

Tajikistan

Country Economic Update
Fall 2017



Heightened
Vulnerabilities Despite
Sustained Growth



Macroeconomics
& Fiscal Management
Global Practice



TAJIKISTAN:

Heightened Vulnerabilities Despite Sustained Growth

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Government Fiscal Year:	January 1 – December 31
Currency Unit:	Tajikistan Somoni (TJS)
Currency Equivalents:	Official Exchange Rate Effective as of November 30, 2017 US\$1 = 8.8001 TJS
Weights and Measures:	Metric System

Abbreviations and Acronyms

BRICS	Acronym for the association of five major emerging economies: Brazil, Russian Federation, India, China and South Africa.
CAREC	Central Asia Regional Economic Cooperation
CASA	Central Asia-South Asia Power Project
EBRD	European Bank for Reconstruction and Development
EBF	Extra-budgetary funds
FOB	Free on board
FDI	Foreign direct investment
HPP	Hydropower plant
IFI	International financial institution
ILO	International Labor Organization
IMF	International Monetary Fund
L2TJK	Listening to Tajikistan Survey
MOF	Ministry of Finance
MPI	Multidimensional Poverty Index
MTDS	Medium Term Debt Strategy
NBT	National Bank of Tajikistan
NPL	Non-performing loans
OSCE	Organization for Security and Co-operation in Europe
PIP	Public Investment Project
PPG Debt	Public and publicly-guaranteed debt
RRS	Rayons of Republican Subordination
SOE	State-owned enterprise
SWB	Subjective Well-Being
TajStat	Tajik Statistical Agency
TSA	Targeted Social Assistance
UK DFID	United Kingdom's Department for International Development
UN	United Nations
USAID	United States Agency for International Development
VAT	Value added tax
WBG	World Bank Group

Table of Contents

Foreword	iv
Overview	1
A. Recent Socio-Economic Developments	2
Recent Political Events.....	2
Economic Growth and Inflation	4
External Sector.....	6
Financial Sector.....	8
Social Sector	8
B. Macroeconomic Policies and Structural Reforms	13
Assessment of Fiscal and Debt Policies.....	13
Assessment of Monetary and Exchange Rate Policies	15
Ongoing Structural Reforms.....	17
C. Economic Outlook and Risks.....	19
Tajikistan's Baseline Scenario	19
Risks	21
D. Focus Section:.....	22
Challenges of Fiscal Management in Tajikistan.....	22
Annex Table 1. Selected Macroeconomic and Social Indicators, 2014–2019.....	25

Figures

Figure 1: Sector Contribution to Growth	4
Figure 2: Consumer Price Inflation	5
Figure 3: Current Account and Exchange Rate Developments.....	7
Figure 4: Exports and Imports of Goods	7
Figure 5: Share of FDI by Sector	7
Figure 6: International Reserves.....	7
Figure 7: Average Monthly Wage by Sector	10
Figure 8: Employment Share by Sector	10
Figure 9: Public Debt Composition.....	14
Figure 10: Refinance Rate	16
Figure 11: Real Effective Exchange Rate Index.....	16
Figure 12: Tajikistan's Doing Business ranking by indicator set.....	18
Figure 13: Poverty Rate Projection	20

Tables

Table 1: Contribution to Real GDP Growth, 2013–2017	5
Table 2: Balance of Payments and Official Reserves, 2014–2017.....	8
Table 3: Consolidated fiscal accounts, 2014–2017.....	15
Table 4: Baseline scenario: selected macro-fiscal indicators, 2016–19	21

Boxes

Box 1: Non-Monetary Poverty Rate is Explained by Insufficient Public Infrastructure and Services	11
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Foreword

This edition of the Tajikistan Country Economic Update (CEU) is part of a semi-annual series designed to monitor socio-economic developments in Tajikistan. It presents an analysis of political, economic and social developments, as well as the progress of and challenges with the implementation of structural reforms in 2017. It also includes a special section highlighting the key fiscal management challenges in Tajikistan.

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Overview

Strong economic growth in 2017 has positive implications for poverty reduction.

Real GDP expanded strongly in the first nine months of 2017, rising by 6.8 percent year on year, according to official estimates. This performance was buttressed by the improving external environment, which drove an improvement of net exports and remittances (supporting private consumption), as well as public investment, particularly during the third quarter of the year. The growth performance was accompanied by a substantially-improved fiscal position and reduced external deficit, although the domestic banking sector remains in crisis. The poverty incidence had already declined from 31.3 percent of the population in 2015 to 30.3 percent in 2016 despite continued reduction in remittances, and the improved conditions in 2017 suggest that a further reduction could materialize. Household survey results indicate that strong economic growth and rising wage income remain the primary drivers of poverty reduction in Tajikistan. Therefore, maintaining robust economic growth and job creation will be crucial for registering a further decrease in the poverty rate.

Fiscal consolidation is underway amid a heightened debt burden and tightening of monetary policy.

Following a significant fiscal expansion in 2016—including funds to support the bank bailout program—the Tajik authorities pursued a path of fiscal consolidation in 2017, seeking to rebuild weakened buffers. A strong overall fiscal revenue performance (despite some reduction in import tax collections), greater scrutiny and cuts to non-priority public outlays as well as some delays in public spending supported this consolidation and led to a lower-than-projected fiscal deficit in the first nine months of 2017. At the same time, large infrastructure projects were ring-fenced, suggesting a possible prioritization of infrastructure investments over social programs. A baseline fiscal deficit of around 2.5 percent of GDP is projected, which is in line with the approved budget. However, fiscal pressures associated with a possible second-round bank bailout may result in a higher overall fiscal deficit by end-2017. The excess liquidity injection resulting from the bank bailout in December 2016 created significant pressures on inflation and the exchange rate, which stabilized by mid-2017 owing to a tightening of monetary policy. International reserves continued to rise in 2017, supported by the improved external environment, the continuation of the surrender requirement on ruble-denominated remittances introduced in 2016, as well as the successful placement of a US\$500 million Eurobond in September. However, Tajikistan's financial sector remains in distress. The sizable recapitalization of the two largest banks in December 2016 was insufficient to improve the situation, which is dampening credit to the economy and crimping future growth prospects. The authorities have held extensive discussions with the international financial institutions on possible resolution mechanisms, but a decision on a potential resolution package remains pending.

Growth potential is undermined by an inadequate macroeconomic policy framework

Despite an improved external environment, particularly in the Russian Federation, growing domestic vulnerabilities are weighing on Tajikistan's prospects for sustained economic growth. In particular, the outlook is constrained by a weak domestic policy framework. The narrowed fiscal space resulting from the rising public debt, a pending resolution of problems in the financial sector, rising contingent liabilities by state-owned enterprises and

**and external
uncertainties.**

the country's challenging business environment (including due to the high cost of regulatory compliance) require stronger and bolder policy responses. The "business as usual" approach is inadequate to effectively address the outstanding macro-financial and poverty reduction challenges confronting the economy. Moreover, the domestic social environment could deteriorate if Russia tightens migration regulations.

A. Recent Socio-Economic Developments

Recent Political Events

**Regional
cooperation
around energy
projects has
continued.**

Tajikistan actively supports the CASA-1000 project, which aims to build a power transmission line in the Central and South Asia region. Dushanbe hosted a summit on July 6, 2017, that was attended by the heads of government of the CASA-1000 member countries (namely Afghanistan, Kyrgyzstan, Pakistan and Tajikistan). Representatives of the World Bank, Islamic Development Bank, EBRD, USAID and UK DFID, which are the project implementation partners, also participated. A follow-up meeting took place in Dubai in early October, reaffirming the high-level political commitment of participating states.

**Relations are
improving
between
Tajikistan and
Uzbekistan.**

Following an extended period of tense relations, there is evidence that shift is taking place in Tajikistan's relationship with Uzbekistan. During the past year, regular air connections have resumed between Tashkent and Dushanbe (May 2017), Uzbek firms have announced new investments in Tajikistan, Tashkent has held Tajik cultural/business days, and high-level public officials have made reciprocal visits to Tashkent and Dushanbe. Furthermore, the Tajik and Uzbek customs authorities signed a Protocol on Cooperation and Mutual Assistance in Customs Matters in May. The protocol aims to facilitate the movement of goods, passengers, and vehicles, timely information exchange, mutual assistance and cooperation to simplify customs clearance and recognition of customs documents. Moreover, high-level Uzbek government officials have publicly stated that Uzbekistan does not oppose to the construction of the Rogun Hydropower Plant (HPP) and that both countries are working to reach an agreement on outstanding riparian issues, with expert negotiations expected to begin in the near term. Importantly, the countries have also started discussions on the resumption of the provision of natural gas to Tajikistan, which was suspended in 2012.

