



**TAJIKISTAN  
SYSTEMATIC  
COUNTRY  
DIAGNOSTIC**

**MAY 2018**

**Making the National Development  
Strategy 2030 a Success:  
Building the Foundation for Shared Prosperity**



**WORLD BANK GROUP**



# **Tajikistan Systematic Country Diagnostic**

**Making the National Development Strategy 2030 a Success:  
Building the Foundation for Shared Prosperity**

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**WEIGHTS AND MEASURES**

Metric System

**ABBREVIATIONS AND ACRONYMS**

BBP	Basic Benefit Package	NDS	National Development Strategy
CAPS	Central Asia Power System	NPL	Non-Performing Loan
CASA	Central Asia South Asia	O&M	Operation and Maintenance
CIS	Commonwealth of Independent States	ODA	Official Development Assistance
DSA	Debt Sustainability Analysis	OOP	Out of Pocket
ECD	Early Childhood Development	PCF	Per-Capita Financing
ECE	Early Childhood Education	PHC	Primary Health Care
FDI	Foreign Direct Investment	PMT	Proxy Means Testing
EGRA	Early Grades Reading Assessment	PIRLS	International Reading Literacy Study
EMIS	Education Management Information System	PISA	Program for International Student Assessment
FM	Family Medicine	PPP	Public-Private Partnership
HBS	Household Budget Survey	SASP	State Agency of Social Protection
HPP	Hydropower Project	SCD	Systematic Country Diagnostic
ICT	Information Communication Technology	SDG	Sustainable Development Goals
IDS	International Debt Statistics	SOE	State-Owned Enterprises
IFC	International Finance Corporation	TALCO	Tajikistan Aluminum Company
ISIS	Islamic State of Iraq And Syria	TIMSS	Trends in International Mathematics and Science Study
LITS	Life-in-Transition Survey	TSA	Targeted Social Assistance
LMIC	Lower Middle-Income Countries	UNICEF	United Nations Children's Fund
MFIs	Micro-Finance Institutions	UEE	Unified Entrance Examination
MPI	Multidimensional Poverty Index	VET	Vocational Education Training Institutes
MSME	Medium-Sized Enterprises		
NBT	National Bank of Tajikistan		

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## Overview

**Landlocked and mountainous, Tajikistan has a young—and mostly rural—population of about 8.7 million and GNI per capita of US\$1,100 in 2016, making it a lower middle-income country.** Although mountains cover 93 percent of its surface area, 34 percent of its land is agricultural and can be used for crops, orchards, and pastures. The country has additional endowments including rivers with hydropower potential and extractive mining as well as mountain and eco-tourism sites. The country is close to large markets in Central, East, and South Asia and the Middle East.

**In 2016, Tajikistan launched the National Development Strategy of the Republic of Tajikistan for the Period Up To 2030 (“NDS 2030”) laying out its master plan of the country’s future economic development.** The NDS 2030—which requires US\$118 billion for full implementation—defines raising the population’s living standards as the ultimate goal of the country. The construction of the 3,600 MW Rogun Hydropower Plant (“HPP”) is the *de facto* centerpiece of the Strategy. Upon full commissioning in 2032, the Government envisages the Rogun HPP to significantly boost hydropower exports and remove energy shortages, contributing to growth, government revenue and, hence, poverty reduction. Although the NDS 2030 and the underlying development strategies set ambitious economic and social goals, clear guidance on implementation is lacking, such as the necessary policy measures, monitoring and implementation arrangements, and a realistic financing envelope.

**This systematic country diagnostic (“SCD”) identifies the most critical challenges and opportunities facing Tajikistan as it strives to raise the population’s living standards through the implementation of NDS 2030.** Specifically, the SCD will answer the following three questions: (i) what are the key constraints to achieving inclusive and sustainable growth as envisaged in the NDS 2030; (ii) what are the main risks; and (iii) what priority areas can Tajikistan focus on to have the largest impact on sustainable economic and social development?

## Context

**Tajikistan’s independence after the disintegration of the Union of Soviet Socialist Republics (“USSR”) in 1991 was immediately followed by political and economic instability.** Tajikistan entered a five-year civil war, which severely damaged the already weak economic infrastructure, and caused a sharp decline in Tajikistan’s industrial and agricultural production. The destruction caused by the civil war was exacerbated by the dissolution of trade and economic ties with the Russian Federation and former Soviet republics.

**The civil war has significantly disrupted the development of inclusive state institutions in Tajikistan.** Unlike other former Soviet republics, Tajikistan was unable to come to achieve a smooth transition from a centrally planned economy towards a more market-oriented system in the immediate post-Soviet period. Despite the presence of some democratic institutions, their effectiveness is low, with executive, legislative, and judicial powers remaining centralized (both the Freedom House’s ‘Freedom in the World’ and the Economist Intelligence Unit’s ‘Democracy’ indices are very low for Tajikistan). Important aspects of politics in Tajikistan are linked to patronage networks and dependent on personal loyalties. Impartial civil society organizations free to voice concerns or issues of public interest are largely lacking. Low levels of transparency and accountability, together with limited checks and balances in the system, have weakened governance and increased (the perception of) corruption.

**Weak governance has had widespread consequences on the effectiveness and accountability of public institutions, civil trust, and the legitimacy of the state.** Weak governance is reflected in the Government’s difficulty in fulfilling its responsibilities to the population—possibly, reflecting the lack of an effective

social contract between the state and its citizens. The tradition of governance aimed at providing public goods (energy, clean water, transport) and services (health, education) to the population or creating an environment conducive to sustainable growth has not yet fully developed. Instead, only limited investments in human capital and basic infrastructure, essential for productivity growth, have occurred.

**In this difficult environment, labor migration became a key avenue for Tajikistan’s citizens seeking a better life.** Every year, between 600,000 and 1 million prime-age Tajiks (mostly men) leave to work, principally in Russia, sending remittances to their families. Migrant transfers in 2013 totaled more than US\$3.4 billion, equivalent to 40 percent of GDP, making Tajikistan one of the world’s most remittance-dependent countries. The abundant inflows of remittances were mostly used for consumption and did not translate into increased private investment, a common observation in many remittance-reliant countries.

## Progress toward the Twin Goals

### Trends and Drivers of Growth

**Tajikistan enjoyed rapid economic growth during the post-civil war period, more than doubling per capita real income (in local currency terms) between 1998 and 2016.** Output expansion was particularly fast during 1998–2008, attributed mainly to a favorable external environment and buoyant foreign financial inflows, which allowed a rapid economic recovery after the significant output loss of the 1990s. Tajikistan’s growth was driven mainly by sharp increases in private consumption, supported by accelerated inflows of remittances on the back of strong regional growth.

**The pace of economic expansion has slowed slightly since 2009, affected by the weakening external environment.** Over the past decade, the Tajik economy experienced two major external shocks, in 2009 and 2014. These led to a sharp fall in remittance inflows and prices of and demand for aluminum and cotton, its main export commodities. Due to the strong rebound of remittances and commodity prices as well as increased support from the development partners, Tajikistan was able to weather the global financial crisis relatively well. However, its economic recovery was short-lived. The second shock wave that began in late 2014—a dramatic fall in cotton and aluminum prices and sharp declines in remittances due to Russia’s recession—have proved to be more long-lasting, considerably depressing private consumption, Tajikistan’s main growth driver. Tighter restrictions of labor migrants by Russia may have also contributed partially to the decline in remittances. Yet overall growth remained robust, as the domestic demand composition changed—this time to be supported by a large increase in foreign-financed public investment, which stimulated industry and construction and compensated partially for the decline in private consumption.

**Tajikistan’s economy has not achieved the same structural transformation as some of the other former USSR countries, especially in terms of the role of the state in the economy.** The state retains direct and indirect controls in every major sector of the economy, through its ownership of large Soviet-era enterprises. At the beginning of 2015, there were 898 state-owned enterprises (“SOEs”). While many of them are small- and medium enterprises, 24 large SOEs dominate energy, transport, water resources, and heavy industry. Available evidence suggests a declining profitability of SOEs over time, leading to an accumulation of liabilities, which were estimated at 38 percent of GDP, including arrears (inputs, salary, tax, debt services) and penalties on these arrears.

**Squeezed by the large presence of the state, the private sector in Tajikistan has remained underdeveloped and played a limited role in the economy.** Very few new businesses are created each year. Existing private firms are mostly small and do not grow to their full potential across the firm life-

cycle, while the informal sector of the economy is reportedly large and growing. Formal employment in the private sector represents 13 percent of total employment. Private investment has averaged only 4.4 percent of GDP since 2000, well below the CIS average investment rate of 21 percent. Years of insufficient investment have prevented the private sector from building its productive capabilities and, in turn, from contributing to the country's competitiveness and job creation—a key factor in expanding welfare gains.

### **Trends and Drivers of Poverty Reduction**

**Tajikistan has achieved rapid poverty reduction over the past two decades, but in recent years, progress has slowed.** Extreme poverty, as measured by the international poverty line of US\$1.90 a day (PPP 2011), fell from 54 percent in 1999 to 5 percent in 2015—significantly better than the average performance of lower middle income countries. According to the Government's own national poverty line based on country norms, poverty in 2016 stood at 31 percent of the population with significant spatial variation across the country. For example, rural areas are significantly poorer than urban areas (35 percent vs. 23 percent) and 80 percent of the poor live in rural areas. In recent years, the pace of poverty reduction has slowed concurrent with the economic slowdown in the region.

**In contrast to the decline in monetary poverty, Tajikistan has done less well in improving the quality and accessibility of public goods and services.** An important measure of the quality of economic growth is the extent to which it successfully improves the lives of the population. Tajikistan's multidimensional poverty index indicates that non-monetary deprivations in the country are widespread. On health and education outcomes, the government performs well in comparison to other lower middle-income countries. However, the high population growth rate driven by high fertility, makes maintaining these gains difficult. Furthermore, many residents are not satisfied with the quality of key public services such as electricity, water, heating, and roads. Though electricity is universally available, there are frequent outages. Only three out of four persons have access to an improved water source—essential for maintaining good health. Market accessibility mapping highlights the lack of infrastructure integration outside the largest cities.

**The population suffers from undernourishment and stunting, which undermine the accumulation of human capital and incomes.** Although Tajikistan has achieved considerable progress in domestic food production, low domestic agriculture production of major crops, low meat consumption, and poverty-related food insecurity are still common. Children are especially vulnerable to malnutrition due to limited access to clean water and sanitation or inadequate access to nutritious food. Stunting among children under 5 years old was 21 percent of all children, and 2 percent of children are wasted. Undernutrition (the precursor of stunting) leads to poor cognitive development, decreased years of schooling, and reduced productivity.

**Poverty reduction has been driven mostly by labor earnings and remittances—although to varying degrees over the past 15 years.** Welfare gains and poverty reduction in Tajikistan—as in many other countries—hinges on the ability of households to find jobs. During 2003–09, about two-thirds of the decline in poverty was due to higher labor earnings followed by remittances that contributed about one-fifth to poverty decline. However, during the years of declining remittances, increased labor earnings and pensions played an important role in reducing poverty in 2013–15. The absence of a national social safety net meant that unless the poor worked—whether in Tajikistan or abroad, there were few resources to help them meet their basic needs.

**Yet there are relatively few jobs and employment rates are low, especially among youth.** To maintain the progress in improving the population's welfare, especially monetary welfare, households need a source of labor income. However, the economy is producing fewer jobs today both due to lower economic

growth and the declining employment to growth elasticity which fell sharply in recent years, from 0.33 in 2000–09 to just 0.13 in 2010–14. Private sector growth is weak further limiting demand for labor in the economy. The lack of domestic jobs represents a serious constraint to expanding welfare gains and continued social stability. The share of adults either out of the labor force or unemployed exceeds those who have a job, especially among the poor. Around 41 percent of the youth are inactive, raising social concerns of their disenfranchisement and economic concerns of capacity underutilization.

## A Wake-Up Call

**Growth based on heavy reliance on external financial inflows has allowed Tajikistan to achieve rapid poverty reduction.** The question is: how sustainable is this progress? Can Tajikistan continue to rely on foreign financial inflows (remittances, foreign savings) to grow rapidly and improve the welfare of its population, without creating major economic and social problems in the future? Will the commissioning of the 3,600 MW Rogun HPP, the centerpiece of Tajikistan’s development masterplan, transform Tajikistan as anticipated in the NDS 2030?

**The SCD finds that under the status quo approach, the pursuit of the US\$118 billion NDS 2030, including continued borrowing for the Rogun HPP, could risk debt sustainability and threaten the country’s economic and social stability.** The remittance-driven growth is ill-suited to sustain high growth and absorb the rapidly growing working-age population, without increasing Tajikistan’s external vulnerabilities. A successful commissioning of the Rogun HPP could spur growth. But to realize that, Tajikistan needs to surmount several short and long-term challenges, including the mobilization of financing to complete the Rogun construction and cross-border transmission lines for exports, risks of debt distress, macroeconomic management, youth unemployment, fragility and climate change, just to name a few. Failure to manage them successfully could have dire economic, social and political consequences.

## New Growth Driver Wanted

**The sustainability of Tajikistan’s current remittance-based growth model is unlikely due to the uncertain regional economic outlook, rising vulnerabilities, and growing macroeconomic instability.** Rapid growth in the past has been driven predominantly by buoyant private consumption supported by remittances, although commodity exports and foreign-financed public investment have also played some role. Once external conditions deteriorate, however, under this growth model Tajikistan’s economy loses growth impetus, as acutely felt over the past few years. While Russia’s economy is bottoming out in 2017, its growth outlook remains unclear given stagnant prospects for oil prices, structural constraints, as well as the expanded US sanctions, which would undermine Russia’s medium- to long-term growth prospects. That is, remittance-financed private consumption is not a reliable source of growth and poverty reduction in the long run. Tajikistan needs to find alternative, more stable, and sustainable sources to support growth.

**A full commissioning of the Rogun HPP could significantly boost Tajikistan’s growth, but there are a multitude of risks and challenges.** The full commissioning of the Rogun HPP, scheduled for 2032, is envisaged to boost Tajikistan’s electricity exports and remove energy shortages that constrain business activity today, contributing to growth and government revenue. However, realizing this scenario is possible only when the following short- and long-term challenges and risks are managed successfully.

**The construction of the Rogun HPP entails serious economic and social risks, which could trigger instability unless managed very well.** The first relates to the financing of the construction. The Government has yet to secure full financing necessary to complete the construction the Rogun dam. The

scope of domestic borrowing is limited, given the shallow domestic financial market and banking sector fragility, and doing so would likely crowd out private investment. Boosting revenue collection is challenging given the small private sector (tax base). Since construction delays could give rise to safety implications, the Government may feel compelled to reallocate budgetary resources from critical sectors and increase revenue collection targets to keep up with the schedule. Technical and governance issues may pose additional risks to financing the project and increase their total costs, a widespread problem in the world of large dams. The Lesotho Highlands Water Project is one famous example. Second, regardless of how it is financed, an investment project of this magnitude, albeit spread over many years, will likely have a significant impact on the exchange rate, inflation and external indebtedness, challenging the authorities' ability to maintain macroeconomic stability.

**A successful and timely commissioning of the Rogun HPP will present a new set of risks and challenges to the Tajik authorities.** First, there is a need to build cross-boundary high-voltage transmission lines, which will enable Tajikistan to export surplus hydropower to Afghanistan and Pakistan. The second concerns public financial management. The Government will need to manage hydropower revenue wisely to (i) service debt; (ii) allocate resources for operation and management ("O&M") of the HPP; and (iii) strike a delicate balance between spending for productive (including the transmission lines) and social purposes, and saving some to safeguard macroeconomic stability. Management of large-scale revenue will require a strong institutional arrangement and administrative capacity. Failure to adequately manage large export proceeds could destabilize the economy, as experienced by Bhutan, whose main growth driver is hydropower exports. Finally, hydropower-led growth will not create enough employment opportunities, for the growing young population. All in all, while the full commissioning of the Rogun HPP could bring significant benefits to Tajikistan, for that to happen, a number of conditions need to be met.

### Rising External Vulnerabilities

**Tajikistan's external sustainability has weakened considerably in recent years, with the sharp accumulation of foreign debt.** Tajikistan's external debt (including external borrowing by the corporate sector) more than doubled over the past 10 years to reach 67 percent of GDP in 2016, due mainly to the large-scale infrastructure projects, financed by foreign loans, as well as increased corporate sector borrowing and short-term debt. Tajikistan's external debt is likely to have exceeded 70 percent of GDP by end-2017, with the issuance of a US\$500 million Eurobond (about 7 percent of 2016 GDP) in September 2017 to finance the construction of the Rogun HPP. The latest IMF/World Bank Debt Sustainability Analysis evaluates Tajikistan's risk to external debt distress is high under the status quo scenario, including continued borrowing for the Rogun HPP.

**There is a rapid build-up of unguaranteed corporate sector debt and short-term debt, but details are unknown.** Available information suggests that at end-2016, a large part of short-term external debt was owed by Tajikistan's financial institutions in the form of non-residents' short-term deposits and short-term loans owed by Tajikistan's corporate sector.

**Despite the elevated risks, Tajikistan's policy buffers are limited to counter future shocks.** Official reserves are low, especially relative to the country's short-term debt, raising concerns about a liquidity crisis. Fiscal space has narrowed and public debt has risen, driven by falling revenue, bank recapitalization costs, and large-scale public investment. Continued reliance on external borrowing to support growth is not sustainable, and could trigger a costly debt crisis. The scope for domestic borrowing is also limited by low private savings, banking distress, and underdeveloped capital markets.

**Macro-financial difficulties since 2014 are also undermining economic activity.** Tajikistan's macroeconomic policies have been generally prudent, but significant ground was lost recently due to



inadequate policy responses to the spillover from Russia's recession. The large somoni depreciation had a detrimental impact on the banks' already fragile financial position—attributed to years of weak risk management and poor supervision—pushing up the non-performing loan (NPL) ratio significantly and leading to a credit crunch.

### Risks of Fragility and Natural Disasters

**Added to all this, Tajikistan's young and rapidly growing population could threaten Tajikistan's economic and social stability.** Tajikistan currently does not have a large and vibrant private sector that can absorb the growing population into productive employment. Given the country's current growth strategy, prospects for significant job creation are slim due to the capital-intensive and enclave nature of the electricity sector, and the scope for labor migration is uncertain. The growing number of unemployed and idle youth could become a future threat to stability in Tajikistan. However, a rapidly growing working-age population also presents opportunities for Tajikistan to accelerate growth and poverty reduction, as some East Asian countries did successfully in the 1950s and 1960s (by benefiting from the demographic dividend).

**Tajikistan also faces security and cross-border risks, which could be exacerbated by economic exclusion of the youth.** With its unique geographic location, Tajikistan is vulnerable to drug trafficking, political-religious extremism, possibly even terrorism. The country's porous and 1,400 km long border with Afghanistan has made it a major transit country for illegal drugs to Russia, Kazakhstan, and Europe. Furthermore, some regional tensions persist with its neighbors stemming from such problems as border disputes and control of water resources. In the north, the use of transboundary rivers is a sensitive topic given the countries' economic dependence on the water. Tajikistan has unresolved border disputes in the Fergana valley with the Kyrgyz Republic, which is a source of regular, low-level friction over access to water and pasturage.

**Natural disasters and climate change also threaten Tajikistan's economic and social development, but there is little capacity to respond.** Tajikistan's terrain and geological and hydrological features make it prone to many natural hazards such as floods, earthquakes, and landslides. Environmental degradation and deteriorating infrastructure that were mostly built during the Soviet era—have increased the population's vulnerability to extreme weather events and seismic risks. Climate change is expected to increase the intensity and frequency of extreme climate events. Agriculture, the main employer in the economy, depends on water resources and is therefore exposed to climatic variability. Adverse effects on agriculture and, in turn, food production may increase relative prices and reduce agricultural wages, affecting the poor dependent on agriculture. The reliance on hydropower also makes the electricity sector directly vulnerable to climate change.

### Challenges and Opportunities: Private Sector Growth and Demographic Dividends

**What can Tajikistan do to ensure economic and social stability in the current economic context?** Is there any way to reduce these risks and make the Rogun HPP a truly transformational investment, not an expensive gamble? If so, how? The SCD argues that fostering a vibrant private sector to create employment opportunities will reduce social risks, while allowing Tajikistan to reap the demographic dividend, accelerate growth, and soften the risk of debt distress emanating from Rogun financing. Tajikistan could achieve socio-economic transformation through the Rogun HPP if this project is embedded prudently in a set of complementary policies to develop a healthy private sector that invests and creates jobs, thereby expanding the tax base.



**The analysis finds many of the challenges encountered by Tajikistan’s private sector have their root in weak governance and corruption.** Private sector activity is hampered by a difficult business environment. These include an unpredictable regulatory environment, an unequal playing field, high cost of tax compliance, limited access to longer-term loans, erratic electricity supply, high transport cost, foreign exchange shortages, just to name a few. The analysis discussed below finds that these problems have their roots in or are exacerbated by weak governance and corruption. Building an enabling environment for private sector development therefore requires decisive governance reforms, designed to reduce the role of the state and enlarge that of the private sector in the economy.

### **Difficult Environment for Private Businesses**

**Implementation shortcomings, discretionary enforcement, and informal practices have created an unpredictable regulatory environment.** The regulatory environment is unpredictable and non-transparent, as reforms have often just remained “on the books” without generating marked gains in the business environment. Many of the well-written laws have suffered poor implementation due to the weak rule of law, lack of judicial independence, corruption, and inconsistent interpretation and implementation—all raising the cost of doing business in Tajikistan. The judiciary’s ability to enforce contracts and protect property rights is compromised, while shortcomings in regulatory transparency have also hampered effective enforcement.

**A good example can be found in areas such as foreign trade and competition.** Although Tajikistan’s trade regime is open in theory, importing goods into Tajikistan is still complicated due to the high degree of physical inspections, corruption and patronage networks, which make access to foreign inputs and modern technology more difficult. Competition policy is often ignored, hurting private sector development and the economy’s competitiveness. Real market competition is present only in some segments of the economy, with vested interests still restricting competition. Legislative and procedural rules regulating market competition are often neglected, shielding SOEs and politically connected firms from robust market competition. While SOEs are granted preferential access to inputs, finance and government contracts, arbitrary taxation and multiple inspection rules with informal arrangements levied on the private sector discourage market competition.

**The private sector in Tajikistan also faces a tax regime that is complex, imprecise, and difficult to comply with.** The private sector (domestic and international) has increasingly indicated uneasiness with ongoing distortive tax collection practices and the ad hoc interpretation of the tax code to achieve revenue targets. Reportedly, the authorities have increased pressure on businesses to make “irregular” advance tax payments, while intensifying retroactive tax audits to raise revenue through fines and penalties to compensate for revenue shortfalls caused by the weakening economy due to Russia’s recession.

### **Shallow Financial Intermediation**

**Limited access to loans represents a major constraint to private investment.** Numerous indicators confirm that access to finance is one of the top obstacles in doing business in Tajikistan. Getting loans is difficult due to several reasons: (i) distortion in resource allocation due to directed lending, including to loss-making SOEs; (ii) low financial inclusion; (iii) limited long-term funding sources; (iv) absence of benchmark yield curve for government bonds; (v) poor enforceability of loan repayment due to the weak judiciary system, to name a few. Thus, many businesses raise capital through other means, including selling assets and borrowing from other companies or individuals outside the official financial system, but the limited nature of private funding keeps businesses small.

**Tajikistan's private sector also suffers from the poor quality and scale of infrastructure, especially in energy and transport infrastructure.** Although a sizable share of government expenditure has been allocated to capital outlays, large investment may have failed to improve Tajikistan's productive capabilities, raising concerns about the effectiveness of public investment. Albeit improving gradually over time, Tajikistan's infrastructure is of poor quality. Contractual arrangements between the Government and the private sector could potentially address many pressing needs in infrastructure, but private sector participation is limited due to the poor business environment and legislative gaps for public-private partnerships.

### Infrastructure Gap

**The SCD finds that Tajikistan's precarious energy situation can be attributed to a combination of factors.** Acute energy shortages are serious obstacles for economic activity and social welfare. Currently, Tajikistan cannot guarantee to fully meet the domestic demand for electricity, the primary source of energy, especially during the winter months. Businesses face frequent outages, incurring economic losses. The factors creating the dire energy situation are: increased demand for electricity and reduced supply in winter, due to the lack of alternative energy sources, very low electricity tariffs, and reliance on hydropower generation, which is susceptible to seasonality. The problems are further aggravated by the erosion of the existing assets, high transmission losses and operational inefficiencies, caused by the financially distressed electricity SOE, Barqi Tojik. With the residential, industrial, and agricultural sectors consuming 80 percent of domestic energy, a major breakdown of the power system could cause enormous damage to Tajikistan's economy and social welfare.

**Inadequate transport infrastructure in Tajikistan raises trade costs, limiting the country's connectivity and undermining its competitiveness.** Despite Tajikistan's proximity to major markets, its trade costs are among the world's highest, which represent a significant constraint to the country's trade opportunities, especially with Afghanistan and China. Improving connectivity goes beyond physical infrastructure and logistics. Equally, if not more, important is the commitment to cooperation at political levels. The limited availability of logistical services—support to move goods and connect domestic producers and consumers with international markets—also hampers Tajikistan's connectivity and competitiveness.

### Agriculture Development

**Enterprises in the agriculture sector face specific challenges and addressing these obstacles are critical for raising the population's incomes and food security.** Despite Tajikistan's successful agriculture reforms, the productivity and competitiveness of the country's agriculture are still well below potential and those of other CIS countries with more successful reforms. Since agriculture plays a vital role in socio-economic development and food security in Tajikistan, improving agriculture will have the largest and most direct impact on creating employment and contributing to economic and social stability in the present economic structure.

**Tajikistan's potential to further develop its agriculture sector, including value chains, is constrained by several inter-related challenges.** These range from farm fragmentation, access to inputs, lack of tradability of land user rights, deteriorating farm infrastructure, soil degradation, to the weak link between farmers and food-processors. The SCD identifies that some of the challenges are attributed to the delayed implementation of the Land Code, which prohibits trade of land user rights, and unclear ownership structure of assets.

## Challenges and Opportunities: Employability

**Better skilled labor will be needed to propel Tajikistan in the early stages of modernizing its economy and achieving the goals in the NDS 2030.** Tajikistan is faced with the challenge of developing its human capital base for private sector driven growth, particularly since prospects for foreign employment and higher wages have contracted. The Government has an important role to play in improving skills and labor productivity. Policies and programs that further improve human capital will also have the benefit of making growth inclusive and increasing the population's commitment to a stable and prosperous Tajikistan. The State Labor Market Development Strategy for 2020 lays out the objectives to increase employment by improving the business environment and creating a flexible, secure and accessible labor market. The strategy indicates the Government's clear understanding of the domestic challenges affecting Tajikistan's working age population. In conjunction with the steps laid out in the strategy, Tajikistan can improve human capital by strengthening education, health services (including family planning), and the population's nutritional status.

**Improvements in access to and equity of education help to lay the foundation for enhancing skills of the domestic labor force—a necessary step forward for increasing worker productivity and reaping the demographic dividends.** The Government has taken important steps already through its initiatives in per capita financing, the Education Management Information System, the National Testing Center, and the competency based curriculum for primary grades. Going forward, to ensure that the labor force is positioned to contribute to economic growth, the education system needs further strengthening, but with a long-term view that spans the full educational experience of citizens. The Government can do this by addressing three main challenges: limited early childhood education quality and coverage, deficient quality of basic, secondary (including vocational education training institutes) and higher education, and inadequate relevance of educational curriculum in preparing students for the labor market. Making major advances in addressing these challenges will help to increase worker productivity—and, ultimately, economic growth.

**The Government is also committed to improving equitable access to essential health care services.** The priority problem areas are maternal and child health, reproductive health, noncommunicable diseases, malaria, tuberculosis, HIV/AIDS, and other sexually transmitted infections. The main thrust of recent reforms in Tajikistan aim to strengthen the primary health care system and, concurrently, restructure the oversized—and unaffordable—hospital delivery network which was inherited from the Soviet period. Recent reforms include a pilot introduction of the basic benefit package and per-capita financing for primary health care services.

**The main challenges for the health care system are increasing affordability, equity, quality of services.** People's health is another vital factor in influencing productivity. If the challenges of the health care system are successfully addressed, the health of the population will not only see greater improvements, but it will also prevent households falling into poverty due to unexpected medical expenses. There is also the broader challenge of stunting that affects the most vulnerable in society, children and population growth. Although this is indeed a health challenge, the factors that lead to it are more complex and at times beyond the scope of any single government ministry or agency to address.

**Addressing stunting and malnutrition effectively requires a multi-pronged and inter-sectoral approach.** This approach would cover infrastructure gaps such as access to water and adequate sanitation, together with food security and dietary diversity, health care, child care practices and early childhood education. Given that stunting and wasting affect children from a very young age and have long-term consequences, early childhood interventions to prevent life-long impairments may be warranted. However, in addition

to attacking undernourishment among young children from multiple angles, it is also important to address—and reduce—high fertility rates. The aim would be to focus on smaller and healthier families.

**Tajikistan’s high population growth rate undermines the pace of monetary and non-monetary poverty reduction.** The government’s ability to expand the delivery of basic public services—such as health, education, water or electricity—to a rapidly growth population is both difficult and expensive. For households with low incomes and few remunerative employment opportunities, having a large family is expensive and increases dependency on the few income earners. To reduce the challenges of a rapidly growing population, the government needs to address the issue of early marriage, inadequate low contraceptive prevalence, high fertility rates and high *wanted* fertility rates. By changing peoples’ fertility preferences as well as ability to control their fertility through contraceptives, the pressure on job creation, government spending, and public services can be reduced.

**The government has also been modernizing the social assistance system.** Beginning in 2011, it piloted the Targeted Social Assistance (“TSA”) program, which replaced two old and inefficient legacy programs. Until recently, safety nets and cash transfers have not played a major role in helping the poor and the programs suffered problems of low coverage, efficacy and efficiency. Gradually the TSA has been expanded from two districts to 40 districts, or close to two-thirds of the country. It has been adopted as a core part of the government’s reform agenda for the social assistance system. The plans are to have it rolled out nationally in 2018. An important reason for establishing the TSA was to achieve better targeting with the move towards using proxy means testing for the beneficiary selection mechanism. Once it is fully established and rolled out nationally, it will present an opportunity for reaching a greater share of the population in need—and eliminating the scourge of absolute destitution.

