Tajikistan

Following the peace settlement in 1999, the economy has experienced a strong recovery, but per capita income remains among the lowest in the world. Progress has been made in implementing a poverty reduction strategy, despite the legacy of weak institutional capacity and a limited resource base. The pace of economic growth slowed to 6.7% in 2005, due mainly to falling cotton production and deteriorating terms of trade. Slippages in implementing structural reforms were also in evidence. Economic prospects are promising, though, in view of the start of major foreign-invested projects and renewed efforts at implementing the structural reforms outlined in the national development strategy.

Economic performance

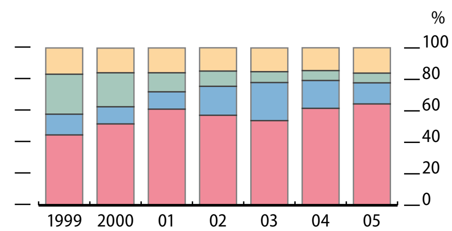
A period of strong recovery and economic expansion has followed the agreement in 1999 that ended the civil war. Growth of gross domestic product (GDP) averaged nearly 10% in the 4 years through 2004. GDP growth then slowed to about 6.7% (preliminary estimates), reflecting weak performance in agriculture, slower growth in industrial output, and less favorable terms of trade caused both by higher import prices for oil products and natural gas and by a softening of cotton export prices. Cotton and aluminum are the traditional pillars of the economy and, even with some diversification in activity, they continue to drive outcomes in agriculture and industry, and account for more than three quarters of exports (Figure 2.5.1).

Cotton production appears to have declined by about 20% from its 2004 level, mainly because of a reduction in the area planted (and because of poor weather). However, the cotton sector suffers from a slew of structural problems, including heavy debt ($280 million) resulting from unfavorable credit terms and slow implementation of land and marketing reforms. The weaker growth in industry stemmed from a slowdown in the growth of aluminum production where growth in output, estimated at 6%, was about one half that seen in 2004.

On the expenditure side, domestic demand was driven essentially by higher private consumption spending, in turn financed mainly by strong growth in workers' remittances and, to a lesser degree, by public sector wage rises. Remittances are estimated in the 2005 balance of payments to have increased to about $600 million, including small-scale export receipts, which are usually 30% of transfers. This amount is likely double that, if unofficial inflows are counted. These funds, largely from workers in the Russian Federation, have buoyed growth in services activities, such as retail trade and light manufacturing. They have also financed some investments in small enterprises.

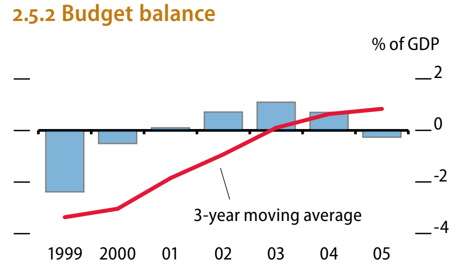
Diversification of the economy continued (though slowly), bringing the share of the services sector to nearly 50%, with trade, construction, communications, and financial activities the fastest growing. The share of agriculture has declined steadily from 36% in 1991 to 22% in 2005. The

2.5.1 Composition of exports



Source: National Bank of Tajikistan, available: http://www.nbt.tj/en/files/docs/pl_balans/str_exp_en.xls, downloaded 14 March 2006.

2.5.2 Budget balance



Sources: State Statistical Committee of Tajikistan; National Bank of Tajikistan.

protracted approach to land reform and resolution of cotton farmers' debt remain major issues that have accelerated the decline of agriculture. The Government's Farm Debt Reduction Strategy advocates land reforms and liberalization of cotton production, which together hold the key to agricultural growth, but little headway was made on either in 2005.

Reflecting a cautious fiscal policy, and excluding the foreign-financed public investment program, a budget deficit of 0.3% of GDP was achieved in 2005, according to preliminary estimates (Figure 2.5.2). Having been stagnant at about 15% of GDP since 2000, tax revenue exceeded budget expectations and rose sharply to 16.6% in 2005, chiefly because of larger collection of income taxes and value-added tax. Ongoing reforms in tax administration, including a new tax code that came into effect in January 2005, helped boost revenues. The Government for the most part exercised restraint in spending, and the outcome was as budgeted. In an attempt to improve the quality of services, though, it raised wages, as it had done a year earlier—especially in health care and education—to help bring up the prevailing extremely low levels. There has been a substantial reduction in the level of external debt, which reduced the strain on the general government budget.

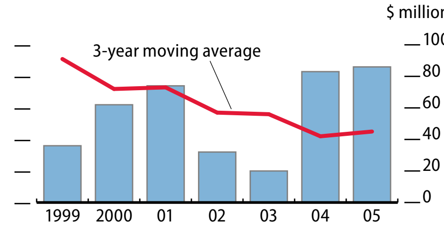
International Monetary Fund (IMF) stabilization programs are delivering results. For example, average annual inflation was brought down from 38.6% in 2001 to 7.1% in 2004, even as the economy expanded rapidly. In 2005, inflation was at 7.1%, but stayed within the central bank's 7.5% target limit. It reflected unusually high food prices in the summer, rises in electricity and petroleum fuel prices, temporary disruptions to border trade with Uzbekistan, and exchange rate depreciation.

