

73715

Tajikistan:

Sustaining Post-Crisis Recovery,
Investment, and Growth



Tajikistan Economic Report
Number 1, 2012

The World Bank - Tajikistan



Contents

<i>Contents</i>	2
<i>Summary</i>	3
<i>1. Recent Macroeconomic Developments</i>	3
Growth in Remittances, Domestic Demand, and Output.....	3
Consumer Prices and Inflation	4
Poverty Headcount Rate	5
Satisfaction with Life and Public Service Delivery	6
Current Account Balance.....	6
<i>2. Economic Policies</i>	7
Key Fiscal and Debt Policy Developments.....	7
Monetary and Exchange Rate Policy Developments.....	8
<i>3. Economic Outlook</i>	9

Acknowledgements

This Inaugural Tajikistan Economic Report was prepared by Zuhro Qurbonova (Economist, ECSP1) and Salman Zaidi (Lead Economist, ECSP1), with inputs from Elena Glinskaya, Mame Fatou Diagne and Victor Sulla. The report benefited from comments from Francisco Carneiro (Lead Economist and Country Sector Coordinator, ECSP1), and was prepared under the general supervision of Ivailo Izvorski, Sector Manager ECSP1.

Summary

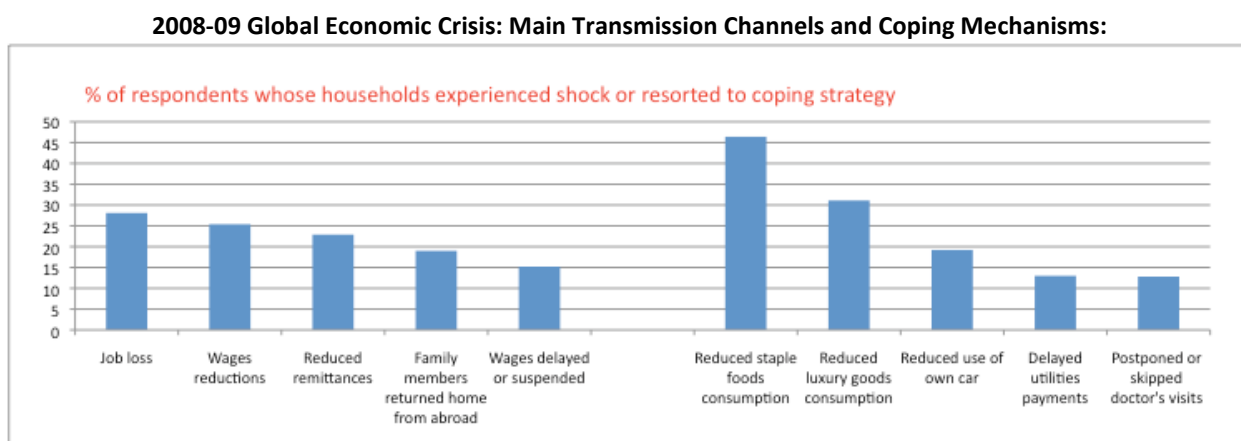
Tajikistan is one of the world's most remittance-dependent economies, receiving net remittance inflows equivalent to approximately 40 percent of GDP. Falling remittance inflows was one of the main transmission channels through which the 2008-09 global economic crisis adversely impacted the economy. Conversely, the pickup in growth since 2009 can also be traced to the rebound in remittance inflows (primarily from Russia, where more than 90 percent of Tajik migrants work), which reached 42 percent of GDP in 2010 and an estimated 40 percent of GDP in 2011. As the World Bank's 2011 Country Economic Memorandum has argued, future growth in Tajikistan will depend crucially on increasing efficiency and raising private investment rates. Remittances are likely to grow more slowly than the earlier trend over the last 5-6 years, but could nonetheless be a major contributor to future growth if more go into private investment than in the past.

