Tajikistan

Underpinned by record-high remittance inflows and supported by expansion in agriculture, services, and industry, growth accelerated in 2011, continuing the recovery to precrisis levels. Inflation remained high for most of 2011 but gradually eased toward year-end. In the short and medium term, continued moderate growth is forecast, but heavy reliance on remittances and public investment as drivers of demand-driven growth alongside extremely low private investment may not be sustainable.

Economic performance

GDP growth accelerated to 7.4% (from 6.5% in 2010), reflecting strong domestic demand and expanding agriculture, services, and industry, despite limited electricity supply and disruptions to rail transit through neighboring countries that held back output in the first half (Figure 3.6.1).

Driven by record remittances, services were the main driver of growth, expanding by 13.5%. Agriculture grew by 7.9%, despite difficult climatic conditions. Cotton production shot up by 34%, reflecting a 30% rise in the area devoted to cotton, as high international prices encouraged additional planting. Other crops, particularly fruits and vegetables, also showed double-digit growth.

Industry grew by 5.9%, encompassing a wide variation between a more than 38% increase in mining and extraction industries and a 16% contraction in aluminum output caused by disruptions to alumina imports and reduced electricity generation in the early part of the year.

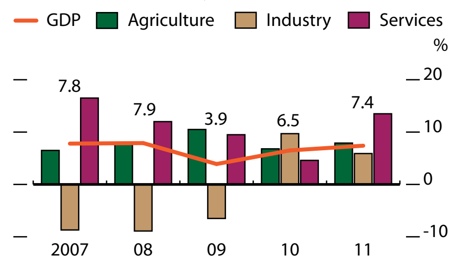
Consumption, reflecting higher imports, was the main source of growth on the demand side. Private investment showed little expansion, and its share in GDP remained extremely low at about 3%. Domestic investment was dominated by the government through state-owned enterprises.

Rising global food and fuel prices and higher remittances (which boosted domestic demand for imports) nearly doubled year-average inflation to 12.5% from 6.5% in 2010, although core inflation (excluding food and fuel) remained moderate at 5.7%.

Increases in export duties for oil products imposed by Tajikistan's main supplier, the Russian Federation, in the first half of 2011 raised fuel prices by 59%. Food price inflation peaked in that half in response to rising world prices (Figure 3.6.2), with staple foods rising by an average of 32%, before slowing in the second. Massive public expenditure on infrastructure and special projects to commemorate the 20th anniversary of Tajikistan's independence added to inflationary pressures.

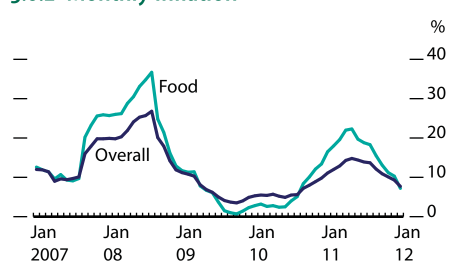
The overall budget deficit widened to 3.1% of GDP, although the more narrowly defined fiscal deficit (excluding foreign-financed public investment projects) was less than 1% of GDP (Figure 3.6.3).

3.6.1 GDP growth by sector



Sources: International Monetary Fund; Tajikistan State Statistics Agency. http://www.stat.tj (accessed 15 March 2012).

3.6.2 Monthly Inflation



Source: Tajikistan State Statistics Agency. http://www.stat.tj (accessed 15 March 2012).

This chapter was written by Kakhorjon Aminov of the Tajikistan Resident Mission, ADB, Dushanbe.

Revenue receipts exceeded the budget target, with tax collection surging by 30% from 2010, reflecting high prices for key exports and increased imports. Nevertheless, a narrow tax base and heavy dependence on import-based taxes contributed to a fragile fiscal position. Total revenue equaled 24.4% of GDP.

Government expenditure, in particular capital spending on infrastructure, rose by close to 30%, reflecting strong revenue and heavy foreign financing. Government investment surged by 41%, with increased spending focused on energy and transport infrastructure projects, including rehabilitation of the massive Roghun hydropower plant. Spending for social insurance and social protection grew by about 7%, as the state budget focused on capital outlays. Total expenditure amounted to 27.6% of GDP.