## **Making NDS 2030 a Success: Priority Actions for Best Case Scenario**

**Imagine. In 2030, Tajikistan is a steadily growing, competitive country that provides decent living standards for population, equal opportunities for each person to realize his or her potential based on equality, justice and respect for human dignity (NDS 2030).** As the result of earlier investment in critical infrastructure and human capital, coupled with successful governance reforms, Tajikistan’s business environment has improved significantly, enabling vibrant private sector activity, and in turn boosting exports, reducing reliance on imports, and creating formal sector employment. With the increasingly educated young population actively participating in the labor market, Tajikistan is reaping the demographic dividends. Poverty has fallen as more people have regular labor earning. Supported by an efficient financial system, private investment is rising as firms try to meet buoyant domestic consumer demand. Budget revenue has grown over thanks to the expanded tax base, enabling the government to remain current on debt service obligations, pay for the Rogun construction, and enhance social protection. Efforts to improve public service delivery has created a sense of a social contract among the population, contributing to stability. The Rogun HPP project is in the final phase of construction, and the full commissioning is scheduled for 2032. Tajikistan now is a well-established upper middle-income country.

**Development of a vibrant, competitive private sector is the backbone of this scenario, including the successful completion of the Rogun HPP.** Realizing the NDS 2030 depends critically on the development of a healthy, competitive private sector that invests and creates employment for the growing working-age population. A vibrant private sector will create employment opportunities and reduce the risk of social unrest, while allowing Tajikistan to benefit from the demographic dividends, spur growth, and soften the risk of debt distress. In other words, the successful commissioning of the Rogun HPP requires a thriving private sector to keep economic and social stability in check.

Tajikistan's private sector faces three broad challenges that are inter-related: (i) macro-financial instability; (ii) weak public institutions; and (iii) infrastructure gaps and underdeveloped human capital, which are exacerbated by weak governance. To adopt effective policies and institute reforms for private sector development—in turn, a successful commissioning of the Rogun—Tajikistan needs to address its problems of governance. Without it, any efforts to stimulate growth, including through hydropower exports, will unlikely to produce a sustainable economic and social prosperity in Tajikistan. The economic situation since late 2014 highlights the increased urgency of addressing existing weaknesses and constraints that hamper private sector activity, job creation and pursuit of the NDS 2030.

### **Restore Macro-Financial Stability**

**Restoring macro-financial stability is an urgent priority to improve market confidence.** Macro-financial stability is the cornerstone of any successful effort to promote private sector development and sustained economic growth. A stable and well-functioning financial system is pivotal in mobilizing and allocating resources efficiently towards their most productive use, provide financial safety nets, and facilitate efficient and secure payments. A deep financial system can also contribute to macroeconomic stability, by facilitating the transmission of monetary policy and cushioning the impact of macroeconomic shocks, which tend to affect the vulnerable population disproportionately. Greater communication of future policy directions would help reduce uncertainties, alter expectations about future inflation and exchange rate, and boost confidence in overall economic policies.

### **Banking Sector Reform as Top Priority**

**The banking system has the highest priority for macro-financial stabilization.** The current banking sector problems come at a cost of low lending, high interest rates, and depressed private investment. At present, Tajikistan's banking system no longer assumes its intermediation function properly, and is a major obstacle for private sector investment, in the absence of the alternative sources of capital. If left addressed, the precarious banking situation will further undermine public confidence in the economy, and could potentially trigger a financial sector meltdown with dire economic consequences and fiscal ramifications.

**Tajikistan needs to implement legal reforms to resolve the banking distress, improve governance to prevent recurrence of the problem, and deepen the financial system to foster efficient financial intermediation.** Needed policy actions include legal reforms to establish a bank resolution framework to minimize cost to public taxpayers. Restructuring of outstanding non-performing SOE debt is also important to accelerate banks' balance sheet repair. The practice of directed and connected lending should be discontinued. Efforts are necessary to promote financial inclusion and instill a savings culture in Tajikistan. Increased somoni-denominated longer-term deposits will help facilitate financial intermediation in local currency by alleviating banks' severe funding constraints, and contribute to macroeconomic stability through improved monetary policy transmission. The importance of financial education and awareness campaign are increasingly recognized as an effective way to enhance financial inclusion and promote savings.

### **Macroeconomic Management Needs Reinforcement**

**Policy coordination needs to be stepped up to ensure macroeconomic stability, in the context of large-scale public investment.** Despite Tajikistan's good track record, recent experience suggests the need to significantly reinforce the implementation of consistent monetary, exchange rate and fiscal policy mix to maintain a stable environment for private sector activity and reduce social impact. The Rogun project, given its size and complexity will pose a major challenge to the authorities' macroeconomic management.

Large-scale domestic borrowing to meet the Rogun financing needs should be carefully evaluated against its impact on the domestic economy, including the risk of crowding-out of private investment.

**Rebuilding policy buffers can safeguard macroeconomic stability from future shocks, including natural disasters.** International reserves should be increased to cover a full amount of the country's short-term debt to reduce risks of liquidity crisis. The authorities are encouraged to maintain greater exchange rate flexibility, which will also help ease foreign currency shortages, which are progressively impairing the ability of firms to carry out their business activities. Consideration could be given to abolish the administrative controls on foreign exchange or replace them with market-based instruments. Fiscal space should be widened to safeguard macroeconomic stability from future shocks. Fiscal policy will remain the key macroeconomic policy instrument in Tajikistan, given the limited monetary policy effectiveness in the context of shallow and highly dollarized financial system.

**There is a need to boost the capacity to manage public debt and fiscal risk.** A validation of government debt records for external, domestic and guaranteed debt is necessary to adequately understand the overall debt portfolio, and inform risk and cash management, while a more comprehensive and reliable SOE financial databases should be developed to monitor and manage fiscal risks. Finally, there is a need to undertake vigorous credit assessment before providing on-lending or guarantees to SOEs, to avoid a further build-up of contingent liabilities.

### Create Effective Public Institutions

**A modern, rationally and effectively functioning public institutions is an irreplaceable prerequisite for sustainable socio-economic development.** International evidence suggests that countries rarely achieve sustainable economic and social development in the absence of effective state institutions. Without well-functioning public institutions, efforts to develop the economy, including through large investment, is often ineffective and unsustainable.

### *Get the Business Environment Right*

**To create an enabling environment for the private sector, existing laws and regulations, including competition laws, should be enforced.** Tajikistan already has relatively well developed legal and regulatory frameworks to support a market-based economy. However, implementation weaknesses, corruption, and informal and non-transparent practices have created great uncertainty for firms and perceived risks of doing business in Tajikistan. A good example is tax administration practices that apply laws in an unpredictable and punitive manner, dampening firms to grow or go informal to avoid visibility.

**SOE reform is indispensable to promote market competition to drive productivity growth, while reducing fiscal risks.** The importance of free and fair competition cannot be overemphasized, as competition drives innovation, cost reduction and management efficiency. Enhancing incentives for the restructuring of SOEs, improving corporate governance and financial accountability, and promotion of robust competition are important economic reform priorities for Tajikistan. SOE operation with extensive use of energy, inputs and financing at below market prices has created a stream of subsidies, depriving public sector revenue, generating SOE losses, and giving rise to large contingent liabilities.

**Good governance, the fight against corruption, a sense of justice, and a level playing field for all would go a long way towards shifting the private sector into a key driver of growth and job creation, while boosting the state's legitimacy.** Stronger rule of law, especially with regard to property rights, and judicial independence are particularly important in protecting investors from expropriation and enforcing contractual obligations. Significant efforts are needed to create an independent judicial system, which is



known to have a far-reaching, positive impact on various segments of the economy by instilling a culture of compliance.

### *Strengthen Public Institutions*

**Tajikistan needs to reinforce its fiscal institutional capacity, accountability, and independent administration to serve the public interest.** Weak governance has also compromised resource allocation decisions and significantly undermined the population's faith in the ability of the government to deliver basic public goods and services to its population. Strong institutional capacity for public financial management capacity, including debt management, is crucial to manage effectively large-scale investment projects, such as the Rogun HPP, and utilize future large fiscal revenue from electricity exports wisely for debt infrastructure, social spending (education, health, social protection), and debt services. Despite some progress in public financial management, further efforts are necessary to improve the composition, quality and cost-effectiveness of government outlays, and create space for critical spending. This will go a long way towards mitigating risks and vulnerabilities for households and installing a sense of the social contract with the population.

**By improving social safety nets, the Government can help to reduce risks and vulnerabilities for households but also install a sense of the social contract with its population.** Extreme poverty continues to exist in Tajikistan and can be directly addressed by expanding the reach of the public safety net, especially the relatively recent cash transfer program while also improving its overall efficiency through improving coordination between various benefits and programs. The success of the transfer program can be measured by how well it reaches the target beneficiary population, how little leakage of resources occurs to others, and how adequate the amount is to raise beneficiaries out of poverty. By lifting the incomes of the poorest in society, the government can also increase social cohesion as well as strengthen its social contract with the population.

**There is also considerable scope to strengthen revenue administration and tax policy.** The distortive tax collection practice is counterproductive, and should be discontinued as a matter of urgency. There is a need to strengthen revenue forecasts, so as not to create performance pressure in the revenue administration and use irregular means to deliver on ambitious targets. On the tax policy side, the focus should be placed on the rationalization of tax policy, such as closing loopholes, and reduction in compliance cost, taking a longer-term perspective. The ongoing Evidence Based Tax Assessment will offer an excellent opportunity to identify areas for potential improvement. Existing incentives could be reviewed and realigned with national development priorities. With the increase in formal private enterprises, the disproportionately heavy weight on indirect taxes can be corrected. At the same time, efforts can be stepped up to strengthen the collection of dividends and recovery of tax arrears from SOEs.

### *Invest Strategically in Key Infrastructure and Human Capital*

**Tajikistan has considerable scope to increase productivity and maximize the demographic dividends by investing strategically in key infrastructure and human capital.** During rapid population growth, East Asian countries invested in their youth and expanded access to family planning allowing people to start families later and have fewer children. Decreases in fertility rates resulted in healthier women and lower economic pressures to households, boosting domestic consumer demand and contributing to the national budget. Growing fiscal resources were directed towards strategic investment in infrastructure and human capital, resulting in unprecedented economic growth led by the competitive private sector.

### *Closing Infrastructure Gaps*

**Fostering a competitive, profitable private sector requires the Government to strategically invest in infrastructure that can have a largest bearing on economic activity and social welfare.** Reliable and adequate supply of electricity and connectivity infrastructure are the priority areas for the government to focus on. To ensure improved energy supply and successfully manage the Rogun HPP, Barqi Tojik's institutional capacity and financial viability needs to be bolstered significantly. Tajikistan can take advantage of its geographical proximity to very large markets by improving connectivity and thus reap the potential from regional and global integration.

**China's Belt-Road Initiative represents a major opportunity for Tajikistan to develop physical infrastructure, access new markets via cheaper routes, generate and strengthen competitiveness.** To benefit from this Initiative, however, commitment at the political level and effective inter-republic cooperation, which can be as big a constraint as infrastructure bottlenecks. At the same time, decisive actions are necessary to improve the condition for trade activity (soft infrastructure), especially the elimination of informal barriers and improvement of logistics support.

### *Building Human Capital*

**Tajikistan's human productive capabilities are significantly underutilized because of years of limited investment in human capital and emigration.** Tajikistan can focus on fostering the conditions that empower its people to contribute productively to the country's continued development of labor force. The role of public policy is to help ensure its population to become a productive member of the society, thereby increasing their employability and enhancing non-monetary welfare.

**Education systems are constantly evolving to meet the needs of a changing economy—and society more broadly.** For Tajikistan to improve the acquisition of cognitive, non-cognitive, and technical skills, it should take a multi-pronged approach dealing with all education tiers beginning from early childhood. Some of the key reforms to achieve significant improvements in learning outcomes are as follows: (i) increased coverage of quality early childhood education, (ii) equitable access to quality general education, especially through the implementation of the competency-based curriculum, (iii) improve the relevance of the vocational education training system, and (iv) renew the role of higher education in increasing the availability of relevant knowledge.

**A well-functioning health care system plays a critical role in furthering economic development and reducing poverty.** Examples include the contribution of ECD, especially nutrition, to academic performance; the reduction of "catastrophic expenditures" due to the out of pocket ("OOP") cost of treatment for major illnesses; or the impact of family planning on economic growth and improving household welfare by lowering dependency ratios. The Government can accelerate improvements in the health system by taking the following steps in the medium- to long-term: (i) national rollout of the basic benefit package and improvements in its composition and financing, (ii) Improve efficiency and equity of health financing, (iii) Improved allocation of funds to address key gaps, (iv) strengthening the health service delivery system, and (v) enhancing inter-sectoral solutions to improve nutrition status, especially among children and women, influence fertility preference, and strengthen family planning.



# 1 Introduction

1. **Landlocked and mountainous, Tajikistan has a young population of about 8.7 million and GNI per capita of US\$1,100 in 2016 (Atlas method) making it a lower-middle income country.** Though mountains cover 93 percent of its surface area, 34 percent of its land is agricultural and can be used for crops, orchards, and pastures. The country has additional endowments including rivers with hydropower potential and extractive mining, especially gold, silver, antimony and selected rare metals as well as mountain and eco-tourism sites. The country borders onto Afghanistan, China, the Kyrgyz Republic, and Uzbekistan, and is close to large markets in Central, East and South Asia and the Middle East.<sup>1</sup>

2. **In 2016, Tajikistan launched the National Development Strategy of the Republic of Tajikistan for the Period Up To 2030 (“NDS 2030”) laying out its masterplan of the country’s future economic development (Box 1).**<sup>2</sup> The NDS 2030 defines raising the population’s living standards as the ultimate goal of the country. The construction of the 3,600 MW Rogun Hydropower Plant (“HPP”) is the *de facto* centerpiece of the Strategy. Upon full commissioning, the Rogun HPP is envisaged to boost hydropower exports, and remove energy shortages that undermine business activity and social welfare today, contributing significantly to growth, government revenue, and hence poverty reduction.

3. **The objective of this report is to identify the most critical challenges and opportunities facing Tajikistan as it strives to raise the population’s living standards through the implementation of the NDS 2030.** The report draws upon extensive analyses carried out by the World Bank and by other institutions and researchers both within and outside of Tajikistan. Consultations were also conducted for the Systematic Country Diagnostic (“SCD”) and background inputs during February – May 2017 to solicit views of different stakeholders, and to help validate the main findings of the report (Annex 1). Specifically, the SCD will answer the following three questions: (i) what are the key constraints to achieving inclusive and sustainable growth as envisaged in the NDS 2030; (ii) what are the main risks; and (iii) what priority areas can Tajikistan focus on to have the largest impact on sustainable economic and social development?

4. **The SCD is organized into 7 chapters.** The next chapter discusses the country context to help lay the basis for understanding Tajikistan’s unique characteristics. Chapter 3 discusses the progress of the country to achieving the twin goals of poverty reduction and shared prosperity. Chapter 4 discusses the economic, social and environmental sustainability of Tajikistan’s achievement in the context of the NDS 2030. It finds that the under the status quo approach, including continued borrowing for the construction of the Rogun HPP, entails a number of risks and challenges, which, if not managed well, could threaten the country’s economic and social stability. Realizing the NDS 2030 goals—including the successful commissioning of the Rogun HPP and economic and social stability—requires a vibrant, healthy and competitive private sector that creates employment for the growing population. Chapter 5 discusses the challenges faced by Tajikistan’s private sector, and Chapter 6 covers the challenges and opportunities to harness employability of its population and discusses health, education and safety nets. The final chapter identifies three priority areas that Tajikistan can focus on to promote private sector activity: (i) macro-financial stability; (ii) strong public institutions; and (iii) strategic investment in key infrastructure and human capital. To institute effective policies and reforms for creating an enabling environment for private sector growth and delivering public goods and services to its population, Tajikistan needs to address its

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<sup>1</sup> In this report, China refers to People’s Republic of China.

<sup>2</sup> Republic of Tajikistan (2016a).

problems of governance. Without it, any efforts to raise income, including through electricity exports, will unlikely result in a sustainable economic and social prosperity in Tajikistan.

**Box 1: National Development Strategy 2016-30**

**In December 2016, the Government launched the National Development Strategy of the Republic of Tajikistan for the Period Up To 2030 (“NDS 2030”).** The NDS 2030 envisions a Tajikistan in 2030 that is “steadily growing, competitive country that provides decent living standards for population, equal opportunities for each person to realize his or her potential based on equality, justice and respect for human dignity”. The document identifies four areas that represent the broad objectives of the Strategy to improve the living standards of the population by 2030: (i) achieving energy security; (ii) improving transport and communication connectivity; (iii) improving food security and population’s access to good quality nutrition; and (iv) expanding productive employment. The construction of the 3,600MW Rogun Hydropower Project (“HPP”) is the *de facto* centerpiece of this development masterplan. The NDP 2030 will be implemented in three phases, each of which is underpinned by a 5-year medium-term development strategy.

**The NDS 2030 recognizes that past drivers of growth are not sustainable and suggests a new model based on increasing investment, export-promotion of import-substitution, which will allow for accelerated growth of manufacturing and exports, reduction of import dependence, and creation of employment opportunities.** A transition to this model will be accomplished through the completion of ongoing infrastructure projects as well as the successful implementation of structural reforms aimed at strengthening public administration, creating conditions for fair competition, eliminating unnecessary barriers for private sector development, reinforcing legislation for comprehensive protection of property rights, and improving the quality of vocational training. Together with the commissioning of the Rogun HPP, these reforms are expected to generate an average GDP growth rate of 6-7 percent a year, raising Tajikistan’s per capita income to levels comparable to those in upper middle-income countries. This will allow the country to expand formal sector employment, thereby halving poverty from its current level of 30 percent and eradicating extreme poverty by 2030.

**Importantly, the NDS 2030 is designed as a directive of implementation by the Government and as an indicative plan for the private sector,** reflecting the legacy of central planning. It is highlighted that the Strategy serves as guidepost that sets a large number of country-level quantitative targets, to which the sectoral and regional development reform efforts need to be directly aligned.

**While the NDS and MTDS both acknowledge candidly many of the problems the country is faced with, they suffer from a few weaknesses:** (i) absence of policy measures to achieve the many ambitious goals; (ii) weak prioritization; (iii) described monitoring and implementation arrangements; (iii) unrealistic financing envelope; and (iv) lack of coordination with other strategies. Full implementation of the NDS 2030 requires US\$118 billion (equivalent to 1,621 percent of 2017 GDP).<sup>3</sup> Of this amount, 46 percent is expected to come from the private sector, including foreign investors, and the remainder shared by the budget (48 percent) and development partners (6 percent). The NDS 2030 makes no attempt to link with existing strategies, such as the State Labor Market Development Strategy, National Disaster Risk Management Strategy, and Medium-term Fiscal Strategy (2017-20).

**Moreover, the Strategy reveals the Government’s priority to develop heavy industry, and pays limited attention to agriculture, which has critical importance for food security and employs more than half of the population in Tajikistan.** The document is silent about other most pressing issues such as banking distress and financially troubled state-owned enterprises (“SOEs”). Finally, the NDS 2030 presents no macroeconomic framework, and there is no attempt to analyze the macroeconomic impact of large investments envisaged in the NDS 2030.

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<sup>3</sup> Republic of Tajikistan (2016a).

## 2 Country Context

### 2.1 The Soviet Era

5. **Tajikistan's modern economic history begins with its integration into the USSR.** This followed decades of Russian influence beginning in the mid-1800s on Tajikistan's territory. In 1924, Tajikistan became an autonomous republic within the new Soviet republic of Uzbekistan and, in 1929, a full-fledged Soviet republic. Tajikistan, like all other republics in the Soviet Union, was officially a Soviet republic governed by the Tajik republican branch within the Communist Party of the Soviet Union in all organs of government, politics, and society. Although the Soviet constitution provisioned for self-rule in the republics, in practice autonomy was extremely limited—particularly in economic matters, which were controlled by the ministries located in Moscow. Meanwhile, subsidies from Russia made up at least 50 percent of the republic's budget. This central planning system gave rise to dependency, which stymied the development of domestic institutions with long-term consequences for the country.

6. **During the 70 years of centralized Soviet administration, the economy of Tajikistan was integrated into the centrally planned system.** For centuries, Central Asia was a bridge of inter-regional trade between Europe and East Asia, and North and South Asia, known as the Silk Road. During the Soviet era, like in other Central Asian republics, Tajikistan's economic development was oriented towards the needs of the USSR rather than the long-term prosperity of Tajikistan's population. All systems of trade, transport and energy were redirected towards Moscow, away from other regional neighbors. Eventually, Central Asia became isolated from the economic, cultural, and religious interaction with the rest of the world.<sup>4</sup>

7. **The Soviet system designated Tajikistan to specialize in cotton cultivation, taking advantage of the optimal climate conditions.** This resulted in a dramatic decline in staple crops and animal husbandry, creating a legacy of food insecurity—one of the most pressing challenges facing the country today. Large quantities of cereals, meat, and dairy products had to be imported for the rapidly growing population, along with most consumer goods, from other Soviet republics. Tajikistan's agriculture was largely collectivized. Villages and private farms were absorbed into collective farms, and a considerable number of inhabitants of mountain villages were resettled to work in the new collective farms. At the same time, the construction of an extensive network of irrigation canals improved cultivation techniques and a greater use of fertilizers and insecticides increased cotton yields, making Tajikistan the third largest cotton producer in the Soviet Union, after Uzbekistan and Turkmenistan. However, the cotton monoculture with its lack of crop rotation led to soil degradation, while the extensive use of chemical fertilizers led to the contamination of underground water and health problems.

8. **The boost to industrialization arrived in the 1960-70s, with the creation of the South Tajik Territorial Production Complex.** The utilization of the area's enormous hydropower potential formed the centerpiece of the design. As was the case of cotton specialization, the industrial complex was developed disregarded of local interests and production costs, and constituted part of "an economically implausible production chain".<sup>5</sup> Along with the 3,000 MW Nurek Hydropower Project ("HPP"), a number of large facilities were simultaneously installed, including the world's largest aluminum smelter, an electrochemical plant, a nitrogen-fertilizer plant, a cement plant as well as 46 other enterprises. These industries were energy-intensive and reliant on electricity generated by the Nurek HPP and supplemented

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<sup>4</sup> Ruslan (2014).

<sup>5</sup> The South Tajik Territorial Production Complex is referred to as an example of a failed endeavor from the economic, environmental, and technical points of view. See, for example, Rumer (1989) and Pomfret (1995).

by electricity imports through the Central Asia Power System in winter when Nurek HPP is idle.<sup>6</sup> The commissioning of the Nurek HPP also created possibilities of expanding irrigated agriculture. Most of the workers in industry were non-Tajik who were relocated from Russia and other Soviet republics. Similarly, capital and key raw materials, such as alumina for the aluminum smelter, were also imported from and exported to other republics by railways, the dominant mode of transport then.<sup>7</sup> Light industries in this time—including silk, carpets, leather goods and refrigerators—employed local Tajiks, relieving demographic pressures on the labor market to some extent. Despite the expansion of selected heavy industry, it operated largely as an enclave and the economy of Tajikistan remained primarily agricultural.

## 2.2 Independence and Civil War

9. **Tajikistan's independence after the collapse of the USSR in 1991 was immediately followed by political and economic instability.** Tajikistan entered a five-year civil war, which severely damaged the already weak economic infrastructure, and caused a sharp decline in Tajikistan's industrial and agricultural production. The civil war took as many as 100,000 lives, displaced up to 20 percent of the population inside and outside Tajikistan, and drove many of the country's best educated people out of the country (especially, ethnic Russians), resulting in a mass outflow of doctors, teachers and qualified production workers. Industrial output, most of which had arisen within a centralized command structure, was shut down. Collective farms were unattended, farm infrastructure was destroyed, and livestock and farm machinery were looted. The damage caused by the civil war was exacerbated by the disintegration of trade and economic ties with Russia and former Soviet republics. Tajikistan lost access to the free use of former federal infrastructure (electricity, transport) and considerable financial transfers from Moscow.

10. **An agreement signed by warring parties in 1997 led to an interlude of peace before effectively collapsing less than two decades later.** In 1997, a peace agreement was signed between the Government of President Rahmon, who came to power in 1992, and its major opponents. The power sharing agreement brought a few years of peaceful political competition. However, as frequently discussed in the literature, starting in 2000, Tajikistan gradually moved towards autocracy.<sup>8</sup> The ruling party began to consolidate its dominance over other political parties, primarily the Islamic Renaissance Party of Tajikistan ("IRPT"). By 2006, the Government decimated the leadership of the IRPT.<sup>9</sup> In 2015, Tajikistan's Supreme Court declared the IRPT a terrorist group, which led to banning all its activities and the imprisonment of most of its members. Thus, the last remaining opposition party was effectively eliminated; this was followed by a pronounced backsliding on democratic gains, especially in areas such as freedom of expression and religion, and other basic human rights. This occurred in the international context of growing movement of radicalization (especially, in the Middle East) and the rise of religious extremism in neighboring countries. As political consolidation intensifies, decisions within government are made by an increasingly smaller number of persons.

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<sup>6</sup> Hydropower generation capacity declines in winter months due to of low river flows. During the summer period, Tajikistan's surplus electricity was sold to other republics through the common grid.

<sup>7</sup> Tajikistan has no native aluminum ore. In the Soviet era, bauxite was shipped from Guinea to Ukraine, where it was transformed into alumina before being set to Tajikistan. The aluminum ingots produced in Tajikistan were then sent by train to Russia for processing (Pomfret 1995).

<sup>8</sup> See, for example, Pomfret (1995), Pomfret (2006), and Olcott (2012).

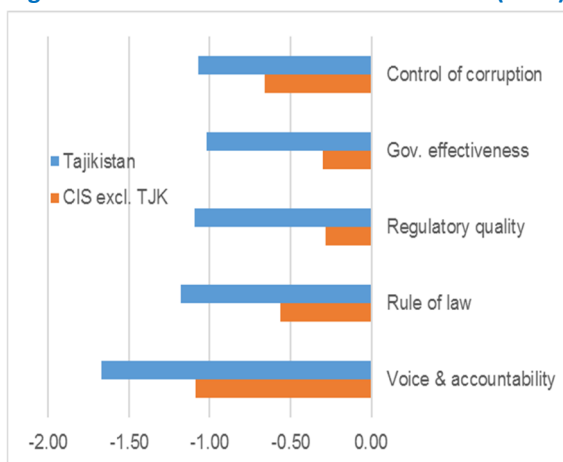
<sup>9</sup> See, for example, Olcott (2012) and Stronski (2016).

## 2.3 Weak Governance

11. **The civil war has severely disrupted the development of inclusive state institutions in Tajikistan.** While other former Soviet republics were on their way to making a reasonably successful transition, Tajikistan was unable to come to achieve a smooth transition from a centrally planned system towards a more market-oriented system in the immediate post-Soviet period. The brain drain during the civil war has no doubt had an impact on Tajikistan's transition process.

12. **Politics in Tajikistan is interwoven with patronage networks and personal loyalties.**<sup>10</sup> Tajikistan is not classified as an electoral democracy, and the country scored "7 (least free)" in Freedom Houses' rating for political rights in 2016.<sup>11</sup> Despite the presence of some democratic institutions, their effectiveness is low and instead executive, legislative and judicial powers are controlled by an elite minority.<sup>12</sup> Political developments over the last decade has restricted the role of impartial civil society organizations and their ability to voice concerns or issues of public interest. Non-governmental organizations ("NGOs") are essentially technical intermediaries to implement donor programs. Tajikistan's mass-media is predominantly state-controlled and the Government also occasionally blocks social network websites (e.g., Facebook, YouTube, and Twitter) to control the flow of information.<sup>13</sup>

**Figure 1: Worldwide Governance Indicators (2016)**



Source: World Bank.

Note: Scores range from -2.5 (very low) to 2.5 (very high).

13. **The lack of transparency, accountability, and limited checks and balances in the system have undermined governance and increased the perception—and most likely the prevalence—of corruption.**<sup>14</sup> Tajikistan scored below the Commonwealth of Independent States ("CIS") averages on the Transparency International (2016) and Worldwide Governance Indicators (2016) (Figure 1).<sup>15</sup> Despite donor-driven technical assistance aimed at modernizing legal and regulatory frameworks, the rule of law is weak. This adversely affects the population in obtaining independent justice services, enforcing contracts in the business activities, and preventing predatory practices by the Government. Amendments to the constitutions in May 2015 removed term limits for the presidency, lowered the eligibility age to become

president, and instituted a ban on forming parties based on religion. These changes followed the earlier approval of a bill that provided immunity from prosecution to the president and first family.

<sup>10</sup> U.S. Department of State (2016a).

<sup>11</sup> Political rights are based on a 1 (most free) to 7 (least free) scale.

<sup>12</sup> Bertelsmann Stiftung Transformation Index (2016).

<sup>13</sup> Freedom House (2017).

<sup>14</sup> In this SCD, "governance" refers to institutions, mechanism and practices through which power is exercised in the management of a country's economic and social resources and regulations (World Bank 1992). Corruption refers to the abuse of public office for private gain.

<sup>15</sup> The 2017 Freedom House Nations in Transit downgraded Tajikistan's score on corruption the last two years due to growing nepotism and corruption from small informal payments to the tightened control of state agencies (Freedom House 2017).

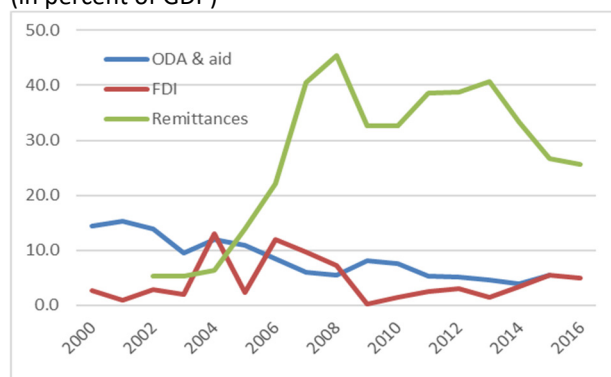
14. **Weak governance has had widespread consequences on the effectiveness and accountability of public institutions, civil trust, and legitimacy of the state.** Weak governance has contributed to the Government's difficulty in fulfilling its responsibilities to the population—possibly, reflecting an ineffective “social contract” between the state and its citizens. The tradition of governance aimed at providing public goods and services to the population or creating an environment conducive to sustainable growth has not fully developed. Instead, only limited investments in human capital and basic infrastructure, essential for productivity growth, have occurred leaving much of the population to find its own means of living. Economic decision-making appears to be heavily influenced by short-term interests and rent-seeking, in the absence of comprehensive public scrutiny. Key public economic assets as well as major private businesses in Tajikistan, from mining to banking, hydropower, and foreign trade, are believed to be controlled.<sup>16</sup>

15. **Eroding civil trust and declining state legitimacy are exacerbated by limited government responsiveness to local concerns.** Strong central control has disempowered local governments and communities, thereby failing to capitalize on local capabilities to support the flow of views from communities and households to the Government. A 2013 survey funded by USAID of 1,500 respondents across 15 *jamoats* appears to indicate, for example, that over half of respondents identified the lack of qualified public servants as the main obstacle to improving life in the community.<sup>17</sup> This research also identified the widespread existence of informal community organizations, such as *makhalla* and *gozars*, regarded as responsive and accountable to the needs of community members.

