

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR  
TAJIKISTAN**

**As approved by the Board of Directors at its meeting on 15  
November 2005**

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## **I. EXECUTIVE SUMMARY**

Over the past two years Tajikistan has made progress towards implementation of the principles of Article 1 of the Agreement Establishing the Bank. Progress towards a market economy was clearly evident, while transition towards a multi-party democracy and pluralism remained uneven, with the last parliamentary elections in February 2005 failing to meet international standards, despite showing some improvement over previous elections.

Macroeconomic conditions have improved during the past two years. The economy grew by 10 per cent annually during 2002-2004, supported by increased consumer spending fuelled by higher incomes and foreign remittances as well as greater output of aluminium. A sharp reduction in inflation was also observed during the course of 2004, partly thanks to improved monetary policy and its governance. The state budget remains in near balance (excluding public investment programmes) and the expenditures are in line with the objectives set out by the Poverty Reduction Strategy Paper (PRSP). Moreover, the bilateral debt reduction agreements with Russia and Pakistan have led to a significant improvement in the external debt position, reducing the external debt to GDP ratio to 40 per cent from 82 per cent two years ago. Nevertheless, given the limited fiscal resources, the government continues to limit externally financed public investments to four per cent of GDP annually. The authorities continue to refrain from borrowing any non-concessional loans.

Tajikistan remains one of the low-income countries among the Bank's countries of operation, with a per capita income of US\$ 316 in 2004. The government has been committed to a Poverty Reduction Strategy since 2002 and a certain measure of success in reducing poverty has already been achieved, as indicated in the 2004 PRSP progress report. Nevertheless, the level of poverty remains high. During the last Consultative Group meeting in November 2004, multilateral and bilateral donors confirmed their support of the policies set out by the PRSP and stressed the need for comprehensive land reform, a reduction of barriers to private sector development, urgent improvements to local service delivery by strengthening local government capacity and improvements in public sector efficiency and accountability.

Tajikistan maintains the managed floating exchange rate regime with full currency convertibility. The country made rapid progress in small-scale privatisation and price and trade liberalisation in a difficult environment during the 1990s. However, little progress has been made in the areas of large-scale privatisation, enterprise restructuring and governance, and market-orientated development of infrastructure. Although steady development has been made in recent years, the financial sector still remains weak, and has not yet provided the corporate sector with sufficient financing sources, especially for micro and small enterprises.

The country still faces enormous challenges in moving forward, relating to a complex political situation in a potentially volatile region, and the combination of key development issues with specific transition challenges, in line with the Millennium Development Goals. Government capacity to introduce, implement and enforce new legislation remains weak and the functioning of domestic markets is still impeded by many informal and physical barriers.

Under these circumstances, the key transition challenges are i) private sector development through enterprise restructuring and privatisation of large state-owned enterprises, as well as through improvements in corporate governance and the business environment; ii) creating a financial sector that is able to function as financial intermediary, attracting private savings and

meeting the financial needs of private domestic enterprises; and iii) promoting commercialisation and private sector participation in public infrastructure, with an initial focus on hydro-electricity. To achieve these goals, impediments such as corruption and excessive bureaucracy need to be reduced and the accountability of private and public activities require improvement.

Given the macroeconomic environment and the stage of reforms mentioned above, the Bank, with a strong commitment to deliver more projects, will focus on the following during this strategy period:

### **Financing the Private Sector**

The Bank will continue to focus on micro businesses, through further development of micro and small business credit lines administered by local banks and non-bank financial institutions. A particular focus will be to develop the branch networks, fostering penetration of financial institutions in secondary cities and towards the rural areas, thus increasing financial intermediation in rural areas and the agricultural sector.

In parallel, the Bank will initiate the launch of much-needed SME facilities through local banks with technical cooperation. The Bank will also continue to promote enterprises engaged in foreign trade through the Trade Facilitation Programme. In addition, it will seek to attract regional and international investors, including from Russia, Turkey, China, Kazakhstan, Pakistan and India, particularly in the agribusiness and financial sectors. The Bank is ready to support further efforts on the part of the government towards large-scale privatisation, if improvements in corporate governance, efficiency and transparency can be achieved.

The Bank will make use of the recently launched ETC products to explore opportunities for direct financing in a number of key sectors, including agribusiness and food processing, textiles and other light industries, construction materials, property and tourism, natural resources and telecommunications. The new banking tools introduced with the ETC Initiative, such as the Direct Lending Facility (DLF), Direct Investment Facility (DIF), Medium Co-Financing Facility (MCFF), as well as the support of a team dedicated to the ETC Initiative, are well adapted to the Tajik scale and will enhance opportunities to develop local and smaller projects.

### **Strengthening the Financial Sector**

Despite significant improvement and consolidation, the banking sector still has a limited impact on economic development. Given the constraints of a small capital base, the Bank will be more proactive in advocating increased capitalisation and will remain ready to support the entry of new private investors, i.e. reputable local investors and regional and international investors, including Russia and Kazakhstan, and will seek further opportunities for equity participation, in order to strengthen the banking sector's institutional capacity.

The Bank will actively seek opportunities to involve more banks in its programmes, including the Micro and SME credit lines, TFP and MCFF. It will strengthen the banking sector through Technical Cooperation activities, including capacity and institution building programmes, seminars and legal advice on anti-money laundering, banking supervision, credit bureau and advice on the introduction of sound deposit insurance.

The capacity to expand the full range of bank lending products (MF, SME and TFP) will be constrained by the size and strength of the partner banks. The Bank will therefore continue to utilise the Central Asia Risk Sharing Special Fund's (CARSSF) bilateral risk mitigation facilities and ETC funds to maximise exposure to local banks.

### **Supporting Critical Infrastructure**

The investment needs in infrastructure are considerable and remain critical to the country's development as well as to the attraction of foreign investment, but progress is constrained by limited public resources and restrictions on sovereign borrowing. Given the Bank's inability to provide concessional loans, the Bank will consider financing non-sovereign infrastructure that produces cash flows to meet debt repayments without recourse to sovereign guarantees. This could be the case in the hydro power sector which should develop considerably in the coming years.

In the municipal infrastructure and transport sectors, including road and air transportation, in which the Bank has developed much needed expertise, the Bank will attract further donor grants to blend with its resources, in order to achieve the necessary concessional terms. The ETC Initiative and bilateral support should enhance the availability of such funds. The Bank will cooperate with the ADB and the WB Group with a view to participating in road and power transmission projects.

### **Policy Dialogue**

During the strategy period, the Bank will strengthen its policy dialogue with the authorities, in order to improve the investment climate, governance, transparency and to support reform efforts. The Bank will coordinate closely with other IFIs and the business community within the existing donor coordination structures. As noted above, the Bank will seek co-financing opportunities with other IFIs and bilateral institutions to mobilise greater resources, especially in the hydro power sector and in projects that could enhance regional cooperation.

## LIST OF ABBREVIATIONS

|        |   |
|--------|---|
| ADB    | Asian Development Bank                                      |
| AM     | Annual Meeting  |
| AML    | Anti-money laundering                                       |
| ATC    | Assessment of Transition Challenges                         |
| BAS    | Business Advisory Service                                   |
| BEEPS  | Business Environment and Enterprise Performance Survey      |
| CACO   | Central Asian Cooperation Organisation                      |
| CAD    | Civil Aviation Department                                   |
| CARSSF | Central Asia Risk Sharing Special Fund                      |
| CDM    | Clean Development Mechanism                                 |
| CIS    | Commonwealth of Independent States                          |
| CL     | Credit Line   |
| DIF    | Direct Investment Facility                                  |
| DLF    | Direct Lending Facility                                     |
| EAEC   | Euro-Asian Economic Community                               |
| EAP    | Environmental Action Plans                                  |
| ECO    | Economic Cooperation Organisation                           |
| ETCI   | Early Transition Countries Initiative                       |
| EU     | European Union  |
| EUR    | Euro  |
| FDI    | Foreign Direct Investment                                   |
| FI     | Financial Institutions                                      |
| GDP    | Gross Domestic Product                                      |
| GSM    | Global System for Mobile Communications                     |
| ha.    | hectare   |
| IAS    | International Accounting Standard                           |
| IFC    | International Financing Corporation                         |
| IFI    | International Financial Institution                         |
| ILO    | International Labour Organisation                           |
| IMF    | International Monetary Fund                                 |
| IOM    | International Organisation for Migration                    |
| IsDB   | Islamic Development Bank                                    |
| KfW    | Kreditanstalt für Wiederaufbau                              |
| LTT    | Legal Transition Team                                       |
| MCFF   | Medium Size Co-Financing Facility                           |
| MF     | Micro finance   |
| MSE    | Micro and Small Enterprises                                 |
| NBT    | National Bank of Tajikistan                                 |
| NEAP   | The National Environmental Action Plan                      |
| NGO    | Non-Governmental Organisation                               |
| ODIHR  | Office for Democratic Institutions and Human Rights         |
| OSCE   | Organisation for Security and Cooperation in Europe         |
| OTC    | Over the Counter  |
| PIP    | Public Investment Programme                                 |
| PRGF   | Poverty Reduction and Growth Facility                       |
| PRSP   | Poverty Reduction Strategy Paper                            |
| PCF    | Prototype Carbon Fund                                       |
| RR     | Resident Representative                                     |
| SCO    | Shanghai Cooperation Organization                           |
| SME    | Small and Medium Enterprise                                 |
| TACIS  | Technical Assistance for Commonwealth of Independent States |
| TAM    | Turn Around Management                                      |
| TC     | Technical Cooperation                                       |

|         |  |
|---------|--|
| TFP     | Trade Facilitation Programme                       |
| TMAC    | Tajik Mine Action Centre                           |
| TMSEF   | Tajik Micro and Small Enterprise Finance           |
| TRACECA | Transport Corridor of Europe-Caucasus-Asia         |
| TSA     | Tajik State Air Company                            |
| TSOB    | Tajik Sodirot Bank                                 |
| UNEP    | United Nations Environment Programme               |
| UNDP    | United Nations Development Programme               |
| UNICEF  | United Nations International Children's Fund       |
| US\$    | US Dollar  |
| USAID   | United States Agency for International Development |
| WB      | World Bank   |
| WHO     | World Health Organisation                          |
| WTO     | World Trade Organisation                           |

## II. STRATEGY

### 1. The Bank's Portfolio

#### 1.1 Overview of the Bank's activities to date

Tajikistan became a member of the EBRD in 1992. Until 1996 the Bank's operations were limited to TCs. Since then, the Bank has approved twelve investment projects, two with equity and ten as loans or credit lines, three of them being framework projects, generating sub-projects. Signed commitments currently stand at EUR 43.5 million of which EUR 21 million have been disbursed.

During the last strategy period the Bank signed:

- 1 project in municipal infrastructure, the Khujand Water Supply Improvement Project with a Bank investment of EUR 1.0 million.
- 1 project in the public aviation sector aiming at the modernisation of the state air fleet with a Bank investment of EUR 4.2 million. This project, signed in July 2005, is structured without sovereign guarantee, and disbursement is under preparation.
- 9 sub-projects under 3 framework agreements, mainly in the financial sector, worth EUR 13.6 million broken down as follows:
  - i) TFP framework – Tajprombank (EUR 1.9m)
  - ii) TFP framework – Tajik Sodiro Bank (EUR 3.1m)
  - iii) TFP framework – Eskhata Bank (EUR 0.2m)
  - iv) TFP framework – AgroInvest (EUR 1.7m)
  - v) TMSEF framework – Eskhata Bank (EUR 0.8m)
  - vi) TMSEF framework – Tajik Sodiro Bank (EUR 1.7m)
  - vii) TMSEF framework – Tajprombank (EUR 1.7m)
  - viii) TMSEF framework – Agroinvest (EUR 1.7m)
  - ix) ETC Non-Bank Microfinance Institution Imon (EUR 0.8m).

**Table 1: Overview of the Bank's Activities to Date as at end-September 2005**

|   | No. of Projects  | Total Project Value (EUR million) | EBRD Finance (EUR million) | Debt (EUR million) | Equity (EUR million) | % share of Commitments |
|---|------------------|-----------------------------------|----------------------------|--------------------|----------------------|------------------------|
| <b>Private</b>                            | 3.6 <sup>1</sup> | 32                                | 20                         | 18                 | 2                    | 47%                    |
| <b>State</b>                              | 5.0              | 35                                | 23                         | 23                 | 0                    | 53%                    |
| <b>Bank Equity</b>                        | 1.0              | 3                                 | 0.5                        | 0                  | 0                    | 1%                     |
| <b>Bank Lending</b>                       | 0.7              | 7                                 | 7                          | 7                  | 0                    | 16%                    |
| <b>Equity Funds</b>                       | 0.0              | 1                                 | 0                          | 0                  |                      | 1%                     |
| <b>Small Business Finance</b>             | 0.9              | 8                                 | 7                          | 7                  | 0                    | 16%                    |
| <b>Municipal &amp; Env infrastructure</b> | 1.0              | 4                                 | 1                          | 1                  | 0                    | 2%                     |
| <b>Transport</b>                          | 3.0              | 18                                | 11                         | 11                 | 0                    | 25%                    |
| <b>Agribusiness</b>                       | 1.1              | 14                                | 6                          | 4                  | 2                    | 14%                    |
| <b>Telecoms Informatics &amp; Media</b>   | 1.0              | 13                                | 11                         | 11                 | 0                    | 25%                    |
| <b>Totals</b>                             | <b>8.7</b>       | <b>68</b>                         | <b>43.5</b>                | <b>41</b>          | <b>2</b>             | <b>100 %</b>           |

<sup>1</sup> In the case of framework projects, the Bank calculates the number of projects by dividing the committed amount by the framework amount approved. The sub-projects are not listed in this table, for the detailed portfolio, refer to Annex 3.

## 1.2 Implementation of the previous Country Strategy

The Bank's previous strategy for Tajikistan included the following strategic priorities:

- **Financing the private sector** – Supporting private enterprise focusing on the financing of small and medium sized enterprises and micro businesses.
- **Strengthening the financial sector** – Supporting the banking sector through credit lines, technical assistance and where possible by increasing capitalisation and investment.
- **Supporting critical infrastructure** – Supporting infrastructure projects with a clear focus on high priority, commercially orientated investments, thereby closely collaborating with other donors and IFIs.
- **Policy dialogue** – Improving transparency, governance and the investment climate.

Through projects that represented significant levels of FDI in Tajikistan over this period, the Bank made progress in implementing its Strategy, in particular in the financial sector and the financing of micro and small enterprises.

### *Financing the Private Sector*

The Trade Facilitation Programme (TFP) and Micro and Small Enterprise Facilities were introduced in October 2003 and have expanded rapidly to support MSE/SME businesses. By the end of August 2005 the Tajik Micro and Small Enterprise Finance programme (TMSEF) had disbursed 6,456 loans for a total amount of US\$ 17.1 million to micro and small businesses. TFP had disbursed more than US\$ 14 million to around 5,000 clients. Both programmes had a direct impact on poverty alleviation and job creation. This financing has been achieved through four participating banks and one NGO with a total of 24 lending units, and was delivered in Dushanbe and eight other cities, covering most regions of the country.

During the strategy period, the Bank monitored its DIF portfolio, but was unable to expand beyond the existing two projects. The Obi Zulol project, a relatively large FDI in the country, involving the construction and operation of a bottled water and soft drinks plant, was not able to access the originally targeted Uzbek market, because of trade and custom barriers. As a result, the company has been unable to generate sufficient cash flow and is in default on its loans. The shareholders are seeking an investor to resolve the financial difficulties of the company and enable the Bank to exit.

It is in this context that, within the last strategy period, the Early Transition Countries Initiative (ETCI) was launched by the Bank. Under this initiative, the Bank has introduced several financial facilities suitable to Tajikistan, including Direct Lending (DLF), Medium Size Co-Financing Facility (MCFF) and the revised Direct Investment Facility (DIF). The Bank has developed a pipeline of several DLF projects in the country, mainly related to the agribusiness and textile industries, and is considering how to develop MCFF projects, thereby taking into account the weak capital base of the banking sector.

### *Strengthening the Financial Sector*

As noted above, the TFP and MSE facilities have become important sources of finance for the banking system, allowing access to finance for entrepreneurs who could not be served by the

banking sector before. Both programmes include strong capacity-building technical cooperation, with a significant training component, thus ensuring sustainability, local ownership and high standard operations.

The Bank continued to improve levels of corporate governance in the participating banks. An additional TC has been launched to support the restructuring of Bank Eshkata and Tajprombank. By working closely with the banks' management teams, the Bank has been able to recommend further improvements to corporate governance; these should attract more investments in the form of equity participation and enhance the local populations' trust of commercial banks, thus increasing the levels of deposit.

On the equity side, following the exit with no loss from Tajik Sodiro Bank (TSOB) in Spring 2003, the Bank is ready to participate in capital increases, within the frame of the new minimum capital requirements introduced by the National Bank, US\$ 5 million by the end of 2005.

On the National Bank side, the Bank provided active policy support, including technical cooperation in the areas of anti-money laundering, deposit insurance and pledge legislation.

### ***Support for Critical Infrastructure***

In the municipal infrastructure field, the Khujand Water Supply Improvement Project, which was signed in July 2004, is currently being implemented. This project corresponds to the main priorities of the Poverty Reduction Strategy Paper, by providing access to safe drinking water in the Khujand region. It also acts as a pilot project that could be replicated in southern cities. Within the ETC Initiative and with the support of several donors (Switzerland, Norway, Belgium, and Sweden), a pipeline of municipal infrastructure projects has been developed. It includes water supply improvement projects in two southern cities and a waste management and urban transport project in the capital Dushanbe.

In the aviation and telecoms sectors, the Bank has leveraged its operations in order to retain an open dialogue with the Government about sector reform and privatisation. The Bank implemented two projects in the aviation sector – the emergency rehabilitation of the runway at Khujand Airport and the modernisation of air navigation equipment of the Tajik State Air Company (TSA). A crucial transport project, TSA Air Fleet Modernisation, was signed in summer 2005. The other important infrastructure project is the modernisation of Tajiktelecom. This combines the renewal of all the old switchboards in the country's main cities with the establishment of a sector regulatory and legal framework.

Overall, however, the Bank's activities in this field remain limited, partly owing to the tight governmental and IMF limitations on the Public Investment Programme (PIP) and non-concessional public financing. This discipline in public expenditure, which limits public investment financing to 4 per cent of the GDP and prioritises projects in relation to the Poverty Reduction Strategy, substantially reduces the Bank's opportunities for financing the public sector. In fact, in order to participate in public sector financing, the Bank needs to attract a co-financing grant facility, to reach the IMF concessionality requirements in terms of interest rates and other financing conditions.

## *Policy Dialogue*

The Bank maintains an active policy dialogue with the government, both directly through its projects, and via the donor community. The Bank has been a regular participant in consultative meetings with Ministers, the National Bank, and local authorities, to discuss policies in the areas of microfinance, trade, reform of the Banking sector, water supply, air transport, telecoms and mining. Most recently the Bank made an important contribution to a large Banking Conference aimed at improving the investment climate in the banking sector and banking supervision. The Bank is seen as a strong promoter of private sector development and good governance.

### **1.3 Transition Impact & Lessons Learned**

#### **1.3.1 Influence on the Transition Process**

The transition impact of the Bank's projects has been satisfactory. Specific improvements have been achieved in niche areas. Still more needs to be done, in cooperation with the donor community, to further transition, to overcome administrative resistance to the implementation of economic reforms, and to further liberalise and develop the private sector.

The Bank's public infrastructure loans in telecommunications and aviation provided not only vital technical improvements, but also helped to advance corporate governance and market orientation in state-owned enterprises. However, their implementation has been met with some resistance and privatisation is unlikely in the short term. The TSA Air Fleet Modernisation project has been structured without sovereign guarantee, thus favouring a commercial management of the state-owned air company.

The municipal infrastructure project introduces concepts of cost-recovery and viability in municipal utilities services, and impacts on thousands of households in terms of providing safe drinking water, and promoting a rational use of water.

The financial sector projects give private enterprises access to finance, thereby stimulating the development of hundreds of small businesses. In addition to fuelling grassroots economic activity, they are reinforcing the weight of the private sector in the economy and promoting its vital role in poverty alleviation.