Although the stock of public and publicly-guaranteed debt climbed, rapid GDP growth reduced the ratio of public and publicly-guaranteed debt to GDP to 33.3% from 36.5% in 2010 (Figure 3.6.4). Potential contingent liabilities for state enterprises and the financial sector continued to raise questions about fiscal sustainability over the medium term.

Although high dollarization and an underdeveloped financial market undermined such moves' effectiveness, the National Bank of Tajikistan (NBT) pursued contractionary monetary policy during much of the year to curb inflation, raising its refinancing rate from 8.25% to 9.0% in February and again to 10.0% in October 2011. Yet reserve money still grew by more than 27% during the year, reflecting the recovery of private sector credit and considerable liquidity support from the central bank to commercial banks.

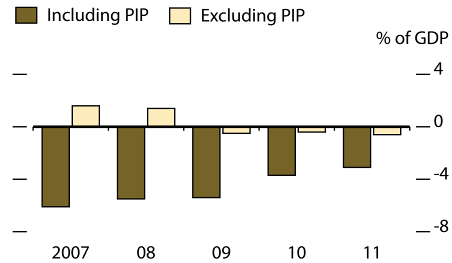
Since late December, with inflation slowing, the NBT has relaxed policy somewhat, lowering the refinancing rate in two steps to 9.0% by February 2012, to stimulate the economy.

Although financial sector indicators improved somewhat, more than 15% of loans remained nonperforming. The sector is constrained by limited private investment, few deposits, and exposure to risky agricultural loans. The exchange rate of the somoni, the local currency, depreciated by more than 8% against the US dollar and Russian ruble and 10% against the euro in 2011 (Figure 3.6.5).

The current account switched to a 4.1% of GDP deficit, after a 2.1% surplus in 2010. High remittances helped boost imports by about 20%, but exports picked up by only 5.2%, widening the trade deficit to over $2 billion. The limited production base, noncompetitive products, and a focus on a few export commodities—mainly aluminum and cotton—limited export growth. Import growth largely reflected surges in food products (38%) and textiles (27%), as well as industrial products (13%).

After hitting a trough in 2009–2010 of less than $20 million, foreign direct investment edged up to an estimated $30 million in 2011, but even this was very low. The government continued borrowing for energy and transport infrastructure projects. Gross reserves climbed to $582 million at end-2011, equivalent to 2 months of imports, from $476 million at end-2010. Public and publicly guaranteed external debt declined to 31.3% of GDP at end-2011, compared with 34.4% of GDP a year earlier.

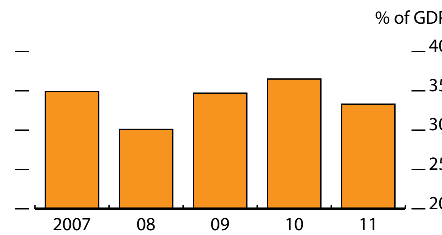
3.6.3 Fiscal balance



PIP = public investment program.

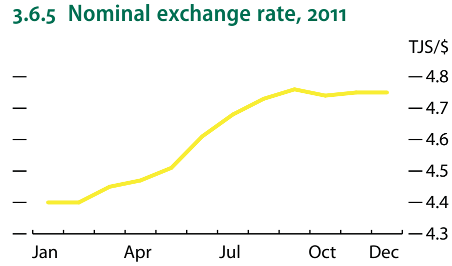
Sources: International Monetary Fund. 2010. *Country Report No. 10/374*. December; 2011. *Country Report No. 11/130*. June; 2012. *Country Report No. 12/32*. February. http://www.imf.org

3.6.4 Public and publicly guaranteed debt



Sources: International Monetary Fund. 2010. *Country Report No. 10/374*. December; 2011. *Country Report No. 11/130*. June; 2012. *Country Report No. 12/32*. February. http://www.imf.org

3.6.5 Nominal exchange rate, 2011



Source: National Bank of Tajikistan.