16. **The pursuit of protected economic power and the appropriation of assets has become more prevalent.** There have been reports of a growing tendency to appropriate private property seen as highly profitable or perceived to be in direct competition with protected business interests.<sup>18</sup> Despite some structural reforms, Tajikistan still lacks effective market institutions necessary to foster free and fair competition and promote private sector activity. The state retains direct and indirect controls in every major sector of the economy, leaving little space for the private sector to flourish and create jobs.

## 2.4 Migration, Remittance Dependence, and Consumption

**Figure 2: Net Foreign Financial Inflows**  
(in percent of GDP)



Source: World Bank.

17. **In this difficult environment, labor migration has become a key avenue for Tajikistan's citizens seeking a better life.** In the early 2000s, a growing number of young men began to leave mainly for Russia to seek employment opportunities.<sup>19</sup> Unlike the earlier wave of migration in the 1990s, those who began to leave the country in the 2000s are mostly seasonal laborers. They work from spring to autumn, often in construction, and return to Tajikistan in winter. It is estimated that between 600,000 to one million working-age men (and

<sup>16</sup> Bertelsmann Stiftung Transformation Index (2016).

<sup>17</sup> USAID (2013).

<sup>18</sup> U.S. Department of State (2016a).

<sup>19</sup> The agreement of labor migration signed by Tajikistan and Russia in 2004 also contributed to this process.



some women) leave the country every year, sending remittances to their families left behind.

18. **Over time, worker remittances have grown in importance as a source of growth and foreign exchange in Tajikistan.** In 2013, migrant transfers totaled more than US\$3.4 billion, equivalent to 40 percent of GDP, making Tajikistan one of the most remittance-dependent countries in the world, as measured as a proportion of GDP and relative to other sources of foreign exchange, such as foreign direct investment (“FDI”), official development assistance (“ODA”) and trade (Figure 2). The abundant inflows of remittances were mostly used for consumption, and did not translate into increased private investment, a common observation in many remittance-reliant countries.<sup>20</sup>

## 2.5 Changing Regional Relations

19. **Following the dissolution of the USSR, the economic and political relationship within the CIS countries has gradually changed.** Initially, their trade was heavily oriented towards CIS market because of the inherited supply links, currency, and infrastructure. However, over time, trade patterns have changed, as each country introduced new currency to replace the ruble, and established customs posts at crossing points of what had been inter-republic borders. Transit of goods across republics became more cumbersome, involving crossing several international borders and clearing customs requirements. There is also a political dimension. With independence, each head of now a new state sought ways to remain in power, identifying allies, and fighting potential opposition, resulting in increasing barriers to economic interchange within Central Asia. Despite a number of regional summits and formal agreements for free-trade or common economic space, the idea to strengthen regional economic cooperation within the CIS has made little practical progress.<sup>21</sup>

20. **While its relationship with neighboring Uzbekistan become strained in the years after independence, Tajikistan has developed a strong economic tie with China.** With resumption of the construction of the 3,600MW Rogun HPP—originally started in 1982 but was subsequently halted due to the dissolution of the USSR—political tension between Uzbekistan and Tajikistan has intensified over water use, resulting in the cut-off from the regional electricity grid, discontinuation of natural gas sales to Tajikistan, and a periodic closure of borders blocking Tajikistan’s main outlets and access to regional and global markets. Tajikistan had to face a serious economic consequence as discussed later in this report, although political tension began to ease considerably with a new administration in Uzbekistan (Box 2). In the meantime, China has emerged as an important player in the Tajik economy. Over the past 10 years, China has steadily increased its significance in the Tajik economy, and the bilateral tie is expected to strengthen further in the context of the Belt-Road Initiative.<sup>22</sup> Today, China is the main source of external borrowing, imports, and FDI. Reportedly, Chinese companies are already heavily involved in several key sectors, from extractives, cement, construction to agriculture sectors. As of end-2016, China was the largest creditor for Tajikistan, accounting for over half of public and publicly guaranteed debt.

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<sup>20</sup> See for example, Abdih, et al. (2012).

<sup>21</sup> Pomfret (2006).

<sup>22</sup> <http://english.gov.cn/beltAndRoad/>.

### Box 2: Recent Developments in the Tajikistan-Uzbekistan Relations

**Under the new administration of President Shavkat Mirziyoev, the two countries' relations have improved significantly.** On September 29, 2016, less than a month after President Karimov's death, Uzbekistan's Minister of Foreign Affairs, Abdulaziz Kamilov visited Tajikistan and met with Tajikistan's President Emomali Rahmon. Both sides expressed willingness to "reset" bilateral relations, signifying a new page of dialogue and cooperation between the two countries.

In April 2017, direct commercial flights between the two countries were resumed for the first time since 1992.

In January 2018, the visit by the Uzbek Prime Minister Abdulla Aripov led to two important agreements: mutual visa-free travel for stays of up to one month, and an agreement on sharing the Farkhad Dam on the Uzbek-Tajik border in northern Tajikistan.

On March 1, 2018, Uzbekistan and Tajikistan opened 10 new bordering crossings, which represented a significant mark of progress in relations between the two countries. The new transit points include one for railway connection, eight for both automobiles and people on foot and another just for foot passengers.

In March 2018, the Galaba-Amuzang railway section, which connects Uzbekistan and southern Tajikistan, was reopened for the first time since 2011.

During the March 9-10, 2018 visit of the President of Uzbekistan Mirziyayev, a package of nearly 30 documents covering a wide spectrum of sectors was signed. In a Joint Statement, both Presidents stressed the critical importance of open dialogue, mutual understanding, constructive cooperation,

In mid-March 2018, the visa free agreement came into force for both countries.

In April 2018, after 9 years of suspension, Tajik and Uzbek energy transmission lines were restored, Tajikistan started exporting electricity to Uzbekistan. Tajikistan has agreed to provide Uzbekistan with up to 1.5 billion kilowatt hours in 2018 at around \$0.02 per kilowatt hour.

In early April 2018 Uzbekistan resumed natural gas exports to Tajikistan, ending a six-year interruption. Under a deal reached in March during Mirziyayev's visit to Dushanbe, Uzbekistan has pledged to deliver 126 million cubic meters of gas for \$15.1 million in 2018.

## 3 Progress towards Twin Goals

21. **This chapter reviews Tajikistan's progress in reducing poverty and boosting shared prosperity, and summarizes the main drivers that have contributed to these trends.** To help illustrate the key challenges that the country faces as it strives to make progress, this chapter presents a brief overview of economic growth, a discussion of poverty, inequality, access to services and living standards of population. The discussion looks at past economic growth and household welfare. The focus of the second half of the chapter is on the micro-level, which will help to explain the macro-micro linkages and whether economic recovery observed in last decade translated into meaningful improvements in human capital and non-monetary aspects of population's welfare. This "bottom-up" analysis of livelihood challenges faced by households will inform the prioritization stage.



### 3.1 Trends and Drivers of Growth

#### *Tajikistan has grown rapidly...*

22. **Tajikistan exhibited rapid economic growth during the post-civil war period, more than doubling per capita real income (in local currency terms) between 1998 and 2016, according to official estimates.** In current US dollar terms, Tajikistan's GNI per capita stood at US\$1,100 (Atlas method) in 2016, compared with US\$180 in 1998.<sup>23</sup> Following a 51 percent economic contraction during 1992-97 owing to the disruptions associated with the collapse of the USSR and the civil war, macroeconomic and political stabilization were restored, facilitating a strong economic rebound. Growth performance in the run-up to the global financial crisis in 2008 was particularly brisk, albeit from a very low base. Official data suggest that during 1998-2008, the economy expanded by an average rate of 8 percent a year, whereas income per capita grew by 6 percent a year on average.

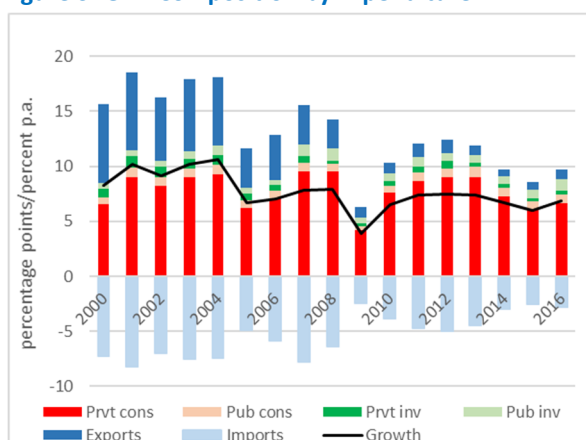
23. **The rapid economic expansion during the 2000s was driven mainly by a favorable external environment and buoyant foreign financial inflows, which allowed a rapid economic recovery after the significant output loss of the 1990s.** While ODA financed public investment facilitated post-war reconstruction, Tajikistan's growth was driven mainly by sharp increases in private consumption, supported by accelerated inflows of remittance on the back of strong regional growth (Figure 3). The rising international prices of, and external demand for, unwrought aluminum and raw cotton (which together accounted for over 65 percent of total exports in the 2000s), and recovery in capacity utilization also fueled Tajikistan's growth. Gross capital investment, undertaken mostly by the state, has played a smaller role in the country's output expansion until recently.

24. **The pace of economic expansion has slowed slightly since 2009, but still averaged 6.5 percent a year (official source).** Over the past decade, the Tajik economy experienced two major external shocks, in 2009 and 2014, both of which led to a sharp fall in remittance inflows and prices of and demand for aluminum and cotton, its main export commodities. While Tajikistan weathered the global financial crisis relatively well, thanks to the strong rebound of remittances and commodity prices as well as increased support from the development partners, its economic recovery was short-lived. The second shock wave that began in late 2014—a dramatic fall in cotton and aluminum prices and sharp declines in remittances due to Russia's recession—have proved to be more long-lasting, considerably depressing private consumption, Tajikistan's main growth driver (Figure 4). Tighter restrictions of labor migrants by Russia may have also contributed partially to the decline in remittances. Yet overall growth remained robust, as the domestic demand composition changed—this time to be supported by a large increase in public investment, which stimulated the industry and construction sectors and compensated partially for the decline in private consumption. The bulk of these investment projects were financed by Chinese loans.

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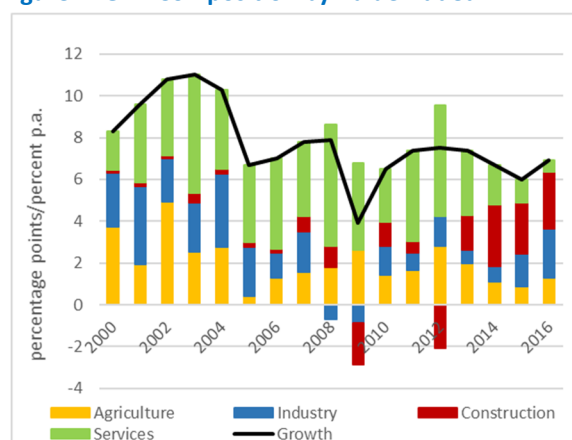
<sup>23</sup> WDI database.

Figure 3: GDP Composition by Expenditure



Source: WEO.

Figure 4: GDP Composition by Value Added



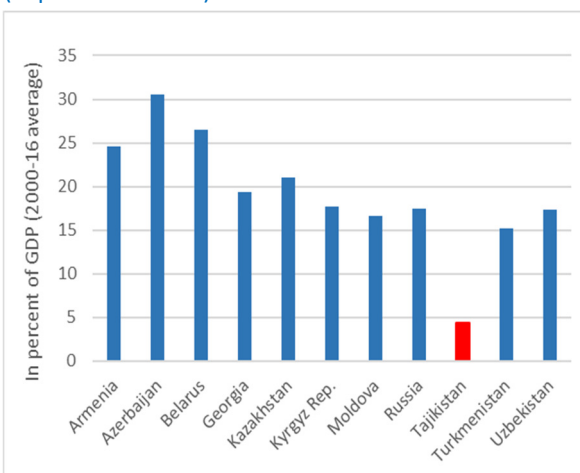
Source: World Bank staff estimates.

*... but structural transformation has lagged....*

25. **Tajikistan's economy has not achieved the level of structural transformation as some of the other former USSR countries.** The state retains direct and indirect controls in every major sector of the economy, through its ownership of large Soviet-era enterprises. SOEs are active in a wide range sectors of the economy, from energy, metal manufacturing, food processing, agricultural, construction, services, transport, finance, to information and communication. At the beginning of 2015, there were 898 SOEs, of which 797 were wholly owned by Government.<sup>24</sup> While many of these SOEs are small- and medium-sized enterprises, there are 24 large SOEs that dominate the energy, transport, water resources, and heavy industry sectors. As of end-2015, the total assets of the 24 large SOEs were estimated at 51 percent of GDP (35 percent excluding current assets such as receivables).<sup>25</sup>

26. **In sharp contrast, the private sector remains underdeveloped, and has played a limited role in the economy.**<sup>26</sup> Very few new businesses are created each year compared with other countries in the region. Existing private firms are mostly small, and do not grow to their full potential across the firm life-cycle, while the informal sector of the economy is reportedly large

Figure 5: Private Investment (in percent of GDP)



Source: WDI.

<sup>24</sup> Republic of Tajikistan (2016b).

<sup>25</sup> Republic of Tajikistan (2015).

<sup>26</sup> Research shows that the amount and diversity of this knowledge embedded in a society, "capabilities," explains the enormous income gap between rich and poor nations. Countries do not simply make the products and services they need. They make the ones they can with the knowledge they possess (Hausman, et al., 2013).

and growing.<sup>27,28</sup> Formal employment in the private sector represents 13 percent of total employment.<sup>29</sup> Gross fixed capital formation by the private sector has averaged only 4.4 percent of GDP since 2000, well below the CIS average investment rate of 21 percent (Figure 5). Years of insufficient investment have prevented the private sector from building its productive capabilities and, in turn, from contributing to economic diversification.

*... and the economic base is narrow.*

**27. Tajikistan has a narrow economic base and has made limited progress in expanding its productive capabilities.** The country's exports composition has remained largely unchanged for the past two decades, dominated by a few commodities (particularly raw aluminum, metals, and unprocessed cotton).<sup>30</sup> Heavy industry from the Soviet era has largely waned, once the inter-republic supply system broke down. With the disintegration of the USSR, Tajikistan lost access to raw materials, year-round supply of electricity, and captive markets. This, combined with obsolete production technology, aging equipment, and the lack of skilled workers, put Tajikistan's heavy industry at great disadvantage in international markets.<sup>31</sup> While the state-owned aluminum smelter—Tajikistan Aluminum Company ("TALCO")—has survived as a prime earner of foreign exchange, the output level, quality and profitability of aluminum production have reportedly fallen considerably.<sup>32</sup> The collapse of the inter-republic energy trade and permanent closure of one of the rail lines to Tajikistan by Uzbekistan in 2011 has also exacerbated the situation by creating an acute energy shortage during winter and hindering transit of Tajik products in and out of the country, respectively.<sup>33</sup> Traditional light industries that fit Tajikistan's comparative advantage (knitwear, shoes, cotton and silk fabric production) have virtually disappeared during the 2000s, but this did not result in the creation of new industry. In contrast, agriculture—where formal private sector firms operate mainly—has regained its strength, steadily growing since the end of the civil war. Yet productivity remains below its potential, and the agricultural sector has been unable to keep pace with rapid population growth. Consequently, remittance-fueled robust consumption demand has been met by growing imports of consumer goods and food (grains, processed food stuffs and livestock products), significantly contributing to growth of the service sector, which was underdeveloped during the Soviet economy and is almost entirely privatized. Further analysis of sectoral growth contribution and hence Tajikistan's economic transition process is hampered by serious data limitations as discussed in Box 3.

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<sup>27</sup> About 70 percent of registered private firms in Tajikistan have fewer than 10 employees (Strokova and Ajwad 2017).

<sup>28</sup> The share of wage employees in the informal sector increased from 28 percent to 39 percent between 2007 and 2013 (Strokova and Ajwad 2017). Bertelsmann Stiftung Transformation Index (2016) estimates that the informal sector constitutes about a third of GDP and provides employment to more than 40 percent of the working population.

<sup>29</sup> Strokova and Ajwad (2017).

<sup>30</sup> Roster and Cader (2016).

<sup>31</sup> Energy shortages have become particularly acute since 2009 when energy trade with neighboring countries through the Central Asia Power System ("CAPS") stopped. See Chapter 5.1.4 for further information.

<sup>32</sup> Olcott (2012). Details of the aluminum industry is a state secret.

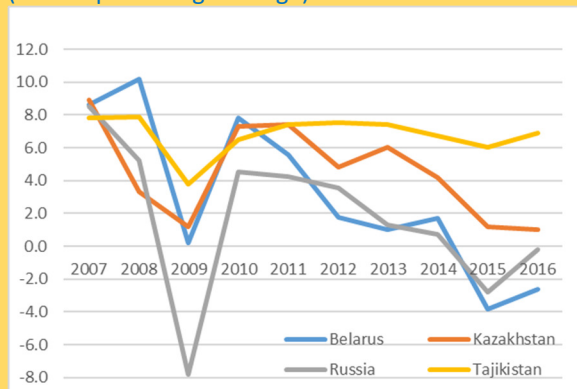
<sup>33</sup> Since 2009, the system has been affected by temporary railway closures, with permanent closures of the southern connection with Uzbekistan since 2011 (World Bank 2016b).

### Box 3: Tajikistan Official Statistics

Access to and reliability of official statistics have represented a serious challenge for the preparation of the SCD. While the Statistical Agency under President of the Republic of Tajikistan has a well-functioning website, basic economic indicators such as the components of national accounts in constant prices are not available. Published data are often partial and outdated, and there are serious concerns about data quality and coverage, limiting the scope of the analysis and qualifying its conclusions.

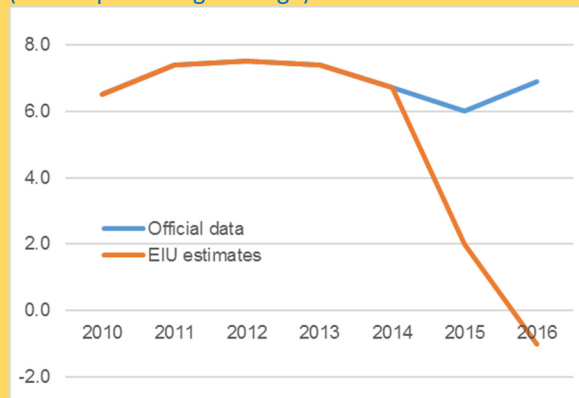
The reliability of official GDP data is open to question among analysts. There are views that the spillovers from the recent Russian recession are not adequately reflected in national accounts data, even if one takes into account the fiscal expansion. The disparity between the official economic performance of Tajikistan and its neighboring countries with a strong economic linkage with Russia, such as Belarus, is rather implausible (Figure 6).<sup>34</sup> For this reason, independent analysis, such as those in the Economic Intelligence Unit (“EIU”), began to publish growth estimates that differ significantly from the official statistics from 2015, when the full impact of the Russian spillover started to affect other economic indicators (Figure 7).

**Figure 6: GDP Growth**  
(annual percentage change)



Source: World Bank.

**Figure 7: Tajikistan: GDP Growth**  
(annual percentage change)



Sources: World Bank and EIU.

For instance, the growth accounting exercise using official data produces puzzling results and highlights the need for at most caution in interpreting analysis due to Tajikistan’s data deficiencies. Growth accounting analysis shows that a significant part of Tajikistan’s rapid growth since 2000 was driven by large residuals that cannot be explained by factors of production, capital and labor (Figure 8). These residuals, termed total factor productivity (“TFP”) growth, indicate that Tajikistan’s rapid growth has been driven primarily by sharp productivity growth from efficiency gains. While an increase in the labor force has played a small role, capital accumulation has made a negligible or even a negative contribution.

Growth driven by large efficiency gains is common among transition economies in the early phase of structural changes, which entailed resource reallocation to more productive sectors of the economy and increased market contestability (creative destruction). However, over time in these countries, capital accumulation grew to account for a larger component of output expansion and TFP growth slowed, as productivity gains from the transition wore off.<sup>35</sup>

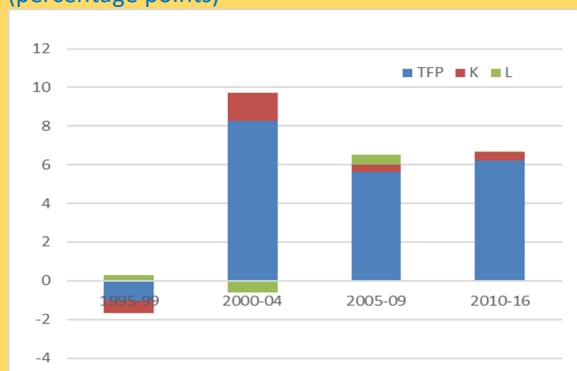
There is no reason to doubt that Tajikistan’s growth was rapid in the aftermath of the civil war, driven by TFP growth and capital accumulation related to post-war reconstruction, although some view that serious mismeasurement of GDP and GNI may have exaggerated the economy’s initial decline and confused the picture with respect to its subsequent recovery. Moreover, the unusually large, sustained TFP growth rates of over 5 percent in the subsequent periods are difficult to explain. For instance, the analysis using official data suggests

<sup>34</sup> Alturki, et al. (2009) find that a one standard deviation shock to the Russian economy (about 2 percent) lowers GDP growth of Belarus, Kazakhstan and Tajikistan by 0.6 percent, 1.7 percent, and 2 percent, respectively.

<sup>35</sup> Gill, et al. (2014).

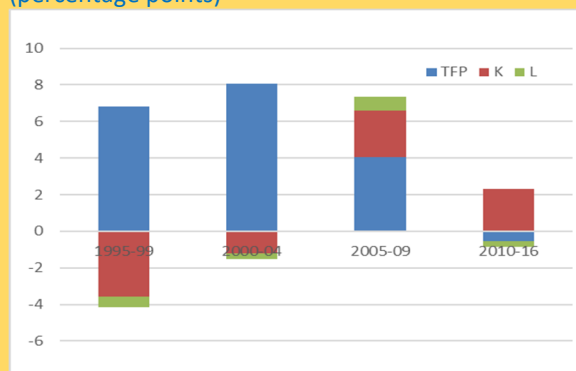
that over 90 percent of Tajikistan’s growth during 2010-16 was led by productivity growth alone, but this is rather contradictory to the economic condition portrayed by other official data and qualitative information discussed in this report. Growth accounting analysis for Belarus—whose growth has been fueled mostly by growth in private consumption—shows a gradual decline of TFP growth as economic transformation has taken place (Figure 9). Productivity decomposition for individual industries is hampered in the absence of components of national accounts.

**Figure 8: Tajikistan: Growth Accounting**  
(percentage points)



Source: Staff calculation based on Total Economy Database by Conference Board.

**Figure 9: Belarus: Growth Accounting**  
(percentage points)



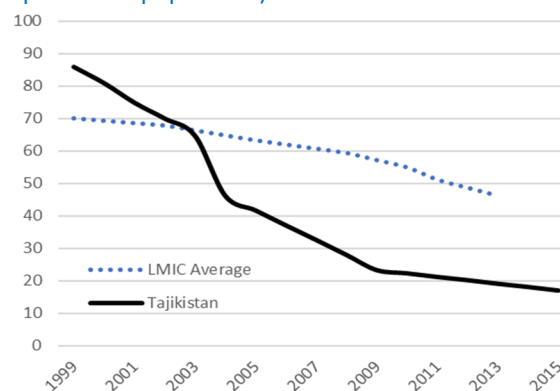
Source: Staff calculation based on Total Economy Database by Conference Board.

## 3.2 Trends and Drivers of Poverty Reduction and Shared Prosperity

### 3.2.1 Monetary Poverty Reduction

28. **Tajikistan has achieved rapid poverty reduction over the past two decades.**<sup>36</sup> Tajikistan’s extreme poverty, measured by the international poverty line of US\$1.90 a day (PPP 2011), fell markedly from 54 percent in 1999 to 5 percent in 2015. The country’s poverty reduction is equally significant when measured by the (higher) international poverty line for lower middle-income countries (“LMICs”) of US\$3.10 per day. In 2015, 17 percent of its population lived in poverty, compared with 86 percent in 1999.<sup>37</sup> Tajikistan has performed much better in terms of poverty reduction than other LMICs for over a decade (Figure 10).

**Figure 10: Poverty Headcount Ratio**  
(in percent of population)



Source: WDI. Household data available for selected years and intermediate rates are interpolated. The poverty line used is US\$3.10 (PPP 2011).

<sup>36</sup> There are several ways to measure the population’s wellbeing—and the choice of measure depends upon the purpose. One measure used by the World Bank to compare extreme poverty across countries is the extreme poverty line (US\$1.90 in 2011 PPP). Many countries, including Tajikistan, develop their own poverty line to track progress over time. National poverty lines are usually more applicable to the country’s own circumstances as they identify the minimum acceptable standard of living given societal norms.

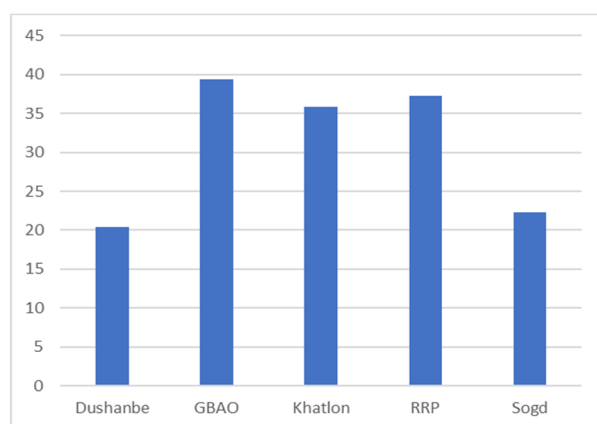
<sup>37</sup> While the household surveys in 1999 and 2015 are not fully comparable, they provide the best source of information on comparing consumption in Tajikistan. The government household surveys were conducted over a shorter span of 2013-16. Though these are fully comparable with each other, the period of coverage is much shorter.

According to the Government's own calculations using a national poverty based on country norms, poverty in 2016 stood at 31 percent.<sup>38</sup>

29. **Nevertheless, Tajikistan's poverty remains high, and the pace of poverty reduction has slowed recently.** The sharp poverty decline during 1999-2003 may have been due to a rebound in normal economic activity following the end of civil war. The following years of the decade saw a sharp increase in migration and economic growth. The data reveal that this period of rapid poverty reduction has been followed by stagnation. Beginning in 2014, the economic slowdown in the region began to affect the welfare of Tajikistan's migrants and their households. Poverty declined modestly from 34 percent to 30 percent in 2013-16 using the national poverty line.

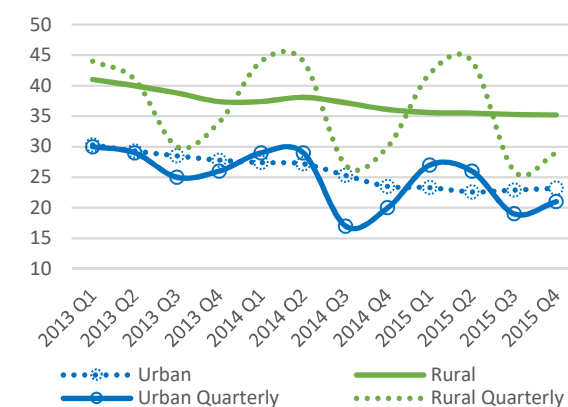
30. **There is substantial spatial and temporal variation in poverty, and rural areas remain significantly poorer than urban areas.** Similar to other countries, poverty rates vary significantly across Tajikistan spatially. As an economy with a large rural population, seasonality of incomes is also common and affects the level of poverty significantly in the country. This spatial and temporal variation reflects many factors—such as food production, wages, employment opportunities, remittances, local prices, social norms (e.g., whether women work and household size), and social assistance. In Tajikistan, using the national poverty line, rural and urban poverty rates are 35 percent and 23 percent respectively in 2015. Most of the poor live in rural areas (80 percent) reflecting not only the population distribution, but also the higher incidence of rural poverty. At the provincial level, poverty rates also vary greatly as seen in Figure 11 but also across districts (see Annex 4 for the poverty map). In terms of seasonality of poverty, variations are especially driven by the relatively harsh conditions and the cyclical nature of economic activity in the country. In 2015, quarterly poverty rates varied by about 8 percentage points in urban areas and 16 percentage points for rural areas; thus, the number of people in living in poverty increases by almost 1.2 million (13 percent of the population) during the winter months.<sup>39</sup>

**Figure 11: Regional Poverty Rates**  
(in percent of *oblast* population)



Sources: HBS 2013-15 and Agency of Statistics.

**Figure 12: Seasonal and Annual Poverty Rates in Urban and Rural Areas**  
(in percent of population)



Sources: HBS 2013-15 and Agency of Statistics.

31. **Thus, unsurprisingly, a significant share of the population remains vulnerable to falling below the poverty line.** This is not only due to households residing close to the poverty line where small changes

<sup>38</sup> The Government follows international best practice in poverty estimation methodology beginning with data from end-2012. It is presently upgrading the national household survey and sampling methodology to further improve the quality of the underlying data, including its representativeness at the national level.

<sup>39</sup> World Bank (2017c).

in income can have large consequences, but also their exposure to economic shocks. Tajikistan's population faces many risks ranging from weather (adversely impacting harvests or mobility), loss of job opportunities abroad, to slowing economic growth—all of which increase food insecurity.<sup>40</sup> Households are vulnerable to monetary and non-monetary risks, and lack the means to insure themselves against exposure to shocks or find alternative means of sustenance whether in the domestic labor market or through safety nets. This vulnerability to poverty is a reality for over half of the population who lived in poverty for at least one quarter of the year. Consequently, many households are food insecure and during periods of inadequate income or farm production, these families cannot fulfill their caloric and micronutrient needs resulting in such problems as illness, stunting, and undernutrition.

