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THE WORLD BANK

Tajikistan

Policy Notes on Public Expenditures

Policy Note No. 6 Capital Expenditures and Public Investment Management

Report No. 89184-TJ

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Capital Expenditures and Public Investment Management

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Poverty Reduction and Economic Management Unit
Europe and Central Asia Region

THE WORLD BANK
Washington, D.C.

REPUBLIC OF TAJIKISTAN
Government Fiscal Year: January–December

Currency Equivalents
(Exchange rate as of June 16, 2014)
Currency Unit = Tajikistan Somoni
USD 1.00 = TJS 4.9237
TJS 1.00 = USD 0.2031

Weights and Measures
Metric System

Abbreviations and Acronyms

ADB	Asian Development Bank	*MABA*	Main Administrator of Budgetary Allocations
BOOST	World Bank public expenditure database and analysis tool	*MoEDT*	Ministry of Economic Development and Trade
CAD	Current account deficit	*MoF*	Ministry of Finance
CSIP	Centralized State Investment Program	*MTEF*	Medium-Term Expenditure Framework
DSA	Debt Sustainability Analysis	*OECD*	Organization for Economic Co-operation and Development
EBRD	European Bank for Reconstruction and Development	*PEFA*	Public Expenditure and Financial Accountability Assessment
ECA	Europe and Central Asia	*PER*	Public Expenditure Review
FDI	Foreign Direct Investment	*PFM*	Public Financial Management
GBAO	Gorno-Badakhshan Autonomous Oblast	*PIM*	Public Investment Management
GDP	Gross Domestic Product	*PIP*	Public Investment Program
GFS	Government Finance Statistics	*RRS*	Rayons of Republican Subordination
IMF	International Monetary Fund	*SOE*	State-Owned Enterprise
KMK	*Khochagii Manziliyu Kommunali* (public utility enterprise)	*TARP*	Tax Administration Reform Project
LSIS	Living Standards Improvement Strategy	*UCOA*	Uniform Chart of Accounts
MDG	Millennium Develop Goals	*UNDP*	United Nations Development Programme

Vice President	Laura Tuck
Country Director	Saroj Kumar Jha
Country Manager	Marsha M. Olive
Acting Sector Director	Roumeen Islam
Sector Manager	Ivailo V. Izvorski
Task Team Leader	Marina Bakanova

Contents

List of Figures

List of Tables

List of Boxes

List of Annexes

Preface

At the request of the government of Tajikistan, the second stage of the Public Expenditure Review (PER-2) continues to support it in analyzing public spending, fiscal management, and fiscal risks and making recommendations. PER-2 consists of three policy notes: *Key Issues in Public Finance Management, Fiscal Risks from State-Owned Enterprises*, and *Capital Spending and Public Investment Management*.

PER-2 continues the fiscal policy dialogue conducted in FY12–13. It builds on the findings of the three PER-1 Public Expenditure Review Notes completed in FY13: *Government Expenditures: Size, Composition and Trends; Review of Public Expenditures on Health*; and *Review of Public Expenditures on Education*.

This note was prepared by a World Bank team comprised of (in alphabetical order) Marina Bakanova (TTL, ECSP1), Karen Stephanie Coulibaly (Consultant, ECSP1), Iryna Shcherbyna (Public Sector Specialist, ECSP4), and Ravshan Sobirzoda (Economist, ECSP1). Hassan Aliev (Public Sector Specialist, ECSP4), Dilshod Karimova (Procurement Specialist, ECSO2), Rouselle Lavado (Economist, ECSH4), Pier Mantovani (Lead WSS Specialist, ECSUW), Yuri Miroshnichenko (Senior Energy Specialist, ECSEG), David Nummy (Senior Public Sector Specialist, ECSP4), Yarissa Sommer (Urban Specialist, ECSUW), and Zuhro Qurbonova (Consultant, ECSP1) made valuable contributions. Nasiba Saidova (ECCTJ) and Sarah Babirye (ECSP1) supported the team.

The peer reviewers were Chiara Bronchi (Lead Public Sector Specialist, AFTP5), Frederico Gil Sander (Senior Economist, EASPT), and John Zohrab (Regional PFM Advisor, IMF). The team benefited from the guidance and advice of Ivailo V. Izvorski (Sector Manager, ECSP1), Adrian Fozzard (Sector Manager, ECSP4) and Marsha M. Olive (Country Manager, ECCTJ). This note also reflects comments from the World Bank and the International Monetary Fund colleagues made in internal presentations and informal discussions.

The team is grateful to the Tajikistan authorities for their collaboration and input during the preparation of the PER-2. The team is particularly grateful to the Ministry of Finance for facilitating the overall coordination of the work from the Government side. The work was coordinated with and benefitted from the continuing technical assistance that is part of the public financial management project.

Support of the ECA regional BOOST initiative, financed by trust funds from Bank-Netherlands Partnership Program and the ECA Public Financial Management Multi-Donor Trust Fund, is gratefully acknowledged.

1. Main Messages

1. **Tajikistan spends over one-third of the general budget on public investment but there are significant inefficiencies in allocation and implementation of capital budgets.** Capital expenditures averaged over 10 percent of GDP for 2010–13—higher than in most ECA countries and above the spending of many countries with comparable income per capita. These significant public resources are scattered on small and poorly prioritized projects that take a long time to complete; they are not used efficiently to ensure that investments are aligned to national priorities and contribute to economic growth and poverty reduction.

2. **The country's investment needs are considerable but fiscal space is likely to continue to be extremely tight given high global and regional uncertainties and fragility of domestic economy.** Given debilitated infrastructure and social and demographic developments, the pressure on total public spending, especially capital spending will intensify even as the fiscal space narrows. Despite some improvements, fiscal and debt positions are fragile given Tajikistan's remittances-driven growth model, narrow export base, high dependence on concessional financing, large infrastructure needs (including in social sectors), and risks generated by state-owned enterprises (SOEs). The country is extremely vulnerable to external shocks, and its ability to dampen shocks is limited not only because its external and fiscal buffers are low but, more importantly, because of its weak institutions and governance.

3. **Tajikistan will find very challenging to sustain its current capital spending rate; policies now should be directed to making its capital spending more efficient while creating an attractive environment for private investment.** What is critical is that the government ensures that its spending is efficient, funds are channeled to high-return investments, and the significant amounts of public investment translate into correspondingly productive assets. Increasing the efficiency and transparency of public capital spending is also vital if Tajikistan is to address the challenge of very low private investment in the country and thus overcoming a binding constraint on future growth.

4. **Improving public investment management has high priority on the PFM reform agenda, which is directed to improved public service delivery.** The Government of Tajikistan has moved to reform PIM. Elements of strategic planning and medium-term expenditure framework (MTEF) have been introduced in recent years. The Program of Public Investments, Grants, and Capital Construction has been made a core medium-term strategic planning tool. Meanwhile, medium-term budget planning is ensured through three-year budget requests that cover capital spending and the needs of public investment projects.[1] Resolutions establishing procedures for public investment have created bases for development of the PIM system.[2] Yet much more still has to be done to make public spending more efficient and heighten value for money in public investments.

1 Ministry of Finance. *On Preparation of the Draft State Budget for 2014 and Budget Forecast 2015–16*.
2 Government Resolutions No. 385, September 11, 2000; No. 370, 1 August 201; and No.483, October 4, 2011.

5. **This note proposes reforms to reinforce public investment policies and institutions and to achieve better outcomes for Tajik public capital spending.** According to the main findings related to the current PIM system weaknesses, the proposed main areas for reform are the following[3]:

- **Provide for legislative and regulatory reform to ensure that strategic planning of public investments is realistic and consistent with the budget.** Reform should be based on a clear definition of what constitutes a public investment project; delineation of the power and responsibilities of all stakeholders; and identification of key elements of the PIM that are made legally enforceable.

- **Heighten the quality of new projects by better preparation and project appraisal.** The higher requirements should be applied to large and strategically important projects; procedures might be simplified for medium and small projects. The definitions of a public investment project and a construction object should be differentiated clearly. It is advisable to use a programmatic approach and combine identical entities where possible into one investment project.[4] This will reduce the number of small and ineffective projects and concentrate financial and human resources on strategically sound projects.

- **Improve the selection of new projects and ensure continuity of funding for current projects.** It will be vital to eliminate the duplication of project selection functions between the Ministry of Economic Development and Trade (MoEDT) and the Ministry of Finance (MoF) so as to increase selection objectivity and make it easier to prioritize projects. Bringing new projects into the budget consistent with the fiscal space available after allocations for efficiently moving active projects forward would improve efficiency by reducing delays due to interrupted funding.

- **Systematically monitor project implementation and introduce ex-post evaluation to ensure more value for money from public investments.** This will provide information on both financial and nonfinancial matters that could be analyzed to contribute to making coming public investments more effective.

- **Establish the legislative and capacity basis for gradual de-concentration of local capital spending to ensure that local authorities are more responsible and accountable in dealing with public investments.** This will also significantly reduce national information flows by abolishing selection of small construction projects and allow central authorities more opportunity to concentrate financial and human resources on strategic projects.

6. **The proposed reforms need to be sequenced to take into account implementation capacity and expected benefits.** The initial focus could be on strengthening monitoring system for projects under the implementation and pipeline; this would help better budget forecast and appropriations. To ensure continuity and consistency, no new project should be approved if a certain number or volume of investments is under implementation. Rationalization of regulations and procedures and clarification of the roles of the MoEDT and MoF could be completed over the medium-term. In the long term, clear assignment of budget responsibilities to different levels of government and

3 The format of the Note did not allow for full application of the special PIM diagnostic tool ("A Diagnostic Framework for Assessing Public Investment Management", World Bank Policy Research Working Paper No. 5397, 2010). However, the assessment is based on analysis of the key elements in the lifecycle of any investment project that create an effective PIM system.

4 For instance, construction of schools for one oblast or specific rayon.

building local capacity in PIM would allow to de-concentrate local capital spending. In the longer term, a system of ex post evaluation would leverage the experiences of past projects to inform identification and implementation of follow-up projects.

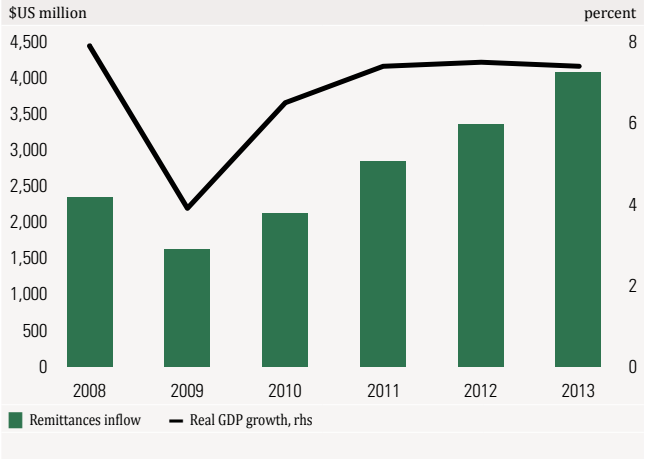
7. **The rest of the note is organized as follows.** Chapter 2 sets a macro-fiscal context for the analysis with a particular focus on fiscal policy challenges. Chapter 3 analyzes the composition and trends in capital expenditures to identify issues and offer solutions for improving efficiency of capital spending. Chapter 4 reviews a Public Investment Management process in Tajikistan to identify weaknesses in the capital budgeting cycle—planning, budgeting, implementation and audit—and to recommend measures and remedies to address the shortcomings in these processes. Chapter 5 provides conclusions and detailed recommendations. Annexes provide additional information on data issues and on the structure of domestic and externally financed public investment programs. The work has been closely coordinated with and benefitted from the on-going TA under the PFM project.

