

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

**ECAPDEV GRANT FOR PREPARATION OF THE COMMUNAL SERVICES
DEVELOPMENT FUND PROJECT**

Project Name	GRANT FOR PREPARATION OF THE COMMUNAL SERVICES DEVELOPMENT FUND PROJECT
Region	EUROPE AND CENTRAL ASIA
Country	Tajikistan
Sector(s)	Water supply (80%); Solid waste management (10%); Sub-national government administration (5%); Sanitation (5%)
Lending Instrument	Grant
Project ID	P133449
Borrower(s)	Government of the Republic of Tajikistan
Implementing Agency	“Khojagiyyi Manziliyu Kommunalii” (KMK)
Environmental Category	FI -Financial Intermediary Assessment
Date PID Prepared/Updated	13-May-2013
Estimated Date of Appraisal Completion	30-April-2014
Estimated Date of Board Approval	24-September-2014
Concept Review Decision	25-June-2013

I. Introduction and Context

A. Country Context

1. Tajikistan is a land-locked country covered with mountains over 90% of its surface. Its population of 7.3 million is young and growing rapidly, at 2 percent per year during 2000-07. A 2009 Poverty Assessment Update indicated that households with three or more children account for 53 percent of the total population, and 62 percent of the poor population. Severe limitations in employment opportunities in Tajikistan have led a large number of workers (up to 40 percent of the working population) to seek better job prospects overseas—largely in Russia. The resulting dependence on remittances increases vulnerability in the economy and among the Tajik population, which is also regularly affected by natural disasters such as floods, mudflows, landslides, avalanches, earthquakes, droughts and epidemics due to the country's geography,

topography and climate.

2. Immediately after independence, the country fell into a devastating civil war (1992-1997). Notwithstanding the relative stability since the end of the war and an average economic growth rate of 8.6 percent per year between 2000 and 2008, Tajikistan remains the poorest country in Europe and Central Asia (ECA) region. Per capita GNI is US\$860, and 41 percent of the population lives below the poverty line. Although after 1997, peace and stability prevailed, followed by macroeconomic and political stabilization (supported by the international community), which opened the path towards a modern government based on democratic principles, decision-making remains centralized and political accountability is limited.
3. Tajikistan's 1,400 km-long southern border is shared with Afghanistan, and the country is separated from Pakistan in the south by the narrow Wakhan corridor. Tajikistan's remoteness, existence of regional physical barriers together with deteriorating Soviet-style transport infrastructure networks and weak governance and regulatory policy frameworks, poses significant barriers to international trade, connectivity and investment. Its economic growth in 2000-2008 was driven mainly by restoration of fiscal discipline and macroeconomic stability which stimulated a recovery of consumption, production and investment facilitated by implementation of some structural reforms to liberalize the economy following the end of conflict, and a favourable external environment. World prices for cotton and aluminium—Tajikistan's main export commodities—soared, while growth in Russia and other trading partners boosted demand for Tajik labor. The resulting growth in remittances fuelled a consumption boom in Tajikistan, which helped to support buoyant growth in real Gross Domestic Product (GDP) during the 2000s. However, being it dependent on key commodity exports; aluminium, cotton, and labor, which (measured through remittances) accounted for 51.8 percent of GDP in 2008, Tajikistan was hit hard by the global economic crisis.
4. Despite progress in some areas, it is unlikely that Tajikistan will achieve its Millennium Development Goals (MDGs) by 2015. The indicators related to infant mortality (per 1,000 live births), under-five mortality (per 1,000 live births), and maternal mortality (per 100,000 live births) stand at 56, 68, and 97, compared to the 2015 MDG targets of 25, 30, and 30, respectively. The incidence of tuberculosis (TB) and HIV/AIDS has been increasing, and the use of contraception and knowledge of HIV/AIDS prevention remains limited.). Coverage of water supply services is reported to be 59 percent nationwide (93 percent in urban areas and 47 percent in rural areas compared to a target of 74 (rural) percent by 2015. The reasons for this have much to do with the limited financial, institutional, and human resources available to the country to adequately address its basic social challenges. Social sector expenditure remains lower than those prevailing in other Commonwealth of Independent States (CIS) countries due to budget constraints. Despite efforts to improve its social sector, the quality of education and health services remains below Soviet-era levels. A large proportion of the population still has only limited access to basic services. The social safety net system that was established to protect the vulnerable, including the unemployed, is rudimentary.
5. Tajikistan has a sub-national administration system that still follows, to a large extent, the Soviet system in place before 1991 and has three levels: provinces (oblasts), towns and rayons (rural districts), and sub-districts (jamoats). The relationship between these units is generally but not universally, hierarchical. Even though the Government has started working in recent years on creating the legal framework for decentralization and local government reform,