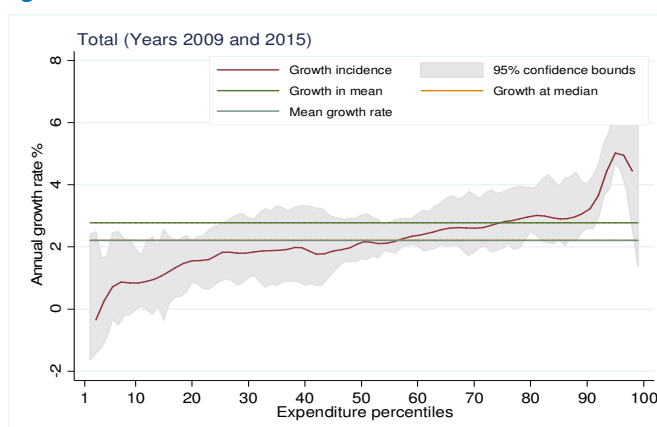
**32. Aside from location, household size and the share of employable adults in the household play an important role in explaining poverty as does relatively lower levels of education.** Poor households in Tajikistan are substantially larger (and have more dependent members) than non-poor households. Poor households have on average 8.0 persons compared to 5.9 persons in non-poor households.<sup>41</sup> With a high birth rate and moderate life expectancy, the dependency ratio in Tajikistan is mostly driven by a large number of children, rather than by the share of elderly members.<sup>42</sup> Female-headed households are slightly more common among the non-poor than among poor households.<sup>43</sup> Other variables such as education play a more complex role in explaining poverty. Most adults in Tajikistan have completed basic school education, thus, there is little variation across income groups. However, access to tertiary education is much lower compared to secondary education, both now as well as historically (i.e., during the Soviet era and post-independence). Women, in particular, lag behind men in terms of admissions to universities. Tertiary education is more prevalent among affluent households: 15 percent and 25 percent of adults living in poor and nonpoor households had tertiary education in 2015.<sup>44</sup>

Female-headed households are slightly more common among the non-poor than among poor households.<sup>43</sup> Other variables such as education play a more complex role in explaining poverty. Most adults in Tajikistan have completed basic school education, thus, there is little variation across income groups. However, access to tertiary education is much lower compared to secondary education, both now as well as historically (i.e., during the Soviet era and post-independence). Women, in particular, lag behind men in terms of admissions to universities. Tertiary education is more prevalent among affluent households: 15 percent and 25 percent of adults living in poor and nonpoor households had tertiary education in 2015.<sup>44</sup>

*Though prosperity was widely shared, inequality is rising.*

**33. During 2009-15, consumption per capita increased for all population groups, including the bottom 40 percent, indicating that prosperity was shared widely.**<sup>45</sup> While household survey data captured the overall improvements in welfare and reduction in poverty rates, annualized consumption growth of the bottom 40 has been slower compared to the top 60 percent of the population during 2009-

**Figure 13: Growth Incidence Curve**



Source: World Bank calculations based on Tajikistan Living Standards Survey (TLSS) 2009 and Proxy Means Testing (PMT) 2015.

<sup>40</sup> Food insecurity is defined as not having reliable access to sufficient quantity of affordable, nutritious food.

<sup>41</sup> The poverty estimates reported here are as estimated in per capita terms, which may underestimate economies of scale in consumption, and differing needs relating to age.

<sup>42</sup> Life expectancy is 69.8 years at birth in 2015, placing Tajikistan in 115<sup>th</sup> place among all countries.

<sup>43</sup> Female-headed household prevalence is in large part due to male migration to Russia. Households headed by women are equally likely to receive remittances compared to male-headed households.

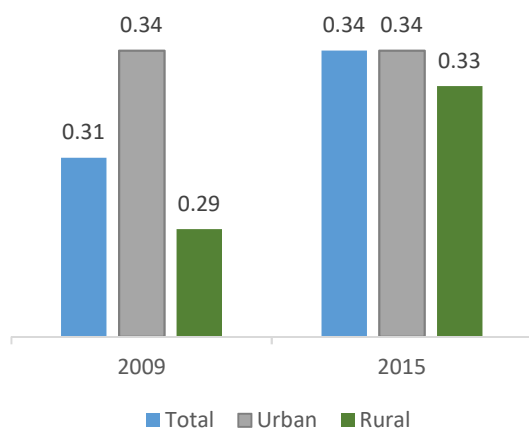
<sup>44</sup> World Bank (2017h).

<sup>45</sup> Consumption is used as a proxy for income.



15 at 1.5 percent and 3.4 percent per year respectively.<sup>46</sup> Moreover, the growth of consumption was higher in urban areas compared to rural areas, 4.5 percent per annum vs. 2.3 percent. The bottom 40 in rural areas experienced the least growth in consumption of just 0.8 percent. The slowdown of income growth for the bottom 40 overlaps with period of reduction in flow of remittances following global financial crisis of 2009 and slowdown in the migrant hosting economies in 2014.<sup>47</sup>

**Figure 14: Gini Coefficients, 2009 and 2015**



Sources: World Bank estimates based on TLSS 2009 and PMT 2015.

34. **While inequality is moderate in Tajikistan, it increased during 2009-2015.** Inequality in Tajikistan is higher than in the CIS, as measured by the Gini coefficient, though moderate by international standards. However, frequently, it is not the actual level of inequality that matters, but the perceived level—and whether citizens believe that they have opportunities to improve their living standards. Inequality increased in Tajikistan based on consumption growth patterns between 2009 and 2015. The Gini coefficient (based on consumption) increased from 0.31 in 2009 to 0.34 in 2015. The increase was largely due to the rise in inequality in rural areas, from 0.29 to 0.33 during 2009-2015, while urban inequality as measured by the Gini coefficient remained constant at 0.34. Even when using an alternative measure of inequality—

the ratio of the mean consumption of the top to the bottom quintile, it too shows a moderate increase during 2009-15 in urban (5.2 to 5.6) and especially in rural areas (4.5 to 5.6). Both measures show convergence in inequality between urban and rural areas—due to worsening rural inequality.

#### *Labor earnings and remittances were important drivers of poverty reduction.*

35. **Labor earnings have been the main factor in poverty reduction in the context of large remittance inflows.** Labor earnings and remittances were the main driving forces behind poverty reduction during 2003-09. About two-thirds of the decline in poverty was due to higher labor earnings followed by remittances that contributed about one-fifth to poverty decline. These results are not surprising given the importance of labor earnings in the total income of households and the real growth of labor earnings, pensions and remittances during 2003-09. Other factors such as pensions and social assistance were also factors in poverty reduction but to a minimal extent.<sup>48</sup> The drivers of poverty reduction differed across urban and rural areas. Labor market gains were more beneficial for urban rather than rural residents. New employment opportunities did not play any role in poverty reduction in rural areas and the role of labor earnings was higher in urban areas compared to rural ones. In contrast, remittances played a more important role for rural residents (Figure 15).

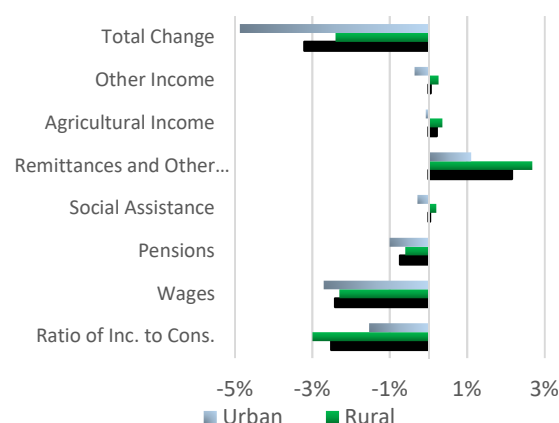
<sup>46</sup> Based on consumption data from the 2009 TLSS and 2015 PMT surveys.

<sup>47</sup> “The share of households receiving any remittances between 2013 and 2015 declined for poor and non-poor households alike, but the decline was greater among poor households (5.8 percent) than non-poor households (4.4 percent).” (World Bank 2017h).

<sup>48</sup> Azevedo, et. al (2013).

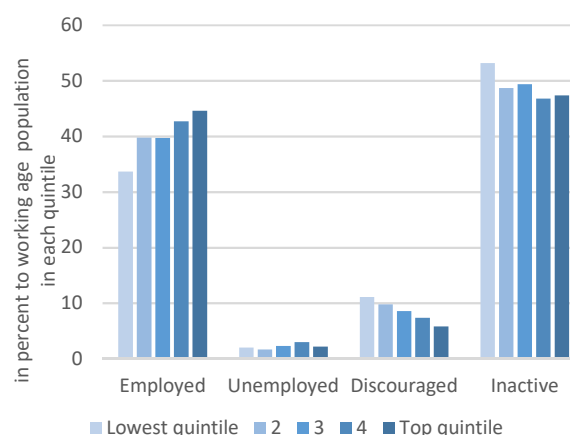


**Figure 15: Decomposition of Poverty Changes, 2013-15**



Source: World Bank staff calculations based on the household budget survey (“HBS”) 2013-2015.  
Note: “Ratio of Inc. to Cons.” stands for the ratio of income to consumption.

**Figure 16: Labor Market Status by Consumption Quintiles, Ages 15-64 Years**



Source: Strokova and Ajwad (2017).

36. **During the years of falling remittances between 2013-15, poverty reduction was due to the increase in labor earnings and pensions.**<sup>49</sup> At the national level, remittances decreased but labor earnings grew over the period, both in urban and rural areas. Yet even with falling remittances, about half of poor households still received remittance income indicating their dependence on this type of transfer. The ratio of income to consumption also drove a substantial portion of the change in poverty potentially dissaving or the growing importance of consumption from own production, which is a more commonly found in rural areas.<sup>50</sup> Social assistance played a negligible role, indicative to the relatively small formal safety net in Tajikistan—one that is currently being developed. However, declining agricultural income adversely impacted rural incomes.

*... but there are relatively few jobs and the poor are disadvantaged in the labor market.*

37. **Tajikistan’s economy is characterized by low levels of employment.** The share of adults who are either out of the labor force or unemployed exceeds those who have a job as seen in Figure 16. This is especially true for the poor. Labor force participation has been falling in Tajikistan due to women exiting the labor market after independence as well as remittances driving up the domestic reservation wage for workers.<sup>51</sup> The lack of domestic jobs represents a serious constraint to expanding welfare gains. The economy added fewer than 500,000 jobs during 2003-13. During this period, employment expanded by an estimated 2.1 percent per year implying an average employment to growth elasticity of around 0.3, which is similar to the averages for the Europe and Central Asia (“ECA”) region and LMICs. In Tajikistan, this elasticity decreased sharply in recent years, from 0.33 in 2000-09 to just 0.13 in 2010-14, further exacerbating the lack of domestic job creation in recent years.<sup>52</sup>

<sup>49</sup> World Bank (2017a).

<sup>50</sup> Another factor behind the importance of the ratio of income to consumption is the divergence between reported income and consumption due to households’ reluctance to fully report income.

<sup>51</sup> Empirical analysis by Abdulloev, et al. (2014) shows that women’s labor participation is correlated negatively with the presence of a migrant family member and women’s level of education.

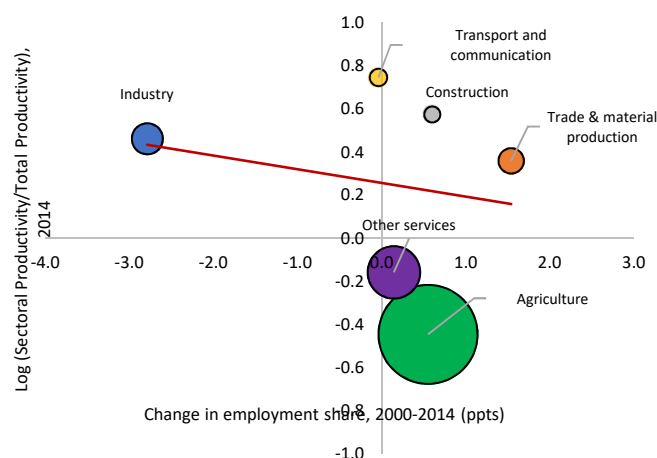
<sup>52</sup> Strokova and Ajwad (2017).

38. **The youth appear to have especially low levels of employment which may lead to disenfranchisement.** Tajikistan has a large proportion of young and formally educated men and women who are at the cusp of entering the labor market. An estimated 20 percent of the population is between the ages of 15-24 years and another 10 percent are 25-29 years old. However, around 41 percent of the youth are inactive which raises social concerns of their disenfranchisement and economic concerns of capacity underutilization. Employment rates for youth are 25 percentage points lower than for the total population. Overall, more than 54 percent of females and 27 percent of males of ages 15-24 are not studying and not working. The social and economic costs of a country having a large share of idle youth can be significant. The longer people stay out of the labor force, the more likely is their human capital to deteriorate. As importantly, youth inactivity might be persistent, leading to lower probability of being employed in the later stages of the life cycle and, thus, trapping individuals in poverty.

39. **There are relatively few “good” jobs available to the workforce due to the small size of the formal sector.** “Good” jobs are defined as those that offer some job security and benefits, such as leave with pay, pensions, and social insurance. Many formal sector jobs were lost during the early 2000’s due to the decline in industry; the share of industrial workers fell from 6 to 4 percent of total employment—which constituted a loss of about 25,000 jobs. Those who lost their jobs but still needed to work, migrated or moved to less productive jobs in agriculture or the informal sector. Most new jobs created were in agriculture indicative of the large rural population, but also meant that many new jobs—whether in agriculture or services—were in the informal sector. Thus, most private sector demand is for informal labor and providing only temporary or seasonal employment with no benefits—even when wages may be comparable.<sup>53</sup> Informal employment constitutes about 31 percent of total employment. The most desirable jobs in Tajikistan are in the public sector given their security and benefits. About 28 percent of the employed work in the public sector, of which half are in SOEs.<sup>54</sup> Yet these jobs benefit mostly the better educated and are not accessible to the bottom 40.

40. **Women have lower labor force participation rates in Tajikistan compared to men.** Over the past decade, women’s labor force participation has declined from 46 percent to 27 percent in 2003-2013. Men’s participation rates are much higher at 63 percent. There are multiple factors that impact women’s ability to participate in the labor market. Some of the main impediments to participation are the lack of affordable quality childcare, lack of education and marketable skills, and wage discrimination. Other factors that may have had an impact on labor force participation are increased remittances and fewer employment opportunities.

Figure 17: Job Creation by Sector, 2000-14



Source: Strokova and Ajwad (2017).

41. **Most jobs were created in low productivity sectors.** Since GDP growth outpaced employment growth, this means that *de facto* labor productivity—or at least, value added per work—increased

<sup>53</sup> Arabsheibani and Staneva (2012).

<sup>54</sup> Strokova and Ajwad (2017).

significantly by 5.3 percent per annum during 2000-14 (Figure 17).<sup>55</sup> This was true across the board in all sectors, but the subsectors which saw the highest productivity increases were construction and transport and communications at 14 and 13 percent per annum, respectively. Agriculture value added per worker grew at a relatively more modest pace of 4.6 percent annually.

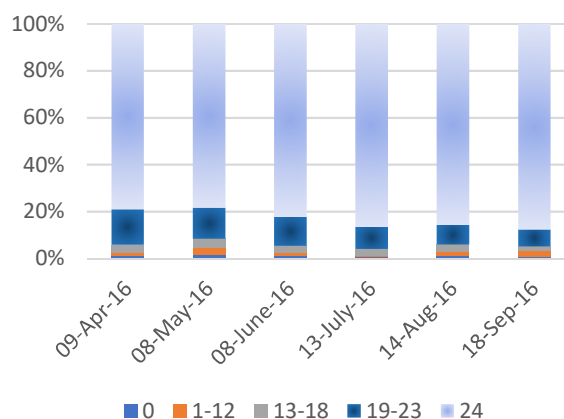
### 3.2.2 Non-monetary Poverty

42. **In contrast to the decline in poverty reduction, Tajikistan has done less well in improving the quality and accessibility of public goods and services.** An important measure of the quality of economic growth is the extent to which it successfully improves the lives of the population. Tajikistan's multidimensional poverty index ("MPI") indicates that non-monetary deprivations in the country are widespread.<sup>56</sup> According to the 2016 Life in Transition Survey ("LITS"), less than 50 percent of respondents in Tajikistan are satisfied with the quality of key public services such as electricity, water, heating, and roads.<sup>57</sup> For example, market accessibility mapping highlights the lack of infrastructure integration outside of the largest cities commonly found in predominantly rural lower-middle income countries.<sup>58</sup> In general, while living conditions are generally difficult in Tajikistan, variations exist across income groups and geographical regions. There are expected disparities in access to infrastructure services between urban and rural areas; however, within urban-rural areas, there are differences among poor and affluent households and between men and women (e.g., educational attainment).<sup>59</sup>

*Inadequate access to energy and clean water has life-threatening impacts on households.*

43. **Though access to electricity is universal and low by international standards, consistency of energy supply is a problem, especially in the winter months.** Thus, households turn to alternative sources of energy such as wood for heating and cooking, which has negative implications for air quality, health, and environmental sustainability. As of 2014, the bottom two quintiles of rural households were estimated to spend 24 and 19 percent of their disposable income on electricity during the winter heating season (while urban households were often less burdened). This is substantially above the 10 percent benchmark, which is often used to define "energy poverty". Satisfaction with electricity provision in rural areas is low. Tajikistan also suffers from a large divergence in satisfaction between urban and rural areas (83 percent vs. 34 percent).<sup>60</sup>

**Figure 18: Hours of Electricity Per Day**



Source: Listening to Tajikistan Survey, World Bank.

<sup>55</sup> Strokova and Ajwad (2017).

<sup>56</sup> The MPI complements official poverty estimates by measuring social welfare by three dimensions: demographic and labor, education, and services and infrastructure.

<sup>57</sup> <http://litsonline-ebrd.com/countries/tajikistan/>

<sup>58</sup> World Bank (2017b).

<sup>59</sup> Also in 2012, based on Demographic and Health Survey the internationally comparable multidimensional poverty index has been calculated, which indicated that more than 13 percent of population were multidimensionally poor. MPI uses 10 indicators across 3 domains: education, health and living standards.

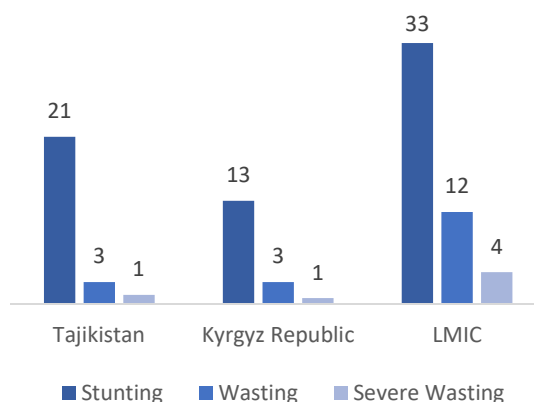
<sup>60</sup> Source: LITS (2016).

44. **Access to piped drinking water is among the most unequally distributed services in Tajikistan.** During 2000-16, the proportion of households using “improved/basic water” sources increased from 55 percent to 74 percent.<sup>61</sup> Women and girls are disproportionately responsible for collecting water which reduces time for education and economic activities outside the home.<sup>62</sup> Conditions have been slowly improving in rural areas, where access to improved or basic water sources increased mainly due to replacement of surface water by water from public standpipes and neighbors as the main water source. Yet despite this progress, Tajikistan has the second lowest share of households in ECA with access to tap water, and rural areas are particularly under-served. One-quarter of households do not have access to sufficient quantities of water when needed. About 26 percent of rural households have access to tap water in 2016, in comparison to 88 percent in urban areas.<sup>63</sup> Yet even households with access to piped water suffer outages that last 3-4 hours at a time. Households without access to piped water rely on open water or a well for their main drinking water source, making them vulnerable to illness. Infectious diarrhea and other serious waterborne illnesses are generally recognized as leading causes of infant and child mortality and malnutrition. Their impact extends beyond health to the economic realm in the form of lost work days and school absenteeism.<sup>64</sup> 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.<sup>65</sup>

*The population’s health is compromised, especially the health of the children.*

45. **Tajikistan achieved gains in life expectancy and improved health.** Life expectancy in Tajikistan is higher than comparable averages of LMICs and Central Asia, yet continued gains are not assured. In addition to longevity, the quality of health matters. Threats to the population’s health come from inadequate public health programs such as malaria eradication or the spread of diseases (from neighboring countries, especially Afghanistan). More urgently, poor nutrition and health status operates largely through a compromised immune system due to micronutrient deficiencies and growth failures and many women and children in Tajikistan suffer from such basic deficiencies as iodine and anemia. In addition, parental feeding practices exacerbate children’s access to essential foods such that even when food is available, the appropriate ones are not given to children. Yet the lack of adequate amounts of food for households is indeed a problem as seen from the continued high levels of poverty, especially during the winter months.

**Figure 19: Stunting and Wasting**  
(in percent)



Sources: WDI for all countries except Tajikistan.

<sup>61</sup> World Bank (2017a).

<sup>62</sup> World Bank (2017a).

<sup>63</sup> Source: LITS (2016).

<sup>64</sup> Banerjee and Morella (2011).

<sup>65</sup> World Bank (2017a).

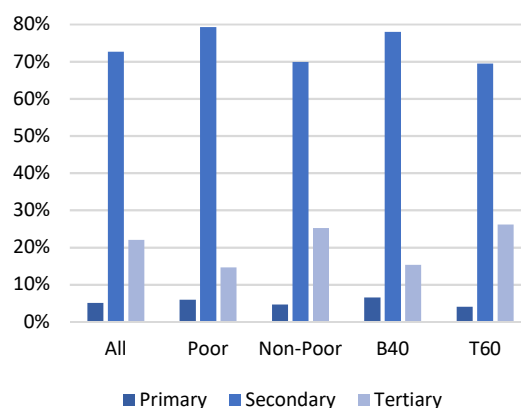
46. **Undernourishment and stunting are humanitarian concerns and undermine the accumulation of human capital, productivity and incomes.**<sup>66</sup> Although Tajikistan has achieved considerable progress in domestic food production, low domestic agriculture production of major crops, low meat consumption, and poverty-related food insecurity are still common. Children are especially vulnerable to malnutrition due to many factors, including limited access to clean water and sanitation or inadequate access to nutritious food, and the results can be seen in stunting and wasting outcomes. Though Tajikistan has made important strides in reducing stunting and wasting over the past decade, it still remains of concern. Stunting among Tajikistan's under 5 years old was 21 percent of all children which was higher than the Kyrgyz Republic's current average of 13 percent.<sup>67,68,69</sup> In Tajikistan, 2 percent of children are wasted, with higher incidence in areas affected by the civil war in the 1990s.

47. **Violence against women and girls is not uncommon in Tajikistan and has detrimental effects on their physical and mental health.** According to the Demographic and Health Survey (2012), 19 percent of women ages 15-49 years experienced physical violence at least once since age 15, while 13 percent have experienced it within 12 months prior to the survey.<sup>70</sup> Overall, about one in five ever-married women (ages 15-49 years) have experienced emotional, physical, or sexual violence from a husband. About one-fifth of women choose to seek assistance to try to stop the violence. The experience of physical and sexual abuse does not only impact physical well-being of the victim, but also associated with higher probability of suicidal thoughts. The presence of gender based violence constitutes a serious public health issue and has repercussions for the victim of abuse but also on other family members.

*Access to basic education is high but the quality of education is not strong.*

48. **Most adults in Tajikistan have completed secondary school, which means that the country has high stock of human capital that is potentially under exploited.**<sup>71</sup> Access to secondary-level education in the Soviet Union was widespread, and much of the education system in Tajikistan continued to follow the Soviet model after independence. In contrast, access to university education was limited both in the Soviet era and post-independence. Post-secondary education (including university) education is much more prevalent among non-poor households: while only about 15 percent of adults living in poor households are university educated, about 25 percent of adults living in non-poor households, and 26

**Figure 20: Adult Educational Attainment**



Source: HBS (2015).

<sup>66</sup> Stunting is when children under age 5 whose height for age is more than two standard deviations below the median for the international reference population ages 0-59 months.

<sup>67</sup> Swiss Tropical and Public Health Institute (2017).

<sup>68</sup> Appropriate parental knowledge and skills about infant and young child feeding practices, which play a critical role in children's nutritional status, are also where major gaps exist. The problem is perpetuated by a sub-optimal feeding culture. For example, in some rural areas, pregnant women are discouraged to eat vegetables because they were told that it could lead to some defect when the baby is born.

<sup>69</sup> Statistical Agency under the President of the Republic of Tajikistan, Ministry of Health of the Republic of Tajikistan, and ICF International (2013).

<sup>70</sup> Statistical Agency under the President of the Republic of Tajikistan (SA), Ministry of Health (Tajikistan), and ICF International (2013).

<sup>71</sup> About 11 years of education in most cases.

percent of adults living in top 60 households are tertiary educated. Income from employment is strongly associated with educational attainment: in 2013, only 35 percent of the population aged 25-65 who had not completed secondary education were employed, while more than 79 percent of those who had completed higher education were employed.<sup>72</sup> However, little is known about the quality of education, especially primary and secondary levels, as Tajikistan does not conduct standardized large scale national assessments and does not participate in any international assessments like the Program for International Student Assessment (“PISA”), Progress in International Reading Literacy Study (“PIRLS”), or Trends in International Mathematics and Science Study (“TIMSS”).

49. **The average gender gap in education is narrow but grows at higher levels of education.** Current enrollment statistics in public educational institutions indicate that enrollment rates are similar at primary levels but falls beginning in secondary school. Between 2008 and 2012, the net enrollment ratio was 3 percent lower for girls in primary school, and nearly 10 percent lower for secondary school. The average net secondary school attendance ratio for girls was 13 percent lower over the same period. Combined, these estimates indicate that the legacy of a relatively high share of women completing secondary school in Tajikistan gradually eroded though current indications are that enrollment of young women is growing faster than their male counterparts (similar to other LMICs). By investing in women’s education, the country increases its stock of human capital, and slowly could reduce entrenched gender imbalances present in the labor market. The policies to close the gender gap in education could also be accompanied by measures to facilitate girls’ transition to the labor market, including vocational skills development.

50. **Another important but little understood area of living conditions is housing quality and affordability.** Housing is frequently the most valuable asset for the vast majority of households second only to land for rural households. At present, housing is largely an unfunded mandate, with an unclear sharing of competencies between national and local bodies. The housing stock is mostly privately owned, and many multifamily residential buildings are deteriorating due to lack of maintenance and repair. This may be attributed to a combination of: (i) the legacy of the previous regime where the state played a key role in management and maintenance of housing stock, and the near-absence of functional home-owners’ associations; (ii) a mix of income levels in these buildings, including many low-income households, which makes it difficult to get consensus on capital improvements, and (iii) the lack of enforcement of the management function under the condominium law. An added complexity is that capital improvements are very expensive, and much of the resident population is unlikely to be able to afford them without government assistance – both in terms of co-financing as well as technical expertise. Housing in rural areas appears to be especially undeveloped with 49 percent of the population indicating they have only dirt (unfinished) floors.

## 4 How Sustainable Is the Progress? A Wake-up Call

51. **Growth based on heavy reliance on external financial inflows has allowed Tajikistan to achieve rapid poverty reduction.** The question is: how sustainable is this progress? Can Tajikistan continue to rely on foreign financial inflows (remittances, foreign savings) to grow rapidly and improve the welfare of its population, without creating major economic and social problems in the future? Will the commissioning of the 3,600MW Rogun HPP, the centerpiece of Tajikistan’s development masterplan, will transform Tajikistan as anticipated in the NDS 2030? These are the questions this chapter attempts to answer.

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<sup>72</sup> World Bank (2017a).



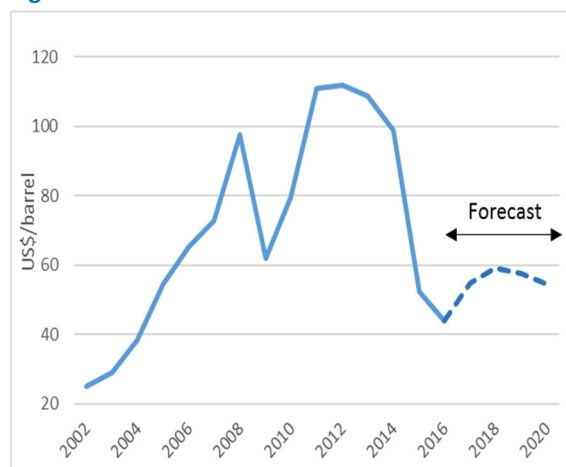
52. **The chapter finds that the pursuit of Tajikistan’s NDS 2030, including continued borrowing for the Rogun HPP, could risk debt sustainability and threaten the country’s economic, social, and political stability.** The remittance-driven growth is ill-suited to sustain high growth and absorb the rapidly growing working-age population, without increasing Tajikistan’s external vulnerabilities. A successful commissioning of the Rogun HPP could spur growth. But to realize that, Tajikistan needs to surmount several short and long-term challenges, including the mobilization of financing to complete the Rogun construction, risks of debt distress, macroeconomic management, youth unemployment, fragility and climate change, just to name a few. Failure to manage them successfully could have dire economic, social and political consequences.

## 4.1 Growth Sustainability at Risk

### *Growth Driver Wanted*

53. **The sustainability of Tajikistan’s remittance-based growth model is unlikely due to the uncertain regional economic outlook, rising vulnerabilities, and growing macroeconomic instability.** Rapid growth in the past has been driven predominantly by buoyant private consumption supported by remittances, although commodity exports and foreign-financed public investment have also played some role. Once external conditions deteriorate, however, under this growth model Tajikistan’s economy loses growth impetus, as acutely felt over the past few years. With the economic slowdown of Russia—the main source of remittances and an important external market—beginning in late 2014, inbound remittance to Tajikistan more than halved during 2013-16, depressing private consumption while putting pressure on the external accounts. Despite large-scale intervention, during 2015-16, the somoni depreciated nearly 50 percent against the US dollar, aggravating banking sector weaknesses (see below). Imports of consumption goods contracted, weakening excise and VAT revenue and widening the fiscal deficit, which was closed by government borrowing. Meanwhile, the plummeting cotton and aluminum prices led to a 40 percent contraction in exports (US dollar value) between 2012 and 2016, further exacerbating pressures on the external account.

**Figure 21: Oil Prices**



Source: Economist Intelligence Unit (2017a)

Note: Expressed in nominal US dollar.

54. **Private consumption cannot continue to drive growth as before without a significant and sustained recovery of remittance inflows.** While Russia’s economy is bottoming out in 2017, its growth outlook remains unclear given stagnant prospects for oil prices, structural constraints, as well as the expanded US sanctions, which would undermine Russia’s medium- to long-term growth prospects (Figure 21).<sup>73</sup> Although remittance inflows rebounded somewhat in 2017, the level Tajikistan once enjoyed is unlikely to be sustained in the long run, suggesting that remittance-financed private consumption is not a reliable source of growth and poverty reduction in the long run. Besides the issue of sustainability, growth that depends on foreign resources will continue to expose Tajikistan to external shocks,

<sup>73</sup> By limiting financing and investment opportunities to several sectors of the economy (including railway, metal, oil industries, and the banking sector), the extended US sanctions against Russia imposed in August 2017 is expected to hurt Russia’s long-term, rather than short-term, prospects (Institute of International Finance, 2017).



requiring the authorities to accumulate enough policy buffers to mitigate their economic and social impacts. This argues for the need to find alternative, more stable, and sustainable sources to support growth.

