibility for developing sectoral policies and their capacity increased to fulfill this responsibility, this should include setting up internal policy development units closely linked to the budgetary / finance units of the ministry, so that sectoral strategies and policies can be developed and costed, so as to be used as inputs into a strategic policy making framework at the center of the Government. These units should be responsible both for reviewing the outcomes of existing programs and expenditure assignments, and for developing policies and proposals to deal with problems identified, taking into account likely budget constraints. They should also maintain a dialogue with

corresponding sector units in the Hukumats, in order to identify problems at a local level so as to provide guidance and develop policy incentives for local governments in dealing with problems. The policy units would be the main mechanism for developing proposals to be included in the MTBF and the annual budget, and would be expected to produce a short sectoral policy paper as an input to the discussions on priorities by the SRMPC. As a pilot, such a process could begin at the education and health ministries.

In order to fulfill their policy development responsibilities line ministries need to develop a review capacity. In order to assist the evaluation of outcomes of policies and activities line ministries need to be able to review and assess the results of programs they implemented. This review capacity is a key element in the introduction of agency and program budgeting, which will be piloted in health and education ministries. There may well be an argument that developing the policy review and development capabilities should precede the introduction of program budgeting, since these are necessary to the definition of useful programs.

B. Improving Budget Preparation and Execution

B.1 Resource Envelope and Revenue Predictability

The process for the identification of the resource envelope can be improved by better coordination in the short-run and by making this effort as part of the MTBF exercise in the medium term. As was discussed previously, the principal source for the resource envelope in the budget process should be the macro-economic and fiscal forecasts, combined with an assessment of the volume of resources available for borrowing, compatible with macro-economic stability and long term solvency. The forecasting process as described has a number of clear weaknesses. The real forecast (that of the MOF) is begun too late in the year to provide guidance as to the resources likely to be available. The macroeconomic and fiscal forecasts should ideally start being produced in December, so as to provide inputs to the government early by February or March in order to set the resource envelope for the budget process. The roles and responsibilities of the MOEF and MOF should be clarified. Given the acute shortage of human and technical resources to produce macroeconomic forecasts, this function should be located entirely in the MOF. The MOF, working with other agencies, could then factor this aspect of budget process in the MTBF exercise.

The role of the National Bank and Goskomstat should not be overlooked. Macroeconomic forecasting activity in the MOF requires close cooperation and exchange of data with the Central Bank, which has its own macroeconomic analytical capacity. Although the Central Bank's focus may be somewhat different (with a greater emphasis on monetary variables, inflation and the balance of payments, an effective budgetary process requires broad agreement on the macroeconomic outlook which will be agreed by the government and serve as the basis of both the medium term and annual budgetary processes. The practice of producing forecasts on the basis of consolidated production plans should be discontinued and a review be carried out of the utility of the collection of production data from individual enterprises. It is suggested that such a review should be linked to the IMF's recommendation to move the emphasis of the State Statistics

Committee (Goskomstat) work from the collection of detailed individual statistics to the use of sampling methodologies.

Increasing the predictability of revenues is critical for improving budget execution and direct recording of revenues by Treasury should be considered. As discussed in the previous sections, there has been a large discrepancy between the approved budgets and the actual budgetary outcomes. This will require significant strengthening of budget execution framework and improving cash management and financial planning. While considerable progress has been made by the treasury, the capacity of the treasury for financial planning and cash management is weak. There is a need to establish formal procedures between the treasury and other relevant departments to provide the treasury with the necessary information for producing cash management forecasts. Furthermore, the treasury needs to work in a much more coordinated manner with the MSRD. Direct recording of tax revenues through the treasury is a promising option to reduce delays and lags in the transfer of funds to the treasury. Under the current arrangements revenues are not recorded directly through the Treasury but at the MSRD and this is not efficient from the budget execution point of view. The Ministry of Finance sees the solution in changing the way how transit accounts operate; by close of every business day there is a need to have a breakdown of all tax and other revenue proceeds by types of taxes.

B.2 Initial Budget Allocations and Preparation of Initial Budgets

Allocation of initial budget ceilings must be set at the first stage of budgetary process. Budget ceilings should be issued together with budget instructions to all key budgetary organizations, and include a statement of strategic and sectoral priorities from the Budget Strategy Paper. This is a major weakness of the current system and the budget constraint must be given to the line ministries and all other budgetary organizations. The budget ceiling is the very step of prioritization process.

Preparation of initial budgets should focus on outputs rather than inputs and the removal of dual accountability structures. For budget preparation to become a meaningful exercise in resource allocation at each level there needs to be either: (i) a match between the tasks and activities for which the budget is being prepared and the likely available resources, or (ii) that units preparing budgets, at whatever level, have authority or a mechanism to either reduce activities to the available budget, or the ability to raise revenues, through recognized and legal channels in order to fund the activities. The focus of budget preparation should be moved to outputs and outcomes rather than resources to supply the needs of institutions. To achieve the previous objective considerable training will be required for staff in Rayons, Oblasts and Line Ministries, in the principles of budgeting as a resource allocation exercise. The most fundamental reform required in budget preparation is the removal of dual accountability structures, so that, for example, if primary education is to be funded at a local level then preparation of budgets, and accountability for service levels should be entirely the responsibility of the local administration, with the only potential role of the Ministry of Education to set general standards compatible with resource availability.

B.3 Planning for Recurrent and Investment Expenditures

The recurrent and investment planning processes should be integrated. As discussed in detail in Ch. 5, Tajikistan has two major investment programs and recurrent and capital expenses are not fully integrated. For Tajikistan integrating recurrent and investment outlays is important as this is one of the reasons the IMF has imposed a 3 percent of GDP as PIP disbursements in a given year. Also, this is needed to demonstrate that same strategic objectives drive the formulation of the recurrent and investment budgets. Another issue is the role of sectoral ministries and how they treat these. It is important that the budget planning process at the sector level starts by considering implications for recurrent or investment expenditures based on a predefined resource envelope for the sector; (iii) that projects are selected based on a range of economic and non-economic criteria. While it is clear that full integration of the recurrent and capital budget planning processes will take time and should be considered within the context of the MTBF process, the SRMPC, if founded, should as a first step require improvements to the estimation of the recurrent cost implications of the ongoing investment projects from the line ministries.

B.4 Negotiations with the Center and Agreement on the Final Budget

The nature of negotiations with the center should aim for consensus building. For budget negotiations to be effective a continuous dialogue on policy issues between the MOF and the line ministries and local governments needs to be established on policy issues and funding. This dialogue should be one not confined to the budget process and in particular not confined to budgetary units of the ministries and local governments, but should involve the policy units of the ministries so as to focus discussion on choices and alternatives and not just how to finance existing needs and institutions. To establish such a dialogue training will be needed for both MOF officials in the Budget Department and their counterparts in line ministries in policy issues in their sector areas and results oriented management of resources.

Agreement on the final budget should not be mechanical exercise. For the Budget Process to be coherent it is important that the final draft budget agreed between the MOF and the line ministries is closely linked to the Budget Policy Paper and the first year of the MTBF. It is also important that there is a clearly institutionalized process to resolve disputes on budget allocations, probably involving the Budget Commission providing recommendations to the Government on outstanding issues, and the implications of these for the Government's strategic goals and medium term fiscal position. The successful implementation of the strategic approach to budgeting implies that in the final stage of the Government's consideration of the budget there should be no major reallocations of resources, and the discussion should focus on unresolved issues in the light of recommendations of the SRMPC. Such a discussion will only be possible to the extent that the Government and individual ministers feel institutionally bound by the strategic decisions taken early in the budget process and expressed in the Budget Policy Paper. Securing this consensus at the highest levels of the Government is perhaps one of the most difficult aspects of the reforms of the budgeting process, and may take several years

to establish. It will also require an active dialogue and technical assistance, perhaps in the form of workshops for the most senior officials of the Government, including ministers.

B.5 Parliamentary Approval and Accountability

Budgetary approval process should facilitate transparency and accountability. For there to be effective accountability the Budget Law approved by Parliament should be based upon allocations to institutions rather than functions or sectors. It should also include explanations of the main purposes of the allocations, and in particular the most significant changes of policy and allocations of resources compared with previous years and what had been previously foreseen in the MTBF. The allocation to each institution should also be shown by functions and economic classification, as the institution can then be held accountable for the use of resources allocated to it. The Budget Law should also show the volumes of grants allocated from the Republican Budget to each local government. Parliament will not be able to hold the Government accountable for the budget without adequate expertise in fiscal analysis. The possibility of setting up a fiscal analysis office in Parliament, staffed by economists and financial experts should be explored. The parliamentary Budget Committee would also benefit by getting greater exposure to the working of similar committees to learn and adapt international best practices to Tajikistan.

B.6 External and Internal Audits and Accountability Framework

Tajikistan's external and internal audit frameworks need strengthening. While these frameworks are evolving and both the SFCC and treasury internal audit departments are new institutions, improving public sector transparency and accountability requires measures in three key areas: (i) making the reporting among the Executive Office, SFCC, and the Parliament more transparent by submitting detailed audits to the Parliament and including this in the law on SFCC; and (ii) having the Parliament approve the report on budget execution by the SFCC. There is also the need to improve the workings of the SFCC and its mandate and organizational structure should be reviewed. Its mandate is too broad and is not in line with international norms which are discussed in detail in the CFAA. The SFCC also needs training to improve the quality of its audits by applying better auditing techniques and staff training. A twinning arrangement with a foreign supreme institution would be highly beneficial. For internal controls and audit, the Government should improve the legal framework and address the role of internal audit within the public sector. With its present governance problems, the most important objective should be to ensure compliance with the financial laws and regulations. This could be achieved if an internal audit function were developed within MoF, with a special cadre and concentration of scarce audit resources, also discussed in detail in the CFAA.

B.7 Reforming Organizational Structure of the Ministry of Finance

The organizational structure of the MOF needs to be modernized. As discussed earlier the restructuring of the MOF in 2003 did not change its organizational format and the budget preparation and monitoring is still split in four separate departments. Furthermore, the MOF deals with tasks outside of its core function, such as running schools, and

managing a construction company. Equally important is that the new structure does not give a clear mandate to the Ministry to formulate macro-economic policy, which is implicitly left with the Ministry of Economy through the SEDP. Hence, the MOF should be reorganized in line with its responsibilities and be the agent of change for developing a modern budgetary framework which Tajikistan needs.

CENTER-SUB-NATIONAL RELATIONS

INTRODUCTION

*Sub-national units of administration*⁷⁶ play a major role in the provision of public services. Education and health services are supplied by sub-national units and they play an indirect role in communal services such as water supply and solid waste management. Since the breakup of the Soviet Union, the quality of these services has been in sharp decline. This is partly due to the drop in Government revenues that followed the breakup. With the severing of economic ties to the rest of the CIS and the end of subsidies from Moscow, Tajikistan's GDP fell by 60% between 1990 and 2000. Government spending fell proportionately. Subnational spending, in 2003, was equivalent to only US\$10 per capita.⁷⁷

There is evidence that the economy and government spending are now on the upswing. Between 2000 and 2002, GDP (in current US\$ terms) grew by 22%. Subnational expenditure increased by 15% in real terms between 2001 and 2002. But relying solely on revenue growth to restore the former level of local services is not a sufficient solution. First, it is unlikely that revenues will return to their Soviet-era levels in the near future. In the interim the Government will have to find ways to do more with less. Second, it is unlikely that the management system of the Soviet era—based on the Communist Party's monopoly of political power—can function indefinitely in a political environment characterized by openly competing regional interests. In the long term, the Government will have to find a structure that is better able to balance national and regional interests.

STRUCTURE AND FINANCING OF SUBNATIONAL ADMINISTRATION

A. Overview

Tajikistan is a highly centralized state. While it has the formal structure of a multi-tier democracy, power is concentrated in the hands of the president. The current Constitution, adopted in 1994 and significantly amended in 1999 and 2003, calls for an elected president and parliament. The president is directly elected by universal suffrage for a term of seven years. Under the terms of the 2003 amendments, he may be reelected for two subsequent terms. Parliament consists of two houses. The lower house--the *Majlisi Namoyandagon*--consists of 63 members elected by popular vote for five-year terms. Twenty-two are elected by proportional representation (in which representatives are elected from party lists in proportion to the number of votes each party receives) and 41 are elected from single-member constituencies (geographical areas which each have one representative). The upper house--the *Majlisi Milli* was created after the civil conflict ended in 1997 and was intended to give greater voice to regional political leaders. Three

⁷⁶ This term (along with 'local administration') will be used in this chapter to refer to oblasts, rayons, towns, and jamoats, unless otherwise specified.

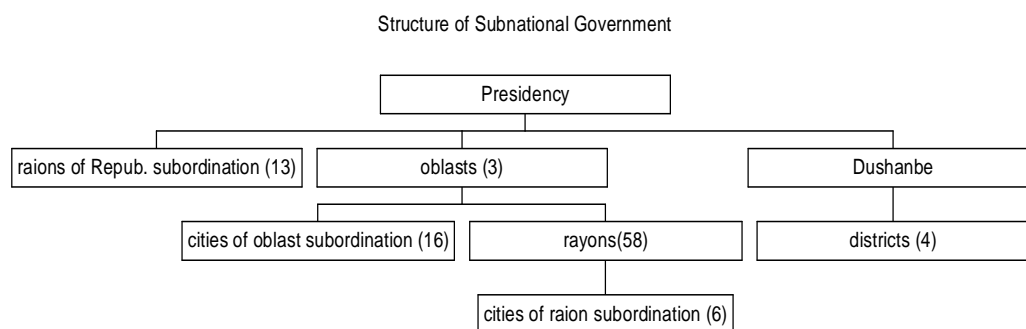
⁷⁷ Calculated from Wright, Glen Report on the Development of Expenditure Assignments, Revenue Sources, and Intergovernmental Transfers for Local Government in Tajikistan, April 2002.

quarters of the members of the *Majlisi Milli* are elected at a joint meeting of the deputies of subnational units of administration (oblasts, rayons, and towns). One quarter of the members of the *Majlisi Milli* are appointed by the President of the Republic of Tajikistan.

Under the Constitution, the power of the president to rule by decree is limited. Parliament has the exclusive authority to enact legislation. A simple majority in the lower house is sufficient to approve legislation, unless otherwise specified by the Constitution. Laws approved by the *Majlis Namoyandagon* are then presented to the *Majlisi Milli*, (except for the laws on state budget and amnesty) which may adopt laws by a simple majority of the total number of its members. Despite the formal structure of government, power is nevertheless concentrated in the office of the president. As the chief executive, the president remains the main initiator of policies in Tajikistan, aided by the presidential team of advisers, personally appointed by him.⁷⁸ As the head of the majority political party, he has considerable influence over the lower house of parliament. His influence over the upper house is assured, first, by his power to designate one-quarter of the members, and second, by his power to nominate the executives of subnational administrations who in turn comprise the majority of the *Majis Milli*'s elected members.

B. Organization

The structure of subnational administration consists of four types of units: provinces (oblasts), towns, rayons (rural districts), and sub districts (jamoats). Following Soviet practice, the relationship between these units is generally, but not universally, hierarchical. In geographic terms, the majority of Tajikistan's national territory is divided into three oblasts, comprising the northern region of Sogd, the southern region of Khatlon, and the mountainous and sparsely populated eastern region of GBAO. The territory immediately surrounding the capital is not organized as an oblast, but is instead divided into 13 rayons of republic subordination and the city of Dushanbe (which is in turn divided into four districts.). As shown in Chart 1, the three oblasts, the city of Dushanbe, and the 13 rayons of republic subordination report directly to the President. Other rayons and cities report to their respective oblasts.



⁷⁸ The role of the president's office has nevertheless been reduced significantly over the last two years. Where in the past the units actually developed much of the draft legislation and policy proposals for the government, this task has now been formally decentralized to the line ministries. The sector units have been reduced in size by about 50%, with many of the staff being transferred to the line ministries to develop their policy-making capacity

Rayons are divided into jamoats. These were established in 1994 under Law of Village Governance and are essentially successors to the former village soviets. Jamoats are of two types: *jamoati shakhrak* cover one relatively large village. *Jamoati dehot* cover several villages and the surrounding areas. In total there are 359 jamoats. The vast majority (80%) have populations of 5,000-25,000. Only eight percent have populations over 25,000 and none of those has more than 50,000 people.

Executive power at the oblast, town, and rayon level is exercised by political appointees of the President. These units of local administration are headed by chairmen (known as governors, *rais* and mayors at the oblast, rayon, and town level, respectively). Under the Constitution, the President directly nominates the chief executives of the oblasts, rayons, and towns, and the city of Dushanbe. (Rayon executives appoint the executives of the jamoats.) In principle, governors, *rais*, and city chairmen serve five year terms. In practice, they serve at the pleasure of the president who may dismiss them at any time or reappoint them for an unlimited number of terms. In 2000, all 72 incumbents at the rayon and city level were reappointed. Since 2000, only 18 have been replaced.⁷⁹ According to the Urban Institute, one major criteria for centrally appointed executives is loyalty to the president and they are monitored for their observance of policy directives handed down from higher levels.

Table 1: Characteristics of Subnational Governments							
	Oblasts			RRS*	Subtotal	Dushanbe	Total
	GBAO	Khatlon	Sugd				
Population (000)	209	2,197	1,900	1,369	5,674	576	6,250
# of rayons	7	24	14	13	58		62
# of cities of oblast subordination (1)	1	4	8	3	16		16
# cities of rayon subordination		3	2	1	6		6
# jamoats	42	131	94	92	359		359
*RRS: Rayons of Republic Subordination							

Although each level of local government has its own legislative branch, these exert little control over the executive. Under Article 77 of the Constitution (as amended through the referendum of June 2003) oblasts, towns and rayons each have assembly of people's deputies, whose members are elected for five year terms. In principle, these councils have the authority to ratify the nomination of the chief executive and adopt the local budget. But oblast and rayon councils convene infrequently (as a rule twice a

⁷⁹ Formally, current law (Constitutional Law 616 of May, 1998) requires the President to submit his nomination to the local majlises for approval. It is reported that few candidates have ever been rejected.

year).⁸⁰ During the prolonged intervals between council meetings, the appointed executive enjoys a high degree of discretion.

Jamoats are, at present, merely administrative appendages of their respective rayon governments and have few of the attributes of a separate tier of government. They do not have their own budgets but instead depend on line item budget transfers from their respective rayons. Each jamoat is headed by a chairman who is nominated by the chairman of his respective rayon. In principle, jamoats have representative councils, whose members are appointed ‘by the community’ to represent community interests at one specific session. Jamoat councils meet for a single session. When the session is over, the council is disbanded.

Below the official tiers of local administration are a variety of community based organizations. These include neighborhood, street, or apartment block committees as well as culturally or religiously based organizations. These are voluntary organizations, which have no official standing in local government legislation. They often perform traditional roles in connection with lifecycle events, the cultural life of the community, the provision of local law and order, and the delivery of social services. In some jurisdictions, they are involved in local service provision such as water and serve as intermediaries between formal government structures and local residents.

C. Functions

Mandate of sub-national units is broad. The Law on Local Self Management (1991, amended in 1992 and 1993) assigns a broad range of responsibilities to subnational units of administration. These include education, health, and social assistance (although the local role in pensions is limited to assisting unpaid pensioners to contact the appropriate Government authorities). Local administrations were required to pay the salaries of local police until 1999, when this function was assumed by the Ministry of Internal Affairs.

