



# Progress Report on Tranche Release

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## Tajikistan: Investment Climate Reforms Program (Subprogram 2)

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**Asian Development Bank**

## CURRENCY EQUIVALENTS

(as of 13 October 2017)

Currency Unit	–	somoni (TJS)
TJS1.00	=	\$0.113
\$1.00	=	TJS8.796

## ABBREVIATIONS

ADB	–	Asian Development Bank
AQR	–	asset quality review
GDP	–	gross domestic product
PIP	–	public investment project
RIA	–	regulatory impact analysis

## NOTE

In this report, “\$” refers to United States dollars.

<b>Vice-President</b>	W. Zhang, Operations 1
<b>Director General</b>	S. O’Sullivan, Central and West Asia Department (CWRD)
<b>Director</b>	R. Hartel, Public Management, Financial Sector, and Trade, CWRD
<b>Team leader</b>	H. Mukhopadhyay, Principal Public Management Specialist, CWRD
<b>Team members</b>	M. Boboev, Economics Officer, Tajikistan Resident Mission (TJRM), CWRD
	F. Dodomirzoeva, Project Assistant, TJRM, CWRD
	M. Etrata, Associate Project Analyst, CWRD
	L. Nazarbekova, Principal Counsel, Office of the General Counsel (OGC)
	D. Perkins, Senior Counsel, OGC
	M. Sual, Operations Assistant, CWRD

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## I. BACKGROUND

1. The Asian Development Bank (ADB) Board of Directors approved a policy-based loan and a policy-based grant to Tajikistan for subprogram 2 of the Investment Climate Reforms Program on 22 December 2016.<sup>1</sup> Subprogram 1 was approved on 4 December 2015.<sup>2</sup>

2. Subprogram 2 provides budget support to facilitate the expansion of economic opportunities and the development of the private sector. The impact of subprogram 2 is aligned with increased private investment, economic diversification, and competitiveness. The outcome will be increased capabilities and opportunities of businesses to set up and expand higher value-added production. Subprogram 2 includes 13 policy actions to deliver three outputs approved under the program: (i) reduced cost of doing business, (ii) strengthened protection for businesses, and (iii) increased business innovation and productivity. Subprogram 2 also includes two important loan effectiveness conditions.

3. Subprogram 2 was declared effective on 22 September 2017.

## II. MACROECONOMIC SITUATION

4. Economic growth in Tajikistan slowed to 6.0% in the first half of 2017 from 6.5% in the same period of 2016. Industry expanded by 21.3%, up from 12.1% a year earlier on gains of 26.3% in mining, 20.9% in manufacturing, and 16.2% in electricity generation. Retail trade and services grew by 3.6% despite low remittances. Average annual inflation accelerated to 7.7%, mainly because the recapitalization of troubled banks led to a 17.8% increase in the broad money supply. Consumer prices rose cumulatively by 5.9% in the first half of 2017, up from 3.1% a year earlier, reflecting price increases of 8.3% for food, 1.3% for other goods, and 4.9% for services. To curb inflation, the National Bank of Tajikistan raised the refinancing rate by 5 percentage points in two steps—from 11.0% to 12.5% in February 2017 and to 16.0% in March. It also more than doubled open market sales of securities and treasury bills to rein in liquidity. Despite these measures, the somoni depreciated by 11.9% against the United States dollar in the first half of 2017, mainly because the official exchange rate became realigned with the market rate.

5. Tajikistan's fiscal situation is presented in Table 1. General revenue and grants constituted about 24% of gross domestic product (GDP) excluding special funds and grants for public investment projects from development partners. If those funds were included, general revenue and grants was about 29% of GDP in the same year. Deficit will remain at around 4% of GDP without further fiscal initiatives. There will be one percentage point decline in deficit between 2017 and 2019. Public debt to GDP ratio will decline from 47% in 2017 to 43% in 2020.

6. Uncertain remittances contributed to a 15.0% decline in imports in the first half of 2017, while higher industrial production contributed to a 73.4% rise in exports. The current account deficit is forecast at about 5.5% of GDP in both 2017 and 2018 because of further anticipated currency depreciation and uncertainty about remittances.

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<sup>1</sup> ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan and Grant for Subprogram 2 to the Republic of Tajikistan for the Investment Climate Reforms Program*. Manila.

<sup>2</sup> ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan and Grant for Subprogram 1 to the Republic of Tajikistan for the Investment Climate Reforms Program*. Manila.