1. Recent Macroeconomic Developments

Output, Demand, and Remittances

Tajikistan was adversely impacted by the 2008-2009 global economic crisis as a result of a decline in remittances and a fall in exports of cotton and aluminum. Economic growth fell to 3.9 percent in 2009 from 7.9 percent in 2008. Remittances fell from \$2.3 billion in 2008, equivalent to 45 percent of GDP to \$1.6 billion in 2009. Exports dropped by almost 13 percent due to lower international prices of cotton and aluminum. The financial sector was also adversely affected by falling exports, remittances and GDP growth, with non-performing loans in the banking sector rising to record levels. The disruption of cargo deliveries due to border closures with Uzbekistan and large amounts of directed lending to the cotton sector added to financial sector difficulties, which in turn led to a fall in credit flows to the private sector.

Chart 1. Tajik households dealt with job losses and wage reductions by reducing consumption



Source: World Bank staff calculations based on data from 2010 LITS

The impact of the crisis was widely felt across the country. According to the 2010 EBRD-World Bank Life in Transition Survey (2010 LITS), 58 percent of households in Tajikistan declared they had been affected adversely by the global economic crisis. International migration and remittances were one of the main transmission channels, reflecting the slump in demand for migrant labor in Russia during the downturn. One-third of respondents reported they were affected through a reduced flow of remittances or the return home of household members who used to work abroad (Chart 1). One-quarter of respondents were affected through job loss. Reductions of working hours, wages and remittances were more common among the poorest one-third of households. Almost half of respondents reported they had to reduce consumption of staple foods during the past two years preceding the household survey.

The government adopted a fiscal management plan to mitigate the impact of the global financial crisis. Under the fiscal management plan, the government revised the 2009 State Budget to reflect the revenue

shortfalls compared to the approved budget. To protect critical social spending (education, health, and social protection), it increased public spending under its anti-crisis action plan and expanded employment opportunities through social programs such as a cash-for-work scheme and measures to facilitate entrepreneurship. Additionally, the authorities restrained nonessential current spending, including operation and maintenance spending, but excluded essential nondiscretionary expenditures like wages and salaries, employer contributions and interest payments. Development partners also provided increased external assistance in 2009, which helped the government maintain expenditures on health, education, and social protection. On the revenue side, the VAT rate was reduced from 20 to 18 percent.

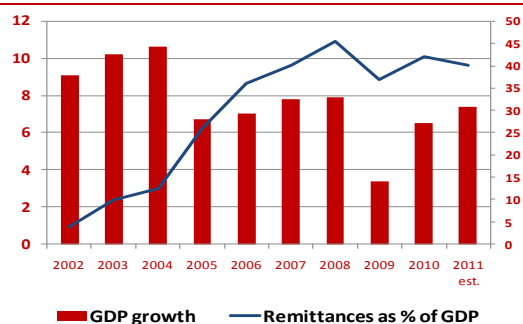
Table 1: Selected Macroeconomic Indicators for Tajikistan: 2008-2011

	2008	2009	2010	2011
Real GDP growth	7.9	3.9	6.5	7.4
CPI inflation (end-of-period percent change)	11.9	5.0	9.8	9.3
Public Sector Balance*				
Overall revenues and grants	22.1	23.4	23.2	24.4
Expenditures and net lending	27.6	28.9	26.9	27.4
Fiscal Balance (including the public investment program, PIP)	-5.5	-5.4	-3.7	-3.0
Fiscal Balance (excluding PIP)	1.4	-0.5	-0.4	0.5
Total public and publicly guaranteed debt	29.2	34.0	34.4	32.5
Current account balance	-7.6	-5.9	2.2	-1.4

Source: IMF, Ministry of Finance, WB staff calculations. * Provisional estimates for 2011.