#### ***Financing the Private Sector***

The transition impact of the Tajik Micro Small Enterprise Facility (TMSEF) goes well beyond company-level. Informal lenders applying extremely high interest rates have been pushed out of the market and small lending is now practised in a transparent and competitive way. The number of borrowers is growing rapidly, as more distribution points have been opened in secondary towns, approaching rural communities at close range. Training programmes for the participating banks are conducted by local trainers.

Increasing access to finance has contributed to improved trust between the population and commercial banks and the start-up of micro and small enterprises, thereby creating jobs. Almost 90 per cent of the borrowers are first time borrowers. Inevitably, these customers will start using banking services for their commercial activities (deposits, payrolls, payments, etc).

The ETC Initiative has introduced new banking tools, which are better adapted to the small-scale business environment. An interesting pipeline of small projects has been built up. SME development, however, still suffers from a lack of private investment, in particular from abroad. The Bank has not, therefore, been able to participate in start-ups.

The Bank maintains an active policy dialogue with the government on privatisation, especially with regard to large scale public monopolies.

### ***Strengthening the Financial Sector***

The Bank has had a significant transition impact on the Tajik banking sector over the past strategy period.

The MSE and TFP facilities have not just provided vital financing for the enterprise sector, but have also been backed by TCs to help banks develop key skills needed for their activities. The TMSEF has already trained around a hundred and thirty five loan officers to use modern credit methods, based on analysis of a business and its cash flow, rather than heavy collateral or personal relations. This has now started to influence credit practice in the Tajik commercial banks. The borrowers also benefit from advice given by trained loan officers. Specific training has also been given in the area of trade finance, with emphasis on the use of letters of credit for international transactions, instead of non-transparent cash transactions.

It is important to note that one of the best performing banks in these programmes, is the Tajik Sodiro Bank (TSOB), from which the Bank and IFC exited in May 2003 due to concerns over sound corporate governance following the emission of free shares to the founding shareholders, which diluted our stake and did not respect the basic principles of corporate governance in terms of equality of shareholders. Our exit from the TSOB investment with IFC was negotiated without losses to the IFIs. Because of TSOB's central role in the Tajik banking sector, in particular in the field of retail credit and trade finance, we maintained a constructive relation with TSOB. After having launched the Microfinance and Trade Facilitation Programme with two other participating banks, we considered the participation of TSOB in these facilities. Following important changes on the executive board of TSOB, in particular the change of the Chairman of the board, TSOB confirmed its willingness to adhere to the Bank's rules and requirements, in terms of corporate governance and respect of agreements. Both facilities were then activated with TSOB in autumn 2004, with very good results, allowing us to turn a problematic relationship into a performing asset.

### ***Support for Critical Infrastructure***

The recently launched water management and distribution project is designed to implement i) tariff reform (including rationalisation of the system of subsidies to various groups of customers); ii) commercialisation (including introduction of service contract); iii) organisation of payments by public entities; iv) transfer of skills; and v) initiation of basic steps to improve the management capacity of the utility. The project is still at an early stage but is progressively achieving these goals that are expected to provide much-needed transition impact.

The existing sovereign projects in the telecommunications and aviation sectors have continued to perform well. The TSA Air Navigation Systems project supported the establishment of the Civil Aviation Department (CAD) as a regulator, and also contributed to

the commercialisation of the company. The latest aviation project, based on asset collaterals rather than state guarantee, is reinforcing this tendency.

The Tajiktelecom Modernisation Project has contributed to the adoption of the new telecommunication law and the establishment of an independent regulator (initially within the Ministry of Communication). The consultants also prepared a tariff plan for 2003-2007 which was approved in February 2004. Accordingly tariffs have been increased twice in 2003, and starting from 2004 a new re-balancing regime is in place.

### ***Policy Dialogue***

The implementation of EBRD projects in the public and the private sector has given numerous occasions for pursuing policy dialogue with the government, mainly concentrating on improving the investment climate and developing the private sector. The active participation of the Bank in different donor organisations has also contributed to introduce key elements of the Bank's mandate in policy discussions.

With regard to the National Bank, the Bank's interventions in legislation have mainly related to pledge law issues and branch network development. Further improvements in the pledge law and legal practice will help banks to expand lending, and introduce clarity to the bank-borrower relation. Training for National Bank staff, as well as commercial bank staff, in anti-money laundering, is helping the banking sector to introduce proper AML procedures.

#### **1.3.2 Financial Performance of Existing Portfolio**

Out of 12 projects in the cumulative portfolio, two projects have been fully reimbursed, eight projects are being disbursed and three projects are repaying, while two projects are under corporate recovery and not repaying.

The microfinance credit lines, which are currently released in tranches, are experiencing strong demand. The Bank's TFP-lines are actively utilised; one Tajik bank has even shown the quickest rate of full utilisation in the history of the TFP programme. The three existing public loans are sovereign guaranteed. They are performing well.

#### **1.3.3 Mobilisation of Co-Financing**

The Bank has been successful in mobilising donor grant co-financing for blending in order to meet the government's objective of not incurring any non-concessional sovereign loans. The governments of Japan, Switzerland, Norway, the EU, UK's DFID and USAID have provided a significant grant element in support of various projects. Tajikistan still depends on the blending element in public financing structure projects. Commercial co-financing has remained weak, reflecting the very low levels of FDI, and no co-financing with commercial banks has been undertaken during the strategy period. The Bank will continue to actively explore areas of co-financing with other IFIs, in particular the ADB, the WB/IFC and the IsDB.

### **1.3.4 Lessons Learned**

#### ***Private Sector***

The difficulties encountered in two agribusiness DIF projects (mineral water and juices), are the result of a number of factors, including market constraints, created by the difficult trading environment in the region. These projects, located in the northern region of Tajikistan, bordering Uzbekistan, have not managed to overcome the new conditions created by the financial losses which occurred with the Russian crisis, and the closure of the Uzbek border following the 1999-2001 security problems. Despite strong support in technical cooperation, additional funding and efforts deployed by the Bank, these companies did not manage to turn around, given the small Tajik domestic market. This clearly demonstrates the necessity of improved economic cooperation in the region, especially for mountain-locked Tajikistan. It also shows the necessity for in-depth due diligence for SME projects, in particular in the assessment of market risk.

The difficulty of developing more direct financing in the private sector contributed to the shaping of the ETC Initiative, in particular in bringing down the minimum size of potential projects. The new banking products which emerged with the ETC initiative, mainly for developing small projects, such as the Direct Lending Facility, Medium-size Co-financing Facility and the renewed Direct Investment Facility, are a direct consequence of the lessons learned here.

The limited level of foreign direct investments, particularly from the West, indicates that the Bank needs to approach non-traditional foreign investors, including investors from Russia, Turkey, Kazakhstan and China.

#### ***Financial Sector***

The current level of corporate organisation and governance calls for institution building programmes with training and management support. The case of TSOB clearly shows that improvements in corporate governance are achievable; although TSOB breached a clause in its investment agreements with EBRD and IFC, which led both IFIs to disinvest, it continued to cooperate with EBRD on lending products. TSOB has been posting strong performances on two of EBRD's banking programmes providing finance to a wide range of retail and corporate customers. Relationships with the shareholders have resumed on constructive grounds.

#### ***Infrastructure***

In light of the Public Investment Programme (PIP) and the priorities set out in the Poverty Reduction Strategy, the Bank can apply its expertise in a limited number of areas, mainly related to the development of municipal infrastructure and only if combined with grant support from other donors. Another approach, chosen for the air fleet modernisation project, is to structure a loan to a state-owned enterprise without sovereign guarantee, but with a collateral, similarly to a commercial loan. This is particularly well adapted to the Tajik budget situation and reinforces the commercial management of such entities.

The large potential investments in the hydro sector will require a further assessment of the commercial viability of financing long-term infrastructure projects without sovereign guarantee.

### ***Other Areas***

Effective cooperation and strong support from the National Bank allowed for a successful implementation of the Bank's non sovereign guaranteed MSE facility.

The difficult licensing process and legal obstacles, such as the protection of a monopoly on refining, were obstacles to any Bank projects in the field of mining.

Although the Tajik authorities made good progress in reforming and improving the investment climate, local and foreign private investment has not significantly increased over the past strategy period. For all that, new opportunities are likely to emerge following restructuring of the country's debts to Russia and upon completion of potential investments in hydro power generation.

### **1.4 Portfolio Ratio**

Due to the Bank's focus on private sector development in the previous strategy period, the portfolio ratio has significantly progressed towards an equilibrium between private and public sectors. Nine out of eleven signings during the strategy period were in the private sector. Despite this trend, the cumulative ratio of the Bank's portfolio currently still stands at 53:47 in favour of the public sector which is a substantial improvement from the previous strategy period which presented a ratio of 67:33 in favour of the public sector. Currently the majority of projects in the pipeline are private sector.

## **2. Operational Environment**

### **2.1 General Reform Environment**

#### **2.1.1 Political Developments**

Tajikistan is a republic with strong executive power concentrated in the presidency. President Emomali Rakhmonov's current term in office expires in 2006, although the amended Constitution leaves open the possibility for the President to remain in office for two further seven-year terms. The last parliamentary elections in February 2005 failed to meet OSCE standards, despite showing some improvement over previous elections. The reported problems included candidate registration, closure of opposition newspapers and unbalanced composition of election commissions. The ruling People's Democratic Party has retained its dominant position in parliament, winning the majority of the 63 seats in the lower house of parliament, with the Communist Party coming second and the Islamic Renaissance Party finishing distant third.

Tajikistan, an ETC country, was the poorest republic of the Soviet Union and remains among the most impoverished countries in the region. Widespread poverty, high unemployment, low salaries, combined with weak institutions, ineffective judiciary and significant drug transit, creates an atmosphere conducive to corruption and makes poverty alleviation a key priority for the country.

Externally, the proximity of Afghanistan remains an important factor. Despite major efforts by the Tajik authorities, resulting in increased seizure of narcotics, significant volumes of drugs continue to cross the Afghan-Tajik border. Tajikistan has close traditional ties with Russia and strives to maintain balanced relations with all its regional neighbours.

#### **2.1.2 Environmental Issues**

##### ***Background***

Tajikistan is a unique country in Central Asia, with significant water resources, arable land and mountainous regions, and a number of rare animal and plant species. The country's rivers constitute two major river systems of Central Asia, the Amu Darya and the Syr Darya which feed the Aral Sea. The rivers enable irrigation of about 80 per cent of the arable land and contributing to Tajikistan's specialisation in cotton production and hydroelectric power generation. Irrigation uses up to 90 per cent of all fresh water consumption in the country, although Tajikistan has lower per capita annual water consumption and land irrigation than other Central Asian countries.

Inappropriate and intense use of pesticides and fertilizer in the major cotton producing areas of the country has resulted in contamination of soil, surface, and ground water in some areas. The Global Environment Facility (GEF) together with other donors has developed the Aral Sea Basin Program to address the root causes of the overuse and degradation of the international waters of the Aral Sea Basin (Uzbekistan, Kazakhstan, Tajikistan, Turkmenistan, and Kyrgyzstan).

Tajikistan's most noticeable environmental issues are soil erosion, soil damage due to irrigation, deforestation, environmental damage associated with aluminium smelters;

inefficient use of water resources, and natural disasters. The inadequate supply of clean drinking water appears to be the single greatest health hazard in the country. Environmental degradation and pollution have also reduced habitat for rare and endangered species, such as the snow leopard.

### ***National Environmental Action Plan***

Tajikistan is implementing a state ecological programme for use of natural resources (land, water, air, biodiversity) and human health (1998-2008); however, none of these have an overall environmental context, which will be laid out in the National Environmental Action Plan (NEAP), which is still in preparation. A National Biodiversity Action Plan was prepared in 2003 and UNDP and World Bank both initiated biodiversity projects in 2004.

In accordance with decision of World Summit on Sustainable Development (WSSD) there is signed Memorandum between SCEPF and UNEP to assist Tajikistan design the National Strategy of Sustainable Development (NSSD). On the basis of the memorandum, an Implementation Plan was approved and the government is preparing manuals and guidelines for the National Sustainable Development Commission and National Strategy on Sustainable Development in 2005.

A notable legal development since the 2003 EBRD Strategy for Tajikistan was the adoption of the 2003 Law “On ecological expertise”, which relates to projects requiring environmental impact assessment. A major structural change has also been undertaken, in January 2004, when the Ministry of Natural Protection was replaced by the State Commission for the Environment Protection and Forestry (SCEPF).

### ***Protected Areas, Biodiversity, and Desertification***

Plans are being made for a 2.5 million ha. Pamir National Park, which was legally established in 2003. This project is to create a special conservation area for Marco Polo sheep, ibex, snow leopard and other vulnerable species. The territory will create a large reserve involving parts of Tajikistan, Afghanistan, Pakistan and China and is supported by the European Commission and TACIS.

The government of Tajikistan has signed and ratified a number of international conventions on environment, including the UN Convention on Biological Diversity, the Ramsar Convention on the protection of wetlands (94,600 ha of land are designated Ramsar sites), the UN Convention on Climate Change, Stockholm Convention on Persistent Organic Pollutants (POPs), the UNESCO World Heritage Convention, and the UN Convention on Combating Desertification. Action plans have been developed for many of the conventions (e.g., climate change, desertification, biodiversity); however, the majority of implementation programmes will have been financed through donor programmes.

Desertification is a key issue for Tajikistan, and in 2001, the government agreed a National Action Programme (NAP) for combating desertification, following three years of drought. Drought in the region has caused a shortage of food, and increase of erosion and land degradation. Power shortages have resulted in increasing deforestation, and this has accelerated the desertification process. In this context the government approved a “State programme on environmental education and training of population in Tajikistan for 2000 -

2010”, which is currently being implemented and it is hoped that this will help the Republic’s ability to deal with drought.

### ***Environmental Organisations and Public Consultation***

In 2004, Tajikistan had 50 registered environmental NGOs working at the national level, an increase of 25 per cent over 2002 numbers. There is strong evidence that the NGOs are becoming more active, with a number of them being directly involved in development of NEAP and implementation of the Central Asia Regional Environmental Action Plan (REAP).

Tajikistan signed and ratified the Aarhus Convention on Public Access to Environmental Information, Public Participation in Decision-Making, and Access to Environmental Justice in 2001. Tajikistan held an International Day of the Environment, organised by the local Aarhus Centre and the State Committee for the Environment Protection and Forestry and the schools of Dushanbe.

As the poorest country of the CIS, Tajikistan needs to address environmental and related health issues in the context of economic improvement of the people. Tajikistan is unable to implement the many obligations under the conventions and plans on its own, and is working with international institutions and organisations. Significant assistance is likely to be needed in the foreseeable future to improve environmental management and requirements.

### **2.1.3 Social & Labour Issues**

In spite of the reduction in levels of poverty since 1999, Tajikistan is still the poorest country in the region, with an estimated 64 percent of the population living on less than US\$ 2.15 per day (at purchasing power parity). Rural and urban poverty rates are both high (65 per cent rural and 59 per cent urban). The poverty is regionalised, with the lowest rates of poverty found in Regions of Republican Subordination oblast (RRS) and Dushanbe and highest rates observed in Gorno-Badakhstan Autonomous Oblast (GBAO) and Khatlon.<sup>2</sup> However of note that is while poverty rates fell in rural areas between 1999 and 2003, poverty in urban areas remains persistent. Although consumption levels have increased for most income groups, inequality has increased slightly from 0.33 in 1999 to 0.36 in 2003, as measured by the Gini coefficient.<sup>3</sup> The government of Tajikistan developed a Poverty Reduction Strategy Paper (PRSP) in 2002 and issues annual reports.

There are concerns about the levels of service delivery in the educational health sectors and new health problems are appearing, such as a growing prevalence of chronic malnutrition and communicable diseases. Poverty restricts access of poor households to education, health care and important social services. Although Tajikistan has few reported cases of HIV/AIDS infection, the country is experiencing a serious drug crisis.<sup>4</sup> This would indicate that there is the potential for an increase in HIV infection in the near future. Furthermore, according to

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<sup>2</sup> Tajikistan is divided into four regions (oblasts), Gorno-Badakhstan Autonomous Oblast (GBAO) in the east, Khatlon Oblast in the south, Leninabad Oblast in the north and the Regions of Republican Subordination (RRS) in the centre.

<sup>3</sup> The Gini index measures inequality over the entire distribution of income or consumption. A value of 0 represents perfect equality, and a value of 1 perfect inequality.

<sup>4</sup> Source: US State Department annual report on Tajikistan

both UNICEF and WHO data, Tajikistan has the lowest indicators for access to safe drinking water in the former Soviet Union.

Partly as a result of the poor socio-economic environment, human trafficking has become a significant problem in Tajikistan. According to the International Organisation for Migration (IOM), Tajikistan is a major country of origin for trafficked women and children. The Tajik authorities have taken some measures to curb trafficking; including adopting a bill to criminalise such activities, but it still remains a significant problem.

Weak governance is another dimension of poverty in Tajikistan. Corruption and bribes are pervasive in everyday life. This creates obstacles for ordinary citizens in accessing essential services and economic and social opportunities, which in turn, exacerbates the social exclusion of poor people. It is not limited to public services but has also become an intrinsic part of formal banking.

Integrity remains a significant challenge for the Bank's operations in Tajikistan. Petty corruption is widespread and a large impediment to the operations of small businesses. Tajikistan ranks 185<sup>th</sup> among 204 countries according to the 2004 World Bank Governance Indicators on control of corruption and 144<sup>th</sup> among 158 countries according to the Transparency International Corruption Perceptions Index 2005. The World Bank survey also revealed that over 90 per cent of small businesses make unofficial payments to complete registration and inspection procedures.

However, there are increasing signs of improvements. Many of the largest enterprises are now obliged to comply with international standards of accounting. Moreover, the Law on the fight against corruption was adopted in April 2005 and the draft legislation on money laundering has been prepared and is shortly to be adopted by parliament. Although these are welcome developments, it is still uncertain how effectively these laws will be implemented, since government capacity to implement and enforce legislation remains relatively weak. Under these circumstances, the Bank needs to continue to develop projects in a highly selective manner.

Tajikistan joined the ILO in 1993 and has ratified all of the core ILO conventions, including, most recently, Convention 182 on the worst forms of child labour. The Constitution prohibits forced or bonded labour, including by children, except in cases defined in the law. However, forced or bonded labour has been reported. University and secondary school students are regularly compelled to participate in the cotton harvest, which is justified in terms of 'helping the family' and is permitted under the law. Persons who formerly had worked on state or collective farms may be required to pick cotton, although wages are usually not paid, and the farms do not provide the social services they once did.

As in other Central Asian countries, child labour has been a long-standing practice in Tajikistan, particularly in the agricultural sector. In 2005, the country ratified laws on "Elimination of Child Labour, Protection of Children and Young Persons" and Act #52 "On Young People and State Youth Policy.

The law accords women equal rights with men; however, discrimination against women in the work place remains a problem. Traditionally there has been a high level of female participation in the workforce. According to the US Department of State reports, there is no formal discrimination against women in employment; in urban areas where women are employed throughout government, academic institutes, and private-sector companies. Women

are legally entitled to receive equal pay for equal work; however, this regulation is not always effectively enforced. The average working woman earns just over half of what the average working man takes home.

Like all other former Soviet republics, Tajikistan experienced large-scale labour migration flows following the break-up of the USSR in 1991. This peaked in 1994 and 1995. The majority of migration is to Russia and, to a lesser extent, other CIS states. Labour migration from Tajikistan includes the following i) exodus of unskilled or semi-skilled labour for a limited period of time; ii) the “brain drain,” i.e. the emigration of highly skilled specialists; iii) migration by commercial traders, or “shuttles” and iv) replacement migration, namely when migrants from Tajikistan replace Russians who migrate to the West.

#### **2.1.4 Regional Cooperation**

Tajikistan is located in a difficult geographical area. The country is land-locked, with no commercial access to the sea, mountain-locked by one of the highest mountains in the world and distance-locked far away from key markets – Europe and Russia. Therefore, the country is dependent on neighbourly relations for market access and significantly affected by regional security issues, related to drug transit and the political situation in the region. Tajikistan’s major export routes are through Uzbekistan and Kazakhstan to Russia. Concerns over regional security and drugs have repeatedly disrupted trade flows from Tajikistan through border closures with Uzbekistan.