**Tajikistan
deepened
cooperation
with China and
participated in
the 9th BRICS
Summit.**

President Emomali Rahmon visited Beijing in late August 2017 for bilateral negotiations with China and to attend the 9th BRICS¹ Summit as an observer. He called China a "good neighbor, partner, and brother" and praised the close cooperation between Tajikistan and China in politics, culture, trade, and investment. New investments—including a US\$230 million grant for the construction of a new government building and parliamentary complex and a US\$79 million loan from China's Eximbank on preferential terms for the construction of 500 kilowatt (KW) power transmission line—underscore the success of the visit. China is Tajikistan's single largest economic partner,

¹ BRICS stands for an association of five major emerging national economies: Brazil, Russia, India, China and South Africa.

An official anti-graft campaign resulted in convictions.

Parliament strengthened regulation of traditions.

The OSCE has reduced scope of its activities in Tajikistan.

Dushanbe hosted 16th CAREC Ministerial Conference.

holding over 80 percent of the country's bilateral debt, accounting for half of FDI inflows and about one-third of imports.

The Tajik authorities launched an anti-graft campaign in April 2017 with a focus on former officials of the Anti-Corruption Agency and Customs Service. The former Deputy Director of the Anti-Corruption Agency and the former Deputy Chief of the Customs Service in Sughd Province were subsequently sentenced to more than ten years in prison. The former head of the agency's Investigative Directorate and his subordinates were also convicted of fraud and bribery and sentenced to lengthy prison terms.

The lower house of the Tajik parliament, Majlisi Namoyandagon, unanimously approved amendments to Tajikistan's "Law on the regulation of traditions, celebrations, and ceremonies" on August 23, 2017. The changes impose restrictions on traditions considered to be excessive and restrict lavish spending on celebrations. The authorities view the restrictions as a means of strengthening public order and preventing a decline in living standards.

The Organization on Security and Co-operation in Europe (OSCE) reduced its mandate in Tajikistan from an operation to a program office, thereby shuttering several provincial offices and considerably cutting its operational activities. The organization must now pre-approve any activities with the Ministry of Foreign Affairs, while all programs with a political element have been suspended.

The 16th Central Asia Regional Economic Cooperation (CAREC) conference was held on October 27th 2017 and resulted in the adoption of a new long-term strategy (CAREC 2030) unanimously endorsed by eleven country members². In addition to existing priority areas such as communication, energy and trade the new strategy also envisages broadening its scope of activities to support education, health, agriculture, tourism and financial sector development. The CAREC 2030 is expected to help countries in the region to achieve United Nation's Sustainable Development Goals and targets under Paris Climate Accord through the improved partnership and strategic vision.

² CAREC members include Afghanistan, Azerbaijan, China, Georgia, Kazakhstan, Kyrgyzstan, Mongolia, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan.

Economic Growth and Inflation

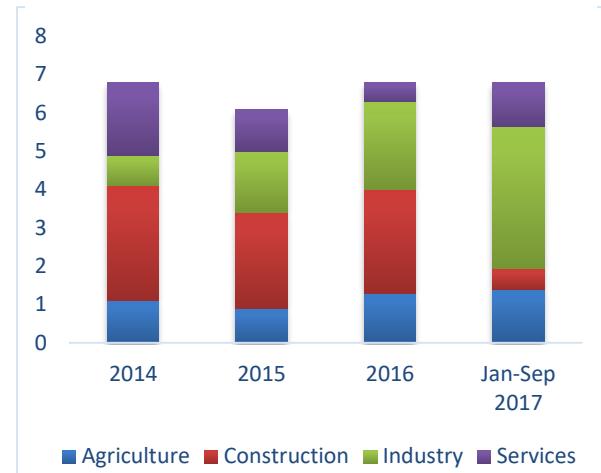
Economic growth remained strong, driven by improved net exports and private consumption.

Real GDP grew by a robust 6.8 percent year on year in the first nine months of 2017, broadly unchanged from the rate of growth recorded in the year-earlier period, according to official estimates. Growth was driven by higher net exports spurred by rising external demand for Tajikistan's mineral resources, a general improvement in the terms of trade and an incipient pickup in private consumption as remittances rose by over 18.4 percent year on year in the nine months of 2017 (compared to an annual growth rate of minus 14.5 percent in the year-earlier period).³

Overall investment was supportive, though to a lesser extent than in 2016. After declining by about 17 percent year on year in the first half of 2017, investment surged during the third quarter, resulting in a positive contribution to overall economic output. However, the surge in investment was not owing to some fundamental change in the investment climate but was the result of an increase in public sector investment. Public investment comprises the bulk (70 percent) of total investment in Tajikistan, with the rest equally split between the domestic and foreign private sectors. Affected by ongoing financial sector challenges, private investment declined by nearly 17 percent year on year in the first nine months of 2017, while public investment from domestic sources jumped up by more than 33 percent in the same period.

Figure 1: Sector Contribution to Growth

(Annual percentage change)



Source: TajStat and World Bank staff calculations.

³ According to the broad definition published by the Central Bank of Russia, in January-September 2017 money transfers totaled US\$1.7 billion compared to US\$1.43 billion in the same period of 2016.

Industrial output drove growth, but other sectors also contributed positively.

On the supply side, industrial production was the largest contributor to growth in the first nine months of 2017, accounting for 3.7 percentage points of overall growth, and rising by 22 percent year on year. Extractives (up 23.3 percent year on year), the manufacturing industry (particularly food-processing and textiles) and electricity production and utilities (up more than 15 percent), led industrial output growth. Nearly two-thirds of industrial output was generated by the public sector, underscoring the prevalence of administrative methods of economic management over market mechanisms in Tajikistan. Agriculture, the economy's most significant source of employment, expanded by 6.1 percent year on year during the first nine months of 2017, making the second largest contribution to the overall growth (although slightly less than in the same period of 2016 owing to unfavorable weather conditions). The construction sector's contribution to growth would have been more pronounced were it not for the sharp decline of foreign-financed public investment, which fell by about 28 percent year on year.

Table 1: Contribution to Real GDP Growth, 2013–2017
(In percentage points)

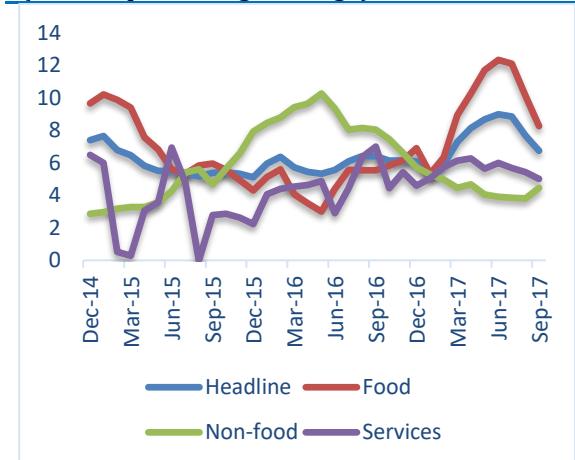
	2013	2014	2015	2016	2017 Jan-Sep
Real GDP growth	7.4	6.7	6.0	6.9	6.8
Agriculture	2.0	1.1	0.9	1.3	1.4
Construction	1.6	3.0	2.5	2.7	0.5
Industry	0.6	0.8	1.6	2.3	3.7
Services	3.1	1.9	1.1	0.5	1.2

Source: Tajik authorities and World Bank staff estimates.

The monetization of the financial sector bailout led to inflationary pressures in early 2017.

Annual consumer price inflation stood at 6.7 percent in September 2017, close to the year-earlier level of 6.4 percent (figure 2). Inflationary pressures were high at the beginning of the year driven by the monetization of the banking sector bailout. Currency depreciation during the first half of 2017 led to higher prices for imported goods. Supply-side shocks to some food staples and administrative adjustments in gas and water tariffs also drove inflationary pressures in 2017.

Figure 2: Consumer Price Inflation
(Annual percentage change)



Sources: TajStat and World Bank staff estimates.

External Sector

The protracted contraction of imports and an expansion of exports helped improve the external balance.