Tajikistan, at this point, still operates as a heavily centralized state. Local authorities play only a marginal role in delivery of basic municipal services. Delivery of such services is primarily a responsibility of a central government agency, the State Unitary Enterprise Khochagii Manziliu Kommunalni (or KMK, formerly known as TajikKomunServis), and its local subsidiary utility enterprises.

B. Sectoral and Institutional Context

6. Since the civil war (1991-1997), the infrastructure inherited from the Soviet times has continued to deteriorate rapidly as lack of fiscal resources has forced the Government to curtail investments and maintenance expenditure. Tajikistan's municipal sector features substantial infrastructure gaps and degradation, as well as low institutional capacity, particularly in urban water supply, sanitation and solid waste management. Laws passed in 2009 and 2010 support the decentralization and transfer of public service responsibility from KMK to local governments, but are not being effectively enacted on the ground, due to various factors including the lack of capacity and sufficient funding. Most utilities thus continue to be ambiguously subordinated to both the central administration of KMK and to the Mayor's office.
7. The GoRT is currently seeking to strengthen service regulation functions. Legislation was recently passed¹ to update service standards for improved efficiency of water use, and to clarify the rights and responsibilities of utilities and consumers. Implementation however has been weak due to capacity constraints and insufficient funding of local utilities (local branches of the KMK). The GoRT recently introduced regulations to improve water use efficiency by updating per capita consumption and service standards, and clarified responsibilities of utilities and the rights of consumers. KMK is mandated to implement these acts over the next two years. It also intends to pilot initiatives to improve financial sustainability of its branch utilities and to enhance KMK's management and oversight functions.
8. To date, the World Bank, EBRD and the Swiss Cooperation are Tajikistan's main partners for urban water supply rehabilitations. The World Bank-financed improvements to urban services have mainly focused on water supply through two ongoing operations, the Second Dushanbe Water Supply Project (DWSP II) and the Municipal Infrastructure Development Project (MIDP, and its Additional Financing), targeting provincial towns. The Grant will support the preparation of an additional operation, the Communal Services Development Fund Program, which is expected to broaden Bank support and extend it to much needed improvements in the delivery of basic municipal services in other, economically more challenged, towns and contribute to improving the quality of life of their populations.

Key Issues in the Sector

9. *Inadequate implementation of reforms at the local level.* Tajikistan's National Development Strategy (2015) identifies implementation of reforms at the local level as one of the key challenges to overcome. It recognizes that the current centralization of government revenues

¹ Under the Local Governance and Citizen Participation program supported by USAID landmark laws were passed in August 2009 ("Law on Local Self Government in Towns and Townships" and the "Law on Housing Associations") and a recent presidential Decree "Concept of Housing and Communal Services Sector Reform (2010-2015)" was passed in July 2010. Law on "Potable Water and Its Supply" dated December 16, 2010, "Regulation on the use of water supply and sewerage networks in the Republic of Tajikistan" dated April 30, 2011";

and the insufficient clarity with regard to the rights, powers and accountability of local governments and local self-government authorities discourages implementation of reforms at the local level. Tajikistan's communal services sector features substantial infrastructure gaps and degradation, as well as low institutional capacity, particularly in urban water supply, sanitation and solid waste management. Although laws passed in 2009 and 2010 support the decentralization and transfer of public service responsibility from KMK to local governments, they are not being effectively enacted on the ground, due to various factors including the lack of capacity and sufficient funding. Most utilities thus continue to be ambiguously subordinated to both the central administration of KMK and to the Mayor's office in each town or city.