Monetary policy, directed at fighting inflation, remained cautious in 2005. In this regard, IMF has indicated that all monetary program targets were met in September (and they appear to have been met in December as well). The previous relative stability of the national currency, the somoni, against the dollar was lessened as the authorities focused on stabilizing reserve money growth. Over all of 2005, the somoni depreciated modestly in nominal and real terms, reflecting worsening terms of trade and a weakening against main trading partner currencies in the second half of the year.

The current account deficit, which had been narrowing consistently since 2000, widened to 4.0% of GDP in 2004 and then contracted slightly in 2005 to 3.7% (preliminary estimates), as higher remittances more than offset the deteriorating terms of trade (Figure 2.5.3). Continued flows of development assistance financed most of the current account deficit. Gross official reserves increased by $30 million to $219 million (providing only about 2 months of import cover) (Figure 2.5.4). Total external public and private debt amounted to $894.9 million, or about 39% of GDP, at end-2005.

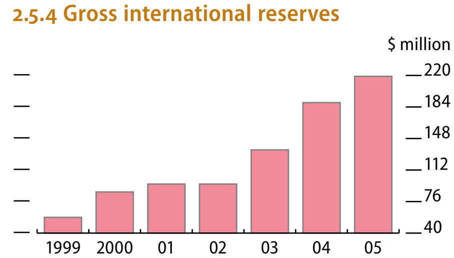
The Government has secured a substantial reduction in its external debt, which as a share of GDP fell by more than half (113% to 38%) between end-1999 and end-2005 (Figure 2.5.5). It held direct negotiations with bilateral creditors for debt rescheduling, write-offs, and asset swaps (most of the creditors were outside the Paris Club), enabling it to use its historical ties. The main breakthrough was the restructuring of the heavy debt owed to the Russian Federation, through a debt-asset swap in October 2004. This involved exchanging $242.4 million of debt

2.5.3 Current account deficit



Sources: National Bank of Tajikistan; International Monetary Fund *2004 Article IV Consultation and Fifth Review Under the Poverty Reduction and Growth Reduction Facility*, April 2005; IMF, *Sixth Review Under the Poverty Reduction and Growth Facility*, February 2006.

2.5.4 Gross international reserves



Sources: National Bank of Tajikistan; International Monetary Fund *2004 Article IV Consultation and Fifth Review Under the Poverty Reduction and Growth Reduction Facility*, April 2005; IMF, *Sixth Review Under the Poverty Reduction and Growth Facility*, February 2006.

2.5.5 External debt

Sources: State Statistical Committee of Tajikistan; National Bank of Tajikistan.

against Russian state ownership of the Nurek space tracking station, in the process lowering Tajikistan's external debt by more than 20%. IMF's decision to write off this year, under the Multilateral Debt Relief Initiative, 100% of the approximately $100 million that Tajikistan owes it, is another major boost to the debt consolidation effort.

Economic outlook

GDP growth is projected to be 8.0% in 2006 and 6.0% in 2007 (Figure 2.5.6). This reflects the assumption that export prices for cotton and aluminum do not improve substantially over 2005's levels and that cotton production recovers to normal levels. In these circumstances, exports are expected to expand by about 6%. The current account deficit is projected at about 4.5% of GDP, as growth in workers' remittances is seen as remaining buoyant and offsetting rising imports, including higher costs of energy from both price and volume increases. The deficit should be financed from expected concessional loans and grants and some rise in foreign direct investment associated with the start of construction of large-scale, Russian-financed hydropower projects.

Macroeconomic policy is expected to stay cautious within the existing framework of the economic program with IMF. Several revenue measures were included in the 2006 budget and the overall deficit is limited to 0.5% of GDP, excluding the foreign-financed public investment program, which will be maintained at 4.0% of GDP. A conservative monetary program has been set as part of the overall economic framework, containing inflation to 5–7% (Figure 2.5.7).

The Government is currently formulating a National Development Strategy (NDS) for 2006–2015. Macroeconomic growth projections for the NDS have been developed under three scenarios. Under the most ambitious, high-growth, scenario, growth will average 9% in 2006–2010 and 8.5% in the 5 years to 2015. The assumptions are, between 2005 and 2015, that: the investment rate rises from 6.7% of GDP to 11–12%; tax revenues improve from 16.6% of GDP to 22.0%; the current account balance switches from a deficit of 3.7% of GDP to a surplus of 2.0%; inflation declines from 7.1% to 3.0%; and the planned multibillion dollar investments in new aluminum and hydropower capacity are completed.

Growth averaged nearly 10% in the 4 years through 2004. The question is whether this is sustainable given the lag in reform momentum in key sectors, and institutional and infrastructure bottlenecks that the economy faces, as highlighted by 2005's sharp reduction in growth. Five main structural weaknesses are discernible.