Tajikistan has actively participated in regional organisations such as the Euro-Asian Economic Community (EAEC), Shanghai Cooperation Organization (SCO), Central Asian Cooperation Organisation (CACO), and Economic Cooperation Organisation (ECO). The EU is also currently trying to establish a regional political dialogue with five Central Asian countries. These organisations have contributed to the harmonisation of trade policies, re-establishing economic linkages, and ultimately to the accession to WTO membership. However, in the absence of the active participation of some of Tajikistan’s neighbouring countries, the benefit of regional cooperation is limited. Tajik traders continue to face delays at the border, high and frequent official and unofficial payments for border crossings and harassment of traders.<sup>5</sup>

One of Tajikistan’s main economic assets and a key export is hydro power. Tajikistan’s trade in water and electricity is guided by complex bilateral barter arrangements. For example, under annually negotiated bilateral agreements, Tajikistan purchases power from Uzbekistan and Turkmenistan during winter time and releases water in summer used for irrigation purposes. Tajikistan also exports surplus power in summer. The pricing arrangements implicit in these barter deals do not reflect true costs, and disagreements over terms have led to the accumulation of debts and repeated supply disruptions. Creating the economic conditions for efficient regional trade in power and water remains a key challenge for Tajikistan’s future and for the whole of Central Asia. The new Sangtuda and Rogun hydro power projects will generate an important export capacity and provide a new dimension to regional cooperation.

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<sup>5</sup> These payments constitute more than 30 per cent of the total road transport costs from Dushanbe to Moscow, according to the recent IMF report. Cargo needs to be unloaded and reloaded on vehicles with Uzbek licence plates at the Tajik-Uzbek borders.

## **2.1.5 Legal Environment**

The legal environment in Tajikistan is one of the least developed of the EBRD's countries of operations.

Its commercial laws, taken as a whole, remain substantially inadequate. This is despite some recent efforts at reform in specific areas: a new leasing law, introduced in April 2003; a telecommunications law, adopted in 2002; and certain environmental protection laws, introduced in 2001 and in 2002. Some further steps towards reform were taken during 2004, in particular by the adoption of new laws on the licensing of specific types of activity and on microfinance organisations, both adopted in May of that year. However, at mid-July 2005, these latter two laws have yet to be fully implemented, as the government has not yet endorsed the necessary implementing regulations.

There has been some progress in the field of secured transactions when, in March 2005, a law on pledge of movable property was adopted. At mid-July 2005, the extent to which the law has been implemented remains unclear. More generally, the proper development of secured transactions in Tajikistan is hindered by various factors, including by the inadequacy of the existing laws and regime for the registration of transactions with immovable property.

Although bankruptcy laws are in place and their reform is under consideration, this process has not yet been pushed forwards. The country still lacks effective bankruptcy courts, trustees and enforcement mechanisms. Progress in reforming company law appears to have stalled. Tajikistan has yet to ratify or accede to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and is one of only two countries among the Bank's countries of operations which have not done so.

Beyond these specifics, the lack of implementation of such laws as are on the books and the problem of corruption in the judiciary are amongst the most serious constraints on Tajikistan's transition to a functioning market economy.

## **2.2 Economic Developments and Progress in Transition**

### **2.2.1 Macroeconomic conditions for Bank operations**

Tajikistan has made considerable progress in strengthening its economic performance in recent years. Real economic growth averaged 10 per cent during 2002-2004, which resulted in a reduction in poverty. Domestic demand is growing, fuelled by strong wage growth and increasing remittances. Output of aluminium also contributed to high growth. There is also some evidence of economic diversification and productivity increases in other sectors (particularly in the services sector). Strong growth is expected to continue in the future, thanks to planned large-scale investments in the energy and metallurgy sectors and its output capacity expansions, as well as continued increases of foreign remittances. However, key concerns remain in the industrial sector, which still suffers from lack of investment and low productivity (some rebound is observed in the aluminium sector only) and uncertainties in the cotton sector with regard to cotton finances and structural changes. Economic growth slowed slightly to 7.5 per cent during the first eight months of 2005.

Inflation has been on a downward trend since 2000, with a year-end inflation rate of 5.6 per cent in 2004, significantly lower than the 13.7 per cent recorded the previous year. This was

partly because the National Bank of Tajikistan maintained a tight monetary policy focusing on price stability. Strong monetary growth has largely been matched by the steady monetisation of the economy. However, inflationary pressures seem to have re-emerged in early 2005 with increases of utility and food prices as well as public sector wages. The recent exchange rate depreciation trend (against the US Dollar) as well as continued high oil prices should also put further inflationary pressures this year.

Fiscal policy remains prudent. Although the overall fiscal balance deteriorated slightly during 2004, the preliminary 2005 figure shows a surplus of 45.8 million Somoni (3.6 per cent of GDP excluding public investment programmes) during the first quarter. This is partly attributable to strong economic growth, improved tax administration and tight expenditure management. Further improvements should be made with the introduction of a new tax code, which will simplify the procedures, improve tax administration and reduce the cost of collecting taxes. The 2005 general government budget envisages a small fiscal deficit (0.5 per cent of GDP), with outlays mainly limited to social sector expenditures. Nevertheless, Tajikistan's fiscal revenue to GDP ratio is among the lowest in the region. Moreover there are some plans for expenditure increases, including a 65 per cent increase of the public wage bill to retain qualified personnel for the delivery of social services. Under these circumstances, further improvements in fiscal management are required to achieve sustainable public finances.

Tajikistan, as a small land-locked country, has a fairly open economy with foreign trade exceeding 100 per cent of GDP. However, exports are highly concentrated in a few commodities (i.e. cotton and aluminium) and are affected by price fluctuations of these commodities. The trade balance has recently deteriorated due to increased imports, driven by high oil prices and robust consumption demand, and delayed cotton shipments following the sharp drop in cotton prices in late 2004. Accordingly the current account deficit deteriorated from 1.3 per cent of GDP in 2003 to 3.9 per cent in 2004. Increased remittances partly offset the increased current account deficit as the amount increased from US\$ 189 million in 2001 to US\$ 313 million in 2004.<sup>6</sup> The increase reflects not only the growing number of migrant workers abroad but also increased confidence in the banking sector. FDI inflows nominally jumped up to US\$ 272 million, but the majority is attributed to the debt-equity swap with Russia and foreign investments remained limited in a real term. Gross international reserves increased substantially to US\$ 189 million by the end of 2004. There is a hope that these massive remittances remain in the banking system to be invested in the real sector, but so far most remitted funds are used for immediate family needs and home construction.<sup>7</sup>

The external debt restructuring has progressed substantially. After a series of bilateral debt reduction agreements, Tajikistan's external debt stock has been declined to US\$ 895 million. Accordingly the ratio of external debt to GDP declined from 82 per cent in 2002 to 40 per cent by the end of 2004. During 2004, Russia, the largest bilateral creditor, wrote off US\$ 306 million of its bilateral debt, primarily in exchange for the ownership rights over Sangtuda hydro power station and the Nurek space tracking station. In future, the country's public external debt is expected to rise moderately in nominal terms, however, thanks to its concessional nature it will remain at a sustainable level. Nevertheless, the government

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<sup>6</sup> The number reflects only remitted funds through the banking system and does not reflect cash carried by migrant workers and money transferred by illegal methods. The true figure is hard to estimate but estimates go up to US\$ 1 billion (about 50% of GDP). Most remittances come from Russia (92% of total).

<sup>7</sup> 82% of the respondents under the NBT survey mentioned they were not ready to deposit remitted funds in the banking system.

continues to limit externally financed public investments to four per cent of GDP (approximately US\$ 91 million for 2005) and continues to refrain from borrowing any non-concessional sovereign loans and issuing financial guarantees to foreign investors.

Under these circumstances described above, key macroeconomic challenges for a new strategy period can be summarised as;

- *Maintaining high economic growth:* continued economic growth should be achieved through economic diversification. The non-cotton agriculture sector should be developed as well as non-aluminium industry. The country should also be encouraged to retain some remittances in the banking sector for productive investments.
- *Maintaining prudent fiscal policy:* fiscal adjustment is required to deliver the recent commitments to increase public wages and pensions. In particular, the effective implementation of a new tax code is a major challenge. Tax revenues need to be increased with improvements in tax and customs administration to achieve the fiscal balance target of 0.5 per cent of GDP.
- *Maintaining tight monetary policy:* the monetary authorities should continue to exercise tight monetary policy to contain inflation. The effective implementation of capital account convertibility, as committed with the IMF, is also critical.
- *Further reductions of external debts:* the authorities need to deliver financial commitments made with Russia (i.e. invest in Sangtuda on behalf of Russia). The government is also encouraged to further restructure remaining bilateral debts, i.e. with the US, Turkey and Uzbekistan.

## **2.2.2 Progress in Transition and Remaining Challenges**

### **2.2.2.1 Progress in Transition**

Tajikistan has made good progress in small-scale privatisation and price and trade liberalisation during the 1990s, as shown by EBRD transition indicators (see Table 2). The country maintains the managed floating exchange rate regime with full currency convertibility and is currently negotiating for membership of the WTO. Most prices are fully liberalised while utility prices are regulated by relevant regulatory authorities. Tajikistan recently accepted the full obligations of the IMF's article VIII, Sections 2, 3, and 4 in December 2004, eliminating the foreign exchange restrictions on current transactions.

However, little progress has been made in the areas of large-scale privatisation, enterprise restructuring and governance, and market orientated development in infrastructure. The financial sector (including non-bank institutions) remains weak as a financial intermediary, although there has been good progress made in the banking sector in recent years. Commercial banks have neither gained the full confidence of the public nor provided long-term finances in the real sector, especially for micro and small enterprises, as banking activities are more focused on providing short-term trade financing and foreign exchange operations.

The government has been committed to a Poverty Reduction Strategy Paper (PRSP) since 2002 to increase the real incomes and achieve fair distribution of the benefits of growth as well as to ensure a rise in the living standards of the poorest groups of the population. The strategy focused on four key objectives; i) encouraging equitable, labour intensive economic growth, with an emphasis on exports; ii) supporting the fair and efficient provision of basic

social services; iii) targeting support to the poorest groups of the population; and iv) improving governance and security. Private sector development was an important part of the strategy. The international community acknowledges the modest progress made so far in reducing poverty and improving policy effectiveness. Poverty has already been reduced moderately, as indicated in the 2004 PRSP progress report, as the population living below the poverty level declined from 83 per cent in 2001 to 68 per cent in 2003. However, institutions must much be strengthened throughout all sectors to implement the PRSP objectives more comprehensively. A new PRSP is due to be prepared in 2006.

**Table 2 Transition Indicators of the CIS countries, 2005**

| Countries           | Enterprises               |                           |                                       | Markets and Trade    |                                 |                    | Financial Institutions                        |  | Infrastructure        |
|---------------------|---------------------------|---------------------------|---------------------------------------|----------------------|---------------------------------|--------------------|---|--|-----------------------|
|                     | Large-scale privatisation | Small-scale privatisation | Governance & enterprise restructuring | Price liberalisation | Trade & foreign exchange system | Competition policy | Banking reform & interest rate liberalisation | Securities markets & non-bank financial institutions | Infrastructure reform |
| Armenia             | 4-                        | 4                         | 2+                                    | 4+                   | 4+                              | 2+                 | 3-  | 2  | 2+                    |
| Azerbaijan          | 2                         | 4-                        | 2+                                    | 4                    | 4                               | 2                  | 2+  | 2-   | 2                     |
| Belarus             | 1                         | 2+                        | 1                                     | 3-                   | 2+                              | 2                  | 2-  | 2  | 1+                    |
| Georgia             | 4-                        | 4                         | 2+                                    | 4+                   | 4+                              | 2                  | 3-  | 2-   | 2+                    |
| Kazakhstan          | 3                         | 4                         | 2                                     | 4                    | 3+                              | 2                  | 3   | 2+   | 2+                    |
| Kyrgyz Republic     | 4-                        | 4                         | 2                                     | 4+                   | 4+                              | 2                  | 2+  | 2  | 2-                    |
| Moldova             | 3                         | 3+                        | 2                                     | 4-                   | 4+                              | 2                  | 3-  | 2  | 2+                    |
| Russia              | 3                         | 4                         | 2+                                    | 4                    | 3+                              | 2+                 | 2   | 3-   | 3-                    |
| <b>Tajikistan</b>   | <b>2+</b>                 | <b>4</b>                  | <b>2-</b>                             | <b>4-</b>            | <b>3+</b>                       | <b>2-</b>          | <b>2</b>                                      | <b>1</b>   | <b>1+</b>             |
| Turkmenistan        | 1                         | 2                         | 1                                     | 3-                   | 1                               | 1                  | 1   | 1  | 1                     |
| Ukraine             | 3                         | 4                         | 2                                     | 4                    | 3+                              | 2+                 | 3-  | 2+   | 2                     |
| Uzbekistan          | 3-                        | 3                         | 2-                                    | 3-                   | 3-                              | 2-                 | 2-  | 2  | 2-                    |
| <b>CIS Average</b>  | 3-                        | 3+                        | 2-                                    | 4-                   | 3+                              | 2                  | 2+  | 2-   | 2                     |
| <b>EBRD Average</b> | 3                         | 4-                        | 2+                                    | 4                    | 4-                              | 2+                 | 3   | 2+   | 2+                    |

Note: The index ranges from 1, indicating little or no progress, to 4+ pointing to standards similar to advanced economies. See Transition Report 2005 for the detailed definitions.

Source: EBRD Transition Report 2005.

The detailed sector-by-sector analyses of the remaining transition challenges in the EBRD's countries of operation are in Annex 9. The analyses have been made to map specific transition challenges under the transition indicator headings i) Structure and extent of markets (e.g., extent of competition); ii) Market institutions and policies (e.g. regulatory framework); and iii) Market-based skills, conduct and innovation (e.g., improvements in corporate governance). Looking forward, Tajikistan still faces significant transition challenges in almost all sectors and in all transition indicator headings. Particular emphasis was placed on weaknesses in market institutions and policies.

Considering the country's key priorities and the assessments made by the Bank, the following three areas are considered particularly important as related to the Bank's activities.

### ***Private Sector Development***

The private sector in Tajikistan remains underdeveloped. The public sector still dominates the most important parts of the economy; as a result, the private sector share of GDP remains limited to about 50 per cent. FDI inflows are also limited (around 2-3 per cent of GDP annually) reflecting the difficult business environment. Although small-scale privatisation is now almost complete, progress in large-scale privatisation remains modest, particularly for utility companies. There remain over 400 medium and medium to large-scale state-owned enterprises. Almost all strategically important enterprises remain in public hands (including telecom and power companies). Nevertheless, the authorities have established a special committee, headed by the Prime Minister, to formulate concrete plans for restructuring and private sector participation (e.g. management contract, concessions and privatisation) for these enterprises. The process needs to be completed by the end of 2005. The restructuring

of large-scale enterprises, including TADAZ, BarkiTojik, Tajiktelecom, TSA and TajikRail, needs to proceed in parallel to reduce the drain on public resources and attract foreign investment.

Tajik enterprises continue to perceive the business environment as very difficult. The business environment survey, conducted by the IFC (2003), identified key impediments for doing business in Tajikistan.<sup>8</sup> These impediments include excessive procedures for inspection and registration, high costs (including unofficial payments), the length of time required to obtain or renew licenses, difficulties in obtaining information and access to finance. According to the survey, small businesses undergo an average of 16 inspections every year, which cost firms US\$ 110 in fines and unofficial payments and take 17 working days. Registering a firm takes an average of 25 days and costs US\$ 176 for SMEs (including both official and unofficial payments). 65 per cent of SMEs face difficulties obtaining comprehensive and reliable information on registration process. 98 per cent of small businesses make unofficial payments to complete regulatory procedures. 82 per cent of SMEs do not use bank accounts in their business activities. These facts reconfirm the difficult business environment in Tajikistan, particularly for micro and small enterprises. Nevertheless, the 2005 Business Environment and Enterprise Performance Survey (BEEPS), conducted by the World Bank and the EBRD, revealed that all indicators improved from the last survey conducted in 2002.

Another important area where major restructuring is necessary is agriculture, particularly in the cotton sector. With the majority of the rural population either directly or indirectly dependent on agriculture, rural reforms are critical to improve economic activities and reduce poverty. But the process of land reform has been slow, and most farms, including dekhan farms (individual land plots), do not have land certificates. Moreover, dekhan farms are heavily indebted from past operations and are having difficulties in obtaining new financing. The international community has been concerned and worked together with the government in recent years but no resolution has been adopted yet.

### ***Financial Sector Development***

Good developments have been made in recent years. Banking sector consolidation progressed as a number of weak banks have exited or transferred to non-bank institutions. Currently there are 12 banks (including one publicly-owned bank), 6 credit unions and 7 non-bank financial institutions. The minimum capital requirement was increased to US\$ 5 million in January 2005, which is already applicable to the four largest banks and any new entrants, and the other existing banks need to comply with the requirement by the end of 2005. The NBT granted two new banking licenses during 2004 (both foreign participated banks) and there are a couple of other foreign banks expressing their interest in obtaining new licenses. This is because the government is in the process of liberalising regulations as foreign banks are able to own 100 per cent of banks' shares (currently restricted to 35 per cent) and the corporate manager can also be a foreign citizen (currently must be a Tajik national). The law on pledge of movable properties was also adopted to allow pledging small movable properties (such as cars) as collaterals for loans.<sup>9</sup> Moreover, the deposit insurance scheme became operational in 2004. These developments certainly increased public confidence and both

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<sup>8</sup> The IFC's Business Environment in Tajikistan as seen by Small and Medium Businesses was published in 2004.

<sup>9</sup> This should be particularly useful for micro and small enterprises and farmers who do not have any eligible fixed assets to pledge.

deposits and capital have increased significantly during the past two years. The authorities are also willing to develop a securities market, primarily a primary and secondary bond market.

Nevertheless, the banking sector remains underdeveloped and concentrated and the level of financial intermediation is among the lowest in the transition economies. The four largest banks control 70 per cent of assets, 81 per cent of household deposits and 71 per cent of private loans. The domestic credit to GDP ratio remains low, at 16 per cent, of which half relates to cotton financing. Deposits are dominated by dollar deposits and only represent 4.3 per cent of GDP. Moreover, commercial banks' activities are mainly focused on providing short-term trade financing, often to bank insiders, and operations related to foreign exchange markets. The authorities aim to develop mortgage financing and consumer credits but the size is negligible for the time being.

### *Infrastructure Reforms*

Tajikistan inherited a comprehensive infrastructure from Soviet times, but due to tight budgetary constraints and partly due to the impact of the civil war, new investments and even basic maintenance of the existing infrastructure have been neglected during the transition period. Therefore there are large investment needs in infrastructure rehabilitation and modernisation. A particular concern is the quality of irrigation and water systems, which has been addressed by a number of donor initiatives, but only limited progress has been made. Other priority areas are transport and power. Over the past few years, the government has begun to implement a series of institutional and tariff reforms to lay the foundations for sustainable institutional structures and future private sector participation in infrastructure. Regulatory functions were essentially separated from operational functions but the separation is often fragile and regulators are often not fully independent.

On the institutional side, a telecom regulator was established initially within the Ministry of Communication, but is not fully independent yet. In the aviation sector, the Civil Aviation Department (CAD) was created as a regulator, but airline business, airports and air navigation functions remain in one company. In the energy sector, the restructuring process is also progressing, albeit at a slow pace. BarkiTojik is now operated as a holding company managing 28 subsidiary companies. In future, some companies might be consolidated (e.g. national grid company), and/or sold to private investors. Distribution functions are likely to be consolidated into three regional monopolies (north, centre and south). Nevertheless, the separation between policy making and operations is effectively weak. It is crucial to increase the efficiency of public utilities through the introduction of commercial principles and the enforcement of regulatory reform. This may initially happen under public ownership but should involve various forms of private sector participation at a later stage. For all utilities, privatisation is perceived as premature under the present environment as it is unlikely attract foreign strategic investors. However, other forms of private sector participation, including management contracts, leases, and concessions, might be feasible and the government is currently considering these options seriously.