2. Macro-fiscal Context

A. Recent Economic Performance and Macroeconomic Prospects

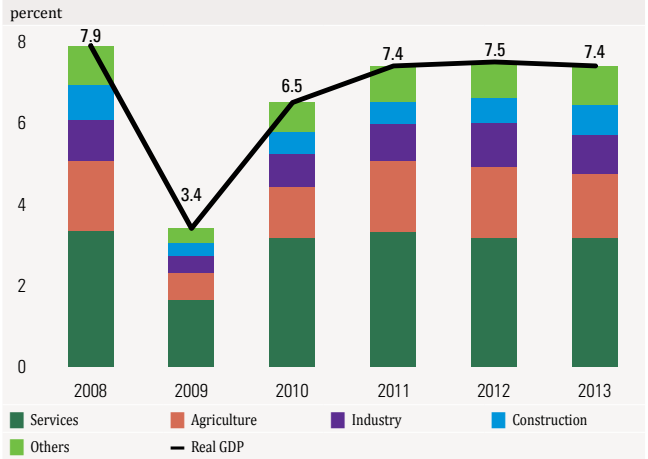
8. **Tajikistan's economy grew at a healthy rate in 2010–13, when economic growth rebounded from a low of 3.9 percent in 2009 to an average of more than 7 percent a year.** Economic activity in post-crisis period has been spurred by a pickup in remittance inflows, which in 2013 shot up to a record high of over 50 percent of GDP (Figure 1). Remittances fueled private consumption and, to a much lesser extent, investment. This in turn pushed up growth in services, which accounted for more than half of 2013 growth, followed by agriculture at one-fifth (Figure 2). Consistent with lower international food and fuel prices and a relatively stable exchange rate, consumer price inflation declined from close to 10 percent at year-end 2010 to 3.7 percent by year-end 2013 (Table 1).

Figure 1. Economic Growth and Remittances



Source: TajStat and NBT data.

Figure 2. GDP Growth by Sector



Source: TajStat data.

9. **The external balance has improved but the Tajik economy is vulnerable because it is too reliant on remittances and on two commodities, cotton and aluminum.** The current account deficit (CAD) narrowed from 5.9 percent of GDP in 2009 to less than 3 percent in 2013. The high trade deficit—47 percent of GDP on average for 2011–13—is financed by remittances. High export concentration, with aluminum and cotton together accounting for 60 percent of total export value in 2009–13, makes the country extremely vulnerable to the possibility of adverse impact of external demand and price shocks on internal and external balances. On the import side, high dependence on food and fuel imports heightens vulnerability to higher global food and fuel prices.[5] As foreign direct investment (FDI) was below 2 percent of GDP in 2013, remittances remain the major source of financing of the CAD (Figure 3

5 Food imports constitute over 80 percent of food consumption, and food accounts for 58 percent of the CPI basket.

Table 1. Tajikistan: Selected Economic Indicators, 2009–13

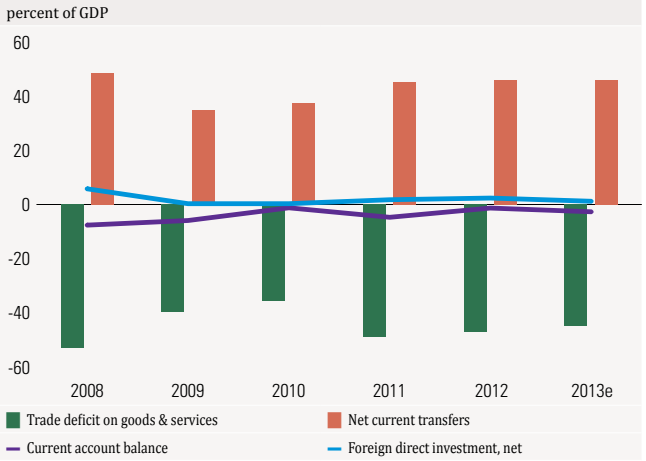
Percent of GDP, unless otherwise indicated

	2009	2010	2011	2012	2013
National accounts and prices					
Atlas GNI per capita (U.S. dollars)	750	810	870	880	970
Real GDP growth (percent change)	3.9	6.5	7.4	7.5	7.4
CPI inflation, Dec/Dec (percent)	5.0	9.8	9.3	6.4	3.7
External accounts					
Current account balance	-5.9	-1.2	-4.7	-1.3	-2.7
Balance on goods and services	-39.8	-35.6	-49.0	-47.0	-44.8
Net worker remittances	32.6	37.6	43.6	44.2	46.1
Fiscal accounts					
General government revenue and grants	23.4	23.2	24.9	25.2	25.5
Government expenditure and net lending	28.8	26.9	27.3	25.1	26.8
Overall fiscal balance (incl. PIP)	-5.4	-3.7	-2.5	0.1	-1.3
External public debt	35.8	34.4	32.6	28.6	25.4

Sources: World Development Indicators, Statistical Agency of Tajikistan, National Bank of Tajikistan, and Ministry of Finance of Tajikistan; World Bank and International Monetary Fund estimates.

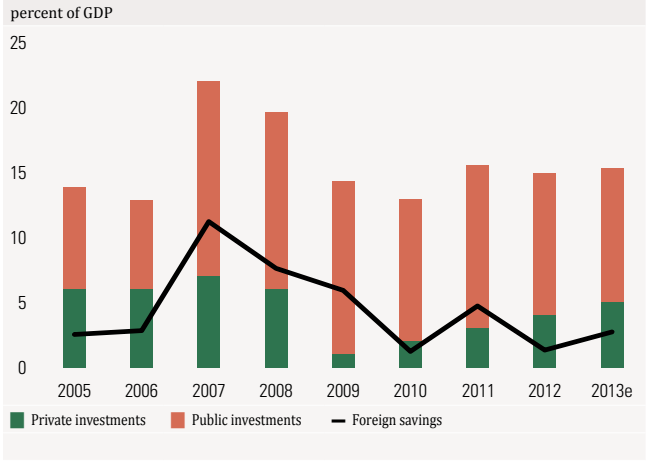
and 4). Low foreign exchange reserves, high dependence on remittances, high concentration of exports and imports, and high costs of transportation and chronic trade disputes expose Tajikistan's economy to external shocks.

Figure 3. Current Account Deficit: Sources of Financing



Source: NBT and TajStat data.

Figure 4. Investments and Savings

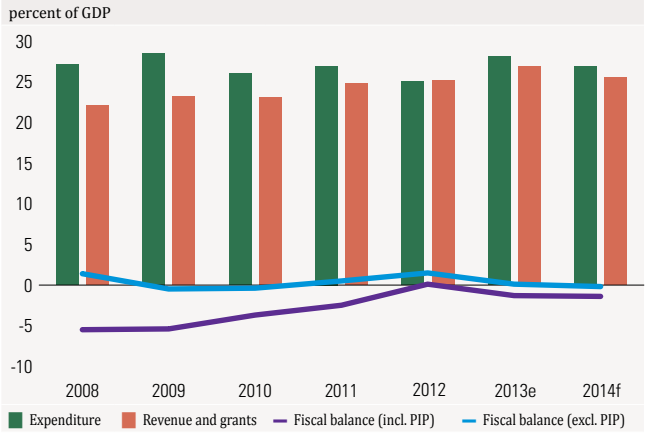


Source: NBT and TajStat data.

10. **Though the fiscal balance improved, fiscal buffers are low, and vulnerabilities stem from the quasi-fiscal activities of SOEs and from directed lending.** During the global crisis, fiscal policy gave priority to the social sectors and advancing social protection reforms. The government was also able to move from a deficit of 5.4 percent of GDP in 2009 to a surplus of 0.1 percent in 2012 because of higher revenues and lower spending in relation to GDP (Figure 5). The fiscal consolidation, however, was the result of external factors (e.g., wrapping up some externally funded projects) rather than domestic policies, and the situation has reversed in 2013 when despite buoyant revenue performance the deficit widened to 1.3 percent of GDP because of higher spending by

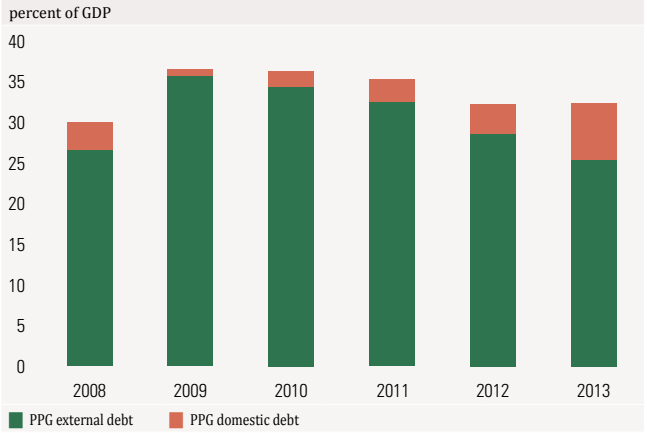
the externally financed Public Investment Program (PIP). Major vulnerabilities are poor management and flabby governance of SOEs[6] and the financial sector, creating additional fiscal outlays and depleting already low (and lower than in pre-crisis level) fiscal buffers.

Figure 5. Government Revenues, Expenditures and Budget Balance



Source: MoF and TajStat data.

Figure 6. Total Public and Publicly Guaranteed Debt



Source: MoF and TajStat data.

11. **Tajikistan's risk of debt distress is moderate but its debt sustainability is vulnerable to shocks.** Total government debt fell from 36.6 percent of GDP in 2009 to 32.3 percent in 2013 (Figure 6). The 2013 Debt Sustainability Analysis (DSA) incorporating remittance flows reassessed Tajikistan's risk of debt distress from high to moderate. However, as in the previous DSA, the standard stress tests with a one-off shock to non-debt-creating flows (a large part of which is private transfers) reveals significant vulnerability to the sustainability of its debt. Furthermore, the fiscal picture is likely to be in more difficult to descry than official statistics suggest because of soft budget constraints on SOEs (largely in the energy sector), continued directed lending by banks, and other quasi-fiscal risks. Public sector debt is arguably much higher given the large liabilities of SOEs.[7] Given limited fiscal buffers and high external vulnerability, further fiscal consolidation may be needed. The 2013 DSA for Tajikistan underscores the need for fiscal prudence. As the economy becomes more resilient to external shocks, the benefits of higher fiscal buffers should be carefully weighed against foregone investment opportunities.

12. **GDP growth is projected to ease to 6.3 percent in 2014 and average 6 percent in the medium term as long as macroeconomic policies continue to be prudent and there are moderate structural reforms.** Three factors explain this trajectory: (i) slowing growth in China over the medium term and lower growth in Kazakhstan, Russia, and Turkey in 2014—the four countries that accounted for two-thirds of Tajik exports in 2013; (ii) continued low demand and low prices for aluminum; and (iii) slower growth in remittance flows. The baseline scenario also assumes medium-term fiscal consolidation consistent with debt sustainability.[8] The fiscal deficit is projected to stay within 1 percent of GDP as PFM improves and revenue collection partially compensates for slower economic growth.

6 See PER Note No.5 on *Fiscal Risks from State-Owned Enterprises* (World Bank 2014).
7 *Ibid*.
8 The baseline scenario for Tajikistan employs the Bank's most recent projections for global, regional, and country growth. It uses the latest updated baseline scenario for Russian growth: 0.5 percent in 2014 and 1.5 percent in 2015.

