

# Tajikistan

Economic growth was robust in 2007, reflecting strong expansion outside the aluminum and cotton sectors, but inflation accelerated on rising food and energy prices. The medium-term prospects are for continued healthy growth, though inflation will remain problematic. The Government is implementing an expansive infrastructure-focused national development strategy, largely financed by external borrowing. This runs the risk of debt distress reemerging.

## Economic performance

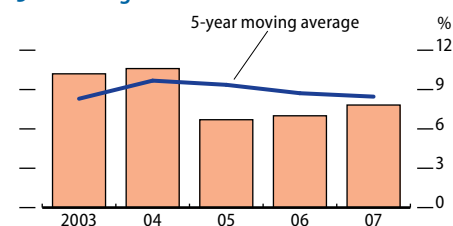
At 7.8%, Tajikistan recorded another year of robust economic growth in 2007, improving on its performance in 2005 and 2006 (Figure 3.6.1). But it is still below the very high rates achieved in 2000–2004, reflecting the sluggish pace of reforms in agriculture, a weak business environment, and high energy costs.

Aluminum and cotton, the traditional economic mainstays, failed to drive expansion in 2007. Growth in aluminum output (up by only 1.5%), as well as in chemicals, was hit by higher prices of imported natural gas from Uzbekistan and by electricity shortages stemming from shortfalls in hydropower generation. Cotton performed even worse: production fell by 4%, reflecting both a reduction in the planted area and declining productivity. The protracted approach to land reform and the lack of progress in solving the long-standing problem of a large debt overhang owed by cotton farmers created disincentives for production of that crop.

Rapid expansion elsewhere compensated. Industry nearly doubled its growth rate to 9.9%, with double-digit rates in almost all subsectors (except aluminum and electricity). Expansion in food processing, textiles, and construction materials was especially buoyant. The power shortages had little impact on food processing because it was given supply priority, for food security reasons. Robust growth in non-cotton sectors lifted agriculture's growth to 6.5% from 5.4% in 2006; the major drivers were higher production of livestock and of fruits and vegetables. Services sector growth of 8.0% was led by trade, construction, and finance, reflecting growing consumer spending and demand generated by an increasing range of infrastructure projects.

Domestic demand was fueled by burgeoning private consumption expenditure and by rising project investment. Strong private consumption is evidenced by double-digit growth in consumer goods imports, as households receiving migrants' remittances spent more. Such recipients are also starting to invest in housing and in small businesses. Investment activity is mainly directed to large government infrastructure projects, which are funded by bilateral loans and foreign direct investment (FDI)

3.6.1 GDP growth



Source: State Statistical Committee of the Republic of Tajikistan, available: <http://www.stat.tj>, downloaded 5 February 2008.

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on a joint-venture basis. Private sector FDI is yet to take off, against a background of multiple obstacles to doing business.

Average inflation in 2007 was 13.1%, but the year-end rate came in at 19.7% (Figure 3.6.2). Inflation pressure stemmed from higher food and fuel prices, increases in utility and transport tariffs, and strong consumer demand on the back of a near doubling in workers' remittances. Prices of wheat—the major staple—jumped in September 2007, following the pattern of price escalation in other Central Asian countries. (Tajikistan imported about one half of its wheat from Kazakhstan.) Wheat prices rose by about 80% in 2007, and were the main driver of inflation, as the weight of wheat is about one tenth of the consumer price index basket.

Utility prices climbed steeply in 2007. Natural gas prices rose by 60%, owing to higher prices for imports from Uzbekistan. Electricity tariffs saw a 50% adjustment, as part of a multiyear plan to bring tariffs to levels that would justify badly needed investment in new generation capacity by foreign investors.

In response to the inflation pressure, the National Bank of Tajikistan tightened its lending to the financial sector. Monetary policy, however, is constrained by weak institutional capacity, the underdeveloped nature of the financial sector, and the continued reliance on the central bank for directed lending, mainly to the cotton sector. Tajikistan has a managed floating exchange rate policy, intervening only to smooth sharp fluctuations. In 2007, the nominal exchange rate was stable at around TJS3.44/\$1 (Figure 3.6.3).

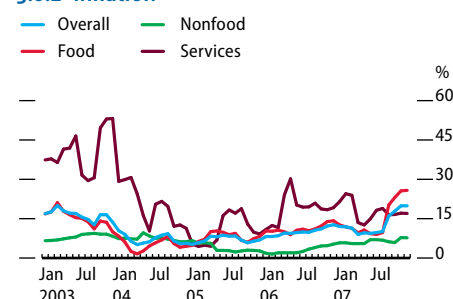
Parliament approved a 3-year Poverty Reduction Strategy (PRS) for 2007–2009 and a National Development Strategy through 2015. The PRS marks a significant shift in government focus from the prudent macroeconomic policies of the transition period to an emphasis on aggressive policies to implement long-term development goals. The financing of the new PRS is envisaged at about \$5 billion, compared with \$0.7 billion for the previous strategy. It is expected to be financed largely by FDI in infrastructure, especially in energy and transport.