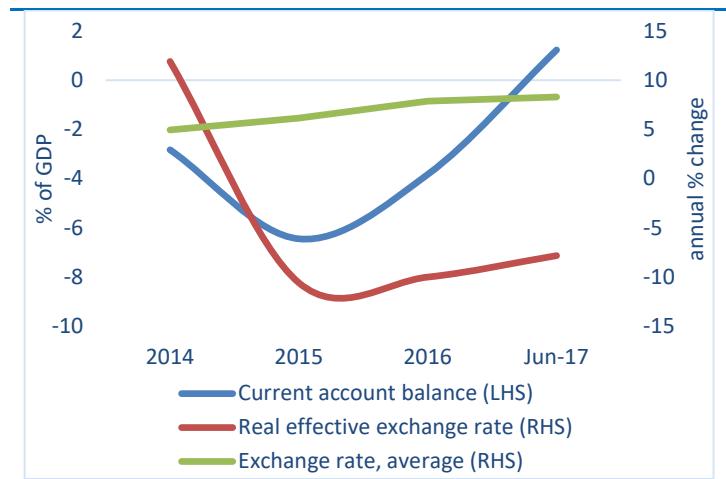
While Tajikistan's external position continued to improve in 2017 in the context of a substantial import contraction and accelerated export growth, the steady decline of the investment content of imports since early 2016 hints at weakening prospects for future growth. The current account posted a surplus of 1.2 percent of GDP in the first half of 2017 compared to a deficit of 4.9 percent of GDP in the same period of 2016 (figure 3). Affected by the sharp decline in investment and restrained consumer demand, merchandise imports fell by 17.5 percent year on year in the first half of 2017 in U.S. dollar terms, while significant reductions in import spending on capital-intensive goods, construction materials and vehicles were also recorded (figure 4).⁴ Conversely, merchandise export growth surged by over 60 percent year on year, bolstered by minerals and, to a lesser extent, the textile industry.⁵ However, exports of key commodities (such as primary aluminum and cotton fiber) continued to decline sharply (by 21.6 percent and 18.5 percent, respectively), reflecting the volatile price dynamics in international markets in recent years. However, cotton producers are expected to adjust to the price hike of more than 20 percent observed in the market in the next cycle of production.

Trade in services remains small and dominated by the transport and construction sectors. Although the number of visiting tourists grew by double digits in 2017, it did so from a low base and was unable to offset the overall deficit of trade in services. As part of the institutional reforms to facilitate the tourism sector's development, the government separated the Tourism Agency from the Ministry of Youth and Sport and made it a separate government entity. The government will need to upgrade tourism infrastructure, improve the quality of basic utilities and the country's overall connectivity to increase the attractiveness of the sector.

⁴ In the first half of 2017, total investment was down by over 17 percent year on year. However, investment picked up markedly in the third quarter, resulting in a year-on-year increase of 22 percent compared to the first nine months of 2016.

⁵ High exports are believed to be driven mainly by strong gold production, however this data is classified and therefore not publicly available.

Figure 3: Current Account and Exchange Rate Developments

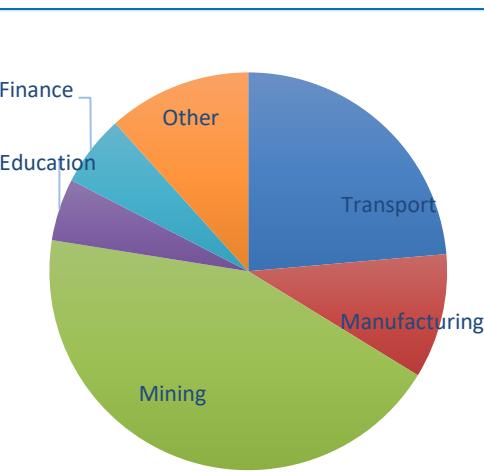


Sources: NBT and World Bank staff calculations.

The bulk of foreign investment was in the mining sector.

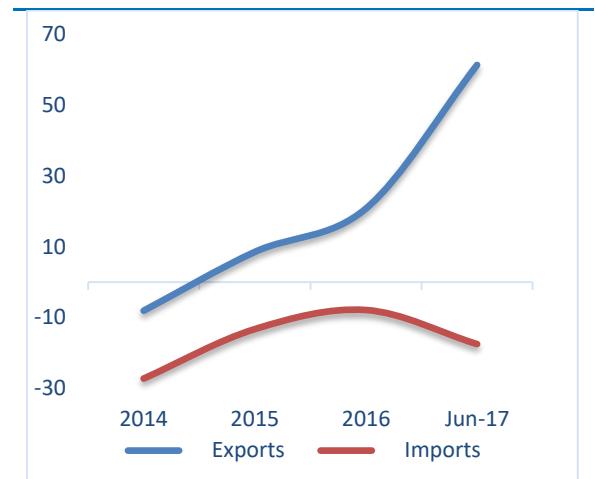
FDI inflows declined considerably in the first half of 2017, to just 1.9 percent of GDP, down from 6.3 percent of GDP in the same period of 2016. The mining sector received nearly half of all foreign investment, followed by the transport and manufacturing sectors (figure 5). About 80 percent of foreign investment originated in China (47.3 percent) and Russia (31.3 percent). The third largest investment flows came from Switzerland (6.8 percent). The Japanese government recently announced that it would invest \$200 million in the Dushanbe airport cargo terminal; this will diversify the FDI base and its sectoral composition.

Figure 5: Share of FDI by Sector (January-June 2017)



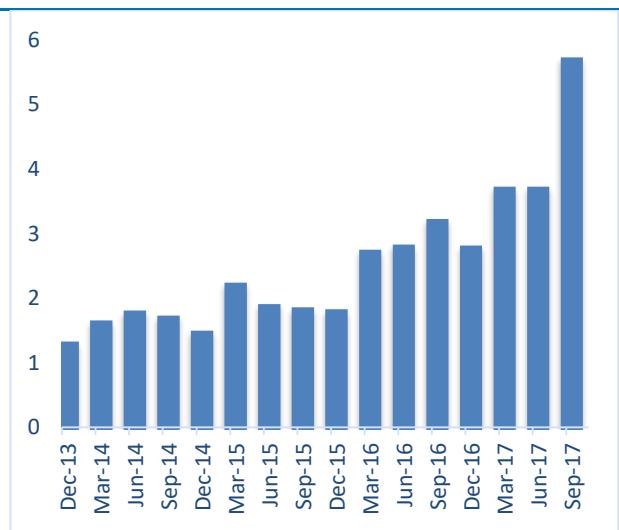
Sources: NBT and World Bank staff calculations.

Figure 4: Exports and Imports of Goods (Annual percentage change)



Sources: NBT and World Bank staff calculations.

Figure 6: International Reserves (Months of import cover)



Source: NBT.

External buffers remain limited and vulnerable to global price shocks. International reserves held by the NBT rose sharply in the first nine months of 2017 to 5.6 months of import cover (figure 6), but this was largely the result of one-off effects and not indicative of a sustained improvement in economic fundamentals. The surge in reserves came primarily at the cost of debt accumulation, reflecting a US\$500 million Eurobond issuance in September.⁶ Reserves were also supplemented by the acquisition of monetary gold through domestic currency issuances and foreign exchange purchases facilitated by administrative measures. In the medium-term, reserve levels are expected to gradually moderate as imports recover and construction of the Rogun HPP accelerates.

Table 2: Balance of Payments and Official Reserves, 2014–2017
(In US\$ million)

	2014	2015	2016e	H1 2017e
Current account balance	-258	-472	-265	88
Merchandise trade	-3,001	-2,254	-1,913	-533
Exports f.o.b.	527	572	691	526
Imports f.o.b.	3,258	2,826	2,604	1,059
Services	-306	-241	-138	-155
Primary income	2,184	1,526	1,214	521
Secondary income	865	497	572	253
Capital and financial account balance	422	648	630	122
Capital account	124	144	144	65
Foreign direct investment	309	426	344	54
Portfolio investment	2	0	0	0
Other capital flows	-13	78	142	3
Errors and omissions	-249	-146	-207	-214
Overall balance	-85	30	158	-4
Memorandum items:				
NBT official reserves (months of imports)	1.4	1.7	2.7	3.6
Nominal GDP (US\$ million)	9,242	7,857	6,922	2,897

Sources: NBT and IMF.

Financial Sector

The financial sector remains in distress. Despite a considerable capital injection in 2016—totaling more than 6.1 percent of GDP - Tajikistan's two main banks remained operationally insolvent and in breach of regulatory prudential norms.⁷ Although the system-wide capital adequacy ratio improved from 15.1 percent in December 2016 to 19.4 percent in June 2017, non-performing loans (NPLs)

⁶ On September 8, 2017, Tajikistan issued US\$500 million in 10-year bonds with a yield of 7.125 percent to finance construction of the Rogun HPP. Tajikistan's sovereign rating was assessed at B3 by Moody's and B- by Standard & Poor's, both with a stable outlook.