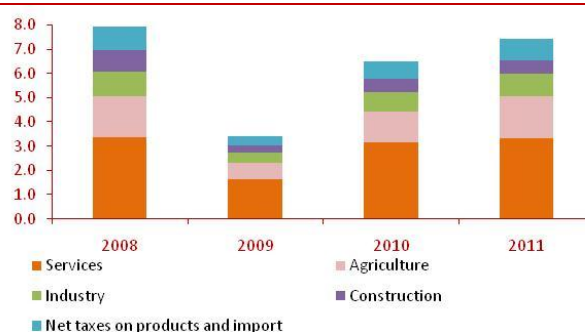
Economic recovery is underway in Tajikistan following the 2009 slowdown. GDP growth recovered to 6.5 percent in 2010 and further to 7.4 percent in 2011 (Table 1). Economic activity in the post-crisis period was correlated with the pickup in remittance inflows, which rebounded sharply in 2010 and 2011 (Chart 2). Total remittance inflows continued to fuel domestic demand, and reached 42 percent of GDP in 2010 and an estimated 40 percent of GDP in 2011, reflecting an increasing flow of migrants to Russia due to Russia's economic recovery. This in turn contributed to strong growth in services, which accounted for more than one-third of total growth in 2011 (Chart 3). Strong agricultural growth also contributed to growth, rising by 7.9 percent during the year mainly due to the largest-ever cotton harvest in Tajikistan's 20-year history (up 34 percent compared to 2010). Industry also performed well, rising by 5.9 percent, mostly driven by processing industry (textile production, food processing, and chemicals production).

Chart 2. Remittances rebounded in 2010 and 2011, contributing to faster economic growth



Source: State Statistical Agency, IMF. GDP growth is in percent

Chart 3. The services sub-sector was the largest contributor to growth, followed by agriculture

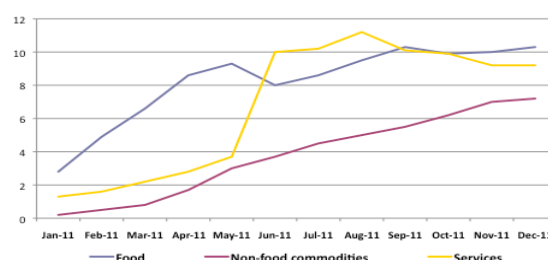


Source: State Statistical Agency. GDP growth is in percent.

Inflation

Consumer prices increased nearly 10 percent in 2011, driven mainly by external factors. The consumer price index rose by 9.3 percent in 2011, mainly reflecting increases in international food and fuel commodity prices, and Russia's introduction of custom duties on fuel exports. Food prices increased by

10.3 percent in 2011, prices of services rose by 9.2 percent, while prices of non-food commodities rose by 7.2 percent (Chart 4). Increase of rail tariffs for transit cargo through Uzbekistan in March led to higher transportation costs, consequently pushing up the prices of food and other imported goods. Price increases for wheat and grain in Kazakhstan and higher transport charges explain a large part of the increase in wheat and flour prices. Prices for wheat flour first-grade increased by 31 percent in 2011 compared to the previous year. Lamb and beef prices rose by 39 percent and 33 respectively in 2011, as prices of fodder for livestock rose because of increases in the price of fuel and transportation costs. Cooking oil prices also increased considerably (42 percent) due to rising international prices. The most significant upward contributions to inflation in services came from increases in public transportation fare, effective as of June 1, 2011, reflecting fuel price increases.

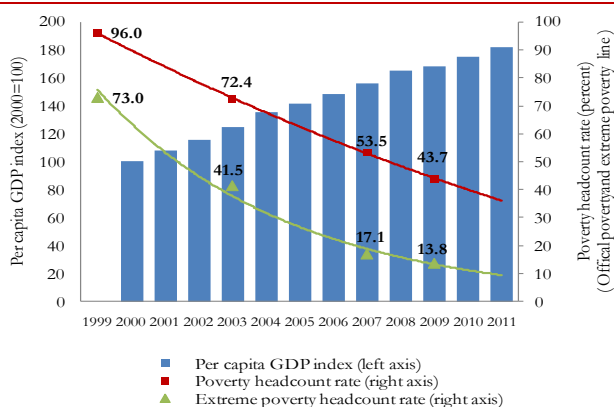
Chart 4. Food prices rose faster than inflation, 2011


Source: State Statistical Agency. Percent, year-on-year.