Capital spending as a share of GDP would fall only moderately since the externally financed public investment program remains significant and government continues to invest in energy and the social sectors. Social spending, such as outlays on the national-wide poverty benefit program, is projected to benefit most from higher revenues. The efficiency of public spending is expected to improve as a result of dialogue with and financial support from the World Bank Group and other development partners.

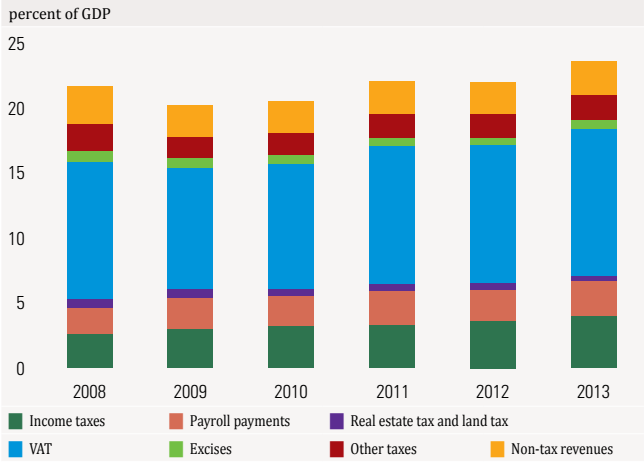
13. **The risks to the baseline outlook are substantial.** Among them are lower-than-projected Russian or global growth; a steeper reduction in remittances; a slower recovery in global aluminum and cotton prices, and delayed structural reforms. External risks stem from the country's reliance on imports of food and fuel, both subject to price volatility, and its exposure to ever-more-serious regional trade and transit obstacles. Domestic policy risks arise from the financial sector's vulnerability, with spillover effects to the whole economy, and the quasi-fiscal activities of large SOEs. There is also major uncertainty about the financing and timing of large infrastructure investments, such as the proposed Rogun project. On the upside, besides faster growth in the economies of Tajikistan's main trading partners and improved terms of trade, more decisive structural reforms by the new government—including actions to channel remittances into productive private investments and to reap the benefits of WTO membership—would yield medium and long-term growth dividends.

B. Fiscal Policy Challenges

14. **Maintaining fiscal sustainability will not be easy given the uncertainty of the external environment and domestic governance issues.** Although it has improved in the last five years, Tajikistan's fiscal and debt position is still subject to significant risks given the remittances-driven growth model, narrow export base, high dependence on concessional financing, large infrastructure needs (both physical and social) and aggravated SOE risks. Amortization of foreign debt is also surging. All of these make Tajikistan extremely vulnerable to external shocks even as its ability to dampen shocks is limited because its external and fiscal buffers are low (e.g., foreign exchange reserves account for less than 1.5 months of imports and government deposits in banks are below pre-crisis level). But the main problems are inadequate institutions and governance issues.

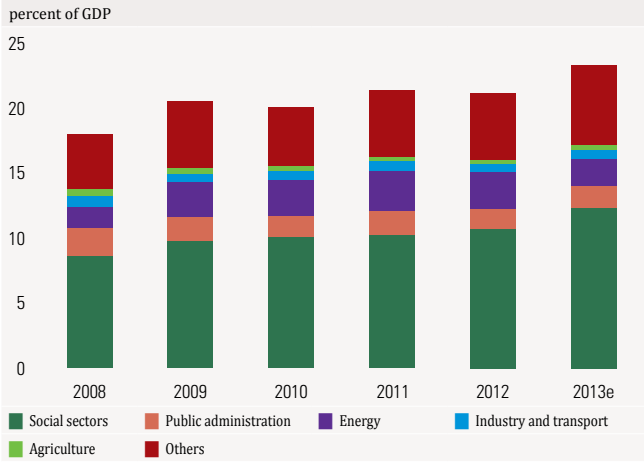
15. **Revenues have improved due to buoyant economic activity and better collections but there is scope for increasing the efficiency of revenues collection further.** General government revenues (excluding PIP grants) went up from 20 percent of GDP in 2009 to almost 24 percent in 2013 reflecting the post-crisis economic growth and tax collection efforts. Indirect taxes remain generating sixty percent of tax revenues, predominantly through the value-added tax which continues to be the main contributor to the growth in overall revenues on the back of increased import (Figure 7). Other important taxes are direct taxes, in particular income and payroll taxes, together amounting to almost one-third of total tax revenues. Tajikistan faces substantial challenges in revenue collection because of low capacity of the Tax Committee to detect tax evasion and weak capacity of the Ministry of Finance to do good quality tax policy analysis, forecasting and policy formulation. The World Bank Tax Administration Reform Project (TARP) is to support the reform of tax administration to become more efficient and effective in collecting

Figure 7. Revenue Structure in Tajikistan[a]



Source: MoF and TajStat data.
a Excluding PIP.

Figure 8. Expenditure Structure in Tajikistan[a]



Source: MoF and TajStat data.
a Excluding PIP.

revenue, enhance the level of voluntary compliance, and improve the quality of taxpayer services that would help reduce the compliance burden for taxpayers, thus improving business environment and competitiveness.[9]

16. **The structure of public spending has been shifted toward social expenditures and the pressure for that to continue is heavy.** General government expenditures (excluding PIP) increased from 20.5 percent of GDP in 2009 to 23.3 percent in 2013. Social sectors, particularly education, benefitted most (Figure 8). Demographic developments are projected to put additional upward pressure on education financing over the next decade, including for additional capital investments.[10] Further education reforms could improve efficiency in pre-schools and tertiary education. Yet public spending on health is the lowest in ECA region and even this small allocation, less than 2 percent of GDP, is used inefficiently.[11] The largest source of fiscal space for social sectors is expected to come from sound macroeconomic policies and accelerated structural reforms that would support economic growth, increase government revenues, and in turn make it affordable to invest more in social sectors in response to projected demographic trends and the need for better quality.

17. **Given the limited fiscal space, more efficient capital spending and better PIM need to be high priorities for the government.** As highlighted in the PER 1, Tajik government spending relative to GDP is on par with most countries with similar per capita income but it is too heavily skewed to capital outlays. Meanwhile, investment needs are huge and private participation is very low. Policies should not only be directed to more efficiency in public spending but also to creating an enabling environment for higher private investment. Challenges to the business environment for both domestic and potential foreign investors need to be addressed, as do financial sector problems, given how little financial intermediation there is. These challenges need to be addressed by decisive governance reforms. While the governance agenda needs to apply to the entire economy, specific reforms may be better addressed to specific sectors.

9 World Bank (2012). *Tax Administration Reform Project (TARP)*, Project Appraisal Document. Report No.71924-TJ, October 2, 2012.
10 See, PER-1 Note No.3. World Bank (2013).
11 See, PER-1 Note No.2. World Bank (2013).

3. Capital Spending in Tajikistan: Composition and Trends

A. Structure and Classification of the Capital Budget

18. **Tajikistan adopted its current budget classification in 2008; it came into force in January 2009.** It is roughly aligned with IMF Government Finance Statistics (GFS) 1986 standards.[12] Capital expenditures are classified as:

- **Acquisitions of fixed (nonfinancial) assets, including major overhauls:** construction of gas pipelines, roads, educational and health facilities, housing, production and administrative buildings, purchases of equipment, machinery and inventory, etc.
- **Purchases of strategic or emergency goods and services, land, and intangibles.**
- **Capital transfers:** transfers to SOES and financial institutions, and intra-budgetary transfers.

19. **Transition to a GFS 2001-compliant budget classification began in 2014.** With support from the World Bank PFM Modernization project (and massive preparatory efforts, with more than 6,800 budget organizations involved in training and subsequent implementation), economic and functional segments of increasing amounts of spending are progressively reported according to the new budget classification and new unified chart of accounts (UCOA) for public institutions, within the new PFM system.

20. **Government capital expenditures are almost exclusively investments.** Less than 1 percent of capital spending is expanded on items other than purchases of fixed assets (mainly new construction and renovation and rehabilitation of existing facilities). Subsidies, such as capital transfers to SOEs (excluding transfers to the Rogun hydro-power project fund) represented about 0.4 percent of total domestic capital spending for 2007–13.

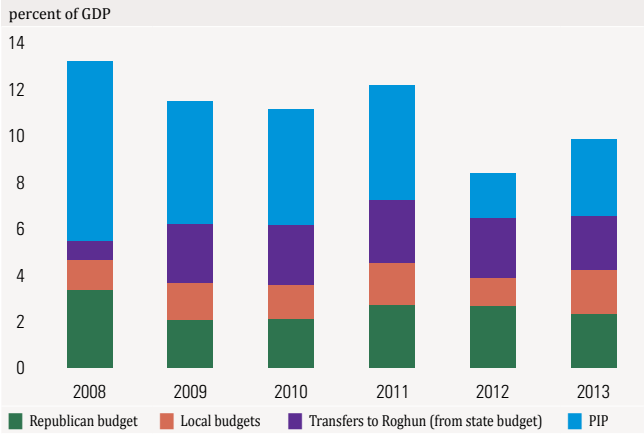
B. Financing Sources

21. **Capital spending in Tajikistan is financed from both domestic and external sources.** The largest share is under the umbrella of the Centralized State Investment Program (CSIP) and the Public Investment Program (PIP). The CSIP is financed by central and local government budgets and the PIP by development partners; it combines loans and grants and, as required, government co-financing (see Annex 2 and 4). Small capital expenditures are financed by the regular budgets of line agencies. Local governments may also co-finance capital construction

12 See Annex 1 for more details.

projects if their fiscal space allows. Central government capital spending also includes extra-budgetary funds and Social Protection Fund spending of about 0.5 percent of GDP on average for 2008–13.

Figure 9. Government Capital Spending by Main Source, 2008–13



Source: Ministry of Finance, WDI.
Note: Excludes extra-budgetary and Social Protection Fund capital spending.

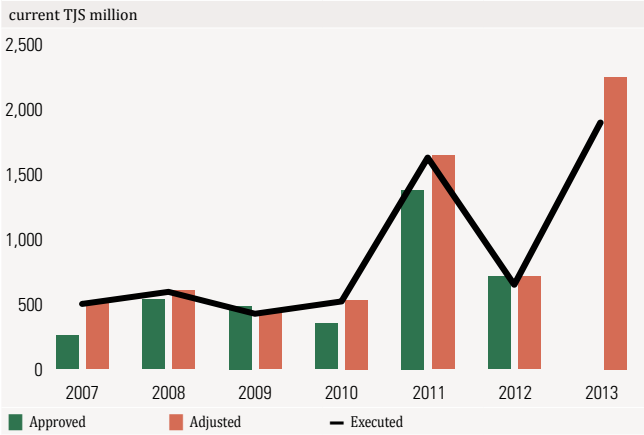
22. **Total government capital spending fell in 2009–10 after the global crisis.** It recovered in 2011, fell again in 2012, and recovered again in 2013 (Figure 9), but at 9.6 percent of GDP in 2013, it is still far from the pre-crisis level of 13.2 percent in 2008 (excluding extra-budgetary spending).

23. **Capital spending is now mostly financed from domestic sources.** Externally financed capital spending plunged from 7.7 percent of GDP in 2008 to 3.3 in 2013. The decline was coupled with an increase in domestic financing from 5.5 percent of GDP in 2008 to 6.6 percent in 2013, with a peak at 7.1 percent in 2011. In 2008, 58.4 percent of capital spending was externally funded; by 2013 that share had fallen to 33.5 percent.