⁷ The banking sector in Tajikistan represents almost 90 percent of total financial sector assets and comprises 17 commercial banks, including one fully state-owned bank, two majority state-owned banks and six majority foreign-owned banks. The largest four banks account for more than 80 percent of total banking sector assets.

remained at more than 50 percent of total loans on average; this figure was even higher in distressed banks.⁸ Other financial soundness indicators (such as liquidity and exposure to foreign exchange risk) also showed a deteriorating trend. Unresolved banking sector issues have translated into negative spillovers to the economy with total lending contracting by 4 percent year on year in somoni terms (14 percent in U.S. dollar terms) in the first half of 2017. Similarly, the volume of outstanding deposits fell by 2 percent in somoni terms and 13 percent in U.S. dollar terms. Limits and the inability of banks to meet their operational obligations due to liquidity shortages and continued insolvency constrained deposit withdrawal. While some positive steps were taken to stabilize the financial system, the required comprehensive approach—including the package of legislative amendments and institutional changes for banking resolution—remains pending.

Tajikistan ranks low among its peers on financial sector indicators.

Bank credit to the private sector averaged just 16.7 percent of GDP as of June 2017, less than half of the average of 33 percent among all Commonwealth of Independent States (CIS) economies.⁹ Lending interest rates, already prohibitively high, continued to rise in 2017, from 25 percent at end-2016 to as high as 32.6 percent in June 2017. As a result, resources are directed higher-yielding yet riskier projects. Deposit penetration rates are low compared to other regional economies, the result of the troubled history of Tajikistan's banking sector and constant government interference in operational decisions which has distorted proper resource mobilization and allocation for decades. In the wake of the financial sector crisis, the deposits to GDP ratio has deteriorated further; it currently stands at just 16 percent compared to a regional average of 40 percent.¹⁰ Local currency deposit rates remained relatively unchanged at between 15 and 16 percent.

Social Sector

Labor market pressures remain unchanged.

The official unemployment rate remained broadly unchanged at 2.3 percent in July 2017, with the total labor force reported at 2,289,900 people. However, ILO model-based unemployment estimates suggest a significantly higher unemployment rate (of 10.8 percent) for 2016. Despite a slight (1.3 percent) increase in job vacancies since mid-2016, the number of applicants per vacancy stood at the same level (8.6–8.7) in July 2017, indicating high employment demand.

The average nominal wage rose by 26.4 percent (or 18.1 percent in real terms) in July 2017, according to official data (figure 7).¹¹ However, labor productivity growth has significantly lagged behind recent wage increases, challenging Tajikistan's ability to maintain its external competitiveness. Of the 33,327 jobs created in the first half of 2017, most were in education, processing, and agriculture; financial sector employment fell by 15 percent. Agriculture continues to absorb the bulk of labor force (figure 8), with a share

⁸ The NBT starts classification of NPLs at the next day of overdue repayment.

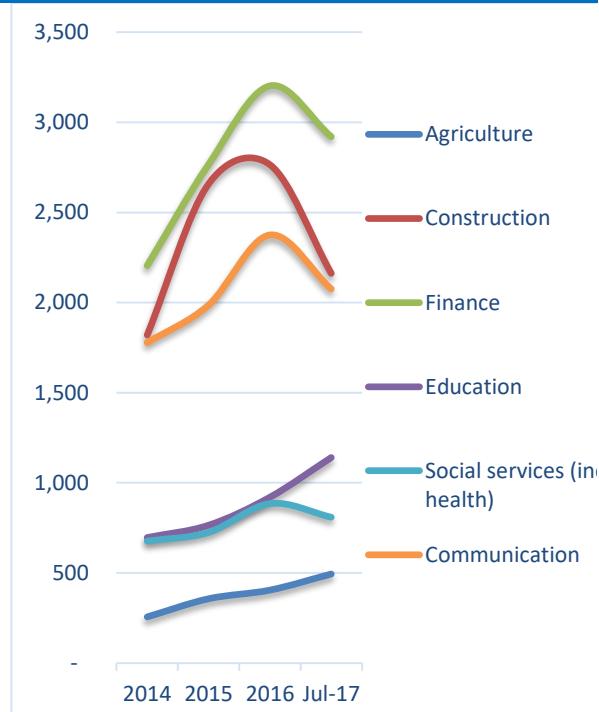
⁹ The regional figure excludes Uzbekistan.

¹⁰ Regional data are for 2015 and were obtained from <https://datamarket.com>.

¹¹ The upward revision of administrative wages in July 2016 gradually prompted wage increases in the rest of the economy.

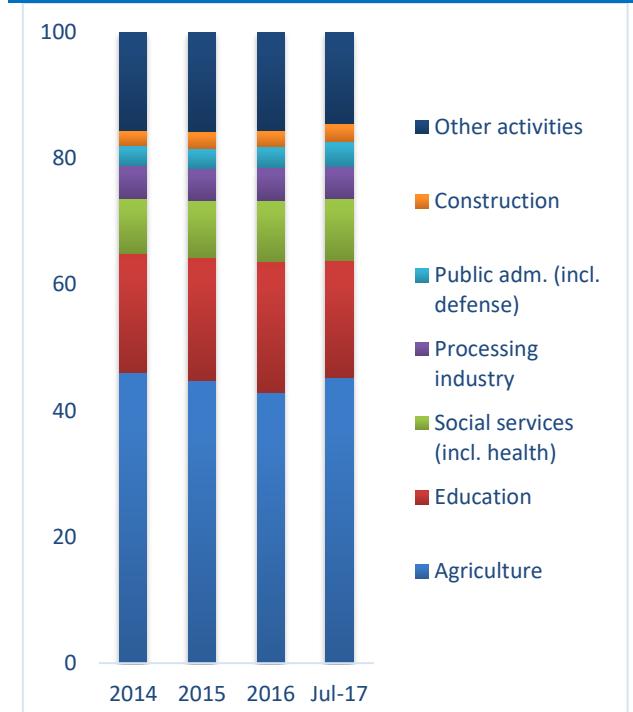
of 45.3 percent of total employment, followed by education and healthcare at 18.5 percent and 9.8 percent, respectively.

**Figure 7: Average Monthly Wage by Sector
(In Tajik somoni)**



Sources: TajStat and World Bank staff calculations.

**Figure 8: Employment Share by Sector
(In percent of total)**



Source: TajStat and World Bank staff calculations.

Wage income is the main driver of poverty reduction.

The official poverty rate fell from 31.3 percent in 2015 to 30.3 percent in 2016, while extreme poverty fell from 15.1 percent to 14 percent during the same period. While income from employment remained the primary driver of poverty reduction, lower remittance inflows slowed the pace of poverty reduction in 2016; many remittance-dependent households were pushed into poverty. Poverty levels fell primarily in rural areas, where the official poverty rate dropped from 35.3 percent to 33.5 percent. In contrast, the poverty rate remained unchanged in urban areas (at about 24 percent). The Listening to Tajikistan (L2T) survey indicates a modest decline in the share of households reducing food expenditure, from about 40 percent in January 2017 to about 35 percent in September 2017. Although the share of food expenditure has fallen steadily, food still accounts for more than 70 percent of consumption for poor and vulnerable households.

Box 1: Insufficient Public Infrastructure and Services Explain the Non-Monetary Poverty Rate

Subjective perceptions of poverty are more strongly linked with non-monetary dimensions of poverty than monetary measures. The L2T survey indicates that, at the individual level, there is substantial variation in reported subjective well-being (SWB) over time. The most important determinants of SWB in Tajikistan are related to non-monetary shocks such as electricity outages, losing one's job, sickness, and lacking sufficient means to pay for basic needs. Rising income, employment, and other measures of increasing monetary welfare are predictive of improving SWB. The L2T data also suggest important tradeoffs between income and SWB in Tajikistan. Migration is strongly associated with lower SWB, and particularly so around the time that household members migrate. This perception may be an indication that migrants are "pushed out" of the country because of a lack of domestic economic opportunities, and households would be "happier" if the economic migrants could have stayed. Selling assets is associated with higher income (as expected) but with lower SWB.^a

About 70 percent of respondents to the L2T survey believe that they are "poor"—more than two times higher than the official national poverty rate. However, when asked to classify oneself as "poor," "middle class," or "rich," about 42 percent of respondents classify themselves as "poor," with 57 percent classifying themselves as "middle class" (and less than one percent of respondents classifying themselves as "rich"). These results indicate that perceptions of poverty and middle-income status are not mutually exclusive categories in Tajikistan and that many respondents who believe that they are "middle class" also believe that they are "poor."