Good progress has recently been made in tariff reform. In the power sector, under an ADB supported programme, average prices rose substantially and the collection ratio has increased significantly. However, electricity tariff levels remain low and need to be increased substantially in future to reach a cost recovery level. The authorities will soon adopt a new resolution to eliminate payment exemptions of public entities and some privileged

households. In the telecom sector, local call and related charges increased once in 2002 and twice in 2003. A Tariff plan for 2003-2007 was approved in 2004, aiming for full cost recovery to be achieved in 2006. The collection rates of all utilities have significantly improved, but collections from state entities remain poor and substantial payment arrears remain from previous years.

In the energy sector, large investment commitments have been made recently. The Tajik government signed investment agreements with the Russian authorities (and Russian companies including RAO UES and Rusal) for a total of US\$ 1.57 billion over 7 years. This includes two hydro-power stations (Rogun and Sangtuda which were initiated under the Soviet time and never completed). Iran is also committed to invest in Sangtuda II. German Lahmeyer International is currently conducting a feasibility study for the Rogun station (the final report will be ready by end-2005). The government's public investment programme (PIP) includes numerous infrastructure projects, and the authorities are aware of the need for further tariff increases and institutional reform if such investments are to be made in future. During the course of PRSP, one criticism related to the prioritisation of public investments. The critical challenge in infrastructure is to prioritise investments given limited public funds and to promote private investment in the modernisation of infrastructure.

### **2.2.2.2      *Transition Challenges***

The following areas emerge as the key transition challenges for Tajikistan over the next strategy period:

#### ***Private sector development***

Privatisation and other modes of Private Sector Participation (PSP) for remaining large-scale state enterprises should be carried out without further delays. For the enterprises already privatised, which have faced difficulties operationally and financially, it is important to ensure post-privatisation restructuring and investments to improve productivity, quality of products/services, and governance. To this end FDI should be encouraged with a view to attracting strategic investors. Further improvements are needed along all business environment dimensions including streamlining the government's role, addressing weaknesses in the legal and regulatory framework, strengthening the integrity of the courts, and reducing corruption. For unviable businesses, the enforcement of the bankruptcy procedure needs to be streamlined. The agriculture sector reform process should be accelerated.

#### ***Creating a financial sector that is able to function as financial intermediary***

Further financial sector consolidation and increased capitalisation as well as the entry of foreign banks are encouraged. The banking sector needs to gain more public confidence and attract additional domestic deposits, partly by the successful implementation of the deposit insurance scheme. Financial intermediation needs to be further deepened by providing access to finance for domestic enterprises, particularly long-term funding and funding for entrepreneurs and micro and small enterprises. Finances in the real sector and for new products such as mortgages are also encouraged. Creditors' rights to collateralised assets must be strengthened and the transfer process should be simplified. The authorities are also encouraged to develop a securities market, both primary and secondary.

## ***Promoting commercialisation and private sector participation in public infrastructure***

Continued efforts are needed to commercialise and/or privatise infrastructure enterprises. Regulatory institutions should be strengthened or established if an independent regulator has not been established. The success of ongoing restructuring in the energy sector and recently started commercialisation efforts in the transport sector represent important steps; these should be followed in the infrastructure sectors by further tariff adjustments and improvements in collection rates to ensure commercial viability.

### **2.3 Access to Capital**

Tajikistan has substantial investment needs both in the public and private sectors. Public finance remains essentially dependent on official financing from donors and IFIs for most of its public investments. The country has held a number of successful Consultative Group meetings in the past and the donor community is committed to support the country's poverty reduction policy. Most bilateral aid is in the form of grants. Externally financed public investment programmes are restricted to 4 per cent of GDP (around US\$ 90 million for 2005); however, as many multilateral donors are likely to reduce their exposure to Tajikistan, the actual disbursements could be less than the 4 per cent ceiling. The government has not issued any international bonds.

Private sector access to medium- and long-term finance is extremely limited in Tajikistan. Credit to the private sector remains among the lowest in the region and private enterprises are not able to access to international financial markets. Interest rates remain high and most bank lending is short-term (up to 3 months). Access to bank lending is especially difficult for micro and small enterprises (which account for more than 90 per cent of total enterprises). One sector which has attracted private financing is the cotton sector. The sector used to attract around US\$ 90 million annually. However, the key foreign financier decided not to extend the traditional financing, partly because farmers' debts have reached unsustainable levels. Another sector is aluminium. The state-owned aluminium company (TADAZ) holds around US\$ 160 million in commercial debt, much of this as working capital finance from alumina suppliers. There are no functioning domestic equity or bond markets and access to international debt/equity markets by Tajik enterprises remains almost impossible. The opportunity to increase the amount of FDI exists, particularly from neighbouring countries and Russia, but it all depends on regional stability and the relationship with Russia. Foreign investors from the West remain limited.

### **3. Strategic Orientations**

#### **3.1 The Bank's Priorities**

Within the current macroeconomic environment and transition challenges, the country's progress on key structural reforms, and the priorities set in the ETC Initiative, the Bank will continue to focus on the development of the private sector. This will be achieved directly with ETC products, or through the banking sector at the micro, small and medium enterprise level, or by attracting and co-financing foreign direct investment.

The Bank will also pursue the development of public financing projects within the priorities of the Poverty Reduction Strategy. The Bank seeks to co-finance major infrastructure projects, such as roads and power, with other IFIs.

In addition, the Bank will continue its efforts to improve the investment climate. This will be achieved directly through project implementation, but also through active dialogue with the government, within the existing donor community structures, or directly. Technical cooperation will also address specific concerns, including pledge legislation, further commercialisation of state-owned enterprises, tariff reform and institution building.

##### **3.1.1 Financing the Private Sector**

The Bank will continue to focus on micro businesses, through further development of micro and small business credit lines administered by local banks and non-bank financial institutions. A particular focus will be to develop the branch networks, fostering penetration of financial institutions in secondary cities and towards the rural areas, thus increasing financial intermediation in rural areas and the agricultural sector.

In parallel, the Bank will initiate the launch of much-needed SME facilities through local banks with specific technical cooperation. The Bank will also continue to promote enterprises engaged in foreign trade through the Trade Facilitation Programme. In addition, it will seek to attract regional and international investors, including from especially Russia, Turkey, China, Kazakhstan, Pakistan and India, particularly in the agribusiness and financial sectors. The Bank is ready to support further efforts on the part of the government towards large-scale privatisation, if improvements in corporate governance, efficiency and transparency can be achieved.

The Bank will make use of the recently launched ETC products to explore opportunities for direct financing in a number of key sectors, including agribusiness and food processing, textiles and other light industries, construction materials, property and tourism, natural resources and telecommunications. The new banking tools introduced with the ETC Initiative, such as the Direct Lending Facility (DLF), Direct Investment Facility (DIF), Medium Co-Financing Facility (MCFF), as well as the support of a team dedicated to the ETC Initiative, are well adapted to the Tajik scale and will enhance opportunities to develop local and smaller projects.

##### **3.1.2 Strengthening the Financial Sector**

Despite significant improvement and consolidation, the banking sector still has a limited impact on economic development. Given the constraints of a small capital base, the Bank

will be more proactive in advocating increased capitalisation and will remain ready to support the entry of new private investors, i.e. reputable local investors and regional and international foreign investors including Russia and Kazakhstan, and will seek further opportunities for equity participation, in order to strengthen the banking sector's institutional capacity.

The Bank will actively seek opportunities to involve more banks in its programmes, including the Micro and SME credit lines, TFP and MCFF. It will strengthen the banking sector through technical cooperation, including capacity and institution building programmes, seminars and legal advice on anti-money laundering, banking supervision, credit bureau and advice on the introduction of sound deposit insurance.

The capacity to expand the full range of bank lending products (MF, SME and TFP) will be constrained by the size and strength of the partner banks. The Bank will therefore continue to utilise the Central Asia Risk Sharing Special Fund's (CARSSF) bilateral risk mitigation facilities and ETC funds to maximise the exposure to the local banks.

### **3.1.3 Support for Critical Infrastructure**

The investment needs in infrastructure are significant and remain critical to the country's development as well as the attraction of foreign investment, but constrained by limited public resources and sovereign borrowing. Given the Bank's inability to provide concessional loans, the Bank will consider financing non-sovereign infrastructure that produces cash flows to meet debt repayments without recourse to sovereign guarantees. This could be the case in the hydro power sector which should develop considerably in the coming years.

In the municipal infrastructure and transport sectors, including road and air transportation, in which the Bank has developed much needed expertise, the Bank will attract further donor grants to blend with its resources, in order to achieve the necessary concessional terms. The ETC Initiative and bilateral support should enhance the availability of such funds. The Bank will cooperate with the ADB and the WB Group with a view to participating in road and power transmission projects.

### **3.1.4 Policy Dialogue**

During the strategy period, the Bank will strengthen its policy dialogue with the authorities, in order to improve the investment climate, governance, transparency and to support reform efforts. The Bank will coordinate closely with other IFIs and the business community within the existing donor coordination structures. As noted above, the Bank will seek co-financing opportunities with other IFIs and bilateral institutions to mobilise greater resources, especially in the hydro power sector and in projects that could enhance regional cooperation. The Bank's Environmental Policy and Public Information Policy will apply to all projects developed in Tajikistan.

## **3.2 Sectoral Challenges and Bank Objectives**

### **3.2.1 General Industry**

The Bank's main transition goal in this sector is to strengthen the private sector base of the economy. Despite the recent encouraging expansion of private sector employment, making this sustainable will be the key to absorbing Tajikistan's rapidly expanding and largely rural population.

With the introduction of the ETC Initiative (ETCI) in early 2004 the Bank is now able to work directly and more easily with small and medium enterprises, thus helping to unlock the country's economic potential. The ETCI will increase its role in supporting private sector companies through the Direct Lending and Investment Facilities and will extend the Medium Sized Co-financing Facility to local participating banks. This will promote not only growth in the capitalisation of real sector of the economy, but also the introduction of international management practices at these enterprises. The target sectors for such projects include agribusiness and food processing, glass and other packaging materials, textiles and other light industry, construction materials, property and tourism, power, natural resources and telecommunications.

The Bank is currently working on a pipeline of potential projects, from EUR 0.5 to 5 million, and will further examine and implement new project proposals during the strategy period. The current pipeline covers the production of high quality cotton seed oil, giving additional value to the cotton farmers, and a glass jar plant, vital for the development of agro conservation, and small scale exports to Kazakhstan and Siberia. The Bank is also considering the development of a tomato processing plant with large scale export potential to the world markets.

Another goal of the Bank in the private sector is to attract additional foreign investment into larger local enterprises. Tajikistan has not been attracting many investments until now, for reasons mainly related to the civil war, access to markets and levels of poverty, but the prospects are now improving dramatically. Indeed, several opportunities have appeared, primarily in agribusiness, food and cotton processing, and the Bank will seek to market these actively.

As medium- and large-scale privatisation and restructuring gather pace, additional investment opportunities may become available and will allow the Bank to support these critical reforms. The Bank is ready to support further efforts on the part of the government towards large-scale privatisation, if improvements in corporate governance, efficiency and transparency can be achieved. The Bank will also monitor the development of one of the country's key export enterprises, the aluminium smelter TADAZ, in close cooperation with other IFIs, in particular to see how the company is progressing on issues such as restructuring, corporate governance and transparency.

### **3.2.2 Agribusiness**

Agriculture remains the main economic sector in the republic of Tajikistan, both in terms of output, transformation and employment. Agribusiness will be targeted in priority by our bankers in order to develop projects in this area. Tajikistan's climate and soil conditions favour the growing and processing of cotton, as well as top-fruit and vegetable crops, with the large Russian market ready and able to absorb any and all quality products that Tajikistan can produce. The agri-processing sector has been mostly privatised but the industry is still using Soviet-era equipment and suffering from severe under-investment due to lack of equity and debt capital.

A competitive, export-orientated modern agri-processing industry will be able to create value in the economy directly and indirectly by improving the prices paid to farmers and bringing in valuable foreign currency earnings.

To address the transition challenge of industry modernisation, the focus of the agribusiness team in Tajikistan will be finding bankable projects in the agri-processing sector with local enterprises or, on an opportunistic basis, with foreign industry investors. Priority sub-sectors will be in the primary processing of agricultural commodities such as cotton ginning, fruit and vegetable processing and edible oil manufacturing, where Tajikistan has good natural potential for the cultivation of raw materials.

The Bank has identified some key projects which are listed in Annex 3. It will endeavour to develop more projects in this sector through such measures as conducting additional surveys of the sector to focus on fruit and vegetable processing enterprises in the south of the country. As agribusiness is strongly dependent on transportation and water management systems, the Bank's activities in infrastructure will also contribute to the development needs of agribusiness.

### **3.2.3 Natural Resources**

Tajikistan has considerable mineral resources that, with the exception of the aluminium industry, have yet to see significant commercial operations. The reason for this is that the overall investment climate is still not conducive to attracting foreign investors. There is, for instance, a need for better and more transparent revenue management, particularly in accountability of licensing agreements and concerning revenue flows between private companies and the state. This needs to be supported by sector reforms including the removal of direct and indirect subsidies and greater clarity for the policy and regulatory frameworks under which the sector operates.

For all that, the sector as a whole could give rise to significant investment possibilities, if the above issues will be tackled and credible strategic investors can be attracted. The transition goals of the Bank are therefore to support the creation of markets and suitable regulatory regimes. This will be done by seeking opportunities to promote private sector participation and encouraging policy dialogue through specific, viable projects. The Bank will thus aim at setting high standards for business conduct and environmental protection. The Bank will also continue to assist in the privatisation and restructuring of state oil, gas and mining assets.

In the short term, the Bank's specific operational focus will be to develop the growing potential for individual private sector projects in metal mining. This will in most cases require institutional reform, especially in respect of gold mining, where investment to date has not provided returns comparable to international benchmarks. In this respect the Bank is willing to assist in dealing with project-specific issues in order to support suitable gold and other precious metals investments. The Bank has worked closely with the Western sponsor over the Zarafshan gold mine project, which represents a potential opportunity for investment. There is also potential for brown coal, oil and gas projects, which will be evaluated on a case-by-case basis.

### **3.2.4 Financial Institutions**

The transition goal in this sector is to work selectively with local financial institutions to improve their performance and provide safe intermediaries for the Bank's MSE, SME and TFP facilities. By asking for high standards of corporate governance and financial transparency, and through participating in existing or newly-created financial institutions in Tajikistan, the Bank expects to strengthen competition in the sector and achieve

demonstration effects, as other financial institutions attempt to emulate the success of the Bank's partner banks.

The key tools for the Bank to improve the operational performance of local banks will be the provision of medium- to long-term term funding through new MSE/SME Framework, as well as continued support of successfully implemented Microlending programme and continued expansion of the TFP facility, all combined with technical cooperation components. The Bank will seek to work with more financial institutions in these projects. CARSSF will be a crucial tool to increase Bank's operations, given the growing volume of TFP transactions, the need for a further TFP limit increase and considering local financial institutions' constrained capital base.

Continued expansion of MSE/SME and TFP programmes envisage provision of substantial technical assistance to improve credit assessment and financial management skills and to help introduce these new products to the local banks. So far, with donor support the Bank has mobilised a number of consultants covering such crucial areas as corporate governance practices, anti-money laundering procedures, training of local banks' trade finance staff and development and implementation of credit procedures and lending techniques.

Although the Bank experienced serious corporate governance issues arising from the dilution of the Bank's equity in TSOB, the Bank continued to seek opportunities in the sector and intends to complete an equity investment in Eskhata Bank, a small, well-managed bank, by the end of 2005. Going forward, the Bank will screen further opportunities to participate in the equity of the existing banks in order to strengthen their capital base and, through the Bank's involvement, facilitate institutional development and, ultimately, increase the level of financial intermediation in the Tajik banking sector. Thorough due diligence on selected partner institutions will be key to these efforts, as will be the ongoing policy dialogue with the NBT to enhance mutual understanding of the conditions necessary to promote direct private investment in the banking sector. The Bank will strengthen policy dialogue with regard to the issues related to corporate governance, banking regulations and supervision. Where possible, the Bank will seek to mobilise additional official and private sources of co-investment into the capital of selected banks.

### **3.2.5 Transport**

The main transition goal in this sector is to improve the quality of transport infrastructure in a way that is commensurate with the limited public resources available and that creates the basis for sustainable future operations of infrastructure enterprises, where possible through the attraction of private investment. As mentioned in Section 2.3.3, the state of infrastructure deteriorated sharply during the last decade due to poor maintenance and lack of new investments. The Bank will aim to support new investment selectively in the light of the limited borrowing capacity of the country.

#### ***Roads***

The key road sector issue today is the establishment of an effective road maintenance programme and how to implement a road rehabilitation programme. Currently many kilometres of the main road network are effectively lost each year due to lack of adequate maintenance. The future cost of reinstating these into the network will be many times the cost of an adequate maintenance programme. The Bank will seek to promote the allocation of

adequate budgetary resources for road maintenance budgets and to increase the effectiveness with which funds are used.

The Bank will focus on road rehabilitation projects that facilitate internal communication within Tajikistan and also regional trade with neighbouring countries, especially the Kyrgyz Republic and Afghanistan. Such projects would assist with poverty reduction and promote economic growth through infrastructure rehabilitation and foster regional cooperation. Focus on rehabilitation will also promote transition impact by strengthening public sector governance, and making more effective use of public funds.

### ***Aviation***

The aviation sector will continue to play a vital role for land-locked Tajikistan. Increased labour mobility with the Russian Federation (remittances from Tajik workers are anticipated to increase, raising foreign currency resources), trade within the region and the rest of the world, and development of the tourism sector depend significantly on aviation. The Bank has been active in the sector for some time with assistance for the renovation of airport runways, air navigation modernisation and a project preparing for the modernisation of the Tajik air fleet. Throughout, Bank assistance has supported reforms in the sector, mainly with technical cooperation programmes. The regulatory functions of the Tajikistan State Air Company (TSA) were transferred to a Civil Aviation Department within the Ministry of Transport in 2001. Further, the Bank has been supporting the restructuring of TSA through creating initially three business units (air transport services, airport services and air navigation services). In the context of the Fleet Modernisation project, the Bank will continue to engage with TSA and the government on further reforms.

### **3.2.6 Power**

Tajikistan's power resources, with its substantial hydro potential among the highest in the world, could arguably become the country's main export item. However, there are a number of factors that have so far hindered the realisation of this potential. Due to the post-war impoverishment of the population, electricity tariffs remained the lowest in the Central Asian region. The fiscal limitations on state borrowing precluded major international financial institutions from direct investments into the much-needed rehabilitation of the ageing assets. With Tajikistan's transmission infrastructure closely tied to those of its neighbours Uzbekistan and the Kyrgyz Republic, regional cooperation is also important.

The sector reforms started in 2000 with the separation of the operational and regulatory functions of the Ministry of Energy and creation of Barki-Tojik, a vertically integrated state-owned holding and its 28 subsidiaries in generation, distribution and transmission. Serious changes in tariffs commenced in 2001 with the adoption of a two-tier tariff system for life-line (250 kWh per month) and above life-line levels, which in turn change in summer and winter.

These developments, coupled with improvements in overall economic performance, helped Tajikistan's power export potential gain the interest of both IFIs and foreign investors. Thus, in 2004 RAO UES Russia declared its commitment within the recent Russian/Tajik debt restructuring agreements, to finance construction and completion of a large hydro on the Vakhsh River, Sangtuda, left unfinished after the break down of the Soviet Union. Along with other IFIs, the EBRD is ready to consider financing the project. The Bank will also

closely follow developments of the other power projects in the country, in particular Rogun hydro power station and North-South electric transmission lines.

The Bank's strategy in Tajikistan's power sector will focus mostly on cooperating with the other IFIs in adding new export-orientated capacity, developing the electricity transmission network to allow exports, initially towards the South and later towards the North, as well as supporting rehabilitation of existing assets. Considering the limitations on public finance, the Bank will favour Public-Private-Partnership structures and cooperation with private utilities companies. A strong consideration will be given to projects with regional dimensions.

### **3.2.7 Telecoms**

Development of the telecoms sector is at an early stage although new players have emerged, especially in the mobile and internet service provision markets. While some revisions have been made to the legal and regulatory framework for the sector, meaningful implementation of reform to critical areas of that framework lags, delaying, and potentially restricting, development of a liberalised and commercialised telecom sector. If this is not rectified, there will increasingly be tensions and problems for the private sector operators.