Subnational administration accounts for about one quarter of total public spending in Tajikistan. Rayons and cities account for the

⁸⁰ Urban Institute, 2003, *Assessment of Intergovernmental Relations and Local Governance in the Republic of Tajikistan*

	2000	2001
Education	34.9	49.98
Health care	13.36	19.58
Housing services	14.32	20.4
Roads, transport	4.92	12.58
Administration	8.58	12.35
Public security	2.62	3
Social asst.	2.49	2.26
Other	5.38	10.52

majority of this. (Oblasts, in contrast, perform a largely administrative and supervisory role.) As shown in Table 2, the lion's share of local government spending (nearly 40%) is devoted to education.⁸¹ Health is a distant second. Outpatient medical services are provided by 622 outpatient clinics and 1,597 FAPs⁸². Inpatient medical services consist of 114 polyclinics, 174 rural hospitals and 70 urban hospitals.⁸³ With the exception of certain specialized hospitals in Dushanbe and polyclinics operated by large factories and enterprises, virtually all public health care is managed by local administrations and financed through municipal budgets. Under the general rubric of communal services, local governments also have an indirect role in water and sewerage, solid waste management, and maintenance of communal property, including the exteriors of multi-family housing. Although local administrations bear nominal responsibility for these functions, they are carried out, in urban areas, by units of the State Unitary Enterprise.⁸⁴

BUDGET PROCESS

The principal instrument defining the relationship between tiers of administration is the budget. During the Soviet period, budgeting was subordinate to national planning, and the budget was merely the financial reflection of a detailed set of production plans, rather than an instrument of resource allocation and policy choices. Despite the adoption of many of the forms of modern budgetary arrangements, much of the philosophy and practice of the Soviet system still persist.

A. Expenditure Estimation

The budget process is, in principle, built up from the rayon and town level, based on projections of expenditures and revenues. The formal process of expenditure estimation begins with the distribution of budget directives by the Ministry of Finance. In theory, this requires local administrations to assemble detailed information regarding the number of "expenditure drivers" in various sectors (e.g. number of schools, teachers and students for various levels of education, number of local health institutions and their staffing, and the number of households or housing units of various sizes for expenditures related to communal services). Each local budget institution (schools, health clinics, etc.) is responsible for collecting the relevant data and applying a set of standardized financial

⁸¹ While the Ministry of Education is directly responsible for specialized secondary schools and universities, local administrations are responsible for preschool and general schools (which include primary grades 1-4, secondary grades 5-9, and upper secondary grades (10-11) and finance their costs through their budgets..

⁸² FAPs consist of a paramedic (*feldscher*) and a midwife (*accouture*).

⁸³ UNDP, 1995, *Tajikistan Human Development Report*

⁸⁴ The SUE is a large *undertaking*, consisting of 62 municipal services enterprises, responsible for solid waste management, street lighting and district heating in cities and regional centers; 32 water supply and sewerage enterprises; 5 heating enterprises (providing heating and hot water supply) and 50 enterprises for the repair and construction of property and a array of smaller units. In principle, they are self financing. In practice, low tariffs and poor tariff collection performance force local governments to subsidize these organizations from general revenues.

norms to these physical units across line items of the budget classification (input-based articles such as wages, pension contributions, utility payments, supplies, maintenance and repairs, etc.)⁸⁵ Adjustments are incorporated for centrally determined financial indices, principally inflation, and for changes in other budget parameters controlled by the central government, such as wage rates for various civil service grades, allowable staffing levels across grades and tariffs for certain public utilities and communal services. The Budget Preparation Instructions for 2003⁸⁶ for example, specify that expenditures on electricity, communications, gas, and communal utilities will be based on 2002 expenditures, adjusted for projected tariff increases (which will be provided by the Ministry of Economics and Trade), and that expenditures on salaries will be based on 2002 levels pending a Government decision on any new wage increases.

While with sharp decline in revenues following the breakup of the Soviet Union the monetary value assigned to these factors has fallen to derisory levels but norm based costing is still used. The wage factor used to convert teaching hours to salaries, for example, no longer yields a living wage. Nevertheless, the practice of basing budget calculations on physical indicators persists. Not all norms applied with equal rigidity. Staffing appears to be the most-norm based element of local expenditure. The allocation of teaching positions, for example, follows from the existing allocation of classrooms. As wage levels are determined by a decree of the President, a rayon's wage bill is essentially a function of the physical facilities it has acquired in the past and any salary adjustments decreed by the President. In principle, chairmen can increase their discretionary resources by dismissing a staff member, keeping the position intact, and appointing an existing employee to fill in temporarily. Budget rules specify that under these conditions, the temporary replacement is paid only half the incumbent's salary and the chairman may use the surplus funds at his discretion. But this is a risky and short term strategy. After six months, if the position is not filled by a full time person, it can be lost.)

Non-salary items are far more negotiable. In addition to staffing, the budget proposals normally include basic operating costs, including utilities and fuel, along with some relatively modest amounts for purchases of goods and services.⁸⁷ In addition local chairmen will have a prioritized list of additional local projects for which they seek funding. These calculations obey no particular rule. Local administrations tend to base their budget proposals on actual expenditures in the previous year, adjusted for inflation and revenue growth with an additional margin included as an opening position for subsequent budget negotiations.

B. Revenue Estimation

While the directors of the various budget-financed spending units develop the expenditure side of the local budget, local representatives of the national tax committee

⁸⁵ Urban Institute, 2003, *Assessment of Intergovernmental Relations and Local Governance in the Republic of Tajikistan*, mimeo

⁸⁶ MOF, *Procedure for Drafting The State Budget of the Republic of Tajikistan For 2003 and Budget Forecasts for 2004-2005*

⁸⁷ Urban Institute, op.cit.

work with the local finance department to develop projections of tax revenues. Article 41 of Law on Local Self Management assigns local government two categories of taxes to local administrations. The largest group—the so-called regulated taxes—include the VAT (on domestic transactions), excise taxes (excluding those collected by customs), the enterprises profits tax, the personal income tax, the natural resource tax and the motor vehicles tax. (The law reserves to the Government, however, the all-important sales taxes on aluminum and cotton exports, and taxes on imports.) These taxes are imposed at rates fixed by the Government.

In addition, local governments are permitted imposed certain so-called ‘non-regulated’ taxes. According to the current Tax Code⁸⁸, local governments may impose a retail sales tax (up to a ceiling of 5 percent); a tax on immovable property owned by individuals (up to a ceiling of one percent) and a tax for maintenance of public transportation, imposed as a surcharge on the base of the payroll tax, up to a ceiling of two percent. For revenue estimation purposes, the current budget instructions require local governments to assume the maximum tax rate for the retail sales and public transport taxes. Revenue estimates for the land tax are to be made ‘in accordance with the decision of the local majlis.’ As shown in Table 3, the personal income tax is the largest single source of local revenue, accounting for nearly 40% of the total. The corporate income tax (along with taxes on small business and on business property) contribute 20%. The major non-regulated taxes—on retail sales and land—accounted for about 13% of the total.

Charging for Health and Education

Recent amendments to the Constitution will, in principle, also allow local governments to impose certain fees for education and health. This authority appears to be tightly circumscribed by the wording of the changes, however. With respect to health care, the new wording still guarantees every person the ‘right to health care’ and ‘access to free medical assistance in medical establishments’. It merely asserts the proviso, “within the framework determined by law” into the second clause. By the same token, the new wording guarantees access to ‘free basic general education in state education establishments’, as well as “free general, primary, professional vocation and higher education in state educational establishments, within the framework determined by law.” According to Wright, the legislation will nevertheless permit MOH to develop a list of free and paid medical services, and will allow schools to charge for certain programs, such as after school programs.

It is important to note that these taxes do not ‘belong’ to local administrations in the sense that local administrations are expected to live within the amount of revenue they produce. Instead, they are merely the basis for determining the size of local contributions to, or subsidies from, the Republic Budget. Local administrations whose projected revenues exceed the level of expenditures determined by the budget process are required to transfer the surplus to the Government. Local administrations whose budgeted expenditures exceed their projected revenues are eligible for a subsidy.

⁸⁸ Chapter 26, article 284

C. Budget Negotiations

After estimating expenditures and revenues, the negotiating process begins. The estimate of expenditures is first presented by the chairman of the rayon or town to the oblast governor (or to the MOF in the case of rayons and cities of Republic subordination). In principle, individual sectoral department are to negotiate with its sectoral counterpart at the next higher tier. In practice, negotiations are normally conducted exclusively by the chairman and the head of the local finance department.

Negotiations between the oblast governor and individual rayons and town chairmen then ensue.

These may result in reductions in some spending proposals, or the addition of other items, for which the oblast executive is expected to be able to contribute supplementary funding.⁸⁹ The oblast chairman, after completing a similar process of budget negotiations with departments and enterprises of the oblast itself, packages a consolidated budget and submits it to the Ministry of Finance. The MOF is responsible for reconciling the sum of consolidated oblast and RRS spending proposals with the overall availability of resources and the demands of the various Government ministries and agencies. It is advised by an *ad hoc* budget commission typically consisting of the Minister and Deputy Minister of Finance, the tax committee, the statistical office, the customs service, and other, sectoral, ministries as required.

Table 3 Sources of Local Administration Tax Revenue (thousands of somoni)			
	2000	2001	2002
Personal income tax	40,282	54,606	67,559
Corporate income tax, business tax	19,969	33,711	36,090
Value added tax	32,396	43,163	27,158
Retail sales tax	7,270	11,818	13,300
Land tax	7,196	8,518	10,148
Excise taxes	1,492	3,249	6,950
Mineral royalties	1,486	2,454	2,442
Other	2,660	9,508	12,034

These proposals are whittled down during the course of negotiations with higher levels of government. At the national level, the MOF directs the process of reconciling the sum of consolidated oblast spending proposals, including both basic operating expenditures and priority lists of projects, with projections of budgetary income.⁹⁰ At present, the IMF retains a significant role in final projections of both aggregate revenues and expenditures at the Republic level. According to a recent Bank report, the ratio of actual MOF funding to planned funding among rayons varies from 47% to 93%, with no apparent underlying rationale for the differences.⁹¹

Once the aggregate level of subnational funding is determined, the MOF then determines the budget ceiling for each oblast and RRS. A second round of budget negotiations then ensues, in which the oblast governor (or the MOF in the case of rayons

⁸⁹ Urban Institute, 2003, op. cit.

⁹⁰ Urban Institute, 2003 op.cit.

⁹¹ World Bank, 2000, *Project Appraisal Document on Proposed Credit to the Republic of Tajikistan for a Project on Primary Health Care*

of Republic subordination) negotiates a substantially reduced budget ceiling with the city and rayon executive in his jurisdiction. The Budget Law precludes cuts being made to a specific set of “protected items” including wages, pensions, stipends and utility payments.) The cuts imposed on local spending are therefore concentrated in areas such as capital investment, purchases of supplies, and low priority items such as travel. Once the local government receives the disaggregated “control figures” from the oblast, the total funding reflected in those figures is not subject to change. While the local council must officially approve the budget, this step is largely a formality.

In geographical terms, the net result of the budget process is a substantial flattening of variations in per capita revenues, at least among first tier local governments. (the three oblasts, Dushanbe, and the 13 RRS.) In 2002, for example, Dushanbe was required to transfer 50% of its VAT and 100% of its excise

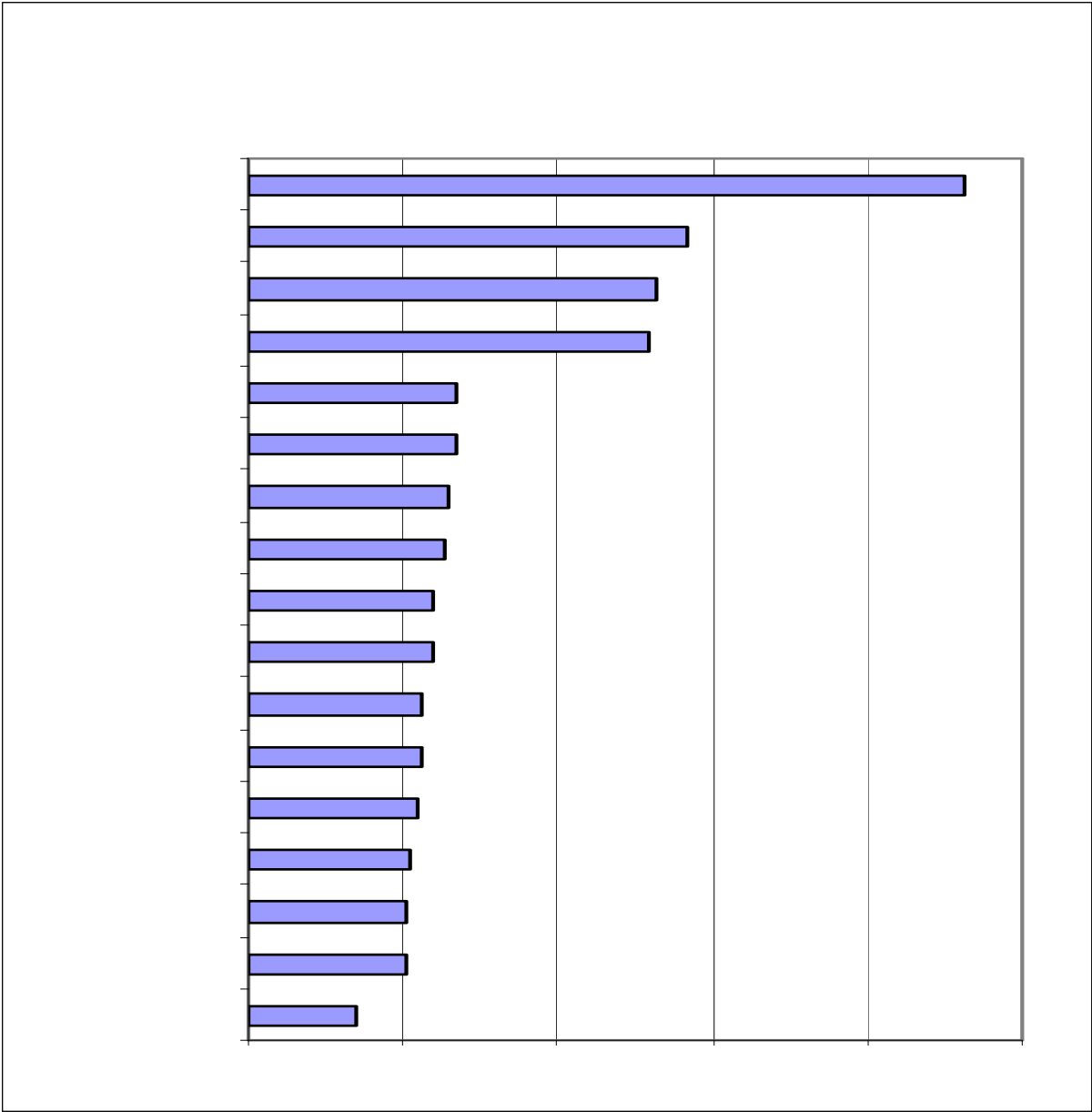
revenues to the Republic budget. Sogd was required to transfer 70% of its VAT, and 50% of its excises. Tursunzode shared 80% of its VAT, 100% of its excises, 100% of its corporate income taxes, 73% of its personal income tax and 100% of its tax on business properties. The RSSes of Hisor and Shakhriyav and the Khatlon Oblast were also required to make minor contributions. All remaining jurisdictions—where projected expenditures exceeded projected revenues--were allocated subsidies from the general budget. As shown in Table 4, general subsidies accounted for about 17 percent of local revenues in 2002, up from 14% in 2001. Under the 2003 budget, this share would rise to about twenty percent.

Table 4 Sources of Local Government Total Revenue
Million somoni

	2001	2002	2003*
Taxes	113.1	143.6	142
Subsidies for deficits	19.4	32.3	37
Ad hoc gov't grants	12.9	10.2	0
Total local revenues	145.4	186.1	179

(Note that discrepancy in tax revenues between tables 3 and 4 is unexplained)

Source: G Wright, 2003, op.cit.



the average. The variation among local governments at this level partly reflects the disproportionately high level of tax revenue retained in city governments—particularly in Khatlon. This is only partly offset by the distribution of subsidies, which tend to be distributed to poorer jurisdictions. (The correlation between per capita subsidies and per capita tax revenues was $-.36$ in 2000.)⁹²

It is important to note that the entire budgeting process excludes certain major sources of funding. One such source consists of payments made illegally or informally by individuals seeking favors or services. This includes bribes to teachers (in exchange for passing grades) and payments to physicians in return for access to public facilities. It also includes non-cash forms of compensation paid by local administrations to their staff. Teachers in rural areas, for example, are permitted to use municipal land to grow crops, as part of their compensation. Such payments do not enter into the budget negotiation process. In addition, there are also mechanisms for *ad hoc* Government grants during the course of budget execution. These include *ad hoc* allocations from reserve funds controlled by higher levels of government and so-called offset revenues used to provide supplemental funding for both specific projects and for unforeseen circumstances. Offset revenues constitutes a substantial share of local government revenue (8 percent in 2000; 9 percent in 2001; although the proportion dropped to 5% in 2002), as shown in Table 4.

D. Budget Execution

The mechanism for the release of budgetary funds is somewhat unusual, at least by the standards of former Eastern European socialist countries. One would expect that the majority of tax revenues would be paid into the

Oblast	Indicator	Taxes	Subsidies	Ad hoc Grants	Total
GBAO	avg.	3.82	11.85	2.31	17.98
	std. dev.	3.52	5.2	0.81	2.7
Khatlon	avg.	9.12	1.18	1.39	11.68
	std. dev.	9.18	1.89	1.88	9.52
Sugd	avg.	15.58	1.15	2.13	18.86
	std. dev.	15.21	1.81	1.96	15.51
Total	avg.	10.57	2.84	1.79	15.2

Government treasury, and disbursed to local governments over the course of the budget year according to their cash flow requirements. This is not the case in Tajikistan. Instead, branches of the two banks authorized to receive tax payments divide individual payments among the accounts of the Republic, oblast, and rayon/city levels as they are received. (As noted above, each level's share of each tax is pre-determined during budget negotiations.) As a result, tax revenues (even from so-called regulated taxes) never enter the treasury, except in the case of shares contributed by the three donor jurisdictions. Budget transfers to the deficit jurisdictions, as well as other forms of central government funding, do, of course, pass through the treasury.

⁹² The distribution of *ad hoc* grants, however, is unrelated to tax revenues. (The correlation between the two was only $+.05$ in 2000.)

ISSUES

A. Public Service Delivery

The quality of the public services nominally under local responsibility are in sharp decline. The coverage of basic education (compulsory grades 1-9) has been declining since the early 1990s. In 1989, the coverage stood at 94.3%. In 2000, it had fallen to 88.4%.⁹³ Men in their twenties now have only the same level of education as those in their late 50s, and less than those in their thirties and forties.⁹⁴ Women in their 20s are less educated than those in their thirties. The outlook is similarly bleak in the health sector.⁹⁵ Health facilities suffer from limited stocks of medicines and medical supplies, aging and damaged facilities, reduced utilization rates and a growing tendency for people to postpone medical care or rely on self medication.⁹⁶ Most primary health services are provided at facilities that do not meet minimal sanitation requirements.⁹⁷

Lack of access to clean water is a major cause of health problems. Only 57% of the population has access to reasonably safe water. UNICEF studies show that only 40% of Tajikistan's population uses freshly piped water at home or outdoors. Currently, approximately half of the water purification plants in the republic can not meet minimum requirements for clean water.⁹⁸ Solid waste services have deteriorated as well. According to the Urban Institute Report, lack of funds for maintenance has meant fewer trucks in operation each year, with some being "cannibalized" to keep others in service. Revenues largely go to pay for fuel and wages, and an arrears problem has developed.

