I. Project Context

Country Context

Prior to the 2008-09 global financial crisis, Tajikistan had been enjoying a period of sustained economic growth. The economy grew at an average of 8 percent per year during 2000-2008. This growth was driven mainly by a favorable external environment. World prices for cotton and aluminum, Tajikistan’s main export commodities, soared. Rapid growth in Russia and other trading partners boosted demand for Tajik labor. The resulting growth in remittances fueled a consumption boom in Tajikistan, which helped to support buoyant growth in GDP during the 2000s.

However, this period of buoyancy masked the build up of severe macroeconomic imbalances which were unveiled at the end of 2007. The fiscal position was weakened by an increase in external borrowing from bilateral creditors to finance large infrastructure projects (the fiscal balance shifted from a surplus to a large deficit of 6.2 percent of GDP in 2007), while supply side shocks (a steep rise in global fuel and food prices in the second half of 2007 and first half of 2008) and the growth of aggregate demand (fueled by expansionary monetary policies) led to a spike in inflation and the widening of the trade and current account deficits. At the end of 2007, the National Bank of Tajikistan’s (NBT) international reserves fell below two weeks of imports; the money supply nearly tripled, and inflation accelerated to nearly 20 percent.

Despite an International Monetary Fund (IMF) economic stabilization program and a temporary improvement in macroeconomic performance in 2008, Tajikistan’s economy remained weak and suffered significantly from the 2008-09 global financial crisis. Under an IMF and a Poverty Reduction Growth Facility (PRGF) program, and the backdrop of increasing commodity prices, the economy grew by 8 percent in 2008, inflation receded to 12 percent by end 2008, and the current account deficit declined to 8.8 percent. However, these successes were short-lived as the global financial crisis led to economic stagnation in 2009 and a steep exchange rate depreciation, as a result of a sharp drop (of 30-50 percent compared to 2008 levels) in remittance flows (resulting from Russia’s recession and the consequent depreciation of the ruble), a deterioration in terms of trade. This led to an increase in the current account deficit to 12.6 percent of GDP in 2009, and a reduction in foreign direct investment and trade-related finance.

While Tajikistan’s economic prospects have improved after the global financial crisis, severe structural weaknesses continue to depress the country’s longer term growth and poverty reduction prospects. Economic performance began improving gradually in 2010, as demand and trade recovered and the government’s anti-crisis action plan was successfully implemented. However, Tajikistan continues to face important structural challenges. Among these is the fact that Tajikistan is one of the least accessible countries in the world. Its remote, landlocked location, together with a deteriorating infrastructure, high input costs, and weak regulation pose barriers to international trade, connectivity, and investment. Tajikistan is also faced with a young and rapidly growing population making job creation a key policy priority. The average annual growth rate of the population was 1.9 percent during 2003-07, and 40 percent of the population is under the age of 17. Limited employment opportunities in Tajikistan have encouraged a large number of workers (up to 40 percent of the working population) to seek better job prospects overseas. It has also led to a high incidence of poverty (Tajikistan is the poorest country in Eastern Europe and Central Asia (ECA), with an annual per capita income of US$30 in 2010 and 47 percent of the population in poverty by national standards) and food security concerns.

The Tajik government has set, in its Poverty Reduction Strategy Paper for 2010–12, an ambitious target of doubling GDP in a decade. To do so, the government has implemented a number of recent reforms aimed to enable the country to benefit from a growing global and regional economy (see later), although recognizing that Tajikistan still has a significant unfinished reform agenda. With a less favorable external environment than in the years prior to the global financial crisis, it has become critical for the government to accelerate reforms to meet its ambitious growth target.

To sustain the post crisis recovery and support long term economic growth and poverty reduction, Tajikistan needs to improve its productive capacity and develop the private sector. The 2010 Country Economic Memorandum(CEM) for Tajikistan indeed notes that Tajikistan’s biggest challenge in the coming years will be lifting its low rates of private investment. Tajikistan needs indeed to better capitalize on its natural resources to enhance its competitiveness. At the same time, Tajikistan needs to diversify its economy so as to decrease its reliance on imports,
and its dependency on commodity prices. Developing the private sector would also contribute to job creation and poverty reduction. However, the CEM notes that to achieve this, a better investment climate is required.

II. Sectoral and Institutional Context
At present, Tajikistan experiences a low level of private sector activity: the private sector constitutes a relatively low share of national output and employment, even by regional standards. In 2008, Tajikistan’s private sector contributed 48 percent of total GDP, relative to 75 percent in Kyrgyzstan and 77 percent in Kazakhstan. The private sector’s contribution to total employment the same year was even lower (at 31.4 percent), despite consistent growth since 2000. Total investment, dominated by public investment, has hovered at around 20 percent of GDP, while private investment has stagnated at around 5 percent of GDP, the lowest rate in the ECA region. Gross fixed private capital formation in Tajikistan was 4 percent of GDP in 2009, compared to the average of 15.8 and 17.2 percent in low-income countries and ECA region, respectively. The limited economic contribution of the private sector in Tajikistan reflects, inter alia, the wide range of remaining obstacles in the investment climate that continue to prevent enterprise investment and growth.

