Tajikistan

Supported mainly by remittances, growth remained robust at 7.4% in 2013. It is expected to slow to 6.0% in 2014 and 5.8% in 2015 because of anticipated declines in the production of aluminum and cotton, Tajikistan’s primary exports. The main policy challenge is to boost private investment by improving governance and the investment climate.

Economic performance

Growth remained robust at 7.4%, though slightly lower than the 7.5% recorded in 2012. It was driven by strong domestic demand attributable to higher remittances, booming construction, and increased public investment. Private investment expanded but remained barely half the size of public investment.

On the supply side, growth in industry slowed to 3.9% from 10.4% in 2012, reflecting an 18.9% contraction in aluminum production caused by aging technology, disruptions in the supply of raw materials, and the lowest global prices since 2009. Industry nevertheless expanded because of higher output from mining, food processing, and electricity generation and distribution. Growth in agriculture also slowed, to 7.6% from 10.4% in 2012, as a 6.0% decline in cotton production linked to lower international prices offset major gains in newer crops. Growth in services accelerated to 19.3% from 14.5% in 2012, fueled by high remittances, while a recovery in public investment helped boost construction by 18.2%, sharply reversing an 18.9% contraction in 2012 (Figure 3.6.1).

On the demand side, consumption remained the main driver of growth, supported by strong remittances and increased public consumption as spending on social services rose. Public investment expanded by 2.2%, reversing the 3.5% contraction in 2012 with renewed government spending in infrastructure projects, mainly for transport and energy. Private investment expanded by 1.2%, up from 1.0% in 2012. Recent reforms to improve the investment climate, particularly in tax policy and administration, are gradually paying off. However, excessive regulation, problems with governance, and limited property rights hinder the expansion of private investment and wages.

Average annual inflation slowed to 5.1% from 5.8% in 2012, although food prices rose slightly faster based on monthly data (Figure 3.6.2). Prices for services increased by only 6.1%, less than half the 12.9% recorded in 2012 as the price of imported liquefied gas used in transport fell by 5.5% and the Russian Federation eliminated its export duty on oil and oil products.

Monetary policy remained largely accommodative as inflation moderated. The refinancing rate was reduced to 5.5% in October from the
6.5% set in September 2012. Broad money grew by 20.1%, the same rate as in 2012. Credit to the private sector grew by 53.6%, following the 17.2% rise in 2012. Total credit to the economy soared by 38.9%, on top of the 13.0% rise in 2012. Depositors’ confidence in banks is gradually strengthening, as indicated by growth in the share of individual deposits to 8.7% of GDP at the end of 2013 from 7.9% a year earlier. However, the banking system remains prone to risks from low profitability, and the percentage of nonperforming loans rose to 22.0% from 18.2% in 2012. The average exchange rate for the Tajik somoni remained stable at TJS4.77 = $1, which helped moderate import prices and inflationary expectations (Figure 3.6.3).

Fiscal policy became more expansionary during 2013. The budget recorded a deficit equal to 0.8% of GDP, following the surplus of 0.4% in 2012. Excluding investment outlays, the budget surplus narrowed to 0.2% of GDP from 1.7% in 2012 (Figure 3.6.4). Revenues rose to 26.9% of GDP from 25.1% in 2012, reflecting continued improvement in tax administration attributable to a comprehensive reform program. Expenditure grew to 27.7% of GDP from 24.7% in 2012, as social spending expanded further and public spending on infrastructure recovered after a decline in 2012. However, rapid economic growth meant that total public and publicly guaranteed debt decreased as a percentage of GDP to 29.2%, from 32.3% in 2012.

Despite a worsening trade balance, higher remittances narrowed the current account deficit to 1.9% of GDP from the 2.0% recorded in 2012. Exports fell by 0.8%, following 41.0% expansion in 2012, as aluminum and cotton exports fell sharply. At the same time, imports grew by 9.8%, following the 16.8% rise in 2012, as increased remittances helped finance imports of consumer goods. Remittances grew by 8.3% to an estimated $3.9 billion, from $3.6 billion in 2012, with 95% of inward remittances coming from the Russian Federation. Foreign direct investment fell sharply, from $198 million in 2012 to an annualized $81 million based on data for the first 9 months of 2013. Gross reserves rose from $650 million in 2012 to $694 million, equivalent to about 1.4 months of import cover. Total public and publicly guaranteed external debt fell to 25.3% of GDP at end-year from 28.3% at the end of 2012 (Figure 3.6.5).

**Economic prospects**

Growth is forecast to slow to 6.0% in 2014 and 5.8% in 2015, as aluminum and cotton output both decline (Figure 3.6.6). Nevertheless, the overall outlook remains cautiously optimistic. Barring a sharp slowdown in the Russian Federation, remittance inflows should remain sufficiently healthy for growth to continue in 2014 and 2015, stimulating private consumption, imports, and budget revenues. On the supply side, greater diversification into the production of new industrial products and agricultural crops will contribute to more sustainable growth. However, the economy remains vulnerable because income, consumption, and the balance of payments depend heavily on remittances, and because the outlook is weak for the economy’s two main exports: aluminum and cotton.

Aluminum output is expected to decline substantially in response to low international prices for the metal and consequent financial problems facing the Tajikistan Aluminum Company. The continued depreciation...
of production facilities, ongoing problems with power supply, and limited supplies of other inputs will exacerbate the situation. Cotton production is also projected to decrease, reflecting lower international prices, the poor investment climate, and a weak financial sector. Despite recent marginal improvements, Tajikistan’s standing in the comparative rating on ease of doing business published in the World Bank’s Doing Business 2014 report remains the second lowest in Europe and Central Asia and very low globally, at 143rd of 185 countries. Thus, structural reform will be essential to boost private investment.

