Ex post evaluation of the EFA operation in Tajikistan

Framework Contract ECFIN-160-2005

Final report

Client: European Commission, Directorate General for Economic and Financial Affairs

Submitted by

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Research and Consulting

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Rotterdam, 22 March 2007

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Abbreviations list

ADB	Asian Development Bank
AIPRG	Armenian International Policy Research Group
BIS	Bank for International Settlements
BoP	Balance of payments
CAS	Country Assistance Strategy (World Bank)
CCFF	Compensatory and Contingency Financing Facility (IMF)
CIS	Commonwealth of Independent States
CIS-7	Armenia, Azerbaijan, Georgia, Kyrgyzstan, Moldova, Tajikistan, Uzbekistan
CNY	Chinese Yuan
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment (World Bank)
DFID	Department for International Development (Great Britain)
DIPECHO	Disaster Preparedness ECHO
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECFIN	Directorate General for Economic and Financial Affairs
ECHO	European Commission Humanitarian Aid Department
EFA	Exceptional Financial Assistance
EFC	Economic and Financial Committee
EIDHR	European Initiative for Democracy and Human Rights
ESAF	Enhanced Structural Adjustment Facility (IMF)
EU	European Union
FDI	Foreign direct investment
FSP	Food Security Programme (EU)
FSU	Former Soviet Union
G&S	Goods and services
GCR	Global Competitiveness Report, World Economic Forum
GFSY	Government Finance Statistics Yearbook (IMF)
GoT	Government of Tajikistan
GDP	Gross domestic product
GNI	Gross national income
HDI	Human Development Index
HIPC	Highly Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IAS	International Accounting Standards
IDA	International Development Association (World Bank, concessional)
IDF	International Development Fund
IDP	Institutional Development Plan
IFC	International Financial Corporation

IFI	International Financial Institution
IFS	International Finance Statistics (IMF)
IEO	Independent Evaluation Office (IMF)
IMF	International Monetary Fund
IOM	International Organisation for Migration
IT	Information technology
JEDH	Joint External Debt Hub
LRC	Land Reform Committee
MDRI	Multilateral Debt Reduction Initiative
MFA	Macro-Financial Assistance (EC)
MoF	Ministry of Finance
MoU	Memorandum of Understanding (EC)
MTO	Money Transfer Organisation
NAO	National Authority Office
NBT	National Bank of Tajikistan
NGO	Non-governmental organisation
NPV	Net present value
OA	Operational Assessment
OECD	Organisation for Economic Co-operation and Development
PIP	Public investment programme
PFM	Public finance management
PRGF	Poverty Reduction and Growth Facility (IMF)
PRSP	Poverty Reduction Strategy Paper
SAC	Structural Adjustment Credit (World Bank)
SFCC	State Financial Control Committee
SIDA	Swedish International Development Cooperation Agency
SME	Small and medium-sized enterprise
SMP	Staff Monitored Programme (IMF)
SMoU	Supplemental Memorandum of Understanding (EC)
SOE	State-owned enterprise
TADAZ	Tajik Aluminium Plant
UN	United Nations
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VAT	Value-added tax
WB	World Bank
WDI	World Development Indicators (World Bank)
WTO	World Trade Organisation

Introduction

A consortium of ECORYS Nederland BV and CASE – Center for Social and Economic Research was contracted to conduct an ex post evaluation of the effects of the European Commission (EC) Exceptional Financial Assistance (EFA) operation carried out in Tajikistan from 2001 to 2006.

The team would like to express their gratitude to all the officials from the Government of the Republic of Tajikistan and from the EC, and the staff members of the International Monetary Fund, World Bank and other development agencies and projects, whom we met in Dushanbe, Brussels and Washington, DC. Their cooperation and willingness to share their information and insights helped us to gain a good understanding of the EFA operation in Tajikistan. We would also like to thank the evaluation steering committee for its constructive comments during the whole period of this evaluation. All remaining errors are ours.

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Executive summary

Background

1. This report presents the results of an evaluation of the Exceptional Financial Assistance (EFA) granted to Tajikistan by the European Commission (EC) as an extension to the wider EFA operation granted earlier to Armenia and Georgia. The EFA consisted of a loan of EUR 60 million and a grant of EUR 35 million that was intended for disbursement in five successive equal tranches (EUR 7 million each) during the period 2001-2004.

2. The objective of the EFA was to support financial sustainability and allow Tajikistan to reduce its external liability. This goal was reflected in the linkage between disbursement of the assistance and the reduction of Tajikistan's indebtedness. Disbursement of the loan and first grant tranche was conditional on settlement of the existing obligations to the European Community. Prior to disbursement, the Tajik Government fully settled the existing arrears with the Community, amounting to EUR 78.771 million. The loan and first grant tranche were released in March 2001. The subsequent four grant tranches (EUR 7 million each) were linked to early repayment (EUR 8 million per grant tranche) of the new EFA loan, leading to a net payment of EUR 1 million per tranche.

3. The grant tranches were also conditional on successful implementation of the International Monetary Fund (IMF) programme and the fulfilment of structural policy measures. Failures to meet structural conditions led to delays in disbursements of the third, fourth and fifth tranches. As a result of these delays, the last disbursement was executed at the end of 2006 rather than in 2004 as originally planned. The debt to the EC amounted to EUR 28 million at the end of the operation.

4. The EC proposal to extend the EFA operation for Tajikistan (and Georgia) for three years (2005-2007) with an additional grant element of EUR 10 million was rejected by the Economic and Financial Committee in 2004. The main arguments for not granting extension were the good progress achieved by Tajikistan in debt sustainability and deviation of the EFA operation from the 'Genval principles' describing the generic Macro-Financial Assistance (MFA) operation.

Evaluation objective and approach

5. The objective of the evaluation of EFA was to assess the impact of MFA and derive key lessons that can be applied to future MFA interventions. The evaluation was

based on the generic evaluation questions from the *Guidelines for the ex post evaluation of MFA operations,* and focused on impact in three areas: (1) macroeconomic stabilisation, (2) sustainability of the external financial position, and (3) structural reforms.

6. To attribute the effects of the EFA operation in each of the key evaluation areas, the evaluation followed a three-step approach: (i) identification of types and magnitudes of gross short-to-medium-term macroeconomic and structural reform effects, (ii) establishment of a counterfactual situation in the absence of the EFA operation, and (iii) determination of the net effects of the operation.

7. The evaluation employed three main instruments: (1) data collection and literature review, (2) in-depth interviews with key informants, and (3) qualitative and quantitative analysis, including macroeconomic modelling.

Counterfactual

8. Identification of the most probable counterfactual situation was based on several scenarios. Ultimately, we established that in the absence of the EFA operation: (1) the EC would not initiate another arrangement to address the problem of debt arrears, (2) other donors/lenders would also not assist arrears repayment, and (3) Tajikistan could not immediately clear arrears to the EC.

9. However, the failure to clear arrears immediately would not have affected the restart of other EU assistance programmes in the country, notably Food Security Programmes (FSPs) and TACIS technical assistance. Also, the absence of EFA would not have speeded up or slowed down the restructuring of other debt, and the International Financial Institutions' (IFIs) assistance would not have been significantly affected.

10. Willingness to improve relations with the EC and the pressure from the IMF would have prompted the country to start repayment as early as possible, probably with a small repayment in 2002. A gradual increase of the repayments could have been expected over the 2003-2005 period because of the improving macroeconomic situation. It seems plausible that all arrears to the European Union (EU) would have been cleared by the time of completing the second IMF Poverty Reduction and Growth Facility (PRGF) programme (end of 2005).

Impact on macroeconomic stabilisation

11. Tajikistan ensured macroeconomic stabilisation in the period 2001-2006. Economic growth performance and the continued decline of inflation were impressive. The net international reserve position changed from negative to positive and continued to grow after 2002. However, the increase in gross reserves just kept up with the import growth rate. Exchange and interest rates broadly stabilised in the period 2003-2005. Since then, the somoni has depreciated steadily against the dollar.

12. Fiscal policy performance has also improved, contributing to macroeconomic stabilisation. Tax collection has improved considerably, though it remains relatively low. Progress has been made in maintaining aggregate fiscal discipline, strengthening public expenditure and debt management. The quasi-fiscal deficit of the energy sector decreased from almost 23 percent of gross domestic product (GDP) in 2002 to 10 percent of GDP in 2005. This general progress on macroeconomic stabilisation was confirmed by the strong performance of the second IMF PRGF programme.

13. The EFA operation's impact can be better assessed by examining in more detail the counterfactual situation. The main implication of the counterfactual is a different debt repayment structure. While in 2001 Tajikistan would have spent fewer resources on clearing arrears, it would have had to devote substantial budget resources from across-the-board expenditure cuts to clear debts in subsequent years. Some minor adjustment would probably have taken place through IFIs tolerating a slightly deteriorated fiscal balance.

14. The net impact of the EFA operation on macroeconomic stabilisation appears to have been rather limited. EFA brought a marginal improvement in economic growth and minimally lower inflation over the period 2001-2006. The results of quantitative modelling suggest that EFA contributed approximately a cumulative 1.5 percentage point increase in GDP in this period. By decreasing the cost of foreign debt servicing it allowed budget expenditure to be shifted to domestic use.

15. It is worth noting that the limited macroeconomic impact of the EFA operation on macroeconomic stabilisation should be seen in the context of improving economic conditions in Tajikistan in the period 2001-2006. The EFA operation took place in an environment where the risk of economic instability was diminishing.

Impact on external sustainability

16. Tajikistan began transition (in 1991-1992) with practically no foreign or domestic debt. However, throughout the early 1990s and after 1996, liabilities increased at a rapid rate. The consequences of the 1998 financial crisis in Russia led to a major deterioration of Tajikistan's external financial situation, with total nominal government and government-guaranteed debt rising from just below 60 percent of GDP in 1997 to 100-110 percent of GDP in 1998-2000.

17. The period after 2000 was characterised by significant improvement in foreign debt indicators. This improvement reflected a decline in nominal debt levels and a shift to concessional financing (mainly through debt restructuring deals with key creditors, notably Russia), rapid GDP growth accompanied by expansion of exports and budget revenues, and progress in reforms. In 2006, Tajikistan took three loans from China to the tune of US$ 600 million, two-thirds of total outstanding debt as of 2005. Moreover, new Chinese loan projects are being discussed.

18. Among major risk factors for external sustainability is the possibility of a change in the authorities' attitude to debt financing. Abundant global liquidity and in particular the willingness of Chinese creditors to extend loans may potentially create an illusion

of 'easy money' among policy-makers. Lack of proper assessment of new projects financed by foreign borrowing could lead to a return of the recent debt problems.

19. Abstracting from the potential new lending from China, the outlook for medium-term debt sustainability is positive. Specifically, Tajikistan's position against the debt benchmarks worked out by the IMF and World Bank (WB) appears safe, though firm assessment is difficult because of insufficient information on new debt operations. Regarding current account sustainability, a very narrow export base and very low inflows of foreign direct investment are worrying signs. Strongly rising inflows of workers' remittances are a stabilising factor.

20. The impact of EFA on long-term external sustainability is positive but small. The channels where it was relatively easy to identify the direct contribution of EFA appear to play a relatively small part in the long-term perspective. This applies to both the debt-relief element of the operation and slightly higher GDP resulting from EFA. In the long term, other issues related to improved economic governance appear more important. Structural reforms – such as widening the tax base, improving tax collection and strengthening public administration – and improving debt management appear to be among the most important achievements for long-term external sustainability prospects. However, EFA conditionalities in these areas have had limited impact on the overall reform achievements.

Impact on structural reforms

21. Structural conditionalities of the EFA operation in Tajikistan focused on four areas of activities related to: (1) the taxation system, (2) public finance and administration, (3) privatisation process, and (4) restructuring of the banking sector and monetary policy. They reflected a combination of 29 conditionalities borrowed from the IMF and World Bank programmes, and two EC-specific conditionalities. The latter were included as a result of the findings signalled by the Operational Assessment carried out by the Directorate General for Economic and Financial Affairs. The evaluation found that these structural policy conditionalities were relevant to the reform agenda of the Tajik Government. Nevertheless, given the country's lack of capacity to implement reforms at the beginning of the reform process, the number and scope of conditionalities were probably too ambitious.

22. Despite delays in the EFA operation compared with the original planning, the expected structural effects have been realised in most areas. According to the WB implementation completion reports and IMF reviews of PRGF programmes, to which EFA was substantially related, these programmes were successful in achieving their medium-term structural effects. Most successful in achieving their structural sector policies and objectives were the measures relating to tax administration and collection, small-scale privatisation and restructuring of the banking sector. The agricultural and land reforms were slower, and their quality was affected by lack of a proper legal framework and vested interests prevailing in the cotton sector. The Government is committed to reform and it is expected that the major structural achievements of EFA are likely to be sustained. The only area where realisation of

the structural reform objective is unclear relates to the independence of the State Financial Control Committee.

23. Although the expected effects of the structural conditionalities of the EFA operation have been achieved, their net effect remains relatively limited. The evaluation assessed the net impact of EFA by identifying political and operational reinforcing effects and value-added effects of the EFA structural conditionalities vis-à-vis IFI measures. The most evident and strongest net effect on structural reforms was observed in the case of the two EC-specific conditionalities, which through their uniqueness had a value-added effect in the implementation of reforms related to public finance management. Of the other conditionalities, only two had a political reinforcing effect and none had an operational reinforcing effect. The magnitude of the reinforcing effects on structural reforms was affected by such factors as limited active EC presence in the dialogue with the Tajik authorities, lack of EC technical assistance to support the realisation of the structural conditionalities and expected structural reforms, generalised reformulation of the cross-conditionalities, and limited instruments to monitor progress. On the other hand, many stakeholders expressed perceptions of a general reinforcing effect of EFA contributing to the broad success of IFI programmes in the country.

Design and implementation

24. The MFA operation in Tajikistan, known as Exceptional Financial Assistance, was indeed exceptional in character. It was designed and implemented because the EC had no alternative instrument to address the country's unsustainable level of debt arrears towards the EC. As a result, several features of the operation did not correspond strictly to the MFA blueprint as described by the Genval criteria and *Vademecum on EC macroeconomic assistance to third countries*.

25. The main objective of the operation explained well the blend of loans and grants. The additional grant element proposed in 2004 would obviously have been beneficial for the country's external sustainability, but was not necessary because of the positive indebtedness trends that took place during the program's duration.

26. The EC quickly recognised that Tajikistan was not able to meet the original ambitious (maximum) target for net debt repayment. Consequently, the amount was reduced by mutual agreement. This decision benefited Tajikistan during the first phase of the EFA operation. However, the country was able to make larger net debt repayments in the second half of the operation when economic growth picked up and budgetary revenues increased as large remittance flows supported the balance of payments (BoP).

27. Tajikistan was obliged to make debt repayments in excess of disbursements, so the immediate net impact of the disbursements on the BoP was actually small and negative. Therefore, the choice concerning the number of tranches and total length of the operation was of little importance from the macroeconomic point of view.

28. The EFA operation's secondary goal was to promote the structural reform agenda through conditionality. Obstacles to high-quality policy discussion (low EC presence in the country) made effective selection and monitoring of structural conditionalities difficult. These circumstances largely determined the dominant role of cross-conditionalities and the low visibility of EFA conditionalities and their political reinforcing effect, especially at the beginning of the operation. The reinforcing effect was also weakened by frequent reformulation of the original IFI conditionalities.

29. The net effect of EFA structural conditionality was stronger in the later stages of the operation. Of particular importance in terms of net effect were the EC-specific conditionalities, which were included in the Supplemental Memorandum of Understanding as a result of the Operational Assessment. The increased net effects towards the end of the EFA operation could also be ascribed to improved donor coordination in general, and improved coordination between the EC and other donors following the establishment of the EC Delegation in Dushanbe. However, because of the short period of time remaining for completion of EFA, this improvement could not significantly influence the operation.

30. The implementation of EFA offered limited opportunities for coordination with other EU assistance programmes, as the TACIS and FSP programmes were only relaunched when the EFA operation was in its final stages. Consequently, there was no complementarity between EFA and other EC instruments at the start of the operation, and some complementarity with the FSP only in its final stages.

31. The EFA operation addressed the needs of three countries suffering from the same problem of debt arrears towards the EC: Armenia, Georgia and Tajikistan. This multi-country approach saved bureaucratic resources and time, as the basic design of the operation was shared across all three countries. However, it complicated policy discussions at EU level at the time of the proposed extension to the operation in 2004.

32. The findings on the design and implementation of the EFA operation in Tajikistan are quite specific to its special character (debt relief) and particular country circumstances (low EC presence). Nevertheless, this report attempts to generalise some of these lessons so that they can contribute to a future meta-evaluation of several MFA operations, with a view to deriving more strategic lessons about the instrument. The main recommendations can be summarised as follows:
    - Maintain the flexibility of the MFA instrument to address the real problems in the absence of relevant regular EC instruments.
    - Streamline structural conditionality and intensify cooperation with IFIs.
    - Avoid reformulations and generalisations of original IFI conditions.
    - Secure cooperation among relevant EC Directorates.
    - Make use of Operational Assessments as the source of highly relevant EC-specific conditionality.
    - Discuss MFA programmes on country-by-country basis, even in the case of multi-country operations.

1 Evaluation objective and approach

1.1 Objective of the evaluation

Under its Financial Regulation (art. 27.4), the European Commission (EC) is legally obliged to evaluate its main programmes, including Macro-Financial Assistance (MFA).[1] The main objective of this ex post evaluation is to derive key lessons that can be applied to future interventions, and/or determine the possible need for a reorientation of the present approach.

1.2 Main evaluation questions

Table 1.1 outlines the main evaluation questions as stated in the *Guidelines for the ex post evaluation of MFA operations*.

Table 1.1   Generic evaluation questions

No.	Evaluation question
Q1	To what extent has the MFA been effective in terms of the short-term macroeconomic stabilisation of the country concerned?
Q2	To what extent has the MFA been effective in terms of supporting structural reform?
Q3	What have been the indirect and/or unexpected effects of the MFA?
Q4	To what extent has the MFA contributed to returning the external financial situation of the country concerned to a sustainable path over the medium to longer-term?
Q5	How has the way in which the MFA operation was designed and implemented conditioned its effectiveness and efficiency?

The evaluation questions therefore broadly focused on three core groups of effects related to:
1.   macroeconomic stabilisation;
2.   sustainability of the external financial situation;
3.   structural reforms.

Within each of these areas the evaluation focused on the effects over specific time horizons: macroeconomic developments were assessed over the short term (up to two years after disbursement), the external financial situation over the medium to long term (three years or more after disbursement), and structural changes in the economy and institutions over the short and medium term (up to four years after disbursement).

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1   In the case of Tajikistan, the MFA programme is called Exceptional Financial Assistance (EFA).

Table 1.2 gives an overview of these three core areas of the evaluation and how they can be traced back to the evaluation components and sub-evaluation questions from the *Guidelines*.

Table 1.2   Core areas of evaluation, time horizons, approach and evaluation components

Core areas	Time horizon	Approach	Evaluation components	Evaluation questions from *Guidelines*
Chapter 3: Macroeconomic stabilisation	Short term (up to two years after)	Mainly quantitative, modelling	• Objectives • Actual development • Counterfactual objectives • Counterfactual outcomes • Net effect • Indirect effects • Unexpected effects • Instrument design	• Q 1.1 • Q 1.2 • Q 0.1 • Q 0.2 • Q 1.3 • Q 3.1 • Q 3.2 • Q 5.1
Chapter 4: External sustainability	Medium to long term (three or more years after)	Quantitative and qualitative	• Actual development • Main factors • Indirect effects	• Q 4.1 • Q 4.2 • Q 4.3
Chapter 5: Structural reforms	Short and medium term (up to four years after)	Mainly qualitative, supported by assessment of indicators	• Objectives • Relevance • Actual development • Counterfactual objectives • Counterfactual outcomes • Net effect • Unexpected effects • Instrument design	• Q 2.1 • Q 2.2 • Q 2.2 • Q 0.1 • Q 0.2 • Q 2.4 • Q 2.5 • Q 5.1

1.3   Methodological approach

To attribute the effects of the EFA operation in each of the key evaluation areas, we followed a three-step approach in accordance with the *Guidelines for ex post evaluation of EFA*. First, we identified types and magnitudes of gross short-to-medium-term macroeconomic and structural reform effects. Secondly, we established a counterfactual scenario in the absence of the EFA operation. Finally, we determined the net effects of the operation, which for macroeconomic and structural impacts amounted to the difference between observed developments and the counterfactual scenario. For the impact of external sustainability, we did not elaborate on an explicit counterfactual, but studied channels of potential and actual impact. Unexpected and indirect effects, as well as consequences of programme design, were also analysed.

In addition, following guidance from the steering committee, we selected two case studies for more detailed analysis of the structural reform processes linked to two specific EFA structural conditions. This approach proved beneficial for a better understanding of the impact of structural conditionalities on the structural reform progress in the country.

The main evaluation instruments were:

- data collection and a literature review (see Annex 4);
- in-depth interviews with key informants (see Annex 5);
- qualitative and quantitative analysis, including macroeconomic modelling (see Annex 6).

The major difficulties we encountered were related to our ability to interview people who were involved in the first two years of the operation (2000-2002). Tajik officials involved in those early years have changed jobs, and were often quite difficult to locate and not always in a position to share information. In addition, data was not always available and the quality of data was poor. Low quality and internal inconsistency of data, especially balance of payments (BoP) time series, made the macroeconomic impact assessment less robust.

On the other hand, we benefited from cooperation, support and insights from all key stakeholders. This allowed us to gain a good understanding of the facts and events, and to draw conclusions which we can present with great confidence.

2 The EFA operation in Tajikistan

2.1 Economic context

Tajikistan is the poorest country in post-Soviet Central Asia (and CIS in general), and one of the poorest countries in the world. Table 2.1 shows the main development indicators for Tajikistan in 2004 compared with the average of countries in the Europe and Central Asia region and the average of low-income countries.

Table 2.1   Main development indicators for Tajikistan

	Tajikistan	Europe and Central Asia region	Low-income countries
2004			
Population, mid-year (millions)	6.7	473	2,310
Gross national income (GNI) per capita (Atlas method, US$)	250	2,570	450
GNI (Atlas method, US$ billions)	1.7	1,217	1,038
Average annual growth, 1998-2004			
Population (%)	2.0	0.0	1.9
Labour force (%)	2.7	0.2	2.3
Most recent estimate (latest available, 1998-2004)			
Poverty (% of population below national poverty line)	64	na	na
Urban population (% of total population)	26	63	30
Life expectancy at birth (years)	67	69	58
Infant mortality (per 1,000 live births)	87	31	82
Child malnutrition (% of children under 5)	36	na	44
Access to an improved water source (% of population)	55	91	75
Illiteracy (% of population age 15+)	1	3	39
Gross primary enrolment (% of school-age population)	88	103	92

Source: World Bank (WB), *Tajikistan at a glance*.

The collapse of the Soviet Union in 1991 and the subsequent civil war in Tajikistan have severely affected economic developments in the country. The rise of nationalism, religious fundamentalism and political struggles led to the violent conflict which lasted from May 1992 to June 1997. The peace agreement in December 1996 and the final peace accord of June 1997 brought an end to fighting, but the risk of future ethnic, clan and regional tensions is not eliminated.

At the end of the civil war, Tajikistan was in a state of complete devastation. Approximately 50,000-100,000 people died in the conflict. Up to 1.2 million people were displaced inside and outside the country. Tajikistan's physical infrastructure, government

services and economy were in disarray. Real gross domestic product (GDP) had contracted by about 60 percent on a cumulative basis in the period 1991-1996, leading to a rapid rise in poverty. Much of the population was surviving on subsistence hand-outs from international aid organisations.

In this context, the post-conflict recovery which started in 1998 required substantial external assistance through several donor programmes, including Exceptional Financial Assistance from the European Union (EU).

2.2 Donor assistance to Tajikistan

Several donors have been providing assistance to Tajikistan since the end of the civil war.[2] However, the design and implementation of the EFA operation were influenced mostly by the wider EC approach in assisting Tajikistan, as well as the programmes of the International Monetary Fund (IMF) and World Bank. The approximate size of assistance (disbursements) provided by the EC and the two International Financial Institutions (IFIs) are shown in Table 2.2.[3]

The EU has been present in Tajikistan through several financial instruments other than EFA. However, as a result of post-conflict security threats, non-humanitarian activities – including TACIS technical assistance and the Food Security Programme (FSP) – had been suspended since December 1997, and bilateral political relations between the EC and Tajikistan remained at a minimum. So at the start of EFA in 2000, EC support mostly took the form of humanitarian aid through ECHO rehabilitation projects. In subsequent years, positive developments in the country (sustainability of the peace process, improving security and deepening relations with the IFIs) allowed for phasing in of the TACIS and FSP programmes (since 2002-2003). Eventually, the EC Delegation to Tajikistan was established in Dushanbe in 2004.

The IMF has had a leading role in providing macroeconomic assistance to the country, and its programmes provided the framework for the EFA operation. The IMF's financial involvement in Tajikistan started with a Stand-by Arrangement in 1996. This was followed by Emergency Post-Conflict Assistance in the last quarter of 1997, and an Enhanced Structural Adjustment Facility/Poverty Reduction and Growth Facility arrangement (ESAF/PRGF) covering the period 1998-2001. Between January 2002 and July 2002, a Staff Monitored Programme was active. In December 2002, a second PRGF arrangement was initiated, covering the period 2002-2005. The IMF's Executive Board approved the three-year PRGF arrangement on December 11, 2002 for an amount of SDR (Special Drawing Rights) 65 million (about US$ 93.7 million). The size of total IMF assistance is also shown in Table 2.2.

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[2] According to Principals Coordination in Tajikistan, total donor assistance to the country amounted to US$ 1.8 billion between 2003 and 2006 alone (http://www.untj.org/principals/tracking/summary.php).

[3] Annex 2 gives a more detailed description of EU, IMF and WB assistance to Tajikistan and an overview of other donors' activities.

The World Bank has had a leading role in guiding the structural reform agenda in Tajikistan. It has supported projects and carried out non-lending activities in the country aimed at structural adjustment, agricultural and rural development, health, education, social security, infrastructure rehabilitation and disaster management. The WB approved the Structural Adjustment Credit (SAC) (through the International Development Association (IDA) – US$ 50 million) in July 1998. The SAC2 (IDA – US$ 50 million) was approved in June 2001. In June 1999, the WB approved the Second Institution-Building Technical Assistance Project (IDA credit amounting to US$ 6.7 million).

Table 2.2   EFA and other EU, IMF and World Bank assistance to Tajikistan, 2000 to 2006 (EUR millions)

Assistance	2000	2001	2002	2003	2004	2005	2006
EFA*		74		7	7		7
TACIS**	0	0	15	12	12	20	17
FSP**	0	0	5	13	3	10	11
ECHO/DIPECHO**	15	12	10	13	10	9	6
EIDHR**	0	0	0	0	0	1	1
European NGO Action**	0	0	0	0	1	0	1
Rehabilitation**	1	0	0	0	0	0	0
Mine Action Programme**	0	0	0	0	1	0	0
Health**	0	0	0	0	0	0	2
Migration**	0	0	0	0	0	0	1
Total EU	16	87	29	45	34	39	44
IMF*	69	10	25	14	9	10	23
World Bank*	29	29	53	36	16	12	53
Total EU, IMF and WB	115	126	108	95	59	61	120
EFA share of total EU	**0%**	**85%**	**0%**	**16%**	**21%**	**0%**	**16%**
EFA share of total EU, IMF and WB	**0%**	**59%**	**0%**	**7%**	**12%**	**0%**	**6%**
EFA share of GDP	**0,0%**	**6,3%**	**0,0%**	**0,5%**	**0,4%**	**0,0%**	**0,3%**

* Disbursements; ** Commitments.

Sources: EC Delegation, DG ECFIN, http://www.imf.org/external/np/tre/tad/extrans1.cfm?,

http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/TAJIKISTANEXTN/

2.3   Objectives of the EFA operation

The rationale for EFA was not specific to Tajikistan. In 1997, the EC started to consider providing such assistance to Armenia, Georgia and Tajikistan. These countries were facing critical economic and social challenges in the context of reforms and transition to a market economy being implemented with the support of the IFIs.[4] The common feature of these countries was the existence of large external payment arrears to the European

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4   After 1996, Armenia and Georgia implemented comprehensive adjustment and reform programmes under the IMF ESAF.

Community originating from loans that the Community had extended in the early 1990s. Despite some clearance of arrears, the size of the debt arrears in Armenia, Georgia and Tajikistan was continuing to grow. To allow these countries to move forward with their reforms and devote all available financial resources to these reforms, the arrears needed to be settled. Consequently, the EC wanted to use the EFA operation to facilitate settlement of the outstanding financial obligations towards the Community and help the beneficiaries to achieve financial sustainability in the longer term.

On 17 November 1997, the Council adopted a decision providing Exceptional Financial Assistance to Armenia and Georgia (97/787/EC). At the same time, it also agreed to consider a similar operation in Tajikistan once circumstances allowed. Therefore, when Tajikistan embarked on an adjustment and reform programme supported by the IFIs,[5] the Commission made a proposal to extend the programme to Tajikistan. The EC modified the previous decision (Council Decision 2000/244/EC of 20 March 2000) in order to extend the geographical coverage of the operation to Tajikistan.

The stated *general objectives* of the EFA programme were to:
- encourage the Tajik authorities to implement macroeconomic and structural policies fostering external and fiscal sustainability;
- help Tajikistan to improve its external financial position by reducing its net debt position towards the Community.

While the first of these objectives was quite general, the second described precisely the main objective of the EFA operation, which was consistent with the original motivation of the programme: solving the problem of Tajikistan's debt arrears towards the EU.