It is clear that the primary cause of the collapse of local services is the dramatic decline in local revenues since the breakup of the FSU. During the late 1980s, subsidies from Moscow financed about forty percent of the Government's budget. These are now gone. The breakup of the Soviet Union also contributed to the collapse of the economy, due to interruption of trade relations between republics of the former USSR. This was exacerbated by the civil conflict (1992-1997). As a result, the revenue of subnational administrations were equivalent to about US\$ 9.00 per capita. The impact of this decline in resources is most evident in the wages paid to subnational staff. According to the Bank's recent Education Sector Review, the current salary scale for teachers in general

⁹³ Although recent data shows that coverage in basic education rose to 94.4% in 2002 from 93.2% in 2001. The situation has been similar with elementary education (grades 1-4). The data on elementary education shows that coverage increased to 79.1% in 2002 from 77.7% in 2001.

⁹⁴ World Bank, November 20, 2003, *Tajikistan Education Sector Review Meeting the Education Challenge: Policy Options for the Next Generation*

⁹⁵ While basic health indicators appear to show improvement, the data are highly suspect. Reported infant mortality dropped from 41 per 1000 in the early 1990s to 23 per thousand in 1998. Maternal mortality dropped from 98 per 1000 in 1990 to 67 per thousand in 1998.

⁹⁶ World Bank, 2000, Project Appraisal Document on a Proposed Credit...to the Republic of Tajikistan for a Project on Primary Health Care

⁹⁷ Zdravconsult Foundation, 2003, Final Report Development of Primary health Care Rationalization for Dangara and Varzob Rayons of Tajikistan, Primary Health Care Reform Project

⁹⁸ UNDP, Human Development Report 1995

education is from 11-18 Somoni (or only \$4-6) per month.⁹⁹ As a result, qualified local staff have left their profession through emigration and resort to informal sector activities. The health system, similarly, is characterized by inadequate funds to pay personnel even the minimum salaries which they are supposed to receive--health professionals now receive the equivalent of US\$ 3-5 per month.

Officials in the Government argue, almost unanimously, that the decline in public services is entirely a problem of resources. In their view, if revenues could be restored to their former levels, services would revive as well. But waiting for revenues to recover is not an adequate solution. There are two reasons. First, it is unlikely that the level of revenues available to local administrations will return to their Soviet-era levels in the near future. It is true that the economy appears to be rebounding. GDP grew 8.3% in 2000, 10.2% in 2001 and 9.1% in 2002. If these growth rates persist, tax revenues might be expected to rise accordingly. The Government, moreover, has made a specific commitment to increase spending on education and health over the next three years.¹⁰⁰ But high rates of economic growth and the Government's commitment to social spending would have to persist for decades to achieve Soviet-era revenue levels. In the interim, the Government will have to do more with less.

Second, it is unlikely that the management system of the Soviet era—based on the Communist Party's monopoly of political power—can function indefinitely in a political environment characterized by competing regional interests. There is, in fact, some reason to believe that a combination of short term technical fixes, combined with longer term reforms in the political and organizational structure of local government, would permit the Government to improve public service performance, even within its tight resource constraints.

OPTIONS FOR IMPROVING SERVICE DELIVERY

A. Budget Reform

A.1 Expenditure Issues

The present system for determining the budgets of subnational administrations suffers from four major flaws. First, the predominant item of spending—the wage bill—is determined almost entirely by inertia. Estimates of personnel costs are based on the number of authorized staffing positions which in turn largely reflects the accumulation of physical facilities over time. During a decade in which the budgets of local administrations have declined radically, one might expect an equally radical reallocation of staff. This has not occurred (except through the ad hoc, voluntary, staff departures).

⁹⁹ Actual teacher wages are higher (around 25 Somoni per month) as the multiple shift system permits many teachers to be paid for teaching more than one shift. In addition, there are a considerable number of allowances paid to teachers, including, for instance, a 30 percent incentive to teach in remote areas such as the mountainous villages of GBAO.

¹⁰⁰ World Bank, 2003, *Memorandum of the President....on a Country Assistance Strategy for the Republic of Tajikistan*

Instead the Tajik government has taken a ‘salami-slicer’ approach to cutting the wage bill, cutting the wage norm to a derisory level and thereby reducing the real wages for all staff rather confronting the need to cut specific positions.

Second, in protecting the wage component of the budget, the budget system provides insufficient funding for the materials and supplies required to make personnel effective. As noted earlier, clinics lack drugs; schools lack books; and facilities are collapsing due to lack of maintenance. The bias toward salaries in the expenditure estimation process ensures that this will continue to be the case.

Third, funding for non-wage budget items is allocated on an entirely discretionary basis. Each rayon or town’s annual funding request for materials, supplies, repairs and capital improvements is subject to discretionary decisions on the way up (through the oblast to the Ministry of Finance) and on the way down (from the Ministry of Finance through the oblast to the local jurisdiction). There is no evidence that technical criteria play a major role in these decisions.

A.2 Revenue Issues

The final problem lies in the system used to project revenues. It encourages strategic behavior (i.e., game playing) among the tiers of administration. The Republic budget is typically the loser. At present, the process of revenue projection involves complex bargaining among the Ministry of Revenues, the local tax inspection units, the local chairman, and the Ministry of Finance. Because higher projected revenues result in lower subsidies, local chairmen have a strong incentive to see the revenue targets set as low as possible. An additional incentive is furnished by a provision in the Article 17 of the Law on the Basics of the Budget System and Budget Process (LBBSBP), which states that revenues received in excess of budget projections are to be retained by the local administration, protected from seizure by a higher level of government, and are available for use according to the discretion of the local executive subject only to the endorsement necessary of the local council. In principle, the directors of local tax inspection units are subordinate to both the local chairman and the Ministry of Finance and might be expected to play a neutral role in this bargaining process. In practice (as discussed below) in such cases of dual subordination, the will of the local chairman tends to prevail. Revenues are consistently underestimated, resulting in excessive levels of subsidies.¹⁰¹

B. Budget Reform Related Options: Shifting Power to Line Ministries or Local Governments?

To address these problems, two broad strategies should be considered and the first would be further centralize the budget process. This will reduce the influence of oblast, rayon, and town chairmen in favor of the line ministries. Under this option, all regulated

¹⁰¹ One might argue that resulting increase in local discretionary revenues is desirable, as it places more resources under the control of local units of administration. Nevertheless, in a budget system that is intended to centralize control over the allocation of resources, this incentive for local administration to delude the central authorities is, on balance, undesirable.

taxes would be assigned to the Republic budget, eliminating the current system of intra-governmental negotiation over budget projections. The existing position-based system for estimating wages would be eliminated. Intra-tier negotiations over non-wage items of expenditure and over revenue projections would also go. Funds would instead be allocated among ministries on the basis of the budget process described in Chapter 4.

As described in that chapter, sectoral priorities would be determined by a strategic policy committee within the presidential administration, with senior representatives of the MOF, MOE, and key sectoral ministries (education, health, social protection, agriculture). This would provide the basis for budget ceilings for each line ministry. Line ministries would then be free to allocate their respective budgets within these ceilings, shifting funds among economic categories of expenditure (e.g., from personnel to maintenance) and among subnational jurisdictions, according to their own perceptions of priorities. Subnational chairmen would play a peripheral role in these deliberations. Allocations to oblasts, RRS, and Dushanbe would subsume within the budgets of line ministries, rather than separately identified in the budget.

This option has much to recommend it but may not be feasible to regional politics considerations. It would clearly fix responsibility for sectoral performance in the line ministries, and provide these ministries with the budget flexibility required to respond accordingly. Allocations among subnational jurisdictions would reflect sectoral priorities, rather than the existing distribution of physical facilities and regional bargaining power. Line ministries would be free to shift funding from personnel to other categories of expenditure. Intra-governmental bargaining over revenue projections would be eliminated. Nevertheless, it is not clear that this approach would suit the existing political circumstances of Tajikistan. As discussed below, the country's political stability rests on the delicate balancing of regional interests. It is not clear that the wholesale transfer of budgetary authority from subnational chairmen to line ministries at the republic level would stand the test of political feasibility.

The alternative approach would be to shift additional budget discretion to the subnational level; in effect, mimicking the intergovernmental fiscal structures of the multi-tier democracies of OECD countries, but without necessarily adopting their systems of political accountability. Under this approach, regulated taxes would be again assigned to the Republic budget and the existing position-based system for estimating wages would be eliminated. Funding for functions assigned to subnational administrations would be allocated among oblasts, rayons, and cities on the basis of a stable, readily verified formula. Local administrations would have de jure authority to reallocate funds among sectors and economic categories of expenditures according to their perceptions of local priorities.

This approach is used—with considerable local variation—in the majority of multi-tier OECD countries. Transfers financed from centrally (or provincially) collected taxes account for the majority of local revenue in Western Europe, Japan, and North America.

¹⁰² A variety of proposals along these lines have been suggested for Tajikistan. The recent study financed under the Institution Building Technical Assistance Project¹⁰³ for example, proposes a transfer system that would be financed from fixed shares of the VAT, excise, and corporate income taxes and from royalties on mineral income. The proportions of the taxes to be shared with local administrations would be determined through a central-local commission that would meet at 3-5 year intervals, along the lines of the Indian and Australian Municipal Finance Commissions. Funds would be allocated among jurisdictions on a per capita basis. At a less detailed level, the Urban Institute also recommends a more transparent, formula-driven process for allocating local shares of regulated taxes.

In theory, shifting budgetary discretion to the subnational units of administration could result in greater efficiency in the allocation of budget resources. The present expenditure estimation process places decisions over the details of budget allocation in the hands of levels of government--the oblasts and the central government--that are may be too far removed from the information needed to exercise that power intelligently. It could be argued that local chairmen are better positioned to determine how to best to allocate available resources across competing local demands—both among sectors (education or roads) and among economic categories of expenditure (personnel or supplies). Whether this effect would occur under the existing structure of subnational political accountability is not so clear. As noted earlier, subnational chairmen are presidential appointees. As such, they might be expected to carry out the president's wishes in much the same way as line ministers do. But the relationship between the presidency, subnational chairmen, and their constituencies is complex. Field interviews, as well as recent literature on Tajik politics, suggest that chairmen exercise a fairly substantial degree of autonomy within their domains.

There are two reasons for this. First, Tajikistan's current political stability rests on some respect for regional interests. In the first years of independence, politics in Tajikistan were overshadowed by a long struggle for political power. The result was a civil war that began in the second half of 1992. Although cast as an ideological or religious struggle, was in fact a conflict among patronage networks that predated the soviet breakup, most of which were formed around regional identities.¹⁰⁴ Although a 1997 peace agreement ended the war and the Government has been successful in extending its control over the

¹⁰² The U.S. is something of an outlier in this respect. Nevertheless, just over half (51%) of local (county municipal and special district) revenues (excluding fees and charges) are derived from state or federally collected taxes. Only 49 percent are derived from taxes under local control. Source: US Census of State and Local Government Finances, 2000-2001

¹⁰³ Wright (2003), op.cit.

¹⁰⁴ The opposition to the old regime found most of its support among the people from Garm and the Pamirs, both areas that previously had little access to power. On the other side, the Leninabadi nomenklatura used militias based in Kulab and Hissar to fight the opposition. As a result, the Kulabis displaced the Leninabadis as the dominant element of the coalition and remain so. See Rubin, Barnett in 'The Tajikistan Peace Agreement', Eurasianet.org/resource/regional/rubinintro.html; and Roy, Olivier, 'Interregional Dynamics of War' in ICG, www.icg.org/accord/tajik/accord10/dynamics.shtml

country in recent years, regional interests still remain strong.¹⁰⁵ Subsequent presidential (1999) and parliamentary (2000) elections have yet to fully consolidate the Tajikistani state.¹⁰⁶ As a result, decisions of presidential appointees at the local level cannot run roughshod over local interests.

Second, logistical difficulties impede the Government's ability to exercise control. The two major populated areas of the country are inaccessible to each other by land for half the year. With the collapse of road network, communications within regions--especially to rural areas--is difficult. As a result, chairmen can exercise substantial de facto autonomy within their jurisdictions—although always subject to the risk of presidential dismissal. While it would be naïve to suggest that chairmen exercise their autonomy solely to defend the interest of their constituents, increasing the budget autonomy of subnational administrations, even under the existing structure of accountability, bears consideration.

C. Mixed Systems

Mixed systems should also be considered. One of the potential drawbacks to shifting budgetary autonomy to subnational administrations is a loss of central control over spending on functions of national interest. This can be counteracted through the use of earmarking. Recent work on the education sector, for example, envisions separate lines of funding for the sector. The recent World Bank report on education in Tajikistan¹⁰⁷ proposes shifting from the current position-based funding mechanism to a capitation based funding system (i.e., one based on enrollment), while decentralizing detailed spending authority to rayons and schools. The most recent revision of the IBTA report, similarly, proposes a formula based on the number of pupils and number of schools, with additional weights for rural schools, overcrowded schools, and schools with fewer-than-average textbooks per student. Capitation based education financing systems are already employed in other former members of the socialist bloc. Lithuania introduced such a system in 2001; Bulgaria in 2002.

The Tajik Government itself has made a tentative gesture in this direction. The Government's budget instructions for 2003 require local administrations to calculate the per-pupil cost of education on the basis of the previous years' actual expenditures, adjusted for inflation. Education spending for 2003 would then be calculated by applying this figure to the number of pupils expected to enroll in 2003. This falls far short of the reform envisioned by the Bank and IBTA reports, however. Levels of per students spending would continue to vary among jurisdictions on the basis of historic costs. In any event, there is no evidence that these instructions have been implemented. Local jurisdictions interviewed for the IBTA report were not even aware that they existed.

¹⁰⁵ See for example, Dudoignon, Stephane, "Political Parties and Forces in Tajikistan, 1989-1993" in Djalili, Mahammad et.al. (eds) 1997, *Tajikistan: the Trials of Independence*, St Martin's Press, New York

¹⁰⁶ Pauline Luong, 2002, "Political Obstacles to Economic Reform in Uzbekistan, Kyrgyzstan, and Tajikistan: Strategies to Move Ahead", mimeo

¹⁰⁷ IBRD, Tajikistan Education Sector Review: Meeting the Education challenge Policy Options for the Next Generation (November 2003)

*In the health sector, the Bank's strategy for health care financing¹⁰⁸ would centralize the allocation of health care spending in the ministry of health.*¹⁰⁹ Funding for primary health care would be allocated on a per capita basis, once the facilities for universal access to primary care were in place. In principle, these approaches have much to recommend them. They would allow the Government to exercise broad policy control over the sectoral allocation of expenditure (favoring primary health care over secondary and tertiary health care, for example) and to distribute funds geographically on a uniform basis. At the same time, they would permit subnational administrations to make detailed spending decisions according to local conditions.

CENTRALIZING THE RISK OF REVENUE SHORTFALLS

Regardless of the model of budget allocation Tajikistan chooses to pursue, there is a strong case for centralizing the risk of revenue shortfalls. As noted earlier, revenues collected at subnational level are currently retained at that level (except in the case of donor jurisdictions, which retain only the share of revenue allotted to them in the budget). Any excess of actual collections over the amount projected in the budget is retained by the subnational administration. By the same token, any shortfall must be made up by the subnational administration. As noted earlier, this currently works in favor of the subnational administrations. Surpluses are far more common than deficits. But the opposite could occur. This is in fact common in the ex-Socialist countries of Eastern Europe, where under-projections prevail, and local administrations are left to scramble to cover expenditure obligations. Given the high degree of central control over the determinants of local government expenditures, this is an unworkable arrangement. In effect, the Government controls the cost of local services through its control over staff and salary levels, but deprives them of a means to adjust in the event of a revenue shortfall.

Under the existing budgeting system, there is therefore a strong case depositing all tax revenues (at least all revenues from regulated taxes) in the account of the Republic. The Government would then guarantee local administrations the level of revenue provided for in the annual budget. Under such an arrangement, the Government would retain any 'surplus' revenues (i.e., revenues in excess of projected amounts) while being obligated to provide additional funding during budget execution if and where revenues fell below the amounts budgeted amount. In effect, this would shift the risk of revenue shortfalls from local administrations onto the Government itself. As the Government is better positioned to address these risks (through changes in tax rates, for example) this shifting of risks is appropriate.

RETAINING LOCAL CONTROL OVER NON-REGULATED TAXES

Under such a system, local administrations should nevertheless be permitted some control over the yields of non-regulated taxes. Subnational administrations in Tajikistan

¹⁰⁸ IBRD, Strategy for Health Care Financing in the Republic of Tajikistan for the period 2005-2015, (2004)

¹⁰⁹ In rayons subject to oblast subordination, it would permit resources to be pooled at the oblast level.

already have fairly high degree of tax autonomy over non-regulated taxes. They can fix the rate of the retail sales tax (up to a ceiling of 5 percent); the property tax (up to one percent); and the public transportation/payroll tax (up to two percent). To varying degrees, all of these are appropriate local taxes. While the property tax is the most widespread source of local government revenue (in both Europe and Asia), retail sales taxes are common sources of local revenue in the U.S. and surcharges on payroll taxes are commonly used in European members of the former Soviet bloc. A recent IMF recommends abolishing the three taxes subject to local government rate control. Arguing that Tajikistan's tax structure imposes too many taxes on the same transaction, it recommends the elimination of taxes on individual property, retail sales tax, and public transportation tax, as well as the corporate property tax and the taxes non cotton, and aluminum.¹¹⁰ To compensate for the resulting revenue loss, the Fund proposal would expand the VAT base to include domestic sales of cotton fiber, raw cotton, and aluminum (while continuing to exempt cotton and aluminum exports). Despite the benefits of tax simplification, this proposal may be too sweeping. There is a strong case for retaining at least one of the local taxes, to provide local governments with a means of responding to local demands.

DISENTANGLING MANAGEMENT RESPONSIBILITIES

The budget is not the only source of conflict and inefficiency in the relationship between tiers of administration in Tajikistan. Ambiguities in the structure of management accountability are also a problem. Tajikistan, like other ex-Soviet countries, employs a system of dual subordination, in which the heads of the local sectoral departments report not only to the local chairman, but to the corresponding sectoral department at the next-higher tier of government. Thus the head of an education department in an oblast-subordinate rayon would report to both the rayon chairman and the head of the education department in the oblast to which the rayon belongs.

Some observes have argued that dual subordination undermines the authority of the local chairman and confuses accountability. But anecdotal evidence suggests that the writ of a Ministry does not run very far. While appointments to senior technical positions (such as Chief Medical Officer) have to be approved by the responsible ministry, the central government is *not* involved lower level staffing decisions. Thus the Ministry of Health is involved in the selection of heads of local medical departments, but has no say in the appointment of other medical staff. Nurses, for example, are appointed by the chief doctors of the hospitals to which they are assigned. Teachers, similarly, are nominated by local school directors and approved by the chief of the local education department.

Disentangling Management in Eastern Europe

Disentangling management responsibilities will become particularly important if Tajikistan shifts to an OECD-style system of subnational financing. As recent experience in Eastern Europe suggests, efforts to reform the financing of local governments can be stymied by central

¹¹⁰ IMF: Tajikistan: Strategic Priorities for the New Ministry of State Revenues and Duties. IMF August 2002

ministries' refusal to relinquish management control. As noted earlier, both Lithuania and Bulgaria have recently shifted to a capitation based system for financing primary education. In both cases, the effort was aimed at encouraging the closure or consolidation of underenrolled schools. (In theory, municipalities with too many teachers and too few students would have to consolidate classes or run out of money.) But both reforms ran afoul of Ministry of Education efforts to preserve the jobs of teaching staff. In both cases, per-pupil cost factors were ultimately adjusted to allow substantially higher payments to underenrolled schools, substantially reducing the impact of the reform

Even where ministries have de jure authority the absence of direct control over financing appears to limit their influence. Officials in the Ministry of Labor and Social Protection, for example, complain that their counterparts at the subnational level ignore them because their salaries are paid by the local government rather than by the Ministry. Physical proximity also has an effect. While heads of local tax inspection must be approved by the Minister of Revenues, the weakness of communications in Tajikistan makes it difficult for the Ministry to control them once they are in office. As a result (as noted earlier, it is the will of chairman that prevails).