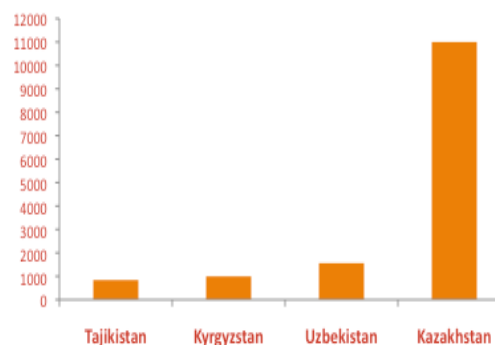
Poverty

Robust economic growth during the past decade contributed to good progress with poverty reduction.

Per capita GDP in Tajikistan grew by more than 5 percent per annum during the past decade, while official government estimates indicate that the incidence of poverty halved during this period (Chart 5). Strong economic growth during the past decade reflected post conflict 'catch-up' and rising domestic demand fuelled by remittances and other inflows. Total investment in Tajikistan, dominated by public investment, hovered around 20 percent of GDP with private investment stagnating at around 5 percent of GDP. Strong growth was made possible by five favorable factors: the peace agreement that permitted businesses and households to return to normal economic activity; a stabilization dividend from the government's success in stabilizing the economy; the growing global and regional economy that led to rising aluminum and cotton export receipts and remittances; rising inflows of donor assistance, including from the international financial institutions; and reforms that permitted existing businesses and households to take advantage of emerging opportunities. However, even though the country's GDP per capita was 2.6 times its prevailing level in 2003, Tajikistan remained the poorest country in Central Asia in 2011 (Chart 6).

Chart 5. Robust growth contributed to good progress with poverty reduction


Source: State Statistical Committee

Chart 6. However, Tajikistan remains the poorest country in Central Asia


Source: World Bank (Per-capita GDP, 2011).

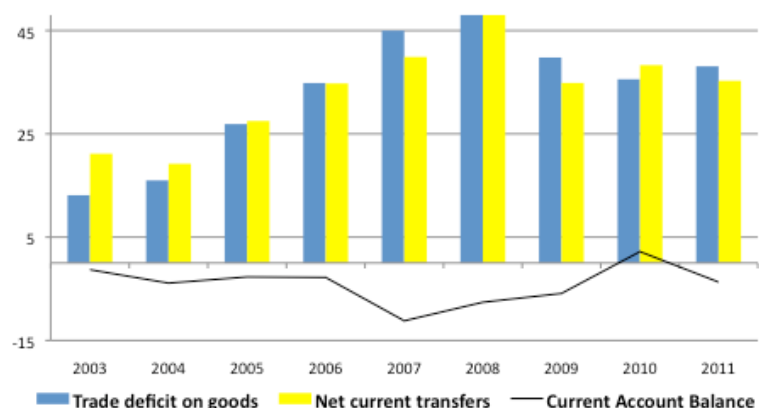
Satisfaction with Life and Public Service Delivery

Several key non-income dimensions of living conditions have also improved. Tajikistan is approaching universal enrollment in primary and lower secondary education. Enrollment for 14 year-olds increased from 88 percent in 2007 to 95 percent in 2009. According to the 2010 LITS, Tajikistan has one of the highest rates of life satisfaction in the Europe and Central Asia region.¹ Over 75 percent of survey respondents said that the economic situation in Tajikistan improved since 2006 and 64 percent said that the political climate also got better. Almost 70 percent of households said they live better today than in 2006 and almost 60 percent were satisfied with their financial situation. In 2010, respondents' rates of satisfaction with public service delivery were considerably higher than in 2006; the data show a 20 percentage point increase for the public health system between 2006 and 2010, and 6 percentage point increase for vocational/tertiary education. In 2010, 62 percent of respondents reported being satisfied with the quality and efficiency of primary/secondary services received, while 57 percent and 51 percent of users were satisfied with the quality and efficiency of public service delivery in the public health system and vocational/tertiary education systems. Moreover, there was widespread optimism for future generations across all age and income groups, despite the fact that Tajikistan remains the poorest country in Central Asia.