The government has announced its intention to privatise state-owned incumbent fixed-line operator, Tajiktelecom. Given the current market conditions in Tajikistan, weak regulatory framework development and limited interest of foreign investors for both this market and the region, this may be difficult to realise in the short term. To enhance prospects for the successful development of the sector, the government should immediately focus on implementation of the legal, regulatory and institutional reforms necessary to attract and sustain private investment in the sector. The Bank is ready to support the development of the sector, including such measures as facilitating the participation of foreign investors.

The key sector challenges in this respect are to:

- Reduce the role of the government in the sector to fully enable a competitive and liberalised market to operate.
- Review government policy for the sector (revising as necessary) clearly and transparently setting out precise objectives and a workable timetable for its development.
- Improve the governance of Tajiktelecom, including board reform, by the introduction of independent non-executive board members.
- Speed up implementation of legal, regulatory and institutional reform for the sector, in particular, create an independent regulatory authority, appropriately independent of both political and sector operator influence.
- Fully implement, in a timely fashion, policies and mechanisms already developed, including licensing and interconnection arrangements. Continue with tariff rebalancing.
- The Bank stands ready to consider further assistance with sector development, where there is implementation of sector reforms already before the government and meaningful commitment to implementation of further necessary reforms.
- The Bank will look for new opportunities to provide financing for private sector projects in the telecoms, informatics and media sector. Given the limited markets currently existing, these efforts are likely to be directed towards smaller companies using existing financing tools, e.g., DIF, TFP and SME credit lines.

- The Bank intends to build on its existing relationship with Tajiktelecom and assist the government in its efforts to privatise the company through a transparent and open tender process.

### **3.2.8 Municipal & Environmental Infrastructure**

Another priority area, both to the Bank and the government, relates to municipal and environmental infrastructure. Specifically, the Bank will support such sectors as water supply, solid waste collection and disposal and urban transport in municipalities where the population suffers severely from the poor quality of services. The Bank will support, within the existing tight affordability constraints, a commercial approach by municipal entities to improve service delivery and cost control, while gradually introducing cost recovery tariffs and improved collection practices to enable these utilities and service companies to provide a financially sustainable service in the medium term. This will require significant organisational restructuring, while municipalities need to ensure that adequate project implementation and supervision capacity at enterprise and municipal level is in place to undertake new investments.

In order to fund such projects within the affordability constraints of Tajikistan, grant co-financing will be required. In addition, such grant components are also necessary to achieve the concessional terms required for public sector borrowing, and to ensure that the funding will be consistent with the restrictions on new public debt and annual public debt service allocation agreed between the Government of Tajikistan and the IMF. The Bank needs to approach the donor community for potential grant co-financing and technical co-operation to leverage the loan financed capital investments with grants.

The Bank will select other infrastructure projects with a view to promoting a commercial approach to projects that would lead to financially sustainable entities as mentioned above. In the light of the rich hydro power resources, the Bank could explore possibilities in small scale power projects. The Bank needs to be innovative to structure such projects and mobilisation of grant funding could be an important element for a viable solution.

### **3.2.9 Environmental Impact of Bank Strategy**

With its emphasis on SME development through local FIs, the Bank plans to provide further support to strengthen environmental risk management capacities of local FIs by organising an in-country environmental due diligence training workshop for partner FIs under the funding of ETC Initiatives. The training will ensure that partner FIs are capable of implementing environmental due diligence procedures which are incorporated into the FIs' credit/investment appraisal process. The training module will include such issues as compliance of partner FI clients with national environmental, health and safety standards and requirements, public disclosure and consultation requirements, and employment laws and standards related to the employment of children and young people, discrimination at work, and forced labour.

Involvement in the hydro sector will require careful review and assessment of the environmental impacts of the proposed projects, given the issues associated with surface water usage in the Central Asian Republics, and implications for agribusiness and desertification.

## **4. IFIs and Multilateral Donors**

### **4.1 International Monetary Fund (IMF)**

The International Monetary Fund (IMF) has supported Tajikistan's economic reform and stability since 1996. Since 1998, the government of Tajikistan has been implementing economic reform programmes with the support of the Poverty Reduction and Growth Facility (PRGF). The first PRGF, which had disbursed a total of SDR 78.3 million, went off track in December 2001 due to the problems primarily in structural reforms. Subsequently a Staff Monitored Programme (SMP) was successfully completed during 2002. Currently the second three-year PRGF, approved in December 2002 (SDR 65 million), is under implementation. In March 2005, the IMF executive board approved the fourth review, releasing SDR 9.8 million, and also concluded the Article IV consultation with largely positive assessments. The Fund welcomed Tajikistan's robust growth, reduced inflation, strengthened fiscal and monetary policies, reduced external debt burden, and progress in the banking sector, however, it also raised some concerns over the slow implementation of the PRSP objectives, weak business environment and public and private sector transparency and governance. The authorities completed the legislative changes to eliminate the foreign exchange restrictions on current transactions and accepted the obligations of Article VIII.

### **4.2 World Bank Group**

Tajikistan became a member of IBRD and IDA in 1993 and of the IFC in 1994. To date, World Bank Group assistance has consisted of poverty reduction measures, agriculture sector reforms, private sector development, institution building and governance. To benefit the most vulnerable groups in rural areas, the emphasis is put on creating ways of transferring agricultural assets from public to private hands, enhancing incentives, and investing in rural infrastructure. This is complemented by investments in health, education, and social funds. As of June 2004, IDA had approved loans for 18 investment projects and three supplemental credits in Tajikistan for a total commitment of about US\$ 322 million. In addition, grants have been provided for over US\$ 3.5 million for building institutions and for post-conflict assistance. Policy based lending is supporting structure reforms. After the successful conclusion of the Structural Adjustment Credit (SAC II) in summer 2004, currently a Policy Based Credit (PBC) is being prepared.

To date the International Finance Corporation (IFC) has provided eight investment loans for a total commitment of US\$ 32 million. The investments have been made in six sectors; textile, agriculture, finances, SME development, mining, and power. The IFC last approved a project to establish Pamir Energy, which was made jointly with the Aga Khan Fund for Economic Development. The Bank's cooperation with the IFC includes Tajikistan Bank investment, co-financing on the MSE project under preparation and the policy dialogue with the government on TADAZ.

The new World Bank Country Assistance Strategy (CAS) was approved in July 2005 consisting of four pillars; improving i) business opportunities in rural and urban areas, ii) the quality of and access to health care, iii) the quality of and access to education, and iv) the delivery of energy services and increasing electricity exports. The indicative IDA envelope for the fiscal year 2006-2009 is SDR 63 million, of which the majority will be in the form of grants.

### **4.3 Asian Development Bank (ADB)**

Tajikistan became a member of the Asian Development Bank (ADB) in April 1998. For the period 1998-2004, the ADB's programme for Tajikistan comprises of 17 loans in the transport, energy, education, healthcare, agriculture and financial sectors, totalling US\$ 265 million equivalent. In addition, about US\$ 36 million has been provided as grant assistance for 43 technical assistance projects, and five grant projects financed by the Japan Fund for Poverty Reduction. The ADB aims to focus on three key areas: i) agriculture, ii) infrastructure (especially energy and transport sectors), and iii) social sector. Tajikistan is fully accessible to concessional resources (i.e. Asian Development Fund). Under the new arrangements, Tajikistan is eligible to receive 40 per cent of the loan amount on a grant basis after 2005.

In the agriculture sector, there are two projects including the agriculture rehabilitation project loan (US\$ 35 million in 2002) and irrigation rehabilitation project loan (US\$ 22.7 million in 2004). In the transport sector, the ADB approved two projects; the road rehabilitation project (US\$ 20 million in 2000), which aims to rehabilitate the Dushanbe-Kurgantobe-Dangara-Kulyab road, and the Dushanbe-Kyrgyz border road rehabilitation project (phase I) (US\$ 15 million in 2003), which improves the transportation link north and east through the Kyrgyz Republic. The second phase of the Dushanbe-Kyrgyz border road rehabilitation project is being prepared for board approval during 2005. In the power sector, the ADB has approved two projects; a power rehabilitation project (US\$ 34 million in 2000), and a regional power transmission modernization project loan (US\$ 20 million in 2002). For social sector development, the ADB has approved i) social sector rehabilitation project (US\$ 20 million in 1999) to address the serious deterioration in living standards and strengthen the delivery of essential social services, ii) health sector reform project (US\$ 7.5 million in 2003) and iii) education sector reform project (US\$ 7.5 million in 2003). In the financial sector, the ADB provided a microfinance systems development programme (US\$ 8 million in 2003). In other areas, the ADB provided programmes for regional trade facilitation and customs cooperation (US\$ 10 million in 2002) and emergency loans (including emergency flood rehabilitation project, emergency restoration of Yavan water conveyance system loan and emergency Baipaza landslide stabilisation project (in a total of US\$ 12 million).

The country strategy and programme for 2004-2008 was approved in September 2003, focusing on supporting Tajikistan's transition to a market economy, post-conflict rehabilitation and reconstruction, and natural disaster rehabilitation. A country strategy and programme update (CSPU) is prepared each year to review ADB lending. Based on the CSPU of September 2004, the annual lending level was reduced to US\$ 35-40 million during 2004-2006 with an annual technical assistance of US\$ 1.9 million. The CSPU for 2005-2006 is under preparation.

### **4.4 United Nations Development Programme**

The United Nations Development Programme (UNDP) has been in Tajikistan since 1994. The UNDP focuses on four broad areas: good governance, economic development, health and environmental management. The new UNDP country programme for 2005-2009 is under preparation and will be approved in 2005. The programme is to support the Government in its progress towards achieving the Millennium Development Goals (MDGs) by advancing economic and democratic reform and fostering the participation of civil society in the

development processes at national and local levels. The financial resources needed for achieving these objectives for UNDP are estimated at US\$ 73.2 million under the current programme.

#### **4.5 Islamic Development Bank (IsDB)**

Tajikistan became a member of the Islamic Development Bank (IsDB) in November 1996. As of May 2005, total commitment amounted to US\$ 87 million for 23 projects (all on concessional terms). This covers financing of ten technical assistance projects (grant of US\$ 1.8 million) to undertake feasibility studies, capacity building and investment conference while the other 13 investment projects are mainly in public utilities, transport and communication, and social sectors. Among projects financed by the IDB are Shagon-Zigar road (Phase I and II) together with the Arab Coordination Group, Dushanbe Water Supply with the World Bank, and Power Rehabilitation with the ADB.

#### **4.6 Aga Khan Development Network**

The Aga Khan Development Network (AKDN) has been active in Tajikistan since 1995, mobilising over US\$ 150 million for its various programmes from its own resources, from the Ismaili Imamat and Ismaili Community around the world and its own donor partners. Its activities were initially focused on drug issues and humanitarian aid and then expanded into agricultural reforms, health, education, physical infrastructure improvement (particularly in power and telecommunications), banking and micro credit, and tourism and culture.

#### **4.7 European Union (EU)**

Once ratified, the Partnership and Cooperation Agreement (PCA) which was signed on 11 October 2004 will provide the legal framework for EU-Tajikistan bilateral relations. Pending ratification in the 25 Member States and Tajikistan, an Interim Agreement on Trade and Trade-related matters (signed in October 2004) will provide the basis for the implementation of the trade related provisions of the Agreement. The Interim Agreement also updates some of the provisions of the Trade and Cooperation Agreement signed in 1989 with the then Soviet Union and subsequently endorsed by Tajikistan.

The Community's strategy towards the Central Asian region is set out in the Commission's Strategy Paper for Central Asia. Tajikistan is by far the most significant per capita beneficiary of EU assistance in Central Asia. From 1992 to 2002, the Community budget has provided to Tajikistan more than EUR 350 million, most of it in grant form. The EU is present in Tajikistan with no less than four assistance instruments: humanitarian assistance through ECHO, the Food Security Programme, exceptional macro-financial assistance and Tacis. Apart from focusing on poverty alleviation, and community and rural development centred on the most vulnerable groups, the EU addresses the issue of regional cooperation in Central Asia, in particular in the field of drug trafficking, and of border management.

Tacis assistance is delivered through a three-track approach, which consists of: i) regional cooperation programmes designed to promote good neighbourly relations and concerted work between the Central Asian countries using a pragmatic, 'variable geometry' format in areas where the EU has a strategic interest. These include transport and energy networks, sustainable use of natural resources and implementation of international environmental conventions, justice and home affairs and border management; ii) regional support

programme, implemented at national level designed to address the main common challenges to sustainable economic development. It focuses on PCA/TCA implementation, socio-economic reforms, Poverty Reduction Strategy implementation as well as reform of the education sector; iii) poverty reduction scheme piloted in 2-3 target regions, focusing on poverty alleviation, community and rural development and centred on the most vulnerable groups. The poverty alleviation schemes are implemented in the district of Khatlon (southern Tajikistan) and in the Ferghana valley in the north of the country.

Tajikistan has also received macro-financial assistance in the form of a loan of EUR 60 million (disbursed in March 2001) and a total available grant amount of up to EUR 35 million, disbursed in successive annual tranches.

EU-EBRD cooperation includes support to the TAM/BAS programme, microfinancing and the transport sector (aviation).

### **III. ANNEXES**

**ANNEX 1 POLITICAL ASSESSMENT**

**ANNEX 2 SIGNED PROJECTS**

**ANNEX 3 TC OPERATIONS**

**ANNEX 4 TC PROJECT PIPELINE**

**ANNEX 5 LEGAL ASSESSMENT**

**ANNEX 6 SELECTED ECONOMIC INDICATORS**

**ANNEX 7 TRANSITION CHALLENGES**

**ANNEX 8 BILATERAL ASSISTANCE**

## **Annex 1 – Political Assessment**

Over the past two years Tajikistan continued to make progress towards implementation of the principles of Article 1 of the Agreement Establishing the Bank. Progress towards a market economy was evident, while transition to a multi-party democracy and pluralistic society remained uneven with the parliamentary elections in February 2005 failing to meet international standards, despite showing some improvement over previous elections. The Government's human rights record also remained poor, although there were some improvements.

After years of devastating civil war (1992-1997), normality has returned to Tajikistan and stability throughout the country has continued to increase with every year since the end of the civil war. With political stability mostly achieved, the key task has shifted to ensuring social and economic stability in the country, which remains among the most impoverished countries in the region. This task presents many challenges. Widespread poverty, high unemployment, low salaries, combined with weak democratic institutions, ineffective judiciary and significant drug transit, creates an atmosphere conducive to pervasive corruption and makes poverty alleviation a key priority for the country.

### ***Elections***

The Constitution establishes a system of separation of legislative, executive and judicial powers but in practice a strong executive is not sufficiently balanced by legislature or judiciary. In 1999 the Constitution was amended to introduce a seven-year mandate for the President and a bi-cameral structure of the Parliament (Majlisi Oli), comprising the National Assembly or upper chamber (Majlisi Milli) and the Assembly of Representatives or lower chamber (Majlisi Namoyandagon). The Majlisi Namoyandagon has 63 members directly elected for five years, while the upper chamber is indirectly elected.

The last presidential election, which took place in November 1999, was not monitored by the OSCE as it failed to ensure a competitive election. As the result of the election Emomali Rakhmonov, who was first elected for a five-year term in 1994, was re-elected for a term of seven years, until the year 2006. The amendments, introduced by the constitutional referendum of 2003, gives the incumbent President the possibility of remaining in office until 2020, i.e. for another 14 years (two seven-year terms) after his current term in office expires in 2006.

The elections to the lower chamber of parliament took place on 27 February 2005, with a second round of voting on 13 March. These were the first parliamentary elections since the completion of the implementation of 1997 peace agreement which ended the civil war and culminated in the 2000 parliamentary polls. The 2005 elections offered the first major test of Tajikistan's progress in democratic transition in the post-war years.

According to the OSCE, which deployed a full-fledged observation mission to monitor the elections, the 2005 parliamentary elections failed to meet many of the key commitments for democratic elections, despite some improvement over previous elections. The reported problems included candidate registration, closure of opposition newspapers and unbalanced composition of election commissions. Proxy voting was a serious problem and there were many instances of manipulation during the vote counting and the tabulation of votes.

More generally, the observation mission noted that the improvements in election law have been undermined by inadequate implementation. The effective closure of four independent newspapers undermined a fundamental aspect of a democratic election process, although the state media was reasonably balanced in its coverage.

There are six political parties in the country, including genuine opposition parties, and all of them have been allowed to contest the latest parliamentary polls. Two new political parties were refused registration. The law prohibits political parties from receiving support from religious institutions; however, political parties of religious character, such as the Islamic Renaissance Party (IRP), are allowed to function.

As a result of the election, the pro-presidential People's Democratic Party (PDP) kept its overwhelming majority in the new parliament with only two other parties – the Communist Party (CP) and the IRP – crossing the 5% threshold, required to gain seats in parliament.

The parliamentary elections have reflected the process of continued consolidation of power in the presidency which has been taking place since the last few years. The President's supporters are holding key positions of state and local government, effectively marginalising political opponents. The opposition no longer holds 30 per cent of senior positions in government as it did under the terms of the 1997 peace agreement.

### ***Human Rights Conditions***

Tajikistan's overall human rights record remains poor, notwithstanding improvements in some areas. Despite the adoption of a new election law and a moratorium on capital punishment, the Government continued to put pressure on opposition, media and religious groups.

The main problems included restrictions on the activities of opposition parties and independent media, restrictions of the freedom of speech and freedom of assembly. There were cases of harassment of independent and opposition journalists, although physical attacks on journalists have declined. Stringent licensing procedures have been primarily used to silence independent media outlets. In 2004, in contrast with the previous year, the Government increased pressure on independent media outlets in an effort to consolidate influence in advance of the February 2005 parliamentary elections.

Over the last year, political power has remained concentrated in the presidency. Opposition has been weakened by a number of measures, including the closure of an independent printing house, leading to suspension of major opposition newspapers, selective tax inspections, restricting broadcast licenses, harassment and arrests of some of the leaders of opposition parties on charges of slandering the President and allegations of embezzlement.

The Tajik Constitution guarantees freedom of religion but, in practice, there are instances of interference with activities of independent religious groups which are considered to be extremist. In the last two years there were numerous arrests of alleged members of the banned political organisation Hizb ut-Tahrir (Party of Liberation).

There are no significant reported problems in the area of labour rights. The Constitution and the laws of the country provide a basic legal framework for the freedom of association, elimination of forced and compulsory labour, the abolition of child labour and non-

discrimination in respect of employment and occupation. Child labour remained a problem as the Government did not enforce regulations on acceptable working conditions for children. The Soviet-era practice of closing schools at cotton harvest time and putting students to work in the cotton fields continued.

As far as trafficking in persons is concerned Tajikistan is qualified by the latest, June 2005, State Department's Report as being a Tier 2 country, which means that the Government of Tajikistan does not fully comply with minimum standards for the elimination of trafficking but it is making significant efforts to bring itself into compliance with those standards. In August 2004 the Government adopted a comprehensive trafficking in persons law which provides a useful framework for the protection of victims. The Government should make strong efforts to meet trafficking victims' needs and increase convictions.

### ***External Relations***

Externally, the proximity of Afghanistan remains an important factor to be reckoned with. Despite major efforts by the Tajik authorities, resulting in increased seizure of narcotics, significant volumes of drugs continue to cross the Afghan-Tajik border. The opening of the US-financed bridge linking Tajikistan with Afghanistan in June 2005 is an important step in strengthening bilateral trade and regional cooperation.

Close traditional ties with Russia have further strengthened in the past two years. In October 2004 an agreement was reached on setting up a Russian military base in Tajikistan. The handover of the border between Tajikistan and Afghanistan from Russian to Tajik border forces was completed in 2005. In the economic field, there are significantly increased Russian commitments to invest in various sectors of the Tajik economy, including strategically important hydro energy.

In the aftermath of May 2005 events in Uzbekistan, the common border between the two countries was temporarily closed but re-opened rather quickly and the general situation in Tajikistan was not affected by the events in Andijan. Despite the declared intention by Uzbekistan to start de-mining the borders with Tajikistan and Kyrgyzstan, parts of the Uzbek-Tajik border remain mined and there were some reported land mine deaths.