2.4   Loan and grant disbursements

Following the decision of the EU Council of Ministers,[6] Tajikistan was to benefit from exceptional Macro-Financial Assistance consisting of a loan of EUR 60 million (15 years maturity, 10 years grace period and a market interest rate[7]) and a grant of EUR 35 million for the period 2001-2004 disbursed in five successive equal (EUR 7 million each) instalments.

The EFA programme was designed as complementary financing to that of the IFIs,[8] so the disbursements were linked to satisfactory implementation of the country's financial arrangements with the IMF. The explicit EFA goal of supporting financial sustainability and allowing beneficiaries to reduce their external liabilities was reflected in the link between disbursement of the assistance and reduction of the beneficiary's indebtedness. Disbursement of the loan and first grant tranche was conditional on settlement of the beneficiary's existing obligations to the Community. The subsequent grant tranches were linked to early repayment of the beneficiary's new debt obligation to the Community

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[5]   The IMF approved a financing arrangement under ESAF in June 1998.
[6]   Council Decision 97/787/EC as amended by Decision 2000/244/EC.
[7]   EURIBOR (Euro Interbank Offered Rate) six-month flat rate (at the time of discussing the loan agreement in May 2000 the interest rate was 4.5 percent) payable semi-annually.
[8]   The IMF's Poverty Reduction and Growth Facility and the World Bank's IDA loans.

originating from the EFA loan. They were also conditional on the fulfilment of structural policy measures, as explained in detail in Chapter 5.

The loan and the first grant tranche were released in March 2001 (see Table 2.3). Prior to this disbursement, the Tajik Government had to fully settle the existing arrears towards the Community, amounting to EUR 78.771 million (Memorandum of Understanding (MoU)). To settle these arrears prior to disbursement of the loan and grant, the Tajik Government took a bridging loan from the Swiss Confederation authorities (agent – Swiss National Bank). Following the clearance of arrears and disbursement of the new loan, the Tajik authorities were committed to secure an early repayment of new loans. The maximum amount of annual early debt repayment by Tajikistan was set at EUR 12 million. Under such a maximum repayment schedule, the net debtor position of Tajikistan towards the Community would have been reduced to EUR 12 million at the end of the operation in 2004. As result of smaller repayments of EUR 8 million annually agreed in subsequent Supplemental MoUs (SMOUs), the debt to the EC stood at EUR 28 million at the end of the operation in 2006.

Occasional failures to meet conditions led to delays in disbursements. This was the case with the third, fourth and fifth tranches. The third tranche could not be disbursed before the IMF Board approved the new three-year PRGF arrangement in December 2002. Release of the fourth grant tranche was delayed because of slow progress in implementing the conditionality related to audit of the Tajik Aluminium Plant (TADAZ). The delay in disbursing the fifth tranche was because of non-fulfilment of the conditions formulated as a result of the Operational Assessment (OA).[9] As a result of these delays, the last disbursement was at the end of 2006 rather than in 2004, as originally planned.

Table 2.3   Design and implementation of the EFA programme in Tajikistan (EUR millions)

	2000	2001	2002	2003	2004	2005	2006	Total
Arrears cleared	-	79	-	-	-	-	-	79
New loan disbursement	-	60	-	-	-	-	-	60
Grant disbursement								
MOU	-	7+7	7	7	7	-	-	35
Actual	-	7+7	-	7	7	-	7	35
New debt repayment								
MOU (maximum)	-	12	12	12	12	-	-	48
Actual	-	8	-	8	8	-	8	32
Net repayment								
MOU (maximum)	-	17	5	5	5	-	-	-
Actual	-	13	-	1	1	-	1	16
Stock of debt								
MOU (minimum)	79	48	36	24	12	na	na	-
Actual	79	52	52	44	36	36	28	-

Source: ECFIN/D/(2004) REP/50436, *Draft Report from the Commission to the European Parliament and the Council, Implementation of EFA to Armenia, Georgia and Tajikistan*

[9]   Also, prior to disbursement of the fifth tranche, the fourth grant tranche needed to be reconverted into a Euro-denominated account.

Unintentional delays in disbursements should not be confused with the proposed extension of the EFA operation for Tajikistan (and Georgia) for three years (2005-2007). This proposal was prepared after a Council review of the implementation and possible continuation of the programme for Georgia and Tajikistan. The review concluded that the EFA programme helped Tajikistan to normalise its financial relations with the EU and subsequently contributed to the goal of achieving a sustainable medium-term financial position. Nevertheless, in terms of the external financial position, the review concluded that much remained to be done in Tajikistan. Despite massive official financial support, the Government was unable to secure a sustainable financial position. Under these circumstances, the specific objective of the extension was to help Tajikistan to make additional principal repayments on its medium-term debts to the Community, and thus improve its debt and debt service profile. The new assistance was expected to amount to a maximum EUR 10 million (on top of what the Commission would have disbursed by the beginning of 2005).

Many Member States opposed the proposal to continue EFA beyond 2004, mainly because the situation in the country had changed significantly since 2000. The debt to Russia had decreased substantially, leading to a far more sustainable debt position. Furthermore, the Member States argued that there was no financing gap.[10] Moreover, the Economic and Financial Committee (EFC) also objected to extending the programme because some of the 'Genval principles' describing the generic MFA operation were not fulfilled (political pre-condition, complementarity, conditionality and financial discipline). The Commission argued that the "specific feature of the programme that differentiates it from other MFA operations, namely the link between the implementation of assistance and early repayments of debt owned to the Community," was sufficient justification for the extension. Nevertheless, the proposal for extension was not accepted.

2.5   Counterfactual scenario

The main objective of the EFA programme was to improve the external financial position of the country through reduction of its net debt position towards the European Community, and solve the problem of Tajikistan's debt arrears towards the Community. In evaluating the effectiveness of the EFA operation, it was therefore necessary to identify the most probable counterfactual situation that could have happened in the absence of EFA. This identification was based on careful study of donor and government documents and a series of interviews with key stakeholders in Dushanbe, Brussels and Washington.

We established that in the absence of the EFA operation:
1. The EC would not have initiated another arrangement to address the arrears problem;
2. Other donors/lenders would not have assisted Tajikistan in clearing arrears towards the EU;

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[10]   Normally one of the main conditions for providing MFA.

3. Tajikistan could not immediately have started to clear arrears to the EU without additional external assistance;
4. Tajikistan would have repaid debt arrears during the second PRGF arrangement (2002-2006).

1. The EC would not have initiated another arrangement to address the arrears problem
From the review of documents and interviews with EC and other officials, we concluded that the EC could not and did not seriously consider any alternative solutions for addressing the problem of debt arrears at the time of granting EFA to Tajikistan.

An explicit bilateral debt restructuring operation would have been the most straightforward way of dealing with the arrears problem. However, all interviews and revised documents consistently showed that this solution was not an option, given the EU's determination to retain the status of privileged creditor. Granting relief or rescheduling on concessional terms would imply an exception to the 'rule' of the Council. The Directorate General for Economic and Financial Affairs (ECFIN) and the Council were determined to avoid such precedent, which could lead to unrealistic demands for debt relief and moral hazard in borrowing among other indebted countries.

Clearing arrears as part of a multilateral debt relief scheme was also not a relevant option. First, Tajikistan has never been a Highly Indebted Poor Country (HIPC). Secondly, the G7 Multilateral Debt Relief Initiative directed at low-income countries (including Tajikistan) was only launched in 2005.

It was not possible to use other EU funds, notably TACIS, to solve the problem of debt arrears. TACIS is a technical assistance programme and is not designed to provide debt relief or budgetary or balance of payment support.

2. Other donors/lenders would not have assisted Tajikistan in clearing arrears towards the EU
It is extremely unlikely that any other donor/lender would have stepped in with additional assistance to help the country to clear its arrears towards the EU. This message came across very strongly in a number of interviews. IMF packages are based on assurances of support from other donors. Assisting the country financially to clear arrears towards another bilateral lender would have been seen as violating the principle of burden sharing. Both the IMF and World Bank would have strongly opposed an operation in Tajikistan that could be interpreted as 'bailing out' the EU. Last but not least, the IFIs' financial involvement was already substantial, and they could not have provided additional resources. On the other hand, the main bilateral lenders to Tajikistan have focused on problems of restructuring their own credits.

It is also worth stressing that any donor would have been extremely reluctant to 'throw good money after bad'. Any new assistance would have been directed at current development needs rather than solving old debt problems.

3. Tajikistan could not immediately have started to clear arrears to the EU without additional external assistance

Data analysis and interviews unambiguously showed that clearing of arrears in the years 2000-2001 without additional external assistance would have been impossible. The stock of EU debt in arrears was close to the total size of gross international reserves, while net international reserves were negative. The stock of these arrears corresponded to around 40 percent of total annual government revenues. Clearing of arrears would have implied cutting down virtually all development spending. Such a policy would not have found support among Tajik policy-makers, the donor community or the population.

Theoretically, the Government of Tajikistan could have tried to generate additional revenues through privatisation. However, in practice this was less realistic, because at the time of launching the EFA operation the country was in the first stages of post-conflict reforms, political and macroeconomic stabilisation was fragile, and there was no proper legal or institutional framework. All of this would have made additional privatisation on top of the scheduled small-scale privatisations unlikely.

4. Tajikistan would have repaid debt arrears during the second PRGF arrangement (2002-2006)

From the above analysis, it is clear that in the absence of the EFA operation, Tajikistan would not have started clearing arrears at least until the year 2002. More substantial repayments could only have been made from around 2003, when the country's macroeconomic situation improved markedly.

What would have been the impact of outstanding arrears on EU-Tajikistan relations? The clearing of debt arrears made EU-Tajik relations less complicated and more open. The EU showed significant goodwill when it provided EFA, and this was appreciated in Dushanbe. Tajikistan was no longer reneging on its external obligations, and this was convenient for justifying further assistance to the country. Nevertheless, interviews with EC officials and a review of available documents suggested strongly that failure to clear arrears would not have affected other programmes of EU assistance to the country, notably FSP and TACIS. The discontinuation of both programmes in 1997 resulted from security concerns, and we found no evidence to suggest that their relaunch was conditional on clearance of arrears. Rather, it was the progress in post-conflict stabilisation that determined the capacity for effective and secure delivery of assistance.

Failure to clear the debt to the EU in 2000-2001 would not have led to the discontinuation of the IMF programme, which would have been a very substantial cost for Tajikistan. Certainly, the IMF is usually reluctant to have a programme with a country that is reneging on its external commitments, where accumulation of external arrears (new arrears) can cause the programme to go off-track. These rules are strictly enforced for middle-income or resource-rich countries when non-payment is intentional or because of policy mismanagement. By contrast, in the case of Tajikistan in 2000-2001, IMF officials clearly recognised that the country fundamentally lacked capacity to back the debt. Furthermore, the debt towards the EU was contracted on non-concessional terms in disorderly conditions, and there was a consensus within the IFIs that Tajikistan should have been supported by grant assistance or highly concessionary loans in the first place. Hence there was little enthusiasm for forcing the country to repay immediately. The scale

of post-conflict development needs and promising progress in reforms also strongly motivated the IMF to remain engaged and be more relaxed regarding arrears. Obviously, the IMF would have had to discontinue the programme if EU Member States had collectively opposed further engagement in Tajikistan at the level of the IMF Board of Directors. However, we viewed that such action would have been extremely unlikely.

Instead of making radical moves, the IMF would increasingly have pushed for good-faith negotiations between Tajikistan and the EU, since the country was regaining the capacity to fulfil its obligations through economic growth and a surge in remittances.[11] Pressure to clear the debt would have become substantial during negotiations on the second PRGF facility in 2002. For this reason, we are of the view that negotiations on this programme would have become more difficult and lengthy in the absence of EFA, and that the programme would have been tougher in order to allow Tajikistan to pay back arrears during its duration (i.e. before 2006). An exact calendar of such payments would have been a highly controversial issue. The way the Tajik Government would have dealt with this payment calendar could have been used by the IMF as a test of the authorities' commitment to normalise the country's external situation. This issue is discussed in more detail in Section 3.3.

With continued IMF engagement, other donor programmes would not have been affected by the absence of EFA. Other bilateral debt restructuring operations would not have been affected either, as these negotiations were not linked to the success of the EFA operation. These restructuring operations were concluded mainly with non-EU and non-Paris Club members that did not coordinate their actions with the European Commission.

The macroeconomic and structural reform effects of this counterfactual scenario are presented in detail in Chapters 3, 4 and 5.

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[11]   The World Bank had a similar experience in dealing with Moldova after 2000. The World Bank was continuously pushing for a bilateral deal with creditors to solve the country's debt arrears problem. The arrears were finally cleared after three years of continued programme engagement.

ECORYS Ex post evaluation of the EFA operation in Tajikistan

3 Impact on macroeconomic stabilisation

3.1 Macroeconomic objectives of intervention

What were the short and medium-term macroeconomic objectives of the assistance?
The collapse of the Soviet Union combined with the impact of the civil war in Tajikistan led to a 60 percent real GDP decline in the country between 1991 and 1996 (see Section 2.1). Following the end of the civil war, economic recovery fuelled by private sector development finally started in 1998. However, the financial crisis in Russia in August 1998 led to a downwards turn in this revival. Output growth slowed, inflation rose, and the exchange rate weakened in 1999. In 2000, the Tajik economy slowly started to pick up again, but macroeconomic performance was mixed and fragile. Inflation was still high, investments were low and the current account deficit increased because of lower exports (cotton and aluminium). Furthermore, the country was in arrears and external debt was as high as annual GDP (see Table 4.1 in Chapter 4).

In these circumstances, the Commission held the view that external assistance was necessary to ensure macroeconomic stabilisation and a structural reform programme. Accordingly, one of the *general objectives* of the EFA intervention was to encourage the Tajik authorities to implement macroeconomic and structural policies fostering external and fiscal sustainability (EC/244/2000).

The MoUs included a set of general economic indicators to monitor macroeconomic and financial policies and developments in the real, external and budgetary sectors. Table 3.1 presents these indicators from the MoUs. A difficulty with the indicators, however, is that they were neither explicitly defined nor accompanied by clear benchmarks. In this chapter, we analyse some of these core macroeconomic indicators over the full period of EFA support. Macroeconomic effects related to the debt position are discussed in Chapter 4, which analyses the external financial sustainability of Tajikistan.

Table 3.1   Macroeconomic indicators used to assess macroeconomic stabilisation

	Effect indicators
Macroeconomy	Growth rates in GDP
	Inflation
	Interest rate
	Exchange rate
Balance of payments	Current account deficit
	Components of current account: exports, imports, current transfers
	Inflow of foreign direct, portfolio and other investment
	International reserves
Public finance	Level of government revenue
	Level of government expenditure
	Deficit
	Financing of the deficit
	Existence of quasi-fiscal operations

Furthermore, the MoUs stated that release of the EFA tranches was conditional on satisfactory implementation of any arrangements reached with the IMF. Therefore, it can be concluded that the EFA programme shared objectives with the IMF programmes. Text box 3.1 shows the ESAF/PRGF (1999-2002) and PRGF (December 2002-2006) objectives. Both IMF programmes applied quantitative macroeconomic performance criteria and benchmarks. (Annex 2 presents an overview of the use of performance criteria in different programme periods.) However, these performance criteria and benchmarks from the IMF programmes were less useful in assessing the achievement of EFA objectives in the medium term, because they were too specific and therefore did not provide an overall picture of macroeconomic developments over time.

> **Text box 3.1   Objectives of IMF programmes**
>
> The key macroeconomic elements of the second annual ESAF/PRGF loan approved by the IMF in June 1999 are of interest:
>
> - restoring monetary and fiscal discipline;
> - stabilising the exchange rate and interest rates;
> - improving domestic resource mobilisation;
> - increasing international reserves.
>
> The primary aims of the IMF programme linked to the PRGF loan in December 2002 were:
>
> - sustaining economic growth (for the period 2002-2005, the programme targeted real GDP growth of at least 5 percent annually);
> - maintaining low inflation (inflation was to decline to 5 percent by the end of the period);
> - exchange rate stability;
> - strengthening of debt management.

3.2 Gross impact – actual macroeconomic outcomes

To what extent have the short and medium-term macroeconomic objectives of the assistance been achieved?

3.2.1 Macroeconomic outcomes

Macroeconomy

Figure 3.1 presents real GDP growth and the development of the average Consumer Price Index (CPI) for the period 1999-2007. Overall, Tajikistan has shown quite an impressive track record of growth during the EFA operation. The EC considered the macroeconomic performance of Tajikistan as satisfactory in its reports prior to disbursement of the grant tranches. Initially, GDP growth was supported by growth in the traditional sectors of aluminium and cotton. However, since 2003 the sources of growth have begun to be somewhat more diversified. Strong growth has been recorded in the services sector (mostly trade/import), construction, energy and textiles as a result of an increase in domestic demand. To a large extent, this increased demand has been driven by rising workers' remittances (see Text box 3.2). However, this somewhat wider growth base has not (yet) translated into a broader export base (see Chapter 4).

Figure 3.1   Real GDP growth rate (right scale) and average Consumer Price Index (left scale) 1999-2007
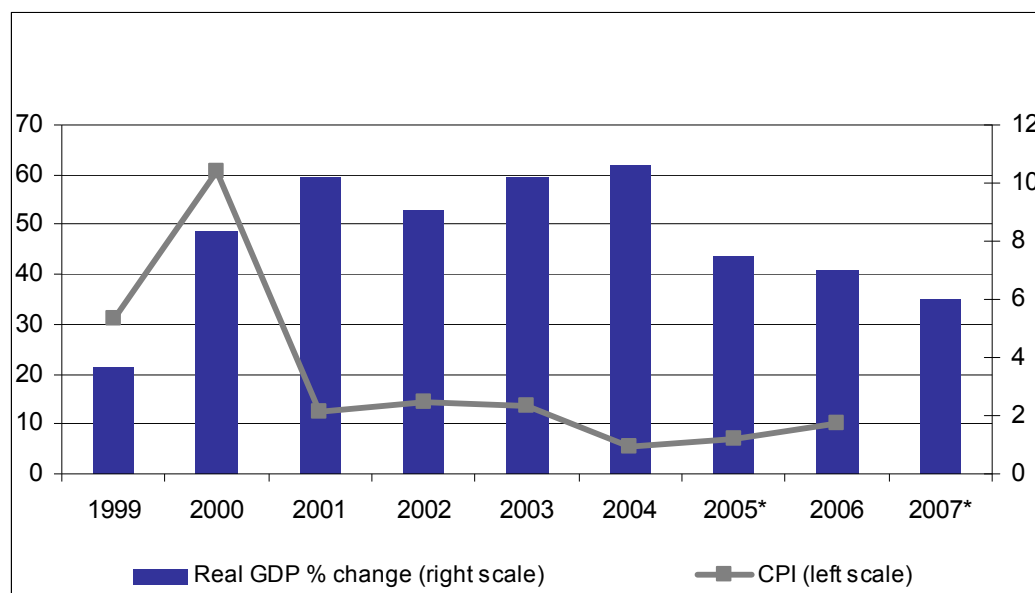
* Figures for 2006 are based on NBT data and 2007 are IMF forecasts.

Source: IMF World Economic Outlook database, September 2006, NBT.

The informal economy has probably also supported the recorded positive developments in the formal economy. The size of the informal economy is estimated at between 30 and 70 percent of the official economy. Illegal criminal activities, particularly drug trafficking along the border between Tajikistan and Afghanistan, contribute to the large size of the informal economy. Drug trafficking has the potential to jeopardise economic

development efforts. In recent years, the severity of problems related to drug trafficking has increased. The International Crisis Group warned in 2003 that rising drug trafficking was undermining the political will for economic reform and corrupting government institutions. Drug trafficking may even be threatening a vital income source for the Tajik population: migrant labour and related remittances (see Text box 3.2). CIS states may become increasingly wary of welcoming Tajik guest workers, because of drug trafficking-related concerns.

Inflation

The IMF was very impressed by the continued decline of inflation in 2000-2001. From 2002 onwards, the economic programme under the PRGF loan targeted an inflation rate of 5 percent. However, in subsequent years some slippages related to monetary policy resulted in higher inflation. These slippages were connected to unsterilised interventions on the foreign exchange market and the creation of excess liquidity in the market through directed credits. However, the IMF judged monetary policy as satisfactory overall. Abolition of direct credit to the cotton sector was subject to structural conditions in the MoU and the second and third SMoUs (see Chapter 5).

In 2006, inflation was a source of some concern again. CPI inflation accelerated from around 8 percent annually at the start of 2006 to 12-13 percent by the end of the year. Average 2006 inflation hit 10 percent. Average wage growth reached close to 40 percent annually in the fourth quarter of 2006. The main factors explaining this high inflation were the increase in input prices and credit growth. Inflation will also probably be above 10 percent in 2007, because of expected rises in gas and electricity prices. This will result in some downward pressure on GDP growth. Inflation in 2008 is likely to be under 10 percent again, with a GDP growth expectation of around 8 percent. The Tajik economy remains very sensitive to external developments such as the import prices of gas, oil and minerals.

Text box 3.2   Remittances

Remittances are the money that migrants send to family and friends or into personal (bank) accounts from the migration destination (host country) to the place of origin (home country). Remittances are private small-sum transfers, mostly for food, education and health care or housing. However, the aggregate of these small sums has been very considerable from the macroeconomic perspective, significantly impacting on economic developments in Tajikistan.

Size of remittance flow

The IMF estimates that total remittance flow (formal and informal) to Tajikistan is between US$ 400 million and US$ 1 billion. This is between approximately 20 percent and 50 percent of GDP (IMF WP/06/2, 2006). These figures for GDP share indicate that Tajikistan is one of the most remittance-dependent countries in the world. Even just taking into account officially recorded formal remittances, the size is still impressive and growing very rapidly (see Figure 3.2). Net remittance inflows through the banking system and Money Transfer Organisations (MTOs) are estimated to have been at least 15 percent of GDP in 2004, comparable in magnitude with net foreign exchange inflows from trade and 10 times higher than foreign direct investment (FDI). Remittances also exhibit strong seasonal patterns, with a peak in October-November when workers come back from abroad.

Figure 3.2   Formal remittances 2001-2006 in million US$
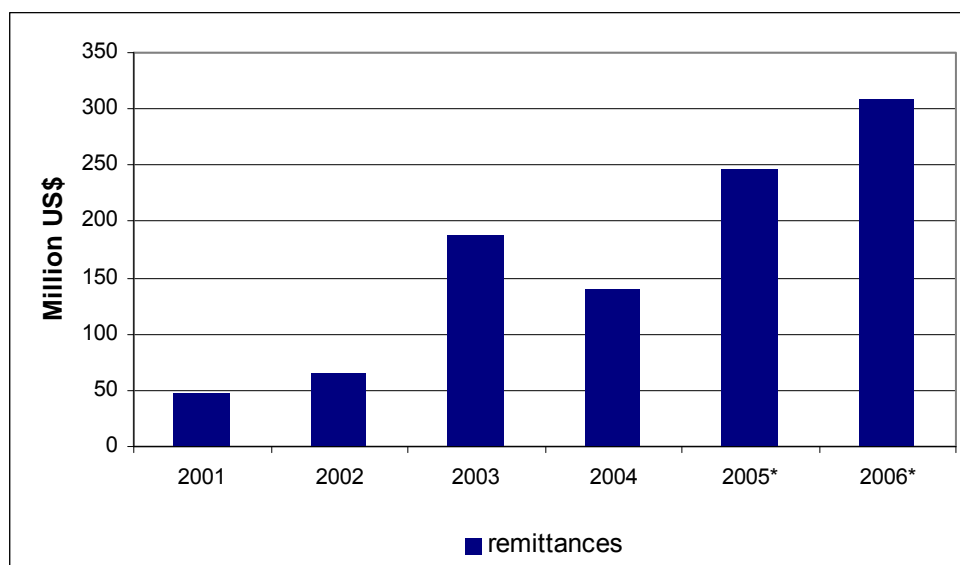
*The 2005 and 2006 figures are forecasts.

Source: IMF country reports

Migration

This large flow of remittances is the result of continuous labour migration since the break-up of the
Soviet Union. Annual labour migration, particularly to Russia, increased steadily in the 1990s and
peaked in 1999. The International Organisation for Migration (IOM) and WB have estimated that about
17 percent of the workforce may reside (permanently or temporarily) outside Tajikistan. The IOM (2003)
estimated that about 84 percent of Tajik labour migrants were working in Russia (legally or illegally).
Currently, labour migration is still high. Most migrants are seasonal workers; the working season is May-
November in construction and agriculture in Russia.

Transfer channels

Remittances began to be noticeable in the official statistics after the Tajik Government removed the 30
percent tax on bank remittances in 2001. Other restrictions on remittances were removed in 2002, such
as the forced exchange of dollars and roubles into somoni. Before 2001, most remittances probably
came into the country by cash carry. After the tax was removed, bank transfers became more popular.
In 2003, it was estimated that approximately 50 percent of remittances already went through banks and
MTOs (IMF 2003). However, remittances transferred through banks are not kept in bank accounts; in
most cases, the money is withdrawn immediately.

Economic impact of remittances

A recent IMF working paper (IMF 2006, WB/06/2) analysed the macroeconomic impact of remittances
for Tajikistan. It concluded that remittances have:

- cushioned the impact of the civil disruption of the 1990s;
- fuelled growth and consumption;
- contributed to financing the trade deficit and kept the current account deficit manageable;
- boosted public revenue through value-added tax (VAT) and import duties. These revenues
  increased by 15 percent per year in the period 2000-2004;
- provided a social safety net;
- contributed to exchange rate stability (and some exchange rate appreciation);

- helped to strengthen the banking system and enhanced competition. For many Tajiks, remittances were their first contact with the banking sector;
- contributed substantially to poverty reduction. The poverty rate declined from 81 to 60 percent in 2000-2003. The direct impact of remittances is unclear, but should be positive.

Most of the above can be seen as positive macroeconomic effects of remittances. However, remittances can also have countervailing effects. The working paper concluded that remittances:

- contributed to the expansion of the trade deficit;
- can exert upward pressure on inflation. Tajikistan is a small country with limited tools for monetary policy. The seasonal flow of remittances is hard to contain;
- are mostly used for private consumption. There is little indication that they are used more productively (investment);
- can exert upward pressure on the national currency, which can hamper competitiveness;
- can create a strong disincentive to save. The steady flow of remittances creates an illusion of financial stability.

Furthermore, the outflow of labour has pushed up wages in Tajikistan and thus inflation.

International literature suggests that in most cases remittances form a persistent and relatively stable flow. However, Tajikistan is very dependent on Russia for its remittances. If Russia implemented restrictions on migrants and guest workers, the effect could be disastrous. However, most experts do not expect Russia to close its borders permanently to these workers, because the Russian economy is dependent on this cheap labour force.

Interest rate

Commercial interest rates have become more market driven. Deposit rates became positive in real terms after inflation fell below 10 percent in 2004. Nominal interest rates have been relatively stable since mid-2004, with deposit rates (1-3 months) between 10 to 15 percent and debit rates for 1-3 months' credit well above 25 percent. The Central Bank refinancing rate has remained stable at around 10 percent (see Figure 3.3). However, the Central Bank has started to increase interest rates since November 2006.

The relatively volatile period from mid-2003 to mid-2004 was caused by fluctuations in the price of cotton. Credit demand in the cotton sector expanded rapidly in response to high cotton prices in early 2004. Credit demand has remained relatively high since 2004, keeping the credit interest rate at a relatively high level.
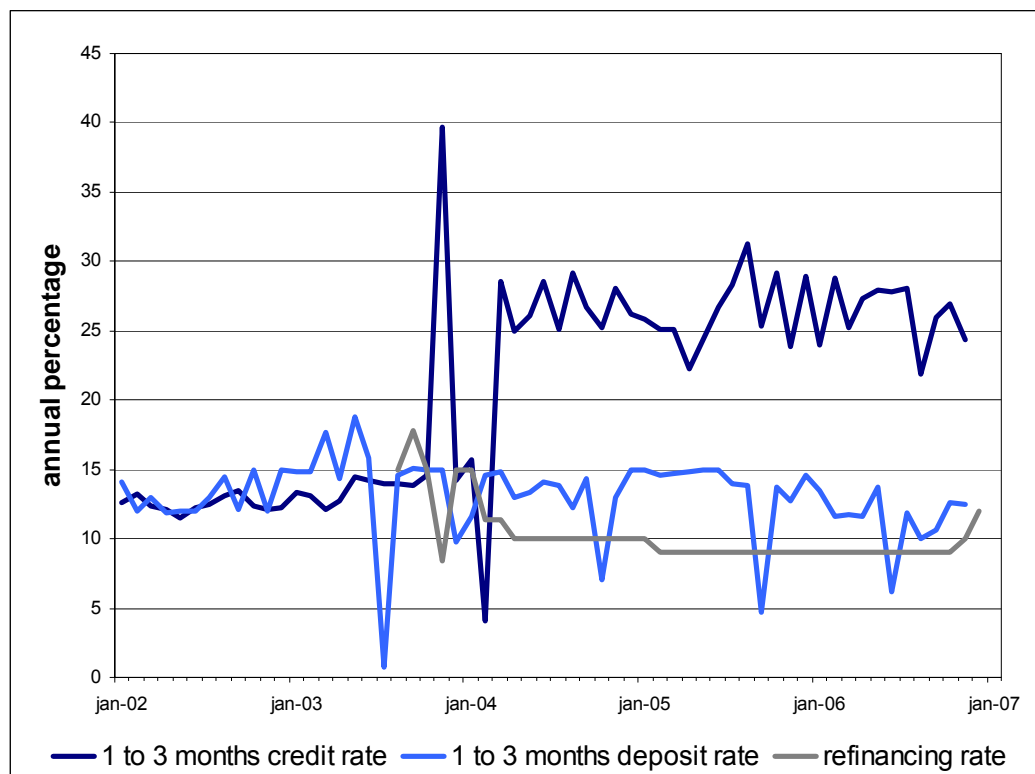
Source: NBT

Exchange rate developments

At the end of 2000, Tajikistan achieved full currency convertibility, with a new currency introduced in October 2000. Tajikistan's currency reform was seen as an important element in the country's macroeconomic stabilisation programme. Figure 3.4 shows the exchange rate development of the somoni against the dollar. The somoni depreciated against the dollar up to the beginning of 2003, then broadly stabilised up to mid-2005. Since then, the somoni has depreciated steadily against the dollar. This steady depreciation contributed to the inflationary push in 2006, because the dollar itself was also depreciating against most other currencies (notably the Euro).