The tendency of local chairmen to prevail in this dispute does not suggest the problem is solved, however. In some policy areas, the view of the ministries *should* carry the day. Recent Bank sector work, for example, suggests that Government efforts to rationalize hospital facilities and shift spending toward primary care should prevail over local efforts to keep expensive and underused hospitals open.

Finding the right balance between central control and local autonomy will require sector by sector analysis. There is an extensive—albeit inconclusive—literature on the management and financing of local government functions. It largely serves to illustrate the variety of factors subject to consideration. In education, for example, school directors can be appointed by Ministries of Education, local governments, or school boards. Any of these entities can assume responsibility for determining the number of authorized teaching positions and the level of salaries. Financing can be provided from local taxes or from transfers. Transfer can be earmarked or not. Some of these combinations work better than others. Allowing local governments to determine the number of staffing positions while requiring central governments to pay for them is likely to succeed. But the variety of successful variations among countries of Europe and North America suggests that no single combination is clearly 'best practice'.

POLITICAL AND ORGANIZATIONAL REFORMS: FEASIBLE OPTIONS

A. Empowering Local Governments

Over the long term, the Government may have to consider more fundamental reforms in the political and organizational framework of sub-national government. In the parlance of the 2004 WDR, Tajikistan's accountability framework relies heavily on the 'long route', in which citizen's demand for services are mediated through the national political system. The relationship between citizens and policy makers is itself very attenuated. In essence, the long route runs through the president himself, who is directly

elected and controls the appointment of executives at each of the sub-national levels though this practice does not differ too much from other countries in the region. The political balancing act and the need to maintain stability may constrain the choice of options and there is no easy answer at what point in time the country should switch to the “short route”.

In principle, one means to strengthen the link between citizens and politicians would be to permit the direct election of the chairman of cities and rayons. Direct election of local executives could provide citizens with both answerability (the right to assess a candidate’s record) and enforceability (vote the candidate in or out).¹¹¹ The Government, however, considers that permitting the election of chairmen at this level is too early. The current draft of the revised law on local authorities, prepared by the Presidential Commission on Local Government, submitted by the Government to Parliament, approved by the lower house and now awaiting approval by the Majlis Milli, continues to specify that the President will appoint and dismiss the chairmen of oblasts, rayons, towns, and the city of Dushanbe. While it continues to grant the local *majlis* the power to approve the President’s appointments, it permits the President to continue to nominate candidates until one is finally approved. The chairman continues to be designated the President’s representative and is granted executive authority ‘on the spot’ as well as the power to direct both the representative and executive bodies within his territorial jurisdiction.

B. Jamoats: Feasible Solution for Scaling-up Community Linked Projects

A more modest but feasible alternative would be to introduce these more direct forms of accountability at a smaller unit of administration—the jamoats, for example—and for a more limited set of functions. As noted earlier, jamoats are currently merely administrative appendages of their respective rayons. They have few functions, beyond the disbursement of salaries, and the registration of births and deaths. Jamoat chairmen, are appointed by their respective rayon executives, subject (in principle) to ratification by a assembly of representatives assembled for this purpose and then disbanded.

This would change under a proposal currently under consideration within the Government. Under the proposed revision to the law on the self government, jamoats would be established as ‘self-governing bodies.’ Each jamoat would have a council, consisting of 15 to 30 members. These would directly elected through universal adult suffrage and serve for five year terms. The council would in turn elect its chairman. Under the terms of the draft legislation, the jamoat government would have the authority to organize its own management structure, to ‘form and approve’ its own budget, and to have a ‘direct source of funding’ for this budget.

¹¹¹ World Bank, 2004, World Development Report

Whether this would result in a more efficient use of budgetary resources depends on two major factors: (1) whether democratic governance at the jamoat level would function effectively; and (2) whether gains in accountability would be offset by losses in scale economies or technical competence. It is clear that shifting power to the jamoats would bring government closer to the people in the geographical sense. Tajikistan is a largely rural country. Seventy-two percent of the population live in rural areas, scattered among 3,803 officially designated villages.¹¹² Sixty percent of the villages have less than one thousand people. Another 32% have between 1000 and 3000. Shifting decision making power to jamoats would clearly reduce the geographical distance between citizens and their governments. It would also increase the density of political representation—i.e., the number of constituents per elected official. As shown in Table 6, rayons are relatively large by the standards of local government in Europe and Japan. The average population of a rayon is 88,000; larger than any of the countries listed in Table 6, except Great Britain. Substituting jamoats for rayons (while retaining the existing city governments) would reduce the average size of a Tajik local government to 15,000. Even this is considerably greater than the average size of local governments Germany or the Mediterranean countries of Europe. In France the average is only 1,500.

Country	Average Pop.
Great Britain	126,128
Tajikistan	88,028
Japan.	36,027
Sweden	30,040
Netherlands	27,559
Denmark	18,760
Poland	15,561
Turkey	13,789
Italy	7,105
Germany	5,575
Spain	4,930
Austria	3,421
Hungary	3,242
Switzerland	2,468
France	1,580

But the effectiveness of democracy at the jamoat level remains to be demonstrated. It is likely that the prevalence of electoral fraud and the constraints on citizen access to information that exist at the national level would exist in jamoat elections as well. Local politics, moreover, are equally vulnerable to capture. In some parts of Latin America and South Asia, large rural landowners dominate rural politics. While Tajikistan has yet to develop its own class of feudal landlords and *latifundistas*, field interviews conducted for this report suggest that the managers of the former collective farms (now nominally designated as chairmen of dekhan farmers associations) may enjoy the same advantages. Under these conditions, it is not obvious that local elections would substantially improve answerability or enforceability. Interviewees also suggested that appointed rayon chairmen are likely to continue to interfere with jamoat decisions, despite the nominal separation of two forms of administration.

Whether gains in accountability would be offset by losses in scale economies or technical competence is equally hard to demonstrate. International technical analyses of optimal local government size have been scarce and inconclusive. A major study (1966-69) by the British Government¹¹³, for example, concluded that “the general impression

¹¹² This figure is from the World Bank indicators for 2002. A detailed breakdown of the urban population by city (in Urban Institute, op.cit.) suggests that the rural population is 80% of the total.

¹¹³ Royal Commission on Local Government in England

(the Commission) gained was of the difficulty of establishing a demonstrable relationship between size and performance. Scale appeared to have little measurable relationship with performance except in certain fairly limited fields such as management aids and some aspects of education, childrens' homes and the mental health services." More recent studies have produced similar conclusions. A 1992 study by the British Audit Commission found that "although there may be some relationships between size and efficiency, which for particular services/functions give encouragement to both large and small authorities, the overall picture gives no leads in either direction. Much more important would seem to be the quality of process and management which makes the difference between authorities."¹¹⁴

Empirical evidence for specific sectors is only slightly more helpful. In primary education, scale economies are most demonstrable at the classroom level, where higher pupil:teacher ratios result in lower per-pupil costs. But primary classrooms can be filled from relatively small population pools. Given the current age composition of Tajikistan's population, a primary school (grades 1-4) could achieve an average of 30 pupils per class from a population base of about one thousand. It is only at the secondary and upper secondary levels (where classes are differentiated by subject and teachers are not permitted to teach more than one subject) that larger pools of population are required to achieve efficient class sizes. Even this constraint can be overcome if small jurisdictions are willing to send students to schools in larger neighboring jurisdictions. Diseconomies of scale are likely to be apparent in the health sector, where the scarcity of trained medical staff and the high cost of sophisticated equipment demand large population pools in order to ensure full-time use. Jamoats would have to agree on the location and financing of secondary care facilities and cooperate closely to ensure that referral hierarchies function effectively.

On balance, while decentralizing major government functions to jamoats would have trade-offs, the situation on the ground, with US\$10 per capita spending at sub-national level, would justify the efforts. While the losses in scale economies may not be large, the burden of increased coordination and the difficulty of attracting qualified staff may be significant. The current draft of the law on local self government is consistent with this view. In effect, it proposes virtually no expansion in the functions assigned to jamoats. They would continue to perform their existing administrative roles. While the law leaves the door open for jamoats to take on other functions "delegated by the normative and legal acts of the Republic" it does compel them to do so. On this basis, the proposed reform is worth supporting.

Developing a strategy to scale-up resources going to Jamoats can attract additional donor resources and support the government's PRSP at the community levels. Within the context of the proposed law, the government is already considering ways of scaling-up programs that could be implemented at the community level, or the Community Linked Development (CLD) projects. While a number of donors are already implementing similar projects, resource flows under these projects are not large enough, given the needs, and furthermore sustainability of some of these projects could be an

¹¹⁴ The Audit Commission, August 1992.

issue. Scaling-up CLD projects initially with donor funds and after developing capacity, annual transfer of funds from the budget would go a long way for sustaining projects at the jamoat and/or local government level. At present most jamoats are financially and institutionally weak, so the challenges of building capacity and downward accountability will be large and long-term. However, if developed and implemented such a scheme would be a powerful instrument of reaching to poor communities and demonstrate the benefits of foreign assistance and deliver the much needed key public services as well increase donor disbursements.

PUBLIC INVESTMENT PLANNING AND PROCESS

INTRODUCTION

The initial review of public capital expenditures in earlier chapters have shown that they are highly fragmented and not guided by a single development strategy. While attempts to improve Tajikistan's public investment planning and process have gathered pace in 2003, the fragmentation of public investment funds continue and this undermines the overall management of public expenditures. The extent of fragmentation is a source of concern as this situation has been negatively affecting the quality of the PIP process and its alignment with the macroeconomic framework. Besides combining both budget and off-budget elements such as the externally funded PIP, even the on-budget components are financially fragmented. As shown in this chapter the institutional fragmentation of the process is the primary reason for this outcome. Different organizational units in the Government, the MOET, and the MOF are responsible for the PIP, domestic capital investment, and other capital expenditures. A more fundamental problem, however, is that there is no single strategy guiding the PIP planning and process and it is not clear whether the PIP is driven by the SEDP or the PRSP. This situation makes it difficult for the government to communicate its priorities to donors which in the past have contributed to low donor disbursements.

Given this situation, the focus of this chapter is on the institutional framework for existing on and off-budget windows through which capital expenditures in the public sector are financed. In order to determine weaknesses institutional arrangements for each window are reviewed and consistency with main principles of capital expenditure budgeting are considered. In order to provide a thorough assessment and to provide a context, institutional evolution of some capital expenditure programs will be presented along with description and evaluation of recent Government initiatives with respect to PIP budgeting. The review follows stages of the budget cycle: from the stage of aligning public investment programs with strategic development objectives of the country, to the stage of program control and post-evaluation. In this way major weaknesses are identified and deficiencies in the budgeting of capital expenditures at subsequent stages of the budget process are discussed. Each window is discussed separately, followed by a summary of main issues important for the whole portfolio of public capital expenditures with policy recommendations and a capacity building package that would be funded by donors.

EXTERNALLY FUNDED PUBLIC INVESTMENT PROGRAM

A. Objectives of the PIP

The main purpose of the public investment programming is twofold. First, it serves to link the public investment program with a medium-term fiscal framework so that it debt and budget deficit constraints are taken into account. In turn, public investment programming provides a feedback for medium-term macroeconomic and fiscal

projections through accounting for the multi-year nature and recurrent cost implications of investment. Second, it helps in transforming strategic development priorities into capital resource allocation across sectors to produce a coherent program of development comprising of specific investment projects in the public sector. In the case of Tajikistan, it is not clear whether this “coherent program” is the PRSP or the SEDP and the government needs to clarify which development program corresponds to its objectives.

Public investment programming has to be an integral part of the budget process. This work has to be done annually, concurrently with the budget, and has to incorporate externally funded public investment portfolio into the budget process. This is a mechanism, through which public investment programming can streamline capital budget allocations of domestic and external resources across all sectors as well as prioritize budget allocations for public investment. The size of public investment program is constrained, on the one hand, by the fiscal, borrowing, and absorptive capacities of the Government, including the allocation of required counterpart funding for project co-financing, and, on the other hand, by the availability of donor programs and the match between government and donor priorities. The main principles of public investment programming are presented in Box 1. They will be used as the benchmarks, which the existing procedures and practices are compared with.

Box 1. Public Investment Programming Framework

Strategic prioritization

Projects are a part of the overall development strategy and the government must allocate available resources between sectors and programs. Prioritization criteria include: (a) consistency between sector and sub-sector allocations with government strategies; (b) appropriateness of the investment program for the socio-economic environment; (d) compatibility with macroeconomic framework; and (d) adequate consideration of externalities.

While identifying priorities, the following key elements of investment programming should be taken into consideration: (a) clear definition of objectives; (b) assessment of resource mobilization capacity; and (c) alternatives of using resources and achievement of objectives.

Process of public investment programming

The process of public investment programming includes three main steps: (1) project selection and overall investment programming; (2) project preparation and appraisal, and (3) monitoring and evaluation. The project cycle includes identification, preparation and appraisal. Project identification is normally carried out by line ministries and precedes the public investment programming process. The first two steps of the process should not be confused. Sound investment programs require good projects and the preparation of good projects requires sound investment programs, but investment programming must be set in a broader policy-focused framework than the isolated analysis of investment projects.

Effectively organized preparation process for public investment programming is similar to the medium-term planning combining: (a) top-down approach in definition of investment packages which are in line with government strategies and fiscal targets; (b) bottom-up approach of submitting project proposals by line ministries; and (c) converging both onto a program which is vertically and horizontally consistent with policy and financial means

B. The Institutional Analysis of PIP

*Historically, PIP preparation was an ad hoc exercise, done outside the regular budget process for the scheduled meetings of the donor Consultative Group (CG).*¹¹⁵ Following the frequency of CG meetings, PIP was prepared every three years. The usual practice has been to establish a working group was established for PIP preparation, which was disbanded once this process had been completed. In all cases PIP was developed under the technical assistance of either UNDP, World Bank, or Asian Development Bank. PIP evolution in detail is presented in Figure 1.

¹¹⁵ Public investment programs for 1996-1998, 1998-2000, 2001-2003 and 2004-2006 were prepared by the Government of Tajikistan for CG meetings that took place in October 1996, May 1998, May 2001 and May 2003 respectively.

Figure 1. TAJIKISTAN: Public Investment Programming Evolution

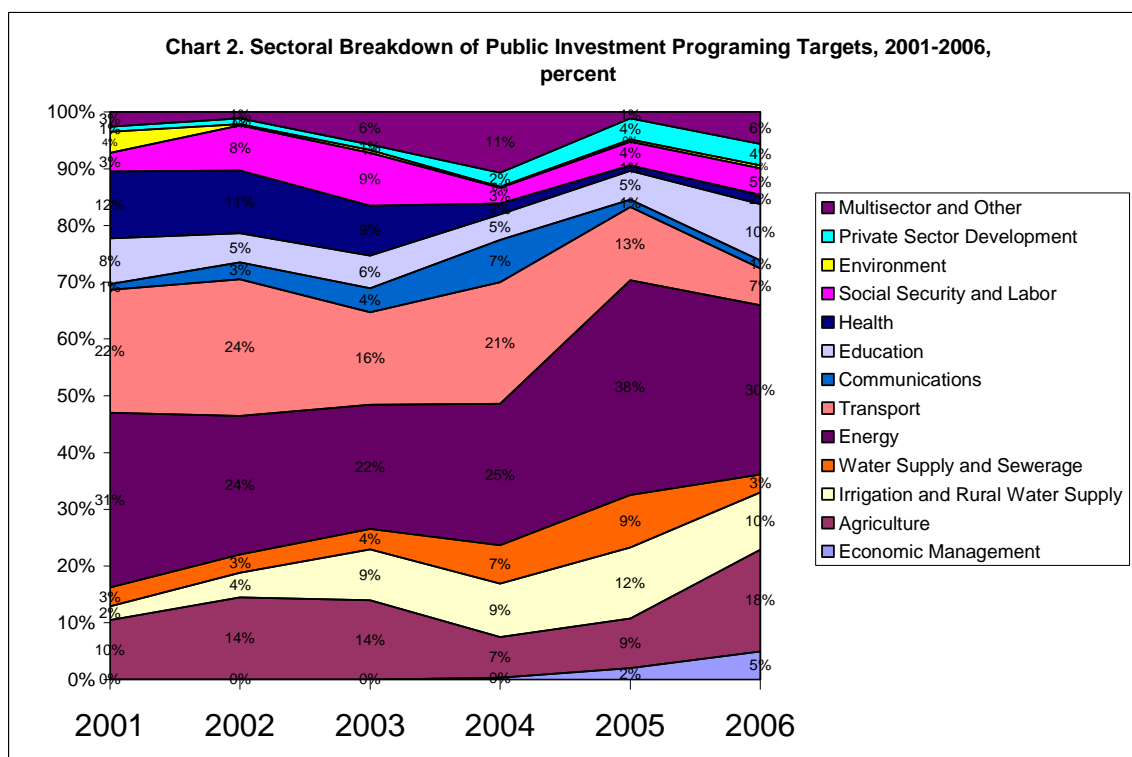
	PIP 1996-1998	PIP 1998-2000	PIP 2001-2003	PIP 2004-2006
GENERAL INFORMATION: A. Number of Projects B. Total Cost C. Average Project Life Cycle D. In percent of GDP	A. B. C. D.	A. 27 Projects B. USD 417.6 million C. 3.75 years D. 6.9 percent	A. 26 Projects B. USD 475 million C. 3.2 years D. 7.4 percent	A. 44 Projects B. USD 638.2 million C. 4.25 years D. 5.1 percent
GENERAL POLICY FRAMEWORK: E. Budget Envelope - resource allocation is in line with government priorities and sector policies and strategies F. Macroeconomic Targets - PIP is consistent with fiscal targets and programming constraints including counterpart funding and absorptive capacity G. Consistency of Planning and Budgeting - there is a strong linkage between planning and budgeting H. PIP Cycle - PIP is prepared on a rolling basis and covers three or four years with costing table by years and sources. I. Coverage - PIP covers investments by central government and investments by public entities that are financed fully or partly by central government. J. "Core" and "Non-Core" Program - Sometimes both "core" and "non-core" PIPs are prepared. It skirts hard choices and increases the risk of including bad projects.	E. The PIP had been prepared for Oct-1996 CGM in Tokyo. "Needs"-based PIP with no clear principles of prioritization. F. No macro- and fiscal targets. G. Actual financing was minimal - only projects with identified donor commitments are funded (WB, IMF), while donors had pledged US\$185 mln incl. BOP support. H. A three-year program I. PIP was limited to projects which donors most likely were to finance. Projects being funded fully by the government had not been included in the PIP. J. No splitting into "Core" and "Non-Core" programs.	E. The PIP was prepared for May-1998 CGM in Paris. "Needs"-based PIP with no clear principles of prioritization. F. No macro- and fiscal targets. Too ambitious program. G. Donors committed \$ 75.2 mln (20% of target) while \$352 mln had been committed under non-PIP projects H. A three-year program I. PIP was limited to projects which donors most likely were to finance. Projects being funded fully by the government had not been included in the PIP. J. The PIP was splitted into "Core" and "Non-Core" programs. None of "Non-Core" program projects (4 projects, 35% of proposed portfolio) received funds.	E. Very conceptual prioritization. Prepared for May-2001 CGM in Tokyo. F. No macro- and fiscal targets. Does not consider fiscal constraints as well as absorptive capacity. G. Donors committed \$ 281.9 mln (45% of target) excl. BOP support. Most of externally funded projects are covered. H. A three-year program I. PIP is limited to projects which donors most likely were to finance. Projects being funded fully by the government had not been included in the PIP. J. No splitting into "Core" and "Non-Core" programs.	E. Prioritization is based on MBTF and PRSP. Prepared for May-2003 CGM in Dushanbe. A bit realistic resource envelope. F. Fiscal constraints are taken into consideration. G. Donors committed \$ 900 mln. All externally funded projects included. H. A three-year program I. PIP was limited to projects being (and to be funded) by donors. Projects being funded fully by the government had not been included in the PIP. J. No splitting into "Core" and "Non-Core" programs.
INSTITUTIONAL FRAMEWORK K. PIP intergration into budget - PIP is fully integrated into capital expenditures component of the budget. There is no practice of having non-PIP portfolio. L. Institutional Capacity - There is an agency responsible to coordinate the whole PIP process without overlaps and duplication of responsibilities. Neglected areas are minimized. The agency oversees the implementation and provides technical assistance in PIP monitoring M. PIP Preparation - There is a sound and transparent decision-making process is in place. Projects are prepared and screened at sectors level and converged with government policy objectives and strategies. N. PIP Monitoring - Adequate institutional framework to monitor PIP implementation is in place. Ideally this should be a continuous work to follow-up on donor pledges and keep PIP updated on an annual basis O. Timing - Feasible and realistic timing. The best practice is having the program prepared a year before the first year of next PIP starts. P. Disbursements - The first year of PIP includes only those projects for which resources are committed. The second year includes those projects for which financing has clearly been identified. The third year holds projects for which funding is probable. One has not to raise high expectations in terms of possibility of external financing. Q. Methodology - There is a clear methodology for economic analysis of projects. No commitments are taken for projects that have not been studied.	K. The PIP is not intergrated into budget and no funds budgeted for co-financing. L. PIP was developed under general coordination of Ministry of Economy . Later, newly established ACU was charged to follow up on donor pledges. Due to lack of coordination among ministries, Government failed to establish a system to oversee the process M. No clear PIP process as well as project preparation and screening. Prepared under external TA based on immediate post-conflict needs. N. PIP had been "strictly" a three-year document with no update in each budget cycle. No adequate monitoring system. O. Prepared in mid of second half of the year of when PIP started which made the program unrealistic in terms timing. P. New projects dominated in the PIP except projects to be funded by the World Bank. Cases of including disbursements of projects without donor commitments dominated which made the program unrealistic in terms disbursements. Q. Lacked project analysis in most cases. Costing was questionable.	K. The PIP is not intergrated into budget and no funds budgeted for co-financing which caused delays in donor disbursements. L. PIP was developed by a working group which was disbanded once PIP preparation process completed. M. No clear PIP process as well as project preparation and screening. Prepared under external TA. N. PIP had been "strictly" a three-year document with no update in each budget cycle. Monitoring had need-to-do nature. Non-PIP projects dominated in actual portfolio. O. Prepared in the same year when PIP started which increased the risk in terms of realistic timing. P. New projects dominated in the PIP (14 out of 27); the rest had been receiving very modest funding from budget. Out of 14 new projects only 5 had resources committed by donors, while PIP proposed that 27.5 percent (weighted average) of resources to be disbursed in the first year. Q. No project analysis. In many cases costing was questionable.	K. Government started to exercise budgeting funds for co-financing. However, PIP was still not fully integrated into budget process, projects funded domestically were still "kept away" from PIP. L. PIP was developed by a working group which was disbanded once PIP preparation process completed. M. Still there is no system to manage the whole programming process. Preparation and screening is mostly coordinated with donors. Prepared under external TA. N. PIP was being updated depending on the developments of donor programs, not systematically. Monitored on need-to-do basis. O. Prepared in the same year when PIP started. P. New projects dominated in the PIP (32 out of 44); the rest had been receiving funds from donors. Out of 32 new projects only 18 had resources committed by donors, while PIP proposed that 14.6 percent (weighted average) of funds for new projects would be disbursed in the first year. Q. Economic analysis of externally funded projects are handled by donors.	K. Co-financing included in budget process. Projects funded domestically are still not in PIP basket. L. PIP was developed by a working group supervised by MOET. Units within MOET and MF are established to coordinate preparation and financing of PIPs accordingly (under ADB TA). M. PIP Unit within MOET was to coordinate PIP preparation process. For recent PIP projects preparation and screening had been handled by donors. PIP was prepared under external TA. N. PIP Unit in MF is charged to take the responsibility of monitoring PIP in terms of budgeting O. Prepared a year before the first year of next PIP starts (more realistic scenario). P. On-going projects dominated in the PIP (25 out of 44) which were being funded by donors. Out of 19 new projects 8 had resources committed by donors Q. Economic analysis of externally funded projects are handled by donors during feasibility studies (mostly under TA).

