

ECONOMIC ANALYSIS

A. Macroeconomic Context

1. Following robust average annual gross domestic product (GDP) growth of 7.5% during 2011–2013, economic growth in Tajikistan eased to 6.7% in 2014 and 6.4% in the first half of 2015. Since November 2014 the slowdown has primarily been the result of a sharp fall in remittances, which were equivalent to almost half of GDP. In the first half of 2015, remittance flows in dollar terms dropped by 32% compared with the same period in 2014,¹ reflecting a prolonged economic slowdown, job losses, and currency depreciation in the Russian Federation. Declining remittances is constraining private consumption. During the last 12 months, approximately 214,000 Tajik migrants returned to Tajikistan in the wake of wage cuts, layoffs, and uncertain future job prospects in the Russian Federation, which hosts up to 90% of the 1.2 million Tajik migrant workers (one eighth of the total population, and largely men). Official data from the Ministry of Labor, Migration and Employment shows that, in the first 7 months of 2015, the number of migrants leaving Tajikistan has declined by 7.5% compared to the first 7 months of 2014.

2. In the first half of 2015, expansion in industry moderated to 14.9% from 16.8% during the first half of 2014, with only 3.5% growth in aluminum production from the country's main industrial producer, Tajik Aluminum Company. In 2014, declines in production and exports of leading export commodities—aluminum and cotton—aggravated trade imbalances, with the current account deficit widening significantly to 9.1% of GDP. In 2015, this deficit is expected to diminish to around 6% of GDP, as currency depreciation reduces imports. In the first half of 2015, imports declined by about 25%, and exports by about 8%.

3. In 2015, inflation is expected to rise to 10.0% from 6.1% in 2014 due to exchange rate pass through, influenced by the depreciation of the Russian ruble. The rise comes mainly from increases in the prices of food and utilities, while prices of other goods are moderated by the falling price of processed petroleum and oils, which are Tajikistan's largest imports.

4. Similar to many other currencies in the region, the Tajik somoni official rate depreciated by 30% against the dollar in the year ending 30 September 2015 (footnote 1). Monetary policy has aimed to support growth and to mitigate currency depreciation. The National Bank of Tajikistan raised the refinancing rate three times in 2014 to 8%. The central bank also has been intervening in the foreign exchange market to stem depreciation of the Tajik somoni.

5. Growth is projected to slow even further, to 3.5% in 2015, due to continued weakness in the Russian economy and in the more general global economic outlook. Growth could recover somewhat to 4.2% in 2016, with some expected improvements in the Russian Federation and in the external environment.²

6. Tajikistan's recent growth pattern—which is similar to that during the 2008–2009 global financial crisis—highlights the economy's structural weaknesses, which make it extremely vulnerable to external shocks. The economy has a narrow base, and is heavily reliant on remittance inflows from migrant workers, and on the export of aluminum and cotton. Private investments are impeded and industrial diversification limited by the extremely unreliable electricity supply (a result of an almost exclusive dependence on seasonal hydropower), an

¹ National Bank of Tajikistan.

² ADB. 2015. *Asian Development Outlook 2015 Update: Enabling Women, Energizing Asia*. Manila.

underdeveloped financial sector, and the very weak investment climate. The number of products exported with comparative advantage has declined from 48 in 1995 to 44 in 2012. The export basket is concentrated in products that face inelastic and falling demand in the world market.

B. Development Financing Needs

7. Tajikistan remains the poorest country in the Commonwealth of Independent States, with the lowest per capita GDP and per capita social expenditure. Development financing needs are substantial, particularly for social security and welfare expenditures (predominantly pensions). The pension system is facing demographic challenges,³ which explains in part the significant increase in the state budget share allocated to social expenditures (from 32.8% in 2010 to 44.4% in 2014) (Table 1).

Table 1: Tajikistan Statistics

Item	2010	2011	2012	2013	2014
GDP (\$ billion)	5.6	6.5	7.6	8.5	9.2
GDP per capita (\$)	740	836	953	1,046	1,113
Nominal GDP (TJS million)	24,707	30,069	36,161	40,525	45,605
Total revenue and grants (TJS million)	4,948	6,509	7,957	9,501	11,549
Tax revenues (TJS million)	4,447	5,849	7,183	8,527	10,404
as % of GDP	18.0	19.5	19.9	21.0	22.8
Total government expenditures (TJS million)	6,713	8,254	9,071	11,433	13,324
Total social expenditures (TJS million)	2,205	2,978	3,958	5,006	5,910
as % of GDP	8.9	9.9	10.9	12.4	13.0
as % of total expenditures	32.8	36.1	43.6	43.8	44.4
Social security and welfare (TJS million)	860	1,056	1,792	2,217	2,692
as % of GDP	3.5	3.5	5.0	5.5	5.9
as % of total expenditures	12.8	12.8	19.8	19.4	20.2
Pensions (TJS million)	698	856	1,351	1,745	2,188
Number of pensioners ('000)	554	570	592	597	611
Public and publicly-guaranteed debt, % of GDP	36.1	35.4	32.4	29.2	28.2

GDP = gross domestic product.