The National Bank of Tajikistan maintained its managed floating exchange rate regime since the introduction of the new currency. The IMF has frequently commented on the intervention strategy, which relies on asymmetrical and unsterilised interventions. The NBT would not resist appreciation of the currency, and interventions to stabilise the somoni exchange rate were not supported with adequate monetary policy actions to keep money supply stable. However, it should be noted that the NBT did not have effective monetary instruments to sterilise interventions.

Source: NBT

Balance of payments

Figure 3.5 presents the current account, capital and financial account, and overall balance in the period 1999-2006. The current account deficit was quite small and decreasing between 1999 and 2003, which contributed to a positive overall balance. However, since 2003 the current account deficit has widened, though this is not confirmed by all data sources – NBT suggests a declining current account deficit since 2005. Uncertainties about the actual size of remittance flows make definite assessment difficult. In the period 1999-2006, surpluses in the capital and financial account have been increasing steadily, contributing positively to the overall balance and leading to accumulation of foreign exchange reserves.

Figure 3.5   Current account, capital and financial account, and overall balance 1999-2006 (in million US$)
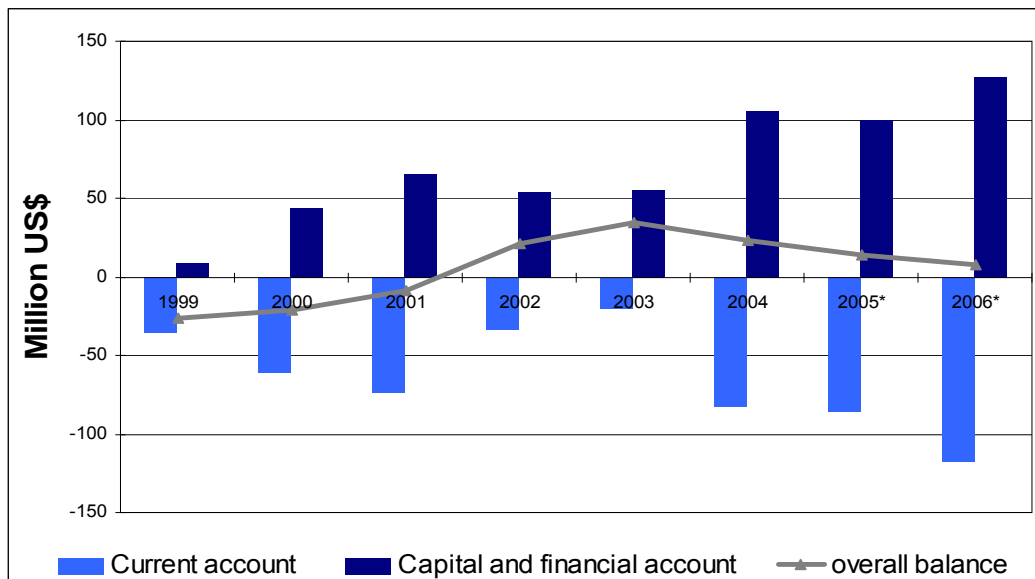
*Figures for 2005 and 2006 are based on IMF projections

Source: IMF country reports

Figure 3.6 takes a closer look at Tajikistan's current account balance for the period 1999-2006. It shows that the increasing trade deficit since 2004 is partly offset by the balance of transfers caused by a rapid increase in the flow of remittances (see Text box 3.2). The increase in the balance of transfers has led to a deterioration of the trade balance. Migrants' remittances have fuelled domestic demand, leading to an increase in imports.

Figure 3.6   Current account 1999-2006 (in million US$)
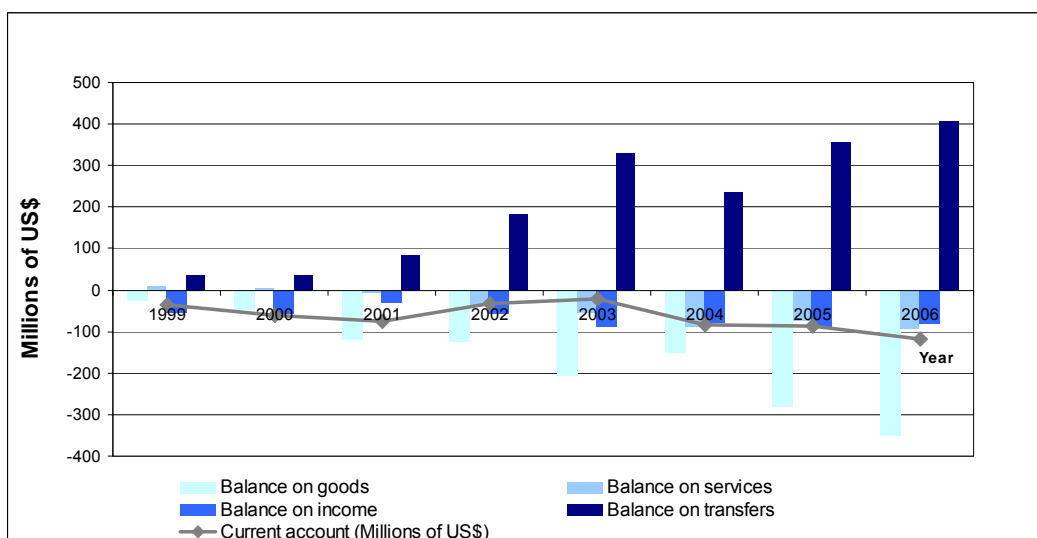
Note: Figures for 2005 and 2006 are based on IMF projections

Source: 2000-2001, IMF country report No. 03/10; 2002-2003, IMF country report No. 04/248; 2004-2006, IMF country report No. 06/062

The growing deficit in the current account is mainly driven by the deficit in the balance of goods. Figure 3.7 presents exports and imports (left scale) in relation to the current

account (right scale). This figure illustrates that the growing deficit can be explained by the sharp increase in imports since 2003, which has not been accompanied by similarly dynamic expansion of exports.

Figure 3.7   Exports, imports (left scale) and the current account (right scale) in million US$ in the period 1999-2006
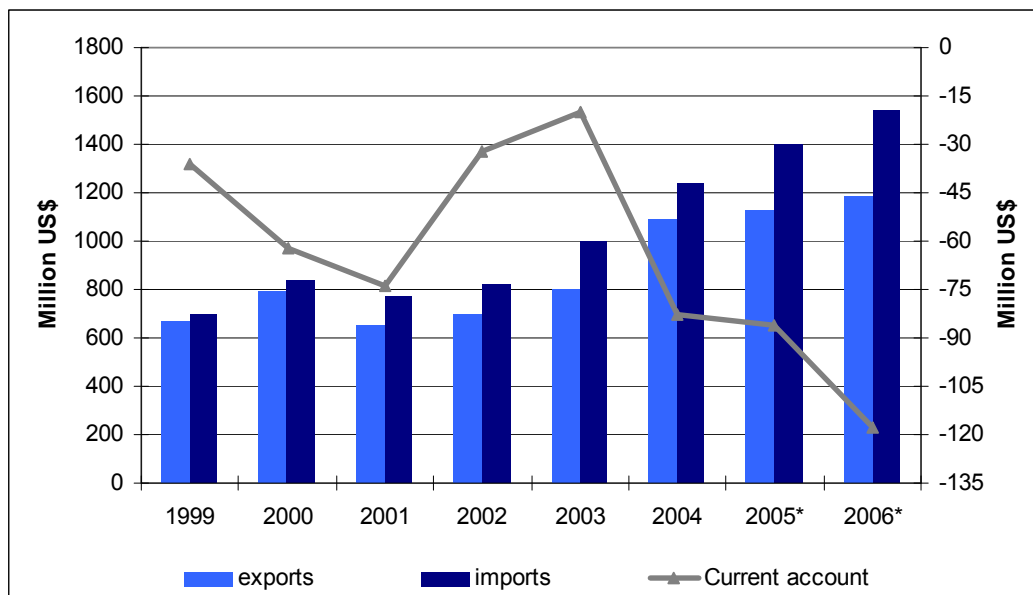
*Figures for 2005 and 2006 are based on IMF projections

Source: IMF country reports

Figure 3.8 presents the capital and financial account in the period 1998-2005. Since the negative balance in 1999, the capital and financial account has turned positive. However, foreign direct investment has been low throughout the years, at about 2 percent of GDP – the second lowest among the CIS-7 countries – because of the unfavourable business environment and investment climate. The peak of FDI in 2004 reflects a debt-asset swap with Russia.
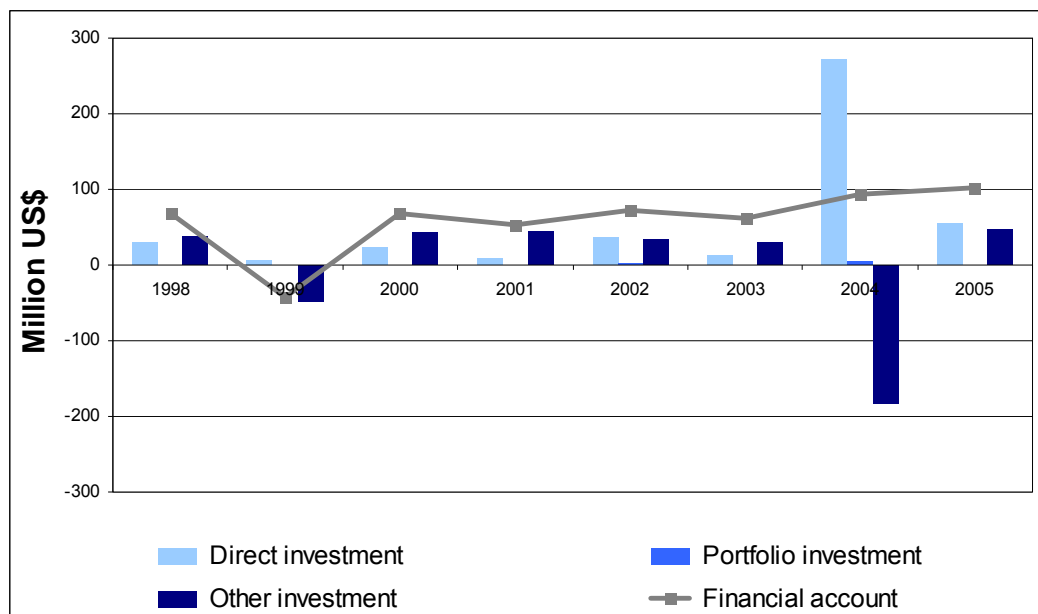
Source: National Bank of Tajikistan

Reserve position

The positive financial and capital account balance has contributed to the accumulation of international reserves. Figure 3.9 presents the development of the gross reserve and net international reserve position in the period 1999-2006. Up to 2002, the net international reserve position was still negative. However, after 2002 the net reserve position became positive and has increased. The gross reserve position also increased substantially after 2002, though the increase in gross reserves has just kept up with the import growth rate. The gross reserves presented as a share of months of imports is still relatively low and has not improved. It has hovered around 1.8-1.9 months of imports since 2001.
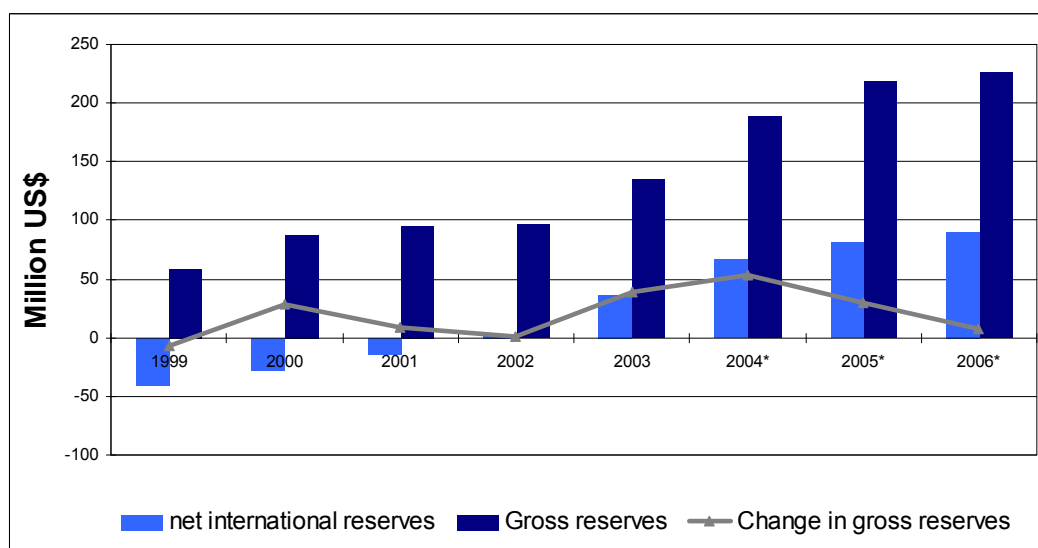
*Figures for 2005 and 2006 are based on IMF projections

Source: IMF country reports

Public finance

Improvement of the taxation system has been the subject of structural conditions. The conditions have mainly focused on improvement of the tax administration and collection system (see Chapter 5). Table 3.2 provides an overview of key public finance indicators such as revenue, expenditure, overall balance and financing. Fiscal performance improved in the period 2000-2006. Tax revenue as a percentage of GDP increased, and the overall balance (excluding the externally financed public investment programme (PIP)) was even positive after 2002. These surpluses facilitated foreign exchange accumulation and supported monetary policy and exchange rate stabilisation. The IMF judged fiscal policy performance as satisfactory under its programmes, despite frequent expenditure pressures (e.g. wage bill, conflict in Afghanistan). The IMF also concluded that the successful fiscal consolidation contributed to macroeconomic stabilisation.

Progress has been made in maintaining aggregate fiscal discipline, strengthening public expenditure and debt management, and allocating resources to the Poverty Reduction Strategy Paper (PRSP) priority sectors.

Tax collection performance improved considerably, mainly because of VAT reforms and reduced exemptions. In 1999, tax collection as a percentage of GDP was among the lowest of the CIS countries. Tax collection has improved considerably, but in 2004 total tax collection was, at 15.2 percent of GDP, still below the CIS-7[12] average of 16.6 percent of GDP (Armenian International Policy Research Group (AIPRG) 2006).

In addition, the Tajik Government managed to control expenditure growth. In 2000, expenditure in relation to GDP was at its lowest, gradually increasing in subsequent years with improved tax collection. Expenditure as a percentage of GDP increased from 16.6 percent in 1999 to 23.1 percent in 2006. However, in 2006 Tajikistan's public sector ranked the second smallest among the CIS-7 countries, after Georgia.

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[12]   Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Tajikistan, Uzbekistan.

Table 3.2   Public finance (general government, % of GDP)

	1999	2000	2001	2002	2003	2004	2005*	2006**
Total revenue and grants	13.5	13.6	15.2	16.7	17.3	17.9	18.8	18.6
Total expenditure[13]	16.6	14.2	18.4	19.2	19.1	20.3	22.6	23.1
Overall balance (including externally financed PIP)	-3.1	-0.6	-3.2	-2.4	-1.8	-2.4	-3.8	-4.5
Overall balance (excluding externally financed PIP)	..	..	..	-0.1	0.9	0.7	0.7	0.1
Financing	**3.1**	**0.6**	**2.2**	**2.4**	**1.8**	**2.4**	**3.8**	**4.5**
Domestic	*0.6*	*0.2*	*-0.8*	*-0.1*	*-1.1*	*-1.7*	*0.9*	*1.1*
• NBT	-0.2	0	-0.9	-0.7	-1.3	-1.9	0.1	0.7
• Commercial banks	0.1	-0.4	0.1	0	-0.2	-0.1	0.1	0.1
• Privatisation	0.8	1.0	0.3	0.9	0.5	0.4	0.6	0.3
• Tajik rail repayment	0	-0.5	-0.3	-	-	-	-	-
External	*2.5*	*0.4*	*3.0*	*2.6*	*2.8*	*4.0*	*2.9*	*3.4*
• Disbursement	2.6	0.6	4.5	2.8	2.7	4.3	4.2	4.7
• Amortisation	-	-	-2.0	-0.5	-0.3	-4.3	-1.2	-1.3
• Arrears	-	-	-4.8	-	-	-	-	-
• Drawdown of Tajikistan's claim on CBR	-	-	-	2.5	0.5	-	-	-
• Debt rescheduling	-	-	5.2	-	-	-	-	-
• Principal repayment	-0.1	-0.1	-	-	-	-	-	-

* indicates projections and ** indicates budgeted

Sources: IMF country reports 05-368 (for 2003, 2004), 05-132 (2002), 03-222 (2001), 01-115 (1999-2000); IMF Country Report No. 06/02, February 2006; IMF Country Report No. 05/132, April 2005; WB *Public Expenditure and Institutional Review*, December 2005. IMF Country Report No. 06-62

In real terms, the budget grew by more than 300 percent in the period 2000-2006. Figure 3.10 illustrates the development of expenditure shares. The share of social expenditure remained more or less constant in the budget, in real terms (2000 prices), but grew in amount from 115 million somoni to 433 million somoni. The shares of protection expenditure (defence), economic services and administrative services in the budget decreased. Externally financed PIP has been included in the budget since 2002, and its relative importance has increased since then.

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13   Plus lending, minus repayments.

2006

2000

■ General Administrative services
■ Protection services
■ Social Services
☐ Economic services
☐ Interest payments
☐ Other services
■ Externally financed PIP
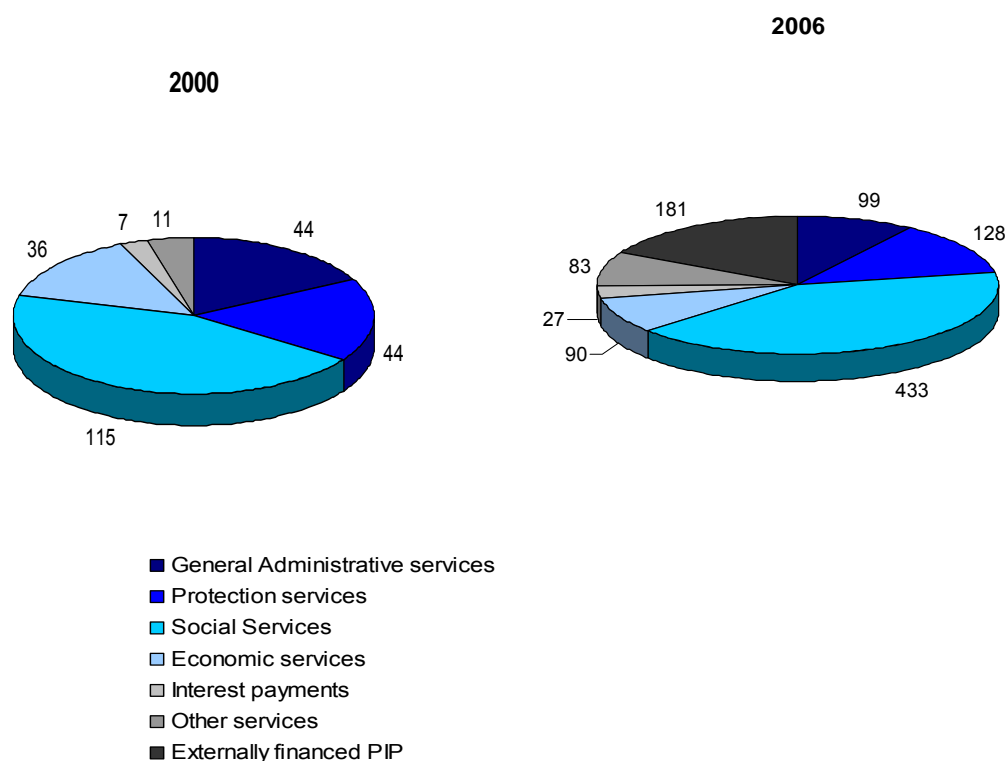
Throughout this period, the Tajik Government focused on external financing, which is still at a relatively high level (see Chapter 4). Domestic financing mainly consisted of privatisations, although the receipts remained insignificant. On average, privatisation generated about 0.6 percent of GDP annually.

Quasi-fiscal deficit
The quasi-fiscal deficit[15] of the state-owned public utilities caused a serious threat to macroeconomic stability. In 2002, the quasi-fiscal deficit of the energy sector (electricity and gas) was estimated at 22.7 percent of GDP.[16] The gas sector was responsible for 2.7 percent of GDP and the electricity sector for 20 percent. The high quasi-fiscal deficit in the electricity sector was caused by low tariffs (below cost-recovery levels), poor collection rates (non-paying customers) and technical losses. These factors encouraged over-consumption and the accumulation of large arrears by big enterprises such as the Tajik Aluminium Plant TADAZ. The Government took steps to increase electricity tariffs and initiated installation of meters. By 2005, the situation had improved. The economic losses of the energy sector due to under-pricing had declined to 10 percent of GDP. However, the IMF judged that not enough progress had been made in increasing electricity tariffs (the target was to raise prices by more than 400 percent). The Tajik

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14   The 2006 figures are IMF projections.
15   The quasi-fiscal deficit of state-owned public utilities is the value of implicit subsidy computed as the difference between the actual revenue charged and collected at regulated prices and the revenue to fully cover the operating costs of production and capital depreciation.
16   IMF Working Paper 06/43.

Government drafted a rehabilitation programme for the electricity sector (supported by the World Bank) to raise electricity prices in the coming years to eliminate the quasi-fiscal deficit by 2010.

Debt

In 1999 and 2000, Tajikistan struggled with addressing the problem of large external debt. In the period 1999-2001, arrears were a cause of concern. In 2001-2002, debt service absorbed a substantial share of government revenues. The debt issue is discussed in more detail in Chapter 4.

3.2.2 Compliance with the IMF performance criteria

Table 3.3 provides an overview of general progress on the quantitative performance criteria under ESAF/PRGF and PRGF as another sign of progress in the macroeconomic stabilisation agenda. The strong improvement in performance under the second arrangement is particularly noteworthy. Annex 2 contains further information on compliance with quantitative performance criteria.

Table 3.3   Overview of compliance with quantitative performance criteria under ESAF/PRF and PRGF (numbers of fulfilled and non-fulfilled criteria).

	Quantitative performance criteria		
	Total	Met	Not met
ESAF/PRGF (1998-2001)			
Mid-term review	9	5	4
Second annual arrangement	13	10	3
First and second review	13	9	4
Third annual arrangement	8	8	-
First review	11	10	1
Second review	10	9	1
PRGF (2002-2005)			
First review	9	8	1
Second review	9	9	-
Third review	9	9	-
Fourth review	9	9	-
Fifth review	9	8	1

Source: IMF Country Report No. 06/63

3.2.3 Conclusion

We conclude that Tajikistan ensured macroeconomic stabilisation in the period 2001-2006. Economic growth performance and the continued decline of inflation were impressive. The overall balance of the BoP is positive, although decreasing since 2003 because of a growing deficit in the current account due to a sharp increase in imports and lagging export growth. The capital and financial account increased steadily from 1999. The net international reserve position changed from negative to positive and continued to grow after 2002. However, the increase in gross reserves just kept up with the import

growth rate. Exchange and interest rates broadly stabilised in the period 2003-2005. Since then, the somoni has depreciated steadily against the dollar. Fiscal policy performance also improved, which contributed to the macroeconomic stabilisation. Tax collection improved considerably, though still remains relatively low. Progress has been made in maintaining aggregate fiscal discipline and strengthening public expenditure and debt management. The quasi-fiscal deficit of the energy sector decreased from almost 23 percent of GDP in 2002 to 10 percent in 2005. This general progress in macroeconomic stabilisation is also confirmed by the strong performance of the second IMF PRGF programme.

3.3 Counterfactual

3.3.1 Alternative arrangements

What arrangements would have been implemented if EFA had not been granted?
The EFA programme focused on solving Tajikistan's arrears to the European Community. In Chapter 2 we reviewed four alternative arrangements that could be considered in the absence of EFA. We concluded that a scenario in which Tajikistan would not receive any additional international assistance and would not clear the arrears until at least 2002 was the most plausible counterfactual scenario. This scenario can be further characterised as follows:

- Absence of EFA would not have speeded up or slowed down restructuring of Tajikistan's other debt;
- The IMF programme would not have been significantly affected. However, a delay in implementing PRGF until 2003 would have been possible;
- Assistance programmes by the World Bank and other donors would not have been affected;
- Willingness to improve relations with the EC and pressure from the IMF would have prompted the country to start repayment as early as possible, probably with a small repayment in 2002;
- A gradual increase of the repayments could have been expected over the 2003-2005 period, because of the improving macroeconomic situation;
- It seems plausible that all arrears to the EU would have been cleared by the time of completing the IMF PRGF programme (end of 2005).

Interviews with officials from the IMF and the Tajik Government confirmed that the most plausible counterfactual situation would have included resolving the EU arrears within the timeframe of the PRGF programme. The IMF would not have started a new programme without an agreement on how to resolve the arrears. It would probably have given Tajikistan until the end of the programme to solve the arrears problem.[17] This seems realistic since the economic situation started to improve from 2002 onwards and prospects at that time were positive. However, most interviewees held the view that large EU arrears would have made negotiations on the new IMF programme more complicated.

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[17]   The PRGF programme expired in February 2006.

Combined with the willingness to improve Tajik-EC relations, the following indicative repayment schedule would have been plausible: EUR 15 million in 2002, EUR 20 million in 2003, EUR 25 million in 2004 and EUR 30 million in 2005.

3.3.2 Outcomes

What are the macroeconomic effects of the most likely implementation scenario(s)?
To measure the macroeconomic effects of the counterfactual scenario, a quantitative modelling approach has been used. The model applied is similar to that used in the evaluation of MFA operations in Romania and the Former Yugoslav Republic of Macedonia; it is described briefly in Annex 6. The model recognises links between and ensures consistency among four basic economic sectors: real, external, government and banking. Figure 3.11 illustrates these linkages.

Figure 3.11   The model structure – linkages between four basic economic sectors: real, external, government and banking
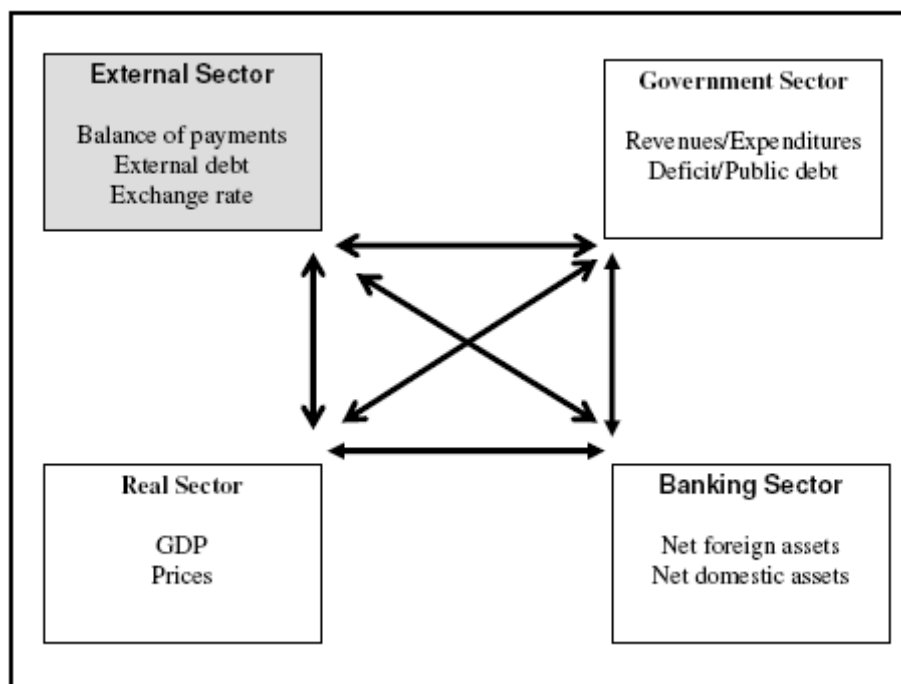
The model has been calibrated using IMF country reports, IMF International Finance Statistics and in some cases data from the National Bank of Tajikistan. The quality and internal consistency of the available data are problematic, forcing us to rely primarily on the dynamics of macroeconomic variables rather than levels (see Text box 3.3). Despite these problems, the quantitative analysis – while inevitably based on assumptions and subject to substantial error margins – can provide useful insights into the magnitude of effects that could have materialised in the absence of EFA.

The main implication of the counterfactual is a different debt repayment structure. While in 2001 Tajikistan would have spent fewer resources on clearing arrears (EUR 13 million fewer), it would have needed to devote substantial budget resources to clearing debts in subsequent years.

The first important economic mechanism relates to fiscal position. Slightly lower debt payments in 2001 would have implied somewhat more room for fiscal manoeuvre in that budget year. A somewhat looser fiscal policy would have given a minor boost to domestic demand, with imports rising and the real exchange rate strengthening. However, in the years 2002-2005 debt payments would have limited the fiscal situation. The majority of adjustment has been assumed to take place through expenditure adjustments, given the limited possibilities of increasing revenues in the short term. The sharp increase in total government revenue in this period (more than 300 percent in real terms), would have made budget adjustments a politically realistic route, though painful.