C. Budget execution and performance

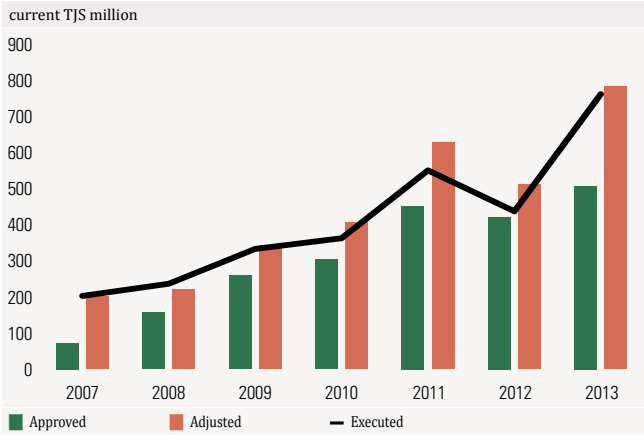
24. **Execution of the capital budget has improved since 2007, but both central and local over-execution still is the norm, as it is externally-financed capital spending, because capital spending is treated as a residual of other expenditures.** Additional resources are allocated to capital expenditures during budget execution when

Figure 10. Evolution of the Republic's Approved, Adjusted, and Executed Capital Budgets



Source: Ministry of Finance.

Figure 11. Evolution of Local Approved, Adjusted, and Executed Capital Budgets



Source: Ministry of Finance.

tax revenues are higher than expected, from the presidential reserve fund or from an entity's own resources. Conservative Ministry of Finance figures and initial budgeting are thus systematically exceeded. Republic and local capital budgets were over-executed by a wide margin in 2007 (183 percent and 93 percent), but the gap between approved and executed republic and local capital budgets narrowed to -9.3 and 3.9 percent in 2012. Over-execution of local budgets by 50.2 percent in 2013 does, however, suggest that execution performance is still cause for concern (Figure 10 and 11).

D. Sector Allocations, Trends and National Strategic Priorities

25. **Government goals as defined in national strategy documents (notably the Living Standards Improvement Strategy of Tajikistan for 2013–15; LSIS) call for increased capital spending on energy, agriculture, transport, housing and communal services, education, and health.** The priorities are (a) construction of small hydroelectric power stations and restructuring and development of new electric infrastructure to reduce electricity loss and offset depreciation of equipment; (b) rehabilitation of local roads, and construction of national border terminals and Vahdat-Yovon railway; and (c) construction or restoration of preschool buildings and facilities, primary schools and secondary vocational education schools, and preventive medicine facilities (Box 1).

Box 1. The Living Standards Improvement Strategy for Tajikistan for 2013–15

The Living Standards Improvement Strategy for Tajikistan for 2013–15 calls for considerable investment. It sets out a range of priorities to improve public administration and the business climate; promote real sectors of the economy; diversify production; build up the country's export potential; and capitalize on its human potential. The strategy outlines the following objectives and areas for investment:

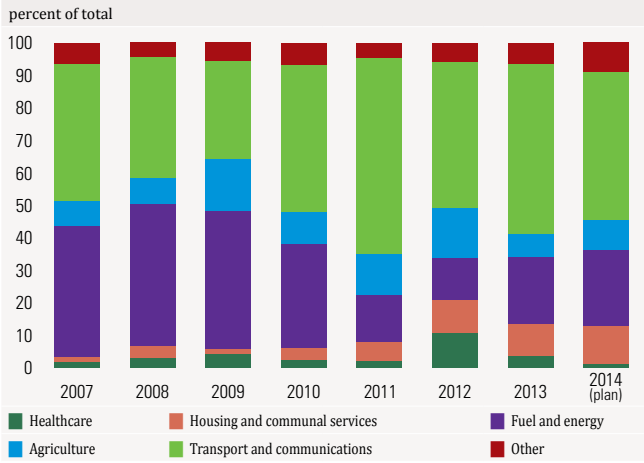
- Develop the energy and infrastructure sectors as well as industry and diversify the economy through private and public sector cooperation.
- Build up the agricultural sector for increased food security by ensuring water supply and land tenure; increasing the effectiveness of producing agricultural goods, including cotton; developing agricultural infrastructure; and improving water resource management.
- Develop and strengthen infrastructure and equipment for road, railway, and air transportation, open up international corridors, and expand regional coverage of the landline telephone network.
- Increase access to drinking water and reconstruct conduits, internal water supply networks and sewage systems.
- Ensure environmental protection and sustainable development; rehabilitate the current system and construct new drainage (…) to prevent repeated soil salinization.
- Improve the quality of education, and expand equal access to high-quality healthcare services.

Source: Living Standards Improvement Strategy of Tajikistan for 2013–15.

26. **PIP spending largely goes to transport and fuel and energy.** Transport is the largest PIP expenditure category (53.2 percent of externally funded capital spending and 1.7 percent of GDP in 2013), followed by fuel and energy. On the whole, however, there has been a marked shift over time in the sectoral distribution of externally

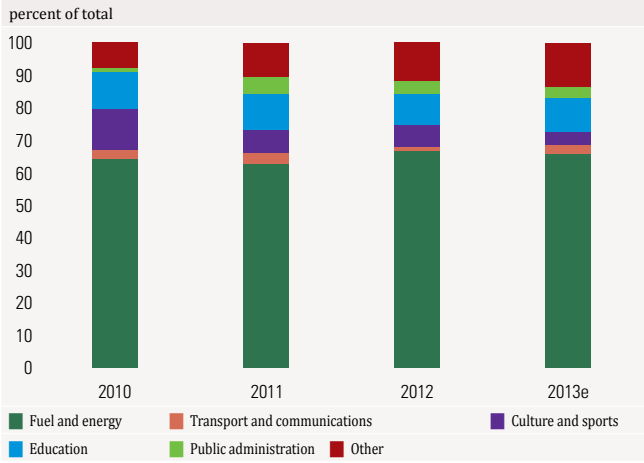
financed capital expenditures with less going to fuel and energy (20.6 percent of PIP spending and 0.7 percent of GDP in 2013, down from 40.4 percent of spending and 3.2 percent of GDP in 2007), and more going to housing and communal services (10 percent of spending and 0.3 percent of GDP in 2013, and a budgeted 11.7 percent of PIP and 0.5 of GDP in 2014). Agriculture remains important, with 7 percent of total PIP spending in 2013 and a projected share of 9.5 percent in 2014 (Figure 12).

Figure 12. Evolution of PIP Spending



Source: Ministry of Finance.

Figure 13. CSIP New Construction Spending, 2010–13



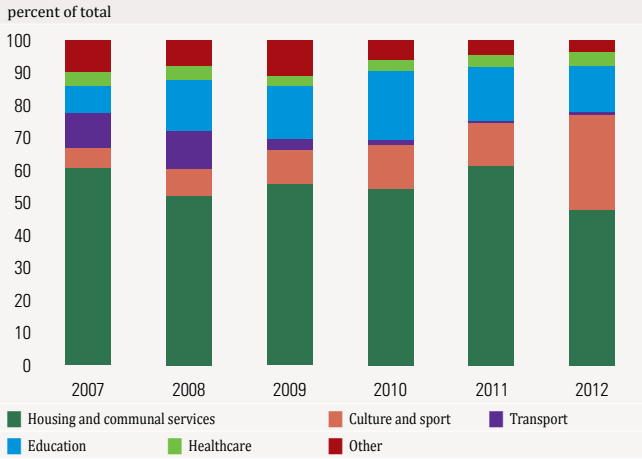
Source: Ministry of Finance.

27. **The domestically financed portion of the capital budget has been expanding toward more power generation.** Energy accounted for 65.7 percent of total CSIP new construction expenditures in 2013 (2.7 percent of GDP on average for 2010–13). The education share was about 10 percent on average for 2010–13 (Figure 13), while combined spending on health and social protection averaged a minimal 2 percent of total CSIP spending for 2010–13.

28. **Local capital spending, as part of the CSIP or through regular budget allocations, goes mostly to housing and communal services, education, and culture and sports, but it is unequally distributed among local entities.** Though local capital spending on housing and utilities accounted for 54.4 percent of local capital expenditures for 2007–12, these were concentrated in the city of Dushanbe, which spent 94.4 percent of all local capital spending (Figures 14 and 15). Only 3.7 percent of the local capital budgets on average for 2007–12 was spent on health facilities, though the Public Finance Law requires that construction and rehabilitation of health infrastructure and equipment be financed solely from local budgets.

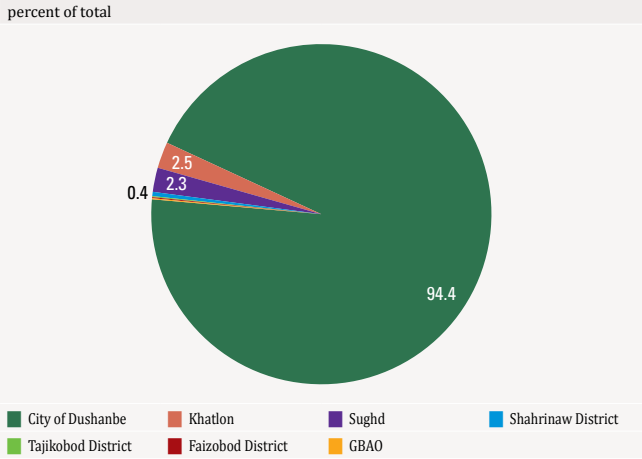
29. **Local capital spending on culture and sports has increased over time, probably at the expense of other sectors.** Spending on culture and sports, which accounted for 6 percent of the local capital budget in 2007, had shot up to 29.3 percent by 2012. For example, 81.5 percent of 2012 Sughd Oblast and 52.8 percent of 2012 Hisor District capital spending was on culture and sports. Meanwhile, in 2012 Sughd Oblast was spending only 8.1 percent of its capital budget on education, 3.5 percent on healthcare, and 4.3 percent on utilities infrastructure in 2012; and Hisor District spent 39 percent of its capital budget on education, 3.1 percent on healthcare, and nothing on utilities infrastructure.

Figure 14. Local Government Capital Spending, Sectoral Distribution, 2007–12



Source: Ministry of Finance data.

Figure 15. Local Capital Spending on Housing and Communal Services, Geographic Distribution, 2012

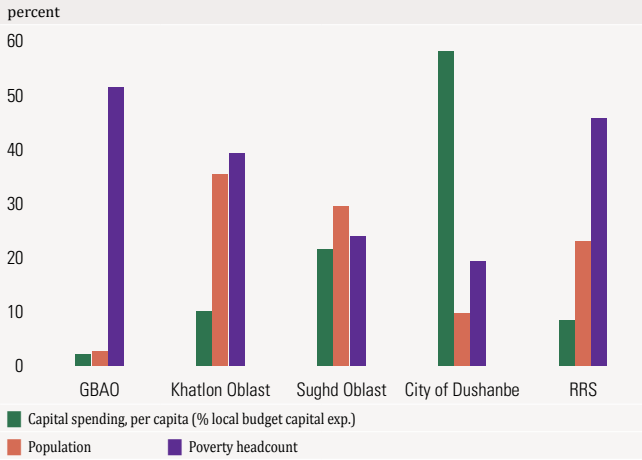


Source: Ministry of Finance data.