The budget for 2007 moved to an expansionary track to accommodate the financing of the PRS. Enlargement of the Public Investment Program (PIP) has led to a substantial widening of the overall fiscal deficit (to 6.4% of GDP) (Figure 3.6.4). Excluding the PIP, the Government achieved a fiscal surplus of 1.6% of GDP. Social sector spending rose (albeit from a low base) aided by strong revenues, in turn supported by robust economic growth and better tax administration. The bulk of PIP spending is on infrastructure projects, mainly in roads and hydropower. Project loans from the People's Republic of China accounted for much of the external financing of the PIP in 2007.

After declining for several years, the ratio of external debt to GDP is set to rise to about 56% of GDP by 2009 (Figure 3.6.5). It was brought down to 31% of GDP in 2006 from more than 100% in 2000 by debt reduction agreements, including those with the Russian Federation and the International Monetary Fund, but external borrowing for the new transport and energy projects will take the debt ratio up again.

The current account deficit is estimated to have sharply widened in 2007 to 15.2% of GDP due to a much larger trade deficit. Imports grew at an estimated 39.2%, primarily for the infrastructure projects (but

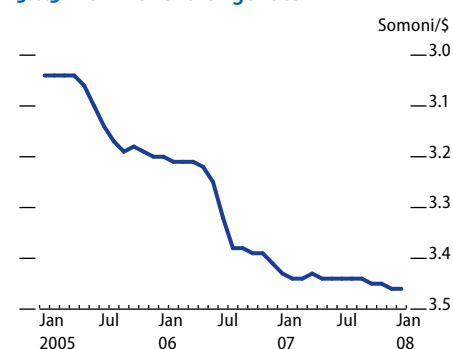
### 3.6.2 Inflation



Source: National Bank of Tajikistan, available: <http://www.nbt.tj/en>, downloaded 3 March 2008.

[Click here for figure data](#)

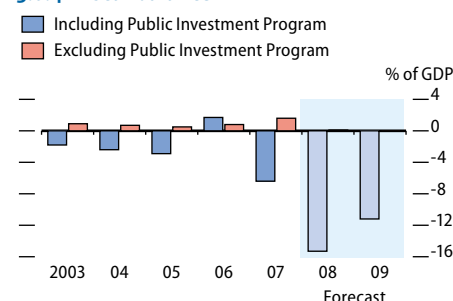
### 3.6.3 Nominal exchange rate



Sources: International Monetary Fund, *International Financial Statistics* online database; National Bank of Tajikistan, available: <http://www.nbt.tj/en/>; both downloaded 27 February 2008.

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### 3.6.4 Fiscal balance



Sources: International Monetary Fund, *Country Report* No. 07/144; Ministry of Finance.

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also greater imports of consumer goods). Much steeper oil and natural gas prices also contributed to the higher import bill. Export growth, in contrast, managed only 9.4% on poorly improving volumes of aluminum and cotton exports.

Remittances grew strongly, as the boom in the construction and oil sectors in Kazakhstan and the Russian Federation continued to attract many Tajik workers. According to the latest estimates from the central bank, workers' remittances surged to an estimated \$1.8 billion in 2007 from the previous year's \$1.2 billion. The current account deficit amounted to an estimated \$476 million in 2007, financed largely by project loans and FDI. The official reserves rose by \$70 million to \$273.8 million.

Progress on structural reforms has been patchy. In agriculture, the growing farm debt in the cotton sector and the protracted approach for its resolution and for implementation of comprehensive sector reform are symptomatic of difficulties. Also, poor farmer incentives and rent seeking continue to hobble a major part of the economy. In power though, the Government has started to adjust electricity tariffs to cost-recovery levels and to provide a compensatory mechanism for the poor.

## Economic prospects

Policy assumptions are that external financing, including FDI in the energy sector, will be attracted at record volumes relative to GDP and that fiscal policy will be expansionary. Monetary policy will seek to contain inflation but implementation will remain difficult given the paucity of policy instruments. The Government will adhere to its policy of a managed float, that is, intervening in the foreign exchange market only in cases of sharp fluctuations. It is also foreseen that the Government will pursue structural reforms only slowly, including those in agriculture, but electricity tariffs are seen being adjusted upward (as per the energy strategy). Moreover, government employees' wages, including those working in primary health care and education, will be gradually raised.