Tajikistan maintains its active participation in the organisations promoting regional cooperation, including the Central Asia Cooperation Organisation (CACO), the Euro-Asian Economic Community (EAEC), the Economic Cooperation Organisation (ECO) and the Shanghai Cooperation Organisation. In October 2004 Tajikistan signed a Partnership and Cooperation Agreement with the EU.

## Annex 2 – Signed Projects

As at 30 September 2005

| Op Name                                    | Signing Date | Total Project Value | EBRD Finance | Operation Stage |
|--|--------------|---------------------|--------------|-----------------|
| Tajikistan FII - Orienbank (debt & equity) | 19/12/96     | 1.7                 | 1.7          | Completed       |
| Khujand Packaging                          | 28/07/97     | 3.3                 | 1.4          | In Default      |
| Obi-Zulol Water Bottling Plant             | 04/09/98     | 10.6                | 4.5          | In Default      |
| TSOB Equity Investment                     | 26/11/99     | 2.5                 | 0.2          | Completed       |
| <i>Framework – ETC NBFI</i>                |              |                     |              |                 |
| ETC Non-Bank MFI FW - IMON                 | 16/06/05     | 0.8                 | 0.8          | Disbursing      |
| <i>Framework – Regional TFP</i>            |              |                     |              |                 |
| Regional TFP: Tajprombank                  | 23/12/03     | 1.1                 | 1.1          | Signed          |
| Regional TFP: TSOB Tajikistan              | 06/10/04     | 3.6                 | 3.6          | Signed          |
| Regional TFP: Eshkhat Bank                 | 06/11/04     | 0.1                 | 0.1          | Signed          |
| Regional TFP: Agro Invest                  | 16/06/05     | 0.4                 | 0.4          | Signed          |
| <i>Framework - MSEFF</i>                   |              |                     |              |                 |
| Tajikistan MSEFF - Eshkhat Bank            | 26/02/04     | 2.5                 | 0.8          | Disbursing      |
| Tajikistan MSEFF - TSOB                    | 17/08/04     | 1.7                 | 1.7          | Disbursing      |
| Tajikistan MSEFF - Tajprombank             | 09/12/04     | 1.7                 | 1.7          | Disbursing      |
| Tajikistan MSEFF - Agroinvest              | 16/06/05     | 1.7                 | 1.7          | Disbursing      |
| Khoujand Airport                           | 22/04/99     | 6.2                 | 2.1          | Repaying        |
| Tajiktelecom modernisation project         | 02/10/01     | 12.6                | 10.8         | Disbursing      |
| TSA Air Navigation Systems                 | 02/10/01     | 6.0                 | 4.6          | Disbursing      |
| Khujand Water Supply Improvement Project   | 13/07/04     | 4.3                 | 1.0          | Signed          |
| Tajik State Air Company Air Fleet Upgrade  | 27/07/05     | 6.1                 | 4.1          | Signed          |
| <b>TOTAL</b>                               |              | <b>67.5</b>         | <b>42.6</b>  |                 |

## Annex 3 – TC Operations

| Commitment Number | Commitment Name   | EUR Committed | EUR Disbursed | Fund Approved Date | Commit. Stage Name |
|-------------------|---|---------------|---------------|--------------------|--------------------|
| AUS-2000-02-02    | Aviation Sector Restructuring Study   | 64,971        | 64,971        | 17/02/00           | Closed             |
| AUS-2000-12-03    | Tajikistan State Air (TSA) Air Navigation Systems   | 66,000        | 66,000        | 07/12/00           | Closed             |
| DEN-1996-03-01    | Overlay network   | 15,849        | 15,849        | 05/03/96           | Closed             |
| ECT96-96-11-11    | Orienbank   | 365,000       | 365,000       | 07/11/96           | Closed             |
| ECT97-97-05-10    | Business Advisory Services - national association of small and medium businesses - phase II | 383,875       | 383,875       | 27/11/96           | Closed             |
| ECT99-2002-10-03  | Restructuring and Implementation of IAS Accounting  | 500,000       | 500,000       | 29/10/02           | Closed             |
| EIPF01-2003-10-05 | TSA Air Fleet Upgrade Project   | 49,700        | 49,700        | 13/10/03           | Closed             |
| EIPF01-2004-12-14 | Implementation of corporate governance in Tajik commercial banks                            | 100,000       | 30,000        | 20/12/04           | Disbursing         |
| ETCF-2005-04-11F  | TAM Programme - framework 2 TAM projects in Tajikistan                                      | 171,000       | 22,134        | 25/02/05           | Committed          |
| ETCF-2005-04-16   | Tajik Micro and Small Enterprise Finance Facility (TMSEF) Credit Advisors                   | 800,000       | 0             | 28/04/05           | Committed          |
| FIN-1995-12-08    | Overlay network   | 47,597        | 47,597        | 21/12/95           | Closed             |
| FLN-2003-09-01    | Khoujand Water Supply - Stakeholder Participation Study                                     | 35,380        | 35,380        | 30/09/03           | Closed             |
| HOL-1995-12-14    | Tajikbankbusiness - accounting and due diligence component                                  | 163,361       | 163,361       | 21/12/95           | Closed             |
| HOL-95-10-12PS    | Dushanbe Runway emergency repairs Phase I   | 3,041,636     | 3,041,636     | 01/10/95           | Closed             |
| IRL-1996-03-01    | Overlay network   | 9,448         | 9,448         | 11/03/96           | Closed             |
| IRL-2004-10-04    | Trade Facilitation Programme - Training for Issuing Banks Extension                         | 21,975        | 11,391        | 21/10/04           | Disbursing         |
| ITA-1995-07-06    | Tajikbank business - credit advice  | 202,018       | 202,018       | 19/07/95           | Closed             |
| ITA-1997-10-06    | F. I. Initiatives Project Implementation TC Orienbank                                       | 347,678       | 347,678       | 22/10/97           | Closed             |
| JAP-1996-02-05    | Overlay network   | 99,151        | 99,151        | 20/02/96           | Closed             |
| JAP-1996-05-14    | Overlay network - Phase II  | 265,934       | 265,934       | 04/06/96           | Closed             |
| JAP-1999-11-18    | Tajikistan: Financial Institutions Development Programme (Vnesheconombank)                  | 485,241       | 485,241       | 11/11/99           | Closed             |
| JAP-2000-02-02    | Khoujand Airport Emergency Rehabilitation Restructuring                                     | 240,911       | 240,911       | 08/02/00           | Closed             |
| JAP-2000-02-03    | Tajiktelecom Diagnostic & Feasibility Study   | 230,280       | 230,280       | 08/02/00           | Closed             |
| JAP-2000-03-06    | Tajiktelecom: Regulatory Development Programme  | 269,759       | 269,759       | 22/03/00           | Closed             |

| Commitment Number         | Commitment Name  | EUR Committed     | EUR Disbursed     | Fund Approved Date | Commit. Stage Name |
|---------------------------|--|-------------------|-------------------|--------------------|--------------------|
| JAP-2001-09-17            | Tajiktelecom Institutional Development Programme (IDP) PIU Component A                         | 407,325           | 407,325           | 19/09/01           | Closed             |
| JAP-2001-09-18            | Tajik Telecom: Corporate Strategy Development Component B                                      | 400,000           | 400,000           | 19/09/01           | Closed             |
| JAP-2001-10-22            | Tajikistan Air Navigation System Modernisation   | 357,453           | 308,982           | 02/10/01           | Disbursing         |
| JAP-2002-07-05            | Tajiktelecom: Regulatory Frame Work Development Programme II                                   | 300,000           | 300,000           | 03/07/02           | Closed             |
| LUX-2004-06-04            | Community TAM Programme - Vorukh - Tajikistan  | 200,000           | 75,744            | 09/06/04           | Disbursing         |
| NORG-2005-01-01           | Khujand Water Supply Improvement Project - Implementation of Financial and Operational Perform | 286,165           | 0                 | 25/01/05           | Committed          |
| POR-1996-02-01            | Overlay network  | 19,040            | 19,040            | 20/02/96           | Closed             |
| SPA-1994-05-02            | Agribusiness investment opportunities  | 150,893           | 150,893           | 17/05/94           | Closed             |
| SWI-2003-02-01PS          | Tajikistan Telecommunications Project: Procurement Advisory                                    | 40,671            | 40,671            | 19/02/03           | Closed             |
| SWI-2003-04-02            | Financial Audit of Eshkata Bank for Tajikistan MSEFF   | 41,504            | 41,504            | 16/04/03           | Closed             |
| SWI-2003-05-03            | TMSEF - Integrity Due Diligence - Eshkata and Orien Banks                                      | 39,500            | 33,388            | 27/05/03           | Disbursing         |
| SWI-2003-08-01            | Khujand Water Supply Improvement Project - Assistance with Financial Due Diligence             | 38,209            | 38,209            | 12/08/03           | Closed             |
| SWI-2004-02-03            | TMSEF - Integrity Due Diligence for 3 Commercial Banks   | 44,989            | 44,989            | 06/02/04           | Disbursing         |
| SWI-2004-10-15            | TMSEF - Integrity Due Diligence for 3 Commercial Banks - Agroinvestbank                        | 21,969            | 21,969            | 08/10/04           | Disbursing         |
| TAI-1996-05-05            | Business Advisory Services   | 60,532            | 60,532            | 03/05/96           | Closed             |
| UKB-1995-11-15            | Legal audit  | 22,653            | 22,653            | 01/11/95           | Closed             |
| UKB-1995-11-16            | Dushanbe Runway emergency repairs (Phase I)  | 47,590            | 47,590            | 08/11/95           | Closed             |
| UKB-1996-11-14            | Assistance in developing a secured transactions law  | 28,037            | 28,037            | 12/11/96           | Closed             |
| UKD-1999-04-09            | Khujand Packaging financial diagnosis  | 20,000            | 20,000            | 30/04/99           | Closed             |
| UKTA-2003-09-01           | Tajik Micro and Small Enterprise Finance Facility (TMSEF) Credit Advisors                      | 1,593,009         | 797,589           | 04/09/03           | Disbursing         |
| USSP-2003-09-01           | Tajik Micro and Small Enterprise Finance Facility (TMSEF) Credit Advisors                      | 202,020           | 140,484           | 04/09/03           | Disbursing         |
| USSP-2004-10-06           | Tajikistan MSE Finance Facility - Credit Advisors  | 160,702           | 57,271            | 29/10/04           | Disbursing         |
|                           |  | <b>12,459,024</b> | <b>10,004,182</b> |                    |                    |
|                           |  | <b>12,459,024</b> | <b>10,004,182</b> |                    |                    |
| <b>No of Commitments:</b> |  | <b>46</b>         |                   |                    |                    |

## Annex 4 – TC Project Pipeline

| TC Title  | Sector Name              | Provisional Amount |
|---|--------------------------|--------------------|
| Southern cities (Kulyab-Dangara) Water distribution project: Feasibility study comprising technical review and cost-benefit analysis of the proposed investment programme; environmental review; and preparation of a Financial and Operational Performance Improvement Programme. Implementation support and Social Assessment and Stakeholder Participation Study | Municipal infrastructure | 600                |
| Dushanbe Solid Waste Management Project : Feasibility study, project implementation and procurement support   | Municipal infrastructure | 800                |
| Khujand-Kulyab-Dangara municipalities Municipality Management Advisory Services and Implementation support  | Municipal infrastructure | 200                |
| Tajik Telecom, Institutional building, corporatisation of the SOE, preparation for privatisation, Telecom Regulatory Development  | Telecom                  | 300                |
| Tajik mining sector, survey of the mining legislation and facilitation of investment in the mining sector   | Natural Resources        | 100                |
| Tajik Micro Small Enterprise Facility (TMSEF and TMSEF 2) Training of loan officers for micro, small and medium loans and capacity building in Tajik commercial banks. Introduction of SME and Agricultural lending   | Group Small Business, FI | 1,400              |
| Tajik banking sector<br>Legal advisory service on the pledge law  | Group Small Business, FI | Internal           |
| Tajik banking sector, Anti-money laundering legal advisory service and institution building (training, drafting of procedures)  | Group Small Business, FI | 100                |
| Tajik banking sector Corporate governance<br>Institution building, preparation for investment (TSOB)(AIB)   | Group Small Business, FI | 100                |
| Tajik banking sector, Eshkata bank<br>post investment institution building IBP and capacity building  | Group Small Business, FI | Tbc                |
| TAM/BAS Economic Development Programme for the Early Transition Countries - Comprising the provision of TAM/BAS Community Programmes  | TAM                      | 200                |
| ETC projects in SMEs<br>Project preparation, BAS, due diligence for DLF, DIF, MCFF  | Central Asia team / ETC  | 150                |

**Annex 5 – Legal Assessment**

**ASSESSMENT OF TAJIKISTAN’S COMMERCIAL LAWS**

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as *extensiveness*) and the actual implementation of laws (also referred to as *effectiveness*). All available results of these assessments can be found at [www.ebrd.com/law](http://www.ebrd.com/law). This annex presents a summary of the results for Tajikistan, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

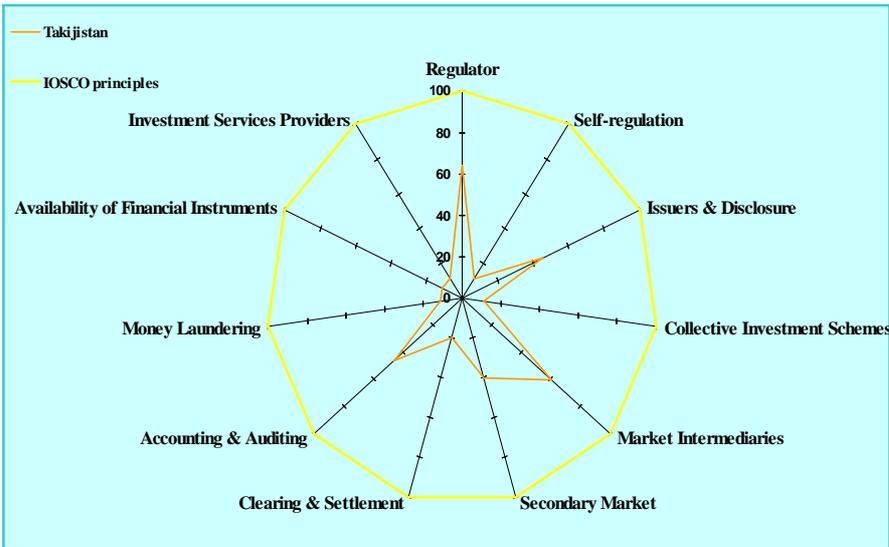
**Capital Markets**

The main legal provisions concerning securities markets in the Republic of Tajikistan are to be found in the Law “on Securities and Stock Exchange” adopted in 1992, in the Law “on Joint Stock Companies” (JSC) adopted in 1991 (both amended in 1998), and in a series of regulations issued by the Ministry of Finance.

The stock market in Tajikistan was founded in 1994, though it appears to have floundered since then mainly due to the lack of new financial instruments. In 2000, the Government of Tajikistan established a Central Share Registry within the Ministry of Finance to record, monitor and facilitate share purchase and sale for more than 400 stock companies. While a bond market does exist it is limited to government issued treasury bills.

There is currently no independent authority for securities market supervision in Tajikistan. The Law on Securities and Stock Exchange grants the Ministry of Finance authority over securities market supervision, while the Central Bank is in charge of banking supervision.

**Quality of securities market legislation –Tajikistan (2004)**



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO’s *Objectives and Principles for Securities Regulations*. The fuller the ‘web’, the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Markets Legislation Assessment 2004

According to the EBRD Securities Markets Legislation Assessment conducted in 2004, the country was found to be in “very low compliance” with the Objectives and Principles of

Securities Regulation published by the International Organization of Securities Commissions (IOSCO) – see above chart - showing a legal framework in critical need of reform.

Among the major shortcomings in the legislation is a lack of provisions concerning protection of minority shareholders, disclosure of qualified shareholding and collective investment schemes. While professional accounting firms have just recently started to develop their IAS activity in the country (two of the “Big Four” have opened offices), there are laws regulating accounting and bookkeeping activities, accounting standards lack specificity and there is no oversight body to monitor their implementation.

Regulation of collective investment schemes is not yet contemplated by law. In addition, anti-money laundering legislation and rules addressing financial instruments and investment service providers are still in discussion.<sup>10</sup> Most of the law on the books relating to securities were promulgated as company law and financial regulation. Tajikistan is in need of the creation of a strong securities regulator and the implementation of laws specific to securities regulation and the protection of securities investors.

### **Company Law and Corporate Governance**

The Law on Joint Stock Companies (JSC) was adopted in 1991 and has been amended several times since. A new law has been under discussion in Parliament for some time, but its approval does not appear likely in the near future. The current draft of this new law aims to significantly increase shareholder rights, improve corporate governance and company procedures, as well as increasing minimum registered capital and prohibiting closed-type joint-stock companies.

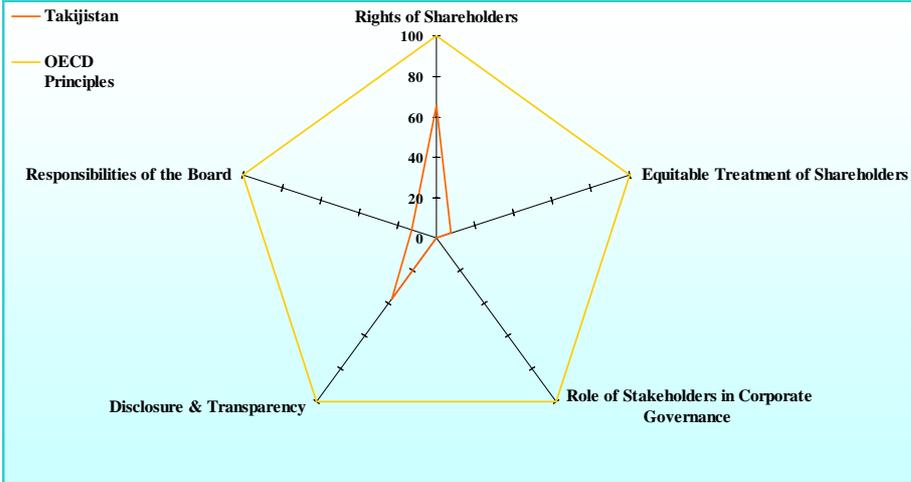
JSCs can be organised in open and closed form, with closed JSCs having up to fifty shareholders. JSCs are organised under a two-tier system and both the board of directors and the supervisory council are appointed by the general meeting of shareholders.

While the existing JSC law provides a basic framework governing the formation, operation and liquidation of JSCs, it is silent on many important issues concerning minority shareholders and general investors.

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<sup>10</sup> On the issue of anti-money laundering (AML), all the Tajiks banks participating in EBRD programmes have to present satisfactory procedures, which are monitored regularly: in addition, in 2005 a specific technical assistance project assisted the banking sector and State regulatory bodies to address this issue and develop adapted internal procedures.

**Quality of corporate governance legislation – Tajikistan (2004)**



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

*Source:* EBRD Corporate Governance Sector Assessment, 2004 assessment

The 2004 EBRD Corporate Governance Assessment placed the country at the very bottom of all EBRD’s countries of operations, evidencing a seriously deficient corporate governance framework when measured against the OECD Principles of Corporate Governance benchmarks.

One of the major shortcomings of the current framework is that the law does not require equality of voting rights among shareholders and lacks prohibitions on insider trading. Rules and procedures governing the acquisition of corporate control and extraordinary transactions are not articulated clearly enough and anti-takeover devices are not subject to shareholder scrutiny. Dissemination of shareholder information is also a concern and shareholders can experience difficulty in finding material information before general meetings.

**Concessions**

Concessions are governed by the 1997 Law on Concessions (the "Concessions Law"), as supplemented in 2000 by regulations on concession agreements and on auction and tenders. The Concessions Law applies only to foreign investors. Article 35(1) of the Law on Foreign Investment, states that foreign investors, and enterprises receiving foreign investment, may enjoy the use of concessions for the exploration of natural resources and engage in other economic activities.

Concession arrangements are governed by agreements between foreign investors and state authorities. Under the Concessions Law, the typical term of a concession agreement is 50 years, though this can be extended to up to 99 years. The Concessions Law defines a concession as an agreement that gives foreign investors the right for temporary exploitation of certain assets. These include mineral resources, hydroelectric power, cotton industry, construction, water, air space, flora and fauna and other natural resources.