B.1 General Policy Framework: Strategy and Sustainability

Initial PIP policies were ad-hoc and aimed to obtain maximum financing from donors and they were out of line with the macroeconomic framework. In order to cope with consequences of the collapse of the FSU and the civil conflict, the Government pursued a policy that aimed at maximization of the amount of donor financing for its public expenditures without having any strategy. As a result, the public investment programs were prepared outside the regular budget and without considering fiscal and debt implications of government's borrowing. It follows from the previous analysis in Chapter 2 that in the past the size of public investment programs permanently exceeded the country's fiscal absorptive and management capacities. The inability to provide sufficient counterpart funding coupled with the limited absorptive capacity resulted in low implementation rates of the programs, which averaged just 20 percent in 2001-2002. PIP

In contrast with earlier externally financed PIPs, the PIP for 2004-2006 for the first time has a disbursement limit of three percent of GDP per year as a step in implementation of its External Debt Reduction Strategy. As reported in the PIP for 2004-2006, besides debt considerations, the last PIP an attempt has been made to take into account the level of general budget revenues affecting the capacity to allocate counterpart funds, future recurrent costs of PIP projects, and the limited institutional capacity of the Tajik authorities to effectively absorb the resources. However, while this is to be welcomed, due to low institutional capacity the process has not been very effective and such estimates are not in the budget. In terms of strategic prioritization, the first three of the PIPs, that covered the periods of 1996-1998, 1998-2000, and 2001-2003, had only some elements of a strategic decision-making. The PIP for 2001-2003 was based on the vaguely defined strategic principles. The new PIP for 2004-2006 differs in that respect as the authorities attempted to link with PRSP although it is not clear to what extent this represents a strategic decision of the government as the SEDP still forms the basis of the PIP.

A closer look at actual sector allocations and priorities in the PIPs reveals a shift in government's priorities from social sectors to infrastructure sectors at the program level. While the PIP for 2001-2003 envisaged the biggest allocation of resources to the energy, transport, health and social protection sectors, in the recent PIP for 2004-2006 the shares of energy, transport, and agriculture sectors are the largest (see Chart 2). This shift may compromise the poverty alleviation objective of the PRSP and the PIP, because it means that new projects in social sectors will have to be crowded out. As far as CSIP is concerned, planned allocations almost coincide with actual allocations. The reason for this is that planning horizon is limited to just one year and the CSIP planning is done as part of the annual budget cycle.



At present, the PIP does not fully reflect the multi-year nature of investment projects and future recurrent costs and the process is not linked to the macroeconomic framework. The PIP document still represents a three-year project list of the Government partially secured with donor funding and it is much more closely related to the SEDP than the PRSP. While it includes most ongoing PIP projects and new projects, the recurrent costs that should be factored into the budget for operation and maintenance (O&M) have not been accounted for as reported in project information documents submitted concurrently with the PIP. Thus, the process is not related to the macroeconomic framework nor the determination of the appropriate resource envelope. However, the positive development is that the PIP for 2004-2006 has some interlinks with the annual budget process and an attempt has been made to link it to the multi-year presentation of the budget. Furthermore, the fact that there is a ceiling of 3 percent of GDP for debt funded PIP projects imposed on annual disbursements makes it necessary to annually review the ongoing PIP for its compliance with the ceiling, and to revise it appropriately.¹¹⁶

Coverage of the PIP has improved. Since the period of 2001-2003, the PIP includes all foreign-financed credits (excluding adjustment lending for general budget support) to the government of Tajikistan and some of the grants and TA funding provided by donors. However, there are still large number of projects funded by grants and TA remaining

¹¹⁶ The amount of donor commitments under the PIP on both ongoing and new projects for 2004 is about 8.0 percent of GDP. This suggests that a significant downsizing of new projects in the pipeline will be required.

outside the PIP envelope, in part due to lack of donor coordination and lack of capacity on the part of the government. While the recent establishment of the Aid Coordination Unit (ACU) may help, it is not clear if this will be the solution as the preparation of the PIP is still institutionally fragmented. The PIP also includes counterpart funds to be provided by the government but the fact that there are a large number of projects outside the PIP planning process, it is not entirely clear if the amount shown in the budget represents the actual amount of counterpart funds provided by the public sector.

The PIP is not integrated into the budget. It is prepared separately from the budget cycle and it does not appear in the annual budget laws, except for its co-financing from the budget. Largely, PIPs are still plans with a fixed three-year horizon that are prepared episodically for the external audience. The experience with PIPs discussed in Chapter 2 showed that the macroeconomic framework for PIP development is inadequate, making PIPs unrealistic. The government has only recently began to report PIP projects to the Parliament *concurrently* with the State Budget Law though as a detached document. The PIP, being prepared and implemented outside the Government's budget, contributes to the institutional fragmentation of public capital expenditures. As a result, the two biggest expenditure windows, domestically funded CSIP and externally funded PIP, are kept apart as separate parallel processes. Furthermore, the counterpart funding of PIP is institutionally separate from CSIP. This complicates PIP preparation and implementation. As the process is not linked to any MTBF process neither the external debt implications and counterpart fund needs are adequately factored into the regular budget process, which results in counterpart fund shortages, a permanent bottleneck for the implementation of donor projects.

Thus, the PIPs, to a large extent, were not consistent with the main principles of public investment programming. Specifically: (a) the size of public investments was not linked to macroeconomic targets and a medium term budget framework; (b) the PIPs were out of budget and regular budget process;¹¹⁷ (d) lack of clear prioritization of the limited public investment envelope; (e) the amount of investment in PIPs was substantially larger than the amount estimated in the annual budgets; and (f) PIPs had inadequate coverage in terms of donor funded credits and grants, domestically funded investment programs are not a part of PIP.

¹¹⁷ With exception of counter-part funding provided by the Government

B.2 PIP Preparation Process

Project selection is becoming more structured. With Government Decree “On procedures of external borrowing and publicly guaranteed loans” in effect, prioritization exercise is to be made during every PIP cycle (see Box 2). It is to be based on the following conceptual principles: (a) *strategic importance*, i.e. whether a project supports strategic development priorities of government; (b) *role of government*, i.e. whether a project should be financed by the private sector or government taking into account their roles in a market economy; (c) *economic justification*, i.e. whether all project’s costs and benefits are identified, and the project appears to be economically viable; (d) *poverty impact*, i.e. whether the poor benefit from the project, and (e) *financing sources and sustainability*. In addition, while doing project selection government is to take into account the results of *social and environmental assessments*, i.e. whether social and environmental impacts have been properly considered; and, *institutional capacity assessment*, i.e. whether an implementing agency can implement the project. Reportedly, these principles are adhered to in preparation of the PIP, although the lack of developed and approved methodology for project selection makes a rigorous application of the aforementioned principles virtually impossible.

Box 2. Main provisions of the Government Decree “On procedures of external borrowing and publicly guaranteed loans” (Adopted Sep. 21, 2001)

- The principles of external borrowing and project selection include: (a) attracting credits on concessional terms; and (b) accounting for debt-service capacity of the Government without a risk of undermining its fiscal sustainability; (c) granting guarantees on a competitive basis.
- Ministry of Economy is in charge of initial review and screening of application package. It submits its recommendations to an Interdepartmental Commission, headed by the Ministry of Finance, for the final review. The Commission signs agreements on external borrowing further to the Government’s authorization.
- The ceiling for public guarantee is limited to 125% of applicant entity’s assets.

Project proposals reviewed are indicative of capacity constraints at the line ministries.

While the government has been attempting to improve project preparation and selection, initial screening of projects has shown that the quality of project proposals prepared by line ministries is low. In most cases they were poorly formulated and were not backed by economic analysis. Projects had unrealistic project costs estimates and appeared to be too ambitious in terms of financing needs, going much beyond the Government’s fiscal capacity (for example, during PIP 2004-2006 preparation process, more than fifty new projects had been submitted and survived initial screening, which totaled almost \$800 mln).

PIP budgeting and implementation has been ad hoc and there have been important process gaps. Since PIP is prepared separately from the budget it is only sent to the MOF at the end of the budget process with the expectation that all included projects would be financed. Once received by the MOF, the PIP unit played the key role in the preparation of *annual* budget allocations of counterpart funding for the PIP. This process usually involved and still involves reducing the PIP substantially but without due to attention to priorities and without clear criteria. In its decision-making one rule that the PIP uses is

the size of the projects. The unit generally ensures that small projects in the PIP would receive sufficient amount of co-financing, and ‘savings’ are typically made on the bigger and more expensive projects. Once this is done, the Government normally agrees with the position of the MOF. For instance, in 2003 budget cycle the Government approved the estimate of co-financing needs made by the PIP unit of the MOF without any revisions.

The recently introduced annual ceiling on the PIP disbursement of three percent of GDP, while working as a fiscal restraint, augments existing institutional weaknesses.

Despite that this ceiling has not been reached in the past, it promotes perverse budgeting practices, which result in the efficiency losses. Controlling *disbursements* without (and instead of) controlling *commitments* necessarily means the artificial slowing down of implementation of approved projects. This happens through hampering procurement, delaying clearance of project documents, and other means. In the end, projects become more expensive and take more time for completion. Clearly, economic and financial return on PIP projects decreases as a result and it appears that reviewing commitment situation and considering the implications of projected commitment would be one of the key measures the government could take. However, this would require capacity building at the MOF and closer coordination with donors. More importantly, this is an issue of the overall resource envelope requiring the involvement of key policy making bodies and not just the MOF.

Financial control and monitoring of the use of counterpart funds are weak and there are classification issues.

The Treasury of the MOF exercises its control over disbursement of counter-part funds from the budget to the special accounts of PIUs, but not beyond. The Treasury issues the entire amount of counterparts allocated for projects to respective PIUs without further involvement in the management of funds. Apart from accountability issues involved in this process, one problem this leads to is related to that of classification. While labeled and counted as investment, not 100 percent of spending under the investment projects included in the PIP represents capital expenditures. Typical credit or grant allocations include operating expenses for credit/grant management. Often they also include purchases of goods and services that are current expenditures. The other issue is that in fiscal accounts government co-financing of the PIP is shown as ‘other recurrent expenditures’, despite the bulk of it is provided for capital expenditures. The difference between the budget classification, that broadly follows GFS principles, and the classification of expenditures used by foreign donors, makes it technically difficult for the Government to collect required data and present the whole public investment envelope in line with GFS singling out capital expenditures.¹¹⁸

The MOF and the MOET supervise PIP project implementation. This supervision is done at the level of the overall portfolio and on a project basis depending upon project implementation reports they regularly receive from PIUs, usually on a quarterly basis. In addition, procurement and financial management issues are coordinated with the MOF and the MOET on the ongoing basis. Representatives of both ministries also participate in tender commissions formed for awarding contracts under PIP projects. This gives the

¹¹⁸ At the same time, the Treasury quite successfully breaks PIP co-financing down by functional and ministerial classification.

government another opportunity to control project implementation including large expenditure commitments. A contracted company with participation of technical experts from a beneficiary ministry exercises the quality control over works completed and services rendered under PIP projects, which seems to be a good arrangement. Besides, the ACU under the Government arranges for regular discussion on projects and reports with PIUs management.¹¹⁹

Existing reporting requirements for PICs look excessive. First, reports have to be submitted to multiple addresses, overall there are about *twelve* government agencies and a donor organization. Secondly, there are different reporting formats established for reports to the MOF, the MOEDT, the ACU, other government agencies, and donors, while about 70 percent of information provided is the same. Hence, it seems that while the supervisory arrangements at the technical level appears to be satisfactory, the monitoring arrangements need to be reviewed and simplified.

B.3 Recent Developments in PIP Process and New Institutional arrangements

The adoption of a the new public finance law in 2002 is expected to lead to improvements in the PIP process. Following the Law of the Republic of Tajikistan “On State Finance” and the Government Decree No. 33, of May 13, 2003, in order to move to an MTBF basis for the budget, the MOF issued a Budget Circular for 2004 annual budget. As noted in Chapter 4, the objective of the Circular is stated to: (a) establish a link between government policy, priorities and the budget, (b) make a linkage between program performance and funding, (c) identify priorities by sectors, (d) integrate PIP into the budget, (e) ensure effectiveness and efficiency as well as development of the more realistic budget document for the following three year period.

The Government is taking the initial steps to align the PIP and budget cycles. The 2004 budget circular asked information and preparation of submissions for request on the MTBF basis, including the PIP. These were provided by the line ministries and the MOF made an initial assessment of these requests. However, in part due to capacity constraints and in part due to lack of priority setting mechanisms starting the process of integration of the PIP has been delayed. The PIP for 2005-2007 is expected to be prepared with budget cycle and include a forecast of expected disbursement is made for another two years. If implemented, this development would help the Government to have more realistic PIP, which would be better coordinated with budget policy and Government priorities. The 2004 budget circular issued by the MOF specifies in detail actions to be taken by budget funds recipients. Table 1 briefly describes how the whole PIP process should look like when provisions of the Circular are implemented. In principle, this would mean integration of the PIP into the budget though this process will take some time. The discussions with the relevant staff at the MOET and MOF suggests that there is a need for considerable capacity building for the achievement of this objective.

¹¹⁹ Existing institutional framework entails a significant risk of overlap in the activities carried out by ACU, the Ministry of Economy, and the Ministry of Finance. ACU’s role frequently goes beyond its main responsibility – country promotion and building government-donor relations.

In order to enhance the institutional capacity of the Government to develop and implement PIP, several organizational units have been recently established but this has not led to a well formulated PIP. These include: Public Investment Management Unit set up in the Budget Department of the Ministry of Finance (PIMU), and the Public Investment and Technical Assistance Program Unit set up in the Ministry of Economy and Trade (PITAPU).¹²⁰ The government has also decided that the ACU would support this process. The units in both the MOET (PITAPU) and the MOF (PIMU) were established on the eve of the last CG meeting in May 2003 and are not fully operational. The Charter of the new unit in MOET is still to be formulated, and staffing of the unit has just recently begun.¹²¹ While these new structures has improved the situation and the 2004 PIP was reduced in size lack of a clear policy and strategic guidance continues. Hence, despite slight downsizing of the PIP for 2004-2006, it would be very difficult to achieve still ambitious program targets given limited budget capacity to co-finance US\$275 mln worth donor disbursements stipulated in the PIP. As for the CSIP, the lack of linkage between overall public investment programming objective and PRSP targets remains the main source of concern. Moreover, CSIP budgeting process is still heavily dependent on Government's ad-hoc decisions which is discussed in the next section.

¹²⁰ PITAPU is established in addition to the already existing Capital Investment and Municipal Housing Department in the MOET (CIMHD) that is responsible for non-PIP capital investment (CSIP), fully financed by the state budget.

¹²¹ Staffing plan envisages seven staff members. As of August 2003, three staff members including Head of the Unit are hired, two more recruitments were still underway.