30. **The most recent CSIP investment plan also gives more prominence to culture and sports.** The State Investment, Grants and Capital Construction Program for 2014–16 earmarks 11.3 percent of spending for culture and sports, compared to only 6 percent in the 2013–15 investment plan.

31. **The Program on Improving Access of the Population to Clean Drinking Water, Tajikistan 2008–20 calls for significant improvements in the efficiency and reliability of existing systems, and for extending the system extension to meet MDG Goal 7.** The Tajik Millennium Development Goal targets for drinking water and sanitation are set at 97 percent of the population having access to improved sources of water (e.g., water piped into the dwelling) and 74 percent with improved sanitation facilities (e.g., flush or pour-flush to pipe sewer systems) by 2015. Though in general the targets are likely to be met, disparities between urban and rural areas are a source of concern: access in urban areas is likely to be universal, but most rural residents will still be deprived of both improved sources of water and sanitation facilities.[13] Inadequate access to safe water and sanitation services is estimated to have a huge negative economic impact (3.9 percent of GDP), but current financing and institutional frameworks are wholly insufficient to meet such sector challenges as the considerable investment needs (see Box 2 for details).

Figure 16. Local Government Capital Spending, Population, and Poverty



Source: TajStat and Ministry of Finance data.

32. **The geographic distribution of local capital expenditures is not consistent with the distribution of the population and redistributive needs.** In 2007–12 58 percent of local capital spending was by the city of Dushanbe, where only 10 percent of the

13 UNDP (2010). Millennium Development Goals Tajikistan Progress Report.

Box 2. Capital Investment in Water and Sanitation

Reflecting limitations in sector organization and capacity, until recently there was no comprehensive urban and rural strategy for water and sanitation systems (WSS) to achieving national service objectives. The State Unitary Enterprise (*Khochagii Manziliyu Kommunali (KMK)*) takes a de-concentrated approach to providing WSS services through subsidiary enterprises throughout the country. The KMK investment program has focused on the main cities beyond Dushanbe. However, there is no strategy for providing WSS services in rural areas where needs are direst.

The WSS sector has to deal with endemic problems of deteriorated and under-maintained distribution networks, underfunded operating budgets, almost nonexistent domestic capital budgets, and limited customer willingness to pay for (and ability to afford) WSS tariffs. Meanwhile, KMK's capacity to deliver adequate management services is diminishing and there is a widespread belief among service enterprise leaders that only large-scale external financial and technical assistance from international organizations can reverse the situation.

Sector investment needs are huge, approximately US$2 billion through 2030 by some estimates. The biggest need is to improve access to water supply in rural areas and confront the major inequity impacts (through such coping mechanisms as reliance on tanker truck water supply, rural households can pay 100+ times more for water than urban ones). The rural WSS agenda is still not a clear government priority; almost all sector investments are now in urban areas. The sanitation agenda, and the extremely dire conditions found in secondary and small towns is also wholly neglected in both urban and rural areas. The problem is that the financing needs dwarf the resources, and government gives priority to the most urgent investments needs in the most densely populated areas. There is insufficient policy-making and planning capacity and too little access to financing in the sector to go beyond short-term investment responses to the most screaming rehabilitation emergencies. Efficiency and sustainability factors in particular (loss reduction, demand management, metering, and energy efficiency) and indispensable tariff reform have yet to become clear policy priorities.

More financing for the WSS sector, especially in rural areas, would significantly reduce the non-monetary dimensions of poverty and heighten the well-being of the bottom 40 percent of the Tajik population. At the same time, given the resource constraints, the emphasis should be on spending more efficiently and sustainably and on the autonomy of operators. A comprehensive medium-term strategy and an action plan need to be not just drafted but also enforced to accelerate WSS structural and policy reform and improve the performance of municipalities and service providers. This needs to be accompanied by efforts to rebuild institutional capacities for policy-making, planning, and executive of optimal sector strategies, and delivery and regulation of improved WSS service.

Sources: Tajikistan's World Bank ECA Urban and Water team input, Interim Report *Development of Municipal and Communal Services Sector Strategy and Design f MSDF*, March 2014, Municipal Infrastructure Development Project Additional Financing (MIDP).

population lives and poverty is the lowest (Figure 16). In contrast, Gorno-Badakhshan Autonomous Oblast (GBAO) has both the lowest share of local capital spending per capita and the highest poverty rate. Khatlon oblast, where more than one third of total population and more than 40 percent of poor reside, accounted for only 7.3 percent of total local capital expenditures in 2012.

33. **Rebalancing of the sectoral distribution of domestic investments is planned, with notably less spending on fuel and energy and more on health and housing and communal services for 2014–16.** The State Investment, Grants and Capital Construction Program for 2014–16 envisages dropping the share of domestic energy capital spending from 65.7 percent of CSIP spending in 2013 to 47.9 percent of CSIP spending and raising the share of

spending on health (to 6 percent of centralized spending) and housing and communal services (to 14.1 percent).[14] However, domestic centralized capital spending on education expected to drop to 7.3 percent.

34. **Tajikistan needs to address both equity issue and sector allocation efficiency issues if resources in support of national priorities are to be better mobilized.** As argued in Section 2, fiscal space is likely to be extremely tight given the global and regional uncertainties and the magnitude of Tajik investment needs. It is therefore critical to ensure that spending is efficient, funds are channeled to higher-return investments and the Government of Tajikistan's significant spending on public investment translates into correspondingly productive assets.

Box 3. Capital Investment in Health

Tajikistan's population has the double burden of high death rates from both communicable and non-communicable diseases. Infant and maternal mortality rates (infant: 34 per 1,000 live births in 2012; material: 65 per 100,000 live births in 2010) are among the highest in Central Asia and the Caucasus. Rates of malnutrition and micronutrient deficiencies are high, so that in 2012 21 percent of children under 5 were moderately or severely stunted, and 16 percent moderately or severely underweight.

The health delivery system is highly specialized and centralized. It emphasizes curative and inpatient care; primary care is neglected. There is a serious misbalance in the distribution of health facilities and the allocation of funds between primary health care and hospital care. Most of the funding goes to secondary health care, where services are too expensive for the poor. The hospital network is too large, but 65 percent of hospital buildings do not meet basic construction standards.

Health houses provide immunization, basic first aid, home visits, basic prenatal care, and medical referrals. They cover rural areas with a catchment population below 1,500. They are also established in isolated villages of fewer than 300 people if the village is more than 4 km away from other health facilities. Rural health centers, usually comprising specialists, provide the next level of primary care. These clinics, which are subordinate to central rayon hospitals, offer diagnostics and basic treatment and surgeries.

Rural health facilities (like most facilities) were constructed before 1980.Their heating, water supply, sewerage systems, sanitation, electricity and communication systems are unsatisfactory. Yet very little funding is allocated to rehabilitating existing facilities or purchasing modern equipment. Where domestic investments occur, they are directed at the over-extensive network of large national-level health facilities or concentrated in Sughd, Khatlon, and city of Dushanbe facilities. Some PIP spending through the community and basic health care project (started in 2000 and funded by the World Bank, ADB, USAID, the Swiss Agency for Development and Cooperation, and the Swedish International Development Cooperation Agency) is directed toward primary care facilities. As of June 2013, 68 buildings had been replaced or rehabilitated, including 61 primary health care centers in 7 rayons. But the overwhelming majority of facilities are in disrepair and the 0.05 percent of GDP a year dedicated to their overhaul is unlikely to adequately address the issue and foster health infrastructure modernization.

The National Health Strategy for 2010–20 and the master plan provide a strategic framework for sector development. The financing needs are huge: the low-cost scenario requires US$ 356 million to implement the master plan. Efficiency and equitable access to quality health care would be improved by rationalizing the hospital network. The master plan would see the number of hospitals drop by 72 percent: of 365 hospitals, 102 should be retained, strengthened, and modernized and the rest merged, transformed into a comprehensive primary health care (PHC) center, or closed. There is scope for rationalizing PHC by closing health houses located near a PHC center, as at least 60 percent of health houses are.

Source: Tajikistan World Bank ECA Health Team Input; World Bank (2013), Tajikistan Public Expenditure Review, Policy Note No.2.

14 See Box 3 for major issues and challenges in capital investment in health sector.

4. Public Investment Management: Issues and Challenges

A. Project Identification, Preparation, and Appraisal

35. **Strategic priorities for public investment are defined in a number of documents, but their realism and the quality of the strategies varies greatly.** As noted above, priority areas for public investments are identified in the LSIS. However, the LSIS does not include cost estimates and monitoring indicators for all six priority investment areas. In addition to the national medium-term strategy, strategies have been drafted for the main sectors, and with UNDP support, regional strategies are also being drafted. Nevertheless, the strategies often identify investment priorities too broadly and investment needs often exceed feasible financing. Because strategies have often been prepared in isolation, with no aggregate resource analysis and little coordination with the Ministry of Finance, they tend not to be realistic.

36. **Tajikistan legislation is not based on a sound concept of what constitutes an investment project.** A project is a group of activities with clearly defined objectives, outputs, and target beneficiaries to be accomplished on a fixed schedule. Therefore, a project must include all the components necessary to achieve its development objectives. Grouping all components together creates a solid foundation for analytical, budgeting, and decision-making purposes. In Tajikistan, in order to attract investments, the Investment Agreement Law treats an investment project as a commercial *project*; It envisages a significant amount of investments that involve serious financial, technological, environmental, and other risks but are strategically important for development of a certain branch of the economy of the Republic of Tajikistan and improvement the living standards of the Tajikistan people. Definition of a *project* is also contained in *Rules for Attraction, Use, Coordination and Monitoring of External Aid in the Republic of Tajikistan*, approved by the Government Resolution №389 from August 2, 2010. Meanwhile, the Law on Public Finance mentions projects as one of the components of the baseline budget—but without defining what a project actually is. As the result, there is no clear differentiation between the terminology and rules for public investment project and construction objects budgeting[15] that creates a base for both gaps and duplications of functions in the PIM system.

37. **Absence of a clear understanding of what constitutes a public investment project results in artificial division of the notions of a project based on a financing source rather than an economic rationale.** As a result, and also due to the imperfect project cycle methodology for all sources (domestic and external funding), objects are specified in the government regulations but not projects. The requirements for "project identification" are regulated by two major documents:

15 For purposes of this note budgeting is understood as comprising all steps for financing from the state or local budget, including budget planning and execution.

(i) For the PIP, the major document is *The Rules for Preparation of Investment Projects and Implementation of Medium-term Programs of* Public *Investments, Grants, and Capital Construction in the Republic of Tajikistan*, approved by Government Resolution No. 370, August 1, 2011.

(ii) For the CSIP, the major document is *The Rules for Preparation and Endorsement the List of Objects, Constructed from the State* Budget approved by Government Resolution No 483, October 4, 2011.

38. **Resolution No.370 provides a fairly clear foundation for preparation of projects based on a number of strategic documents.** It specifies the standard requirements for a project proposal (Box 4). However, a requirement that a project comply with an extensive list of strategic documents and targeted programs, the hierarchy of which is unclear, could be regarded as the only criterion for project identification—i.e., determining whether or not it is needed. Thus, projects are mostly identified based on political decisions.