Source: Agency on Statistics under President of the Republic of Tajikistan; International Monetary Fund.

8. Tajikistan's long-term debt sustainability remains favorable despite short-term balance-of-payment and fiscal shocks.⁴ External debt has declined steadily, from an average of close to 70% of GDP in 2000–2011 to 28% in 2014, as a result of economic growth, debt forgiveness, and grant assistance from key development partners, such as the Asian Development Bank (ADB), the World Bank, and several bilateral agencies. Public and publicly guaranteed debt was 28.2% of GDP at the end of 2014; the China Export Import Bank is the largest creditor (52%), with the remaining 48% owed to multilateral donors (e.g., ADB, the European Bank for Reconstruction and Development, and the World Bank).

9. However, the macroeconomic deterioration and depletion of foreign exchange reserves observed since November 2014 could cause debt ratios to deteriorate. Tajikistan's gross official

³ During 1997–2009, the number of public pensioners increased by only 1.0% (about 6,000 pensioners in total). However, during 2010–2014, the number of pensioners increased by more than 2.5% per year, from 554,000 to 611,000, an effect of the post-World War II 'baby boom.'

⁴ The Debt Sustainability Analysis conducted by the IMF and the World Bank in November 2014 retained its moderate risk rating for debt distress level. The rating was based on debt-to-GDP, debt-to-exports (including remittances), and debt-to-budget revenue ratios.

reserves were equivalent to 1.4 months of imports as of the end of 2014 and are projected to be just 1.2 months equivalent of imports by the end of 2015. In addition, Tajikistan is graduating from all-grant assistance from major development partners such as ADB and the World Bank due to the reduction of the risk of debt distress. The government does not have access to international financial markets to finance sovereign debt, as the country risk is very high.⁵ Domestic financing is very limited and short term.

10. The government is facing increasing pressure to cut expenditures due to lower-than-expected revenues—a consequence of the economic slowdown, particularly in international trade. Revenue collection (particularly value-added tax on imports) in the first 9 months of 2015 were TJS392 million below the target. The estimated financing gap is about \$170 million for the 2015 state budget and about \$42 million for the 2016 state budget (Table 2). Fiscal support is needed to prevent reduction of critical social expenditures and address the demographic challenges affecting the pension system (footnote 3) and the return of migrants.

11. The government requested \$60 million in ADB financing for its development program. The 2015 budget allocates 45.1% of available resources (or 13.2% of GDP) to social expenditures (education, health, and social protection). The government is closing the remaining financing gap by using accumulated cash reserves, reducing non-critical expenditures, and delaying capital expenditure plans and increases in salaries and pensions.

Table 2: Tajikistan State Budget's Financing Gap

Item	2015		2016	
	Amount (\$ million)	% of GDP	Amount (\$ million)	% of GDP
1. Revenues and grants ^a	2,035.5	23.9	2,137.4	25.8
2. Expenditure	2,505.4	29.4	2,671.6	32.2
3. Overall fiscal balance (=1-2) ^a	(469.9)	(5.5)	(534.2)	(6.4)
4. Net financing	300.3 ^b	3.5	492.7	5.9
5. Financing gap	(169.6)	(2.0)	(41.5)	(0.5)

() = negative, GDP = gross domestic product.

Note: The projections are based on the approved 2015 state budget and draft 2016 state budget with the following changes: (i) expected reduction in tax collections of TJS540 million for 2015, based on the revenue collections in the first 9 months of the year, and in budget support operations; (ii) revised GDP using June 2015 International Monetary Fund Article IV projections (TJS52,936 million); and (iii) depreciated Tajik somoni (average exchange rate for 2015 of TJS6.2037 = \$1).

^aExcluding Asian Development Bank budget support under the Investment Climate Reforms Program.

^bIncludes special funds and budget support proceeds from the European Union (€6 million grant) and the Eurasian Fund for Stabilization and Development (\$20 million loan).

Sources: Ministry of Finance of the Republic of Tajikistan; International Monetary Fund.

C. Benefits and Costs of Reforms under the Program

12. The program supports overall economic growth through reforms that increase investment opportunities and improve the capability of firms to set up and expand higher value-added production. The reforms are expected to raise revenues from sales of products made in Tajikistan and to reduce the cost of doing business, thereby increasing expected returns for businesses based in Tajikistan. The primary beneficiaries are current and future entrepreneurs and investors who will benefit from an improved business environment. Women entrepreneurs are specifically targeted under the program. The reforms are expected to provide indirect

⁵ Tajikistan has the highest country risk classification under the Organisation for Economic Co-operation and Development's Arrangement on Officially Supported Export Credits (7 out of 7).

benefits to the working population, both employed and unemployed, as investment opportunities result in the creation of jobs and increased wages.