Table 1. Public Investment Programming Process

	Sequence of Steps	Responsible Body¹²²
Step 1	Setting up general macroeconomic framework and fiscal targets and aligning PIP priorities with PRSP and MTBF.	Government, MOET, MOF, NBT, Budget Committee of the Parliament
Step 2	<u>Prioritization across all sectors.</u> All Key Budget Organizations (KBO) ¹²³ to submit Sector Strategy form describing current plans, medium- and long-term sector needs, priorities and strategies for the development of the sector.	MOET in collaboration with MOF and Government. KBOs
Step 3	<u>For new PIP:</u> the MOET to collect applications from budget recipients – line ministries and other Government Agencies. Sectoral ministries to provide with brief outline of medium-term sector policies and strategies. <u>For ongoing PIP:</u> the ACU and PIUs to provide with project implementation reports which include: (a) implementation progress report for past period; (b) expected disbursement schedule and revised procurement plan; (c) needs for counterpart funding for forthcoming fiscal year, and (d) any other information relevant to project implementation	MOET, line ministries, ACU, PIUs
Step 4	<u>For new PIP:</u> Initial project screening. Revising funding priorities with line ministries (and other stakeholders, including donors) <u>For ongoing PIP:</u> On-going projects are subject to implementation analysis. More realistic disbursement scenario is worked out depending on: (a) absorptive capacity of PIUs to use funds; (b) budget constraints on co-financing; (c) revised procurement plan	MOET, PIUs, ACU, line ministries
Step 5	Protected expenditure categories (which are give a priority in allocation of budget resources) are decided on in the state budget. Such expenditure categories at present include social payments, pensions, salaries, debt service, etc. Capital expenditures component of the budget is identified on a residual basis, after funds are allocated for protected categories. Therefore, PIP budget envelope depends on: (a) revenue generation capacity of the government; and (b) financing of protected expenditures. Revised version of PIP is prepared and approved by the Government and the Parliament. This includes resource allocation for following fiscal year and allocation forecast for another two years.	MOF and MOET, line ministries, PIUs, ACU
Step 6	<u>PIP monitoring process:</u> The frequency of reporting is increased: PIUs to submit reports on a monthly basis (in addition to regular quarter and annual reporting). Based on project implementation progress during fiscal year, the MOF and the MOET may propose funds reallocation between programs and projects within the limit for capital expenditure component. It is to be done along with other revisions to the budget. Those proposals are subject to Government's approval. Providing inputs for revising the PIP in the following budget cycle.	MOF, MOET, PIUs, ACU, line ministries, donors

¹²² A Ministry/Agency listed first has the primary responsibility for any given action.

¹²³ Include 89 governmental organizations: ministries, committees, research and academic institutions, which are direct budget recipients.

Box 3. Institutional Setup for Foreign Financed PIP in Russia

While many institutional weaknesses intrinsic to Tajik PIP also exist in Russia, it has more advanced regulations and procedures governing foreign financed PIP and integrating it in the budget. First, foreign financed investment loans are consolidated in the budget: loans disbursements are planned and reported under the respective expenditure categories in the budget and also mirrored below the line as a source of financing. Secondly, the Russian government carries out a policy of channeling most of its fixed capital investment through federal targeted programs (FTPs). They are multi-year programs, typically combine investment spending with necessary current expenditures, including R&D, and aim at linking resources with objectives and outputs in a particular sector. Joint investment projects with IFIs increasingly become a part of such FTPs.

Organizationally, in order to coordinate World Bank investment portfolio, a special Working group is set up. It consists of representatives from the MOF (Department for foreign debt and collaboration with IFIs), the Ministry of Economic Development and Trade (Department for programs and collaboration with IFIs), the Federal Center for Project Financing, a government owned company, which has to monitor implementation of the project portfolio, and the WB. At the startup phase, the Working group reviews initial project proposals submitted by line ministries and WB sector teams and makes its recommendations to the government regarding including projects in the portfolio

The roles and functions of the newly created units would need to be better clarified. While the MOET and the MOF staff believe that there is no overlap and duplication, the existing legal and regulatory framework suggests this may not be the case:¹²⁴

- Cross-sector prioritization and resource allocation issues have been identified as the key responsibilities of the units in both MOET and MOF. It remains unclear, which unit is given the primary responsibility for these functions. This may result in a possible confusion and a deadlock in the budget preparation process may cause duplication of responsibilities;
- (ii) PITAP, ACU and PIMU - all have to maintain databases for the PIP monitoring purpose and to collect reports from PICs and line ministries. Since it is not clarified, which of them would take the primary role in collecting data and maintaining the PIP database, this arrangement will likely result in three parallel data collection streams and competition among these entities. There is a risk that each of the units will create its own reporting formats and standards, tripling the amount of time and effort for information collection and formatting.
- (iii) All units have to provide technical support to Picks and line ministries in preparation and monitoring PIP projects. Therefore, there is the risk that PIUs would receive conflicting messages from different units, or that each unit would be passing on requests for the technical support to another unit. This risk can be minimized if, first, TA sub-functions are clearly delineated among the units (e.g. MOET unit to be responsible for the technical side of project preparation and implementation, MOF unit – for the financial side,

¹²⁴ The analysis is based on the comparison of Statutes of ACU, PITAPU (draft), PIMU and CIMHD.

and the ACU - for the compliance of projects with PRSP, MTBF, and for the PIP as a whole), and second, information and data sharing procedures are clearly defined and approved.

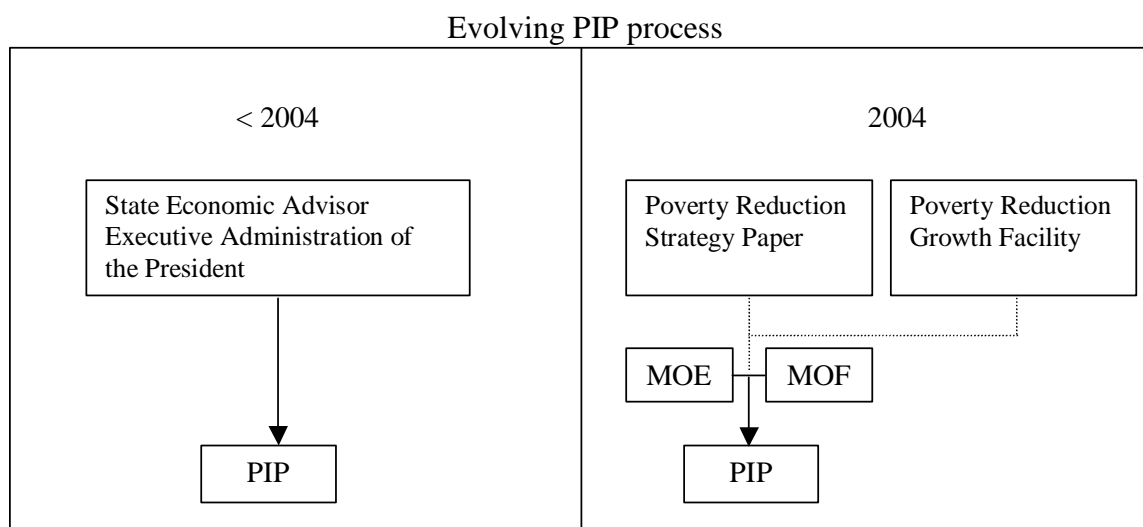
Despite remaining shortcomings, the Government demonstrated its commitment to improve the policy framework and the internal institutional capacity to handle PIP. By and large, there is a modest progress in improving the quality of public investment programming achieved over the past few years, especially since mid 2003. As a result, there is *PIP becoming a systemic process rather than an ad hoc exercise*: special units have been set up in the MOET and the MOF to deal with PIP process. While institutional capacity still remains weak, there is a commitment from the Government to establish an adequate system for coordination of the whole PIP process. To this end, the units in the MOET and the MOF are in charge of aligning PIP with PRSP priorities and work towards the development of a MTBF framework.

The government is beginning to take fiscal constraints into consideration while developing more realistic public investment program. The 2004-2006 PIP for the first time includes fiscal and other macroeconomic targets and proposes measures improve consistency between planning and budgeting. While the Government considers that downsizing PIP may compromise its efforts to reduce poverty, it understands now the importance of debt sustainability in medium and long-term as well as the fiscal constraints stemming from the limited capacity to raise revenues to co-finance larger PIP. The fiscal ceiling of three percent of GDP on disbursements under the externally funded PIP reduces the discretion of the Government to attract external resources, despite that actual spending under PIP has never reached this ceiling in the past. The very existence of the ceiling pushes the authorities to be more selective and to better prioritize the needs in the programming process. This comes, though, at the cost of restraining implementation of already approved PIP projects.

The quality of PIP somewhat improved. The PIP process has been gradually turning into a real programming exercise and efforts since the previous CG have gathered pace. The assistance provided by AsDB and USAID have exposed the government officials to modern ways of approaching PIP development. However, there is much to be done to turn the PIP into a realistic program document that is line with the government's priorities.

While recent developments for improving the PIP are encouraging, it must be emphasized that purely organizational and technical solutions are not likely to be enough. There is still the issue of providing a strategic framework for the development of the PIP and as shown in Chapter 3, the fragmented nature of policymaking in Tajikistan is a major impediment to the articulation of strategic priorities. The creation of SRMPC proposed in Chapter 4 would be one of the key steps in that and this body could be delegated the decision-making authority on strategic priority setting, financing limits for ministries for the purposes of PIP and approving these in the draft budget before it would be considered by the full Government (see Chart 3). As such, the SRMPC would take over the function of issuing of Budget Circular and of establishing financing limits for the

line ministries and other key budget organizations. It is the MOF that presently performs this function.



The key immediate challenge for the Government in this respect is first, making PRSP a real strategy for the development of the PIP. It is noted at the opening that the PIP has been heavily influenced by the SEDP and it is not clear how much of the PIP process is driven by the PRSP. The government should clarify the status of the PRSP vis a vis the SEDP and this would have to be the first step of the prioritization process for the PIP. Second, the integration of PIP and non-PIP investment projects within the same policy and institutional framework and their alignment with PRSP and MTBF. In principle, PRSP should establish strategic priorities for development across and within sectors and the MTBF should be developed to set the fiscally sustainable path for both domestic and foreign public sector investment. Many government agencies still consider PRSP as a document for external use, with virtually any sector presented in it as a priority one.

CENTRALIZED STATE INVESTMENT PROGRAM

A. Overview of the CSIP

The CSIP is an on-budget item. An objective of CSIP is to promote social and economic development in Tajikistan through state budget investment. It is an instrument of government's investment policy at the regional and sector level. CSIP program is a part of the state budget, set aside from both general line ministries budgets and the PIP. It is split into two parts: the republican and the sub national. CSIP consists largely of new investment, though a few capital repairs projects are sometimes also included in it. It provides financing for new construction, reconstruction, and purchase of new assets and equipment when the latter is a part of investment projects financed through CSIP. Purchases of other equipment and furniture are financed out of general budget allocations to line ministries and spending units. As shown in Table 1, CSIP accounts for about 22 percent of the non-interest expenditures of the state budget and 2.0 percent of GDP.

CSIP is institutionally separated from PIP and recurrent budgets of line ministries and spending units. It is the Sector and Regional Policy department (SRPD) of the MOET, which is responsible for overall preparation and management of CSIP. It coordinates line ministries' requests, carries out project expertise, and submits to the government proposals on a list of investment projects to be included in CSIP and on amounts of their funding from the budget. The government program of socio-economic development broadly guides the preferences in sector allocations. While PRSP is named as the basic document, it is not used in the decision-making process with respect to CSIP as judged by the results of actual selection of investment projects. Investment projects that line ministries recommend for inclusion in CSIP are decided on unclear strategic criteria, unlikely linked to any long-term vision, since line ministries do not develop sector strategies.

The 2004 Budget Circular introduces major changes. Specifically, it provides for expansion of the horizon for budgetary planning to three years, for a link between current and capital budget allocations and sector strategies, for consolidation of foreign financed PIP in the budget, and for introduction of some elements of performance budgeting in the budget process. Clearly, these objectives are very ambitious, and at this juncture it is too early to determine the impact of such proposed changes. However, given the capacity issues, most likely it would take several years to get the implementation of the Circular. In this respect, the natural sequence of actions would be, first, the procedural integration of PIP and CSIP and their broad alignment with PRSP and MTBF and, second, the integration of PIP and CSIP investment with the remaining capital and current expenditures in respective sectors in line with sector strategies. Both steps would require a strong political support from both the government and donors.

B. CSIP Preparation Process

B.1 Project prioritizing, selection and approval

The MOET is the lead agency for the development of the CSIP. The MOET is authorized to “develop principles and mechanisms of state investment policy”, to “decide on CSIP priorities” and to “carry out an expertise of investment projects”.¹²⁵ The SRPD of the MOET collects investment proposals from line ministries and regions, checks for their comprehensiveness, assesses quality of feasibility studies and prepares a draft list of investment projects and construction sites for CSIP.

While there is no formal methodology for project selection, there are several groups of non-formalized criteria used: political, technical, and financial. With respect to political criteria, the department gives the priority to investment projects, which are included in Presidential programs and have a status of “construction sites of state importance”. In addition, the government may give the priority to some investment projects up front, early in the budget cycle making them exempt from the scrutiny of regular procedures for project selection. For instance, the government resolution on 2003 state budget specifically provides for funding of the Rogun Hydro Power Plant. Thus, the

¹²⁵ Charter of the MOET, approved by Government Resolution No.77 of February 17, 2001.

importance of political criteria may override the necessity to have feasibility studies and other project documentation for construction sites prepared as a pre-requisite for considering a project as a candidate for inclusion in CSIP. This is especially true for emergency investment projects.

The readiness and completeness of project documentation is another factor taken into account when the selection of investment projects and construction sites for CSIP is made. However, economic analysis, projects' NPVs and rates of return are not prepared and provided along with other project documentation, which seriously undermine the ability of the MOET to select the most efficient projects from financial and social viewpoints. Besides project documentation, other factors used by the SRPD of the MOET for project selection include: the degree of readiness of construction sites, the project type (i.e. whether a project is a new fixed investment project or a capital repairs project), project costs vis-à-vis other projects. Other things being equal, the SRPD selects unfinished investment projects/construction sites, and projects that can be completed within fiscal year. As a rule, the SRPD does not deal with capital repairs projects since they are supposed to be financed out of general budget allocations for a particular line ministry. However, since ministerial budgets are tight, line ministries attempt to include such projects in CSIP and sometimes succeed in doing that.

A closer look at CSIP for 2000, 2001 and 2002 reveals the following:

While available public resources are scarce, CSIP consists of a large amount of small projects instead of focusing on a few projects with highest return. In 2002 the average size of 'state importance' CSIP projects was \$0.1 mln at the republican level and only \$0.02 mln at the sub national level (see Box 4 for details);

Investment projects are implemented in various sectors, including those that should not normally be financed from the budget. For instance, there were a few investment projects in the commercial services sector (catering, gambling) in CSIP in 2002;

Priority is not always given to unfinished projects with high degree of completion. Besides social and general public infrastructure projects, CSIP also includes construction sites of potential commercial use including a cinema and a sport arena.

The CSIP priorities are not clear. While CSIP as a whole does not reveal any clear preference towards social sectors, industry, or public administration sector, its structure broken down by ministries and khukumats does. This suggests the existence of other priorities for some ministries and khukumats, besides poverty alleviation and basic social infrastructure needs, which appear to be more important for them. For example, the Ministry of Nature Protection administers two investment projects under CSIP in 2003. Both represent construction and reconstruction of administrative buildings. Rogun khukumat has three investment projects included in CSIP. One of them is construction of a cinema, another one – construction of a new building for khukumat administration. It

also follows that some ministries and khukumats select for financing investment projects, which cannot be completed within fiscal year, rather than concentrate financial resources on fewer projects to ensure their faster completion.

Box 4. CSIP in 2001-2003

A list of construction sites of *state importance* for 2001 includes 14 units, the one for 2002 – 18 units, totaling 21 units for two years. The budget was Somoni 15.2 mln in 2001 and Somoni 19.7 mln in 2002. Among these 21 units, 7 are of current or potential commercial nature, and they cover electricity, gas, transportation (airports) sectors and [light?] industry. The approved CSIP for 2003 includes 261 construction sites, of which 156 sites are of republican level and the rest are subnational. At both the republican and the subnational levels 2003 CSIP construction sites also include potentially commercial undertakings, for instance, a hotel, garages, cafeteria, apartments, a sport arena, a hippodrome, a cinema. On average each construction site at the republican level receives Somoni 0.3 mln (\$0.1mln), and at subnational level – Somoni 0.06 mln (\$0.02mln), which is a very low amount, not sufficient even for small-scale investment projects.

At the republican level investment are distributed across 27 line ministries, agencies and SOEs. In the republican part of 2003 CSIP the biggest amount of constructions sites belong to military defense, law enforcement, and civil defense sectors (36 units), agriculture and water management (29 units), and education (15 units). That part of CSIP is highly concentrated in money terms with more than 50 percent of allocations ear-marked for just two government agencies: the Ministry of Transportation and the Directorate for Construction of Government Units.

CSIP for 2003 includes construction sites, which are to be completed within fiscal year, and those, which require additional investment in the following year(s). It appears that some line ministries and local governments select for financing construction sites which can be completed within one fiscal year (e.g. Ministry of Defense, Beshkent rayon's *khukumat*, *khukumat* of Kurgan-Tyube city), while other – have none of such sites (e.g. Ministry of Emergencies and Civil Defense, Ministry of Culture, the Directorate for Construction of Government Units, Rogun city *khukumat*). A difference among line ministries and *khukumats* can also be observed with respect to selection of investment projects by sector. Some appear to prefer projects in social sectors (education and health facilities), while others – public administration projects (construction and capital repairs of administrative buildings) and construction of units for the commercial use.

Once the MOET compiles a draft list of investment projects for CSIP broken down by sector and ministry, it submits the list to the government for approval.¹²⁶ The government, together with the MOF and the Administration of the President reviews the list and makes the final decision. What is missing at present is the technical verification of the CSIP compliance with government strategic priorities as well as the medium-term fiscal evaluation of CSIP investment projects. Without that any decision can only be taken on an ad hoc basis and it will necessarily be politically driven. Any attempts to have limited budget resources concentrated on a few projects can not succeed in this environment. Once created, the Budget Committee could play this currently missing role and submit its recommendations on investment projects to the government for a final decision.

All steps in project selection for CSIP described above are not formalized in the key documents governing the budget process in Tajikistan (law on public finance, budget

¹²⁶ Usually it takes place at the beginning of fiscal year after the budget law is approved and enacted.

law and government resolution on budget law implementation). To a large extent, it is just an established practice and a tradition, including the one inherited from the Soviet times. It can be the case that informally applied criteria to selection of projects for financing are rational (e.g. unfinished projects). The problem with the current practice is that it is largely ‘a one man show’, which neither allows understanding the rational behind the decisions made nor ensures consistency in application of these informal criteria. This makes it easy to question decisions made and change them by the upper Government level.

B.2 Budgeting for CSIP

Planning allocations for CSIP is an element of budgeting exercise at the republican level. This process starts with the MOF deciding on a total expenditure ceiling for CSIP, taking into account overall expenditure constraints and the need to finance a protected list of expenditures. According *to* the Law on Public Finance (#7 of December 2, 2002), the MOF has also to take into account medium-term revenue and cost projections prepared by spending units. In reality, however, this provision is almost impossible to implement because spending units request the amount of financing, which goes far beyond the budget capacity.

