The Country Classification of Tajikistan

A. Introduction

1. The Republic of Tajikistan became a regional developing memb,er country (DMC) of the Bank in April 1998, and is seeking Bank assistance to support the coLlntry's development efforts. Thus, the Bank must determine Tajikistan's country classification. This paper discusses the proposed classification and should be read in conjunction with the *Economic Report and Interim Operational Strategy for Tajikistan,*[1] which has been circulated to the Board and is referred to hereafter as the *Economic Report.*

B. The Bank's Classification Policy

2. The Bank classifies its DMCs into groups according to their levels of development to allow for differentiation in operational guidelines across country groups. The Bank has a three- tier country classification system: Groups A, B, and C. The three-tier classification allows for a differentiation in regard to eligibility to borrow from the Asian Development Fund (ADF). Group A DMCs are "fully eligible," Group B DMCs are eligible for "limited amounts in particular circumstances," and Group C DMCs are ineligible for ADF resources. This is consistent with the goal of ADF, which is "to enable the Bank more effectively to carry out its purpose and functions by providing resources on concessional terms for the economic and social development of the developing member countries of the Bank, having due regard to the economic situation of such countries and to the needs of the less developed members."[2]

3. In addition to ADF eligibility, a country's classification also determines the cost-sharing ceilings for Bank financing of its projects and its eligibility for the domestic preference scheme. Total Bank financing of project costs does not normally exceed limits of 80 percent for DMCs in Group A, 60 percent for DMCs in Group B, and 40 percent for DMCs in Group C. Under the Bank's domestic procurement policy, domestic contractors will be given preference for civil works only in Group A DMCs, while each DMC will be given preference 'for procurement of domestic goods for its Bank-funded projects.

4. The criteria for assessing the economic situation of a DMC and in turn its classification are per capita gross national product (GNP) and debt repayment capacity. Countries with a per capita GNP above $1,017 (in 1997 dollars) do not have ADF access. This limit was established in 1974, and is adjusted using the US gross domestic product (GDP) deflator. A DMC's debt repayment capacity is judged by the overall strength of the economy, indicated by factors such as its development performance and prospects, level of savings and investments, ability to generate export earnings, levels of international reserves, outstanding external debt, and debt service burden.

C. Classification of Tajikistan

5. This section focuses on the considerations pertinent to Tajikistan's classification. Relevant economic indicators are given in the Appendix, and more detailed statistics are available in the *Economic Report.*

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[1] Economic Report and Interim Operational Strategy for Tajikistan, September 1998
[2] Regulations of the Asian Development Fund

1. Country Profile

6. Tajikistan is a mountainous, landlocked country in Central Asia. It is bordered by Afghanistan, People's Republic of China, Kyrgyz Republic, and Uzbekistan (see Map). Tajikistan covers a land area of 143,100 square kilometers. The capital is Dushanbe.

7. Tajikistan had about 6 million people in 1997. The population has been growing rapidly, at 2.4 percent per annum during 1985 to 1994[1]; 46 percent of the population is under 16 years of age and 70 percent of the population lives in rural areas.

8. Agriculture accounted for 27.6 percent of GDP in 1997, industry for 20.9 percent, and services for 36.9 percent.[2] Only 7 percent of the land is arable but the country's substantial water resources have enabled irrigation of 85 percent of the arable land. The agriculture sector employs more than 50 percent of the labor force. Cotton is the principal crop, accounting for around 40 percent of agricultural production. Tajikistan's mountainous topography and water resources permit substantial production of hydroelectric power. The country has large deposits of gold, silver, coal, and polymetallic ores. The Tursunzoda aluminum smelter is one of the largest smelters in the world.

9. The 1997 *Human Development Report* categorizes Tajikistan as having medium human development.[3] However, the civil strife following independence has taken a heavy toll on the country's social infrastructure and average living standards have deteriorated markedly. Some 80 percent of the population is now estimated to live below the poverty line.

2. Per Capita Income

10. The World Bank has estimated Tajikistan's per capita GNP as $330 at 1997 prices.[4] This level of per capita GNP is well below the current ADF operational cutoff of $1,017 at 1997 prices.[5] Only four other DMCs[6] have per capita GNP levels below that of Tajikistan. During 1990- 1996, the country's average annual real decline in per capita GNP was 18.5 percent.[7]

3. Debt Repayment Capacity

11. The matter for consideration is whether Tajikistan has the capacity to borrow a substantial portion of its loans on non-concessional terms, including the Bank's OCR terms. If a country has external debt, then to be able to accumulate and service debt on non-concessional terms, either (i) the growth rate should exceed the average interest rate, or (ii) the country

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[1] The population growth in 1997 was 1.6%.