All stakeholders agreed that the only possibility would have been to cut non-protected non-wage expenditure. Tajik officials indicated that social sector expenditure would probably have been spared. This opinion was supported by the IMF. Budgets for health (1.5 percent of GDP, projection budget 2006) and education (4 percent of GDP, projection budget 2006) were already relatively small. IFI officials stated that they would probably have advised making the necessary cuts in non-wage public investment expenditure. This advice was based on their opinion that capital stock in Tajikistan is already relatively high. However, the Ministry of Finance (MoF) expressed doubts whether this sector would have been the most obvious candidate for budget cuts, because of the possible negative impact on economic growth.

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[18]   http://www.imf.org/external/np/sec/pr/2004/pr04253.htm
[19]   IMF (2006).

We could not detect clear priority-setting for possible expenditure cuts for the counterfactual. Therefore, we assumed that expenditure cuts would most probably have affected all expenditure categories. This would also have affected the level of government services. However, to what extent the level of public services would have been affected and the effects on poverty are outside the scope of this evaluation.

A minor part of adjustment would probably have taken place through modification of the overall budget balance. In the period 2003-2005, the overall balance (excluding externally financed PIP) was in surplus. Although the Tajik Government subscribed to a strict fiscal policy, there seemed to be limited room for adjustments through a decrease in the budget surplus. The IMF confirmed that, in the absence of EFA, it probably would have formulated less strict fiscal conditions. However, the Ministry of Finance stressed that it would have been reluctant to loosen its fiscal policy. Therefore, we have assumed that a combination of adjustments would have taken place through less expenditure (80 percent) and a somewhat lower overall budget balance (20 percent).

Overall, tighter fiscal policy would have led to a contraction in aggregate demand. This would have marginally slowed economic growth, reducing demand for imports, while real exchange rate depreciation would have facilitated the adjustment.

The second economic mechanism relates to adjustments in the balance of payments. Debt-related transactions are recorded in capital and financial accounts. In 2001, a somewhat higher current account deficit would have been observed. The counterfactual would have necessitated adjustment of the current account and/or changes in international reserves, with the current account deficit decreasing slightly.[20]

3.4 Net impact on macroeconomic stabilisation

What has been the contribution of the grants and/or loans provided by the EFA operation to achieving the EFA objectives?
The net impact of the EFA operation on macroeconomic stabilisation appears to have been limited. EFA brought a small improvement in the economic growth record and minimally lower inflation over the period 2001-2006. The results of quantitative modelling showed that EFA contributed approximately a cumulative 1.5 percent increase in GDP in the period 2001-2006. By decreasing the cost of foreign debt servicing it allowed for budget expenditure to be shifted to domestic use.

It is worth noting that the limited macroeconomic impact of the EFA operation on macroeconomic stabilisation should be seen in the context of improving economic conditions in Tajikistan in the period 2001-2006. The EFA operation was taking place in an environment where the risk of economic instability was diminishing.

Table 3.4 summarises the results of the quantitative net impact analysis of the EFA. It presents for a few selected indicators (macroeconomic, balance of payments and public

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[20]   The statistical treatment of transactions related to debt arrears is actually quite complicated, but this does not play a role in our analysis.

finance) the annual difference between actual development and the effects of the counterfactual. The differences between the actual and the counterfactual can be attributed to EFA and therefore seen as the net impact of the operation.

Net impact of EFA (differences between actual and counterfactual) – annual developments

	2001	2002	2003	2004	2005	2006
Macroeconomic						
GDP growth rate (% point per annum)	-0.4	0.4	0.5	0.5	0.6	0.0
Inflation rate (% points)	0.3	-0.3	-0.4	-0.4	-0.4	0.0
Exchange rate (somoni per EUR)	0.10	-0.19	-0.45	-0.34	-0.45	0.0
Balance of payment						
Capital account (million EUR)	-13	15	20	25	30	0
Current account (million EUR)	5	-6	-8	-10	-12	0
Public finance						
Debt towards the EU (million EUR)	-30	-18	-8	7	36	28
Government expenditure (% point of GDP)	0.2	-0.2	-0.3	-0.3	-0.3	0.0

Note: The values in the table have been obtained as differences between historical values for the respective variables and counterfactual values in the assumed scenario. Only net effects without actual and counterfactual values are presented because actual series for some data contain break points, making the exposition difficult. This does not affect the modelling results.

Source: Estimations from the model.

The above estimates should be interpreted with caution as they are based on a simple analysis in which many assumptions have been made. Therefore, we have focused primarily on the signs and magnitude of the effects and less on precise values.

3.5 Indirect macroeconomic effects of structural conditionality

What, if any, has been the contribution of actions resulting from respecting the structural conditionality criteria to achieving the short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)?
During our interviews in Washington and Dushanbe, the following structural reforms were identified as having had a considerable effect on macroeconomic development:

- *Tax reform.* The improvement of tax collection, and more specifically the enforcement of VAT, led to an increase in tax revenues which contributed to the improvement of government services. Improved VAT enforcement coincided with rising consumption levels caused by very strong growth in remittances, which reinforced the VAT revenue increase. These reform activities were part of the EFA conditions, which originated from the IMF programme;
- *Privatisation of small and medium-sized enterprises (SMEs).* SME privatisation led to higher-than-expected job creation and development of new services. The MoU contained a condition related to small-scale privatisation, which was linked to World Bank conditions;
- *Banking sector.* Restructuring of the banking system, its improved capitalisation and supervision contributed to the improvement of the financial and macroeconomic stability of the country.

For tax reforms, small-scale privatisation and banking, EFA applied cross-conditionality with the IMF and the WB respectively. The net impact of the structural conditionalities of EFA is analysed in more detail in Chapter 5. We did not identify clear reinforcing effects related to these broad reforms areas. Therefore, we did not identify any indirect contribution from EFA conditionalities to the achievement of macroeconomic stability.

3.6 Unexpected macroeconomic results

Has the assistance given rise to any unexpected short and medium-term macroeconomic effects? What were they and how did they occur?
We did not identify any unexpected macroeconomic effects of EFA.

4 Impact on external sustainability

4.1 Gross impact – actual evolution of external sustainability indicators

How did the external financial situation of the recipient country evolve prior to and during the MFA operation?

Tajikistan began transition (in 1991-1992) with practically no foreign or domestic debt. However, throughout the early 1990s liabilities increased at a rapid pace. Among other problems, scarcity of resources to service external obligations and weak institutional capacity led to serious difficulties in proper monitoring and servicing of foreign debt. Until 2004, foreign debt data was monitored manually without reliance on any computerised system.[21]

The consequences of the 1998 financial crisis in Russia led to a major deterioration of Tajikistan's external financial situation, with total nominal government and government-guaranteed debt rising from just below 60 percent of GDP in 1997 (already a rather high level for a country at this stage of development) to over 100 percent of GDP in 1998 and above 110 percent of GDP in 1999.[22] At the end of 1999, the nominal value of total government and government-guaranteed debt amounted to US$ 887 million. Roughly one-third of this amount (US$ 288 million) was owed to Russia. Other former Soviet Union countries accounted for US$ 162 million and multilateral creditors (mainly World Bank and IMF) US$ 315 million (IMF and WB 2001). Over the last decade, a gradual shift can be observed in debt composition from the predominance of bilateral debt to heavier reliance on multilateral debt typically granted on concessional terms. This process has been important in improving debt sustainability.

Net present values (NPV) may provide a better indication of actual debt burden than nominal values, because of the shift to multilateral concessional lending. In present value terms, the end-1999 total government and government-guaranteed debt was estimated at US$ 564 million, or 36 percent less than the nominal value.

During 2000 there was little change in debt indicators, with end-of-year nominal and present value estimates of US$ 921 million and US$ 612 million respectively. This implied a 137 percent ratio of NPV of debt stock to exports of good and services and a 449.5 percent ratio of NPV of debt stock to central government revenues. With these

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[21] See Ministry of Finance (2006) *Status report on external debt*. Similar problems could have been observed in the Kyrgyz Republic, for instance (see e.g. SECO 2006).

[22] The debt figures cited in this report should be treated with caution. Tajikistan was unable to properly monitor its foreign debt obligations and report them, e.g. to the IMF. Up to February 2007 no comprehensive data on Tajikistan's debt obligations was available in the Joint External Debt Hub (JEDH) developed by the Bank for International Settlements, IMF, Organisation for Economic Co-operation and Development (OECD) and World Bank.

ratios, Tajikistan had the worst result among the CIS-7 except for the Kyrgyz Republic. The ratio of total public debt service to exports of goods and services stood at 10 percent, and the ratio to central government revenue was 35 percent (IMF and WB 2002). Debt service from the government budget was somewhat lower, at above 14 percent of general government revenues (Ministry of Finance 2006).

The subsequent period, coinciding with the EFA operation evaluated in this report, was characterised by a significant improvement in foreign debt indicators. The indicators reflected a decline in debt levels (partly because of debt restructuring deals with key creditors, notably Russia) and rapid GDP growth, accompanied by expansion of exports and budget revenues (see Table 4.1).

Table 4.1   Selected external debt indicators, 2000-2006

	2000	2001	2002	2003	2004	2005	2006
Total external debt (million US$)	1027	1018	984	1031	871	895	866
Total external debt (% of GDP)	108.2	97	82.5	66.3	42.2	38.9	31
NPV of public and publicly guaranteed external debt (% of GDP)	..	..	..	..	26.9	24.4	..
Debt composition: % share of multilateral debt (concessional terms)	36	37	39	45	68	72	76
Debt composition: % share of bilateral debt	52	52	50	46	25	22	24
Total public debt service (government budget, National Bank of Tajikistan and public enterprises) (million US$)	53.1	62.4	88.1	35.3	36.3	67.7	45.6
Government debt service/general government revenue ratio (%)	14.2	27	13.4	9.2	3.8	10.8	..
Public debt service/exports ratio (%)	..	..	7.1	4.1	3.4	5.7	..
GDP growth (%)	8.3	10.2	9.1	10.2	10.6	6.7	7
Growth of exports of goods and services in US$ (%)	..	..	8.6	23.2	20.9	3.3	..
Effective interest rate (%)	..	..	3.7	5.1	3.9	1.8	..

Notes: Effective interest rate is calculated by dividing current-year interest payments by previous-period debt stock. Government debt service is defined as debt service going through government budget. Major excluded categories are IMF debt (serviced through NBT) and debt of public enterprises.

Sources: Ministry of Finance of Tajikistan (2006) *Status report on external debt*; IMF (2006) *Republic of Tajikistan: Sixth review under the Poverty Reduction and Growth Facility – staff report*, Country Report 06/062; IMF World Economic Outlook database, September 2006; National Bank of Tajikistan; interviews at the MoF.

Debt rescheduling and write-offs played a very important role in improved debt indicators between 2000 and 2006. A major breakthrough was the debt-asset swap operation with Russia. This took place in October 2004, bringing Tajikistan's debt to Russia down from around US$ 300 million at the end of 2003 to around US$ 50 million at the end of 2004. Another significant operation was a 100 percent IMF debt relief granted under the Multilateral Debt Relief Initiative. All IMF debt incurred before January 2005 was forgiven, which amounted to US$ 99.1 million. This operation took effect in early 2006. An overview of the major debt rescheduling up to 2006 is presented in Table 4.2. This

overview includes EFA as a debt rescheduling operation. Although officially the EFA cannot be seen as a debt rescheduling operation (see also Section 2.4), de facto it resulted in a new loan under different conditions linked to a grant element of EURO 35 million.

Table 4.2   Overview of debt rescheduling deals, 1998-2006

Creditor	Date of rescheduling	Original date of the loan	Debt before rescheduling	Debt after rescheduling	Comment
Turkey	26 Jan 1998	8 Apr 1993	US$ 50 million	US$ 25.68 million	Rescheduled to 2001
*(EU)**	*26 Jan 2001*	…	*EUR 79 million (arrears)*	…	….
Kazakhstan	8 April 2002	22 Nov 1995	US$ 18.29 million	US$ 12.14 million	Rescheduled to 2006
Belarus	30 May 2002	1 Jan 1992	US$ 0.646 million	US$ 0.646 million	Rescheduled to 2002
Uzbekistan	12 Dec 2002	24 Jan 1997	US$ 199.80 million	US$ 105.62 million	Rescheduled to 2005
Iran	18 May 2003	22 Apr 2000	US$ 25 million	US$ 25 million	Start year moved from 2006 to 2008
Pakistan	16 Sept 2003	31 May 1995	US$ 20 million	US$ 13 million	Rescheduled to 2005
Germany	16 Dec 2003	12 Nov 1997	EUR 4.281 million	EUR 4.281 million	Rescheduled to 2006
China	29 Nov 2004	15 Nov 1994	Chinese Yuan (CNY) 50 million	CNY 50 million	Start year moved from 2002 to 2007
Russia	16 Oct 2004	9 Dec 2002	US$ 299.67 million	US$ 50 million	Start date still 2005, but shorter period (2008 instead of 2018)
IMF	January 2006	…	US$ 127 million	US$ 42 million	Debt relief amounted to US$ 99.1 million

Source: Based on data provided by the Ministry of Finance of Tajikistan, IMF website and JEDH database.

*EFA. – arrears of EURO 79 million were replaced by a loan of EURO 60 million and a grant of EUR 35 million. For more information, see Sections 2.3 and 2.4.

A new development in 2006 was related to discussions on three new loan contracts from China amounting to US$ 603.5 million in total. These loans are being used for road construction (US$ 281.2 million) and two projects for building high voltage electricity lines (US$ 267.2 million and US$ 54.2 million). The relevant loan agreements were signed in June 2006. The rehabilitation project for the road from Dushanbe to Chanak is reported to have started in July 2006. The information gathered during interviews indicated that the loans were given for 20 years with a five years' grace period, at an interest rate of 2 percent. It is worth stressing that the size of this new debt is roughly equal to two-thirds of Tajikistan's previous total foreign indebtedness. Moreover, some interviewees and local newspaper articles indicated that there may be further new lending from China.

Although the road project started in 2006, the Chinese loan has not yet been disbursed; it is scheduled for disbursement in 2007. Abstracting from further new lending from China, the risk of debt distress could be evaluated as moderate as of 2006. Preliminary and informal assessments of the Chinese US$ 603.5 million loan gathered during field

missions in November 2006 and February 2007 indicated that, considering the terms and the road and electricity projects the loan will finance, this new debt issuance may not endanger debt sustainability.[23] The Ministry of Finance indicated that the debt-to-GDP ratio will probably not exceed 48 percent in 2007. The net present value of debt stock is likely to stay below or around 35 percent of GDP.

However, most experts confirmed that pursuing an even more rapid foreign debt accumulation would pose a significant threat to debt sustainability.

4.2   Identification of major risk factors

What are the main internal and external factors on which the current trend in the country's external financial situation and its prolongation into the future are conditional?

A combination of strong economic growth and a number of debt restructuring deals has substantially decreased the risk of debt-related problems, at least in the short to medium term (given grace periods on the key loans). However, the recent discussions on massive new loans from China, in addition to the 2006 loans, may – but do not have to – indicate a change in the approach to external borrowing. Tajik officials stated that new investments, especially in (hydro)power plants, are necessary to safeguard energy supply and thus Tajikistan's future economic development.

Some interviewees expressed their concerns that Chinese loans may be seen by some decision-makers as 'soft' loans, i.e. the ones likely to be written-off or restructured via a debt-to-equity operation. This could be a dangerous perception, possibly leading to lack of vigilance related to foreign-financed investment projects and foreign indebtedness in general. Realisation of such a negative scenario could increase the risk of a debt crisis over the perspective of the next few years.

While the recent period has seen a relatively safe evolution of current account dynamics, some risks remain. One important problem is related to the very narrow export base of Tajikistan (see Figure 4.1). Aluminium has accounted for around 60 percent of exports since 2001, with no tendency to decline. In fact, new investment announcements make it likely that aluminium's share could increase further. In 2006, higher aluminium prices drove its share of the total value of exports up to as much as 75 percent, but in volume terms exports of aluminium have also been rising steadily since 2000. Another important item is cotton fibre, with a share fluctuating between 9 and 25 percent of total exports during 2000-2006. Electricity is the third major export product, with a gradually declining share from above 20 percent in 2000 to around 5 percent in 2004-2006. Both cotton and electricity have witnessed volatile export patterns in terms of volumes. It is also worth noting that the aluminium sector is based on access to cheap hydropower available in Tajikistan. Other exports have only amounted to around 15 percent of the total since 2000; in 2006, the figure was as low as 12 percent.

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[23]   The electricity projects are reported to be profitable. There is insufficient information to provisionally evaluate the road project.
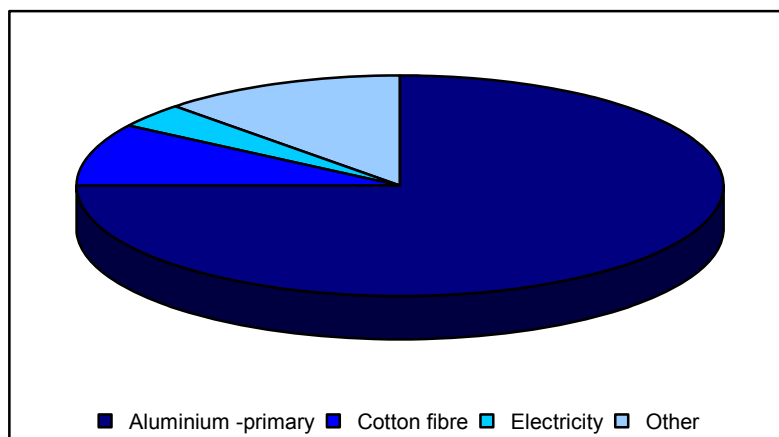
Source: Own calculation based on National Bank of Tajikistan data.

Such a narrow export base makes Tajikistan very vulnerable to external shocks. Aluminium and cotton exports are sensitive to developments in world commodity markets. In addition, the production capacity of both products depends on meteorological conditions. This vulnerability problem of exports is further complicated by reliance on imported petroleum products and gas (more then 15 percent of total imports in 2006), which are also characterised by volatile prices.

Remittances sent by Tajiks working abroad (mainly in Russia) appear to be a stabilisation factor limiting the risk of balance of payment distress. The large size of remittance flows (see Text box 3.2 for a detailed discussion) has been a key element financing imports. Remittances are likely to limit the risk of current account instability, under the plausible scenario of a relative stability of remittance flows. In practice, this boils down to the issue of Russia not imposing effective restrictions on foreign workers from Tajikistan (see also Chapter 3). Despite some rhetoric on the part of the Russian authorities signalling a tougher stance on migrant workers, demographic processes imply that Russia will need migrants to make up for labour-force shortages.[24] Such a view can be confirmed by the outcome of a recent dispute at the turn of 2006-2007 when the Russian authorities tried to introduce quotas for workers from Tajikistan, but eventually dropped this idea.[25]

The small size of FDI inflows remains a problem. These would need to increase substantially to allow for productivity gains, widening the diversity of the production and export base. Improving the competitiveness of non-energy and non-cotton exports is a key precondition for decreasing the risk of distress in the external sector.

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[24] See e.g. http://www.ilo.org/public/english/bureau/inf/features/06/migrant_russia.htm.
[25] See http://en.rian.ru/analysis/20070216/60854847.html.

4.3 Projections for external sustainability

How is the country's external financial situation likely to evolve in the five years following the final EFA disbursement, given the likelihood of changes to current conditions?

The quality of debt data is one issue complicating a presentation of debt sustainability scenarios. In addition, the ongoing discussions on possible additional loans from China will determine the sustainability of the external financial situation. The detailed conditions attached to any new loans would have a major impact on debt profiles over the period 2007-2011 (and beyond). Unfortunately, this information is not yet available.

However, even with limited information on the most recent debt operations, we can conclude that the debt sustainability outlook for the country seems to be positive, unless new Chinese loans permanently reverse Tajikistan's earlier prudential approach to borrowing. This positive assessment is motivated by the mid-2006 low level of debt, which was clearly sustainable in light of the high rates of economic growth. Another important factor was the progress in structural reforms: better policies and institutions allow for safe management of somewhat higher debt levels.

Figure 4.2 illustrates the importance of choice of borrowing strategy for the sustainability outlook. It presents a World Bank analysis of scenarios with relatively small (3 percent of GDP annually) and relatively large (9 percent of GDP annually) foreign-financed public investment programmes. The former scenario could be considered indicative of a situation without new Chinese lending, while the latter could be close to the situation with Chinese lending. These scenarios should be treated as indicative only, particularly as they do not yet take into account the full effects of restructuring of debt to Russia, cancellation of the majority of IMF debt, and Chinese lending during 2006. Thus, although the levels of indicators are not reliable (because of unavailability of recent data), their dynamics are indicative of the trends that can be expected.
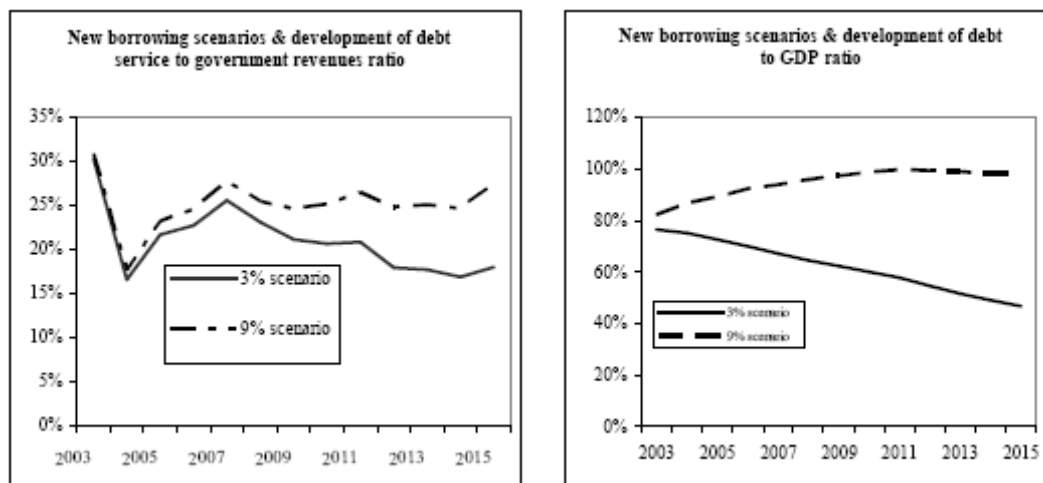
Source: Extracted from World Bank (Dec 2005) *Tajikistan public expenditure and institutional review*, p24.

It may be useful at this stage to review recent quantitative approaches to debt sustainability analysis in low-income countries. Since 2004, the IMF and World Bank have carried out intensive work in this field. These efforts have resulted in setting standards that are applied in policy discussion, as reflected for example in IMF country reports.[26]

The IMF and World Bank staff paper of March 2005[27] proposed the following approach. First, low-income countries should be grouped according to the quality of policies as proxied by the World Bank's Country Policy and Institutional Assessment (CPIA). These assessments are made annually and have been available to the public since June 2006 when the 2005 ratings were released for the first time. CPIA ranking is used for classifying low-income countries into three groups, with weak, medium and strong policies respectively. The dividing points for this classification have been set at CPIA 3.25 (between weak and medium) and 3.75 (between medium and strong). (Another version has suggested 3 as a dividing value between weak and medium policies, and 3.9 separating strong from medium policies.) In the next step, for each group of countries the indicative sustainable debt thresholds are defined in terms of relationships between net present value of debt stock and debt service to GDP, exports and budget revenues excluding grants. These debt thresholds (using the 'preferred' version of CPIA dividing points) are presented in Table 4.3.

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[26] For a review of his work see http://www.imf.org/external/pubs/ft/dsa/lic.aspx

[27] IMF and IDA (2005) *Operational framework for debt sustainability assessment in low-income countries – further considerations*, 28 March.

Table 4.3   Debt-burden thresholds in the option preferred by IMF staff

	NPV of debt as % of exports	NPV of debt as % of GDP	NPV of debt as % of revenues	Debt service as % of exports	Debt service as % of revenues
Weak policy (CPIA ≤ 3.25)	100	30	200	15	25
Medium policy (3.25< CPIA < 3.75)	150	40	250	20	30
Strong policy (CPIA ≤ 3.7)	200	50	300	25	35

Source: IMF and IDA (2005) *Operational framework for debt sustainability assessment in low-income countries – further considerations*, 28 March.

It is clear from the above table that as of 2006, Tajikistan was safely placed well below all relevant thresholds defined by this approach (specific values are not shown as these are difficult to estimate because of lack of information). Also, the US$ 600 million loans from China likely to be disbursed in 2007 should not lead to any alarming signals from these benchmarks. However, it should be noted that these specific thresholds were only meant to provide general guidance, and any analysis needs to treat each country separately.

Debt relief operations granted to some low-income countries during 2004-2006 largely reduced their debt burden and improved their position regarding the above thresholds. This has created a perception of relatively large borrowing space in these countries, coinciding with abundant global liquidity and the emergence of new creditors (e.g. China, Middle East countries). The recent Chinese loans to Tajikistan can be seen as a typical example. This development prompted the IMF to review the application of debt sustainability analysis in countries that have undergone debt relief operations.[28] The IMF concluded that the framework is still broadly appropriate, although a careful case-by-case approach is needed.

Along with the reduction of its debt levels and a shift towards concessional debt, Tajikistan has been gradually improving its CPIA ranking. In 2003, it was classified as a weak performer with a CPIA below 3. In 2005, its CPIA improved to 3.3, giving the country the position of 'medium policy performer'. Further improvement in policies, which is possible over the medium term, would further raise the debt burden thresholds according to the above methodology. However, such an approach should not be overplayed. Quick policy reforms are a positive phenomenon, but their sustainability and irreversibility also matter. Indeed, one recommendation of the IMF directors was to apply three-year moving averages of CPIA scores in debt sustainability analysis. In the case of Tajikistan, we think a more cautious approach should be used in assessing the sustainability of its debt position than suggested by the more 'mechanical' rules described above.

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[28]   See IMF and Word Bank (2006), *Applying the debt sustainability framework for low-income countries post-debt relief*, 6 November.

Lack of sufficient information on the recent (and potential new) loan programmes and continuing discussions between the Government of Tajikistan and the IFIs on future debt strategy make the presentation of medium-term debt sustainability not feasible in this report. The best up-to-date source on the outlook will be provided by the new joint IMF/World Bank debt sustainability analysis, expected to be released in April 2007.

4.4 EFA contribution to medium and long-term external sustainability prospects

What is the EFA contribution to medium and long-term external sustainability prospects?
This section provides a qualitative analysis of EFA's contribution to medium and long-term external sustainability, based on the macroeconomic impact assessment (see Chapter 3), the external sustainability analysis (see previous sections of Chapter 4), and the structural reform impact assessment (see Chapter 5).

EFA could have influenced long-term external sustainability through the following channels:
1. The debt rescheduling character of the EFA operation:
   - It was one of the debt rescheduling deals allowing debt and debt service levels to be brought down to an easily manageable position, thereby providing a comfortable starting point for current and future debt management strategies;
   - It directly reduced the costs of debt service, though to a small extent;
   - It allowed for slightly higher cumulative GDP growth (than would be the case in the counterfactual scenario), thus marginally improving the debt to GDP ratio.

2. Structural reforms. The structural conditionalities might have helped in:
   - strengthening the budget revenue base (especially VAT collection), which can both limit the size of necessary debt financing and provide a safer base for debt service;
   - pursuing privatisation, which in turn limited the need for debt issuance;
   - strengthening public administration, in particular related to public finance and overall debt management, which can bring long-run savings in terms of debt service costs;
   - strengthening the banking system, making the economy less prone to instability.

The above channels have contributed positively to long-term external sustainability. The channel where it is relatively easy to identify the direct contribution of the EFA operation appears to play a relatively small role in the long-term perspective. This applies to both the debt relief element of the operation and slightly higher GDP resulting from EFA. In the long-term perspective, other issues related to improved economic governance appear more important.

A complicating factor is that the structural reforms mentioned above have been driven by a combination of factors, including external pressure from various sources, where EFA conditionalities were just one element. Widening the tax base, improving tax collection and strengthening public administration, including debt management, appear to be among the most important achievements from the perspective of long-term external sustainability

prospects. However, we could not identify any reinforcing effects of EFA conditionalities on these reforms (see Chapter 5).

Another potentially relevant issue may be the impact of the EFA operation on the authorities' general attitude to external indebtedness. Here, two opposite forces might have been at play. On the one hand, the problems with debt arrears to the EU and the gradual nature of EFA with its conditionalities could have illustrated to the authorities the risk attached to foreign debt. On the other hand, the EFA operation (as with any other debt restructuring deal) might to some extent have supported the opinion that all debts can be rescheduled, thus limiting vigilance in taking on new loans. Available evidence does not allow for drawing too firm a conclusion on the relative strength of these two opposing forces. The fact that the EFA operation was part of a larger debt restructuring effort suggests that the latter driving force could only partially be attributed to EFA.

To sum up, if we combine EFA's relatively small direct impact on debt relief and GDP growth with no identified reinforcing effect on specific structural reforms relevant for long-term sustainability, we conclude that EFA provided a positive but small net effect on the outlook for long-term external sustainability.

5 Impact on structural reforms

5.1 Structural objectives of the intervention

What are the short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme)?

The MoU and SMoUs did not include explicit structural reform objectives, but they were reflected by specific structural conditionalities to be fulfilled by the Tajik Government prior to the release of individual grant tranches (except for the first one). The structural conditionalities were mainly based on the conditionalities of the IMF and WB programmes, but also included EC-specific conditionalities.

Table 5.1 lists the structural reform conditionalities of the EFA operation in Tajikistan, along with their origin. These conditions are grouped into four areas that implicitly describe the objectives of the structural conditionalities:
1. system of taxation;
2. public finance and public administration;
3. privatisation and restructuring;
4. banking sector and monetary policy.

