

## SECTOR OVERVIEW

- Fuel and lubricants sector.** The main factors influencing fuel and lubricants consumption are population, income per capita, and the number of vehicles. The population of Tajikistan grew by 2% per year during 2010–2016. Gross domestic product (GDP) grew by 7.2% per year from 1997 to 2014, slowing down to a 2% growth in 2015 and slightly contracting in 2016 because of the economic downturn in the Russian Federation. However, GDP increased by 12% in the first quarter of 2017 compared with the first quarter of 2016, showing signs of economic recovery in Tajikistan. The number of vehicles per 1,000 people in Tajikistan increased from 38 to 43 from 2010 to 2015, remaining at the same level in 2016. In Sughd region, where Sughdneft Limited Liability Company operates, the number of vehicles grew by an average of 6% per year from 2011 to 2015. An upward trend in the number of vehicles and population growth generally leads to increased consumption of fuel and lubricants in Tajikistan, including Sughd region.<sup>1</sup>
- The governments of Tajikistan and neighboring countries influence the fuel and lubricants sector through customs duties, taxes, and licensing. The price of fuel and lubricants in Tajikistan fell by over 25% from 2013 to 2014, after the Russian Federation reduced customs duties on oil and gas (which forms a part of fuel and lubricant cost) in 2013. The price is also expected to be affected by a plan of the Government of Tajikistan to reduce value-added tax to the same level as that of the Kyrgyz Republic, from where fuel and lubricants are exported to Tajikistan illegally—leveraging the difference in the value-added tax level, which is 18% in Tajikistan and 12% in Kyrgyzstan. The Government of Tajikistan has the authority to issue operational licenses for the sale and storage of fuel and lubricants, and liquefied petroleum gas (LPG) transportation licenses. Operational licenses allow companies to operate for 5 years while LPG transportation licenses are valid for 1 year. The government plans to extend the validity of the LPG transportation license to 5 years in the near future.
- The cost of fuel and lubricants in Tajikistan is determined by the crude oil price (Brent), the exchange rate of the somoni to the United States dollar, customs duties and taxes, and transportation costs. The wholesale price is determined by adding the sales price margin to the fuel and lubricant costs. Refueling stations (RFSs) add a markup to retail customers, in addition to the wholesale markup, passing on changes in the fuel price and exchange rate to end users. This acts as a natural foreign exchange hedge for retail operators such as Sughdneft, allowing them to borrow in foreign currency because of pass-through pricing.
- About 70% of wholesale LPG is imported from Kazakhstan. Three major companies are active in Sughd region: JE Khujand Nefte gas Konibodom town LLC, Tojiron Sarband LLC, and Gasoil Khujand city LLC, which in aggregate accounted for about 45% of LPG supply in the region in 2012 (footnote 1). The retail market for fuel and lubricants has changed significantly since late 2000s, transforming from sales in glass cans to specialized RFSs. Sughd region has about 365 RFSs, 68% of which sell all three types of fuel and lubricants, including LPG, petrol, and fuel oil, whereas the remaining RFSs sell one or two types. The competitiveness of the RFSs is generally determined by the selling price, the quality of the products, and cost. In addition, since the storage capacity in Tajikistan is much lower than the market demand, it is advantageous for companies to have fuel and lubricants storage (footnote 1).
- Private sector challenges.** Tajikistan's private sector remains weak and has made limited progress in expanding its productive capabilities. According to the World Bank's Doing

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<sup>1</sup> Baker Tilly Tajikistan. 2017. *Commercial and Technical Evaluation and Review of Financials and Financial Model on Expansion of Sughdneft Retail Network*. Dushanbe.

Business 2017 report, Tajikistan ranks 175th out of 189 economies on getting electricity, 140th on taxation, and 162nd on getting construction permits.<sup>2</sup> The complexity of tax regulation is the second highest concern among firms in Tajikistan, according to the Global Competitiveness Report, 2015–2016 of the World Economic Forum.<sup>3</sup> From 2014 to 2017, many firms have been pressured to make advance tax payments. Tight foreign exchange controls have further complicated doing business.