[2] Others, including indirect taxes, account for 14.6 percent.

[3] United Nations Development Programme. 1997. *The Human Development Report.*

[4] The World Bank Operational Manual. Operational Policies. OP3.1 O.-Annex D. June 1998.

[5] The International Monetary Fund (IMF) has estimated Tajikistan's per capita GDP at 1997 prices at $178. World Bank figures for 1996 indicate a per capita GDP of $339, close to their estimate for per capita GNP of $340 at 1996 prices. Significant difference in IMF and World Bank income estimates is likely due to the different methodologies used for obtaining US dollar values from domestic currencies: the *World Bank* estimate is based on a three-year weighted average of the official exchange rate while the IMF estimate is based on the 1997 exchange rate.

[6] Bangladesh, Cambodia, Nepal, and Viet Nam.

[7] The World Bank. 1998. *World Bank Atlas.*

should have the capacity to generate a surplus on merchandise trade and non-interest services. There must also be a matching capacity to generate an internal surplus of savings over investment. Tajikistan's external indebtedness indicators provide the starting point for the analysis, which then extends to the factors affecting the country's debt repayment capacity over the medium term, including the macroeconomic environment; the gap between needed structural reforms and actual progress; and prospects over the medium term.

a. Debt Burden Indicators

12. Tajikistan's external debt burden increased rapidly during 1991-1996, with the debt- to-GDP ratio rising from zero at independence to 86 percent in 1997. This is to be compared with an external debt-to-GDP ratio of some 40 percent during 1994-1996 for countries with recent debt servicing difficulties and a ratio of 71 percent in 1996 for heavily indebted poor countries. The debt service due as a percentage of exports rose from 5.7 percent in 1993 to 32.6 percent in 1996. The steep rise in debt-service ratio reflects the sizeable increase in borrowing on short maturity, the relatively high interest rates charged[1], and the slump in exports in 1996.[2] Bilateral creditors (principally Russia and Uzbekistan) accounted for about 50 percent of the total debt stock with the balance divided between other bilateral, multilateral and private creditors.[3] Tajikistan's inability to meet its debt servicing obligations led to a debt restructuring arrangement in 1996 (the second since 1993) with Uzbekistan and Russia. As Tajikistan has rescheduled a substantial portion of its debt on concessional terms, external debt service in 1997 constituted only 14 percent of export earnings. Tajikistan's outstanding debt is owed almost entirely by the government, i.e., it is a direct budget obligation.

b. Factors Affecting Debt-Servicing Capacity i. Macroeconomic factors

13. As noted earlier, debt-servicing capacity depends in part on the differential between output growth and the interest rate. The lower the output growth and the higher the interest rate; the greater the deterioration in debt repayment capacity. Tajikistan's real GDP contracted by almost 60 percent from 1991 to 1996. The steep decline in output growth was due to the combined effects of the breakup of the former Soviet Union, the civil war, natural disasters, and a stop-and-go implementation of sound macroeconomic and structural policies. Over this period, Tajikistan was accumulating debt at near commercial rates. The average interest rate on new commitments reached 8.1 percent in 1995. The differential between output change and the interest rate meant that Tajikistan's debt accumulation process was unsustainable. This was borne out by the fact that debt service paid (as distinct from debt service due) was near zero during 1993-1996, and Tajikistan had to restructure its debt in late 1996. The economy began to recover in 1997 with a modest growth in real GDP of about 1.7 percent. This was due in large measure to the peace agreement in June 1997 ending five years of civil war. During 1998-2001, the growth rate of real GDP is expected to remain modest, ranging between 3.4 to 4.0 percent.[4] Thus, Tajikistan's growth rate, at least over the medium term, is likely to be below the interest rates normally charged for non-concessional loans, including loans from the Bank's ordinary capital resources.

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[1] In 1995, the average interest rate on new commitments was 8.1 percent and the average maturity period was 3.9 years. The World Bank. 1998. *Global Development Finance* .

[2] In transition countries, the debt-to-exports ratio and the debt-service ratio need to be treated with caution because (i) export earnings tend to fluctuate sharply from one year to the next, and (ii) the high levels of managed trade and barter make the ratio weaker as an objective indicator of the debt burden.

[3] First half of 1998.

[4] *Republic* of *Tajikistan -Enhanced Structural Adjustment Facility- Policy Framework Paper,* 1998-2001. International Monetary Fund.