Tajikistan's multidimensional poverty index (MPI) indicates that non-monetary deprivations in the country are widespread, and more serious in rural areas. The variables used to create the MPI (reported below) are: (i) demographics and labor; (ii) education; and (iii) services and infrastructure. Each dimension is equally weighted, and within each dimension, each indicator is also equally weighted. A household is defined as multi-dimensionally poor when the household is deprived on 33 percent or more of the weighted indicators in the index. In addition, severe poverty is defined as a household which is deprived on 50 percent or more of the weighted indicators in the index. A household is "vulnerable" for multidimensional poverty when deprived on at least 20 percent, but less than 33 percent of weighted indicators in the index. For Tajikistan, the dimensions and indicators were informed by deprivation index analysis across countries.^c

Table B1.1: Dimensions and Indicators of MPI for Tajikistan

Education	Households with individuals (18+) who cannot read or write At least one individual (20+) who has not completed secondary school No household member has completed tertiary education
Demographic and Labor	Dependency ratio>1 Both household heads are not employed
Services and infrastructure	No access to sewage system No access to piped water Heating from oven, or heating is absent No garbage disposal system No toilet inside the house

The national rate of multi-dimensional poverty in Tajikistan is 64 percent, and there are significant regional variations. Driving a considerable portion of these results are high levels of deprivation relating to education and, for those districts outside of Dushanbe and other urban areas, access to infrastructure. In multidimensional terms, Dushanbe is the least poor of the regions. However, in contrast to estimates for monetary poverty, in the case of the MPI, the districts of the Rayons of

Republican Subordination (RRS) fare worst regarding both multidimensional poverty and severe multidimensional poverty (table B1.2).

Table B1.2: MPI Indicators by Region

(in percent)

	National	Dushanbe	Sogd	Khatlon	RRS	GBAO
Multidimensional poverty	64	22	63	72	75	61
Multidimensional vulnerability	22	24	24	21	19	30
Severe multidimensional poverty	33	5	31	38	44	29
Households with adults 18+ cannot read or write	39	1	1	1	1	1
Age dependency>1	22	17	19	27	26	16
Household member (+20) does not have complete secondary education	41	32	37	41	53	29
No household member (+25) has tertiary education	79	58	81	84	83	65
Both heads are unemployed Yes=deprived	13	16	12	13	16	16
No access to sewage	73	19	76	80	85	88
No access to piped water	67	8	70	80	72	89
Heating from oven, or heating is absent	70	9	77	78	80	73
No garbage disposable system	63	4	64	73	76	76
No toilet inside the house	78	21	82	88	89	90

Source: Census 2010.

Note: RSS is Rayons of Republican Subordination; GBAO is Gorno-Badakhshan Autonomous Region.

Access to piped drinking water, one of the key indicators of the multidimensional poverty index, is among the most unequally distributed services in Tajikistan. Tajikistan has the second lowest share of households with access to tap water, and rural areas are particularly underserved. About 26 percent of rural households had access to tap water in 2016, in comparison to 88 percent in urban areas. Infectious diarrhea and other serious waterborne illnesses are recognized as leading causes of infant and child mortality and malnutrition in Tajikistan. Their impact extends beyond health to the economic realm in the form of lost work days and school absenteeism.^e Tajikistan is one of only two countries outside Africa where the Millennium Development Goals for maternal and child health and access to clean water and sanitation were not achieved.

a. Azevedo, Joao Pedro, and William Seitz. 2017. "Subjective Well Being in Tajikistan based on the Listening to Tajikistan Survey Rounds." World Bank, Washington, DC.

b. The MPI is an unofficial measure that complements official poverty estimates. In the approach adopted here, deprivations or vulnerabilities are identified in the 2010 Census, and summarized in the form of an index. Because poverty is officially monitored using a monetary measure of consumption in Tajikistan, the MPI should be seen as a means to deepen the analysis of poverty into non-monetary measures, rather than as a replacement for monetary measures. By design, the MPI does coincide with official measures of monetary poverty.

c. World Bank. 2017. *Glass Half Full: Poverty Diagnostic of Water Supply, Sanitation, and Hygiene Conditions in Tajikistan*. WASH Poverty Diagnostic. World Bank, Washington, DC.

d. According to the 2016 round of the Life in Transition survey.

e. Banerjee, Sudeshna Ghosh, and Elvira Morella. 2011. *Africa's Water and Sanitation Infrastructure: Access, Affordability, and Alternatives*. Directions in Development, Infrastructure. World Bank, DC.

B. Macroeconomic Policies and Structural Reforms

Assessment of Fiscal and Debt Policies

The authorities pursued fiscal consolidation in 2017.

The overall fiscal deficit (including the Public Investment Project, or PIP) was estimated at 2.2 percent of GDP at the end of the third quarter of 2017, in line with the approved deficit for the year. However, compared with the 4.9 percent of GDP deficit in the same period of 2016, it suggests a significant fiscal consolidation.¹² The latter was mainly supported by the sizable contraction of public spending (about 9 percent of GDP) with cuts and scrutiny across all major categories, including some delays (and arrears) on current spending, while adequate financing of large infrastructure projects was preserved. Although the stock of accumulated spending arrears remains moderate, it still compromises the quality of the on-going fiscal consolidation by passing these commitments to subsequent fiscal cycles. Although the revenue performance also contributed to the on-going fiscal consolidation efforts, continued strong over-performance in non-tax collections, particularly due to tax audits, remains a concern and thus requires an in-depth analysis of current practices.¹³

The budget was under-executed due to a low rate of expenditure execution.

Gross tax collections performed slightly below target (2 percent below the original nominal target) with primary shortfalls in domestic value-added tax (VAT) and taxes on trade. The underperformance of collections of VAT on imports and customs duties was associated with sluggish imports—contrary to a projection of import growth of 3 percent. Anticipated tax revenue from foreign trade fell short as a result of the change in trade structure, which is shifting toward tax-exempt exports. While domestic tax revenues over-performed, particularly regarding the collection of corporate profit tax and natural resources use fees, they were unable to offset the underlying shortfall. As in previous years, non-tax revenues continued to significantly outperform at almost 25 percent above budgeted plans, supported by strong collections from penalty charges on tax audits. Grants for public investments lagged behind projections.

On the expenditure side, overall state budget execution was about 9 percent below target, with technical delays resulting in relatively greater under-spending in construction and public facility maintenance. Social spending was under-executed on account of delays to civil servant wage payments, which led to an accumulation of arrears and increased fiscal pressures in the remainder of the year. These pressures, however, did not affect the implementation pace of “strategically important” large infrastructure projects—including construction of the Rogun HPP—which were executed in line with the budgeted targets.

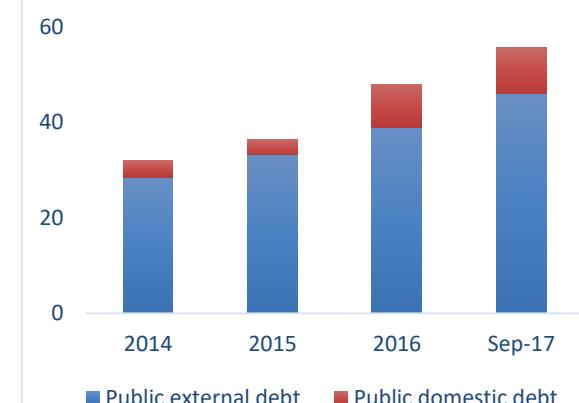
¹² The fiscal deficit for the first nine months of 2016 does not include the bank bailout implemented in December 2016.

¹³ Moving forward, the government intends to improve the revenue classification and show in respective tax categories revenues revealed as a result of tax audits.

Public debt rose sharply following a Eurobond issuance.

The level of public and publicly-guaranteed debt (PPG) rose significantly in 2017, to above 50 percent of GDP by the end of September (figure 9). The primary drivers of this rise were loans for public investment projects (particularly from China), the issuance of domestic debt to support the energy sector (TJS 530 million), and the issuance of a US\$500 million Eurobond in September.

Figure 9: Public Debt Composition
(Percent of GDP)



Sources: MOF and World Bank staff calculations.

The recently updated Debt Sustainability Analysis (DSA) suggests that Tajikistan's debt distress level rose from moderate to high in the baseline scenario as several important indicators passed indicative thresholds.¹⁴ The latter reflects the country's weakened ability to earn foreign exchange for servicing its external debt which started increasing at an accelerated pace.¹⁵ Despite a substantial increase in the level of domestic debt following the financial sector bailout at end-2016, external debt continues to comprise the bulk of the country's total debt portfolio. As of end-June 2017, China remained Tajikistan's top creditor, accounting for over half of the country's total external debt compared to one-third provided by all international financial institutions combined. Tajikistan's Eurobond debut in September 2017, while significantly increasing the country's debt burden, also diversified its debt portfolio.