**Table 1: Fiscal Overview of Tajikistan  
Base Line Scenario (without reform)**  
(as a percent to GDP)

Item	2017	2018	2019	2020
<b>General Revenue and Grants (A+B)</b>	23.6	24.1	24.6	25.1
<b>A. Total Revenue (a+b)</b>	23.0	23.5	24.0	24.5
<b>a. Tax Revenue (1+2+3+4+5+6+7)</b>	20.3	20.8	21.3	21.8
1. Taxes on income and Profit	4.9	5.3	5.6	6.0
2. Payroll Tax	2.6	2.6	2.7	2.7
3. Property Tax and Land Tax	0.4	0.4	0.4	0.4
4. The Sales Tax and Value-Added Tax	9.3	9.3	9.3	9.4
5. Excises	0.7	0.7	0.7	0.7
6. Taxes on Foreign Trade and Transactions	1.2	1.2	1.2	1.2
7. Internal Taxes on Goods and Services	1.2	1.3	1.4	1.5
<b>b. Other Revenues</b>	2.7	2.7	2.7	2.7
<b>B. Budget Support Grants</b>	0.6	0.6	0.6	0.6
C. Special Fund	2.5	2.5	2.5	2.5
D. Grants for Investment Projects (PIP)	2.5	2.5	2.5	2.5
<b>Total Expenditure</b>	32.9	32.8	32.8	32.8
<b>Current Expenditure of which</b>	21.3	21.3	21.2	21.2
Interest Payment	1.0	1.0	1.0	1.0
<b>Capital Expenditure</b>	11.6	11.6	11.6	11.6
<b>Public Debt</b>	46.5	45.6	44.3	42.6
<b>Deficit</b>	4.3	3.8	3.3	2.7

GDP = gross domestic product, PIP = public investment project

Source: Fiscal Strategy Paper, Ministry of Finance, Government of Tajikistan.

### III. LOAN EFFECTIVENESS

7. To mitigate the fiscal and banking system risks, subprogram 2 includes two conditions for effectiveness: (i) the government must have completed, to the satisfaction of ADB, asset quality reviews (AQRs) of the five largest banks (Agroinvestbank, Amonatbank, Eskhatabank, Orienbank, and Tojiksodirotbank); and (ii) the government must have adopted, to the satisfaction of ADB, a fiscal strategy that will credibly reduce the budget deficit, including the public investment program, to 2.5% of GDP in 2017 and assure that the budget deficit in 2018 and 2019 is consistent with debt sustainability.

8. The purpose of the AQRs is to obtain a better understanding of the systemic risks to Tajikistan's banking system, which has been severely affected by the economic decline that began in late 2014. Significant deficiencies in corporate governance, credit underwriting, risk management, and prudential supervision of the banks also pose challenges to the solvency of the banking system. This has constrained the ability of banks to provide funding for private investments. The high liquidity and solvency risks require substantial sovereign liquidity and capital support that are likely to be challenging in the context of Tajikistan's fiscal consolidation initiatives.

9. ADB takes the view that the AQRs provided valuable information on the solvency of the banking system that was hitherto not available. More importantly the AQRs constitute an important milestone to understand the scope of banking system risks as a basis for a more intensive policy dialogue of ADB with government and in coordination with the IMF and other international financial institutions. In this respect, the AQRs are viewed satisfactory as required by ADB's loan effectiveness conditions.<sup>3</sup>

10. ADB helped the government prepare a comprehensive fiscal strategy document, which was approved and adopted by the government on 21 September 2017. The medium-term fiscal strategy is a combination of (i) revenue-led fiscal consolidation, and (ii) moderation in expenditure growth and shifting away from recurrent to growth promoting capital expenditure. The strategy requires an increase in the tax-to-GDP ratio in the medium term. If the deficit is kept at 2.5% of GDP, the debt path would be sustainable in the medium term. The projections under the reform scenario are provided in Table 2.