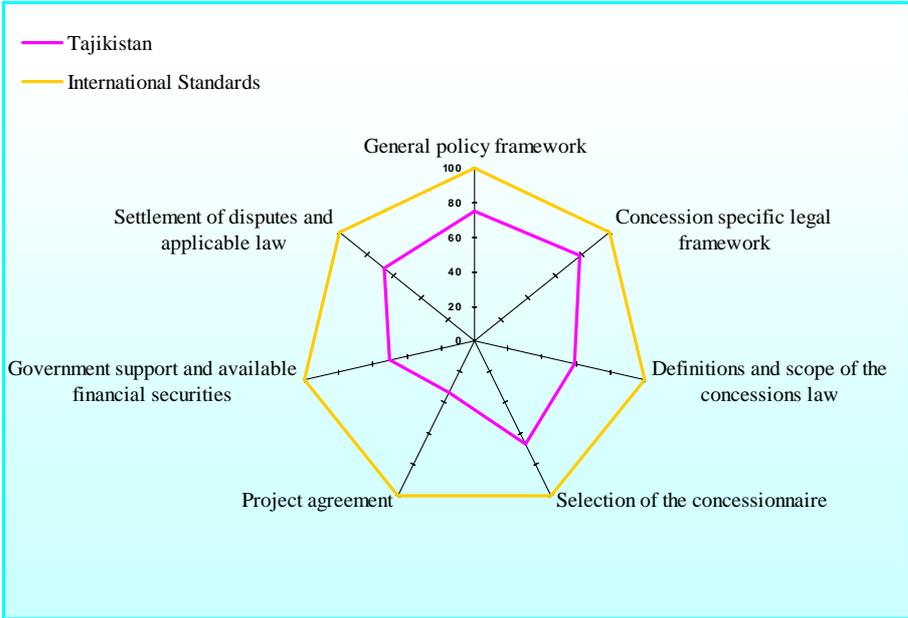
The Concessions Law is fairly vague and its scope of application needs significant improvement. In addition to explicit discrimination against domestic investors, the law is unclear in its main definitions and the identification of sectors and activities where concessions are applicable. The selection procedure also requires further clarification. Even though regulations do exist, in many respects they merely repeat provisions of the primary law, while failing to cover critical elements. For example, pre-selection procedure is not mentioned; the grounds for direct negotiations are unclear; "exceptional cases" are subject to

government decision; and there is no regulation of unsolicited proposals. On the positive side however, the Concessions Law provides for notification to all participants of tender results and affords a right to challenge the results. The Concessions Law also provides for the registration of project agreements and also contains a reference to "non-involvement in economic activity of the concessionaire". The possibility of unilateral termination by the contracting authority, although provided for, is however expressed to only be possible in case of misrepresentation by the concessionaire.

Unlike a number of other jurisdictions, the Concessions Law does not contain a so-called “stability clause”, stating that in the event that a new law introducing rules that are less favourable than those upon which the agreement was signed, the terms of the concession agreement remain in force. Additionally, even though the Concessions Law contains provisions governing the project agreement, they do not contribute to the creation of a flexible environment for negotiation of such agreements (e.g. priority of the State to purchase concession production, non-assignment of concessionaires' rights and other essential clauses). Further, the Concessions Law is not sufficiently developed as far as support and financial securities are concerned and recourse to international arbitration is limited.

Despite certain positive components, the Concessions Law does not appear to constitute a sufficiently solid legal basis for the development of private sector participation (PSP) in infrastructure and utility services in Tajikistan.

**Quality of concession legislation –Tajikistan (2004)**



*Note:* the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the ‘web’, the more closely concessions laws of the country approximate these standards.

*Source:* EBRD Concessions Sector Assessment 2004

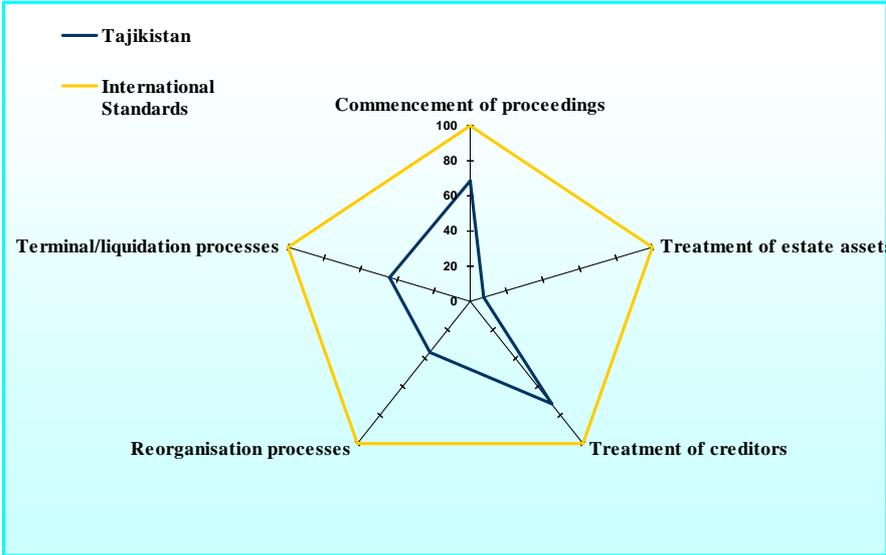
A recent EBRD Assessment of Concession Laws undertaken to evaluate applicable regime throughout the EBRD’s 27 countries of operations (the “law on the books” as opposed to how they work in practice), revealed that Tajikistan laws had “very low compliance” with internationally accepted standards in this sector. As can be seen from the above graph, virtually all of the key areas of the concessions framework should be further developed. In particular, the rules governing project agreement and availability of financial instruments and state support need to be dramatically improved in order to meet the requirements of a modern legal framework facilitating PSP. One more dimension that will inevitably require the

attention of the authorities is policy framework, the absence of which makes any law, even an ideal one, extremely difficult to implement.

**Insolvency**

Bankruptcy and insolvency in Tajikistan are governed by the Law on Bankruptcy of Enterprises (1992) (as amended) (the “Insolvency Law”). This law scored “very low compliance” when compared with international standards in the EBRD’s 2003 Sector Assessment Survey. The graph below displays the data collected in this project and shows levels of compliance of the Insolvency Law with international standards in five core areas:

**Compliance of the Tajikistan’s Insolvency Law with International Standards  
Quality of insolvency legislation – Tajikistan (2004)**



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank’s Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on “Legislative Guidelines for Insolvency Law”, and others. The fuller the ‘web’, the more closely insolvency laws of the country approximate these standards.

*Source:* EBRD Insolvency Sector Assessment Project, 2003/2004

As the above graph reveals, this law is severely deficient in virtually all of the key areas of insolvency. Specifically, the Insolvency Law provides for no measurable reorganisation provisions. Under the few provisions that are included, there is no requirement for independent assessment of the plan of reorganisation, very little involvement of the general body of creditors and no supervision of the plan’s implementation. Given these limitations, it seems unlikely that an effective, efficient and transparent reorganisation could take place under this law. In addition, the law provides vague financial condition criteria for the commencement of insolvency proceedings, unclear rules on when an insolvency application will be accepted by the court and virtually no requirements for insolvency administrators to have any professional qualification.

The above deficiencies could be classified as ‘critical’ or ‘threshold’ deficiencies in that they are imperative to the basic functioning of a proper insolvency law. In addition to these, however, the Insolvency Law contains several other important deficiencies. Specifically, there are no provisions relating to either the avoidance of pre-bankruptcy transactions or cross-border insolvencies. In light of the foregoing, it is not unreasonable to say that Tajikistan appears to have the weakest insolvency law in the EBRD’s countries of operations and that insolvencies in Tajikistan are likely to be unpredictable and lacking in transparency.

## Secured Transactions

Security rights on movable and immovable assets in Tajikistan are governed primarily by the Civil Code (Part 1) of 30 June 1999, which entered into force on 1 January 2000. The Mortgage Law, enacted on 20 June 1994 and amended in 1995 and 1998, also governs security rights over both movable and immovable property. These provisions were essentially modelled on the Russian Civil Code and 1992 Russian Pledge Law. Since, to a large extent, the Civil Code and the Mortgage Law contain many overlapping and ill-coordinated provisions, there is a good deal of uncertainty and contradiction. Mortgages can be granted over immovable assets (real estate), as well as enterprises (which qualify as immovable). Pledges over movable assets may require transfer of possession by the debtor to the creditor (or appointed third party) or may be non-possessory.

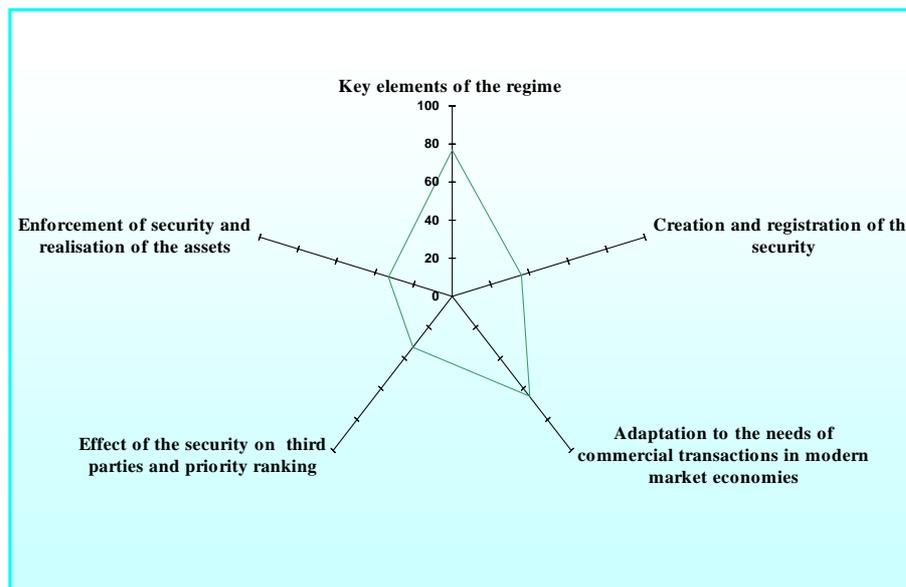
The current Tajik framework also creates a great deal of uncertainty on how security rights should be recorded. On one hand, the Mortgage Law provides that rights over real estate, enterprises, goods in circulation and processing, means of transport and space objects, and other assets subject to state registration must be registered with the administrative agency that is in charge of registering these assets. On the other hand, the Mortgage Law also provides that companies and registered entrepreneurs should maintain a 'pledge record book'. Since such registration is not a pre-requisite to the validity of the charge and there are no penalties for failure to complete the book, pledge books are not maintained in practice. The registry mentioned in the Mortgage Law appears to be held at the Ministry of Justice, though it is unclear whether such registry could be used to register security over movable assets. Users of this registry complain of the time required and the apparent openness of the process to abuse.

The current Tajik framework is also quite unclear in a number of key points, specifically:

- the priority of secured creditors outside and in bankruptcy proceedings;
- the possibility for a third party to obtain title over the pledged assets free of charge in the ordinary course of business (especially for goods in circulation); and,
- the methods of realisation of the charged assets.

The chart below graphically illustrates that the Tajik regime is failing in all of the five key areas.

## Legal and Practical Regime for Taking Security over Movable and Intangible Property in Tajikistan



Note: Scoring on a scale from 1 to 100, where 100 represents the most advanced legal and practical regime

Source: EBRD Regional Survey of Secured Transactions, 2002

The legal regime, however, is likely to change dramatically in the next few months as a new Law on Pledge over Movable Property, reportedly adopted in March 2005 (the draft of this new law is understood to be the product of a USAID funded ARD/CHECCHI Commercial Law Project), comes into play. At the time of preparing this annex, ARD/CHECCHI was also understood to be in the course of finalising a draft of the instruction for the registry.

### Telecommunications

The telecom sector in Tajikistan is currently governed by the Telecommunications Law of 2002 (the “2002 Telecom Law”) and is regulated by the State Inspectorate of Communications, a body within the Ministry of Communications. While the framework established by the 2002 Telecom Law provides for a new independent regulator to take over sector responsibility, the government has yet to implement this critical framework component.

The telecom market in Tajikistan is under-developed and has among the lowest fixed and mobile telephone penetration in the region, standing at approximately 4% and 3% respectively. The digitalisation of the national network underway by EBRD financing which, when complete during 2005, will result in digitalisation of approximately 60%. Full liberalisation of the Tajik telecom market is understood to be planned for 2006 when the TajikTelecom (TT) exclusivity on international calls will be lifted and additional international providers will be permitted. While this liberalisation date could be moved forward, the advent of new technologies, such as Voice-over Internet Protocol (VoIP), means that alternative operators have a current capability of circumventing TT’s existing exclusivity. The government, with the aid of EBRD technical assistance, has been developing a framework to support the intended full liberalisation.

The market is currently dominated by TT, the state-owned incumbent operator, providing local, long-distance and international telephone services throughout the country. TT currently holds a *de jure* monopoly on international traffic and a *de facto* monopoly on all basic services. In addition to TT there are four licensed mobile operators: Tajiktel (mobile arm of TT), Somoncon (a US-Tajik joint venture), Indigo (a US-Aga Khan joint venture) and

Babilon-M (a US-Tajik joint venture). There are also a number of private operators emerging, primarily in the internet and service field.

While the Government has made some progress towards sector reform, much depends upon implementation of the individual rules and procedures for the sector. Although the government has repeated its intention to privatise TT, current market conditions in Tajikistan and weak regulatory framework do little to enhance already limited interest of foreign investors. Accordingly, the Government should immediately focus on practical implementation of all reforms necessary to attract and sustain private investment into TT and the sector. Key sector priorities are: the immediate creation of a independent regulatory authority, independent of both political and sector operator influence; full withdrawal of the government from the commercial aspects of the sector; full and rapid implementation of policies and mechanisms already developed (including those developed as part of EBRD assistance); improved corporate governance of TT and, continuation with current tariff rebalancing programme.

EBRD has provided significant financing and technical assistance to the Tajik authorities, namely the following:

- **Telecommunications Technical Cooperation Projects**

A second phase of the EBRD Tajikistan Regulatory Development Project was completed in 2004. This assistance sought to support the Government's development and implementation of a regulatory framework capable of supporting a liberalised marketplace and encourage private investment. Achievements to date including adoption of modern telecommunications sector policy and framework law. Phase two assisted with practical implementation of the reform initiatives contained in the policy and framework law, preparations for the establishment of an independent regulatory authority, tariff reform framework, new licensing procedures and development of the basis for a universal access policy.

- **Corporate Development Technical Cooperation Projects**

In addition, the EBRD also provided two phases of corporate development technical assistance to TajikTelecom. The purpose of this programme was to provide assistance to the Director General of TajikTelecom and his senior management team on a range of organisational and strategic issues, including organisational and corporate strategy development and accounting and auditing reform. Further assistance, especially to develop capacity in preparation of financial statements to IAS, is necessary

While EBRD wishes to continue supporting the authorities' efforts to reform and develop the sector, the implementation of all necessary reforms appears to have stalled. Accordingly, before EBRD can provide further meaningful and effective assistance it will be necessary for the government to display its full commitment to moving implementation forward.

## Annex 6 – Selected Economic Indicators

| Tajikistan   | 1999  | 2000  | 2001  | 2002  | 2003  | 2004            | 2005              |
|--|---|-------|-------|-------|-------|-----------------|-------------------|
|  |   |       |       |       |       | <i>Estimate</i> | <i>Projection</i> |
| <b>Output and expenditure</b>                              | <i>(Percentage change in real terms)</i>              |       |       |       |       |                 |                   |
| GDP  | 3.7   | 8.3   | 10.2  | 9.1   | 10.2  | 10.6            | 8.0               |
| Industrial gross output                                    | 5.0   | 10.3  | 14.4  | 6.3   | 9.9   | 13.8            | na                |
| Agricultural gross output                                  | 3.8   | 12.4  | 11.0  | 14.0  | 9.1   | 11.3            | na                |
| <b>Employment</b>  | <i>(Percentage change)</i>                            |       |       |       |       |                 |                   |
| Labour force (end-year)                                    | -3.5  | 0.2   | 4.3   | 1.7   | 1.5   | -0.7            | na                |
| Employment (end-year)                                      | -3.3  | 0.4   | 4.8   | 1.5   | 1.7   | -0.7            | na                |
|  | <i>(In per cent of labour force)</i>                  |       |       |       |       |                 |                   |
| Unemployment (end-year) <sup>1</sup>                       | 3.0   | 2.7   | 2.3   | 2.5   | 2.2   | 2.2             | na                |
| <b>Prices and wages</b>                                    | <i>(Percentage change)</i>                            |       |       |       |       |                 |                   |
| Consumer prices (annual average)                           | 27.6  | 32.9  | 38.6  | 12.2  | 16.3  | 7.1             | 7.9               |
| Consumer prices (end-year)                                 | 30.1  | 60.8  | 12.5  | 14.5  | 13.7  | 5.6             | 10.2              |
| Producer prices (annual average)                           | 41.2  | 43.5  | 28.7  | 10.1  | 15.0  | 17.1            | na                |
| Producer prices (end-year)                                 | 64.0  | 33.9  | 9.4   | 19.0  | 14.1  | 15.1            | na                |
| Gross average monthly earnings in economy (annual average) | 35.2  | 25.8  | 50.6  | 38.6  | 36.9  | 36.3            | na                |
| <b>Government sector<sup>2</sup></b>                       | <i>(In per cent of GDP)</i>                           |       |       |       |       |                 |                   |
| General government balance                                 | -3.1  | -5.6  | -3.2  | -2.5  | -1.8  | -2.7            | -4.4              |
| General government expenditure                             | 14.9  | 19.2  | 18.4  | 19.2  | 19.1  | 20.7            | na                |
| General government debt                                    | 113.5   | 124.5 | 97.0  | 78.8  | 63.0  | 39.4            | na                |
| <b>Monetary sector</b>                                     | <i>(Percentage change)</i>                            |       |       |       |       |                 |                   |
| Broad money (M2, end-year)                                 | 24.5  | 70.1  | 40.0  | 39.7  | 29.3  | 14.3            | na                |
| Domestic credit (end-year)                                 | 23.4  | 14.5  | 95.0  | 14.0  | -6.5  | 52.7            | na                |
|  | <i>(In per cent of GDP)</i>                           |       |       |       |       |                 |                   |
| Broad money (M2, end-year)                                 | 6.7   | 8.5   | 8.6   | 9.0   | 8.2   | 7.2             | na                |
| <b>Interest and exchange rates</b>                         | <i>(In per cent per annum, end-year)</i>              |       |       |       |       |                 |                   |
| Monetary policy rate                                       | 20.1  | 20.6  | 23.4  | 21.0  | 15.0  | 10.0            | na                |
| Deposit rate (up to 3 months)                              | 11.4  | 41.3  | 25.5  | 12.1  | 14.6  | 12.4            | na                |
| Lending rate (up to 3 months)                              | 30.6  | 18.3  | 21.3  | 12.1  | 15.6  | 19.8            | na                |
|  | <i>(Tajik somoni per US dollar)</i>                   |       |       |       |       |                 |                   |
| Exchange rate (end-year) <sup>3</sup>                      | 1.4   | 2.2   | 2.5   | 3.0   | 2.9   | 3.0             | na                |
| Exchange rate (annual average) <sup>3</sup>                | 1.2   | 1.8   | 2.4   | 2.8   | 3.1   | 3.0             | na                |
| <b>External sector</b>                                     | <i>(In millions of US dollars)</i>                    |       |       |       |       |                 |                   |
| Current account  | -36   | -63   | -74   | -33   | -19   | -80             | -99               |
| Trade balance  | -27   | -46   | -121  | -124  | -204  | -332            | -376              |
| Merchandise exports  | 666   | 788   | 652   | 699   | 799   | 915             | 985               |
| Merchandise imports  | 693   | 834   | 773   | 823   | 1,003 | 1,247           | 1,361             |
| Foreign direct investment, net                             | 21  | 24    | 9     | 36    | 32    | 272             | 40                |
| Gross reserves, excluding gold (end-year)                  | 58  | 87    | 96    | 96    | 135   | 189             | na                |
| External debt stock  | 1,233   | 1,226 | 1,022 | 1,010 | 1,031 | 823             | na                |
|  | <i>(In months of imports of goods and services)</i>   |       |       |       |       |                 |                   |
| Gross reserves, excluding gold (end-year)                  | 0.9   | 1.2   | 1.4   | 1.2   | 1.4   | 1.6             | na                |
|  | <i>(In per cent of exports of goods and services)</i> |       |       |       |       |                 |                   |
| Debt service   | 6.6   | 9.2   | 16.6  | 14.7  | 6.7   | 7.2             | na                |
| <b>Memorandum items</b>                                    | <i>(Denominations as indicated)</i>                   |       |       |       |       |                 |                   |
| Population (end-year, million)                             | 6.2   | 6.2   | 6.3   | 6.4   | 6.5   | 6.5             | na                |
| GDP (in millions of somoni)                                | 1,345   | 1,807 | 2,512 | 3,345 | 4,758 | 6,158           | 7,250             |
| GDP per capita (in US dollar)                              | 174   | 160   | 168   | 187   | 239   | 319             | na                |
| Share of industry in GDP (in per cent) <sup>4</sup>        | 21.3  | 23.9  | 22.7  | 22.1  | 20.9  | 19.6            | na                |
| Share of agriculture in GDP (in per cent) <sup>4</sup>     | 18.7  | 27.0  | 26.5  | 26.3  | 25.2  | 21.6            | na                |
| Current account/GDP (in per cent)                          | -3.4  | -6.4  | -7.0  | -2.7  | -1.2  | -3.9            | -4.3              |
| External debt - reserves (in US\$ million)                 | 1,175   | 1,139 | 926   | 914   | 896   | 634             | na                |
| External debt/GDP (in per cent)                            | 113.5   | 124.5 | 97.0  | 84.0  | 66.3  | 39.7            | na                |
| External debt/exports of goods and services (in per cent)  | 170.4   | 143.4 | 142.5 | 131.3 | 117.8 | 82.9            | na                |

<sup>1</sup> Officially registered unemployed. The World Bank estimates the true unemployment rate in 2000 was more than 30 per cent of the labour force.