6. Expensive and short-term finance has limited private investors' capacity to expand their businesses and compete internationally. In *Doing Business 2017*, the World Bank ranks Tajikistan 118th among 190 countries for getting credit, down from 109th in 2016. Domestic credit to the private sector was only 15.2% of GDP in 2016, up from 12.9% of GDP in 2012.<sup>4</sup> Since 2014, Tajikistan's banking system has recorded losses, and a sharp rise in nonperforming loans has reduced bank capital. High interest rates and short loan maturities (as banks adopt a very conservative lending position) have kept many firms from undertaking productive investments. Moreover, with more than 70% of loans denominated in foreign currency, firms bear the risk of currency mismatch.

7. Private sector businesses have limited knowledge of modern production techniques. Only 17% of firms have an internationally recognized quality certification.<sup>5</sup> The number of graduates qualifying from Tajikistan's education system is low, and educational attainments (skills and qualifications) do not fully meet labor market requirements. Businesses have limited access to external markets because of lack of knowledge about consumer preferences and price sensitivities, and poor transport and logistics infrastructure.

8. **Need for private sector solution by ADB.** With the negative banking environment, local commercial banks have adopted very conservative lending policies and only provide working capital and/or short-term loans with expensive financing costs. This stunts long-term investment and leads to high opportunity costs, resulting in the loss of jobs and tax revenues. ADB's financial support, using a private sector solution, would provide a local company with the opportunity to expand its business by securing long-term financing that better matches its fixed asset life. In addition, ADB's engagement would help a local company develop its institutional capacities by working with ADB's safeguards consultant on developing an environmental and social management system.

9. ADB's proposed private sector solution is in line with the government's sector strategy. Investment climate improvement, together with private sector development and entrepreneurship, is a pillar of Tajikistan's National Development Strategy, 2016–2030.<sup>6</sup> Raising the low level of private investment and improving productive capabilities to increase exports of higher value-added products to current and new markets is an ongoing challenge.

10. Private sector development will remain an operational priority for ADB in Tajikistan. Under the country partnership strategy, 2010–2014,<sup>7</sup> ADB engagement in the sector included technical assistance for the Implementation Support for Private Sector Development Strategy in Tajikistan,

<sup>2</sup> World Bank. 2017. *Ease of Doing Business in Tajikistan*. Washington, DC. <http://www.doingbusiness.org/data/exploreeconomies/tajikistan>.

<sup>3</sup> World Economic Forum. 2016. *The Global Competitiveness Report, 2016–2017*. Geneva.

<sup>4</sup> National Bank of Tajikistan. 2017. *Banking Statistics Bulletin: Issue of 2016*. Dushanbe.

<sup>5</sup> ADB. 2016. *Country Partnership Strategy: Tajikistan, 2016–2020*. Manila.

<sup>6</sup> Government of Tajikistan. 2016. *National Development Strategy of the Republic of Tajikistan for the Period of up to 2030*. Dushanbe.

<sup>7</sup> ADB. 2010. *Country Partnership Strategy: Tajikistan, 2010–2014*. Manila.

which revealed (i) the need to ensure that knowledge is shared so it can be used by organizations with high staff turnover; and (ii) the importance of addressing weaknesses in the regulatory framework, particularly in the inconsistent application of rules.<sup>8</sup> ADB will continue to support policy reforms that can improve the competitiveness of Tajikistan's products, thus promoting economic diversification and strengthening growth prospects. Investment climate reforms continue to be one of the objectives of the latest country partnership strategy, 2016–2020, whose priority areas include (i) improvement of the investment climate and (ii) an increase in businesses' capabilities and opportunities to set up and expand production of higher value-added products (footnote 5).

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<sup>8</sup> ADB. 2011. *Technical Assistance Completion Report: Implementation Support for Private Sector Development Strategy in Tajikistan*. Manila