10. Weak municipal and utility capacity to deliver and manage communal services and maintain physical infrastructure. Tajik cities suffer from low levels of municipal and KMK management capacity and weak accounting and budgeting. Key deficiencies include - inefficient organizational structure resulting in duplication of tasks, lack of coordination, dysfunctional units, overstaffing, lack of performance incentives and poor staff qualifications; limited capacity and authority to manage inter-agency coordination; and limited engagement of the private sector to support the delivery of municipal services.
11. Rapid decline in quality of communal services. According to the NDS, 59% of the population (93% in urban centers/major cities and 47% in rural areas) has access to centralized water supply systems. The rest of the population draws its water from other sources which do not meet public health requirements and contributes to infectious diseases. At the same time, while official accounts state that 95% of urban residents had access to an improved form of sanitation in 2008, sanitary conditions in many small towns are dire. Recent assessments of small towns provided by KMK for 2011 in the Khatlon Region indicate water supply coverage as low as 14%, solid waste coverage of 1% and sanitation coverage of 0-1% in some towns. Inadequate budget appropriations, low tariffs and poor collection rates with regard to payment of services and insufficient use of domestic and foreign investment have contributed to no serious changes being made in the infrastructure base and in the quality of services provided.
12. Financing Gap. The Program on Improvements of Drinking Water Provision 2020 proposes a range of urgent measures to improve both urban and rural water supply: rehabilitate the existing and construct of new water supply systems; improve the systems efficiency through metering and reduction of losses; reform the tariff policy; strengthen human resources capacity in the sector; and review the State water quality standard. However, the program doesn't mention priorities for development of sanitation. The total cost of the program for the period 2007-2020 was estimated at about 3.3 billion TJS (or about US\$1 billion) in 2006 and was updated by KMK to stand around US\$2 billion in 2011. The funding is expected to come from several sources such as the central budget (via the Ministry of Finance) – 15%; local state administrations (raions and towns) -10%; water utility - 5%. The remaining gap of some 70% is presumed to be covered by external financial assistance. In reality, the domestic sources of financing are highly uncertain judging by the fact that central government sector investments in the year 2007 reached only US\$ 1.8 million²
13. Limited Sources of Financing. According to the Water Code, the sources of financing can include: funds collected from (i) service users; (ii) funds of central state budget and funds of local state budgets; and (iii) funds from individuals and legal entities for development of water

² Tajikistan Water Supply and Sanitation Sector Note, 2009

supply systems, and from other sources, allowed by the law of Republic of Tajikistan. In reality the funds from service users are likely to be low or nil. Financial performance of water supply and sewerage utilities is weak. Funds collected by utilities from consumers are low due to low levels of tariffs, large losses and unaccounted for water/sewerage. According to the World Bank Water and Sanitation Sector Note 2009, domestic financial institutions are not involved in any type of financing of water supply and sanitation investments, apart from providing short term lending to utilities to pay salaries or purchase production inputs. Utilities and municipalities appear to have no financial capacity to borrow from commercial banks.