<sup>2</sup> New series. Includes externally financed public investment programmes.

<sup>3</sup> Tajik roubles (until October 2000) are converted to somoni.

<sup>4</sup> Figures are based on current prices. Variations in the shares reflect changes in relative prices.

## Annex 7 – Transition Challenges

| TAJIKISTAN               | Structure     | Institutions | Conduct       | Comments   |
|--------------------------|---------------|--------------|---------------|--|
| <b>Agribusiness</b>      | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | Most agricultural commodity and input prices have been recently liberalised (with the exception of cotton). Tajikistan is at a very early stage of land privatisation and farm restructuring. A functioning land market is non-existent. The agro-processing sector remains largely in state hands, and foreign participation in the sector is limited to the cotton sector. The banks geared towards agriculture are still subject to high state involvement. |
| <b>Banking</b>           | <i>Medium</i> | <i>Large</i> | <i>Large</i>  | Consolidation in the financial sector has improved bank capitalisation. Banking supervision is as yet weak, and the restructuring of the largest banks has been slow although it is now nearing completion. Weak accounting standards undermine compliance with prudential norms.  |
| <b>Energy Efficiency</b> | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | The country continues to be one of the most energy intensive in the region. The energy sector is a government department, while tariff reforms and the establishment of a regulator have been delayed.   |
| <b>General Industry</b>  | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | Challenges in this area are large. Enterprise sector requires further privatisation, deep restructuring, and support for new entry. Corruption, transparency and corporate governance standards are one of the weakest in region. The Tadaz aluminium smelter, which constitutes over 50% of exports, is still state owned   |
| <b>MEI</b>               | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | Tajikistan has only implemented minimal MEI reforms. Control over some of the local infrastructure has been transferred to municipalities, much needed investment is not forthcoming. A few private companies operate poor quality local transport services, but water services are operated by line ministries. A pilot scheme is under way for a water concession, but tariffs remain extremely low.   |
| <b>MSMEs</b>             | <i>Large</i>  | <i>Large</i> | <i>Medium</i> | The costs for starting up a business are large and the institutional set up and business environment for MSMEs are poor. EBRD credit lines directed to providing finance to MSMEs have been active since end 2003.   |
| <b>Natural Resources</b> | <i>Medium</i> | <i>Large</i> | <i>Large</i>  | In addition to hydro potential, one of the key natural resource in Tajikistan is gold mining. Zeravshan Gold Mining Company, the largest gold mining company in the country, is a joint venture between the government (51%) and Avocet Mining plc (a private London-listed company, 49%). The mining legislation is still not facilitating foreign investment.  |
| <b>NBFIs</b>             | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | Basic legislation and regulation on securities markets are in place but they substantially fall below IOSCO standards in all aspects. A stock exchange exists but it is not functioning. Insurance market is very small.   |

|                             |               |              |               |  |
|-----------------------------|---------------|--------------|---------------|--|
| <b>Power</b>                | <i>Large</i>  | <i>Large</i> | <i>Medium</i> | The power sector is still vertically integrated and characterised by high transmission and distribution losses. There is no independent regulator and tariffs are very low, with substantial problems in collection. The hydro power sector and its export potential is key for the level of investment in the country.  |
| <b>Private Equity Funds</b> | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | Reporting standards and creditor right protection remains poor, and the development of locally operating private equity funds would require progress in the reform of the entire financial sector and robust economic growth.  |
| <b>Property + Tourism</b>   | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | Tradability of land is limited de facto. Property market is at early stages of development, including introducing new products and financing methods. New hotel projects are developing in the capital and main cities.  |
| <b>Telecoms</b>             | <i>Medium</i> | <i>Large</i> | <i>Medium</i> | The fixed line telecommunications network is dominated by the state-owned incumbent operator. All fixed line services apart from international services have been liberalised and the Ministry of Communication intends to liberalise international calls during 2005. There is a developing private sector in the mobile and other advanced services. There is a sound sectoral policy, which includes provision for liberalisation of the market for services in the medium term and directs the establishment of an independent regulatory authority. However, many reforms remains still to be implemented and tariffs are still low and unbalanced. |
| <b>Transport</b>            | <i>Large</i>  | <i>Large</i> | <i>Large</i>  | In railways, operating and policy setting functions are not separated and core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. The road sector remains mostly unreformed in all aspects (institutions, road user charges, private sector participation).  |

## **Annex 8 – Bilateral Assistance**

### **Canada**

Funding for Canadian cooperation efforts with Tajikistan is provided through the Canadian International Development Agency's (CIDA) Programme of Cooperation with Asia. Canada's programming in Central Asia is focused on Tajikistan. Headquarters and field staff (based in Almaty) have developed a programme focusing on the Republic's expressed need for agricultural and water resources reform and technical assistance. Specific policy documents devoted to these two sectors will be developed in late 2005 and early 2006. A gender strategy is also planned for 2006. CIDA's programme goal is to contribute to the creation of legitimate and sufficiently remunerative economic opportunities for the rural poor. Active projects support rural economic diversification, increased agricultural capacity and knowledge in the rural areas, greater market access and increased availability of credit. CIDA's current Tajikistan programme had disbursements in excess of CAD 7 million in 2004/5. Bilateral funds are supplemented by funding through CIDA's multilateral programming.

### **Germany**

After having concentrated for some time on humanitarian aid, emergency and food aid bilateral German development cooperation with the Republic of Tajikistan is now concentrating on cooperation for long term sustainable development. Germany takes account of the foreign debt situation of Tajikistan and provides grant funding to the extent possible. Germany has committed EUR 35.1 million in financial cooperation through KfW mostly in the form of grants and EUR 16.9 million in technical cooperation, mainly through GTZ as grants, to support the PRS implementation process in Tajikistan. The future technical co-operation will focus on 'economic reform and establishing a market economy' (in particular on financial intermediaries, promotion of small and medium sized enterprises (SME), as well as vocational training). Financial cooperation will focus on the health sector (combating tuberculosis, rehabilitation of the medical infrastructure). In addition the German government supports the envisaged reforms of basic education until 2010 through technical cooperation and financial cooperation grants to the NSIF.

Close cooperation with international donors is envisaged. In 2003, the founding of the First Micro Finance Bank was supported in cooperation with the Aga Khan Development Network (AKDN) and IFC. At the last government negotiations Germany agreed to take part in the rehabilitation of the transformer substation of the Nurek hydroelectric power plant to the tune of EUR 20 million. This project will be implemented in cooperation with the Asian Development Bank (ADB).

### **Italy**

In the framework of Italian bilateral assistance and cooperation, Tajikistan can be assisted only for humanitarian aid and for projects promoted by NGOs.

In 2002 a grant of EUR 410,000 was disbursed to the World Health Organization, for medical and sanitary assistance to mothers and children in Tajikistan, Uzbekistan and

Kazakhstan. Its scope was to reduce the neonatal and maternal mortality in Asian countries of the former Soviet Union.

Following the drought which hit Tajikistan in 2003, Italy granted a provision of humanitarian aid for a total amount of around EUR 775,000.

In 2001, in addition to an emergency food aid of around EUR 800,000 in favour to the populations hit by the famine, Italy supported a project promoted by the NGO COOPI for "The improvement of the water and socio-medical conditions of the Districts for Kojamastone, Gozimalik and Vose' in the region of Khatlon". This initiative, amounting to EUR 1.6 million, includes a grant element of EUR 774,000 divided in three annual instalments, of which the first one has been disbursed. The project, still in place, provides the rehabilitation of hydro-power pumping plants, the creation of water distribution plants and the distribution of drinking water in the above-mentioned rural districts.

## **Japan**

Japan commenced bilateral assistance to Tajikistan in 1991. By the end of the Japanese FY2004, contributions to bilateral grant financing totalled about US\$ 72M, and TC totalled about US\$ 14M.

Its support mainly focused on humanitarian aid in the mid 90s through both bilateral and multilateral channels, in response to the situation during the civil war (total approx. US\$ 7.3 M). In the late 90s, as a part of international efforts towards building peace in the country, Japan hosted a series of political dialogues between the government and opposition parties. Since the signing of the peace agreement, Japan has supported Tajikistan and the challenge for consolidation of peace and democracy through TC, providing training opportunity to 500 Tajiks between 1999 and 2003.

Japan reorientated its development assistance based on the assessment in 2002-03 which reflected the Tajikistan Poverty Reduction Strategy Paper (2002) and revised Public Investment Programme (2003). Currently the following four areas are identified as high priority and several projects are under implementation and consideration; i) rehabilitation of health services, ii) rehabilitation of education services, iii) enhancing vocational training, and iv) rural water supply.

Japan's ODA to Tajikistan (¥ million)

| <b>Year</b> | <b>Grant financing</b> | <b>TC</b> |
|-------------|------------------------|-----------|
| 2002        | 856                    | 244       |
| 2003        | 516                    | 271       |
| 2004        | 701                    | 274       |

## **Sweden**

The Swedish International Cooperation Agency, Sida, provides Swedish funding for development cooperation with Tajikistan and has an office in Dushanbe. A new strategy for development cooperation with Central Asia for the period 2006-2009 is expected to come into force in March 2006. The strategy will focus on Tajikistan and

the Kyrgyz Republic. An Agreement on Development Cooperation for the period 2005-2010 has also been concluded with Tajikistan.

The goal for Sida's development cooperation is to contribute to an environment supportive of poor people's own efforts to improve their quality of life. In Tajikistan, the focus will be on democratic governance, economic development and social sector. Cooperation with EBRD through technical cooperation and investment grant support is envisaged in the Dushanbe Solid Waste Management and Kulyab-Danghara Regional Water Supply projects. During 2005, Sida will provide approximately EUR 5 million in grant financing to Tajikistan. This level is likely to be increased in the coming years.

### Switzerland

|                    | 2000       | 2001        | 2002       | 2003        | 2004        |
|--------------------|------------|-------------|------------|-------------|-------------|
| <b>SECO</b>        | 3.0        | 4.8         | 1.1        | 10.7        | 7.8         |
| <b>SDC</b>         | 4.0        | 5.3         | 5.8        | 5.5         | 5.8         |
| <b>Swiss Total</b> | <b>7.0</b> | <b>10.1</b> | <b>6.9</b> | <b>16.2</b> | <b>13.6</b> |

Based on the bilateral framework agreement on technical, financial and humanitarian co-operation, which has been in force since 2000 and the Regional Programme Central Asia 2002-2006, the State Secretariat for Economic Affairs (SECO) and the Swiss Development Co-operation (SDC) are both engaged in co-operation with Tajikistan. Including regional activities covering Tajikistan, funds amount to approximately US\$ 5 million per year and cover infrastructure, private sector development and trade. SDC makes available a similar amount for projects in their priority domains of good governance, health and disaster prevention.

A special priority is given to **infrastructure development**, the focus being on the electricity and the water sectors. US\$ 5 million have been granted to co-finance a World Bank project to finance social protection costs in the framework of a power rehabilitation project in Gorno Badakshan, carried out by Pamir Energy, a non-state owned investor/operator. In 2003 Switzerland also made available a grant of US\$ 8 million to co-finance the ADB's power rehabilitation project focusing on the area around Dushanbe. Furthermore, Switzerland co-finances the EBRD's Khudjand Water Supply project with US\$ 3.15 million.

With respect to **private sector development**, Switzerland focuses on strengthening SMEs through technical assistance projects and improving access to finance. These projects are implemented jointly with partners such as the EBRD, IFC and ITC. Switzerland funded a survey of the Tajik SMEs in order to determine the obstacles for further development and supported the development of the leasing industry.

With regard to **trade**, Switzerland supports Tajikistan in its efforts to join the WTO by providing training to officials involved in the negotiations and the subsequent implementation process. Furthermore, **seco** has also financed a regional technical assistance project in public debt management for Tajikistan. The project aims at assisting the Tajik government to improve the management of external debt and to strengthen the legal and institutional framework for public debt as warranted.

## **United Kingdom**

Due to its high poverty rates and low-income status Tajikistan is one of the Department for International Development (DFID)'s focal countries in the Central Asian region.

DFID's aid framework of GBP 2.6 million in 2004-5 covered: support to micro and small enterprise development (through the EBRD); support to third party arbitration courts and farm debt resolution; support for regional development in the Zarafshan valley, promoting cross border cooperation between Tajik-Uzbek populations; support to National Social Investment Fund; support for improved donor-government coordination.

DFID is also supporting a regional programme to improve the regional response to HIV/AIDS by supporting national HIV/AIDS programmes in four Central Asian countries, including Tajikistan (others are Kazakhstan, Kyrgyz Republic and Uzbekistan). This programme entails provision of GBP 6.4m in assistance over a four-year period (2004-08)

## **United States of America**

The USAID office in Tajikistan is part of the USAID Regional Mission for Central Asia (USAID/CAR) --a unique model for managing U.S. assistance regionally in five newly independent states of Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan. These Central Asian Republics, formerly part of the Soviet Union and situated on the historic "Silk Road," are strategically important to the United States not only for their location, but as a source of oil and other minerals. They are bordered by Russia to the north, China to the east, and Iran and Afghanistan to the south.

Across these five countries, USAID's assistance focuses on the economic, political, social, and environmental aspects of the transition process to more open, free market democratic societies. Kazakhstan and Kyrgyz Republic have the full range of U.S. assistance. In Uzbekistan and Turkmenistan, the range of assistance is more limited by the pace of reform. In Tajikistan, USAID assistance primarily supports the reconciliation process after a civil war. Training, partnerships, and technical assistance are the essential elements of all USAID/CAR programmes. USAID/CAR provides considerable technical expertise through a network of specialized contractor and grantee partners.

The headquarters of the USAID/CAR Regional Mission is located in Almaty, Kazakhstan with a specialized USAID management and technical staff. There are small liaison or country offices in Tashkent, Uzbekistan; Bishkek, Kyrgyzstan; Dushanbe, Tajikistan and Ashgabat, Turkmenistan. USAID/CAR technical officers and staff travel regularly throughout the region.

USAID/CAR has over 50 American and 170 local national employees. Over 80 contractor and grantee teams actually implement the USAID/CAR portfolio of activities.

| Objective   | SO Number | FY 2004       | FY 2005       | FY 2006       |
|---|-----------|---------------|---------------|---------------|
| <a href="#">Small and Medium Sized Enterprise Program</a>         | 119-0131  | 4,402         | 3,525         | 4,581         |
| <a href="#">Energy and Water</a>                                  | 119-0161  | 857           | 1,470         | 1,350         |
| <a href="#">Democratic Culture and Institutions</a>               | 119-0211  | 6,215         | 3,475         | 4,600         |
| <a href="#">Conflict Prevention</a>                               | 119-0240  | 1,498         | 780           | 718           |
| <a href="#">Health and Population</a>                             | 119-0320  | 5,265         | 3,593         | 4,232         |
| <a href="#">Improved Quality of and Access to Basic Education</a> | 119-0340  | 300           | 230           | 212           |
| <a href="#">Cross-Cutting Programs</a>                            | 119-0420  | 1,522         | 1,790         | 1,647         |
| Transfers   |           | 4,392         | 12,137        | 7,660         |
| <b>Total (in thousands of dollars)</b>                            |           | <b>24,451</b> | <b>27,000</b> | <b>25,000</b> |

**The USAID Programme:** USAID's seven strategic objectives in Tajikistan promote reforms and training that foster the growth of small and medium enterprises (SMEs), promote civil society and expand access to information, improve primary health care and prevent infectious disease, encourage better use of the region's water and energy resources, improve primary education, mitigate or prevent conflict, and address cross-cutting issues such as gender, corruption, and youth. Elements of the programme also address the Water for the Poor and Clean Energy Presidential Initiatives through work to improve water resource management at the national and local level and to promote efficient energy use. The specific activities to be funded by FY 2005 and FY 2006 appropriations are described in more detail in the Programme Data Sheets.

The Government's capacity to effect reform is considered weak due to the lack of trained staff. The private sector is poorly developed and continues to be constrained by inconsistent Government regulation. International non-governmental organizations (NGOs), in cooperation with local NGOs, are partially able to provide basic services at the community level. The design of this programme is effectively building both public and private capacity to develop and implement public policies and reforms, particularly in the area of economic reform and regional trade, as well as at the local level where USAID is re-establishing links between communities and local government. Such efforts are critical to USAID's success in a country where neither businesses and communities nor government structures are accustomed to working together to address development needs.

USAID continues ongoing activities in Tajikistan such as fiscal reform, banking supervision, microfinance development, World Trade Organization (WTO) accession activities, customs reforms, identification and removal of investment constraints, restoration of primary irrigation infrastructure, local government, maternal, child, and reproductive health, drug demand reduction, and basic and civic education. USAID has initiated new activities relating to land tenure reform and infectious disease control and expanded programs in HIV/AIDS and tuberculosis and political party development.

**Other Programme Elements:** With funding from USAID's Child Survival Matching Grant Programme, a very successful primary and reproductive health care activity is continuing in Penjikent District, which is cut off from the rest of Tajikistan by the closed Uzbekistan border to the east and mountain passes to the north and south that are closed six months per year. USAID's Office of Food for Peace has provided essential support for the World Food Programme's school feeding and other

vulnerable group feeding programmes using P.L. 480 Title II resources. A recently-approved five-year, US\$ 60 million P.L. 480 Title II Development Assistance Programme was awarded to a consortium of NGOs to further provide assistance to communities and schools for health activities. However, the demand for food aid in other regions of the world threatens the viability of this programme. The Farmer-to-Farmer Programme, also financed through P.L. 480 and managed by USAID's Bureau for Economic Growth, Agriculture, and Trade, has actively supported agriculture-related SME development efforts in Tajikistan. USAID's Office of Foreign Disaster Assistance is undertaking a new regional earthquake preparedness project that targets Dushanbe, Tajikistan. Additionally, the Eurasia Foundation manages small grants in education, small business, local government, and civil society, which reinforce USAID's strategic objectives. The Departments of Commerce, Defence, Agriculture, and State also manage programs complementary to USAID field activities in exchange programmes, training opportunities, support to border guards and customs officials, and emergency feeding programs through the World Food Programme. For example, the State Department's Bureau for International Narcotics and Law Enforcement Affairs and Bureau of Democracy, Human Rights, and Labour continue to collaborate closely with USAID in areas of mutual interest.