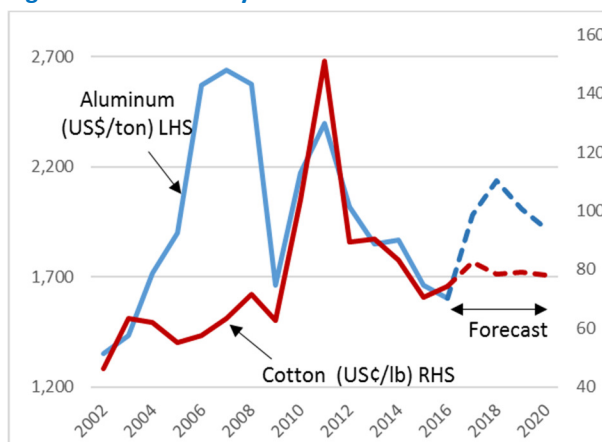
55. **A major boost from commodity exports is unlikely.** Exports of unwrought aluminum and raw cotton, Tajikistan's main export commodities, are subject to volatility and shifting demand. Although price developments were favorable in 2017, cotton and aluminum prices are unlikely to bounce back to the levels witnessed in the past (Figure 22).<sup>74</sup>

56. **A full commissioning of the Rogun HPP could significantly boost Tajikistan's growth, but there are multitude of risks and challenges.** The full commissioning of the Rogun HPP, scheduled for 2032, is envisaged to boost Tajikistan's electricity exports and remove energy shortages that constrain business activity today, contributing to growth and government revenue. However, realizing this scenario is possible only when the following short- and long-term challenges and risks are managed successfully.

57. **The construction of the Rogun HPP entails serious economic and social risks, which could trigger instability unless managed very well.** The first relates to the financing of the construction. The Government has yet to secure full financing necessary to complete the construction the HPP (estimated at around US\$4-5 billion, more than 50 percent of 2016 GDP). The scope of domestic borrowing is limited, given the shallow domestic financial market and banking sector fragility (see Chapter 5.13), and doing so would likely crowd out private investment. Boosting revenue collection is challenging given the small private sector (tax base). Since construction delays could give rise to safety implications, the Government may feel compelled to reallocate budgetary resources from critical sectors and increase revenue collection targets (see Chapter 5.1.2) to keep up with the schedule. Although the construction may be completed on time, taking this approach would have a detrimental impact on the economy and social welfare. Technical and governance issues may pose additional significant risks to financing the project and increase their total costs. Second, regardless of how it is financed, an investment project of this magnitude, albeit spread over many years, will likely have a significant impact on the exchange rate, inflation and external indebtedness, challenging the authorities' ability to maintain macroeconomic stability. Risks of corruption are also high in mega projects, especially in the world of large dams. The best-known case is the US\$8 billion Lesotho Highlands Water Project, involving the construction of dams for hydroelectric power generation and rural development.<sup>75</sup>

58. **A successful and timely commissioning of the Rogun HPP will present a new set of risks and challenges to the Tajik authorities.** First, there is a need to build cross-boundary high-voltage transmission lines, which will enable Tajikistan to export surplus hydropower to Afghanistan and Pakistan. The second concerns public financial management. The Government will need to manage hydropower revenue wisely to: (i) stay current on debt service obligations; (ii) allocate adequate resources for

Figure 22: Commodity Prices



Source: Economist Intelligence Unit (2017b, 2017c, 2017d).

Note: Expressed in nominal US dollar.

<sup>74</sup> Economist Intelligence Unit (2017b, 2017c, and 2017d).

<sup>75</sup> Transparency International (2008).

operation and management (“O&M”); and (iii) strike a delicate balance between spending for productive (including the transmission lines) and social purposes, and saving some to safeguard macroeconomic stability. While hydropower sale will provide a stable income stream, unlike internationally traded commodities, management of large-scale revenue will require a strong institutional arrangement and administrative capacity.<sup>76</sup> Failure to adequately manage large export proceeds could destabilize the economy, as experienced by Bhutan, whose main growth driver is hydropower exports.<sup>77</sup> Finally, hydropower-led growth is not inclusive in that it will not create enough employment opportunities for the growing young population, a major policy challenge Bhutan is faced with. All in all, while the full commissioning of the Rogun HPP could bring enormous benefits to Tajikistan, for that to happen, a number of conditions need to be met.

### *Rising External Vulnerabilities*

59. **Tajikistan’s external debt sustainability has weakened considerably in recent years.** According to the International Debt Statistics (“IDS”) published by the World Bank, Tajikistan’s external debt, including external borrowing by the corporate sector, more than doubled over the past 10 years to reach 67 percent of GDP in 2016, although part of the increase was caused by the exchange rate movement (Figure 23).<sup>78,79</sup> Tajikistan’s external debt is estimated to have exceeded 70 percent of GDP by end-2017, with the issuance of a US\$500 million Eurobond (about 7 percent of 2016 GDP) in September 2017 to finance the construction of the Rogun HPP.<sup>80</sup> Weak public debt management capacities and poorly designed legislative and policy frameworks have also contributed to the build-up of external debt by hampering effective decision-making. The latest IMF/World Bank Debt Sustainability Analysis (“DSA”) evaluates Tajikistan’s risk to external debt distress is high under the status quo scenario, which assumes an additional non-concessional external borrowing of US\$1.2 billion during 2017-28 for the construction of the Rogun HPP and electricity exports from 2021.<sup>81</sup>

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<sup>76</sup> Unlike for globally traded commodities, such as oil and gas, the price of cross-border electricity trade is determined by a long-term sales agreement between the seller and buyer. Because of this, power exports are generally a stable source of income for the exporting country. See Kojo (2005).

<sup>77</sup> Kojo (2015).

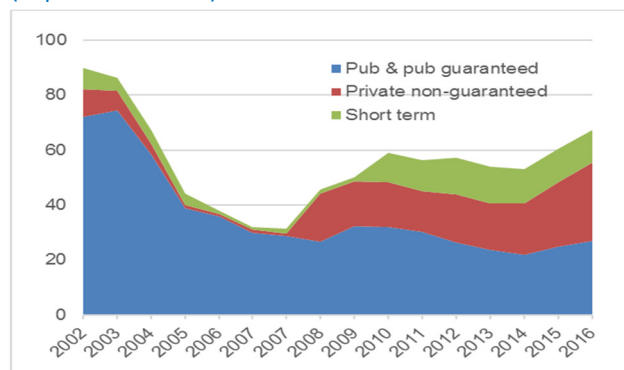
<sup>78</sup> Analysis of Tajikistan’s debt is challenging due to deficiencies in data coverage and quality. The IDS, formerly known as Global Development Finance, provides external debt and financial flows statistics for countries that report public and publicly-guaranteed debt under the World Bank’s Debt Reporting System. External debt data from the IDS are numbers reported by the authorities and are based on actual flows and debt-related transactions. In case the authorities do not report the latter (most often non-guaranteed private sector foreign debt), World Bank staff estimate a country’s total external debt using available market information.

<sup>79</sup> The Tajik authorities’ data suggest the country’s total external debt amounted to 69.9 percent of GDP at end-2016 (National Bank of Tajikistan, 2017).

<sup>80</sup> Tajikistan’s external debt stood at US\$5.3 billion (73 percent of GDP) at end-September 2017 according to the National Bank of Tajikistan (2017). The IDS has not released 2017 debt data yet.

<sup>81</sup> The baseline scenario assumes that the first turbine will be commissioned in 2021, thereby increasing hydropower exports and contributing to the budget.

**Figure 23: External debt**  
(in percent of GDP)



Source: IDS.

60. **There is a rapid build-up of unguaranteed corporate sector debt and short-term debt, but details are unknown.** Available information suggests that as of end-2016, a large part of short-term external debt was owed by Tajikistan's financial institutions in the form of non-residents' short-term deposits and short-term loans held by Tajik corporates. Trade credits accounted for a small proportion of short-term debt. Information is equally limited on non-guaranteed long-term private sector debt. The size and lack of information about these types of debt warrant careful monitoring.

***Policy buffers are too narrow to counter shocks and support growth.***

61. **Low external buffers amplify Tajikistan's susceptibility to a liquidity crisis.** As of end-2016, Tajikistan's international reserves stood at about 50 percent of its short-term debt.<sup>82</sup> The low level of international reserves reflect the authorities' past attempt to mitigate the mounting pressures on the exchange rate, driven by the sharp fall in inward remittances. Reserves grew markedly in 2017, driven by the proceeds of the US\$500 Eurobond, improved external environment, and the surrender requirement on ruble-denominated remittances introduced in 2016. Since the bulk of Tajikistan's short-term debt is in the form of non-residents' short-term deposits, there are risks that these deposits may leave the country, prompted by policy tightening in major economies.

62. **Fiscal space is narrow, limiting the authorities' ability to counter shocks.** Tajikistan's fiscal deficit widened in 2016, exceeding 10 percent of GDP, driven by falling revenue, bank recapitalization costs, and large-scale public investment, leading to an expansion of public debt. The scope of improved revenue is slim without a sustained, significant recovery of remittance inflows to boost domestic consumer demand and a productive, profitable and employment-generating private sector, which Tajikistan currently lacks. A continued reliance on external borrowing to support growth is not sustainable, and could potentially trigger a costly debt crisis. The scope for domestic borrowing is also limited by low private savings, banking distress and underdeveloped capital markets.

63. **Policy buffers are further constrained by growing fiscal risks that, if realized, could jeopardize macroeconomic stability and dampen growth prospects.** At end-2016, total liabilities of the 24 largest SOEs were estimated at 38 percent of GDP, including arrears (inputs, salary, tax, debt services) and penalties on these arrears.<sup>83</sup> The Government has periodically written off outstanding SOE arrears at the expense of tax payers, crowding out public spending of critical importance. Total fiscal costs of financially weak SOEs go far beyond the explicit resource transfers from the national budget, and tend to be significantly larger when quasi-fiscal and implicit budget transfers are factored in.<sup>84</sup> Aware of the risks, the

<sup>82</sup> There is well-established empirical evidence that the low official reserves to short-term debt ratio is the best predictor of debt crisis (International Monetary Fund 2000). All countries that experienced a debt crisis during the East Asian crisis of 1997 had limited international reserves relative to the scale of short-term liabilities.

<sup>83</sup> Ministry of Finance.

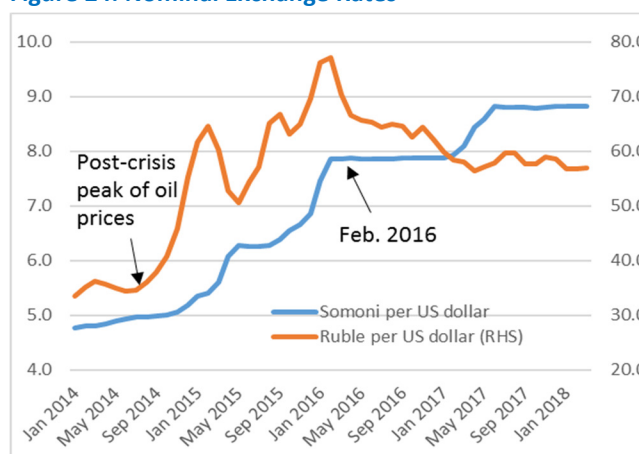
<sup>84</sup> See for example Kojo (2010).

Government has taken major steps to strengthen monitoring and risk management.<sup>85</sup> However, the SOE sector lacks transparency and accountability, which makes it challenging to assess the extent of fiscal risks and develop measures to mitigate these risks. Furthermore, fiscal risks related to the distressed banking system are also present.

*Growing macro-financial instability further dampens growth prospects.*

64. **Macro-financial difficulties since 2014 have eroded public confidence in the economy.** Tajikistan's macroeconomic policies have been generally prudent, but significant ground was lost recently, with the sharp rise in public debt, reserves run-down, dramatic fall of the currency, and increased banking sector distress. The introduction of a range of administrative controls during 2015 to support the currency have caused severe shortages of foreign exchange and economic disruption.<sup>86</sup> The ongoing macroeconomic-financial problems, exacerbated by the inadequate policy responses to the shock, have fueled uncertainty and increased unpredictability, which would encourage investors to withhold major investment decisions to move up the value chain.

**Figure 24: Nominal Exchange Rates**



Source: IFS.

65. **The large somoni depreciation had a detrimental impact on the banks' already fragile financial position, leading to a credit crunch.** Reflecting years of poor risk management and weak supervision, at the time the somoni began to depreciate sharply, banks in Tajikistan were facing a high non-performing loan ("NPL") ratio, and exposed to balance-sheet risks through short open foreign exchange positions and large-scale foreign-currency denominated loans to unhedged borrowers. With the major currency depreciation, banks' balance sheet deteriorated further, while unhedged debtors defaulted. The system-wide non-performing loan ratio shot up to 48 percent at end-2016 from an already high 14 percent in 2013 (see Chapter 5.1.3 for further discussion).<sup>87</sup> In December 2016, the Government bailed out two large banks at a cost of 6 percent of GDP through money creation, triggering a renewed pressure on the somoni and further undermining banks' asset quality. In February 2017, the National Bank of Tajikistan ("NBT", central bank) revoked licenses of two smaller banks. Credit to non-financial private enterprises has been contracting since December 2016 with serious implications for long-term growth.

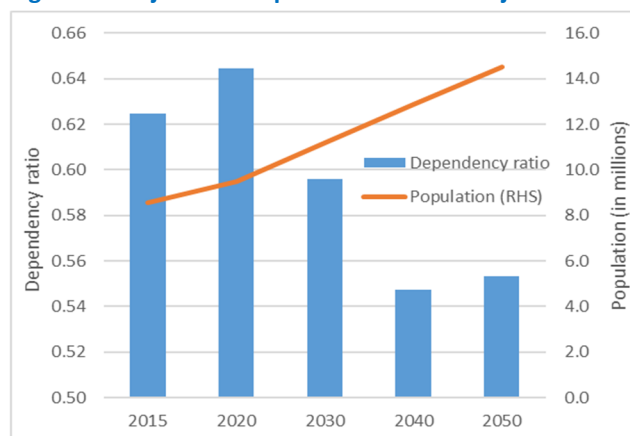
<sup>85</sup> The Ministry of Finance has established a department for monitoring financial activities of large SOEs. In 2012, it began to publish Statement of Fiscal Risks annually.

<sup>86</sup> These measures include the closure of foreign exchange kiosks, ceilings on exchange rates set by foreign exchange offices, and the introduction of a mandatory conversion of ruble-denominated remittances into somoni. Money-transfer agencies (banks and micro-finance institutions) then required to surrender 50 percent of the ruble to the central bank.

<sup>87</sup> At end-2017, the NPL ratio stood at 36.5 percent.

## 4.2 Demographic Dividends or A Time Bomb?

Figure 25: Tajikistan: Population Growth Projection



Source: United Nations.

Note: The dependency ratio is the ratio of working-age population (15-64 years old) to non-working age population (below 15 and over 65 years old).

66. **Tajikistan's young and rapidly growing population is a mixed blessing.** With over a third of population currently under 14 years old, Tajikistan's labor force is set to rise over the long term, pushing down its dependency ratio (Figure 25). Tajikistan has an opportunity to take advantage of the demographic dividend, and accelerate growth and poverty reduction, like some East Asian countries did successfully during the 1950s and 1960s.<sup>88</sup> However, the rapidly growing population will also have a major strain on the economy, from public goods and services, food supplies, to the availability of jobs in the future.

67. **Under the status-quo approach, rapid population growth could threaten Tajikistan's economic and social stability.** Reaping

significant demographic dividends hinges critically on the economy's ability to absorb and productively employ the growing working-age population. Tajikistan currently does not have a large and vibrant private sector that can absorb the growing population into productive employment. Prospects for significant job creation are slim given the capital-intensive and enclave nature of the electricity sector, whereas the scope for labor migration is uncertain. The growing number of unemployed and idle youth could become a future threat to stability in Tajikistan. High youth unemployment, poor public services, corruption, poor living conditions and the lack of political freedom are some of the factors that have triggered major social unrests in the past decade in other countries.

## 4.3 Fragility Risk

68. **Tajikistan faces security and cross-border risks, which could be exacerbated by economic exclusion of the youth.** With its unique geographic location, Tajikistan is vulnerable to drug trafficking, political-religious extremism, possibly even terrorism.<sup>89</sup> The country's porous and 1,400 km long border with Afghanistan has made it a major transit country for illegal drugs to Russia, Kazakhstan, and Europe.<sup>90</sup> Decreased US and NATO-led International Security Assistance Force in 2014 further undermined security and raised the specter of cross-border terrorism and recruitment to violent extremism.<sup>91</sup> To prevent the

<sup>88</sup> A demographic dividend is defined as a boost to economic productivity that occurs when there are growing numbers of people in the workforce relative to the number of people dependent on it. With fewer people to support, a country with both increasing numbers of young people and declining fertility has the potential to reap a demographic dividend (United Nations Population Fund 2016).

<sup>89</sup> United Nations Office of Drug and Crime (2012).

<sup>90</sup> According to the Bureau of International Narcotics and Law Enforcement Affairs, in 2016 Tajikistan was located at one of the highest volume illicit drug trafficking routes in the world, between Afghanistan's opium harvests on its southern border and the illicit drug markets of the Russian Federation and Eastern Europe to the north (U.S. Department of State 2016b).

<sup>91</sup> Reportedly, an estimated 1,094 Tajik nationals have joined the Islamic State of Iraq and Syria ("ISIS") as foreign fighters and are in Syria and Iraq (Asia-Plus 2016).

emergence of sleeper cells in Tajikistan, the Government has allowed the police to enter homes without warrants, increasing tensions with communities.

69. **Some regional tensions persist with Central Asian neighbors stemming from such problems as border disputes and control of water resources.** In the north, the use of transboundary rivers is a sensitive topic given the countries' economic dependence on the water. Tajikistan has unresolved border disputes in the Fergana valley with the Kyrgyz Republic, which is a source of regular, low-level friction over access to water and pasturage.

#### 4.4 Natural, Environmental, and Climate Change Affected Risks

70. **Natural disasters and climate change represent a threat to Tajikistan's economic and social development, but the country currently lacks the capacity to respond to these environmental challenges.**<sup>92</sup> Tajikistan's terrain and geological and hydrological features also make it prone to many natural hazards such as floods, earthquakes, landslides, mudflows, avalanches, droughts, and heavy snowfalls. The country is annually struck by natural disasters that cause damage to the national economy and human fatalities. Environmental degradation and deteriorating infrastructure—irrigation channels, river embankments, roads, bridges and dams that were mostly built during the Soviet era—have increased the population's vulnerability to extreme weather events and seismic risks.

71. **Natural disasters tend to disproportionately affect the poor and marginal populations.** Sometimes, poorer households settle on disaster-prone land, such as in flood zones. This increases their probability of losing or damaging assets thus, potentially exacerbating existing inequalities through the loss of scarce economic assets, such as land, livestock and housing. Moreover, the loss of an asset has much larger implications for the poor due to their smaller buffer and greater difficulty in rebuilding their lives. For instance, droughts in 2001 and 2008 damaged more than a third of the cropping areas in Tajikistan, whereas serious flooding in 2015 caused by heavy rainfall and unusual melting of glaciers claimed direct economic loss amounting to US\$650 million.<sup>93</sup>

72. **Climate change may affect agricultural and in turn Tajikistan's food security.** Tajikistan is considered as the most vulnerable country to climate change in the ECA region.<sup>94</sup> Its agriculture sector is the principal employer in the economy and is dependent on water resources and therefore exposed to climatic variability.<sup>95</sup> Climate change is expected to increase the intensity and frequency of extreme climate events (floods, droughts, extreme temperatures). Adverse effects on agriculture and, in turn, food production may increase relative prices and reduce agricultural wages, affecting the poor dependent on agriculture.<sup>96</sup> The reliance on hydropower also makes the electricity sector directly vulnerable to climate change. As climate change starts having a noticeable impact, there is also an indirect effect as the energy sector will compete for scarce water resources with irrigation infrastructure, industry and human

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<sup>92</sup> The Government has made good progress in disaster management, including the development of a national strategy for disaster management has been prepared. However, weak technical capacity poses a serious challenge in making tangible improvement in disaster risk management.

<sup>93</sup> International Organization for Migration (2015).

<sup>94</sup> World Bank (2016a).

<sup>95</sup> World Bank (2009).

<sup>96</sup> Without including adaptation measures and technological progress, climate-induced water stress may decrease Tajikistan's yields by up to 20 percent by 2100 (Shah 2013).



consumption.<sup>97</sup> Continued reliance on water-intensive cotton cultivation could aggravate water scarcity problems.

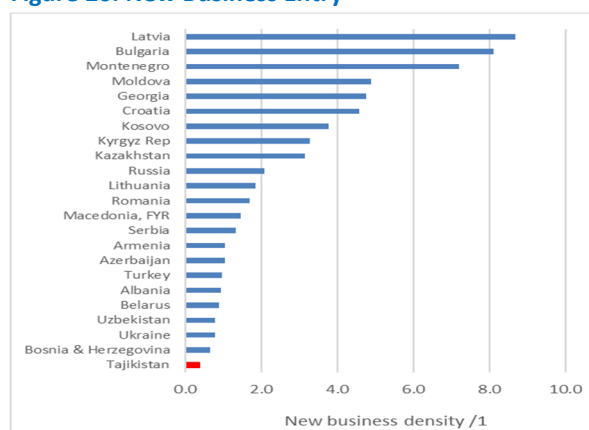
## 5 Challenges and Opportunities: Private Sector Growth and Demographic Dividends

73. **What can Tajikistan do to ensure economic and social stability in the current economic context?** The previous chapter highlighted serious risks stemming from the pursuit of Tajikistan's current development masterplan, including the Rogun HPP. Is there any way to reduce these risks and make the Rogun truly a transformational investment, not an expensive gamble? If so, how?

74. **The SCD argues that fostering a vibrant private sector to create employment opportunities will reduce social risks, while allowing Tajikistan to reap the demographic dividends, accelerate growth, and soften the macroeconomic challenges and risk of debt distress.** Tajikistan could achieve socio-economic transformation through the Rogun HPP if this project is embedded carefully in a set of complementary policies to develop a healthy private sector that invests and creates jobs.

75. **This chapter focuses on factors constraining private sector activity and opportunities for creating jobs.** Despite there is significant entrepreneurial spirit in the country, why are so few new businesses created each year in Tajikistan (Figure 26)?<sup>98</sup> What is keeping Tajikistan's private investment so low? Although Tajikistan may possess productive knowledge necessary to branch into new products in the agro-processing industries—such as processed fruit and vegetables—these sectors remain largely untapped. Why? Challenges and opportunities specific to the agriculture sector are also discussed in this chapter because of its growth potential as well as the expected impact on poverty reduction. Growth in agriculture also contributes to improved food security, one of the strategic priorities of the NDS 2030.

Figure 26: New Business Entry



Source: WDI.

1/ New business entry density is defined as a number of newly registered corporations with limited liability per 1,000 working-age population (2007-16 average).

76. **The analysis finds many of the challenges encountered by Tajikistan's private sector have their root in weak governance and corruption.** Private sector activity is hampered by a difficult business environment—unpredictable regulatory environment, an unequal playing field, limited access to longer-term loans, erratic electricity supply, high transport cost, foreign exchange shortages, just to name a few—the analysis below finds that these take their roots to or exacerbated by weak governance and corruption. Building an enabling environment for private sector development therefore requires potential requires

<sup>97</sup> World Bank (2014a).

<sup>98</sup> Survey data suggest that limited business creation in Tajikistan is not a result of the lack of desire among the population to become an entrepreneur; almost 40 percent of the labor force prefers self-employment, one of the highest rates in the region (Strokova and Ajwad 2017).



decisive governance reforms, designed to reduce the role of the state and enlarge that of the private sector in the economy.

## 5.1 Difficult Environment for Private Businesses

### 5.1.1 Poor Regulatory Environment

77. **Tajikistan’s regulatory environment is not conducive for business activity, despite past reform efforts.**<sup>99</sup> The Enterprise Survey shows that in 2013/14 senior managers in Tajikistan, on average, spent 22 percent of their time to deal with government regulations, which could otherwise have been used for other productive activities.<sup>100</sup> This is nearly twice as much in other ECA countries. Compliance to trade regulations is more time consuming.<sup>101</sup>

78. **Implementation shortcomings, discretionary enforcement, and informal practices have undermined Tajikistan’s regulatory environment.** The regulatory environment is unpredictable and non-transparent, as the earlier reforms have often just remained “on the books” without generating marked gains in the business environment. Many of the well-written laws have suffered poor implementation due to the weak rule of law, lack of judicial independence, corruption, and inconsistent interpretation and implementation, raising cost of doing business in Tajikistan.<sup>102,103</sup> The judiciary’s ability to enforce contracts and protect property rights is compromised, while shortcomings in regulatory transparency have also hampered effective enforcement. Executive documents—presidential decrees, laws, government orders, instructions, and regulations—are often inaccessible to the public, leaving businesses and investors unaware of existing rules.<sup>104</sup>

79. **Tajikistan’s trade regime is open in theory, but informal barriers hamper penetration into new export markets and limit adoption of more advanced foreign technology.** Tajikistan’s formal tariff barriers and quantitative restrictions are low.<sup>105</sup> Yet importing goods into Tajikistan is still complicated due to corruption and patronage networks that restrict trade in certain products, making access to foreign inputs and modern technology more difficult for businesses.<sup>106</sup> Existing customs clearance processes are generally consistent with regional practice and minimum international convention obligations, but with a high degree of physical interventions that makes cross-border trade time-consuming. Anecdotal evidence suggests that actual procedures on the border may differ substantially from official regulations.

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<sup>99</sup> The first-generation structural reforms during 1997-2004 included small scale privatization, price liberalization, corporatization of SOEs, and agricultural reform. Reform efforts intensified in the late 2000s. Procedures to start a business were simplified significantly with the establishment of a one-stop-shop; the minimum capital requirements for establishing a new business was eliminated; paying tax was made easier through an electronic filing system; and the Joint Stock Company Law was amended to strengthen investor protections. Furthermore, the Law on Technology Parks was adopted in 2010 to develop innovative entrepreneurship. Tajikistan was listed as one of the top 10 global reformers in 2010, 2011 and 2015 based on its reforms on the paper.

<sup>100</sup> The Enterprise Survey is a firm-level survey of a representative sample of an economy’s private sector.

<sup>101</sup> The Enterprise Survey results show that managers of exporting firms spent significantly more time dealing with regulations than non-exporters.

<sup>102</sup> Timmermans (2016).

<sup>103</sup> For instance, the one-stop-shop approach mentioned above has not been successfully implemented.

<sup>104</sup> U. S. Department of State (2015).

<sup>105</sup> Following the WTO accession in 2013, Tajikistan has made some progress in this area, reducing the number of documents required for export activity and facilitating electronic customs declarations.

<sup>106</sup> Strokova and Ajwad (2017).

80. **Competition policy is often ignored, hurting private sector development and the economy's competitiveness.** Free and fair competition is an important driver of innovation and productivity growth. However, in Tajikistan, real market competition is present only in some segments of the economy, with vested interests still restricting competition. Legislative and procedural rules regulating market competition are often neglected, shielding SOEs and politically connected firms from robust market competition.<sup>107</sup> While SOEs are granted preferential access to inputs, finance and government contracts, arbitrary taxation and multiple inspection rules with informal arrangements are also used to discourage market competition.<sup>108</sup>

81. **Foreign firms do not perceive Tajikistan as an attractive investment destination despite the country's liberal policy towards FDI.** Tajikistan has no laws that discriminate against foreign investors by prohibiting, limiting, or conditioning foreign investment in any economic sectors. Foreign firms may acquire assets, and land and mineral usage use rights. Notwithstanding high potential in a number of sectors, the Government's interest in developing new industries through FDI has achieved mixed results in terms of employment creation, integration into the global value chain, and technology transfer and spillover.<sup>109</sup> In addition to the poor business environment, decisions to invest in Tajikistan are impeded by a lack of transparency and unreliability of financial information. While there is no confirmed case of property appropriation from foreign entities, fears for state expropriation of private property have discouraged investment and reduced chances for economic diversification, given the state's predatory behavior towards locally owned private property under politically motivated circumstances and without effective due process.<sup>110</sup>

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<sup>107</sup> The Law on Natural Monopolies (2008; amended in 2013) lists a large number of activities in different sectors as natural monopolies, to which antimonopoly rules are not applicable (United Nations Conference on Trade and Development 2016). The protected activities include (but not limited to): production, transmission and distribution of electricity, transport services, airports, postal services, telecommunications using the network of local lines, services of water supply and sanitation systems, and local lines of air transport services.

<sup>108</sup> US Department of State (2015).

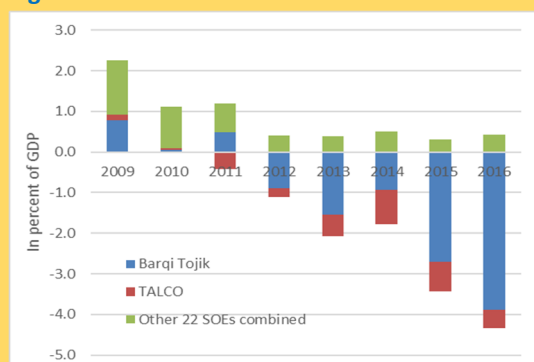
<sup>109</sup> According to the American Chamber of Commerce, Tajikistan has high potential for developing agriculture, agribusiness, tourism, transport infrastructure, communication, and electricity production (<http://www.amcham.tj/investors/investment/>). Foreign companies are engaged mostly in the mining enclave (coal, gold, and silver deposits). FDI inflows in mining increased sharply in 2014, attributed to the government's initiatives, including the adoption of a program for the improvement of investment attraction in subsoil resources. More lately, foreign investors began to renovate the cement plants.

<sup>110</sup> U.S. Department of State (2016a).

#### Box 4: SOE Sector

**SOE are active in a wide range of sectors of Tajikistan's economy.** Operational and financial performance of large SOEs are deteriorating in the past decade, directly and indirectly affecting Tajikistan's entire economy and its population. Economic costs associated with poorly operating SOEs in terms of lost growth opportunities and unemployment could be significant, while the declining quality of services impose large social costs.

**Figure 27: Financial Results: 24 SOEs**



Source: Ministry of Finance, Republic of Tajikistan.