Table 5.1　Conditionalities for EFA to Tajikistan and their origin

Grant tranches	2nd	3rd	4th	5th
Originally scheduled disbursement	2001	2002	2003	2004
Actual disbursement	2001	2003	2004	2006
Source of conditionality	MoU	1st SMoU	2nd SMoU	3rd SMoU
I. Improvement of the system of taxation				
Improvement of the fiscal administration	IMF	-	-	-
The computerisation project at the Tax Committee will be implemented.	-	IMF	-	-
The coverage and collection rates of excise taxes will be increased.	-	IMF	-	-
The existing taxes on agricultural products will be replaced by a uniform land tax.[29]	-	WB	WB	-
Tax exemption will be reduced.	-	IMF	-	-
VAT collection will be improved by enforcing the use of tax invoices by taxpayers.	-	IMF	-	-
Total tax collection of the Ministry of National Income and Duties will be increased as a ratio to GDP, in particular by expanding the tax base and strengthening tax administration.	-	-	IMF	IMF
II. Public finance and public administration				
Consolidation of the Treasury system.	IMF	-	-	-
Submission to Parliament of a draft Treasury Law.	IMF	-	-	-
A complete inventory of state and state-guaranteed debt.	-	IMF, WB	-	-
A code of ethics for public servants will be prepared and adopted.	-	-	IMF	
A government decision prohibiting central and local authorities to interfere with private decisions on cotton production and export will be adopted.	-	-	IMF prior action	
Avoid that new arrears on electricity payments by TADAZ[30] in 2004	-	-	-	WB
Finalise an inventory of all debts and liabilities of the Government and state-owned enterprises (SOEs); improve their monitoring, recording, analysis and reporting.	-	-	-	IMF str. bench-mark
Develop a time-bound action plan to make the Treasury's accounting system compliant with official budgetary classifications, and develop a strategy for an integrated and efficient accounting system in the public sector.	-	-	-	WB
Develop a strategy on the development of an external audit function in the public sector (i.e. independence of the SFCC in line with international standards of auditing).	-	-	-	EC-specific (WB)
Carry out an IT-related risk assessment and consequently develop a risk management plan at the MoF and NBT.	-	-	-	EC-specific

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[29]　For the fourth tranche this condition implied extension of uniform land tax from pilot regions to the whole country.
[30]　Tajik aluminium plant.

Grant tranches	2nd	3rd	4th	5th
Originally scheduled disbursement	**2001**	**2002**	**2003**	**2004**
Actual disbursement	**2001**	**2003**	**2004**	**2006**
Source of conditionality	**MoU**	**1st SMoU**	**2nd SMoU**	**3rd SMoU**
III. Privatisation process				
Completion of small-scale privatisation.	IMF, WB	-	-	-
Substantial progress with regard to privatising medium and large-scale enterprises.[31]	IMF core	WB	WB	-
Audit and restructuring of TADAZ (in accordance with the plan drawn up in cooperation with the International Finance Corporation (IFC))	WB, IMF supportive	WB	WB	-
Completion of privatisation of cotton ginneries.	WB	-	-	-
Progress with land privatisation.	IMF	IMF	IMF	-
Progress in establishing a legal basis for privatising infrastructure and public utilities enterprises and corporatisation of these enterprises.	-	-	WB	-
An external audit of the gas distribution company Tajikgas will be conducted.	-	-	-	IMF str. bench-mark
Progress in issuance of land-use certificates to individual farmers and transformation of state farms into private farms (in a fair and transparent way).	-	-	-	WB
IV. Restructuring of the banking sector and monetary policy				
The implementation of restructuring plans for the four main banks will continue.	IMF core measure	IMF	IMF	
Measures to ensure banks' compliance with prudential regulations.	IMF	-	-	
Following the four main banks, restructuring plans will be drawn up for the remaining Tajik banks (including liquidation of a number of non-viable banks).	-	IMF	IMF	
The banking regulatory environment will be strengthened.[32]	-	IMF	IMF	IMF
Measures to assure banks' compliance with International Accounting Standards (IAS) (i.e. the next Central Bank audit will be made compliant with IAS).	IMF	IMF	IMF	IMF
The National Bank of Tajikistan will ensure that no direct credit is issued and all other activities not related to core functions of a Central Bank are abandoned.	-	-	IMF cont. perf-ce	IMF cont. perf-ce
Number of conditionalities	**11**	**13**	**13**	**11**

Sources: EFA Loan Agreement, Memorandum of Understanding, Supplemental Memoranda of Understanding; IMF PRGF reviews; SAC2 – implementation completion report.

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[31] For the fourth tranche this particularly required privatisation mandates to be signed with international advisers.
[32] For the fifth tranche this included elimination of all waivers for minimum capital requirement; the capital requirement was raised from $ 1.5 million to $ 2 million.

Table 5.1 illustrates that most of the conditionalities originated from the IMF and WB programme, the exception being two conditionalities for the final, fifth tranche. The link with the IMF is not surprising, given that the EFA operation was directly related to the status of the IMF programme.

The interviews suggested that negotiations between the Tajik Government and the Commission on the focus and amount of conditionalities to be included in the Loan Agreement, MoU and subsequently in the SMoUs were at a high level. As a result of security concerns, EU relations with Tajikistan were in the building-up phase. Given this situation, the EC decided to select conditionalities from the ongoing agreements with the IFIs. At the time of negotiating structural conditionalities for the SMoU of July 1999, the ongoing World Bank SAC1 programme was approaching completion, while the matrix of conditions for the SAC2 programme was not yet available. This explains why EFA conditionalities for the second and third grant tranches were mainly borrowed from the IMF programme. For the subsequent tranches, the EFA conditionalities were a combination of conditionalities from both IMF and WB programmes.

A change of approach in terms of setting conditionalities took place prior to the final grant tranche. This was as a result of the Operational Assessment (OA) carried out on behalf of the EC in June 2004. The OA was carried out following ECFIN's decision to perform an analysis of the administrative procedures and financial circuits of organisations/processes involved in the MFA. The OA for Tajikistan concluded that:

"the framework for sound financial management of the Ministry of Finance and Economy and of the National Bank of Tajikistan is effective with regard to formal compliance with internal control requirements, but it requires improvement with respect to the effectiveness of internal control, financial management and planning."

Among the recommendations of the OA was to strengthen the internal control environment, in particular by addressing:
i) "the ambivalent position of the State Financial Control Committee [SFCC] and absence of an audit organ linked to the legislative branch of power";
ii) "the weak IT development at the Ministry of Finance and insufficient risk management measures related to IT."

These two recommendations were translated as conditionalities in the area of public finance and included in the SMoU for disbursement of the fifth grant tranche. Although the IMF and WB programmes had conditions related to PFM systems, they did not directly include any that were similar to these two EFA conditionalities. Therefore, these two conditionalities are considered to be EC specific. The conditionality on the independence of the SFCC is discussed in more detail in Section 6.2.

As the ECFIN files revealed,[33] the EFA structural conditionalities were designed to support the reform process in the country, not only by constraining the Government, but also by helping it to persuade Parliament to adopt new reform measures. As ECFIN wanted to obtain/keep net payments from the country, it was difficult to propose

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[33]   ECFIN, Report on mission to Tajikistan in May 2000.

conditionalities very different from those of the IMF and WB. Given the specific character of the EFA operation, namely as a 'rescheduling exercise', this argument was even stronger and any conditions different from those of the IMF and WB would have to be justified. ECFIN consequently decided to choose 'clear and easy to verify' conditionalities.

In terms of prioritisation and selection of conditionalities, the most important issues as seen by ECFIN concerned:
- liberalisation;
- monetary policy;
- fiscal/quasi-fiscal policy and management;
- business climate;
- civil service reform;
- poverty reduction and social measures;
- enterprise privatisation and restructuring;
- energy sector reform;
- banking sector reform;
- land reform.

The basic selection criteria, which ECFIN followed for deciding on the final EFA conditionalities, were that the conditions should facilitate bringing new money into the Tajik budget and economy, and should increase Tajikistan's liquidity and solvency. This resulted finally in exclusion of conditionalities in the following areas: liberalisation, business climate, poverty reduction and social measures, and energy sector reform.

For the fifth grant tranche, only two conditionalities in the area of public finance were added, based on the recommendations of the OA, because the timing of this final tranche required concrete measures that could be implemented over the short run.

The consultation process for the selection of conditionalities became more active with the arrival of the EC Delegation in Dushanbe. The presence of the EC Delegation in Dushanbe facilitated direct contact and discussion with all relevant parties prior to the fifth tranche. Nevertheless, this improvement took place too late to have any considerable influence on further implementation of EFA.

Conclusions
The EFA structural reform objectives were implicitly highlighted by the structural conditionalities attached to the EFA operation and included in the Loan Agreement, Memorandum of Understanding and Supplemental Memoranda of Understanding. The EFA structural conditionalities focused on four areas of activities: the system of taxation, public finance and public administration, the privatisation process, and restructuring of the banking sector and monetary policy. With the exception of two EC-specific conditionalities, all EFA structural reform conditionalities were borrowed from the IMF PRGF agreement and the WB Structural Adjustment Credit (SAC2). The final tranche of EFA included two EC-specific conditionalities which were not part of any other agreement of the Tajik Government with the IFIs. This change in approach to setting conditionalities was possible as a result of the Operational Assessment carried out on behalf of ECFIN.

The consultation process for selecting conditionalities between the EC and the Tajik Government, as well as with the IMF and WB, was less in-depth at the beginning of the EFA operation. The consultation process improved significantly prior to the final grant tranche, in particular as a result of setting up the EC Delegation in Dushanbe, which facilitated improved coordination and discussion with donors and the Government. However, because of the short period of time remaining for completion of the EFA operation, this improvement could not significantly influence the EFA operation.

5.2 Relevance of the structural objectives

How relevant are the short and medium-term expected structural effects of the assistance to the needs of the recipient country?

In terms of reform priorities, the EFA areas of structural conditionalities were highly relevant for the implementation of reforms, as underlined in the country's basic strategic documents (the Government Economic Programme, the Interim PRSP and the PRSP).[34] All EFA structural conditionalities were relevant to, and in line with, the measures and actions embodied in the (Interim) PRSPs.[35] Moreover, many EFA conditionalities corresponded with the actions and measures included in the PRSPs, particularly in the areas of private sector development, agricultural reforms, public administration and institutional reforms, fiscal and monetary policy, and external debt management.

The interviews revealed that the two EC-specific conditionalities were highly relevant to the needs of Tajikistan. Although a supreme audit institution (the SFCC) had been created, it was not considered to be independent because it was accountable to the President and not to the legislative. The SFCC's independence was not considered at that moment as a priority issue by other IFIs. Setting the SFCC's independence as an EFA conditionality was therefore highly relevant in terms of strengthening the country's external control environment.

In addition, IT specialists from the Ministry of Finance and the Treasury had signalled on different occasions the problem of very limited IT-related risk management possibilities and measures in terms of protection of information, access rights to information, levels of automation and data storage. Given this situation, development of a comprehensive risk management plan was indispensable and therefore very relevant for reform of the public finance management (PFM) system.

Although relevant and supportive to the country's reform programme, the EFA structural conditionalities were:
1. broad in terms of their number and scope;
2. imprecisely formulated.

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[34] The Interim PRSP was completed in October 2000, and the PRSP was completed in June 2002.
[35] The conditionalities of the second and third grant tranches were in line with the Interim PRSP, and the fourth and fifth grant tranches with the PRSP.

Ad 1. Number of conditionalities and their scope

As underlined by the IMF's ex post assessment of its long-term involvement in Tajikistan,[36] the use of structural conditionalities in the ESAF/PRGF was excessive. The original programme had close to 120 specific measures (of which only about a third were met), and a number of policy commitments (not strictly conditions) in various areas. The IMF ex post assessment concluded that the conditionalities imposed on Tajikistan in the ESAF/PRGF (1998-2001) were over-ambitious given the lack of capacity to implement reform in the country (see Text box 5.1). This period corresponded with the start of the EFA operation in Tajikistan. Given the relatively high number of EFA conditionalities (31) and the IMF origin of most of them (particularly for the first two grant tranches), the same conclusion is valid.

Text box 5.1   Main conclusions of the IMF ex post assessment

The IMF ex post assessment underlined that: "the broad and ambitious structural agenda in the first ESAF/PRGF arrangement, coupled with weak institutions, led to persistent underperformance, numerous requests for waivers, and eventually the programme going off-track in each of the last two years of the first arrangement. Performance has improved significantly since then, with stronger programme ownership of the second PRGF and a much more streamlined policy agenda". Under 'institutional and administrative limitations and weak ownership', the extent and detail of structural conditionality contained in the original programme were just too broad and ambitious for a country at an early stage of development. Moreover, compliance with a number of these conditions was very difficult to monitor.[37]

Source: IMF (2006) *Republic of Tajikistan: Ex post assessment of longer term program engagement*, Country Report 06/063.

As revealed by the interviews, at the beginning of the reforms the Tajik Government was committed to reform. However, because of lack of capacity it could not meaningfully lead the reform process. Consequently, donors have played an important role in the development of the (Interim) PRSP and shaping the reforms.

Ad 2. Formulation of conditionalities

Most EFA conditionalities were short-term policy objectives of an operational nature related to processes which can be relatively easy to implement and monitor, but may have little impact in the longer term:

- implementing the computerisation project at the Tax Committee;
- conducting an external audit of Tajikgas;
- submission to Parliament of a draft Treasury Law;
- preparing and adopting a code of ethics;
- progress with issuance of land-use certificates.

For example, the conditionality on issuance of land-use certificates required quantitative progress (without specifically mentioning a quantitative target), its output being the number of land certificates issued. Nevertheless, fulfilment of this conditionality did not

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[36] The IMF ex post assessment covered Tajikistan's performance under the last two PRGF arrangements, namely ESAF/PRGF (1998-2001) and PRGF (2002-2005).

[37] Examples include the privatisation of an increasing (and large number) of public enterprises, and the conversion of state and collective farms, 'in their entirety', into private farms.

necessarily imply functioning of the certificates in practice and consequently success of the land reforms. The success of land reforms would also depend on such factors as relevance and appropriateness of the legal framework, and its enforcement.

Some EFA conditionalities aimed to achieve more strategic (long-term) objectives:
- improvement of fiscal administration;
- progress in privatisation of enterprises;
- strengthening of the banking regulatory environment.

However, the potential impact of most of these conditionalities was diminished by the way in which they were formulated. In many cases, EC conditionalities (which were borrowed from IMF and WB programmes) were *synthesised* or *generalised*. Some conditionalities were formulated by combining several IMF or WB conditionalities in the same area. In others, the IFIs' conditionalities were generalised, using such terms as 'progress in …', and 'improvement of …'. In both instances, the conditionalities left room for subjective interpretation in terms of their fulfilment and consequently impact. The impact of the conditionalities is discussed in Sections 5.3 and 5.5.

The imprecise formulation and generalisation of the conditionalities has had several consequences. They were hardly quantifiable, and consequently it was more difficult to monitor and verify their implementation.

Conclusions
The EFA conditionalities were relevant and supportive to the country's reform programme as set up in the Tajik strategic documents. Nevertheless, they were broad in terms of their number and scope and imprecisely formulated. Given the country's lack of capacity to implement reforms at the beginning of the reform process, the number and scope of conditionalities was too ambitious. The imprecise formulation of the conditionalities, including the limited focus on longer-term objectives, may influence their potential impact in the longer term. The relationship between the formulation of objectives and the net effect of conditionalities is discussed in Section 5.5.

5.3 Gross impact – actual structural reform outcomes

To what extent have the short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme) occurred as envisaged?
According to the IMF's ex post assessment of its long-term involvement in Tajikistan, progress in implementing structural reforms under the second PRGF was satisfactory and has improved strongly when compared with the period before 2002. In addition, the WB has deemed progress in the overall reforms linked to SAC2 as satisfactory. Given that most of the EFA conditionalities were borrowed from the IMF and WB programmes, we can generally conclude that progress in structural reforms under EFA was successful. This section provides a brief overview of the progress in structural reforms in the core areas of the EFA structural conditionalities.

5.3.1   System of taxation

With the adoption of a new Tax Code, significant progress was achieved in 1999 in terms of transforming the fiscal system into a modern, rule-based instrument of government policy. Despite this improvement, tax administration and tax collection were still weak. Under the EFA operation, seven conditionalities to support improvement of the taxation system were formulated. Table 5.2 presents these conditionalities and their status according to ECFIN review mission reports. Of the seven conditionalities, five have been fulfilled, one partially fulfilled and one waived.

Table 5.2   Conditionalities for improvement of the taxation system and their implementation status

Improvement of the taxation system conditionalities	2nd tranche 2001	3rd tranche 2003	4th tranche 2004	5th tranche 2006
Improvement of fiscal administration.	Satisfied	-	-	-
The computerisation project at the Tax Committee will be implemented.	-	Satisfied	-	-
The coverage and collection rates of excise taxes will be increased.	-	Satisfied	-	-
The existing taxes on agricultural products will be replaced by a uniform land tax.[38]	-	Satisfactory progress	Satisfactory progress	-
Tax exemption will be reduced.	-	Unsatisfactory progress; waived[39]	-	-
VAT collection will be improved by enforcing the use of tax invoices by taxpayers.	-	Satisfied	-	-
Total tax collection of the Ministry of National Income and Duties will be increased as a ratio to GDP, in particular by expanding the tax base and strengthening tax administration	-	-	Satisfied	Satisfied

According to IMF reports and ECFIN review mission reports, tax administration and collection have improved steadily over recent years. General government tax collection increased from 14.1 percent of GDP in 2001 to 15 percent in 2002 and 2003, and about 16 percent in 2005 (see Table 5.3). The increase was mainly brought about by VAT reform and improved administration of VAT, including better VAT collection on imports and reduced delays in issuing VAT refunds. In 2002, the authorities continued to strengthen tax administration by enforcing the use of tax invoices by large taxpayers, and ensuring that funds were available to improve the functioning of the large-taxpayer inspectorate created in 2001.

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[38]   For the fourth tranche this condition implied extension of uniform land tax from pilot regions to the whole country.
[39]   Waiver for non-compliance was granted based on good results in other areas of tax reform.

Table 5.3   Total tax revenue as a percentage of GDP

	2001	2002	2003	2004	2005*	2006*
Tax revenue (% of GDP)	14.1	15.0	15.0	15.2	16.0	16.2
- VAT	-	4.8	5.2	5.7*	5.7*	-
- excises and other internal indirect taxes	-	2.2	2.3	2.2*	2.2*	-

*Preliminary data.

Source: IMF Country Report No. 06/062 (February 2006), No. 05/132 (April 2005).

The efficiency of tax and customs collection also improved as a result of creating the Ministry of National Incomes and Duties in 2002 by amalgamating the Tax and Customs Committees; computerising taxpayer data, especially at local tax offices; and introducing a single taxpayer identification number. A new Tax Code took effect in 2005. This simplified the tax structure, eliminated a number of distortions and exemptions, and is expected to raise tax revenue from its current low level.

Legislation for a pilot project on a unified agricultural tax was adopted in March 2002. While the pilot was ongoing, the political decision was taken to introduce a uniform land tax in the new Tax Code. However, the impact of this uniform land tax will not be as significant as intended until the unified land register is fully developed and running.

A somewhat sensitive issue during the EFA operation was that of tax exemptions. The Government was reluctant to reduce tax exemptions, arguing that as most of them were targeted at vulnerable groups, abolishing them would not increase tax revenues significantly. This conditionality has not been met. Nevertheless, given the satisfactory progress in other areas of tax reforms a waiver has been granted. At present, a number of tax exemptions are still in place.

Positive development in the area of tax administration is confirmed by some indicators of the World Bank's Doing Business survey. The major improvement is recorded in terms of time needed for preparing and paying taxes. Although the figure is higher than the OECD average, it is well below the regional average (see Table 5.4). The number of payments an entrepreneur must make and the percentage of profit paid in taxes are still above the OECD and regional averages.

Table 5.4   Paying taxes (2006)[40]

Indicator	Tajikistan	Region[41]	OECD
Payments (number)	55	48.3	15.3
Time (hours)	224	423.0	202.9
Total tax rate (% profit)	87.0	56.0	47.8

Source: WB Doing Business survey.

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[40]   The data shows the tax that a medium-sized company must pay or withhold in a given year, as well as measures of the administrative burden in paying taxes. These measures include the number of payments an entrepreneur must make; the number of hours spent preparing, filing and paying; and the percentage of their profits they must pay in taxes.

[41]   Europe and Central Asia excluding OECD countries.

5.3.2 Public finance and public administration

Good progress in establishing a Treasury system was achieved in 2000. All fiscal revenue was brought under the Treasury's control. Some efforts were made to restructure the central Treasury, strengthen internal audit and control and improve debt management. Nevertheless, much remains to be done to improve transparency in fiscal operations. The EFA operation included 10 conditionalities for public finance and public administration. Of these, eight have been fulfilled and two partially fulfilled (see Table 5.5).

Table 5.5   EFA conditionalities related to public finance and public administration and their implementation status

Public finance and public administration conditionalities	2nd tranche 2001	3rd tranche 2003	4th tranche 2004	5th tranche 2006
Consolidation of the Treasury system.	Satisfied	-	-	-
Submission to Parliament of a draft Treasury Law.	Satisfied	-	-	-
A complete inventory of the state and state-guaranteed debt.	-	Satisfied	-	-
A code of ethics for public servants will be prepared and adopted.	-	-	Satisfied[42]	
A government decision prohibiting central and local authorities to interfere with private decisions on cotton production and export will be adopted.	-	-	Satisfied[43]	
Avoid that new arrears on electricity payments by TADAZ[44] are built-up in 2004.	-	-	-	Satisfactory progress[45]
Finalise an inventory of all debts and liabilities of the Government and SOEs; improve their monitoring, recording, analysis and reporting.	-	-	-	Satisfied
Develop a time-bound action plan to make the Treasury accounting system compliant with official budgetary classifications, and develop a strategy for an integrated and efficient accounting system in the public sector.	-	-	-	Satisfied
Develop a strategy on the development of an external audit function in the public sector (i.e. independence of the SFCC in line with international standards of auditing).	-	-	-	Satisfied
Carry out an IT-related risk assessment and consequently develop a risk management plan at the MoF and NBT.	-	-	-	Satisfactory progress

Reform of public finance management has mainly focused on improving budget processes and establishing a modern Treasury. Noticeable improvements in the up-stream

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[42] This conditionality was considered as showing unsatisfactory progress during the first review mission (March 2004) for disbursement of the fourth grant tranche and a waiver was considered. Nevertheless, a waiver was not granted and the conditionality was fulfilled by the next review mission in June 2004.

[43] A presidential decree issued on 23 September 2002 prohibited the intervention by local authorities in the financing, production and pricing decisions of cotton farmers and producers.

[44] Tajik aluminium plant.

[45] New payment arrears amounting to about 0.5 percent of GDP were accumulated in the last quarter of 2004, from TADAZ towards Barki Tajik (the state electricity company). However, the Government has taken measures to ensure that TADAZ remains current on its tax and electricity payments, in addition to progressively paying off its arrears. A payment mechanism has been set up, whereby TADAZ transfers a monthly amount into a special account, to be used to pay the electricity and tax bill. This has allowed TADAZ to pay off arrears and stay current on its payments.

of the budget cycle include the development of a medium-term budget framework, though its full integration into the budget process has still to be achieved. The impact of reforms related to the down-stream of the budget cycle is not yet fully achieved. Consolidation of the Treasury was facilitated by the adoption of a Treasury Law in May 2001. In December 2004, a decree was adopted to establish a treasury accounting system compliant with official budgetary classifications (Government Finance Statistics) and to ensure consistency with line ministries. As of 2005, the Treasury has been working according to the new classifications. However, basic treasury systems are not yet firmly established. The regulations for budget execution and basic treasury operations are not yet well developed. Owing to lack of financing, computerisation of the PFM system is still at an early stage. Many budget and treasury operations – especially at local level – are still run manually, which significantly reduces the effectiveness of the reform effort.

In terms of transparency in using public resources, the creation of the SFCC has brought about important improvements. Nevertheless, the SFCC's independence has not yet been secured (see Section 6.2 for in-depth discussion on the SFCC's independence).

Recording, monitoring and reporting of external debt has improved. According to the legislation, the Ministry of Finance is the sole authority to undertake external loans on behalf of the Government. In addition, the Government has the responsibility to report quarterly to Parliament on debt service obligations and any arrears.

A code of ethics, which is an important element of public administration reform, was adopted in June 2004. It applies to all levels of the civil service and requires civil servants to perform their duties in a professional, fair and independent manner. Its impact on the reforms, however, will depend on its successful implementation.

The handling of the conditionality regarding the Government's decision prohibiting central and local authorities from interfering in private decisions on cotton production and export is an example of the limitations of external conditionality. A presidential decree issued in September 2002 prohibited local authorities' intervention in the financing, production and pricing decisions of cotton farmers and producers, which led to the 'satisfied' conclusion on fulfilment of the condition. Yet it is widely recognised that such intervention notoriously continues to the present day. Notably, reducing interference is step one in the road map for cotton-sector restructuring proposed by the donor community (under the leadership of the Asian Development Bank and the World Bank) to the Government at the end of 2006.

5.3.3 Privatisation and restructuring

By the end of 1999 and the beginning of the EFA operation, the programme of small-scale privatisation was nearly completed. The privatisation programme was launched in 1991 and in the period up to 1999 a total of 5,286 small state enterprises (out of 5,400) were sold. Privatisation of larger enterprises was slower. Only 17 percent of enterprises included in the privatisation programme were sold by the end of 1999. The major problem in the privatisation process was lack of transparency. In the case of large enterprise, another issue was the existence of the de facto minimum price and delays in

receiving full payment after signing the sale contract. Given the importance of cotton for the Tajik economy, special significance was attached to the privatisation of cotton ginneries. Although all ginneries were sold by the end of 1999, in most cases payment was not received and the ginneries were re-offered for sale. There was widely held concern about public interference with cotton production decisions. Land reform and the privatisation of state farms were considered one of the main measures impacting on poverty reduction if carried out in an equitable and efficient manner.

The EFA operation included eight conditionalities related to privatisation and restructuring. Of these, two have been characterised by mixed progress, while six have been fulfilled (see Table 5.6).

Table 5.6   Privatisation-related conditionalities and their implementation status

Privatisation process conditionalities	2nd tranche 2001	3rd tranche 2003	4th tranche 2004	5th tranche 2006
Completion of small-scale privatisation.	Satisfied	-	-	-
Substantial progress with regard to privatising medium and large-scale enterprises.[46]	Satisfied	Unsatisfactory progress; waived[47]	Satisfactory progress	-
Audit and restructuring of TADAZ (in accordance with the plan drawn up in cooperation with the IFC).	Satisfied, acceptable progress[48]	Satisfied	Satisfied[49]	-
Completion of privatisation of ginneries.	Satisfied[50]	-	-	-
Progress with land privatisation.	Satisfied, acceptable progress	Satisfied	Satisfied	-
Progress in establishing a legal basis for privatising infrastructure and public utilities enterprises and corporatisation of these enterprises.	-	-	Satisfactory progress	-
An external audit of the gas distribution company Tajikgas will be conducted.	-	-	-	Satisfied
Progress in issuance of land-use certificates to individual farmers and transformation of state farms into private farms (in a fair and transparent way).	-	-	-	Satisfied

The small-scale privatisation was completed by the end of 2000. Progress with large-scale privatisation slowed down in 2001 as a result of the Government's increased focus on political stability and activities relating to the conflict in Afghanistan. Progress in privatising large enterprises was unsatisfactory for the disbursement of the third grant

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[46]   For the fourth tranche this particularly required privatisation mandates to be signed with international advisers.

[47]   Waiver for non-compliance granted, based on good progress in privatising medium-sized enterprises.

[48]   The audit and restructuring plan for TADAZ was not completed, but because of acceptable progress in this area the conditionality was considered as satisfied.

[49]   This conditionality was considered as not satisfied during the first review (March 2004), and no waiver was considered by the EC. It was fulfilled prior to the second review (June 2004) of conditionality fulfilment for the release of the fourth tranche.

[50]   The state cotton monopoly was liquidated in January 1999, and the privatisation of cotton ginneries was completed in 2000.

tranche. However, because of the satisfactory progress in privatising medium-size enterprises, a waiver for this condition was granted.

In November 2003, a new 2004-2007 strategic plan for privatising medium and large enterprises and restructuring national monopolies and the largest enterprises was adopted. By the end of 2005, the quantitative outcomes in terms of privatised medium and large-scale enterprises were met and even substantially exceeded the SAC2 targets. Nevertheless, a serious issue during the privatisation process was the quality and transparency of the process, as reflected by irregularities and shortcomings in some cases. According to the WB, there was evidence that in many cases the privatisation resulted in share purchases by insiders.

Also in November 2003, a government resolution was adopted requiring restructuring plans for large state-owned enterprises (including TADAZ, Tajik Air, Tajik Telecom, Tajik Gas and Barki Tajik, the electricity monopoly) to be prepared by the end of 2005. A new energy law was enacted in 2003 to promote the corporatisation of Barki Tajik and to establish an independent regulatory body in the energy sector. No privatisation of infrastructure enterprises has taken place so far, but individual restructuring plans are being worked out.

Least successful have been the pace and quality of agricultural and land reforms. This is mainly because of vested interests and poor governance, which have allowed rich entrepreneurs and interest groups to secure most of the fertile land, to the detriment of landless and poor kolkhoz workers. During 1995-1999, about 180 state and collective farms (out of 600) were privatised through the issuance of marketable land share and use certificates to private farmers. The pace of farm privatisation started to slow down in the second half of 2001 (see Table 5.7).

Table 5.7   Privatisation of state farms

	2000	2001	2002	2003	2004	2005	2006*
State farms	393	289	248	165	114	53	22
Privatised farms	45	104	41	83	51	61	31
Dehkan (small) farms	300	594	177	420	711	1,003	603

*Figures for 2006 are preliminary.

Source: Land Reform Committee.