14. The second issue is whether the country has the capacity to generate a surplus on merchandise trade and non-interest services. Tajikistan's current account imbalance, after an initial sharp deterioration, shrank during 1994-1997. This trend does not however amount to an improvement in the country's debt repayment capacity because the reduction resulted from suppressed import growth. Depressed import growth contributed to declining investment rates and in turn to contraction in output. In fact, Tajikistan's shrinking current account deficit is consistent with a deteriorating economic situation where a significant drop in the savings rate was accompanied by an even steeper decline in the investment rate (exact figures on the savings and investment rates are not available).

15. The budget deficit may be viewed as a proxy for the public sector's contribution to the imbalance between national saving and domestic investment. Tajikistan's budget deficit, estimated at 29.1 percent of GOP in 1992, had been brought down to 3.3 percent by 1997. However, the deficit reduction has in part been achieved by postponing capital spending and deferring payments for wages and pensions. Moreover, most spending continues to be for current rather than capital expenditure purposes. Revenue collections are poor, accounting for around 14 percent of GOP in 1997. In this context, it is useful to calculate two additional ratios that capture the burden on the government budget of servicing the total public debt: the ratio of public debt service to government revenue (PDSR) and that of public debt service to government expenditure (PDSE).[1] In 1996, Tajikistan's POSR was 120 percent,[2] compared to the mean of 16.6 percent for the Baltics, Russia, and other countries of the Commonwealth of Independent States. Corresponding figures for the PDSE are 95.5 percent and 12.7 percent, respectively. Until 1996, the budget deficit was financed by central bank credits but hyperinflation led the government to reduce deficits and look for non-inflationary external and domestic financing. Clearly, public finances in Tajikistan are in a perilous state.

16. Inflation raises debt servicing costs through depreciation of the exchange rate. Tajikistan has experienced high rates of inflation during 1991-1997, coupled with wide year-to-year swings in the inflation rate.[3] Initially, the country suffered from imported inflation because the Russian ruble was the currency used. The persistence of high rates of inflation even after the Tajik ruble was introduced in 1995 was due to the easing of Tajikistan's domestic price controls and loose monetary and fiscal policies. Figures for the first half of 1998 show progress in containing inflation through tight monetary and fiscal policies and in stabilizing the exchange rate.

17. The composition of the capital account is relevant for assessing debt repayment capacity because it indicates the significance of non-debt-creating capital inflows. Foreign direct investment into Tajikistan has been low because of the unstable economic situation. The capital account recorded a net outflow of funds from 1993-1996 because the buildup of external debt on short maturity led t heavy amortization payments. Short-sighted attitudes towards borrowing thus resulted in raising debt servicing costs. In 1997, there was a net capital inflow due to a drop in amortization payments following debt restructuring. Foreign reserves need to be at prudent

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[1] The PDSR measures the government's ability to service its total debt out of current income without taking into account domestic financing or foreign disbursements to the budget. The POSE ratio measures the burden of servicing public debt vis-a-vis other government expenditure and thereby provides an indicator of the extent of discretionary spending that is available.

[2] *External Borrowing by the Baltics, Russia and Other Countries of the Former Soviet Union: Developments and Policy Issues*. IMF Working Paper. June 1997.

[3] In 1993, while Tajikistan was still in the ruble zone, the inflation rate exceeded 7000 percent, dropped to 1.1 percent in 1994, rose to over 2000 percent in 1995, subsided to 40.6 percent on 1996 before rising again to 159.8 percent in 1997.

levels to meet scheduled payments of external debt. Tajikistan's reserves constituted only 0.7 months of import cover at the end of the first quarter of 1998.

18. Clearly, a number of key indicators of macroeconomic imbalances have been brought down to more manageable levels. However, the macroeconomic environment remains fragile because the fiscal and current account deficit reduction has taken place at very low levels of domestic investment and savings rates. To boost private investment and domestic savings, structural reforms a e essential before sustainable growth and enhanced ability to service debt can be achieved.

I ii. Structural Reforms

19. Most aspects of structural reform have some bearing on private sector development. The Share of the private sector in GDP is therefore a useful indicator to begin the assessment of progress in implementing structural reforms. For Tajikistan, the private sector is estimated to contribute about 20 percent of GDP.[1] Progress with privatization has been slow, involving primarily small-scale enterprises.

20. Most state enterprises are operating well below capacity. Reflecting their operational inefficiency, the accumulated losses of state enterprises amount to 20 percent of GDP. While loss-incurring enterprises have been identified, their restructuring has been hampered by lack of implementation of bankruptcy and related enterprise adjustment laws. In the agriculture sector, implementation of land reform and farm restructuring has also been halting. Although land may be leased to farmers on a long-term basis, the state still legally owns all the farmland. Farmers do not have security of tenure and a sense of ownership. This has contributed to low productivity. Accelerating the pace of privatization and restructuring in the agriculture and industry sectors will be crucial to sustainable output growth.