Box 4. Requirements for an Investment Project Proposal

An investment project proposal should:

- Reflect the general strategy of the Government of the Republic of Tajikistan with respect to economic development and correspond to the sector goals, objects, and strategy.
- Be properly arranged (project quality, justification for the costing presented, etc.).
- Reference the feasibility study, with supporting documents.
- Assign the responsibilities of the Government and the private sector
- Detail the capacity of the implementing agency to complete the project and any need to amend standard regulations.
- Take into account the environmental and social impact and ensure compliance with Tajik law related to environmental protection and environmental standards.
- Provide full information on the need to attract investment or whether resources of ministries, departments, and local executive bodies of State power will be necessary.
- Spell out the total project cost (when attracting a credit should not be less than US$ 5 million. Public borrowing is limited to attracting preferential credits with a grant element of no less than 35 percent;
- Make sure the total project amount when attracting a grant is not less than US$100,000
- Describe the impact of project activities on development in f the region.

Source: Government of RT Resolution No. 370 from August 1, 2011.

39. **CSIP planning focuses on discrete 'objects' rather than projects.** The objects are understood to be buildings and structures. As is the case for investment projects, Resolution No.483 specifies that objects be included in the CSIP list (Box 5). Objects are identified for inclusion in the CSIP list based on whether they comply with the country's strategic or programmatic documents, with an option to consider how close they are to completion. Resolution does not specify the hierarchy of documents. In practical terms, there are also a number of other documents (ordinances, action plans, etc.) that require strict conformity from heads of ministries, departments, and local authorities. Therefore, just as with investment projects, a political decision—presidential directive, government regulations and programs, and proposals from ministries and agencies—tends to be the main factor for identifying and preparing objects. Using the analysis of policy compliance as the key argument for project identification without

Box 5. Priorities for Selection of CSIP Objects

The following priorities have to be taken into account while compiling the CSIP list:

1. Unfinished objects expected to be completed in the next year.
2. Objects whose construction is authorized by a law of the Government of the Republic of Tajikistan.
3. Construction projects and objects with certain funds obligated in republic and local budgets but that are unfinished because allocated funds are insufficient.

Source: Government of RT Resolution No.483 from October 4, 2011

any preliminary evaluations reduces the likelihood that subsequent managerial decisions will be efficient, since no possibly cheaper or more socioeconomically beneficial alternatives are considered.

40. **Lack of full appraisal and proper selection of projects and objects is the weakest link in the PIM system in Tajikistan, which undermines the efficiency of public investment.** Selection of projects and objects for the Program[16] should be based on a thorough preliminary appraisal that analyzes the quality of project preparation, financial and economic analysis, and analysis of compliance with strategic objectives. The first analysis determines how well all official requirements are met and evaluates the completeness of the data. A project that receives a negative evaluation at this stage could be either rejected or returned for elaboration. The financial and economic analysis highlights costs and economic benefits, appraises possible fiscal impact (e.g., the amount of spending that will be necessary to maintain objects after an investment project is completed; and possible sources of financing). Cost-benefit analysis can also be used, but because of its complexity use is normally restricted to the largest projects.

41. **Who does what in deciding on externally-funded investments and centralized capital expenditures is rather blurred.** Apparently, preparation of projects funded from external sources is of higher quality in Tajikistan, because Resolution No. 370 requires presenting a project request that describes the project in detail. However, the MoEDT coordinates selection of projects for the CSIP, and in selecting objects it looks at the degree of completion and in general terms compliance with strategic and other government documents. How parties participating in preparation of the Program interact is not clearly defined. For instance, local governments request their own construction objects or investment projects directly without calling on any expertise from line ministries, even though line ministries prepare strategies for development of their sectors. Also, there are no official established procedures requiring the State Committee for Investments and Management of State Property (SCIMP) to evaluate the potential attractiveness to investors of proposed projects before the MOEDT compiles the Program. There is partial coordination with line ministries and the SCIMP, but it is more an exception than the rule and is based on negotiation rather than clear-cut regulations. The Ministry of Finance's responsibilities are not clearly defined in a legally enforceable manner so that there is a lack of correspondence between the Program and the state budget.

16 The Program of Public Investments, Grants, and Capital Construction is Tajikistan's main strategic document for PIM and covers the PIP and the CSIP as well as all kind of financial resources over the medium term.

B. Budgeting and Implementation

42. **The government has made progress in implementing the recommendations of the 2005 Public Expenditure Review for improving capital budgeting.** Historically in Tajikistan preparation of the PIP was an ad hoc exercise, done outside the regular budget process for scheduled meetings of the Donor Consultative Group. As highlighted in the 2005 PER, the external debt implications of neither the PIP nor its counterpart funding needs were adequately factored into the regular budget process. Since passing a public finance law in 2002, the government has gradually adopted a MTEF and moved to integrating PIP preparation into the regular budget process. However, as highlighted in the 2012 PEFA, despite some progress, investment and recurrent budgeting are still rather separate. Estimates of future recurrent costs are still not part of the process of planning and selecting investment projects; and domestically financed and externally financed investment plans are still not linked.[17] Despite some improvements during the last five years, the budget process still does not seem to be driven by a strong policy orientation (Table 2).

Table 2. Scoring of PEFA Indicators for Policy-based Budgeting in Tajikistan

Policy-Based Budgeting	2007	2012
PI-11 Orderliness and participation in the budget process	B	B+
i) Existence of and adherence to a fixed budget calendar	B	B
ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent)	D	D
iii) Timely budget approval by the legislature or similarly mandated body (within the last three years)	A	A
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	D+
(i) Preparation of multi-year fiscal forecasts and functional allocations	C	C
(ii) (Dimension not relevant)	C	B
(iv) Existence of sector strategies with multi-year costing of recurrent and investment expenditure	C	D
(v) Linkages between investment budget and forward expenditure estimates	D	D

Source: 2012 PEFA Assessment for Tajikistan.

43. **Furthermore, the impact of the MTEF process on budgetary decisions is not very evident.** The latest MOF Instruction "On Formation of the 2014 Draft State Budget and Estimation of Budget Indicators for 2015–2016" includes appendices (forms) for centralized public capital investments, yet the situation described in the LSIS for 2013–15 had hardly changed by year-end 2013. MTEFs require substantial capacity to develop long-term plans, determine the cost of those plans, and then prioritize the plans to fit within expected resources over at least a three-year horizon. Low capacity coupled with fragmentation of functional responsibilities (stemming from an excessive number

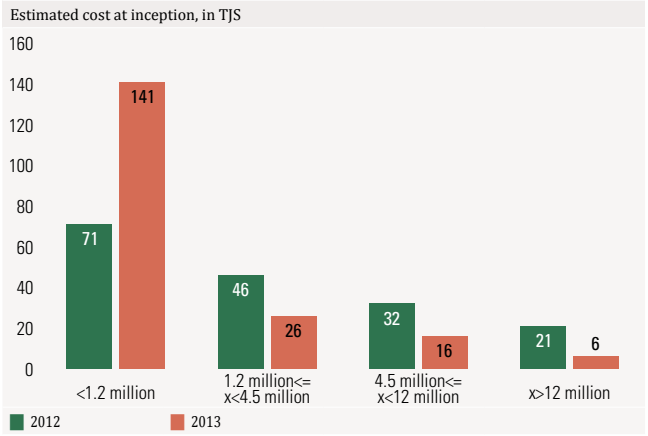
> "Distribution of resources, such as the budget, public investment program, and other national, departmental, and regional programs as well as the programs of assistance to the country still remains uncoordinated and is not consolidated into a unified process. The required structure and mechanism fir this process have not been implemented at an appropriate level and are insufficiency adapted to the development priorities and key strategic directions of the country."
>
> *Source:* Living Standards Improvement Strategy of Tajikistan for 2013–2015.

17 World Bank 2012a.

of Main Administrator of Budget Allocations (MABAs) makes sector-wide expenditure planning difficult and affects its impact on budgetary decisions.

44. **Despite some progress, public investment budgeting is still not well linked to recurrent budget planning.** As a result, estimates for the MoEDT PIP and SCIP budgets are significantly higher than actual financial capacity and proposed projects and construction objects are often not included in the Annual Budget Law. Furthermore, lack of a project screening and appraisal methodology, as well as rigid centralization of public capital investments,[18] has brought about a situation where clients (government entities) put as many objects as possible on their lists. As a result, a huge amount of information flows to the MoEDT, which, after negotiations with the clients, is transformed into the Program. At that, the cost of objects and projects at times exceeds budget and investment capacity. The proliferation of many low-value capital objects, especially local ones, makes prioritization almost unmanageable. The number of new projects ("objects") worth less than TJS 1.2 million (about US$250,000) doubled in 2013 compared to 2012 and their share in the total value of new projects rose from 40 percent to 75 percent (Figure 17). However, since the Program is a declarative document, its preparation is not linked to the budget calendar and to the real scope of state investments.

Figure 17. Objects Initiated in 2012 and 2013 by Size



Source: MoEDT data.

45. **The Ministry of Finance duplicates MoEDT functions by also selecting projects and objects.** This is done, however, within the deadlines for budget preparation. In this process, as with the MoEDT, the MoF considers how far along existing projects and objects are and whether they conform to the policy, rather than looking at their economic and social impact. Overall, technical steps for budget defense by ministries, agencies, and local governments with regard to capital investments are identical to the procedures of the Program and are based on negotiation and evaluation of compliance with political decisions, but with much fewer official rules for project appraisal. Therefore, both processes require large human and financial resources but are hardly interrelated, which significantly reduces the efficiency of the PIM system.

46. **Despite some progress with regard to the MTEF, the official methodology in effect since January 1, 2014 does not address the problems described.** The methodology does not set out rules for planning a total amount of public capital investments and how they should be distributed among budget spending agencies. Nor does it improve institutional links or envision the need to evaluate budgetary capacity not only for construction financing, but to a greater extent for future maintenance.

18 Even small, local objects that respond to the problems of an individual inhabited locality (e.g., construction of a rural school, apartment building in a city), are mainly financed by centralized funds. Objects funded from local budgets also have to be coordinated with central government agencies (with the MOEDT for inclusion in the Program, and with the Ministry of Finance for inclusion in the budget).

47. **Public procurement in Tajikistan is not properly integrated with PFM.** Procurement planning, both during budget formulation and execution, is poor. Because the budget cycle does not provide for multiyear procurement contracts, long-term contracts, especially for construction works, are awarded and initiated in one fiscal year with no assurance that completion will be funded in coming fiscal years. This leads to undesirable practices of continuing to work on a contract only as funds become available. No systematic procurement completion reports are prepared for certification of budget execution and for reconciliation with budget programming.[19]

48. **The main problem in getting projects done is inconsistency of financing, resulting in a large number of unfinished structures, a lengthy construction period, and cost overruns.** The legislation does not contain any clear regulations related to changes in the budget throughout a fiscal year and any norms ensuring mandatory annual financing of an object under construction (project co-financing) until the moment it is commissioned. Every year ministries and local authorities carry out the procedure for clearance of objects (projects) virtually from scratch, and they cannot be sure that objects already started will be funded again, since in practice new political decisions may require new objects (projects), for the sake of which financing of those in process ends. Construction of PIP projects is regulated more clearly using the procedures of donors and creditors, so that financing of projects is more predictable throughout. But CSIP financing may cease at any time, even in the middle of a fiscal year.

Table 3. Summary of Analysis of CSIP Object Efficiency, 2012–13

	2012	2013
Number of active objects in the program	575	652
Average allocation per object in portfolio (US$ million)	1.9	1.6
Average allocation per new object (US$ million)	1.8	0.97
Share of budget allocated to object with completion rate < 50 percent (%)	73	80
Of which: Percent of budget spent on new objects	*48.2*	*33.3*
Share of budget allocated to objects with completion rate between 50 and 80 percent (%)	14	16
Share of budget allocated to objects with completion rate > 80 percent (%)	13	4
Number of objects with implementation period longer than 7 years	51	55
Average allocation per object implemented for the past 7 years (US$ million)	1.9	3.2
Number of objects with implementation period longer than 10 years	36	29
Program financial completion rate	3	2.7

Source: MoEDT data.