**Table 2: Reform Scenario, 2017–2020**  
(% of GDP)

Item	2017	2018	2019	2020
<b>General Revenue and Grants (A+B)</b>	23.7	24.2	24.7	25.3
<b>A. Total Revenue (a+b)</b>	23.1	23.6	24.1	24.7
<b>a. Tax Revenue (1+2+3+4+5+6+7)</b>	20.4	20.9	21.5	22.0
1. Taxes on income and Profit	4.7	4.9	5.0	5.2
2. Payroll Tax	2.6	2.6	2.7	2.7
3. Property Tax and Land Tax	0.5	0.5	0.5	0.5
4. The Sales Tax and Value-Added Tax	9.6	9.8	10.1	10.4
5. Excises	0.7	0.7	0.7	0.7
6. Taxes on Foreign Trade and Transactions	1.2	1.2	1.2	1.2
7. Internal Taxes on Goods and Services	1.2	1.3	1.3	1.3
<b>b. Other Revenues</b>	2.7	2.7	2.7	2.7
<b>B. Budget Support Grants</b>	0.6	0.6	0.6	0.6
C. Special Fund	2.3	2.1	1.9	1.8
D. Grants for Investment Projects (PIP)	3.0	2.2	1.6	1.4
<b>Total Expenditure</b>	31.4	31.0	30.7	30.9
<b>Current Expenditure of which</b>	20.9	20.5	20.1	19.6
Interest Payment	1.0	0.9	0.9	0.8
<b>Capital Expenditure</b>	10.5	10.5	10.6	11.3
<b>Public Debt</b>	43.9	41.4	39.1	37.1
<b>Deficit</b>	2.5	2.5	2.5	2.5

GDP = gross domestic product, PIP = public investment project

Source: Fiscal Strategy Paper, Ministry of Finance, Government of Tajikistan.

<sup>3</sup> ADB accepted the AQRs and informed the government in a letter on 21 September 2017.

#### IV. COMPLIANCE STATUS OF THE POLICY ACTIONS

11. For disbursement, 13 policy actions need to be complied with. The status of compliance is summarized in Table 3.

**Table 3: Compliance Status of the Policy Actions**

Policy Actions	Compliance Status
<b>Output 1: Reduced Cost of Doing Business</b>	
1. The government reduces and consolidates the number of bodies with inspection powers.	<b>Fully Complied With.</b> The authority to inspect businesses was removed from 10 bodies and the consolidation of the pedigree livestock inspectorate into the veterinary inspectorate was evidenced. A government resolution approved an action plan to further reduce the number of bodies with inspection powers.
2. To reduce the tax burden on businesses, (i) the Parliament approves the reduction of the coefficient for calculation of profit tax from 1.1 to 1.0 of last year's profits; (ii) the Tax Committee issues an internal order establishing disciplinary measures for staff that request advance tax payments from businesses not permitted in the Tax Code; and (iii) the government implements a nation-wide communication campaign to increase awareness of taxpayers' rights regarding advance tax payments.	<b>Fully Complied With.</b> The relevant amendments to the Tax Code were approved by the Parliament. An internal order was issued and placed at the website of the Tax Committee. A nationwide communication campaign was arranged.
3. The Tax Committee accepts electronic declarations (without asking the corresponding paper declaration) from at least 30,000 taxpayers (of which 30% are women owned businesses) through its website using a login/mobile password authentication system.	<b>Fully Complied With.</b> E-filing of tax declarations was arranged by the tax authorities through its website <a href="http://andoz.tj/ru/">http://andoz.tj/ru/</a> and <a href="http://office.andoz.tj/?lang=ru">http://office.andoz.tj/?lang=ru</a> .
4. The government (i) further reduces the number of goods subject to outdated (mandatory) technical regulations by removing those that do not meet international standards, and (ii) discloses the updated list of technical regulations.	<b>Fully Complied With.</b> Relevant resolutions were adopted to remove technical regulations that do not meet international standards. The updated list of technical regulations is available on Tojikstandart's website <a href="http://standard.tj/documents/6.pdf">http://standard.tj/documents/6.pdf</a> .
5. The introduction of mandatory regulatory impact analysis (RIA) in the rule-making process is submitted to Parliament for approval, including (i)	<b>Fully Complied With.</b> Amendments to the Law on Normative Acts were introduced that envisaged RIA in the rule making process.