21. Development of the financial sectors, particularly of the banking sub-sector, is critical to the enhancement of debt repayment capacity as it can facilitate international payments and foreign exchange transactions. The banking sub-sector in Tajikistan is relatively underdeveloped. Commercial banks are narrow in profile and limited to serving as channels for directed credit to priority sectors. Moreover, they are burdened with a large number of non-performing loans, mainly due to past policies of directed credit. Due to the insolvency of Agroinvest, the only institution for agricultural credit, investment in agriculture has been choked off. A comprehensive restructuring program for commercial banks is currently being implemented to revitalize banking. The nonbank financial subsector comprises a number of insurance companies. A securities market has been established but is not yet in operation. Clearly, Tajikistan's weak financial sector is a serious constraint on sustained growth.

[1] *Transition Report* 1997. *Enterprise Growth and Performance.* European Bank for Reconstruction and Development.

22. Liberal trade and exchange regimes are necessary to encourage broad-based export growth. TajikIstan's substantial liberalization of its trade and exchange regimes in early 1996 was followed by policy reversals. Notwithstanding recent efforts to reestablish liberalization measures, including the removal of state trading monopolies, a large share of external trade is still handled by state organizations. This may be attributable to the difficulties that small private firms have In competing with state trading companies in the export market. Also, the government and the central bank still dominate major foreign exchange transactions. Remaining impediments to an open trade and exchange system must be removed to provide impetus to diversified growth in exports.

23. Adoption of market discipline also requires domestic price liberalization. Price control have been eliminated across a broad range of goods and services except for prices of electricity, fuel, irrigation water, telecommunications, and transport. However, subsidies in the energy sector continue to encourage inefficient use of resources.

24. Export concentration provides an indicator of a country's vulnerability to shocks. Tajikistan's two main exports, aluminum and cotton, accounted for 61 percent of the export earnings in 1997. The country is therefore highly vulnerable to swings in international prices for aluminum and cotton. Also, production of both commodities requires imports of intermediate capital goods and fuel that in the past have faced financing constraints. Further, the Government's strategy of increasing cotton production for exports could have negative effects. Continuing the practice of monoculture that has been in effect over the past 50 years could exacerbate environmental problems. On the side of imports, Tajikistan has a sizeable energy trade deficit with import costs of coal, oil, and gas outweighing export revenues from the sale of electricity. The proximate cause of the rapid buildup of debt after independence was the need to finance energy imports, principally from Russia and Uzbekistan. In the initial years, such imports took place without full payment being made and the resulting arrears were subsequently converted into intergovernmental loans. Later, as arrears mounted, a cash payment policy was imposed, resulting in a fall in energy imports. Net energy imports are likely to increase as economic recovery gains momentum.

25. Thus, more fundamental structural reforms are required to encourage nontraditional exports. Such reforms include financial sector development, privatization of medium and large enterprises, and increased efficiency of the public investment program to build a better infrastructure for exporters.

iii. Prospects and Risks

26. The *Economic Report* projects real GDP growth of 4 percent per annum during 1998-2001 based on the assumptions that (i) the peace process will be accelerated, (ii) required macroeconomic stabilization and structural adjustment will be pursued, and (iii) adequate and timely external financing will be forthcoming. The balance-of-payments position is expected to remain weak over the medium term with the current account imbalance projected to widen as the investment rate picks up and output growth accelerates. Foreign exchange reserves will need to be built up to a safe level of around three months of import cover. Therefore, substantial infusion of external financing (ranging between 4.0 to 4.5 percent of GDP during 1998-2001) will be required over the next few years. Consequently, external debt is expected to increase from around $0.9 billion in 1997 to about $1.5 billion in 2003, reflecting mostly borrowing from international financial institutions. As it is currently under International Monetary Fund (IMF) arrangements, Tajikistan is committed to contracting new loans only on highly concessional terms and from international financial institutions. According to IMF projections, the debt-to-export ratio will fall from around 200 percent in 1997 to around 160 percent by 2003.

27. The main risk to the growth scenario presented above is renewal of civil strife, which could derail the economic adjustment process now under way. A second risk is unfavorable weather conditions that could affect agriculture, in particular, the cotton crop. External risks include a fall in the world prices for cotton and aluminum as well as adverse economic developments in Russia and Uzbekistan. Overall, Tajikistan clearly lacks debt servicing capacity for non-concessional loans.