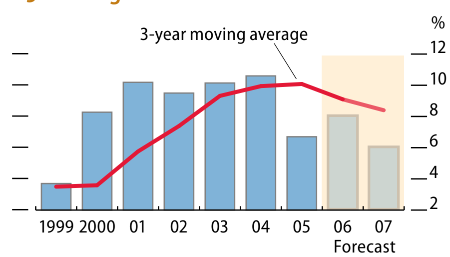
First, national income is still below the level of 1991. In 2003, the latest year for which data are available, 64% of the population still lived below the poverty line (defined as $2.15 a day using 2000 purchasing power parity exchange rates), down from 81% in 1999. The high growth rate, to some extent, therefore reflects a catching up with earlier levels. Real progress is hampered by the fact that more than 60% of the labor force are employed in low-productivity agriculture. Successful policy implementation, especially in the areas of land reform and resolution of cotton farmers' debt, is needed to substantially raise agricultural output and help reduce poverty.

2.5.1 Selected economic indicators

	2006	2007
GDP growth	8.0	6.0
Inflation	7.0	5.0
Current account balance (% of GDP)	-4.5	-4.5

Source: Staff estimates.

2.5.6 GDP growth



Sources: International Monetary Fund *Country Report 04/248*, August 2004; State Statistical Committee of Tajikistan; National Bank of Tajikistan

Second, the main drivers of growth are remittances from the Russian Federation (and, if transfers outside official channels are included, total remittances may well account for some 20% of national income); export earnings from cotton and aluminum (these commodities together account for about three quarters of export earnings); and construction (primarily Russian-financed hydropower plants). When the heavy dependence on imported oil and natural gas (Figure 2.5.8), and the landlocked nature of the economy, are considered, the economy's extreme susceptibility to exogenous shocks is apparent.

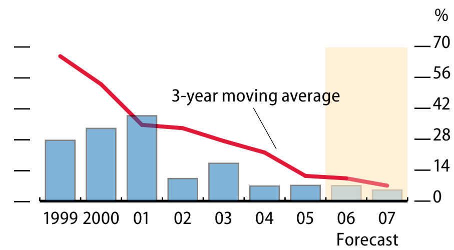
Third, low inflation and relative exchange rate stability provide an auspicious environment for growth, but power and transport bottlenecks remain a serious handicap for sustained development. Reforms in the energy sector require urgent government attention. While utility rates for gas have been adjusted to reflect imported gas prices, electricity rates remain significantly below economic viability levels. Together with large and still-growing account receivables of the power utility, low power prices have generated a large quasi-fiscal deficit. On a positive note, however, the Government has committed itself to wide-ranging reforms for development of indigenous hydropower resources, including greenfield hydropower projects with public-private partnerships and a trading and transmission infrastructure designed to satisfy domestic energy demand and augment export revenues. In transport, air services are particularly poor in the absence of competition, with Tajik Air enjoying a virtual monopoly.

Fourth, channeling private savings into productive investment faces major hurdles. The bulk of savings are "under the carpet" and banks are not the usual repository, although financial intermediation via formal banking channels has, from a very low base, been growing steadily. A significant step-up in bank lending to business would, however, require addressing weaknesses in property rights, in the judicial system (including contract enforcement), in bankruptcy procedures, and in accounting standards.

Fifth, access to education and to primary health services remains limited and of poor quality—the latter rendering the population vulnerable to the spread of disease. The main reason is low public spending (2.7% on education and 1.0% of GDP on health in 2004) relative to international standards. The Government has in fact used most of the resources released by external debt relief for the social sectors, and public spending on education and health together climbed to nearly 5% of GDP in 2005. Public investment in education will also be boosted by a recent decision of the Education For All Fast Track Initiative to grant $18.4 million over 2006–2007 as budgetary support.

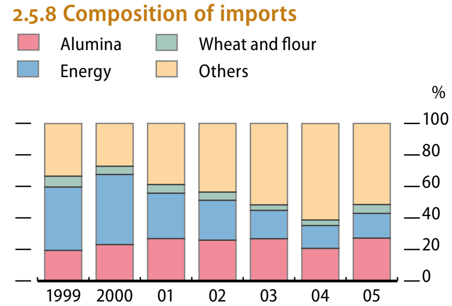
The authorities recognize that they have to undertake sweeping reforms to achieve the high-growth scenario. For example, the investment climate must dramatically improve, since it is crucial for diversifying the sources of growth. Public-private partnership models must be tested and adopted for realizing planned investments in generating and exporting hydropower. The public administration reform strategy that is currently being finalized must be speedily implemented. And the long-awaited reforms in agriculture and energy need to be implemented, in accordance with the Government's own commitments.

2.5.7 Inflation



Sources: International Monetary Fund, *Country Report 04/248*, August 2004; State Statistical Committee of Tajikistan; National Bank of Tajikistan.

2.5.8 Composition of imports



Sources: National Bank of Tajikistan, available: http://www.nbt.tj/en/files/docs/pl_balans/str_exp_en.xls, downloaded 14 March 2006.