Current Account Balance

Fueled by rising remittances and pent-up demand, imports surged more than 20 percent in 2011. Several factors contributed to this sharp rise. First, import inflows in 2010 were constrained by intermittent blockage of rail transit through Uzbekistan. Second, the higher demand for imports was driven by the recovery of remittance inflows from Russia. Third, the rise in international food and fuel prices increased import costs. Fourth, higher public spending related to the twentieth independence anniversary celebrations and rehabilitation of the Roghun hydropower project site may also have contributed to the sharp rise in imports in 2011. Finally, a substantial hike in taxes by Russia on export of refined fuels compounded these factors: according to IMF estimates, the increase in duties of refined fuels added US\$44 million to Tajikistan's import bill for 2011.² The sharp increase in imports caused the current account balance to change from a 2.2 percent of GDP surplus in 2010 to 1.4 percent of GDP deficit in 2011 (Chart 7).

Chart 7. Remittance inflows have covered the trade deficit on goods



Source: World Bank staff calculations. Percent of GDP.

¹ Glinskaya and Zaidi *Satisfaction with Life and Public Service Delivery in Tajikistan: Key Findings from the 2006 and 2010 EBRD-World Bank Life in Transition Surveys* World Bank (mimeo), Washington DC, November 2011.

² Tajikistan Fifth Review under the Extended Credit Facility. International Monetary Fund, Washington DC, 2012.

2. Economic Policies

Fiscal Policies

Total government revenues posted strong growth in 2011. The improved performance in all key sectors of the economy and increase in imports contributed to strong growth in tax revenues, which increased from 18.0 percent of GDP in 2010 to 19.5 percent of GDP in 2011 (Table 2). Indirect taxes generated two-thirds of total revenue in 2011, predominantly through the value-added tax (VAT), which contributed 38 percent of total revenues, or approximately 8.4 percent of GDP. Shortfalls occurred in 2010 in external taxes (predominantly in VAT) due to disruptions to rail transit through Uzbekistan, which resulted in temporary contraction of imports. However, the 20 percent increase in imports in 2011 helped VAT collections increase by 38 percent in nominal terms compared to their 2010 level. As a percentage of GDP, VAT collection remained low compared to its 2008 pre-crisis level, partially as a result of reduction in the VAT rate in 2009 from 20 to 18 percent, a measure taken in response to the global economic crisis. On the other hand, individual income tax, profit tax, and social tax have all shown relatively strong growth since 2006. Looking ahead, the Government of Tajikistan intends to draft a new Tax Code in 2012 to make the tax system more efficient, simpler, and more productive. Revisions to the Tax Code are expected to enhance incentives for growth of businesses while reducing incentives for tax avoidance. This exercise will also involve reviewing the administrative provisions of the laws and other regulations.

Table 2: Selected Fiscal and Debt Indicators for Tajikistan: 2009-2011

(In percent of GDP; unless otherwise indicated)

	2009	2010	2011*
General government revenue	23.4	23.2	24.4
o/w Tax revenue	17.7	18.0	19.5
o/w Grants (incl. PIP financing)	3.4	2.3	2.3
Government expenditure and net lending	28.8	26.9	27.4
Current expenditure	14.6	15.0	15.2
o/w Wages and salaries	4.7	4.3	4.9
Capital expenditure	13.3	10.9	12.0
Fiscal balance (including grants)	-5.4	-3.7	-3.0
Public debt	34.7	37.6	34.8
External debt (public and publicly guaranteed)	34.0	34.4	32.5
Domestic debt	0.7	3.2	2.3
External debt service payments (% of exports)	20.3	7.3	6.2