Reasons for this slowdown included the limited capacity of the Land Reform Committee (LRC) and increased interference by local officials. To accelerate the issuance of land certificates, in 2001 the Government phased out charges and fees for land use certificates. Budget allocations for this function were increased in 2001 and 2002 to cover the issuance costs and support an increase in the capacity of the LRC.

According to the WB *Implementation completion report on SAC2* (December 2004), the extent to which restructuring of the collective farms empowered farm workers to improve their incomes varied greatly. Improving the method of farm restructuring and privatisation remains a critical challenge for Tajikistan in order to reduce poverty.

Some improvements in the structural areas related to EFA conditions on privatisation as briefly described above are reflected by European Bank for Reconstruction and Development (EBRD) transition indicators, as presented in Table 5.8.

Table 5.8   Progress in structural reforms related to privatisation: transition indicators, 2000-2005

	1999	2000	2001	2002	2003	2004	2005
EBRD index of small-scale privatisation	3.0	3.3	3.7	3.7	3.7	3.7	4.0
EBRD index of large-scale privatisation	2.3	2.3	2.3	2.3	2.3	2.3	2.3
EBRD index of enterprise reform	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Index of infrastructure reform	1.0	1.0	1.0	1.0	1.0	1.3	1.3
- electric power	1.0	1.0	1.0	1.0	1.0	1.7	1.7

Source: EBRD, *transition report 2005, Tajikistan*.

The EBRD indicators show substantial improvements in small-scale privatisation, while no progress can be seen in large-scale privatisation. This is more or less in line with the above qualitative assessment (shared also by the IMF), which indicates that small-scale privatisation has been more successful than large-scale privatisation. The index on infrastructure reform also improved in 2004.

5.3.4   Banking sector and monetary policy

By 2000, the Tajik authorities had already made significant progress in improving banking sector regulation and supervision, including:
- increasing the minimum capital requirement from US$ 300,000 to US$ 1 million from January 1999;
- expanding and restructuring the Banking Supervision Department of the NBT;
- strengthening prudential regulations.

Despite these improvements, the banking sector remained weak and highly concentrated. Most banks were burdened with non-performing loans. Their operational management was often weak, and financial systems suffered from a weak regulatory environment and lack of functioning capital markets. This resulted in overall low confidence in the banking system and limited ability of banks to mobilise savings. The efficiency of the banking system was further constrained by the direct credits (guaranteed by the Government) channelled to specific sectors. This practice was influencing the loan portfolios of banks.

To strengthen the banking system, the EFA operation included six conditionalities on restructuring the banking sector and monetary policy. Table 5.9 presents these conditionalities and their status according to the ECFIN review mission reports.

Table 5.9   Conditionalities related to restructuring the banking sector and their implementation status

Restructuring the banking sector and monetary policy conditionalities	2nd tranche 2001	3rd tranche 2003	4th tranche 2004	5th tranche 2006
The implementation of restructuring plans for the four main banks will continue	Satisfied, acceptable progress	Satisfied	Satisfactory progress	
Measures to ensure banks' compliance with prudential regulations	Satisfied, acceptable progress	-	-	
Following the four main banks, restructuring plans will be drawn up for the remaining Tajik banks (including liquidation of a number of non-viable banks)	-	Satisfied	Satisfactory progress	
The banking regulatory environment will be strengthened[51]	-	Satisfied	Satisfactory progress	Satisfied
Measures to assure banks' compliance with IAS (i.e. the next Central Bank audit will be made compliant with IAS)	Not satisfied; waived[52]	Satisfied	Satisfactory progress	Satisfied
The National Bank of Tajikistan will ensure that no direct credit is issued and all other activities not related to core functions of a Central Bank are abandoned	-	-	Satisfied	Satisfied

The main achievements in this area related to strengthening the capital base of the banks to allow them to meet prudential requirements, and development of a comprehensive bank restructuring programme. This programme started with restructuring of the four major banks (Orion; Agroinvest; Sberbank, which later became Amonat; and Vneshekonombank, which later became Sohiro). It then shifted to restructuring of the other banks.

The four main banks signed restructuring agreements with the NBT in May 2000 and prepared preliminary business plans as part of their operational restructuring effort. Progress in implementing these plans was mixed. Three of the four banks exceeded their non-performing loan recovery targets, and there were delays in reducing the number of branch offices. The conditionality for the second tranche was not completely fulfilled. Nevertheless, because of the acceptable progress made – in particular, completion of an independent external audit of the four banks, improvement of risk management and strengthening of internal audit programmes – the conditionality was considered as satisfied. Prior to disbursement of the third grant tranche, there was partial success in restoring positive net worth in the banks. Despite this, two large banks (Amonat and Agroinvest) remained financially weak. Restructuring of Amonatbank was completed in 2004. Agroinvestbank was restructured in 2003 into two independent entities: a commercial bank and a non-bank financial institution (Creditinvest) financing cotton-

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[51]   For the fifth tranche this included elimination of all waivers for minimum capital requirement; the capital requirement was raised from $ 1.5 million to $ 2 million.

[52]   Waver for non-compliance granted, given that the Letter of Intent of the Government of Tajikistan of 22 June 2001 on the policies to be implemented in the context of the country's IMF programme contained an important chapter related to this condition.

sector operations. As result of this reorganisation, Creditinvest took over all bad cotton loans to clean the books of Agroinvestbank.

Progress in restructuring the other commercial banks is discussed in more detail in the case study in Section 6.1. As of 1 January 2006, 10 banks were operating in Tajikistan (one state bank, seven joint stock banks, one joint bank, one foreign bank), compared with 15 in 2002.

The increase in minimum capital requirements and restructuring of the banks has contributed to consolidation of the banking sector and consequently increased the banks' efficiency and profitability. Other measures, such as operationalising a deposit insurance scheme, allowing banks to have part of their capital in foreign exchange and amendments to the Tax Code, have strengthened the banking regulatory environment and consequently increased confidence in the banking sector.

As confidence in the banking sector has increased, domestic credit has grown substantially since 2004. The quality of banking assets has improved as the non-performing loan ratio has declined to 9.8 percent (see Table 5.10). The reduction in transfer fees, along with improved banking regulation and supervision, has contributed to greater use of banks for transferring remittances (see more on remittances in Chapter 3).

Table 5.10   Financial soundness indicators (%)

	2001	2002	2003	2004*	2005*
Non-performing loans					
Non-performing loans to gross loans	43.3	85.1	71.5	9.8	8.4
- excluding Agroinvest	29.0	20.5	11.5	-	-
Provisions to non-performing loans	78.1	7.9	8.7	91.1	62.1
- excluding Agroinvest	82.9	93.0	89.9	-	-
Liquidity					
- liquid assets to total assets	15.7	14.6	22.1	36.9	32.9
- liquid assets to demand and saving deposits	89.6	88.1	124.7	113.5	87.0
- liquid assets to total deposits	75.6	75.6	75.6	71.2	58.2

* data for 2004 is as for September 2005.

Source: IMF Country Report No. 06/062, February 2006.

In 2003, a Monetary Policy Committee was set up. A decree of February 2003 withdrew lending authority from all NBT branch managers, department heads and deputy chairs, to stop the practice of direct credits from the NBT to the cotton sector. According to the NBT, no direct credits have been issued since then. It must be mentioned, however, that among donors and other parties there are concerns that in practice direct lending still occurs, though there is no concrete evidence of these activities.

Some improvements in bank restructuring as described briefly above are reflected by the relevant EBRD transition indicators as presented in Table 5.11.

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	1999	2000	2001	2002	2003	2004	2005
EBRD index of banking sector reform	1.0	1.0	1.0	1.7	1.7	2.0	2.0
EBRD index of reform of non-bank financial institutions	1.0	1.0	1.0	1.0	1.0	1.0	1.0

Source: EBRD, *transition report 2005, Tajikistan*.

Banking sector reform started from a very low base, especially compared with other countries in the region. Therefore, the progress achieved in banking sector reform is very significant. Nevertheless, compared with the other countries in the region the Tajik banking sector needs to be developed further.

5.3.5   Conclusion

Despite delays in the EFA operation compared with the original planning, most of the structural conditionalities have been successfully fulfilled. Implementation of these conditionalities has contributed to the realisation of expected structural effects in the four reform areas. Reforms in the banking sector appear to have been the most successful. Measures focused on strengthening the banks' capital base, which led to improved compliance with prudential regulations, and restructuring of the banks, which led to consolidation of the banking sector. All these reforms have resulted in increased efficiency and profitability of the banking sector.

Reforms also gained momentum in the area of public finance. Measures were most successful in reforming the up-stream of the budget cycle, while the treasury system still remains to be firmly established. Of most significance to PFM reform were the improvements in the system of tax collection and administration. Progress was also made on both farm and enterprise privatisation during the EFA operation. Small-scale privatisation was more successful than medium and large-scale privatisation, which was affected by transparency issues and errors in the process. Progress was achieved in privatising state farms and issuance of land use certificates, but restructured farms and private-sector cotton producers are still affected by implicit state control over production.

Through their realisation, the EFA conditionalities have contributed to structural reforms in the four areas. The Government is committed to reform and it is expected that the major structural achievements of EFA are likely to be sustained. The only area where realisation of the structural reform objective is unclear relates to the independence of the SFCC. Based on interviews with different stakeholders, however, it is believed that the Government is looking for a compromise to resolve this issue.

5.4   Counterfactual

What arrangement would have been implemented if the MFA had not been granted?
What are the structural effects of the most likely implementation scenario(s)?
As far as structural effects are concerned, the counterfactual hypothesis remains highly speculative, because it is based on subjective assessments not necessarily corroborated by

facts. In analysing the alternative arrangements that would have been implemented to promote structural reforms if MFA had not been granted, we must first consider the alternative arrangements that could have been considered to replace EFA conditionalities.

In the case of cross-conditionality, there does not seem to be another donor programme that would have attempted to reinforce the IFIs' original conditionalities in the way that EFA did. There would also have been no adjustments to the original conditionalities by the IMF or World Bank, as these institutions selected their conditionalities (at least prior to the last grant tranche) with no or limited consultation with the EU.

The two EC-specific conditionalities were drawn from the findings of the Operational Assessment directly linked to EFA. Therefore, these two conditions would not have been included in other (EC) arrangements in the absence of EFA. However, it could be expected that conditions with a similar reform objective would have been included sooner or later in conditionalities by the FSP and/or IFIs in programmes linked to PFM reforms.

As noted in Section 5.2, the structural conditionalities were fully in line with the Interim PRSP and PRSP developed by the Government. As interviews confirmed, the Tajik Government was committed to the reforms in the areas covered by the structural conditionalities of the EFA operation. Therefore, it is expected that without EFA the Government would have moved forward with implementing these reforms. Nevertheless, because of the lack of capacity and weak institutions, as well as the low starting point, the reforms might have been implemented with less determination. In the case of the EC-specific conditionalities, we expect that the related reforms would not have been included in the Government's agenda at the time of the EFA operation.

Conclusion

The most likely counterfactual implies less donor pressure on fulfilment in the case of cross-conditionality, while actions related to the EC-specific conditionalities would not have been included in the reform agenda, or would have been delayed. These effects are discussed in detail in the following section.

5.5   Net impact on structural reforms

What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects?

As the EFA conditionalities largely matched those of the IFIs, it is difficult to disentangle the specific contribution of EFA from that of the IFI programmes. To analyse the net impact of EFA conditionalities on structural reforms, that is the contribution of actions resulting from the EFA structural conditionalities to the corresponding structural effects, we have used an analytical model based on three types of effects:

1. a *political* reinforcing effect (cross-conditionality – by signalling to the Government the importance of given reforms);
2. an *operational* reinforcing effect (cross-conditionality – by speeding up, deepening or widening the scope of certain IFI conditionalities);

3. a value-added effect (EC-specific conditionality – by introducing new conditions and ultimately contributing to the achievement of certain structural results that would not take place otherwise).

Table 5.12 highlights specific conditionalities that had any of these effects on structural reforms in the country.

The political reinforcement effect
The success achieved in some areas of reform could be because of the joint approach of the EC and other IFIs in setting their programme conditionalities. Including the same conditionalities in different IFI programmes signals the importance of the reforms in the areas related to these conditionalities. Consequently, this might lead to more determination by the Government to implement the reforms.

During the interviews, many stakeholders in Dushanbe, Brussels and Washington expressed their perceptions of a general reinforcing effect of EFA. This general reinforcement effect took place at a high government level and at the Ministry of Finance and contributed to the general success of IFI programmes in the country. This general reinforcement effect occurred because the EC operated in close cooperation and consultation with the IMF and World Bank regarding reform programmes, and this was clear to the Government. IFI staff members confirmed that the EFA's cross-conditionality provided leverage for their own conditions. The grant component in particular increased the authorities' willingness to implement reforms. Finally, especially in the later stages of the operation, monitoring of the EFA structural conditionalities led to more frequent visits of ECFIN staff to Dushanbe. These visits were mutually seen as constructive, and contributed to maintaining the momentum of reform.

On the other hand, the interviews also revealed that most of the Tajik officials in implementing agencies were not aware of the EFA structural conditionalities. This was not surprising given the high level of consultation involved in the EFA operation and the relative lesser visibility of the EC in the country compared with the IMF and WB – especially prior to the set-up of an EC Delegation in Dushanbe. Given this limited awareness, we can generally say that the EFA conditionalities had little political effect on the implementation of specific structural reforms. From the long list of 29 cross-conditionalities, and based on the discussion above, we conclude that only two had a visible political reinforcing effect (see Table 5.12). Delaying the fourth grant tranche because of non-compliance with the conditions on adopting a code of ethics for public servants and carrying out an audit of TADAZ led to strong pressure on the Government to introduce these two conditions.[53]

The operational reinforcement effect
An operational reinforcement effect takes place when cross-conditionality not only provides additional pressure for implementation but also speeds up, deepens or widens

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[53] There were opportunities for a similar reinforcement effect in the case of two conditions linked to the third grant tranche: reduction of tax exemptions and privatisation of medium and large-scale enterprises. These opportunities were not realised as ECFIN decided to speed up disbursement of the tranche rather than insisting on full compliance (considering the conditions as fulfilled and granting a waiver).

the scope of the original conditionality. The imprecise formulation of the cross-conditionalities (see Section 5.2) excluded the possibility of such an effect in the case of EFA in Tajikistan. Nevertheless, it should be mentioned that the formulation of the conditionalities seemed to be a conscious and justifiable choice of the EC. This was because of the exceptional character of the operation (clearance of debt arrears to the EC), lack of adequate monitoring capacities within the EC, the short time period given for implementing the conditionalities under individual grant tranches, and the Tajik Government's limited capacity to implement reform (especially in the early stages of the operation).

Value-added effects

The most evident and strongest net effect on structural reforms is observed in the case of the EC-specific conditionalities (see Table 5.12). Through their uniqueness they have had an added-value effect in the implementation of PFM-related reforms. The relevance of the conditionality related to the IT risk system has been discussed above, and its value added was clearly indicated during the interviews. Therefore, we conclude that EFA conditionality provided an important stimulus for a comprehensive risk management plan that was indispensable for reform of the PFM system. The case study in Section 6.2 concludes that while EFA conditionality related to SFCC independence played a very important role in initiating positive changes, the uncertainty over shifts of direction following recent changes in government administration reduces the significance of the value-added effect.

Table 5.12 Contribution of EFA conditionalities to structural reforms

Conditionality	Comment	EFA net impact
A code of ethics for public servants will be prepared and adopted.	This cross-conditionality was not fulfilled prior to planned release of the fourth grant tranche. No waiver was granted for non-fulfilment and the release of the tranche was delayed, putting strong pressure on the Government to comply.	*Political reinforcing effect*
Audit and restructuring of TADAZ (in accordance with the plan drawn up in cooperation with the IFC).	This cross-conditionality was technically fulfilled. However, the EC recognised the inadequacy of audit claimed by the WB and delayed release of the fourth tranche, putting strong pressure on the Government to comply fully.	*Political reinforcing effect*.
Carry out an IT-related risk assessment and consequently develop a risk management plan at the MoF and NBT.	This *EC-specific conditionality*, which was not part of any other IFI programme, led to concrete government actions.	*Added-value effect*
Independence of the SFCC in line with international standards of auditing.	This *EC-specific conditionality* signalled the importance of the SFCC's independence and put it back on the Government's agenda, although true fulfilment is uncertain because of political sensibility (see discussion in Section 6.2).	*Added-value effect*

Factors affecting the magnitude of reinforcement effects

In general, the magnitude of the reinforcing effects on structural reforms depends on several factors, including:

- the role and presence of the EC in the dialogue with the Tajik authorities;
- the extent of consultation and agreements with the other IFIs to increase the collective leverage of conditionalities;
- the complementarity with EC technical assistance to support realisation of the structural conditionalities and achievement of expected structural reforms;
- formulation of the conditionalities;
- monitoring of the progress in implementing reforms related to the areas of structural conditionalities.

In the case of EFA in Tajikistan, the analysis and interviews indicated that a mix of these factors played a role in the rather low reinforcement effects. It is worth noting, however, that the reinforcing effects were getting stronger in the later stages of the EFA operation. This was because at the beginning of the operation, EC-Tajik relations were in a building-up phase and consequently the consultation between the EC and the Tajik Government on EFA structural conditionalities was somewhat limited. This dialogue became more in-depth towards the end of the operation.

Of most importance in terms of net effect were the EC-specific conditionalities included in the SMoU as a result of the Operational Assessment. The increased net effects towards the end of the operation were also because of improved donor coordination in general, as well as improved coordination between the EC and other donors as a result of the establishment of an EC Delegation in Dushanbe. The limited opportunities for complementarity with other EU instruments are discussed in more detail in Section 5.6. Finally, the reinforcement effect was becoming stronger as the improving debt position allowed the EU to focus more on strict enforcement of structural conditionality.

The general and imprecise formulation of the conditionalities not only eliminated the possibility of operational reinforcement, but also weakened the political reinforcement effects. Another factor affecting the reinforcement effect was the relatively limited direct monitoring of the implementation of the conditionalities. Monitoring took place mainly from Brussels with rather infrequent missions. According to the MoU and SMoUs, the Government had to present periodic reports on implementation of the structural conditionalities. However, the reports submitted by the Tajik authorities were in most cases too succinct and did not provide a full picture of the realisation of the specific conditionalities. Therefore, fulfilment needed to be assessed through review missions as well as by analysing the progress made under the IMF and WB programmes.

Conclusions

The net effect of the structural conditionalities remains relatively limited. Many stakeholders shared the perception of a general EFA reinforcing effect on successful implementation of the IMF and World Bank programmes, through the use of cross-conditionality. In terms of more specific tangible impact, the most evident and strongest net effects on structural reforms have been observed in the case of the two EC-specific conditionalities. Through their uniqueness, these conditionalities have had an added-value effect in the implementation of PFM-related reforms. However, the significance of the

added value regarding the conditionality on the independence of the SFCC is reduced by uncertainties about shifts in direction following recent changes in government administration.

Of the other conditionalities, two of the 29 have had a political reinforcing effect and none an operational reinforcing effect. The magnitude of the reinforcing effects on structural reforms was affected by such factors as: limited active EC presence in the dialogue with the Tajik authorities; lack of EC technical assistance to support realisation of the structural conditionalities and achievement of expected structural reforms; and limited mechanisms for monitoring progress on structural reforms. A more generalised reformulation of the cross-conditionalities led to the absence of operational and weakened political reinforcement effects.

5.6   Impact on complementarity with other EU instruments

To what extent have structural effects been enhanced, if at all, by complementarities between the MFA and other EU instruments?

At the start of the EFA operation in Tajikistan, no other EU programmes/projects were directly supporting implementation of the EFA structural conditionalities. At that time, the EC was providing humanitarian aid to Tajikistan through ECHO. ECHO funding is intended to cope with the immediate aftermath of natural or manmade disasters, as well as conflicts. It is not intended to support structural reforms, and therefore is not relevant for the discussion on complementarity. TACIS and FSP assistance was gradually phased in from 2002-2003. Therefore, complementarity with these instruments became possible in the later stages of the EFA operation.

In 2003-2004, the FSP agenda covered reforms in the areas of public finance management and agriculture, and consisted of budget support and technical assistance. Budget support was conditional on fulfilment of specific structural conditionalities and is therefore relevant to the discussion on complementary with the EFA operation during its whole duration. The area of potential complementarity of the FSP with EFA is land reform. Here, the conditionalities attached to the FSP were not related to the EFA conditionalities except for two, namely:
- Design and implement a country awareness-building campaign on procedures, rights and obligations of the different institutions of land titling. This condition was considered as fulfilled during the mid-term review in July 2003.
- Design a simplified procedure and hand out an additional 20,000 titles for plots based on computerised title registration. This conditionality is considered to be partially fulfilled (8,000 out of a planned 12,000 titles have been produced; procedures need to be further simplified and become more transparent).

Despite the fact that we could not find evidence of a consultation process between EFA and FSP, the implementation of the above conditionalities facilitated implementation of the relevant EFA conditionality (progress with land privatisation) by building up a platform for land privatisation and easing the process in operational terms, thereby speeding up the reforms. Although the last FSP (2004-2006) coincided with the period when negotiations on the fifth grant tranche were taking place, we could not find

evidence of coordination of the conditionalities between FSP and EFA with a view to enhancing the structural effects of both programmes. The EC files make reference to the possibility of including some of the findings of the Operational Assessment in the FSP, but no evidence of follow-up actions could be found.

The only potential areas of overlap between EFA and TACIS would be public finance and privatisation. TACIS projects on privatisation were dealing with such subjects as implementing anti-monopoly regulations, separating policy-making and technical aspects in the aviation sector, and mortgage regulation regarding land privatisation in the cotton sector. In the area of public finance management, TACIS projects were dealing with streamlining the Poverty Reduction Strategy Paper with PIP, developing a strategy for internal control (July 2006) and macroeconomic forecasting. None of this TACIS assistance in public finance management and privatisation, however, coincided with the focus of EFA conditionalities, and therefore discussion on complementarity of EFA with TACIS is irrelevent. In terms of consultation on potential assistance, it should be mentioned that ECFIN discussed with TACIS potential assistance for external audit. Unfortunately, at that time there was nothing that TACIS could do, especially as the National Authority Office (NAO) was already providing assistance to the SFCC under World Bank funding.

Conclusions
There was some complementarity between EFA and the FSP. The FSP's actions in respect of land reform reinforced the EFA conditionalities in this area. However, because of the limited collaboration between the FSP and EFA, complementarity of actions was limited. We did not identify complementarity with other EC instruments.

5.7   Unexpected impact on structural reforms

Has the assistance given rise to any unexpected short and medium-term structural effects? What were they and how did they occur?
Based on the interviews with stakeholders, IMF country reports and World Bank implementation completion reports, we conclude that the MFA did not give rise to any unexpected structural effects.

6 Structural reforms: case studies

To exemplify the impact of EFA on structural reforms, this chapter examines in more detail two case studies on specific structural conditionalities. The case studies were selected based on two criteria:

1. The EFA conditionality should cover a sector or area with (almost) purely 100 percent specific EU conditionality.
2. The EFA conditionality should cover a sector or area with similar conditionality to reinforce an already imposed IMF and/or World bank conditionality.

6.1 Case study A: Restructuring plans for Tajik banks

One conditionality for disbursement of the second and third tranches was: *"following the four main banks, restructuring plans will be drawn up for the remaining Tajik banks (including liquidation of a number of non-viable banks)"*. The IMF and United States Agency for International Development (USAID) were monitoring progress in the area of bank restructuring, the IMF having the lead. The IMF conditionalities for banking sector reform included acceleration of financial sector restructuring and closing of weak banks. The main reform objectives of the WB SAC2 programme in this area focused on improvements in the legal and institutional framework to improve banking and other financial services.

> **Text box 6.1　　　Background to the restructuring of the banking sector**
>
> Reform of the banking sector started in 1997. At that time, there were 33 commercial banks and the years 1997-1998 were characterised by an increasing number of commercial banks. The NBT designed operational restructuring plans for the four major banks in 1998. Regarding the smaller banks, restructuring schemes were agreed with some of them, while many faced problems. Liquidation and specific restructuring measures were taken against those banks that systematically failed to comply with the prudential regulations. In 1999, the process of bank liquidation started under the framework of general liquidation of non-performing enterprises. Small (though stable) banks could not comply with the changes in capital requirements, which resulted in removal of the licence of such banks. In 1999, some eight licenses were removed, and licences later continued to be removed from banks that did not comply with the capital requirements. The consolidation of the banking sector led to a decrease in the number of commercial banks to 10 by the end of 2006. Currently, the majority of banks comply with the prudential regulations on a regular basis.

Structural reform efforts in the banking sector have been successful (progress in the banking sector is described in Section 5.3.4), though there is still a long way to go. This positive development is confirmed by the EBRD index on banking sector reform, which increased from 1.0 to 2.0 over the five years 1999-2004 (see Table 6.1).

Financial sector in Tajikistan

	1999	2000	2001	2002	2003	2004
Asset share of						
- state-owned banks (%)	6.9	6.8	4.8	4.5	6.1	12.2
- foreign-owned banks (%)	60.9	71.9	70.3	1.8	3.6	6.2
Non-performing loans (% of total)	15.8	10.8	12.5	84.2	73.6	18.7
Domestic credit to the private sector (% of GDP)	4.6	11.3	13.6	11.5	10.5	-
EBRD index on banking sector reform	1.0	1.0	1.0	1.7	1.7	2.0

Source: EBRD *transition report 2005, Tajikistan.*

As a result of the restructuring efforts, the number of banks has decreased significantly and the structure of the banking sector has changed (see Table 6.2).

Table 6.2   Banking sector in Tajikistan

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Banks										
State banks	1	1	1	1	1	1	1	1	1	1
Banks with foreign investment capital	6	6	6	6	6	6	6	5	5	6
Foreign banks	1	1	1	1	1	1	2	2	2	2
Commercial banks (non-state banks)	18	10	8	7	6	5	5	4	4	1
Number of banks	26	18	16	15	14	13	14	12	12	10
Other financial institutions										
Number of credit societies	-	-	-	1	2	3	4	5	7	9
Number of non-bank financial associations	-	-	-	-	-	-	-	7	7	1
Number of small credit funds	-	-	-	-	-	-	-	-	20	30
Number of small credit societies	-	-	-	-	-	-	-	-	1	20
Number of small saving and credit societies	-	-	-	-	-	-	-	-	-	5

Source: NBT

The driving factor for restructuring of the commercial banks was the change in capital requirements. The decrease in the number of commercial banks was accompanied by an increase in the numbers of other types of financial institutions, such as credit and savings societies. All the banks are now required to produce annual audit reports on a regular basis within 120 days following closure of the fiscal year. The four large banks publish their audit reports.

Although the progress in banking sector restructuring has been impressive, the impact of EFA was limited by the low intensity of EC dialogue with the NBT. The NBT authorities were aware of the existence of this EFA conditionality, but did not explicitly feel the EC influence on its fulfilment since the NBT was not aware of any EC reporting requirements. The leader in this area was the IMF, to which the NBT was reporting. Therefore, we conclude that the EFA conditionality on restructuring the commercial banks has played no or a marginal *political reinforcing effect* vis-à-vis the IMF conditionalities for the banking sector. As EFA conditionality did not provide for speeding up the implementation of certain IFI measures, or for widening their scope, there was no possibility of an operational reinforcement effect.

Conclusions

The EFA conditionality on commercial bank restructuring has played at most a marginal political reinforcing effect and no operational reinforcing effect vis-à-vis the IMF conditionalities in advancing the restructuring of the banking sector in Tajikistan.

6.2 Case study B: Strategy for developing an external audit function

Developing a strategy on external audit function in the public sector was one of the conditions for release of the fifth grant tranche. This condition was included as a result of the findings and recommendations of the Operational Assessment carried out by the EC in 2004. The objective of the OA was to determine the effectiveness of the framework for sound financial management. The OA identified numerous weaknesses in Tajikistan's financial management systems, and underlined a number of issues that needed to be addressed to further strengthen the internal control environment.

The creation of an independent supreme audit institution in Tajikistan has a long history going back to 2000, when the IMF and WB included such a structural conditionality under their programmes.[54] Since at that time budget implementation and control were under the responsibility of the same institution, the IFIs stated that responsibilities for control and budget implementation should be split. Parliament adopted the Law on the State Financial Control Committee on 17 April 2002. According to this law, the SFCC is the supreme audit institution. The law defines the criteria, frequency and rules for conducting inspections of the activities of enterprises and organisations. This law came into force on December 2, 2002. With the creation of the SFCC, the corresponding conditionality of the IMF and WB was considered as fulfilled, although independence "was not fully complied with". As it stands, the State Financial Control Committee reports to the President only. This can give rise to conflicts of interest as the President is the head of the executive.

The WB decided that, as a next step, parliamentary involvement in oversight would be desirable, possibly through the establishment of an additional audit institution that would

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[54] One conditionality of SAC2 was "the law on the Financial Control Office has been enacted". The IMF had as a structural benchmark (supposed to be fulfilled by the end of June 2001) the following condition: "prepare, in consultation with the staff of the IMF and in line with Annex IV of the Memorandum on Economic Policies of October 2000, a draft law on an independent audit agency and submit to Parliament".

supervise the work of the SFCC and report to Parliament. In 2004, the WB started discussions with the SFCC on a twinning arrangement under International Development Fund (IDF) grant. The IMF urged the authorities to enhance the independence of the agency by considering a five-year fixed-term appointment for the Auditor General.

Discussions on the independence of the SFCC started in 2004, after finalisation of the Operational Assessment carried out by the EC. As a result of the OA, one conditionality for the fifth grant tranche was defined as "develop a strategy on the development of an external audit function in the public sector (i.e. independence of the SFCC)". At that time, no other IFIs had a similar conditionality. To comply with this conditionality, the SFCC initially considered carrying out an international external audit. But since no interested party was found to carry out this task, the idea was abandoned.