49. **The limited project-level information suggests that the efficiency of public investment can be improved.** Till recently there was no unified centralized database of projects and objects with details on value, terms, previous financing, and degree of completion broken down by industry and political division. The MoEDT only prepare the database in 2012. The number of objects increased by 14 percent in 2013 over 2012, and the average size fell by 16 percent for all objects and by 46 percent for new ones (Table 3). In 2013 80 percent of centralized capital investments went to finance construction of objects that were less than half completed and one-third of the budget was allocated to new projects. Despite the large number of projects and their small size, the CSIP completion rate is almost three years—rather long considering the vast majority of objects are so simple they should normally

19 For more information on procurement issues in Tajikistan, see the 2012 PEFA (PI-19 and its dimensions) and the World Bank CPSR (2012b). Unfortunately, neither document explicitly addresses procurement for public investment.

be completed within a year—two at most. The database needs to be expanded and better maintained, along with capacity for its analysis and timely input into the budget process.

50. **Another factor that significantly undermines the efficiency of public investment is the use of obsolete sector-specific norms and building regulations and standards.** Thus, while preparing requests for construction of new objects or rehabilitation, the main local and central budget agencies are guided by the regulations for forming a network of budgetary institutions that go as far back as the Soviet period.[20] Regulations and standards for construction and architectural works are also obsolete in terms of modern building technologies. Environmental protection regulations require specific attention.

C. Monitoring and Evaluation

51. **While creditors and donors are most likely to carry out regular monitoring and interim evaluation of progress on projects they have funded using their own techniques, there is no such methodology for domestically funded objects.** As a result, only the Ministry of Finance and the finance departments of ministries and local authorities monitor execution of budget plans execution (comparing actual with planned financing) based on quarterly financial reports. Other authorities that design and conduct centralized capital investments do no monitoring and interim evaluation; there are no criteria or indicators for such work. Obviously, this situation is exacerbated by the lack of a methodology for identifying and evaluating projects, and the problems with the selection methodology already noted.

52. **If there were an interim evaluation, it could allow for timely modification of a project or object if it were necessary to resolve omissions during planning or any significant changes in circumstances.** Ministries and agencies in fact have no leverages to manage a sector policy that is causing in efficient use of public funds. On the one hand, there are plenty of examples when central ministries have authority over institutions that are not directly related to their own mandates. For example, several higher educational entities are not subordinated to the appropriate ministry.[21] Despite a declared responsibility for development of a sector, the activity of a ministry is limited to setting out sectoral strategies, which, like the Program, are poorly related to the budget. The State Treasury submits quarterly project financing reports only to the Ministry of Finance only. Thus, ministries and agencies interested in what is happening with projects and objects of only directly subordinated to them institutions.

53. **Project costs may be contained at the expense of quality.** The MoEDT reported no object cost over-runs in 2012: the amount left to spend to bring each active object to completion was always recorded as positive. Nonfinancial dimensions of progress should also be monitored. This would allow for comparison of financial and physical completion rates and help ensure than costs are not contained at the expense of quality.

20 Such regulations set out input-based capacities of budgetary institutions; for example, number of beds in a hospital is calculated based on the number of local residents.

21 Tajik State Medical University is subordinate to the Ministry of Health and Social Protection; Agricultural University to the Ministry of Agriculture; the Institute of Entrepreneurship and Service and the Technological University of Tajikistan are subordinate to the Ministry of Industry and New Technologies.

54. **Results for even the largest projects are not evaluated ex post.** Like other post-soviet economies, Tajikistan has an effective handover process by which new facilities are verified as consistent with the original design specification and fit for purpose (post-completion control). In global practice it is common to evaluate a large project two to three years after completion. This provides valuable information about lessons learned that can be taken into consideration in selecting new projects and helps to significantly improve the quality of decisions made and PIM efficiency. Requiring a formal completion report presenting not only certification/acceptance of works but also an analysis of such things as the original versus the achieved budget, the achieved time-line versus the planned and offering explanations and lessons learnt could be a first step towards full ex-post evaluation, which maybe an ambitious requirement in the near term.

5. Conclusions

55. **The main conclusions from this note are as follows:**

- High economic growth and substantial external assistance have helped to keep capital spending in Tajikistan at a high level in relation to GDP.
- However, increasing uncertainties about the global environment and the Russian growth outlook put Tajikistan's growth prospects at high risk.
- Furthermore, despite recent strong growth, Tajikistan's economy and the vulnerability of its public finances to shocks has increased as a result of slowing or delay of important structural reforms.
- While there is scope for raising revenues through better tax collection, given growing spending pressures, both recurrent and capital, the fiscal space available will still be very tight.
- This suggests that Tajikistan should move promptly to improve its efficiency to better utilize its resources and better implement good projects when more resources became available.

56. **Tajikistan needs to address both equity and sector allocation efficiency issues to better mobilize resources in support of national priorities.** It is critical to ensure that spending is efficient, funds are channeled to higher-return investments and the Government of Tajikistan's significant spending on public investment translates into correspondingly productive assets.

57. **Analysis of the PIM system in Tajikistan suggests that lack of a unified methodological framework, fragmentation, and poor institutional links discourage efficient use of limited domestic resources and attraction of external financing.** These weaknesses need to be addressed as part of comprehensive PFM and other public administration reforms. The government is advised to consider the following recommendations, stemming from the analysis above:

- **Set up a unified methodological framework for PIM operations.** This could be done by amending the Law on Public Finance to introduce clear terminology, principles, and institutions of effective PIM. In particular,
    - The notion of an economic rationale-based public investment project that could be financed out of various sources (budget and external funds) should be set forth.
    - All inter-related project cycle stages and the distribution of powers between all participants of the process should be identified, the duplication of functions and processes should be eliminated.
    - Project cycle specifics for small, medium and large or strategic projects, as per a cost ceiling, should be identified.

- **Reinforce the link between investment forecasting and the budget process to ensure predictability, continuity, and sequencing of financing.** In particular:

  - The powers and responsibilities of the MoF and the MoE and rules for their interaction need to be clearly delineated in a legally enforceable manner.
  - The process of preparing the Program of Public Investments, Grants, and Capital Construction should be synchronized with the budget process to ensure that estimated amounts of its financing are clearly specified by the MoF. The MoF should define the amount of state capital investment spending for the planning year and send it to the MoE at the start of the budget process (before budget requests are prepared) or even before the budget process itself begins. That amount could not be significantly changed in the annual budget law and must be used by the Program.
  - To ensure the stability of public investment financing, a medium-term forecast of state capital spending for the next two to three years should be presented.
  - Procurement needs to be better integrated into the budget cycle and into the MTEF.
  - The timing for preparing the Program should be revised. The proposed list of projects recommended for budget financing based on the Program has to be sent to the MoF in time for it to be included in the annual budget law.

- **Build up strategic guidance for identifying and selecting projects.**

  - Only selected projects must be recommended for public financing.
  - The possibility of including in the budget any projects outside the Program must be restricted.
  - To reduce the risk of corruption and increase the objectivity of the selection process, the MoE could consider establishing a special inter-agency council for public investments that would select projects for the Program.

- **Assure the consistency and continuity of public investment financing.** Consistency will help to reduce the number of frozen or unfinished projects.

  - The possibility of including in the Program and in the annual budget new projects and objects the cost of which exceeds a difference between the amount required to finance ongoing projects (objects) and the estimated cost should be limited.
  - The practice of stopping work during a fiscal year to include new projects in the budget should be eliminated.
  - It is also advisable to set a clear-cut mechanism for suspending or terminating projects in case of significant changes in circumstances or other problems found in the course of monitoring or interim evaluation.

- **Enhance the quality of project preparation and appraisal.**

  - Project identification and appraisal system should start with the spending agency and be based on financial and economic analysis of costs and economic benefits, possible fiscal impact (e.g., the amount to be spent to maintain objects after an investment project is completed and possible sources of financing), and assessment of risks.

- There needs to be a better mechanism for comprehensive appraisal of large and strategic projects and simplified procedures for small- and medium-cost projects.
- Clear guidelines should be drafted and disseminated for all participants in the public investment process and staff capacity should be built up.

- **Professionalize monitoring and evaluation.**

  - Non-financing indicators should be systematically monitored, with interim evaluation, especially for large and strategic projects to reinforce the current quarterly monitoring of financing and improve the price/quality ratio and speed up schedules. The MoEDT as the government body responsible for public investment policy should lead this process.
  - It could be recommended that the government review the annual monitoring report of the MoE as the budget law for the following year is being prepared.

- **Introduce project ex post evaluation.**

  - Methodological approaches to ex post evaluation for small, medium, and large or strategic projects should be identified.
  - Schedules and an institutional framework for mandatory independent external evaluation of large and strategic projects should be established.
  - An evaluation calendar should be incorporated into the budget process so that lessons learned can be taken into account in future decision-making.
  - It should be recommended that new Chamber of Account be given power to perform external audits of completed investment projects as ex post evaluations of their results.

- **Consider gradual decentralization of capital expenditures to the local level.**

  - Funds for capital spending on construction of low-cost social and cultural objects of exclusively regional importance should be decentralized to the regional level.
  - The same approach should be used for important district projects.
  - De-concentration of funds could be achieved through inter-governmental transfers or changes in sharing of state taxes. Currently, as no budget responsibilities are clearly assigned to different levels of government in Tajikistan, identical objects may be financed by different budget levels.[22] This situation complicates establishment of a simple, unified, approach to decentralization of financial resources.

- **Invest in building capacity for efficient PIM.** The lack of local staff capacity in terms of both quantity and quality is the next big challenge and must be addressed if there are to be PIM improvements.

58. **The proposed reforms need to be sequenced to take into account implementation capacity and expected benefits.** The initial focus could be on strengthening monitoring system for projects under the implementation and

22 For instance construction of a new school in one district could be financed from this district budget and other similar schools in this district– from the regional oblast or even republican budget.

pipeline; this would help better budget forecast and appropriations. To ensure continuity and consistency, no new project should be approved if a certain number or volume of investments is under implementation. Rationalization of regulations and procedures and clarification of the roles of the MoEDT and MoF could be completed over the medium-term. In the long term, clear assignment of budget responsibilities to different levels of government and building local capacity in PIM would allow to de-concentrate local capital spending. In the longer term, a system of ex post evaluation would leverage the experiences of past projects to inform identification and implementation of follow up projects.