Inflation is projected to accelerate slightly, to 5.5% in 2014 and 6.0% in 2015, mainly because of higher utility prices, particularly for electricity (Figure 3.6.7). Stable global and regional food prices are foreseen, as is only modest depreciation of the Tajik somoni, which should help keep inflation moderate, although sharper depreciation, perhaps triggered by the depreciation of the ruble and the Kazakh tenge early in 2014, would accelerate inflation in 2014.

Fiscal policy is expected to tighten somewhat. The budget deficit will likely narrow to 0.7% of GDP in 2014 and further to 0.5% in 2015, while the budget balance excluding investment is projected to record surpluses of 0.5% of GDP in 2014 and 0.7% in 2015. While public debt should decline as a percentage of GDP, external borrowing for large infrastructure projects, mainly in energy and transport, should continue. Higher imports, fueled by remittances, and the effects of the tax code approved in January 2013 and the implementation of tax administration reforms are expected to raise revenues to 19.0% of GDP in 2014 and 19.5% in 2015. While public debt should decline as a percentage of GDP, external borrowing for large infrastructure projects, mainly in energy and transport, should continue. Higher imports, fueled by remittances, and the effects of the tax code approved in January 2013 and the implementation of tax administration reforms are expected to raise revenues to 19.0% of GDP in 2014 and 19.5% in 2015. Expenditures are projected to moderate to 27.3% of GDP in 2014 but rebound to 27.7% in 2015. The announced public debt management strategy aims to keep public plus publicly guaranteed debt below 40% of GDP, ensure that new loans have a grant element of at least 35%, and undertake cost–benefit analyses of large investments. The strategy is expected to further reduce public plus publicly guaranteed debt to 28.2% of GDP in 2014 and 28.0% in 2015.

Over the next 2 years, monetary policy will need to balance support for growth with ensuring price stability. The refinancing rate is expected to remain between 4.5% and 5.5% in 2014 and 2015. Broad money growth is projected to fall to 18.3% in 2014 and further to 17.8% in 2015, envisaging slower growth in credit to the private sector. Some depreciation of the somoni is expected in 2014, in view of the depreciation of the ruble, though remittances should limit the downward pressure on the somoni exerted by weak export performance. Continued exchange rate flexibility and closely coordinated monetary and fiscal policies will be important to maintain competitiveness and avoid shocks.

The current account deficit is forecast to widen to 2.1% in 2014 and 2.3% in 2015 (Figure 3.6.8). Exports are projected to expand moderately, reflecting growth in nontraditional goods. On the other hand, shipments of traditional goods such as aluminum and cotton will shrink in line with declining international commodity prices. Imports are projected to expand by 7.9% in 2014 and 9.3% in 2015 because of higher remittances (Figure 3.6.9). Foreign direct investment should continue to rise gradually, to 2.1% of GDP in 2014 and 2.5% in 2015, in line with ongoing

### 3.6.1 Selected economic indicators (%)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>6.0</td>
<td>5.8</td>
</tr>
<tr>
<td>Inflation</td>
<td>5.5</td>
<td>6.0</td>
</tr>
<tr>
<td>Current account balance (share of GDP)</td>
<td>–2.1</td>
<td>–2.3</td>
</tr>
</tbody>
</table>

Source: ADB estimates.
reform initiatives and major infrastructure projects. External debt is forecast to stabilize at around 27.5% of GDP in 2014 and 2015. Reserves are expected to rise to $930 million at the end of 2014 and $1.1 billion a year later, equivalent to less than 3 months of imports.

**Policy challenge—promoting good governance and investment climate reform**

One of the most serious challenges in Tajikistan is to sustain a high rate of economic growth and generate employment through higher private investment. The government undertook a number of broad legal and regulatory measures to improve the business environment, such as signing the New York Arbitration Convention and joining the World Trade Organization in 2013. These moves were matched by some progress in lightening the burden of regulation on businesses and curtailing government intervention in several sectors of the economy. Nonetheless, private sector participation in the economy remains limited. Private investment stands at only about 5% of GDP, and the private sector still runs less than half of the formal economy. These statistics reflect an unfavorable business environment and lack of investor confidence. More is needed to boost investor confidence and promote private investment. This will require improvements in governance, property rights, and the rule of law.

While some progress has been achieved in preparing and issuing laws, regulations, and general policies, their enforcement and implementation remain problematic. The legal system does not support effective enforcement, and systemically poor governance continues to undermine the impact of reform, imposing risk on any potential private investment. There is limited momentum toward serious structural reform that would cut red tape and improve governance and public management. The quality of governance suffers a lack of capacity within the government and of accountability and transparency in service delivery. The consequences are visible problems with the regulatory and investment climate: subsidies for large state-owned enterprises, patchy rule of law and enforcement, and a high perception of corruption. Bank loans to related parties are also problematic. Good governance requires more decisive action to enforce laws that protect property rights and counter corruption. Mechanisms and structures to impose accountability are urgently needed.

Tajikistan has several sectors that can compete domestically, regionally, and even globally, but developing them depends upon attracting greater private investment. Immediate action is therefore needed to eliminate constraints on private investment and accelerate structural reform. Continued improvements to the business and investment climate are important, especially to make policy more predictable, reduce excessive regulation, secure property rights, and further improve tax policy and administration. More broadly, improving security and maintaining political and economic stability are key to encouraging private investment inflows and improving the business environment.