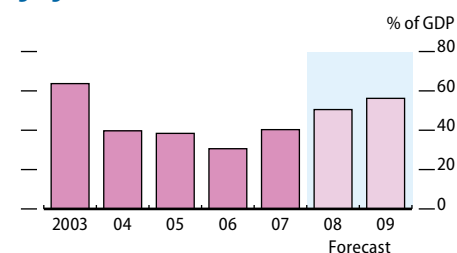
A booming construction sector in the Russian Federation and across Central Asia will sustain demand for Tajik workers. World prices for cotton are also expected to be stable. Prices for fruits and vegetables should rise, creating incentives for exporters.

On the import side, higher prices for energy and food will add to production costs and consumer inflation, respectively. Food prices, including those for wheat, are expected to keep on climbing as global demand rises faster than supply. Domestic production of wheat this year is likely to be hurt by the recent cold winter.

The economy is projected to expand at a slightly higher pace than in 2005–2007, at about 8%. Services will continue to be an important source of growth, largely on rising remittance-based consumption spending. Industrial growth, led by food processing and construction materials, will also buttress expansion. Non-cotton sectors, including fruits and vegetables, will underpin agricultural growth, although the slow pace of reforms in the sector and declining cotton production will hold it back.

Inflation is expected to be in double digits in a context of cost-push and demand-pull pressures. The former are expected to come mainly from higher prices for food and energy. The price of natural gas imported

### 3.6.5 External debt



Sources: International Monetary Fund, Country Report No. 07/144; Ministry of Finance.

[Click here for figure data](#)

### 3.6.1 Selected economic indicators

	2008	2009
GDP growth	8.0	8.0
Inflation	17.0	10.0
Current account balance (% of GDP)	-15.3	-11.1

Source: Staff estimates.

from Uzbekistan in 2008 was set at \$145 per 1,000 cubic meter, a 45% increase from 2007. The latter pressures are seen emanating from rising remittances and wages, and an expansionary fiscal policy. Inflation expectations will remain high over the medium term.

The current account deficit is set to be wide at about 15% of GDP this year and then moderate in 2009 (Figure 3.6.6). Import growth will largely reflect the schedule for ongoing infrastructure implementation. Export growth is likely to decelerate, perhaps averaging about 10%, though workers' remittances are expected to continue rising healthily. Project loans and FDI are seen fully covering the current account deficit and providing moderate additions to official reserves.

A major downside risk to economic prospects is the impact of unusually cold weather in early 2008, which pushed the water levels at major hydropower stations to record low levels. This may well mean that electricity rationing will continue. The cold winter will also likely have severely damaged agriculture. An additional difficulty emerged in early March 2008 when the International Monetary Fund (IMF) Executive Board decided that Tajikistan had to advance repayment of about \$47.4 million because of misreporting of information under an IMF loan agreement.

## Development challenges

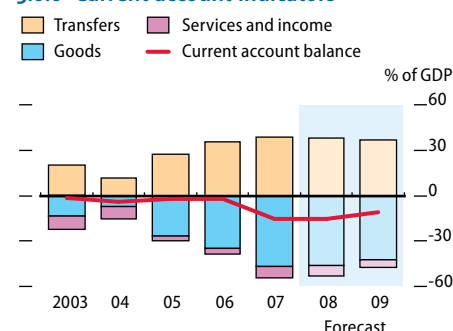
The small, landlocked, and open Tajik economy faces two main challenges: maintaining macroeconomic stability and diversifying the economy to sustain high growth rates.

The external loans attracted for financing infrastructure projects are expected to have a marked impact on the economy, because the projected volume of their disbursements is large relative to GDP. In the annual PIPs, the externally financed parts of the development budget are projected to be 10–15% of GDP in 2008–2009. Moreover, activities related to the projects are exempt from taxes and duties. Thus, the overall budget deficit is set to widen sharply. A debt-sustainability analysis by IMF and the World Bank in 2007, which took into consideration the new loans, classified Tajikistan as having a high risk of debt distress. A balancing act will therefore be required to maintain stability while implementing the PRS.

The economy now needs to diversify more than ever as the contributions from its former bastions—aluminum and cotton—shrink. The robust, fairly widespread growth of 2007 suggests opportunities for private sector-led diversification. Obstacles abound though, including an inadequate legal framework and judicial system, weak public administration, and meager public and private infrastructure.

Lack of profitable investment opportunities (given the small size of the economy) and limited physical access to export markets constrain private sector development. Improvements, primarily in transportation and energy, as well as in the financial system and information technology, are therefore needed. Regional integration, including cross-border trading arrangements, would help foster private activities. The Government should accelerate the pace of structural reform, and implement a strategy for the private sector.

### 3.6.6 Current account indicators



Source: International Monetary Fund country reports.

[Click here for figure data](#)