Policy Actions	Compliance Status
<p>preparation and disclosure of forward regulatory plans and RIA for all normative acts with potential impact on businesses adopted by the Parliament, Government, ministries, National Bank of Tajikistan, and other public bodies at the central government level; (ii) a system of electronic registries of forward regulatory plans, RIAs, and adopted normative acts; (iii) the mandate for a RIA oversight body or unit; and (iv) a single publication source for all normative acts adopted at the central government level that gives legal force to electronic version of normative acts.</p>	
<b>Output 2: Strengthened Protection of Businesses</b>	
<p>6. The government establishes a web portal with universal, free of charge access to the database of normative acts (forward regulatory plans, RIA reports, draft normative acts, and adopted normative acts).</p>	<p><b>Substantially Complied With.</b> Ensuring full compliance to this policy action requires completion of the following actions: (a) Ministry of Justice letter approving: (i) the introduction of a web portal that provides universal, free-of-charge access to forward regulatory plans, RIA reports, draft normative acts, and adopted normative acts; and (ii) the selection of the hardware and software vendors; and (b) Government Resolution with allocation of funding from the state budget to the Ministry of Justice for maintenance of the new web portal for 2017–2020. A government resolution for the establishment and maintenance of a web portal was signed on 27 February 2017. An ADB consultant prepared the terms of reference (approved by the government) for the procurement of hardware and software to be financed under the related ADB TA.<sup>4</sup> An authorized person (focal point) from the Ministry of Justice was appointed by the government. ADB is now facilitating procurement of hardware and software following ADB's Procurement Guidelines (2015, as amended from time to time) and expected to be completed by December 2017.</p>
<p>7. The government discloses all incentives provided to investors to the general public.</p>	<p><b>Fully Complied With.</b> Information on signed investment agreements is available on the website of the State Investment Committee and State Property Management.</p>

<sup>4</sup> ADB. 2013. *Technical Assistance to Tajikistan for Investment Climate Reforms*. Manila (TA 8557-TAJ, \$1,600,000, approved on 13 December, financed by the Japan Fund for Poverty Reduction and the Technical Assistance Special Fund).

Policy Actions	Compliance Status
	<a href="http://gki.tj/ru//nvestitsii_v_rt/nformatsiya_i_statistika/reestr_soglashenii/">http://gki.tj/ru//nvestitsii_v_rt/nformatsiya_i_statistika/reestr_soglashenii/</a> .
8. The government publishes an electronic report with gender-disaggregated statistics of business ownership for 2011–2015.	<b>Fully Complied With.</b> Information is available on the website of the State Statistical Agency under the President of Tajikistan. <a href="http://www.stat.tj/ru/gender/businesswomans/">http://www.stat.tj/ru/gender/businesswomans/</a> .
<b>Output 3: Increased Business Innovation and Productivity</b>	
9. The Government (i) carries out public consultations in the course of development of a new tariff policy for electricity that is in line with good international practice and eliminates cross customer subsidies; (ii) adopts and makes effective this new tariff policy for electricity and decides on gradual tariff adjustment to cost recovery levels; and (iii) increases allocation in the 2017 state budget for subsidies to low income consumers to mitigate the impact of tariff increases (a total of at least TJS80 million).	<b>Substantially Complied With.</b> Consultations were carried out, new tariff policy was adopted, relevant allocations from state budget for vulnerable groups of population under Targeted Social Assistance program were earmarked. The Government has already allocated TJS69.4 million (as against TJS 80 million) for low income consumers to mitigate the impact of tariff increase in 2017. Thus, meeting the 87% of the targeted subsidy in 2017 is a substantial accomplishment of the intended policy action.
10. The National Accreditation Center becomes fully independent from Tajik standard and receives funding from the state budget.	<b>Fully Complied With.</b> The National Accreditation Center becomes independent (minutes of the Board of Trustees meeting were evidenced). State Budget allocation was provided.
11. The government improves the Entrepreneurship Support Fund's long term results framework and internal control function, including the disclosure of the 2015 audited financial statements and the appointment of independent members of the supervisory board.	<b>Fully Complied With.</b> The strategy of the Fund was approved, and reports about its operational and financial performance were disclosed on their website <a href="http://www.fdstj.org/index.php/tj/isobot-o">http://www.fdstj.org/index.php/tj/isobot-o</a> .
12. The government transfers at least TJS210 million in assets or cash to a microcredit refinancing fund duly established and operating in accordance with a charter that sets out a governance structure aligned with international good practice, and that has all necessary licenses to operate, including a license from NBT to finance rural development.	<b>Fully Complied With.</b> The microcredit refinancing fund was established and obtained its license from the National Bank of Tajikistan. Amendments to instruction #198 were made and the Board of Trustees (BoT) were nominated. An independent recruiting firm identified candidates for the top-management of the Fund. The first meeting of BoT was held on 4 October 2016. The bank account for the Fund received TJS210 million in assets and cash. The BoT also selected the COO and CFO for the Fund in the meeting held on 11 October 2017.