Annexes

Annex 1. Economic Classification of Tajik Capital Expenditures

5 Purchase of fixed assets

5.1 Centralized capital investments

5.1.1 New construction

5.1.2 Reconstruction and rehabilitation

5.1.3 Purchase of buildings and premises

5.2 Purchase of equipment, machines, and inventory considered as fixed assets

5.2.1 Equipment, machines and inventory

5.2.2 Transport vehicles

5.2.3 Art collections, museum exhibits, etc.

5.2.4 Computer programs/software

5.2.5 Library funds

6 Purchase of goods, land, and intangible assets to establish reserves

6.1 Purchase of goods to establish reserves

6.1.1 Purchase of goods to establish reserves

6.2 Purchase of land and intangible assets

6.2.1 Land and intangible assets to establish reserves

7 Capital transfers

7.1 Internal capital transfers

7.1.1 Capital transfers to other levels of government

7.1.2 Capital transfers to nonfinancial state enterprises

7.1.3 Capital transfers to nonfinancial private enterprises

7.1.4 Capital transfers to financial institutions

7.1.5 Internal capital transfers not elsewhere classified

7.2 Capital transfers abroad

7.2.1 Capital transfers to foreign governments and international organizations

7.2.2 Supranational government bodies

7.2.3 From supranational government bodies to their headquarters

7.2.4 Capital transfers abroad not elsewhere classified

Source: Order of the Ministry of Finance of the Republic of Tajikistan No 159, dated 12.28.2004

Annex 2. Data Used, Issues, and Methodology

To date, capital spending data repositories are fragmented in Tajikistan. Data reside in multiple systems and figures for spending on investments or new construction, purchases of fixed assets and land, major repairs, and donor- and domestically-funded spending financed from budget funds and extra-budgetary funds are often generated separately, and obtained from a variety of units within the Ministry of Finance (MoF) and the Ministry of Economic Development and Trade (MoEDT). This leads to increased costs for collecting data for both Bank teams and the government. The costs rise in proportion to the number of separate data requests required.

The Treasury system put in place in 2009 somewhat improved the quality, detail and availability of the republic's budget data but more remains to be done. Spending from local budgets and local extra-budgetary funds, for instance, can only be disaggregated into the following 17 subnational units: GBAO, Khatlon Oblast, Sughd Oblast, the City of Dushanbe, and the 13 Rayons of Republican Subordination (RRS). Donor-financed Public Investment Program (PIP) spending is available by main function (sector) but cannot be disaggregated into sub-functions; it also cannot be disaggregated by administrative or economic classification, and most PIP spending is de facto classified as for new construction (code 5.1.1.; see Annex 1). Current initiatives to improve and extend the operation of the Treasury and to introduce standard functional and economic classification for reporting (consistent with IMF GFS 2001 standards) for all financing sources will over time help address some of these data deficiencies.

The analysis of capital spending in this Note used as its main source MoF budget execution reports (republic, local, and extra-budgetary economic and functional breakdowns), and the Tajikistan BOOST—a tool that facilitates analysis of public expenditures—was updated. The BOOST is a database of disaggregated expenditures at the lowest level available within the country's treasury system. It follows the national fiscal reporting methodology and includes information on approved, revised and actual budgets broken down by government level (central, local, other), administrative units, subnational spending units, economic classification, functional classification, and financing source (budget funds/general budget revenues, extra-budgetary funds, and external funds). It covers 2007–12 and was notably used to document recent expenditure levels, patterns, and the financing mix (focusing on public investments and major capital repairs) as well as sectoral allocations of resources and shifts in the economic composition of expenditures.

Assessment of the performance of Tajikistan's PIM system concentrates on the project cycle key phases and compares the rules and procedures associated with investment projects in Tajikistan with minimum accepted international institutional standards rather than OECD best practices. Object-level new construction budget execution data for the Centralized State Investment Program (CSIP) was obtained from the MoF and object-level monitoring information (planned implementation period, estimated cost at inception, amount spent since inception, remaining amount to spend, financial rate of completion and amounts budgeted for 2012 and 2013) was obtained from the MoEDT to supplement the PIM diagnostics, particularly the analysis of the project implementation process and institutional arrangements. The data were also used to identify the main areas or sectors affected by poor planning of capital expenditures, examine the trade-off between selection of new projects/objects and conduct of the domestic public investment program, and analyze delays in project/object completion and cost over-runs.

Annex 3. Centralized State Investment Program

The CSIP is the government's main domestic investment policy instrument. The Ministry of Economic Development and Trade (MoEDT) is the lead agency but collaborates with other line ministries, agencies, and local governments. The latest investment plan covers 2014–16, and earmarks the lion's share of the CSIP budget to the energy sector (47.9 percent of the TJS 8.6 billion or US$1.8 billion total envisaged CSIP outlays). Housing and communal services (15 percent) and culture and sports (11 percent) are the next two most important sectors (Table A3.1).

Table A3.1. Centralized Capital Investments Budget, 2014–16

	2014	2015	2016	Total	2014–16
		Million TJS			Percent
Total[1]	2,723	2,820	3,030	8,573	100.0
Social sectors, *of which:*	652	625	826	2,104	24.5
Education	186	197	242	626	7.3
Healthcare	97	133	280	510	6.0
Culture and sports	370	295	303	968	11.3
Economic affairs, *of which:*	2,071	2,195	2,204	6,470	75.5
Energy	1,353	1,349	1,403	4,105	47.9
Housing and communal services	384	502	435	1,321	15.4
Transport	14	16	12	42	0.5
Other sectors	319	328	354	1,001	11.7

Source: Ministry of Economic Development and Trade of Tajikistan.
Note: 1/ Does not include spending on maintenance and repairs, and spending from extra-budgetary funds.

The Rogun hydropower project accounts for nearly a third of government capital spending. The project addresses Tajikistan's energy deficit, and is one of the government's strategic priorities as described in strategy and policy documents, such as the government's Memorandum of Economic and Financial Policies. Between 2007 and 2013, the government disbursed TJS 4.1 billion (US$844 million) for rehabilitation of the power station (Table A3.2). The investment plan for 2013–15 envisages additional transfers to the RHPP fund of TJS 2.6 billion (US$506 million), or about 28 percent of the total capital budget for 2014–15.

Table A3.2. Public Expenditures on the Rogun Hydropower Project, 2007–15

	2007	2008	2009	2010	2011	2012	2013	2014p	2015p
Budget allocation (millions of TJS)	6	146	526	641	888	937	947	1,290	1,350
Budget allocation (millions of US$)	2	43	127	146	176	197	195	252	254
Percent of GDP	0.0	0.8	2.5	2.6	3.0	2.6	2.3	2.7	2.5
Percent of. capital investments	0.6	11.1	30.8	31.5	31.1	31.3	24.4	29.8	26.0

Sources: Data from the Ministry of Finance of Tajikistan. p- projected.

The government has financed all Rogun expenditures to date from the budget and other domestic financing sources. It launched an equity campaign in 2010 to raise funds for the project but agreed to suspend the campaign within months because of development partners concerns about possible adverse social and macroeconomic implications of the project. However, TJS 820 million had by then been raised; the government received an additional TJS 197 million in 2011 (Table A3.3).

Table A3.3. Funds Received by the Rogun Open Joint Stock Company, 2010–12

	2010	2011	2012
Total cash inflows (Millions of TJS)	1,461	1,085	939
Government (state budget)	641	888	937
Equity campaign, *of which:*	820	197	2
Population (shares)	568	0	0
Banks (shares)	41	197	0
Enterprises (shares)	186	0	0
Other non-bank entities (shares)	0	0	2
Donations	25	0	0

Source: Ministry of Finance of Tajikistan.

Annex 4. Public Investment Program

In the past five years, PIP spending has mostly gone to transport and energy; comparatively little has been spent on other sectors, particularly social sectors. This reflects both government priorities as articulated in the Poverty Reduction Strategy, and the rising importance of some development partners as the main sources of PIP financing. As of 2012, Tajikistan's PIP comprised 56 active projects with combined project commitments of US$2 billion, financed through a combination of credits (51 percent), grants (38 percent), and government contributions (11 percent). The breakdown of the sources of financing is as follows:

(i) *US$1 billion credits:* China (56.7 percent of total PIP credits), ADB (13.5), Islamic DB (10.7), Saudi Fund (4.0), World Bank (3.2), Kuwait Fund (3.0), OFID (3.0), KfW (2.7), EBRD (1.8), Abu Dhabi Fund (1.5)

(ii) *US$764 million grants:* ADB (57.7 percent of PIP grants), World Bank (26.4), EBRD (4.5), Japan (4.5), KfW (3.5), IFAD (1.6), and JICA (1.8)

(iii) *US$211 million:* Government contribution.

Credits from China have been a key source of financing for capital spending (Table A4.1). For 2007–13, Chinese credits for transport and energy exceeded US$970 million (Table A4.1). These credits have a 20-year maturity, a 5-year grace period, and 2 percent annual interest rate, implying a grant element of 40 percent.

Table A4.1. Chinese Credits for Investment Projects by Sector, 2007–13

	2007	2008	2009	2010	2011	2012	2013	2007–13
Total (million TJS)	747	953	620	476	630	112	268	3,806
Energy	359	532	414	192	-	8	18	1,523
Transport	388	421	207	285	630	104	250	2,285
Total (million US$)	217	279	150	109	137	24	55	971
Total (percent of GDP)	5.8	5.4	3.0	1.9	2.1	0.3	0.7	2.7

Source: Ministry of Finance of Tajikistan.

Recent projects financed through Chinese credits include:

North-South Electricity Transmission Line: One of the largest public investment projects in the past five years, this transmission line has helped connect the northern Sughd region to the national grid. The Sughd region was previously supplied electricity through the unified Central Asia electricity grid via Uzbekistan. Uzbekistan's decision to withdraw from the Central Asia grid in 2009 made completion of this project a Tajik national priority. The initial estimated value of the project was US$281.3 million, of which more than US$267.2 million was financed by long-term loans from China. Additional funds were transferred in the second half of 2009 under a new credit agreement for supplemental construction. The North-South transmission line has been operational since November 2009.

220kV Lolazor-Khatlon Electricity Transmission Line: The Lolazor-Khatlon transmission line has been operational since June 2008. This 90 km transmission line has helped connect the southern region to the national grid. Total initial value of the project was US$58.1 million, of which more than US$55.2 million was financed by China. Additional funds were transferred in the second half of 2009 under a new credit agreement with China for supplemental construction.

220kV Khujand-Ayni Electricity Transmission Line: The project includes construction of the Ayni and Shakhristan substations and transmission lines. The Khujand-Ayni power transmission line will connect the Zarafshon Valley to the unified power system through the 500kV South-North power grid. Total value of the project is US$36.9 million, US$35.1 million which is being financed from Chinese loans.

Construction of the unified power system/ single power grid for the north of Tajikistan: A new Sughd-500 substation will supply electricity to the north of Tajikistan. Total value of the project is US$27.9 million, with US$1.4 million co-financed by the government. Construction of the Sughd-500 substation is a first step in the Central Asia South Asia Electricity Trade and Transmission Project (CASA 1000), which aims to establish the necessary transmission systems and trading infrastructure to enable Tajikistan and Kyrgyzstan to supply surplus electricity to Afghanistan and Pakistan.

Reconstruction of the Dushanbe-Khujand-Chanak Highway: This 350-km road connects the capital Dushanbe with Ayni, Istaravshan, and Khujand in the northern Sughd region; it ends at the Tajikistan-Uzbekistan border at Chanak. The project also includes construction of a 5 km tunnel under the Shahristan pass, bridges, drainage ditches, and anti-avalanche galleries. Reconstruction is being financed by a Chinese Eximbank credit. Total value of the project is US$295.9 million. To help repay the loan and cover road maintenance expenses, the government converted the highway to a toll road in 2010 and allowed a private company, Innovative Road Solutions, to collect tolls.

Dushanbe-Dangara Road: This 154-km road between Dushanbe, Vakhdat, and Dangara is the first phase of the 1,100 km Tajikistan-China highway project, completion of which is expected to significantly boost trade between the two countries. The first phase of the project also includes construction of the 4.4 km Chormagzak tunnel. As of April 2013, TJS 1.4 billion (US$296 million) had been spent.

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