The authorities intend to revise the medium-term debt strategy (MTDS) and relax the domestic fiscal rule on the debt ceiling by increasing it from the current 40 percent of GDP to 60 percent of GDP. Over 40 percent of Tajikistan's total debt repayments fall due in the next five years, necessitating the continuation of ongoing fiscal consolidation efforts to accommodate these higher debt service obligations.

¹⁴ The IMF Staff Report on Article IV Consultations including the DSA was discussed by the IMF Board of Directors on November 3, 2017.

¹⁵ This means that the present value of the country's public and publicly guaranteed debt relative to the size of its economy (PV of PPG debt/ (GDP + remittances)) and of the debt service relative to the domestic revenue mobilization effort (PV of PPG debt service to revenue) became higher.

Table 3: Consolidated fiscal accounts, 2014–2017

(In percent of GDP)

	2014	2015	2016e 1/	Sep 2017e
Revenue and grants	28.4	29.9	28.8	30.6
Tax revenue	22.8	22.0	20.6	22.4
Income and profit taxes	4.2	4.8	4.4	5.4
Payroll taxes	3.0	2.8	2.5	2.7
Property taxes	1.5	1.2	1.2	0.5
Taxes on goods and services	12.8	12.0	11.3	12.7
International trade and operations taxes	1.3	1.1	1.2	1.1
Non-tax revenues	4.0	5.0	5.2	6.0
of which EBF	1.6	2.1	2.5	3.8
Grants	1.5	3.0	3.0	2.1
of which PIP	1.5	2.1	3.0	2.1
Expenditure and net lending	28.4	31.8	38.5	32.7
Current expenses	18.1	18.0	17.4	18.0
Capital expenses and net lending	10.2	13.8	21.1	14.8
Overall fiscal balance (incl. PIP)	0.0	-1.9	-9.8	-2.2
Overall fiscal balance (exc. PIP)	1.0	1.2	-6.6	0.0
Memorandum items				
Total public debt	32.1	36.4	48.0	55.7
Nominal GDP (TJS million)	45,605	48,402	54,471	42,417

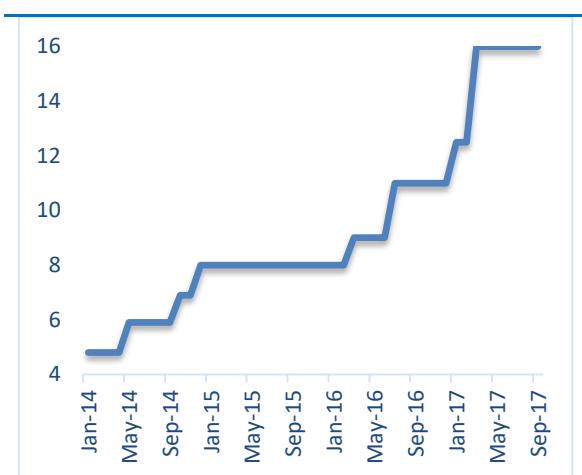
Note: 1/ In 2016, fiscal operations include financial sector bailout in the amount 6.1 percent of GDP. Without bailout, the overall fiscal deficit (incl. PIP) made 3.7 percent of GDP.

Assessment of Monetary and Exchange Rate Policies

Monetary policy has been tightening gradually amid currency and inflationary pressures.

Tajikistan's money supply grew by more than 23 percent year on year in the first nine months of 2017. The authorities gradually mopped up excess liquidity resulting from the financial sector bailout by intensifying sterilization efforts and raising the benchmark refinancing rate from 11 percent at end-2016 to 12.5 percent in January 2017 and 16 percent in March 2017 (figure 10). Credit to the private sector continued to contract reflecting sluggish business activity and ongoing difficulties in top banks.

Figure 10: Refinance Rate
(In annual percent)



Sources: NBT and World Bank staff calculations

Figure 11: Real Effective Exchange Rate Index
(December 2009=100)



Source: NBT.

Note: An increase in the index value indicates an appreciation.

Inflation was kept within target range. Despite rising price pressures, inflation has been kept within the NBT's target range of 7 percent (+/- 3 percentage points) and is expected to average about 9 percent in 2017. The introduction of new instruments for open market operations and standing facilities at the beginning of 2017 should contribute to the improvement of policy rate transmission mechanisms.¹⁶ The NBT has taken several initial steps to improve transparency and communication with the public, including the regular publication of news releases about ongoing structural and policy framework changes, increasing access to statistical information and broadcasting programs on television, to manage inflationary and exchange rate expectations.

The somoni became even more undervalued.

A liquidity surge in the wake of the financial sector bailout at end-2016 coupled with seasonal demand in early 2017 created significant pressure on the exchange rate. The authorities responded by gradually sterilizing excess money supply, conducting a one-off adjustment in mid-May by 4 percent, while at the same time maintaining administrative measures introduced in early 2016 along with strict control of black market transactions. While this helped to stabilize the currency, in nominal terms the somoni depreciated by 10.5 percent against the U.S. dollar during the first nine months of 2017. As a result, the undervaluation of the real effective exchange rate increased to around 14 percent in mid-2017, compared to 3 percent at end-2016 (figure 11).¹⁷

¹⁶ In early 2016, the NBT introduced an overnight rate on credits and deposits, intra-day credits and credit auctions. These new policy instruments benchmark the refinance rate set by the NBT.

¹⁷ The IMF's recent Article IV Report suggests that the somoni would need to appreciate in the range of 2.5-12 percent to align with market equilibrium.

Ongoing Structural Reforms

Structural inefficiencies constrain financial intermediation.	The high rate of dollarization, low rate of deposit penetration, excessive NPLs, and heavy reliance on wholesale financing have become the distinguishing features of Tajik banks, constraining their role as financial intermediary. ¹⁸ Interest rate spreads increased to 16 percent in June 2017 from 10 percent in December 2016, signaling rising financing constraints. The development of Tajikistan's financial sector is hindered by structural issues that include: (i) lack of stable funding sources and deficiencies in tools and infrastructure for liquidity management; (ii) limited credit risk assessment and mitigation mechanisms; (iii) lack of usable collateral; and (iv) a weak business environment.
Energy sector reform remains a challenge.	The authorities have prioritized energy sector reform given the sector's strategic importance in ensuring the country's overall economic development. However, despite the strategic objectives and policy measures already underway (including an 18 percent increase to average tariffs since October 2016), the sector remains in financial distress. Although some efficiency improvements have been realized by the energy company, Barqi Tojik (BT), including higher collection rates and a reduction in inventory turnover, the company is still experiencing operational cash shortages due to: <ul style="list-style-type: none">➤ Below cost-recovery tariffs. The average tariff is estimated to be at 45 percent of the cost-recovery level. Debt service costs have a significant impact on cost-recovery tariff levels because over 90 percent of long-term and short-term debt is denominated in foreign currency. The depreciation of the somoni in 2017 led to a significant rise in debt servicing costs because BT's revenues are in somoni; there has been no exchange rate-based tariff adjustment. An additional 12 percent average tariff increase took effect from October 2017.➤ Low collection rates. The average collection rate for billed electricity reached 86 percent in 2017. However, nearly 10 percent of sales still do not generate revenue for the company.➤ Excessive electricity losses. Losses are believed to be around 17 percent (although data is unreliable), which is well above the typical level for systems with comparable characteristics and age (11 percent).
Despite improvements, the business environment remains challenging.	Tajikistan's business environment remains challenging. The country ranked 123 of 190 economies in the World Bank Group's 2018 Doing Business report, an improvement from its rank of 128 in Doing Business 2017. Tajikistan scored relatively well (figure 12) in enforcing contracts (ranked 54) and protecting minority investors (33) but still lags behind on paying taxes (although improving, to 132 from 140) and access to electricity (171). On the distance to frontier

¹⁸ Tajik banks are reliant on lending from foreign banks, but they do not have stable partnerships making it challenging to obtain wholesale funding from abroad. More recently, the placement of government deposits has supported the liquidity of large banks. Banks also resort to liquidity lending from the central bank.

metric, Tajikistan's score improved from 55.93 in 2017 to 56.86 in Doing Business 2018, using a comparable methodology. As such, in 2017 Tajikistan improved business regulation in absolute terms as captured by the Doing Business indicators—the country is narrowing the gap with the global regulatory frontier. In 2016/17 Tajikistan reformed in two areas measured by Doing Business. To improve its ranking on the starting a business indicators, Tajikistan raised the VAT threshold for mandatory registration. It now takes four procedures and 11 days to start a business compared with five procedures and 22 days a year ago, though it remains to be assessed whether the current VAT threshold is appropriate for the size of the economy. On the registering property indicators, Tajikistan made it easier and less costly to register property by eliminating the need to register the sale-purchase agreement at the municipal office.