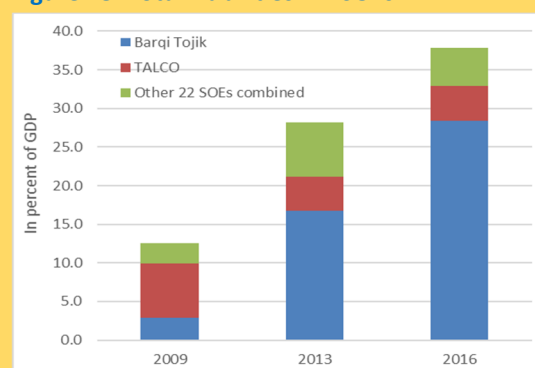
**Weakening SOE performance.** Available information suggests the combined financial results of the 24 largest SOEs has been progressively declining for the past decade, driven largely by the debilitating financial health of Barqi Tojik (electricity company) (Figure 27).<sup>111</sup> Profitability of TALCO (aluminum company) is also on the fall. Faced with financial difficulties, some SOEs have become unable to meet contractual obligations, accumulating a considerable amount of arrears to suppliers, and creditors (commercial banks and the Government) and creating ripples across the entire economy.<sup>112</sup> As limited resources have been allocated for the maintenance, existing infrastructure has eroded and the quality of services have declined, turn adversely affecting the population's welfare.

**Mounting debt.** At end-2016, total liabilities of the 24 largest SOEs were estimated at 38 percent of GDP, including arrears (inputs, salary, tax, debt services) and penalties on these arrears. Overdue tax payments and debt services to the Government have undermined the fiscal account, whereas the build-up of payables to suppliers (e.g., other SOEs and private firms) have led to the weakening of their financial health. The Government has occasionally written off outstanding SOE arrears at the expense of tax payers, crowding out public spending on critical importance.

**Banking sector distress.** Reportedly, some commercial banks were, until recently, directed by the Government to provide financing to financially inviable SOEs at below market interest rates, crowding out productive private investment, while undermining the performance of banks over time. It is believed that, with the recent large currency depreciation, an increased share of bank loans to SOEs became bad. This has contributed to the erosion of banks' asset quality and to banking sector distress, requiring the Government to bail out two large banks through money creation, and in turn weakening the somoni.

**Fiscal cost.** Financially weak SOEs have likely absorbed a considerable amount of fiscal resources through explicit, implicit and quasi-fiscal means. Given Tajikistan's limited revenue mobilization capacity, the large fiscal costs associated with inefficient SOEs represents a major fiscal drain, which crowds out spending for more productive purposes with longer-term implications to the country's competitiveness. Total fiscal costs of financially weak SOEs go far beyond the explicit resource transfers from the national budget, and tend to be significantly larger when quasi-fiscal and implicit budget transfers are included.<sup>113</sup>

**Figure 28: Total Liabilities: 24 SOEs**



Source: Ministry of Finance, Republic of Tajikistan.

<sup>111</sup> Some data presented in Republic of Tajikistan (2015) differ significantly from those reported in SOEs audited financial statements of SOEs.

<sup>112</sup> Ministry of Finance of the Republic of Tajikistan.

<sup>113</sup> See for example Kojo (2010).

### 5.1.2 High Cost of Tax Compliance

82. **Despite recent simplification, Tajikistan's tax regime remains complex, imprecise, and the cost of tax compliance is high.**<sup>114</sup> The Tax Compliance Cost Survey conducted in 2013/14 suggests that, on average 67 days were spent by legal entities in Tajikistan to fulfill obligatory requirements according to the tax legislation.<sup>115</sup> The private sector (domestic and international) has increasingly indicated uneasiness with ongoing distortive tax collection practices and the *ad hoc* interpretation of the tax code.<sup>116</sup> The authorities have increased pressure on businesses to make “irregular” advance tax payments in order to compensate for the revenue shortfalls owing to subdued consumption and import contraction, and deliver on the revenue target, which is the amount needed to meet expenditure needs rather than the best estimates of expected receipt.<sup>117</sup> Reportedly, the authorities have also intensified retroactive tax audits to raise revenues from fines and penalties. This practice has the potential to encourage entrepreneurs to shift to the informal economy, further eroding the already limited tax base.

### 5.1.3 Poor Financial Intermediation Limits Private Sector Growth

83. **Access to loans represents a major constraint to private investment.** Numerous indicators confirm that access to finance by new borrowers is one of the top obstacles in doing business in Tajikistan.<sup>118</sup> Domestic credit to the private sector averaged only 18 percent of GDP for the past 5 years in Tajikistan, half of the CIS median of 36 percent.<sup>119</sup> Only 5 percent of investment undertaken in 2013 was financed by bank loans. Firms do not seek bank credit for three main reasons: lack of long-term financing, high lending rates, and collateral requirements.<sup>120</sup> Thus, many businesses raise capital through other means, including selling assets and borrowing from other companies or individuals outside the official financial system, but the limited nature of private funding keeps businesses small.

84. **The banking sector in Tajikistan has a long history of weak performance due to poor lending practices.** Banks in Tajikistan, which dominate the financial system, lack independence and capacity to play a major role in the country's development by channeling resources efficiently towards their most productive use.<sup>121</sup> Until recently, some banks have regularly been subjected to extensive directed lending at subsidized rates for priority projects, to politically connected borrowers, and to loss-making SOEs. These practices discouraged adequate risk assessment and management, distorted resource allocation and weakened the loan repayment culture.<sup>122</sup> The recent large depreciation of the somoni simply brought the banking sector's long-standing vulnerability to the fore.

85. **The lack of public confidence in the system have made most people reluctant to deposit their money in banks.** Banks' deposit penetration is low, averaging 10 percent of GDP for the past 5 years, well

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<sup>114</sup> Tajikistan has implemented various reforms to simplify the tax regime and reduce compliance cost, including the introduction of an electronic filing system for corporate taxes, VAT and social tax in 2012.

<sup>115</sup> International Finance Corporation (2014).

<sup>116</sup> U.S. Department of State (2016a).

<sup>117</sup> Strokova and Ajwad (2017).

<sup>118</sup> For instance, the World Economic Forum (2017) shows that tax rates and tax regulations are most problematic areas for doing business in Tajikistan, along with foreign currency regulations, access to finance, and inflation. Similar results are also found in the 2013/14 Enterprise Surveys.

<sup>119</sup> Excludes Uzbekistan.

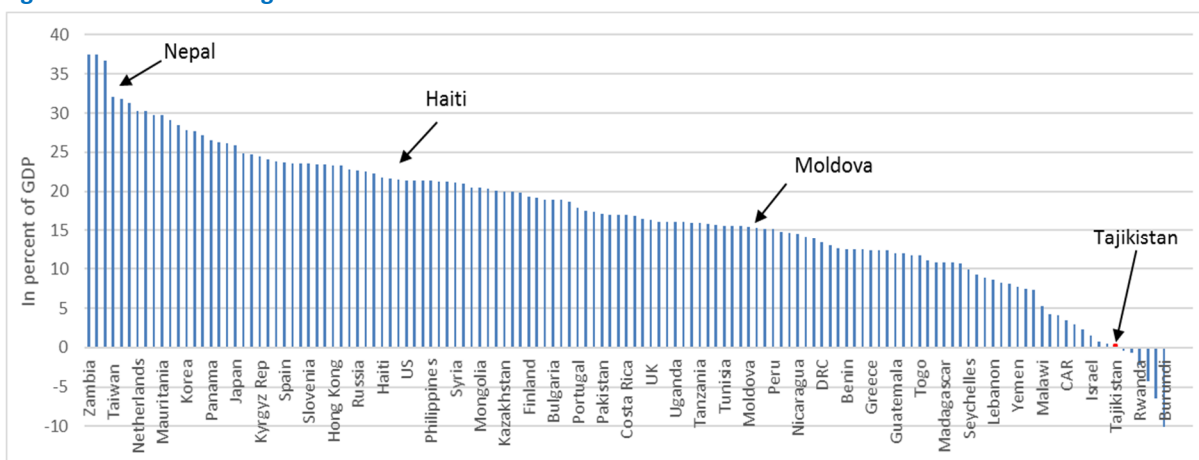
<sup>120</sup> Enterprise Survey (2013/14).

<sup>121</sup> The small financial sector also poses challenges for the conduct of monetary policy.

<sup>122</sup> IMF (2016).

below the CIS average of 26 percent, and is lowest among the lower middle income countries.<sup>123</sup> Cash held outside the financial system is large, representing 80 percent of the money supply as of July 2017, suggesting the public's strong preference to hold cash.<sup>124</sup> The low public confidence in banks also reflects dissatisfaction with customer services; concerns about consumer protection and information disclosure; and weak dispute resolution mechanisms.<sup>125</sup> While the consumer protection framework was revamped in 2016, its effects would take time to be reflected in savings rates. The country's gross national savings rate of 10 percent of GDP (2010-15 average) is one of the lowest in the world. Private savings are particularly limited, averaging only 0.4 percent of GDP over the period 2010-15, compared with those in other remittance-dependent countries, such as Nepal (37 percent), Haiti (27 percent) and Moldova (15 percent) (Figure 29). However, what makes Tajikistan's savings so low and what limits access to finance is not clearly understood.

**Figure 29: Private Savings**



Source: IMF World Economic Outlook database.

86. **Deposits are mostly short term, which limits banks' ability to provide long-term loans.** Short of local loanable funds, banks have increased reliance on liquidity lending from the NBT as well as borrowing from foreign banks. Tajikistan's banks are reluctant to provide longer-term loans, particularly in local currency, due to the lack of stable long-term funding source, which is aggravated by deficiencies in the secure transaction framework that limit the amount of usable collateral, and shortfalls in liquidity and risk management capacity. The average maturity of loans to enterprises is only slightly above 1.5 year. Moreover, the near absence of capital markets—due to the lack of a government bond yield curve—makes securing longer-term financing extremely challenging in Tajikistan. Over half of all bank lending in Tajikistan is in foreign currency to unhedged borrowers, exposing banks to foreign exchange induced credit risk not adequately addressed by prudential regulations.

87. **Cost of finance, especially for non-established borrowers, is prohibitively high.** Lending rates for 6 months to one year loan have hovered around 25-35 percent per annum for domestic currency and 20-30 percent per annum for foreign currency for the past years. The high lending rates in Tajikistan reflect a number of inter-related factors: dominance of weak banks, low levels of competition, high inflationary expectation, funding constraints, and operational inefficiencies. Again, the lack of a bench-mark yield

<sup>123</sup> World Bank Global Finance Development Database.

<sup>124</sup> Measured by M0/M2 as of end-July 2017. The high ratio of cash holding outside the financial system also reflects the limited diffusion of non-cash payment instruments (e.g., debit and credit cards).

<sup>125</sup> U.S. Department of State (2016a).

curve for government bonds makes it difficult to price longer-term loans. Poor enforceability of loan repayment due to the weak judiciary system, and the lack of bankable collaterals (e.g., land user right, movable collateral) raise the cost of loan recovery in the event of a default and increase credit risk premium. Furthermore, by raising the riskiness of bankable projects in general, the unconducive business environment inclines banks to charge higher rates, contributing to adverse selection of borrowers by directing resources to more risky but higher yielding project.

88. **High levels of collateral requirements as another deterrent to seeking credit.** According to the 2013/14 Enterprise Survey, firms were required to pledge a collateral valued 165 percent of the loan on average. The volume of collaterals was significantly higher for credits extended to the retail sector (271 percent) compared with manufacturing (137 percent). The high collateral requirement reflects weaknesses in creditor rights as discussed above, as well as the lack of standard evaluation method for assets in Tajikistan.

89. **Access to loans is particularly challenging for micro, small, and medium-sized enterprises (“MSME”), which reduces scope for job creation.** MSMEs are important players in Tajikistan’s private sector in terms of the number of registered companies (about 70 percent) and their share of employment.<sup>126</sup> While growing micro-finance institutions (“MFIs”) have entered to fill this gap, providing services to financially underserved population, they face the same constraints of lacking longer-term funding in local currency, sufficient volumes of bankable collaterals, and insufficient credit information.<sup>127</sup> Moreover, much of their lending is offered in dollar denominated loans and the lending rates offered by MFIs may be even higher than those of commercial banks, reflecting their small deposit bases and high transaction costs disproportional to the size of loans.

90. **With the December 2016 bank bail-out unable to stabilize the banking system, further reforms are needed.** Since 2016, the NBT has strengthened supervision, while financial regulations have been reinforced. However, more needs to be done. Reform of banking legislative framework can considerably strengthen bank resolution and supervision mechanisms, while decisive actions are needed to fully address the underlying problem, weak corporate governance and government interference, to improve banks’ performance. Parallel efforts are necessary to promote savings and deepen the financial system that can support productive economic activities.

#### 5.1.4 Infrastructure Bottlenecks

91. **The infrastructure (transport, energy, and irrigation networks) built during the Soviet era was designed to optimize the Soviet system of interrepublic linkage, but not to meet Tajikistan’s economic interests as an independent nation.** At the time of independence, Uzbekistan was a major trade partner and supplier of gas for Tajikistan. The Soviet infrastructure, which the two countries inherited, made Tajikistan dependent on Uzbekistan for exit routs, since roads, railways, and electricity grids run across Uzbek territory.<sup>128</sup> Because of this dependence, Tajikistan suffered seriously by the strained relation with Uzbekistan, which began to ease recently. The infrastructure it inherited at independence was badly damaged by the civil war, repeated natural disasters, and lack of adequate maintenance, exacerbating the country’s energy and connectivity challenges.

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<sup>126</sup> Tilekeyev (2014). MSMEs also play an important social role in rural areas and in the employment of women.

<sup>127</sup> The NPL ratio in the MFI sector was about 13 percent as of September 2016.

<sup>128</sup> Johnson (2007).



92. **Poor quality and scale of infrastructure is an important factor restricting Tajikistan's economic and social development.**<sup>129</sup> Although a sizable share of government expenditure has been allocated to capital outlays, large investment may have failed to improve Tajikistan's productive capabilities, raising concerns about the effectiveness of public investment. Albeit improving gradually over time, Tajikistan's infrastructure is of poor quality. Contractual arrangements between the Government and the private sector could potentially address many pressing needs in infrastructure. However, private sector participation is limited in Tajikistan due to its poor business environment and gaps in the legislative framework for public-private partnership ("PPP"). To date, Tajikistan's PPP experience remains very limited.

*Electricity shortages are taxing economic activity.*

93. **Acute energy shortages are serious obstacles for economic activity and social welfare.** Currently, Tajikistan cannot guarantee to fully meet the domestic demand for electricity, the primary source of energy, especially during the winter months. Businesses face frequent outages, incurring economic losses.<sup>130</sup> With the residential, industrial, and agricultural sectors consuming 80 percent of domestic energy, a major breakdown of the power system could cause enormous damage to Tajikistan's economy and social welfare.

94. **Tajikistan's precarious energy situation today attributes to a combination of factors:** high demand for heating in winter; reduced electricity supply in winter; lack of alternative energy source (e.g., gas); transmission loss; and financial distress of the state-owned energy company, Barqi Tojik, which dominates the sector. Tajikistan's winter-time demand for electricity is unusually high because of limited alternative means of heating and low electricity prices (amongst the lowest in the world).<sup>131</sup> Increased demand in winter coincides with the minimum availability of electricity generated by hydropower plants due to low river flows, causing severe electricity shortage. In contrast, there is an energy surplus in summer, given relatively lower electricity demand in the country. The discontinuation of electricity trade in 2009 through the unified Central Asia Power System also contributed to Tajikistan's energy shortages today.

95. **Barqi Tojik is in serious financial distress due to operational inefficiencies, political interference and weak corporate governance.** The company's financial health has been deteriorating, because of below-cost-recovery tariffs, excessive transmission losses, power thefts, and low collection of user charges, resulting in the accumulation of large receivables.<sup>132,133</sup> Over time, Barqi Tojik has found it increasingly difficult to make timely payment to suppliers, pay tax, service debt, and conduct required capital repairs and maintenance, causing a serious repercussion impact on the rest of the economy. The issue of debt service is particularly acute due to the size of the company's total liabilities, including short-

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<sup>129</sup> Tajikistan scored poorly on the quality of overall infrastructure in the World Economic Forum's Global Competitiveness Index 2017/18 (3.3 out of 7, where 7 is the highest score).

<sup>130</sup> The 2013/14 Enterprise Survey suggests that firms experienced six electric outages in a typical month incurring a loss of 9 percent of annual sales. Fields, et al. (2013) estimate that electricity shortages impose economic losses exceeding US\$120 million a year.

<sup>131</sup> The resumption of gas imports from Uzbekistan is not expected to reduce the need for electricity-based heating in the short run, since the gas is imported only for the needs of TALCO (about 130 million cubic meters).

<sup>132</sup> During 2012-14, the end-user tariffs were raised by a cumulative 46 percent (nominal terms), but it was not sufficient to allow the company to recover its costs. Estimate suggests that the average tariff was 55 percent below the cost recovery level in 2015.

<sup>133</sup> TALCO, by far the largest electricity user in the country, is responsible for over 90 percent of Barqi Tojik's accounts receivable (Barqi Tojik 2017).



term debt, estimated at 28 percent of GDP at end-2016.<sup>134</sup> Of this amount, 56 percent was owed to the Government, mostly in the form of on-lending, but also tax payables, and penalties on overdue debt service payments and outstanding arrears. Barqi Tojik's delinquency has forced the Government to shoulder some of the company's external debt service obligations from the state budget. In 2015, the Government allowed Barqi Tojik to clear its outstanding payables to independent power producers through capital injection.

96. **To close winter electricity generation gaps, new coal-fired projects, including the Dushanbe-2 project, are being built.** In parallel, existing hydropower plants are being rehabilitated with assistance from development partners, while the construction of the Rogun HPP continues. Furthermore, efforts are also under way to improve the reliability of electricity supply through the construction and rehabilitation of transmission lines and substations. The installation of transmission lines is advancing, including the Central Asia South Asia ("CASA-1000") electricity transmission project, which upon completion will allow Tajikistan to export its summer energy surplus to Afghanistan and Pakistan.<sup>135</sup>

97. **Measures to improve Barqi Tojik's financial viability are being implemented.**<sup>136</sup> The Action Plan for Financial Recovery of Barqi Tojik, approved by the Government in April 2017 includes key actions such as: (i) adoption of a cost-recovery electricity tariff methodology; (ii) a gradual increase of average end-user tariffs to full cost-recovery levels; (iii) improved payment collection, including outstanding receivables; (iv) reduction in transmission losses; and (v) repayment of commercial loans from additional cash or cost savings generated from the implementation of the measures in the Action Plan. Progress made thus far includes a partial settlement of part of outstanding payables to independent power producers and two tariff increases. The Government is currently discussing the approach to restructure Barqi Tojik's liabilities.

*Large gaps in transport infrastructure and services undermine Tajikistan's competitiveness.*

98. **Tajikistan can improve its integration into value chain at the national, regional and global levels by lowering trade costs and enhancing connectivity.** Given Tajikistan's topology and geographic location, distance naturally functions against the development of trade supply chains and integration into value chains at the national, regional, and global level. Limited regional and global integration restricts access to foreign inputs, a major conduit of technology and transfer, and in turn hinders Tajikistan to develop new capabilities necessary to produce high complexity industries and economic diversification.<sup>137</sup> Poor domestic and regional connectivity also affects social conditions by raising domestic price levels of both imported and domestically produced goods and services, and for the population's access to them, especially during the harsh winter periods.

99. **Improving connectivity goes beyond physical infrastructure and logistics.** Equally, if not more, important is the commitment for cooperation at political levels. Numerous agreements to deepen economic cooperation, both among CIS countries and with their neighbors (Russia, China, Iran, Turkey), have generated no substantive results, reflecting sensitive geopolitical dynamics, although the bilateral relationship with Uzbekistan is improving at a fast pace lately.

100. **Tajikistan has one of the world's highest trade costs due to its remoteness, inadequate transport infrastructure, and limited logistics support, which undermine the country's**

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<sup>134</sup> Ministry of Finance.

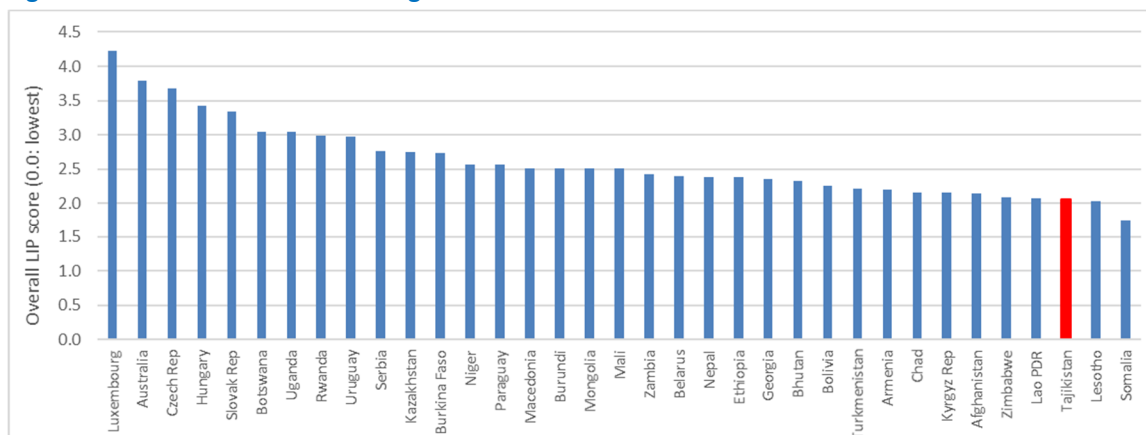
<sup>135</sup> <http://www.casa-1000.org/>.

<sup>136</sup> World Bank (2017c).

<sup>137</sup> Hidalgo, et al. (2007).

**competitiveness.**<sup>138</sup> The country's logistical performance—which measures the efficiency of moving goods and connecting domestic producers and consumers with international markets—is significantly below most of the land-locked countries in African (such as Chad, Mali, Niger, and Zimbabwe) and Asia (including Afghanistan, Bhutan, Lao, and Nepal) (Figure 30). The NDS 2030 rightly puts a highest priority towards improving connecting infrastructure at the domestic and regional levels.

**Figure 30: Land-locked Countries: Logistics Performance Index**



Source: World Bank LPI database.

101. **Despite major efforts, Tajikistan's road connectivity within the country and with neighboring countries in Central, East and South Asia is limited and subject to winter closures.** With the assistance of development partners, Tajikistan has made good progress in rehabilitating key road links of strategic importance, reducing transport times and cost between major cities and key border points.<sup>139</sup> The Government is now focusing on the improvement of links to China and Afghanistan, while making steady progress in asset management and preservation strategies.<sup>140</sup> This will not only restore reliable, affordable and safe access, increase regional connectivity and stimulate the development of an outward-looking private sector. However, much remains to be done. The road network is inadequate for increasing traffic volumes and loads. Vehicle overloading has increased, and road-safety has deteriorated.

102. **The reopening of rail link with Uzbekistan in March 2018 is expected to boost Tajikistan's trade with Uzbekistan and the rest of the world.** Since all rail cargo into and out of Tajikistan transits through Uzbekistan, Tajikistan had suffered from functionality and reliability of freight trains, which reflected difficult relations between the two countries. In particular, the closure of the railway Amuzang-Khatlon in 2011 by Uzbekistan was a major blow to Tajikistan, forcing many exporters to use more expensive but reliable road transport.<sup>141</sup> The completion of the tri-nation Turkmenistan-Afghanistan-Tajikistan railway, inaugurated in June 2013, is expected to further enhance Tajikistan's trade opportunities with global markets by providing a direct access to Indian Ocean. Despite these benefits, however, Tajikistan has not

<sup>138</sup> World Bank (2016b).

<sup>139</sup> During 2011-15, about 878 kilometers of roads, 130 bridges and 2 tunnels were rehabilitated and reconstructed with foreign support.

<sup>140</sup> The Government is in the process of creating a modern road database, information technology hardware and software as well as implementing a pilot project on the introduction of weigh-in-motion systems that are designed to capture and record axle weights and gross vehicle weights automatically as vehicles drive over a measurement site.

<sup>141</sup> For instance, TALCO—once the largest railway customer—shifted its traffic shares to trucks, an uneconomical transport mode for bulk goods, following the closure of the rail link in 2011. See World Bank (2015).

begun the work of its portion of the railroad, as Afghanistan has not yet started the construction of its own section, due to a deteriorating security situation of the area concerned.

103. **For a country with underdeveloped road network, air connectivity is key to its economic development.** As Tajikistan is regularly affected by natural disasters that tend to isolate communities for long periods, air connectivity also serves as a critical lifeline for emergency situations. The country's geographical location could enable it to become a regional transit hub, once its airports are expanded to accommodate bulk airfreight and passenger transfers. However, air transport and civil aviation services are relatively underdeveloped. Overall Tajikistan's air transport system is expensive and inefficient due to limited competition, and has inadequate coverage, with no major international airlines flying into and out of Tajikistan, except for Turkish Airlines.

104. **Connectivity can be improved through the development of the telecommunications sector including expanding internet availability that could widen economic opportunities.** Information communication technology ("ICT") capabilities have become particularly important for innovation, enabling new businesses models and the emergence of new markets, especially for landlocked countries.<sup>142</sup> However, the use of the internet is still limited in Tajikistan, due in part to the prohibitively high prices of internet services, arising from the limited competition in the market.<sup>143</sup> Although there is no evidence to indicate that the limited use of the internet has constrained Tajikistan's economic development as yet, there is no question that a wider and more affordable access to ICT services can bring efficiency gains to all the players in the country, Government, private enterprises and households, and help expand their economic opportunities.

## 5.2 Agriculture Development

105. **Agriculture plays a vital role in socio-economic development and food security in Tajikistan.** The sector employs more than half of the total population and accounts for about a quarter of GDP. Income from agricultural production is the largest source of income for the poorest rural households. More than 40 percent of formal private sector firms in Tajikistan operate in the agriculture sector. Thus, improving agriculture will have the largest and most direct impact on creating employment and contributing to economic and social stability in the present economic structure.

106. **Tajikistan has undertaken important reforms, albeit belatedly, removing the basic impediments to efficiency gain and agriculture productivity.**<sup>144</sup> Soviet-style collective farms have been restructured, and land plots withdrawn from the collective have been redistributed to individual and family-held "*dekhan* (peasant)" farms with lifelong-inheritable rights to use ("farm privatization").<sup>145</sup> This, coupled with price liberalization of the domestic cotton market, "freedom to farm" reform, reduced local government interference in farming decisions, and the resolution of cotton debt problems, has provided important impetuses to productivity growth and crop diversification. Furthermore, land use rights certificates have been issued to strengthen tenure security, and a unified registration and cadaster system has been established to immovable property and rights to it. The latest reforms to the Land Code (2012),

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<sup>142</sup> Kelly, et al. (2017).

<sup>143</sup> Only 17 percent of Tajikistan's population are connected to the internet (on any device), compared with 55 percent in Kazakhstan. Tajikistan's fixed broad-band penetration is less than 1 percent, significantly lower than Kazakhstan's 30 percent. In 2014, the prices for fixed internet (per Mbit per month) was over US\$110 (in PPP) in Tajikistan, compared with US\$25 in Kazakhstan. See Kelly, et al. (2017) and World Bank (2016c) for further discussion.

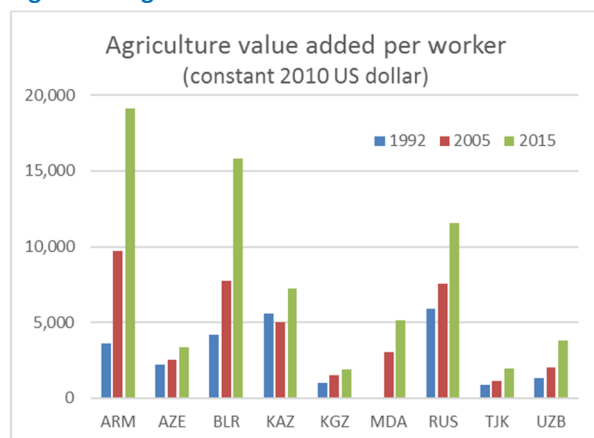
<sup>144</sup> World Bank (2014b).

<sup>145</sup> According to the law, all land belongs exclusively to the state.

when implemented fully, will allow for buying and selling as well as mortgaging of land use rights to raise credits, laying the foundation of a land market.

107. **These reforms have led to a dramatic change in the farming structure, sharp increase in crop diversity and productivity.** While the state owns all the arable land in Tajikistan, today private farms contribute to 91 percent of gross agricultural output.<sup>146</sup> A more profitable and sustainable balance between cotton, other crops and livestock is emerging, whereas there is increasing investment in the production and processing of high value fruit and vegetable crops, leading to a marked increase in the volume of output per hectare. Commercialization of agriculture is also emerging.<sup>147</sup>

**Figure 31: Agriculture Value Added Per Worker**



Source: WDI.

108. **Nevertheless, productivity and competitiveness of Tajikistan's agriculture are still well below its potential and those of other CIS countries with more successful reforms (Figure 31).** Growth in livestock production has not kept pace. The development of agricultural value chains has lagged, while exports of agribusiness products remain limited and concentrated in a few markets. Despite the sharp increase of the past, labor income from agriculture remains very low, and Tajikistan continues to face food insecurity, requiring to import nearly 70 percent of domestic food demand every year, and thus vulnerable to developments in global food prices.<sup>148</sup>

109. **Tajikistan's potential to further develop its agriculture sector, including value chains, is constrained by several inter-related challenges.** First, the agricultural sector is highly fragmented and thus limits economies of scale, because of farm reorganization (which have shifted agricultural production patterns away from large-scale mechanized farming towards small-scale subsistence) and close-down of agro-processing facilities from the Soviet era.<sup>149</sup> Second, farmers often have difficulty obtaining seeds, fertilizer, and fodder at reasonable prices, due to the under-developed seed and agro-chemical industry and monopolies of suppliers and high input costs.<sup>150,151</sup> Moreover, the lack of tradability of land use rights preclude farmers' access to credit due to collateral, as well as their willingness to use land in a sustainable and expand their production capability and invest. The lack of clear ownership structure of assets and concerns over O&M responsibilities has impeded further investment, leading to the continued

<sup>146</sup> More than 150,000 *dekhan* farms have now largely replaced collective farms that dominated agriculture at independence on 550,000 hectares of arable land, accounting for 80 percent of total arable land in use in the country in 2015.

<sup>147</sup> According to official statistics, agriculture value added has grown at an average rate of 8 percent a year since 2000. However, caution is required to interpret official statistics. For instance, agriculture value added produced by the official sources do not show any impact of major droughts that periodically hit the country.

<sup>148</sup> Asian Development Bank (2016).

<sup>149</sup> World Bank (2012).

<sup>150</sup> Many able-bodied men migrate to work outside their country, often in Russia, and the labor force in some villages is reduced to women, youth and pensioners. Families may experience labor shortages, especially in seasons when migrants are not at home, which in turn may lead to increased vulnerability.