The SRDP is the main driver of the budget process. The SRPD is to select investment projects for inclusion in CSIP and to propose budget resources allocation for each project within the established aggregate expenditure ceiling for CSIP. The government then is to approve budget allocations for each investment project in CSIP together with a list of projects broken down by ministries and khukumats. However, in reality, alike other budget requests, draft CSIP prepared by the MOET included projects with total required financing exceeding the expenditure ceiling. In the previous years this prompted the necessity to negotiate CSIP (list of projects and amount of financing) between the MOET and the MOF, and then with the government. As a result, the finally approved CSIPs were downsized compared to original MOET wish lists to make them broadly consistent with the expenditure ceiling.

Classification issues blur the distinction between capital and current expenditures. Besides financing the acquisition of new fixed assets, CSIP allocates about 10-13 percent of total investment project cost to line ministries and spending units for procurement of complementary items necessary to start the use of acquired fixed assets. It is not very clear whether these items represent only current expenditures or include also capital expenditures (e.g. procurement of office furniture). In the present institutional setup neither the MOF nor the MOET accounts for the need to rollover domestically financed public investment and for recurrent costs of investment made. The recently developed MTBF does not account for this either. Decisions on financing public investment are made within one-year time horizon. This appears to be a common problem for most if not all CIS countries.

Small annual allocations delay project implementation. Average investment project in CSIP receives a pretty small budget allocation, and this is why most of them are small by size and require continuous financing for several years before a project can be completed.

Apparently, such thin resource spreading can not be efficient. At the same time, two sectors receive a lion's share of CSIP allocation at the republican level: transportation and public administration (Box XX). This may point to the 'true' priorities pursued by the authorities not necessarily consistent with the poverty alleviation objective.

Execution of CSIP budget have been uneven. Over past few years the government and the MOF in the course of budget execution found it possible to allocate additional funds to CSIP in addition to what had been originally budgeted. These funds were used: (i). for investment projects initially proposed by the MOET but rejected by the MOF and the government due to fiscal considerations; (ii). new emergency investment projects (e.g. rehabilitation of fixed capital assets damaged by earthquakes). Three financing sources were used for the provision of additional funding: first, the reserve funds of the President and the government; secondly, expenditure savings on counterpart funds for PIP (when actual claims for counterpart funding were lower than expected and budgeted for); thirdly, extra-budgetary revenues stemming from underestimation of GDP growth and higher than expected inflation. If such allocations/reallocations changed the functional and/or ministerial structure of expenditures they had to be approved as amendments to budget law by the Parliament.

New budget processes are being introduced. The Budget Circular for 2004 issued by the MOF completely changes the criteria of investment project selection for inclusion in CSIP. It limits CSIP by only unfinished projects carried over from previous years and already included in past CSIPs. It remains unclear from the Budget Circular though, whether donor financed PIP will be consolidated in the budget and merged with CSIP over time, or will remain as a separate budget window for public investment projects. However, it is still too early to see the results of these policy changes on the CSIP budget process.

B.3 Implementation of the CSIP

Cash management weaknesses affect the implementation of the CSIP. As reported in CFAA, The single treasury accounting system in Tajikistan has imposed stronger control over cash at the aggregate level. However, the treasury disburses funds from the budget with a certain time lag after civil works are done and capital goods procured and delivered. One reason for the arbitrary variations in payment dates and the inefficient use of resources is that there is no formal system of cash management or cash forecasting. As a result, a decision on disbursement of available budgetary funds has to be made daily by senior officials at the MoF, including the Minister. When available budgetary funds fall short of expectations, they are disbursed first to priority expenditure items, and CSIP does not fall into this category.

Expenditure arrears continue to be a problem. In addition, the treasury system lacks the mechanism to effectively control expenditure commitments thereby preventing the build-up of expenditure arrears. This allows spending units to take on commitments beyond their authorized appropriations. This problem is particularly acute with regard to non-

protected payments for goods and services, including CSIP.¹²⁷ The only preventive mechanism that exists today is tender commissions, which set up to approve large contracts and which include a treasury representative. In this case, contracts exceeding the amount of authorized spending are not approved.

Another reason for expenditure arrears building up is that, as mentioned above, CSIP is often revised during fiscal year. Resources are usually reallocated to high priority investment projects for the government at the expense of other projects being implemented under CSIP. Such practice causes significant delays in project implementation and creates budgetary arrears to suppliers. It is aggravated by the lack of regular monitoring of and **control** over budgetary arrears by the Government. Besides, the MOF and the MOET have little interest in allocating funds for arrears clearance when CSIP is compiled or revised because this would deduct resources from spending on new contracts. The 2004 Budget Circular aims to address this problem by instructing line ministries and *hukumats* to collect information on CSIP arrears accumulated over past years. This information would be used presumably for the provision of adequate funding for CSIP arrears clearance in 2004.

The actual CSIP allocation across sectors and projects differs considerably from both original and revised budget law. This leads to either accumulation of budget arrears, or untended overfinancing of many projects. The main reason for that is that often authorities push contractors for carrying out more works than stipulated in contracts promising retroactive authorization and budget financing in future. 2003 CSIP is very illuminating in this respect. While the originally approved spending were 51.5 mln Somoni, the revised spending authorizations exceeded 82 mln Somoni, and the preliminary year outturn was more than 121 mln Somoni on the commitment basis and will likely to grow further when contractors submit their final invoices later in 2004. So, actual commitments exceeded the authorized ones by at least 40 mln Somoni.

Financial Monitoring and control of the CSIP is weak. Public sector accounting and financial reporting in Tajikistan are not sufficiently strong. While the Treasury performs its basic function verifying the conformity of payment documents with the regulations and checking whether requested payment is within the authorized limits, the treasury accounting process is hampered by a lack of computerization in local treasury offices; this slows the consolidation process and leaves little time for monitoring and supervision. Further, there are deficiencies in the accounting regulations and the information provided is not being used to manage budgetary institutions.¹²⁸ The internal control of the Treasury has been ineffective for dealing with CSIP and this is a source of concern. Additionally, the SFCC fails to understand the difference between general accounting and GFS budget classification used for budget reporting and its audits of CSIP projects have not been particularly useful for improving accountability in the CSIP context.

¹²⁷ CFAA, 2003

¹²⁸ Ibid.

Technical audits are common but their effectiveness is questionable. With respect to the CSIP, there are procedures of *technical* control and expertise, which are employed. Once a construction site (or a separate part of an investment project) is completed, a special state commission, consisting of representatives from a contractor, a customer, specialized government inspections (e.g. sanitary) is formed. It has to verify that the site construction is indeed completed and to confirm that acquired assets meet the required technical and other standards. However, as far as project technical specifications and verification of actual costs are concerned, state commissions do not have capacity to do it properly, because they do not have qualified staff. Back to the Soviet times, this function used to be performed by so-called building banks (*stroybanks*). Factual lack of control in this area leads to inflated project costs and lower quality of construction and installation works.

REFORMING PUBLIC INVESTMENT PLANNING AND BUDGETING

The Government achieved a modest progress in improving the quality of externally financed public investment program over past few years. PIP preparation is gradually becoming a systemic process and a part of the budget cycle rather than an ad hoc exercise. Fiscal constraints are being paid more attention while developing more realistic public investment program and the quality of PIP somewhat improved. In addition, the MOF has developed new budget preparation procedures aimed at the integration of the PIP with the CSIP and the budget. However, the implementation of these procedures as designed appeared to be problematic in the short-term because of the low institutional capacity of line ministries, the MOET, and the MOF, as well as of political considerations.

Despite this progress challenges facing public investment management are significant. Capital expenditures in Tajikistan still have a number of policy and institutional weaknesses as discussed earlier. Many of these weaknesses are common for all or majority of public capital expenditure windows and they are classified into three broad categories and discussed below.

A. Macroeconomic Framework: Resource Envelope and Fiscal Sustainability

With respect to promoting consistency between the public capital investment envelope and the macroeconomic *stability* and *debt sustainability* objectives, the deficiencies are the following:

- ☐ *The size of the public capital expenditure envelope* (estimated at 6 percent of GDP in 2003) may not be consistent with fiscal stability in the longer-term. While the recent growth of PIP is understandable in that there has been a backlog of investment needs, it has been growing as a percent of GDP and as percent of government spending and has already exceeded the OECD and international average levels. Secondly, the increasing share of credit financed PIP in the public capital expenditure envelope will make it difficult for the Tajik government to sustain it in future. Third, recurrent costs implications of ongoing public investment are not properly accounted

for, which will require additional budget allocations to maintain public capital assets in coming years, adding to the debt burden.

- 🕒 *Unrealistic programming.* Externally financed PIP remains too ambitious and unrealistic and does not fit into the macroeconomic and fiscal framework, which led to low rate of implementation. Only 20 percent of the amounts stipulated in the 3-year PIP have been disbursed in 2001-2002 and preliminary data show that similar disbursement rates registered in 2003. *Recent* improvements in disbursements, which narrowed the gap between program targets, donor commitments and disbursement, may jeopardize the fiscal stability if PIP is not scaled down to the fiscally affordable levels. If PIP is to be funded by grants, then both the recurrent and counterpart requirements need to be considered and the government should approach the issue in a medium-term context.
- 🕒 *Macroeconomic Framework and Resource Envelope:* The government needs to estimate its absorptive capacity. A *simple* exercise bringing available resources, tax revenues, new borrowing, grants, and other resource creating schemes, such as reduction in foreign debt, together against public expenditures, including debt payments, recurrent component of public investments, and counterpart requirements need to be carried out. In this way, the government can determine its financial absorptive capacity, and this applies to grant funded PIP projects as well.

B. Priority Setting and Institutional Issues

As analyzed in detail in this chapter, strategic prioritization, aligning public capital expenditure priorities with the overall development strategy of the government show a number of weaknesses and these undermine effective policy formulation as discussed in Chapter 3, as well as donor perceptions which in turn affect disbursement patterns.

- 🕒 *Lack of clarity of strategic priorities.* Present PRSP and the PIP set a wide range of strategic development priorities for the country, embracing a large number of sectors and allowing virtually any investment project to be justified as a PRSP/PIP consistent project.¹²⁹ This setup does not allow concentrating the scarce resources on just a few key areas/problems of paramount importance.
- 🕒 *Duality of strategic priorities.* Many government agencies consider PRSP as a document for external use, which secures foreign financing of the PIP. With respect to budget funds (both recurrent and capital), the Government follows the guidance of national and regional development programs and Government decisions which are guided by the SEDP. This is the major reason that there are large differences between the PIP priorities and the PRSP priorities. This further aggravates the resource allocation problem institutionalizing the separation of the PIP from the CSIP.

¹²⁹ The PIP for 2001-2003 covered 10 sectors, the PIP for 2004-2006 covered 13 sectors.

- ⌚ □ *Shrinking share of social sectors.* The revealed PIP preferences points to the *de facto* decreasing importance of social sectors and increasing importance of energy and transport infrastructure sectors.¹³⁰ Similar preferences also pertain to the CSIP – domestic public investment program. This makes the stated poverty alleviation objective of both PRSP and PIP highly questionable.¹³¹
- ⌚ □ High level of *fragmentation* of public capital expenditure envelope. The existence of multiple windows for capital expenditure spending does not allow concentrating financial resources on a few strategic priorities. As a result, resources are thinly spread across multiple projects and construction sites. Institutional independence of each window makes it impossible for the government to carry out a coherent investment policy across all windows, which leads to duplications, loss of strategic focus and inefficiencies.¹³²

C. Technical and Budgetary Aspects of PIP Process

The efficiency of institutions and procedures employed in the preparation, implementation, audit and evaluation of different capital expenditure programs and projects, are important elements of effective PIP process. The most important shortcomings in these areas are the following:

- ⌚ □ *Inadequate budget coverage.* (i) PIP is not integrated in the budget financially (except for counterpart funding) and has not become a part of the budget process institutionally;¹³³ (2) PIP itself does not include all donor financed capital expenditure projects – some grants remain outside both the budget and PIP.¹³⁴
- ⌚ □ *Inadequate classification of capital expenditures.* Up to 2000 the PIP co-financing was financed and reported off-budget. Since then, it is included in the budget and classified as “other current expenditures”. Such misclassification misleads policy makers underestimating the size of public capital expenditures.

¹³⁰ As judged by the share in PIP allocation.

¹³¹ Responding to donor concerns, the MOET while drafting PIP pipeline for 2004 rejected proposals on five new infrastructure projects adding instead one new project in the health sector. If such practice continues, the existing bias of PIP towards infrastructure will be corrected.

¹³² The recent Government’s initiative to set up a Commission on Resource Allocation (BC) is the right way to go in order to solve this problem.

¹³³ Currently, PIP is presented to the Parliament concurrently with draft Budget Law along with other accompanying documents for reference. Although the PIP document contains valuable information about PIP projects including project amount, estimated disbursement and co-financing, donor and sector breakdown, this information is not used as an integral part of the overall budget process.

¹³⁴ ACU under the Presidential Administration works as an information center for both PIP and grant funded projects. However, it does not go beyond playing this function.

- ⌚ □ *Classification of capital and current expenditures.* Public investment are institutionally separate, first, between PIP and CSIP and, second, from current expenditures and minor capital expenditures. Both PIP and CSIP are prepared, approved, and implemented in isolation from the rest of sector resource envelope. Moreover, there is no link between PIP and CSIP investment. In such environment, development of meaningful sector policies is impossible
- ⌚ □ *Weak inter-agency coordination.* (i) Procedures for inter-ministerial coordination are not adequately defined at present. (ii) Existence of organizational units with unclear and overlapping functions is an impediment for the efficient public investment management. With respect to PIP alone, there is an overlap of functions performed by the Aid Coordination Unit in the Office of the Prime Minister (ACU), Public Investment Management Unit in the MOF (PIMU), and the Public Investment and Technical Assistance Program Unit in the MOET (PITAPU).
- ⌚ □ *Weak project selection procedures.* Despite the existence of five criteria developed for a project to be included in PIP, those criteria are applied only *pro forma*, often *a posteriori*, when a project is already agreed on between the parties. Project efficiency analysis, while being one of the five selection criteria, is not considered at all in the PIP framework. With respect to CSIP, only vaguely defined project selection principles are in place, and projects efficiency is not assessed at all. As a result, CSIP suffers from political interference, and some of CSIP projects are of commercial nature, which should not be normally financed from the budget.
- ⌚ □ *Weak fiduciary management.* The legal, regulatory and institutional framework for public procurement are not well developed. As discussed in the CPAR, the institutional framework for efficient and procurement at a minimal cost to the public is considerably less than satisfactory. The low domestic institutional capacity is also one of the key factors negatively affecting disbursement of committed funds under PIP. In the financial management area, which is reviewed in detail by the CFAA, there are also serious weaknesses that affect the PIP and the CSIP. Among the most important issues are (i) Lack of a formal system of cash management or forecasting exists, which creates arbitrary variations in payment dates and inefficient use of resources; (ii) cash controls are particularly weak in local treasury branches which still largely use manual systems; (ii) no system exists to record and control commitments and arrears within the Treasury, although the present system actually has the mechanism to do so; and (iv) the existing control framework fails to address the role, functions and accountabilities of internal audits within government.
- ⌚ □ *Inefficient monitoring and supervision mechanisms.* In the past, PIP monitoring have been done on an ad hoc basis, and implementing agencies and PICs prepared project progress reports on occasional requests of supervisory bodies usually when a new three-year PIP was to be prepared

for CG meetings. As opposed to PIP projects, which provide targeted financing for outside quality control, the lack of adequate technical expertise and financial resources on the government side in some cases resulted in the unsatisfactory quality of works carried out by contractors under the CSIP program. Reporting on PIP projects while being excessive and duplicative does not help in preventing from accumulation of budget arrears to supplier under the PIP.

POLICY RECOMMENDATIONS AND CAPACITY BUILDING

Given the issues discussed in the previous section, a set of policy recommendations are developed and these are presented below. Given the capacity issues, TA needs are also considered and for the technical and methodological elaboration and the preparation of action plans can be identified for possible donor financing.

A. Consistency of the PIP with the Macroeconomic Framework

First and foremost, public capital expenditure envelope, especially its PIP part, has to be consistent with a financial framework that has a medium-term perspective. Until a reasonable MTBF is developed, the PRGF framework could be taken as the basis for such exercise. The process should include:

Once macroeconomic and fiscal targets are defined for the medium-term, multi-year rolling ceiling for *new commitments* (instead of disbursement) under investment credits should be determined. This ceiling would form a macroeconomic framework for the externally financed PIP, which time horizon is to be the same as for MTBF and which is to be updated annually concurrently with MTBF. The possibility to replace credit instruments for grants and increase co-financing from the budget of projects largely financed by foreign credits should be explored. This work would further the ongoing TA on MTBF under IBTA-2.

Three year and annual PIP planning should be significantly strengthened. While ideally this should be part of the MTBF process, future spending under ongoing PIP projects needs to be better estimated. Specifically, using project implementation plans as benchmarks, expected disbursement under each of ongoing PIP projects needs to be determined, taking into account project restructuring (if any), progress in projects implementation, procurement cycles for different types of procurement, and institutional capacity of Tajik counterparts (line ministries, PICs, MOET, MOF) to timely process project documents. This would also help in better planning of counterpart funding from the Tajik budget. Foreign financed grants are to be included in this exercise since some of them require counter-part funding, and all of them along with foreign credit load onto the limited institutional capacity of the Government.

It is important to make it mandatory for preparation of investment projects under PIP and CSIP to provide reasonable estimates of *future recurrent costs* for projects maintenance in order to ensure sustainability. Those estimates would have to be taken into account in the mid-term fiscal framework, future budget plans, and PIP. This can be done as a part of MTBF TA and is not of immediate priority in the plan of action.

B. Policies and Measures for Mainstreaming of Government's Priorities

Clarification of Priorities. As noted in this and other chapters, Tajikistan's priority setting capacity is low and this has affected donor disbursements. The Government needs to act decisively to begin addressing these policy issues. There are two main issues. First, the government needs to clarify which development agenda it wishes to pursue and decide whether this is the PRSP or the SEDP. This is a fundamental issue. As discussed in Chapter 3 the SEDP does not offer a reasonable development framework and its resource needs far exceed Tajikistan's capacity to raise them and donor's capacity to deliver them in the form of grants. Second, once a decision has been made, the government needs to deal with the fragmentation of policy making and prioritization and clearly communicate its priorities to donors.

SRMPC and PIP Policy and Priority Setting: In view of Tajikistan limited borrowing and absorptive capacity, priorities in PRSP have to be better and clearer defined: instead of broadly defined priority areas, a focused set of fewer but the most important priorities and sectors needs to be presented. This would help to align the overall public expenditure envelope (including capital expenditure and PIP) with the narrowly defined strategic priorities in a few sectors. The resource concentration, that would be achieved, would enable to reduce the gap between program targets and PIP commitments, and between PIP commitments and disbursement. This should be done by the SRMPC proposed earlier with the participation of the MOET and the MOF and technically supported by the ACU.¹³⁵ PRSP should become the only strategic document guiding MTBF and annual budget preparation.

Streamline public capital spending windows. The public capital expenditure *windows* have to be streamlined, including gradual institutional integration of the PIP and the CSIP in a 'broad' PIP.¹³⁶ As a first step, CSIP projects need to be presented as a part of the PIP. The second step would be to ensure that the CSIP is guided by the same policies and principles that guide the PIP:

¹³⁵ In order to coordinate external assistance, in 1995 Tajik Government issued a decree on establishing the Aid Coordination Unit (ACU) under the Ministry of Economy and Foreign Economic Relations financed under World Bank TA program. Later on, UNDP continued to support the Unit after WB TA grant phased out. The Unit was de facto closed down when UNDP funded program discontinued, and it was officially integrated into the SME Support Agency at the Office of the Prime Minister. A new ACU was established in September 2001 under ADB technical assistance. It plays largely a technical role.