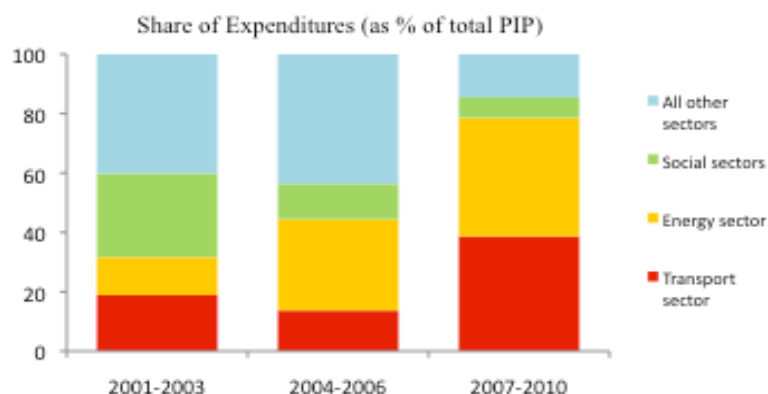
Source: IMF, Ministry of Finance, WB staff calculations. * Provisional estimates.

Following the peak levels recorded over 2007-2009, the government reduced capital spending in 2010 and 2011 compared to 2009. Increased capital spending in Tajikistan over the 2007-2009 period was mainly targeted at the transport and energy sectors: the combined share of PIP allocated to these two sectors increased from 32 percent in 2001-2003 to 79 percent in 2007-2010 (Chart 8). The sharp increase in PIP was financed through bilateral borrowing from China: during the past four years, Chinese credits for the transport and energy sectors averaged, respectively, 2.2 and 1.9 percent of GDP per annum.³ Total capital spending declined from 13.3 percent of GDP in 2009 to 10.9 percent in 2010 and slightly increased to 12

³ Recent such projects include rehabilitation of the Dushanbe-Chanak highway (connecting Dushanbe with the Soghd region and Uzbekistan border), the North-South and Lolazar-Khatlon electricity transmission lines, and new hydropower projects. The road from Dushanbe to Dangara is also being financed by China, with the aim of eventually extending this to China. These credits have a grant element of 40 percent (20 years maturity, 5-year grace period, 2 percent annual interest rate).

percent of GDP in 2011 in part reflecting increase in expenditures for Roghun construction and higher spending for Tajikistan's 20th anniversary celebrations (Table 2).

Chart 8. Rising share of PIP allocated to the Transport and Energy sectors



Source: World Bank staff calculations based on data from the Ministry of Finance

Social and energy sectors remained priority recipients of budgetary funds. Government spending increased from 26.9 percent of GDP in 2010 to 27.4 percent of GDP in 2011. Thanks to increased tax revenues in 2011, annual fiscal targets were fully met, and the budget (excluding the PIP) recorded a better-than-expected surplus of about 0.5 percent of GDP. As a result, the overall fiscal deficit (i.e. including the externally financed PIP) decreased from 3.7 percent of GDP in 2010 to an estimated 3.0 percent of GDP in 2011. The government remains committed to further deficit reduction. As a share of GDP, government spending on social sectors (excluding externally financed PIP) remained at the 2010 level of 8.9 percent of GDP. Capital spending on the energy sector accounted for the largest share. The construction of the Roghun hydropower plant to address Tajikistan's growing energy deficit remains the government's highest strategic priority: around 48 percent of the CSIP was allocated for Roghun construction in 2011; this share is projected to rise to 50 percent in 2012.

The Ministry of Finance identified debt management as a reform priority. According to the joint IMF-World Bank 2011 Debt Sustainability Analysis, Tajikistan remains at high risk of debt distress. In 2011, the Ministry of Finance identified debt management as a priority reform area, and prepared a Public Debt Management Strategy for 2012-14, reaffirming the government's commitment to keep its debt/GDP ratio at less than 40 percent of GDP. The share of external public and publicly guaranteed debt to GDP decreased from 34.4 percent of GDP in 2010 to 32.5 percent in 2011. Through World Bank support, the government also conducted an assessment of debt management issues using the Debt Management Performance Assessment Tool. New external borrowing will be restricted to concessional loans.