Figure 12: Tajikistan's Doing Business ranking by indicator set



Source: Doing Business database (<http://www.doingbusiness.org/data>).

Note: Rank 190 at center, rank 1 at outer edge.

The recently initiated inspection reform aims to lower the cost of doing business in Tajikistan

With the aim of improving the business environment and reducing business administrative burdens, in early 2017 the government made changes to legislation governing inspections. The new regulations set out the procedures and criteria for risk assessment in inspection practices. The government also established a Coordination Council to oversee the implementation of the reform. The Council estimates that there was a significant reduction in business inspections in 2017 compared with 2016. Additionally, the various inspection functions in the Ministry of Agriculture and the Ministry of Health and Social

Protection are being streamlined, a process that is expected to be completed in 2018. The government plans to consolidate and merge several inspection agencies which will lead to a further reduction in the total number of business inspections from the current 28 to 23 (still a large number given the size of the Tajik economy).

Tajikistan is complying with key WTO commitments.

Since the country's accession to the WTO in 2013, the Tajik authorities have been preparing to comply with the articles of the WTO Trade Facilitation Agreement (WTO TFA), which entered into force in February 2017. Most recently, the country notified the WTO of its compliance with the requirement that it establish a Coordinating Committee on Trade Facilitation, a body comprised of representatives from both the private and public sectors that leads the trade facilitation agenda of the country, including compliance with the TFA. The committee has established several specialized working groups, which are exploring various policy approaches including a single window to facilitate cross-border trade. Tajikistan also developed its first national terminology in 2017 in accordance with the World Customs Organization Harmonized System Code of 2012. The first national code takes into account specific Tajik products; previously the country used the terminology of the Eurasian Union. The new nomenclature has been in use since July 2017 and will serve as the official basis for tariff determination, customs revenue and correct trade statistics.

C. Economic Outlook and Risks

Tajikistan's Baseline Scenario

Weak capacity and uncertainty weigh on economic growth prospects.

Under the baseline scenario, which assumes insufficient implementation of structural reforms, Tajikistan's economic growth rate is projected to slow from its recent high levels. Real GDP growth is estimated to have slowed to 5.2 percent in full-year 2017. Growth rates will slow further in 2018 before accelerating to 5.5 percent in 2019, supported by sustained high rates of industrial output, construction of the Rogun HPP and the resulting increase in electricity production from late 2018 as the first two generators join the production stream. In line with recovering remittance inflows, private consumption will continue its positive contribution to economic growth, although continuing uncertainty over the performance of the Russian economy will act as a damper. Inflation is expected to moderate slightly, in line with the officially-stated objective of keeping headline inflation in the single digits. The authorities may consider bolder and stronger reform efforts to create a level playing field for the private sector which could then become a significant driver of economic growth and boost the country's growth potential to that envisaged by the National Development Strategy.

Vulnerability to external shocks is likely to increase in the medium-term.

The current account deficit is estimated to have improved slightly in 2017, to 3.1 percent of GDP, but rising consumer demand and import spending associated with the construction of the Rogun HPP will result in a renewed deterioration in the coming years. While a gradual recovery of remittance inflows and a depreciated real exchange rate will have a positive impact on the external balance, continued muted price prospects for key export commodities—such as cotton and aluminum—will limit export revenue

growth. With the business climate remaining challenging, FDI inflows are expected to slow over the medium term. International reserves are projected to steadily moderate.

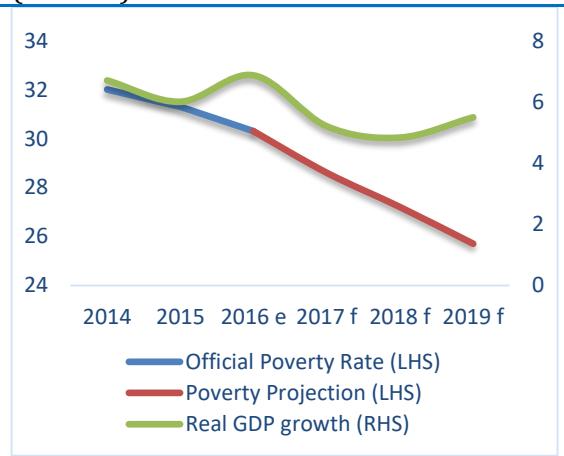
Large public investments and contingent liabilities will strain fiscal and debt sustainability indicators.

The overall fiscal deficit is estimated to have remained within the initial target of 2.5 percent of GDP in 2017, reflecting a tightening of regular government operations (however, it could rise to near 5 percent of GDP if a second banking sector bailout were to materialize). For 2018, the authorities envisage a higher consolidation of baseline budget operations with an approved fiscal deficit of 2 percent of projected GDP. In the medium-term, fiscal policy is expected to remain contractionary as the authorities attempt to place the public debt portfolio on a more sustainable footing. There are some risks to this forecast, particularly if construction of the Rogun HPP moves ahead faster than expected or another round of bank recapitalization becomes necessary. The medium-term fiscal policy framework will be complicated by the accelerating debt service/repayment schedule and by the need for fiscal consolidation to restore macro-fiscal and debt sustainability while striking a balance between competing demands for public spending.

Poverty reduction prospects depend on domestic wage income growth and remittances.

Tajikistan's poverty rate is expected to fall in line with overall economic growth, a gradual increase in wage income earnings, recovering remittance inflows and the expansion of the Targeted Social Assistance (TSA) program envisaged by the Law on Social Assistance. The nationwide poverty rate is projected to fall from 30.3 percent in 2016 to 25.7 percent by 2019 (figure 13).

Figure 13: Poverty Rate Projection
(Percent)



Sources: TajStat and World Bank staff calculations.

Table 4: Baseline scenario: selected macro-fiscal indicators, 2016–19

(In percent, unless otherwise indicated)

	2016e	2017f	2018f	2019f
Real GDP growth	6.9	5.2	5.0	5.5
Private consumption	-4.1	2.4	2.9	3.5
Government consumption	2.4	-8.8	3.2	4.7
Gross fixed investment	21.2	-2.1	3.8	4.6
Exports, goods and services	7.7	10.2	7.5	7.8
Imports, goods and services	-15.0	5.0	5.2	5.6
Consumer price inflation, period average	5.9	9.0	8.5	7.0
Current account balance (percent of GDP)	-3.8	-3.1	-4.4	-5.1
Overall fiscal balance (percent of GDP)	-9.8	-4.7	-4.0	-3.2
Government debt (percent of GDP)	48.0	55.7	58.6	59.0

Sources: Tajik authorities, and World Bank staff estimates and projections

Risks

External and domestic factors present downside risks.

Despite recent improvements in the global economic environment, important risks remain—for example, the continued lackluster economic performance of regional economies or a sharp decline in commodity prices would negatively impact remittance inflows and export earnings. The lack of proper governance in the financial sector, in state-owned enterprises and business-related elements of public administration remains a serious challenge to an effective (and needed) consolidation. At the same time, the limited fiscal space resulting from the higher debt burden, and weak domestic and external buffers, leave Tajikistan vulnerable to potential shocks.

There are also upside risks to Tajikistan's economic outlook. Most notable is the possibility of higher energy export potential after the installation of the first two generators in 2018–19, assuming no delays. However, this prospect is conditional not only on additional investments into the generation capacity but also on the transmission network expected to pass through other countries in the region.

Any slower-than-expected recovery in regional economies, the toughening of immigration regulations by Russia, or delays in the expansion of the targeted social assistance program could derail expected progress in poverty reduction.¹⁹ Moreover, a further protraction in financial sector challenges could undermine growth prospects, diminishing the pace of poverty reduction through reduced access to credit in pro-poor economic sectors and slowing the pace of job creation in low-skill sectors, such as construction and agriculture.

¹⁹ It was reported by RBK news channel on August 30, 2017, that Russia's Ministry of Internal Affairs has prepared a law on the deportation of migrant workers that lack an employment contract. Tajikistan is currently considering the possibility of redirecting its labor migration flows to Middle Eastern countries and South Korea.

D. Focus Section:

Challenges of Fiscal Management in Tajikistan

Current macroeconomic constraints require urgent fiscal reforms.

To improve the efficiency and transparency of the use of public resources, gradually expand the fiscal space to meet the growing demands of the population and the economy, and improve the business environment while mobilizing domestic revenues, fiscal reforms are urgently needed. This section of the Country Economic Update provides a broad account of the main subsections of the fiscal system and highlights key issues that require further analysis in separate reports.²⁰

Public policy planning and budget linkages can be enhanced.