C. Relationship to CAS

14. The proposed ECAPDEV Grant and CSDF Project (P133449) are linked with the current Country Partnership Strategy (CPS) for Tajikistan (FY2010-2013) formulated in April 2010 (Report No. 50769-TJ). The project is linked to the second objective of the CPS which seeks to 'pave the way for post-crisis recovery and sustained development' and includes improved provision of safe water in Dushanbe and selected municipalities as one of its main results. In addition, the proposed activities are aligned to Tajikistan Government's effort to scale up improvements in access to basic services and enhance service delivery.
15. Therefore, the proposed project is highly relevant to Tajikistan current development priorities. The idea of developing a fund-based mechanism was developed during preparation of the Additional Financing for the Municipal Infrastructure Development Project (approved in April 2013), when the GoRT approached IDA with the request to assist them in establishing a fund at the central level to mobilize capitals from different donors and government counterparts, leveraging available funding, and channeling the funds (initially mainly as grants) to localities and/or to service providers based on clear priorities and criteria.

II. Proposed Development Objective(s)

16. The development objective of the ECAPDEV grant is *to conduct preparation activities and studies for the Communal Services Development Fund Project (CSDFP) in Tajikistan (P133449)* at the DMT, there was discussion that this project may be go to board in early FY15. The objectives also include capacity development of government counterpart agencies to enhance their readiness for project implementation.
17. The Proposed CSDFP project aims to support the financing and development of municipal services by increasing coverage and improving service delivery capacity of municipalities and communal service enterprises such as water supply, sanitation, and solid waste management in Tajikistan. The proposed investment lending would target the un-served or under-served areas (both urban and rural) through the establishment of a Fund-based mechanism (tentatively called Communal Services Development Fund). Potential benefits of such a Fund-based mechanism could include: (i) facilitation of resource mobilization; (ii) rationalization and prioritization of investment decisions; (iii) clarification of roles and responsibilities of various sector agencies; (iv) more harmonious donor coordination under the coherent sector policies; (v) capacity building of municipalities/service providers; and (vi) improved services at the municipal level.

Key Results

18. Five key results expected to be achieved under the Grant PDO are as follows:

- (i) The Government of Tajikistan meets readiness criteria for CSDF Project appraisal.
- (ii) The Government of Tajikistan meets readiness criteria for CSDF Project negotiations.
- (iii) The capacity of government counterparts is enhanced in the areas of financial management, procurement, and safeguard issues.
- (iv) Key outputs of the grant activities such as the CSDF design report, Operational Manual, and sub-project identification and designs have been submitted to the Government, discussed and approved.
- (v) The capacity of beneficiaries (services providers and municipalities of participating towns/cities) to prepare sub-projects and qualify to meet CSDF funding criteria is enhanced.

III. Preliminary Description

Background and Rationale

19. The on-going World Bank Additional Financing of MIDP is supporting the Government of the Republic of Tajikistan to develop a Municipal and Communal Services Development Strategy (MCSDS). As part of this exercise, the GoRT approached IDA with a request to assist them in harmonizing donor financing aimed towards development of communal services. The government is keen to explore the establishment of an appropriate rules-based financing mechanism at the central level that could mobilize, as well as, pool capitals from different donors and government counterparts and channel funds to municipalities and/or service providers based on an agreed set of priorities and criteria. The MCSDS is seen as an essential first step in understanding the municipal sector before launching any type of financing mechanism. It was therefore agreed that the process and preparation of establishing the Communal Services Development Fund (CSDF) under the proposed IL project would follow two Phases. Phase I is the development of the Municipal Strategy, that would provide the technical and sectoral analysis to carry out Phase II- design and development of an appropriate financing mechanism, i.e the Communal Services Develop Fund, that is suitable for a low capacity country such as Tajikistan. This grant proposal is being put forward in order to finance Phase II project preparation activities. Tendering of contracts for the development of the Municipal Sector Strategy under MIDP-AF is in its final stages and activities are expected to start shortly.