Overall, it is clear that the business environment in Tajikistan is not conducive to the development of the private sector due to a number of constraints faced by enterprises. Results of the various studies conducted on the business environment in Tajikistan are largely consistent with one another. For instance, the 2010 CEM noted that the combination of strong regulation and weak enforcement creates significant opportunities for rent-seeking by public officials, while the BEEPS survey concludes that corruption in interactions with public officials comprises one of the top constraints for private businesses in Tajikistan. Tajikistan’s low Doing Business results for the Starting a Business indicator are consistent with the findings of Tajikistan’s 2010 CEM which notes that Tajikistan’s low image for investors as a place to start and operate a business is a major deficiency for attracting investment and stimulating growth in a country that does not have a big domestic market and is not close to large markets. The BCB’s results are mostly consistent with the BEEPS findings. The most-frequently mentioned obstacles to doing business according to the BCB are high tax rates and high loan costs which effectively limit access of enterprises to finance, while the BEEPS survey also lists tax issues and access to finance among the top four constraints. According to the IFC SME Survey (2008), interest rates were also cited as the primary reason for SMEs not applying for a loan.

Constraints in the business environment prevent the emergence of a thriving private sector, even in sectors where Tajikistan has a competitive advantage, such as mining. Tajikistan has a rich geological potential, but the mining sector has not yet taken off in Tajikistan and its mineral sector potential remains largely untapped. The sector is currently dominated by small operators and artisanal miners that are not well positioned to take advantage of the global mining investment boom.

Tajik laws and regulations that control business activities are a great hindrance to entrepreneurs in the mineral sector. Drafting of the legislation has been dominated by outdated Soviet philosophy which provides for significant government control and makes Tajikistan uncompetitive relative to other exploration expenditure destinations. The competition comes not from other CIS countries who suffer from a similar throwback philosophy, but rather from emerging countries in South America, Southeast Asia and Africa which have business regulations much more conducive for entrepreneurs.

In addition to constraints arising from shortcomings in general business regulations, the mining sector faces other constraints due to the specific nature of the sector. For instance, there is no law specific to minerals and the legal and regulatory responsibilities pertaining to the sector are spread over a large number of agencies, resulting in long time lags between requests by the private sector to advance on mineral projects and the time when all the necessary approvals come through. In addition, geological data are very difficult to access, greatly dissuading new entrants to the sector. Due to these challenges, Tajikistan is presently not well positioned to take advantage of the global mining investment boom without a significant transformation of the operation of its mining sector.

III. Project Development Objectives
The development objective of the project is to remove key constraints to business development and investment by: (i) simplifying business registration and construction permitting processes; (ii) improving regulations and infrastructure underlying access to financial services; and (iii) encouraging development of the mining industry, where Tajikistan has a competitive advantage.

IV. Project Description

Component Name
Strengthening the business environment
Encouraging the development of the mining industry

Project Management

V. Financing (in USD Million)

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<td>Total</td>
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VI. Implementation
The SCISPM will be the implementing agency for the project. The SCISPM has prior experience in implementing World Bank-financed projects, as it was the implementing agency for the World Bank IDF grant in the past few years. Project activities will be managed by a PMU that has been established within the SCISPM as dedicated division. One procurement expert and one FM expert from SCISPM’s International Relations Department have been appointed as PMU staff. In order to strengthen the capacity of the PMU and ensure appropriate segregation of duties, the project will also finance additional procurement, FM, and technical consultants. Fiduciary aspects of the project will be managed by the PMU.

Day-to-day management of the project will be assured by a team of project coordinators representing all implementing partners (e.g., SCISPM,
A high-level Project Steering Committee (PSC) with representation from all counterparts and/or their ministries will be established to oversee the project implementation. Specific roles and responsibilities include:

- **PSC:** The PSC will be established to ensure adequate participation of all beneficiary institutions. The PMU will work under the overall guidance of a PSC composed of members of the main agencies benefiting from the project (e.g., the SCISPM, the NBT, Ministry of Energy, State Tax Committee, and the Geological Survey, among others). The PSC will be chaired by the Chairman or Vice-Chairman of the SCISPM. The scope of work of the PSC will include: (i) strategic guidance for overall project implementation; (ii) development and approval of annual plans for project activities, project budget, and procurement plan; (iii) coordination and consensus building on key policy issues related to implementation; and (iv) monitoring of broad issues related to the implementation of reforms.

- **PMU:** The project currently does not yet fully meet the minimum requirements but upon meeting the two conditions of the effectiveness, the PMU will satisfy the Bank's fiduciary requirements and financial management operational policies. The PMU will be responsible for day-to-day management of the Project activities, including procurement, disbursement, reporting, accounting, and auditing, and M&E. The PMU has developed a draft Procurement Plan and a draft Project Operational Manual (POM).

- **Project Coordinators:** The implementing partners will appoint Project Coordinators to be responsible for defining the tasks under each component and preparing technical TORs for contracting needs. Project coordinators will remain with their respective agencies, but will be responsible for the coordination with the PMU. The TORs will be reviewed for quality by the PMU, which will proceed with competitive contracting and selection ranking procedures, using a panel of appointed experts and appropriate tender/selection committees.

### VII. Safeguard Policies (including public consultation)

<table>
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### VIII. Contact point

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