13. **Reduced cost of doing business.** The average small and medium-sized company incurs indirect costs imposed by inspections and certification equivalent to 16.6% of profits.⁶ More than 1,000 legal acts are adopted every year in Tajikistan and any of these can impose unnecessary costs on businesses, because the government performs limited quality checks on the legal drafts. Regulatory impact analysis will improve the quality of decision making and reduce unnecessary costs of doing business arising from new policy and regulatory proposals. More than 100 outdated technical regulations were eliminated in 2015, helping to reduce the regulatory burden on firms. Electronic tax declarations will improve transparency and reduce opportunities for corruption. The new filing system will help increase the number of taxpayers filing electronically to more than 40,000 (from about 6,500 taxpayers as of the end of 2014). This reduction of regulatory costs will attract more businesses to the formal sector, and increase the number of formal jobs.

14. **Strengthened protection of businesses.** The perceived risk of corruption and expropriation is high, discouraging businesses and investors from expanding or investing in Tajikistan. Private investment was 5% of GDP during 2005–2013, one of the lowest levels in the world.⁷ Disclosing the ownership of businesses on the Tax Committee’s website will increase transparency and reduce expropriation risks for businesses. Increased stability in legislation—particularly regarding taxation—provided by the new law on investment will improve the attractiveness of investing in Tajikistan. Recent large private investments in Tajikistan in the beverages and distribution sectors are encouraging.

15. **Increased business innovation and productivity.** The restructuring of Tajikstandard is expected to improve the institutional and regulatory framework for firms in Tajikistan applying for certification of product quality. Improvements in the quality of products made in Tajikistan are critical to reversing the decline in the number of products exported with comparative advantage (para. 6). In 2013, only 17% of firms reported having an internationally recognized quality certification (16.7% in 2008).⁸ Government support through the Entrepreneurship Support Fund and through grants to women entrepreneurs is expected to improve financing for investments in product and service innovation. Credit to the private sector was just 21.5% of GDP in 2014, which is nevertheless an improvement from 16.9% of GDP during 2009–2013.

16. **Improved access to electricity.** Access to electricity is a binding constraint to business development. Tajikistan ranks 177th out of 189 economies on the ease of getting electricity.⁹ Firms are reluctant to invest in new equipment and automated production if they cannot access a stable supply of affordable electricity. Existing indirect (tariff-based) cross-customer energy subsidies distort both the pricing structure and market competition. The new tariff policy for electricity is expected to bring (i) additional revenues to a system that charges consumers at a rate lower than required to fully recover costs, and thus is not yet self-sufficient; and (ii) fairer competition for private businesses, which pay tariffs that are almost triple those paid by organizations (e.g., budgetary organizations and state-owned enterprises) that successfully lobby to secure lower tariffs. The reform will improve access to a reliable supply of electricity.

⁶ International Finance Corporation. 2009. *Business Environment in Tajikistan as Seen by Small and Medium Enterprises*. Dushanbe.

⁷ World Bank. *World Development Indicators*. <http://data.worldbank.org/products/wdi> [Accessed on 31 August 2015].

⁸ World Bank. *Enterprise Surveys*. www.enterprisesurveys.org [Accessed on 31 October 2015].

⁹ World Bank. 2015. *Doing Business 2016. Measuring Regulatory Quality and Efficiency*. <http://www.doingbusiness.org/reports/global-reports/doing-business-2016>

17. The government is expected to incur significant adjustment costs and revenue losses in the implementation of policy reforms under the program (Table 3). The majority of the costs will come from the increase of state budget allocations to (i) budgetary organizations, to pay for higher electricity tariffs arising from removal of implicit subsidy in their tariff; (ii) the low-income population for higher electricity costs (through the Utility Subsidy and the Targeted Social Assistance Program), arising from the new tariff policy that will remove implicit cross-customer subsidies from the tariff;¹⁰ and (iii) the Entrepreneurship Support Fund, for financing of businesses. Revenue losses will arise from strengthening the investment incentives regime, i.e., from the increase of the stabilization period for investors that signed investment agreements with the government.

Table 3: Indicative Cost of the Program Reforms
(\$ million)

Item	2015	2016	2017	2018	2019
Output 1. Reduced cost of doing business	1	2	1	1	1
Output 2. Strengthened protection for businesses					
Changes to investment incentives	0	20	20	20	20
Other actions	1	1	1	1	1
Output 3. Increased innovation and knowledge of external markets					
Restructuring of Tajikstandard	0	1	1	1	1
Funding for businesses (Entrepreneurship Support Fund)	11	21	25	28	30
New electricity tariff policy	0	0	16	19	23
Other actions	1	1	1	1	1
Total	14	46	65	71	77

Source: Asian Development Bank staff calculations.

¹⁰ The Targeted Social Assistance Program provides an unconditional cash benefit to eligible low-income households selected using a centrally administered proxy means test.