Tajikistan has a developed system of multi-year policy planning, comprising a long-term National Development Strategy (covering a horizon of about 15 years), a medium-term development plan (covering five years) and annual socio-economic development plans. Parallel to policy planning, the country has budgeting practices in place that cover a fiscal horizon of up to three years. However, linkages between strategic policy planning and budgeting through annual and medium-term plans are rather weak, as the latter does not provide a robust financing framework for achieving the stated objectives of economic policy. Moreover, the medium-term debt strategy does not seem to be viewed as an operational document nor as part of the medium-term fiscal framework.²¹ Reducing the coordination shortcomings between different institutions dealing with macro-fiscal policy may help to address the existing fragmentation and divergence between policy planning and budgeting, thereby strengthening the credibility of declared public policies.

Macroeconomic projections affect the quality of fiscal management.

The coordination challenge referenced to above often leads to unrealistic macroeconomic projections which can negatively impact the quality of fiscal management.²² As a result, during budget execution, the actual fiscal parameters might differ significantly from the macroeconomic forecasts on which the budget was based.

Tax policy should be guided by strategic development objectives.

Any proposed change to tax policy should be assessed in the context of a strategic policy framework to balance different and potentially conflicting objectives. Conflicting objectives include those between enhancing domestic revenue mobilization efforts (either raising existing tax rates or eliminating exemptions which do not attract private investments) vis-à-vis the need to provide a stable and competitive environment for the private sector. In this context, it is important to develop a set of criteria against which to screen tax policy proposals. These could include generic criteria (such as ensuring horizontal equity of taxation be applied to economic sectors as well as

²⁰ One of these reports, the Tajikistan Country Economic Memorandum, is currently in preparation.

²¹ For example, the most recent medium-term fiscal framework lacked any scenario development pertaining to issuance of Eurobonds while both the National Bank and the Ministry of Finance had been actively preparing for this process.

²² The Ministry of Finance often relies on forecasts from the Ministry of Economy, which tend to be relatively ambitious. As a result, there is additional pressure placed on the tax authorities to meet revenue targets so as not to jeopardize the government's spending plans.

individual taxpayers), and more specific incentives to help reduce informality. The current design of Tajikistan's tax policy appears to lack a strategic framework for introducing amendments. Problematically, there are too many ways to introduce changes, and too many branches of the public administration are allowed to submit proposed amendments; as such, the process is disjointed and not coordinated by a single representative.²³

Simplicity and predictability are important characteristics of any tax system.

A good tax system is characterized by simplicity, transparency, and stability of tax policy rules which are both easy to administer by tax authorities and to follow by the private sector. Other important characteristics include the elimination of ambiguities, loopholes and different tax exemptions which erode the tax base, introduce unnecessary distortions and discriminate against different taxpayers. Tajikistan's current tax code is complex. It includes multiple tax rates for different sectors for the same corporate income tax ranging from 0 to 13 and 23 percent. At the same time, the current tax regime for the mining sector is not effectively capturing the sector's windfall profits. Together with good governance practices and modern licensing regimes, the introduction of a proper fiscal regime in the mining sector may ensure an adequate economic return on the country's natural resources. Internationally-compliant processes and practices will attract more reputable international companies into the sector, even if the new fiscal regime includes a higher tax burden for the extractive sectors.

Tax exemptions may not be the most effective policy tool to stimulate investment.

Tajikistan's tax code currently includes massive exemptions. Exemptions from different taxes and for different taxpayers are estimated to be the equivalent of about 50 percent of total tax revenue in recent years. This foregone revenue is not reflected in the budget, as recommended by international good practice. Where present, tax exemptions (and their beneficiaries) should be recorded, monitored and made publicly available. Without a monitoring system, there is no feedback on whether tax exemptions are having the desired impact on the broader economy or specific investors' business activity. Excessive tax exemptions distort the two basic functions of any fiscal policy, namely affecting aggregate demand and re-distributing economic growth through tax and spending policies. The current stock of tax exemptions in Tajikistan has been accumulated overtime. Therefore, revising these decisions may face resistance by a circle of beneficiaries. On the other hand, maintaining tax exemptions will imply unequal treatment of taxpayers and unfair competition environment, which support the argument of revision and removal of inefficient ones.

There should be a renewed focus on voluntary tax compliance.

The authorities should aim to change the nature of the tax administration from primarily a fiscal agent ensuring revenue collection into a public institution that provides services to taxpayers to increase their motivation to comply voluntarily with tax regulations. The experience of both low-income and middle-income economies show that there are ways to improve domestic revenue mobilization while at the same time improving tax compliance. The dual goals of a prudent tax policy for Tajikistan would, therefore, be to create an investment-friendly environment on the one hand and strengthen its tax

²³ Proposals on tax policy changes may come from different branches of the government, including the State Committee on Investments, Ministry of Economic Development and Trade, and so on. Formally, there is an inter-agency working group that is tasked with screening proposals, but it does not appear to fulfill this role effectively.

policy and tax administration (instrumental for revenue generation) on the other.

Fiscal risks emanating from SOEs should be mitigated.

State-owned enterprises (SOEs), which engage in significant quasi-fiscal activities, represent a significant challenge to Tajikistan's budget system. The introduction of international accounting standards and the adoption of external audit standards at the country's SOEs has yet to take place. Before this can happen, there will be a need for intensive capacity building accompanied by upgrades to the regulatory framework and advisory services to ensure satisfactory implementation of a reform to enhance the governance, transparency, and efficiency of SOE financial planning and management. As a follow-on activity, an analysis of the SOE sector should be conducted to evaluate the operating effectiveness and business needs of individual SOEs, the feasibility of privatization or public-private partnerships to stimulate private sector activity and competitiveness, and the introduction of mechanisms to increase the accountability and efficiency of SOE management. The debt held by SOEs poses a serious threat to fiscal stability, and therefore supervision should be established at the highest level. Official estimates indicate that SOE contingent liabilities totaled more than 8 percent of GDP in 2016. The majority of this debt is concentrated in the aluminum and electricity producing companies.

Annex Table 1. Selected Macroeconomic and Social Indicators, 2014–2019

	2014	2015	2016e	2017f	2018f	2019f
National Income and Prices		(Percent, unless otherwise indicated)				
Real GDP growth	6.7	6.0	6.9	5.2	5.0	5.5
Private consumption growth	1.8	-12.3	-4.1	2.4	2.9	3.5
Gross investment (percent of GDP)	4.6	5.4	6.1	5.7	5.6	5.6
Consumer price inflation, period average	6.1	5.8	5.9	9.0	8.5	7.0
Average exchange rate (TJS per USD)	4.93	6.17	7.84	...	...	...
External Accounts		(Percent of GDP, unless otherwise indicated)				
Exports of goods and services	9.0	10.5	13.3	16.6	18.1	19.3
Imports of goods and services	44.8	42.7	43.0	48.1	50.7	53.6
Current account balance	-2.8	-6.4	-3.8	-3.1	-4.4	-5.1
Financial and capital account	5.5	7.9	8.1	7.1	8.4	9.0
Foreign direct investment, net	3.3	5.4	5.0	3.2	3.2	3.4
Consolidated Fiscal Accounts		(Percent of GDP, unless otherwise indicated)				
Revenue	28.4	29.9	28.8	28.5	28.9	29.4
Expenditure	28.4	31.8	38.5	33.2	32.9	32.6
Overall fiscal balance 1/	0.0	-1.9	-9.8	-4.7	-4.0	-3.2
Primary fiscal balance 1/	0.5	-1.1	-9.2	-3.0	-2.1	-1.4
Total public debt 2/	32.1	36.4	48.0	55.7	58.6	59.0
Monetary Accounts		(Percent, unless otherwise indicated)				
Broad money growth	7.1	18.7	37.1	...	...	...
Reserve money growth	13.2	16.0	71.1	...	...	...
Private sector credit growth	31.5	12.7	-4.9	...	...	...
Refinance rate	5.5-8.0	8.0	8.0-11.0	...	...	...
Social Indicators						
Population, total (millions)	8.3	8.5	8.6	8.8	9.0	9.2
Population growth (percent)	2.3	2.4	2.2	2.2	2.1	2.1
Unemployment rate (officially registered)	2.5	2.5	2.4	...	...	...
Poverty rate, (national poverty line TJS 175.2/month)	32	31.3	30.3			
Inequality – Gini coefficient	30.8	27.5	28.0	...	...	...
Life expectancy (years)	69.6	69.4	...	...	...	...

Sources: Tajik authorities and World Bank staff estimates and projections

Note: An ellipsis (...) indicates that data are not available.

1/ The overall and primary fiscal balances for 2016 include the government's bank bailout support.

2/ Historical data was revised to include external debt incurred by SOEs which have implicit government guarantees.

Tajikistan
Country Economic Update | Fall 2017