Economic prospects

Remittances will continue supporting aggregate demand, but GDP growth is forecast to decline to 5.5% in 2012, reflecting slower growth in the Russian Federation and other key trading partners, before recovering to 6.0% in 2013 as the world economy improves (Figure 3.6.6). Large remittances should boost consumption, maintaining sizable consumer imports and helping finance higher public investment through increased tax revenue. Although the overall outlook for exports is uncertain, construction of an international power line and the signing of an export agreement in 2011 should boost summer exports of electricity to Afghanistan in 2012 and 2013.

Output projections are less certain on the supply side. Moreover, the economy will remain prone to risks from recurrent shocks such as drought, natural disasters, and regional trade and political disputes.

Agriculture's performance will depend heavily on cotton output, which could expand further if global cotton prices stay high. Industry (including construction) and services will continue to fuel growth but at slower rates than in 2011 because of continued problems in the power sector, limited supplies of inputs, and aging production facilities, particularly in aluminum.

Inflation is forecast to stay around 8.5–9.0% in the next 2 years (Figure 3.6.7), as upward pressures on nonfood prices from higher imports and other factors offset the impact of moderating food prices. The Russian Federation is considering exempting from export duties only a fraction of oil products exported to Tajikistan, so inflation pressures from high fuel prices will persist in 2012. Additional pressure is likely to come if the government proceeds with plans to raise electricity tariffs.

Although the narrowly defined fiscal deficit is projected to remain around 0.5% of GDP, the overall deficit may widen beyond the forecast 5.5% of GDP. Slowing export growth may limit revenue. On the other hand, any increase in revenue will likely encourage a corresponding rise in expenditure, mainly for infrastructure, which would add to external borrowing under the public debt management framework.

The government plans to expand reforms in social assistance programs, which remain highly inefficient and poorly designed to the needs of the most vulnerable social groups. Tajikistan is unlikely to meet its Millennium Development Goal targets by 2015, although the government aims to focus more on investment strategies for more inclusive growth through initiatives to improve access to health care and education, including universal access to education for girls.

Continuing large consolidated deficits are expected to raise the public debt-to-GDP ratio to 37.3% by end-2012 and 37.8% a year later, which could prove risky in view of the possible recurrence of shocks to the economy.

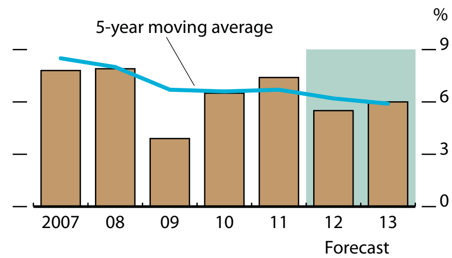
Despite persisting inflation, monetary policy may need to reflect more of a balance between supporting economic recovery and ensuring price stability, given the expected slowdown in growth and the limited volume of loanable funds for the economy. Slowing inflation has already led the central bank to reduce the refinancing rate from 9.8% in December 2011 to 9.0% in February 2012, and it may follow with further steps to more expansionary monetary policy. Weak external performance is expected to put further downward pressure on the national currency.

3.6.1 Selected economic indicators (%)

	2012	2013
GDP growth	5.5	6.0
Inflation	8.5	9.0
Current account balance (share of GDP)	-7.0	-6.5

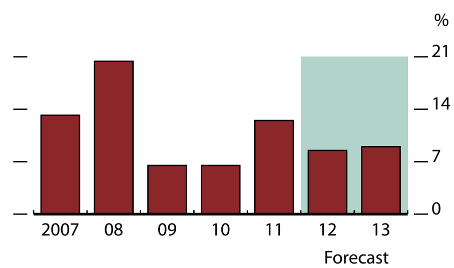
Source: ADB estimates.

3.6.6 GDP growth



Sources: International Monetary Fund; Tajikistan State Statistics Agency. http://www.stat.tj (accessed 15 March 2012); ADB estimates.