¹³⁶ Despite the MOF provides for this in its last Budget Circular, it is politically difficult to implement in the environment in which some investment projects in the CSIP are decided on according to political considerations and the whole CSIP is guided by strategic documents other than PRSP.

Project Selection Criteria under the PRSP, and PIP.¹³⁷ The third step would be a merger of two organizational units in the MOET, responsible for the PIP and the CSIP, into one unit covering both of them. In the longer-term, the ‘broad’ PIP would have to become an integral part of sector strategies and ministerial expenditure allocation, so that recurrent and capital spending would not be institutionally separated anymore. This process can be assisted by resident consultancy provided to the MOET, the and the MOF.

The PIP should become a part of budget document and annual budget law. Initially, the foreign financed part of the PIP could be presented separately from the rest of the budget, but gradually the PIP would have to be moved from off-budget to on-budget expenditure presented according to standardized functional, ministerial, and economic classification of budget expenditures. The MOF and the SRMPC would be the main beneficiaries of possible TA in this area.

The amount of public capital expenditure projects needs to be reduced. Partly, this could be achieved as a result of implementation of the aforementioned steps; partly, this has to be stated as a Government’s objective. Apparently, in terms of quantity, the major cuts would come from the CSIP. This would be a function of the MOEDT and the BC, assisted by a possible TA.

C. Dealing with Technical Issues

There are many technical issues that need to be dealt with in such areas as project preparation, project screening, procurement and financial management, reporting and auditing. Upgrading business processes, developing necessary skills would help to improve the technical efficiency of investment projects, to speed up project implementation, and to achieve better results. We highlight here only some of them.

Carry out a review of various units dealing with the PIP. To overcome the lack of adequate inter-agency cooperation and poor information exchange, a review of statutory and actually performed functions of the ACU, the MOEDT (PITAPU and SRPD), and the MOF (PIMU) with respect to the PIP and the CSIP is to be conducted. The review should reveal overlapping, duplicative as well as poorly defined functions and assess actual performance of these institutions as compared to the regulations and the statutes. In anticipation of setting up the SRMPC – to act as a strategic policy maker and to align strategic priorities with budget allocations - the functions of the currently existing units need to be clarified, streamlined, and any functional duplication eliminated.

Use economic justification for project analysis. The quality of investment project preparation has to be improved, in particular, the quality of those projects that are included in the CSIP. Projects should not be accepted for consideration if project documentation is not complete. A special attention has to be paid to the economic justification of projects and risks analysis, which is missing at present in the CSIP and in

¹³⁷ Each project included in the CSIP should be presented and published along with its criteria values. “Politically driven” projects, which will inevitably survive for some time in the CSIP, should be classified as such referencing to ad hoc Government decisions approving them.

some PIP projects. As initial step, this would be the requirement for PIP projects, for which donors could help in preparing this justification and analysis. Results of this work should be used in the formal project selection process assigning higher ranking to the projects with higher economic return on investment as outlined in paragraph below. A formal methodology for the CSIP and PIP projects evaluation and selection needs to be developed. It should formalize selection criteria currently used informally. With respect to the PIP, the results of economic analysis should be one of selection criteria.¹³⁸ Once developed, the project selection based on this methodology could be done by the MOET with the technical support from the ACU. The results in the form of project ranking would then be discussed by the SRMPC, who would have to make a final decision. An example of some elements of such methodology is attached below.

Improve classification of public capital spending. The aforementioned integration of the PIP in the budget would be only possible, if PIP project costing at both planning and implementation phases is consistent with GFS principles (or can be easily reclassified) and present project cost in both functional and economic classifications. For instance, PIP project spending has to be reported in the functional classification of budget expenditures in the same way, in which the Treasury presently reports PIP co-financing. Different donors have different internal regulations on project financial management. It would be unrealistic to expect that donors financing PIP projects would adjust their internal fiduciary procedures to allow for that. However, this can be done at the level of PIUs, who perform financial transactions, keep appropriate records, and report on project implementation to the Government and donors.¹³⁹ Thus, a possible TA could include the development of a methodology allowing reconciliation of project cost accounting with general budget accounting and classification, drafting new reporting templates, and creating supplementary accounting software and for projects financed by main donors (WB, ADB, IsDB, etc.).

Simplify and regularize PIP and CSIP reporting. Overall reporting on PIP projects implementation has to be regularized, and reporting requirements for the PIP and CSIP projects need to be unified. This would allow improved project monitoring on the part of line ministries, the MOET, and the ACU. To this end, a review of regulatory base for project reporting under the PIP and the CSIP should be conducted and amendments to it proposed. With respect to PIP reporting the review should identify the excessive and duplicative information flows and develop recommendation on their elimination. In the end, new templates for reporting would have to be developed for PIP and CSIP.

Ensure proper classification of PIP current and capital expenditure items. Budget co-financing of PIP needs to be reclassified as capital expenditures from current expenditures as it is reported presently. Once PIUs start presenting their reporting in accordance with economic classification of budget expenditures, it would be possible to

¹³⁸ Currently, the procedures for project selection in the PIP do not include this criterion.

¹³⁹ The Russian State Customs Committee, for instance, is doing this under the Customs Development Project of WB.

further break down the co-financing part by specific capital and current expenditure classification items.

Clarify roles and responsibilities. Adopt a simple PIP processing schedule with clear definition of roles and responsibilities of various government agencies in the process. As a proposal, the following matrix could be considered in this context:

PIP level	Expected Output	Sequencing / Division of Responsibilities among Agencies	Key Players and Timeframe
General macroeconomic framework and forecast; Identification of strategic development priorities	Medium- and long-term public investment allocations are prepared and approved	1a. Sectoral Ministries develop and propose medium- and long-term strategies and policy objectives 1b. ACU produces foreign aid (lending, grants and TA) report specifying expected disbursement/commitments of donors across sectors and by years 2. MOET puts together inputs from sectoral ministries and ACU and submits the summary proposal to the SRMPC along with the costing of ongoing public investment program 3. SRMPC identifies the overall resource envelope for public investment and strategic development priorities and discusses it with key stakeholders, including Parliament	MOET, Ministry of Finance, ACU, Line Ministries <u>Supervised by:</u> Government, SRMPC, Parliament Due by: _____
PIP Preparation	Three-year integrated PIP (broken down by sectors and years) is produced ¹⁴⁰	1. MOET prepares a draft three-year integrated PIP, project by project, with the established resource envelope and in accordance with approved development priorities ¹⁴¹ 2. SRMPC approves the Program	MOET and Ministry of Finance, ACU <u>Supervised by:</u> SRMPC Due by: _____
PIP Budgeting	PIP is wholly integrated into the budget and approved along with the budget	1. Ministry of Finance integrates the PIP into the draft budget (functional, economic, and ministerial classifications of expenditures). 2. SRMPC reviews and approves possible amendments to the Program 3. Government discusses the draft budget, including integrated PIP, and submits it for the Parliament's approval	Ministry of Finance, MOET <u>Supervised by:</u> SRMPC Due by: _____

¹⁴⁰ Integrated PIP refers to an investment program, which is: (a) based on the consolidation of existing CSIP, externally funded PIP, and other investment programs, if any; and (b) checked for consistency with domestic absorptive capacity and fiscal constraints.

¹⁴¹ The resource envelope covers CSIP, PIP co-financing, and donor commitments.

PIP Monitoring		<p>1. MOET issues quarterly and annual monitoring reports on implementation of the integrated PIP¹⁴²</p> <p>2. MOET produces analytical reports on public investment and, together with Goscomstat, integrates them into overall macroeconomic reporting</p>	<p>Ministry of Economy and Trade, PICs, ACU, Goscomstat</p> <p><u>Supervised by:</u> MOET</p>
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If implemented, the proposed matrix would allow:

- 🕒 Identification of financing sources in a more realistic way;
- 🕒 More productive interaction among all stakeholders with some of them taking the leading role at different stages of programming, budgeting, and monitoring of public investment portfolio;
- 🕒 The SRMPC and the Parliament to play important role in the budget formulation process;
- 🕒 Integration of CSIP and PIP as well as local budget capital expenditures under the single public investment programming framework

The integration of PIP and CSIP at the preparation level in the MOET should be pursued as part of further institutional streamlining in the area. Merging the two units under the MOET into the single one, which would be responsible for the integrated PIP would be natural way of moving forward.

The ACU seems well positioned to perform, in addition to its present role, the function of data warehouse and investor information center as either an inter-ministerial or autonomous structure of the Government. Besides collecting and processing data on donor programs and projects, the ACU may expand this function to include information gathering and processing on the CSIP projects and other public investment projects as well as on ongoing and planned private investment projects. As such, the ACU could become a key player in the expenditure tracking process complementing the improvements in PIP formulation with a mechanism for tracking the follow-through on where the donor-provided resources and government-funded actually get spent.

Summing up, there are no easy solutions to the discussed problems. What have been proposed is the work agenda that can be ***implemented*** only gradually, step-by-step. The work including TA should be arranged along two major tracks. First, fixing existing problems related to technical efficiency: development and implementation of new procedures, generation of meaningful information flows, staff training, etc. Donor funded TA can promote it. Second, is the strategic formulation of the PIP process under a single development vision and setting up the SRMPC which would allow streamlining PRSP and transforming it into the key strategic document of the Government, and the like.

¹⁴² PICs and ACU provide information on donor disbursements and Ministry of Finance submits quarterly and annual reports on capital expenditures to MOET. Once PIP classification and reporting problem is resolved, the MOF will be able to submit integrated information on public capital expenditures to MOET.

Investment Project Selection Methodology: A Case for Russia¹⁴³

Action Plan 8. Eliminate those programs which (a) have commercial orientation and do not meet criteria for federal public investment, or (b) have been going along for too long without much success of completion, or (c) are non-programmed investments.

These proposals apply only to existing projects, primarily to those which make part of the federal targeted investment program. Item (c) should not apply to other investment programs funded from the federal budget.

The likely algorithm which may be followed by the authorized State body (Ministry for Economic Development and Trade) in selecting investment projects for inclusion in the State budget as part of the federal targeted investment program and other parts of the budget is shown below.

List of actions:

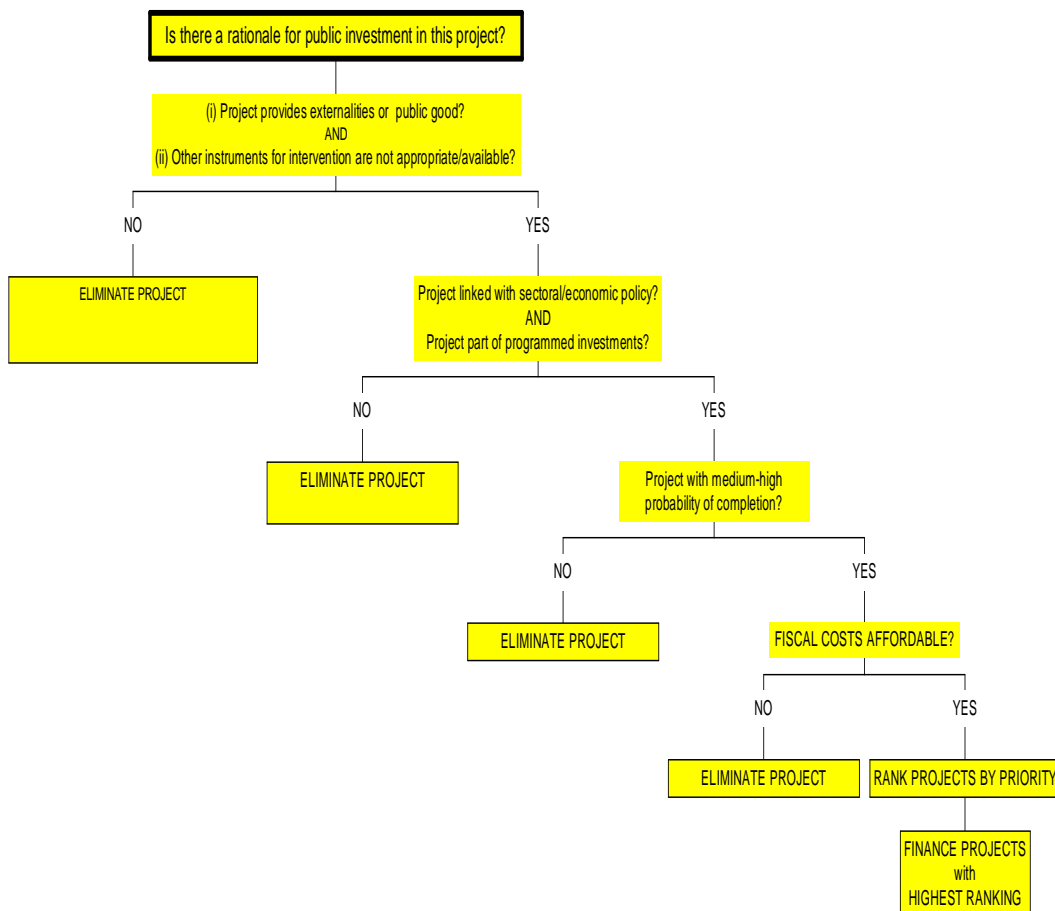
Draft the regulation on selection of investment projects to be financed by the federal budget in 2002 (Ministry of Economic Development and Trade, an order, third quarter of 2001).

Action Plan 9. Prioritize for investment spending on (a) completion of existing programs and projects, particularly those close to completion, rather than new investment projects; and (b) expenditure for capital repairs and equipment purchases.

This applies to those existing projects which have passed the test of Action Plan 8 as well as to new projects. The following approach can be used for ranking projects according to an explicit objective criteria based upon the developmental priorities of the Government. A sample approach is presented below with some ideas for criteria and some hypothetical weights. Both the criteria and the weights to be applied to them would need to reflect these priorities.

¹⁴³ An excerpt from WB report No.22693-RU *Russia: Towards Improving The Efficiency Of Public Investment Expenditures*, 2001.

Decision Tree for Screening Public Investment Projects



Sample approach for prioritizing projects

<i>Economic Internal Rate of Return</i>	
Given criterion is useful for comparing projects distinguished by various risk levels. Projects with higher internal rate of return (IRR) value shall have more priority compared to projects with lower IRR.	<p>IRR>60% - 7 points 60%>IRR>40% - 5 points 40%>IRR>30% - 3 points 30%>IRR>20% - 2 points 20%>IRR>10% - 1 point IRR<10% or no calculation – 0 points</p>
<i>Social significance of a project</i>	
<p>Evaluation of a project is based on adequacy to the following aspects of social significance:</p> <ul style="list-style-type: none"> • Provision of housing for public servants and re-deployed servicemen • Improving employment of the population and reduction of unemployment • Improving access to the quality health services • Improving access to the quality education services • Poverty reduction: <ul style="list-style-type: none"> - Provision of sufficient potable water supply to the population - Reduction of death-rates - Improving the scope of secondary education cover - Enhancement of economic opportunities for the poor - Ensuring access to provision of social services for the poor - Coverage of distant back-country districts • Environmental concern of the project 	<p>Evaluation is based on summing-up of applicable aspect-specific points.</p> <p>4 points</p> <p>2 points</p> <p>2 points</p> <p>2 points</p> <p>4 points</p> <p>2 points</p> <p>2 points</p> <p>4 points</p> <p>4 points</p> <p>2 points</p> <p>2 points</p> <p>4 points</p>
<i>Environmental safety of the project</i>	
<p>Evaluation of environmental safety of the project (taking into consideration environmental pollution contingencies and utilization of limited irreplaceable natural resources).</p> <p>Environmental safety of a project</p> <p>A project involves avoidable contingencies</p> <p>A project bears high hazard of risk for the environment</p>	<p>4 points</p> <p>2 points</p> <p>(-4) points</p>
<i>Internal co-financing (from the budgetary resources) requirement</i>	
Considering certain difficulties with provision of internal co-finance, absence of the requirement demanding obligatory participation of the Government in co-financing of a part of a project's cost is thought an advantage.	<p>Up to 10% of the overall cost of a project – 4 points</p> <p>10% to 20% of the overall cost of a project – 2 points</p> <p>More than 20% of the overall cost</p>

	of a project – (-2) points
<i>Terms of procurement within the framework of a project</i>	
A project that implies procurement of work, goods or services based on competitive bidding, invites maximum possible amount of participants to take part in the bidding and has no restriction on amount and pattern of bidding participants, shall have more priority over the projects that impose restrictions on bidding.	<p>No restriction on bidding – 4 points</p> <p>Purchase of work, goods and services from domestic sources only – (-2) points</p> <p>Bidding is not allowed (instead, work, goods or services are purchased directly) – (-4) points</p>
<i>Project-related risks</i>	
Priority of a project depends on the level of risks involved. Higher risks result in substantial decrease of a project's priority.	<p>Insignificant risks – 3 points</p> <p>Moderate risks – 2 points</p> <p>Substantial risks – 1 point</p> <p>High risks – 0 points</p>
<i>Project implementation evaluation (for current projects)</i>	
Based on use of special indicators each of the projects is evaluated in terms of implementation and accomplishment of tasks and goals set within the framework of the project. Unsatisfactory implementation of a project shall result in less priority compared to the successfully accomplished ones.	<p>Procurement quality:</p> <p>Satisfactory – 1 points Unsatisfactory – (-1) points</p> <p>Compliance with the project implementation timetable:</p> <p>Compliant – 1 points Non-compliant – (-1) points</p> <p>Project finance development rates:</p> <p>Satisfactory – 1 points Unsatisfactory – (-1) points</p> <p>Quality of work, goods and services:</p> <p>Satisfactory – 1 points Unsatisfactory – (-1) points</p> <p>Compliance with the tasks and goals of a project:</p> <p>Compliant – 1 points Non-compliant – (-1) points</p> <p>Evaluation of compliance is</p>

	premature – 0 points
<i>Evaluation of implementor's capacity for maintenance and exploitation of the resources acquired</i>	
Should the end-implementor have no sufficient amount of finance to maintain and utilize/exploit resources purchased on account of borrowed funds (including specialists who are knowledgeable, skillful and experienced enough to be capable of maintaining and utilizing resources purchased), the consequence is less priority of a project.	<p>Sufficient capacity / amount of finance – 2 points</p> <p>Insufficient capacity / amount of finance – (-2) points</p>
<i>Inspecting quality of preparation for a project</i>	
Quality of preparation for a project is being appraised based on availability of detailed project documentation (terms of reference) as well as project auditing results. Absence of detailed Terms of Reference as well as negative auditing results considered disadvantage at evaluation of a project.	<p>Available terms of reference and the auditing results are positive – 2 points</p> <p>Terms of reference are not available or in the making – 0 points</p> <p>Terms of reference are available, yet auditing results are negative – (-2) points</p>
<i>Availability within executive agency (ministry / department) of a structural unit responsible for administering sector investment projects associated with the project under consideration</i>	
Availability within executive agency (ministry / department) of a structural unit (several structural units) that is responsible for administering sector investment projects associated with the project under consideration, and has experience of implementing various international projects is considered advantage at evaluation of the project.	<p>Availability of such executive agency and correspondent experience in implementation of international projects – 2 points</p> <p>Availability of such executive agency – 1 point</p> <p>Absence of such unit – 0 points</p>
Maximum aggregate result: 37 points	

The above weighting scheme gives higher weights to projects for capital repairs and equipment purchases, and against new construction. This is important to address the rapid depreciation of the capital stock and its efficiency. The weighting scheme also gives preference to projects with low future recurrent costs which would help to minimize future costs and enable the sustainability of the new investments.

List of actions:

Draft the regulation on the objective criteria for investment project ranking after careful assessment and modifications to the above (Ministry for Economic Development and Trade, an order, second quarter of 2002).