Policy Actions	Compliance Status
13. The government allocates grants to at least 80 businesswomen for co-financing of investments (TJS2 million in 2016).	<b>Fully Complied With.</b> Grants were allocated to businesswomen through the Committee of Family and Women Affairs under the Government of Tajikistan.

ADB = Asian Development Bank, BoT = Board of Trustees, CFO = Chief Financial Officer, COO = Chief Operating Officer, RIA = regulatory impact analysis, TA = technical assistance

## V. CONCLUSION

12. The government has made significant progress in implementing reforms under subprogram 2. It has fully complied with 11 policy actions and incurred adjustment costs as envisaged under subprogram 2.<sup>5</sup> There are two policy actions which are not fully complied with. The government has completed all the actions related to the web portal (substantially complied policy action 6). Selection of the software vendor for the web portal is not a difficult reform, and will be completed soon with ADB's financial and procurement support. The other substantially complied policy action deals with budget allocation of TJS80 million for subsidies to low income consumers to mitigate the impact of tariff increases in 2017 (policy action 9). The government has allocated TJS69.4 million (Table 3), representing a sharp rise of 61.4% over 2016 amount (TJS43 million). The government has shown a strong commitment to carrying out the reforms to their logical conclusion in these two areas.

13. Subprogram 2 was developed as a follow up on subprogram 1. Many of the structural shortcomings in Tajikistan's economy—low competitiveness of products in particular—reflect the limited progress in expanding its productive capabilities and in tapping economic opportunities that create more wealth. Binding constraints to private investment include an unfavorable business environment, unreliable access to electricity (particularly during the winter), poor transport connectivity with external markets, and limited integration with global sources of knowledge. Since 2016, access to finance has also emerged as a binding constraint, given the credit crunch associated with the deteriorating solvency and liquidity in the banks. A programmatic approach with three separate subprograms was launched to address these binding constraints.

14. Subprogram 2 seeks to consolidate the gains made during subprogram 1. It is targeted at improving the ease of doing business by addressing the constraints in three areas: (i) poor infrastructure, (ii) limited integration with global sources of knowledge, and (iii) weak institutional structure.

15. Significant achievements have been seen in several key areas, such as a reduction in inspection bodies, a reduction in taxes, transparency in government acts and incentives, and strengthened microcredit. These steps forward were possible because the government took ownership to ensure that the reforms were implemented successfully. Implementation of some policy actions and two loan effectiveness conditions were challenging and required support and coordination across several line ministries and development partners, which caused delays. ADB provided strong support to (i) set up the web portal (policy action 6), (ii) select the management personnel for the microcredit refinance fund (policy action 12),<sup>6</sup> and (iii) design the fiscal strategy

<sup>5</sup> Some of these adjustment costs include higher budget allocations for (i) the refinancing credit fund for financing rural businesses and farmers; (ii) government institutions, to pay for higher electricity tariffs arising from the reduction of implicit subsidies in the tariffs; (iii) the low-income population to compensate for higher electricity costs; and (iv) the Entrepreneurship Support Fund for financing of businesses.

<sup>6</sup> A recruitment agency was hired for this purpose.

paper. These were extremely time-intensive initiatives. The government accomplished the enormous task of completing the AQRs of five banks. Despite these delays, the achievements were the result of proactive steps taken by the executing agency staff and strong support from the senior staff of the government's Finance Department.

## VI. RECOMMENDATION

16. In view of the substantial progress made in implementing subprogram 2 of the Investment Climate Reforms Program, as demonstrated by (i) full compliance with 11 policy actions, and two loan effectiveness conditions; (ii) substantial compliance with two policy actions, the President recommends that the Board approve, on a no objection basis,

- (i) the waiver of full compliance for two tranche release conditions based on the achievement of substantial compliance of policy actions 6 and 9 under subprogram 2, and
- (ii) the release of the loan in the amount of \$50 million<sup>7</sup> for the subprogram 2 of the Investment Climate Reforms Program in Tajikistan.

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<sup>7</sup> Consisting of Loan 3513-TAJ in the amount of SDR22,433,000, and Grant 0530-TAJ in the amount of USD19,240,000.