3.6.7 Inflation



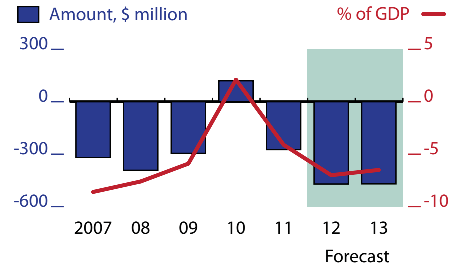
Sources: International Monetary Fund. 2011. World Economic Outlook database. September; Tajikistan State Statistics Agency. http://www.stat.tj (accessed 15 March 2012); ADB estimates.

The current account deficit is expected to widen from 4.1% in 2011 to 7.0% in 2012 before narrowing to 6.5% in 2013 (Figure 3.6.8). Export receipts are projected to fall as a result of declining international prices for cotton and other exports. Imports, though, should remain at least at the current level because of higher remittances (Figure 3.6.9).

The government is likely to continue external borrowing to finance infrastructure projects, mainly in energy and transport. However, the above-mentioned debt management framework requires all new government borrowings to have at least a 35% grant element and to limit borrowings to priority projects. Total public debt is projected to stay below 40% of GDP over the foreseeable future.

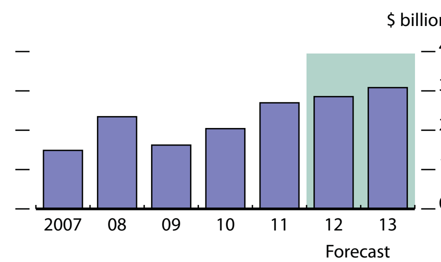
Foreign direct investment inflows are projected to continue rising gradually over the medium term, in line with current reform initiatives in tax administration and regulatory simplification. The bulk of investments will likely go to several large infrastructure projects, such as hydropower stations, toll roads, and supporting facilities for mining. Public and publicly guaranteed external debt is forecast to reach 37.2% of GDP at end-2012 and 37.5% of GDP 12 months later.

3.6.8 Current account balance



Sources: International Monetary Fund. 2010. *Country Report No. 10/374*. December; 2011. *Country Report No. 11/130*. June; 2012. *Country Report No. 12/32*. February. http://www.imf.org

3.6.9 Net remittances



Sources: International Monetary Fund. 2010. *Country Report No. 10/374*. December; 2011. *Country Report No. 11/130*. June; 2012. *Country Report No. 12/32*. February. http://www.imf.org

Policy challenge—boosting investment

A big concern remains the very limited share of private investment and foreign direct investment inflows, and more generally, a weak business environment and problems in the financial sector. The government relies extensively on public investment, an approach that may be unsustainable given the limited room for additional budget outlays. The private sector still represents less than half of GDP—and private investment less than 5%—reflecting an unfavorable business environment and lack of investor confidence. Most private enterprises are still small or of medium size and require little capital, operating in areas such as trade and services.

Serious efforts are necessary to reverse the lack of investor confidence and declining levels of private investment. Reducing risks to private investors—by providing and then enforcing property rights, for example, by reducing corruption, and by enhancing supportive infrastructure—is critical. Improving the security situation at the border with Uzbekistan, where clashes between border guards have closed an important rail line, and maintaining macroeconomic stability would also encourage private investment inflows.

Difficult business regulations also discourage private investment. Despite being among the top 10 reformers in the World Bank's 2010 and 2011 *Doing Business* reports, in the 2012 report Tajikistan still ranks 147 among 183 economies in the ease of doing business. Tax administration is complicated and time consuming, while the tax burden is high and encourages tax evasion. Limited financial intermediation and costly business financing are also major barriers. Addressing inefficiency, eliminating directed lending, and promoting competition by allowing international banks to enter the market could facilitate more lending and help cut financing costs.

Overall, understanding and eliminating key constraints to private investment, including deterrents to foreign investment, is critical to achieve sustainable economic growth in the medium term.