20. **Phase I:** The following activities will be carried out in the process of developing the MCSDS:

- i) *Review and assess the current policies, practices and situations surrounding the country's municipal and communal services sector.* This mainly entails: (i) full understanding of who does what under what kind of legal framework and what levels of financial resources in terms of provision of municipal and communal services;(ii) reconcile the various government decrees, laws and national strategies in the sector and analyze their inter-connections and impact on furthering or constraining implementation progress on municipal development; and

(ii) identification of sector issues towards more sustainable and efficient service provision.

ii) *Develop a medium-term Municipal and Communal Services Development Strategy.* This mainly includes: (i) recommendations and action plan for implementation of reforms after considering all applicable legislation, national policies, and strategies (ii) clarification of roles and responsibilities of various sector institutions (including roles of communities and private sector) in terms of policy making, regulations, planning, service provision, supervision, and O&M; (ii) capacity development of such sector institutions according to the clarified roles and responsibilities; (iii) improvement of municipal finance situations and inter-governmental fiscal relations to enhance financial resources for sector investments; and (iv) any other policy issues critical to the sector reform.

iii) *Analyze various financing options to enhance sector investments,* including the possibility and viability of establishing the proposed Communal Services Development Fund (CSDF) in the Tajikistan's context. This should include identification of potential risks and issues of establishing a CSDF and recommendation of risk mitigation measures. Also, the governance structures and institutional options to house such a Fund will be proposed.

Phase I will also include the following analysis that would be the informational basis for proceeding with preparatory work that will be financed by this ECAPDEV Grant Proposal.

- (i) Assessment of current institutional structure and capacity for municipal service provision;
- (ii) Evaluation of regulatory and sector oversight mechanisms in place;
- (iii) Assessment of current assignment of expenditure functions by levels of government;
- (iv) Assessment of current inter-governmental fiscal transfer systems;
- (v) Assessment of financial sustainability in municipal service provision;
- (vi) Assessment of accountability and transparency in municipal services and local public infrastructure;
- (vii) Assessment of demand management, consumption and pricing of municipal services; and
- (viii) Assess involvement of communities and private sector in municipal services provision.

21. The proposed Communal Services Development Fund Project (CSDFP) intends to build on the findings and recommendation of the MCSDS and help the GoRT tackle the huge financing needs in municipal development, particularly with respect to provision of communal services infrastructure. The highest priority among various communal services in the country is water supply. According to KMK, investment needs for water supply alone are estimated to be about US\$ 2 billion. This includes new development of water supply systems in un-serviced areas as well as rehabilitation of deteriorated existing systems in both urban and rural areas. The proposed Project aims to target water supply, sanitation and solid waste management as a priority but could include other communal services in the future.

22. **Phase II** will involve activities that include developing the detailed designs and business processes/procedures for the CSDF which is further elaborated in Para 26 below.

Rationale for a Fund Based Financing Mechanism

23. The main argument in favour of the establishment of a Fund is the need for capital resources given the low coverage in basic services, such as water and sanitation in both urban and rural areas. The fiscal capacity of the municipality is fairly limited and it does not receive, or have access to any capital grants system from the Central Government for investment in basic municipal services and local infrastructure. This need for capital funds for basic local infrastructure seems to be similar across most local governments in Tajikistan.
24. The main element in the rationale of establishing a municipal or communal service development fund also known as MDFs in numerous countries around the world has been an attempt for resolving the issue of a lack of a stable source of capital financing for the expansion and rehabilitation of basic municipal infrastructure. International experience indicates that MDFs usually evolve into three models or phases. A first-generation MDF usually relies on donor-financed grants, while a second-generation MDF may be characterized by a combination of grants and loans and is typically financed by both donors and the central government. In contrast, a third-generation MDF regularly operates as a financial intermediary that on-lends to sub-national levels of government. Some of the best international practices currently in operation have evolved through these three general phases. This is the case for example of the Tamil Nadu Urban Development Fund (TNUDF) in India and the Financiera de Desarrollo Territorial (FINDETER) in Colombia. FINDETER started as an urban development account funded by a bilateral agency (USAID) and managed by a central government institution (The Central Bank). It evolved, at the peak of its performance, to become a financial intermediary supported by World Bank lending and on-lending to sub-national levels of government.
25. The above rationale behind establishing a financing mechanism such as a fund to support the sector also appears to be consistent with the current situation in Tajikistan. The National Social Investment Fund of Tajikistan (NSIF) was established with similar objectives but channels financing mainly for social infrastructure (mainly schools and health care centers) and it currently operates under the office of the Prime Minister. The current need of capital resource for basic municipal infrastructure is substantial. The most pressing needs, from a human and economic development viewpoint, seem to be in potable water in the rural areas. As reported by central government authorities, only about one fourth of the rural population has access to safe drinking water. Though water coverage in the urban areas is substantially much greater in terms of actual water connections, the statistics seem to be misleading in terms of effective connections and the quality of the water. For example, most current urban water networks inherited from the Soviet times are badly in need of rehabilitation. In addition to the frequent breakdowns, linkages and losses of water, many housing building, in their upper floors, simply do not have access to water because the pumping system has practically exhausted its operating life.
26. Therefore the potential economic benefits of expanding the current infrastructure in both rural and urban areas are expected to be significant. Typically, such benefits will be reflected in lower rates of deceases, reduction in health costs, increases in family income associated to higher productivity, and savings in loses of working days, among others. Similar benefits are expected to emerge from projects in sanitation and solid waste.