Monetary and Exchange Rate Policies

The monetary authorities facilitated external adjustments as a response to the crisis. Greater exchange rate flexibility and depreciation of the somoni served as an effective shock absorber during the crisis, contributing to improved competitiveness compared to other countries in the region, and facilitated current account adjustment. The somoni depreciated by about 27 percent relative to the US dollar in 2009, helping the current account balance change from a deficit of 7.6 percent and 5.9 percent of GDP in 2008 and 2009 respectively to a surplus of 2.2 percent of GDP in 2010. Higher international prices of aluminum and cotton were also important contributory factors in facilitating external adjustment.

The government remains committed to a flexible exchange rate regime. Under the IMF-supported 2009-2012 ECF program, the Government of Tajikistan has committed to a flexible exchange rate regime, and targets reserve money as a nominal anchor for the economy. The pressure on the external accounts precipitated by the sharp increase in fuel prices in the first half of 2011 resulted in considerable downward pressure on the somoni. The National Bank of Tajikistan (NBT) allowed a modest depreciation of the currency, but also intervened in the foreign exchange market during the first half of 2011, which resulted in a significant decline in net international reserves. However, NBT gradually rebuilt lost reserves by the end of 2011, which rose back up to over US\$572 mln. In end-2011, the somoni traded at 4.76 somoni per dollar vs. 4.40 TJS/USD in end-2010, and at 1.474 somoni per 10 Russian rubles vs. 1.465 TJS/10RUB in end-2010.

Financial intermediation is limited. There is a high ratio of cash outside of banks in Tajikistan, which indicates both the low confidence that the public has in banks as well as the lack of non-cash payment tools. Cash outside of banks amounted 64 percent of the money supply by December 2011. Deposits rose from 13 percent of GDP in 2010 to 20 percent at the end of September 2011. However, the number of deposits per 1,000 adults in Tajikistan (31 deposit accounts per 1 thousand adults) is the lowest in the Europe and Central Asia region. As nearly half the population lives below the poverty line, the main reason for not saving is lack of sufficient income. Most of the income of Tajik households is used to cover their primary consumption needs. People save irregularly, only when there is money left over after covering everyday living expenses. According to a study conducted in 2010 by Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), the median value of annual savings in Tajikistan was only TJS 900 (US\$ 200) per household.⁴ Another reason why the uptake of financial products is low in Tajikistan is low confidence in banks due to a weak consumer protection regime. At the same time, financial institutions lack marketing materials, communication about products, and show no real effort to actively sell those products.⁵

The financial sector in Tajikistan recovered somewhat from the adverse impact of the crisis and other factors, but remains vulnerable. Non-performing loans (NPLs) in the banking sector peaked at 28 percent of gross loans in March 2010, before falling to around 15 percent in 2011. Several external and internal factors contributed to the deterioration, including the lagged impact of the 2009 global crisis, the negative effects on profitability of disruptions to rail traffic through Uzbekistan, lax lending standards, regulatory forbearance, and directed lending to the agriculture sector. The government has recently taken remedial action to reduce financial sector vulnerability, in particular through systematic monitoring of NPLs and problem banks. With support from the World Bank and IMF, the NBT tightened prudential requirements in 2010, and has required problem banks to submit action plans to reverse growth in NPLs and return to compliance with prudential standards. To reduce the attractiveness of liquidity loans and help assure they are used only for short-term liquidity purposes, the interest rate on local currency loans was raised to 17 percent (foreign currency loans to 21.8 percent) in May 2011 vs. 8.25 percent in January 2011. After having expanded in the first half of 2011, growth of reserve money declined sharply in the second half of the year.