<sup>151</sup> Organisation for Economic Co-operation and Development (2015a), Hofman (2016), and Hofman (2017).

deterioration of irrigation and drainage infrastructure.<sup>152</sup> While several projects supported by development partners have sought to rehabilitate irrigation infrastructure, its vast scale and inherent inefficiencies have made it an extremely large and expensive task.<sup>153</sup> Soil degradation, another major impediment for agricultural productivity improvement, is aggravated by poor water management.<sup>154</sup> Post-harvest losses are significant due to the absence of fast, reliable and economically affordable transport infrastructure and the lack of effective logistic services, including climate-controlled storage facilities. There are no well-organized extension services that can provide the changing skills demand in agriculture. Farmers with technical and business skills are in short supply, and knowledge gaps are acute due to a weak educational system and emigration. The links between farmers and food-processors are weak. Many farmers prefer to sell their production directly to the local fresh markets, leaving food processing plants to operate at a fraction of their capacity and inhibiting growth of agribusiness value chain.<sup>155</sup> Quality control, certification, marketing, packaging, and branding of Tajikistan's products are weak.

## 6 Challenges and Opportunities: Employability

**110. Better skilled labor will be needed for Tajikistan to maximize the demographic dividends, accelerate growth and maintain stability.** Tajikistan is faced with the challenge of developing its human capital base as these are needed for private sector driven growth. Accumulation of human capital is an integral part of the strategy to boost the economy's competitiveness. Thus, though the country has many natural resources as well as unexploited growth opportunities, in addition to a favorable economic policy environment it needs to have productive labor—whether in terms of education, skills, nutrition, or good health. Policies and programs that further improve human capital will also have the benefit of making growth inclusive and increasing the population's commitment to a stable and prosperous Tajikistan.

**111. The State Labor Market Development Strategy in the Republic of Tajikistan up to 2020 lays out the Government strategy to improve opportunities for workers.** The strategy's objectives are to increase labor activity, increase employment by improving the business environment and creating a flexible, secure and accessible labor market. The strategy indicates the Government's clear understanding of the domestic challenges affecting Tajikistan's working age population in terms of lack of sufficient jobs, low wages, and their vulnerability to global and regional economic crises. The document also recognized that labor migration abroad helped to reduce the pressures on the domestic economy to provide employment to the rapidly growing work force.

**112. In conjunction with the steps laid out in the Government's strategy, Tajikistan can achieve significant improvements in human capital by strengthening education, health services (including family planning), and the population's nutritional status.** Tajikistan can reap the demographic dividends by reducing its high fertility rate and increasing labor force participation and ultimately, employment. The

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<sup>152</sup> Despite these efforts, the Land Code is yet to be fully implemented, and Tajikistan still lacks an active land market. There is no standard for land evaluation. Unable to trade land user rights, holders of land user rights cannot access to mortgage-based credits, undermining incentives to invest. The implementation of the Land Code requires a few policy actions, most importantly the adoption of the secondary legislation which provides for the alienability of land use rights, and a sufficient legal protection for property rights (i.e., protection against terminations or revocation of rights by the State). Access to land registries can be improved.

<sup>153</sup> Asian Development Bank (2016).

<sup>154</sup> Land degradation also affects adversely traditional livelihoods of rural poor (such as forest wood, wild plants, and pastures), and water streams (through coastal erosion), increasing the country's exposure to natural disasters.

<sup>155</sup> World Bank (2013b).

Government is the primary provider of social services to the population since the private provision of health and education services is still limited. However, the Government faces many challenges not least due to inadequate current and capital budgets, institutional weaknesses of relevant ministries, and difficulty providing services to a dispersed yet rapidly growing population. Moreover, addressing the under- and mal-nourishment of the population—especially, children—is of paramount importance not least because of humanitarian reasons but also because of the impact on cognitive skills of future workers. However, despite these and other constraints, the country can achieve significantly better outcomes by instituting moderate reforms.

**113. This Chapter discusses the major challenges facing the country in these sectors, but also discusses some of the key policies and reforms to boost the country's human capital,** thereby improving labor productivity, and opportunities for formal sector employment or self-employment. Challenges related to improving non-monetary welfare, including gender issues, will also be discussed.

## **6.1 Education: Access, Quality, Relevance and Equity**

**114. The Government has an important role to play in improving skills and labor productivity.** According to a recent World Bank study, employers are eager to hire skilled workers yet find that many labor force participants lack the necessary skills.<sup>156</sup> The development of skills occurs over a life time with families, the education system, and employers playing a central role. Interventions in education and health improve skill formation from conception to preschool, in general education, in higher education, and while part of the workforce. Ensuring a broader focus on cognitive and noncognitive skills valued by the labor market will result in better welfare outcomes for the population especially if combined with policies on enhancing private sector development.

*Improving educational quality and improving access to higher levels of education are within reach.*

**115. Tajikistan's commitment to universal access to basic education is impressive and allows households to invest and develop their human capital assets. Education is also one of the best pathways out of poverty in Tajikistan.** The Government provides free and compulsory basic education (Grades 1 – 9).<sup>157</sup> With gross and net school enrollment rates near universal, access to basic education is widespread across all income groups, though some mountainous areas with dispersed population still face difficulties. Furthermore, the completion rates of both primary and lower secondary school are high with full gender parity at the primary level and somewhat lower female completion rates at the secondary level (95 vs. 100 percent for girls and boys, according to the WDI database). Upon completion of basic education (9th grade), outcomes are less favorable. Though four in five students continue their education (in 2015), almost one in three drop out before completion—though school retention rates appear to be improving in recent years. Yet even without legislation, there are more students in the 20-24-year-old age group demonstrating the increased interest in professional education among the youth. Tertiary education has seen a steady increase over the past decade with a significant but narrowing gender gap in favor of males.

**116. The Government has been proactive in strengthening of the education system over the last decade, thus providing better services to the population and increasing equity.** The Government's National Strategy for Education Development aims to ensure universal access to relevant and quality education. One key indicator of the Government's commitment to educational reform is the increase budgetary allocation to this sector from 4.0 percent to 5.2 percent of GDP during 2010 and 2015. This

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<sup>156</sup> Ajwad, et al. (2014).

<sup>157</sup> That includes primary level (Grades 1-4) and lower secondary level (Grades 5-9).

increase was accompanied with efficiency improvements such as the decrease in the wage bill share in the school budget from 92.8 percent in 2005 to 71 percent in 2010 (86.6 percent in 2016) and higher average class size to 23 students in 2016. In addition to providing more resources, the Government has taken the following four key reforms:

- **Introduction of per capita financing** has led to (i) improved equity in public resource allocation across the regions, (ii) increased efficiency of education spending in general education, and (iii) increased school autonomy.
- **Development and expansion of the Education Management Information System (“EMIS”)** helped to improve the quality of education data for decision makers thereby, providing valuable input to crafting an education strategy. The information collected through the EMIS helped policymakers identify important gaps such as scarcity of teachers in rural areas in the first decade of 2000s, high level of dropouts during the schooling and factors influencing education sector trends.<sup>158</sup>
- **Establishment of the National Testing Center** and implementation of a new university admission system in 2014. The launching of the Unified Entrance Examination (“UEE”) for universities led to greater merit-based admissions to universities and consequently increased equity by increasing female admissions (by 10 percent) and students from rural areas (by about 40 percent).
- **National launch of a new primary grades competency-based curriculum** which should help to improve educational outcomes. However, the reform is at the early stages and needs continued support to ensure its success.

These major reforms led to addressing teacher shortages, improved teachers’ educational qualifications, increased availability of textbooks and equipment, and helped improve to teachers’ and education managers’ qualification.

117. **Key challenges.** Successful improvements in access to and equity of education help to lay the foundation for enhancing skills of the domestic labor force—a necessary step forward for increasing worker productivity and raising wages sustainably. This is especially important since foreign employment—and higher wage—prospects have contracted, leaving the population dependent upon domestic employment and wage opportunities. To ensure that the labor force is positioned to contribute to the growth of the economy, the education system needs to be further strengthened—but with a long-term view that spans the full educational experience of citizens. The Government can do this by addressing three main challenges: (i) limited early childhood education (“ECE”) quality and coverage, (ii) deficient quality of basic, secondary and higher education, and (iii) inadequate relevance of educational curriculum in preparing students for the labor market. Making major advances in addressing these challenges will help to increase worker productivity—and, ultimately, economic growth.

118. **Access to pre-school education.** Preschool education (ages 3-6 years) is an important step in improving long-term learning outcomes by supporting physical growth and overall development (including cognitive, linguistic, and socio-emotional). Enrollment of children from poor families is especially important as it helps to increase school readiness, prevent stunted growth, and ensure better care of the child. Tajikistan’s current preschool enrollment rate is 12.4 percent, well below the

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<sup>158</sup> EMIS data is also used to predict student intake in grade 1 and thus to allocate required resources, to plan teachers’ training and professional development, and investments in schools’ physical infrastructure.



Government's target of 40 percent by 2030. Though the number of public preschools and student enrollments have increased rapidly in recent years, the system faces constraints that need to be tackled to expand preschool coverage, especially in rural areas. The key constraints are (i) lack of qualified teachers and specialists, (ii) high student-teacher ratio (25:1), and (iii) lack of adequate physical space. There are an insufficient number of trained personnel with appropriate skills to nurture the development of young children and prepare them for lifelong learning. Moreover, the lack of teaching-learning material and poor facilities makes the ability of teachers to deliver quality services even more difficult. However, it is not only the availability of public preschools that act as a binding constraint to coverage, but also the population's attitudes towards the added value of this education—especially, since preschools charge fees that are a financial burden on poor households with multiple school-aged children.

119. **Quality of general education.** To enhance returns to education, especially in a country with such high rates of access, the key is to focus on student learning levels. Though there is no systematic standardized student assessment for general education, there are some assessments that are indicative of quality deficiencies. For instance, the 2014 Early Grades Reading Assessment (“EGRA”) found that only 13 percent of Grade 2 students met the national literacy standard (due to poor performance in reading fluency, though many students met comprehension, phonological, and dictation benchmarks) and many scored low on critical thinking skills.<sup>159</sup> Quality of secondary education can be assessed indirectly based on UEE results. For example, 35 percent of students who took the exam in 2014 did not achieve the minimum score required for being eligible for competition. Several factors contribute to the poor quality of learning including below average number of instruction hours (76 percent of OECD countries average), a curriculum biased towards language instruction with limited emphasis on higher-order analytical skills and organization skills, and excessive number of courses in Grades 8 and 9 which may lead to inadequate attention to essential subjects. In addition, the physical school environment itself is lacking and adversely impacts learning. Almost one-third of school buildings require rehabilitation and many schools lack basic amenities such as running water, sanitation, lighting and heating.<sup>160</sup>

120. **Vocational skills development.** Students can acquire professional skills for the labor market at vocational education training institutes (“VET”) following the completion of Grade 9 or Grade 11. According to the United Nations Children’s Fund (“UNICEF”), the Ministry of Education and Science has made progress in upgrading the curricula and learning standards at VET institutes, yet lacks a VET strategy and enabling framework to adopt major reforms. At present, about 4 percent of general secondary graduates enroll in VET institutes. However, upgrading VET systems can be costly (more so than general education) due to the need for up-to-date equipment, technology, and qualified training staff. Moreover, VET reforms are complex as they require (i) close coordination with businesses to ensure relevance of skills, (ii) targeting of priority sectors that could absorb graduates, and (iii) instituting flexibility in the curricula to respond to changing market needs. A successful VET system helps to train the country’s workforce, improve labor productivity and reduce underemployment in low skill occupations.

121. **Strengthening higher education.** As knowledge becomes an important driver of economic growth, so does higher education. Consequently, Tajikistan needs to educate more of its youth to a higher standard. However, quality of knowledge generated within higher education institutions matters for national competitiveness. Tajikistan’s tertiary gross enrollment rate of 29 percent is above the average of lower middle income countries (23 percent) indicating the emphasis already being placed by the Government on higher education. Yet there are concerns about the quality of education and equitable

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<sup>159</sup> The 2011 EGRA found that 31 percent of Grade Two students did not meet national standards for reading fluency, rising to half of all students in Grade Four.

<sup>160</sup> [https://www.unicef.org/tajikistan/overview\\_27465.html](https://www.unicef.org/tajikistan/overview_27465.html).

access. Some of the drivers of inadequate quality are poor—and possibly—declining quality of the teaching workforce, lack of research capacity, poor governance structures, and the lack of preparedness of many of the students. The lack of cooperation with the private sector (due to the rigid and centralized governance structure of the higher education institutions) also has a detrimental impact on the relevance of the curricula for the labor market making many students feel unprepared for employment.<sup>161</sup> In addition to these difficulties, there are problems of equitable access with a bias towards males (59 percent of the student body) and students from more affluent households. However, the move to a merit based selection process is helping to address this problem.

## 6.2 Health

*Closing health deficits as well as reforms will consolidate the foundation for productivity gains.*

**122. The Government is committed to improving access—especially, equitable access—to essential health care services.** The priority problem areas are maternal and child health, reproductive health, noncommunicable diseases, malaria, tuberculosis, HIV/AIDS, and other sexually transmitted infections. The Government has established a regulatory framework for the health sector that includes nine laws, 18 government decrees, and about 40 orders of the Ministry of Health. The National Health Council of Tajikistan was established by government decree to coordinate efforts to improve population health. The Ministry of Health is responsible for “the development, implementation, monitoring, evaluation, and coordination of a unified state policy in the health sector, and for controlling the quality, safety and effectiveness of health services, pharmaceuticals, and medical equipment.”<sup>162</sup> The steps are indicative of the Government’s attempt to institutional and regulatory development of the health sector.

**123. Tajikistan has identified reforms to improve the effectiveness and financial sustainability of the health sector to deliver services to the population.** Reforming the health sector is a complex endeavor which potentially can have a positive impact on all households irrespective of income. The main thrust of recent reforms in Tajikistan aim to strengthen the primary health care (“PHC”) system and, concurrently, restructure the oversized—and unaffordable—hospital delivery network which was inherited from the Soviet period. Two major reforms recently begun are as follows:

- **Pilot introduction of the basic benefit package (“BBP”)** wherein a limited number of PHC services are free and some hospital and diagnostic services have formal co-payments with some exemptions; the goal is to make the benefit package explicit, to avoid informal payments, and to facilitate an exemption mechanism for the needy.
- **Introduction of per-capita financing (“PCF”) for primary health care services.** This approach to government financing of PHC would be based on the size of the catchment population, thus narrowing the gap in financing between districts because it enforces a minimum PCF level. Beginning in 2016, the Government passed a decree with a roadmap for rolling out the PCF nationally. Over the long-run, this should also help improve the efficiency in the system, as district authority in principle can decide to shut down underused facilities without fear of loss of central government funding.

Additional important reforms in recent years include (i) building managerial and financial capacity at PHC facilities; (ii) introduction of the Family Medicine (“FM”) model of practice; clinical capacity building of PHC physicians and nurses in FM; and (iii) rehabilitation and provision of medical equipment to PHC

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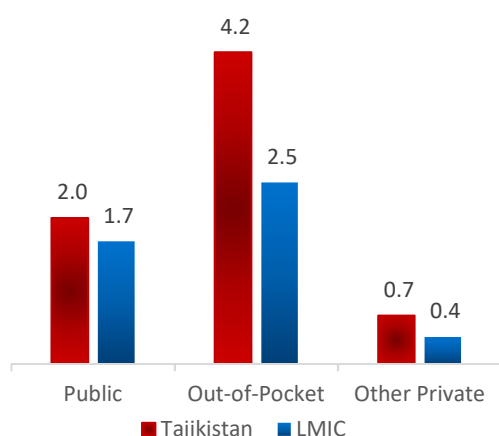
<sup>161</sup> Amoroso, et al. (2014).

<sup>162</sup> Khodjamurodov and Bernd (2010).

facilities. The Government has also attempted to introduce Mandatory Health Insurance, which has seen limited success in middle income countries, especially with large formal sectors.

124. **Key challenges.** The health care system in Tajikistan continues its implementation of reforms yet challenges remain which will require significant changes in the financing, structure and delivery of services to the population. The main challenges for the system are increasing affordability, equity, quality of services. If these challenges are successfully addressed, the health of the population will not only see greater improvements, but it will also lead preventing households falling into poverty due to unexpected medical expenses. Yet in addition, to health system challenges, there is also the broader challenge of stunting that affects the most vulnerable in society, i.e., children and population growth. Though this is indeed a health challenge, the factors that lead to it are more complex and at times beyond the scope of any single government ministry or agency to address.

**Figure 32: Health Expenditures in 2014**  
(in percent of GDP)



Source: WDI.

health services not covered by the BBP could potentially face a financial burden that may be excessive, especially for low and middle income groups. For example, in 2011, 27 percent of households in the lowest consumption quintile faced catastrophic expenditure.<sup>164,165</sup>

126. **Equity.** Inequities in health care are exacerbated by the current financial mechanism. Until the BBP and PCF programs are nationally rolled out, these inequities are likely to persist. At present, public financing depends principally on regional and local authorities, thus extending regional inequalities across the country. The health services provision is organized by the administrative tiers and differs in urban and rural areas. The equity (and efficiency) of the health system is undermined by the lack of pooling of funds across administrative areas. Thus, poorer *rayons* and *oblasts* rely on their own limited resources while more affluent administrative areas can access their own larger resource pool. Without the central government taking steps to redistribute income, across administrative regions, these inequities are likely to continue to grow.

125. **Affordability.** The population's access to affordable health services remains a concern, especially to hospital and diagnostic services which are mostly not free.<sup>163</sup> Public health care expenditures are modest at 2.0 percent of GDP, while private expenditures far exceed this amount at 4.9 percent of GDP (in 2014). As seen in Figure 32, about two-thirds of health expenditures are private of which the majority are out-of-pocket ("OOP") expenses. High levels of private OOP expenditures hurt poor families disproportionately and may also discourage households from seeking out essential health care. The national roll out of the BBP is critical as it will help to ease the financial burden of health expenditures. Yet the BBP is not comprehensive as non-PHC services will not be covered. The exclusion of selected services implies that households that need

<sup>163</sup> Emergency care is free and some groups of population who are exempted from co-payment (fee) based on social or medical status.

<sup>164</sup> Catastrophic expenditures are measured as OOP spending on health of 40 percent or higher of a household's non-subsistence spending.

<sup>165</sup> Khodjamurodov and Bernd (2010).

127. **Efficiency.** The below average public financing for health care is compounded by the inefficient allocation of scarce resources. As the latest *Health Public Expenditure Review* noted, hospitals and multi-profile polyclinics absorb more than three quarters of public spending.<sup>166</sup> However, low hospital service standards affect their effectiveness, quality and efficiency. Around 65 percent of buildings were built from the period 1938 to 1990 and do not meet basic requirements. There is an oversupply of beds and avoidable inpatient admissions (estimate shows around one out of three patients could have been treated in outpatient settings). Salary of health personnel comprise more than 70 percent of total health spending, squeezing expenditures for necessary supplies such as drugs and laboratory consumables.

128. **Quality of services.** The health system also suffers from problems of clinical quality of care which could be improved by changing the skill mix of health care providers. An example of the lack of training is from the verification analysis conducted in 2013 by the UNICEF.<sup>167</sup> The health system in Tajikistan suffers from an over-reliance on specialists—which is also exacerbated by consumers—one-third of whom seek some type of specialist (polyclinic specialist, hospital doctor, private doctor, or pharmacist), as opposed to a nurse/feldsher or family doctor (generalists). Furthermore, the culture of seeking out preventive care—for example, annual checkups, is not well-developed in Tajikistan. In the previous year, about 20 percent of the population was estimated to have had a general health check-up, but 27 percent had some type of x-ray or other scan, despite these being more specialized procedures.

129. **Stunting and malnutrition.** Stunting and wasting of children under the age of 5 years and under-nutrition are major problems affecting Tajikistan. Addressing stunting and malnutrition effectively requires a multi-pronged and inter-sectoral approach which covers environmental factors such as access to water and adequate sanitation together with food security and dietary diversity, health care, and child care practices. Also, given that stunting and wasting affects children from a very young age and has long-term consequences, early childhood interventions to prevent life-long impairments may be warranted. The Early Childhood Development (“ECD”) System Approach for Better Education Results analysis conducted by the World Bank in 2013 classified policy interventions for ECD in Tajikistan as “emerging” and requiring considerable improvement to ensure equal opportunities for all children to reach their full development potential.

130. **Population growth.** Tajikistan’s population growth rate is high and calls into question the continued progress of poverty reduction. The Government’s ability to expand the delivery of basic public services—such as health, education, water or electricity—to a rapidly growth population is both difficult and expensive. For households with low incomes and few remunerative employment opportunities, having a large family is expensive and increases dependency on the few income earners. To reduce the challenges of a rapidly growing population, the Government needs to address the issue of early marriage, inadequate low contraceptive prevalence (28 percent of women ages 15-49 years), high fertility rates (especially among adolescents) and high *wanted* fertility rates. By changing peoples’ fertility preferences as well as ability to control their fertility through contraceptives, the pressure on job creation, government spending, and public services can be reduced.

### 6.3 Social Safety Nets

131. **Strengthening the social contract with citizens is an important step, especially given Tajikistan’s social and economic vulnerabilities.** There are many ways available to the Government to improve its

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<sup>166</sup> World Bank (2013c).

<sup>167</sup> This study revealed 40 percent of hypertension diagnoses were not in compliance with the protocol indicating the lack of health professionals’ knowledge and potentially having an adverse impact on patients’ health status.

relationship with the population such as increasing peoples' opportunities to voice their concerns, being responsive to their demands, and providing expanded coverage of high quality public services. Yet, at the most basic level, there are some population groups that are so desperate that they struggle to meet basic human needs of food, water, and shelter. As the economy has grown, there are some groups that remain largely untouched by the increase in prosperity. For these groups, the Government has been working to modernize the social assistance system.

132. **The Government rolled out a new program, Targeted Social Assistance ("TSA").** Beginning in 2011, the Government piloted the TSA which replaced two old and inefficient legacy programs. Up until very recently, safety nets and cash transfers have not played a major role in helping the poor and they suffered problems of low coverage, efficacy and efficiency.<sup>168</sup> Gradually the TSA coverage has been expanded from two districts to 40 districts, or close to two thirds of the country. The TSA now has been adopted as a core component of the Government's reform agenda for the social assistance system having been signed in a Law by the President in February 2017. The plans are to have it rolled out nationally in 2018. An important reason for establishing the TSA was to achieve better targeting with the move towards using proxy means testing ("PMT") for the beneficiary selection mechanism. Once it is fully established and rolled out nationally, it will present the opportunity for reaching a greater share of the population in need.

133. **Key Challenges.** To sustain the current success of the safety net reform, additional investments are required. The State Agency of Social Protection ("SASP"), which oversees administering the system of social assistance, has been in existence only for three years. In addition to the TSA, it manages several other benefits. Furthermore, as of September 1, 2017, all administrative functions in managing the broad range of social services will be transferred to SASP. This creates great opportunities in improvements of service provision, as it helps unify the system of eligibility assessment for different types of benefits for the needy and vulnerable families. At the same time, this puts a significant pressure on the young agency and requires a considerable effort of capacity building. As the TSA rolls out, new district and *Jamoat* offices will need to be prepared and staff trained. Furthermore, as part of the new delivery model, it will be important to expand the network of the Regional Coordination Centers under SASP with a broad range of service functions for the clients of the TSA program and for other units of administration.<sup>169</sup> Finally, the systems of controls and monitoring will need to be strengthened since feedback will be an important part of institutional development.

## **7 Making NDS 2030 a Success: Priority Actions for Best Case Scenario**

134. **Imagine: in 2030 Tajikistan is a steadily growing, competitive country that provides decent living standards for population, equal opportunities for each person to realize his or her potential based on equality, justice and respect for human dignity (NDP 2030).**<sup>170</sup> As a result of earlier investment in critical infrastructure and human capital, coupled with successful governance reforms, Tajikistan's business environment has improved significantly, enabling vibrant private sector activity, and in turn boosting exports, reducing the reliance on imports, and creating formal sector employment. With the increasingly educated young population actively participating in the labor market, Tajikistan is reaping the demographic dividends. Poverty has fallen as more people have regular labor earning. Supported by an

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<sup>168</sup> World Bank (2014c).

<sup>169</sup> So far, two regional centers haven been established in Dushanbe and in Khorog to facilitate processing of the TSA applications and to provide various related services to the *Jamoats* and the districts.

<sup>170</sup> Republic of Tajikistan (2016a).

efficient financial system, private investment is rising as firms try to meet buoyant domestic consumer demand from an increased number of wage earners. Thanks to the expanded tax base and phased commissioning of the Rogun HPP, fiscal revenue has grown over time. Significantly strengthened public financial management capacity helps the Government allocate and spend resources effectively, while adequately managing domestic demand. Efforts to improve public service delivery has created a sense of a social contract among the population, contributing to stability. The Rogun HPP project is in the final phase of construction, and the full commissioning is scheduled for 2032. Tajikistan now is a well-established upper middle-income country.

**135. Development of a vibrant, competitive private sector is the backbone of this scenario, including the successful completion of the Rogun HPP.** Realization of the NDS 2030 depends critically on the development of a healthy, competitive private sector that invests and creates employment for the growing working-age population. A vibrant private sector will create employment opportunities and reduce the risk of social unrest, while allowing Tajikistan to benefit from the demographic dividends, spur growth, and soften the risk of debt distress. In other words, the successful commissioning of the Rogun HPP requires a thriving private sector to keep economic and social stability in check.

**136. Tajikistan's private sector faces three broad challenges that are inter-related: (i) macro-financial instability; (ii) weak public institutions; and (iii) infrastructure gaps and underdeveloped human capital, which are exacerbated by weak governance.** To adopt effective policies and institute reforms for private sector development—in turn, a successful commissioning of the Rogun—Tajikistan needs to address its problems of governance. Without it, any efforts to stimulate growth, including through hydropower exports, will unlikely to produce a sustainable economic and social prosperity in Tajikistan. The economic situation since late 2014 highlights the increased urgency of addressing existing weaknesses and constraints that hamper private sector activity, job creation and pursuit of the NDS 2030.

## **7.1 Macro-Financial Stabilization Needs Urgent Attention**

**137. The restoration of macro-financial stability is an urgent priority to improve market confidence.** Macro-financial stability is the cornerstone of any successful effort to promote private sector development and sustained economic growth. Macro-financial stability, in other words, greater predictability allows economic agents to better resource allocation decisions. A stable and well-functioning financial system plays a pivotal role in mobilizing and allocating resources efficiently towards their most productive use, provide financial safety nets, and facilitate efficient and secure payments.<sup>171</sup> A deep financial system can also contribute to macroeconomic stability, by facilitating the transmission of monetary policy and cushioning the impact of macroeconomic shocks, which tend to affect the vulnerable population disproportionately. Greater communication of future policy directions would help reduce uncertainties, alter expectations about future inflation and exchange rate, and boost confidence in overall economic policies.

### **7.1.1 Banking Sector Reform as a Top Priority**

**138. The banking system has the highest priority for macro-financial stabilization.** The current banking sector problems come at a cost of low lending, high interest rates, and depressed private investment. At present, Tajikistan's banking system no longer assumes its intermediation function

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<sup>171</sup> A deep financial system can also facilitate the transmission of monetary policy, and thereby cushion the impact of macroeconomic shocks. A good track record of macro-financial stabilization can also contribute to a long-lasting reduction in financial dollarization.



properly, and is a major obstacle for private sector investment, in the absence of the alternative sources of capital.<sup>172</sup> If left unaddressed, the precarious banking situation will further undermine public confidence in the economy, and could potentially trigger a financial sector meltdown with dire economic consequences and fiscal ramifications. The magnitude of Tajikistan's banking problem today requires the full implementation of the following actions. There are no alternatives.

**139. In the immediate short run, legal reforms are necessary to resolve the banking distress, while tackling governance issues to prevent recurrence of the problem.** Needed policy actions include legal reforms to establish a bank resolution framework to minimize cost to public taxpayers. Restructuring of outstanding non-performing SOE debt is also important to accelerate banks' balance sheet repair. The practice of directed and connected lending should be discontinued. Banks that are found insolvent but with no viable recovery plan should be liquidated in an orderly manner. At the same time, free and fair competition should be promoted to improve market discipline and operational efficiency, which in turn is expected to revamp cost structure and rationalize loan pricing.<sup>173</sup> The development of innovative approaches to the financial sector (e.g., mobile, digital banking) could also help improve the competitiveness in the financial sector.

**140. Parallel efforts are necessary to deepen the financial system and foster efficient financial intermediation in the medium term.** Besides strengthening financial infrastructure, it is paramount important to promote financial inclusion and instill a savings culture in Tajikistan. Increased somoni-denominated longer-term deposits will help facilitate financial intermediation in local currency by alleviating banks' severe funding constraints, and contribute to macroeconomic stability through improved monetary policy transmission. Increased savings and effective financial intermediation can help lower Tajikistan's external vulnerabilities by increasing resource mobilization at home. The importance of financial education and awareness campaign are increasingly recognized as an effective way to enhance financial inclusion and promote savings.<sup>174</sup>

### **7.1.2 Macroeconomic Management Needs Reinforcement**

**141. Policy coordination needs to be stepped up to ensure macroeconomic stability, in the context of large-scale public investment.** Despite Tajikistan's good track record, recent experience suggests the need to significantly reinforce the implementation of consistent monetary, exchange rate and fiscal policy mix to maintain a stable environment for private sector activity and reduce social impact. The Rogun project, given its size and complexity will pose a major challenge to the authorities' macroeconomic management. Large-scale domestic borrowing to meet the Rogun financing needs should be carefully evaluated against its impact on the domestic economy, including the risk of crowding-out of private investment.

**142. Efforts are necessary to rebuild policy buffers to safeguard macroeconomic stability from future shocks, including natural disasters.** International reserves should be increased to cover a full amount of the country's short-term debt to reduce risks of liquidity crisis. The authorities are encouraged to maintain greater exchange rate flexibility, which will also help ease foreign currency shortages, which are progressively impairing the ability of firms to carry out their business activities. Administrative controls on foreign exchange tend to lose effectiveness over time. Consideration could be given to abolish them or

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<sup>172</sup> International Monetary Fund (2017).

<sup>173</sup> In January 2018, the minimum authorized capital for newly established banks was reduced from TJS 80 million to TJS 50 million to ensure healthy competition in the banking system.

<sup>174</sup> Organisation for Economic Co-operation and Development (2015b).



replace them with market-based instruments. Fiscal space should be widened to safeguard macroeconomic stability from future shocks. Fiscal policy will remain the key macroeconomic policy instrument in Tajikistan, given the limited monetary policy effectiveness in the context of shallow and highly dollarized financial system.