Grant components

27. The Grant will support Phase II activities towards preparation of the CSDF Project in Tajikistan and will be composed of three components: (1) developing a detailed design for the

Communal Services Development Fund, (2) developing the Operational Manual for CSDF and identification of sub-projects, (3) capacity building and (4) conducting a Grant audit. These components are expected to be developed by a consulting firm with broad international experience and a proven record dealing with municipal development projects in developing countries. The Terms of Reference for this work have already been drafted. A more detailed description of each of the components is found below.

28. Component 1: Detailed Design of Communal Services Development Fund. This component will focus on the development of a detailed design for the CSDF and its expenditure category is Consultancy Services.

29. Component 2: Development of Operational Manual and identification of sub-projects. This component will focus on the development of the Operational Manual for the proposed CSDF and identification of an initial pipeline of sub-projects. The expenditure category of the component is Consultancy Services.

30. Component 3: Capacity building and stakeholder consultations. While most of the capacity building and training directly related to the establishment and management of the Communal Services Fund will be financed under the proposed Bank Project, this grant will mainly cover the areas of environmental and social safeguards, procurement, financial management, and other operational aspects in order to enhance the readiness of government counterpart agencies as well as participating municipalities and utilities to prepare sub-projects. In addition, this component would assess the political-cultural environment of the communal services sector and identify a strategy for stakeholder engagement; and disseminate the results of the beneficiary consultations and of the diagnostic assessment of the sector, in order to inform and mobilize momentum for reforms.

31. Component 4: Grant Audit. This component will help conduct the required Grant Audit and the expenditure category is Other (audit).

IV. Safeguard Policies that Might Apply to the project

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01	X	X While the ECAPDEV Grant does not trigger this safeguard the proposed CSDF project is categorized as an FI and OP4.01 is triggered.	
Natural Habitats OP/BP 4.04			X Based on the CSDF project design it will be clear if this OP is triggered.

Forests OP/BP 4.36		X	
Pest Management OP 4.09		X	
Physical Cultural Resources OP/BP 4.11			X Based on the CSDF project design it will be clear if this OP is triggered.
Indigenous Peoples OP/BP 4.10		X	
Involuntary Resettlement OP/BP 4.12	X	While the ECAPDEV Grant does not trigger this safeguard the proposed CSDF project triggers OP4.12	
Safety of Dams OP/BP 4.37		X	
Projects on International Waterways OP/BP 7.50		X	
Projects in Disputed Areas OP/BP 7.60	X	The proposed CSDF project triggers OP7.60	

V. Tentative financing

Financing Source	Amount
BORROWER/RECIPIENT	0.00
International Development Association (IDA)	0.00
ECAPDEV Grant	0.45
Municipalities of Borrowing Country	0.00
Total	0.00

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