3. Economic Outlook

With the global economy projected to grow at a slower pace in 2012, the growth outlook for Tajikistan will depend crucially on what happens to remittance flows. The global economy is predicted to grow by 3.3 percent in 2012: the primary risk it faces is deterioration in high-income Europe, which could result in a significantly weaker external environment for Europe and Central Asia's main trading partners. The main risks for Tajikistan of a global slowdown are through declining remittances and exports. A recession in

⁴ *The market for MDO deposit services in Tajikistan* Justyna Pytkowska, Piotr Koryński, November 2010

⁵ Ibid

Russia (where more than 90 percent Tajik migrants are employed) would lower domestic demand and likely lead to a fall in construction and industrial production. Under baseline projections, Tajikistan's economy is projected to grow at 6 percent in 2012 and 5 percent in 2013. Under the downside scenario analysis recently carried out by the IMF of 2 percent contraction in the Russian economy in 2012, GDP growth in Tajikistan would slow to 3.2 percent in 2012, but recover to 4.0 percent in 2013 (Table 3).⁶ Lower growth and imports would adversely impact government revenues, leading to an increase in the projected fiscal deficit. On the plus side, given Tajikistan's heavy reliance on imports, the current account balance is projected to improve compared to the baseline scenario: lower international prices of food and fuel items would reduce the import bill, and would likely also contribute to a sharp decline in inflation.

Table 3: Risks for Tajikistan: 2012-2013

Indicators	Actual		Baseline		Downside Scenario	
	2010	2011	2012	2013	2012	2013
Output growth	6.5	7.4	6.0	5.0	3.2	4.0
Fiscal balance	-3.7	-3*	-3.1	-3.5	-3.4	-4.0
Current account balance	2.1	-1.4	-6.5	-6.2	-5.7	-5.6

Note: The downside scenario assumes oil prices drop to US\$55 in 2012, but recover to US\$70 in 2013; food prices decline by 15 percent in 2012, but increase by 10 percent in 2013; lower growth and oil prices depress growth in Russia to -2 percent in 2012, but with a slow recovery starting in 2013. Data are in percent of GDP

Over the medium term real GDP in Tajikistan is projected to grow at around 5-6 percent a year. Tajikistan's growth outlook as discussed in the 2011 Country Economic Memorandum is based on a less favorable external environment than prevailed during the past decade. Most of the projected 5-6 percent per annum growth over the medium term is expected to come from construction, trade, and other services initially; with time, exports of non-cotton agriculture, power, and mining are expected to make an increasing contribution. Cotton and aluminum are unlikely to be as important as in the past. Remittances are expected to grow more slowly from their high base than the earlier trend over the last 5-6 years, but they could nonetheless be a bigger contributor to future growth if more go into private investment than before. The expected sales of summer surplus electricity to Afghanistan will also be important for future growth, once Tajikistan has resumed earning much-needed foreign exchange through electricity exports, which stopped in 2010 due to Uzbekistan's withdrawal from the Central Asia Unified Electricity grid.

Future growth will depend on increasing efficiency and private investment. Concerted efforts will have to be made to reduce cost and raise profitability of private investments and exports, especially in agriculture and agro-processing. Earlier reforms in agriculture have created an improved environment on which to build further. The government is committed to making it less costly for investors to start a business and pay taxes as well as to increase access to reliable power, in order to address the major constraints cited by investors. Efforts are also underway to make investment in agriculture, especially for exports, more profitable by enhancing access to markets, empowering farmers by removing the debt overhang and strengthening their rights to land, targeting irrigation investment and improving farmers' access to inputs. The recent growth in non-cotton agricultural exports suggests that there is considerable room to tap the potential for future growth in agriculture and in agro-processing, provided there are appropriate reforms to help stimulate higher private investment, and more competitive cross-border movement of goods to regional markets. Enhanced regional cooperation and priority public investments in roads and energy will be important for that purpose.

⁶ Tajikistan Fifth Review under the Extended Credit Facility. International Monetary Fund, Washington DC, 2012.