**143. To manage risks stemming from large financing needs of the Rogun HPP, Tajikistan should develop a realistic and cohesive medium-term macro-fiscal framework, while bolstering its capacity to manage public debt and fiscal risks.** Annual and medium-term budgeting should include a borrowing strategy as well as future cost to maintain public assets, including the Rogun HPP. It is critically important to boost the capacity to record and manage debt data. As recommended by World Bank experts, a validation of government debt records for external, domestic and guaranteed debt is necessary to adequately understand the overall debt portfolio, and inform risk and cash management.<sup>175</sup> Annual fiscal risk analysis by the Ministry of Finance is encouraging. However, a more comprehensive and reliable SOE financial databases are necessary for adequate risk monitoring and management. Finally, there is a need to undertake vigorous credit assessment before providing on-lending or guarantees to SOEs, to avoid a further build-up of contingent liabilities.

## **7.2 Create Effective Public Institutions**

**144. A modern, rationally and effectively functioning public institutions is an irreplaceable prerequisite for sustainable socio-economic development.** International evidence suggests that countries rarely achieve sustainable economic and social development in the absence of effective state institutions. Without well-functioning public institutions efforts to develop the economy, including through large investment, is often ineffective and unsustainable.<sup>176</sup>

### **7.2.1 Get Business Environment Right for Private Sector Development**

**145. Private sector development hinges critically on Tajikistan's ability to create a fair, transparent, and predictable business environment, in which firms feel comfortable to make investment decisions and create employment.** An empirical study on the Central Asian countries finds a strong correlation between a favorable business climate and well-functioning public institutions with longer periods of positive and sustained employment growth.<sup>177</sup>

**146. Existing laws and regulations, including competition laws, need to be enforced to improve Tajikistan's business environment and create pre-conditions for investment, innovation and job creation.** Tajikistan already has relatively well developed legal and regulatory frameworks to support a market-based economy. However, implementation weaknesses, corruption, and informal and non-transparent practices have created great uncertainty for firms and perceived risks of doing business in Tajikistan. A good example is tax administration practices that apply laws in an unpredictable and punitive manner, dampening firms to grow or go informal to avoid visibility.

**147. SOE reform is indispensable to promote market competition and thereby drive productivity growth.** The importance of free and fair competition cannot be overemphasized, as competition drives innovation, cost reduction and management efficiency. However, competition policy is often ignored with the objective of creating an unfair advantage for SOEs and politically connected firm with welfare losses

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<sup>175</sup> World Bank and International Monetary Fund (2017).

<sup>176</sup> See Gill, et al. (2014).

<sup>177</sup> World Bank (2013b).

for the entire economy. Enhancing incentives for the restructuring of SOEs, improving corporate governance and financial accountability, and promotion of robust competition are important economic reform priorities for Tajikistan. SOE operation with extensive use of energy, inputs and financing at below market prices has created a stream of subsidies, depriving public sector revenue, generating SOE losses, and giving rise to large contingent liabilities. A large amount of directed lending to keep financially weak SOEs afloat has crowded out productive private sector projects, limiting economic diversification and job creation, and at the same time led to serious banking distress, requiring costly bail-outs. Given the influential role that SOEs play in the national economy, the government should have a thorough understanding of their financial status, and an understanding of the potential risks that they pose to the economy, the government budget and to service delivery.

**148. Good governance, the fight against corruption, a sense of justice, and a level playing field for all would go a long way towards shifting the private sector into a key driver of growth and job creation, while boosting the state's legitimacy.** Stronger rule of law, especially with regard to property rights, and judicial independence are particularly important in protecting investors from expropriation and enforcing contractual obligations.<sup>178</sup> Significant efforts are needed to create an independent judicial system, which is known to have a far-reaching, positive impact on various segments of the economy by instilling a culture of compliance.

**149. The decisive implementation of agricultural reforms in the late 2000s is an excellent example of reforms that led to a successful outcome.** Going forward, it is paramount important to ease farmers' access to seeds, fertilizer and fodder, accompanied by the speedy implementation of the Land Code (2012) to allow for tradability and mortgaging of agricultural land user rights, a pre-requisite for the consolidation of fragmented farming system. A clear asset ownership structure is also expected to encourage adequate maintenance of existing infrastructure (e.g., irrigation) and new investment. Without tackling these preconditions, any efforts to promote the commercialization of agriculture in Tajikistan, including the development of agricultural value chains, are unlikely to generate a major and long-lasting result.<sup>179</sup>

## **7.2.2 Strengthen Fiscal Institutions to Meet the Population's Needs**

**150. Tajikistan needs to reinforce its fiscal institutional capacity, accountability, and independent administration that serve public interest.** Weak governance has also compromised resource allocation decisions and significantly undermined the population's faith in the ability of the Government to deliver basic public goods and services to its population. Strong institutional capacity for public financial management, including debt management, is crucial to manage effectively large-scale investment projects, such as the Rogun HPP, and utilize future large fiscal revenue from electricity exports wisely. Managing large revenue is more challenging than one might imagine. For Tajikistan to benefit from electricity exports, it needs to have significantly stronger fiscal institutions, which will enable the Government to allocate resources adequately for the enhancement of public goods and services, O&M spending for the Rogun HPP and debt service obligations, while carefully managing aggregate demand to avoid overheating pressures.

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<sup>178</sup> There is ample international evidence that foreign investors are more willing to invest in countries where robust system of property rights and registration exist.

<sup>179</sup> The implementation of the Land Code requires a few policy actions, most importantly the adoption of the secondary legislation which provides for the alienability of land use rights, and a sufficient legal protection for property rights (i.e., protection against terminations or revocation of rights by the state).

151. **Despite some progress in public financial management, further efforts are necessary to improve the composition, quality and cost-effectiveness of government outlays, and create space for critical spending.**<sup>180</sup> Tajikistan's expenditure composition is skewed unevenly to capital outlays, diverting resources from spending that improves the quality of citizen's life, such as basic infrastructure, health, education, and social protection. Continued deprivation of resources in these sectors can have a long-term consequence on Tajikistan's productive capabilities, which drive growth and economic diversification, but take a considerable time to develop (see Chapter 7.3). Prolonged negligence of the population's basic needs could potentially backfire. Along with expenditure reorientation, efforts are needed to improve public investment management, in terms of project selection, disclosure, and efficiency of execution.

152. **By improving social safety nets, the government can help to reduce risks and vulnerabilities for households but also install a sense of the social contract with its population.** Extreme poverty continues to exist in Tajikistan and can be directly addressed by expanding the reach of the public safety net, especially the relatively recent cash transfer program while also improving its overall efficiency through improving coordination between various benefits and programs. The success of the transfer program can be measured by how well it reaches the target beneficiary population, how little leakage of resources occurs to others, and how adequate the amount is to raise beneficiaries out of poverty. By lifting the incomes of the poorest in society, the government can also increase social cohesion as well as strengthen its social contract with the population.

153. **There is also considerable scope to strengthen revenue administration and tax policy.** First, the increasingly distortive tax collection practice is counterproductive, and should be discontinued as a matter of urgency. There is a need to strengthen revenue forecasts, so as not to create performance pressure in the revenue administration and use irregular means to deliver on ambitious targets. On the tax policy side, the focus should be placed on the rationalization of tax policy, such as closing loopholes, and reduction in compliance cost, taking a longer-term perspective. The ongoing Evidence Based Tax Assessment will offer an excellent opportunity to identify areas for potential improvement. Existing incentives could be reviewed and realigned with national development priorities. With the increase in formal private enterprises, the disproportionally heavy weight on indirect taxes can be corrected. At the same time, efforts can be stepped up to strengthen the collection of dividends and recovery of tax arrears from SOEs.

### 7.2.3 Data and Transparency

154. **Tajikistan needs to improve the quality of data, transparency over the use of public resources, and information access to provide the foundation for more accountability and improve people's trust in public institutions.** Access to comprehensive and reliable data, both macro and micro, is extremely challenging in Tajikistan, which prevents comprehensive understanding of Tajikistan's development challenges and identify policy priorities. Deficiencies in data affect the formulation and implement evidence-based policy. A strong evidentiary foundation will be vital to inform policy decisions across the board, ranging from budgetary resource allocation, service delivery, to risk monitoring. To this end, it is crucial to focus on collecting of data needed to build a solid knowledge base. Increased communication, coupled with greater transparency and accountability of the service providers, goes a long way to boost

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<sup>180</sup> Tajikistan has made some progress on public financial management and the information system, strengthening the budget planning, budget execution, treasury, accounting and financial reporting functions across government.

the population's confidence in public institutions and gain state's legitimacy. See Annex 5 for the list of information and analytical gaps that call for attention.

### 7.3 Invest in Strategic Infrastructure and Human Capital

155. **Tajikistan has considerable scope to increase productivity and maximize the demographic dividends by investing strategically in key infrastructure and human capital.** During rapid population growth, East Asian countries invested in their youth and expanded access to family planning allowing people to start families later and have fewer children. Decreases in fertility rates resulted in healthier women and lower economic pressures to households, boosting domestic consumer demand and contributing to the national budget. Growing fiscal resources were directed towards strategic investment in infrastructure and human capital, resulting in unprecedented economic growth led by the competitive private sector.

#### 7.3.1 Close Critical Infrastructure Gap

156. **Fostering a competitive, profitable private sector requires the Government to strategically invest in infrastructure that can have a largest bearing on economic activity and social welfare.** It is important to emphasize that public investment is not to expand the State's productive activities, but to help ensure the right conditions are in place, and to remove or mitigate the constraints that discourages the private sector from investing and creating jobs, and improve the welfare of its population through improved service delivery.

157. **Reliable and adequate supply of electricity and connectivity infrastructure are the priority area for the Government to focus on.** However, to for any investment to produce good outcome, Tajikistan needs to strengthen its public investment management and prevent corruption to distort decision making, without which attracting investors for PPP will remain difficult. Strong corporate governance of the contractors, including SOEs, is also important for efficient and effective delivery of public investment.

158. **To ensure improved energy supply and successfully manage the Rogun HPP, Barqi Tojik's institutional capacity and financial viability needs to be bolstered significantly.** To this end, it is crucial to fully implement the Action Plan for Financial Recovery of Barqi Tojik, including the introduction of effective mechanism to enforce electricity bill payments, especially by SOEs such as TALCO, while strengthening corporate governance, and internal management and financial information systems to enhance efficiency. Empirical evidence suggests that complementary policy and institutional quality—market operations, price regulation, and contract or purchase agreements—are as important as the construction of core physical infrastructure.<sup>181</sup>

159. **Tajikistan can take advantage of its geographical proximity to very large markets by improving connectivity and thus reap the potential from regional and global integration.** Cross-border trade with Afghanistan, and more lately with Uzbekistan, is expanding at a fast pace. Investing strategically in transport and ICT infrastructure can ease transport and digital connectivity constraints and promote Tajikistan's access to economic opportunities and integration into regional and global economies, thereby nurturing the country's export sector.

160. **China's Belt-Road Initiative represents a major opportunity for Tajikistan to develop physical infrastructure, access new markets via cheaper routes, generate and strengthen competitiveness.** To

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<sup>181</sup> Asian Development Bank (2015).

benefit from this Initiative, however, commitment at the political level and effective inter-republic cooperation, which can be as big a constraint as infrastructure bottlenecks. At the same time, decisive actions are necessary to improve the condition for trade activity (soft infrastructure), especially the elimination of informal barriers and improvement of logistics support.<sup>182</sup> There is empirical evidence that many potential benefits of great connectivity are derived not so much from the physical infrastructure itself as from the connectivity of services—the availability and quality of third party logistics, trucking services, storage and warehousing, intermodal integration, customs administration, and border management.<sup>183</sup> The removal of corruption and improvement in public institutions are key as discussed in Chapter 7.2.1.

### 7.3.2 Building Human Capital

161. **Tajikistan’s human productive capabilities are significantly underutilized because of years of limited investment in human capital and emigration.**<sup>184</sup> Tajikistan can focus on fostering the conditions that empower its people to contribute productively to the country’s continued development of labor force. The role of public policy is to help ensure its population to become a productive member of the society, thereby increasing their employability and enhancing non-monetary welfare.

#### *Education*

162. **Education systems are constantly evolving to meet the needs of a changing economy—and society more broadly.** For Tajikistan to improve the acquisition of cognitive, non-cognitive, and technical skills, it should take a multi-pronged approach dealing with all education tiers beginning from early childhood. Some of the key reforms to achieve significant improvements in learning outcomes are as follows:

- **Increased coverage of quality ECE programs.** As a first step to developing ECE is an assessment to identify affordable models for pre-school institutions and scalable programs. Following the assessment, the Government will need to determine how to ensure adequate availability of resources including trained teachers, teaching-learning materials, and facilities. The decisions will need to be made in the context of government resources to finance both investment and operating costs of ECE programs and will need to be rolled out judiciously over the next decade.
- **Equitable access to quality general education.** The most significant reform in general education to improve quality will be the implementation of the competency-based curriculum to replace the existing knowledge-based curriculum. The reform started in 2016 with national introduction of new curriculum in primary grades. To move the reform further, substantial resources will be needed to fund expenses such as new textbooks and teacher training. Reforms to improve equity in general education will be to improve dilapidated school buildings (especially in remote areas) and provide social assistance for vulnerable children. In

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<sup>182</sup> Research shows that many potential benefits of great connectivity are derived not so much from the physical infrastructure itself as from the connectivity of services, i.e., the availability and quality of third party logistics, trucking services, storage and warehousing, intermodal integration, customs administration, and border management.

<sup>183</sup> Asian Development Bank (2015).

<sup>184</sup> Azevedo, et al. (2013).

addition, the improving student assessment instruments will be key to evidence-based reforms.

- **Improve relevance of VET.** Reforms in the VET system would benefit from establishing a reliable quality assurance system to assess the quality and relevance of the existing programs. Depending upon the results of the assessment, it will be necessary to develop a strategy and enabling framework. This may require significant rationalization to make the system affordable.
- **Renew the role of higher education in increasing the availability of relevant knowledge.** The higher education institutions (“HEIs”) could benefit from improving (i) quality and relevance of services provided; (ii) governance of the sector by reducing centralized control, building administrative and institutional capacity, and aligning incentives of faculty and administration; (iii) access and equity through scholarships and academic support to disadvantaged or under-represented student groups; and (iv) the efficiency of spending through reallocation towards more effective universities and to research combined with revisiting the envelope for higher education.

## Health

163. **A well-functioning health care system plays a critical role in furthering economic development and reducing poverty.** Examples include the contribution of ECD, especially nutrition, to academic performance; the reduction of “catastrophic expenditures” due to the OOP cost of treatment for major illnesses; or the impact of family planning on economic growth and improving household welfare by lowering dependency ratios. The Government can accelerate improvements in the health system by taking the following steps in the medium- to long-term.

- **National rollout of the BBP and improvements in its composition and financing.** The faster the national expansion of the BBP, the better will be the implications for the health status of the population. Any necessary adjustments can be made along the way. The key will be the availability of the BBP to every citizen which covers a range of services. Priority services, such as maternal and child health, nutrition, should be included for free (and will have significant positive implications for women’s welfare). Over time, the copayment should constitute only a small portion of financing while most of it is financed by the Government budget. In addition, exemption from co-payments should be explicitly poverty-based.
- **Improve efficiency and equity of health financing.** This can be achieved by (i) establishing a mechanism to pool health funding across districts in the hand of a single purchaser and (ii) instituting a poverty targeting mechanism in health care that shields the poor from catastrophic payments for health. At the same time, the Government may also wish to consider whether given the country’s population growth rate and health care needs, whether it should allocate a higher share of public resources to the health system.
- **Improved allocation of funds to address key gaps.** The quality of the health system could be improved through a comprehensive quality improvement plan that builds health workers practical competence at all levels and other quality assurance mechanisms. In addition, the Government would also need to look at existing infrastructure and plan accordingly—rather than allocating limited public health resources to new facilities.
- **Strengthening the health service delivery system.** This will require rebalancing between PHC and hospitals while ensuring the continuum of care from PHC to hospitals. Some basic steps

to achieve this would be for PHC to have fewer but better qualified staff, fewer hospitals and hospital beds, and higher quality standards for hospitals. In addition, the Government would need to pay more attention to community outreach, public health, health prevention and promotion, especially as these can help to address issues of malnutrition.

- **Enhancing inter-sectoral solutions to improve nutrition status, especially among children and women, influence fertility preference, and strengthen family planning.** The problems of stunting and malnutrition are complex and require working on multiple fronts including water, health and education. In addition, improving and expanding the availability of family planning services will be key component in reducing high fertility.



## Annex 1. Consultations

**To identify policy priorities the SCD team relied heavily on internal and in-country consultations.** The design of consulting process involved three different approaches, which took advantage of the comparative and country knowledge advantages of each stakeholder group. The *internal team approach* had several rounds of consultation sessions were held with country team in a brainstorming format. This was followed by intensive bilateral and collective meetings with the World Bank Global Practices/International Finance Corporation (IFC) and team members. The SCD team also relied on parallel work conducted by the Fragility CCSA and the Social Development GP, *Risk and Resilience Assessment* for Tajikistan conducted in March 2017. In addition, the findings of the IFC's consultations with private sector stakeholders in February 2017 were also used by the SCD team. With an initial draft narrative of the SCD, the team iterated the discussion among the extended SCD team to stimulate the debate and agree on main messages and hypothesis. The external approach involved solicitation of feedback from online audience (i.e., social media) and in-country wide consultations, including Government, NGO and the civil society more broadly.

**To ensure the participatory principle of SCD preparation, a diverse range of in-country stakeholders were consulted in the Spring 2017.** The team held formal meetings with representatives of civil society organizations, media, academia, think tanks, youth/student groups, the private sector, international development partners, ministries/state agencies and President of the Republic of Tajikistan. The discussion focused on the country's development strategy going forward, pressing challenges and opportunities in a constantly changing regional and global environment, shaped by demographic, financial and climate factors.

**There were common key messages and themes across groups of in-country stockholders, which resonated with SCD narrative.** (i) The development of the energy sector and the provision of secure energy to all are high priority in Government agenda and reflected in recently adopted National Development Strategy 2016-30. The team was encouraged to focus on human development issues. (ii) The problem of deteriorating quality of education and the need of education system to be aligned with job opportunities were mentioned a number of times. (iii) Country needs to address the multiple sources of disadvantage and cultural bias that many girls face in terms of access to education. (iv) Despite country efforts, undernourishment continues to be a persistent issue in Tajikistan. The feedback from consultation sessions also included following topics: addressing decline in remittances, large labor market informality and insufficient domestic job creation; fragility and instability of financial sector; fostering entrepreneurship and improving business climate. Overall the narrative of the SCD was well received by many in-country stakeholders. Participants pointed for the need of more active engagement with the World Bank to assist the country in achieving the goals of sustainable development.

## Annex 2. Selected Macroeconomic Indicators

	2014	2015	2016	2017	2018	2019	2020
	Act.	Act.	Act.	Est.	Proj.		
(Percent, unless otherwise indicated)							
<b>National Income and Prices</b>							
Real GDP growth	6.7	6.0	6.9	7.1	6.1	6.0	6.0
Private consumption growth	1.8	-15.0	6.4	3.3	3.4	3.5	3.5
Gross investment (percent of GDP)	4.6	5.4	6.1	5.8	5.7	5.5	5.4
Consumer price inflation, period average	6.1	5.8	5.9	7.3	8.5	7.0	7.0
Average exchange rate (TJS per USD)	4.93	6.17	7.84	8.5	...	...	...
(Percent of GDP, unless otherwise indicated)							
<b>External Accounts 1/</b>							
Exports of Goods and Services	9.1	10.5	13.3	15.7	15.2	15.7	16.1
Imports of Goods and Services	44.9	42.3	42.8	40.9	48.8	49.5	50.1
Current Account Balance	-2.8	-6.0	-3.8	-0.5	-2.4	-2.5	-2.6
Capital and Financial Account	5.5	7.4	8.1	-5.9	2.4	2.5	2.6
Foreign direct investment, net	3.4	5.3	4.9	2.8	3.3	3.3	3.3
(Percent of GDP, unless otherwise indicated)							
<b>Consolidated Fiscal Accounts</b>							
Revenues	28.4	29.9	28.8	29.7	28.5	28.9	29.2
Expenditures	28.4	31.8	38.5	32.3	31.5	31.9	32.4
Overall fiscal balance 2/	0.0	-1.9	-9.8	-2.6	-3.0	-3.1	-3.3
Primary fiscal balance	0.4	-1.3	-9.1	-1.1	-1.2	-1.2	-1.3
Total Public Debt	32.2	36.7	49.0	54.7	55.5	56.0	56.5
(Percent, unless otherwise indicated)							
<b>Monetary Accounts</b>							
Broad money growth	7.1	18.7	37.1	21.8	...	...	...
Reserve money growth	13.2	16.0	71.1	21.0	...	...	...
Private sector credit growth	31.5	12.7	-4.9	-20.2	...	...	...
Refinance rate	5.5-8.0	8.0	8.0-11.0	12.5-16	...	...	...
(Percent, unless otherwise indicated)							
<b>Social Indicators 1/</b>							
Population, total (millions)	8.3	8.5	8.6	8.8			
Population growth (percent)	2.3	2.4	2.2	2.2			
Unemployment rate (officially registered)	2.5	2.5	2.4	2.2	...	...	...
Poverty rate, (national poverty line TJS 175.2/month)	32	31.3	30.3	28.6			
Inequality – Gini coefficient	30.8	27.5	28.0	...	...	...	...
Life expectancy (years)	69.6	69.4	...	...	...	...	...

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

1/ Forecast in 2017

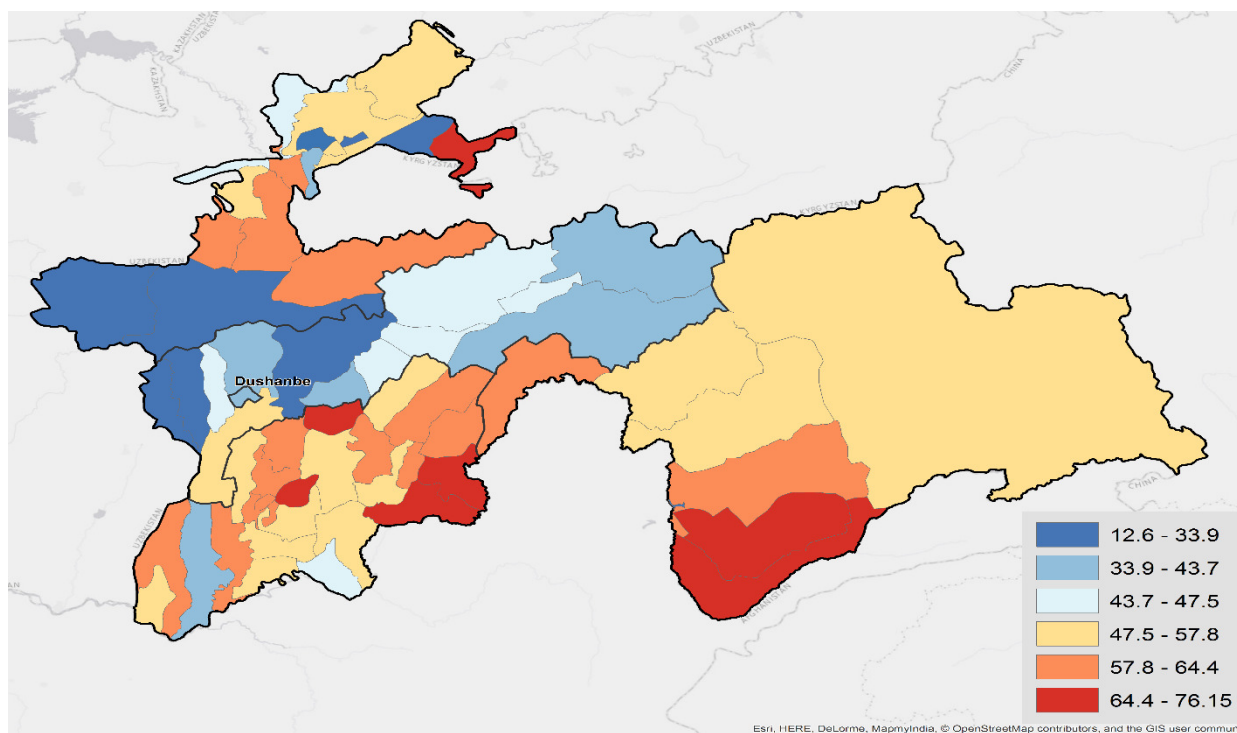
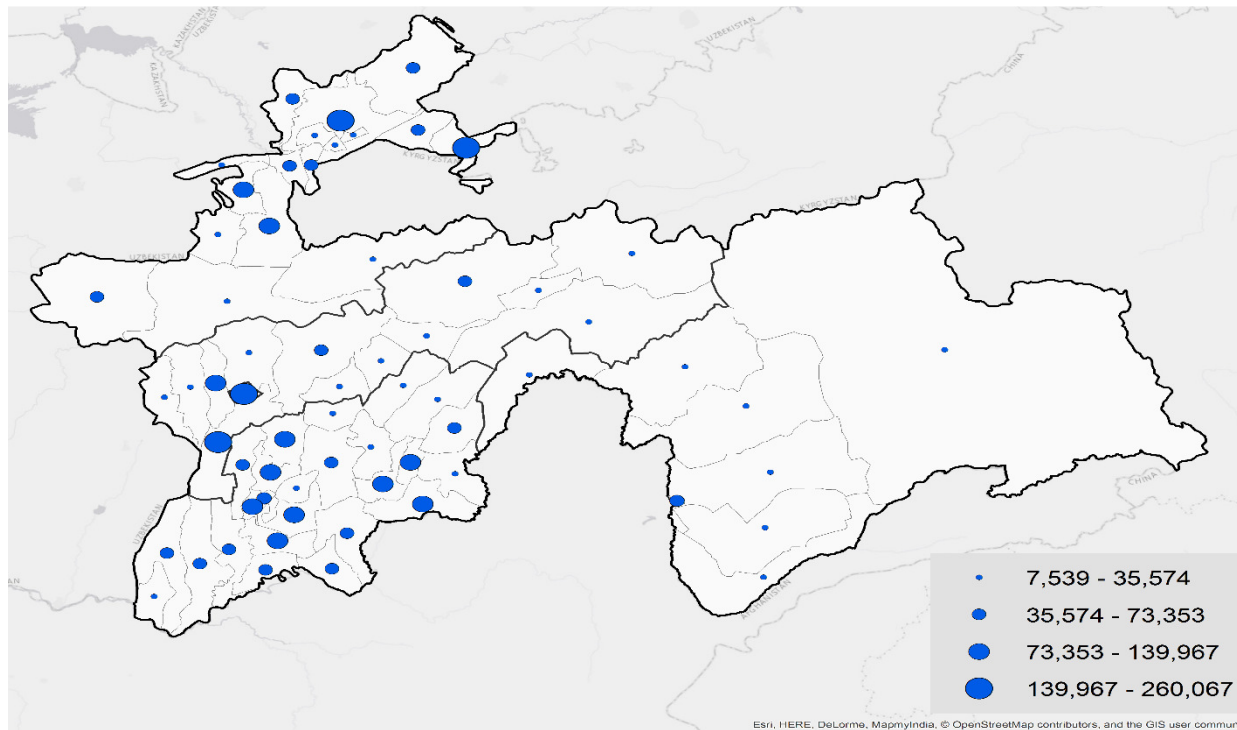
2/ In 2016, overall fiscal deficit excluding banking bailout program made 3.7 percent of GDP

### Annex 3. Selected Poverty and Social Indicators

Indicators	2000	2005	2010	Latest available (2011-2016)
<b>Population</b>				
Population total (in ml)	6.2	6.9	7.6	8.7
Population growth (annual %)	1.6	2.1	2.2	2.2
Rural population (% of total population)	74	74	74	73
Age dependency ratio (% of working-age population)	86	72	64	63
Population ages 0-14 (% of total)	43	38	36	35
Fertility rate, total (births per woman)	3.9	3.5	3.5	3.4
<b>Health and Gender</b>				
Life expectancy at birth, total (years)	66	68	70	71.0
Mortality rate, infant (per 1,000 live births)	74	54	45	39
Maternal mortality ratio (modeled estimate, per 100,000 live births)	68	46	35	32
Prevalence of stunting, height for age (% of children under 5)	42	33	na	15
Prevalence of undernourishment (% of population)	39	42	37	33
Prevalence of wasting, weight for height (% of children under 5)	9	9	na	2
Improved water source (% of population with access)	60	65	70	74
Women who believe a husband is justified in beating his wife (any reason) (%)	na	74	na	60
<b>Education</b>				
School enrollment, primary (% gross)	95	99	100	101
School enrollment, secondary (% gross)	73	80	84	88
School enrollment, tertiary (% gross)	18	21	23	29
School enrollment, tertiary (gross), gender parity index (GPI)	0.4	0.5	0.5	0.7
<b>Labor and Social Protection</b>				
Labor force participation rate, total (% of total population ages 15+) (modeled ILO estimate)	67	66	67	69
Children in employment, unpaid family workers (% of children in employment, ages 7-14)	na	71	na	
Coverage of social safety net programs in poorest quintile (% of population)	na	na	na	13.0
Benefit incidence of social safety net programs to poorest quintile (% of total safety net benefits)	na	na	na	7.6
<b>Other</b>				
Account at a financial institution (% age 15+)	na	na	na	12
Individuals using the Internet (% of population)	0.0	0.3	12	21
Mobile cellular subscriptions (per 100 people)	0.0	4	78	107
Intentional homicides (per 100,000 people)	na	na	2.0	1.4

Source: World Development Indicators.

#### Annex 4. Poverty Map for 2009.



## Annex 5. Information and Analytical Gaps

The SCD has highlighted several information and analytical gaps that need to be closed to design effective policies.

- **National Accounts:** More disaggregated and reliable national accounts information is necessary to understand the structure of the economy, as well as the reason for the unusually high total factor productivity growth (Box 1).
- **State enterprises:** Accurate and complete financial information is needed to have a clear understanding about SOE operational and financial performance. Data on SOE debt and arrears need verification, and information on the respective terms and creditors will help evaluate fiscal risks from SOEs and formulate a strategy to manage risks. The information will also inform SOE reforms that are crucial to improve Tajikistan's competitiveness and diversify the economy.
- **External debt:** There is an acute need to collect information on external debt, including short-term debt, owed by Tajikistan's private sector.
- **Financial sector:** For effective policy formulation, analytical work is necessary to deepen understanding about the factors driving high lending and deposit rates, low financial inclusion (especially for women), and lack of savings culture in Tajikistan.
- **Informal sector:** While Tajikistan's informal sector is believed to be large, little is known about economic activity and employment opportunities.
- **Climate change:** Given Tajikistan's vulnerability to climate change, it is important to consider how to build long-term resilience of existing and future physical assets, including hydropower plants, to the natural, environmental and climate change risks discussed in Chapter 4.4.

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