D. Bank Assistance

28. Assuming that the stabilization and reform program remains on track, Tajikistan will require Bank assistance to alleviate the costs of adjustment and to ensure that the economy is well launched on the path of sustainable growth. Consultations have been held with the Government on the objectives and sector priorities for Bank assistance and on this basis an interim operational strategy has been framed. The objectives of the strategy are to (i) facilitate the country's transition to a market economy, (ii) assist in its post-conflict rehabilitation and reconstruction efforts, and (iii) provide support for natural disaster rehabilitation. The sector priorities identified for Bank assistance include agriculture and agro-processing; infrastructure rehabilitation, especially roads and power; and education.

E. Proposed Classification

29. Given its low per capita income and weak debt repayment capacity over the medium term, it is proposed that Tajikistan be classified as a Group A country. Tajikistan is an International Development Association-only borrower of the World Bank.

F. Operational Implications

1. ADF Access

30. As a Group A DMC, Tajikistan would be fully eligible for concessional funding from ADF for the remainder of the ADF VII period. Actual lending of concessional resources to Tajikistan would be predicated on its needs and performance relative to other DMCs with ADF access and on the availability of ADF resources.

2. Other Operational Implications

31. If Tajikistan is classified as a Group A country, under the Bank's project cost-sharing policy, the maximum proportion of project costs that the Bank may normally finance would be 80 percent. Under the Bank's domestic procurement policy, preference will be given to domestic contractors in Tajikistan for civil works and preference for procurement will be given to domestic goods, as is the case in all borrowing DMCs of the Bank.

G. Recommendation

32. It is recommended that Tajikistan be classified as a Group A country. If the Board approves the proposed classification, (i) Tajikistan will be fully eligible for ADF resources for the remainder of the ADF VII period, (ii) Bank financing of projects will be subject to the cost-sharing ceiling of 80 percent, and (iii) domestic contractors will be given preference for civil works and procurement of goods will also be given domestic preference.

Appendix

Tajikistan: Key Socioeconomic Indicators

Indicator			Most Recent Estimate	Year
Are (thousand square kilometers)			143.1	(1997)
Population			6.0	(1997)
Total (million)			42.2	(1997)
Density (persons per square kilometer)			1.6	(1997)
Annual Growth (percent)				
Employment (percent share)				
Agriculture			64	(1997)
Industry and Construction			12	(1997)
Others			24	(1997)
Social Development Indicators				
Infant Mortality (per 1,000 live births)			53.4	
Population per Doctor			476.2	
Life Expectancy at Birth (years)			69.6	
Poverty (per cent of population)			80.0	
Student/ Teacher Ratio			15.0	
National Accounts	**1994**	**1995**	**1995**	**1997**
Gross Domestic Product (GDP) at Current Prices (billion Tajik rubbles)	1,786.5	64.8	308.5	632.0
Real Growth of GDP (percent)	-18.9	-12.5	-4.4	1.7
Real Growth of Per Capita GDP (percent)	-19.8	-14.3	-5.9	0.1
Per Capital Gross National Product (GNP) ($) [a]	350.0	340.0	340	330.0
GDP by Sector (current prices, percent share)				
Agriculture	19.0	15.3	27.7	27.6
Industry and Construction	32.4	38.5	22.5	20.9
Services	28.1	36.6	37.7	36.9
Others [b]	20.4	9.6	12.1	14.6
Consolidated Fiscal Balance (percent of GDP)	-10.1	-11.2	-5.8	-3.3
Prices (annual change in consumer price index, end of period, percent)	1.1	2,131.9	40.6	159.8
External Debt				
Total External Debt ($ million)	760	817	868	936
Debt service Ratio (percent of exports)	9.7	25.5	32.6	13.9
Exports (annual growth, percent)[d]	22.6	50.1	-8.2	-3.1
Exchange Rate (TJR/$, average) [e]	n.a.	135	298	564

[a] Data for 1994-1996 were taken from the World Bank Atlas, 1995, 1996 and 1997; the 1997 data were taken from the World Bank Operational Manual, Operational Policies, OP3.10- Annex d, June 1998.

[b] Including net index tax.

[c] Cash basis; 1994 balance was computed from amounts in Russian rubles, 1995-1997 data were derived from amounts in Tajik rubbles; 1995 figure refer to the period 11 May – 31 December 1995 only, the figure of 8.7% corresponding to the period 1 January – 10 May was computed from amounts in Russian rubbles.

[d] Exports consist primarily of cotton and aluminum.

[e] Official exchange rate.

Source:
Economic Report
International Monetary Fund
World Bank