Eventually, the SFCC came to an understanding with the WB, which was willing to provide technical assistance to assess the legal framework for the SFCC and carry out a functional review of the SFCC. The British National Authority Office carried out a review of the SFCC under the IDF grant and elaborated an Institutional Development Plan (IDP) in cooperation with the SFCC. As part of this technical assistance, manuals and guidelines were developed, and training and study tours to Hungary and the UK took place. The SFCC sent requests to around 12-20 different organisations to finance activities to finalise the work done by the NAO. So far, no interested party has been found. With the development of the IDP, the EFA conditionality for the fifth tranche was considered technically as fulfilled. As a result of government reorganisations at the end of 2006, the future of the IDP has been put in danger by recent developments.

Following a Presidential Decree on 30 November 2006, new government administrative structures were put in place. As a result, the SFCC was transferred under the President Administration and jointly in a body together with the anti-monopoly agency and prosecution of economic crimes. There are different opinions on how the supreme audit functions will be carried out in the future and to what extent this will affect the current structures and role of the SFCC. Given these recent developments, the future of the IDP and its effects in terms of ensuring the independence of a supreme audit institution in Tajikistan remains uncertain. It should be mentioned, however, that the WB is closely following this issue and has continuous dialogues with the Government. The Government is willing to find a compromise and make the SFCC accountable to Parliament. How the issue will be definitively resolved is not yet clear, however.

Conclusion
The EFA conditionality related to the independence of the SFCC has had a 'potential' *added-value effect* since through this conditionality the independence of the SFCC was directly placed on the Government's agenda, and efforts were made to develop an Institutional Development Plan for the SFCC.

Through its conditionality on the independence of the SFCC attached to the fifth grant tranche, the EC has played a significant role in fostering discussions on and the importance of the independence of the SFCC. This conditionality was initially pursued by the IMF and WB. However, after the creation of the SFCC, little attention was paid to its

independence. The EC was de facto the first to not only signal this issue, but also to include it as a programme conditionality.

Technically, the conditionality has been fulfilled as some actions have been initiated, but real independence has not yet been accomplished. As a result of recent changes in government administration, the future of the SFCC (in terms of its form and scope) as well as its independence remains unclear. This uncertainty reduces the significance of the added value of the EFA conditionality.

7 Design and implementation of EFA

7.1 Introduction

In what way has the design and implementation of the EFA conditioned the performance of the EFA operation in respect to its cost and its objectives?
This chapter describes the impact of the design and implementation of EFA in Tajikistan on the operation's performance in respect of its cost and objectives. The assessment contains a number of observations that might also be relevant for the design and implementation of other future MFA operations.

Section 7.2 presents specific findings on the operation's design and implementation that conditioned the performance of EFA in Tajikistan. Section 7.3 sets out our conclusions and recommendations. They can be seen as input for a meta-evaluation of several MFA operations, with a view to deriving more strategic lessons about the MFA instrument.

7.2 Findings and conclusions

Based on our interviews and review of relevant documents, we have identified the following design and implementation features that influenced the impact of the EFA operation in Tajikistan. We paid particular attention to the way in which general MFA principles were implemented to address the pressing needs of the country.

Exceptional character
The MFA operation in Tajikistan, known as 'Exceptional Financial Assistance', did indeed have an exceptional character. It was designed and implemented because the EC had no alternative instrument to address the country's unsustainable level of debt arrears towards the EC.[55] As a result, several features of the operation did not correspond strictly to the MFA blueprint as described by the Genval criteria and *Vademecum on EC macroeconomic assistance to third countries (Vademecum)*. This issue had profound importance for some aspects of the design and implementation of the operation as described below, and was raised explicitly during the discussions on its extension.

Lack of geographical proximity or strong EC interests
The operation in Tajikistan deviated from strict interpretation of the Genval geographical principle:

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[55] The same comment is relevant to EFA operations in Armenia and Georgia.

> "MFA is in principle reserved for third countries geographically close to the EU territory, which respect democracy and human rights and with which the EU has important political, economic and commercial ties."

Tajikistan is geographically distant from the EU, and the EU had weak economic or commercial ties with the country (although from the Tajikistan perspective the EU was its most important export partner). At the time of the operation's launch, the EC had no permanent presence in Dushanbe and limited specific economic interests. This influenced greatly the way in which the operation was designed and implemented, in particular the choice and effectiveness of structural conditionality.

EFA as debt relief operation

The main objective of EFA in Tajikistan was to solve the problem of the country's debt arrears towards the European Union. This objective was not fully consistent with the nature of an MFA operation as described in the *Vademecum*:

> "MFA is a policy-based financial instrument of untied and undesignated BoP support to partner third countries. It has evolved in recent years to also provide budget support."

While the support for debt repayment is linked to the concept of BoP or budgetary support, it could be much better characterised as a debt relief operation. Also, in economic reality (as opposed to formal wording) the EFA instrument was neither untied nor undesignated. Tajikistan was obliged to use both loan and grant disbursements to pay back its outstanding obligations towards the EC (even if, technically, debt repayment was made before the actual EFA disbursement). The issue of external financial gap was not relevant for the disbursement of grant tranches as they were disbursed in order to make early debt repayment on the new EFA loan, which was not due during the programme implementation period. This special character of the operation meant that prior debt repayment towards the EC was the most essential conditionality for each loan and grant tranche disbursement. Most visibly, no other conditionality was attached to disbursement of the loan and first grant tranche.

Size of loan and grant components

The main objective of the operation explains well the blend of loan and grants. The size of the loan was established at a level enabling Tajikistan to clear its debt arrears towards the EC. The size of the grant component corresponded to the size of debt relief the EC was willing to provide the country. If an additional grant of EUR 10 million proposed in 2004 for possible extension of the operation had been granted, it would have led to additional debt reduction. This would obviously have been beneficial for external sustainability. With the benefit of hindsight, however, it was not necessary as the country nevertheless achieved a sustainable debt outlook by the end of the EFA operation in 2006.

Size of net debt repayment

The size of early repayment was determined as the sum of the grant and agreed net debt repayment. The EC recognised shortly after the start of the EFA operation that Tajikistan was not able to meet the original ambitious (maximum) target for net debt repayment of EUR 4 million per grant tranche mentioned in the MoU. This was because of the

country's extremely precarious financial situation. Consequently, by mutual agreement the amount was reduced to EUR 1 million in subsequent SMoUs. This decision benefited the country during the first phase of the EFA operation by easing the debt repayment burden.

However, our analysis suggests that the country was able to make larger net debt repayments in the second half of the operation when economic growth picked up and budgetary revenues increased as large remittance flows supported the balance of payments. Higher repayments would not only have reduced the EC's loan exposure, but would also have reduced the country's stock of non-concessionary debt. We did not find any indication that the EC considered increasing net debt repayments attached to later grant tranche disbursements.

Number of grant tranches
The country was obliged to make debt repayments in excess of disbursements, so the immediate net BoP impact of disbursements was actually small and negative. Among other consequences, this implied that the number of tranches and timing of their disbursement had no crucial macroeconomic importance, and delays did not constitute a serious problem to financial stability. This meant that the tension between the main macroeconomic objective and the structural reform agenda was not as strong as was the case in some other MFA operations (e.g. Former Yugoslav Republic of Macedonia and Romania). Consequently, the EC could have established more demanding structural conditionality and insisted on strict compliance without risking endangering macroeconomic stabilisation.

Similarly, the choices concerning the number of tranches and total length of the operation were of little importance from the macroeconomic point of view. They could have been selected to maximise the impact of structural conditionalities, based on the trade-off between the intensity of political pressure and its duration. The four-year disbursement period corresponding roughly to the length of a typical IMF PRGF was a good ex ante choice in this respect. Lengthening the actual operation because of delays in disbursements did not have a macroeconomic impact, though it influenced the choice of structural conditionality for the last grant tranches.

Quality of policy discussions
The secondary goal of the EFA operation was to promote the structural reform agenda through policy conditionalities. At the beginning of the operation, effective selection, prioritisation and monitoring of structural conditionalities were very difficult as various obstacles made qualitative policy discussions scarcely feasible. At its launch and during the first three years of the operation, the EC only had a regional presence (Almaty) and no local presence in the country. TACIS and FSP programmes were suspended until 2002-2003 because of security concerns, although humanitarian operations were still active. Security and transport difficulties also meant that missions to the country could only be occasional (usually one per year).

Consequently, the opportunities for policy discussions were limited – normally twice a year during the EC review mission in Tajikistan and during the IMF annual meeting in Washington, or on different ad-hoc occasions outside Tajikistan. The quality of policy

discussion was particularly affected by the fact that EC-Tajik relations were still in the building-up phase in the first years of the operation, and did not yet provide a platform for in-depth policy dialogue. Such a relationship required constant interactions, which were more complicated to establish during occasional discussions. These circumstances largely determined the dominant role of cross-conditionalities, especially at the beginning of the operation, as well as the magnitude of the impact of structural reforms.

Cross-conditionality and EFA visibility
All conditionalities in the first years of the operation were selected from existing IFI programmes. These conditionalities were highly relevant, as documented in Chapter 5. However, the visibility of the EFA conditionalities, as well as their political and operational reinforcing effect, was rather low. This was because the selection and monitoring of specific conditionalities had to be done primarily through IFI programmes and their reviews, with limited opportunities for field research or detailed discussion with relevant stakeholders. As a result, local awareness of EFA conditionalities, especially in line ministries and agencies responsible for the actual implementation of reforms related to the structural conditionalities, was low. Awareness was, however, higher at the political level and also at the Ministry of Finance, which worked directly with the EC.

At the same time, the choice of cross-conditionalities from the IFI programmes had an ad hoc character. Also, as with IFI programmes (particularly the first IMF PRGF arrangement), the number of conditionalities was excessive given the institutional capacities of the country at that time. An additional factor contributing to the low reinforcing effect was the formulation of the cross-conditionalities. Some were a generalisation or synthesis of a number of original IFI conditionalities. This reduced the potential net effects and made monitoring less straightforward and less objective.

Operational Assessment and EC-specific conditionality
From the analysis in Chapter 5, we can conclude that the net effects of the EFA structural conditionalities were stronger during the later stages of the operation. Of particular importance, in terms of net effect, were the EC-specific conditionalities included in the SMoU as a result of the Operational Assessment. The increased net effects towards the end of the operation can be also ascribed to improved donor coordination in general, as well as improved coordination between the EC and other donors following establishment of the EC Delegation in Dushanbe. However, because of the short period of time remaining for completion of the EFA operation, this improvement could not significantly influence the operation's overall performance.

Coordination with other EU assistance instruments
The design and implementation of EFA offered limited opportunities for increasing the role of coordination with other EU assistance programmes in order to improve EFA's performance in terms of its effectiveness and efficiency. When the TACIS and FSP programmes were relaunched, the EFA operation was in its final stages. Consequently, there was no direct or intended complementarity between EFA and other EC instruments except the FSP. However, FSP activities in the area of land reform indirectly reinforced the EFA conditionalities in this area. Optimal complementarity of actions was not ensured, because of the limited collaboration between the FSP and EFA. The complementarity effect in this case was limited to a slight operational reinforcing effect.

Multi-country approach
EFA was the operation addressing the needs of three countries suffering from the same problem of debt arrears towards the EC: Armenia, Georgia and Tajikistan. This multi-country approach saved bureaucratic resources and time since the basic design of the operation was shared across all three countries.

However, this approach complicated policy discussions at EU level at the time of the proposed extension to the operation in 2004. Specifically, one argument cited against programme extension for Georgia and Tajikistan was the existence of major setbacks in EFA implementation because of policy slippages. But these setbacks were specific to the EFA operation in Georgia and did not characterise the operation in Tajikistan. Nevertheless, Tajikistan's lower than originally planned early repayments towards the EC (agreed with the EC at the very start of the operation) were wrongly linked to these slippages. It is worth considering whether the proposal to extend the more successful EFA operation in Tajikistan should have been considered jointly with the extension proposal for the more problematic operation in Georgia.

7.3 Conclusions and recommendations for future MFA operations

Evaluation of the operation in Tajikistan confirmed the majority of recommendations drawn previously from evaluations of other MFA operations. None of these recommendations have been rejected; however, some are not applicable because of the exceptional character of EFA in Tajikistan (see Annex 3 for a systematic review of earlier recommendations).

The new findings on the design and implementation of the EFA operation in Tajikistan are quite specific to its exceptional character and specific country circumstances, such as the absence of local EC presence and the existence of large technical assistance projects in the country at the launch of EFA. Nevertheless, we attempt to generalise some of these lessons so that they can contribute to a future meta-evaluation of several MFA operations, with a view to deriving more strategic lessons about the MFA instrument.

Recommendation I: Maintain the flexibility of the MFA instrument
The EFA operation in Tajikistan proved that the MFA instrument can be used effectively to provide much-needed and timely debt relief to countries in a particularly vulnerable situation. Although the EU could in the future introduce a specific instrument to conduct debt relief operations, maintaining the general flexibility of the MFA to address the wide range of extraordinary situations seems justified. The basic features of the instrument (combination of loans, grants and conditionalities) make it easily adjustable to specific country needs so long as strict interpretation of the Genval principles is not adopted.

Recommendation II: Streamline structural conditionality and intensify the cooperation with IFIs.
Experience of the EFA operation in Tajikistan shows that in cases of low government capacity and weak EC presence in the country, the EC could consider limiting the number and scope of MFA structural conditions to a minimum. In addition, in the absence of EC-specific economic or political interests, the EC could refrain from creating its own

conditionality matrix and include a sole condition related to the IMF programme staying on-track. This could free time and resources to intensify collaboration with the IFIs and better communicate EC support to the national authorities, in order to enhance the political reinforcement impact. Such an approach would contribute to better donor harmonisation (an important principle of the Paris Declaration) and should not imply lower EU visibility, as the IFIs could be expected to regularly use the leverage of EC support in policy discussions.

Recommendation III: Avoid reformulations and generalisations of original IFI conditions
In selecting cross-conditionality, it is advisable to avoid synthesis and generalisation of original IFI conditions as this can lead to lesser net effects and make compliance assessment less straightforward and objective.

Recommendation IV: Secure cooperation among relevant Directorates.
While seeking complementarities between EFA and other EC programmes, it would be especially beneficial if these programmes were implemented simultaneously. Complementarities could also be productively explored when the time overlap between programmes is limited. In particular, systematic discussion on possible follow-up on EFA conditionality by new technical assistance projects or new conditionality could help to reinforce the effects of the EFA operation. Exploring such complementarities requires investment in better information sharing between ECFIN and other Directorates.

Recommendation V: Make use of Operational Assessment as the source of highly relevant EC-specific conditionality
Including some of the recommendations from the Operational Assessment as structural conditionalities under EFA allowed the EC to play a significant if not leading role in some aspects of public finance management reform in Tajikistan. Operational Assessment is particularly useful if alternative public finance management tools are not implemented. Selected findings from the OA which is now regularly conducted at the start of an operation should be included as part of MFA conditionality.

Recommendation VI: Discuss programmes on a country-by-country basis
While multi-country MFA programmes can have many benefits, it is important to have a separate decision-making process for each country to facilitate the unbiased assessment of country needs and achievements.

Annex 1   Historical overview of EFA

Table I.0.1   Historical overview of EFA events

Date	Event
17 November 1997	Council Decision 97/787/EC to grant EFA to Armenia and Georgia
20 March 2000	Council Decision 2000/244/EC to extend the geographical coverage of the operation to Tajikistan
15-20 May 2000	Review mission
October 2000	Third annual arrangement with IMF under a 3-year PRGF in amount of US$ 51 million was approved
15 December 2000	Signing of the Loan Agreement and its MoU by the Tajik authorities
26 January 2001	Loan Agreement and Memorandum of Understanding concluded
March 2001	The loan (EUR 60 million) and the 1st grant tranche (EUR 7 million) released
25-28 October 2001	EU Mission to Tajikistan, negotiations with authorities on implementation of assistance
	1st addendum to the MoU
5 December 2001	1st Supplemental MoU, lays down the structural conditionality for the disbursement of the 3rd grant tranche planned for 2002
December 2001	Release of the 2nd grant tranche
April 2002	PRSP for Tajikistan finalised
17-23 June 2002	Review mission
9-14 December 2002	Review mission
13 December 2002	2nd addendum to the MoU of 26 January 2001
December 2002	Approval of a new three-year arrangement under PRGF by the IMF
December 2002	Release of the 3rd grant tranche
2-3 May 2003	Consultative group meeting for the Republic of Tajikistan
12-16 May 2003	Staff mission to Tajikistan
28 May 2003	2nd supplemental MoU, lays down the conditions for the release of the 4th grant tranche
March 2004	3rd supplemental MoU lays down the conditions for the release of the 5th grant tranche
15-19 March 2004	Review mission
26 March-1 April 2004	Mission to Dushanbe to draft TOR for the AP 2003 project "Support to Civil Service Reform to Tajikistan"
April 2004	Operational Assessment of administrative procedures and financial circuits that relate to the management of the EFA operation in Tajikistan carried out
14-18 June 2004	Review mission
5 November 2004	4th CG meeting
2004	3rd addendum to the MoU
2004	Proposal for extension of the programme for three more years which was later abandoned

Date	Event
11-14 July 2005	Review mission to Tajikistan
13 December 2005	Supplement to the Grant Agreement No ECFIN/D/3(2004)REP/ 50504, prolonging the validity date of the EFA to 31/12/2006
February 2006	IMF completed the 6th (final) review under PRGF Arrangement
2006	The disbursement of the 5th grant tranche is expected in November 2006

Annex 2 International assistance to Tajikistan

European Union

This description of EU relations with Tajikistan with the focus on EU assistance is copied from the European Commission's Delegation to Kazakhstan, Kyrgyzstan and Tajikistan website: http://www.delkaz.cec.eu.int/pr/eng/proj/first.php?a=151

General framework
The legal framework for EU-Tajikistan bilateral relations is the Trade and Cooperation Agreement (TCA) in 1989 between the EU and the former Soviet Union, which was endorsed by Tajikistan by exchange of letter in 1994. Since December 2001, four EC-Tajikistan Joint Committees have taken place in the framework of the TCA dealing with trade, economic and cooperation issues. The Fifth Joint Committee will be held on 24 November in Brussels.

A Partnership and Cooperation Agreement (PCA) between the EU and Tajikistan was signed in Luxemburg on 11 October 2004, replacing the TCA. The PCA will heighten the EC's profile and EU interests in Tajikistan. It will reinforce the country's stability and the fight against drugs and terrorism. The PCA with Tajikistan is the most recent agreement to be negotiated with a CIS partner, and it brings EU relations with Tajikistan into line with relations with the other Central Asian countries. With ratification in 25 EU Member States still to be completed, the new PCA will probably not be fully operational before 2006/2007. Pending its ratification by the 25 Member States, an Interim Agreement on Trade and Trade Related Matters will be implemented. The Interim Agreement came into force on 1 May 2005. A Textiles Agreement, which was amended and extended various times, expired on 31 December 2004.

Main assistance instruments
The main assistance instruments used by the European Commission in Tajikistan are: Technical Assistance for the Commonwealth of Independent States (TACIS), the Food Security Programme (FSP), the Exceptional Financial Assistance (EFA), the European Initiative for Democracy and Human Rights (EIDHR) and humanitarian assistance (ECHO).

Food Security Programme (FSP)
The FSP promotes long-term food security, by improving agricultural productivity and competitiveness, whilst alleviating the impact of transition and reforms. The FSP focuses on the poorest of the population through budget support combined with technical assistance to the Ministries of Agriculture and the Ministry of Social Protection of

Tajikistan. The FSP is also supporting a number of agricultural projects with European NGOs, for which EUR5 m was allocated for 2002-2004. The budgetary support amounts to EUR 7-8 million annually.

European Initiative for Democracy and Human Rights (EIDHR)
The European Initiative for Democracy and Human Rights (EIDHR) was launched in August 2003 with a budget of EUR 300,000 for 2003-2004, to promote human rights, support penal reform and prisoner's rights, democracy and good governance, media freedom, rule of law and security structures (police/armed forces), as well as conflict prevention.

Technical Assistance (TACIS)
TACIS is a European Union initiative, which supports the process of transition to market economies and democratic societies in CIS countries. A dialogue-driven approach to programming better addresses the differing needs and priorities of the partner countries. In line with this new approach, National Coordinating Units (NCU) have been established in the partner countries to participate more effectively into the programming of the EC technical assistance. In Tajikistan, the definition of TACIS priorities takes into account EU/EC's cooperation objectives and the country's own policy agenda, including those set in the Poverty Reduction Strategy Paper.

The core objective of the EC assistance strategy for Central Asia is to promote the stability and security of the countries of Central Asia, to assist in their pursuit of sustainable economic development and poverty reduction. The following priority areas of cooperation have been identified: (1) Support for institutional, legal and administrative reform; (2) Support in addressing the social consequences of transition; and (3) Development of infrastructure networks.

Assistance to Central Asia is guided strategically by the Indicative Programme (IP). The IP 2005-2006 builds firmly upon and continues the approach initiated under the IP 2002-2004 and the corresponding TACIS Action Programmes, stepping up EC assistance for the cooperation between neighbouring countries on justice and home affairs, the energy sector and environmental issues. At national level, the links between assistance and political dialogue in the framework of Partnership and Cooperation Agreements will be strengthened, with particular emphasis on trade and civil service. Poverty reduction schemes will be consolidated in comprehensive medium-term development plans. Complementarities between TACIS and other EC aid will be enhanced, notably with the EC Food Security Programme. The indicative budget for 2005-2006 is EUR 150 million for the five states of Central Asia.

TACIS assistance is delivered via three 'tracks':

- A Regional Cooperation Programme (Track 1) to promote good neighbourly relations and concerted efforts on transport and energy networks, sustainable use of natural resources and the implementation of international environmental conventions, as well as the rule of law. Under the IP 2002-2004, Tajikistan benefits from a number of projects, including border management and drug control (BOMCA/CADAP), support to environmental protection and to global climate change commitments under the

Kyoto Protocol, and a feasibility study for road sections of the Termez-Dushanbe-Sari Tash road;

- A Regional Support Programme Implemented at National Level (Track 2), to further join sustainable economic development and help the Central Asian economies integrate into the world economy. Under the IP 2002-2004, the focus in Tajikistan is on civil service reform, improved customs and border management, support in the implementation of the Trade and Cooperation Agreement, support to the Ministry of Labour and the Statistics Committee, as well as education reform and vocational training;

- A Poverty Reduction Scheme (Track 3) piloted in 2 target regions, the Ferghana Valley and Tajikistan's Southern Khatlon region, focusing on community development for the most vulnerable groups.

As from 2007 EC non-humanitarian assistance will be provided using a new set of instruments including the European Neighbourhood and Partnership Instrument (ENPI) Regional Programmes.

Humanitarian Aid
ECHO, the Humanitarian aid department of the European Commission, provides funding in the immediate aftermath of natural or manmade disasters, as well as in conflicts, with the aim to save lives. ECHO funds European humanitarian organisations, UN agencies and the Red Cross and the Red Crescent Societies.

For the last few years, the following humanitarian sectors have been covered through annual programmes: food aid, nutrition, in particular for malnourished children, agricultural inputs, irrigation works following the 2000-2001 drought, food-for-work projects, medical and pharmaceutical supplies, medical training and health education, drinking water and sanitation.

ECHO intends to phase down its programme in Tajikistan over the period 2005-2007. The exit strategy will not be undertaken without a clear analysis of the situation and the needs. Its process will go in parallel with the development of more sustainable types of assistance by other Commission services and other donors.

In 2003, ECHO launched its first disaster preparedness programme (DIPECHO) for Central Asia, with EUR 3 million allocated to Tajikistan, Kyrgyzstan and Uzbekistan. DIPECHO aims at reducing the impact of natural disasters by strengthening local physical and human resources in high-risk areas. The success of this programme encouraged ECHO to continue funding disaster preparedness activities in the region, with EUR 2.3 million allocated in 2004.

Following the June 2004 torrential rains, which hit Dushanbe and its surroundings, ECHO allocated emergency funding of EUR 350,000 in favour of the affected populations. Between 1992 and 2004, the total ECHO funding to Tajikistan amounted to over EUR 153 million.

Other EC Instruments

Other EC instruments are used to support activities in areas such as mine action and migration. A projects focusing on surveying suspected mine contaminated areas and training of Tajik de-miners and supervisors will be supported by the EC in 2005. Moreover, the EC is a major contributor to the Global Fund against AIDS, TB and malaria. In 2004, a grant of US$ 2.5 million was awarded to Tajikistan by the Global Fund.

Two other projects co-financed by the EC and NGOs support relevant and accessible primary education for children in Tajikistan and promote cross border cooperation in the Ferghana Valley.

IMF and the World Bank

Table II 0.1 presents the total disbursements of WB and IMF support to Tajikistan from 1999 to 2006.

Table II 0.1   IMF and World Bank gross disbursements

	1999	2000	2001	2002	2003	2004	2005	2006
IMF[56] (in million US$[57])	64.1	8.9	24.3	15.5	11.4	11.7	28.6	28.9
World Bank[58] (in million US$)	26.7	25.8	50.0	40.8	20.0	15.3	66.0	30.0

Source: IMF and WB website (see footnotes).

IMF ESAF/PRGF arrangements

Table II 0.3 presents the overview of the IMF programs in Tajikistan. In June 1998 IMF approved a 3-year credit (US$ 128 million) under the Enhanced Structural Adjustment Facility (ESAF) in favour of Tajikistan. On July 2, 1999 the IMF approved a second annual ESAF/PRGF loan and January 2000 successfully concluded the 1st and 2nd reviews under the second year programme. The 3rd review, in March 2000, was not completed favourable because of direct credits of Central Bank to various sectors of economy. The 3rd annual arrangement (US$ 52 million) was approved in November 2000. The IMF-supported programme went off track in the middle of 2001, primarily because of poor progress with structural reform and weak management of external debt, including accumulation of external arrears with respect to the state guaranteed debts and misreporting. IMF concluded that waivers of non-observance of the performance criterion could not be granted, because the problem of misreporting was neither minor nor temporary and Tajikistan had to make early repayments to the IMF.

Between January and June 2002, Tajik authorities implemented satisfactorily an IMF monitored programme which opened the way for a new three-year PRGF arrangement.

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[56]
    http://www.imf.org/external/np/tre/tad/extrans1.cfm?memberKey1=925&endDate=2006percent2D06percent2D30&fin position _flag=YES.

[57]   SDR Exchange rate of 15th of June for every year.

[58]   http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/TAJIKISTANEXTN/0,,menuPK:287289~ pagePK:64030134~piPK:241685~theSitePK:258744,00.html

On 11 December 2002 the IMF approved a three-year arrangement under the PRGF amounting to ca. US$ 87 million to support Tajikistan's economic programme through 2005. Conditionality under the second PRGF arrangement was significantly reorganised. The key structural reforms to be implemented aimed at:

- eliminating weaknesses in the banking sector;
- eliminating distortions in the energy sector;
- eliminating government interference in the agricultural sector; and
- improvement of debt management and fiscal sustainability.

Given low per capita income of Tajikistan, remaining problems of lack of access to financial markets and the probability of financing gaps in the medium term, it seems likely that another PRGF arrangement might be concluded in near future.

Table II 0.2   IMF lending arrangements to Tajikistan, 1996-2005 thousands of SDR

Facility	Date of agreement	Date of expiration or cancellation	Amount agreed	Amount drawn
PRGF Commitments	December 11, 2002	February 10, 2006	65,000	55,200
PRGF Commitments	June 24, 1998	December 24, 2001	100,300	78,280
Emergency Post-Conflict Assistance	December 19, 1997	March 31, 1998	15,000	15,000
Standby Arrangement	May 8, 1996	December 7, 1996	15000	15000

Source: IMF, PRGF 6th Review

The record of compliance with the conditionality under the two PRGF arrangements (summarized in the Tables II 0.3 , II 0.4 and II 0.5) has been mixed. In particular the implementation of the first PRGF arrangement was riddled with problems partly due to the broad and ambitious structural agenda (120 specific measures included in the original programme) that was not best suited for the country with very low institutional capacity. As a result the programme was going off-track in each of the last two years of the first arrangement. The conditionality under the second arrangement was substantially streamlined, what together with stronger domestic ownership resulted with substantially better compliance rates.

Table II 0.3 Quantitative performance criteria in IMF programmes

	ESAF/PRGF June 1999 – March 2000	ESAF/PRGF Sept 2000 – Dec 2001	ESAF/PRGF Dec 2000 – Dec 2001	PRGF Oct 2002 – Sept 2003	PRFG April 2003 – September 2003	PRGF Oct 2003 – March 2004
Quantitative performance criteria						
Ceiling on net domestic assets of the NBT						
Ceiling on NBT's net credit to general government						
Ceiling on net credit of the banking system to general government						
Ceiling on cumulative overall fiscal balance						
General wage, and non working pensioners' pension arrears						
Tax collection of the STC and SCC						
Floor on total net international reserves						
Ceiling on cumulative amount of non-concessional loans contracted or guaranteed						
With maturities of 1 to 5 years						
With maturities of less than 1 year						
Ceiling on the net disbursement of short-term external debt with original maturity of up to and including 1 year						
Ceiling on the contracting or guaranteeing of medium and long term non-concessional external debt with original maturity of more then one year						
New external payment arrears (continuous)						
Indicative targets						
Reserve money						
New arrears of budget entities and key state-owned enterprises to Naftrason, Barqui Tajik and Tajikgas						
Floor on health and education spending						

Ex post evaluation of the EFA operation in Tajikistan

Table II 0.4   Compliance IMF quantitative performance criteria under ESAF/PRGF, 1998-2001

	First annual arrangement		Second Annual arrangement		Third annual arrangement		
	approval	Mid term review	Approval	First and second reviews	approval	First review	Second review
Domestic credit		W	M	M	M	W	M
Credit to Government		M	M	M	M	M	M
BOP/reserve Test		W	M	M	M	M	M
Med/long term ext. debt ceiling		M	M	M	M	M	M
Med/long term ext. debt sub ceiling		M	M	M	M	M	M
Short term debt		M	M	M	M	M	M
No new external arrears		W	W	W	..	M	NM
Fiscal deficit		M	M	NM	M	M	M
General govt. wage, compensation payments and pension arrears		W	W	W	..	M	M
Tax collection of STC and SCC		..	M	M	..	MOD	M
All NBT credit via auctions		..	W	W	..	M	..
Sign sale contracts for all cotton ginneries		..	M	M	..	..	..
Govt resolution on external debt limits		..	M	M	..	..	..

Source: IMF country report 06/63

M= Conditionality was met
NM = not met
MOD = modified
PM = partially met
W = waived

Table II 0.5   Compliance IMF quantitative performance criteria under PRGF, 2002-2005

	First review	Second review	Third review	Fourth review	Fifth review
Net domestic assets of the central bank	M	M	M	M	M
Banking sector credit to Government	M	M	M	M	M
Fiscal deficit	M	M	M	M	M
Domestic arrears on wages and pensions	M	M	M	M	M
Tax collection	M	M	M	M	M
Net international reserves	M	M	M	M	NM/W
Disbursements of short-term external debt	M	M	M	M	M
Disbursement of medium and long-term external debt	M	M	M	M	M
New external arrears	NM/W	M	M	M	M

Source: IMF country report 06/63

M= Conditionality was met
NM = not met
MOD = modified
PM = partially met
W = waived

Among specific areas of structural conditionality in PRGF operations, the banking sector received much attention as reflected by number of conditions attached in programs and the progress in reform has been substantial. SME privatisation was completed rapidly, while large scale enterprise privatisation has been slow. There are doubts about the quality of farm restructuring. There was some progress in implementing structural conditionality to reduce quasi-fiscal activities in energy sector, however it is still high.

The macroeconomic performance under the PRGF programs has been more robust. In particular, programme fiscal quantitative targets have been met throughout the period, often by wide margin. However the persistence of quasi fiscal activities during the first arrangement limited broader efforts at fiscal consolidation. More positively, revenue collection and tax administration improved steadily, although public finance management reform proceeded more slowly than expected. The record of monetary policy has been more mixed. In particular, the NBT was repeatedly issuing the direct credit to state enterprises and cotton industry (especially during the first arrangement) what contributed to the outburst of inflation, exchange rate volatility and caused several delays in programme reviews and many requests for waivers. The situation improved under the second arrangement when explicit restriction on central bank direct credit was strengthened by condition that central bank withdraws form the primary monetary market (credit auctions). However effectiveness of monetary policy is still constrained by a lack of appropriate instruments and weak institutional capacity. Reserve money targets were also jeopardized by the unsterilised foreign exchange interventions by the NBT, that often diverged from PRGF commitment of flexible exchange rate.

PRGF programs by discouraging the government from acquiring (or guaranteeing) new non-concessional loans or accumulating external arrears and by encouraging negotiations with bilateral donors contributed to bringing down the level of indebtedness. However, low debt monitoring capacity led to incidences of misreporting, while the progress in constructing the database of external debt has been slow.

World Bank assistance
World Bank's three previous assistance strategies for Tajikistan were intended to provide support for meeting Tajikistan's immediate post-conflict needs and economic recovery. World Bank assistance, in the form of soft loans, has helped the country rebuild the infrastructure destroyed during the civil war and has supported economic reforms. These reforms, along with the peace agreement, have helped Tajikistan achieve a turnaround in economic growth.

In July 1998 the WB approved the Structural Adjustment Credit (IDA - US$ 50 million). This programme intended to support the Government's efforts to:
1. restore macroeconomic stability;
2. develop the private sector;
3. promote an efficient banking system; and
4. enhance budgetary provisions for health, education, and social safety net. Major benefits of the project include further progress toward sustained stabilization and growth as well as financing imports critical to economic activity.

The WB disbursed in August 1998 the 1st tranche (US$ 20 million) under its SAC1 programme (US$ 50 million). In July 1999, in order to support the Government efforts to deal with effects of the Russian crisis and unexpected export price shocks, the remaining tranche of US$ 30 million was restructured into two tranches of US$ 23 million and US$ 13.7 million.

The SAC2 (IDA-US$ 50 million, grace period=10 years; maturity=40 years) was approved in June 2001. The credit was designed to improve the investment climate and help maintain high economic growth rates which are the main mechanisms to reduce poverty on a sustained basis. It supported the implementation of the first stages of reforms outlined in the Interim Poverty Reduction Strategy Paper (I-PRSP) endorsed by the Board of the World Bank on October 31, 2000. The main areas of the reforms undertaken by the government included:
- public sector management;
- service delivery; and
- budget and expenditure planning.

The credit was also to assist the government in implementing the reform programme in the private sector including policy actions in the financial sector, privatisation and enterprise reform and reforms in the infrastructure sector.

In June 1999 The WB approved the Second Institution Building Technical Assistance Project (credit amount IDA-US$ 6.7 million equivalent, maturity=40 years, grace period=10 years). This project was intended to strengthen the country's public sector management capacity to implement the government reform programme. The credit included consulting services, training, and office technology to help the government reform public administration, enhance budget management systems, and privatise medium and large-scale enterprises.

The World Bank Country Assistance Strategy (CAS) for 2002-2005, the period that coincided with the EFA operation has been focused on improving services to people, fostering private sector development, and continuing the longer term task of building institutions for a market economy. These are medium term goals and the strategy took a medium term perspective, arguing that to achieve results would require five to seven years or longer. The strategy was centred on enhancing the participation of local government and communities in public service delivery, supported by a unified programme of donor assistance. In parallel, support was to be provided to the central government to build and strengthen institutions needed for the country's longer term development. This approach required Government acceptance of local participation in the development process and a high degree of donor coordination and harmonization.

A review of outcomes after implementation of the Country Assistance Strategy in 2005 suggests that while there has been progress (in private agricultural activities, privatisation of state-owned enterprises, financial sector reform, government capacity building, health and education sector strategies, local infrastructure) the approach needed adjusting. The overall development framework did not develop at the planned pace. The government saw the focus on local communities as an NGO-driven agenda disconnected from its primary concern of state-building and enhancing central government capacity. The

analysis suggested therefore that while the goals o f the previous CAS remained valid, a more traditional sector-oriented approach might be needed to demonstrate the value of engaging all levels of government, communities, and donors in the provision of public sector services.

Other donors

The following information about other donors active in Tajikistan is copied from World Bank Country Assistance Strategy:

Asian Development Bank - Total assistance in 2004 was some US$ 25 million. The 2003 ADB CAS supports promoting economic growth through rural development and regional cooperation in areas such as customs modernization, regional energy trade, rehabilitating the transport network.

USAID - The three-year resource envelop for 2007-2010 is estimated at US$ 20 million focused on economic reforms in energy and agro business, democracy and conflict mitigation, health and education.

Islamic Development Bank - Current assistance is approximately US$ 37 million targeted to increasing reliable generation, transmission and supply of electricity and ensuring availability of a year round direct land transport link between western and eastern Tajikistan.

UNDP - During 2001-2004, UNDP's assistance totalled US$ 37 million (including US$ 22 million in non-project grant aid from Japan). UNDP's assistance framework for 2005-2009 focuses on four interlinked thematic areas of improved capacity to prevent and reduce infectious diseases, sustainable agricultural production, management of natural resources, and improved responsibility and responsiveness of the justice system.

EBRD - Since 1996, EBRD has provided US$ 45 million in loans and US$ 8 million in technical assistance. The future strategy of EBRD is geared to supporting small and medium sized enterprises through private sector development and alleviating constraints facing these enterprises especially in the financial sector and selective support for critical investments in infrastructure.

CIDA – Its assistance is aimed at poverty reduction, human security, and economic growth and its programs are concentrated in two areas: (i) agriculture, and (ii) water resource management. Its project portfolio totals CDN$ 34 million.

Aga Khan Development Network - Even though its financial resources may be somewhat limited, its presence and support, most notably in poverty alleviation and capacity building, make it a valuable and trusted partner in development of the country.

Other bilateral programs - The government of Japan provided US$58 million over 10 years from 1993 - 2003, with programs in health, education, infrastructure, preservation of cultural heritage, and capacity building. GTZ with projects totalling US$ 13 million since 1993, and KfW with financial support totalling EUR 10.5 million support programs

in health, education and microfinance. DFID's current assistance totals EUR 2.5 million a year in areas such as micro enterprises, living standards survey, poverty alleviation, and a small grants programme. The Swiss programme totalling CHF 12.5 million focuses on a number of areas such as violence against women and support to mass media, which are critical but not covered by other donors. SIDA's current allocation to Tajikistan totals some US$ 9 million, targeted to health and humanitarian assistance programs.

Table II 0.6   Donor matrix

	World Bank Group		IMF	ADB	EBRD	EU	UN System	GER	Japan	SWISS	DFID	USAID	SIDA	IDB	CIDA	AKDN
	IDA	IFC														
Marco Framework	M		H		H											
Financial Sector		H			H			M		H					L	L
Legal & Judicial Reform	M					M	M			M						
PSD/Investment Climate	H	H			H					M						M
Fiscal Reform	H															
Governance	M	M	M			H	M				H	L				
Agriculture/Rural Development	H	H	M	H		M	M	M			M	L	M	L	L	M
Environment/Forestry	M						M		M	H						
Land Reform	H	H		H			M					L	M			
Power	H	H	M	H					M	H				L		
Transport				L										L		
Oil/Gas																
Water	H				L				M					M	L	L
Telecoms					L											
Urban									M							
Health	H			H		M	H		M	M		L	H	L	L	L
Education	H			H		M	H	M		M		L	M	L		M
Social Protection	M					M										
Labour Market																
Public Sector Mgt.	H		M	M		M				M	H					
Capacity Building	H	M		M						M	M					M

Annex 3   Review of earlier recommendations

Recommendations arising from ex-post evaluations of MFA operations	
FYRoM, Romania, Armenia	**EFA Tajikistan**
Objectives	
The objectives for MFA should be clearly specified and presented more explicitly to all MFA actors involved. Also, the possible hierarchy of objectives should be set out more clearly.	Confirmed (The objectives and their hierarchy have been clearly and explicitly specified what contributed to successful implementation of the operation)
Given the success of the operation in terms of contributing to the short-term macroeconomic stabilisation of the Armenian economy, it is recommended that future MFA operations are more focused on achieving this objective.	Modified (Given the success of the operation in terms of contributing to the short-term macroeconomic stabilisation and medium term external sustainability of the Tajik economy, it is recommended that future MFA operations are more focused on achieving these objectives)
It is recommended that MFA operations focus primarily on supporting a return to macroeconomic stability in the shorter term. EU support to promote medium to longer-term institutional and economic change should be left to other instruments implemented in the framework of the European Neighbourhood Policy.	Non-applicable (There was no conflict between main objective of reducing net debt position towards EU and structural conditionalities, therefore even limited net impact on structural reforms was worth pursuing. At the time of the launch of the programme there were no other instruments to promote medium and longer term structural reforms).
Conditionality	
Conditionality should primarily have directly measurable links with the core objective of MFA, i.e. filling a foreseen residual financing gap.	Confirmed (Selection of conditionalities was relevant to the achievement of the main objective what contributed to successful implementation of the operation)
The choice for cross-conditionality with IMF/WB appears to be logical and pragmatic. However,	Confirmed (The scope and number of conditionalities was too ambitious given the government implementation

Recommendations arising from ex-post evaluations of MFA operations	
FYRoM, Romania, Armenia	EFA Tajikistan
more selective use of cross-conditionality could improve the reinforcing effects.	capacities and EC low monitoring capacities)
A less ambitious and more focused approach with a restricted number of 'critical' structural MFA conditions should be considered, especially when the implementation capacity of a government is limited.	Confirmed (The scope and number of conditionalities was too ambitious given the government implementation capacities and EC low monitoring capacities)
If the EC has explicit preference for more EU-specific conditions within MFA, it should ensure that other EU programmes provide technical assistance to help in the design and monitoring of these conditions.	Confirmed (More support from EU technical assistance programs would lead to more effective structural conditionality, however it was difficult to achieve due to narrow scope of EC activities in the country in the beginning of the operation)
In relation to structural reforms it was recommended that: (a) Structural conditionalities should in the main be focused on reform areas that have a direct and unambiguous link to underpinning macroeconomic stability in the shorter term. In cases where support is provided for reforms that by their nature have to be implemented on a step-by-step over a number of years, or will only give rise to effects over the medium to the longer-term, timescales should be made explicit when conditionalities are established.	Confirmed (Selection of conditionalities was relevant to the achievement of the main objective what contributed to successful implementation of the operation)
(b) Efforts should be focused on ensuring complementarity and coherence of MFA operations with instruments implemented as part of the European Neighbourhood Policy, as well as with possible future budget support operations under the European Neighbourhood Partnership Instrument.	Confirmed (More complementarity with other EU assistance instruments would lead to more effective structural conditionality, however it was difficult to achieve due to narrow scope of EC activities in the country in the beginning of the operation. More attention should be paid to sharing lessons learnt from EFA operation with TACIS and FSP activities that were launched in the final phases of EFA)
(c) When broader ranging conditionalities are considered necessary to support essential reforms in areas that are more intractable/cross-cutting in nature, they should be implemented as early as possible in the operation so that they support subsequent conditionalities aimed at underpinning other reforms that are to some extent contingent upon early reform efforts (i.e. as illustrated by the	Non-applicable (The operation did not include broader ranging conditions)

Recommendations arising from ex-post evaluations of MFA operations	
FYRoM, Romania, Armenia	**EFA Tajikistan**
interlinked nature of corruption, business environment and tax administration reforms in this evaluation)	
(d) Looking forward, structural conditionalities should be formulated in a homogeneous and unambiguous fashion in order to avoid potential misinterpretations or divergences of views regarding their fulfilment.	Confirmed (Synthesis and generalizations in the conditionality formulation made monitoring less objective and less straightforward and contributed to weak reinforcement effects
Management	
It should be investigated to what extent MFA procedures could be made less rigid to allow modification of some terms and conditions within the original agreement (e.g. granting waivers, changing conditions, targets).	Not applicable (No such problems emerged during the implementation of the operation)
When deciding on the terms of MFA, the EC should not only pay attention to its own support, but should also take into consideration the terms of the total support package to a country. This requires timely information to be available about the support programmes of the IFIs and/or other donors.	Confirmed (There was adequate consultation with IFIs what contributed to the success of the programme)
Also, the Commission should carefully consider the necessity of small tranches in the case of support to large economies. Splitting up tranches should be carefully assessed as it might reduce its intended (economic and non-political) effects.	Not applicable (The choices concerning the number of tranches and their size had little importance from macroeconomic point of view <because of use of tranches for debt repayment> and four year disbursement period <corresponding roughly to the length of a typical IMF PRGF> seems adequate to maximize the impact of structural conditionalities)
Close and regular policy dialogue with the authorities in charge of implementing the reform measures is key to ensuring ownership and to monitoring results. The evaluation shows that a greater presence in the field or the direct involvement of qualified staff in the EC Delegations would be necessary to increase the impact of future MFA operations.	Confirmed (The low presence of EC in Tajikistan and low intensity of policy discussion with authorities especially in the first phases o of the operation, limited the potential impact of EFA on the structural reforms in the country)

Annex 4   Sources of information

The main data sources we use are the MoUs, the Council Decisions on EFA, the Annual Reports on the implementation of EFA and other relevant documents. Furthermore we will use documentation on support programs of other donors like IMF, WB, ADB. We further intend to collect statistical data from the State Statistical Office of Tajikistan, the Ministry of Finance, the Central Bank, the IMF and the World Bank.

EC documents

- Council decision providing exceptional financing to Armenia, Georgia and if appropriate Tajikistan, Brussels 03.02.1997, COM(97) 24 final, 97/0028 (CNS);
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Annex 5   Key people interviewed

Table IV 0.1   Key persons interviewed

Organisation	Name	Role/involvement in the EFA operation
European Institutions		
ECFIN	Baudouin Lamine	Country desk officer Tajikistan
ECFIN	Peter Bekx	Former head of unit. Responsible for start EFA in Tajikistan. Participated in review mission in 2000, 2002
RELEX	Joseph Busini	Southern Caucasus and Central Asia: Unit 3: International Relations Officer - Desk Officer Azerbaijan and Tajikistan
ECFIN	Andreas Papadopoulos	Deputy head of Unit, Unit 3: Economic affairs within the Mediterranean countries, Russia and the new independent States. Economic aspects of Neighbourhood policy.
EC Delegation Dushanbe	Frederik Ceune*	TACIS manager (overall TACIS support + links to EFA conditions)
EC Delegation in Almaty	Francois Ruel	First counsellor, regional coordinator for Cooperation, delegation of the European Commission to the republic of Kazakhstan, the Kyrgyz Republic and the Republic of Tajikistan. In Almaty, Active from 2004 until now
ECFIN	Paul Toulet-Morlanne	Unit 4: Horizontal issues and co-ordination of financial assistance. Development policy. Links with multilateral banks, Active from 2004 until now
ECFIN	Sirpa Tulla	Country desk officer end 2001 to end 2003 (Currently at still at DGECFIN managing the MFA operation in Georgia. Currently she is also desk officer for Ukraine)
ECFIN (currently at DGTRADE)	Tom Swinnen	Country desk officer from end 2003 to June 2006.
EC Delegation Almaty	Mr. J.B. Demilito**	Food Security Programme Coordinator
EC Delegation Dushanbe	Barbara Plinkert	Charge d'Affaires a.i., EU office in Tajikistan
EC Food Security Programme	Robert Brudzynski*	Food Security Programme Technical Assistant, Providing assistance to the Ministry of Finance, Ministry of Labour of Social Protection as well as National Statistic Office
EC Food Security Programme	Gerard Deshayes*	Responsible for FSP component dealing with agriculture and land reform since May 2006

Organisation	Name	Role/involvement in the EFA operation
Tajik institutions		
Executive Administration of the President	Matlubhon Davlatov	State Adviser to the President on Economic Policy
Executive Administration of the President	Negmajon Buriev	Head of Economic Reform Division
Executive Administration of the President	Abdulaziz Sharipov	Adviser to the President on Economic Policy
Ministry of Finance	Shavkat Sohibov*	Deputy minister responsible for EFA operation
Ministry of Finance	Rustam Boboev	Head of banking operations union of the Treasury Department
Ministry of Finance	Rakhmon Kurbonov	Head of Audit and accounting department
Ministry of Finance	Mokhinav Kimatshoeva*	Deputy head of the state debt department
Ministry of Finance	Kasim Muminov	Head, External Debt Department, contacted during mission May 2000, currently Deputy Head of the Parliamentary committee on economic, budget, tax and finance Issues
National Bank of Tajikistan	Turakul Hakhnazarov	Head of banking supervision department
National Bank of Tajikistan	Kodirov Bozorcul**	Deputy chief of Monetary Policy and statistic department
National Bank of Tajikistan	Jamshed Yusupov	Head of monetary policy and statistic department
National Bank of Tajikistan	Gafurov Asadulo	Head of Balance of payment department
National Bank of Tajikistan	Sanovbar Boboevna	Deputy Head of Monetary Policy and Statistics Department
National Bank of Tajikistan	Tilohojaeva Zamira	Deputy Head of Banking Supervision Committee
Ministry of Economic development and Trade	Maruf Saifiev	Deputy Minister
Ministry of Economic development and Trade	Bakhronova Tahmina**	Senior specialist of the PIP department of the MOET
State Financial Control Committee	Sharif Mulloev	First Vice Chairman
State Committee of Foreign Investment and State Property management	Israil Nosirov	Head of state property department
Tax Committee	Bahtier Sultanov	Deputy Chairman
Land Committee	Davlatsho Gulmakhmadov	Head
Land Committee	Mahmud Habirov	Deputy Head
Land Centre	Akram Kaharov*	Director
Land Committee	Nusratullo Nozaninov	Head of external affairs department
	Mahmadi Mullaev	Independent Economic Expert
	Rustam Babajanov	Independent Economic Expert

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Organisation	Name	Role/involvement in the EFA operation
International development community		
ADB	Tariq Anwar	Project Implementation Specialist,
EBRD	Fernand Pillonel	Head of EBRD Resident Office, Dushanbe, Tajikistan
EBRD	Pauline Grosjean	Country Economist, EBRD Headquarter, London, UK
IMF	Peter Winglee	Chief of Mission to Tajikistan, 2003-2005
IMF	Francis Kumah	Senior Economist, covered Tajikistan 2002-2004
IMF	Roman Zytek	Senior Economist, Middle East and Central Asia Department, covered Tajikistan 2003-2006
IMF	Alexey Kireyev	Senior Economist, Policy Development and Review Department, covered Tajikistan 2003-2005
IMF	Zuzana Brixiova	Senior Economist, PRGF Division, Policy Development and Review Department, , covered Tajikistan 2005-2006
IMF	Djamoliddin Nuraliev	Adviser to Executive Director (i.e. he is representative of Tajikistan on the IMF Board)
IMF	Luc Moers	Resident Representative
Overseas Development Institute	Verena Fritz	Research Fellow conducting PEFA evaluation as part of World Bank financed project
The First Micro Finance Bank	Jim Egan	Chief Executive Officer
USAID	Carolyn Bryan	Tajikistan Country Director
USAID	Barbara Kaminsky*	Country Leader, technical assistance to Central Bank on Banking supervision, since 2002
USAID	David Martin**	Regional Chief of Party
USAID	Ubaidullo Mirvaidulloev	Project Management Specialist/Economic Growth
World Bank	Sudhee R. Sen Gupta	Senior Development Specialist, Private Sector Development Department
World Bank	Sudharshan Canagarjah	Senior Country Economist for Tajikistan, Europe Central Asia Region, since 2006
World Bank	Sergei Shatalov	Lead Country Economist, Social and Economic Development Department, Middle East and North Africa Region, coordinated work on CIS7 countries at the Bank including debt sustainability analysis
World Bank	Christian Petersen	Lead Economist for South Caucasus, Europe Central Asia Region, before 2003 lead economist for Central Asia, 2000-2002
World Bank	Jariya Hoffman	Economist, Poverty Reduction and Economic Management Unit, Europe Central Asia Region, coordinated several IBTA and SAC2 programs in Tajikistan, since 2003
World Bank	Cevdet Denizer	Country Manager for Tajikistan
World Bank	Utkirdjan Umarov	Economist, Poverty reduction and management unit (WB)

* persons who were interviewed and participated in the stakeholders' meeting

** persons who only took part in the stakeholders' meeting

Annex 6 Methodology for counterfactual modelling

In order to illustrate the macroeconomic effects of the counterfactual (sections 3.3 & 3.4 of the report), the quantitative modelling approach has been used. This exercise is based on a simple model recognising the key linkages and ensuring consistency among four economic sectors: real, external, government and banking. The structure of the model is very similar to the one used in evaluations of MFA operations in Romania and FYROM.

The model has been calibrated using annual IMF data available through IMF International Finance Statistics (IFS), IMF Country Reports and in some instances data from National Bank of Tajikistan and State Statistical Office of Tajikistan. The quality and internal consistency of the available data is problematic, forcing us to rely primarily on dynamics of macroeconomic variables rather than levels.

The major objective of the model is to derive consistent alternative scenarios of main macroeconomic variables in the counterfactual scenario of no EFA operation constructed on the basis of assumptions formulated in sections 2.5 and 3.3 of the report.

Key features
The absence of the EFA affects the economic system though three main channels. First, there is a direct impact on the balance of payment in the year of disbursement. The second channel of impact operates through budgetary accounts as the absence of the EFA implies higher debt service expenditures and thus lower non-debt expenditures, higher budget deficit or an adjustment on the side of budget revenues. Third, the combination of changes in net foreign assets and credit to the government translate into money supply changes and consequently alternative inflation scenario.

Differences from the actual scenario
All channels described above are explicitly modelled to capture differences between counterfactual and actual scenarios. The model is linear and accordingly, most equations used in the model describe the difference between counterfactual and actual values of variables. For example, the equation for a variable X that is determined by some two other variables Y and Z typically takes a form:

$$DIF(X) = F[DIF(Y), DIF(Z)]$$

where DIF (…) denotes the difference between counterfactual and actual values of a variable and F[] is a function (identity or behavioural equation as discussed below) . The advantage of such specification is the strong focus on variability related to the EFA intervention and the straightforward interpretation of obtained results in terms of net

impact of the intervention. Also, it allows for overcoming problems related to breaks in the historical macroeconomic series making the comparison of levels of variables infeasible.

Identities and behavioural equations
Two major types of equations are used in the model: identities and behavioural relations.

Identities are equations that must hold by definition to ensure accounting consistency (e.g. balancing balance of payment, financing budget deficit, equating assets and liabilities of the banking sector). The only necessary assumption in simulating the counterfactual in case of identities is the determination of size of adjustment of each of the variables entering the identity in response to a given shock. Often this choice is conditional on policy response or external factors and assumptions in this respect are based on information gathered during interviews with policy makers, analysts and advisors in Dushanbe, Washington and Brussels.

In case of behavioural relations (e.g. determinants of GDP growth, inflation and imports), their functional forms are designed to best reflects the economic impact that should take place according to the economic theory, ideally confirmed by available statistical evidence and taking into account limitations in data availability and quality. The modelling assumption involves the choice of the variables that are best in explaining dynamics of an independent variable and in quantification of the size (elasticity) of the impact. The elasticity can be calibrated or assumed depending on available evidence from Tajikistan and other similar economies.

Although the model consists of larger number of equations, we describe below three most important identities and three behavioural equations that are at the core of the simulation of the counterfactual.

Budget identity
The first core identity used in the formulation of the counterfactual describes budgetary accounts. The stylised version of this equation is given by

DIF (non-debt gov expenditures) – DIF(gov revenues) = DIF (EFA loans & grants + other Deficit Financing items + EU debt repayment)

From the perspective of the budgetary identity the counterfactual scenario without the EFA assistance implies higher net debt repayments to the EU. In order to balance its books, the government needs to adjust its other expenditures program and/or revenue collections and/or identify alternative sources of deficit financing. In this respect, the counterfactual is fully determined by availability of alternative sources of financing and policy decisions about fiscal tightening. Following the discussion with IFIs and Tajik government officials we assume unchanged budget revenues, with an adjustment taking place through non-debt expenditure cuts (80% of the necessary adjustment) and somewhat higher budget deficit (20% of the adjustment).

BoP identity

The second essential equation necessary for establishing the counterfactual is the identity describing the balance of payment. Below we show stylized version of actual equation that illustrates the character of modelling choice in determining the type and strength of BoP response in the counterfactual scenario.

DIF (CA items) + DIF (EFA loan + other KA items) = DIF (reserve accumulation)

where DIF is the difference between counterfactual and actual value as defined before, CA is current account and KA is capital and financial account. The absence of the disbursement of the EFA and higher debt repayments are reflected as a drop in capital and financial account. As balance of payment has to balance ex post, and resulting tighter BoP constraint must lead to adjustment in other items. Specifically, we assume that 60% of the necessary BoP adjustment takes the form of lower accumulation of foreign reserves in the counterfactual. The rest of the adjustment takes place through current account items, primarily through the slowdown of imports.

Banking sector balance sheet identity

The third core identity describes the accounts of the banking sector. This stylised presentation illustrates key linkages with balance of payment situation that determines through series of auxiliary identities the net foreign assets (NFA), and budgetary accounts that determine the size of credit to the government (NDC government), with adjustment in other items of net domestic assets (NDA) determining the change in money supply.

DIF (NFA) + DIF (NDC government) + DIF (NDA other) = DIF (Money Supply)

In the counterfactual scenario, the assumed adjustments to lower foreign reserve accumulation and higher net domestic credit to the government lead to an increase in the money supply.

Real sector behavioural equations

The set of core identities described above, together with other auxiliary equations constitute the logical framework of the model and indeed produces majority of the presented results. However, in order to quantify the impact of counterfactual arrangement on the real sector, behavioural equations have to be introduced. This is a challenging task since the character and strength of the linkages from balance of payment, fiscal and monetary developments to real sector is highly speculative – neither standard theory, nor available econometric literature provides precise insights about the size of these effects. Due to short time series and structural breaks it is also not possible to properly estimate relevant elasticities. Therefore, elasticities are selected within the range typically found in other countries or assumed in similar models. They thus reflect economic common sense supported with very crude estimation techniques.

The first central behavioural equation predicts real GDP growth rates under the counterfactual scenario. The major impact mechanism here is related to government consumption and investment expenditures.

DIF (real GDP growth) = F[DIF (government expenditures), DIF (net domestic credit to private sector)]

The second central behavioural equation that predicts counterfactual inflation rates is based on the standard theory of inflation, where price increases are related to money stock and real incomes – in the specification below, additional inflation in the counterfactual is determined by the additional money growth and additional GDP growth. Such a specification is typically found to be relatively robust in explaining the money – inflation nexus, at least in the long run, reflecting the famous insight by Milton Friedman that 'inflation is always and everywhere a monetary phenomenon'.

DIF (inflation rate) = F[DIF (money growth rate), DIF (real GDP growth)]

The last equation is the reverse of the import demand equation that allows deriving nominal exchange rate response in the counterfactual that is consistent with the import development (as predicted by the BoP identity) as well as real GDP and price dynamic (as predicted in two equations above).

DIF (exchange rate) = F[DIF (inflation rate), DIF (imports)]

Sensitivity analysis
Tables in the main text of the report present point estimates of potential impact of the EFA intervention that are related to the model specification and assumed parameter values. Given the intrinsic uncertainty related to the model and data, interpretation of results should be concentrated on signs and relative size of effects, rather than on particular numerical values. Nevertheless, the qualitative results are quite robust to modifications in the parameter values within the reasonable range, in particular net effects remain small for virtually all plausible parameters.